

131 FERC ¶ 61,020
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Jon Wellinghoff, Chairman;
Marc Spitzer, Philip D. Moeller,
and John R. Norris.

Southern California Edison Company

Docket Nos. ER08-375-000
ER08-375-001

ORDER ON PAPER HEARING AND REQUEST FOR REHEARING

(Issued April 15, 2010)

	<u>Paragraph Numbers</u>
I. Background	<u>2.</u>
A. Incentives Order	<u>3.</u>
B. SoCal Edison's Rate Filing	<u>6.</u>
C. February 2008 Order	<u>7.</u>
D. Rehearing Request.....	<u>9.</u>
II. Paper Hearing.....	<u>10.</u>
A. Procedural Issues	<u>11.</u>
B. Establishment of a Base Rate of Return	<u>12.</u>
C. Time Period for the Base ROE Data Set	<u>17.</u>
D. Proxy Groups.....	<u>24.</u>
1. February 2008 Order.....	<u>24.</u>
2. Protests	<u>26.</u>
3. Determination	<u>27.</u>
E. ROE Proposals	<u>32.</u>
1. SoCal Edison	<u>33.</u>
2. Six Cities	<u>34.</u>
3. CPUC	<u>36.</u>
F. ROE Analysis: Risk Screening Factors	<u>37.</u>
1. Commission Determination.....	<u>51.</u>
G. Other Risk Related Issues	<u>61.</u>
1. California's Business and Regulatory Environment and Incentive Adders.....	<u>61.</u>

2. CPUC Proceeding	<u>71.</u>
H. Securing Capital	<u>74.</u>
I. Median vs. Midpoint.....	<u>78.</u>
1. SoCal Edison’s Proposal	<u>78.</u>
2. Protests	<u>83.</u>
3. Determination	<u>85.</u>
J. Updating of Financial Data	<u>97.</u>
K. Other Issues	<u>104.</u>
1. Burden of Proof	<u>104.</u>
2. Other ROE Models	<u>115.</u>
L. Result of Paper Hearing.....	<u>118.</u>

1. On February 29, 2008, the Commission issued an order¹ accepting certain tariff revisions implementing rate incentives approved by the Commission for three Southern California Edison (SoCal Edison) transmission projects. The *February 2008 Order* suspended the tariff provisions, to be effective March 1, 2008 and established paper hearing procedures to determine the reasonableness of SoCal Edison's return on equity (ROE). In this order, the Commission approves a base ROE of 9.54 percent, rather than SoCal Edison's proposed base ROE of 11.5 percent. Combined with the previously Commission-approved incentive adders of 125 basis points for the Rancho Vista Project (Rancho Vista) and 175 basis points for the Devers-Palo Verde II Project (DPV2) and the Tehachapi Transmission Project (Tehachapi Project) (collectively, the Transmission Projects), the overall ROE for these projects will be 10.79 percent and 11.29 percent respectively. In addition, the Commission denies the request for rehearing of the *February 2008 Order*.

I. Background

2. In the Energy Policy Act of 2005 (EPAAct 2005), Congress added a new section 219² to the Federal Power Act (FPA) directing the Commission to establish, by rule, incentive-based (including performance-based) rate treatments for electric transmission. The Commission issued Order No. 679,³ which set forth processes by which a public utility could seek transmission rate incentives pursuant to section 219 of the FPA.

A. Incentives Order

3. In accordance with Order No. 679, on May 18, 2007, and as amended on August 16, 2007, SoCal Edison filed a petition for declaratory order seeking incentive rate treatment for its Transmission Projects, with capital expenditures totaling \$2.5 billion. On November 16, 2007, the Commission issued the *Incentives Order* granting SoCal Edison's

¹ *Southern California Edison Co.*, 122 FERC ¶ 61,187 (2008) (*February 2008 Order*).

² Pub. L. No. 109-58, § 1241, 119 Stat 594, 961, *to be codified at* 16 U.S.C. § 824s (2006).

³ *Promoting Transmission Investment through Pricing Reform*, Order No. 679, FERC Stats. & Regs. ¶ 31,222, *order on reh'g*, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 (2006), *order on reh'g*, 119 FERC ¶ 61,062 (2007).

request for transmission rate incentives for the Transmission Projects.⁴ Subsequently, on June 23, 2008, the Commission issued an order denying rehearing of the *Incentives Order*.⁵

4. In the *Incentives Order*, the Commission found that, consistent with Order No. 679, SoCal Edison's proposals for the construction of the DPV2 Project, the Tehachapi Project and the Rancho Vista Project would significantly improve the reliability of the California Independent System Operator Corporation's (CAISO) bulk power transmission system and would reduce the cost of delivered power to customers by reducing transmission congestion on the CAISO-controlled transmission grid.⁶

5. The *Incentives Order* granted rate incentives to SoCal Edison, including:

(1) ROE Project adders of 125 basis points for the DPV2 and Tehachapi Projects, and 75 basis points for the Rancho Vista Project;

(2) Recovery of 100 percent of any prudently-incurred abandonment costs for the DPV2 and Tehachapi Projects, if these projects, or any portion thereof, are cancelled due to factors beyond SoCal Edison's control;

(3) Recovery in the transmission rate base of 100 percent of CWIP during the construction of these Projects; and

(4) ROE adder of 50 basis points to its overall ROE based on SoCal Edison's participation in CAISO.

B. SoCal Edison's Rate Filing

6. On December 21, 2007 (December 2007 Filing), SoCal Edison filed revisions to its Transmission Owner Tariff (TO Tariff)⁷ to reflect proposed changes to its transmission revenue requirement and transmission rates to implement the CWIP rate incentives granted in the *Incentives Order*. SoCal Edison also proposed to establish a base ROE. For its calculation, SoCal Edison followed the Discounted Cash Flow (DCF) methodology, used a national proxy group, screened for a range of risk factors and, based upon this analysis, applied the midpoint of these calculations to establish a proposed base ROE of 11.5 percent. Using SoCal Edison's calculations, the incentive adders approved in the *Incentives Order*

⁴ *Southern California Edison Co.*, 121 FERC ¶ 61,168 (2007) (*Incentives Order*).

⁵ *Southern California Edison Co.*, 123 FERC ¶ 61,293 (2008).

⁶ *Incentives Order*, 121 FERC ¶ 61,168.

⁷ FERC Electric Tariff, Second Revised Vol. No. 6.

would result in overall ROEs of 12.75 percent for the Rancho Vista Project and 13.25 percent for the DPV2 and Tehachapi Projects.

C. February 2008 Order

7. The Commission's analysis of the December 2007 filing preliminarily determined that a just and reasonable ROE for SoCal Edison should be based upon a Western Electric Coordinating Council (WECC)-wide proxy group, with appropriate consideration for risk.⁸ Specifically, the Commission applied the screening parameters that were accepted in *Atlantic Path 15*⁹ and found that a reasonable range of return on equity for SoCal Edison appeared to be from 7.97 percent to 13.67 percent. The Commission concluded that SoCal Edison's proposed overall ROEs for its three projects, inclusive of incentive adders, were within the upper end of the zone of reasonableness. The Commission accepted SoCal Edison's proposed tariff revisions, and suspended them for a nominal period, to be effective March 1, 2008, subject to refund.

8. Additionally, because the Commission evaluated the range of reasonableness of the company's ROE using a different proxy group and screening criteria than those provided in the application, the Commission established a paper hearing to allow parties the opportunity to analyze the Commission's preliminary conclusion. The Commission directed that all interested parties should submit comments within forty-five days,¹⁰ and such comments should specifically address the use of utilities in the WECC as the proxy group for determination of the appropriate ROE for SoCal Edison, the screening parameters used, and other related issues relevant to determining SoCal Edison's appropriate ROE.¹¹

⁸ SoCal Edison's Base Transmission Revenue Requirement in effect in December 2007 was adopted pursuant to a "black box" settlement accepted by the Commission in *Southern California Edison Co*, 116 FERC ¶ 61,010 (2006).

⁹ 122 FERC ¶ 61,135 (2008) (*Atlantic Path 15*).

¹⁰ By order dated March 25, 2008, the Secretary granted the CPUC's request that the deadline be extended to May 5, 2008.

¹¹ The Commission also commented that the paper hearing would not include issues already decided in the *Incentives Order*, such as whether SoCal Edison is entitled to the ROE adders. *February 2008 Order*, 122 FERC ¶ 61,187 at P 27.

D. Rehearing Request

9. On March 28, 2008, the Public Utilities Commission of the State of California (CPUC) filed the only request for rehearing of the *February 2008 Order* in Docket No. ER08-375-001.

II. Paper Hearing

10. Briefs or comments in the paper hearing were filed by the Pacific Gas and Electric Company (PG&E), the CPUC, SoCal Edison, Six Cities,¹² and the California Department of Water Resources State Water Project (SWP). The CPUC filed a Motion for Leave to Answer and Answer to SoCal Edison's Brief, and SoCal Edison filed a Motion for Leave to file a Reply to the Briefs of the CPUC and Six Cities. Six Cities filed an Answering Brief.

A. Procedural Issues

11. Pursuant to Rule 213(a)(2) of the Commission's Rules of Practice and Procedures, 18 C.F.R. § 385.213(a)(2)(2009), prohibits an answer to an answer, a reply to a brief, or an answering brief to a reply brief, unless otherwise ordered by the decisional authority. We will accept the Answer filed by the CPUC, Six Cities Answering Brief, and SoCal Edison's Reply Brief because they have provided information that assisted us in our decision-making process. In addition, because the CPUC raised issues in its request for rehearing that it also raised in its pleadings in the paper hearing, the order will address those rehearing issues in the discussion of issues in the paper hearing.

B. Establishment of a Base Rate of Return

12. SoCal Edison argues that while the Commission did not set a base ROE in the *February 2008 Order*, if the Commission determines that a base ROE should be established in this proceeding, then SoCal Edison requests that the Commission accept its December 2007 request of a base ROE of 11.5 percent.¹³

13. Six Cities assert that the Commission erred in the *February 2008 Order* by pre-approving SoCal Edison's overall ROEs without first approving a base ROE.¹⁴ Six Cities

¹² Six Cities includes the Cities of Anaheim, Azusa, Banning, Colton, Pasadena, and Riverside, California.

¹³ SoCal Edison Brief at 20, 37. SoCal Edison also requests that if the Commission determines a base ROE in the paper hearing proceeding using the DCF analysis, then the Commission should revise that analysis by including non-WECC as well as WECC utilities in the proxy group. SoCal Edison Brief at 37.

¹⁴ Six Cities Brief at 7.

argue that because SoCal Edison does not have a Commission-approved base ROE, the Commission should follow the precedent of *Xcel*,¹⁵ *AEP*,¹⁶ and *Duquesne*,¹⁷ and establish hearing and settlement proceedings to determine the justness and reasonableness of SoCal Edison's base ROE. Six Cities contend that the Commission's preliminary analysis of SoCal Edison's overall ROE bypassed the step for evaluating a base ROE. By so doing, Six Cities assert that the Commission appeared to have "rubber-stamped" SoCal Edison's requested overall ROEs because they were below the upper end of the Commission's proxy group range.¹⁸ Six Cities argue that the Commission should have followed its precedent of applying a three-step process for determining a just and reasonable ROE. According to Six Cities, the Commission's precedent requires it first to determine what incentives should be authorized, including any incentive adders. Then the Commission should find a just and reasonable base ROE and, after adding any Commission-based ROE adders to that base level, determine that the overall ROE does not exceed the upper end of the zone of reasonableness.¹⁹

14. Six Cities cite to *Westar Energy*²⁰ to support its argument that it is appropriate for the Commission to omit evaluating the justness and reasonableness of a base ROE only if the utility seeking incentive adders already has a Commission-approved base ROE.²¹ Six Cities note that SoCal Edison proposed a base ROE of 11.5 percent in its initial filing and attempted to support this base ROE request before adding the ROE incentives.²² Further, Six Cities argue that in the *Incentives Order*, the Commission reduced SoCal Edison's requested incentives because the Commission determined that its total incentives were excessive in view of other risk-reducing aspects of other incentives approved by the Commission.²³ Accordingly, Six Cities argue that in this proceeding, the Commission must

¹⁵ *Xcel Energy Services, Inc.*, 122 FERC ¶ 61,098 (2008) (*Xcel*).

¹⁶ *Am. Elec. Power Serv. Corp.*, 120 FERC ¶ 61,205 (2007) (*AEP*).

¹⁷ *Duquesne Light Co.*, 118 FERC ¶ 61,087 (2007) (*Duquesne*).

¹⁸ Six Cities Brief at 8.

¹⁹ *Id.* at 9, citing *AEP*, 120 FERC ¶ 61,205.

²⁰ *Westar Energy, Inc.*, 122 FERC ¶ 61,268 (2008) (*Westar Energy*).

²¹ Six Cities Brief at 11.

²² *Id.* at 12.

