171 FERC ¶ 61,154
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Association of Businesses Advocating Tariff Equity — Docket No. EL14-12-004
Coalition of MISO Transmission Customers
Illinois Industrial Energy Consumers
Indiana Industrial Energy Consumers, Inc.
Minnesota Large Industrial Group
Wisconsin Industrial Energy Group

v.

Midcontinent Independent System Operator, Inc.
ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

Arkansas Electric Cooperative Corporation
Mississippi Delta Energy Agency
Clarksdale Public Utilities Commission
Public Service Commission of Yazoo City
Hoosier Energy Rural Electric Cooperative, Inc.

Docket No. EL15-45-013

v.

ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

OPINION NO. 569-A

ORDER ON REHEARING

(Issued May 21, 2020)

1. On November 21, 2019, the Commission issued Opinion No. 569.[1] In that order, the Commission acted on the then-pending rehearing requests and the Initial Decision, as well the Order Directing Briefs,[2] in the above-captioned proceedings. In brief, Opinion No. 569 applied a revised methodology for analyzing the base return on equity (ROE) component of public utility rates under section 206 of the Federal Power Act (FPA) that used the discounted cash flow (DCF) model and capital-asset pricing model (CAPM), instead of only the DCF model, and established a range of presumptively just and reasonable ROEs based on the quartiles of the zone of reasonableness. Multiple parties request rehearing of Opinion No. 569.[3] In this order, we grant in part and deny in part the requests for rehearing.

2. In particular, in Opinion No. 569, the Commission used the DCF model and CAPM in its determinations under the first and second prongs of section 206, giving each model equal weight under both prongs, and did not use the expected earnings (Expected Earnings) or risk premium (Risk Premium) models, as proposed in the Briefing Order. In addition, the Commission used the ranges of presumptively just and reasonable ROEs in its analysis under the first prong of section 206, as the Commission proposed in the Briefing Order, used the high-end outlier test as proposed in the Briefing Order, used the Institutional Brokers' Estimate System (IBES) as the source of short-term earnings growth estimates in the DCF and CAPM, and used a revised low-end outlier test that eliminates DCF and CAPM proxy group ROE results that are less than the yields of generic corporate Baa bonds plus 20% of the CAPM risk premium. In this order, we are granting rehearing of Opinion No. 569 to use the Risk Premium model under both prongs of our section 206 analysis, to give the short-term growth rate 80% weighting and the long-term growth rate 20% weighting in the two-step DCF model, to modify the high-end outlier test to treat any proxy company as high-end outlier if its cost of equity estimated under the model in question is more than 200% of the median result of all of the potential proxy group members in that model[4] before any high or low-end outlier test is applied, subject to a "natural break" analysis, to consider the use of *Value Line* short-term earnings growth estimates in the CAPM in future proceedings, and to calculate the ranges

[1] *Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 569, 169 FERC ¶ 61,129 (2019).

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

[3] *See infra* PP 23-24.

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

because the median of the two-step DCF may be unreliable or produce unjust and unreasonable results, its use in the high-end outlier test is similarly unreliable.[264]

150. Transource Energy contends that there is no evidence that a logical high-end outlier test exists that would apply generically as the low-end outlier test does. Transource Energy argues that a generic exclusion based on distance from the median may reject potentially useful observations. Transource Energy contends that, if the Commission were to utilize a high-end outlier test, the Commission should treat the test as a high-end cap on the result and not a high-end exclusion of data points.[265]

151. Exelon contends that the high-end proxy group utilities that are excluded under the high-end outlier test represent actual data regarding utilities of a similar risk profile, and thus application of the test changes the range of studied ROEs from those that actual investors consider in the market.[266]

C. <u>Commission Determination</u>

152. We grant in part and deny in part the requests for rehearing on the high-end outlier test. While the high-end outlier test uses the median, it is not solely meant to serve as a statistical test to remove proxy group companies that are not representative of typical utilities. Rather, the high-end outlier test, when coupled with a natural break analysis, screens for observations that are irrationally or anomalously high.

153. As an initial matter, we note that some parties have characterized the high-end outlier test as stricter than it is. As noted above, the high-end outlier test is subject to a natural break analysis, meaning observations that are shown to be rational and not the result of error may still be included, even if they are over the threshold.

154. However, we find that it is appropriate to modify the high-end outlier test to treat any proxy company as high-end outlier if its cost of equity estimated under the model in question is more than 200% of the median—as opposed to the 150% of the median threshold applied in Opinion No. 569—result of all of the potential proxy group members in that model before any high or low-end outlier test is applied, subject to a “natural break” analysis. The high-end outlier test is the Commission’s best attempt to use an objective test to identify proxy group ROEs that are irrationally or anomalously high because, for example, they are the result of atypical circumstances that are unrepresentative of the subject utility’s risk profile or otherwise likely to be in error.

