170 FERC ¶ 61,265
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

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

Midcontinent Independent System Operator, Inc. Docket Nos. ER20-276-000
ER20-276-001

ORDER REJECTING PROPOSED TARIFF REVISIONS

(Issued March 27, 2020)

1. In a filing made on November 1, 2019 (Filing), as amended on January 29, 2020 (Deficiency Response), pursuant to section 205 of the Federal Power Act (FPA),[1] Midcontinent Independent System Operator, Inc. (MISO), on behalf of Prairie Power, Inc. (Prairie Power), filed proposed revisions to Prairie Power's transmission formula rate in Attachment O-PPI to the MISO Open Access Transmission, Energy and Operating Reserve Markets Tariff (MISO Tariff).[2] The proposed revisions would allow Prairie Power to adopt a hypothetical capital structure of 50% equity and 50% long-term debt for purposes of determining its transmission revenue requirement, rather than using its actual capital structure of 18.9% equity and 81.1% debt. In this order, we reject the Filing, as discussed below.

I. November 1 Filing

2. Prairie Power states that it is a not-for-profit, non-FERC-jurisdictional generation and transmission cooperative in central Illinois. Prairie Power owns and operates 328 MW of generating capacity and approximately 604 miles of transmission lines. It transferred functional control of its networked 138 and 69 kV transmission facilities to MISO in 2013, becoming a transmission owner in MISO's Ameren Illinois Company pricing zone with its own company-specific Attachment O formula rate using forecasted data with a true-up mechanism.

[1] 16 U.S.C. § 824d (2018).

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

3. Prairie Power states that, for its calendar year 2018 Attachment O rates, its equity percentage comprised approximately 19% of its capitalization, with the remainder being long-term debt. Prairie Power states that this equity ratio is significantly lower than the majority of other transmission owners in the Ameren Illinois Zone of MISO. Prairie Power requests approval to increase Prairie Power's equity ratio percentage of its capital structure to 50% for its formula rate effective January 1, 2020. Prairie Power does not propose a time limit on the proposed hypothetical capital structure.[3]

4. Prairie Power provides evidence showing that the 85 MISO transmission owners that use a capital structure/return on rate base construct feature an average equity ratio of 51%, weighted by rate base, and that the dominant transmission owner in the Ameren Illinois Zone, Ameren Illinois, had an actual capitalization ratio in 2018 that was 52.3% equity and 47.7% long-term debt.[4]

5. Prairie Power also states that it is in the process of making financing arrangements for an accelerated transmission spending plan of approximately $200 million over the next three years with additional transmission investment to follow soon thereafter. Prairie Power states that the addition of significant long-term debt from these investments will put further pressure on Prairie Power's equity percentage, resulting in less return on assets dedicated to MISO. Prairie Power also states that its credit ratings agency has raised concern about Prairie Power's debt burden.[5]

6. In addition, Prairie Power points to a proceeding involving Tex-La Electric Cooperative of Texas, Inc. (Tex-La), in which Tex-La was granted a hypothetical capital structure of 50% debt and 50% equity because Tex-La's actual capital structure was not indicative of other similar transmission owners in an RTO.[6] Prairie Power also states that the Commission has permitted non-jurisdictional transmission owners within RTOs to

[3] November 1 Filing at 2.

[4] *Id*. at 3 (citing Att. C (Smith Test.) at 10.

[5] *Id*. at 3-4 (citing Att. D (Riney Test.) at 2-3, Ex. PPI-003 (Kroll Bond Rating Agency) at 2).

[6] *Id*. at 4 (citing *Midcontinent Indep. Sys. Operator, Inc.*, Docket No. ER13-1827-000 (Dec. 12, 2013) (delegated order) (Tex-La Delegated Order)).

apply to their own revenue requirement the same overall rate of return as applied by the pricing zone's dominant transmission owner.[7]

7. Prairie Power states that the application of the proposed 50-50 long-term debt-to-equity capital structure would increase Prairie Power's 2019 and 2020 projected MISO transmission revenue requirement by approximately eight percent each year, yielding revenue increases of $673,000 and $1,121,176, respectively.