²³ *Id.*

establish a base ROE to ensure that SoCal Edison's Commission-approved ROE incentive adders are not exceeded as a result of the allowed overall incentive ROEs.²⁴

15. SoCal Edison argues in reply that the Commission need not establish a base. SoCal Edison asserts that, although the Commission may follow established methods of developing incentive ROEs by determining a base ROE and then applying specific adders to that base, it also has the flexibility to accept incentive ROEs that fall within the zone of reasonableness.²⁵

Determination

16. In the *February 2008 Order*, the Commission initially did not establish a base ROE for SoCal Edison. Instead, in an attempt to expedite resolution, we provided an up-front analysis of SoCal Edison's proposed overall ROEs, and determined on a preliminary basis with a limited record, that the overall ROEs, were within the upper end of the zone of reasonableness.²⁶ In so doing, we disregarded the request by SoCal Edison in its December 2007 Filing²⁷ to establish a base ROE and, as Six Cities notes, we also departed from precedent.²⁸ As such, we conclude that it is reasonable to establish a base ROE for SoCal Edison to which the previously granted incentives would be added. The establishment of a base ROE, in the context of this proceeding where substantial evidence has been proffered not only by SoCal Edison in the December 2007 Filing, but also by parties in the paper hearing, is appropriate. This finding is also consistent with our discussions in Order Nos. 679 and 679-A that contemplated proceedings such as this, where incentive adders are established in a declaratory order, and a subsequent section 205 filing is used to establish a base ROE and to determine whether the resultant overall ROE falls within an established zone of reasonableness.²⁹ Therefore, we conclude that it is reasonable to establish a base ROE using the DCF methodology.

²⁴ *Id.*; see also Six Cities Brief, Affidavit of Mr. J. Bertram Solomon at 11 and 14.

²⁵ SoCal Edison Reply Brief at 4, *citing to* Order No. 679, FERC Stats. & Regs. ¶ 31,222, at P 92-93.

²⁶ *February 2008 Order*, 122 FERC ¶ 61,187 at P 47.

²⁷ December 2007 Filing at 6.

²⁸ See, e.g., *Duquesne*, 118 FERC ¶ 61,087; *Westar Energy*, 122 FERC ¶ 61,268 at P 85.

²⁹ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 76-80, Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 62-65.

C. Time Period for the Base ROE Data Set

17. In its December 2007 Filing, SoCal Edison supported its proposed 11.5 percent base ROE with financial data from the six-month period ending September 30, 2007. However, in the *February 2008 Order*, the Commission relied upon the financial data utilized in the *Atlantic Path 15* proceeding,³⁰ which was for the six-month period ending November 30, 2007.

18. In its paper hearing brief, SoCal Edison provides amended financial data through the six-month period ending November 30, 2007 to conform to the same time period that the Commission utilized in the *February 2008 Order*. SoCal Edison states that it has amended its data because it would be discriminatory to use financial data from a time period in this case that is different from that used in the other ROE cases, simply because SoCal Edison's case was set for paper hearing and the others were not. SoCal Edison states that all parties to this proceeding have notice that data for this six-month period ending November 30, 2007 are the data used by the Commission in the *February 2008 Order*. SoCal Edison argues that the Commission should not allow those participants to turn that initial determination into a constantly moving target.³¹

19. Six Cities prepared a DCF analysis to establish a base ROE that consisted of amended financial data for the six-months ending April 30, 2008. Six Cities assert that this was the most recent data available prior to the filing of its brief. Six Cities state that SoCal Edison's limited update is not consistent with Commission precedent, which typically requires the use of the most recent cost of capital data that are available.³² Therefore, Six Cities argue that SoCal Edison should have updated its analysis using data for the six-month period ending April 30, 2008 because the ROEs at issue in this proceeding will apply prospectively beginning March 1, 2008.

20. The CPUC also objects to using financial data through the six-month period ending November 30, 2007, because the data are outdated and do not reflect current market conditions. The CPUC argues that the Court of Appeals has frequently supported the use of updated data in Commission ROE determinations.³³ The CPUC asserts that in *Town of*

³⁰ Financial data for this time period was also use in *Startrans IO, L.L.C.*, 122 FERC ¶ 61,306 (2008) (*Startrans*).

³¹ SoCal Edison Brief at 4.

³² Six Cities Brief at 18, citing *Bangor Hydro-Elec. Co.* Opinion 489, 117 FERC ¶ 61,129, at P 80 (2006) (*Bangor Hydro*).

³³ CPUC Brief at 28, citing to *Union Elec. Co. v. FERC*, 890 F.2d 1193, 1203 (D.C. Cir. 1989) (*Union Electric*); *Boston Edison Co. v. FERC*, 885 F.2d 962, 967 (1st Cir. 1989).

(continued)

*Norwood v. FERC*³⁴ the Commission reduced the applicant's ROE because of reduced risks, but it did not lower the ROE below the zone of reasonableness. On appeal, the court overturned the Commission's decision, holding that "the record is replete with evidence that the original zone of reasonableness is no longer viable . . . the Commission should have developed a new zone of reasonableness either from the evidence before it, or if necessary, after supplementing the record."³⁵

Commission Determination

21. We find that it is appropriate to establish the base ROE using financial data for the six-month period ending November 30, 2007. At the time of SoCal Edison's filing in December 2007, the latest six-month data available were for the period that ended November 30, 2007. Using any different six-month period other than the latest available at the time of SoCal Edison's filing could create a continual moving target and would make it difficult to determine the most appropriate six-month period. Additionally, the base ROE established herein is for the locked-in period from March 1, 2008 through December 31, 2008. Therefore, it is not reasonable to apply data ending April 30, 2008 because the effective date for the rates would have already taken place prior to the time some of the financial data would be available.

22. With respect to the CPUC's argument that the Commission should develop a new zone of reasonableness, we find that the CPUC's reliance on the *Town of Norwood v. FERC* is misplaced. In that case, the Court found that the record was replete with evidence that the original zone of reasonableness was no longer viable because of changed circumstances due to the shutdown of the Yankee plant. Therefore, the Court remanded the case to the Commission with instructions to develop a new zone of reasonableness that took account of Yankee's reduced risk. Based on our review of the record evidence, we have no such changed circumstances here. Therefore, we are establishing a base ROE and a new zone of reasonableness associated with that base ROE.

23. The Commission notes that the CPUC raised the issue of the time period for the base ROE data set to be applied for SoCal Edison in its request for rehearing of the *February 2008 Order*.³⁶ For the reasons discussed above, the Commission denies the CPUC's request for rehearing.

See also Bangor Hydro, 117 FERC ¶ 61,129.

³⁴ 80 F.3d 526, 536 (D.C. Cir. 1995) (*Town of Norwood*).

³⁵ CPUC Brief at 29, *citing Town of Norwood*, 80 F.3d 526, 536.

³⁶ CPUC Request for Rehearing at 34-36.

D. Proxy Groups

1. February 2008 Order

24. SoCal Edison originally proposed in its December 2007 Filing to establish a base ROE by using the DCF methodology, beginning with a national proxy group comprising 23 investor-owned utilities from throughout the country. In the *February 2008 Order*, the Commission determined that instead of using a national proxy group, as proposed by SoCal Edison, it would follow the rationale of *Bangor Hydro*³⁷ and *Midwest ISO*³⁸ and use a regional proxy group comprising companies from the region in which the utility is located.³⁹ The Commission explained that “being located in the same geographic and economic region is a relevant factor to consider in determining whether companies face similar business risks.”⁴⁰ Because the Commission previously found that the WECC region was integrated both electrically and commercially,⁴¹ the Commission concluded that the just and reasonable ROE for SoCal Edison should be based upon a WECC-wide proxy group, with appropriate consideration for risk. The Commission applied the screening parameters accepted in *Atlantic Path 15*, which resulted in a six-company proxy group, and determined that a reasonable range of returns on equity for SoCal Edison appeared to be from 7.97 percent to 13.67 percent.⁴²

25. However, because the Commission provided an upfront analysis of SoCal Edison’s ROE, the Commission established a paper hearing on the range of reasonableness of SoCal Edison’s ROE and specifically invited comments addressing the use of a WECC-wide proxy group, the screening parameters used and other related issues relevant to determining SoCal Edison’s appropriate ROE.⁴³

³⁷ *Bangor Hydro*, 117 FERC ¶ 61,129.

³⁸ *Midwest Indep. Sys. Oper.*, 100 FERC ¶ 61,292 (2002) (*Midwest ISO ROE Order*).

³⁹ *February 2008 Order*, 122 FERC ¶ 61,187 at P 25, citing *Bangor Hydro*, 117 FERC ¶ 61,129 at P 38, and *Midwest ISO ROE Order*, 100 FERC ¶ 61,292 at 9-12.

⁴⁰ *Id.* P 25.

⁴¹ *Id.* P 26 n.25, citing *Order on the California Comprehensive Market Redesign Proposal*, 100 FERC ¶ 61,060, at P 2 (2002); *Removing Obstacles to Increased Electric Generation and Natural Gas Supply in the Western United States*, 94 FERC ¶ 61,272, at 61,973 (2001).

⁴² *Id.* P 27.

⁴³ *Id.*

2. Protests

26. SoCal Edison is joined by Six Cities, the CPUC, SWP and PG&E in its objection to the Commission's use of the WECC-wide regional proxy group.⁴⁴ The parties assert that using the WECC-wide proxy group results in a proxy group that does not adequately represent companies of comparable risk.⁴⁵ Instead, they argue that the Commission should use a national proxy group comprising companies with business risks that are comparable to those of SoCal Edison, regardless of the companies' geographic location.⁴⁶ They assert geographic location does not establish that companies within the same region face business or financial risk comparable to SoCal Edison,⁴⁷ which they contend is necessary to reflect the risk perceptions of equity investors.⁴⁸ Parties also assert that using a national proxy group more accurately reflects the reality that SoCal Edison competes with utilities across the country in securing capital.⁴⁹ Further, they argue that limiting the proxy group to the WECC will distort the DCF analysis.⁵⁰ SoCal Edison and PG&E assert that the Commission can achieve its goal of regulatory certainty and greater efficiency⁵¹ by establishing a single starting group rather than groups for members of different regional transmission organizations (RTOs), and applying objective criteria, such as published credit

⁴⁴ SoCal Edison Brief at 3-16; Six Cities Brief at 18; CPUC Brief at 10-15; SWP Comments at 2-3; PG&E Comments at 1-8.

⁴⁵ SoCal Edison Brief at 12; Six Cities Brief at 18; PG&E Comments at 4-5.

⁴⁶ The CPUC supports its contention that SoCal Edison and Atlantic are different companies, deserving of different proxy groups, by explaining that Atlantic is a small company, with one 83-mile long transmission asset and a total capital of approximately \$161 million, whereas SoCal Edison is a large vertically-integrated utility, with projected capital expenditures of \$10.87 billion between 2007 and 2011. CPUC Brief at 12-14.

⁴⁷ See SoCal Edison Brief at 12, *citing* Exhibit SCE-12, testimony of Dr. Hunt at 10; PG&E comments at 5-7.

⁴⁸ PG&E Comments at 4-5.

⁴⁹ See CPUC Brief at 13. SoCal Edison argues that competition for capital can be national or international in scope. SoCal Edison Brief at 14; Exhibit SCR-12, Testimony of Dr. Hunt at 12.

⁵⁰ SoCal Edison Brief at 14-15; Exhibit SCR-12, Testimony of Dr. Hunt at 14; SWP Comments at 2-3.

⁵¹ *February 2008 Order*, 122 FERC ¶ 61,187 at P 26.

ratings, that clearly reflect comparable risk.⁵² SoCal Edison also argues that in *Consumers Energy*,⁵³ the Commission rejected using geographic location or climatic differences as a proxy group screening factor. Hence, SoCal Edison contends that the use of a WECC-wide regional proxy group in the *February 2008 Order* represents an unexplained departure from the Commission's rationale in *Consumers Energy*.⁵⁴

3. Determination

27. Traditionally, the DCF analysis has used nationwide proxy groups for determining ROEs for individual utilities. Under this approach, the Commission selects companies from throughout the country to form a proxy group that "best represents the risks and business profile of a single utility."⁵⁵

28. More recently, the Commission has accepted proxy groups comprising companies from the same geographic and economic region.⁵⁶ In keeping with these more recent decisions, the Commission proposed to apply a WECC-wide regional proxy group for SoCal Edison in this proceeding.

29. However, the record developed by the parties to this proceeding supporting a national proxy group is sufficient to render a decision consistent with the requisites of the U.S. Supreme Court standard enunciated in *Federal Power Comm'n v. Hope Natural Gas Co.* that a proxy group should consist of companies of "commensurate returns on

⁵² SoCal Edison Brief at 16; PG&E Comments at 6.

⁵³ SoCal Edison Brief at 13-14, citing *Consumers Energy Co.*, 86 FERC ¶ 63,004, at 65,023 (1999), *aff'd*, Opinion No. 456, 98 FERC ¶ 61,333, at 62,412 (2002) (*Consumers Energy*).

⁵⁴ SoCal Edison also cites to other cases to assert that the Commission has been inconsistent in its use of regional proxy groups. See *Bangor Hydro*, 117 FERC ¶ 61,129; *Midwest ISO ROE Order*, 100 FERC ¶ 61,292; but see *Golden Spread Elec. Coop. Inc v. Sw. Pub. Serv. Co.*, Opinion No. 501, 123 FERC ¶61,047, at P 62 (2008) (*Golden Spread*).

⁵⁵ *Midwest ISO ROE Order*, 100 FERC ¶ 61,292; *order on remand*, 106 FERC ¶ 61,302 (2004), *aff'd in relevant part sub nom. Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004, 1010-11 (D.C. Cir. 2005) (*MISO Remand Order*).

