175 FERC ¶ 61,136
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Richard Glick, Chairman;
Neil Chatterjee, James P. Danly,
Allison Clements, and Mark C. Christie.

Entergy Arkansas, Inc.	Docket Nos. ER13-1508-001
Entergy Gulf States Louisiana, L.L.C.	ER13-1509-001
Entergy Louisiana, LLC	ER13-1510-001
Entergy Mississippi, Inc.	ER13-1511-001
Entergy New Orleans, Inc.	ER13-1512-001
Entergy Texas, Inc.	ER13-1513-001

OPINION NO. 575

ORDER ON BRIEFS AND INITIAL DECISION
(Issued May 20, 2021)

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1. This order addresses briefs on and opposing exceptions to an Initial Decision issued on May 12, 2015, by the presiding Administrative Law Judge (Presiding Judge) in the above-captioned proceedings,[1] as well as the April 30, 2019 Order Directing Briefs and responsive briefs in this proceeding.[2] The Initial Decision set forth the Presiding Judge's findings concerning the return on equity (ROE) in a tariff, submitted pursuant to section 205 of the Federal Power Act (FPA),[3] governing sales of energy and capacity among the Entergy Operating Companies.[4] The Briefing Order directed the participants to the above-captioned proceedings to submit briefs regarding: (1) a proposed framework for determining whether an existing base ROE is unjust and unreasonable under the first prong of FPA section 206[5] and (2) a revised methodology for determining just and reasonable base ROEs under the second prong of FPA section 206.[6]

2. On November 15, 2018, the Commission issued a similar Order Directing Briefs in two complaint proceedings involving the base ROEs of Midcontinent Independent System Operator, Inc. (MISO) transmission owners (MISO TOs).[7] Subsequently, the Commission issued Opinion Nos. 569, 569-A and 569-B[8] in those proceedings involving

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[1] *Entergy Ark., Inc.*, 151 FERC ¶ 63,008 (2015) (Initial Decision).

[2] *Entergy Ark., Inc.*, 167 FERC ¶ 61,091 (2019) (Briefing Order).

[3] 16 U.S.C. § 824d.

[4] At the time the Initial Decision was issued, the Entergy Operating Companies were: Entergy Arkansas, Inc. (Entergy Arkansas); Entergy Gulf States Louisiana, L.L.C. (Entergy Gulf States Louisiana); Entergy Louisiana, LLC (Entergy Louisiana); Entergy Mississippi, Inc. (Entergy Mississippi); Entergy New Orleans, Inc. (Entergy New Orleans); and Entergy Texas, Inc. (Entergy Texas) (collectively, Entergy Operating Companies or Operating Companies). Since then, the assets of Entergy Gulf States Louisiana and Entergy Louisiana were combined to form a new entity, now named Entergy Louisiana, LLC. For simplicity, in this order we will continue to refer to Entergy Gulf States and Entergy Louisiana as separate entities.

[5] 16 U.S.C. § 824e.

[6] *See, e.g.*, *Coakley v. Bangor Hydro-Elec. Co.*, 165 FERC ¶ 61,030, at PP 1, 15 (2018) (*Coakley* Briefing Order).

[7] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 165 FERC ¶ 61,118 (2018) (MISO Briefing Order).

[8] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 569, 169 FERC ¶ 61,129 (2019), *order on reh'g*, Opinion No. 569-A,

the MISO TOs' base ROE, in which the Commission adopted a revised base ROE methodology. As noted in Opinion Nos. 569, 569-A and 569-B, the revised base ROE methodology differed in certain ways from the proposal in the MISO Briefing Order and the Briefing Order in this proceeding. In this order, we address the above-captioned proceedings in light of the revised base ROE methodology that was adopted in Opinion Nos. 569, 569-A and 569-B. As a result, we reverse the Initial Decision and find that 10.37% is the just and reasonable ROE for the Entergy Operating Companies in this proceeding, as discussed further below.

I. Background

A. Entergy Filing and Initial Decision

3. Historically, the Entergy Operating Companies' generation and transmission facilities operated as a single system under the Entergy System Agreement (System Agreement). Service Schedule MSS-4 of the System Agreement governed the purchases and sales of energy and capacity among the Operating Companies. In 2005 and 2007, respectively, Entergy Arkansas and Entergy Mississippi notified the other Entergy Operating Companies of their intent to withdraw from the System Agreement effective 2013 and 2015, respectively.[9] Subsequently, Entergy Texas gave notice of its intent to withdraw from the System Agreement effective 2018, and Entergy Louisiana and Entergy Gulf States Louisiana gave notice of their intent to withdraw effective 2019. The Commission conditionally accepted these notices subject to the outcome of hearing and settlement judge procedures.[10] In 2015, Entergy Texas, Entergy Louisiana, Entergy Gulf States Louisiana, and Entergy New Orleans entered into a settlement agreement to terminate the System Agreement effective August 31, 2016.[11]

4. On April 25, 2011, the Entergy Operating Companies announced a proposal to join MISO, with a target implementation date of December 19, 2013, to coincide with

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171 FERC ¶ 61,154 (2020), *order on reh'g*, Opinion No. 569-B, 173 FERC ¶ 61,159 (2020).

[9] *See Entergy Servs., Inc.*, 129 FERC ¶ 61,143, at P 58 (2009) (accepting Entergy Arkansas' and Entergy Mississippi's notices of withdrawal from the System Agreement).

[10] *See Entergy Ark., Inc.*, 149 FERC ¶ 61,262, at P 120 (2014).

[11] *See Entergy Ark., Inc.*, 153 FERC ¶ 61,347 (2015) (approving settlement agreement to terminate System Agreement effective August 31, 2016). Pursuant to the settlement agreement, Entergy Louisiana and Entergy Gulf States Louisiana filed amended notices to withdraw effective August 31, 2016.

Entergy Arkansas' withdrawal from the System Agreement.[12] Prior to its withdrawal from the System Agreement in 2013, Entergy Arkansas made sales to Entergy Louisiana and Entergy New Orleans under Service Schedule MSS-4. To facilitate Entergy Arkansas' withdrawal from the System Agreement, Entergy Services, Inc. (Entergy) filed amendments to the System Agreement in Docket No. ER13-432-000, including the removal of all references to Entergy Arkansas from the System Agreement. Entergy also committed to make an FPA section 205 filing by mid-2013 to establish an "MSS-4-like" rate schedule to govern ongoing sales of energy and capacity between Entergy Arkansas and the other Entergy Operating Companies at cost-based rates outside of the System Agreement.

5. Consistent with its commitment in Docket No. ER13-432-000, on May 17, 2013, Entergy submitted the Unit Power Sales Tariff (Tariff) that is at issue in this proceeding.[13] Entergy stated that the Tariff is nearly identical to Service Schedule MSS-4 of the System Agreement. The Tariff establishes a general rate schedule for making unit power purchases and/or power sales between any of the Entergy Operating Companies.[14] Entergy explained that the Tariff would ensure that the six then-existing Service Schedule MSS-4 transactions in which Entergy Arkansas is obligated to sell capacity and energy to the other Entergy Operating Companies[15] beyond December 18, 2013, continue after Entergy Arkansas withdrew from the System Agreement and, along with the other Entergy Operating Companies, joined MISO. The Tariff would also govern any new agreements for capacity and energy sales between Entergy Arkansas and the other Entergy Operating Companies, and sales between other Entergy Operating Companies if and when they withdraw from the System Agreement.[16] According to Entergy, the Tariff merely passes through MISO's ancillary services charges and credits,

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[12] Initial Decision, 151 FERC ¶ 63,008 at P 2. The System Agreement is a Commission-approved tariff among Entergy Systems Inc. and the six Operating Companies of Entergy Corporation. The System Agreement governs energy exchange transactions between the Entergy Operating Companies, providing the basis for planning and operating generation and bulk transmission facilities on an integrated, single-system basis.

[13] Entergy May 17, 2013 Tariff Filing.

[14] *See* section 3.01 of the Tariff.

[15] The six existing agreements, whose terms extend beyond December 18, 2013, appear in Attachment A to Entergy's filing.

[16] The System Agreement will continue to govern sales of capacity and energy between the Entergy Operating Companies that remain within it.

uplift charges and credits, and administrative charges, and carries forward the 11% ROE contained in Service Schedule MSS-4.

6. In the Hearing Order issued December 16, 2013, the Commission accepted Entergy's proposed tariff effective December 19, 2013, subject to refund, and established settlement and hearing procedures.[17] On June 12, 2014, the parties filed a Partial Settlement Agreement that resolved all disputes in this proceeding except the ROE to be used in the Tariff's formula rate.[18] On June 16, 2014, the Chief Administrative Law Judge severed the ROE issue for hearing before the Presiding Judge.[19]

7. On May 12, 2015, the Presiding Judge issued the Initial Decision finding, *inter alia*, that: (1) the ROE in the Tariff should be based on the risk profile of Entergy Arkansas, not the risk profile of all six Entergy Operating Companies; (2) Louisiana Public Service Commission's (Louisiana Commission) discounted cash flow (DCF) study is the most consistent with the Commission's DCF methodology; and (3) the record does not show that capital market conditions are unusual. The Presiding Judge declined to consider the alternative financial methodologies that Entergy used in its testimony and briefs. The Presiding Judge stated that, unlike the New England TOs, Entergy "did not meet [the] burden to develop a record showing that the rate of return required by Entergy Arkansas's investors has been similarly impacted by anomalous market conditions."[20] Based on these findings, the Presiding Judge concluded that the just and reasonable ROE in this proceeding is 9.01%—i.e., the median of the zone of reasonableness produced by Louisiana Commission's initial DCF study.

8. On June 15, 2015, Entergy filed a brief on exceptions to the Initial Decision. On July 1, 2015, Commission Trial Staff (Trial Staff), Louisiana Commission, and the Council of the City of New Orleans (New Orleans Council) filed briefs opposing exceptions.

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[17] *Entergy Arkansas, Inc.*, 145 FERC ¶ 61,216 (2013) (Hearing Order).

[18] On September 8, 2014, the Commission approved the settlement agreement. *Entergy Ark., Inc.*, 148 FERC ¶ 61,178 (2014) (Partial Settlement Agreement).

[19] Initial Decision, 151 FERC ¶ 63,008 at P 9.

[20] *Id.* P 86.

B. Subsequent ROE Developments

1. ***Emera Maine***

9. In 2014, the Commission issued Opinion No. 531,[21] which addressed complaints challenging the ROE of the New England transmission owners (New England TOs). In Opinion No. 531, the Commission adopted certain changes to its use of the DCF model for evaluating and setting the Commission-allowed ROE. 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 by providing 33% weighting to long-term gross domestic product (GDP) growth.[22] 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 standards."[23]

10. The Commission therefore looked to four alternative benchmark methodologies: three financial models—a risk premium (Risk Premium) analysis, a capital-asset pricing model (CAPM) analysis, and an expected earnings (Expected Earnings) analysis—as well as a comparison with state-allowed ROEs.[24] In considering those methodologies, the Commission emphasized that it was not departing from its long-standing reliance on

[21] *Coakley v. Bangor Hydro-Elec. Co*., Opinion No. 531, 147 FERC ¶ 61,234 (2014).

[22] *See generally* 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*).

[23] Opinion No. 531, 147 FERC ¶ 61,234 at PP 144-145 & n.285. "*Hope*" and "*Bluefield*" refer to *FPC v. Hope Nat. Gas Co.*, 320 U.S. 591 (1944) (*Hope*) and *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679 (1923) (*Bluefield*), respectively, 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 *Hope*, 320 U.S. at 603 and *Bluefield*, 262 U.S. 679).

[24] Opinion No. 531, 147 FERC ¶ 61,234 at PP 147-149.

the DCF model, but rather relying on those methodologies only to "inform the just and reasonable placement of the ROE within the zone of reasonableness established . . . by the DCF methodology."[25]

11. On April 14, 2017, the United States Court of Appeals for the District of Columbia Circuit (D.C. Circuit) issued the *Emera Maine* decision, which vacated and remanded Opinion No. 531 *et seq*. The D.C. Circuit rejected 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 produced by the DCF did not necessarily indicate that it was just and reasonable for the purposes of the FPA.[27]

12. 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]

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[25] *Id.* P 146.

[26] *Emera Maine*, 854 F.3d at 22-23.

[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.*

13. The D.C. Circuit also found that the Commission had not adequately shown that the 10.57% 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-allowed 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] Similarly, the D.C. Circuit noted that the Commission had concluded that a base ROE of 9.39%—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% 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]

2. <u>Briefing Orders</u>

14. In response to the D.C. Circuit's decision, the Commission issued, on October 16, 2018, an order that directed the participants to the proceeding that was the subject of *Emera Maine*, and the participants in three other proceedings involving New England TOs' ROE, to submit briefs regarding: (1) a proposed framework for determining whether an existing ROE is unjust and unreasonable under the first prong of FPA section 206; and (2) a revised methodology for determining just and reasonable ROEs under the second prong of FPA section 206.[34] 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, the Commission explained that relying

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[31] *Id.* (quoting *FPC v. Nat. Gas Pipeline Co.*, 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 on the other hand, it stressed that none of these analyses were used to select the 10.57% base ROE.").

[33] *Id.* at 28-30.

[34] *See Coakley* Briefing Order, 165 FERC ¶ 61,030.

on multiple financial models makes it more likely that the Commission's decision will accurately reflect how investors make their investment decisions.

15. Specifically, the Commission proposed 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 would be given equal weight and averaged to determine the composite zone of reasonableness. The Commission also proposed a framework for using the composite zone of reasonableness in evaluating whether an existing base ROE remains just and reasonable.

16. For purposes of establishing a new just and reasonable base ROE, the Commission proposed to use the above three financial models, plus the Risk Premium model. For an average risk single utility, the Commission proposed to determine the median of each zone of reasonableness produced by the DCF, CAPM, and Expected Earnings models and average those ROEs with the Risk Premium model's ROE, giving equal weight to each of the four figures. The Commission proposed to use the medians of the lower and upper halves of the zones of reasonableness to determine ROEs for single utilities of below and above average risk, respectively.[35]

17. Finally, the Commission proposed generally to use the same proxy group screening criteria as outlined in Opinion No. 531. However, the Commission proposed to apply a high-end outlier test to the results of the CAPM, Expected Earnings, and DCF analyses, noting among other things that neither the CAPM nor Expected Earnings analyses include a long-term growth projection based on GDP that would normalize the ROEs produced by the model. The Commission proposed to treat as high-end outliers any proxy company whose cost of equity estimated with a given model is more than 150% 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 that is similar to the approach the Commission uses for low-end DCF analysis results.[36]

18. The Commission subsequently issued a similar briefing order in the case involving the MISO Transmission Owners' ROE, in which it explained that, as in the *Coakley* Briefing Order involving the New England TOs' ROE, the "scope of the paper hearing established in [the MISO TOs' Briefing Order] includes all aspects of [the] proposed methodology."[37]

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[35] *Id.* P 17 & n.62.

[36] *Id.* P 53.

[37] MISO Briefing Order, 165 FERC ¶ 61,118 at P 20.

19. The Briefing Order in this proceeding proposed the same framework and similarly requested briefs addressing the framework. On July 16, 2019, Trial Staff, Entergy, Louisiana Commission, Public Utility Commission of Texas (PUCT), and New Orleans Council filed initial briefs, and, on August 30, 2019, Trial Staff, Entergy, PUCT, and New Orleans Council filed reply briefs.

3. Opinion Nos. 569, 569-A, and 569-B

20. In Opinion No. 569, as modified by Opinion Nos. 569-A and 569-B, the Commission adopted the proposal in the *Coakley* Briefing Order, with certain revisions. In particular, the Commission used the DCF, CAPM, and Risk Premium models in its determinations under the first and second prongs of FPA section 206, giving each model equal weight under both prongs, and did not use the Expected Earnings model, as proposed in the *Coakley* Briefing Order. In addition, the Commission made numerous clarifications regarding the implementation of the DCF, CAPM, and Risk Premium models. For instance, the Commission employed historical bond yields[38] in the Risk Premium model under both prongs of the analysis of a challenged base ROE under FPA section 206,[39] gave the short-term growth rate 80% weighting and the long-term growth rate 20% weighting in the two-step DCF model, and established the high-end outlier test to treat any proxy company as a high-end outlier if its cost of equity estimated under the model in question is more than 200% of the median result of all of the potential proxy group members in that model[40] before any high or low-end outlier test is applied, subject to a natural break analysis. The Commission used the Institutional Brokers' Estimate System (IBES) as the source of short-term earnings growth estimates in the DCF and CAPM, used 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% of the CAPM risk premium, and considered the use of *Value Line* short-term earnings growth estimates in the CAPM in future proceedings. The Commission calculated the ranges of presumptively just and reasonable base ROEs by dividing the overall composite zone of reasonableness into thirds. The Commission also used the ranges of presumptively just and reasonable ROEs in its analysis under the first prong of FPA section 206, and

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[38] *See id.* PP 3, 121, 127-128.

[39] In order to be used for the first prong under 206, the Commission used the average size of the zones of reasonableness under the DCF and CAPM to impute a zone of reasonableness around the point estimate produced by the Risk Premium Model. *See* Opinion No. 569-A, 171 FERC ¶ 61,154 at P 107.

[40] As noted below, the high-end outlier test only applies to the DCF model and CAPM because those models utilize results of the relevant analysis applied to a proxy group, while the Risk Premium model is derived from actual ROEs.

established the range of presumptively just and reasonable ROEs based on the thirds of the zone of reasonableness.

II. Overview of the Commission's Findings in this Order

21. As discussed below, we apply the revised base ROE methodology adopted in Opinion No. 569, as modified in Opinion Nos. 569-A and 569-B to the above-captioned proceedings. In Opinion No. 569-A, the Commission noted that, in future proceedings, "parties will have an opportunity to argue that the base ROE methodology . . . should be modified or applied differently because of the specific facts and circumstances of the proceeding involving that party."[41] However, as discussed below, we find that no party has demonstrated that the methodology applied in those proceedings should not be applied to the facts and circumstances of this proceeding. Applying the revised base ROE methodology to the facts of this proceeding, we reverse the Initial Decision and find that 10.37% is the just and reasonable ROE for the Tariff. We direct Entergy to submit a compliance filing within 30 days of the date of this order revising the Tariff to reflect a 10.37% base ROE. We also direct Entergy to submit a refund report within 30 days of the date of this order quantifying refunds associated with the ROE in the Tariff. Finally, we direct Entergy to make refunds, with interest, accordingly.

III. Discussion

A. Use of Multiple Models

1. Briefing Order and Opinion No. 569 *et seq.*

22. On April 30, 2019, the Commission established a paper hearing on whether and how the methodology proposed in the *Coakley* Briefing Order and MISO TO's Briefing Order should apply to the Tariff. As noted above, the Commission specifically proposed 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. For purposes of establishing a new just and reasonable base ROE, the Commission proposed to use the three financial models, plus the Risk Premium model.[42] In Opinion No. 569, the Commission used the DCF model and CAPM.[43] In Opinion

[41] *Id.* P 27.

[42] Briefing Order, 167 FERC ¶ 61,091 at PP 12-13.

[43] *See, e.g.*, Opinion No. 569, 169 FERC ¶ 61,129 at P 18.

Nos. 569-A and 569-B, the Commission modified that finding and used the DCF model, CAPM, and Risk Premium model.[44]

2. Initial Briefs

23. Entergy states that use of the Commission's four proposed models in the Briefing Order provides a sound framework to inform the resolution of this proceeding in a manner that meets the Commission's statutory responsibilities, satisfies Supreme Court mandates for ROE cases, and advances the Commission's ROE policy.[45] Entergy argues that use of the Commission's four proposed models in the Briefing Order provides a broader, less rigid approach than sole reliance on the two-step DCF model and avoids relying on a single methodology to find the only acceptable ROE.[46] According to Entergy, the solution to concerns about the two-step DCF model is to directly rely on other financial models, as investors would, instead of relying on a different point within the DCF analysis.[47]

24. Entergy asserts that use of the Commission's four proposed models in the Briefing Order connects the holdings of *Hope* and *Bluefield*, as well as other cases pointing to the importance of investors' expectations in setting an ROE, to the models that investors use, to evidence of how to weight those models, and to the accuracy of the models, and arrives at a concrete expression of a just and reasonable ROE.[48] Entergy contends that that the record in this proceeding further demonstrates that each of the four models expresses investors' expectations and establishes a rational, evidence-based connection between a decision to use those models and the capital attraction standard from *Hope* and *Bluefield*.[49] Entergy states that the "DCF method generally provides a workable and practical approach to estimate investors' required return."[50] Entergy states that the CAPM is widely referenced by professional practitioners, because it "is the dominant model for estimating the cost of equity outside the regulatory sphere, [it] provides

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[44] *See, e.g.*, Opinion No. 569-B, 173 FERC ¶ 61,159 at P 2.

[45] Entergy Initial Brief at 1.

[46] *Id.* at 6-7.

[47] *Id.* at 8.

[48] *Id.* at 12 (citing *Coakley* Briefing Order, 165 FERC ¶ 61,030 at PP 32-38).

[49] *Id.* at 13.

[50] *Id*. (citing Ex. No. ESI-100 at 24 n.34).

important insight into investors' required rate of return."[51] Entergy avers that, for the Expected Earnings model, there is a relationship between the approach and the "comparable earnings test established by the Supreme Court in *Hope* and *Bluefield*," and that "expected earned returns on invested capital provide a direct benchmark for investors' opportunity costs."[52] According to Entergy, the Risk Premium model "is routinely referenced by the investment community" and is "an informative indicator of investors' required rate of return."[53] Entergy states that the use of the Commission's four proposed models in the Briefing Order also avoids the practical risks of sole reliance on the two-step DCF model and recognizes that it is not an infallible expression of market efficiency.[54]

25. Entergy states that the Commission should implement each of the four models in a manner consistent with the Briefing Order. Entergy explains that use of the Commission's four proposed models in the Briefing Order cures the concern that the ROE result was divorced from numerical results of the alternative models.[55] Entergy notes that the Commission's analysis of the CAPM, Expected Earnings, and Risk Premium models in Opinion Nos. 531, 531-A, and 531-B, was based on an extensive record and is directly analogous to this proceeding.[56]

26. Entergy states that the hearing in this proceeding featured a significant dispute over the issue of anomalous market conditions.[57] Entergy states that, consistent with the Commission's finding in the *Coakley* Briefing Order, this dispute would be rendered largely irrelevant if the Commission employs the four model approach proposed in the Briefing Order.[58] Specifically, Entergy notes that this approach "should serve as an

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[51] *Id*. (citing Ex. No. ESI-100 at 37).

[52] *Id.* (citing Ex. No. ESI-100 at 42).

[53] *Id.* (citing Ex. No. ESI-100 at 32).

[54] *Id.*

[55] *Id.* at 15-16 (citing *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 13).

[56] *Id.* at 17 (citing Ex. No. ESI-100 at 2, 32, 37, PP 40-41).

[57] *Id.* at 30 (citing Initial Decision, 151 FERC ¶ 63,008 at PP 62-91).

[58] *Id.* at 30-31.

integral part of the decision-making underlying the determination of a just and reasonable ROE *at all times and under all capital market conditions.*"[59]

27. Entergy states that the results of the four models, as well as record evidence of other reliable benchmarks of the return that investors require, show that the results of the two-step DCF model are "far below investors' required return" and thus create a downward bias in the end result of a strict application of use of the Commission's four proposed models in the Briefing Order.[60] Specifically, Entergy notes that the two-step DCF model produces median and midpoint results that are on average 191 basis points lower than the other models. Entergy further notes that the two-step DCF median result is more than 100 basis points lower than the next lowest non-DCF value and is below the lowest of the 19 proxy company results for the CAPM analysis.[61]

28. Entergy explains that other benchmarks reinforce the conclusion that the DCF results are substantially lower than investors' requirements. Entergy states that, during the hearing, Entergy demonstrated that an analysis of state-allowed ROEs supported an ROE more than 100 basis points higher than the median of the two-step DCF results, no matter which proxy group was used. Entergy explains that state commissions allowed the companies in Trial Staff's proxy group to receive a median ROE of 10.5%, and the median state-allowed ROE for Louisiana Commission's proxy group (which was adopted by the Initial Decision) was 10.30%, while Entergy's national proxy group fell in the middle with a median state-allowed ROE of 10.46%.[62] Entergy states that setting the ROE for Commission-jurisdictional utilities below state-allowed ROEs would undermine the ability of Commission-regulated operations to compete for capital.[63]

29. Entergy states that averaging the results of the two-step DCF model with other approaches dilutes, but does not remove, the gap between investors' expectations and this component of the Commission's four proposed models in the Briefing Order. Entergy urges the Commission to address the downward bias of the DCF model by exercising judgement and considering the totality of the evidence instead of simply applying the Commission's four proposed models in the Briefing Order.[64] Specifically, Entergy

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[59] *Id.* at 32 (emphasis in original) (citing McKenzie Aff. at 13).

[60] *Id.* at 26 (citing McKenzie Aff. at 15-16).

[61] *Id.*

[62] *Id.* at 26 (citing Ex. Nos. ESI-124 and ESI-125).

[63] *Id.* at 27.

[64] *Id.* (citing McKenzie Aff. at 13-22).

recommends that the Commission modify its low-end and high-end tests to better reflect the reasoning the Commission gave for adopting the tests, as well as consider a constant growth DCF model and an empirical CAPM analysis.[65]

30. PUCT and New Orleans Council argue that the Presiding Judge employed the correct methodology and contend that the Commission should affirm the Presiding Judge's Initial Decision of using a two-step DCF methodology, without applying any additional methodologies. PUCT asserts that there exists no need or basis for the Commission to alter the Initial Decision "by applying a still-proposed policy change that the PUCT respectfully suggests is unnecessary, flawed, and destined to artificially increase ROEs at the expense of customers."[66]

31. PUCT and New Orleans Council argue that the two-step DCF analysis remains the most robust, carefully developed, and consistently upheld model that the Commission employs in base ROE proceedings. PUCT states that this method is most consistent with the requirements of *Hope* and *Bluefield* and that it relies on market prices that efficiently incorporate capital market and economic conditions. PUCT and New Orleans Council argue that the Commission should not dispense with the DCF analysis just because it is producing lower results than usual. Rather, PUCT and New Orleans Council argue that the low results reflect recent years' decline in the market cost of capital.[67] PUCT avers that seeking to boost the ROE by overhauling the ROE methodology would be unnecessary to attract capital, would increase shareholder profitability with no corresponding improvement to customer service outcomes or protections, and in this case would be contrary to the record evidence.

32. New Orleans Council similarly argues that the Presiding Judge correctly found, based on record evidence, that for the cost-based power purchase transactions under the Tariff, Entergy had not met its burden to develop a record that supported a return above the median of the range of reasonableness of the DCF calculated by all experts in this case. According to New Orleans Council, an ROE must be justified based on the particular circumstances faced by the utility in question. New Orleans Council asserts that, unlike the *Coakley* or MISO proceedings, this proceeding lacks concerns about incentivizing transmission investment, and Entergy has not shown that there are any unique or exceptional factors in the instant proceeding that would call into question the

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[65] *Id.* at 27-29 (citing McKenzie Aff. at 21-22, 43-57). Entergy asserts that empirical evidence shows that low-beta securities earn returns somewhat higher than the CAPM would predict, and high-beta securities earn somewhat less than predicted, and the empirical CAPM adjusts the CAPM to account for this. *See id.*

[66] PUCT Initial Brief at 5.

[67] *Id.* at 6; New Orleans Council Initial Brief at 8.

reliability of the DCF methodology. New Orleans Council further asserts that Entergy made no showing that an ROE of approximately 9%, either in this Tariff of limited application or more generally, would undermine Entergy's ability to attract capital, operate successfully, maintain its financial integrity, or compensate investors for the risks assumed.[68]

33. New Orleans Council asserts that this proceeding is about the Tariff that will govern existing power sales transactions among affiliated entities that have little, if any, impact on investment decisions made by investors in Entergy. Therefore, New Orleans Council argues that efforts to push up the median ROE to incentivize transmission investment through application of the other methodologies that the Commission has proposed would be unwarranted, inappropriate, and would result in unjust and unreasonable rates under the Tariff. Furthermore, New Orleans Council states that reliance on the DCF model has not caused a decline in transmission investment and strikes an appropriate balance between the Commission's policy objectives of ensuring continued investment in essential critical transmission infrastructure and protecting consumers from unreasonable rates.[69]

34. New Orleans Council argues that the facts that the *Hope* court relied upon in upholding a Commission decision approving a lower return than what the utility in that proceeding was seeking are strikingly similar to the facts in this proceeding. According to New Orleans Council, Hope Natural Gas Company (Hope), like the Entergy Operating Companies, was a wholly-owned subsidiary of a public holding company parent, did not sell stock, maintained financial health, had a diverse supply portfolio, was "a seasoned enterprise whose risks ha[d] been minimized, and its investment decisions were based on the parent company's performance and not on that of Hope."[70] Therefore, New Orleans Council asserts that the Commission should affirm the Presiding Judge's decision, without sending the parties back to hearing to examine results calculated by application of other methodologies that are not necessary in this case.[71]

35. PUCT claims that using the DCF model to set the ROE has supported capital attraction and that recent market conditions have not rendered the DCF method unreliable.[72] PUCT argues that the Risk Premium, CAPM, and Expected Earnings

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[68] New Orleans Council Initial Brief at 9-13.

[69] *Id.* at 1-2, 5, 8.

[70] *Id.* at 13-14.

[71] *Id.* at 14.

[72] PUCT Initial Brief at 8 & n.21 (citing Edison Electric Institute, *Transmission Projects: At a Glance* (Dec. 2016),

models are subject to significant model risk, that these methods have not been subjected to decades of regulatory scrutiny, and that they are prone to being applied in ways that do not appropriately reflect the cost of equity.[73] However, PUCT asserts that if the Commission decides to no longer rely solely on the DCF model, it should at least weigh the DCF's results more heavily than that of other methodologies, and the Commission should not use the Expected Earnings model.

36. New Orleans Council similarly states that it is concerned that some of the other models contemplated by the Commission are subject to significant model risk. For example, New Orleans Council states that the CAPM methodology is well-established, but the Expected Earnings and Risk Premium models have not withstood the decades of regulatory scrutiny that the DCF model has endured.[74] However, New Orleans Council argues that if the Commission decides to apply another methodology in addition to the DCF model, the CAPM analysis is the only one that should be considered because it is a conceptually sound and market-driven methodology that may produce reliable results when properly implemented. Additionally, if the Commission does decide to adopt additional analyses, New Orleans Council argues that the Commission should give greater weight to the DCF model and use the additional analyses only to test the validity of the result produced by the DCF model.[75]

37. Trial Staff recommends adjustments to the Commission's proposed methodology and asserts that the Commission should not include the Expected Earnings model in its new methodology for several reasons, as discussed in detail below.[76]

38. Louisiana Commission asserts that there are differences in the power purchase agreements (PPAs) among Entergy Operating Companies that render a traditional ROE analysis applicable for some, but irrelevant for others, as discussed below. According to Louisiana Commission, significant timing issues and facts related to the breakup of the Entergy system distinguish sales from generating units owned by Entergy Arkansas and sales from units owned by Entergy Louisiana. However, Louisiana Commission

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http://www.eei.org/issuesandpolicy/transmission/Documents/Trans_Project_lowres_bookmarked.pdf).

[73] *Id.* at 9.

[74] New Orleans Council Initial Brief at 15.

[75] *Id.* at 16.

[76] Trial Staff Initial Brief at 8.

disagrees with the Commission's proposed new methodology and its application in this proceeding.[77]

3. Reply Briefs

39. Entergy states that only Entergy's initial brief met the Commission's directive by demonstrating that the evidence in this case supports applying the Commission's four proposed models in the Briefing Order here and confirms the Commission's evidence and reasoning in the *Coakley* Briefing Order. Entergy states that use of the Commission's four proposed models in the Briefing Order provides a sound basis to determine a proper ROE under the Tariff and supports setting it at 10.5%.[78]

40. Entergy contends that there is no basis to rely solely on the results of a two-step DCF analysis to determine the Tariff's ROE. Entergy states that the parties that support that result ignore the Commission's explanation that "the DCF methodology alone no longer captures how investors view utility returns because investors do not rely on the DCF analysis alone and the other methods by investors do not necessarily produce the same results as the DCF model."[79] Entergy further states that these arguments contradict the Commission's conclusion that relying on the DCF methodology alone will not produce a just and reasonable ROE.[80] Entergy explains that, to satisfy the Supreme Court's *Hope* and *Bluefield* capital attraction standards, the Commission must consider and rely on methods other than the DCF model to evaluate what is a just and reasonable ROE under the Tariff.

41. Entergy argues that the record in this proceeding reinforces the rationale expressed by the Commission in the *Coakley* Briefing Order. Entergy states that the Commission's reasons for not solely relying on the DCF methodology supersede and persuasively rebut the Initial Decision's finding that "straightforward application of the DCF methodology in this case meets the standards of *Hope* and *Bluefield*."[81] Entergy states that the Commission explained that its primary reason for not relying solely on the DCF methodology is that investors use multiple models in addition to the DCF methodology,

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[77] Louisiana Initial Brief, Baudino Aff. at 5.

[78] Entergy Reply Brief at 2.

[79] *Id.* at 3 (citing *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 40).

[80] *Id.* at 14 (citing *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 32).