II. Notice of November 1 Filing and Responsive Pleadings

8. Notice of the November 1, 2019 Filing was published in the *Federal Register*, 84 Fed. Reg. 60,077 (Nov. 7, 2019), with interventions and protests due on or before November 22, 2019. On November 22, 2019, Ameren Services Company (Ameren) filed a motion to intervene and protest. On January 2, 2020, Prairie Power filed a motion for leave to answer and answer.

9. In its protest, Ameren urges the Commission to reject the proposed hypothetical capital structure. Ameren argues that the Commission orders cited by Prairie Power do not support the proposition that a transmission owner may simply adopt the capital structure of another transmission owner. Ameren argues that Prairie Power erroneously extrapolates Commission policy on return on equity (ROE) to hypothetical capital structure, conflates overall rate of return and ROE, and has not shown that the resulting eight percent increase to the revenue requirement from the use of a hypothetical 50% equity is just and reasonable.[8] Ameren argues that Prairie Power's filing raises a broader issue of whether it is appropriate for a cooperative transmission owner or non-profit transmission owner to use an equity capitalization in the calculation of its transmission rate that is divorced from its actual capital structure.[9]

10. In its answer, Prairie Power responds that it is not requesting to adopt another transmission owner's capital structure, but is instead requesting to adopt a capital structure of its own that enables it to be on par with other transmission owners in the same joint pricing zone. Prairie Power states that it lacks access to institutional investors and shareholders to issue its own stock and raise capital. Further, it states that it only gains access to those investors through the debt market. It asserts that granting the hypothetical capital structure will provide the proper signal to the Prairie Power

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[7] *Id.* (citing, e.g., *Pac. Gas & Elec. Co. v. FERC*, 306 F.3d 1112, 1116, 1120 (D.C. Cir. 2002) (*PG&E*); and the Initial Decision in *City of Vernon v. CAISO*, 109 FERC ¶ 63,057, at P 126 (2005) (City of Vernon Initial Decision)).

[8] Ameren January 2, 2020 Protest at 4-8.

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

customers and lenders who take a significant risk to build facilities in the Ameren Illinois zone.[10]

11. Prairie Power also disputes Ameren's assertion that Prairie Power's proposal will result in a transmission rate that is separate from its actual costs for an unspecified time. It contends that the costs captured in the formula rate do not represent the true cost of network transmission investments for cooperatives like Prairie Power. It argues that its requested hypothetical capital structure captures risks for cooperatives that differ from risks for investor-owned utilities.[11]

12. In response to Ameren's argument that some of the costs of the eight percent revenue increase will be borne by non-members of Prairie Power, Prairie Power states that its members have and will continue to pay the MISO transmission rates, which largely reflect the higher capital costs of the investor-owned utilities, including Ameren, instead of reflecting the lower capital costs of Prairie Power. Additionally, Prairie Power argues that, without a hypothetical capital structure, it is likely to encounter higher interest rates on any debt it issues for new transmission projects and that "[a] hypothetical capital structure would serve to lower interest rates and even out Prairie Power's costs over time, thus providing savings for all customers, including non-members of Prairie Power."[12]

13. Prairie Power notes that Ameren's transmission arm, Ameren Transmission Company, itself has received incentive-based hypothetical capital structure treatment for certain transmission investments in the past.[13] Finally, Prairie Power argues that the Commission has permitted municipals and cooperatives to use a hypothetical capital structure for ratemaking purposes when they have relied upon non-equity financing for a project.[14]

III. Deficiency Letter

14. On December 30, 2019, the Commission's staff issued a deficiency letter requesting additional information. The Deficiency Letter requested the current credit

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[10] Prairie Power Answer at 3.

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

[12] *Id*. at 4.

[13] *Id*.