[264] *Id.* at 74-76.

[265] Transource Energy Rehearing Request at 28-29.

[266] Exelon Rehearing Request at 13-14.

B. Rehearing Requests

157. RPGI argues that the Commission has not justified revising the low-end outlier test, and specifically has not supported including 20% of the CAPM risk premium.[269]

158. CAPs contend that using the Baa bond yield index is an inappropriate way to determine whether a ROE is an unreliable low-end outlier. CAPs further contend that this is inconsistent with Commission precedent, noting the Commission's explanation in Opinion No. 489 that, when applying a low-end outlier test, "it is appropriate to consider the company's own cost of debt, not the composite debt of the proxy group."[270] CAPs note that applying this to a company's own cost of debt results in OGE Energy being added back into the proxy group for the Second Complaint.[271]

159. CAPs similarly argue that the Commission's use of the risk premium should be rejected. However, CAPs contend that, if the Commission continues to utilize a risk premium, it should instead be 20% of the difference between the CAPM equity market return and the Moody's Baa utility bond yield.[272]

160. MISO TOs argue that the Commission erred in adopting its low-end outlier test and should instead apply the low-end methodology described by Mr. McKenzie in order to account for the inverse relationship between equity risk premiums and bond yields.[273]

C. Commission Determination

161. We deny the requests for rehearing on the low-end outlier test. We are not persuaded by RPGI's and MISO TOs' assertions that the Commission erred in adopting its low-end outlier test based on 20% of the CAPM risk premium. Likewise, we disagree with CAPs that the low-end outlier test is inconsistent with prior Commission precedent. As the Commission noted in Opinion No. 569, the Commission has applied this test differently in the past and did not always examine a company's own cost of debt.[274]

[269] RPGI Rehearing Request at 27-31.

[270] CAPs Rehearing Request at 88-90.

[271] *Id.* at 94.

[272] *Id.* at 90-92.

[273] MISO TOs Rehearing Request at 83-84.

[274] Opinion No. 569, 169 FERC ¶ 61,129 at P 389 n.783 (citing Opinion No. 531, 147 FERC ¶ 61,234 at P 123).

The Commission also found that "using the specific bond yield for each company . . . renders [the calculations] (and the resulting ROE) less predictable, as the credit ratings for individual companies are likely more volatile than the generic corporate rate Baa credit rating."[275] Thus, we reiterate our finding here that applying the low-end outlier test to the Baa bond yield is appropriate. We also decline to adopt CAPs' proposal to instead use 20% of the difference between the CAPM equity market return and the Moody's Baa utility bond yield, and affirm our use of the United States 30 year treasury note in calculating the CAPM equity risk premium. There is no compelling evidence that, with respect to determining the risk premium, using Moody's Baa utility bond yields is superior to the treasury yields. Treasury yields are generally more stable than corporate bond yields, which here increases model stability. Furthermore, the low-end outlier test already incorporates the Moody's Baa utility bond, to which it adds 20% of the risk premium to determine the test. Using it twice would be unnecessarily duplicative. Additionally, we note that the risk premium is meant to reflect the opportunity cost of investing in equities generally, and therefore, using an industry-specific measure to determine the low end of the risk premium's range is inappropriate.

162. We also decline to adopt MISO TOs' proposed methodology. Opinion No. 569's proposed low-end outlier test methodology recognizes the dynamic nature of risk premiums without eliminating numerous proxy group members as the MISO TOs' methodology might in certain conditions. In Mr. McKenzie's example, use of his proposed test leads to the exclusion of six rather than three companies, the upper three of which feature ROEs very close to those of other companies.[276] This indicates that MISO TOs' proposed outlier test is excluding more than just outliers, systematically adding a significant upward bias to the DCF results.

XII. Consideration of State ROEs

A. Opinion No. 569

163. The Commission found that the ROE determination in these proceedings did not need to consider state-authorized ROEs. The Commission agreed with MISO TOs that there are material differences between state and Commission ROEs. As a result, the Commission stated that it would only consider state-authorized ROEs on a case-by-case

[275] *Id.*

[276] Appendix 3 to McKenzie Affidavit in MISO TOs Initial Brief.