⁵⁶ See, e.g., *Bangor Hydro*, 117 FERC ¶ 61,129; *Midwest ISO ROE Order*, 100 FERC ¶ 61,292 (2002), *order on remand*, 106 FERC ¶ 61,302 (2004), *aff'd sub nom. Pub. Serv. Comm'n of Ky v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005).

investments in other enterprises having corresponding risks.”⁵⁷ We are persuaded by the parties that using a national proxy group in this case complies with the *Hope* standard of risk that is necessary “to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.”⁵⁸ We are also persuaded by the arguments of the parties that limiting the composition of the proxy group, as we proposed in the *February 2008 Order*, may not adequately reflect SoCal Edison’s business risks. Therefore, in keeping with the *Consumers Energy* standard that the proxy group reflects comparable risk,⁵⁹ and in consideration of the record developed in this proceeding, we will accept SoCal Edison’s proposed national proxy group, with modifications explained herein, as an appropriate proxy group to determine its ROE.

30. The Commission notes that the CPUC raised the issue of the use of the WECC-wide proxy group in its request for rehearing of the *February 2008 Order*, asserting that the Commission’s use of the WECC-wide proxy group violated due process and was arbitrary and capricious.⁶⁰ We will dismiss the CPUC’s request for rehearing as moot in this respect.⁶¹

E. ROE Proposals

31. In response to the Commission’s establishment of the paper hearing, SoCal Edison submitted testimony and associated workpapers supporting its request for a base ROE of 11.5 percent. Six Cities argue that SoCal Edison’s requested ROE is not supported by SoCal Edison’s testimony and workpapers, and they offer three alternatives. The CPUC submitted testimony and workpapers in support of its position that SoCal Edison’s proposal is excessive. The positions of the various parties regarding the appropriate ROE are explained below.

⁵⁷ *Fed. Power Comm’n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (*FPC v. Hope* or *Hope*).

⁵⁸ *Id.*

⁵⁹ *Consumers Energy*, 86 FERC at 65,023; *aff’d* 98 FERC at 62,412.

⁶⁰ CPUC Request for Rehearing at 3, 24-27.

⁶¹ The Commission also notes that the CPUC asserted in its request for rehearing that the Commission should have ruled on the CPUC’s rehearing request of the *Incentives Order*, 121 FERC ¶ 61,168, before issuing the *February 2008 Order*. (CPUC Request for Rehearing at 9-10.) Because the Commission issued an order in Docket No. EL07-62-001 on June 23, 2008 denying rehearing of the *Incentives Order*, we deny rehearing on this issue.

1. SoCal Edison

32. SoCal Edison explains that its proposed base ROE of 11.5 percent, as filed in December, 2007, is supported by a DCF analysis utilizing a six-month data set ending November, 2007. SoCal Edison's analysis uses a national group of companies categorized as electric utilities by Value Line Investment Survey. SoCal Edison then selected from this group companies with Standard and Poor's issuer credit rating of A-, BBB+ or BBB. Further, SoCal Edison selected companies having annual electric revenues of at least \$1 billion, that were paying a stock dividend as of the time of this analysis, and that were expected to continue paying dividends. Finally, none of the selected companies was involved in merger activity or major restructuring during the period of analysis.⁶² In addition, SoCal Edison adjusted the resulting DCF range to exclude results for companies whose low-end DCF results were less than 100 basis points above the yields for A and Baa utility bonds, as well as high-end DCF results above 17.7 percent, consistent with *ISO New England*.⁶³ SoCal Edison argues that, based upon the resulting DCF range from 7.46 percent to 16.53 percent, with a midpoint of 12.00 percent, this analysis supports a base ROE of 11.5 percent.⁶⁴

2. Six Cities

33. Six Cities argue that SoCal Edison's requested base ROE of 11.5 percent is unjust and unreasonable, and when combined with the incentive adders, results in incentive ROEs that are excessive and inconsistent with Commission precedent. Six Cities contend that in keeping with precedent and relying upon Order No. 679 and Order No. 679-A, the Commission should approve a base ROE of 9.5 percent, and incentive ROEs of 11.25 percent for DPV2 and Tehachapi and 10.75 percent for Rancho Vista.⁶⁵

34. Six Cities submitted three separate sets of DCF analyses to determine the proper base ROE for SoCal Edison.⁶⁶ In their first analysis, Six Cities made several adjustments to the *Atlantic Path 15* analysis adopted in the *February 2008 Order*. In the second analysis, Six Cities updated the *Atlantic Path 15* analysis, as adjusted in the first analysis, using data for the six-month period ending April, 2008. Six Cities state that their third and preferred

⁶² SoCal Edison Brief at 20-21; Exhibit SCE-7 at 16, 18-19.

⁶³ *ISO New England, Inc.*, 109 FERC ¶ 61,147, at P 205 (2004).

⁶⁴ SoCal Edison Brief at 21-22; Exhibit SCE-7.

⁶⁵ Six Cities Brief at 2,7,8.

⁶⁶ *Id.* at 18, *citing* Affidavit of Mr. Solomon, Exhibit Nos. SC-1, SC-2, SC-3.

method applies the Commission-approved DCF analysis to a national proxy group of companies, rather than a regional proxy group, and has added additional screening criteria in determining the appropriate proxy group. These additional screening criteria include: (1) only companies with a Value Line Safety Rank of 3; (2) companies with an S&P business profile of “excellent” or “strong;” and (3) other variations to the high-end growth screen and low-end bond yield screen. Six Cities contend that this analysis is the most appropriate and consistent with the Commission’s traditional approach to ROE determinations.⁶⁷ Six Cities assert that this preferred analysis results in a range of 7.3 percent to 11.5 percent, with a median of 9.5 percent.

3. CPUC

35. The CPUC disagrees with both SoCal Edison’s ROE analysis and the Commission’s analysis in the *February 2008 Order*. The CPUC’s analysis applies adjustments to SoCal Edison’s DCF analysis that are similar to those used by Six Cities. In addition to those adjustments, the CPUC proposes to eliminate from the proxy group those companies with less than 80 percent revenues from regulated business. Based on these adjustments, the CPUC determined that a reasonable range of returns on equity to be from 8.01 percent to 10.7 percent. Therefore, the CPUC concludes that SoCal Edison’s base ROE should be set at 9.35 percent, which is the midpoint of the range.⁶⁸ The CPUC also explains that after adding 175 basis points to the midpoint of 9.35 percent for DPV2 and Tehachapi results in an ROE of 11.1 percent. However, because the ROE must be capped by the top of the range of reasonableness, CPUC would give these projects an ROE of 10.7 percent. Adding 125 basis points to Rancho Vista results in an ROE of 10.6 percent, which is within the range of reasonableness.⁶⁹ The CPUC argues that its analysis shows that these ROEs are sufficient for SoCal Edison to attract necessary capital and represents a reasonable balance of investor and consumer interests.⁷⁰

F. ROE Analysis: Risk Screening Factors

36. In the *February 2008 Order*, the Commission stated that once the appropriate proxy group is identified, it should be screened to ensure that only companies with comparable risks are included.⁷¹ The Commission utilized the screening parameters accepted in

⁶⁷ *Id.*, Exhibit. No. SC-3.

⁶⁸ CPUC Brief at 3, 27, Exhibit PUC-1 at 3-6.

⁶⁹ *Id.* at 28, Exhibit PUC-1 at 3-6.

⁷⁰ *Id.* at 3.

⁷¹ *February 2008 Order*, 122 FERC ¶ 61,187 at P 25.

Atlantic Path 15, including: (1) using only those utilities that are currently paying cash dividends; (2) using utilities that are covered by two generally recognized utility industry analysts; (3) using utilities that had similar senior bond and/or corporate credit ratings; (4) using utilities that had not announced a merger during the six-month period; and (5) using utilities that have both a Thompson Financial First Call (IBES) growth rate and are covered by Value Line.⁷²

37. In their briefs and paper hearing filings, the parties⁷³ suggested different DCF proposals using a national proxy group that would include some combination of the following screening criteria: (1) a national comparable group of companies categorized as electric utilities by Value Line Investment Survey; (2) Standard and Poor's issuer credit rating of A-, BBB+ or BBB for each company; (3) have a Value Line Safety Rank of 3; (4) have a Standard and Poor's business profile of "excellent" or "strong;" (5) each of the companies having annual electric revenues of at least \$1 billion; (6) were currently paying a stock dividend as of the time of this analysis and each company's dividend payments were expected to continue; (7) none of these companies were involved in merger activity or major restructuring during the period of analysis; (8) utilities with annual revenues from 80 percent of regulated business; and (9) analyst forecast having consensus of at least two analysts. In addition, the parties differ on adjusting the resulting DCF range to (1) exclude results for companies whose low-end DCF results were either less than 30 or 100 basis points above the yields for A and Baa utility bonds, and (2) exclude utilities whose high-end DCF results above 17.7 percent or utilities whose growth rates are above 13.3 percent.

38. In addition to listing its preferred screening factors, the CPUC raised several additional concerns about the establishment of a comparable proxy group. The CPUC argues that the Commission relied upon a faulty DCF calculation, because the WECC-wide proxy group resulted in creating an exaggerated high-end of the zone of reasonableness.⁷⁴ The CPUC argues that the Commission's WECC-wide proxy group eliminated three low-end DCF results of companies, IDACORP, Inc., Pinnacle West, and PNM, but kept in the high-end DCF results for these companies.⁷⁵ The CPUC argues that selective use of data is improper, and that in *Bangor Hydro* the Commission recently acknowledged the inappropriateness of including only one end ROE in a DCF calculation.⁷⁶ In keeping with

⁷² *Id.* P 27.

⁷³ CPUC Exhibit PUC-1 at 42; Six Cities Affidavit of Mr. Solomon at 12-13.

⁷⁴ CPUC Brief Exhibit PUC-1 at 30-34, 44-48.

⁷⁵ *Id.* at 16; Exhibit PUC-1 at 35.

⁷⁶ *Id.* at 16, citing *Bangor Hydro*, 117 FERC ¶ 61,129 at P 54.

this decision, the CPUC contends that the Commission should not have used data for these companies. The CPUC asserts that the proxy group adopted by the Commission in the *February 2008 Order* excluded three companies with corporate credit ratings of BBB-, but included a fourth company, PNM with an identical rating.⁷⁷ The CPUC also argues that NiSource Inc. should be excluded from the proxy group, because of its Standard and Poor corporate credit rating of BBB-. The CPUC explains that SoCal Edison's corporate credit rating is BBB+, and that SoCal Edison's company risks and overall DCF results are exaggerated by the inclusion of these lower rated companies.⁷⁸

39. The CPUC further asserts that the DCF analysis "suffers from outlier bias"⁷⁹ because it relies on only two companies, PNM Resources, with the lowest DCF, and Exelon, with the highest DCF, to set the zone of reasonableness. Further, the CPUC argues that PNM's 13.67 percent ROE was used to establish the upper end of *Atlantic Path 15's* zone of reasonableness. In turn, the CPUC alleges this upper end ROE was used by the Commission in the *February 2008 Order*. The CPUC contends that by using PNM's 13.67 percent ROE, the Commission did not rely on a proxy group, but, instead, relied entirely on the highest company's ROE to establish the zone of reasonableness, thereby ignoring other companies' data.⁸⁰ The CPUC further argues that if the Commission accepts this approach, an applicant will only need to show that its proposed ROE is not as high as one other comparable company's high DCF ROE and, accordingly, an applicant will be able "simply to cherry pick" one company's outlying high ROE.⁸¹

40. Regarding SoCal Edison's proposal, the CPUC argues that SoCal Edison's analysis includes certain companies with growth rates that are higher than the Commission would include. The CPUC contends that the Commission has stated that companies with growth rates of 13.3 percent or higher should not be included in a DCF analysis.⁸² Thus, the CPUC argues that Exelon Corp., Constellation Group, and Public Service Enterprise Group Inc. (PSEG) should be eliminated from SoCal Edison's proxy group.

⁷⁷ *Id.* at 14; *see also* CPUC Brief Exhibit PUC-1 at 33; Ex. PUC-8. The CPUC argues that PNM's credit rating is as of December 17, 2007, prior to SoCal Edison's submission of its proposal.

⁷⁸ *Id.*; Exhibit PUC-1 at 18.

⁷⁹ *Id.* at 27; CPUC Brief Exhibit 1 at 33-35.

⁸⁰ *Id.* at 16.

⁸¹ *Id.* at 17.