[14] *Id*. at 5 (citing *Cent. Minn. Mun. Power Agency*, 134 FERC ¶ 61,115, at P 31 (2011)).

ratings and related reports from Prairie Power's credit rating agencies other than the one from Kroll that was submitted with the Filing, Prairie Power's target credit rating for each of its credit rating agencies, and a description of how its requested capital structure change would affect its debt burden or otherwise improve its credit quality. The Deficiency Letter also requested evidence that Prairie Power's financial metrics and capital expenditures have hindered or are likely to hinder its ability to raise capital to fund future transmission projects, given Prairie Power's A- credit rating, and whether any of Prairie Power's credit ratings agencies cited insufficient transmission revenue in conjunction with planned transmission expenditures as grounds for a potential credit downgrade.

15. The Deficiency Letter asked Prairie Power to explain the cost overruns it was referring to when it stated that debt service coverage that is consistently lower than 1.15 would likely result from cost overruns for planned expenditures, including Prairie Power's ongoing transmission projects. The Deficiency Letter also requested a description of Prairie Power's targeted cash flow rates and, if possible, how such cash flow rates compare to other cooperative or municipal utilities of comparable size. Finally, the Deficiency Letter requested that Prairie Power explain why the proposed rate increase based on a proxy equity ratio is just and reasonable.

IV. Prairie Power's Deficiency Response

16. On January 29, 2020, Prairie Power submitted its Deficiency Response. Prairie Power states that the only credit rating it has attained thus far is from Kroll Bond Rating Agency and that it does not have one from the "Big Three" credit rating agencies (Moody's, Standard & Poor's, or Fitch) on which the Commission usually bases its credit rating. Prairie Power states that it has no target credit rating, but seeks to access debt at the most favorable terms for its members. Prairie Power states that the Commission has repeatedly acknowledged the relationship between debt coverage and access to credit, and that its cash flow would improve with the additional return and generally improve its financial condition, making it easier for it to originate or refinance debt at more favorable terms. Prairie Power states that no credit rating agencies have cited insufficient transmission revenue as grounds for a potential credit downgrade.[15]

17. Regarding evidence that Prairie Power's financial metrics and capital expenditures have or are likely to hinder its ability to raise capital to fund future transmission projects, Prairie Power states it is critical for Prairie Power to optimize its financial metrics in order to access debt at the most favorable terms possible. It states that regulator-

[15] Deficiency Response at 4-6.

approved enhanced cash flows from a hypothetical capital structure will improve these metrics.[16]

18. With respect to the potential effect of cost overruns, Prairie Power states that there are no cost overruns associated with its transmission projects presently. However, it asserts that it is reasonably possible that cost overruns could occur as Prairie Power is competing for resources and heavy demand could put upward pressure on cost and that generation-related expenditures also weigh heavily on its annual expenditures.[17]

19. In response to the Deficiency Letter's request for a description of its targeted cash flow rates, Prairie Power states that it is unsure as to the meaning of "targeted cash flow rate." However, it notes that it does not have a "targeted cash flow rate" or information regarding that of other cooperatives.[18]

20. With respect to why the proposed rate increase based on a proxy equity ratio is just and reasonable, Prairie Power contends that, at its significant low equity level of 18.9%, it is arguable that transmission users of the Joint Ameren Illinois/Prairie Power system in the Ameren Illinois transmission pricing zone are getting service at an unwarranted discount for use of Prairie Power's facilities relative to service over similar facilities of Ameren. Prairie Power notes that Ameren's equity level included in its Attachment O formula is 51.3% while receiving the same ROE as Prairie Power. Prairie Power argues that the question is not whether use of a proxy is appropriate, but whether there may be alternative methods of arriving at what the appropriate proxy is. It maintains that it has developed a reasonable proxy by selecting MISO transmission owners in its zone. If the Commission believes the level of Prairie Power's proxy equity ratio is questionable, it argues that the matter should be set for hearing and settlement judge procedures.[19]

21. In addition, Prairie Power proffers what it characterizes as relevant legal background to place its response in context. Prairie Power states that, because MISO's ROE was developed to reflect the average risk profile of the MISO transmission owners, it is appropriate that its capital structure would be as well. Prairie Power states that the Commission applies a three-part test in determining whether to use a filing company's actual capital structure. Prairie Power states that the Commission will use a filing company's actual capital structure: (1) if the debt issued by the company is non-

[16] *Id*. at 6.