173 FERC ¶ 61,159
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Association of Businesses Advocating Tariff Equity — Docket No. EL14-12-015
Coalition of MISO Transmission Customers
Illinois Industrial Energy Consumers
Indiana Industrial Energy Consumers, Inc.
Minnesota Large Industrial Group
Wisconsin Industrial Energy Group

v.

Midcontinent Independent System Operator, Inc.
ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

Arkansas Electric Cooperative Corporation
Mississippi Delta Energy Agency
Clarksdale Public Utilities Commission
Public Service Commission of Yazoo City
Hoosier Energy Rural Electric Cooperative, Inc.

Docket No. EL15-45-014

v.

ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

OPINION NO. 569-B

ORDER ADDRESSING ARGUMENTS RAISED ON REHEARING, AND SETTING ASIDE PRIOR ORDER, IN PART

(Issued November 19, 2020)

C. Commission Determination

140. We sustain the result that the Commission reached on the high-end outlier test in Opinion No. 569-A and will continue to treat any proxy company as a high-end outlier if its cost of equity estimated is more than 200% of the median. We disagree with LPSC's assertion that the Commission raised the threshold so high as to render the high-end outlier test essentially useless. The high-end outlier test is an objective test to identify proxy group ROEs that are irrationally or anomalously high because, for example, they are the result of atypical circumstances that are unrepresentative of the subject utility's risk profile or are otherwise likely to be in error. We again note that the high-end outlier test is the first, but not the only, method for screening a high-end result from the proxy group.

141. We disagree with LPSC that the high-end outlier test disproportionately favors utilities over ratepayers compared to the low-end outlier test. The high-end and low-end outlier tests have different purposes and thus do not have to be proportionate or symmetric. The purpose of the low-end outlier test is to eliminate from the proxy group companies with ROEs that are so low that they are essentially indistinguishable from debt. The high-end outlier test, on the other hand, is meant to screen for observations that are the result of atypical circumstances that are unrepresentative of the subject utility's risk profile or are otherwise likely to be in error.

142. We disagree with LPSC and CAPs that the Commission did not support the increase to the high-end outlier test threshold and that the revision of the test does not eliminate a risk. The high-end outlier test only screens for observations resulting from atypical circumstances that are unrepresentative of the subject utility's risk profile or are likely erroneous. Upon reconsideration, the Commission found that proxy group member ROEs could exceed 150% of the median without being either the result of atypical circumstances that are unrepresentative of the subject utility's risk profile or likely erroneous. Further, the high-end outlier test is used in conjunction with the natural break analysis, which allows results that appear illogical to be removed from the proxy group despite not violating the low or high-end thresholds. In adopting the revised high-end outlier test, the Commission expressly included a discretionary element to screening high-end results, with the high-end outlier test used for the most extreme observations and the natural break analysis for all others.

VIII. Refund Issues

A. Background

143. In Opinion No. 569, the Commission found that the challenged 12.38% base ROE in the First Complaint proceeding was unjust and unreasonable, and additionally found that a replacement base ROE of 9.88% was just and reasonable—instead of the 10.32% replacement ROE that was set in Opinion No. 551. The Commission made the 9.88%

169 FERC ¶ 61,129
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Neil Chatterjee, Chairman;
Richard Glick and Bernard L. McNamee.

Association of Businesses Advocating Tariff Equity — Docket No. EL14-12-003
Coalition of MISO Transmission Customers
Illinois Industrial Energy Consumers
Indiana Industrial Energy Consumers, Inc.
Minnesota Large Industrial Group
Wisconsin Industrial Energy Group

v.

Midcontinent Independent System Operator, Inc.
ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

Arkansas Electric Cooperative Corporation
Mississippi Delta Energy Agency
Clarksdale Public Utilities Commission
Public Service Commission of Yazoo City
Hoosier Energy Rural Electric Cooperative, Inc.

Docket No. EL15-45-000

v.

ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
Entergy Arkansas, Inc.
Entergy Gulf States Louisiana, LLC
Entergy Louisiana, LLC
Entergy Mississippi, Inc.
Entergy New Orleans, Inc.
Entergy Texas, Inc.
Indianapolis Power & Light Company
International Transmission Company
ITC Midwest LLC
Michigan Electric Transmission Company, LLC
MidAmerican Energy Company
Montana-Dakota Utilities Co.
Northern Indiana Public Service Company
Northern States Power Company-Minnesota
Northern States Power Company-Wisconsin
Otter Tail Power Company
Southern Indiana Gas & Electric Company

OPINION NO. 569

ORDER ON BRIEFS, REHEARING, AND INITIAL DECISION

(Issued November 21, 2019)

than the calendar year average Baa bond yields for every year since 2002, except for the bond yield spike period of 2008 and 2009.[779] Trial Staff asserts that it is arbitrary to assume that the baseline for the change in interest rates should be constrained to a comparison between the 2007 and 2008 study periods and the study periods for the First and Second Complaint Proceedings.