[81] *Id.* (citing Initial Decision, 151 FERC ¶ 63,008 at P 61).

to inform the investment decisions.[82] Entergy states that the Commission makes it clear that looking at how investors analyze and compare their investment opportunities is required to determine what ROE to award a utility and to ensure that the ROE rewarded satisfies Supreme Court mandates in *Hope* and *Bluefield*.[83] Entergy states that relying solely on the DCF model would be contrary to the D.C. Circuit's findings in *Emera Maine*. Entergy asserts that, according to these findings, any ROE decision must incorporate a rational connection between the record evidence that undermines the reliability of the DCF analysis, and the Commission's placement of the base ROE. Entergy continues to argue that rote application of one method is contrary to the D.C. Circuit's instruction that "ratemaking is not a science," and therefore, the Commission must use models to inform, not rigidly determine its judgement as to an appropriate ROE for a utility.[84]

42. Entergy points out that Louisiana Commission argues that the DCF methodology has not been proven inaccurate for the PPAs at issue in this proceeding.[85] Entergy takes issue with Louisiana Commission's argument, New Orleans Council's reference to the "the particular circumstances of this case" and "the minimal risk associated with the specific, limited application of the tariff in question in this proceeding,"[86] and PUCT's claim that upholding the Initial Decision "will do no harm to [Entergy's] ability to attract additional capital investment, and mirrors the declining risks the company faces in both the credit and capital markets."[87]

43. Entergy asserts that these arguments are unavailing for two primary reasons. First, Entergy argues that the Commission has already decided that strict adherence to the DCF model does not singularly reflect how investors make their decisions and investors appear to base their decision on numerous data points and models, including the DCF, CAPM, Risk Premium, and Expected Earnings methodologies. Entergy states that looking at how investors analyze and compare their investment opportunities is required in order to determine what ROE to award to a utility and to ensure that the ROE awarded satisfied the Supreme Court mandates in *Hope* and *Bluefield*. Entergy contends that, therefore, using the DCF methodology alone under any sort of facts would be inconsistent with the

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[82] *Id.* (citing *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 44).

[83] *Id.* at 15 (citing *Coakley* Briefing Order, 165 FERC ¶ 61,030 at PP 33, 35).

[84] *Id.* at 16 (citing *Emera Maine*, 854 F.3d at 27-28).

[85] *Id.* at 17 (citing Louisiana Commission Initial Brief at 8).

[86] *Id.* (citing Council Initial Brief at 6, 2).

[87] *Id.* (citing PUCT Initial Brief at 4).

Commissions requirements under *Hope* and *Bluefield*.[88] Second, Entergy argues that the parties' citations to special or unique circumstances are an attempt to cabin the Commission's ROE policy to transmission tariffs, as if what investors look to is any different in the transmission or generation space. Entergy argues that parsing ROEs on a function-by-function basis is inconsistent with Commission precedent, and Entergy asserts that the Commission has rejected invitations to do so, holding such approaches to be "not appropriate" because efforts to unbundle the various functions of the electric business of a utility and then apportion an equity return commensurate with the risk of that function would be an impossible task.[89] Entergy states that there is no basis in the record for the Commission to revert to sole reliance on a methodology that the Commission has found does not result in just and reasonable returns simply because the Tariff sets rates for generation rather than transmission service.

44. Entergy argues that the Commission can apply its new ROE policy in this case, given that it has provided all parties the opportunity to comment on its application, and notes that the Commission was not in 2013 required to apply the two-step DCF methodology in any event.[90] Entergy states that, as the Commission explained in the Briefing Order, court precedent allows the Commission to apply new rulings retroactively, so long as the parties are given the opportunity to submit additional evidence and comment on application of the policy.[91] Entergy states that, even if the Commission considers this a policy change rather than a rule or law change, the Commission would still have to explain why the pending case should be decided on the basis of the old versus the new policy.[92] Entergy also notes that the Commission recognized in the *Coakley* Briefing Order that the D.C. Circuit has repeatedly observed that the Commission is not required to rely upon the DCF methodology alone or at all.[93]

45. Entergy states that, when Trial Staff applied the Commission's four proposed models in the Briefing Order without modification, it found that it implies a point

[88] *Id.* at 17-18 (citing *Coakley* Briefing Order, 165 FERC ¶ 61,030 at PP 33, 40).

[89] *Id.* at 18-19 (citing *Conn. Light & Power Co.*, Opinion No. 305, 43 FERC ¶ 61,508, at 62,266 (*Conn. Light & Power*), *reh'g denied*, 45 FERC ¶ 61,370 (1988) (citing *Otter Tail Power Co.*, 12 FERC ¶ 61,169, at 61,414 (1980)).

[90] *Id.* at 19.

[91] *Id.* at 20 (citing *Consol. Edison Co. of N.Y. v. FERC*, 315 F.3d 316, 323 (D.C. Cir. 2003)).

[92] *Id.* at 20-21.

[93] *Id.* at 21.

estimate ROE of 10.26%, but also claimed that modifications need to be made to the Commission's calculations. Entergy states that Trial Staff proposes to exclude the Expected Earnings model because it is not widely used by investors, is not a market approach, and does not rely on consensus estimates.[94] Entergy states that Trial Staff also proposes changing the way in which the Commission applies the CAPM analysis to use a two-step DCF methodology to calculate the market return, removing the size adjustment, and implanting a screening criterion for growth rates.[95] Lastly, Entergy states that Trial Staff proposes changing the way in which the Commission applies the Risk Premium analysis to remove vintage or stale ROEs and remove bond yields for certain periods.[96] Entergy notes that, after factoring those modifications, Trial Staff recommends an ROE of 9.32% or, in the alternative, 9.4%.[97] Entergy states that these modifications and the result that Trial Staff recommends are inconsistent with the purpose of the Commission's four proposed models in the Briefing Order and simply rehash a number of arguments the Commission has already heard and rejected.

46. Trial Staff disagrees with Entergy's claim that there is substantial evidence that the four models proposed in the Briefing Order are valid indicators of the return that investors require under the standards set forth in *Hope* and *Bluefield*.[98] Trial Staff also disagrees with Entergy's proposal to use a "strict application" of the Commission's proposed methodology. Trial Staff explains that it outlined in its initial brief, as discussed below, why certain adjustments to the Commission's proposed methodology should be adopted. Trial Staff asserts that, although Entergy recommends the Commission's proposed methodology, Entergy also includes unwarranted adjustments to two of the models including the use of a constant-growth DCF model and certain modifications to the CAPM while simultaneously ignoring long-standing concepts related to screening and growth rates.

47. New Orleans Council claims that Entergy, despite its claims of strict adherence to the four models proposed by the Commission in its Briefing Order, departs from the proposed four models by looking to other benchmarks like the empirical CAPM and constant growth DCF models.[99] New Orleans Council adds that these models are flawed,

[94] *Id.* at 26.

[95] *Id.*

[96] *Id.*

[97] *Id.* at 23-24 (citing Trial Staff Initial Brief at 36).

[98] Trial Staff Reply Brief at 6-7.

[99] New Orleans Council Reply Brief at 9.

will not result in a just and reasonable rate, and fail to satisfy the standards of *Hope* and *Bluefield*.

48. New Orleans Council states that *Hope* and *Bluefield* stand for the proposition that all relevant factors are to be assessed and that the Commission must strive to strike a balance between the needs of the utility and the interests of the consumers.[100] New Orleans Council states that it shares the Commission's concerns that proper incentives are in place to ensure adequate investment, especially since its history of extreme weather events makes it particularly conscious of critical infrastructure.[101] New Orleans Council maintains that this is, however, not about incentives or investor expectations but, rather, about the just and reasonable ROE component to be included in an umbrella tariff that is applicable to existing (and possibly future) life-of-unit PPAs. New Orleans Council asserts that these assets represent virtually no risk for the owning utility and will not affect Entergy investor decisions.

49. New Orleans Council argues that the factors present in Opinion No. 531 that dissuaded the Commission from mechanically applying the DCF methodology are not present here.[102] New Orleans Council claims that, during the hearing, Entergy's witnesses displayed that they were not basing their analyses on the particular circumstances of this case at all.[103] New Orleans Council alleges that Entergy instead focused on the Opinion No. 531 case and broad, general notions of investors' expectations. New Orleans Council adds that these assertions largely repeat testimony in the now-vacated Opinion Nos. 531 and 531-B by the very same witnesses. New Orleans Council argues that Entergy's reliance on these opinions is unsupported and circular because each case has the same witnesses and, therefore, the witnesses in the instant case are relying on their own analysis.

50. New Orleans Council notes that, at the time of the hearing, the two-step DCF methodology was the relevant precedent and that the alternative methods examined in Opinion No. 531 and this case were meant to test whether the DCF analysis yielded a just and reasonable result.[104] New Orleans Council states that the Presiding Judge then found that Entergy failed to show that the DCF methodology was affected by anomalous

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[100] *Id.* at 2-3.

[101] *Id.* at 1-2.

[102] *Id.* at 4-5.

[103] *Id.* at 6-7.

[104] *Id.* at 10.

conditions or otherwise defective and that, therefore, the Commission should decline to require parties to apply the CAPM, Expected Earnings, and Risk Premium models.

51. PUCT claims that the Commission's charge is to balance investors' expectations while ensuring customers are protected from unjust and unreasonable rates.[105] PUCT argues that Opinion No. 531 involved the establishment of an RTO/ISO-wide ROE, whereas the Tariff at issue concerns only PPAs by and between Entergy Operating Companies.

52. PUCT states that the Commission's two-step DCF analysis is well-established for estimating investor expectations and asserts that the Commission should not discard the DCF model just because it is now producing lower results when these lower results simply reflect market conditions. PUCT argues that in *Emera Maine* the D.C. Circuit did not mandate that the Commission adopt a new methodology nor did it prohibit a continued reliance on the DCF model. PUCT contends that, instead, *Emera Maine* stands for the proposition that the Commission may not replace the midpoint of the zone of reasonableness with a midpoint at the upper half of the zone of reasonableness without record evidence in support.

53. PUCT argues that the Commission having additional information obtained from other models does not mean it must depart from its reliance on the two-step DCF analysis in this case.[106] PUCT claims that the record evidence does not support a conclusion that an ROE based on the median of the zone of reasonableness under the two-step DCF analysis would result in an ROE that is too low. PUCT points out that Entergy proposed other models and that the Presiding Judge found Entergy had not met its burden under Opinion No. 531 to develop a record demonstrating that Entergy Arkansas had been impacted by anomalous market conditions.[107] PUCT claims that any evidence that Entergy points to in order to argue in favor of other financial models cannot be overcome by the Presiding Judge's findings that Entergy failed to establish record evidence in support of a higher placement of its ROE or application of models beside DCF. PUCT states that the Presiding Judge's Initial Decision is neither misplaced nor outdated because it was based on *Hope* and *Bluefield* standards and that the only material change since then is that today Entergy Texas and Entergy Louisiana are now making sales under the Tariff, in addition to Entergy Arkansas.

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[105] PUCT Reply Brief at 7-8.

[106] *Id.* at 11.

[107] *Id.* (citing Initial Decision, 151 FERC ¶ 63,008 at P 86; 150 FERC ¶ 61,165; Opinion No. 531, 147 FERC ¶ 61,234).

54. PUCT then argues that the Commission therefore must turn its attention to whether and how the straight application of the two-step DCF analysis accepted by the Presiding Judge should be updated.[108] PUCT avers that at the hearing Entergy argued that the two-step DCF analysis should be based on all six Entergy Operating Companies, despite the companies other than Entergy Arkansas only possibly selling under the Tariff in the future.

4. Commission Determination

55. We find that it is appropriate to use the CAPM and Risk Premium models in addition to the DCF model, consistent with the Commission's findings in Opinion No. 569, as modified by Opinion Nos. 569-A and 569-B, to determine the ROE in this proceeding. The Commission explained that using these models will better reflect how investors make their investment decisions. In Opinion No. 569, the Commission stated that a key consideration in determining a just and reasonable utility ROE 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, the Commission explained that it must look to the methods investors actually use to analyze and compare their investment opportunities, regardless of any flaws in those methods. The Commission found that investors use the DCF model and CAPM in making investment decisions and explained that the application of the CAPM mitigates some of the model risk that the DCF model may perform poorly in certain circumstances.[109] In Opinion No. 569-A, the Commission found that the defects of the Risk Premium model do not outweigh the benefits of model diversity and reduced volatility resulting from using the Risk Premium model.[110] Therefore, consistent with the Commission's findings in Opinion No. 569, as modified by Opinion Nos. 569-A and 569-B, we will use the DCF, CAPM, and Risk Premium models to determine the ROE in this proceeding. We will address arguments related to each of the individual models, including the exclusion of the Expected Earnings model, in separate sections below.

56. We disagree with PUCT and New Orleans Council that the Commission should only apply the two-step DCF analysis in this proceeding, as the Presiding Judge did in the Initial Decision. In the Initial Decision, the Presiding Judge relied on the DCF model alone—and looked to other models only to inform placement of the ROE within the DCF zone of reasonableness—because that approach was consistent with the then-relevant precedent. However, subsequent to the Initial Decision, the Commission issued Opinion

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[108] *Id.* at 13.

[109] Opinion No. 569, 169 FERC ¶ 61,129 at P 171.

[110] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 104.

No. 569 *et seq.* in which the Commission deliberately changed that precedent.[111] Therefore, although the DCF methodology applied in the Initial Decision was consistent with the then-relevant precedent, that precedent has changed, and PUCT and New Orleans Council have not provided sufficient reason for the Commission to rely on superseded precedent in this proceeding.

57. Moreover, rather than discarding the DCF analysis from our ROE methodology, we are adopting models in addition to the DCF analysis to capture the variety of models used by investors and to mitigate risk. For example, in Opinion No. 569-A, the Commission explained that model risk includes the broad conceptual issue of models being imperfect and not always working well in all situations. The Commission also noted that it entails errors of specific model inputs.[112] Therefore, the Commission affirmed its findings from Opinion No. 569 that the use of multiple models reduces model risk. Accordingly, in rejecting the requests to only use the DCF model, we are not disregarding evidence from the DCF model, but instead considering other evidence in addition to the DCF model. We are not persuaded that the facts and circumstances of this proceeding make using only the DCF model superior to adhering to relevant precedent and considering the wider variety of evidence from the DCF model, CAPM, and Risk Premium model.

58. As the Commission explained in Opinion No. 569, the revised approach to determining just and reasonable ROEs involves averaging the results of multiple 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.[113] It does not involve making an adjustment above the central tendency of the zone of reasonableness as the Commission did in Opinion Nos. 531 and 551. Therefore, the Commission stated that there was no need to find that anomalous capital market conditions distort the results of a DCF analysis to justify increasing the ROE for average risk utilities above the central tendency. The Commission explained that whether a change in capital market conditions is anomalous or persistent is of little importance under the Commission's revised ROE methodology, because relying on multiple financial models makes it more likely that the Commission's decision will accurately reflect how investors are making their investment decisions. We find that this revised methodology should be applied in this proceeding and therefore, we find that arguments in this proceeding regarding the existence of

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[111] *See, e.g.*, Opinion No. 569, 169 FERC ¶ 61,129 at P 31 ("We will expand our methodology . . . to rely on multiple financial models.").

[112] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 43.

[113] Opinion No. 569, 169 FERC ¶ 61,129 at P 170.

anomalous market conditions, including whether a party has demonstrated the existence or absence of anomalous market conditions, are moot.

59. We are not persuaded by arguments that the particular facts of this proceeding justify not applying or somehow changing the revised ROE methodology that was adopted in Opinion Nos. 569, 569-A and 569-B. PUCT suggests that this methodology is somehow inappropriate for this proceeding because this proceeding involves PPAs instead of an RTO/ISO-wide ROE for transmission owners.[114] New Orleans Council similarly suggests that the revised ROE methodology should not be applied in this proceeding because it was developed in a proceeding involving transmission owner ROEs, but this proceeding involves life-of-unit PPAs that represent little risk and will have "virtually no impact on the decision-making by Entergy's potential investors."[115] New Orleans Council further argues that "the policy considerations and the business and financial risks associated with transmission that the Commission has found compelling in cases involving the ROE for RTOs or ISOs simply are not present in this case."[116] We are not persuaded that the revised ROE methodology is inappropriate for this proceeding or that the Commission's rationale behind the revised ROE methodology is not applicable to this proceeding because it involves PPAs instead of RTO/ISO transmission tariffs. As Entergy notes, the Commission has explained that "to unbundle the various functions of the electric business of a utility (e.g., production, transmission, etc.) and then apportion an equity return commensurate with the risk of that function would be an almost impossible task."[117]

60. We are not persuaded that the specifics of this case justify attempting such a task. Regardless of whether generation or transmission is at issue, the goal of the Commission's ROE methodology is to estimate the ROE that is commensurate with other enterprises of similar risk, and that is sufficient to allow the utility to maintain its credit, attract capital, and meet its service obligations to customers. Specific agreements and business units within integrated utilities lack individual credit ratings. Consequently, any attempt to parse out their respective risks and associated proxy group, placement within the zone of reasonableness, and the resulting ROE would be highly speculative. As a result, for the CAPM and DCF models, we include proxy group companies with similar risk to the Entergy Operating Companies based on their overall credit ratings and do

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[114] PUCT Reply Brief at 8-9.

[115] New Orleans Council Reply Brief at 2.

[116] *Id.* at 5.

[117] *Conn. Light & Power*, 43 FERC ¶ 61,508 at 62,266 (citing *Otter Tail Power Co.*, 12 FERC ¶ 61,169 at 61,414).

attempt to estimate the risk to the utility, and corresponding appropriate proxy group, for these PPAs or infer a different placement within the zone of reasonableness for the ROE.

61. We find that the revised ROE methodology described above is the appropriate approach to achieve this goal in this proceeding, even though this proceeding involves PPAs. As described more fully below, one step of the revised ROE methodology involves determining the risk profile of the applicable entity, and this determination is then used in other steps of the methodology and ultimately affects the resulting ROE. Arguments about the risks, or lack thereof, faced by the entity are appropriately addressed there and there is no need to change the methodology itself to properly consider Entergy's risks in this proceeding.

B. Appropriate Risk Profile for Determining the ROE

1. Initial Decision

62. The Presiding Judge found that the proxy group to be used in determining the ROE in the Tariff should be selected based on the risk profile of Entergy Arkansas, and that Entergy erred by instead basing the ROE on the risk profile of all six Entergy Operating Companies.[118] The Presiding Judge rejected Entergy's contention that the Tariff should be treated as an umbrella tariff governing the sales by all six Entergy Operating Companies, finding, based on circumstances at the time of the Initial Decision, that Entergy Arkansas was the only seller under the Tariff now and would be for the foreseeable future.[119] The Presiding Judge found that Entergy Texas and Entergy Mississippi are the only other companies that might become sellers under the Tariff, but that Entergy Texas would not leave the System Agreement for five more years and Entergy Mississippi "will leave the System Agreement in November 2015, but will not be a seller under the [Tariff] for the foreseeable future."[120]

63. The Presiding Judge stated that *Bluefield* requires the ROE to be "grounded on the 'circumstances, locality, and risk' of a particular case."[121] The Presiding Judge found that establishing an ROE based on Entergy Arkansas would satisfy that requirement, but establishing an ROE for the Entergy Operating Companies as a group would not because the ROE would be "based on factors that are not germane to the risks associated with the

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[118] Initial Decision, 151 FERC ¶ 63,008 at P 50 (citing *S. Cal. Edison Co. v. FERC*, 717 F.3d 177 (D.C. Cir. 2013) (*Southern California Edison*)).

[119] *Id.* P 51.

[120] *Id.*

[121] *Id.* P 52 (quoting *Bluefield*, 262 U.S. at 693).

power sales made by Entergy Arkansas."[122] The Presiding Judge also found that basing the ROE on Entergy Arkansas's risk profile acknowledges that a "reasonable return must be 'sufficient to yield a reasonable return on the value of the property used *at the time it is being used to render the service*.'"[123] Conversely, the Presiding Judge determined that the current business and financial circumstances of the Entergy Operating Companies, as a group, may not necessarily be true for Entergy Arkansas alone, or for Entergy Texas and Entergy Mississippi when and if they become sellers under the Tariff.[124]

64. The Presiding Judge found unpersuasive Entergy's arguments in favor of using the risk profile of all six Entergy Operating Companies. The Presiding Judge acknowledged that the other five Entergy Operating Companies may make sales under the Tariff, but found that in order for one of those companies to make such sales it would first have to file a service agreement with the Commission and, therefore, could propose to change the ROE at that time.[125] The Presiding Judge rejected Entergy's argument that the Partial Settlement Agreement in this proceeding foreclosed the argument that the ROE should be based on Entergy Arkansas alone, finding that the Partial Settlement Agreement clearly excepted all ROE issues.[126]

2. Briefs on and Opposing Exceptions

65. Entergy argues that the Initial Decision erred in limiting the DCF proxy group to utilities that reflected the risk profile of only Entergy Arkansas. Entergy agrees with the Initial Decision's findings that the Tariff was designed to govern sales to and purchases from the Entergy Operating Companies that have left the System Agreement and that Entergy Arkansas is currently the only such company.[127] However, Entergy disagrees with the finding that Entergy Arkansas is the only company whose sales today may be made under the Tariff. Entergy states that, if any of the other five Entergy Operating Companies were to make sales to Entergy Arkansas, they would be doing so under the Tariff.[128] Entergy also contends that the Hearing Order does not require the ROE to be

[122] *Id.*

[123] *Id.* (quoting *Bluefield*, 262 U.S. at 693) (emphasis added by Initial Decision).

[124] *Id.*

[125] *Id.* P 53.

[126] *Id.* P 54.

[127] Entergy Brief on Exceptions at 44 (citing Ex. ESI-113 at 3:19-4:6).

[128] *Id*. at 45 (citing Tr. 360: 8-11).

reexamined each time an Entergy Operating Company leaves the System Agreement. Further, Entergy asserts that the Hearing Order established a separate docket number for each Entergy Operating Company, thereby indicating that the Tariff would be treated as an umbrella tariff. Entergy cites the Hearing Order's statement that the Tariff "will also govern any new agreements for capacity and energy sales between Entergy Arkansas and the other Entergy Operating Companies, and sales between other Entergy Operating Companies if and when they withdraw from the System Agreement."[129] Accordingly, Entergy argues that the Commission established the hearing to determine the ROE for all six Entergy Operating Companies.

66. Entergy argues that basing the ROE on Entergy Arkansas's risk profile overlooks the generic nature of umbrella tariffs, which are designed to accommodate future sales without requiring Commission approval of the rate for each transaction. According to Entergy, the Commission routinely approves umbrella tariffs.[130] Entergy argues that the Initial Decision's ruling would defeat the purpose of umbrella tariffs.

67. Entergy also points out that section II.(2) of the Partial Settlement Agreement provides that the Tariff will be used for "*any new transactions* if and when other Entergy Operating Companies depart the System Agreement."[131] Entergy argues that the Initial Decision ignored this section of the Partial Settlement Agreement. Entergy also contends that the Initial Decision misapplies section II.(1), which states that once the Commission approves the Partial Settlement Agreement, all issues regarding the Tariff that were or could have been raised in this proceeding will be resolved. Entergy points out that Trial Staff supported the settlement and neither Trial Staff nor any intervenors raised any concerns in their settlement comments that the formula should be revised to state separate ROEs for each Entergy Operating Company. Entergy argues that the Initial Decision erroneously rejects Entergy's argument that the agreement precluded participants from interjecting into the hearing the argument that this proceeding was intended to establish an ROE for only Entergy Arkansas.[132]

68. Entergy contends that the Initial Decision's reliance on *Southern California Edison*, to reject the use of all six Entergy Operating Companies in determining the DCF

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[129] *Id*. (citing Hearing Order, 145 FERC ¶ 61,216 at P 3).

[130] *Id*. at 46 (citing *Transource Kan., LLC*, 151 FERC ¶ 61,010, at P 81 (2015) (*Transource Kan.*)).

[131] *Id*. at 47-48 (quoting Partial Settlement Agreement at § II.(2)) (emphasis added by Entergy).

[132] *Id*.

proxy group is misplaced.[133] Entergy argues that, in *Southern California Edison*, the court was not addressing the issue of whether it was appropriate to construct a proxy group based on the credit rating of one utility when other utilities were permitted to make sales under a generic tariff. Rather, Entergy asserts that the issue before the court was whether the midpoint or median best approximated the central tendency of the proxy group when establishing the ROE for an individual company. Entergy also contends that it is not contesting the use of the median as the starting point for its analysis of where to place the ROE within the zone of reasonableness. Entergy argues that, just as the proxy group adopted in Opinion No. 531 was based on the risk profiles of the New England TOs that were operating under the tariff at issue in that case, the proxy group here should be based on the risk profiles of all of the Entergy Operating Companies that today may transact under the Tariff.[134]

69. Trial Staff contends that the Presiding Judge correctly found that the ROE in the Tariff should be based upon "publicly traded companies with risk profiles similar to Entergy Arkansas, the only Company currently making sales under this Tariff."[135] Trial Staff asserts that Entergy was able to include in its proxy group individual Entergy Operating Companies with higher credit ratings, thereby inappropriately driving up its DCF results.[136] Trial Staff contends that the evidence introduced in this proceeding demonstrates that Entergy Arkansas is the only party that will be making sales under the Tariff for years to come.[137] Trial Staff states that its proposed ROE is based on current and projected conditions. Trial Staff contends that, if an Entergy Operating Company eventually decides to begin making sales under the Tariff, but believes that the ROE established in this proceeding is inappropriate for that Entergy Operating Company, or for that Entergy Operating Company and Entergy Arkansas, the Entergy Operating Company seeking to make sales under the Tariff could propose a change to the ROE.[138]

70. Trial Staff claims that it did not advocate, nor did the Initial Decision conclude, that this generic umbrella tariff should not operate as designed. Trial Staff asserts that the

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[133] *Id*. at 48.

[134] *Id*. at 48-49.

[135] Trial Staff Brief Opposing Exceptions at 31-32 (citing Initial Decision, 151 FERC ¶ 63,008 at P 50).

[136] *Id.* at 32 (citing Ex. S-4 at 42).

[137] *Id.* at 32-33.

[138] *Id.* at 33.

Initial Decision merely set the ROE in the Tariff based on current facts.[139] Trial Staff disagrees with Entergy's assertion that the Tariff can accommodate future sales without the need to obtain separate Commission approval for such sales. According to Trial Staff, if another Entergy Operating Company proposes to make a sale under this Tariff, that Entergy Operating Company would have to file a Service Agreement with the Commission. Trial Staff argues that changes to the Tariff could be made at that time.[140] Finally, Trial Staff contends that the Initial Decision is in no way inconsistent with the Partial Settlement Agreement that severed the ROE issue for hearing. Trial Staff argues that, although the purpose of this proceeding is to establish an ROE for Entergy Arkansas and the other Entergy Operating Companies when they leave the system, there is no reason to base the ROE on facts that may apply to the other Entergy Operating Companies years from now and may never apply to them.[141]

71. Louisiana Commission explains that the Initial Decision's determination reflects the factual situation as it now stands, because only Entergy Arkansas is making sales pursuant to the Tariff, and Entergy Arkansas is the only company likely to do so in the foreseeable future. Louisiana Commission asserts that Entergy's contention that an ROE should be set for all six Entergy Operating Companies necessarily requires speculation as to future conditions.

72. Additionally, Louisiana Commission asserts that, even if it were appropriate to focus on all six Entergy Operating Companies, the proxy group should be based on the Moody's Baa3 and Standard & Poor's (S&P) BBB credit ratings[142] of Entergy Corporation, the parent company, because Entergy Corporation owns the stock of all the Operating Companies, controls their finances, and guides their operations.[143] Louisiana Commission contends that the Entergy Operating Companies' risk is the same as Entergy's. Louisiana Commission states that the Commission traditionally has focused

[139] *Id.*

[140] *Id.* at 34.

[141] *Id.*

[142] Ex. ESI-103 at 1.

[143] *Id*. As discussed in the next section, the Moody's credit ratings for five of the Operating Companies were higher than the parent's credit rating, while S&P gave all the Operating Companies the same credit rating as the parent. Ex. ESI-100 at P 4.

on the parent company when setting the ROE for the Entergy Operating Companies, and the United States Circuit Court of Appeals for the Fifth Circuit affirmed that approach.[144]

3. Briefing Order and Opinion No. 569 *et seq.*

73. In the *Coakley* Briefing Order, the Commission proposed generally to use the same proxy group screening criteria as outlined in Opinion No. 531. In Opinion Nos. 569, 569-A and 569-B, the Commission also applied those screening criteria.[145] Thus, the relevant screening criteria here is the inclusion of companies with credit ratings no more than one notch above or below the utility or utilities whose ROE is at issue.[146]

4. Initial Briefs

74. Entergy states that it used the proxy group adopted by the Initial Decision, which consisted of 19 companies. However, Entergy asserts that it does not believe that this proxy group reflects the full range of risks that the Entergy Operating Companies face.[147]

75. Trial Staff notes that the Initial Decision found it necessary to examine publicly traded companies with risk profiles similar to Entergy Arkansas, the only Entergy Operating Company making sales under the Tariff at that time. However, Trial Staff states that Entergy Louisiana and Entergy Texas began making sales to other Entergy Operating Companies under this Tariff. Therefore, Trial Staff states that it is appropriate to develop a proxy group based on the credit rating band of one notch above and below the composite credit ratings span for Entergy Arkansas, Entergy Louisiana and Entergy Texas.[148]

76. PUCT states that the Presiding Judge relied on risk profiles similar to Entergy Arkansas and not necessarily all of Entergy's Operating Companies in part because

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[144] Louisiana Commission Brief Opposing Exceptions at 20 (citing *La. Pub. Serv. Comm'n v. FERC*, 688 F.2d 357 (5th Cir. 1982)).

[145] *See, e.g.*, Opinion No. 569, 169 FERC ¶ 61,129 at PP 366, 461.

[146] *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 49 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 107). The Commission requires use of both S&P's corporate credit ratings and Moody's issuer ratings when both are available. *Id.*

[147] Entergy Initial Brief at 20.

[148] Trial Staff Initial Brief, Green Aff. at 6-7.

Entergy Arkansas is the only one making sales under the Tariff.[149] PUCT argues that basing the ROE on a group of companies is not consistent with *Hope* and *Bluefield*'s requirements to establish an ROE based on the utility's risk profile.[150]

5. Reply Briefs

77. Entergy reiterates that it does not agree with the proxy group that was adopted by the Presiding Judge in the Initial Decision because Entergy does not believe that the proxy group reflects the full range of risks that Entergy faces.[151] Entergy states that it appears that Louisiana Commission and Trial Staff disavow this limited proxy group, and instead support the more extensive proxy group offered by Entergy at trial. Therefore, Entergy states that for the purpose of providing the Commission with sufficient information on which to decide the proper ROE, Entergy presents the results of the 26-firm proxy group. Entergy explains that the 26-firm proxy group includes the 25 companies proposed by Entergy at hearing, as well as one additional company whose inclusion Trial Staff supports and Entergy does not dispute.[152] Entergy states that its results confirm the reasonableness of the 10.5% ROE recommendation. However, Entergy states that, if the Commission were to base its findings solely on the analyses for the 26-firm proxy group, Entergy recommends an 10.4% ROE.[153]

78. Entergy also disagrees with PUCT's argument that basing an ROE on a group of companies is not consistent with the requirements of *Hope* and *Bluefield* to establish a company's ROE based on the utility's risk profile.[154] Entergy asserts that the Commission has repeatedly done so for a number of years, including in Opinion No. 551, and therefore asserts that PUCT's argument should be rejected.

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[149] PUCT Initial Brief at 8 (quoting Initial Decision, 151 FERC ¶ 63,008 at PP 50, 52 (stating that developing an ROE based on all six Entergy Operating Companies "would produce an ROE based on factors that are not germane to the risks associated with the power sales made by Entergy Arkansas")).

[150] *Id.* at 9.

[151] Entergy Reply Brief at 45-46.

[152] *Id.* at 46.

[153] *Id.* at 46-47.

[154] *Id.* at 46 (citing PUCT Initial Brief at 9).

79. PUCT states that Trial Staff's proposal to base the risk profile on the composite of the three current Entergy Operating Companies that currently engage in sales under the Tariff is a reasonable resolution.[155]

6. **Commission Determination**

80. We reverse the Initial Decision's finding that the proxy group for this proceeding should be based on the risk profile of Entergy Arkansas and instead find that it should be based on the risk profile of all six Entergy Operating Companies.[156]

81. The Initial Decision properly found that Entergy Arkansas was the only Entergy Operating Company making sales under the Tariff at that time;[157] however, as Entergy correctly points out, Entergy Arkansas is not the only Entergy Operating Company that *may* make sales under the Tariff today. As noted above, the Tariff allows any of the six Entergy Operating Companies, whether or not they are participants in the System Agreement, to make purchases or sales pursuant to the Tariff. In fact, Entergy Louisiana and Entergy Texas began making sales under the Tariff. Accordingly, the Initial Decision's statement that "Entergy Arkansas is the only seller under this [T]ariff now or for the foreseeable future"[158] is no longer true. Furthermore, after the Presiding Judge issued the Initial Decision in this proceeding, the Entergy Operating Companies submitted, and the Commission approved, a settlement agreement terminating the System Agreement on August 31, 2016.[159] Consistent with that settlement, all of the Entergy Operating Companies have terminated their participation in the System Agreement and any sales of energy and capacity among the Entergy Operating Companies must be made pursuant to the Tariff. It is possible that umbrella tariffs in fact may only apply to a single operating company; in which case, the Commission would consider only basing the proxy group on the specific credit rating of that single operating Company. However, as illustrated by Entergy Louisiana's and Entergy Texas's use of the Tariff, that is not the case in this proceeding, and it is reasonable to infer that other Entergy Operating Companies may use it in the future. As a result, we find that it is appropriate to

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[155] PUCT Reply Brief at 14.