[17] *Id*.

[18] *Id*.

[19] *Id*. at 7.

guaranteed, (2) if the company has its own separate bond rating, and (3) if the company's common equity ratio is reasonable, given the equity ratios approved by the Commission in the past. Prairie Power asserts that if any of these three criteria are not satisfied, the Commission may use a capital structure based on a reasonable proxy (i.e., a hypothetical capital structure).[20]

22. Prairie Power states that such a proxy is appropriate because Prairie Power fails two of the three prongs of the test, i.e.: its debt is guaranteed by the National Rural Cooperative Finance Corporation and its actual common equity is dramatically lower than those approved by the Commission in settlements and litigated proceedings. Prairie Power states that its 18.9% common equity ratio is over 1,000 basis points lower than the 29.6% equity ratio that the Commission determined was atypically low in *Embridge Pipelines (Southern Lights) LLC*.[21]

23. Further, Prairie Power argues that its request is consistent with the Commission's ratemaking principles, i.e., the higher the risk, the higher the justified return. It argues that the current relationship between its capital structure and ROE is misaligned. According to Prairie Power, its ROE is the MISO-wide ROE, which is intended to reflect the relative characteristics of all the MISO Transmission Owners. It asserts that, because its equity level is so low, its risk profile is higher, but it is not receiving a higher return through ROE. It argues that its ROE reflects the characteristics of transmission owners that, on average, have much higher equity components. Prairie Power states that this is why its equity needs to be raised and it has selected a proxy of MISO transmission owners to develop its hypothetical capital structure.[22]

V. <u>Notice of Deficiency Response and Responsive Pleadings</u>

24. Notice of Prairie Power's Deficiency Response was published in the *Federal Register*, 85 Fed. Reg. 6149 (Feb. 4, 2020), with interventions and protests due on or before February 19, 2020. On February 19, 2020, Ameren filed a protest and comments.

25. Ameren disputes Prairie Power's reliance on *Williams Natural Gas* and certain other cases regarding the Commission's three-part test concerning the capital structure. Ameren argues that it is unremarkable that Prairie Power does not meet the three-part test because it was established in the context of whether to use the capital structure of a

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[20] *Id*. at 1-2 (citing, among other cases, *Williams Natural Gas Co.*, 80 FERC ¶ 61,158, at 61,683 (1997) (*Williams Natural Gas*)).

[21] *Id*. at 2-3 (citing *Enbridge Pipelines (Southern Lights) LLC*, Initial Decision, 139 FERC ¶ 63,015 (2012), *aff'd*, 144 FERC ¶ 61,044 (2013)).

[22] *Id*. at 3.

pipeline operating company or its parent, and whether a proposed equity ratio was too rich. Ameren argues that, as a customer-owned cooperative, as opposed to an investor-owned company in a holding company corporate structure, Prairie Power's situation is inapt to the precedent it cites.[23]

26. Further, Ameren contends that, even assuming that the three-part test were appropriately applied to Prairie Power's situation as a non-profit cooperative, the question remains as to the representative proxy companies to which Prairie Power should be compared for purposes of establishing the capital structure. Ameren argues that Prairie Power has no parent company to impute a capital structure and that Prairie Power provides no discussion or assessment of why the companies listed should be considered representative of Prairie Power, particularly given its status as a cooperative.[24]

27. Ameren states that MISO Attachment O formula rates are cost-based. It argues that, while the Commission has allowed exceptions in certain circumstances—including for policy reasons such as those elucidated in Order No. 679 (transmission incentives rule)—Prairie Power is not requesting the hypothetical capital structure as an incentive and has not justified an exception to depart from cost-based ratemaking.[25] Ameren argues that departing from cost-based ratemaking because doing so will improve Prairie Power's cash flow and, in turn, make it easier to originate or refinance debt at more favorable terms is not a sufficient rationale, particularly when, by its own admission, it will not suffer a downgrade.[26]

