

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Association of Businesses Advocating Tariff Equity,
et al.

v.

Midcontinent Independent System Operator, Inc.,
et al.

Docket No. EL14-12-002

REPLY BRIEF OF ORGANIZATION OF MISO STATES

Gary J. Newell
Andrea I. Sarmentero Garzón
Jennings, Strouss and Salmon, PLC
1350 I Street, NW, Suite 810
Washington, DC 20005-3305
P: (202) 370-4128
gnewell@jsslaw.com
asarmentero@jsslaw.com

Counsel to the Organization of MISO States

**WASHINGTON, D.C.,
October 13, 2015**

TABLE OF CONTENTS

I. INTRODUCTION.....	2
II. ARGUMENT	4
1. Was the MISO TOs' currently allowed base ROE unjust and unreasonable during the applicable refund period?	4
2. If the MISO TOs' current allowed base ROE was unjust and unreasonable during the applicable refund period, for purposes of determining what base ROE was just and reasonable for that period and any applicable prospective period:	9
(a) What is the proper application of the two-step DCF methodology described in the Commission's Opinion Nos. 531, 531-A and 531-B for purposes of resolving Contested Issues Nos. 1 and 2?	9
(b) Should methods of estimating the MISO TOs' cost of equity other than the two-step DCF methodology be considered in resolving Contested Issues 1 and 2?	26
(c) If any methods of estimating the MISO Transmission Owners' cost of equity other than the two-step DCF methodology are considered, which other methods should be considered, and how should each such other method be applied?	26
(d) What additional information or policy considerations, if any, should be considered for purposes of resolving Contested Issues 1 and 2?.....	27
(e) What Base ROE allowance for the MISO TOs was just and reasonable for the applicable refund period?.....	39
(f) What is the appropriate upper-end of the zone of reasonableness?.....	41
3. Is a base ROE derived from financial data for the refund period's last six months (August, 2014 through January, 2015) more reasonably representative of the MISO TOs' cost of equity capital during the entire fifteen-month refund period than a base ROE derived from financial data from January through June, 2015, which includes data for more than four months after the refund period?	44
III. CONCLUSION	45

TABLE OF AUTHORITIES

CASES

<i>Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm’n of W. Va.</i> , 262 U.S. 679 (1923).....	3, 38
<i>City of Detroit v. Federal Power Comm’n</i> , 230 F. 2d 810, 815 (D.C. Cir. 1955).....	8, 39
<i>City of Winnfield v. FERC</i> , 744 F.2d 871, 875 (D.C. Cir. 1984).....	8
<i>Conn. Dep’t of Pub. Util. Control v. FERC</i> , 593 F.3d 30 (D.C. Cir. 2010)	41
<i>Federal Power Comm’n v. Natural Gas Pipeline Co.</i> , 315 U.S. 575, 585-586 (1942).....	8
<i>FPC v. Hope Natural Gas Co.</i> , 320 U.S. 591 (1944)	3
<i>In the Matter of the Application of Entergy Arkansas, Inc. for Approval of Changes in Rates for Retail Electric Service</i> , Slip Copy , 2014 WL 10385679 (Ark.P.S.C.) at 10 (August 15, 2014)	33
<i>Montana-Dakota Utils. Co. v. Nw. Pub. Serv. Co.</i> , 341 U.S. 246, 251 (1951)	8
<i>Pac. Gas & Elec. Co. v. FERC</i> , 306 F.3d 1112 (D.C. Cir. 2002).....	8
<i>Pub. Sys. v. FERC</i> , 606 F.2d 973, 979 n.27 (D.C. Cir. 1979)	8
<i>Sacramento Municipal Utility Dist. v. F.E.R.C.</i> , 474 F.3d 797, 804 (2007)	41
<i>Transmission Agency of Northern California v. F.E.R.C.</i> , 628 F.3d 538, 549 (2010).....	41

FERC DECISIONS

<i>Association of Businesses Advocating Tariff Equity et al., v. Midcontinent Independent System Operator, Inc. et al.</i> , 148 FERC ¶ 61,049 (2014)	33, 35
<i>Bangor Hydro-Elec. Co.</i> , Opinion No. 489, 117 FERC ¶ 61,129 (2006), <i>on reh’g</i> , 122 FERC ¶ 61,265 (2008), <i>clarified</i> , 124 FERC ¶ 61,136 (2008), <i>review denied sub nom.</i>	40
<i>El Paso Natural Gas Co.</i> , Opinion No. 528, 145 FERC ¶ 61,040 (2013), <i>reh’g pending</i>	11
<i>Martha Coakley, Massachusetts Attorney Gen., et al. v. Bangor Hydro- Elec. Co., et al.</i> , Opinion No. 531, 147 FERC ¶ 61,234 (2014), <i>order on paper</i>	

<i>hearing</i> , Opinion No. 531-A, 149 FERC ¶ 61,032 (2014), <i>order on reh’g</i> , Opinion No. 531-B, 150 FERC ¶ 61,165 (2015); <i>petition for review pending</i> <i>sub nom. Braintree Elec. Light Dept., et al v. FERC</i> , D.C. Cir. Docket No. 15-1119.	passim
<i>Midcontinent Independent System Operator, Inc.</i> , 150 FERC ¶ 61,004 (2015).....	33, 41
<i>Northwest Pipeline Corp.</i> , 87 FERC ¶ 61,266 (1999).....	15
<i>Ozark Gas Transmission System</i> , 68 FERC ¶ 61,032 (1994).....	15
<i>Portland Natural Gas Trans. Sys.</i> , Opinion No. 510, 134 FERC ¶ 61,129 (2011).....	11
<i>Public Service Company of New Mexico</i> , 150 FERC ¶ 63,012 (2015).	40
<i>Tallgrass Transmission, LLC</i> , 150 FERC ¶ 61,224 (2015).....	16
<i>Transcontinental Gas Pipe Line Corp.</i> , Opinion No. 414-B, 85 FERC ¶ 61,323 (1998).....	14

REGULATIONS

<i>Generic Determination of Rate of Return on Common Equity for Electric</i> <i>Utilities</i> , 47 Fed. Reg. 38332-01 (1982).	12, 35
<i>Generic Determination of Rate of Return on Common Equity for Public</i> <i>Utilities</i> , Order No. 442-A, FERC Stats. & Regs. ¶ 30,702 (1986).....	12

STATUTES

16 U.S.C. § 824e (2012).	5
16 U.S.C. § 825 l(c) (2012).....	8

GLOSSARY

<u>Abbreviation</u>	<u>Full Term</u>
Base ROE	ROE prior to application of ROE-increasing incentives
CAPM	Capital Asset Pricing Model
CWIP	Construction Work in Progress
DCF	Discounted Cash Flow
ECAPM	“Empirical” Capital Asset Pricing Model
FPA	Federal Power Act
I.B.	Initial Brief
IBES	Thompson Reuters’ Institutional Brokers' Estimate System
MEPs	Market Efficiency Projects
MISO	Midcontinent Independent System Operator
MVPs	Multi-Value Projects
ROE	Return on Equity
RRA	Regulatory Research Associates
TO	Transmission Owner
Tr.	Hearing Transcript ^{*/}

^{*/} References to the Hearing Transcript will be in the form of “Tr. X:Y”, with X being the cited transcript page and Y being the cited line number(s).

**UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION**

Association of Businesses Advocating Tariff Equity,
et al.

v.

Midcontinent Independent System Operator, Inc.,
et al.

Docket No. EL14-12-002

**REPLY BRIEF
OF
ORGANIZATION OF MISO STATES**

**To: The Honorable David H. Coffman
Presiding Administrative Law Judge**

Pursuant to Rule 706 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“FERC” or “Commission”), 18 C.F.R. § 385.706 (2015) and the Presiding Judge’s Order Establishing Procedural Schedule dated January 23, 2015, the Organization of MISO States (“OMS”)¹ respectfully submits this Reply Brief in the above-

¹ The OMS submits this pleading because the following members, which represent a majority, generally support the contents: Arkansas Public Service Commission, Illinois Commerce Commission, Indiana Utility Regulatory Commission, Iowa Utilities Board, Michigan Public Service Commission, Minnesota Public Utilities Commission, Mississippi Public Service Commission, Missouri Public Service Commission, Council of the City of New Orleans, North Dakota Public Service Commission, South Dakota Public Utilities Commission, and Public Utility Commission of Texas. The Manitoba Public Utilities Board, the Louisiana Public Service Commission and the Wisconsin Public Service Commission abstained. The Kentucky Public Service Commission and the Montana Public Service Commission did not participate in the vote.

captioned proceeding. OMS's Reply Brief responds to the Initial Brief ("I.B.") filed on September 21, 2015 by the transmission-owning members ("TOs") of the Midcontinent Independent System Operator, Inc. ("MISO") who, as Respondents, seek to defend the Base Returns on Equity ("ROE") currently in effect under Attachment O to the MISO Tariff.²

I. INTRODUCTION

The MISO TOs argue that the current Base Returns on Equity ("ROE") of 12.38 percent and 12.22 percent are just and reasonable because they fall below the highest proxy result reached by one of Dr. Avera's Discounted Cash Flow ("DCF") analyses. On that basis, they contend that as a matter of law, no change in the current Base ROEs is warranted. The MISO TOs further argue that in the event the Presiding Judge finds the current Base ROEs to be unjust and unreasonable, any determination of new Base ROEs must take into account that - in the MISO TOs' view - "anomalous" market conditions have distorted the inputs to the DCF studies presented in this proceeding. As a solution, they propose to either: (i) set the Base ROE at the midpoint resulting from a DCF analysis using Value Line Investment Survey ("Value Line") short term growth data, rather than the data published by Thomson Reuters' Institutional Brokers' Estimate System ("IBES"), on which the Commission has relied in the past; or (ii) set

² The MISO TOs that are Respondents to the Complaint are: ALLETE, Inc. (for its operating division Minnesota Power, Inc. and its wholly-owned subsidiary Superior Water Light, & Power Company (Superior Water, L&P); Ameren Illinois Company; Union Electric Company; Ameren Transmission Company of Illinois; American Transmission Company, LLC; Cleco Power, LLC; Duke Energy Business Services, LLC d/b/a Duke Energy Indiana, Inc.; 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 d/b/a ITC Transmission; 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; and Southern Indiana Gas & Electric Company d/b/a Vectren Energy Delivery of Indiana, Inc.

the Base ROE near the top of the zone of reasonableness resulting from the MISO TOs' DCF analysis that incorporated IBES short-term growth data.