⁸² *Id.*

41. Six Cities assert that SoCal Edison has mischaracterized the Commission's rationale for excluding PPL Corporation (PPL) from the proxy group in *ISO New England*.⁸³ Six Cities argue that, although the Commission recognized that PPL's DCF result of 17.7 percent was an extreme outlier, Six Cities contend that SoCal Edison is incorrect that this was the only reason the Commission excluded PPL.⁸⁴ Six Cities argue that PPL was also eliminated from the proxy group because its 13.3 percent growth rate was unsustainable. Six Cities argue that this treatment of companies with unsustainable growth rates is consistent with the Commission's orders in *VEPCO*⁸⁵ and *PATH*.⁸⁶ Therefore, Six Cities contend that Exelon, DPL and Centerpoint Energy should be eliminated from any proxy group because they have unsustainable growth rates.⁸⁷

42. SoCal Edison challenges the CPUC's assertion that, following the reasoning of *ISO New England*,⁸⁸ three companies, Constellation, Exelon Corporation and PSEG, have growth rates that are too high to be included within SoCal Edison's proxy group. On the contrary, SoCal Edison states that it followed the Commission's reasoning in *ISO New England* and excluded Constellation and PSEG from its DCF analysis.⁸⁹ SoCal Edison explains that it excluded these companies because their DCF results were above 17.7 percent. Further, SoCal Edison comments that it included Exelon because this DCF result was below 17.7 percent. SoCal Edison also argues that the growth rates included in its DCF analysis are lower than those rejected by the Commission in *ITC Holdings Corp.*⁹⁰ and, therefore, its analysis is consistent with Commission precedent.⁹¹

43. SoCal Edison also responds to the CPUC's argument that SoCal Edison has included in its proxy group companies that have Standard & Poor credit ratings lower than SoCal

⁸³ Six Cities Answering Brief at 7.

⁸⁴ *Id.* at 8.

⁸⁵ *Va. Elec. Power Co.*, 123 FERC ¶ 61,098 (2008) (*VEPCO*).

⁸⁶ *Potomac-Appalachian Transmission Highline*, 122 FERC ¶ 61,188 (2008) (*PATH*).

⁸⁷ *Id.*

⁸⁸ *ISO New England, Inc.*, 109 FERC ¶ 61,147, at P 205 (2004) (*ISO New England*).

⁸⁹ SoCal Edison Brief at 30.

⁹⁰ *ITC Holdings Corp.*, 121 FERC ¶ 61,229 (2007) (*ITC Holdings*).

⁹¹ SoCal Edison Brief at 31.

Edison's BBB+. SoCal Edison argues that it included only those companies that have the same bond rating as SoCal Edison, plus companies with one rating below (BBB) and one rating above (A-).⁹² Thus, SoCal Edison contends that while the CPUC is correct that SoCal Edison's comparable group includes companies with Standard & Poor ratings that are lower than SoCal Edison's rating, the CPUC is ignoring the fact that the SoCal Edison comparable group also includes companies with Standard & Poor ratings higher than SoCal Edison's rating. SoCal Edison argues that this approach is consistent with Commission precedent.⁹³

44. SoCal Edison disagrees with the CPUC that it should have excluded NiSource and PNM from its proxy group. SoCal Edison asserts that the downgrading of these companies occurred after the time period within which SoCal Edison performed its DCF analyses.⁹⁴ Accordingly, SoCal Edison contends that it would have been improper to exclude these two companies from its DCF analysis.

45. SoCal Edison disagrees with the CPUC's contention that SoCal Edison should have excluded Exelon from its analysis, as well as the low-end DCF estimates for Constellation Energy Group and PSEG. SoCal Edison defends including Exelon, asserting that the CPUC's arguments against including Constellation and PSEG as being based upon a misunderstanding of *Bangor Hydro*.⁹⁵ SoCal Edison argues that the relationship of the company's DCF analysis to the company's cost of debt was at issue in *Bangor Hydro*, not growth rates.⁹⁶

46. SoCal Edison also disagrees with assertions by the CPUC and Six Cities that the Commission should exclude companies with growth rates above 13.3 percent. SoCal Edison explains that the Commission screens high DCF estimates, but it is not proper to screen for growth rates above 13.3 percent because these rates are not sustainable.⁹⁷

⁹² *Id.* at 31; December Filing Exhibit SCE-7 at 18-19.

⁹³ SoCal Edison Brief Exhibit SCE-12 at 17; *see also N. Ind. Pub. Serv. Co.*, 101 FERC ¶ 61,394, at P 38 (2002); *Consumers Energy Co.*, 86 FERC ¶ 63,004, at 65,023, *aff'd*, 98 FERC ¶ 61,333, at 62,412.

⁹⁴ SoCal Edison Reply Brief at 17.

⁹⁵ SoCal Edison Brief at 30-31, *citing Bangor Hydro*, 117 FERC ¶ 61,129 at P 53.

⁹⁶ SoCal Edison Reply Brief at 23.

⁹⁷ *Id.* at 27.

47. SoCal Edison contends that the Commission will remove DCF estimates that are near the cost of debt for a company. SoCal Edison also argues that the CPUC would include Alliant Energy, Hawaiian Electric and Progress Energy even though SoCal Edison excluded all these companies from its DCF analysis because of their low-end DCF estimates.⁹⁸ In response to Six Cities, SoCal Edison argues that it is not reasonable to include the IDACORP's low-end DCF result because it is 90 basis points above the cost of debt. Although SoCal Edison acknowledges that the Commission has not established a "bright-line" requirement for the extent to which a low-end DCF result must exceed the utility's cost of debt, SoCal Edison questions whether an investor will invest in a company that offers a return premium of only 90 basis points above the utility's cost of debt. SoCal Edison argues that the cutoff point should be at least 100 basis points.⁹⁹

48. SoCal Edison disagrees with the CPUC's argument that it should have included in the DCF analysis companies that are considered "high risk" because of the percentage of their revenues that come from unregulated business. SoCal Edison explains that bond ratings are a measure of risk for which it screened when it constructed its proxy group.¹⁰⁰ Further, SoCal Edison comments that it computed the average bond ratings for the companies that the CPUC identified as not deriving 80 percent of their revenue from regulated business and concluded that the bond ratings were nearly identical.¹⁰¹ SoCal Edison also contends that to exclude these companies would only make the DCF analysis less robust.¹⁰²

49. Further, SoCal Edison points out that the Commission's standard DCF analysis does not consider as a factor the percentage of revenues a company derives from regulated business. Thus, SoCal Edison concludes that the CPUC's criticism is unfounded. SoCal Edison contends that Six Cities' DCF analysis is invalid because it uses Value Line Safety Rank for its parent corporation as a screen.¹⁰³ SoCal Edison also disputes the use of both the Standard and Poor's corporate credit rating and business profile. SoCal Edison argues that both of these screens duplicate information because the S&P business profile information already is incorporated in the S&P corporate credit rating. Further, SoCal

⁹⁸ *Id.* at 28.

⁹⁹ *Id.* at 29-30.

¹⁰⁰ *Id.* at 21.

¹⁰¹ *Id.* at 21-22.

¹⁰² *Id.*

¹⁰³ *Id.* at 31.

Edison contends that Six Cities' use of the DCF growth rate criterion is unreasonably restrictive. Six Cities would require that the individual growth rate for a single company be lower than the low estimate of required returns for a group of companies. SoCal Edison asserts that this is inconsistent with Commission precedent and biases Six Cities' recommendation downward.¹⁰⁴

1. Commission Determination

50. In this proceeding, based upon our analysis of the briefs, corresponding testimony and associated work papers, and Commission precedent, we have determined that SoCal Edison's proposed screening factors are generally reasonable, but not entirely consistent with Commission precedent. Specifically, we find that the seven general screening factors utilized by SoCal Edison are consistent with Commission precedent and are appropriate in the determination of the base ROE in this proceeding. However, as discussed below, our review also indicates that modifications to SoCal Edison's proposed screening parameters are required, and these modifications result in a different proxy group and resulting range of reasonableness than proposed by SoCal Edison.

51. First, we note that a number of screening criteria are both consistent with Commission precedent and not protested. As such, we accept the following screening criteria without further discussion: (1) electric utilities that did not announce a merger; (2) electric utilities that paid dividends; (3) a national comparable group of electric utilities covered by Value Line; (4) electric utilities that have an S&P corporate credit rating of A-, BBB+ or BBB; (5) electric utilities having annual revenues above \$1 billion; and (6) electric utilities that are covered by two generally recognized utility industry analysts.

52. We will now address those screening factors that have been contested or are inconsistent with Commission precedent.

a. Corporate Credit Rating

53. Because its corporate credit rating at the time of its filing was a BBB+, SoCal Edison included in its proxy group utilities that had a Standard and Poor's issuer credit rating of A-, BBB+ or BBB for each company. SoCal Edison asserted that including companies with bond ratings one rating below and one rating above is consistent with Commission precedent. We agree. However, the CPUC argues that PNM and NiSource should have been eliminated from the proxy group because they have a corporate credit rating of BBB-, which is outside the one rating below threshold. Our review of the record shows that the corporate credit ratings of both PNM and NiSource were BBB as of November, 2007, and that their ratings did not drop to BBB- until December, 2007. Thus, at the time of SoCal

¹⁰⁴ *Id.*

Edison's filing of its latest six-month financial data, PNM and NiSource had corporate credit ratings within the one rating threshold. Therefore, the corporate credit rating screen does not eliminate either PNM or NiSource from the proxy group at issue in this proceeding.

b. Low-End DCF Results

54. SoCal Edison adjusted its DCF range by excluding the results of companies whose low-end DCF results were less than 100 basis points above the yields for A and Baa utility bonds.¹⁰⁵ Six Cities argue that the low-end DCF result must exceed the Moody's six-month average yield on Baa public utility bonds by at least 30 basis points. A review of the Commission's precedent regarding low-end returns indicates that in Opinion No. 489,¹⁰⁶ the Commission eliminated companies whose ROEs were below the bond yield for that particular rating. In Opinion No. 445,¹⁰⁷ the Commission eliminated companies whose ROEs were less than 36 basis points above the average Moody's bond yield for that particular rating. In *Atlantic Path 15*¹⁰⁸ and *Startrans*,¹⁰⁹ the Commission eliminated companies whose ROEs were less than 100 basis points above Moody's bond yield for that particular rating. More recently, in *Pioneer Transmission, LLC*,¹¹⁰ the Commission excluded from the proxy group companies whose low-end ROEs were within about 100 basis points above the cost of debt.

55. We find that, consistent with *Pioneer*, it is reasonable to exclude any company whose low-end ROE fails to exceed the average bond yield by about 100 basis points or more, taking into account the extent to which the excluded low-end ROEs are outliers from the low-end ROEs of other proxy group companies. This gives the Commission flexibility to exclude from the proxy group companies whose low-end ROE is somewhat above the average bond yield, but is still sufficiently low that an investor would consider the stock to "yield essentially the same return"¹¹¹ as debt. In such individual cases, the cut-off point for

¹⁰⁵ SoCal Edison states that the Moody's bond rate for 'Baa' utilities is 6.44 percent and for 'A' utilities is 6.18 percent.

¹⁰⁶ See *Bangor Hydro*, 117 FERC ¶ 61,129.

¹⁰⁷ See *S. Cal. Edison Co.*, 92 FERC ¶ 61,070 (2000).

¹⁰⁸ 122 FERC ¶ 61,135.

¹⁰⁹ 122 FERC ¶ 61,306.

¹¹⁰ *Pioneer Transmission, LLC*, 126 FERC ¶ 61,281, at P 94 (2009); *order denying reh'g*, 130 FERC ¶ 61,044 (2010) (*Pioneer*).

¹¹¹ *S. Cal Edison*, 92 FERC ¶ 61,070 at 61,266.

including or excluding a company from the proxy group could vary a bit from the standard of about 100 basis points adopted in *Atlantic Path 15* and other recent cases, depending upon where the natural break is in the array of low-end ROEs of the candidate proxy group companies that would distinguish outliers from non-outliers.

56. In this proceeding, we have determined that the Moody's six-month average yield on Baa public utility bonds ending November, 2007 is 6.44 percent. There are five companies whose low-end ROEs are less than the 6.44 percent bond yield plus 100 basis points, or 7.44 percent. These are Hawaiian Electric Industries, Inc. (Hawaiian), PNM, NiSource, DTE Energy Co. (DTE), and Progress Energy Inc (Progress), whose low-end ROEs are 5.39 percent, 6.54 percent, 6.74 percent, 7.31 percent, and 7.41 percent respectively. The companies with the next lowest low-end ROEs are Alliant Energy Corp. (Alliant) and OGE Energy Corp. (OGE) with low-end ROEs of 7.46 percent and 7.80 percent respectively. SoCal Edison thus presents an awkward situation, whereby strict application of the 100 basis point standard would lead to exclusion of Progress with a low-end ROE 97 basis points above the bond yield, but the inclusion of Alliant with a low-end ROE 102 basis points above the bond yield. In these circumstances, it would appear more reasonable to exclude Alliant along with the other five companies, on the ground that the natural break point between the too low ROEs and those not too low lies between Alliant's 7.46 percent ROE and OGE's 7.80 percent ROE, rather than between Progress's 7.41 percent ROE and Alliant's 7.46 percent ROE. Thus, when applying the low-end screen to SoCal Edison's proposed proxy group, the following companies are eliminated from the group: DTE, Hawaiian, NiSource, Progress, PNM and Alliant.

c. High-End DCF Results

57. SoCal Edison states that it adjusted the DCF range to exclude high-end DCF results above 17.7 percent, consistent with *ISO New England*.¹¹² As a result of this adjustment, SoCal Edison removed the high-end results of Constellation Energy Group and PSEG from its proxy group analysis. Six Cities¹¹³ and the CPUC argue that although the Commission recognized in *ISO New England* that PPL's DCF result of 17.7 percent was an extreme outlier, SoCal Edison is incorrect that this was the only reason the Commission excluded PPL. Six Cities and the CPUC argue that PPL was also eliminated from the proxy group because its 13.3 percent growth rate was unsustainable. We agree with the intervenors here. In *ISO New England*, the Commission found that PPL should be excluded from the proxy group based on both its growth rate (13.3 percent) and its resulting ROE (17.7 percent).¹¹⁴

¹¹² *ISO New England*, 109 FERC ¶ 61,147.