28. Ameren also contends that the rate impact of Prairie Power's proposal is not insignificant and would constitute an unwarranted cost shift to Ameren Illinois customers. Ameren also argues that Prairie Power's proposal deviates from existing precedent in that Prairie Power has not requested the capital structure for a finite period of time or even for a specific project; rather, it seeks approval in perpetuity and for the entirety of its transmission rate base. Ameren also argues that, if Prairie Power is concerned that it is perceived as riskier by lenders because of its highly leveraged balance sheet, perhaps the more transparent way for Prairie Power to be compensated for that risk would be to demonstrate the increased risk (and the associated cost of that risk) through

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[23] Ameren February 19, 2020 Protest at 3 (February Protest).

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

[25] *Id*. at 4 (citing *Promoting Transmission Investment through Pricing Reform*, Order No. 679, 116 FERC ¶ 61,057, *order on reh'g*, Order No. 679-A, 117 FERC ¶ 61,345 (2006), *order on reh'g*, 119 FERC ¶ 61,062 (2007); *Promoting Transmission Investment Through Pricing Reform*, 141 FERC ¶ 61,129 (2012) (policy statement)).

[26] *Id*.

the establishment of an appropriate return on equity as opposed to use of a hypothetical capital structure.[27]

29. On March 10, 2020, Prairie Power filed a motion for leave to answer and answer. Prairie Power argues that if it fails certain elements of the Commission's three-part test, then it fails the test, and the Commission should impute a reasonable proxy. Prairie Power also reiterates arguments from its Deficiency Response while citing additional cases[28] and reiterates its reliance on the Commission's determination in *City of Vernon*.[29]

VI. Discussion

A. Procedural Matters

30. Pursuant to Rule 214 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.214 (2019), Ameren's timely, unopposed motion to intervene serves to make it a party to this proceeding. Rule 213(a)(2) of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.213(a)(2) (2019), prohibits an answer to a protest unless otherwise ordered by the decisional authority. We will accept Prairie Power's January 2 Answer and March 10 Answer because they have provided information that assisted us in our decision-making process.

B. Substantive Matters

31. We find that Prairie Power has not demonstrated that using its proposed hypothetical capital structure as a basis for its transmission revenue requirement is just and reasonable, and we therefore reject the Filing. Cost-based rates are intended to recover the costs of providing service, including the cost of capital. While using a hypothetical cost of capital, in lieu of the actual cost of capital, may be appropriate in

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[27] *Id*. at 5-7.

[28] Prairie Power March 10 Answer at n.9 (citing *Mo. Interstate Gas, LLC*, 119 FERC ¶ 61,074, at PP 59-63 (2007), *vacated on other grounds sub nom. Mo. Pub. Serv. Comm'n v. FERC*, 601 F.3d 581 (D.C. Cir. 2010); *High Island Offshore Sys., L.L.C.*, 107 FERC ¶ 63,019, at PP 111, 118, 141 (2004), *order on initial decision*, 110 FERC ¶ 61,043, at PP 143-147 (2005); *City of Vernon*, 111 FERC ¶ 61,092, at P 84 (2005) (*City of Vernon*); *Dynegy Midwest Generation, Inc*., 121 FERC ¶ 61,025, at PP 40, 45, 55 (2007); *Bluegrass Generation Co., L.L.C*., 118 FERC ¶ 61,214, at P 86 (2007); *Chehalis Power Generating, L.P*., 123 FERC ¶ 61,038, at PP 133-134, 166 (2008)).

[29] *Id*. at 10.

some circumstances, Prairie Power has not justified its proposed departure from cost-based ratemaking.