[156] The results under both approaches put forth by the participants—i.e., basing the ROE on the risk profile of Entergy Arkansas alone or basing it on the risk profile of all six Operating Companies—produce nearly identical numerical ROE results in this proceeding.

[157] Initial Decision, 151 FERC ¶ 63,008 at P 51.

[158] *Id.*

[159] *Entergy La., LLC*, 156 FERC ¶ 61,146, at PP 2,4 (2016).

determine the proxy group in this proceeding using the risk profile of all six Entergy Operating Companies—three of which have made sales under the Tariff, and the remainder which now must make any sales of energy and capacity to another Entergy Operating Company pursuant to the Tariff.

82. The Commission has explained that umbrella tariffs like the one at issue in this proceeding allow utilities to meet "the filing requirements of the FPA and our regulations, while retaining maximum flexibility in transacting business in an evolving, increasingly competitive generation market."[160] Accordingly, the Commission has "encourage[d] the filing of umbrella tariffs as a means of assisting the industry in making short-term economic transactions where speed is often essential."[161] Indeed, as Entergy correctly notes, the Entergy Operating Companies have used Service Schedule MSS-4 as an umbrella tariff, with a single ROE, for over 30 years—and five of the six Entergy Operating Companies have been sellers under Service Schedule MSS-4.[162] We therefore find that basing the ROE on the risk profiles of all six Entergy Operating Companies in this proceeding will encourage the same type of transactional flexibility that the Entergy Operating Companies used under Service Schedule MSS-4.[163]

83. We also find that Trial Staff's proxy group construction is generally consistent with the Commission's methodology, except that Trial Staff's proxy group is based on the risk profiles of Entergy Arkansas, Entergy Louisiana, and Entergy Texas—the

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[160] *Prior Notice and Filing Requirements Under Part II of the Fed. Power Act*, 64 FERC ¶ 61,139, at 61,983 (1993).

[161] *Id.*; *see also, e.g.*, *Transource Kan.*, 151 FERC ¶ 61,010 at P 81; *Transource Wis., LLC*, 149 FERC ¶ 61,180, at P 63 (2014).

[162] *See* Ex. ESI-113 at 23:9-16.

[163] We disagree with the Initial Decision's finding that *Southern California Edison* is relevant to the analysis of this issue. *Southern California Edison* dealt with the issue of whether the median or midpoint is the appropriate measure of central tendency in determining the ROE for a single utility, as compared to the ROE for a diverse group of utilities whose facilities are operated by a regional transmission organization (RTO) or independent system operator (ISO). *Southern California Edison*, 717 F.3d 177. *Southern California Edison* did not address the issue of what risk profile should be used to determine the ROE in an umbrella tariff applicable to a group of affiliated operating companies.

three Entergy Operating Companies that have made sales under the Tariff.[164] Nevertheless, we find that there would be no difference if the proxy group construction were to be based on the risk profiles of all six Entergy Operating Companies, since all Entergy Operating Companies have S&P credit ratings of BBB and a range of Moody's credit ratings of Baa1 – Baa3.[165]

84. We disagree with Louisiana Commission's contention that the Commission should base the proxy group on the credit ratings of the parent company, Entergy Corporation, as opposed to the credit ratings of the Entergy Operating Companies. While the Commission has found it appropriate to base the proxy group on a parent company's credit rating under certain circumstances, e.g., where the utility whose ROE is at issue is not publicly traded and does not have its own credit rating,[166] we find it unnecessary to rely on the parent company's credit rating in this case. To the extent that a utility issues its own debt and has its own credit rating, the utility typically should be viewed independently from its corporate parent, which may have more diversified business interests and, therefore, a different risk profile.[167] Because the Entergy Operating Companies in this case issue their own debt and have their own credit ratings, which are based on the risks specific to each company, we find that those credit ratings provide an appropriate starting point in identifying proxy companies whose risks are comparable to the Entergy Operating Companies.

C. Outlier Tests and Natural Break Analysis

1. Briefing Order and Opinion No. 569 *et seq.*

85. In the *Coakley* Briefing Order, the Commission proposed to continue to use its then-existing low-end outlier test that excluded companies from the proxy group whose

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[164] Trial Staff Initial Brief, Green Aff. at 25. Entergy Arkansas, Entergy Louisiana, and Entergy Texas have Moody's credit ratings of Baa2, Baa1, and Baa3 respectively. These three Entergy Operating Companies have S&P credit ratings of BBB.

[165] Entergy Arkansas, Entergy Gulf States Louisiana, Entergy Louisiana, Entergy Mississippi, Entergy New Orleans and Entergy Texas have Moody's credit ratings of Baa2, Baa1, Baa1, Baa2, Ba2, and Baa3 respectively. All the Operating Companies have S&P credit ratings of BBB. Ex. ESI-100 at 4.

[166] *See, e.g.*, *New England Power Co.*, 22 FERC ¶ 61,123, at 61,186-87 (1983).

[167] *See ITC Holdings Corp.*, 121 FERC ¶ 61,229, at P 49 (2007); *see also Transcon. Gas Pipe Line Corp*., Opinion No. 414-A, 84 FERC ¶ 61,084 at 61,413-415, *reh'g denied*, Opinion No. 414-B, 85 FERC ¶ 61,323 (1998), *rev. denied sub nom.*, *N.C. Util. Comm'n v. FERC*, 203 F.3d 53 (D.C. Cir. 2000).

ROE failed to exceed the average 10-year bond-yield by approximately 100 basis points.[168] The Commission excludes these low end outliers because 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. The Commission proposed to apply this test for purposes of the DCF, CAPM and Expected Earnings analyses.[169]

86. The Commission proposed to apply a high-end outlier test to the results of the CAPM, Expected Earnings, and DCF analyses, treating as high-end outliers any proxy company whose cost of equity estimated with a given model is more than 150% 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.[170]

87. The Commission also proposed to apply its low-end and high-end outlier screens, subject to a natural break analysis.[171] 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.[172]

88. In Opinion No. 569, the Commission adopted a low-end outlier test that eliminates from the proxy group ROE results that are less than the prevailing yields of generic corporate Baa bonds plus 20% of the CAPM risk premium.[173] In Opinion No. 569-A, the Commission continued to find that this was an appropriate low-end outlier test.[174] In

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[168] *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 51 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 123).

[169] *Id.* (citing *S. Cal. Edison Co.*, Opinion No. 445, 92 FERC ¶ 61,070, at 61,266 (2000)).

[170] *Id.* P 53.

[171] *See Id.* PP 51, 53.

[172] *See, e.g.*, *S. Cal. Edison Co*., 131 FERC ¶ 61,020, at P 56 (2010) (*S. Cal. Edison*) (applying a natural break analysis to exclude from the proxy group a company whose ROE was 102 basis points above the applicable bond yield).

[173] *See* Opinion No. 569, 169 FERC ¶ 61,129 at P 19.

[174] *See* Opinion No. 569-A, 171 FERC ¶ 61,154 at P 161.

Opinion No. 569, the Commission applied the high-end outlier test proposed in the *Coakley* Briefing Order, but in Opinion No. 569-A, the Commission modified the high-end outlier test to treat any proxy company as a high-end outlier if its cost of equity estimated under the model in question was more than 200% of the median, as opposed to 150% of the median.[175] In Opinion No. 569 *et seq.*, the Commission applied the natural break analysis as proposed in the *Coakley* Briefing Order.[176]

2. Initial Briefs

89. Entergy recommends updating the low-end outlier test to raise the spread over public utility bond yields by 165 basis points in order to reflect the inverse relationship between equity risk premiums and bond yields. Additionally, Entergy recommends that the high-end outlier test reflect 150% of the highest median among the three financial models so the test is consistent.

90. Entergy also argues that the 150% median-based high-end outlier test should not be applied to the DCF model because the median of the DCF results presents a meaningful guide to investors' required range of returns for the proxy group companies.[177]

91. Regarding the natural break test, Entergy argues that the difference between individual cost of equity estimates can be used as a gauge of reasonableness. Entergy asserts that the fundamental flaw in the notion of a natural break test is that it represents a misappropriation of statistical concepts based on the false premise that evaluating individual cost of equity estimates is akin to statistical sampling, which Entergy disputes. Entergy argues that the goal in evaluating the results of the DCF, CAPM and Expected Earnings analyses is not to identify outliers, but to remove estimates that are clearly illogical for purposes of identifying the broad range of potentially lawful ROEs that constitutes the zone of reasonableness.[178]

92. PUCT emphasizes that appropriate screening of outliers "is particularly important where the Commission uses the midpoint of the zone of reasonableness because a single

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[175] *Id.* PP 154-155.

[176] *See, e.g.*, *id.* PP 145-146; Opinion No. 569, 169 FERC ¶ 61,129 at PP 395-397.

[177] Entergy Initial Brief, McKenzie Aff. at 36.

[178] *Id.*, McKenzie Aff. at 38.

outlier can dramatically affect the resulting ROE."[179] PUCT therefore encourages continued use of the low-end outlier test and adoption of a high-end outlier test. PUCT acknowledges that the Commission has proposed treating any proxy company exceeding 150% of the median result as a high-end outlier before any high- or low-end outlier test is applied. However, PUCT urges the Commission to adopt the method proposed by MISO Complaint Aligned Parties in the Opinion No. 569 proceeding.[180] PUCT represents that this method is superior because it relies on standard deviation, which appropriately measures and considers the dispersion and underlying array of the dataset and ROEs produced by each model. PUCT adds that the Commission should establish clear and objective standards regarding the way it intends to perform the natural break analysis for low- and high-end outliers.[181]

3. Reply Briefs

93. Trial Staff argues that Entergy's adjustment to the Commission's low-end outlier test does not meet the threshold test of economic logic and should be rejected. Trial Staff asserts that under Entergy's proposed adjustment, the low-end threshold would be 7.38% (265 basis points above the bond yield of 4.73%) but that no rational investor would consider a 7.38% ROE to yield "essentially the same expected return" as a 4.73% bond yield.[182] Trial Staff further asserts that it is illogical to assume that the baseline for the change in bond yields should be constrained to a comparison between the data periods in 2007 and 2008 and the data period in this proceeding. Trial Staff also contends that the 6.69% bond yield relied on by Entergy is higher than all calendar year averages as far back as 2002, except for the bond yield spike periods of 2008 and 2009.[183]

94. Trial Staff asserts that Entergy's argument that the Commission should not apply its proposed 150% high-end outlier test to the DCF model has no basis. Trial Staff claims that the Commission acknowledged in the *Coakley* Briefing Order and MISO Briefing Order that the two-step DCF could produce unsustainably high results in certain circumstances and the Commission's high-end outlier test is necessary to identify

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[179] PUCT Initial Brief at 11 (quoting MISO Briefing Order, 165 FERC ¶ 61,118 at P 55).

[180] The Complaint Aligned Parties are identified at footnote 57 of Opinion No. 569.

[181] *Id.* at 11-12.

[182] Trial Staff Reply Brief, Green Reply Aff. ¶¶ 15-16.

[183] *Id.* P 17 (citing Trial Staff Reply Brief, Green Reply Aff., attach. 1 at 27).

companies whose cost of equity under an ROE model is not representative of the risk profile of a more normal utility.[184]

95. Trial Staff argues that Entergy's claim that a natural break test provides no relevant information is meritless and contravenes Commission policy. Trial Staff notes that the Commission has stated that there could be ROE analyses that result in egregious distortion by the lowest or highest number and the Commission has applied the natural break test to ensure that no outliers were included in the DCF results.[185] According to Trial Staff, the Commission has found that elimination of high-end outliers is particularly important when the midpoint is used because a single outlier can dramatically affect the resulting ROE.[186] Trial Staff further argues that, even where the median is the measure of central tendency, outliers, by definition, impermissibly skew the results and should be removed.

4. Commission Determination

96. We decline to adopt Entergy's proposed revisions to the low-end outlier test. In Opinion No. 569, the Commission revised its low-end outlier test to include a risk premium instead of a generic basis point spread as proposed in the *Coakley* Briefing Order. The Commission stated that, because the risk premium that investors demand changes over time, it is imprecise to simply add 100 basis points to the bond yield. Therefore, the Commission adopted a low-end outlier test that eliminates from the proxy group ROE results that are less than the yields of generic corporate Baa bonds plus 20% of the CAPM risk premium. The Commission found that it was necessary to exclude ROEs whose yield was "essentially the same expected return" as debt in order to determine the low end of the zone of reasonableness.[187] Additionally, the Commission noted that the risk premium that investors demand changes over time and found that using 20% of the CAPM risk premium struck an appropriate balance of accounting for the additional risk of equities over bonds while not inappropriately excluding proxy group members whose ROEs are distinguishable from debt.[188] Accordingly, we continue

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[184] Trial Staff Reply Brief at 9-10 (citing MISO Briefing Order, 165 FERC ¶ 61,118 at P 53; *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 52).

[185] *Id.* at 10 (citing *Midwest Indep. Transmission Sys. Operator, Inc.*, 106 FERC ¶ 61,302, at P 12 (2004), *aff'd in relevant part sub. nom. Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005)).

[186] *Id.* at 10 (citing MISO Briefing Order, 165 FERC ¶ 61,118 at P 55).

[187] Opinion No. 569, 169 FERC ¶ 61,129 at P 387.

[188] *Id*. P 388.

to find that the low-end outlier test adopted in Opinion No. 569 properly excludes companies from the proxy group with ROEs that are so low that they should not be considered in determining the low end of the zone of reasonableness. In this proceeding, 20% of the CAPM risk premium is 189 basis points and Moody's Baa Utility Bond Yield is 4.71%, leading to a low-end outlier test threshold of 6.60%. Applying this outlier test results in the elimination of four proxy group companies for the DCF model, as discussed below.

97. We also reject Entergy's proposal to revise the high-end outlier test to reflect 150% of the highest median among the financial models. In Opinion No. 569, the Commission adopted the high-end outlier test for the CAPM and DCF models, as those models may produce unsustainably high results for a particular proxy company in unusual situations. Therefore, the Commission found it necessary to apply a high-end outlier test to the results of these methods. However, the Commission rejected MISO TO's proposal to use 150% of the highest median ROE produced by either the DCF or CAPM models as the high-end outlier test for both models, as Entergy similarly proposes in this proceeding. The Commission noted that each model is based on different assumptions and thus estimates the cost of equity in different ways. Accordingly, the Commission found that 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.[189]

98. Subsequently, in Opinion No. 569-A, the Commission modified the high-end outlier test to treat any proxy company as a high-end outlier if its cost of equity estimated under the model in question is more than 200% of the median—as opposed to the 150% of the median threshold applied in Opinion No. 569—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.[190] We continue to find that this high-end outlier test is the Commission's best attempt to use an objective test to identify proxy group ROEs that are irrationally or anomalously high. This outlier test results in the elimination of no proxy group companies for either the CAPM or DCF model.

99. We also reject PUCT's proposal to adopt a low-end or high-end outlier test that relies on a standard deviation as proposed by the Complaint Aligned Parties in the Opinion No. 569 proceeding. In Opinion No. 569, the Commission found arguments for this proposal unpersuasive because statistical methodologies may be based on

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[189] *Id.* P 377 (citing Ex. JCI-107 at 29).

[190] The high-end outlier test only applies to the DCF model and CAPM because they utilize results of the relevant analysis applied to a proxy group, while the Risk Premium model is derived from actual ROEs.

assumptions such as the distribution of the underlying population being normal.[191] The Commission explained that these underlying assumptions may not always hold for a given proxy group, especially a small proxy group. Thus, the Commission found that its high-end outlier test has the advantage that it is relatively easy to carry out, places a well-defined upper bound on the proxy group, and can be used with small proxy groups because it utilizes a percentage differential compared to the median. We do not agree with PUCT's arguments to deviate from the Commission's findings in Opinion Nos. 569 and 569-A.

100. We further disagree with Entergy's assertion that the natural break analysis provides no relevant information, is meritless, and contravenes Commission policy. In Opinion No. 569-A, the Commission explained that the natural break analysis may be used as evidence for retaining one or more cost-of-equity estimates that might otherwise be excluded because of a high-end or low-end outlier test. The Commission further stated that observations that are shown to be rational and not the result of error may still be included, even if they otherwise would fail one of the outlier tests. By the same logic, the Commission also stated that the natural break analysis can be used to argue for exclusion of cost-of-equity estimates that do not fail either outlier test but can be shown to be irrational, anomalous, or the result of human error. The Commission explained that model inputs can be flawed, due to incorrect inputs or the result of poor judgement by analysts, and such errors can improperly influence the analysis, especially when they affect estimates at the high and low end of the proxy group.[192] Therefore, we are not persuaded by Entergy's criticisms of the natural break analysis. In this proceeding, we found that no proxy group companies should be excluded based on a reasonable application of the natural break analysis.

101. Lastly, we reject PUCT's proposal that the Commission should establish clear and objective standards regarding the manner in which it intends to perform the natural break analysis for low- and high-end outliers. In Opinion No. 569, the Commission declined to enumerate a rigid formula, such as specifying how close the company must be to the next proxy group member to justify inclusion or exclusion from the proxy group, for the application of the natural break analysis. The Commission found that 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 and found that it is appropriate to develop a policy on this issue through case-by-case analysis, rather than adopting a

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[191] Opinion No. 569, 169 FERC ¶ 61,129 at P 376 (*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.")).

[192] Opinion No. 569-A, 171 FERC ¶ 61,154 at PP 145-146.

specific formula.[193] We continue to reach the same finding and do not find arguments raised by PUCT availing.

D. Central Tendency of the Zone of Reasonableness

1. Initial Decision

102. The Presiding Judge stated that the Commission's policy in ROE cases involving a single utility is that the median value of the proxy group is the just and reasonable rate, absent unique circumstances in the particular case.[194] The Presiding Judge thus set the ROE at 9.01%, the median of Louisiana Commission's proxy group.[195] The DCF model used by the Presiding Judge was the two-step DCF model established in the *Coakley* proceeding, which weighted the short-term growth rate and the long-term growth rate evenly, then evaluated whether any adjustment was needed to the resulting ROE for it to be in compliance with the requirements of *Hope* and *Bluefield*.[196]

2. Briefs on and Opposing Exceptions

103. Entergy proposes a 10.66% ROE, based upon the midpoint of the upper half of Entergy's initial DCF results, from the six-month period from February 2014 to July 2014, rather than its updated DCF results, from the six-month study period from June 2014 to November 2014. Entergy argues that it appropriately used the midpoint, and not the median of the upper-end of the zone of reasonableness, and that the Commission did not rule or suggest in Opinion No. 531 using the median instead of the midpoint. Rather, according to Entergy, the Commission stated that there may be different points in the range that produce a reasonable ROE.[197]

104. Additionally, Entergy states that Louisiana Commission's proxy group would produce a just and reasonable result, 10.3%, if the Commission were to place the ROE at the midpoint of the upper half of Louisiana Commission's zone of reasonableness.[198]

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[193] Opinion No. 569, 169 FERC ¶ 61,129 at P 397.

[194] Initial Decision, 151 FERC ¶ 63,008 at P 49.

[195] *Id.* PP 40, 84, 92.

[196] *Id.* PP 24-25 (citing Opinion No. 531, 147 FERC ¶ 61,234).

[197] Entergy Brief on Exceptions at 39 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 151 n.306).

[198] *Id*. at 49.

105. Trial Staff contends that the Presiding Judge correctly found that Entergy "largely ignores the value of the DCF method itself and merely uses the DCF outcome as a reference for the non-precedential methodologies it relies on instead."[199] Trial Staff explains that, while Entergy's recommended ROE of 10.66% is within the zone of reasonableness, it is higher than the median of the range, higher than the median of the top half of the range, and higher even than the midpoint of the range.[200] Similarly, Louisiana Commission contends that, in making the upward adjustment, Entergy's expert erroneously deviated from the Commission-prescribed method for determining the "central tendency" of results. Louisiana Commission states that the central tendency of the upper half of the results of all three experts, consistent with Commission precedent requiring use of the median, is far below the 10.66% ROE recommended by Dr. Avera.

106. Louisiana Commission contends that Commission policy, approved by the D.C. Circuit, requires using the median to determine the central tendency of a data set for a single utility, such as Entergy Arkansas or Entergy as a whole.[201] Thus, Louisiana Commission contends that if the ROE in this case must be placed in the top half of the zone, the appropriate method would be to: (1) determine the median result for the proxy group; and (2) determine the median result in the top half of the zone.[202]

107. Louisiana Commission states that, as the D.C. Circuit recognized in *Southern California Edison*, a main disadvantage of using the midpoint is that, in a skewed distribution, it '"is drawn in the direction of the skew more than the median.'"[203] Louisiana Commission explains that the use of the midpoint gives more weight to "the impact of atypical outliers in the proxy group."[204] Louisiana Commission states that the Commission permits using the midpoint only in the "'unique circumstances'" in which "the ROE was going to apply to a diverse group of companies, rather than to a single company of average risk."[205]

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[199] Trial Staff Brief Opposing Exceptions at 19 (citing Initial Decision, 151 FERC ¶ 63,008 at P 88).

[200] *Id.* at 19-20.

[201] *Id.* (citing *Southern California Edison*, 717 F.3d at 183).

[202] *Id.* at 33.

[203] *Id.* at 34 (citing *Southern California Edison*, 717 F.3d at 183).

[204] *Id.* (citing *Southern California Edison*, 717 F.3d at 185).

[205] *Id.*

3. Briefing Order and Opinion No. 569 *et seq.*

108. In the *Coakley* Briefing Order, for an average risk single utility, the Commission proposed to determine the median of each zone of reasonableness produced by the DCF, CAPM, and Expected Earnings models and average those medians with the estimate produced by the Risk Premium model, giving equal weight to each of the four figures. The Commission proposed to use the medians of the lower and upper halves of the zones of reasonableness to determine ROEs for single utilities of below and above average risk, respectively.[206] In Opinion No. 569, the Commission stated that the median is the appropriate measure of central tendency for a single utility.[207]

4. Initial Briefs

109. Entergy asserts that the Commission should not limit itself to considering the median in this case. Entergy states that only considering the median of the results of the financial models is not consistent with investors' requirements. Furthermore, Entergy argues that relying solely on the median, based on a generic determination regarding all single-utility ROE cases conflicts with the Commission's recognition that the "primary question to be determined here is not what constitutes the best overall method for determining ROE generically (i.e., the midpoint versus median or mean); it is whether use of the midpoint is most appropriate in this case."[208] Entergy states that it and the Entergy Operating Companies must compete for capital with utilities across the nation, and, as a result, failing to consider the midpoint solely because Entergy is a single utility ignores the requirements of investors.[209] Entergy states that the Commission should find that a "mechanical policy of referencing the median would understate the ROE for the Entergy Operating Companies" in their use of the Tariff.[210]

110. Trial Staff asserts that the new ROE should be set at the average of the DCF and CAPM medians and the Risk Premium model point estimate, consistent with the Presiding Judge's previous determination. Trial Staff asserts that the Entergy Operating Companies are not a diverse group of utilities like the New England TOs or MISO TOs where the midpoint is appropriate because the Entergy Operating Companies do not

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[206] *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 17 & n.62.

[207] Opinion No. 569, 169 FERC ¶ 61,129 at P 425 n.86.

[208] Entergy Initial Brief at 25 (citing *Midwest Indep. Transmission Sys. Operator, Inc.*, 106 FERC ¶ 61,302 at P 8).

[209] *Id.* at 25 (citing McKenzie Aff. at 16-18).

[210] *Id.* (citing McKenzie Aff. at 17).

encompass a region-wide RTO/ISO nor do they have a comparable footprint. Additionally, Trial Staff argues that the median is appropriate given the low level of risk faced by the Entergy Operating Companies for the PPAs. Trial Staff states that the risks are minimal because most of the power sales are contracted for the life of the units and the only risk the Entergy Operating Companies face in recouping the cost of its unit power sales is counterparty risk.[211]

5. Reply Briefs

111. Trial Staff argues that Entergy provides no support for why the midpoint is an appropriate measure of tendency for establishing non-RTO/ISO-wide ROEs. Trial Staff asserts that the Entergy Operating Companies are not a diverse group of unaffiliated companies and are wholly owned subsidiaries of a single publicly traded company, Entergy Corporation. Furthermore, Trial Staff explains that this proceeding involves generation, not transmission, and the Entergy units are not centrally dispatched. Finally, Trial Staff contends that the Commission has stated that the median is superior to other measures of central tendency because it is less affected by extreme numbers and ROEs that are atypically higher or lower than the mean or midpoint.[212]

6. Commission Determination

112. We disagree with Entergy that the midpoint should be considered in this proceeding and we find that the median is the appropriate measure of central tendency of the zone of reasonableness in this proceeding.

113. In determining where to place the ROE within the zone of reasonableness, the Commission's policy is to use the midpoint of the zone of reasonableness in cases involving an RTO/ISO-wide ROE that applies to a diverse group of utilities.[213] The Commission has employed the median for single utilities of average risk and joint ventures of more than one company.[214] The rationale for this difference is that, when setting an ROE for a single utility of average risk, the median calculation is superior to a midpoint calculation in determining the central tendency of the zone of reasonableness,

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[211] Trial Staff Initial Brief at 15-18.

[212] Trial Staff Reply Brief at 21-22 (citing *Southern California Edison Co.*, 139 FERC ¶ 61,042, at PP 16-20, 37 (2012) (*S. Cal. Edison Co.*)).

[213] Opinion No. 569, 169 FERC ¶ 61,129 at P 410 (citing *Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d at 1010).

[214] *See S. Cal. Edison Co*., 136 FERC ¶ 61,074, at P 30 (2011); *S. Cal. Edison*, 131 FERC ¶ 61,020.

because the median gives consideration to more of the proxy group companies and reduces the impact of any single company that has an atypically high or low cost of equity result. By comparison, when setting the ROE for a diverse group of utilities, the impact of particularly high or low cost of equity estimates is less of a concern because the diverse group of utilities themselves represent a range of equity costs, and giving weight to the full range of results is more likely to produce an ROE that is sufficient for each utility in the diverse group.[215]

114. In this case, the ROE in the Tariff does not apply to a diverse group of utilities; rather, it applies only to the Entergy Operating Companies. While the Entergy Operating Companies are not a single utility, they also are not a "diverse group of utilities" based on how the Commission has used that phrase. In other words, as affiliated subsidiaries of the same holding company, with risk profiles similar to each other, the Entergy Operating Companies do not reflect the type of diversity that one would find among a group of utilities that make up an RTO/ISO.

115. Accordingly, we find that, based on the record in this proceeding, the median represents the best measure of central tendency. Thus, we will use the average of the point estimate of the Risk Premium model and the medians of the CAPM and DCF models to determine the ROE, as suggested by Trial Staff.

116. We, therefore, find that 10.37%, i.e., the average of the point estimate of the Risk Premium model and the medians of the DCF and CAPM models, is a just and reasonable ROE for the Entergy Operating Companies.

E. DCF

1. Initial Decision

117. The Presiding Judge found that Louisiana Commission's proxy group, based solely on the risk profile of Entergy Arkansas, most closely follows the screening criteria that the Commission described in Opinion No. 531.[216] The Presiding Judge stated that the Commission's policy in ROE cases involving a single utility is to set the ROE at the median of the proxy group, and that the median of Louisiana Commission's proxy group is 9.01%.[217]

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[215] *See Midwest Indep. Transmission System Operator*, *Inc.*, 106 FERC ¶ 61,302 at PP 8-15.

[216] *Id.*

[217] *Id.* P 56.

2. Briefs on and Opposing Exceptions

118. Entergy asserts that the Initial Decision erred in relying on Louisiana Commission's proxy group because that proxy group failed to account for the risk profile of all six Entergy Operating Companies.[218] However, Entergy states that Louisiana Commission's proxy group would yield a just and reasonable result if the Commission places the ROE at the 10.3% midpoint of the upper half of the zone of reasonableness produced by that proxy group.[219]

119. Louisiana Commission states that Entergy erroneously applied the Commission's low-end outlier test and, as a result, eliminated from its proxy group the 5.97% cost of equity estimate for Entergy Corporation. Louisiana Commission explains that the Commission's test for low-end outliers examines whether a proxy group company is within 100 basis of the bond yield or is unevenly distributed from the other results in the proxy group.[220] Louisiana Commission states that Entergy Corporation's cost of equity estimate is 126 basis points above the 4.71% bond yield that Entergy used for its low-end outlier test.[221] Louisiana Commission states that, not only is Entergy Corporation's cost of equity result more than 100 basis points above the bond yield, but it is also "at least as well distributed" as the high-end companies in the group.[222] Louisiana Commission also contends that Entergy departed from the Commission's test by comparing Entergy Corporation's ROE to future, estimated bond yields. Louisiana Commission states that, if Entergy Corporation is included in Entergy's proxy group, then the median becomes the average of the results for DTE Energy of 9.10% and Duke Energy of 8.92%, i.e., 9.01%, exactly the result that the Initial Decision reached. Thus, Louisiana Commission contends, the empirical evidence fully supports the Initial Decision's determination.[223]

120. Louisiana Commission argues that Entergy also erred by using the wrong dividend rate for its proxy group companies.[224] Louisiana Commission states that Commission

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[218] Entergy Brief on Exceptions at 48.

[219] *Id.* at 49.

[220] Louisiana Commission Brief Opposing Exceptions at 21 (Opinion No. 531, 147 FERC ¶ 61,234 at P 122).

[221] *Id.*

[222] *Id.* at 22 (citing Avera Tr. 176-77).

[223] *Id.*

[224] *Id.* at 38.

precedent requires multiplying "the dividend yield by the expression (1+.5g) to account for the fact that dividends are paid on a quarterly basis."[225] Louisiana Commission asserts that the "g" to be used in the term (1+.5g) is the composite growth rate, i.e., the weighted average of the short- and long-term growth rates, with the short-term rate given two-thirds weight and the long-term rate given one-third weight. Louisiana Commission asserts that Entergy inflated its dividend yield by using only the short-term IBES growth rate estimates, which were higher than the composite growth rates. Louisiana Commission contends that inclusion of a different growth rate than the constant, long-term growth rate is not consistent with the assumptions in the DCF model because it would render the growth in dividends non-constant, and produce an overall growth rate that is slightly higher than the composite growth rate used in the model.[226]

3. Briefing Order and Opinion No. 569 *et seq.*

121. As noted above, in the *Coakley* Briefing Order, the Commission proposed to utilize the CAPM and Expected Earnings models in addition to the DCF model to determine the zone of reasonableness and the ROE rather than to simply inform placement of the ROE within the zone of reasonableness produced by the DCF.[227] However, the *Coakley* Briefing Order did not propose changes to the DCF model. In the Briefing Order, the Commission sought comment on the application of that methodology to the instant proceeding. The Commission stated that participants may supplement the record with additional written evidence necessary to support their arguments advanced in their briefs, but any additional financial data or evidence concerning economic conditions must relate to periods before the conclusion of the Initial Decision in this proceeding.[228] In Opinion Nos. 569, 569-A and 569-B, the Commission continued to use the DCF model as part of its ROE analysis. In Opinion No. 569-A, the Commission set aside Opinion No. 569 in part to give the short-term growth rate 80% weighting and the long-term growth rate 20% weighting in the two-step DCF model.[229] In Opinion No. 569, the Commission found that the short-term growth rate should be used to calculate the (1+.5g) adjustment to dividend yield in the DCF model.[230]

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[225] *Id.* (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 15).

[226] *Id.* at 39.

[227] *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 32.

[228] Briefing Order, 167 FERC ¶ 61,091 at P 16.

[229] *See* Opinion No. 569-A, 171 FERC ¶ 61,154 at P 2.

[230] Opinion No. 569, 169 FERC ¶ 61,129 at PP 98-100.

4. Initial Briefs

122. Entergy states that its two-step DCF analysis gave the short-term growth rate two-thirds weighting and the long term-growth rate one-third weighing. Entergy also states that its short-term growth projections are based on IBES growth rate projection published by *Yahoo! Finance* and the long-term growth rate projection is equal to forecasted growth in GDP based on forecasts from HIS Global Insight, the Energy Information Administration, and the Social Security Administration.[231]

123. However, Entergy states that a constant growth DCF model more closely aligns with investors' expectations for utilities and that a two-stage model that uses estimates of GDP as a proxy for long-term growth, which Entergy contends imparts a downward bias to the results of the Commission's ROE methodology. Entergy explains that a two-stage DCF model that relies on a projection of GDP growth confuses the theory underlying the DCF model with the practicalities of its application in real-world situations.[232] For example, Entergy states that investors do not expect that GDP growth rates will act as a limit on utilities' long-term earnings.[233] Entergy states that a solution to the two-stage DCF model would be to use a single-stage version of the DCF model as a benchmark because it is widely referenced by financial practitioners and regulatory agencies.[234] Entergy states that the results of the constant-growth DCF model are a median of 10.03% and a midpoint of 10.9%.[235]

124. Trial Staff contends that the DCF results used in the Initial Decision are no longer applicable because Entergy Arkansas is no longer the only seller under the Tariff and now should include Entergy Louisiana and Entergy Texas. Therefore, Trial Staff states that it presents a new proxy group to address these facts. Trial Staff asserts that it followed the Commission's approach as articulated in Opinion Nos. 531 and 551 and the *Coakley* Briefing Order to identify the appropriate proxy group. Trial Staff states that it started with the list of publicly traded companies classified under the Electric Utility Industry by *Value Line* and applied specific screening criteria to potentially include companies in the proxy group comparable to Entergy Arkansas, Entergy Louisiana, and Entergy Texas. Trial Staff states that it ultimately determined that 26 electric utilities

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[231] Entergy Initial Brief at 22 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 39 & n.67).

[232] *Id.* at 28 (citing McKenzie Aff. at 45).

