

## **FERC Establishes New England Return On Equity (ROE), Sets MISO ROE for Hearing**

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On October 16, 2014, the Federal Energy Regulatory Commission (FERC) issued two orders applying the new two-step, constant growth discounted cash flow (DCF) methodology for determining the base return on equity (ROE) for public utilities that it recently established in [Opinion No. 531](#) (Coakley, Mass. Attorney Gen. v. Bangor Hydro-Electric Co., 147 FERC 61,234 (2014)). An in-depth analysis of Opinion No. 531 is available [here](#).

### **Opinion No. 531-A**

In [Opinion No. 531-A](#) (Coakley, Mass. Attorney Gen. v. Bangor Hydro-Electric Co., 149 FERC ¶ 61,032 (2014)), FERC issued an order on the paper hearing it initiated in Opinion No. 531 to determine the appropriate long-term growth rate to use in the two-step DCF methodology for purposes of determining the base ROE for a group of New England transmission owners (NETOs). Based on the evidence presented in the hearing, FERC confirmed that the projected long-term growth in GDP is the appropriate long-term growth projection to be used (*id.* at P 10), and that 4.39% is the appropriate projection of long-term GDP growth. Based on this finding, FERC determined that the NETOs existing 11.14% base ROE is unjust and unreasonable and that a just and reasonable base ROE is 10.57%. (*Id.*)

FERC also explained the impact of this finding on the NETOs' transmission incentive ROE adders. According to FERC, a "utility's total ROE, inclusive of transmission incentive ROE adders, should not exceed the top of the zone of reasonableness produced by the two-step DCF methodology." (*Id.* at P 11) Applying the 4.39% projection of long-term GDP growth, FERC calculated a zone of reasonableness for the NETOs of 7.03% to 11.74%. Accordingly, FERC found that the NETOs' maximum ROE, including transmission incentive ROE adders, cannot exceed 11.74%. (*Id.*) The NETOs must make refunds within 30 days of the date of the order.

### **Association of Businesses Advocating Tariff Equity v. Midcontinent Independent System Operator, Inc.**

In [Association of Businesses Advocating Tariff Equity v. Midcontinent Independent System Operator, Inc.](#), 148 FERC 61,049 (2014), FERC addressed a Complaint asserting that the current 12.2% to 12.38% base ROE earned by Midcontinent Independent System Operator, Inc. (MISO) transmission-

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owning members (MISO TOs) through the MISO Tariff is unjust and unreasonable and should be reduced to 9.15%. The Complaint also contended that MISO TOs' capital structures should be capped at 50% common equity, and that ROE incentive adders received by certain MISO TOs are unjust and unreasonable. FERC granted in part, denied in part and dismissed in part the Complaint.

## **ROE**

FERC granted the portion of the Complaint addressing ROE. In doing so, FERC found that the Complaint raises issues of material fact that cannot be resolved based upon the record before it. Accordingly, FERC established hearing and settlement judge procedures. (Id. at P 183) FERC noted its recent issuance of Opinion No. 531, in which it adopted a two-step DCF methodology for determining base ROEs. Accordingly, FERC stated that it expects the participants' evidence and DCF analyses in the ordered hearing and settlement proceedings to be guided by that decision. (Id. at P 186)

## **Capital Structure**

FERC denied the Complaint with respect to certain MISO TOs' use of actual or FERC-approved hypothetical capital structures including more than 50% common equity. In doing so, FERC found that Complainants had not demonstrated that such capital structures are not just and reasonable, and have not cited any precedent for capping the level of common equity used in capital structures for purposes of ratemaking. (Id. at P 190). FERC explained that it has not dictated the level of common equity in utility capital structures used in ratemaking beyond very limited and specific circumstances not present here.

FERC has established a three-part test to determine when an operating company can use its actual capital structure. Specifically, FERC "uses an operating company's actual capital structure if the operating company: (1) issues its own debt without guarantees; (2) has its own bond rating; and (3) has a capital structure within the range of capital structures approved by [FERC]." (Id.) If these requirements are not met, FERC uses the consolidate capital structure of the parent company or a proxy capital structure to set the operating utility company's overall ROE. FERC found that, in the case at issue, Complainants had not demonstrated that the MISO TOs do not meet the requirements of the three-part test (id. at P 192), nor had they otherwise shown that an across-the-board equity cap is appropriate (id. at P 193-199).

## **Incentives**

FERC also denied Complainants' request that it terminate certain MISO TOs' ROE incentives. In doing so, FERC found that Complainants and other commenters did not provide any evidence that transmission incentives are no longer necessary, and that nothing in FERC's transmission incentive policy requires periodic reexamination of whether incentives are needed. (Id. at P 204) FERC did note, however, "that a utility's total ROE, including any incentive ROE, is limited to the zone of reasonableness, and an incentive ROE may not be implemented in full by the utility if the total ROE exceeds the zone of reasonableness." Since FERC set the MISO TOs' base ROE for hearing and settlement judge procedures, the MISO TOs' total ROE and zone of reasonableness may change as a result of the proceeding. Accordingly, the MISO TOs' may not be able to implement the full amount of incentive ROE that FERC previously granted. (Id. at P 205)

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