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Transmission Report: FERC Methodology for Establishing Base Return on Equity

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Historical Evolution of ROE Methodology

- US Supreme Court cases *Hope* (1944) and *Bluefield* (1923)
- FERC's historical use of DCF model since 1980s
- 1990s changes to implementation of model, primarily for natural gas and oil pipelines
- Opinion 531 (2014) adopted two-step, constant-growth DCF model for public utilities; reaffirmed use in Opinion 551
- *Emera Maine* decision (D.C. Cir. 2017) – vacated Opinion 531

ROE Is in a State of Flux

- 2018 Briefing orders
- 2019 FERC issued ROE NOI, Docket No. PL19-4-000, prompted by:
 - Multiple complaint proceedings in ISO-NE and MISO
 - Competing white papers

DCF vs. Blending Four Methodologies (for determining range of reasonableness)

- Proposal under consideration is blending methodologies:
 - DCF Model
 - Capital Asset Pricing Model (CAPM)
 - Expected Earnings
 - *Risk Premium
- Average three methodologies to determine composite range of reasonableness
- Average four separate base ROE estimates

Proxy Group Selection Criteria (to use as inputs to selected methodology(ies))

- National companies considered electric utilities by Value Line
- Credit Rating Screen – established by a bandwidth of three credit (bond) ratings assigned by both S&P's and Moody's, including one credit below, one credit above, and same credit rating as subject utility
- Mergers and Acquisitions – eliminate if activity could distort their DCF results
- Pays Dividends – neither made nor announced a cut
- Annual Revenue Threshold, when appropriate
- ICOFs Pass Economic Logic Test

Placement of Base ROE (within selected range of reasonableness)

- Point of Central Tendency
- Are adjustments warranted?
 - Relative Risk to:
 - Other proxy companies
 - Other projects
 - Market conditions
 - Weather-related

Proposed Limitation on FPA Section 206 Complainant Rights

- Proposed framework for evaluating whether existing base ROE remains just and reasonable – first prong of FPA 206 ROE determination

- 205 vs. 206 rights

Potential Effects of Proposed ROE Policy

- DCF results would be diluted
- Zone of reasonableness would be expanded after incorporating additional methodologies
- Proxy group would be expanded with less stringent screening criteria
- Point of central tendency would be subject to expansion for the determination of a base ROE
- Amount of subjectivity in ROE determinations would increase, resulting in more complex, lengthier, and more contentious litigation
- Customer groups are less likely to participate in these determinations due to the expense and duration of anticipated litigation

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APPENDIX – ADDITIONAL BACKGROUND

Citations

- The Federal Power Act §§ 205 -206, 16 U.S.C § 824d-824e (2019).
- The Natural Gas Act §§ 4-5, 15 U.S.C § 717c-717d (2019).
- *MISO Complaint Proceedings: Ass'n of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Docket No. EL14-12-003; *Arkansas Elec. Coop. Corp. v. Allefe, Inc.*, Docket No. EL15-45.
- *NE-ISO Complaint Proceedings: Coakley, Mass. Attorney Gen. v. Bangor Hydro-Electric Co.*, Docket No. EL11-66; *Environment Northeast v. Bangor Hydro-Electric Co.*, Docket No. EL13-33; *Mass. Attorney Gen. v. Bangor Hydro-Electric Co.*, Docket No. EL14-86; *Belmont Municipal Light Dept. v. Maine Power Co.*, Docket No. EL16-64.
- *Inquiry Regarding the Commission's Policy for Determining Return on Equity*, 166 FERC ¶ 61,207 (2019).
- *Coakley, Mass. Attorney Gen. v. Bangor Hydro-Elec. Co.*, Opinion No. 531, 147 FERC ¶ 61,234, Opinion No. 531-A, *order on paper hearing*, 149 FERC ¶ 61,032 (2014), Opinion No. 531-B, *order on reh'g*, 150 FERC ¶ 61,165 (2015), *Emera Maine v. FERC*, 854 F.3d 9, 23-24 (D.C. Cir. 2017) ("Emera Maine") (vacating Opinion No.531 & 531-B and remanding), *Coakley, Mass. Attorney Gen. v. Bangor Hydro-Elec. Co.*, 165 FERC ¶ 61,030 (2018) (Briefing Order).
- *Ass'n of Businesses Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, Opinion No. 551, 156 FERC ¶ 61,234 (2016).

Citations (cont.)

- *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944) (“*Hope*”).
- *Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923) (“*Bluefield*”).
- *S. Cal. Edison Co. v. FERC*, 717 F.3d 177 (D.C. Cir. 2013).
- *Potomac-Appalachian Transmission Highline, LLC*, Opinion No. 554, 158 FERC ¶ 61,050 (2017).
- *Portland Nat. Gas Transmission Sys.*, Opinion No. 510, 134 FERC ¶ 61,129 (2011).
- *Transcon. Gas Pipe Line Corp.*, Opinion No. 414-B, 85 FERC ¶ 61,323 (1998).
- *See Portland Natural Gas Transmission Sys.*, 142 FERC ¶ 61,197 (2013).
- Opinion No. 396-B, 79 FERC at 62,382-83, reh'g denied, Opinion No. 396-C, 81 FERC ¶ 61,036 (1997).