[233] *Id.* (citing McKenzie Aff. at 44-45).

[234] *Id.* at 28-29 (citing McKenzie Aff. at 52-53).

[235] *Id.* at 29 (citing McKenzie Aff. at 53, attach. 7).

meet the Commission's criteria for inclusion in the proxy group. Trial Staff explains that using this proxy group, the DCF results produce a zone of reasonableness of 5.99% to 11.58%, with a median of 9.17%.[236]

125. Trial Staff states that it relied on the same two-step DCF methodology that the Commission established for electric utilities in Opinion No. 531 and applied in Opinion No. 551. Trial Staff notes that it used the six-month period from June 1, 2014 through November 30, 2014, since it represents the most recent six months prior to the filing of the last testimony in the record in this proceeding, which Trial Staff states is the rebuttal testimony of Entergy filed on December 11, 2014. However, Trial Staff states that an exception to this is that it used the IBES growth rates from December 4, 2014, which Trial Staff states is the date for growth rates used by Entergy in its updated analysis. Trial Staff asserts that it followed the Commission's guidelines in the Briefing Order and used screening criteria that are consistent with those used in Opinion Nos. 531 and 551.[237]

5. Reply Briefs

126. Trial Staff disagrees with Entergy's use of a one-step DCF model and argues that the Commission has issued numerous orders in support of a long-term growth component to the DCF model.[238] Trial Staff asserts that expectations of the long-term future level of earnings growth are factored into company stock prices and GDP forecasts are widely available to investors. Trial Staff also states that Entergy's one-step DCF model produces distorted estimates of the cost of equity for companies whose short-term growth differs significantly from GDP.[239] Additionally, Trial Staff states that its reasons for why the Commission should utilize a two-step DCF model when calculating the market return portion of the CAPM, as discussed below, also apply here.

127. Trial Staff explains that the small difference in ROE between that calculated by Entergy and Trial Staff can be attributed to the fact that Trial Staff's proxy group includes two companies that Entergy did not include and different dividend levels for several companies in various months during the data period were used. Trial Staff states that it included in its proxy group El Paso Corp. and UIL Holdings, while Entergy did not. Trial Staff asserts that Entergy failed to incorporate indicated dividend increases for

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[236] Trial Staff Initial Brief at 18-21, Green Aff., attach. B at 4.

[237] *Id.*, Green Aff. at 23.

[238] Trial Staff Reply Brief at 12-13 (citing Opinion No. 531,147 FERC ¶ 61,234 at P 36 n.63)

[239] *Id.*, Green Reply Aff. ¶¶ 58-71

several companies during the data period, including American Electric Power, Inc., DTE Energy Company, and IDACORP, Inc.[240]

6. Commission Determination

128. We reverse the Initial Decision's finding that the ROE in the Tariff should be based on Louisiana Commission's DCF study. We further find that Trial Staff's updated DCF study provided in its initial brief using financial data for the period June to November 2014, which is based on the risk profile of Entergy Arkansas, Entergy Louisiana, and Entergy Texas, is generally consistent with the Commission's two-step DCF methodology. However, as discussed below, we find that the DCF study should be based on the risk profiles of all six Entergy Operating Companies.

129. In addition, we apply a composite growth rate gives the short-term growth rate 80% weighting and the long-term growth rate 20% weighting, consistent with the Commission's decision in Opinion No. 569-A. We find that the short-term growth rate should be used to calculate the (1+.5g) adjustment to the dividend yield, consistent with Opinion No. 569.[241] We also adopt the low-end and high-end outlier tests adopted in Opinion No. 569-A, as discussed above. Incorporating these revisions, the appropriate zone of reasonableness produced by our DCF analysis in determining the Entergy Operating Companies' ROE is 7.30% to 12.21%, and the median of that zone is 9.60%.

130. Trial Staff conducted its updated DCF study by applying the Commission's two-step DCF methodology to a national proxy group of companies that meet the following criteria: (1) are included in the Electric Utility Industry groups compiled by *Value Line;* (2) paid dividends over the six-month June to November 2014 study period without making or announcing a dividend cut during that time; (3) are not involved in merger and acquisition activity significant enough to distort the DCF results; (4) have either S&P's or Moody's credit ratings, and for each credit rating service that has assigned a rating, are within plus or minus one credit rating notch of Entergy Arkansas, Entergy Louisiana, and Entergy Texas's credit ratings from those services.[242] Those criteria produced a group of 26 companies.[243] Trial Staff then screened from that group any company whose cost of equity estimate is below the average bond yield or fails to

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[240] *Id*. PP 9-12.

[241] *See* Opinion No. 569, 169 FERC ¶ 61,129 at PP 98-100.

[242] Trial Staff Initial Brief, Green Aff. at 23-24.

[243] *Id.*, Green Aff., attach. B at 1.

exceed the average bond yield by about 100 basis points.[244] Using that low-end outlier test, Trial Staff eliminated FirstEnergy Corporation from its proxy group.[245] That methodology produced a final proxy group of 25 companies whose cost of equity estimates ranged from 5.99% to 11.58%. With the exceptions of the weight given to the long and short-term growth rates in the two-step DCF analysis, the growth rate used in the (1+.5g) adjustment to the dividend yield, and the low-end and high-end outlier tests, we find that Trial Staff's DCF study is consistent with the methodology that the Commission set forth in Opinion No. 569-A.[246] Trial Staff did not eliminate any companies using the high-end outlier test.

131. As the Commission stated in Opinion No. 569-A, short-term growth rate projections for electric utilities have declined and are now closer to the current GDP growth projection than those from the 1990s when the Commission adopted the two-step DCF using one-third weighting for GDP in the long-term growth rate for natural gas and oil pipelines that was subsequently adopted for public utilities. Additionally, the Commission noted that, when IBES growth projections are only marginally higher than GDP projections, investors are likely to view those rates as more sustainable than the substantially higher natural gas pipeline IBES growth projections when the Commission established its two-thirds/one-third weighting policy.[247] Accordingly, we find it reasonable to give the IBES short-term growth projection 80% weighting and the long-term growth rate 20% weighting.

132. We also disagree with Entergy that a single-stage version of the DCF model is more closely aligned with investors' expectations for utilities. As the Commission held in Opinion No. 531:

> The DCF model is based on the premise than an investment in common stock is worth the present value of the infinite stream of future dividends discounted at a market rate commensurate with the investment's risk.[[248]]

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[244] *Id.*, Green Aff. at 24, attach. B at 3-4 (indicating that FirstEnergy Corporation's DCF result should be excluded).

[245] Ex. ESI-128 and Ex. ESI-149 (showing that Entergy eliminated Entergy Corp. and FirstEnergy Corp. as low-end outliers in its updated DCF study that used IBES as the source of short-term growth rate estimates).

[246] *See* Opinion No. 531, 147 FERC ¶ 61,234 at PP 96, 100-02, 106-08, 112, 114, 118, 122-123 and cases cited therein.

[247] Opinion No. 569-A, 171 FERC ¶ 61,154 at PP 57-58.

[248] As the Commission explained, "[t]he DCF model assumes growth for an infinite period of time. This can be approximated as 50 years because the present value

> 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.[249]

133. Entergy has not provided a persuasive basis for us to depart from this policy. Accordingly, we dismiss Entergy's assertion that a single-stage version of the DCF model should be used.

134. As explained above, we adopt a low-end outlier test that eliminates from the proxy group ROE results that are less than the yields of generic corporate Baa bonds plus 20% of the CAPM risk premium. As discussed below, our CAPM analysis indicates a risk premium of 9.43% and using Moody's Baa Utility Bond Yield, we find that companies with a cost of equity estimate below 6.60% are required to be excluded from the proxy group. Therefore, we find that Public Service Enterprise Group Inc., Edison International, Entergy Corporation., and FirstEnergy Corporation should be excluded from the proxy group because their cost equity estimates are below 6.60%. Additionally, we adopt a high-end outlier test, as discussed above, that treats any proxy company as a high-end outlier if its cost of equity estimated under the model in question is more than 200% of the median. Our DCF analysis indicates a median of 9.44% prior to excluding companies that do not pass the low-end and high-end outlier tests and therefore, we will treat any proxy company as a high-end outlier if its cost of equity estimate is greater than 18.88%. We find that no companies should be treated as high-end outliers.

135. We find that the short-term growth rate should be used to calculate the (1+.5g) adjustment to the dividend yield. As the Commission explained in Opinion No. 569, the appropriate dividend figure to use in the DCF equation is the amount which is expected to be received by the investor during the 12 months following the purchase of the stock and the short-term growth rate is more representative of the growth investors expect over the coming year than the two-stage growth rate.[250] The Commission reasoned that,

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of a one dollar dividend received 50 years in the future, discounted at 12%, is less than one cent." *Ozark Gas Transmission Sys*., 68 FERC ¶ 61,032, at 61,105 n.32 (1994) (citing Eugene F. Brigham & Louis C. Gapenski, Financial Management 291 (1991)).

[249] Opinion No. 531, 147 FERC ¶ 61,234 at P 33 (footnotes omitted) (quoting *Consol. Gas Supply Corp.*, 24 FERC ¶ 61,046, at 61,105 (1983)).

[250] Opinion No. 569, 169 FERC ¶ 61,129 at PP 98-99.

because the first dividend following the purchase of a stock would necessarily be 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.[251] The Commission further noted that 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.[252] We continue to agree with this reasoning and find that the short-term growth rate should be used to calculate the (1+.5g) adjustment to the dividend yield. Accordingly, we disagree with Trial Staff's use of the composite growth rate in calculating the adjusted dividend yield. We also disagree with Louisiana Commission's contention that this approach would be inconsistent with the assumptions of the DCF model. As the Commission explained in Opinion No. 569, the adjusted dividend yield concerns only the dividend received in the first year after a stock's purchase and thus the growth rate used in that calculation is logically distinct from the composite, two-stage growth rate, which is used to estimate the growth rate of an infinite stream of expected dividends for an indefinite period into the future by using both a short-term growth rate and a long-term growth rate.

136. Despite the fact that Entergy Corporation's cost of equity result is 127 basis points above the cost of debt, Entergy argues that Entergy Corporation should nonetheless be excluded from the proxy group because its cost of equity estimate is significantly below the 6.65% average expected bond yield for the period of 2015-2018, which Entergy based on forecasts from IHS Global Insight and the Energy Information Administration.[253] The Commission has never used such an approach, and we decline to adopt it here. The Commission uses the average bond yield during the six-month study period, not a forward-looking, estimated bond yield, to determine the cost of debt for purposes of the low-end outlier test.[254] We are not persuaded that it would be appropriate to use projected data from outside the study period to determine whether any companies are low-end outliers. While we disagree with Entergy's reasoning, we reach the same result and find that Entergy Corporation does not pass our low-end outlier test and should be excluded from the proxy group.

137. After correcting Trial Staff's application of the low-end and high-end outlier tests, their calculation of the adjusted dividend yield, and applying the calculation for determining the composite growth rate adopted in Opinion No. 569-A, Trial Staff's DCF

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[251] *Id.* P 98.

[252] *Id.* P 100.

[253] Ex. ESI-100 at 29.

[254] *See, e.g.*, Opinion No. 531, 147 FERC ¶ 61,234 at P 123.

study using IBES as the source of short-term growth rate estimates produces a final proxy group of 22 companies, with a zone of reasonableness from 7.30% to 12.21% and a median value of 9.60%. For the reasons discussed above, we find this corrected DCF study to be consistent with Commission precedent and representative of the Operating Companies' risks. We therefore find it appropriate to rely on this corrected DCF study in determining the proper ROE to use in the Tariff.

138. We find that Trial Staff's use of IBES as the source of short-term growth rates in its DCF study is appropriate for determining the just and reasonable ROE in this case. We are not persuaded that Entergy's alternative DCF study, referenced in Entergy's brief on exceptions, and which uses *Value Line* as a source for the short-term growth rate, accurately reflects the Operating Companies' cost of equity. In Opinion No. 569-A, the Commission explained that IBES short-term growth rates should be used for the DCF model, absent compelling reasons for using an alternative source, given the longstanding practice of using IBES short-term growth rates for the DCF model and the experience that entities coming before the Commission have gained in using IBES for the DCF model in light of that practice.[255] Here, we find that there is no compelling reason to use *Value Line* growth rates instead of IBES growth rates for the DCF model. The record does not contain evidence demonstrating that IBES growth rates are not appropriate for the DCF model under the facts and circumstances of this proceeding or that *Value Line* growth rates are more accurate or otherwise superior to IBES growth rates for the DCF model in this proceeding. Accordingly, we will not rely on Entergy's DCF study that uses *Value Line* short-term growth rates.

F. CAPM

1. Initial Decision

139. While Entergy presented a CAPM analysis to inform placement of the ROE within the DCF zone of reasonableness, the Initial Decision did not incorporate a CAPM analysis.[256]

2. Briefs on and Opposing Exceptions

140. Entergy states that its forward-looking CAPM analysis for each company in the proxy group produced a return of 11.49%. Entergy states that the CAPM is a widely used model, and that the methodology it used was endorsed by the Commission in Opinion

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[255] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 55.

[256] Initial Decision, 151 FERC ¶ 63,008 at 40, 68, 84, 92.

No. 531.[257] As explained in the exhibits cited by Entergy, its study used the 3.2% six month average yield on 30-year U.S. Treasury as of November 2014 for the risk-free rate, beta values for each proxy company reported by *Value Line*, and a market risk premium based on a DCF study of all dividend-paying companies in the S&P 500.[258] In the DCF study Entergy added the weighted average dividend of those companies (2.3%) to the average of the weighted average short-term growth rates projected for the companies by IBES (10.8%). This resulted in a uniform cost of equity for the dividend-paying companies in the S&P 500 of 13.1%. Entergy states that it then subtracted from that figure the 3.2% risk-free rate to obtain a risk premium of 9.9%. Entergy states that it multiplied this risk premium by the beta listed for each proxy company by *Value Line* and added the risk-free rate to that product. Entergy states that this CAPM analysis produces an unadjusted ROE range of 9.14% to 12.61% for the proxy group, with a median value of 10.63%.

141. Entergy states that after adjusting for the effect of each proxy company's size, its CAPM analysis produced an ROE range of 8.81% to 14.36%, with a median value of 11.49%.[259] Entergy explains that the size adjustment is necessary because "CAPM does not fully account for observed differences in rates of return attributable to firm size."[260] For example, Entergy explains that "the betas of small companies do not fully account for the higher realized rates of return associated with small company stocks."[261] Entergy states that it based the size adjustments on data contained in a table published in Morningstar Inc.'s (Morningstar) "2014 Ibbotson SBBI Market Report."[262] 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.

142. Trial Staff opposes Entergy's reliance on its CAPM analysis to justify placing its ROE above the median of the zone of reasonableness. Trial Staff contends that, when Entergy's CAPM analysis is adjusted to correct its flaws, it produces an ROE of only

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[257] Entergy Brief on Exceptions at 41 (citing Ex. ESI-100 at 37:8-9; Ex. ESI-123 at 83:13-15); Entergy Brief on Exceptions, Appendix B at B-4 to B-6 (citing Ex. ESI-130 containing the updated results of Dr. Avera's CAPM analysis).

[258] Entergy Brief on Exceptions, Ex. ESI-100 at 37-38 and Ex. ESI-130 at 1.

[259] *Id.*, Ex. ESI-130 at 1.

[260] *Id.*, Ex. ESI-100 at 39.

[261] *Id.*, Ex. ESI-123 at 59.

[262] Ex. ESI-130 at 1.

8.69%, well below Entergy's proposed 10.66% ROE, and thus a CAPM analysis cannot be used to corroborate placing Entergy's ROE above the median of the zone.[263]

143. Trial Staff, while conceding that many of its and Louisiana Commission's criticisms of Entergy's CAPM study were dismissed in Opinion No. 531-B, contends that Opinion No. 531-B is not dispositive of whether Entergy's use of the one-step DCF analysis of dividend paying firms in the S&P 500 to estimate the expected market rate of return in this proceeding is appropriate.[264] Trial Staff contends that, once the Commission adopted the two-step DCF methodology for electric utilities, even though there was no evidence to indicate that the growth rate of the S&P 500 index was unsustainable, Entergy should have applied the two-step DCF methodology in its CAPM analysis and applied the expected growth in GDP as the long-term growth component for consistency, as recommended by Trial Staff witness Douglas Green.[265] Trial Staff asserts that, if Entergy had used a long-term growth rate in the CAPM, the result would have been much closer to Entergy's initial DCF analysis.[266] Trial Staff argues that combining Louisiana Commission's two-step DCF result of 8.69% with Entergy's higher 1.35% size adjustment would produce a CAPM result of 10.04%, and this is not sufficient to corroborate a move of the ROE from the median to either 10.34% (the top half of the DCF range) or to Entergy's requested 10.66%.[267] Finally, Trial Staff argues that any size weighting should be rejected in this case and the Entergy CAPM analysis should be further reduced by 1.35%, as the size adjustment in *Coakley* was applied to account for the size difference between the smaller New England Transmission Owners and the larger dividend-paying companies in the S&P 500.[268] Trial Staff contends that no such weighting is justified because Entergy is in the top half of the S&P 500, and Entergy's proxy group is not limited to just companies with risk similar to Entergy Arkansas.[269]

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[263] Trial Staff Brief Opposing Exceptions at 26.

[264] *Id.* The Commission's one-step DCF methodology uses two short-term growth rate projections, including one sourced from IBES, but does not use any long-term growth projections such as the expected growth in GDP.

[265] *Id.* (citing Ex. S-4 at 71).

[266] *Id.*

[267] *Id.* at 27-28.

[268] *Id.* at 28-29.

[269] *Id.* at 28.

144. Louisiana Commission argues that Entergy's application of the CAPM contains an inherent mismatch and conflicts with accepted practices in the field.[270] Louisiana Commission states that Entergy's mismatch of a method for determining short-term expectations for equities, with a long-term risk-free interest rate, inflated its alleged "risk premium" for equities and distorted its result, and had Entergy used long-term growth per the two-step DCF, Entergy's ROE result would have been 8.69% rather than 10.1%.[271]

145. Louisiana Commission states that Entergy did not match its *Value Line* beta coefficient with its proxy group for measuring market return requirements.[272] Louisiana Commission asserts that Entergy applied the NYSE derived betas to a proxy group that included only dividend-paying firms from the S&P 500.[273] Louisiana Commission states that Entergy's betas were not matched with its market index and thus cannot produce credible results. Further, Louisiana Commission asserts that Entergy's size adjustment had no empirical basis to support it because the size adjustment theory asserts that the beta does not capture the entire difference in risk for small companies compared to the market as a whole.[274] Louisiana Commission contends that, even if that were true for unregulated firms, Entergy presented no empirical data showing that ROE requirements for utilities are affected by their size, compared to the market.

3. Briefing Order and Opinion No. 569 *et seq.*

146. As noted above, in the *Coakley* Briefing Order, the Commission proposed to utilize the CAPM as one of the models to determine the zone of reasonableness and the ROE rather than to simply inform placement of the ROE within the zone of reasonableness produced by the DCF.[275] In the Briefing Order, the Commission sought

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[270] Louisiana Commission Brief Opposing Exceptions at 90 (citing Avera Tr. 243-46; Ex. LC-37 (CAPM formula); Ex. LC-38 (Avera method)).

[271] *Id.* at 92 (citing Avera Tr. 252; Ex. LC-38).

[272] *Value Line* betas are derived from a least-squares regression analysis between weekly percent changes in the price of a stock and weekly percent changes in the New York Stock Exchange (NYSE) average over a period of five years. Roger A. Morin, *New Regulatory Finance* (Public Utilities Reports, Inc. 2006) at 71 (Morin).

[273] Louisiana Commission Brief Opposing Exceptions at 93 (citing Ex. ESI-123 at 53).

[274] *Id*. (citing Ex. ESI-100 at 39).

[275] *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 32.

comment on the application of that methodology to the instant proceeding.[276] In Opinion No. 569, the Commission used the CAPM in its ROE analysis, giving it equal weight with the DCF model.[277] In addition, the Commission decided to: (1) estimate the 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 less than or equal to zero or that are greater than or equal to 20%; and (5) include a size premium adjustment. In Opinion No. 569-A, Commission clarified that it would consider the use of *Value Line* short-term growth rates in CAPM analyses in future proceedings.[278]

4. <u>Initial Briefs</u>

147. Entergy provided a CAPM using the same methodology as it did in hearing, described above.[279] However, Entergy states that it supports the use of an empirical CAPM and contends that empirical research shows that securities with lower-than-average volatility (i.e. beta less than one) earn real-world returns that exceed the returns that the CAPM estimates. Entergy states that the empirical CAPM uses the results of this published research and corrects for the observed discrepancy between the CAPM's theory and empirical results by introducing weighting factors.[280] Therefore, Entergy contends that the traditional CAPM would understate the cost of equity because utilities generally have betas less than 1.0. Entergy asserts that this empirical finding is widely reported in finance literature.[281]

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[276] Briefing Order, 167 FERC ¶ 61,091 at P 16.

[277] Opinion No. 569, 169 FERC ¶ 61,129 at P 425.

[278] Opinion No. 569-A, 171 FERC ¶ 61,154 at PP 78-83.

[279] Entergy Initial Brief at 22 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 108).

[280] *Id.* at 29, McKenzie Aff. at 53-55.

[281] *Id.*, McKenzie Aff. at 54 (citing Morin at 189 ("As discussed in the previous section, several finance scholars have developed, refined, and expanded versions of the standard CAPM by relaxing the constraints imposed on the CAPM, such as dividend yield, size, and skewness effects. These enhanced CAPMs typically produce a risk-return relationship that is flatter than the CAPM prediction in keeping with the actual observed risk-return relationship. The [empirical] CAPM makes use of these relationships.")).

148. Entergy states that the *Value Line* betas are adjusted for the observed tendency of beta to converge toward the mean value of 1.00 over time. Entergy further states that the purpose of the adjustment in the empirical CAPM is to refine beta values determined using historical data to better match forward-looking estimates of beta, which Entergy asserts are the relevant parameters in applying the CAPM or empirical CAPM. Entergy explains that the empirical CAPM does not involve any adjustment to beta, but instead represents a recognition of findings in financial literature that the observed risk-return tradeoff is flatter than predicted than by the CAPM.[282] Entergy concludes that even if a firm's beta values were estimated with perfect precision, the CAPM would still understate the return for low-beta stocks and overstate the return for high-beta stocks.[283] Entergy states that applying this empirical CAPM to the relevant proxy group in this proceeding yields a median implied cost of equity of 12.46% and a midpoint of 12.35%.[284]

149. Entergy states that other regulators have relied on the empirical CAPM, including the Maryland Public Service Commission, Regulatory Commission of Alaska, Montana Public Service Commission, Colorado Public Utilities Commission, and Wyoming Office of the Consumer Advocate.[285] According to Entergy, the Maryland Public Service Commission noted that the empirical CAPM adjusts for the tendency of the CAPM to underestimate for low beta stocks and concluded that under the current economic conditions, the empirical CAPM gives a more realistic measure of the ROE than the CAPM does.[286]

150. Entergy also recommends modifying the Commission's standard CAPM analysis by using projected U.S. Treasury bond yields in determining the risk-free rate, which is consistent with the approach the Commission has already adopted for the Risk Premium model. Entergy states that applying this modified CAPM to the relevant proxy group in this proceeding yields a median implied ROE of 12.18% and a midpoint of 12.12%.[287]

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[282] *Id.* at 55.

[283] *Id.*

[284] *Id.*, McKenzie Aff. at attach. 8.

[285] *Id.*, McKenzie Aff. at 56-57.

[286] *Id.*, McKenzie Aff. at 56 (citing Baltimore Gas and Electric Co., *Direct Testimony and Exhibits of Julie McKenna*, at 9, Case No. 9299 (Maryland PSC, at 9 Oct. 12, 2012).

[287] *Id.*, McKenzie Aff. at attach. 4.

151. Trial Staff states that the Commission's proposal includes using the CAPM as it was used in Opinion No. 531 and that Trial Staff supports the use of a forward-looking CAPM analysis.[288] However, Trial Staff proposes that the Commission implement three adjustments: (1) utilize the two-step DCF result for calculating the market return; (2) remove the size adjustment; and (3) implement screening criteria for growth rates.

152. Trial Staff states that its proposed analysis uses a two-step DCF result for calculating the market return to align with Commission precedent regarding estimation of long-term growth. Trial Staff argues that it would be inconsistent to state that under the Commission's preferred two-step DCF method, companies in the long-term grow at the rate of GDP, but under the market return within the CAPM, the same companies would be able to maintain a higher short-term growth rate in perpetuity. Trial Staff also argues that a short-term growth horizon for the market return is inconsistent with the time horizon of the risk-free rate. For example, Trial Staff states that if an investor establishes a long-term risk-free rate based on a 30-year U.S. Treasury bond yield in the CAPM, the same investor would not limit his time horizon to short-term growth rates of five years when developing his market return.[289] Trial Staff asserts that in Opinion No. 531, the Commission stated that "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."[290]

153. Trial Staff also supports removing the use of a size premium adjustment. Trial Staff avers that scholars disagree over the use of a size premium adjustment and there are numerous studies that demonstrate that a size adjustment is unwarranted for utilities.[291] Trial Staff also argues that the size adjustment is developed based on historical data and is another misuse of historical, backward-looking data that the Commission has rejected. Lastly, Trial Staff states that the lack of correlation between forward-looking DCF results and current market capitalizations in its regression analysis is important because, if the

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[288] In a forward-looking CAPM, the market risk premium is calculated by subtracting the risk-free rate from the result produced by the DCF analysis. Trial Staff Initial Brief at 23.

[289] Trial Staff Initial Brief at 23-24.

[290] *Id.* at 24-25 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 36 n.63).

[291] *Id.*, Green Aff. ¶¶ 62-63 (citing Aswath Damodaran, *The Small Cap Premium: Where Is the Beef?*, Musings on Markets (Apr. 11, 2015), http://aswathdamodaran.blogspot.com/2015/04/the-small-cap-premium-fact-fiction-and.html; Annie Wong, *Utility Stocks and the Size Effect: An Empirical Analysis*, 33 J. Midwest Fin. Ass'n 95 (1993); Richard Roll, *On Computing Mean Returns and the Small Firm Premium*, 12 J. Fin. Econ. 371 (1983)).

market return that was found informative in Opinion Nos. 531 and 551 shows no relationship between individual forward-looking ROEs and their corresponding market capitalizations, then it would be a contradiction to assume that a size adjustment is warranted on a forward-looking basis for the proxy group companies. Therefore, Trial Staff argues that companies with relatively large market capitalizations do not need an upward adjustment based on the findings of the regression analysis and it is inappropriate to assume that electric utility stock returns must be derived in part by the size of their market capitalizations.[292]

154. Trial Staff states that growth rates less than or equal to zero and greater than or equal to 20% should be removed from an analysis.[293] Trial Staff asserts that screening criteria are a necessary component of a reasonable analysis and a zero short-term growth rate is unrealistic and unsustainable. According to Trial Staff, the Commission stated in Opinion No. 531 that it will adopt the same two-step DCF methodology used in natural gas and oil pipeline cases. Accordingly, Trial Staff states that Commission precedent from natural gas and oil pipeline cases supports removing a company from the proxy group because it had a negative short-term growth rate. For high-end short-term growth rates, Trial Staff asserts that the Commission previously removed a company from the proxy group because it found a 13.3% short-term growth rate "not a sustainable growth rate over time and therefore does not meet threshold tests of economic logic."[294] Trial Staff also argues that screening provides consistency among the ROE models. According to Trial Staff, the zone of reasonableness of the CAPM calculated using its adjustments is 7.74% to 10.39%, with a median of 8.88%.

155. PUCT claims that a properly performed CAPM analysis considers limitation on S&P 500 growth rates and that many utilities improperly assume growth rates that exceed this by three to four times. PUCT argues that a proper CAPM analysis must include both short-term and long term-growth rates.[295] Louisiana Commission recommends using its CAPM results for the CAPM portion of the Commission's ROE analysis. Thus, Louisiana Commission recommends the value of 9.29%, the average of the top end of its historical CAPM, 8.33%, and its two forward-looking CAPM results, 9.60% and 9.93%.[296]

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[292] *Id.* at 25-27.

[293] *Id.* at 28 (citing Trial Staff Aff. ¶ 68).

[294] *Id.* at 29 (citing *ISO New England, Inc.*, 109 FERC ¶ 61,147, at P 205 (2004)).

[295] PUCT Initial Brief at 10.

[296] Louisiana Commission Initial Brief, Baudino Aff. at ¶ 14.

5. **Reply Briefs**

156. Entergy states that the Commission recognized in the *Coakley* Briefing Order that the CAPM method is one that investors may use to estimate the expected return from an investment in a company and is a market-based approach determined by beta, a measure of the risk based upon the volatility of a company's stock price over time in comparison to the overall market, and the risk premium between the risk-free rate and the market's return.[297] Entergy argues that the Commission found the CAPM to be the dominant model for estimating the cost of equity outside the regulatory sphere, providing important insight into investors' required rate of return for utility stocks. Entergy states that it applied the CAPM consistent with the approach relied on by the Commission in Opinion Nos. 531 and 551, while Louisiana Commission and Trial Staff do not.[298]

157. Entergy asserts that the Commission has repeatedly rejected the argument, advanced by Trial Staff, that the CAPM should be performed using a two-step DCF result for calculating the market return on the S&P 500 and doing so is consistent with Commission precedent.[299] Entergy states that the Commission made clear in Opinion No. 551 that a long-term growth rate component is not required in the DCF study used to develop the market risk premium for a CAPM analysis.[300] Entergy states that Trial Staff's argument is also flawed because it assumes that the CAPM analysis should mimic the Commission's two-stop DCF analysis. Entergy argues that the Commission envisioned in the Briefing Order that there would be minor differences between the models it adopted, and by combining different approaches to estimating the cost of equity, the Commission reduces the risk of relying on only one model, including the risk that the long-term growth estimate in the DCF model understates investors' expectations. Entergy asserts that the CAPM should serve as a valid check on the results of the two-step DCF analysis and it would serve no purpose if the CAPM simply duplicated the results of the two-step DCF.[301]

158. Entergy asserts that Trial Staff's proposed growth rate screening criteria should be rejected because, while growth rates for individual companies can be expected to change over time, it is reasonable to expect that the weighted average of these individual

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[297] Entergy Reply Brief at 37-38.

[298] *Id.* at 38.

[299] *Id.* at 38-39 (citing McKenzie Reply Declaration at 18).

[300] *Id.* at 39.

[301] *Id.* at 39-40 (citing *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 153 FERC ¶ 63,027, at P 308 (2015)).

projections is representative of investors' expectations for the entire portfolio of dividend-paying firms in the S&P 500 index, and that index serves as a proxy for investors' current expectations regarding the required rate of return for the market in common stock as a whole.[302] Regarding Trial Staff's argument that the Commission should remove the size adjustment, Entergy asserts that the Commission stated in both Opinion No. 551 and Opinion No. 531-B that the use of such an adjustment is a generally accepted approach to CAPM analyses. Therefore, Entergy states that a size premium should be applied in the CAPM analysis, and the Commission has consistently recognized.[303]

159. Entergy states that Louisiana Commission, while relying on Entergy's proxy group for its application of the other tests, reverts to a different proxy group for the CAPM analysis. Entergy argues that Louisiana Commission improperly relies on book value growth estimates, contrary to Commission practice and relevant guidance. Entergy also states that Louisiana Commission incorporates historical results that Louisiana Commission states should also be considered, although Entergy contends that doing so is improper and has been evaluated and rejected by the Commission.[304]

160. Trial Staff also argues that Entergy's proposed empirical CAPM as an alternative model is not a widely used model and thus, should not be used in place of the CAPM. Additionally, Trial Staff contends that, in addition to the same problems as the CAPM methodology proposed in the Briefing Order, the empirical CAPM is not a forward-looking model and relies on an additional factor that is unconfirmed by financial literature, called "alpha."[305] Trial Staff contends that a review of the studies attempting to identify alpha suggests that it is no longer viewed as relevant because Dr. Morin's review of empirical studies analyzing the impact of alpha found no studies that were conducted after 1995. Additionally, Trial Staff states that these studies' estimates of alpha ranged from -9.61% to 13.56%, suggesting that the impact of alpha is unconfirmed in the financial literature.[306] Furthermore, according to Trial Staff, Dr. Morin explains that "[t]he use of a long-term risk-free rate rather than a short-term risk-free rate already incorporates some of the desired effect of using the [empirical] CAPM" and "the lowering of the tax burden on capital gains and dividend income in 2002 may have

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[302] *Id.* at 41.

[303] *Id.*

[304] *Id.* at 42 (citing *Orange & Rockland Utils., Inc.*, 40 FERC ¶ 63,053, at 65,208-09 (1987), *aff'd*, Opinion No. 314, 44 FERC ¶ 61,253, at 65,208 (1988)).

[305] Trial Staff Reply Brief at 14.

[306] *Id.*, Green Reply Aff. at 46-47 (citing Morin at 189-90).

decreased the required return for taxable investors, steepening the slope of the [empirical] CAPM risk-return tradeoff and bring it closer to the CAPM predicted returns."[307] Given the fact that the proposed CAPM uses the long-term risk-free rate and that the research cited by Dr. Morin was conducted before the 2002 reduction of the tax burdens for capital gains and dividend income, Trial Staff argues that the assumptions of the empirical CAPM no longer hold.