¹¹³ Six Cities Answering Brief at 2-3.

¹¹⁴ *ISO New England*, 109 FERC ¶ 61,147 at P 205; see also *Bangor Hydro*, 117 FERC ¶ 61,129 at P 24.

The Commission found that PPL's high-end cost of equity was an extreme outlier and its inclusion in the calculation would skew the results. The Commission concluded that "it is often necessary to eliminate illogical results from cost of equity estimates that fail to meet threshold tests of economic logic."¹¹⁵ The Commission also concluded that PPL's growth rate of 13.3 percent was not a sustainable growth rate over time and, therefore, did not meet threshold tests of economic logic.¹¹⁶ Therefore, we find that it is appropriate to eliminate from the proxy group all companies whose growth rate is greater than or equal to 13.3 percent. Thus, when applying the 13.3 percent growth rate screen to SoCal Edison's proxy group, we conclude that in accordance with *ISO New England*, PPL Corporation also should be eliminated.

58. Additionally, our review of SoCal Edison's analysis indicates that when SoCal Edison removed a high-end outlier from its proxy group analysis, it did not remove the corresponding low-end result for that company. The CPUC argues that selective use of data is improper and that in Opinion No. 489 the Commission recently acknowledged the inappropriateness of including only one end ROE in a DCF calculation. We agree. As we stated in Opinion No. 489, the use of only one end of the DCF calculation would skew the Commission's DCF method.¹¹⁷ Therefore, when we eliminate either the high-end or low-end ROE outlier of a company, we have also eliminated the corresponding low-end or high-end ROE of that company. Thus, when we screen the national proxy group by applying the risk factors described herein, we determine that the zone of reasonableness for SoCal Edison is between 7.80 percent and 16.19 percent.

59. In its request for rehearing, the CPUC protests the Commission's use of analysis from *Atlantic Path 15* to determine the range of returns in the *February 2008 Order*.¹¹⁸ As we explained above, the Commission established the paper hearing to allow all interested parties the opportunity to comment on the preliminary analysis of SoCal Edison's proposal set forth in the *February 2008 Order*. The Commission's preliminary determination in the *February 2008 Order* was made subject to further review, based upon the record supplemented by the parties. Because we find that all parties were afforded ample opportunity to provide comments regarding our preliminary determinations, we deny the CPUC's request for rehearing. Furthermore, as set forth above, we are providing an analysis of the screening factors. For these reasons, we reject the CPUC's arguments about

¹¹⁵ *Id.* P 205.

¹¹⁶ *Id.*

¹¹⁷ *Id.* P 54.

¹¹⁸ CPUC Request for Rehearing at 7-9, 31-34.

the appropriate DCF analysis and screening factors for developing an appropriate proxy group, and we also deny the CPUC's request for rehearing.

G. Other Risk Related Issues

1. California's Business and Regulatory Environment and Incentive Adders

60. The CPUC contends that the Commission should consider the unique risks and rewards in California that the CPUC asserts make SoCal Edison's investments much less risky than other companies in the SoCal Edison and WECC-wide proxy groups. Specifically, the CPUC asserts that because SoCal Edison's transmission costs are rolled into the CAISO's Transmission Access Charges (TAC), SoCal Edison receives revenues for its transmission costs from transmission users statewide. Additionally, the CPUC argues that the Commission recently granted SoCal Edison a 50 basis point adder, which was added to SoCal Edison's base ROE for participation in the CAISO.¹¹⁹

61. The CPUC also contends that California laws and CPUC's own actions have lowered SoCal Edison's risks. The CPUC comments that in California over 50 percent of the energy revenue requirements are protected by balancing account recovery, but that in this proceeding, there is no evidence to support the position that any of the companies in the WECC or SoCal Edison's proxy group have this same amount of balancing account protection. Moreover, the CPUC asserts that California Public Utilities Code section 454.5 provides mechanisms that reduce regulatory uncertainty and eliminate procurement-related risks. The CPUC also argues that its recent Energy Efficiency decisions¹²⁰ provide the opportunity for high utility profits with funding provided by ratepayers instead of investment by shareholders,¹²¹ and that this consideration should be factored into the determination of risk for SoCal Edison.

62. Moreover, the CPUC argues that SoCal Edison does not have a comparable risk profile because SoCal Edison is the only California company within this proxy group for which the Commission has granted 100 percent recovery of CWIP in their Rate Base,

¹¹⁹ *Incentives Order*, 121 FERC ¶ 61,168 at P 158.

¹²⁰ CPUC Decision (D.) 07-09-043, *Order Instituting Rulemaking to Examine the Commission's post-2005 Energy Efficiency Policies, Programs, Evaluation, Measurement and Verification, and Related Issues*, 2007 Cal. PUC LEXIS 451, *6. (Cal. PUC 2007); D. 08-01-042, *Interim Opinion: Joint Petition for Modification of D. 07-09-043*, 2008 Cal PUC LEXIS 35 (Cal. PUC 2008).

¹²¹ CPUC Brief at 32.

Abandoned Plant and ROE incentives.¹²² The SWP concurs that these Commission actions have reduced SoCal Edison's risk as viewed by investors and offers a shield to ratepayers.¹²³ The CPUC argues that companies without these incentives have higher risks and should be entitled to a higher ROE, but notes that two other large California utilities, San Diego Gas & Electric (SDG&E) and PG&E, have lower authorized ROEs than SoCal Edison.¹²⁴ The CPUC asserts that granting a higher ROE to SoCal Edison than those granted to these other companies would be inconsistent with the Commission's decision in *ITC Holdings*¹²⁵ that denied an ROE based upon a previously authorized ROE for members of the Midwest ISO. The CPUC also argues that if SoCal Edison is granted its requested ROE, the top of the zone of reasonableness will eventually become the base ROE for later applicants, to the detriment of ratepayers.¹²⁶

63. SoCal Edison disagrees with CPUC's contention that California is a "low risk" regulatory environment and argues that the CPUC has not provided adequate support for this allegation. SoCal Edison also contends that there is no evidence that other companies in the proxy group do not benefit from other risk reducing programs in their individual states.¹²⁷

64. SoCal Edison argues that the CPUC's assertions about the effect of SoCal Edison's Commission-approved incentives on its risk amounts to an impermissible collateral attack on the *Incentives Order*. SoCal Edison asserts that in the *Incentives Order* the Commission took into account such reductions of risk and on this basis, the Commission reduced the amount of ROE incentives requested by SoCal Edison.¹²⁸

¹²² *Id.* at 15.

¹²³ *Id.*; SWP Brief at 4.

¹²⁴ The CPUC represents that it authorized an 11.1 percent ROE for San Diego Gas and Electric Company (SDG&E) and an 11.35 percent ROE for PG&E, both of which were at the upper end of the zone of reasonableness. CPUC Brief Exhibit PUC-9, (CPUC D. 07-12-049 at 41-43, 45-47.) The CPUC notes that the ROE for SDG&E was adopted pursuant to a settlement and the parties agreed that it would not have precedential effect. CPUC Brief at 23, n.2.

¹²⁵ *ITC Holdings*, 121 FERC ¶ 61,229 at P 17.

¹²⁶ CPUC Brief at 23.

¹²⁷ SoCal Brief at 37.

¹²⁸ *Id.* at 36-37.

65. SoCal Edison acknowledges that it has balancing account protection, but it also explains that its power procurement mix is substantially different from the typical U.S. electric utility, which creates more volatile fuel and purchase power costs.¹²⁹ Further, SoCal Edison disagrees with the CPUC's comments regarding California's energy efficiency programs and argues that the CPUC ignores the potential for shareholder loss from energy efficiency programs.¹³⁰ SoCal Edison also argues that the Commission did not err by including in the WECC proxy group companies that did not have CWIP in the rate base or have guaranteed recovery of abandoned plant.¹³¹ SoCal Edison argues that the Commission has never used CWIP or abandoned plant recovery as proxy group criteria. SoCal Edison contends that these ratemaking features apply to a relatively small amount of its rate base and, to the extent that they reduce SoCal Edison's risk, that would be reflected in its bond rating.¹³²

66. Finally, SoCal Edison also argues that the CPUC mischaracterizes the *ITC Holdings*¹³³ decision to support its conclusion that SoCal Edison's base ROE is excessive. According to SoCal Edison, the Commission found that the applicant in *ITC Holdings* did not support its requested ROE with a proper DCF analysis. In contrast, SoCal Edison asserts that the Commission previously granted ROE incentives to SoCal Edison, and in this proceeding SoCal Edison has filed a complete DCF analysis showing that its total requested ROE to be applied to CWIP expenditures is within the zone of reasonableness.¹³⁴

Determination

67. The CPUC asserts that the Commission in this proceeding should consider California's business and regulatory environment when determining an ROE for SoCal Edison. However, we find that these additional, California-specific, risk-related considerations raised by the CPUC are the type of risk factors that were previously considered by the Commission in the *Incentives Order*¹³⁵ when it granted the incentives

¹²⁹ SoCal Edison Reply Brief at 24.

¹³⁰ *Id.* at 24-25.

¹³¹ *Id.* at 13.

¹³² *Id.*

¹³³ *ITC Holdings*, 121 FERC ¶ 61,229 at P 41.

¹³⁴ SoCal Edison Brief at 36.

¹³⁵ *Incentives Order*, 121 FERC ¶ 61,168; *order on reh'g*, 123 FERC ¶ 61,293 (2008).

adders. Further, these risk factors are not applicable when determining the base ROE. As we explained herein, when establishing a base ROE for SoCal Edison, we utilize the DCF methodology, and apply a significant set of screening factors. As a result of this process, we have developed a reasonable proxy group that has been sufficiently screened for risk.

68. Further, we do not agree with the CPUC's assertion that *ITC Holdings* requires us to reject SoCal Edison's proposed ROE because it is higher than ROEs granted to two utilities that also operate in California. Unlike ITC Midwest, the ITC Holdings subsidiary operating in the Midwest ISO region, SoCal Edison does not operate in a region where the Commission has granted an ROE for all the ISO/RTO constituent transmission owners. For this reason, *ITC Holdings* does not compel us to limit SoCal Edison's request to ROEs granted to other California companies. However, we agree with SoCal Edison that, following the reasoning of *ITC Holdings*, the applicant must demonstrate that its proposed ROE is supported by a DCF analysis using a proxy group of companies reflecting risks comparable to the applicant and that its proposal is within the zone of reasonableness.¹³⁶

69. In its request for rehearing, the CPUC raised the issue of other risks factors.¹³⁷ For the reasons discussed herein, the Commission denies the CPUC's request for rehearing.

2. CPUC Proceeding

70. Prior to SoCal Edison submitting its December 2007 Filing proposal, the CPUC granted SoCal Edison an ROE for its CPUC-jurisdictional assets in a separate proceeding at the California state level.¹³⁸ In this California proceeding, the CPUC determined that a reasonable range of returns for SoCal Edison's ROE was from 10.20 percent to 11.50 percent. The CPUC included in this range 60 basis points for additional risk factors. Hereafter, in the instant proceeding, the CPUC and SWP argue that this CPUC decision includes risk factors that should not be considered in the instant filing because the Commission authorized SoCal Edison CWIP and Abandoned Plant incentives, which also reduce risk.¹³⁹

¹³⁶ *ITC Holdings*, 121 FERC ¶ 61,229 at P 17.

¹³⁷ CPUC Request for Rehearing at 28-30.

¹³⁸ CPUC Brief Exhibit PUC-9, CPUC Decision 07-12-049, Application of Southern California Edison Company for Authorized Cost of Capital for Utility Operations for 2008. December 21, 2007.

¹³⁹ CPUC Brief at 20 – 21; SWP Brief at 4.

71. SoCal Edison denies that its ROE proposal in the instant proceeding relies upon the CPUC's recently authorized ROE for SoCal Edison.¹⁴⁰ SoCal Edison contends that, although it limited its ROE request in its December 2007 Filing to the ROE approved by the CPUC, its ROE analysis is based upon a discrete analysis provided to the Commission. SoCal Edison also argues that the DCF estimates in the CPUC Decision¹⁴¹ do not define a "zone of reasonableness" in the same way that it is defined by the Commission using individual company estimates. SoCal Edison concludes that the CPUC's protest relies upon a faulty interpretation of the Commission's use of the term "zone of reasonableness" and should be rejected.¹⁴²

Determination

72. The Commission's DCF analysis is based upon the record of this proceeding, and the Commission's independent calculation of the relevant data, as we explain herein. Consequently, our analysis is not affected by the methodology or calculations applied by the CPUC in its proceedings or its final ROE determinations for SoCal Edison. We also find that the assertions of the CPUC and SWP regarding the degree of risk of SoCal Edison's three transmission projects are, in essence, a collateral attack upon the *Incentives Order* in which the Commission granted to these projects incentive rate treatment pursuant to Order No. 679. In the *Incentives Order*, the Commission determined that the CWIP and abandoned plant cost recovery incentives reduced SoCal Edison's overall risk and, consequently, the Commission modified the ROE adders for the three projects.¹⁴³ Accordingly, we reject these assertions and deny the request of the CPUC for rehearing.