As explained in OMS's I.B. and herein, the MISO TOs have failed to demonstrate that the inputs to the DCF studies have been distorted by "anomalous" capital market conditions. Therefore, consistent with FERC precedent, the midpoint of the DCF-based zone of reasonableness is presumed to reflect the cost of equity of the MISO TOs in a manner that meets the *Hope*³ and *Bluefield*⁴ standards. Furthermore, because the Commission has expressed a preference for the use of IBES short-term growth data in DCF analyses, and because there is no basis for questioning the reliability of IBES as a data source in this proceeding, Dr. Avera's Value Line-based DCF studies should not be adopted for the purpose of establishing a new Base ROE for the MISO TOs. Rather, the new Base ROE should be set somewhere within the range of midpoints of the IBES-based DCF studies in the record.

Finally, the MISO TOs assert that, if the Base ROEs were to be reduced to the levels advocated by the Complainants⁵ and supporting intervenors⁶ in this proceeding, the MISO TOs would be dissuaded from investing in Market Efficiency Projects ("MEPs") and Multi-Value Projects ("MVPs"). As further explained in this Reply Brief, the purpose of the Base ROE is not to promote the development of specific types of transmission projects, but rather to enable the MISO TOs to attract sufficient capital to fulfil their public utility duties. Any unusual risks

³ *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) ("*Hope*").

⁴ *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679 (1923) ("*Bluefield*").

⁵ The Association of Businesses Advocating Tariff Equity, the Coalition of MISO Transmission Customers, the Illinois Industrial Energy Consumers, Indiana Industrial Energy Consumers, Inc., the Minnesota Large Industrial Group, and the Wisconsin Industrial Energy Group (collectively, "Complainants").

⁶ Joint Consumer Advocates ("JCA"), Joint Customers ("JCI"), Southwestern Electric Cooperative, Inc, and Resale Power Group of Iowa ("RPG").

associated with MEPs or MVPs can, and must, be addressed through the various incentives the Commission makes available to encourage such projects. Finally, the MISO TOs present no evidence to show that, if the Base ROE is reduced to a just and reasonable level in this proceeding, MEPs and MVPs will not be built.

II. ARGUMENT

In this section of the Reply Brief, OMS responds to various arguments of the MISO TOs regarding each of the contested issues enumerated in the Joint Statement of Contested Issues filed on July 31, 2015 in this proceeding.

1. Was the MISO TOs' currently allowed base ROE unjust and unreasonable during the applicable refund period?

As noted, the MISO TOs defend the current Base ROEs of 12.38 percent and 12.22 percent as “just and reasonable”⁷ even though, in today’s circumstances, ROEs at that level are excessive essentially on their face. Not surprisingly, the arguments the TOs present in defense of the current ROEs are untenable. The MISO TOs rationalize their position by: (i) simply refusing to accept a key Commission holding in Opinion No. 531, *et al.*⁸ regarding the meaning of the zone of reasonableness; and (ii) attacking the validity of the numerous DCF studies that show the current ROEs to be unjust and unreasonable, even though all but one of the MISO TOs’ own

⁷ See MISO TOs’ I.B. at 11-15.

⁸ *Martha Coakley, Massachusetts Attorney Gen., et al. v. Bangor Hydro- Elec. Co., et al.*, Opinion No. 531, 147 FERC ¶ 61,234 (2014), *order on paper hearing*, Opinion No. 531-A, 149 FERC ¶ 61,032 (2014), *order on reh’g*, Opinion No. 531-B, 150 FERC ¶ 61,165 (2015); *petition for review pending sub nom. Braintree Elec. Light Dept., et al v. FERC*, D.C. Cir. Docket No. 15-1119.

DCF studies show the very same thing. Their arguments and, more importantly, the evidence, sustain neither of these positions.

The record evidence convincingly demonstrates that the MISO TOs' current Base ROEs (12.2 percent and 12.38 percent) were unjust and unreasonable during the applicable refund period, and remain so. The Presiding Judge should reject the MISO TOs' unsupported claims that: (i) the Complainants and supporting intervenors have not met their burden of proof under Section 206 of the Federal Power Act ("FPA");⁹ and (ii) the current Base ROEs are just and reasonable.

A. The Complainants and supporting intervenors have met their burden of proof under Section 206 of the FPA.

In Opinion No. 531-B (at P 32), the Commission explained that: "showing the existing Base ROE established in the prior case is unjust and unreasonable merely requires showing that the Commission's ROE methodology now produces a numerical value below the existing numerical value." The Complainants and supporting intervenors have made this showing and, so, they have met the applicable burden of proof.

The currently allowed Base ROEs of the MISO TOs are *higher* than the midpoints and medians of the zones of reasonableness resulting from each and every one of the many DCF analyses presented in this proceeding, including the MISO TOs' own DCF analyses.¹⁰ Furthermore, the currently allowed Base ROEs exceed the top ends of the zones of

⁹ 16 U.S.C. § 824e (2012).

¹⁰ See Exh. No. JC-8, Exh. No. JC-25, Exh. No. JCA-6, Exh. No. JCA-22, Exh. No. JCI-2, Exh. No. JCI-9, Exh. No. RPG-7, Exh. No. RPG-14, Exh. No. MTO-5 at 1-2, Exh. No. MTO-28 at 1-2, Exh. No. S-2 at 7, and Exh. No. S-5 at 5.

reasonableness resulting from: (i) every DCF analysis conducted in this proceeding that used IBES short-term growth data, including the TOs' own IBES-based studies; and (ii) the MISO TOs' own updated DCF analysis incorporating Value Line short-term growth data.¹¹ In fact, of the fourteen DCF analyses presented by the parties (including the MISO TOs), *all fourteen* result in zones of reasonableness for which the midpoints are lower than the current Base ROEs of the MISO TOs. Additionally, the current Base ROEs of the MISO TOs fall entirely outside of the zones of reasonableness established by *thirteen of the fourteen* DCF studies.

The MISO TOs argue that the parties seeking a reduction in the current Base ROEs rely on flawed DCF analyses that fail to conform to the methodology prescribed in Opinion No. 531, *et al.*¹² That argument rings hollow when one considers that the current Base ROEs are higher than the midpoints and medians produced by *every one* of the MISO TOs' own DCF studies, regardless of study period or choice of source for short-term growth data.¹³ The current Base ROEs even exceed the top ends of the zones of reasonableness that result from the TOs' two IBES-based DCF studies and their updated Value Line- based DCF study.¹⁴ Presumably, the MISO TOs are not arguing that their own DCF studies are flawed and inconsistent with Opinion No. 531, *et al.* So, even if one were to assume - solely for argument's sake - that the Complainants' and supporting intervenors' DCF studies are in some way flawed, the current

¹¹ American Transmission Company, LLC's ("ATC") Base ROE of 12.2 percent exceeds the top end of the zones of reasonableness resulting from all of the IBES-based DCF studies, with the single exception of the MISO TOs' IBES-based DCF study using updated financial information (which produces a range with an upper-end of 12.27 percent). ATC's current 12.2 percent ROE also falls within the 6.10 -12.22 percent zone of reasonableness produced by the TOs' updated Value Line-based DCF study.

¹² See MISO TOs' I.B. at 14.

¹³ Exh. No. MTO-5 at 1-2, and Exh. No. MTO-28 at 1-2.

¹⁴ See MISO TOs' I.B. at 14.

Base ROEs *still* would be unjust and unreasonable when tested against three of the four DCF studies presented by the MISO TOs themselves.¹⁵

B. The MISO TOs' "zone of immunity" argument is a collateral attack on Opinion No. 531, et al., and other FERC precedent.

Under Section 206 of the FPA, the Commission has the authority (indeed, the obligation) to change an existing Base ROE even if the evidence shows that it falls within a calculated zone of reasonableness. This is because, as the Commission stated in Opinion No. 531, "the determination of the zone of reasonableness is simply the first step in the determination of a just and reasonable ROE for a utility or group of utilities."¹⁶

The MISO TOs nevertheless argue in their I.B. that the current Base ROE cannot "as a matter of law" be unjust and unreasonable because it falls within the zone of reasonableness resulting from one of Dr. Avera's Value Line-based DCF studies.¹⁷ However, the Commission already considered and rejected these arguments in Opinion No. 531,¹⁸ so the MISO TOs'

¹⁵ Faced with these results, the MISO TOs had no choice but to fall back on their original Value Line-based DCF study, since the top end of the range produced by that study (16.17%) exceeds the current Base ROE. Apart from the fact that 16.17% should be rejected as outlandish on its face, the results of the TOs' Value Line-based DCF studies cannot be accepted because Value Line's short-term growth forecasts are tainted by their use of average historical earnings as a baseline, an approach that is at odds with the Commission's forward-looking DCF method. *See* Section 2(a), *infra*.