161. Trial Staff also argues that Entergy's criticisms of the Commission's proposed outlier tests have no merit. Trial Staff asserts that Entergy's proposal to increase the low-end threshold to 265 basis points above the 4.73% bond yield is in direct conflict with the Commission's policy, which Trial Staff states is to exclude a company from the proxy group if its ROE estimate does not exceed the average utility bond yield by approximately 100 basis points.[308] Trial Staff argues that Entergy's proposed adjustment is based on an arbitrary choice of time periods for a comparison of interest rates and the 6.69% bond yield relied on by Entergy is higher than all calendar year averages since 2002, with exception of the 2008 and 2009 bond yield spike years. Trial Staff further argues that Entergy's low-end outlier test is based on a flawed Risk Premium analysis that results in an inflated equity risk premium and bond yield relationship, as bond yields declined. Trial Staff states that Entergy's adjustment to the low-end outlier test suggests that equity risk premiums increase almost one-for-one with declines in bond yields, which Trial Staff asserts is in direct contrast to academic literature. Therefore, Trial Staff argues that Entergy's proposed revision to the Commission's low-end outlier test does not meet the threshold test of economic logic and should be rejected.[309]

6. <u>Commission Determination</u>

162. The Commission has never allowed the use of the empirical CAPM and Entergy's arguments to use an empirical CAPM methodology do not persuade us to do so now in this proceeding. The Commission stated in Opinion No. 569 that most parties to that proceeding generally agreed that proper application of the CAPM can produce reliable ROE results and that investors use the CAPM. Therefore, the Commission adopted the CAPM as one of the models that the Commission will use in its methodology for assessing whether an ROE is just and reasonable. We continue to use CAPM for that purpose in this proceeding. However, regarding Entergy's proposal to include the empirical CAPM, we do not find, based on the record evidence in this proceeding, that the empirical CAPM is widely used by investors. Entergy is the only party proposing to include the empirical CAPM, and, as Trial Staff points out, there is some uncertainty as

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[307] *Id.*, Green Reply Aff. at 47 (citing Morin at 190-91).

[308] *Id.* at 8 (citing *S. Cal. Edison*, 131 FERC ¶ 61,020 at P 55).

[309] *Id.* at 8-9.

to how the empirical CAPM should be used, as demonstrated by the large range of values for alpha. We note that the evidence provided on the empirical CAPM significantly predates this proceeding, and that various factors may have changed, which would lead to a less accurate empirical CAPM. We also agree with Trial Staff's interpretation of Dr. Morin's statement that the use of a long-term risk-free rate in the CAPM already incorporates some of the desired effect of using the empirical CAPM, such as the CAPM having a higher intercept and a flatter slope than the short-term, risk-free version.[310] Accordingly, we find unpersuasive Entergy's proposal to use an empirical CAPM methodology as part of the Commission's ROE methodology.

163. We are not persuaded by Louisiana Commission's argument and we disagree with Trial Staff's proposal to use a two-step DCF result for calculating the market return in the CAPM analysis. To the contrary, we continue to find that it is reasonable to use a one-step DCF model. The Commission addressed the use of a one-step DCF model in Opinion No. 569, and the Commission's reasoning in that proceeding holds true here. 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.[311] 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.[312] The purpose of the DCF analysis in the CAPM is to determine the "required return on the overall market" that will be used to determine the market risk premium.[313]

164. In Opinion No. 569, the Commission stated that, 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 (i.e., a portfolio of companies behaves differently than an individual company).[314] Accordingly, we reject Trial Staff's proposal to use a two-step DCF result for calculating the market return in the CAPM analysis.

165. We reject Trial Staff's proposal to remove the size premium adjustment in the CAPM analysis. The Commission found in Opinion No. 569 that the use of such an

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[310] *See* Morin at 190-91.

[311] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 113.

[312] *See* Opinion No. 531, 147 FERC ¶ 61,234 at P 36 n.63.

[313] *See id.* P 113.

[314] Opinion No. 569, 169 FERC ¶ 61,129 at P 266.

adjustment is "'a generally accepted approach to CAPM analyses'"[315] and will improve the accuracy of the CAPM results and cause it to better correspond to the costs of capital estimates employed by investors.[316] The Commission pointed to evidence indicating that the CAPM does not fully capture the difference in required returns between large and small firms and concluded that it is appropriate to include a size premium adjustment in the CAPM analysis.[317] We continue to find that using a size premium adjustment in the CAPM analysis is appropriate and accordingly, do so here.

166. The Commission also found that 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 higher. The greater risk of small stocks does not fully account for their higher returns over many historical periods.[318]

167. In Opinion No. 569, the Commission found unconvincing parties' regression analyses purporting to demonstrate that a size premium adjustment is not appropriate for the CAPM, similar to Trial Staff's arguments in this proceeding. The Commission stated that "although DCF results do reflect the cost of capital required by investors, the DCF model is fundamentally different than the CAPM, which relies on a distinct set of assumptions, inputs, and calculations."[319] The Commission explained that this diversity is part of the reason for including the CAPM in the Commission's ROE methodology. Therefore, we continue to find that the size adjustment is necessary to correct for the CAPM's inability to fully account for the impact of firm size when determining the cost of equity.

168. We accept Trial Staff's proposal to screen from the CAPM analysis S&P 500 companies with growth rates that are less than or equal to zero and greater than or equal to 20%. In Opinion No. 569, Trial Staff proposed the same screening criteria that it is proposing in this proceeding and the Commission stated that such screening is consistent with the elimination of outliers elsewhere in its ROE methodology. The Commission

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[315] *Id.* P 296 (quoting Opinion No. 531-B, 150 FERC ¶ 61,165 at P 117).

[316] *Id.* P 297.

[317] *Id.* PP 296-303.

[318] *Id.* P 299 (quoting Morin at 181).

[319] Opinion No. 569, 169 FERC ¶ 61,129 at P 302.

found that evidence indicates that the use of this growth rate screen is appropriate in the CAPM analysis and stated that such high or low growth rates are highly unsustainable and non-representative of the growth rates of the electric utilities in the proxy groups. The Commission pointed to examples in the evidence applying similar screens and/or indicating that growth rates excluded by such screens are unsustainable.[320] We reiterate the Commission's reasoning in Opinion Nos. 569 and 569-A and find that the screen proposed by Trial Staff is appropriate because it will exclude companies with growth rates that are not representative of sustainable growth rates. Accordingly, we find that S&P 500 companies with growth rates that are less than or equal to zero and greater than or equal to 20% should be excluded from the CAPM analysis in this proceeding.

169. We find that Trial Staff's CAPM approach with a one-step DCF is a generally accepted methodology routinely relied upon by investors and, therefore, one appropriately used to corroborate our own analysis.[321] Although it is not Trial Staff's recommended approach to using the CAPM, we find that Trial Staff's CAPM analysis, using a one-step DCF analysis, adjusting for the effect of firm size, and applying screening criteria, is consistent with the Commission's CAPM approach adopted in Opinion No. 569 and affirmed in Opinion No. 569-A. Trial Staff used the 3.2% six-month average yield on 30-year U.S. Treasury bonds as of November 2014 for the risk-free rate, beta values for each proxy company reported by *Value Line*, and calculated a market return based on a DCF study of all dividend-paying companies in the S&P 500. Trial Staff's one-step DCF analysis produced a market return projected growth of 10.28% and an average dividend yield of 2.36% after applying Trial Staff's proposed screening criteria, as discussed above. After adjusting for the effect of firm size, Trial Staff's CAPM analysis produces a median cost of equity estimate of 11.34%.[322]

170. Although we adopt Trial Staff's CAPM approach as a component of the methodology to calculate Entergy's ROE, we recognize that arguments against Entergy's CAPM analysis similarly apply to Trial Staff's CAPM analysis. Therefore, we address those arguments here.

171. We first are not persuaded by Louisiana Commission's assertion that the CAPM analysis is flawed because it relies on 30-year U.S. Treasury bond yields for the risk-free rate, which do not match the short-term expectations for equities. In Opinion No. 569, the Commission adopted the 30-year U.S. Treasury average historical bond yield over a six-month period as the risk-free rate to be used in the calculation of the market risk

[320] *Id.* PP 267-268.

[321] Trial Staff Initial Brief, Green Aff., attach. B at 8.

[322] Ex. ESI-130.

premium in the CAPM.[323] The Commission cited evidence that this is a generally accepted measure of the risk-free rate.[324] In Opinion No. 531-B, the Commission similarly found that "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."[325] Louisiana Commission has not demonstrated that the 30-year U.S. Treasury bond yields are an inappropriate proxy for risk-free rates or that another measure or proxy is superior. Therefore, we continue to find that 30-year U.S. Treasury bond yields are an appropriate basis for the risk-free rate in a CAPM analysis.

172. We are unpersuaded by Louisiana Commission's argument that betas derived from the NYSE cannot be used with the S&P 500. In Opinion Nos. 569-A and 569-B, the Commission agreed with Louisiana Commission that there was an imperfect correspondence with applying *Value Line* betas derived from the NSYE to risk premiums developed using the S&P 500. However, the Commission found that it is not reasonable to calculate the risk premium using the full 2800 companies in the NYSE. Additionally, the Commission noted that no parties asserted that investors do not use *Value Line* betas or that such betas are materially different from betas derived from only the S&P 500. Accordingly, the Commission found that while it is not a perfect match, the use of *Value Line* betas is appropriate for the CAPM calculation.[326]

173. We find that each of Louisiana Commission's CAPM analyses, which indicate cost of equities ranging from 6.75% to 9.33%, are flawed. As an initial matter, Louisiana Commission calculated and used the average 0.76 beta for its national proxy group members for all of its CAPM analyses, rather than using each beta individually to

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[323] Opinion No. 569, 169 FERC ¶ 61,129 at PP 237-238.

[324] *Id.* P 237 n.505 (citing Morin at 151-52 ("[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.")).

[325] *See* Opinion No. 531-B, 150 FERC ¶ 61,165 at P 114 (citing Morin at 151-52 ("[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.")). Moreover, we note that Louisiana Commission used 20-year U.S. Treasury bond yields for two of its own alternative CAPM analyses, including one based upon short-term three-to-five year expectations for equities, undermining its own argument that using long-term interest rates creates a "mismatch" here. *See* Ex. LC-10; Ex. LC-11.

[326] Opinion No. 569-A, 171 FERC ¶ 61,154 at PP 75-76; Opinion No. 569-B, 173 FERC ¶ 61,159 at PP 100-01.

estimate the cost of equity for each proxy group member and then calculating the proxy group's median value and zone of reasonableness, which is the method used by Entergy and identical to the method the Commission relied upon in Opinion No. 531.[327] While we acknowledge that there may be more than one acceptable way to estimate the market return and market risk premium beyond this approach,[328] we find that the use of a growth rate for the book value to be less reliable than the earnings growth rate,[329] and reject the use of a five-year U.S. Treasury bond for the risk-free rate as too short. Because Louisiana Commission failed to adjust any of its CAPM estimates for company size, we reject the 9.33% CAPM estimate as well, even though its CAPM methodology is based upon a reasonable market return estimate and a long-term risk-free rate that otherwise could be relied upon.

174. Here, we use IBES growth rates for the CAPM to calculate the ROE. While other proceedings have discussed using *Value Line* for the CAPM growth rates, no parties in this proceeding advocate for use of *Value Line* data. Additionally, IBES growth rates have a full record in this proceeding promoting the use of IBES in the CAPM.

175. Finally, we reject the CAPM analyses based upon historical market return data.[330] In Opinion No. 569, the Commission found that the CAPM expected market return should be estimated using a forward-looking approach.[331] We find that the CAPM

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[327] Opinion No. 531, 147 FERC ¶ 61,234 at P 147.

[328] Louisiana Commission estimated its 11.29% market return portion for its DCF-based CAPM estimate by averaging the forecasted growth in earnings and book value for the companies that Value Line follows, as well as the projected total annual return over the next three to five years. Specifically, Louisiana Commission utilized the Value Line Investment Analyzer, Plus Edition, for September 27, 2014, an edition which covers 7,000+ stocks. Finally, Louisiana Commission estimated the market risk premium, based on a DCF analysis applied to current data, at 8.20% using the 20-year U.S. Treasury bond and 9.61% using the five-year U.S. Treasury bond.

[329] The DCF model uses the growth rate of earnings per share, and not book value per share, as a proxy for the growth rate of dividends per share.

[330] Louisiana Commission determined two additional CAPM cost of equity estimates of 6.75% and 8.27%, respectively, using geographic and arithmetic means, based upon using Ibbotson data on long-term, historical market returns.

[331] Opinion No. 569, 169 FERC ¶ 61,129 at P 19 ("In the CAPM, we will . . . estimate the CAPM expected market return using a forward-looking approach."); *id.* P 260 ("We continue to find reasonable the MISO TOs' proposal to estimate the CAPM expected market return using a forward-looking approach.").

analyses presented by Louisiana Commission are flawed because they are not sufficiently forward-looking and therefore the CAPM results based on historical data are not representative of the capital market conditions present during this proceeding.[332]

G. Risk Premium

1. Initial Decision

176. While Entergy presented a Risk Premium analysis to inform placement of the ROE within the DCF zone of reasonableness, the Initial Decision did not incorporate a Risk Premium analysis.[333]

2. Briefs on and Opposing Exceptions

177. Entergy argues that the Risk Premium model is widely accepted in academia and regulatory proceedings and that the Commission has used the risk premium approach as an informative indicator of investors' required rate of return.[334] Entergy's risk premium analysis considered 74 Commission-approved ROEs from 2006 to 2013.[335] Entergy determined equity risk premiums for each of those years by subtracting the average yield of BBB-rated public utility bonds in each year from the average allowed ROE for electric utilities in each year.[336] Entergy states that the resulting annual equity risk premiums averaged 4.73% while the yield on BBB-rated public utility bonds averaged 6.04%.[337]

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[332] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 118 (finding that a CAPM study is reliable if it is prospective and does not pre-date the Great Recession, then it is sufficiently representative of the capital market conditions in the proceeding); *see Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys.Operator, Inc.*, Opinion No. 551, 156 FERC ¶ 61,234, at P 172 (2016) (rejecting a CAPM study that relied on historical data because that study "[wa]s not representative of the capital market conditions present during th[e] proceeding").

[333] Initial Decision, 151 FERC ¶ 63,008 at PP 40, 68, 84, 92.

[334] Entergy Brief on Exceptions at 40-41 (citing Ex. ESI-100 at 32:1-3, Ex. ESI-100 at 14-16 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 146 and ESI-123 at 83:4-7)).

[335] Entergy Brief on Exceptions, Ex. ESI-100 at 33:19-20.

[336] *Id.*, Ex. ESI-129 at 3.

[337] *Id.*.

178. However, Entergy states that the average yield of BBB-rated public utility bonds during the six months ending November 2014 was only 4.71%, 133 basis points below the 6.04% average yield for the 2006-2013 study period.[338] To account for the inverse relationship between interest rates and equity risk premiums, Entergy performed a regression analysis between the interest rates and annual equity risk premiums during the 2006-2013 study period. That analysis indicated that equity risk premiums increased approximately 88 basis points for each 100 basis point drop in the average yield of public utility bonds.[339] Based on this relationship, Entergy calculated that the 133 basis point drop in the yield of public utility bonds resulted in an increased equity risk premium for the six month period ending November 2014 of 5.90%, 117 basis points higher than the 4.73% average risk premium for the 2006-2013 study period.[340] Entergy states that adding this 5.90% equity risk premium to the 4.71% average bond yield for the six months ending November 2014 produced a cost of equity of 10.61%.[341] Entergy states that this risk premium analysis indicates that the Entergy Operating Companies' cost of equity is above the 9.10% median value of Entergy's two-step DCF analysis.

179. Trial Staff asserts that Entergy's Risk Premium analysis does not come close to supporting its proposed ROE of 10.66%, when corrected for its flawed regression analysis.[342] Trial Staff points out that Entergy's Risk Premium analysis produces an average risk premium of 4.73% for its eight year study period. Trial Staff states that adding that risk premium to the 4.71% yield on public utility bonds for the six months ending November 2014 produces an ROE of only 9.44%, which is not sufficient to support a move of the ROE from the median to the midpoint of the top half of Entergy's DCF range of 10.34% or to Entergy's requested ROE of 10.66%.[343] Trial Staff argues that, because Entergy's own risk premium calculation and bond yield data only support a cost of equity of 9.44%, Entergy performed a regression analysis in an attempt to support a higher ROE. Trial Staff posits that the results of Entergy's regression analysis should

[338] *Id.* at 1.

[339] *Id.* at 6.

[340] *Id.* at 1 (1.33 times .88 equals 1.17).

[341] Ex. ESI-129. The 10.61% cost of equity estimate for Commission-approved ROEs is the sum of Entergy's estimated current 5.90% adjusted risk premium and the 4.71% six-month average yield ending November on the Moody's BBB utility bond index.

[342] Trial Staff Brief Opposing Exceptions at 23-24 (citing Entergy Brief on Exceptions at 38-43).

[343] *Id.* at 25-26.

be rejected as conjecture, consistent with Trial Staff's assertion that "it is difficult, if not impossible[,] to know for certain what the impact of the more recent, historically low capital costs ha[ve] had on current equity risk premiums to use in estimating a company's cost of equity."[344] Trial Staff contends that Entergy's assumed inverse relationship between the ROE requirements and bond yields, based on its regression analysis, bears no relationship to the inverse relationship normally found for the Risk Premium method.[345] Trial Staff asserts that the regression adjustment should be disregarded in favor of the typical Risk Premium method which yields a cost of equity for electric utilities of 9.44%, because Entergy's assumed inverse relationship is circular, and produces "ridiculous results" in that ROEs dropped only 0.16%, as bond yields dropped 1.33%.[346]

180. Louisiana Commission argues that Entergy departed from accepted financial theory in performing the Risk Premium analysis.[347] Louisiana Commission states that, instead of relying on data for the longest possible period to ensure that variations in bond yield and risk premiums are smoothed out, Entergy relied on data for only eight years. Louisiana Commission states that reliable authorities caution that a historical Risk Premium analysis "should reflect the longest possible period for which data are available."[348] Moreover, Louisiana Commission asserts that Entergy relied on data from settlements, decisions allowing the continuation of previously approved ROEs, decisions allowing transmission owners to receive the previously approved ROE for a transmission organization, and similar determinations.[349]

181. Additionally, Louisiana Commission states that Entergy assumed an inverse relationship between the risk premiums and bond yields, based on its study of the purported Commission allowances, of 88.16%.[350] Thus, Louisiana Commission states that Entergy's analysis took the ROE result for 2014 right back to what the Commission supposedly allowed in the previous eight years, with a very slight reduction. Louisiana Commission explains that the bond yield decreased by 1.33%, but Entergy's calculated

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[344] *Id.* at 25 (citing Ex. S-4 at 68:19–69:1).

[345] *Id.*

[346] *Id.* at 25-26 (citing Louisiana Commission Initial Brief at 23-25).

[347] Louisiana Commission Brief Opposing Exceptions at 80.

[348] *Id.* at 81-82 (citing Morin at 114).

[349] *Id.* at 80-81.

[350] *Id.* at 83 (citing Avera Tr. 226).

risk premium went up by 1.17%, resulting in a net decrease of the ROE of only 16 basis points.[351] Louisiana Commission contends that Entergy's inverse relationship produces unreasonable results because, as Entergy admitted, applying its risk premium factor, bond yields could fall from 6.04% to zero, and Entergy's method would still produce an ROE in excess of 10%.[352]

182. Louisiana Commission asserts that Entergy relies on bad data because there is no evidence that the Commission ROE decisions Entergy cited were based on records containing capital market data, except for two reported decisions over eight years.[353] Louisiana Commission avers that there is no evidence that market data, if any existed, was compiled at a time relatively contemporaneous with the reported bond yields. Louisiana Commission explains that there is an easy proof that the data is bad because under the Risk Premium theory, if bond yields go down, the cost of equity should go down in some proportion to the change in bond yields, and vice versa. However, Louisiana Commission contends that Entergy's data shows an aberrational relationship.[354]

183. Louisiana Commission concludes that Entergy's Risk Premium analysis does not satisfy the minimum standard of reliability required for expert evidence. According to Louisiana Commission, Entergy's applications conflict with accepted norms in the field. Louisiana Commission further states that Entergy embedded gimmicks in its analyses that inflated its results and rendered Entergy's methods untestable, unreliable, unsupported in peer-reviewed publications, and contrary to generally accepted views in the field.[355] Louisiana Commission contends that, under Federal Rule of Evidence 702, Entergy's deviations from accepted methodologies probably could not even be admitted in a court of law and should not be deemed reliable by the Commission.[356]

184. Louisiana Commission explains that under *Daubert*, a tribunal is supposed to scrutinize all experts' methodologies for reliability given accepted scientific or economic

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[351] *Id.* at 84 (citing Avera Tr. 227).

[352] *Id.* (citing Avera Tr. 228-29).

[353] *Id.* at 80-81 and 84-85 (citing *S. Cal. Edison Co.*, 139 FERC ¶ 61,042; *Bangor Hydro Elec. Co.*, 117 FERC ¶ 61,129 (2006)).

[354] *Id.* at 85.

[355] *Id.* at 9 (citing *Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579, 593-94 (1993)).

[356] *Id.* at 10.

theory, not accept the analysis as "'corroborative'" based on the expert's conclusory pronouncements.[357] Louisiana Commission asks the Commission to at least examine the methods to assess their reliability. Here, Louisiana Commission contends that, what it describes as the gimmick-filled analyses were prepared for litigation, are not supported by accepted financial theory, and should be rejected.

3. Briefing Order and Opinion No. 569 *et seq.*

185. As noted above, in the *Coakley* Briefing Order, the Commission proposed to utilize the Risk Premium model as one of the models to determine the zone of reasonableness and the ROE, rather than to simply inform placement of the ROE within the zone of reasonableness produced by the DCF.[358] In the Briefing Order, the Commission sought comment on the application of that methodology to the instant proceeding.[359] In Opinion No. 569, the Commission declined to use the Risk Premium model because its benefits were outweighed by its deficiencies, it has redundancy with the CAPM, and its tendency to undermine both transparency and predictability.[360] However, in Opinion No. 569-A the Commission set aside this finding and determined that the defects of the Risk Premium model do not outweigh the benefits of model diversity and reduced volatility resulting from including the Risk Premium model.[361] The Commission also found it appropriate to impute a zone of reasonableness from the single numerical result of the Risk Premium model.[362]

4. Initial Briefs

186. Entergy states that the Commission has rejected criticisms of the Risk Premium model relating to: (1) the dates the model assigned to regulatory decisions; (2) Entergy's inclusion of decisions involving settlements; (3) the inverse relationship ratio that the model used to adjust risk premiums when interest rates change; and (4) claims that the model was inconsistent with Commission precedent. Entergy asserts that the

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[357] *Id.* at 94 (citing *Daubert v. Merrell Dow Pharms., Inc.*, 43 F.3d 1311, 1318-19 (9th Cir. 1995)).

[358] *Coakley* Briefing Order, 165 FERC ¶ 61,030 at 32.

[359] Briefing Order, 167 FERC ¶ 61,091 at P 16.

[360] Opinion No. 569, 169 FERC ¶ 61,129 at PP 340-352.

[361] Opinion No. 569-A, 171 FERC ¶ 61,154 at PP 104-114.

[362] *Id.* P 107.

Commission's analysis is consistent with Entergy's analysis in this proceeding.[363] Additionally, Entergy states that the Commission found that the Risk Premium model "is nonetheless an approach that investors routinely rely upon."[364]

187. Entergy states that the Commission's justification for using the Risk Premium model goes directly to the legal standard applicable to this case, and that the Commission's analysis in Opinion No. 531-B of the CAPM and Expected Earnings models should also apply here, as it reveals the same extensive and detailed approach that the Commission applied to the Risk Premium model.[365]

188. Entergy states that the Risk Premium analysis was performed by identifying ROEs approved by the Commission for electric utilities since 2006, subtracting the corresponding average yield on Baa rated public utility bonds over the study period from the allowed ROE for electric utilities to determine the average risk premium for the study period, performing a regression analysis to identify the inverse relationship between equity risk premium and interest rates to calculate the adjustment for the average risk premium, adding the average risk premium over the study period with the adjustment to the average risk premium to determine the adjusted risk premium, and adding the adjusted risk premium to the average yield on public utility bonds.[366]

189. Trial Staff argues that the Risk Premium model should be adjusted to ensure the results are timelier and more accurate, ensuring a closer match between the ROE and cost of equity. First, Trial Staff proposes to remove any Commission-authorized ROE that was not developed using market data contemporaneous with the applicable bond yields, eliminating stale or vintage ROEs. Therefore, Trial Staff removed from its analysis ROEs that were not based on a market analysis at the time they were authorized, such as when the market analysis had taken place years before the Commission issued an order assigning an ROE to a utility or RTO/ISO-wide ROEs that are granted to a utility because it became a member of that RTO. Trial Staff argues that such Risk Premium results will overstate the cost of equity. From the remaining list of Commission-authorized ROEs, Trial Staff states that it calculated average ROEs for the period relative to the contemporaneous yield on Moody's Baa Public Utility Bond Yields. Trial Staff asserts that this adjustment improves the likelihood of a resulting ROE that accurately represents what is required for the attraction of capital from investors, and more closely meets the

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[363] Entergy Initial Brief at 17-18 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at PP 98-101; Ex. No. ESI-123 at 47-51).

[364] *Id.* at 18 (citing Opinion No. 531, 147 FERC ¶ 61,234 at 98).

[365] *Id.*

[366] *Id.* at 22-23 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at PP 146-147).

courts' and the Commission's fundamental requirement that to be just and reasonable, an ROE must be commensurate with returns on investments in other enterprises having corresponding risks.[367]

190. Second, Trial Staff proposes to remove the six-month average Moody's Baa Public Utility Bond Yields for the months October 2008 through August 2009 because they were exposed to high volatility. Trial Staff supports this adjustment because, during the time period, bond yields spiked, understating the actual risk premiums required by investors. Trial Staff asserts that the Commission-approved ROEs during this time period do not account for these bond yield spikes in any meaningful way.

191. Finally, Trial Staff notes what it assumes to be the inadvertent use of projected bond yields in the Risk Premium analysis referenced in the *Coakley* Briefing Order and argues that these projected bond yields should be removed. After applying these modifications, Trial Staff states that its point estimate result for the Risk Premium model is 9.92%.[368]

192. PUCT argues that the Risk Premium model is inherently less accurate than a well-constructed DCF or properly performed CAPM method due to its reliance on past regulatory decisions and that it perpetuates market-based methods applied in prior cases rather than current market conditions. PUCT argues that this means that the Risk Premium method will tend to overestimate the cost of equity when it is declining. PUCT asserts that, if the Commission uses the Risk Premium model, it should ensure that the market information used should apply: (1) ROE determinations made by the Commission or state commission at the time of the order; (2) observable market evidence of risk differentials; and (3) a comparison of utility stock yields to utility bond yields and U.S. Treasury bond yields.[369]

193. New Orleans Council argues that the Risk Premium model, along with the Expected Earnings model, do not reflect the market cost of equity that the Commission has long held as a requirement of the FPA and *Hope* and *Bluefield*. New Orleans Council states that the Risk Premium model relies on "echoes" of market-based methods applied in prior regulatory decisions to extrapolate a present cost of equity, but is not necessarily reflective of current market forces or conditions.

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[367] Trial Staff Initial Brief at 31-33.

[368] *Id.* at 35.

[369] PUCT Initial Brief at 9-10.

5. Reply Briefs

194. Entergy states that investors use the Risk Premium model to estimate the expected return from an investment company and that it is a market-oriented methodology based on the premium investors require above the return they expect to earn on a bond investment to reflect the greater risk of a stock investment.[370] Entergy states that it applied the Risk Premium method in a manner consistent with Commission precedent and the *Coakley* Briefing Order. Entergy states that Louisiana Commission and Trial Staff implement Risk Premium analyses that differ from the Commission's application and make unsupported changes that should be rejected.[371]

195. Entergy argues that Trial Staff's adjustments to the Risk Premium model related to removing data of certain ROEs and bond yields for certain periods are unwarranted.[372] Entergy argues that Trial Staff's argument has repeatedly been considered and rejected by the Commission, and should be rejected here as well.[373]

196. Regarding Trial Staff's proposal to remove certain ROEs from the Risk Premium analysis that Trial Staff asserts are vintage or stale, Entergy argues that ignoring certain ROE data points is improper because approved ROEs are closely followed by investors, and provide a direct signal that influences their expectations and required rates of return. Entergy also argues that this ignores Commission precedent, under which the Commission has explicitly held that whether the regulatory decision involved a settlement agreement or the application of a cost of equity that was calculated in the past does not affect the reliability of a risk premium analysis. Entergy thus asserts that Trial Staff's removal of data should be rejected.[374]

197. Entergy states that Trial Staff also removes bond yield data for the period of October 2008 through August 2009 because bond yields jumped and then steadily decreased, but contends that Trial Staff does not offer support for why this observation justifies removing the data. Entergy argues that all previous iterations of Risk Premium analyses that the Commission considered have included this data, and Trial Staff's

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[370] Entergy Reply Brief at 42 (citing *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 34).

[371] *Id.* at 43.

[372] *Id.*

[373] *Id.* at 44 (citing Opinion No. 551, 156 FERC ¶ 61,234 at PP 173-200; Opinion No. 531-B, 150 FERC ¶ 61,165 at PP 90-101).

[374] *Id.*

approach violates the underlying premise of the Risk Premium method, which points that the ROEs allowed by the Commission are representative of the returns required by investors. Entergy states that Trial Staff's approach should be rejected.[375]

198. Trial Staff reiterates its argument that the adjustments discussed in its initial brief should be made to the Risk Premium analysis. Trial Staff notes that Entergy presents a Risk Premium estimate using two separate Risk Premium analyses, one based on historical bond yields and another based on projected bond yields. Trial Staff states that it assumes the use of the projected bond yields in the Risk Premium analysis referenced in the *Coakley* Briefing Order was inadvertent and therefore, asserts that Entergy's projected cost of equity estimate should be ignored. Trial Staff argues that the Commission clearly set forth why it was important to reject the use of projected bond yields in Opinion No. 551, where Trial Staff claims that the Commission agreed with the Presiding Judge's finding that "projected yields used in risk premium analyses are speculative and less reliable than historical yields."[376] Trial Staff asserts that, in order for the Risk Premium analysis to most accurately determine the Entergy Operating Companies' cost of equity, Entergy's proposed use of projected bond yields must be rejected and Trial Staff's proposed adjustments must be adopted.[377]

6. <u>Commission Determination</u>

199. In Opinion Nos. 569-A and 569-B, the Commission found that the Risk Premium model has a strong theoretical basis and is sufficiently distinct from the CAPM to use in ROE analysis.[378] We have not been persuaded otherwise here and we continue to find that the Risk Premium model should be included in determining the ROE component of the Tariff. However, we find neither Entergy's nor Trial Staff's Risk Premium analyses are consistent with the Commission's revisions to the Risk Premium model applied in Opinion Nos. 569-A and 569-B.

200. We disagree with Trial Staff's proposal to remove the six-month average Moody's Baa Public Utility Bond Yields for the months October 2008 until August 2009 because they were exposed to high volatility. In Opinion No. 569-A, the Commission found that all periods should be included because the Risk Premium analysis should factor in

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[375] *Id.* at 45.

[376] Trial Staff Reply Brief at 14-16 (citing Opinion No. 551, 156 FERC ¶ 61,234 at P 194).

[377] *Id.* at 16.

[378] Opinion No. 569-A, 171 FERC ¶ 61,154 at PP 104-7; Opinion No. 569-B, 173 FERC ¶ 61,159 at PP 113-114.

periods where the bond yields change. The Commission further stated that a full sample size in this case reflects the Risk Premium at the time and such economic disturbances, which periodically recur.[379]

201. With respect to Trial Staff's argument regarding vintage or stale ROEs, we note that the Commission addressed this concern in Opinion No. 569-A. There, the Commission revised the bond yields and corresponding risk premiums to correspond to the six months preceding the offer of settlement and not Commission orders approving the settlements. The Commission explained that the bond yields and corresponding risk premiums should be aligned by corresponding to the relevant test periods on which the ROE arrived it in those settlements is based. For settlements, the relevant date would be the date the settlement was filed, so the six-month time period for bond yields should be the six months preceding the settlement filing date.[380] The Commission upheld this finding in Opinion No. 569-B.[381]

202. In Opinion No. 569-A, the Commission also found that it was appropriate to eliminate certain cases from the Risk Premium analysis where the Commission did not consider the justness and reasonableness of the base ROE or the zone of reasonableness in making decisions. For example, the Commission excluded cases where transmission owners joined MISO and received the prevailing 12.38% ROE that was approved in 2002 without examination of the justness and reasonableness of that ROE. In Opinion No. 569-A, the Commission also noted that in an order on a transmission rate incentives filing by Public Service Electric and Gas Company, the Commission explicitly stated that the ROE was beyond the scope of the proceeding.[382] The Commission also explained that, in other cases, the MISO TOs' analysis unjustifiably contained multiple ROEs counted in the analysis from the same case.[383] Additionally, the Commission eliminated cases where the test period is in 2004, well before other proceedings on the list, given that there were likely other proceedings with test periods during 2004 and 2005 that were not included. The Commission also proposed, in order for the results of the Risk Premium analysis to be consistent with those of other models, to update the list of applicable cases

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[379] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 114.

[380] *Id.* PP 109-111.

[381] Opinion No. 569-B, 173 FERC ¶ 61,159 at P 129.

[382] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 110 (citing *PJM Interconnection, L.L.C.*, 147 FERC ¶ 61,142, at P 48 (2014)).

