



Federal Energy Regulatory Commission
November 21, 2019
Open Commission Meeting
Staff Presentation
Item E-11

Good morning Mr. Chairman and Commissioners,

Item E-11 is a draft order that changes the Commission's methodology for analyzing the base return on equity, or ROE, component of public utility rates. The draft order applies this revised base ROE methodology to two complaint proceedings involving the base ROEs of Midcontinent Independent System Operator, or MISO, transmission owners: the first proceeding is rehearing of Opinion No. 551, in which the Commission applied the base ROE methodology established for New England transmission owners in Opinion No. 531, and the second proceeding is review of an Initial Decision.

In *Emera Maine v. FERC*, the U.S. Court of Appeals for the D.C. Circuit remanded the Commission's decision in Opinion No. 531, finding that the Commission had neither properly demonstrated that the existing base ROE in that proceeding was unjust and unreasonable under the first prong of section 206 nor properly justified its selection of a new base ROE under the second prong of section 206. Subsequently, the Commission issued Briefing Orders for both these MISO proceedings and separate New England proceedings at issue in Opinion No. 531. In the Briefing Order in these MISO proceedings, the Commission proposed changes to its ROE methodology to address the issues that the D.C. Circuit remanded to the Commission in *Emera Maine v. FERC*, and directed the parties to submit briefs addressing those proposed changes. This draft order addresses those proposed changes in light of the briefs and other evidence in these proceedings.

The draft order adopts the changes that were proposed in the Briefing Order, with certain revisions. Principally, this draft order adopts the use of the discounted cash flow, or DCF, model and capital-asset pricing model, or CAPM, to determine utilities' cost of equity. However, the draft order rejects the Briefing Order's proposal to also use the expected earnings or the risk premium models in the Commission's revised ROE methodology. This draft order concludes that using the DCF and CAPM models will make the Commission's ROE determinations more accurately reflect how investors make their investment decisions, while also avoiding deficiencies in other models.

Pursuant to the draft order, the DCF and CAPM models will be used to establish a composite zone of reasonableness. The zone of reasonableness produced by each model will be given equal weight and averaged to determine the composite zone of reasonableness. The Commission will use that composite zone of reasonableness to evaluate whether an existing base ROE remains just and reasonable under the first prong of FPA section 206 and to establish a new just and reasonable base ROE, under the second prong of FPA section 206, when the existing base ROE has been shown to be unjust and unreasonable. The draft order adopts the proposal in the Briefing Order to use ranges of presumptively just and reasonable ROEs in the Commission's analysis of existing ROEs under the first prong of section 206. Specifically, within the composite zone of reasonableness, the revised methodology will establish quartile ranges of presumptively just and reasonable ROEs. If an existing ROE falls within the applicable quartile range based on the risk of the utility or utilities, it is presumed just and reasonable. If it falls outside of the applicable quartile range, it is presumed unjust and unreasonable. The range of presumptively just and reasonable ROEs for each utility or group of utilities would be based on its risk profile. For example, the range for an average risk group of utilities, like the MISO transmission owners, is the quarter of the zone of reasonableness centered on the midpoint of the zone.

In addition, the draft order adopts certain other changes to the Commission's ROE methodology, such as the high-end outlier test that was proposed in the Briefing Order. The draft order also adopts a revised low-end outlier test that eliminates from the DCF and CAPM proxy groups any ROE results that are less than the yields of generic corporate Baa bonds plus 20 percent of the CAPM risk premium.

In applying the revised base ROE methodology, including the CAPM, to these proceedings, the draft order grants the complaint in the first proceeding, finding that the MISO transmission owners' 12.38 percent base ROE is unjust and unreasonable and that a just and reasonable replacement base ROE for the MISO transmission owners is 9.88 percent. The draft order requires appropriate refunds based on that determination. The draft order also applies the revised base ROE methodology to the complaint in the second proceeding, which results in dismissing that complaint. The draft order finds that, in order to grant relief in the second proceeding, the Commission would need to find the 9.88 percent ROE established in the first proceeding to be unjust and unreasonable. The draft order finds, however, that the 9.88 percent ROE falls within the range of presumptively just and reasonable ROEs

established in the second proceeding, and that the evidence in that proceeding does not rebut this presumption. Therefore, the draft order dismisses the complaint in the second proceeding, does not order a prospective change to the 9.88 percent ROE and does not require refunds in that proceeding.

Thank you. We are happy to answer any questions you might have.