¹⁴⁰ SoCal Edison Brief at 33.

¹⁴¹ CPUC Decision No. 07-12-049, Application of Southern California Edison Company (U 338-E) for Authorized Cost of Capital for Utility Operations for 2008, issued on December 21, 2007, *available at* http://docs.cpuc.ca.gov/word_pdf/final_decision/76920.PDF.

¹⁴² SoCal Edison Brief at 35.

¹⁴³ *Incentives Order*, 121 FERC ¶ 61,168 at P 129, *citing* Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 at P 6 ("[i]f some of the incentives in the package reduce the risks of the project, that fact will be taken into account in any request for an enhanced ROE"); *order on reh'g*, 123 FERC ¶ 61,293 (2008).

H. Securing Capital

73. The CPUC argues that neither SoCal Edison nor the Commission determined whether SoCal Edison's proposed ROEs are higher than necessary to attract capital.¹⁴⁴ The CPUC also argues that the SoCal Edison request of over \$7 billion in capital additions in a general rate case filing it submitted to the CPUC¹⁴⁵ shows that SoCal Edison will not have difficulty attracting capital at a much lower ROE than it is requesting here.¹⁴⁶

74. SoCal Edison responds that the CPUC misunderstands that the incentives are designed to induce SoCal Edison to allocate scarce capital to projects that are riskier than other projects that are competing for capital within SoCal Edison.¹⁴⁷ SoCal Edison also contends that the CPUC's comments address the *Incentives Order* and not the *February 2008 Order*.¹⁴⁸

Determination

75. We do not agree with the CPUC that SoCal Edison should show that an ROE lower than its request would make it difficult to attract capital. In essence, this assertion is a collateral attack on the Commission's *Incentives Order*, which specifically considered intervenors' protests concerning SoCal Edison's assessment of the financial risks it would undertake with these projects. The Commission determined that SoCal Edison's risks and challenges warranted incentives for these three projects. However, the Commission also concluded that SoCal Edison's overall risk would be ameliorated by the CWIP and abandoned plant cost recovery. For this reason, in the *Incentives Order*, the Commission reduced SoCal Edison's proposed adders in accordance with its assessment of SoCal Edison's reduced overall risk.¹⁴⁹ In the paper hearing, we establish a base ROE and add to it the incentives approved in the *Incentives Order* to determine an overall ROE that is within the zone of reasonableness. Thus, we find that this process complies with the

¹⁴⁴ CPUC Brief Ex. PUC-1 at 7.

¹⁴⁵ *Id. citing to* A.07-11-011, Application of Southern California Edison Company (U 338-E) for Authority to, Among Other Things, Increase Its Authorized Revenues For Electric Service In 2009, and to Reflect That Increase In Rates.

¹⁴⁶ CPUC Brief Ex. PUC-1 at 7.

¹⁴⁷ SoCal Edison Reply Brief at 16-17.

¹⁴⁸ *Id.* at 17.

¹⁴⁹ *Incentives Order*, 121 FERC ¶ 61,168 at P 129.

directive in Order No. 679 to achieve a balance between the investor and consumer interests.¹⁵⁰

76. The CPUC raises the issue of the level of SoCal Edison's ROE for securing capital in its request for rehearing of the February 2008 Order.¹⁵¹ For the reasons discussed herein, the Commission denies the CPUC's request for rehearing.

I. Median vs. Midpoint¹⁵²

1. SoCal Edison's Proposal

77. In its December 2007 Filing, SoCal Edison proposed an 11.5 percent base ROE that was calculated using the midpoint of the range of returns on equity generated from a national proxy group.¹⁵³ SoCal Edison asserts that the use of the midpoint is consistent with a long line of Commission precedent for determining the ROE for electric utilities.¹⁵⁴

¹⁵⁰ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 94.

¹⁵¹ CPUC Request for Rehearing at 22-24.

¹⁵² The median is calculated by sorting the average of the high and low DCF results of each company in the proxy group from lowest value to highest value, and then selecting the central value of the sequence. Where there is an even number of results, the median is the average of the two central numbers. The midpoint is the average of the highest and lowest data points in the range of reasonable returns.

¹⁵³ SoCal Edison Brief at 22, Exhibit SCE-7 at 24.

¹⁵⁴ SoCal Edison Brief at 22, citing *Norwalk Power, LLC*, 120 FERC ¶ 61,048, at P 48 (2007); *Bangor Hydro-Electric Co.*, 117 FERC ¶ 61,129, at P 2 (2006); *Bridgeport Energy, LLC*, 112 FERC ¶ 61,07,7 at P 48 (2005); *Milford Power Co., LLC*, 110 FERC ¶ 61,299, at P 72 (2005); *ISO New England, Inc.*, 108 FERC ¶ 61,272 (2004); *Midwest ISO*, 100 FERC ¶ 61,292 (2002), *order on remand*, 106 FERC ¶ 61,302, at PP 9-10 (2004), *aff'd sub nom. Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir. 2005); *Devon Power Co.*, 106 FERC ¶ 61,264, at P 23 (2004); *PPL Wallingford Energy LLC*, 105 FERC ¶ 61,324, at P 27 (2003); *Allegheny Power*, 103 FERC ¶ 63,001, at 65,003 (2003), *aff'd*, Opinion No. 469, 106 FERC ¶ 61,241, at P 24 (2004); *Devon Power Co.*, 104 FERC ¶ 61,123, at P 4 (2003); *N. Ind. Pub. Serv. Co.*, 101 FERC ¶ 61,394, at P 38 (2002); *Consumers Energy Co.*, Opinion No. 456, 98 FERC ¶ 61,333, at 62,416 (2002); *Southern California Edison Co.*, Opinion No. 445, 92 FERC ¶ 61,070, at 61,266-67 (2000); *System Energy Resources, Inc.*, Opinion No. 446, 92 FERC ¶ 61,119, at 61,147 (2000).

For example, SoCal Edison argues that in *Southern California Edison*¹⁵⁵ the Commission refused to apply the two-stage DCF method used in gas cases to electric utilities and, instead, relied upon the midpoint to set the ROE.¹⁵⁶ SoCal Edison also argues that in 2003, the Commission rejected the use of the median in electric utility cases and stated in *Devon Power Co.*¹⁵⁷ that, as a general rule, the Commission applies the midpoint of the zone of reasonableness as the appropriate ROE. SoCal Edison contends that as recently as 2007 the Commission followed this precedent.¹⁵⁸

78. However, SoCal Edison also acknowledges that in *Golden Spread*¹⁵⁹ the Commission affirmed the use of the median rather than the midpoint for a single utility. The Commission stated that it preferred the use of the midpoint for deriving the ROE for a diverse group of utilities.¹⁶⁰ SoCal Edison indicates that it is not clear from *Golden Spread* that the Commission intended to reverse its policy of using the midpoint for determining the ROE for single electric utilities, or if the Commission's holding in *Golden Spread* is limited to that case. However, SoCal Edison also asserts that the recent *VEPCO* order suggests that the Commission is changing its policy.¹⁶¹ SoCal Edison argues that if the Commission is changing its policy of using the midpoint, it must explain its new policy or explain why it is disregarding its existing policies. Thus, SoCal Edison concludes that the Commission's disregard of existing policies, without explanation, is a failure of reasoned decision-making, and is therefore arbitrary and capricious.¹⁶²

79. Notwithstanding this concern, SoCal Edison also argues that the midpoint is the proper method to determine its base ROE because: (1) "only the midpoint *emphasizes* the range, as it is equally placed between the top and bottom values;"¹⁶³ (2) distortions occur

¹⁵⁵ *S. Cal. Edison Co.*, 92 FERC ¶ 61,070, at 61,260-62 (2000).

¹⁵⁶ *See Consumers Energy Co.*, 98 FERC 61,333, at 62,416 (2002); *Allegheny Power*, Opinion No. 469, 106 FERC ¶ 61,241, at P 24 (2004).

¹⁵⁷ *Devon Power Co.*, 104 FERC ¶ 61,123, at P 49 (2003).

¹⁵⁸ *Citing Norwalk Power, LLC*, 120 FERC ¶ 61,048, at P 48 (2007).

¹⁵⁹ *Golden Spread*, 123 FERC ¶ 61,047.

¹⁶⁰ *Id.* P 63, *citing Midwest ISO Order on Remand*, 106 FERC ¶ 61,302, at P 10 (2004).

¹⁶¹ 123 FERC ¶ 61,098 (2008).

¹⁶² SoCal Edison Brief at 25.

¹⁶³ *Id.* at 26, *quoting Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004, 1010 (D.C. (continued)

when using the median because it disregards the range of returns created by a DCF analysis;¹⁶⁴ and (3) applying the median results in lower returns on equity which undermines the Commission's and Congress' goal of expanding the transmission grid.¹⁶⁵

80. SoCal Edison also contends that when the distribution of proxy group estimates is symmetric, then the median and the midpoint will give nearly the same result. However, SoCal Edison points out that when the distribution is skewed, the midpoint generally takes the skewed distribution into account and will provide a more appropriate estimate when compared to the median.¹⁶⁶

81. SoCal Edison also disagrees with the assertion that using the median lessens the impact of any single proxy company whose ROE is atypically high or low. To the contrary, SoCal Edison argues that the median does not lessen the impact of the remaining, reasonable data elements; rather, the median ignores them.¹⁶⁷

2. Protests

82. Six Cities argue that the median is the best measure of central tendency for individual utilities, and that the use of the median of the proxy group range for individual utilities has been the Commission's policy since 2004.¹⁶⁸ Six Cities also contend that the use of the median was reaffirmed by the Commission in *Golden Spread*,¹⁶⁹ where the Commission reasoned that the median "had the advantage of taking into account more of the companies in a proxy group rather than only those at the top and bottom."¹⁷⁰ Six Cities assert that the Commission has explained that it prefers the median because the median, unlike the midpoint, gives full weight to the range¹⁷¹ while also recognizing that companies

Cir. 2005) (emphasis in original).

¹⁶⁴ *Id.* at 26, citing SoCal Edison Brief Exhibit SCE-12 at 21.

¹⁶⁵ *Id.* at 29.

¹⁶⁶ *Id.* at 22.

¹⁶⁷ *Id.* at 25.

¹⁶⁸ Six Cities Answering Brief at 3, citing to *Midwest ISO*, 106 FERC ¶ 61,302, *aff'd in relevant part sub nom., Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004, 1010-1011 (D.C. Cir. 2005) (the "MISO Remand Order").

¹⁶⁹ *Golden Spread*, 123 FERC ¶ 61,047.

¹⁷⁰ *Id.* P 64.

in the middle of the range are more likely to reflect the appropriate level of risk and the business profile of an individual utility.¹⁷²

83. Similarly, the SWP argues that the median is the appropriate standard, because the Commission has recognized the median as being more accurate than the mean or the midpoint.¹⁷³ Six Cities contend that SoCal Edison's criticism of the use of the median for deriving ROEs for a group of utilities, as compared to using the median for deriving ROEs for individual utilities, ignores Commission precedent.¹⁷⁴ Six Cities assert that the Commission has clearly articulated a preference for use of the median in calculating an ROE for a single electric utility.¹⁷⁵ Finally, Six Cities assert that SoCal Edison's observation that the use of the median is likely to reduce the resulting ROE is irrelevant to this proceeding.¹⁷⁶

3. Determination

84. SoCal Edison argues that the midpoint should be applied here because the median provides a less reliable measure of an electric utility's cost of capital than does the midpoint. Moreover, SoCal Edison asserts that distortions can result from the median because it disregards the range of returns created by the DCF analysis. SoCal Edison also argues that the median only takes into account companies in the proxy group that are at the top and the bottom, and can result in lower ROEs than the midpoint. In turn, SoCal Edison contends that this could undermine the expansion of the nation's transmission grid.

¹⁷¹ Six Cities cite to *Golden Spread*, 123 FERC ¶ 61,047 at PP 63-64; *VEPCO*, 123 FERC ¶ 61,098 at P 66.

¹⁷² Six Cities Answering Brief at 6, citing *MISO Remand Order*, 397 F.3d 1004 at P 9-11.

¹⁷³ SWP Brief at 2-3, citing *Northwest Pipeline Corp.*, 99 FERC ¶ 61,305, at 62,276 (2002) (*Northwest Pipeline*); *Midwest ISO*, 106 FERC ¶ 61,302 at 9-10, *aff'd sub.nom.*, *Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir 2005).

¹⁷⁴ Six Cities Answering Brief at 5-6, citing SoCal Edison Exhibit 12, Testimony of Dr. Hunt at 19-20.

¹⁷⁵ *Id.* at 6, citing *Golden Spread*, 123 FERC ¶ 61,047 at PP 63-64; *VEPCO*, 123 FERC ¶ 61,098 at P 66.

¹⁷⁶ Six Cities Answering Brief at 4.