[383] *Id.* P 110 n.202. Note that when a case has multiple *different* ROEs, each of those are counted in the analysis.

to include data up through the conclusion of the test period, which concluded November 2014 for this proceeding.[384]

203. Consistent with the Commission's explanation in Opinion No. 569-B, we reiterate that we require the Risk Premium analysis to use historic bond yields.[385] Although the Commission inadvertently used projected bond yields in the Risk Premium analysis referenced in the MISO Briefing Order, we reiterate that, consistent with the Commission's finding in Opinion No. 551, Risk Premium models should employ historical and not forward-looking bond yields.[386]

204. Although we disagree that Entergy's Risk Premium analysis is consistent with the Risk Premium analysis as revised by the Commission in Opinion Nos. 569-A and 569-B, we also disagree with certain arguments made by other parties. Louisiana Commission and Trial Staff both argue that Entergy's Risk Premium analysis is flawed because it is based on a regression analysis that produces results that are inconsistent with the standard practice in the field, and it relies on regulatory decisions that include ROEs established by settlement agreements. The Commission was unpersuaded by these exact arguments in Opinion No. 569-B.[387] The purpose of the regression analysis in the Risk Premium study is to ascertain the statistical relationship between risk premiums and interest rates over a relevant time period to more accurately estimate the risk premium. Without using a regression analysis, a Risk Premium analysis merely represents a snapshot of the relationship between interest rates and risk premiums. Although both approaches provide an estimate of the current risk premium, an analysis that relies on a regression analysis is likely to produce a more accurate estimate.

205. We are also unpersuaded by Louisiana Commission's assertion that the longest time period possible should have been used. Although longer time periods may be theoretically preferable, we find that the eight-year period is sufficiently large to inform a risk premium study with 64 observations constituting a statistically significant study

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[384] *Id.* P 110.

[385] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 121.

[386] Opinion No. 551, 156 FERC ¶ 61,234 at P 194; *see also* Opinion No. 569-B, 173 FERC ¶ 61,159 at P 121.

[387] Opinion No. 569-B, 173 FERC ¶ 61,159 at P 120.

size.[388] Further, this eight-year period covers both before and after the 2008-09 financial crisis.

206. We disagree with Louisiana Commission and Trial Staff's assertion that Entergy's Risk Premium analysis is flawed because it relies on ROEs that were established through settlement agreements. The Commission found in Opinion No. 569-A that "parties engaged in arms-length negotiations seriously consider the ROE in the course of reaching settlements, even if the records in certain proceedings do not contain specific ROE calculations or testimony."[389] Additionally, as the Commission explained in Opinion No. 531-B, risk premiums allowed by regulators "are presumably based on the results of market-based methodologies presented to regulators in rate hearings and on the actions of objective unbiased investors in a competitive marketplace."[390] This is no less true in the case of settlement agreements, as settling parties rely upon the same market-based methodologies in determining the rates they are willing to accept. For that reason, the Commission concluded in Opinion No. 531-B that "whether the regulatory decision involved a settlement agreement or the application of a cost of equity that was calculated in the past" does not affect the reliability of a risk premium analysis.[391]

207. Further, we disagree that the inferred inverse relationship between interest rates and equity premiums suffers from "circularity" infirmities because, as the Commission found in Opinion No. 569-A, although the Risk Premium analysis contains some circularity, "the averaging of the results with those of the DCF and CAPM models sufficiently mitigates that circularity."[392] Additionally, the Commission noted that all of the models contain some circularity and that the level of circularity in the Risk Premium model is acceptable.[393]

208. After accounting for these revisions adopted by the Commission in Opinion Nos. 569-A and 569-B, we find that our Risk Premium analysis indicates a 6.25% average yield over the study period and an average risk premium of 4.34% over the study

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[388] *Cf.* Opinion No. 551, 156 FERC ¶ 61,234 at P 192 (finding that a nine-year period is sufficiently large to inform a risk premium study).

[389] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 109.

[390] Opinion No. 531-B, 150 FERC ¶ 61,165 at P 98 (internal quotations omitted) (quoting Morin at 125).

[391] *Id.* P 98; Opinion No. 551, 156 FERC ¶ 61,234 at P 198.

[392] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 106.

[393] *Id.*

period. Adjusting for the statistical relationship between the risk premium and interest rates, our Risk Premium analysis produces a 10.17% ROE and an imputed zone of reasonableness of 7.59% to 12.74%.

H. Expected Earnings

1. Initial Decision

209. While Entergy presented an Expected Earnings analysis to inform placement of the ROE within the DCF zone of reasonableness, the Presiding Judge did not incorporate an Expected Earnings analysis[394]

2. Briefs on and Opposing Exceptions

210. Entergy states that it prepared a forward-looking Expected Earnings analysis, using the same proxy group that it used in its two-step DCF analysis. Entergy states that its Expected Earning analysis produces an ROE range of 7.62% to 13.96%, with a median value of 9.73%.[395] Entergy asserts that the simple concept underlying the method is that investors will compare the rate of return of a given utility to the next best investment opportunity the investor has and that, assuming the companies are of comparable risk, the investor will opt for the investment that offers the greater return.[396] Entergy conducted its Expected Earnings analysis by using the return on book equity that *Value Line* forecasted for the national group of companies that are listed as Electric Utilities. Entergy then multiplied each of those forecasted returns by an adjustment factor to determine each utility's average return, rather than its year-end return, explaining that using the year-end return would understate actual returns because of growth in common equity over the year.[397]

211. Trial Staff opposes Entergy's reliance on an Expected Earnings analysis. Trial Staff contends that Entergy's Expected Earnings results can be disregarded because "when price to book ratios are above one, investors' required return on market value is less than their expected return on book value."[398] Moreover, Trial Staff states that Entergy's own median result of 9.73% for the national proxy group does not support

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[394] Initial Decision, 151 FERC ¶ 63,008 at 40, 68, 84, 92.

[395] Entergy Brief on Exceptions at 42 (citing Ex. ESI-123 at 84:1-2).

[396] *Id.* at 42 (citing Ex. ESI-100 at 41:3-9).

[397] Ex. ESI-100 at 41:15-21.

[398] Trial Staff Brief Opposing Exceptions at 29 (citing Ex. S-4 at 75:5-7).

moving the ROE from the median to the top half of the zone of reasonableness, 10.34%, or to Entergy's requested 10.66%.[399]

212. Louisiana Commission argues that Entergy's Expected Earnings analysis determines Expected Earnings on book equity, a method long-since discredited by regulators who rely on market evidence, and that Entergy presented data showing what analysts expect utilities to earn on book value in the years 2017-19.[400] However, Louisiana Commission asserts that this analysis is inapplicable to determining investors' ROE requirements because when investors buy stock they pay market price, not book price.

3. Briefing Order and Opinion No. 569 *et seq.*

213. As noted above, in the *Coakley* Briefing Order, the Commission proposed to utilize the Expected Earnings model as one of the models to determine the zone of reasonableness and the ROE, rather than to simply inform placement of the ROE within the zone of reasonableness produced by the DCF.[401] In the Briefing Order, the Commission sought comment on the application of that methodology to the instant proceeding.[402] In Opinion Nos. 569 and 569-A, the Commission found that the Expected Earnings model should not be used in the Commission's ROE analysis.[403]

4. Initial Briefs

214. Entergy states that it identified a relationship between the Expected Earnings methodology and the comparable earnings test established by the Supreme Court in *Hope* and *Bluefield* and concluded that expected earned returns on invested capital provide a direct benchmark for investors' opportunity costs.[404]

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[399] *Id.* at 29-30 (citing Ex. ESI-123 at 84:1-2).

[400] Louisiana Commission Brief Opposing Exceptions at 94-95 (citing Ex. ESI-100 at 40-43; Ex. S-4 at 74-75 (Green)).

[401] *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 32.

[402] Briefing Order, 167 FERC ¶ 61,091 at P 16.

[403] *See, e.g.*, Opinion No. 569, 169 FERC ¶ 61,129 at P 200; Opinion No. 569-A, 171 FERC ¶ 61,154 at P 125.

[404] Entergy Initial Brief at 13 (citing Exhibit No. ESI-100 at 42).

215. Trial Staff, PUCT, and New Orleans Council argue that use of the Expected Earnings model is inappropriate because it does not reflect the market cost of equity that the Commission has long held as a requirement of the FPA and *Hope* and *Bluefield*.[405] Trial Staff argues that the Commission has relied on using a market-based approach for more than 30 years. According to Trial Staff, in 1985, the Commission rejected the use of accounting rates of return because they are not reliable measures of the current market cost of capital.[406] Trial Staff, PUCT, and New Orleans Council argue that the Expected Earnings model is based on expected accounting returns on the book value of the utility's common equity and therefore, is not a reliable indicator of the cost of equity.[407] According to New Orleans Council, the Expected Earnings model also excludes critical data from the analysis such as the rate of return that investors require to invest in the market-priced common equity capital of a utility, i.e., the utility's cost of capital.[408] Furthermore, New Orleans Council and PUCT argue that the Expected Earnings model is based on past rates earned by other utilities and does not necessarily reflect present rates.[409]

216. Trial Staff and PUCT also assert that the Expected Earnings model is not widely used by investors. Trial Staff asserts that the Commission did not provide references to support the investment community's common use of the Expected Earnings model in the *Coakley* Briefing Order. According to Trial Staff, the Commission noted Dr. Morin's book, *New Regulatory Finance*, in reference to the Expected Earnings model, but Dr. Morin does not discuss the type of Expected Earnings model used by the New England TOs. Trial Staff asserts that in *New Regulatory Finance*, Professor Eugene Brigham, a "widely respected scholar and finance academician," states that the three models typically used for estimating the cost of equity are the CAPM, DCF, and Risk Premium models. Furthermore, Trial Staff argues that Professor Brigham has

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[405] Trial Staff Initial Brief at 13-14; PUCT Initial Brief at 10; New Orleans Council Initial Brief at 15.

[406] *Id.* at 13 (citing *Generic Determination of Rate of Return on Common Equity for Pub. Utils.*, Order No. 420, FERC Stats. & Regs. ¶ 30,644, at 31,367 (1985) (cross-referenced at 31 FERC ¶ 61,168)).

[407] *Id.* at 13; PUCT Initial Brief at 10; New Orleans Council Initial Brief at 15.

[408] New Orleans Council Initial Brief at 15.

[409] *Id.*; PUCT Initial Brief at 10.

observed that the more generic comparable earnings method has been thoroughly discredited.[410]

217. Trial Staff asserts that, if the Commission uses the Expected Earnings model, certain modifications are needed. Specifically, Trial Staff contends that the average of all three of the return on book value projections provided by *Value Line* should be used. Trial Staff contends that this averaging approach is consistent with how the Commission incorporated *Value Line* projections in Opinion 445 and that this approach is superior to the use of only one estimate because multiple estimates would moderate the impact of any one irregular estimate.[411]

5. Reply Briefs

218. Entergy states that the Commission explained why the Expected Earnings analysis should be considered in Opinion Nos. 531-B and 551, and no party in the instant proceeding refutes this reasoning. Entergy points out that, in Opinion No. 551, where the Commission reversed the Presiding Judge's rejection of an Expected Earnings analysis, the Commission noted that an Expected Earnings analysis is sound when it is forward-looking and based on a reliable source of earnings data.[412] Entergy states that the Commission made the same determination in Opinion No. 531-B. Entergy states that ultimately the Expected Earnings model should be considered because investors rely on Expected Earnings analyses to help estimate the opportunity cost of investing in a particular utility and that there is no basis to exclude the analysis in this proceeding.[413] Entergy notes that the Commission found that investors rely on the Expected Earnings model to help estimate the opportunity cost of investing in a particular utility in the *Coakley* Briefing Order.[414]

219. Entergy states that the arguments for excluding an Expected Earnings analysis from the Commission's determination of a just and reasonable ROE contradict the fundamental goal of the Commission's proposed approach by insisting that the differences between Expected Earnings and the DCF models are flawed. Entergy

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[410] Trial Staff Initial Brief at 11-12.

[411] *Id.* at 29-30 (citing Trial Staff Aff. ¶¶ 74-75 (citing Opinion No. 445, 92 FERC ¶ 61,070 at 61,263)).

[412] Entergy Reply Brief at 27-28 (citing Opinion No. 551, 156 FERC ¶ 61,234 at P 231).

[413] *Id.* at 28.

[414] *Id.* at 27.

contends that part of the fundamental reasoning for using four models is that all of the models yield imperfect estimates that should be combined and given equal weight to most accurately capture the returns investors expect.[415] Entergy explains that the difference between the Expected Earnings model and the other models serves the critical function as acting as a check on the possibility that a faulty common input could undermine the results of the other three models, because the Expected Earnings analysis is produced from a different set of premises that are simpler and less vulnerable to assumptions that other models use.[416]

220. Entergy states that, while Trial Staff and Louisiana Commission argue that the Expected Earnings approach is not widely used by investors, the Commission expressed that the Expected Earnings approach is used by investors in Opinion No. 531-B, Opinion No. 551, and in the *Coakley* Briefing Order.[417] Entergy disputes Trial Staff's and Louisiana Commission's criticism that the Commission has repeatedly rejected the Expected Earnings model because the model is an accounting-based measure, not a reliable indicator of the cost of equity, and is therefore flawed because it is not a market-based measure of an investor's required return. Entergy notes that the Commission has considered and consistently rejected this premise.[418] Entergy argues that the Commission in Opinion No. 551 rejected Trial Staff's and Louisiana Commission's argument that estimates of expected returns on book value used in the Expected Earnings approach do not represent a consensus estimate.[419] Entergy notes that, even though the projections included in *Value Line's* reports for the individual firms that it covers are sponsored by a single analyst, they are developed under a common, proprietary analytical framework that is supported by a network of analysts within the *Value Line* organization, and are reviewed by an internal panel of other analysts prior to publication.[420]

221. Entergy states that, in applying the Expected Earnings analysis, the Commission should follow Entergy's proposed approach, which is consistent with Commission precedent, without the modifications proposed by Trial Staff and Louisiana

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[415] *Id.* at 28-29.

[416] *Id.* at 29.

[417] *Id.* at 30 (citing *Coakley* Briefing Order 165 FERC ¶ 61,030 at P 34; Opinion No. 551 156 FERC ¶ 61,234 at P 234; Opinion No. 531-B 150 FERC ¶ 61,165 at P 129).

[418] *Id.* at 31-32.

[419] *Id.* at 34.

[420] *Id.*

Commission.[421] Entergy contends that the instant proceeding is different from the Opinion 445 precedent cited by Trial Staff, as that proceeding concerned the formula for calculating the growth component previously relied on by the Commission in its former one-step DCF method and did not address an application of the Expected Earnings analysis.[422] Additionally, Entergy argues that Louisiana Commission's Expected Earnings model is flawed because it does not apply an adjustment factor to the expected returns, even though such a factor is well-supported.[423]

222. Trial Staff argues that Entergy's citations to the Briefing Order create a circular argument to support the Expected Earnings model. Trial Staff further argues that Dr. Morin's *New Regulatory Finance* does not even acknowledge the existence of an Expected Earnings model. According to Trial Staff, the fundamental question is whether investors commonly use the Expected Earnings model to measure the cost of equity, and Trial Staff argues that the record evidence shows this is not the case.[424] Trial Staff asserts that in Opinion No. 314, the Commission expressly stated why it is critical to establish an ROE based on the market cost of equity required by investors and not on the Expected Earnings of the utility.[425] Additionally, Trial Staff argues that the Expected Earnings model does not measure the cost of equity, comply with the Commission's history of using market-based methodologies, or use consensus estimates. For these reasons, Trial Staff asserts that the Commission should disregard the Expected Earnings model.[426]

6. Commission Determination

223. The Commission found in Opinion No. 569 that the Expected Earnings model would not improve its ROE determinations and declined to use the model, as discussed below.[427] The Commission upheld this decision in Opinion No. 569-A[428] and we

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[421] *Id.*

[422] *Id.* at 35-36 (citing Opinion No. 445, 92 FERC ¶ 61,070).

[423] *Id.* at 36-37.

[424] Trial Staff Reply Brief at 6-7.

[425] *Id.* at 7 (citing Opinion No. 314, 44 FERC at 61,952).

[426] *Id.* at 7-8.

[427] *See* Opinion No. 569, 169 FERC ¶ 61,129 at P 31; *see also* Opinion No. 569-A, 171 FERC ¶ 61,154 at PP 43-46.

[428] Opinion No. 569-A, 171 FERC ¶ 61,154 at PP 125-132.

continue to do so in this proceeding. We are not persuaded by Entergy's arguments to include the Expected Earnings model when determining the just and reasonable ROE in this proceeding.

224. In Opinion No. 569, the Commission explained that, under the Commission's market-based approach, the Commission sets a utility's ROE at 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."[429] The Commission stated that, in order to determine this, the Commission must analyze the returns that are earned on "investments in other enterprises having corresponding risks."[430] However, 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 Commission stated that 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.[431] Accordingly, we agree with Trial Staff, PUCT, and New Orleans Council and we continue to find that the Expected Earnings model is not a market-based model and relying on it does not satisfy the requirements of *Hope*.

225. Entergy argues that the Expected Earnings model calculates earnings an investor expects to receive on the book value of a particular stock, using forward-looking estimates of earnings on book value. However, as the Commission explained in Opinion No. 569, the return on book value is not indicative of what return an investor requires to invest in the utility's equity or what return an investor receives on the equity 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, not book value. Because the return on book value does not reflect the return to the equity owner that must be commensurate with returns on investments in other enterprises, the Commission found that the Expected Earnings model is not useful in ensuring that the standards of *Hope* and *Bluefield* are satisfied.[432]

226. Entergy asserts that the Commission previously found in the *Coakley* Briefing Order that the Expected Earnings model is useful in determining a utility's ROE because

[429] Opinion No. 569, 169 FERC ¶ 61,129 at P 201 (citing *Hope*, 320 U.S. at 603).

[430] *Id*. PP 201, 221.

[431] *Id.* P 201.

[432] *Id.* P 202.

investors rely on it to help estimate the opportunity cost of investing in a particular utility. However, the Commission issued the *Coakley* Briefing Order prior to Opinion No. 569. The Commission merely proposed an ROE methodology in the *Coakley* Briefing Order. Subsequently in Opinion No. 569, the Commission considered that proposal but explicitly decided to exclude the Expected Earnings model from the methodology that it ultimately applied. Entergy also asserts that the Commission explained why the Expected Earnings analysis should be considered in Opinion No. 531-B and Opinion No. 551. However, Opinion No. 531-B was remanded by the court and Opinion No. 569 set aside Opinion No. 551 in part on rehearing. In Opinion No. 569, the Commission considered its previous discussion of the Expected Earnings model along with all of the other relevant evidence and concluded, on balance, that the Expected Earnings model should not be used in its ROE methodology. Moreover, in Opinion No. 531-B and Opinion No. 551, the Expected Earnings model was only being used as corroborative evidence, while in Opinion No. 569, the Commission considered whether the Expected Earnings model should be used as a direct input in the ROE methodology. We are not persuaded that previous Commission statements regarding the Expected Earnings model in Opinion No. 531-B or Opinion No. 551 are sufficient to justify including the Expected Earnings model when those statements were considered by the Commission in Opinion No. 569, and the Commission nonetheless decided to exclude the Expected Earnings model. In Opinion No. 569, the Commission found that there was insufficient 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. The Commission also found that the record in that proceeding demonstrated that investors cannot purchase equity at book value; 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.[433]

227. Therefore, we find that it is not appropriate to use the Expected Earnings model when determining the ROE in this proceeding. Accordingly, we find that Entergy's use of the Expected Earnings model is not consistent with the Commission's findings in the Opinion Nos. 569 and 569-A and dismiss as moot all arguments made by parties regarding the specific implementation and application of the Expected Earnings model.

I. Just and Reasonable ROE

1. Briefs on and Opposing Exceptions

228. Louisiana Commission asserts that Entergy's proposed 10.66% ROE is based on its original DCF analysis, rather than its updated analysis. Louisiana Commission states

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[433] *Id.* P 210 (citing CAPs Initial Br. (I) at 41, Ex. JCI-100 at 30; CAPs Initial Br. (II) at 41, Ex. JCI-200 at 29).

that the original DCF analysis reflected an error that inflated the growth rate of the highest-cost proxy company in Entergy's original DCF study, i.e., Portland General Electric.[434] Louisiana Commission states that the midpoint calculation underlying Entergy's proposed 10.66% ROE directly relied on the incorrect cost of equity result for Portland General Electric. Louisiana Commission further asserts that Entergy admitted the error, and Entergy's updated DCF analysis did not contain a similar error. However, Louisiana Commission contends that Entergy never changed its ROE recommendation and, thus, there is no error-free study in the record that would support a 10.66% ROE.[435]

2. Initial Briefs

229. Entergy states that it relied on record evidence in this proceeding to apply the Commission's four proposed models in the Briefing Order to estimate the cost of equity for the Entergy Operating Companies during the time period before the conclusion of the Initial Decision in this proceeding. Entergy notes that it uses the proxy group advocated by Louisiana Commission and adopted by the Presiding Judge in the Initial Decision.[436]

230. Entergy explains that its application of all four models draws heavily on data and computations provided by exhibits in the existing record, such as using Louisiana Commission's two-stage DCF analysis of the Initial Decision's proxy group as a data source for the two-stage DCF analysis.[437] Entergy states that, in conducting the CAPM, Expected Earnings, and Risk Premium analyses, it relied on underlying data produced during the hearing. However, Entergy states that it applied that data and calculated model results for the 19 companies in the Initial Decision's proxy group instead of the 24 company national proxy group that Entergy included in the testimony filed before the hearing.[438] Entergy states that the April to September 2014 study period for the analysis was the same six-month study period adopted in the Initial Decision.[439] Entergy then

[434] *Id.* at 4 (citing Avera Tr. 191).

[435] *Id.* at 1, 2 (citing Entergy Brief on Exceptions at A-15).

[436] Entergy Initial Brief at 19-20.

[437] *Id.* at 23 (citing McKenzie Aff., attach. 3 (identifying, e.g., Ex. No. LC-5 as the source for six-month average dividend yields and IBES growth rates)).

[438] *Id.* (citing McKenzie Aff., attach. 4, 5, and 6).

[439] *Id.* at 20 (citing McKenzie Aff. at 24, 27, 30).

averaged the highest and lowest results of each model to identify a composite zone of reasonableness of 7.91% to 13.30%.[440]

231. Entergy states that it then determined the measures of central tendency for each of the CAPM, DCF, and Expected Earnings analyses by applying the models using the proxy group adopted by the Initial Decision and employed the Commission's tests for high-end and low-end results.[441] Entergy states that it also calculated the single result for the Risk Premium analysis, which does not use a proxy group, and averaged the Risk Premium results using both historical bond yields and projected bond yields.[442] Entergy explains that it then gave all four financial models equal weight in computing the results of a strict application of the Commission's four proposed models in the Briefing Order.[443] Entergy states that the result of the calculations would be an ROE of either 10.44% based on the median of the CAPM, DCF, and Expected Earnings analyses, or 10.63% based on the midpoint of the CAPM, DCF, and Expected Earnings analyses.[444] Entergy states that, under a strict application of the Initial Decision and the *Coakley* Briefing Order, the measure of central tendency for a single utility is the median, and the implied ROE is 10.44%; however, Entergy recommends that the Commission adopt an ROE in this case based on certain limited refinements to this strict approach.[445]

232. Entergy states that, based on the analysis of the evidence and the particular circumstances of this proceeding, especially due to the results of Entergy's strict application of the Commission's four proposed models in the Briefing Order, Entergy concludes that an ROE of 10.5% would provide an accurate estimate of investors' expectations for the Entergy Operating Companies and would satisfy the capital attraction standards of *Hope* and *Bluefield*.[446] Entergy states that this end result is between the 10.44% median result and the 10.63% midpoint result under the

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[440] *Id.* (citing McKenzie Aff., attach. 2).

[441] *Id.* at 20 (citing McKenzie Aff. at 22-23).

[442] *Id.* at 20-21 (citing McKenzie Aff., attach. 2 and 6; *Coakley* Briefing Order, 165 FERC ¶ 61,030 at P 59 & n.115).

[443] *Id.* at 20 (citing McKenzie Aff. at 15; *Coakley* Briefing Order, 165 FERC ¶ 61,030 at PP 15, 17, 32, 59).

[444] *Id.* at 21.

[445] *Id*.

[446] *Id.* at 30 (citing McKenzie Aff. at 15-20).

Commission's proposed four models in the Briefing Order.[447] Additionally, Entergy asserts that an ROE of 10.5% is below the prior 11% ROE contained in Service Schedule MSS-4 that Entergy originally proposed and less than the 10.66% ROE that Entergy supported at the hearing based on the Commission's applicable precedent at the time. Entergy notes that the ROE would be above the 9.01% proposed by Trial Staff and adopted by the Presiding Judge. Entergy further notes that the 9.01% ROE was less than the ROE level that the Commission contemporaneously found in Opinion No. 551 to be insufficient to satisfy the Supreme Court's capital attraction standard.[448]

233. Trial Staff states that it presents a new proxy group to address the capital attraction standards of *Hope* and *Bluefield* and relies on the same two-step DCF methodology that the Commission established for electric utilities in Opinion No. 531 and applied in Opinion No. 551. Trial Staff states that it ultimately determined that 26 electric utilities meet the Commission's criteria for inclusion in the proxy group.[449]

234. Trial Staff states that it applied the Commission's proposed methodology to develop a just and reasonable ROE to be included in the Tariff and that it also provided additional evidence regarding whether and how to apply the proposed methodology to determine the just and reasonable ROE. Trial Staff explains that it recommends various adjustments to the proposed methodology, as discussed above, to comply with the *Hope* and *Bluefield* requirements and asserts that the ROE for the Tariff should be set at 9.32%, the median of Trial Staff's composite zone of reasonableness.[450] However, Trial Staff states that if the Commission uses the Expected Earnings model, it should adopt Trial Staff's revisions, resulting in the average of all four models producing an ROE of 9.40%.

235. Louisiana Commission disputes the Commission's proposed new methodology and its application in this proceeding, but presents ROE results for the Commission's consideration for informational purposes. Louisiana Commission notes that it relies on Entergy's proxy group for the DCF model results and states that the median result is 9.10%. Louisiana Commission states that it recommends revisions to the CAPM analysis and the inclusion of historical results. Louisiana Commission further recommends averaging the top end of the historical CAPM and the two forward-looking CAPM results, resulting in an average CAPM result of 9.29%. Louisiana Commission also recommends Entergy's approach of using state-allowed ROEs and historical bond yields in the Risk Premium model, which Louisiana Commission states results in an ROE of

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[447] *Id.* (citing McKenzie Aff. at 15-20).

[448] *Id.* at 3-4.

[449] Trial Staff Initial Brief at 18-21.

[450] *Id.* at 8-10.

10.09%. Lastly, Louisiana Commission states that it calculated a median ROE of 9.5% using expected common equity returns over the three-year period of 2017 through 2019. Louisiana Commission notes that the average of these four results is 9.5%.[451]

3. Reply Briefs

236. Entergy states that, for the purpose of providing the Commission with sufficient information to decide the proper ROE, Entergy presents the results of the 26 firm proxy group. Entergy states that the results confirm the reasonableness of the 10.5% ROE recommendation but that, if the Commission bases its findings solely on the analyses for the 26 firm proxy group, it recommends a 10.4% ROE.[452] Entergy also states that its supplemental analyses adopt the June to November 2014 study period relied on by Louisiana Commission and Trial Staff.[453]

237. Entergy states that Trial Staff's proposed changes to the methodology would undermine its advantages and contend the Commission has previously rejected virtually identical proposed changes.[454]

238. Entergy states that Louisiana Commission improperly shifts between proxy groups for different tests without discussion and without basis, such as using the proxy group suggested at trial by Entergy for the DCF and Expected Earnings models, but using Louisiana Commission's own proxy group for CAPM analysis.[455] Entergy states that Louisiana Commission also recommends using a Risk Premium model based on state-allowed ROEs rather than the approach the Commission proposed in the *Coakley* Briefing Order. Therefore, Entergy argues that Louisiana Commission's analysis should be rejected.

239. Entergy states that no party arguing for continued reliance on the Initial Decision addresses that fact that the ROE Louisiana Commission argues for—9.01%—falls well below the 9.29% ROE level that Entergy asserts the Commission determined would not satisfy *Hope* and *Bluefield* in Opinion No. 551. Entergy notes that the Commission's determination in Opinion No. 551 applied to a time period contemporaneous with the record at issue in this proceeding. Additionally, Entergy states that no party has tried to

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[451] Louisiana Commission Initial Brief, Baudino Aff. ¶¶ 11-17.

[452] Entergy Reply Brief at 46-47.

[453] *Id.*, McKenzie Aff. at 5.

[454] *Id.* at 2.

[455] *Id.* at 24-25.

demonstrate how a 9.01% ROE result could be upheld in the Tariff while a higher ROE was simultaneously found to be unjust and unreasonable.[456]

240. Trial Staff asserts that Entergy's use of data through September 2014 is stale and not consistent with the Commission's preference to use the most recent six months of financial data in the record (i.e., June 2014 to November 2014).[457] Trial Staff asserts that if the Commission were to implement some form of the Commission's proposed methodology, then the Commission should use the median of Trial Staff's two-step DCF, CAPM analysis, and Risk Premium result, resulting in an ROE of 9.21%.[458] For the going-forward period beginning September 1, 2016, Trial Staff recommends that the Commission apply an ROE that reflects the collective riskiness of the three Entergy Operating Companies using a proxy group based on the risk profiles and credit ratings of Entergy Arkansas, Entergy Louisiana, and Entergy Texas. Trial Staff states that, in using its various adjustments to the proposed methodology, the ROE for the period beginning on September 1, 2016, should be set at 9.32%.[459]

241. New Orleans Council argues that Entergy's assertion that the Commission's rejection of the 9.39% base ROE in the ISO-NE proceeding as too low is irrelevant to this case. New Orleans Council argues that every case must be evaluated on its own factors and that "[r]ates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the 'fair value' rate base."[460]

242. New Orleans Council argues that the record in this proceeding supports the two-step DCF-derived 9.01% base ROE, recommended by the Presiding Judge.[461] New Orleans Council argues that nothing in the record suggests that this ROE would impact the Entergy Operating Companies' ability to operate successfully, maintain its financial integrity, attract capital or otherwise discharges its duties as a public utility.

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[456] *Id.* at 22.

[457] Trial Staff Reply Brief, Green Reply Aff. ¶ 52 (citing Opinion No. 551, 156 FERC ¶ 61,234 at P 18).

[458] *Id.* at 4-5 (citing Trial Staff Reply Aff. ¶¶ 79-80).

[459] *Id.* at 5-6.

[460] New Orleans Council Reply Brief at 3 (quoting *Hope*, 320 U.S. at 605).

[461] *Id.* at 3.

243. PUCT asserts that the Commission should either affirm the Initial Decision's recommendation of a 9.01% base ROE or, alternatively, affirm the Initial Decision's rationale but with an updated two-step DCF analysis as presented by Trial Staff, resulting in an ROE of 9.17%.

4. Commission Determination

244. For the reasons described above, we continue to apply the methodology adopted by the Commission in Opinion Nos. 569, 569-A, and 569-B for determining a just and reasonable ROE under FPA section 205 using a June to November 2014 study period. Our DCF analysis produces a zone of reasonableness of 7.30% to 12.21%, with the median of 9.60%. Our CAPM analysis produces a zone of reasonableness of 8.53% to 13.91%, with a median of 11.34%. Lastly, our Risk Premium analysis produces a 10.17% point estimate. In Opinion No. 569-A, the Commission stated that it would impute the average width of the zones of reasonableness from the CAPM and DCF models onto the point estimate produced by the Risk Premium model.[462] Accordingly, we imputed a zone of reasonableness of 7.59% to 12.74% from our Risk Premium analysis.

245. In Opinion No. 569-A, the Commission found substantial value in the CAPM and Risk Premium models and also found that the evidence indicates that none of the three models is conclusively superior to any other. Therefore, the Commission found that the models used in its methodology should be afforded equal weighting to fully capture the model diversity that each brings.[463] Consistent with the Commission's revised ROE methodology adopted in Opinion No. 569-A, averaging the top and bottom of the DCF, CAPM, and Risk Premium zones of reasonableness produces a composite zone of reasonableness in this proceeding of 7.81% to 12.96%. The average of the point estimate of the Risk Premium model and the medians of the CAPM and DCF models is 10.37%. Therefore, we reverse the Initial Decision and find that the just and reasonable ROE for the Tariff is 10.37%. As a result, we direct Entergy to make refunds, with interest, accordingly.

J. PPA Specific ROEs

1. Initial Briefs

246. Louisiana Commission argues that there are differences in the PPAs among the Entergy Operating Companies that render a traditional ROE analysis applicable for some, but irrelevant for others. Louisiana Commission states that the Entergy Louisiana PPAs

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[462] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 107.