¹⁶ Opinion No. 531 at P 51; *accord*, Opinion No. 531-B at P 25 ("[T]he establishment of a DCF zone of reasonableness is simply one step in the process of determining a just and reasonable ROE for inclusion in the cost of equity service of the subject public utility or utilities.").

¹⁷ *See* MISO TOs' I.B. at 12-14.

¹⁸ For example, quoting *City of Winnfield v. FERC*, 744 F.2d 871, 875 (D.C. Cir. 1984), the MISO TOs argue that the statutory protection contained in Section 206 of the FPA requires that a utility's rate "be found to be entirely outside the zone of reasonableness before the agency can dictate their level or form." MISO TO I.B. at 12. As the Commission pointed out in Opinion No. 531 (at P 54) however, *City of Winnfield* did not involve the ROE component of a utility's cost of service and, as such, the D.C. Circuit did not use the term "zone of reasonableness" as it is commonly used in proceedings involving a utility's ROE. The apposite law was articulated in *City of Detroit v. Federal Power Comm'n*, 230 F. 2d 810, 815 (D.C. Cir. 1955) (citing *Federal*

position is simply an impermissible collateral attack on that opinion. The MISO TOs apparently consider themselves at liberty to disregard this element of Opinion No. 531 because “that ruling has not been the subject of judicial review, and cannot be reconciled with prior interpretations of the FPA by the Commission and the courts.”¹⁹ Affirmance following judicial review, however, has never been the test for whether parties appearing before the Commission are bound by its prior rulings. Unless and until a Commission decision is reversed or vacated on review, it remains in full force and effect and parties must adhere to and comply with it.²⁰

Power Comm’n v. Natural Gas Pipeline Co., 315 U.S. 575, 585-586 (1942), a case that (unlike *City of Winnfield*) involved allowed return on rate base. In *City of Detroit*, the D.C. Circuit held that the complaint provisions of federal energy regulatory statutes, while leaving the Commission a zone of reasonable discretion in which rates can be “just and reasonable” without being the “lowest reasonable,” mean “that a decrease ordered by the Commission which leaves the utility with rates which are non-confiscatory will not be held invalid; that is, [they]... permit[] but do[] not compel the Commission to go to the very limit of constitutional power.” As MISO TOs neither do nor could contend that a measured decrease ordered by the Commission in this case would be constitutionally confiscatory, the statute plainly permits such relief.

The MISO TOs also rely on *Montana-Dakota Utils. Co. v. Nw. Pub. Serv. Co.*, 341 U.S. 246, 251 (1951), to support their claim that the zone of reasonableness represents a range of permissible rates. The argument was made and rejected in *Coakley*, however. In Opinion No. 531, the Commission correctly interpreted the Supreme Court decision in *Montana-Dakota* to mean that, while statutory reasonableness is an abstract concept, the Commission must translate that concept into a concrete rate. Opinion No. 531 at n. 93.

The rest of the case law cited by the MISO TOs (I.B. at 12-14) was similarly found to be inapposite in Opinion No. 531. For example, *Pac. Gas & Elec. Co. v. FERC*, 306 F.3d 1112 (D.C. Cir. 2002) (“*Pacific Gas*”). *Pacific Gas* involved the pass-through rates of a non-jurisdictional entity and the use of the term “zone of reasonableness” by the D.C. Circuit in this case was not referring to a range of rates resulting from a DCF study, but to a zone determined by the standards in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) “bounded on one end by investor interest and the other by the public interest against excessive rates.” 306 F.3d 1112 at 1116. This is consistent with the Commission’s ruling in Opinion No. 531 (at P 50) that an existing ROE above the level that satisfies *Hope* and *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm’n of W. Va.*, 262 U.S. 679 (1923) (“*Bluefield*”) ¹⁸ would exploit customers and is, therefore, unjust and unreasonable.

Finally, the MISO TOs argue that Section 206 of the FPA provides some sort of enhanced protection to utilities with respect to challenges to existing rates. The Commission rejected that argument in *Coakley*, however, because the notion of a higher level of protection under Section 206 cannot be reconciled with the consumer protection purpose of the FPA. See Opinion No. 531 at n. 95, citing *Pub. Sys. v. FERC*, 606 F.2d 973, 979 n.27 (D.C. Cir. 1979).

¹⁹ See MISO TO I.B. at 13 n.28.

²⁰ 16 U.S.C. § 825 1(c) (2012) (stating that commencement of judicial review proceedings shall not, unless specifically ordered by the court, operate as a stay of the Commission’s Order).

For these reasons, the Presiding Judge should reject the MISO TOs' argument that the current Base ROEs cannot be found unjust and unreasonable because it falls within the zone of reasonableness produced by one of Dr. Avera's DCF studies. Further, the overwhelming weight of the evidence demonstrates that the current Base ROEs of the MISO TOs are unjust and unreasonable. The Complainants' burden of proof under Section 206 has been met.

2. If the MISO TOs' current allowed base ROE was unjust and unreasonable during the applicable refund period, for purposes of determining what base ROE was just and reasonable for that period and any applicable prospective period:

- (a) What is the proper application of the two-step DCF methodology described in the Commission's Opinion Nos. 531, 531-A and 531-B for purposes of resolving Contested Issues Nos. 1 and 2?**

The initial briefs confirm the existence of a number of significant disagreements between the MISO TOs and the Complainants (and other parties) about how the DCF methodology approved in Opinion No. 531, *et al.* should be applied.²¹ OMS does not express a position on all of the many points of disagreement, but instead focuses below on certain of the more substantial areas of controversy regarding application of the Commission's DCF methodology.

²¹ Through their use of somewhat imprecise language, the MISO TOs suggest that the range of disagreements is narrower than is actually the case. Specifically, the MISO TOs state in their I.B. that the "proxy group selection" of their witness, Dr. Avera, is "uncontested." MISO TOs' I.B. at 10; *see also id.* at 2-3 ("[T]here is little, if any, disagreement among the parties here regarding ... the selection of proxy companies ..."). What appears not to be in dispute is whether the proxy group should be based on a national or a regional sample. There are, however, substantial disagreements about whether particular utilities should be excluded from the proxy group, as evidenced by the lengthy discussion of those disagreements in the MISO TOs' own I.B. (at 36-55).

A. Dividend yield calculation.

In their I.B., the MISO TOs defend Dr. Avera's use of a dividend yield calculation method that the Commission has never approved. *See* MISO TOs I.B. at 25-27. The TOs claim that, for each proxy group company, yields during the six-month study period should be calculated by dividing average high and low prices in each month by "the most recent dividend declared in that [six month] period," which is to say the declared dividend in effect for each proxy group company at the end of the study period.²² FERC Trial Staff, on the other hand, applied the Commission's long-accepted method of dividing average high and low prices in each month by the declared dividend in effect *during each such month*.

The MISO TOs make only a limited effort in their I.B. to defend Dr. Avera's approach on grounds of economic or financial logic. Indeed, their methodological defense is confined to two sentences in a footnote.²³ Instead, the TOs rely on the bold claim that "only Dr. Avera's dividend yield calculations conform to the calculations adopted by the Commission in Opinion No. 531."²⁴ In actuality, the TOs rely not on Opinion No. 531 itself, but instead on a "reverse-engineered" understanding of an appendix to the opinion.²⁵ In contrast to the TOs' method, Trial Staff's approach finds actual, explicit support in the language of Opinion No. 531 itself:

[T]he dividend yields of the proxy companies in this case should be calculated in the same manner that the Commission has consistently calculated dividend yields when applying the two-step DCF methodology. That methodology derives a single dividend

²² For simplicity, we omit from this discussion the $1 + 0.5g$ adjustment to the calculated yields that is implemented in arriving at the final dividend yield values for the DCF calculation. The $1 + 0.5g$ adjustment is not in dispute.

²³ *See* MISO TOs I.B. at 26-27 n.77.

²⁴ *See* MISO TOs I.B. at 27.

²⁵ *See* Trial Staff I.B. at 33, discussing Tr. 574:2-5.

yield for each proxy group company, using a three step process: (1) averaging the high and low stock prices as reported by the New York Stock Exchange or NASDAQ for each of the six months in the study period; (2) dividing the company's indicated annual dividend for each of those months by its average stock price for each month (resulting in a monthly dividend yield for each month of the study period); and (3) averaging those monthly dividend yields.

Opinion No. 531 at P 77 (footnote omitted). Leaving no doubt as to its intent, the Commission footnoted the second listed element as follows:

In Opinion No. 510 [*Portland Natural Gas Transmission System*, 134 FERC ¶ 61,129 (2011)], the Commission approved the use of *the most recent dividend* declared by the relevant company to determine the “indicated annual dividend” *for each of the six months*.

Id. at P 77 n.135 (emphasis added).

Trial Staff's I.B. clearly demonstrates that the MISO TOs' interpretation of Opinion No. 531 is contradicted, not only by the text of the opinion itself, but also by long-standing Commission precedent.²⁶ It is reasonable to assume that, had the Commission intended to change course in Opinion No. 531, it would have said so in the body of the opinion rather than tucking the change into an appendix, with no express acknowledgement that a new approach was being adopted, and in a manner that did not require a “reverse-engineered” understanding of the methodology purportedly being adopted by the Commission. Moreover, the appendix treatment of this issue was *dicta* at most: neither of the two midpoint-defining proxies in Opinion No. 531 changed its dividend during the six-month study period used in that case, so there was no effect

²⁶ See *id.* at 33-34, discussing (in addition to Opinion No. 531), *Portland Natural Gas Trans. Sys.*, Opinion No. 510, 134 FERC ¶ 61,129 (2011), and *El Paso Natural Gas Co.*, Opinion No. 528, 145 FERC ¶ 61,040, P 658 (2013), *reh'g pending*.

on the Opinion No. 531 ROE calculation from any difference between the Opinion's body and its appendix.²⁷ Be that as it may, the point OMS wishes to emphasize is that Trial Staff's approach is methodologically sound, while the TOs' approach creates an illogical mismatch of dividend and price data.