85. We disagree with SoCal Edison that the median results in these limitations. In *Transcontinental Gas*,¹⁷⁷ the Commission explained the benefits of using the median rather than the midpoint to set the ROE for a company of average risk.¹⁷⁸ The Commission stated that the median lessens the impact of atypical outliers in the proxy group.¹⁷⁹ The Commission also stated that the median gives “consideration to more of the companies in the proxy group, rather than only those at the top and bottom. This will lessen the impact of any single proxy company whose ROE is atypically high or low.”¹⁸⁰

86. The Commission further addressed this issue in an order on remand from the U.S. Court of Appeals for the D.C. Circuit in *Northwest Pipeline*.¹⁸¹ In this order, the Commission affirmed its policy of using the median of the range of returns for companies of average risk. The Commission explained that the median is preferable to the midpoint or mean¹⁸² because it aids the Commission in its effort to treat all companies that face average risk equally. The Commission further stated:

The laws of statistics support the Commission’s use of the median in setting ROE for a company facing average risk because it has important advantages over the mean and midpoint approaches in determining central tendency.

The median best represents central tendency in a skewed distribution over the mean because the latter is drawn in the direction of the skew more than the median. That is, in a very positively skewed distribution, the mean will be higher than the median. In a very negatively skewed distribution, the mean will be lower than the median. These statistical facts make the median an appropriate average to use to represent the typical observation in a skewed distribution because it is less affected by

¹⁷⁷ *Transcontinental Gas Pipe Line Corp.*, 84 FERC ¶ 61,084 (1998) Opinion No. 414-A, *aff’d* Opinion No. 414-B, 85 FERC ¶ 61,323 (1998) (*Transcontinental Gas*), *petition for review denied*, *N.C Util. Comm’n v. FERC*, 203 F.3d 53 (D.C. Cir. 2000).

¹⁷⁸ *Transcontinental Gas*, 84 FERC ¶ 61,084 at 61,427.

¹⁷⁹ *Id.*, see also *Williston Basin Interstate Pipeline Company*, 84 FERC ¶ 61,081 (1998) (relies on Opinion No. 414-A and states that the median is preferable to the midpoint in setting ROE because it lessens the impact of atypical outliers in the proxy group).

¹⁸⁰ *Id.*

¹⁸¹ *Northwest Pipeline*, 99 FERC ¶ 61,305.

¹⁸² The mean is the average of all of the numbers in the data set.

extreme numbers than the mean.¹⁸³ Similarly, the median is also less affected by extreme numbers than the midpoint in a skewed distribution. Since the midpoint is the average of the highest and lowest numbers in the group, it is clearly subject to distortion by extremely high or low values.¹⁸⁴

87. The Commission believes that using the median is advantageous for a single utility of average risk because it takes into account more of the companies in the proxy group, and not just those at the top and the bottom. It also minimizes the impact of a potentially skewed proxy group.

88. SoCal Edison cites a series of cases urging the Commission to use the midpoint.¹⁸⁵ However, several of the cases cited by SoCal Edison involve setting the ROE for a diverse group of utilities and thus are distinguishable from this situation, which involves a single utility of average risk.¹⁸⁶ In the remainder of the cases, the issue of how to determine the middle of the range when setting the ROE for a single utility of average risk was not specifically raised by the parties or addressed by the Commission.¹⁸⁷

¹⁸³ *Northwest Pipeline*, 99 FERC ¶ 61,305 at 62,276 (citing Robert D. Mason, *Statistical Techniques in Business and Economics* 86-7 (3d ed. 1974) (stating that “[o]ne disadvantage of the mean is that it is unduly affected by extremely high or low values. This feature makes it an inappropriate average to use when the distribution is highly skewed. ... [The median] is not affected by a few extremely high or low values, as is the mean. This characteristic makes it an appropriate average to use to represent the typical observation in a skewed distribution); and A.J. Jaffe & Herbert F. Spirer, *Misused Statistics Straight Talk for Twisted Numbers* 90 (1987)).

¹⁸⁴ *Id.*

¹⁸⁵ *See supra* n.154.

¹⁸⁶ *See Bangor Hydro*, 117 FERC ¶ 61,129; *Devon Power Co.*, 106 FERC ¶ 61,264 (2004); *Devon Power Co.*, 104 FERC ¶ 61,123 (2003); *PPL Wallingford Energy LLC*, 105 FERC ¶ 61,324 (2003); *Midwest ISO ROE Order*, 100 FERC ¶ 61,292; *order on remand*, 106 FERC ¶ 61,302 (2004), *aff’d sub nom. Pub. Serv. Comm’n of Ky. v. FERC*, 39 F.3d 1004 (D.C. Cir. 2005).

¹⁸⁷ *See Norwalk Power*, 120 FERC ¶ 61,048, *reh’g denied*, 114 FERC ¶ 61,311 (2006); *Bridgeport Energy, LLC*, 112 FERC ¶ 61,077 (2005); *Milford Power Co., LLC*, 110 FERC ¶ 61,299 (2005); *ISO New England, Inc.*, 108 FERC ¶ 61,272 (2004); *Allegheny Power*, 103 FERC ¶ 63,001 (2003), *aff’d*, Opinion No. 469, 106 FERC ¶ 61,241 (2004); *N. Ind. Pub. Serv. Co.*, 101 FERC ¶ 61,394 (2002); *Consumers Energy Co.*, Opinion No. 456,

(continued)

89. In some of the cases cited by SoCal Edison to support the use of the midpoint, the Commission discussed the differences between the gas and the electric industries with regard to the DCF analysis.¹⁸⁸ However, this discussion pertained to the differences in the relative growth rates of each industry, and not to the measure of central tendency.¹⁸⁹ For example, in *SoCal Edison*, the Commission stated that gas pipeline companies have low dividend payout ratios and reinvest a high portion of their earnings into their businesses to promote future growth, while electric utilities typically have much higher dividend payout ratios and reinvest less than a third of their earnings.¹⁹⁰ The Commission explained that this distinction is important because retained earnings are a key source of dividend growth, which is a component of the DCF analysis.¹⁹¹ However, the difference in the relative growth rates of the two industries has no bearing on whether it is appropriate to use the median or the midpoint when determining the ROEs.

90. Rather, as the Commission explained in the *Midwest ISO* series of cases, there are other important considerations when choosing between the median and the midpoint. In the *Midwest ISO* cases, the Commission was charged with setting a generic ROE for the transmission owners in the Midwest ISO footprint. In the *Midwest ISO* Order on Initial Decision, the Commission used the midpoint of the range of returns to set the base ROE, to which it applied incentives.¹⁹² Several parties appealed the *Midwest ISO* Order on Initial Decision to the U.S. Court of Appeals for the D.C. Circuit; however, the Commission moved for a voluntary remand. In the *Midwest ISO* Order on Remand, the Commission supported its use of the midpoint by emphasizing the unique circumstances of this case.¹⁹³

98 FERC ¶ 61,333 (2002); *So. Cal. Edison Co.*, 92 FERC ¶ 61,070 (2000); *Sys. Energy Res., Inc.*, Opinion No. 446, 92 FERC ¶ 61,119 (2000), *reh'g denied*, 96 FERC ¶ 61,165 (2001).

¹⁸⁸ See *So. Cal. Edison Co.*, Opinion No. 445, 92 FERC ¶ 61,070, at 61,260-62 (2000); *Sys. Energy Res., Inc.*, Opinion No. 446, 92 FERC ¶ 61,119, at 61,443-45 (2000), *reh'g denied*, 96 FERC ¶ 61,165 (2001).

¹⁸⁹ The differences between electric and gas industries continue to be used as a basis to justify different growth rates and the implementation of single-stage or two-stage DCF analyses.

¹⁹⁰ See *So. Cal. Edison Co.*, Opinion No. 445, 92 FERC ¶ 61,070, at 61,262 (2000).

¹⁹¹ *Id.*

¹⁹² *Midwest ISO ROE Order*, 100 FERC ¶ 61,292 at P 30-31.

¹⁹³ *Midwest Indep. Transmission Sys. Operator*, 106 FERC ¶ 61,302, at P 8-15 (2004) (*Midwest ISO* Order on Remand).

Specifically, the Commission argued that it was just and reasonable to use the midpoint when determining a generic ROE for a diverse group of electric transmission owners, such as the Midwest ISO transmission owners. The Commission explained that because the ROE was going to apply to a diverse group of companies, rather than to a single company of average risk, it was important to consider the entire range of results yielded by the proxy group. The Commission further explained that the midpoint considers the wide range of returns because it is derived directly from the endpoints of the range.¹⁹⁴

91. The Commission also stated that in cases involving a diverse group of companies, it is less concerned about distortions that may occur because of the highest or lowest number. The Commission explained that instead, it must ensure that the base ROE sufficiently supports the entities that have ventured into the RTO membership and that it results in a reasonable rate of return as applied to all the companies in the group. In the Order on Remand, the Commission noted that the median places more weight on the middle values of a range of values than does the midpoint, and thus, it potentially produces a value that is not appropriate for a diverse group of utilities. The Commission explained that it was not seeking the most refined measure of central tendency, which might be achieved with the median, because it was not establishing an ROE for a single company of average risk.¹⁹⁵ The Court of Appeals upheld the *Midwest ISO* Order on Remand on appeal.¹⁹⁶

92. In light of the *Midwest ISO* Order on Remand, the Commission finds that in this SoCal Edison proceeding, for a single electric utility of average risk, the best measure of central tendency is the median. Moreover, in *Golden Spread*¹⁹⁷ and *Virginia Electric Power Company*,¹⁹⁸ the Commission confirmed that in cases which involve a single utility of average risk, the best measure of central tendency is the median.

93. Thus, while SoCal Edison is correct that the Commission has traditionally used the midpoint for setting the ROE in electric proceedings and the median in gas proceedings,¹⁹⁹ as the electric and gas industries have evolved, the Commission finds that, when establishing the ROE of an individual utility, there is no longer a sufficient basis for divergent approaches to determining the middle of the range of reasonable returns in the gas

¹⁹⁴ *Id.*

¹⁹⁵ *Id.*

¹⁹⁶ *Pub. Serv. Comm'n of Ky v. FERC*, 397 F.3d 1004, 1012 (D.C. Cir. 2005).

¹⁹⁷ *Golden Spread*, 123 FERC ¶ 61,047 at P 62-64.

¹⁹⁸ *VEPCO*, 123 FERC ¶ 61,098 at P 66.

¹⁹⁹ *See supra* n.154.

and electric industries. Rather, the Commission finds that here, the median is appropriate because it is the most accurate measure of central tendency for a single utility of average risk, such as SoCal Edison. However, the Commission will continue to use the midpoint when determining a generic ROE for a diverse group of electric transmission owners in an RTO.

94. When applying the median to the national proxy group, screened for risk, as explained above, we determine the base ROE for SoCal Edison to be 10.55 percent.

95. The Commission notes that the CPUC raised the issue of the use of the median in its request for rehearing of the *February 2008 Order*.²⁰⁰ For the reasons discussed herein, the Commission denies the CPUC's request for rehearing on this issue.

J. Updating of Financial Data

96. The CPUC contends that the Commission's analysis should utilize updated market information because the Commission typically relies on the most recent market conditions in determining an appropriate ROE. The CPUC relies upon *Bangor Hydro*²⁰¹ as authority for its argument that updating data is required here. The CPUC also notes that the ten-year constant maturity U.S. Treasury bond value has decreased from October 2007 to March 2008.²⁰²

97. Six Cities also argue that the Commission has long recognized the fact that the cost of capital changes over time, and that the Commission's standard practice is to use the latest available financial information. In support of its position, Six Cities rely upon the Commission's determination in *Bangor Hydro* in which the Commission explained "[b]ecause capital market conditions may change significantly between the time the record closes and the date on which the Commission issues a final decision, we have consistently required the use of updated data in setting a company's ROE for the period subsequent to the date of our Opinion."²⁰³

98. SoCal Edison responds that the CPUC's argument supporting the update of data to reflect changes in ten-year constant maturity U.S. Treasury bonds is irrelevant, because the Commission did not establish a base ROE. Moreover, SoCal Edison argues that the

²⁰⁰ CPUC Request for Rehearing at 33-34.

²⁰¹ *Bangor Hydro*, 117 FERC ¶ 61,129.

²⁰² CPUC Brief at 30, Ex. PUC-13.

²⁰³ Six Cities Answering Brief at 7, *citing Bangor Hydro*, 117 FERC ¶ 61,129 at P 80-81; *Westar Energy*, 122 FERC ¶ 61,268 at n.77.

updating requested by the CPUC and Six Cities does not involve a ten-year constant maturity U.S. Treasury bond-based updating. Instead, they call for updates that would replace SoCal Edison's (and the Commission's) original analysis with ones performed four months later. SoCal Edison concludes that the approaches proposed by the CPUC and Six Cities create continuously moving targets.²⁰⁴

Commission Determination

99. The intervenors are correct in asserting that Commission's policy is to update the ROE by adjusting for the yields on 10-year constant maturity U.S. Treasury bonds in determining the appropriate ROE.²⁰⁵ We find no compelling reason to change our procedures here. Moreover, because the Commission has applied a national proxy group, with appropriate screens for risk, the DCF analysis used herein is no longer linked to the data used in either *Atlantic Path 15* or *Startrans*.²⁰⁶

100. Our policy for updating equity allowances in rates is well-established. Our policy has been to accept an appropriate equity return, within a zone of reasonableness, based upon test period evidence. However, because market conditions often change substantially between the time a utility files its case-in-chief and the date the Commission issues a final decision, we update the return on equity.²⁰⁷ Where the rate under consideration is "locked-in" (that is, the rate being litigated has been superseded or is otherwise no longer in effect), the Commission updates the equity allowances for the locked-in period based on the change in average yields on ten-year constant maturity U.S. Treasury bonds.²⁰⁸

101. SoCal Edison's base ROE in Docket No. ER08-375-000 became effective on March 1, 2008 and was superseded by a new base ROE that became effective on January 1, 2009 with our preliminary acceptance, subject to refund of SoCal Edison's updated ROE filed in Docket No. ER09-187-000. Thus, we consider the appropriate ROE for consideration herein to be effective from March 1, 2008 through December 31, 2008. The 10.55 percent base ROE adopted above was calculated based upon a DCF analysis using data for the six-

²⁰⁴ SoCal Edison Reply Brief at 15.