[463] *Id.* PP 140-141.

were filed to take effect on September 1, 2016, after the termination of the System Agreement. Louisiana Commission asserts that the Entergy Louisiana PPAs were not effective until 16 months after the Initial Decision, which Louisiana Commission states determined a just and reasonable ROE for Entergy Arkansas. Louisiana Commission further states that, because the resources now sold pursuant to the Entergy Louisiana PPAs were sold pursuant to Service Schedule MSS-4 of the System Agreement, which contained an ROE approved by the Commission as just and reasonable, any change in this proceeding can only be effective from September 1, 2016, forward. Louisiana Commission argues that attempting to apply an ROE earlier would violate the filed rate doctrine and the rule against retroactive ratemaking.[464]

247. Louisiana Commission contends that, for four of the sales by Entergy Louisiana, the Entergy investors have no interest in the ROE set by the Commission. Louisiana Commission states that these include: (1) the sale to Entergy Texas of a portion of a 70% share of the River Bend nuclear unit (River Bend 30); (2) the sale to Entergy Texas from the Perryville generating unit; (3) a "slice of system" sale to Entergy New Orleans from generating units that served the Algiers section of New Orleans when service to that area was provided by Entergy Louisiana; and (4) the sale from the Ninemile generating unit to Entergy New Orleans. According to Louisiana Commission, investors will not earn the ROE established by the Commission because Louisiana Commission employs the "revenue credit" methodology for retail ratemaking concerning those wholesale sales, which, according to Louisiana Commission, means that the only parties with an interest in the ROE are consumers. Louisiana Commission further states that, for Louisiana retail ratemaking, all the generating plant, except a 30% share of River Bend 30, is included in the retail rate base, Louisiana Commission sets the ROE that the utility earns on all of the plant, and the revenues received for the sales are credited against the retail revenue requirement.[465]

248. Louisiana Commission states that, if the revenues contain a higher ROE than the retail allowance, the selling company's ratepayers will benefit, investors will not, and the buying company's consumers will pay rates that provide a subsidy. In the alternative, Louisiana Commission states that, if the ROE for the sales is lower, the selling company's ratepayers must make up the difference, the utility is indifferent, and the buying company's ratepayers receive a benefit. Louisiana Commission asserts that, for each buying company, the PPA costs are simply passed through to consumers and do not affect the rate of return paid on the buying company's rate base because the payments made by the buying companies cancel with the receipts of the seller from the perspective of Entergy, resulting in zero effect on Entergy's earnings. According to Louisiana

[464] Louisiana Commission Initial Brief at 1-2, 18-19.

[465] *Id.* at 2-3, 8.

Commission, for those four contracts, investors can only earn the ROE established by the retail regulator and, therefore, investors are indifferent to the ROE established by the Commission.[466]

249. Louisiana Commission provides an example with the assumptions that the Commission determined that a 20% ROE is necessary to attract capital and established that ROE for the four PPAs, Louisiana Commission determined that a 9.8% ROE is just and reasonable and the PUCT found that a 10.2% ROE is just and reasonable. According to Louisiana Commission, Entergy Louisiana would earn a 9.8% ROE on the assets devoted to the sale to Entergy Texas, Entergy Texas would earn 10.2% on its equity in its rate base, but Entergy Texas ratepayers would pay an ROE of 20% of the purchase, which would be credited to Louisiana retail rates. Louisiana Commission argues that the Entergy Texas ratepayers would pay a significantly higher ROE than the investors realize and that the Entergy Louisiana customers would pay significantly less.[467]

250. Louisiana Commission asserts that, if the Commission were to set the ROE based on cost-of-capital concepts for the four Entergy Louisiana "revenue credit" PPAs, it would only accomplish discriminating among ratepayers, with no cost of capital impact on investors. Louisiana Commission argues that the Commission is obliged under the FPA to set rates that avoid undue discrimination and the best approach to minimize discrimination is to use the average ROE allowed in the selling and buying retail jurisdictions. Louisiana Commission notes that these PPAs are long-term, life of unit contracts and argues that the discrimination will continue for the long term if the Commission determines an ROE using traditional methods. Louisiana Commission argues that its proposed technique of averaging the ROEs in the selling and buying jurisdictions for the sales from the units that are included in the retail rate base is similar to the method the Commission employed for the System Agreement Bandwidth Tariff, which used the average ROEs in the affected jurisdictions.[468] Louisiana Commission contends that this precedent is important because it affected almost all of the generating units in the Entergy System.[469]

251. Louisiana Commission argues that there are other significant differences for the Entergy Louisiana PPAs that are in the retail rate base including that the units were planned to serve the buying and selling jurisdictions and that the ROEs for the units were

[466] *Id.* at 3.

[467] *Id.* at 11-12.

[468] *Id.* at 7, 12 (citing *La. Pub. Serv. Comm'n v. Entergy Servs., Inc.*, 119 FERC ¶ 61,095 (2007)).

[469] *Id.* at 6-7.

set by the retail regulators. Louisiana Commission further argues that the PPAs are the result of corporate reorganizations and are devices to allocate the costs between jurisdictions and function to mimic a joint ownership structure. Louisiana Commission asserts that the same cannot be said for the Entergy Arkansas sales or River Bend 30 because the units were not meant to be shared by the Entergy Operating Companies. Additionally, Louisiana Commission claims that the Entergy Arkansas PPA does affect investors because the resources are not in the retail rate base and the revenues are not credited against the retail revenue requirement. Louisiana Commission also states that the River Bend 30 resource was historically unregulated and investors benefit from the sales under the River Bend 30 PPA. Therefore, Louisiana Commission asserts that investors earn the Commission-authorized ROE and traditional cost-of-capital methodologies should apply. Louisiana Commission further argues that Entergy Arkansas can no longer be considered a "sister" of the other Entergy Operating Companies because it withdrew from the System Agreement in 2013 and there is no longer an Entergy System that includes Entergy Arkansas. Therefore, Louisiana Commission contends that a "generic" rate of return no longer applies to Entergy Arkansas or the River Bend 30.[470]

252. Louisiana Commission contends that for, the Entergy Arkansas PPAs, the ROE methodology deemed just and reasonable by the Commission should be employed, but Louisiana Commission asserts that it would be inappropriate to retroactively apply a new methodology to a case filed five years earlier. Louisiana Commission further asserts that the DCF method has not been proven inaccurate for those PPAs and the Commission should affirm the ROE from the Initial Decision. However, Louisiana Commission states that, if the Commission decides to apply its proposed methodology, it should adopt a 9.5% ROE, based on Louisiana Commission's analysis. Additionally, Louisiana Commission states that it takes no position on the ROE for the River Bend 30 PPA, but states that, for consistency, it would be reasonable to apply the same ROE as is applied to the Entergy Arkansas PPAs.[471]

2. <u>Reply Briefs</u>

253. Entergy states that the ROE established in this proceeding is used in a single formula rate that applies to all sales under the Tariff and that, therefore, the ROE should be uniform for all such sales. Entergy argues that this result is consistent with the Tariff itself, the settlement and hearing orders that brought about this proceeding, and with Commission policy. Entergy contends there is no basis to follow Louisiana

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[470] *Id.* at 3-6.

[471] *Id.* at 17-18.

Commission's approach and begin a contract-by-contract and customer-by-customer analysis of what ROE should apply.[472]

254. Entergy argues that Louisiana Commission's focus on contract-by-contract analysis of different PPAs is fundamentally at odds with Commission precedent and inconsistent with the nature of the umbrella sales tariff at issue in this proceeding. Entergy explains that that umbrella tariff here contains a standard formula rate that is used to determine the monthly charges for each PPA that is under the tariff and that the sole purpose of this proceeding is to set the one ROE for that formula rate for all of the sales made among the companies that contracted pursuant to the Tariff.[473] Entergy states that Louisiana Commission's attempt to set a new ROE for each PPA based on state commission rulings finds no support in the Tariff or in Commission precedent.[474]

255. Entergy explains that the Tariff was designed to govern sales to and purchases from any of the Entergy Operating Companies that left the System Agreement, given that those companies could no longer transact under the previous umbrella tariff that they had used. Entergy notes that section 3.01 of the Tariff states "[t]he purpose of this Tariff is to provide the basis for making a unit power purchase between the Companies and/or the sale of power purchased between the Companies. A company may be the seller or purchaser under this Tariff."[475] According to Entergy, the Commission confirmed in the Hearing Order that the Tariff would "govern any new agreements for capacity and energy sales between Entergy Arkansas and the other Entergy Operating Companies and sales between other Entergy Operating Companies if and when they withdraw from the System Agreement."[476] Entergy argues that this means that the Commission's determination of the ROE for the Tariff necessarily sets the ROE for each PPA thereunder and not, as Louisiana Commission proposes, separate ROEs for each Entergy Operating Company that is a seller under those PPAs.[477]

256. Entergy states that Louisiana Commission agreed that the ROE would be uniform when it signed the Settlement Agreement in this proceeding. Entergy states that section II of that Settlement Agreement provides that the Tariff "will be used for the

[472] Entergy Reply Brief at 2-3.

[473] *Id.* at 5.

[474] *Id.* at 5-6.

[475] *Id.* at 6.

[476] *Id.* at 6-7 (citing Hearing Order, 145 FERC ¶ 61,216 at P 3).

[477] *Id.* at 7.

existing agreements for sales and purchases of energy and capacity between Entergy Arkansas and the other Entergy Operating Companies to the extent applicable and for any new transactions if and when other Entergy Operating Companies depart from the System Agreement."[478] Entergy notes that the Presiding Judge reiterated this statement in certification of the Settlement[479] and that the Commission did so as well in its order approving the Settlement.[480] Entergy states that Louisiana Commission's attempt to claim now that the Tariff does not apply to all sales directly contradicts the agreement that Louisiana Commission signed.

257. Entergy states that Louisiana Commission agreed "that the Sales and Purchases Tariff and all of the formula rates therein, effective December 19, 2013, will be the as-filed tariff and rates contained in Entergy's tariff filing, except for the input for ROE in the monthly capacity charge"[481] Entergy states that, if Louisiana Commission took issue with this construct or any part of the Tariff except for the single ROE input, Louisiana Commission had the opportunity to raise such challenge in the settlement process and, having failed to do so, Louisiana Commission is bound by section 2 of the Settlement Agreement, which expressly provides that once the Commission approved the Settlement Agreement "any and all issues with respect to the [Tariff] that were raised or could have been raised in this proceeding will be resolved with finality," and the issue of a uniform ROE in the Tariff has therefore been resolved.[482]

258. Entergy states Louisiana Commission's arguments for varied ROEs also fail because they are inconsistent with two lines of Commission precedent. Entergy explains that the Commission has rejected the approach taken by Louisiana Commission as a matter of policy, finding that customer-to-customer and contract-by-contract ROEs are "not appropriate."[483] Entergy goes on to explain that the Commission stated that there is

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[478] *Id.* (citing Entergy Services, Inc, Offer of Settlement, ER13-1508, et al. (filed June 12, 2014)).

[479] *Id.* (citing *Entergy Ark., Inc.*, 148 FERC ¶ 63,005, at P 7 (2014)).

[480] *Id.* (citing Partial Settlement Agreement, 148 FERC ¶ 61,178 at P 2).

[481] *Id.* at 8 (citing Entergy Services, Inc, Offer of Settlement, ER13-1508, et al. at 3 (filed June 12, 2014)).

[482] *Id.* (citing *Entergy Ark., Inc.*, 148 FERC ¶ 63,005 at P 7).

[483] *Id.* (citing *Conn. Light & Power*, 43 FERC ¶ 61,508 at 62,266 ("We find, as a matter of policy, that it is not appropriate to establish differentiated rates of return on equity to be applied to individual customers based upon the risks that a utility may face under its contracts with those customers.")).

no precedent to support a discrete allowed equity return on a service-by-service or customer-by-customer basis, because an investor is not going to invest in a utility based on only one of the contracts; the investor would look at the company as a whole when deciding whether or not to invest.[484]

259. Additionally, Entergy argues, Louisiana Commission's argument would require the Commission to defer to state ratemaking decisions. Entergy states that, with respect to the four of the PPAs under which Entergy Louisiana is the seller, Louisiana Commission argues that the ROE should be "the average ROE allowing in the selling and buying jurisdictions" because "the ROE they earn is established by [Louisiana Commission], with the receipts from power sales flowing directly into consumer rates," so capital attraction or comparable earnings methods are irrelevant in such circumstances.[485] Entergy states that the proposal is contrary to the Commission's precedent.

260. Entergy states that, under the FPA, the Commission "has exclusive jurisdiction over [a utility's] wholesale power sales rates," and therefore has "no legal obligation to review, much less rely upon, the findings by [a state commission]."[486] Entergy states that the Commission's authority to decide issues concerning a company's wholesale rates is not constrained by the jurisdictions of state commissions over that same company's retail rates and that, while state ROEs can be used by the Commission to inform its decisions, a ratemaking methodology proposed at the retail level does not govern the Commission's determination of the appropriate ratemaking methodologies to be used in developing wholesale rates.[487]

261. Entergy argues that Louisiana Commission's proposal would create undue discrimination among the sellers and buyers. Entergy states that, under Louisiana Commission's approach, when customers would be buying from Entergy Arkansas, the ROE they would pay would be 9.01%, but when buying from Entergy Louisiana under

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[484] Entergy Reply Brief at 8-9 (citing *Conn. Light & Power*, 43 FERC ¶ 61,508 at 62,266; *S. Co. Servs., Inc*., 60 FERC ¶ 63,013 at 65,165-66 (1992), *opinion and order on initial decisions*, Opinion No. 427, 84 FERC ¶ 61,266 (1998), *reh'g denied*, Opinion No. 427-A, 87 FERC ¶ 61,097 (1999)).

[485] Entergy Reply Brief at 9 (citing Louisiana Commission Initial Brief at 6, 9).

[486] *Id.* (citing *Barton Vill., Inc. v. Citizens Utils. Co*., 100 FERC ¶ 61,244, at P 12 (2002), *rev'd on other grounds sub nom. Barton Vill., Inc. v. FERC*, 106 F. App'x 88 (2d Cir. 2004)).

[487] *Id.* at 9-10 (citing *La. Pub. Serv. Comm'n v. Entergy Servs., Inc*., 76 FERC ¶ 61,168, at 61,955 (1996)).

the same Tariff, the ROE would be as high as 10.5%. Entergy claims that this means that Louisiana Commission wants Louisiana retail customers to receive a higher offset in their retail bills for sales made under the Tariff, while paying as low of an ROE as possible for purchases.[488] Entergy states that such dissimilar treatment would be arbitrary and capricious and that it finds no support in Commission law. Entergy states that a rate design that creates an undue disparity between the rates of return on sales to different groups of customers or that assign different rates to customer classes which are similarly situated may be found to be discriminatory.[489] Entergy states that Louisiana Commission proposes that different customer groups pay very different ROEs depending on who they were transacting with, only because in some cases Entergy investors care and in other cases those investors do not care.[490]

262. Entergy disputes Louisiana Commission's argument that a single uniform ROE is not permissible because, when the case was filed, some of the sales were not yet under the Tariff. Entergy contends that this argument ignores that the Commission regularly sets ROEs, among other rates, for sales that may occur well into the future.[491] Entergy notes that in *Kanstar Transmission, LLC*, the Commission made it clear that the "ROE that is determined through the hearing and settlement judge procedures that have been ordered herein for Kanstar" would apply to future formula rates for Kanstar's affiliates, including entities that had not yet been formed.[492] Entergy states that the nature of umbrella tariffs is that sales under the tariff will occur at different times and that it would defeat the purpose of an umbrella tariff if the Commission reexamined the general rates and terms every time a new sale is made. Entergy states that, until the ROE established for this umbrella tariff is modified, either through FPA section 205 or section 206, there is no basis to claim that the ROE must be re-litigated for each new sale made under the Tariff.[493]

263. Trial Staff disagrees with Louisiana Commission and asserts that the ROE in the Tariff should not look to the state average ROEs for several reasons. First, Trial Staff

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[488] *Id.* at 10.

[489] *Id*. at 11.

[490] *Id.*

[491] *Id.* (citing Louisiana Commission Brief at 17-18).

[492] *Id.* at 11-12 (citing *Kanstar Transmission, LLC*, 152 FERC ¶ 61,209 (2015), *order denying reh'g*, 155 FERC ¶ 61,167 (2016), *aff'd sub nom. Kan. Corp. Comm'n v. FERC*, 881 F.3d 924 (D.C. Cir. 2018)).

[493] *Id.* at 12.

contends that the Commission has repeatedly declined to establish electric utilities' ROEs based on state-authorized ROEs. Trial Staff states that state commission ROEs apply to state-regulated electric distribution assets and that those ROEs are established at different times in different jurisdictions using different policies, standards, and methodologies in setting rates. Additionally, Trial Staff states that revenue crediting may not always exist. Second, Trial Staff avers that Louisiana Commission's argument is a collateral attack on the Commission's jurisdiction because it appears that Louisiana Commission is suggesting that the Commission cede its authority to retail rate regulators even though the Tariff is under the Commission's jurisdiction. Trial Staff argues that the Commission is tasked with making an independent determination and would not be able to satisfy the *Hope* and *Bluefield* requirements without an independent analysis of market conditions to make sure that the ROE is set to a level sufficient to attract investment in interstate electric transmission. Third, Trial Staff asserts that the System Agreement Bandwidth Tariff is different from the Tariff because it applies to provisions of a rate schedule prescribing the basis for allocating and pricing exchange energy. Trial Staff states that the Commission did not include any analysis on the ROE when addressing the issues related to cost allocations and whether certain costs should be adjusted when comparing the production costs among the Entergy Operating Companies.[494]

264. However, Trial Staff supports Louisiana Commission's approach to have one ROE for the period from December 19, 2013, to September 1, 2016, that reflects the riskiness of Entergy Arkansas as the only seller under the Tariff during that period and another ROE from September 1, 2016, going forward that reflects the collective riskiness and expanded credit range of Entergy Arkansas, Entergy Louisiana, and Entergy Texas because Entergy Louisiana and Entergy Texas began making sales under the Tariff on that date. However, Trial Staff asserts that the record does not contain data relating to the six months surrounding the September 1, 2016, time period.[495]

265. Trial Staff states that the first time period (reflecting the riskiness of Entergy Arkansas alone) could be based on the findings by the Presiding Judge in the Initial Decision and that the Commission could affirm the Initial Decision's finding of an ROE of 9.01% based on the DCF model. Trial Staff states that, in the alternative, the Commission could rely on the data provided in Louisiana Commission's briefs submitted to the Presiding Judge or Entergy's initial briefs and affidavits pursuant to the Briefing Order, which use proxy groups based only on the riskiness of Entergy Arkansas. Trial Staff states that it has provided an updated analysis including the Commission's proposed methodology with certain adjustments if the Commission determines that it is appropriate to use the proxy group used in the Initial Decision. Trial Staff asserts that, if the

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[494] Trial Staff Reply Brief at 18-20.

[495] *Id.* at 3-4.

Commission were to implement some form of the Commission's proposed methodology, it should use the median of Trial Staff's two-step DCF and CAPM analysis, and the Risk Premium result, which results in an ROE of 9.21%.[496] For the going-forward period beginning September 1, 2016, Trial Staff recommends that the Commission apply an ROE that reflects the collective riskiness of the three Entergy Operating Companies using a proxy group based on the risk profiles and credit ratings of Entergy Arkansas, Entergy Louisiana, and Entergy Texas. Trial Staff states that using its various adjustments to the proposed methodology, the ROE for the period beginning on September 1, 2016, should be set at 9.32%.[497]

266. PUCT disagrees with Louisiana Commission's approach for establishing ROEs for sales under the Tariff when the seller is an Operating Company other than Entergy Arkansas.[498] PUCT states that Louisiana Commission is proposing a "technique of averaging the ROEs in the selling and buying jurisdictions for the sales from the units that are included in retail rate base" and argues that this approach would substantially depart from the Commission's established methodology for setting wholesale rates.[499] PUCT argues that, contrary to Louisiana Commission's claims, its proposed approach would not mitigate the alleged discrimination that would occur as a consequence of the differential between the Commission-approved ROE and the ROE allowed by the state regulator for purposes of retail ratemaking. PUCT adds that the Tariff is substantially similar to the Entergy System Agreement's Service Schedule MSS-4, for which a Commission-based ROE already exists.

267. PUCT disputes Louisiana Commission's claim that Entergy Arkansas investors earn a Commission-authorized ROE because Entergy Arkansas PPA resources are not in the retail rate base and the revenues are not credited against the retail revenue requirement.[500] PUCT argues that Louisiana Commission's approach is flawed because, as a practical matter, Entergy Louisiana not only buys from Entergy Arkansas and Entergy Texas but also sells to both; therefore, PUCT claims, this would lead to Entergy Louisiana, at least with respect to the Entergy Arkansas PPAs, to pay a lower ROE as a buyer and collect a higher ROE as a seller. PUCT argues that this proposal is not

[496] *Id.* at 4-5 (citing Trial Staff Reply Aff. ¶¶ 79-80).

[497] *Id.* at 5-6.

[498] PUCT Reply Brief at 15.

[499] *Id.* at 15-16 (quoting Louisiana Commission Initial Brief at 7-13).

[500] *Id.* at 16-17.

relevant to the Commission's traditional two-step DCF or any other Commission methodologies.

3. Commission Determination

268. We are unpersuaded by arguments that there should be an ROE from the period spanning December 19, 2013, to September 1, 2016, reflecting when Entergy Arkansas began making sales under the Tariff, and a different ROE from September 1, 2016, going forward, reflecting when Entergy Louisiana and Entergy Texas joined. As noted above, any of the six Entergy Operating Companies may make purchases or sales pursuant to the Tariff. Additionally, a finding that there should be two different ROEs would be inconsistent with our finding above that it is appropriate to base the ROE on the risk profiles of all six Entergy Operating Companies. As Entergy notes, the nature of umbrella tariffs is that sales under the tariff will occur at different times and doing so would undermine the primary benefit of umbrella tariffs, including that "such tariffs give the selling utility the flexibility to respond to market opportunities while satisfying its obligation to have its rate on file" and "provid[e] the industry with assistance in meeting the filing requirements of the FPA and our regulations."[501] Moreover, as Entergy notes, in the Hearing Order the Commission explained that the Tariff would "'govern any new agreements for capacity and energy sales between Entergy Arkansas and the other Operating Companies, *and sales between other Operating Companies if and when they withdraw from the System Agreement*.'"[502] Accordingly, the Commission's determination in this proceeding of the ROE for the Tariff necessarily sets the ROE for each PPA for sales under the Tariff because the Tariff, including the applicable ROE, governs sales between the Operating Companies after withdrawal from the System Agreement and sales made pursuant to the PPAs are such sales. Therefore, we find that only one ROE should apply to the Tariff beginning on December 19, 2013.

269. Louisiana Commission's argument that applying an ROE earlier than September 1, 2016, violates the filed rate doctrine and rule against retroactive ratemaking is incorrect because Entergy Arkansas withdrew from the System Agreement, which contained Service Schedule MSS-4 and the associated ROE, and began making sales under the Tariff effective December 19, 2013. As noted above, the Tariff was established to ensure that the six then-existing Service Schedule MSS-4 transactions in which Entergy Arkansas is obligated to sell capacity and energy to the other Entergy Operating Companies would continue after Entergy Arkansas's withdrawal. Accordingly, it is

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[501] Entergy Reply Brief at 12 n.40 (citing *Prior Notice and Filing Requirements Under Part II of the Fed. Power Act*, 64 FERC ¶ 61,139 at 61,983).

[502] *Id.* at 6-7 (emphasis in original) (quoting Hearing Order, 145 FERC ¶ 61,216 at P 3).

consistent with the filed rate doctrine and the rule against retroactive ratemaking to make the ROE for the Tariff effective as of the date that sales under the Tariff began.

270. For the same reasons provided above, we reject Louisiana Commission's proposal to use an average of the state-authorized ROEs in the selling and buying retail jurisdictions because determining an ROE specific to each PPA would undermine the benefits of an umbrella tariff. As Entergy correctly notes, in Opinion No. 305, the Commission found that it is not appropriate to establish differentiated rates of ROE to be applied to individual customers based upon the risks that a utility may face under its contracts with those customers.[503] Additionally, we find that the record evidence supports the continued application of a single ROE to wholesale rates within the Tariff, regardless of the seller or buyer, similar to the transactions previously made under the Schedule Service MSS-4. As Trial Staff notes, the Commission has repeatedly rejected basing such rates on state-authorized ROEs and we continue to do so here.[504] We are unpersuaded by Louisiana Commission's argument that a generic rate of return should not apply to Entergy Arkansas because it is no longer a "sister" to the Entergy Operating Companies due to its withdrawal of the System Agreement in 2013. We find this argument unavailing because this proceeding involves the Tariff, under which unit power purchases and/or power sales may be made between any of the Entergy Operating Companies, including Entergy Arkansas after withdrawal from the System Agreement.

271. Lastly, we find that Louisiana Commission's reliance on *Louisiana Pub. Serv. Comm'n v. Entergy Servs., Inc.* is misplaced because the System Agreement Bandwidth Tariff at issue in that case is distinguishable from the Tariff at issue here. While the Tariff is similar to Service Schedule MSS-4 of the System Agreement, the System Agreement Bandwidth Tariff applies to provisions of Service Schedule MSS-3. As discussed above, the Tariff establishes a general rate schedule for making unit power purchases and/or power sales between any of the Operating Companies, while the System Agreement Bandwidth Tariff relates to allocating and pricing Exchange Energy on an after-the-fact, hourly basis. In Opinion No. 519, the Commission explained that the bandwidth formula, which is designed and implemented to roughly equalize total production costs among the Entergy Operating Companies, is distinct from a traditional wholesale rate, and, therefore, the Commission's ratemaking decision regarding a

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[503] *Conn. Light & Power*, 43 FERC ¶ 61,508 at 62,266.

[504] Opinion No. 531, 147 FERC ¶ 61,234 at P 148 (citing *Middle S. Servs., Inc.*, Opinion No. 124, 16 FERC ¶ 61,101, at 61,221 (1981); *see also Boston Edison Co.*, Opinion No. 411, 77 FERC ¶ 61,272, at 62,171-72 (1996); *Jersey Cent. Power & Light Co.*, Opinion No. 408, 77 FERC ¶ 61,001, at 61,002 (1996)).

bandwidth issue should not apply in this instance.[505] We find no basis in the record to support Louisiana Commission's assertion that whether investors have an interest in the ROE set by the Commission should determine whether ROEs should vary depending on the contract.

K. State Commission Authorized ROEs

1. Brief on and Opposing Exceptions

272. Entergy states that it provided a meaningful evaluation of state-allowed ROEs, finding that at no point during the 40-year period from 1974 to 2013 did the average state-allowed ROEs for electric utilities fall into single-digits, and that they averaged 10.16% from 2010 through the third quarter of 2014.[506] Entergy also notes that, since 2010 only three ROEs fell in the 8% to 9%% range, and these lower ROEs were approved in connection with revised rate structures and/or ROE penalties.[507]

273. Trial Staff asserts that the state ROEs in the record are not high enough to corroborate Entergy's recommended placement of the ROE at 10.34%, the midpoint of the top half of Entergy's zone of reasonableness.[508] Trial Staff claims that Entergy's state ROE study is in the context of a risk premium analysis and "implies a current cost of equity for electric utilities of 10.13%." Further, Trial Staff points out that in *Coakley*, the Commission considered state ROEs from the most recent 24-month period that overlaps the data period, and in this record the Regulatory Research Associates January 15, 2015 report shows electric utility ROEs for the last two full years as being 10.02% for 2013 and 9.92% for 2014, or an average of 9.97%.[509]

2. Commission Determination

274. The Commission has repeatedly held that it does not establish utilities' ROE based on state commission-approved ROEs for state-regulated electric distribution assets because those ROEs are "established at different times in different jurisdictions which

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[505] *La. Pub. Serv. Comm'n v. Entergy Corp.,* Opinion No. 519, 139 FERC ¶ 61,107, at PP 42, 112 (2012).

[506] Entergy Brief on Exceptions at 42 (citing Ex. ESI-123 at 6:13-15).

[507] *Id*. (citing Ex. ESI-123 at 7:3-5).

[508] Trial Staff Brief Opposing Exceptions at 30.

[509] *Id.* (citing Ex. S-9 at 3).

use different policies, standards, and methodologies in setting rates."[510] We again decline to adopt a policy that establishes Commission-jurisdictional ROEs based on state commission-approved ROEs. The Commission found in Opinion No. 569 that it would only consider state-authorized ROEs on a case-by-case basis to the extent that they demonstrate that the results of the models that the Commission utilizes are substantially excessive or deficient. It clarified that it did not expect that the Commission would regularly consider state-authorized ROEs, but rather that they would merely serve as a check given the model risk as the Commission formulates its ROE determinations.[511] The state-authorized ROEs in the record here do not indicate that the results of the Commission's ROE analysis are substantially excessive or deficient. The methodology from Opinion No. 569, as modified by Opinion Nos. 569-A and 569-B, as applied here, produces a composite zone of reasonableness of 7.81% to 12.96%. The average of the point estimate of the Risk Premium model and the medians of the CAPM and DCF models is 10.37%, which is 21 basis points above the 10.16% average for all state commission-approved ROEs from 2010 through the third quarter of 2014.[512] We find that the state commission-authorized ROEs in the record here do not demonstrate that the 10.37% base ROE result of the Commission's ROE analysis is substantially excessive or deficient and we therefore find they do not provide a basis for changing those results.

L. Anomalous Capital Market Conditions

1. Initial Decision

275. The Presiding Judge found that a direct application of the DCF methodology in this case, which produces an ROE of 9.01%, is consistent with *Hope* and *Bluefield*.[513] The Presiding Judge found that, unlike in Opinion No. 531, where the Commission placed the base ROE in the upper half of the zone of reasonableness because the record showed that unusual capital market conditions affected investors' required rate of return, the record evidence in this proceeding does not demonstrate that unusual capital market conditions exist.[514] The Presiding Judge stated that Opinion No. 531 did not intend to "mark a new period of 'anomalous conditions' during which all ROE's would benefit

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[510] Opinion No. 124, 16 FERC ¶ 61,101 at 61,221; *see also* Opinion No. 411, 77 FERC ¶ 61,272 at 62,171-72; Opinion No. 408, 77 FERC ¶ 61,001 at 61,002; Opinion No. 531, 147 FERC ¶ 61,234 at P 148.

[511] Opinion No. 569, 169 FERC ¶ 61,129 at P 363.

[512] Entergy Brief on Exceptions at 42 (citing Ex. ESI-123 at 6:13-15).

[513] Initial Decision, 151 FERC ¶ 63,008 at P 84.

[514] *Id.*

from an upward adjustment."[515] Rather, the Presiding Judge explained that Opinion No. 531-B made clear that any such adjustment would be made on a case-by-case basis.[516] The Presiding Judge found that a concurring statement in Opinion No. 531-B made it apparent that a utility seeking such an adjustment "must meet a high burden of proof."[517]

2. Briefs on and Opposing Exceptions

276. Entergy argues that the Initial Decision erred in finding that Entergy failed to meet its burden to demonstrate that the anomalous market conditions cited in Opinion No. 531 affected the expectation of Entergy Arkansas' investors.[518] Specifically, Entergy contends that the Initial Decision erred in finding that Entergy needed "to show that a unique environment specifically impacts" Energy Arkansas and its investors, as allegedly required under Opinion No. 531. Entergy contends that the anomalous market conditions identified in Opinion No. 531 are not unique to specific regions, sets of investors, or tariffs. Rather, according to Entergy, they affect the DCF analysis used to determine an ROE for Entergy's electric generation business in the same manner that they affected the DCF analysis for New England electric transmission owners, whose tariff was at issue in *Coakley*. Entergy contends that the Commission had already cited favorably the same market analysis that Entergy undertook in this proceeding. Specifically, Entergy states that the Commission rejected claims in Opinion No. 531-A that the same analyst reports cited by the Initial Decision contradicted the finding that a base ROE of 9.38% in that proceeding "could undermine the [New England transmission owners'] ability to attract capital."[519]

277. Trial Staff avers that the Presiding Judge correctly found that Entergy failed "to analyze the impact on this Tariff in particular," and further failed to calibrate its proxy group to reflect "that the rates at issue relate to guaranteed, life-of-plant unit power sales contracts that only entail counterparty risk and are therefore less risky than the risk of

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[515] *Id.* P 85.

[516] *Id.*

[517] *Id.*

[518] Entergy Brief on Exceptions at 12-13 (citing Initial Decision, 151 FERC ¶ 63,008 at P 84).

[519] *Id*. at 14 (citing Opinion No. 531-B, 150 FERC ¶ 61,165 at P 51).

distribution that is typically compensated for in state authorized ROEs, where there exists no guarantee of payment for the life of the assets."[520]

278. Louisiana Commission states that Entergy's proposal reflected an "upward adjustment" to the ROE, in the absence of evidence showing that economic conditions distorted the DCF analyses, or that unusual risk requires a higher ROE for Entergy Arkansas.[521] Louisiana Commission asserts that Entergy's proposal lacks any empirical evidence to support it. Moreover, Louisiana Commission avers that Entergy failed to present any evidence as to how economic conditions distort any aspect of the DCF analysis.

279. Louisiana Commission states that the anomalous conditions that the Commission found in Opinion No. 531 are no longer present and presents evidence of economic stabilization.[522] Louisiana Commission explains that the Commission did not find that anomalous capital market conditions alone justified an increase in the ROE, but rather anomalous circumstances plus investor perception of special risks of transmission investment and policy objectives may justify an upward adjustment.[523] Louisiana Commission states that, unlike the transmission owners in Opinion No. 531, Entergy did not show heightened investor perception of risk associated with the generating units and transactions at issue here, and that Entergy made only a passing two-line reference to "the very real risks associated with the ownership of generating assets used to produce the power sales," without identifying what those risks are or providing any evidence of how Entergy investors perceive them.[524]

280. New Orleans Council contends that the Presiding Judge correctly rejected Entergy's argument that it is necessary to set the ROE at a point above the median in this case. New Orleans Council asserts that *Bluefield* requires the ROE to be based on the particular circumstances of the case, but that Entergy did not base its ROE recommendations on the specific circumstances of the Tariff.[525] New Orleans Council argues that Entergy: (1) conducted no analysis of the risks associated with the Tariff or

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[520] *Id.* at 14 (citing Initial Decision, 151 FERC ¶ 63,008 at P 90; Ex. S-4 64:15-19).

[521] *Id.* at 2.