The price of a stock at any given point in time represents what an investor is willing to pay to obtain two things: (i) an entitlement to receive the dividend then being paid; and (ii) expected growth in market value. Because changes in the dividend are discretionary with management, an investor cannot know (and factor into the price she is willing to pay) whether or by how much the dividend will go up, or down, until a new dividend actually is declared. For that reason, the average price of a stock in month one, for example, cannot reflect what an investor is willing to pay to secure a dividend that isn't declared until month six. By failing to synchronize the price an investor pays for a share of stock and the dividend the price is paid to secure, the TOs' method is a mismatch of data. And when a proxy group member hikes its dividend during the study period, dividing the increased dividend by the pre-hike price simply results in a higher yield value than can be logically defended.²⁸

²⁷ Compare Exh. No. MTO-25 (last column, showing 0.00% for both El Paso Electric and UIL Holdings) with Opinion No. 531 appendix (showing that those two proxies established the 10.57% midpoint).

²⁸ The MISO TOs' view seems to be that investors can anticipate dividend growth announcements and factor the expected new dividend into the price they are willing to pay for a share. *See* MISO TOs' I.B. at 26 n. 77. That contention, even if credited, would not make it appropriate to find the dividend yield by mismatching the stock price of the study period's early months with a dividend level that is declared subsequently. In *Generic Determination of Rate of Return on Common Equity for Public Utilities*, Order No. 442-A, FERC Stats. & Regs. ¶ 30,702, at 30,301-02 (1986) the Commission explained how its dividend yield computation accounts for such anticipation. It does so through the adjustment for earnings growth, which represents a compromise between two computationally feasible forms of the DCF model: the original "Gordon" or "continuous" model which assumes that dividends are paid out continuously (i.e., 365 daily payments per year), and the "discrete" model which assumes that dividend models are paid out once annually, at the end of each year. In the continuous model the dividend yield term of the DCF equation (i.e., "D" for dividends divided by "P" for price) reduces to D_0/P_0 ,

[Footnote continued on following page]

It is telling that the MISO TOs' I.B. makes no substantial effort to defend Dr. Avera's yield calculation on grounds of economic or financial logic. At bottom, the MISO TOs' position has the earmarks of an attempt to capitalize on an error in the Opinion No. 531 appendix.²⁹ OMS urges the Presiding Judge to reject that attempt, and to adopt instead the dividend yield calculation method properly recommended by FERC Trial Staff and supported by Commission precedent.

B. Source of short-term growth data.

As OMS pointed out in its I.B. (at 9), the Commission has indicated a preference for use of the short-term growth data published by IBES in applying its two-step DCF methodology. Although the Commission acknowledged in Opinion No. 531 that it had relied on data sources other than IBES on occasion, it did so when IBES data was not available in the record. Where IBES short-term growth estimates are available, the Commission will rely on those estimates rather than estimates from other sources, as it did in Opinion No. 531.³⁰

In their I.B., the MISO TOs argue that the Commission has no preference for one data source over another so long as the "mixing and matching" of data is avoided. The TOs assert that IBES and Value Line are "comparable" sources of short-term growth estimates because "[t]he

whereas in the discrete model, the dividend yield term reduces to $D1/P0$. That is, in the continuous model the numerator of the dividend yield term represents the dividends paid during the baseline study period ($D0$), whereas in the discrete model that numerator predicts the dividends that will be paid at the end of the next year. In reality, of course, dividends are paid neither continuously nor annually; they are paid quarterly. After they are paid, investors have use of those dividends and can reinvest them, either with the utility through a dividend reinvestment program, or elsewhere. As the numerator of the dividend yield term, therefore, the Commission uses the compromise, $D = D0 * (1+g/2)$. The intended $D0$ in this formula represents the annualized dividend level received during the baseline study period. It is distorted upwards if it is calculated, following Dr. Avera, as four times the highest quarterly dividend received during the baseline study period.

²⁹ See Trial Staff's I.B. at 34. .

³⁰ See Opinion No. 531 at P 90.

Value Line short-term growth rate estimates meet the same objective criteria as the IBES projections.” On that basis, the MISO TOs urge the Presiding Judge to reject claims that the Value Line growth rate estimates used by Dr. Avera are not appropriate for use in the DCF model.³¹

In an attempt to portray the choice between IBES and Value Line as a coin-toss for the Commission, the MISO TOs rely on an incomplete and therefore inaccurate discussion of Opinion No. 531, *et al.* Thus, while the TOs’ I.B. cites portions of Opinion No. 531 they claim lend support to their view that IBES and Value Line are essentially interchangeable, they fail to reconcile that view with Opinion No. 531-B, which expresses a decided preference for IBES. Specifically, in rejecting a rehearing petitioner’s complaint that IBES included only one analyst’s growth estimate for a member of the proxy group, the Commission referred to “years of established Commission precedent approving the use of IBES short-term growth projections in the two-step DCF methodology.”³² As an example, the Commission pointed to its decision in *Transcontinental Gas Pipe Line Corp.*,³³ which, as recounted in Opinion No. 531-B, rejected claims that IBES analysts are overly optimistic based on a record-supported finding that “investors rely on IBES growth projections in making investment decisions.”³⁴ The Commission further noted that it “has supported its use of IBES growth projections based on the fact that the IBES data is a compilation of projected growth rates from various knowledgeable financial

³¹ See MISO TOs’ I.B. at 30.

³² Opinion No. 531-B at P 71.

³³ *Transcontinental Gas Pipe Line Corp.*, Opinion No. 414-B, 85 FERC ¶ 61,323, at 62,268-9 (1998) (Opinion No. 414-B).

³⁴ Opinion No. 531-B at P 71.

advisors,”³⁵ and it described IBES as the source “which the Commission has long relied on as the source of the growth rate projections to be used in the Commission’s DCF analyses.”³⁶ Viewed in the light of these statements, it is not credible for the MISO TOs to claim that the Commission views IBES and Value Line as equally valid sources for use in the DCF calculation.³⁷

One important reason the Commission expressly favors IBES over Value Line is that the growth estimates published by IBES are purely forward-looking; they represent an array of analyst growth projections that are not tainted by historical performance data. In this way, the use of IBES data comports with the Commission’s own view that the cost of equity is an expression of *prospective* investor requirements. Thus, in further explaining its holding in *Transcontinental Gas Pipe Line Corp.*, the Commission stated in Opinion No. 531-B that:

the appropriate dividend growth rate to include in a DCF analysis is the growth rate expected by the market. While the market may be wrong in its expectations as reflected in the IBES growth projections, the cost of common equity to a regulated enterprise depends upon what the market expects, not upon precisely what is actually going to happen.

Opinion No. 531-B at P 71. Value Line, on the other hand, is *not* a purely forward-looking source. Rather, as the MISO TOs acknowledge in their I.B., Value Line’s earnings growth estimate uses as its baseline an average of earnings for the most recent available three-year

³⁵ *Id.* at P 72, citing *Northwest Pipeline Corp.*, 87 FERC ¶ 61,266 at 62,059 (1999).

³⁶ *Id.* See also *Northwest Pipeline Corp.*, 87 FERC ¶ 61,266 at 62,057 (“Since *Ozark Gas Transmission System* [68 FERC ¶ 61,032 (1994)], the Commission consistently has required that the DCF study employ both short and long-term growth projections. The Commission uses five-year Institutional Broker’s Estimate System (IBES) growth projections for short-term growth.”)

³⁷ In their I.B. (at 30), the MISO TOs point to footnote 145 of Opinion No. 531-B, where the Commission also referred to reliance on Value Line data as “the source of earnings estimates in ROE proceedings.” The phrasing of the footnote is puzzling; it might make sense to refer to Value Line as “a” source of earnings estimates in ROE proceedings, but Value Line and IBES cannot both be “*the*” source of earnings estimates in ROE proceedings.

historic period.³⁸ This necessarily means that Value Line includes multiple years of already-realized growth. Given this crucial difference between Value Line and IBES, it is patently incorrect for the MISO TOs to characterize the two sources as “comparable.”

A second important reason the Commission expressly favors IBES over Value Line is that IBES data aggregate multiple financial advisors’ growth rate projections,³⁹ and thus provide a useful sample of the myriad of growth projections that are available directly to investors. In contrast, Value Line’s “annual rates” growth figure is *not* a compilation of growth rates from multiple sources, and thus cannot provide a broad sample of growth rates available to investors. This difference between Value Line and IBES likewise precludes any finding that the two sources are “comparable.”

In arguing for use of IBES data, it is not OMS’s contention that reliance on Value Line estimates will produce ROEs that are either too high or too low in all instances. Rather, the point is that reliance on Value Line will produce idiosyncratic ROEs that are necessarily affected by past conditions and events, which *in particular instances* can produce skewed results - sometimes extremely skewed results. An ROE set by reference to the Value Line-based midpoint, or a “zone of reasonableness” top end set by reference to the highest Value Line-based proxy result, will then emphasize the most skewed proxy company result. Indeed, as OMS discussed in its I.B., that is exactly what happened in Dr. Avera’s Value Line-based DCF, where

³⁸ In the Value Line estimates, “[f]orecasted rates of change are computed from the average figure for the most recent three-year period to an average for a future three-year period.” MISO TO I.B. at 34, quoting a Value Line glossary (*see* MISO TO I.B. at n.112).