²⁰⁵ See *Bangor Hydro*, 117 FERC ¶ 61,129; *Union Electric Co. v. FERC*, 890 F.2d 1193, 1203 (D.C. Cir 1989).

²⁰⁶ *Startrans*, 122 FERC ¶ 61,306.

²⁰⁷ See *City of Vernon, Cal.*, Opinion No. 479, 111 FERC 61,092 (2005); *Jersey Cent. Power and Light Co.*, Opinion No. 408, 77 FERC ¶ 61,001 (1996) (*Jersey Cent. Power*).

²⁰⁸ *Jersey Cent. Power*, 77 FERC ¶ 61,001.

month period ending November, 2007. Federal Reserve Bulletins indicate that during this period, the average yield on ten-year constant maturity U.S. Treasury bonds was 4.66 percent. During the period in which the base ROE was in effect in Docket No. ER08-375-000 (March 2008 through December 2008), the average yield on ten-year constant maturity U.S Treasury bonds was 3.65 percent. This represents a 1.01 percentage point (101 basis points) reduction in yield ($4.66 - 3.65 = 1.01$) which, when subtracted from the 10.55 percent base ROE accepted herein, results in an adjusted base ROE of 9.54 percent.

102. The CPUC raised the issue of updating of market information in its request for rehearing.²⁰⁹ As we explained in our discussion herein of proxy groups, although the Commission provided a preliminary analysis of SoCal Edison's proposed ROE in the February 2008 Order, the Commission established a paper hearing to allow all interested parties the opportunity to comment on our preliminary analysis. The Commission's preliminary determination in the *February 2008 Order* was made subject to further review, based upon the record supplemented by the parties. Because we find that all parties were afforded ample opportunity to provide comments regarding our preliminary determinations, we deny the CPUC's request for rehearing. Additionally, as set forth above, we are adjusting our analysis to include an updating using ten-year constant maturity U.S. Treasury bonds.

K. Other Issues

1. Burden of Proof

103. The CPUC and Six Cities argue that SoCal Edison has not met its burden of proof to show that its ROE proposal is just and reasonable.²¹⁰ The CPUC argues that because the Commission relied upon *Atlantic Path 15* analysis for its preliminary determination, and not the analysis submitted by SoCal Edison, SoCal Edison has not shown its proposal to be just and reasonable.²¹¹ Six Cities assert that the Commission's failure to make findings with respect to SoCal Edison's proposed base ROE contradicts the section 205 burden of proof for applicants and is fundamentally unfair to the parties.²¹²

104. The CPUC also contends that before the Commission can make an upfront determination approving SoCal Edison's proposed ROE, the Commission must determine

²⁰⁹ CPUC Request for Rehearing at 36-37.

²¹⁰ CPUC Brief at 7; Six Cities Brief at 16-17.

²¹¹ CPUC Brief at 8.

²¹² Six Cities Brief at 17.

that, pursuant to section 206, the “existing rates or practices are unjust, unreasonable, unduly discriminatory or preferential . . . [and] that its proposed change is just and reasonable.” Because the Commission preliminarily approved SoCal Edison’s proposed ROE without a paper hearing, the CPUC argues that the Commission should have made a section 206 determination, but failed to do so.²¹³

105. The CPUC and Six Cities also argue that the *February 2008 Order* improperly shifted the burden of proof to intervenors by ordering a paper hearing to allow parties “to rebut the proposed ROE determination as set forth above.”²¹⁴ Moreover, Six Cities argue that the Commission did not provide adequate explanation of its decision to employ a paper hearing process, and asserts that appellate courts do not sanction unexplained departures from past practices.²¹⁵

106. In its reply brief, SoCal Edison agrees that it has the burden of proof under section 205 to show that its overall proposal is just and reasonable.²¹⁶ Further, SoCal Edison argues that the Commission did not shift the burden of proof to the intervenors by establishing a paper hearing. Rather, SoCal Edison argues that the Commission simply established procedures by which the parties may submit evidence to the Commission concerning contested issues.²¹⁷

107. SoCal Edison also disagrees with the CPUC’s assertion that SoCal Edison failed to meet its burden of proof because the Commission adopted a different analysis than the one used by SoCal Edison. SoCal Edison asserts that if the Commission were to adopt the CPUC’s argument, then any time it approved an application on grounds other than those advocated by the applicant, it would have to deny the request because the applicant had not met its burden of proving that its proposal was just and reasonable.²¹⁸ SoCal Edison contends that the Commission did not reject its methodology, but, instead, relied upon an alternative methodology that supported the same result as SoCal Edison’s methodology.²¹⁹

²¹³ CPUC Brief at 9.

²¹⁴ CPUC Brief at 9; Six Cities Brief at 4, 17.

²¹⁵ Six Cities cites to *Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970); *E. Ky. Power Coop., Inc. v. FERC*, 489 F.3d 1299, 1306 (D.C. Cir. 2007).

²¹⁶ SoCal Edison Reply Brief at 8-9, citing *FPC v. Hope*, 320 U.S. 591.

²¹⁷ *Id.* at 10.

²¹⁸ *Id.*

²¹⁹ *Id.*

108. SoCal Edison also disagrees with the CPUC's assertion that the Commission is required to find that SoCal Edison's existing rates are not just and reasonable before establishing a paper hearing procedure to consider SoCal Edison's section 205 incentive ROE proposal.²²⁰

Determination

109. In this proceeding, SoCal Edison submitted its proposed incentive ROE pursuant to section 205 and has the burden of proof to show that its overall proposal is just and reasonable.²²¹ In the *February 2008 Order*, the Commission determined on a preliminary basis that SoCal Edison's proposed overall ROE was just and reasonable, because it was within the upper end of the zone of reasonableness.²²²

110. The establishment of a paper hearing does not shift SoCal Edison's burden of proof to prove that its proposal is just and reasonable. That burden remains with SoCal Edison. The Commission ordered a paper hearing to develop a more complete record on the issue of an appropriate ROE for SoCal Edison. This is borne out by the result in this order, in which the Commission is taking into consideration the facts and arguments offered in the paper hearing to reach a different result. SoCal Edison, as the applicant, continued to have the burden of proof through this process.

111. Further, Six Cities are incorrect in asserting that the Commission is required to establish a full evidentiary hearing and that the paper hearing is an improper departure from the Commission's typical procedures. The paper hearing procedure provides all parties with the opportunity to present their respective cases. It also responds to the goals of Order No. 679, which provides that, in order to support incentive projects and avoid processes that can be "time-consuming, expensive, litigious and uncertain," the Commission would not "routinely convene trial-type, evidentiary hearings."²²³ This approach also is consistent with Commission's Civil Penalties Policy Statement, where the Commission explained that "[i]n many instances issues in dispute can be resolved fairly . . . where facts can be determined on the basis of written submissions."²²⁴

²²⁰ *Id.* at 10-11.

²²¹ 16 U.S.C. § 824d.

²²² *February 2008 Order*, 122 FERC ¶ 61,187 at P 27.

²²³ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 79.

²²⁴ *Statement of Administrative Policy Regarding the Process for Assessing Civil Penalties*, 117 FERC ¶ 61,317, at P 6 (2006). *See, e.g., Carlisle & Neola v. FERC*, 741 F.2d 429, 431 (D.C. Cir. 1984)

112. The CPUC is also mistaken in asserting that SoCal Edison did not meet its statutory burden because, when the Commission made its upfront determination, the Commission utilized its own DCF analysis instead of relying upon SoCal Edison's analysis. In any ROE proceeding, the applicant's proposal will be analyzed using a range of criteria, not all of which may have been proposed by the applicant. Nonetheless, the applicant's proposal is not deemed to be unjust and unreasonable simply because the Commission uses different considerations. Similarly, the Commission's use of different considerations, such as proxy groups and screening factors, does not transform a section 205 proposal into a section 206 investigation. Thus, the Commission concludes that SoCal Edison met its statutory burden under section 205 of the FPA, and the assertions regarding the Commission's burden of proof under section 206 of the FPA are unfounded.

113. The Commission notes that in its request for rehearing, the CPUC raised the issue of burden of proof pursuant to sections 205 and 206 of the FPA, and challenged both the Commission's preliminary analysis of SoCal Edison's proposed ROE and the establishment of a paper hearing.²²⁵ For the reasons discussed herein, the Commission denies the CPUC's request for rehearing.

2. Other ROE Models

114. The CPUC argues that while the Commission uses the DCF model to determine a base ROE, SoCal Edison also uses three other models, the Capital Asset Pricing Model, the historical risk premium model and the Fama-French models.²²⁶ The CPUC argues that the Commission has rejected the use of these alternative models in favor of the DCF model.²²⁷

115. In response to CPUC's argument that SoCal Edison should not have tested its ROE against three other analytical models, SoCal Edison contends that these are standard models and that it was reasonable for SoCal Edison to use them to corroborate its DCF analysis.²²⁸

Determination

116. We find that while these alternative models were used by SoCal Edison to test its DCF analysis, they were not offered by SoCal Edison to be used in place of our accepted

²²⁵ CPUC Request for Rehearing at 10-21.

²²⁶ CPUC Brief at 25, IBR-1, Ex. SCE-7 at 16-38; *see also* Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 (2007).

²²⁷ *Id.*, citing *ITC Holding*, 121 FERC ¶ 61,229 at P 43; Order No. 679-A, FERC Stats. & Regs. ¶ 31,236 (2007).

²²⁸ *Id.* at 22.

DCF methodology. Further, they were not used by the Commission in setting a base ROE for SoCal Edison. Rather, as SoCal Edison asserts, they were used to corroborate the results of its DCF analysis. Thus, the CPUC's concerns regarding the use of these models in setting an ROE for SoCal Edison are misplaced.

L. Result of Paper Hearing

117. As a result of the evidence submitted in the paper hearing, and considering the arguments of the parties, we establish a base ROE for SoCal Edison by applying a DCF analysis to a national proxy group, consisting of 23 companies proposed by SoCal Edison and using data for the six month period ending November 30, 2007. We screened SoCal Edison's proxy group for risk by applying screening factors that we determined satisfy the circumstances of this case and ensure that only companies with comparable risks are included. Based upon the risk factors that we applied, as described herein, we narrowed the proxy group down to 14 companies and determined a zone of reasonableness for SoCal Edison between 7.80 percent and 16.19 percent. Thereafter, we applied the median of the proxy group to establish a base ROE of 10.55 percent. After updating the base ROE by adjusting for the change in average yields on ten-year constant maturity U.S. treasury bonds, we determine the revised base ROE to be 9.54 percent. When we add to this base the previously-approved incentive adders of 125 basis points for the Rancho Vista Project and 175 basis points for the DPV2 and Tehachapi Projects, we establish overall ROEs for these projects of 10.79 percent and 11.29 percent, respectively. We conclude that, pursuant to Order No. 679, because the overall ROEs are set within the zone of reasonableness, they are consistent with the just and reasonable requirements of section 205 of the FPA.²²⁹

118. The CPUC argues in its request for rehearing of the *February 2008 Order*²³⁰ that the Commission did not balance adequately consumer protection with the need for investment when it preliminarily established an ROE for SoCal Edison. We do not agree. It is the Commission's responsibility to "reduce the abstract concept of reasonableness to concrete dollars and cents,"²³¹ to ensure that rates are neither less than compensatory to the seller nor excessive to the consumer.²³² As described herein, the Commission has established an

²²⁹ Order No. 679, FERC Stats. & Regs. ¶ 31,222 at P 93.

²³⁰ The CPUC Request for Rehearing at 22-24.

²³¹ *Bangor Hydro*, 122 FERC ¶ 61,038 at P 14, quoting *Montana-Dakota Util. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251 (1951).

²³² *Bangor Hydro*, 122 FERC ¶ 61,038 at P 14, citing *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n*, 262 U.S. 679, 692-93 (1923). See also Order No. 679, FERC Stat. & Reg. ¶ 31,222 at P 22 ("our precedents require the establishment of

(continued)

ROE for SoCal Edison that reflects these considerations. Therefore, we deny the CPUC's request for rehearing.

The Commission orders:

(A) In Docket No. ER08-375-000, the Commission establishes a base ROE for SoCal Edison to be 9.54 percent, as discussed in the body of the order.

(B) The Commission denies the request for rehearing in Docket No. ER08-375-001, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.

a range of returns and we select an ROE within that range that reflects the facts and circumstances of a particular case.”).