386. Trial Staff also states that, in applying the low-end outlier test, the ROE of each proxy company should be compared to the yields of bonds with the same credit rating as the proxy company in question.[780]

5. Commission Determination

387. We will adjust the low-end outlier test to include a risk premium instead of the generic 100 basis points proposed in the Briefing Order, as discussed below. In particular, we will adopt a revised low-end outlier test that eliminates proxy group ROE results that are less than the yields of generic corporate Baa bonds plus 20 percent of the CAPM risk premium. The purpose of the low-end outlier test is to eliminate from the proxy group companies with ROEs that are so low that they should not be considered in determining the low end of the zone of reasonableness. Thus, the mere fact a potential proxy company's ROE may be lower than what would be considered reasonable for an average risk, or even a below average risk, utility is not a sufficient reason to exclude the company from the proxy group. Instead, the Commission's standard has been to exclude companies whose ROEs yield "essentially the same expected return" as debt. As MISO TOs have argued, and the Commission has acknowledged, as bond yields decline, the ROE that investors would consider to yield "essentially the same expected return" as a bond is increasingly higher than the corresponding bond yield.[781] Thus, to ensure that the low-end outlier test properly excludes companies whose ROE is indistinguishable from debt, an adjustment accounting for this risk premium is necessary.

388. We find that 20 percent of the risk premium from the CAPM analysis described above is a reasonable risk premium to apply to the low-end outlier test. Because the risk premium that investors demand changes over time, it is imprecise to simply add 100 basis

[779] Trial Staff Reply Br. (I), Keyton Reply Aff. (I) at 11.

[780] *Id*. at 11-12 (citing *Bangor Hydro-Electric Co*., Opinion No. 489, 117 FERC ¶ 61,129, at PP 56-60 (2006) and Opinion No. 445, 92 FERC at 61,266).

[781] See Morin at 128-129, summarizing empirical research showing that as interest rates decline, the risk premium required by equity investors increases. Morin concludes that the gist of this research is that for every 100 basis point decline in government bond yields, the equity risk premium increases by about 50 basis points.

points to the bond yield. The methodology that we are adopting in this order captures such changes because the risk premium from the CAPM analysis reflects investors' required risk premium under the prevailing market conditions. We find that the 20 percent portion of the risk premium strikes a proper balance by being sufficiently large to account for the additional risk of equities over bonds, but not so large as to inappropriately exclude proxy group members whose return on equity is distinguishable from debt. This raises the low-end outlier threshold in the First Complaint proceeding from 5.65 to 6.47 percent, and it raises the low-end outlier threshold in the Second Complaint proceeding from 6.41 to 7.18 percent.[782] This revision does not result in the exclusion of any additional companies from the proxy group when applied to either the DCF or CAPM analyses in the First Complaint proceeding. However, in the Second Complaint proceeding, the revised low-end outlier test excludes one additional company from the DCF analysis.

389. MISO TOs argue that the low-end outlier test has been and should be based on the average Baa yield, while CAPs argue that the application of the low-end outlier test should be dependent on the bond rating of each company in the proxy group. We note that the Commission has applied this test differently in the past, with the most recent application being to apply the test based on the average Baa yield.[783] Conversely, CAPs contend that the Commission should base the low-end outlier test on Moody's Public Utility Bond index yield for the same rating category proxy utility under consideration. While CAPs argue that this application would be more precise, we find that using the Baa bond yields as the low-end test is consistent with the Commission seeking the proxy group for a diverse group of utilities to be representative of the cost of capital for all of those utilities. Further, using the specific bond yield for each company, in addition to adding complexity to the calculations, renders them (and the resulting ROE) less predictable, as the credit ratings for individual companies are likely more volatile than the generic corporate rate baa credit rating due to company-specific credit rating considerations. As discussed elsewhere in this order, where possible, we seek to provide predictability and transparency to ROE determinations, which is best accomplished by using a single outlier test. We find no reason to adjust the low-end outlier test to be applied to Moody's Public Utility Bond index yield for the same rating category proxy utility under consideration at this time.

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[782] *See* Appendix C. *See also* Opinion No. 551, 156 FERC ¶ 61,234 at P 20; Initial Decision (II), 155 FERC ¶ 63,030 at P 171 and P 174 n.75.

[783] Opinion No. 531, 147 FERC ¶ 61,234 at P 123.