³⁹ *See* note 38, *supra*; *see also Tallgrass Transmission, LLC*, 150 FERC ¶ 61,224, P 70 n.117 (2015) (Commission relies on IBES estimates because they provide “a central location ... to research the different analyst estimates for any given stock without necessarily searching for each individual analyst”).

Otter Tail Power's recovery from an historic year of depressed earnings temporarily resulted in an earnings growth rate of 15.5 percent - an obviously skewed and unsustainable result,⁴⁰ which indeed was not sustained into 2015.⁴¹ The more fundamental point, though, is that Value Line's reliance on a three-year historic "baseline" unavoidably taints the forecast, giving effect as it does to the notion that past is necessarily prologue, at least in some measure.⁴² In that way, use of Value Line estimates is at odds with the forward-looking focus of the Commission's ROE method. The data published by IBES, on the other hand, reflect only forward-looking analyst forecasts, and in that way are fully consistent with the prospective focus of the Commission's DCF method.

The MISO TOs also intimate that what they characterize as "extraordinary market conditions" render IBES growth forecasts less reliable than the Value Line forecasts. Specifically, the TOs state that the testimony of Dr. Avera and Ms. Lapson "further establishes that the ongoing, extraordinary market conditions continue to distort inputs to the Commission's DCF model, *at least insofar as the Commission may rely on IBES EPS growth rates* for [the]

⁴⁰ See OMS I.B. at 10-11, discussing Exh. No. MTO-5 at 2.

⁴¹ See Exh. S-6 at 37 (by the June 2015 Value Line, the 15.5% Otter Tail earnings growth figure that had appeared in the December 2014 Value Line had fallen to 9.0%).

⁴² The MISO TOs assert that Trial Staff Witness Keyton failed to substantiate his testimony that Value Line and IBES differ in their treatment of past growth, and then muddy the waters by positing that "*all* growth forecasts are necessarily a reflection of a rate of change from a historical period to a future period" (MISO TO I.B. at 33, emphasis in original). That view of the forecasting process is simply wrong.) It is undisputed that "IBES growth rates are considered to be estimates for five years as of the date they are published and they do not cover any historical period;" (Exh. S-1 at 82:15-16) whereas Value Line growth rates predict growth over a nine-year period that extends at least three years into the past, *see, e.g.,* Exh. JCI-3 at 63 (showing 15.5% "annual rates" estimate of growth in Otter Tail earnings from 2011-13 baseline to 2017-19 forecast). These differently-derived estimates differ markedly for Otter Tail because Otter Tail experienced very strong GAAP earnings growth during 2011, and the Value Line partly retrospective estimate includes this growth whereas the IBES forward-looking estimate does not. This difference explains why, as soon as 2011 rolled out of the Value Line baseline period, Value Line's growth estimate for Otter Tail fell markedly. *See* Exh.S-6 at 37.

Refund Study Period.”⁴³ If the TOs mean to suggest that “extraordinary market conditions” somehow distort IBES growth rates more than those of Value Line, the argument has no merit. Even in the TOs’ own narrative, the impact of purportedly anomalous market conditions is to depress the yield component of the DCF formulation, by driving up the price of utility stocks. The TOs concede on brief that anomalous market conditions have not affected estimates of earnings growth.⁴⁴ Nowhere have the TOs substantiated a link between so-called “anomalous” market conditions and impacts on earnings growth projections, let alone differential impacts on IBES versus Value Line forecasts; in fact, the MISO TOs’ IBES-based and Value Line-based DCF studies use the exact same values for the yield component. Instead, what the TOs may be arguing in the above-quoted sentence is simply that, if the “distorted” yield data are married up with IBES growth forecasts, the resulting ROE is simply too low for their liking, but the end result is acceptable if the yield data instead are coupled with the Value Line forecasts. That understanding of the quoted sentence clearly exposes the result-driven nature of the TOs’ position regarding the appropriate source of short-term growth data. The TOs prefer Value Line, not because its forecasts are inherently more reliable than those of IBES, but simply because Value Line’s forecasts are high enough that, when coupled with Refund Study Period dividend yields, they produce higher ROE results that are more to the TOs’ liking. That is hardly a legitimate basis for the Presiding Judge to adopt the Value Line forecasts over the IBES forecasts.

⁴³ See MISO TO I.B. at 61-62 (emphasis added).

⁴⁴ See MISO TOs’ I.B. at 70 (hypothesizing that as “investors have turned to utility stocks as a surrogate for fixed-income investments ... utility stock prices rose, and their dividend yields correspondingly fell,” while “earnings-per-share growth rates” were unaffected).

C. Deviation from the calculated midpoint.

Among the most actively contested issues before the Presiding Judge is whether the new Base ROE of the MISO TOs should be set at the midpoint of the range of reasonableness, consistent with a vast body of precedent, or instead adjusted to some higher-than-midpoint value as was done in Opinion No. 531. Seizing on the rationale of Opinion No. 531, the MISO TOs contend that the “anomalous” capital market conditions found to exist during the DCF study period considered in Opinion No. 531 continue to exist; that those market conditions are “distorting” certain inputs to the DCF calculation; that, due to the claimed continuation of those conditions, the midpoint DCF result produced using IBES short-term growth data must be benchmarked against state-allowed ROEs and compared to the results of alternative ROE methods; that doing so shows the IBES-based DCF midpoint result to be inadequate under *Hope* and *Bluefield*; and that, for these reasons, the Commission should adopt either a midpoint DCF result based on Value Line short-term growth data, or a value higher than the midpoint (in fact near the top) of an IBES-based DCF range.

The linchpin of the MISO TOs’ position, of course, is that capital market conditions during the Refund Study Period are, like those considered in Opinion No. 531, “anomalous.” And, in their I.B., the TOs continue to posit the notion that market conditions remain “anomalous” for as long as the forces that are causing current market conditions to be, in some respect, “abnormal” remain in effect, provided that investors perceive an eventual end to those forces. The TOs argue in this regard as follows:

Investors understand that current circumstances result from unprecedented Federal Reserve monetary policy. Their expectation—based on what the Federal Reserve itself is telling them—is that the Federal Reserve will unwind its unprecedented

actions. This means the abnormal situation is temporary, even if it continues for an extended period. What matters is that investors understand that market conditions were the result not of ordinary market forces, but of the Federal Reserve's unprecedented intervention in the capital markets over an extended period of time—and their further understanding that the Federal Reserve will change its policies, and that market conditions were [*sic*] change when it does so. The combination of extraordinary market circumstances created by the Federal Reserve's aggressive market intervention and investors' expectations (based on the Federal Reserve's own advice to them) that bond yields will rise—when and as the Federal Reserve unwinds its prevailing, extremely stimulative policies—is what makes the capital market conditions relevant to this case anomalous.

MISO TOs I.B. at 69-70 (footnotes omitted). In short, according to the MISO TOs, the investor-perceived end-point that makes current conditions “anomalous” and not “continuing” is an expected jump in bond yields as the Fed tacks in a less “stimulative” policy direction.

A critical flaw (among several) in the MISO TOs' argument is that the record lacks evidence to support their claims regarding investor expectations that interest rates and bond yields will climb if and when the Fed further relaxes its current accommodative policies. To be sure, that expectation is not universally held. Even though he claimed in his pre-filed testimony that there is “a widespread expectation that interest rates will increase significantly from today's anomalous levels” as Federal Reserve policy becomes less accommodative,⁴⁵ MISO TO witness Avera backed away from that view at the hearing. Thus, with respect to interest rates, with which bond yields generally move in tandem,⁴⁶ Dr. Avera testified that he does “not believe there's a consensus that interest rates are going [to] rise.”⁴⁷ With regard to discussions in the financial

⁴⁵ Exh. No. MTO-1 at 23:8-9.

⁴⁶ Exh. No. S-2, Schedules 1-3.

⁴⁷ Tr. 706:23-25.

press about the effect of Fed actions on interest rates, Dr. Avera testified that “there are many voices counseling different actions,” and that “you can find an article that says something about anything in terms of the Fed.”⁴⁸

The MISO TOs’ I.B. thus fails to substantiate the TOs’ claim of a widely held investor-perceived end point (a jump in interest rates and bond yields following a Fed policy change) that would make current market conditions “anomalous” and not continuing. In fact, there is evidence in the record pointing in the opposite direction - namely, that interest rates and bond yields are likely to remain low for the foreseeable future. OMS discussed that evidence in its I.B. (at 23-24) and we will not repeat the discussion here; instead, we highlight the MISO TOs’ inadequate and unavailing response to that evidence.