32. We find that the facts underlying the Tex-La Delegated Order case are distinguishable from the circumstances upon which Prairie Power relies. In its filing, Tex-La explained that it featured a unique capital structure, which included approximately $80 million of long-term debt associated with its investment in an interest in a generating facility that it had since sold. Its books still contained this debt, without an asset to accompany the debt, and had almost no debt associated with actual utility assets. Its actual capital structure was exposed to great potential swings in debt and equity levels outside of its control because the long-term debt was subject to potential repayment at any time by the current holder of the related asset, at which point Tex-La's capital structure would immediately go to nearly 100% equity.[30] Prairie Power has made no such showing of unique circumstances meriting its requested departure from use of its actual capital structure.

33. We also disagree with Prairie Power's assertion that the Commission's acceptance of City of Vernon's use of Southern California Edison's capital structure supports its proposed hypothetical capital structure. While on remand and after hearings, the Commission approved the Initial Decision's finding, that City of Vernon's use of Southern California Edison's capital structure was appropriate, it did so only after analysis of evidence regarding comparable risks.[31] In that case, City of Vernon provided data to support its using Southern California Edison's capital structure, including its credit rating, and it supported the ROE that it would receive based on proxy companies following the method used by the Commission at the time for entities such as City of Vernon that do not issue stock. City of Vernon also contended that it was inherently riskier than any of the proxy companies because of its size and the industrial nature of its customer base.[32] In the instant filings, however, Prairie Power has not provided comparable information to support its proposed capital structure.

34. We are not persuaded by Prairie Power's Deficiency Response regarding the use of the three-part test for determining when to use actual capital structure. The test used in the proceedings cited by Prairie Power in its Deficiency Response determined whether to use for ratemaking a subsidiary's actual capital structure or the parent company's actual capital structure, and the test was used to determine whether a subsidiary's financing was

[30] Filing of Midcontinent Independent System Operator, Inc. and East Texas Electric Cooperative, Inc., on behalf of Tex-La Electric Cooperative of Texas, Inc., Docket No. ER13-1827-000, at 3-4 (June 28, 2013).

[31] *City of Vernon*, 111 FERC ¶ 61,092 at PP 101-103.

[32] City of Vernon Initial Decision*,* 109 FERC ¶ 63,057 at PP 97, 115.

independent of the parent company. A parent company's guarantee of debt was evidence against using the subsidiary's actual capital structure. In Prairie Power's situation, there is no issue of a parent-subsidiary relationship and we do not find the three-part test applicable.

35. The additional cases cited for the first time in Prairie Power's March 10 Answer are likewise not persuasive. The hypothetical capital structure determinations in those cases were based on specific circumstances that made reliance on an actual capital structure for those entities not just and reasonable, and we do not find the factual circumstances in those cases to be similar to those presented by Prairie Power.[33]

36. We disagree with Prairie Power's assertion that the Commission has permitted public power transmission owners in RTOs to apply the same overall rate of return as applied by the Zone's dominant transmission owner. Those proceedings only concerned the use of another transmission owner's ROE, not the capital structure or overall rate of return. Additionally, we are not persuaded by Prairie Power's argument that the MISO base ROE, as a small component of Prairie Power's overall return due to its low percentage equity, inadequately compensates Prairie Power for its risk, such that a hypothetical capital structure would be justified. Transmission owners can argue for changes in their ROE to reflect risk. To the extent that Prairie Power believes that its risks are not captured by the MISO transmission owners' ROE in its actual capital structure, Prairie Power may file to request a different ROE under FPA section 205.

37. Prairie Power states that one of the reasons that it requests a hypothetical capital structure is to receive better financing conditions for an upcoming $200 million in transmission project investments, but it has provided no details about those investments. Prairie Power may if it satisfies the applicable criteria, submit a filing requesting a hypothetical capital structure on a project-specific basis under section 219 of the FPA,[34] pursuant to Order No. 679.[35]

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[33] *See supra* note 28.

[34] 16 U.S.C. § 824s (2018).

[35] *See* Order No. 679, 116 FERC ¶ 61,057 at PP 123, 131-133.

The Commission orders:

Prairie Power's Filing is hereby rejected, as discussed in the body of this order.

By the Commission.

(S E A L)

Nathaniel J. Davis, Sr.,
Deputy Secretary.