[522] *Id.*

[523] *Id.* at 64 (citing Opinion No. 531, 147 FERC ¶ 61,234 at PP 145, 149).

[524] *Id.* (citing Ex. ESI-120 at 26).

[525] New Orleans Council Brief Opposing Exceptions at 13.

the contracts thereunder; (2) had no specific knowledge of about Entergy's generating units; and (3) had no knowledge of Entergy's corporate structure, stock, cash flow, or costs.[526]

3. Initial Briefs

281. PUCT states that the Presiding Judge found that Entergy did not meet its burden under Opinion No. 531 to demonstrate it has been impacted by anomalous market conditions.[527] PUCT argues that there is no need to depart from the Presiding Judge's findings to apply the Commission's proposed new methodology and that awarding Entergy a 9.01% base ROE would be adequate for Entergy's financial integrity, capital attraction standards, and Entergy's declining risks in both the credit and capital markets.

4. Commission Determination

282. We decline to address arguments related to whether anomalous capital market conditions are present and whether the presence of anomalous capital market conditions impacts which methodologies should be used in determining Entergy's ROE because those arguments are moot. 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 were of average risk and the Commission ordinarily sets the ROE of average risk utilities at the central tendency of the overall zone of reasonableness.

283. However, the Commission revised its ROE methodology in Opinion Nos. 569 and 569-A to adopt additional models, as discussed above, which mitigates our concern that the applicable measure of central tendency of the zone of reasonableness accurately reflects the equity returns necessary to meet *Hope* and *Bluefield*. As the Commission explained in Opinion No. 569, our revised approach to determining just and reasonable ROEs involves averaging the results of multiple 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. It does not involve making an adjustment above the central tendency of the zone of reasonableness based on the presence of anomalous capital market conditions as the Commission did in Opinion Nos. 531 and 551. Instead,

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[526] *Id.* at 13-14 (citing Tr. 37:11-38.25, 39:15-41:25, 42:1-21, 43:3-17, 43:14-45:2, 47:15-48:1, 48:2-13, 49:13, 111:14, 118:9-119:8, 127:13-129:2; Ex. ESI-120 at 6:2, 26:14-17).

[527] PUCT Initial Brief at 6-7.

adjustments to the ROE are based on the risk profile of the utility in question.[528] Therefore, the Commission stated that there was no need to find that anomalous 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.[529] The use of three distinct models mitigates against specific market conditions adversely affecting the performance of individual models and thereby resulting in an unreasonable ROE. In particular, the Commission explained that whether a change in capital market conditions is anomalous or persistent is of little importance under the Commission's revised ROE methodology, because relying on multiple financial models makes it more likely that the Commission's decision will accurately reflect how investors are making their investment decisions.[530] As discussed above, we find that this revised methodology should be applied in this proceeding and therefore, we find that arguments in this proceeding regarding the existence of anomalous market conditions, including whether a party has demonstrated the existence or absence of anomalous market conditions, are moot.

IV. Conclusion

284. As discussed above, we reverse the Initial Decision and find that, based on the record evidence, the just and reasonable ROE for the Operating Companies in the Tariff is 10.37%, as discussed above. Accordingly, we require Entergy to adopt a 10.37% base ROE in the Tariff effective December 19, 2013. We direct Entergy to submit a compliance filing within 30 days of the date of this order revising the Tariff to reflect a 10.37% base ROE. We also direct Entergy to submit a refund report within 30 days of the date of this order quantifying refunds associated with the ROE in the Tariff. Finally, we direct Entergy to provide refunds based on that 10.37% base ROE, with interest, accordingly.

The Commission orders:

(A) The Initial Decision is reversed, as discussed in the body of this order.

(B) The base ROE for the Tariff is set at 10.37%, effective as of December 19, 2013, as discussed in the body of this order

(C) Entergy is directed to submit a compliance filing within 30 days of the date of this order revising the Tariff to reflect a 10.37% base ROE, as discussed in the body of this order.

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[528] Opinion No. 569-A, 171 FERC ¶ 61,154 at P 194.

[529] Opinion No. 569, 169 FERC ¶ 61,129 at P 170.

[530] *Id.* P 171.

(D) Entergy is hereby directed to provide refunds, with interest calculated pursuant to 18 C.F.R. § 35.19a (2020), within 30 days of the date of this order, for the period beginning with the effective date of December 19, 2013.

(E) Entergy is directed to submit a refund report within 30 days of the date of this order quantifying refunds associated with the ROE in the Tariff, as discussed in the body of this order.

By the Commission. Commissioner Clements is dissenting with a separate statement attached.
Commissioner Christie is concurring with a separate statement attached.

(S E A L)

Kimberly D. Bose,
Secretary.

Appendix I: Risk Premium Results

Risk Premium Model Results

Current Equity Risk Premium	Result
Average Yield Over Study Period	6.25%
Baa Utility Bond Yield	4.71%
Change in Bond Yield	-1.54%
Risk Premium/Interest Rate Relationship	-0.7263
Adjustment to Average Risk	1.12%
Average Risk Premium over Study Period	4.34%
Adjusted Risk Premium	**5.45%**

Implied Cost of Equity	
Baa Utility Bond Yield	4.71%
Adjusted Equity Risk Premium	5.46%
Risk Premium Cost of Equity	**10.17%**

Risk Premium Model Inputs

Docket Number	Utility	Test Period	Base ROE	Baa Bond Yield	Implied Risk Premium
ER05-515	BG&E	Feb-06	10.80%	6.07%	4.73%
ER05-515	BG&E	Feb-06	11.30%	6.07%	5.23%
ER05-925	Westar	Jun-06	10.80%	6.36%	4.44%
ER07-284	SDG&E	Feb-07	11.35%	6.14%	5.21%
ER06-787	Idaho Pwr	May-07	10.70%	6.15%	4.55%
ER06-1320	Wisconsin Elec. Pwr	May-07	11.00%	6.15%	4.85%
ER06-1549	Duquesne	Sep-07	10.90%	6.41%	4.49%
ER07-583	Commonwealth Edison	Sep-07	11.00%	6.41%	4.59%
ER08-92	VEPCO	Oct-07	10.90%	6.43%	4.47%
ER08-374	Atlantic Path	Nov-07	10.65%	6.44%	4.21%
ER08-396	Westar	Nov-07	10.80%	6.44%	4.36%
ER08-413	Startrans IO	Nov-07	10.65%	6.44%	4.21%
ER08-375	SoCal Edison	Nov-07	10.55%	6.44%	4.11%
ER08-686	Pepco Holdings	Jan-08	11.30%	6.41%	4.89%
ER07-562	Allegheny	Feb-08	11.20%	6.42%	4.78%
ER07-1142	Ariz. Pub. Service	Apr-08	10.75%	6.54%	4.21%
ER08-1207	VEPCO	May-08	10.90%	6.62%	4.28%
ER08-1402	Duquesne	Jun-08	10.90%	6.69%	4.21%
ER08-1423	Pepco Holdings	Jun-08	10.80%	6.69%	4.11%
ER09-35/36	Tallgrass / Prairie Wind	Jul-08	10.80%	6.80%	4.00%
ER09-249	Public Service Elec. & Gas	Sep-08	11.18%	6.94%	4.24%
ER09-187	SoCal Edison	Sep-08	10.04%	6.94%	3.10%
ER09-548	ITC Great Plains	Sep-08	10.66%	6.94%	3.72%
ER09-75	Pioneer	Sep-08	10.54%	6.94%	3.60%
ER08-1584	Black Hills	Nov-08	10.80%	7.60%	3.20%
ER09-745	Baltimore Gas & Elec.	Dec-08	10.80%	7.80%	3.00%
ER07-1069	AEP - SPP Zone	Jan-09	10.70%	7.95%	2.75%
ER09-681	Green Power Express	Jan-09	10.78%	7.95%	2.83%
ER08-281	Oklahoma Gas & Elec.	Mar-09	10.60%	8.22%	2.38%
ER08-1457	PPL Elec. Utilities Corp.	Apr-09	11.10%	8.13%	2.97%
ER08-1457	PPL Elec. Utilities Corp.	Apr-09	11.14%	8.13%	3.01%

ER08-1588	Kentucky Utilities Co.	Apr-09	11.00%	8.13%	2.87%
ER08-552	Niagara Mohawk	Jul-09	11.00%	7.62%	3.38%
ER08-313	Southwestern Public Service Co.	Aug-09	10.77%	7.39%	3.38%
ER09-628	National Grid Generation LLC	Sep-09	10.75%	7.08%	3.67%
ER10-160	SoCal Edison	Sep-09	10.33%	7.08%	3.25%
ER08-1329	AEP - PJM Zone	Mar-10	10.99%	6.20%	4.79%
ER10-230	Kansas City Power & Light Co.	Aug-10	10.60%	6.05%	4.56%
ER10-355	AEP Transcos - PJM	Aug-10	10.99%	6.05%	4.95%
ER10-355	AEP Transcos - SPP	Aug-10	10.70%	6.05%	4.66%
ER11-1952	So. Cal Edison	Sep-10	10.30%	5.93%	4.37%
EL11-13	Atlantic Grid Operations	Oct-10	10.09%	5.84%	4.26%
ER11-2895	Duke Energy Carolinas	Oct-10	10.20%	5.84%	4.37%
ER11-2377	Northern Pass Tx	Nov-10	10.40%	5.79%	4.62%
ER10-1377	Northern States Power Co. (MN)	Mar-11	10.40%	5.94%	4.46%
ER10-516	South Carolina Electric and Gas	Apr-11	10.55%	6.00%	4.55%
ER10-992	Northern States Power Co.	Apr-11	10.20%	6.00%	4.20%
ER11-4069	RITELine	May-11	9.93%	5.98%	3.95%
ER12-296	PSEG	Aug-11	11.18%	5.71%	5.47%
ER08-386	PATH	Sep-11	10.40%	5.57%	4.83%
ER11-2560	Entergy Arkansas, Inc.	Dec-11	10.20%	5.21%	4.99%
ER12-2300	PSCo	Mar-12	10.25%	5.08%	5.18%
ER11-2853	PSCo	Mar-12	10.10%	5.08%	5.03%
ER11-2853	PSCo	Mar-12	10.40%	5.08%	5.33%
ER12-1378	Cleco	Nov-12	10.50%	4.74%	5.77%
ER12-778	Puget Sound Energy	Jan-13	9.80%	4.65%	5.16%
ER12-778	Puget Sound Energy	Jan-13	10.30%	4.65%	5.66%
ER12-2554	Transource Missouri	Jan-13	9.80%	4.65%	5.16%
ER11-3643	PacifiCorp Inc.	Feb-13	9.80%	4.62%	5.18%
ER12-1650	Maine Public Service Co.	Feb-13	9.75%	4.62%	5.13%
ER11-3697	SoCal Edison	Jul-13	9.30%	4.82%	4.49%
ER13-941	San Diego Gas and	Jan-14	9.55%	5.22%	4.33%

	Electric				
ER12-1589	PSCo	Aug-14	9.72%	4.76%	4.96%
ER12-91	Duke Energy Ohio	Sep-14	10.88%	4.73%	6.15%

Appendix II: DCF Results

Line	Company	Unadjusted Dividend Yield	Short-term IBES	Long-term GDP	Composite Growth	Adjusted Dividend Yield	DCF Results	Outliers
1	Ameren Corp.	4.04%	8.90%	4.37%	7.99%	4.22%	12.21%	
2	PG&E Corp.	3.88%	8.50%	4.37%	7.67%	4.04%	11.72%	
3	TECO Energy	4.85%	6.43%	4.37%	6.02%	5.01%	11.02%	
4	PNM Resources	2.72%	9.01%	4.37%	8.08%	2.84%	10.92%	
5	Portland General Electric Co.	3.30%	7.83%	4.37%	7.14%	3.43%	10.57%	
6	Otter Tail Corp.	4.20%	6.00%	4.37%	5.67%	4.33%	10.00%	
7	UIL Holdings	4.60%	5.37%	4.37%	5.17%	4.72%	9.89%	
8	ALLETE, Inc.	4.02%	6.00%	4.37%	5.67%	4.14%	9.81%	
9	NorthWestern Corp.	3.25%	7.05%	4.37%	6.51%	3.36%	9.88%	
10	CMS Energy Corp.	3.54%	6.60%	4.37%	6.15%	3.66%	9.81%	
11	Sempra Energy	2.53%	7.71%	4.37%	7.04%	2.63%	9.67%	
12	El Paso Electric Co.	2.95%	7.00%	4.37%	6.47%	3.05%	9.53%	
13	DTE Energy Co.	3.57%	6.09%	4.37%	5.75%	3.68%	9.42%	
14	Black Hills Corp.	2.88%	7.00%	4.37%	6.47%	2.98%	9.45%	
15	Duke Energy Corp.	4.24%	4.71%	4.37%	4.64%	4.34%	8.98%	
16	Avista Corp.	3.91%	5.00%	4.37%	4.87%	4.01%	8.88%	
17	SCANA Corp.	4.04%	4.65%	4.37%	4.59%	4.13%	8.73%	
18	American Electric Power Co., Inc.	3.77%	4.97%	4.37%	4.85%	3.86%	8.71%	
19	Great Plains Energy	3.63%	5.00%	4.37%	4.87%	3.72%	8.59%	
20	Empire District Electric Co.	3.99%	3.00%	4.37%	3.27%	4.05%	7.32%	
21	Westar Energy	3.83%	3.20%	4.37%	3.43%	3.89%	7.33%	
22	IDACORP, Inc.	3.16%	4.00%	4.37%	4.07%	3.22%	7.30%	
23	Public Service Enterprise Group Inc.	3.88%	1.74%	4.37%	2.27%	3.91%	6.18%	Low
24	Edison International	2.45%	3.38%	4.37%	3.58%	2.49%	6.07%	Low
25	Entergy Corp.	4.24%	0.39%	4.37%	1.19%	4.25%	5.43%	Low

26	FirstEnergy	4.21%	-2.94%	4.37%	-1.48%	4.15%	2.67%	Low

Moody's Baa Utility Bond Yield	4.71%
CAPM Risk Premium	9.43%
Low-End Outlier Test	6.60%
High-End Outlier Test	18.88%

Results	
Low	7.30%
High	12.21%
Median	9.60%

Appendix III: CAPM Results

Line	Company	Market Return (Rm)			Risk-free Rate	Risk Premium	Beta	Unadjusted Ke	Market Cap.	Size Adjustment	Implied Cost of Equity
		Div. Yield	Projected Growth (IBES)	Cost of Equity							
1	Otter Tail Corp.	2.36%	10.28%	12.63%	3.20%	9.43%	0.95	12.16%	$1,068	1.75%	13.91%
2	Black Hills Corp.	2.36%	10.28%	12.63%	3.20%	9.43%	0.9	11.69%	$2,414	1.75%	13.44%
3	PNM Resources	2.36%	10.28%	12.63%	3.20%	9.43%	0.85	11.22%	$2,343	1.75%	12.97%
4	ALLETE, Inc.	2.36%	10.28%	12.63%	3.20%	9.43%	0.8	10.75%	$2,245	1.75%	12.50%
5	Avista Corp.	2.36%	10.28%	12.63%	3.20%	9.43%	0.8	10.75%	$2,154	1.75%	12.50%
6	UIL Holdings	2.36%	10.28%	12.63%	3.20%	9.43%	0.8	10.75%	$2,330	1.75%	12.50%
7	IDACORP, Inc.	2.36%	10.28%	12.63%	3.20%	9.43%	0.8	10.75%	$3,162	1.72%	12.47%
8	Portland General Elec.	2.36%	10.28%	12.63%	3.20%	9.43%	0.8	10.75%	$2,916	1.72%	12.47%
9	Great Plains Energy	2.36%	10.28%	12.63%	3.20%	9.43%	0.85	11.22%	$4,109	1.19%	12.41%
10	TECO Energy	2.36%	10.28%	12.63%	3.20%	9.43%	0.85	11.22%	$4,617	1.19%	12.41%
11	El Paso Electric Co.	2.36%	10.28%	12.63%	3.20%	9.43%	0.7	9.80%	$1,536	1.75%	11.55%
12	NorthWestern Corp.	2.36%	10.28%	12.63%	3.20%	9.43%	0.7	9.80%	$2,098	1.75%	11.55%
13	Westar Energy	2.36%	10.28%	12.63%	3.20%	9.43%	0.75	10.28%	$5,128	1.19%	11.47%
14	SCANA Corp.	2.36%	10.28%	12.63%	3.20%	9.43%	0.75	10.28%	$8,222	0.93%	11.21%
15	Ameren Corp.	2.36%	10.28%	12.63%	3.20%	9.43%	0.75	10.28%	$10,573	0.80%	11.08%
16	CMS Energy Corp.	2.36%	10.28%	12.63%	3.20%	9.43%	0.75	10.28%	$9,252	0.80%	11.08%
17	DTE Energy Co.	2.36%	10.28%	12.63%	3.20%	9.43%	0.75	10.28%	$14,628	0.80%	11.08%
18	Edison International	2.36%	10.28%	12.63%	3.20%	9.43%	0.75	10.28%	$20,985	0.80%	11.08%

19	Public Service Enterprise Group Inc.	2.36%	10.28%	12.63%	3.20%	9.43%	0.75	10.28%	$20,756	0.80%	11.08%
20	Empire District Electric Co.	2.36%	10.28%	12.63%	3.20%	9.43%	0.65	9.33%	$1,226	1.75%	11.08%
21	Entergy Corp.	2.36%	10.28%	12.63%	3.20%	9.43%	0.7	9.80%	$15,011	0.80%	10.60%
22	FirstEnergy Corp.	2.36%	10.28%	12.63%	3.20%	9.43%	0.7	9.80%	$15,546	0.80%	10.60%
23	Sempra Energy	2.36%	10.28%	12.63%	3.20%	9.43%	0.75	10.28%	$27,346	-0.33%	9.95%
24	American Electric Power Co., Inc.	2.36%	10.28%	12.63%	3.20%	9.43%	0.7	9.80%	$28,590	-0.33%	9.47%
25	PG&E Corp.	2.36%	10.28%	12.63%	3.20%	9.43%	0.65	9.33%	$24,244	-0.33%	9.00%
26	Duke Energy Corp.	2.36%	10.28%	12.63%	3.20%	9.43%	0.6	8.86%	$58,221	-0.33%	8.53%

Moody's Baa Utility Bond Yield	4.71%
CAPM Risk Premium	9.43%
Low-End Outlier	6.60%
High-End Outlier Test	22.67%

Results	
Low	8.53%
High	13.91%
Median	11.34%

Appendix IV: Overall Results

	Low End	Lower Median	Bound	Median/ Set Point	Bound	Upper Median	High End
DCF (1)	7.30%	8.59%	8.93%	9.60%	9.85%	10.92%	12.21%
CAPM (2)	8.53%	10.60%	11.08%	11.34%	12.41%	12.50%	13.91%
RP (3) (4)	7.58%	8.44%	9.30%	10.17%	11.02%	11.88%	12.74%
Avg.	7.80%	9.21%	9.77%	10.37%	11.09%	11.77%	12.96%

(1) See Appendix II

(2) See Appendix III

(3) See Appendix I

(4) We note that the Risk Premium model does not produce median values and only a point estimate. However, a midpoint is calculated based on the upper and lower bounds of the upper and lower zones of reasonableness.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Entergy Arkansas, Inc.	Docket Nos.	ER13-1508-001
Entergy Gulf States Louisiana, L.L.C.		ER13-1509-001
Entergy Louisiana, LLC		ER13-1510-001
Entergy Mississippi, Inc.		ER13-1511-001
Entergy New Orleans, Inc.		ER13-1512-001
Entergy Texas, Inc.		ER13-1513-001

(Issued May 20, 2021)

CLEMENTS, Commissioner, *dissenting*:

1. I agree that today's order reasonably applies the Commission's return on equity (ROE) policy established in Order 569-A to the facts in these proceedings. I dissent because I do not believe our existing methodology for setting ROEs in jurisdictional cost-based rates fully carries out our consumer protection responsibility under the Federal Power Act. As a result, I cannot conclude that the ROE established in these proceedings is just and reasonable.

2. The common refrains on ROE policy are that setting ROEs is more art than science, and rigid adherence to any one or more financial models does not ensure satisfaction of the capital attraction standard the Supreme Court established in its *Bluefield*[1] and *Hope*[2] decisions. I generally agree with these perspectives, but it is also true that after many years of debate, litigation, and careful consideration by this Commission, financial models remain the tool we have identified as appropriate to evaluate the justness and reasonableness of ROEs. So, while I agree that we must scrutinize any ROE produced by the financial models we employ, our initial choices as to which models to employ and how to calibrate them remain of utmost importance.

3. The Commission in recent years undertook an exercise to evaluate anew its methodological approach to ROE across two series of proceedings involving transmission service ROEs for the New England and Midcontinent Independent System Operator, Inc. transmission owners. In the latter proceeding,[3] the Commission initially established a

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[1] *Bluefield Water Works & Improvement Company v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923)

[2] *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944)

[3] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator,*

new ROE policy in 2019 in Opinion No. 569. While I may not agree with all of the methodological choices in that policy, I believe it moved the Commission in the right direction on ROE. It identified two models, the longstanding Discounted Cash Flow model, or DCF, and the Capital Asset Pricing Model, or CAPM, as worthy of inclusion in our ROE analysis based on strong record evidence of their utility and widespread use by the financial community. It also calibrated those models through myriad small, but important, decisions. While no methodology is perfect, the Commission clearly wrestled with the tough questions and reached what it felt was a reasonable outcome.

4. Unfortunately, much of this was to be undone on rehearing in the same proceeding. Opinion No. 569-A made a number of changes, all of which are difficult to understand based on consideration of the same record that led to Opinion No. 569. The most notable change was the addition of the Risk Premium model, on which the Commission had levied substantial criticism in Opinion No. 569. That criticism included (1) redundancy with the CAPM and over-emphasis on risk premium-based models (given that CAPM is also a risk premium model);[4] (2) potential distortionary effects of using settlement ROEs as inputs to the Risk Premium model;[5] (3) circularity because the Risk Premium model results are largely a function of past Commission ROE decisions;[6] (4) insufficient evidence that investors actually rely on the Risk Premium model to make investment decisions;[7] (5) less predictability and transparency than DCF and CAPM;[8] and (6) difficulty with contemporaneity of study periods and ROE application from prior ROE decisions.[9]

5. In addition to adding the Risk Premium model, Order No. 569-A also made a series of methodological changes to the DCF and CAPM, such as modifying the composite growth rate approach within the DCF and relaxing the high-end outlier test, without, in my view, justification for departure from the underlying order. The effect of

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Inc., Opinion No. 569, 169 FERC ¶ 61,129 (2019), *order on reh'g*, Opinion No. 569-A, 171 FERC ¶ 61,154 (2020), *order on reh'g*, Opinion No. 569-B, 173 FERC ¶ 61,159 (2020).

[4] Opinion No. 569, 169 FERC ¶ 61,129 at P 341.

[5] *Id*. P 342.

[6] *Id*. P 343.

[7] *Id*. P 345.

[8] *Id*. P 346.

[9] *Id*. P 348.

these modifications on the resulting ROE will naturally change over time as market conditions change, but in the aggregate they can be significant. They also appear clearly aimed at raising ROEs. Again, I appreciate that the Commission is obliged to consider not merely the methodology we apply but ultimately the resulting ROE number. But to the extent the Commission finds the ROE produced by our models not just and reasonable, transparency and predictability dictate that we explain why we find the ROE lacking—including the criteria we have applied in reaching that conclusion—rather than altering methodological details to reach an alternate result.[10]

6. I highlight these details to explain my uneasiness with our current approach to ROE. Today's order relies on a strict application of the in my view erroneous methodology adopted in Opinion No. 569-A. Given my skepticism that this methodology reflects a reasonable approach that balances utility and consumer interests, I cannot conclude that the resulting ROE in this proceeding is just and reasonable.[11]

7. The proceeding before us today addresses the ROE embedded in cost-based rates for energy and capacity sales among the Entergy affiliates. But because the Commission's ROE policy applies equally—and to greater overall effect—to transmission rates, I approach this issue with an eye toward that context as well.

8. In the coming years, our nation's electric grid will require tremendous investment in transmission. The need is driven by the changing economics of power supply and flexible demand technologies; local, state, federal, utility and corporate decarbonization policies and commitments; and the need to upgrade aging electric infrastructure and design a more resilient grid in the face of increasing instances of extreme weather. All credible studies suggest that this transmission investment is necessary and can ultimately be a net win for consumers. Smart transmission investment enhances reliability and resilience, unlocks low-cost power sources, allows more efficient use of existing infrastructure, and minimizes the cost of meeting changing customer demand and public policies. The order of magnitude of transmission investment required to achieve these outcomes is unprecedented, which translates into a massive opportunity for utilities and

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[10] Then-Commissioner Glick made this very point in his concurrence in part and dissent in part to Opinion No. 569-A. *See* Opinion No. 569-A, 171 FERC ¶ 61,154 (Glick, Comm'r, concurring in part and dissenting in part).

[11] Preliminarily, I do share some of Commissioner Christie's concerns that 10.37% appears an extraordinary implied risk premium over Treasury bond yields currently and in recent years. *See* 175 FERC ¶ 61,136 (Christie, Comm'r, concurring). While I realize an evaluation of an ROE requires more analysis than a comparison to current interest rates, this spread is a further data point in considering whether our current ROE determination approach is flawed.

transmission developers.[12] But the value proposition for consumers is in no small part dependent on this Commission's rigorous scrutiny of the rates charged for transmission service, of which ROE is a central component.

9. Given this context, I believe the Commission must revisit its existing ROE policy. I appreciate that this policy has been unsettled for years, a state that increases investment uncertainty and extends litigation. To be sure, I share the goal of a stable ROE policy that will speed rate proceedings and allow for timely ROE updates as market conditions change. But we should not double down on the desire for near-term stability to strong detriment of consumer protection, and I worry our current ROE policy does just that.

For these reasons, I respectfully dissent.

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Allison Clements
Commissioner

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[12] A recent Princeton study determines that the lowest-cost approach to the oft cited net zero by 2050 target involves a 60% increase in high voltage transmission by 2030, and another tripling by 2050. E. Larson, C. Greig, J. Jenkins, E. Mayfield, A. Pascale, C. Zhang, J. Drossman, R. Williams, S. Pacala, R. Socolow, EJ Baik, R. Birdsey, R. Duke, R. Jones, B. Haley, E. Leslie, K. Paustian, and A. Swan, Net-Zero America: Potential Pathways, Infrastructure, and Impacts, interim report, Princeton University, Princeton, NJ, December 15, 2020.

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Entergy Arkansas, Inc. Entergy Gulf States Louisiana, L.L.C. Entergy Louisiana, LLC Entergy Mississippi, Inc. Entergy New Orleans, Inc. Entergy Texas, Inc.	Docket Nos.	ER13-1508-001 ER13-1509-001 ER13-1510-001 ER13-1511-001 ER13-1512-001 ER13-1513-001

(Issued (Issued May 20, 2021)

CHRISTIE, Commissioner, *concurring*:

1. The Order grants a Return on Equity ("ROE") of 10.37%. Because that ROE is consistent with the ROE formula established by Orders No. 569, 569-A, and 569-B, I concur. However, I write separately to note the following points.

2. First, while today's order correctly applies the Commission's ROE methodology set forth in Order No. 569 and its progeny, I believe that the Commission's policy is flawed to the extent it replaces judgment with rote application of pre-set formulae[1] and should be reviewed in a general proceeding to consider possible changes to that methodology. Second, I believe the Commission can, and should, issue ROE orders much more expeditiously in the future and matters of procedure, including setting strict

[1] Order No. 569 was intended to address the shortcomings in the Commission's prior ROE methodology that were identified by the D.C. Circuit in *Emera Maine v. FERC*, 854 F.3d 9 (D.C. Cir. 2017) (*Emera Maine*) (remanding Opinion No. 531). *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 569, 169 FERC ¶ 61,129 (2019), *order on reh'g*, Opinion No. 569-A, 171 FERC ¶ 61,154 (2020), *order on reh'g*, Opinion No. 569-B, 173 FERC ¶ 61,159 (2020). In doing so, however, the Commission took a step too far. The D.C. Circuit found that the Commission failed to articulate a "rational connection" between the Commission's findings as to the specific transmission owners' circumstances and its placement of the base ROE. *Emera Maine*, 854 F.3d at 27. *Emera Maine* did not, as appears to be the case in Orders No. 569, 569-A, and 569-B, require the Commission to cede its judgement in favor of purely formula-derived outcomes. In fact, in *Emera Maine*, the court recognized the fundamental principle that "[r]atemaking . . . is not a science," and thus "FERC must use models to inform, *not rigidly to determine*, [its] judgement as to the appropriate ROE for a utility." *Emera Maine*, 854 F.3d at 20 (emphasis added).

procedural deadlines for FERC itself to follow, should be part of any such future proceeding on the ROE issue.

3. As indicia of why this Commission's ROE policy needs to be revisited, I would note that as of May 14, 2021, the 30-year U.S. Treasury bond – one of the most commonly used benchmark 'safe' investments – was yielding 2.36%.[2] Thus the ROE approved in this order represents a risk premium of *approximately 800* basis points. As compared to the 10-year Treasury bond, which was yielding 1.64% May 14, 2021, the ROE approved herein represents a risk premium of *nearly 900* basis points.[3]

4. I recognize that rates on Treasury bonds were somewhat higher on December 19, 2013, the date back to which this order imposes the 10.37% ROE.[4] On a going-forward basis, however, as well as for most of the past eight years, the risk premium represented by a 10.37% ROE is extraordinarily generous for a regulated utility.[5]

5. The goal of the utility regulator is to set a utility ROE that tracks as closely as possible the actual cost of equity capital in the marketplace and is consistent with the landmark *Bluefield* and *Hope* cases.[6] The process should, of course, be informed by data,

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[2] *See* https://www.treasury.gov/resource-center/data-chart-center/interest-rates/pages/TextView.aspx?data=yield.

[3] *Id*.

[4] *Id*.

[5] Rates on 30-year Treasuries were slightly below 4% in December 2013; rates on 10-year Treasuries were mostly slightly below 3%. *Id*. Yields on both have trended downward steadily to the present time.

[6] *See*, *Fed. Pwr. Comm'n v. Hope Natural Gas Co*., 320 U.S. 591, 605 (1944) ("*Hope*") ("Rates which enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so-called 'fair value' rate base."); and *Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of W. Va*., 262 U.S. 679, 692-93 (1923) ("A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public 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; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures. The return should be reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain and support its credit and enable it to

but it is far more art than science, and at the end of the day, common sense also has to be applied.[7] Today's result shows what happens with the rigid application of pre-set formulae.[8] It also demonstrates that, while back-dating an ROE almost eight years may be the unavoidable result of this case's litigation history, the ROE set by today's order – which will also be used on a going-forward basis – no longer reflects the actual equity cost of capital.

6. I also observe that we are today putting into place an ROE with an effective date of December 19, 2013 – roughly seven-and-a-half years ago – ostensibly on the theory that these rates are required to incentivize investment in a future that began, at this point, several years in the past. Although a certain amount of "lag" is perhaps inherent in any regulatory system, I do not accept that this degree of delay is inevitable. Going forward, I believe we can and should do better.[9]

7. The FPA provides both a mechanism for the utility to seek changes to its rates – under Section 205 – and a mechanism for the customer to seek changes to the rates – under Section 206. As long as these mechanisms exist, no unfairness would result from shortening the time periods in which rates were under consideration. On the contrary,

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raise the money necessary for the proper discharge of its public duties.").

[7] *See*, *Cities of Bethany v. FERC*, 727 F.2d 1121, 1138 (D.C. Cir. 1984) ("ratemaking is less a science than it is an art.") (citing *Ala. Elec. Coop. v. FERC*, 684 F.2d 20, 27 (D.C. Cir. 1982)); *accord*, *Emera Maine*, 854 F.3d at 23 ("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 . . . . Whether a rate, even one within the zone of reasonableness, is unlawful depends on the particular circumstances of the case.") (emphasis in original). The key element is actually that "the Commission must explain its reasoning." *Id*. (citing *TransCanada Power Mktg., Ltd. v. FERC*, 811 F.3d 1, 12 (D.C. Cir. 2015)).

[8] *See, e.g.*, *Hope*, 320 U.S. at 602 (noting that "the Commission [is] not bound to the use of any single formula or combination of formulae in determining rates. Its rate-making function . . . involves the making of pragmatic adjustments" because "[i]t is not theory but the impact of the rate order which counts.") (cleaned up, citations omitted).

[9] I recognize that the regulatory lag in this case is not exclusively of the Commission's own doing. The D.C. Circuit disapproved of the Commission's application of its then-prevailing Opinion No. 531 policy on ROE in *Emera Maine*, which prompted the Commission to revise that policy in Opinion No. 569 and its progeny.

tightening the time periods would increase the ability of interested parties to seek relief from – and for the Commission to respond to – changing conditions.

8. In light of the outcome in this case and the time it took, I would urge the initiation of a general proceeding that will allow us to consider modifications to the current ratemaking policy for the purpose of preserving space for the sound exercise of discretion and acting on proposed rate changes much more expeditiously than we have done in the past.[10]

For these reasons, I respectfully concur.

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Mark C. Christie
Commissioner

[10] I recognize that in March 2019, the Commission opened Docket No. PL19-4-000 to examine a subset of these questions and that this docket remains open. *See*, *Inquiry Regarding the Commission's Policy for Determining Return on Equity*, 166 FERC ¶ 61,207 (2019). I am agnostic as to whether the Commission addresses these issues in a wholly new docket or adds them to Docket No. PL19-4-000. I observe, however, that the Commission policies applied in this case were developed subsequent to the initiation of that existing inquiry.