During the hearing, OMS introduced two recent articles from the financial press that directly undercut the MISO TOs’ claim of an expectation that interest rates and bond yields will climb in response to anticipated Fed policy changes. Exhibit No. OMS-22, an article published in the *Wall Street Journal*, discusses the extent to which a shift in Federal Reserve policy that includes an increase in the Fed funds rate would translate into increased interest rates for the general economy. After outlining the basis for the author’s expectation that changes in the Fed funds rate will be small and spread out over time, the article explains why actual interest rates will remain subject to downward pressure even if the Fed’s target rate rises. “The upshot,” according to the author, “is that we are not only likely to see rates stay lower for longer, they

⁴⁸ Tr. 509:13-14 and 23-24.

may flatten further.”⁴⁹ Exhibit OMS-23, an article published by Bloomberg Business, reports on a recent analysis by JPMorgan of the effect on bond yields if the Fed allows Treasury debt securities in its portfolio to mature without using the proceeds to purchase additional debt securities. The article states: “JPMorgan’s analysis suggests the increase isn’t likely to be significant. If the Fed allowed all of its Treasuries that mature in 2016 to run off its balance sheet, 10-year yields would rise by about 0.05 percentage point.”⁵⁰

Again, a key element of the MISO TOs’ position is the claim that investors are expecting a significant jump in interest rates and bond yields sometime in the coming months as the Federal Reserve adjusts its monetary policies. That increase, according to the TOs, is the endpoint that makes current conditions “anomalous” and not simply continuing. Exhibit Nos. OMS-22 and OMS-23, however, both undercut the TOs’ key contention; they demonstrate that widely read sources in the mainstream financial press, as well as at least one of the nation’s largest financial institutions (JPMorgan), expect little to no change in interest rates and bond yields even as Fed policy becomes less accommodative. The MISO TOs’ I.B. ignores this evidence, and the only attempt at a response to the evidence - offered through redirect examination of Dr. Avera - was deeply unpersuasive.⁵¹ Moreover, Dr. Avera acknowledged under cross-examination that

⁴⁹ Exh. No. OMS-22 at 3.

⁵⁰ Exh. No. OMS-23 at 2.

⁵¹ On redirect, Dr. Avera attempted to discount the two articles as being limited in relevance to particular “segments” of the market. He stated in regard to the articles:

They all talk about the expectation of change in interest rates when the Federal Reserve acts, which is expected soon. And that the dispute is over exactly what those changes will be, and how they will affect particular segments of the market. In the "Wall Street Journal," they were talking about banks. In the Bloomberg, they were talking about investors in Treasury bonds.

published reports by investment banks and articles in the financial press are sources that investors consult in forming their expectations about future financial market conditions.⁵² It therefore cannot be assumed that investors widely expect the large and imminent bond yield/interest rate jump on which the MISO TOs' position depends. And without that assumption in place, the TOs' claim that current market conditions are "anomalous" collapses.

Moreover, that assumption is inherently suspect for reasons of both logic and experience. Logically, high bond yields and low bond prices are equivalent propositions,⁵³ so if investors were expecting large and imminent bond yield increases, it would mean that investors paying today's bond prices expect large and imminent bond price decreases. The MISO TOs have not explained, and cannot explain, why investors expecting large and imminent bond price declines would be purchasing bonds at current bond prices, and thereby setting themselves up for large and imminent losses. Experientially, the MISO TOs' prediction of large and imminent bond yield increases echoes the prediction made by the New England Transmission Owners in 2013 and relied upon in Opinion No. 531: that "once the Federal Reserve's Quantitative Easing program ends ... in the very near future, interest rates can be expected to rise to more normal levels."⁵⁴ If "normal" means interest rates and bond yields resembling those of the 2001-02 study

Tr. 662:7-14. Dr. Avera's attempt to cast doubt on the relevance of Exh. Nos. OMS-22 and OMS-23 is not convincing. Review of the articles shows that the authors' comments about the expected effects of Fed actions were not confined to any specific "segment of the market." Moreover, even if that reading were accepted for the sake of argument, "banks" and "investors in Treasury bonds" are hardly obscure niche segments of the economy such that the impacts on those segments of a change in Fed policy can be dismissed as idiosyncratic.

⁵² Tr. 509:7 – 510:1.

⁵³ Bond yields represent bond returns divided by bond prices, so bond yields rise as bond prices fall, and vice versa.

⁵⁴ Opinion No. 531 P 130 (reciting that prediction). *See also id.* P 145 & n.285 (relying thereon).

period that underlies the existing 12.38% Base ROE, that prediction did not pan out.⁵⁵ The MISO TOs' re-tread of that failed prediction should evoke a wise adage: "Fool me once, shame on you. Fool me twice, shame on me."

More fundamentally, the MISO TOs' speculation that utility stock prices someday may fall, and dividend yields someday may rise, fails to address the cost of equity during the refund period here at issue. The MISO TOs speculate that so-called "hot money" has flowed into utility stocks as a substitute for bonds and will flow out at some indefinite future date.⁵⁶ The inherent premise of that speculation, however, is that during the period of record in this proceeding, investors have been eager to purchase utility stocks for the low returns indicated by the IBES-based DCF results of record, and indeed would be satisfied by a bond-like return. The record's many DCF studies that indicate a low cost of equity are accurately capturing the capital market realities, not suffering from "distortion" that somehow masks the true study-period cost of equity. The locked-in Base ROE at issue in this proceeding should reflect those record-period realities.

Like any ROE finding, *see Hope* at 615, the outcome of this proceeding will not be "an order for all time." If the MISO TOs' speculation bears out and capital costs rise in the future, the MISO TOs will have their Docket No. EL15-45 litigation opportunity and their Federal Power Act Section 205 filing rights. As of this record, however, the MISO TOs' cost of equity

⁵⁵ See Exh. No. S-2, Schedules 1-3. For example, whereas public utility bond yields averaged 7.72% in 2001 and 7.53% in 2002, they averaged 4.02% for the six months following the October 2014 end of Quantitative Easing. See *id.*, Schedule 2.

⁵⁶ See MISO TOs I.B. at 71.

capital is low, and the Federal Power Act demands that charges to ratepayers reflect that low cost.

To sum up, the MISO TOs have not carried the burden of demonstrating that current (or Refund Study Period) capital market conditions are “anomalous.” There is therefore no basis for assuming that abnormal market conditions have “distorted” the inputs to the Commission’s two-stage IBES-based DCF model. Accordingly, there is no need for the Presiding Judge to consult alternative ROE methods or state-awarded ROEs to verify that the output of the DCF model satisfies the *Hope* and *Bluefield* standards.

D. Conclusion regarding proper application of the DCF methodology.

From the foregoing, OMS submits that the IBES-based DCF results in the record are just and reasonable, providing compensation to investors that is sufficient for the TOs to attract capital at reasonable rates while at the same time protecting consumers from exploitative rates. Therefore, as stated in OMS’s I.B. (at 39), the Presiding Judge should set the just and reasonable Base ROE for the MISO TOs within the range of midpoints⁵⁷ resulting from application of the IBES-based DCF model to financial data for the six-month study period determined by the Presiding Judge to be appropriate.

⁵⁷ In referring to midpoints in this brief, we include the midpoint approach recommended by Mr. Gorman and the Joint Complainants, which finds the midpoint between high and low values that are each based on multiple outer-quadrant proxy results, rather than the simple midpoint of the two most extreme proxy results. This approach merits consideration, as it prevents the ROE determination from being tied closely to the happenstance of the study-period values found for the two most extreme proxy results.

(b) Should methods of estimating the MISO TOs' cost of equity other than the two-step DCF methodology be considered in resolving Contested Issues 1 and 2?

Because (as discussed above) the MISO TOs have failed to carry their burden of demonstrating that current capital market conditions are “anomalous,” there is simply no basis for considering cost of equity methods other than the two-step DCF methodology prescribed in Opinion No. 531, *et al.* In fact, in the absence of a fully supported finding that current capital market conditions are anomalous, consideration of alternative ROE methods or state-allowed ROEs would be contrary to Commission precedent, and therefore arbitrary and capricious.

(c) If any methods of estimating the MISO Transmission Owners' cost of equity other than the two-step DCF methodology are considered, which other methods should be considered, and how should each such other method be applied?

Because OMS submits that cost of equity methods other than the two-step IBES-based DCF methodology should not be considered in this proceeding, OMS does not offer argument on this topic.

(d) What additional information or policy considerations, if any, should be considered for purposes of resolving Contested Issues 1 and 2?

The Presiding Judge need not and should not take into account state approved ROEs as a benchmark to adjust the midpoint of the zone of reasonableness resulting from IBES-based DCF analyses in this proceeding. Apart from the fact that the MISO TOs have not shown capital market conditions to be anomalous, there is no need to compare the Base ROEs produced by the IBES-based DCF studies with the ROEs approved by state commissions because there is no evidence of competition for capital between transmission and distribution investments in the capital markets. Further, the MISO TOs' claim that MEPs and MVPs will not be built with a lower Base ROE is unsubstantiated.

A. The MISO TOs' proposed consideration of state-approved ROE benchmarks should be rejected.

The MISO TOs argue that Dr. Avera's alternative benchmarks (including the state approved ROEs in Exh. No. MTO-9) and Ms. Lapson's study of state approved ROEs show that the IBES-based DCF midpoint value for the Refund Study Period fails to meet the *Hope* and *Bluefield* standards.⁵⁸ Each of the two state ROE benchmarks offered by the MISO TOs relies on a different data source and different criteria to filter such data. While Ms. Lapson's benchmark results in a range between 9.50 percent and 10.95 percent with a midpoint of 10.23 percent for the integrated electric utilities group,⁵⁹ Dr. Avera's state ROE benchmark results in a range

⁵⁸ See MISO TOs' I.B. at 10-11 (proposed finding No. 74).

⁵⁹ Exh. No. MTO-16 at 55:8, 57:18-19.

between 9.19 percent and 12.50 percent with a midpoint of 10.84 percent.⁶⁰ The Presiding Judge should reject both of these ranges for the following reasons.

- i. The DCF midpoint provides the appropriate Base ROE for the MISO TOs in the absence of anomalous capital market conditions.*

In Opinion No. 531, *et al.*, the Commission found that the existence of “anomalous” capital market conditions—which, according to the Commission, had been acknowledged by the parties in that proceeding - gave reason to consider state approved ROEs as a benchmark to determine how much of an adjustment to the DCF midpoint was necessary to satisfy the *Hope* and *Bluefield* standards.⁶¹ In this proceeding, however: (i) there is no agreement that market conditions are “anomalous;” (ii) the MISO TOs have failed to carry their burden to demonstrate that capital market conditions are “anomalous;” and (iii) in the absence of anomalous capital market conditions, there is no need to test the validity of the DCF results by testing those results against the results of other methods or benchmarks.

Furthermore, the MISO TOs propose using state ROEs as a benchmark to challenge *only* the results of the IBES-based DCF results.⁶² If market conditions (whether or not they are anomalous) affect DCF results, they would affect DCF results that rely on Value Line short-term growth data as well as those that rely on IBES short-term growth data. The Commission’s consideration of state approved ROEs in Opinion No. 531, *et al.*, did not endorse a lop-sided use of the state ROE data, such as that proposed by the MISO TOs.

⁶⁰ Exh. No. MTO-9, Exh. No. MTO-32.

⁶¹ Opinion No. 531 at P 151.

⁶² *See* MISO TOs’ I.B. at 61-62.

ii. Dr. Avera's state ROE benchmark is flawed.

The state-approved ROE benchmark proposed by Dr. Avera does not provide a comparable basis for determining a just and reasonable transmission Base ROE. Dr. Avera's range of authorized state ROEs in this proceeding⁶³ is based on a simple list of information published by Value Line without any explanation or analysis.⁶⁴ It is therefore impossible to ascertain whether the state ROEs he presents are in any way comparable to the ROE being established in this proceeding. For example, Dr. Avera did not conduct any analysis of the state ROE Value Line data he relied on to determine: (1) the time-lag and geographic scope of the underlying state ROE decisions reflected in the Value Line data;⁶⁵ (2) whether the ROE listed for each utility in his proxy group reflected an average of various state commission ROE decisions or any other cumulative analysis;⁶⁶ (3) whether the state ROEs indicated by Value Line resulted from litigated cases or settlements;⁶⁷ or (4) whether the reported state ROEs included ROE adders or other incentives to address specific project risks or adjustments not applicable to transmission ROEs.⁶⁸ In Opinion No. 531, FERC was careful to clarify that it relied upon "the most recent complete study in the record" for state authorized ROEs.⁶⁹ Dr. Avera, however,

⁶³ Exh. No. MTO-9, Exh. No. MTO-32.

⁶⁴ Tr. 483:7- 8.

⁶⁵ Exh. No. OMS-11 at 3; Tr. 483:7- 15.

⁶⁶ *Id.*

⁶⁷ Tr. 484:10-15.

⁶⁸ Exh. No. OMS-11 at 3-4.

⁶⁹ Opinion No. 531-B at P 86.

recognized that his state-approved ROE numbers are not necessarily recently approved state ROEs.⁷⁰

Despite the inadequacy of his analysis, Dr. Avera proposes to use his state ROE range as a benchmark to support the higher midpoint resulting from his Value Line-based DCF analysis.⁷¹ In OMS's view, it would constitute unreasoned decision-making to use Dr. Avera's unfiltered Value Line state ROE data to test whether a DCF-determined Base ROE for transmission assets satisfies the *Hope* and *Bluefield* standards. Without any analysis of incentives or other adjustments included in the state ROEs listed by Dr. Avera, or of the time frame when those state ROEs were authorized, there is no assurance his data provide a valid benchmark for testing the adequacy of a particular Base ROE for facilities used to provide wholesale transmission service.

iii. Ms. Lapson's state ROE benchmark is flawed.

Ms. Lapson relied on two SNL Financial/ Regulatory Research Associates ("RRA") reports for calendar years 2013 and 2014 in her analysis of state approved ROEs.⁷² The Presiding Judge took public notice of these two RRA reports.⁷³ According to the RRA reports, "since 1990 the authorized ROEs have generally trended downward, reflecting the significant decline in interest rates and capital costs that has occurred over this time frame."⁷⁴ By the first quarter of

⁷⁰ Tr. 481: 9-12.

⁷¹ Exh. No. MTO-1 at p. 111:1-4.

⁷² Tr. 348:2.

⁷³ Tr. 710:2-6.

⁷⁴ Tr. 350:21.

2015, the average of new state commission ROE authorizations for electric utilities was 9.67%.⁷⁵ The state-approved ROE benchmark proposed by Ms. Lapson does not reflect this downward trend in state-approved ROEs. When asked during the hearing about the RRA analysis of downward trends in state ROEs, Ms. Lapson admitted that she had not examined trends in state authorized ROEs over any time period,⁷⁶ nor had she examined whether trends in state authorized ROEs over time play a role in shaping equity investor return requirements.⁷⁷ Any analysis of state ROEs used as a benchmark to assess investors' expectations should take into account the ongoing downward trend in state authorized ROEs.

In addition, Ms. Lapson's proposed state ROE benchmark does not satisfy the basic requirement that the relevant sets of data are comparable. In Opinion No. 531, the Commission compared the investment risks of electric transmission infrastructure with electric distribution infrastructure.⁷⁸ Ms. Lapson's analysis, however, uses state ROEs for *integrated* utilities⁷⁹ - as opposed to state ROE decisions for distribution-only utilities - to compare the risks considered in those state decisions with the risks of the MISO TOs. Because the MISO TOs are mostly vertically integrated utilities, Ms. Lapson is essentially comparing the risks of these integrated utilities with the risks of other groups of integrated utilities (as perceived by the state commissions in various ROE cases) and, on the basis of comparing similarly risk-situated

⁷⁵ See Exh. JC-9 at 30. This is Regulatory Research Associates' after excluding Virginia "generation rider" ROE adder cases; such exclusion is appropriate because those decisions do not involve a fresh redetermination of the underlying Base ROE.

⁷⁶ Tr. 351:1-2.

⁷⁷ Tr. 352:24-25.

⁷⁸ Opinion No. 531 at P 149.

⁷⁹ Exh. No. MTO-16 at 54:3-8.

groups, she recommends setting the Base ROE of the MISO TOs above the levels of approved state ROEs. The risks faced by an integrated utility are the same, whether it is FERC or a state commission assessing those risks. An upward adjustment of the transmission ROE based on Ms. Lapson's benchmark is not justified because it will not compensate investors for risks above and beyond those associated with distribution investments; rather, it would simply give a premium to the MISO TOs above and beyond their real cost of equity.

- iv. State commissions adjust their approved ROEs upward to take into account a variety of investment risks that are unknown to the Commission and may be unrelated to transmission.*

State commissions may allow higher ROEs to compensate for risks deriving from state ratemaking practices such as delayed recovery of plant investments and financing costs,⁸⁰ cash-flow liquidity issues in the absence of formula rates for distribution utilities,⁸¹ or a wide array of other factors. For example, on August 15, 2014, the Arkansas Public Service Commission approved a 9.5 percent ROE for Entergy Arkansas, Inc. ("Entergy Arkansas"), above the midpoint of the zone of reasonableness resulting from the DCF analyses in that proceeding, to address (among other things) risks and uncertainties associated with the company joining the MISO and starting to conduct its own generation planning.⁸² Following this example, if the Presiding Judge were to increase the Base ROE of the MISO TOs to reflect the state ROE approved in this case, the risks associated with Entergy Arkansas joining the MISO would be

⁸⁰ Exh. No. JCI-4 at 32:21-23 and 33:1-4.

⁸¹ Exh. No. JCA-11 at 66:12-18.

⁸² *In the Matter of the Application of Entergy Arkansas, Inc. for Approval of Changes in Rates for Retail Electric Service*, Slip Copy, 2014 WL 10385679 (Ark.P.S.C.) at 10 (August 15, 2014).

taken into account to increase Entergy Arkansas' state approved ROE and transmission Base ROE, as well as to obtain the FERC-approved ROE incentive adder for participation in the MISO region.⁸³ The Base ROE of the MISO TOs should not be increased on the basis of other agencies' interpretation of risks and market conditions.

- v. *There is no significant competition for capital between transmission and distribution companies in the MISO region.*

The MISO TOs' assert that transmission assets compete for capital with other investment options.⁸⁴ The Commission's concern regarding competition for capital between transmission and distribution investments in Opinion No. 531 is not germane in this case because most of the MISO TOs are vertically integrated utilities.⁸⁵ In Opinion No. 531 the Commission addressed a possible situation in which equity investors divert capital from riskier companies "whose focus is electric transmission infrastructure" to companies with a focus on less risky electric infrastructure investments.⁸⁶ However, vertically integrated utilities focus on various types of electric infrastructure, not necessarily wholly or predominantly transmission. In the MISO region, the main competition for capital between transmission and distribution investments takes place *within* the integrated utilities themselves, not against one another in the capital markets.

In making investment decisions, equity investors look at the totality of a company's risks, not necessarily at the risks of each specific department or sector within each company.

⁸³ *Midcontinent Independent System Operator, Inc.*, 150 FERC ¶ 61,004 (2015) (granting the MISO TOs, including Entergy Arkansas, a 50-basis point ROE adder for their participation in the MISO).

⁸⁴ See MISO TOs' I.B. at 20.

⁸⁵ See, e.g., *Association of Businesses Advocating Tariff Equity et al., v. Midcontinent Independent System Operator, Inc. et al.* 148 FERC ¶ 61,049 at P 196 (2014) (describing the MISO TOs as vertically integrated utilities with formula rates).

⁸⁶ Opinion No. 531 at P 149.

Consequently, a transmission ROE higher than the midpoint will not necessarily attract more equity capital to the MISO TOs, because the transmission ROE is only one component of the overall integrated utility's risk-adjusted return requirement. As explained herein, a higher Base ROE would only distort allocation of capital between transmission and distribution investments within the integrated utilities.

- vi. *Adjusting the midpoint of the zone of reasonableness upwards to reflect purportedly higher risks of transmission investments can have negative and unintended consequences.*

In the absence of anomalous capital market conditions, using the state-approved ROEs as a benchmark to increase the ROE above the midpoint of the DCF zone of reasonableness will simply skew the integrated utilities' internal investment decisions. As Dr. Avera explained during the hearing, absent external business constraints or requirements, a company will allocate capital to investments that promise the highest risk-adjusted return.⁸⁷ A transmission ROE higher than the midpoint of the zone of reasonableness would over-compensate for transmission risks and tilt the risk-adjusted investment balance within integrated utilities. Such over-compensation for transmission risks may result in overbuilding of transmission infrastructure to the detriment of other necessary electric infrastructure investments. For example, it may undermine necessary distribution investments and obstruct the states' ability to implement their energy policies, many of which are inter-related with the Commission's own goals and policies, such as promoting demand-side management or integration of renewable energy resources.

⁸⁷ Tr. 522:22-24 and 523:9.

B. The proposed adjustments based on equity ratios are not a collateral attack on the October Order.⁸⁸

The MISO TOs claim that the proposed adjustments based on capital equity ratios are a collateral attack on the October Order in this proceeding.⁸⁹ This claim is false. The October Order rejected a petition to cap the capital structure of the MISO TOs at 50 percent common equity because the Complainants had not shown that the MISO TOs, individually or collectively, did not pass the Commission's three-prong test, allowing them to use their actual capital structure for ratemaking purposes.⁹⁰ In this proceeding, the Complainants and the Joint Consumer Advocates ("JCA") propose adjustments to the Base ROE for individual MISO TOs with high equity ratios. These adjustments respond to the fact that high equity ratios mitigate the financial risk accounted for in a utility's Base ROE by reducing the volatility of residual earnings available to common equity holders after servicing debt. The risk-mitigating nature of equity in the capital structure has been recognized by the Commission.⁹¹

An adjustment of the Base ROE to account for reduced risks is not the same as a cap on the capital structure. A cap on the capital structure raises the question of whether an exception to the general Commission policy of allowing the use of actual capital structures in ratemaking is justified. An adjustment of the Base ROE based on the existence of high equity ratios does not

⁸⁸ *Association of Businesses Advocating Tariff Equity, et al. v. Midcontinent Independent System Operator, Inc., et al.*, 148 FERC ¶ 61,049 (2014) ("October Order").

⁸⁹ See MISO TOs' I.B. at 112.

⁹⁰ October Order at P 192.

⁹¹ *Generic Determination of Rate of Return on Common Equity for Electric Utilities*, 47 Fed. Reg. 38332-01 at 38,339 (1982).

raise the same concern because it does not alter the capital structure of the utility, it simply adjusts the return to reflect lower investment risks.

The MISO TOs further argue that the Complainants and JCA have failed to show that the current equity ratio of any MISO TO is “aberrational” and, therefore, in the TOs’ view there is no justification for their proposed adjustments.⁹² The issue of what particular equity ratio should trigger an adjustment of the Base ROE, however, should not prevent the Presiding Judge from finding that higher than normal equity ratios reduce investment risks and that an adjustment of the Base ROE may be justified in those cases.

C. The purpose of the Base ROE is not to support what the MISO TOs claim to be a “public interest” in building certain types of transmission projects.

The MISO TOs argue that placing the Base ROE at the top of the zone of reasonableness will support a “public interest” in getting MEPs and MVPs built.⁹³ The Presiding Judge should not accept this purported policy consideration as a basis for adjusting the Base ROE upwards, to a point above the midpoint of the range of DCF results.

In *Bluefield*, the Supreme Court established that a just and reasonable return must allow a utility to attract enough capital to discharge its “*public duties*.”⁹⁴ The MISO TOs, however, contend that they are not obligated to construct MEPs and MVPs under all circumstances.⁹⁵ In fact, the MISO Tariff establishes a competitive process for selecting transmission developers⁹⁶

⁹² See MISO TOs’ I.B. at 118.

⁹³ See MISO TOs’ I.B. at 102.

⁹⁴ *Bluefield* at 693.

⁹⁵ See MISO TO I.B. at 21 n.56.

⁹⁶ MISO Tariff, Attachment FF, Section VIII.

and Mr. Kramer recognized that the development of MEPs and MVPs fall under MISO's competitive selection process.⁹⁷ Furthermore, although the MISO TOs have an obligation to build other types of transmission projects selected in the MISO transmission planning process,⁹⁸ Mr. Kramer contends that they will continue to devote capital to comply with Reliability Standards and retail service obligations by building local transmission projects as opposed to larger, more costly MEPs and MVPs.⁹⁹

A Base ROE that is designed to help the MISO TOs build larger, more costly transmission projects would go beyond the requirements in *Hope* and *Bluefield* and tilt the balance towards protection of industry interest by exploiting consumers. If the Commission wishes to promote the development of MEPs and MVPs, it has the authority to provide transmission rate incentives to transmission developers selected to build those larger, riskier projects. The FERC transmission rate incentive application process also gives the Commission and stakeholders an opportunity to review, on a case-by-case basis, whether the risks of specific projects are commensurate with the incentive adders sought, so that the total ROE adequately compensates for the project-specific risks. The Base ROE, however, is paid by consumers for old and new transmission alike. Raising the rates associated with existing transmission facilities in order to induce new ones to be developed, rather than targeting any new projects with project-specific incentives, would not be statutory. Such an increase would violate the D.C. Circuit's ruling that, if the Commission contemplates increasing rates above cost on public policy

⁹⁷ Tr. 245:14-15.

⁹⁸ See Transmission Owners Agreement, MISO Schedule 30.0, Appendix B, Section VI.

⁹⁹ Exh. No. MTO-21 at 28: 4-10; Tr. 261: 19-25; Tr. 262: 6-11.

grounds, “it must see to it that the increase is in fact needed, and is no more than is needed, for the purpose. Further than this we think the Commission cannot go without additional authority from Congress.”¹⁰⁰

D. There is no evidence in the record to support a finding that MEPs and MVPs will not be built if the Base ROE is reduced.

The MISO TOs contend that a reduction of the Base ROE as proposed by the Complainants and supporting intervenors would shock investors and reduce the capital available to invest in transmission projects with region-wide economic and public policy benefits, such as MEPs and MVPs.¹⁰¹ The Presiding Judge should not give weight to these unsubstantiated assertions.

Investors are unlikely to be surprised by a reduction to the Base ROE as an outcome of this proceeding. As Dr. Avera admitted in the hearing, the MISO TOs have made accounting adjustments, such as taking charges against earnings or creating reserves, to prepare for a potential reduction in the Base ROE in this proceeding.¹⁰² Furthermore, while taking actions to soften the consequences of a potential reduction of the Base ROE, almost all of the MISO TOs have taken the voluntary steps to be included on MISO’s list of Qualified Developers,¹⁰³ which is a pre-qualification requirement for developers willing to compete to develop MEPs and MVPs

¹⁰⁰ *City of Detroit*, 230 F.2d at 817.

¹⁰¹ See MISO TOs’ I.B. at 104.

¹⁰² Tr. 563:16-25; see also Tr. 564:5-7.

¹⁰³ Exh. No. OMS-1 (listing the following MISO TOs as qualified developers: Allete, Inc.; Ameren Transmission Company of Illinois; Cleco Power LLC; Duke Energy Business Services, LLC; Entergy Arkansas, Inc.; Entergy Gulf States Louisiana, LLC; Entergy Mississippi, Inc.; Entergy New Orleans, Inc.; Entergy Texas, Inc.; Indianapolis Power and Light company; International Transmission Company; ITC Midwest, LLC; Michigan Electric Transmission Company, LLC; and MidAmerican Energy Company).

selected in the MISO regional transmission plan.¹⁰⁴ It is reasonable to assume that, if the TOs anticipated that the overall return they might be allowed to earn on such projects were inadequate, they would not have sought to be included on the list. There is simply not enough evidence in the record to conclude that a lower Base ROE coupled with available transmission rate incentives will be insufficient to attract sufficient capital to build MEPs and MVPs.

(e) What Base ROE allowance for the MISO TOs was just and reasonable for the applicable refund period?

The MISO TOs argue that their Base ROE should not be lower than the 10.57 percent approved for the New England TOs because: (1) it would be unduly discriminatory; and (2) it would not allow the MISO TOs to compete with the New England TOs for capital.¹⁰⁵

Pursuant to FERC precedent, undue discrimination exists when similarly situated entities are treated differently.¹⁰⁶ The MISO TOs have not demonstrated that their cost of equity as of the present proceeding is similar to that of the New England TOs as the latter was established in the proceeding leading to Opinion No. 531. In fact, such an assertion runs against the MISO TOs' claim in this proceeding that their current Base ROEs of 12.38 percent and 12.20 percent are just and reasonable, because these values are substantially greater than the New England TOs' current Base ROE of 10.57 percent. Furthermore, the Commission has rejected this invalid

¹⁰⁴ MISO Tariff, Attachment FF, Section VIII. B-1.

¹⁰⁵ See MISO TOs' I.B. at 105.

¹⁰⁶ See, e.g., *Transmission Agency of Northern California v. F.E.R.C.*, 628 F.3d 538, 549 (2010) (holding that the court will not find a rate determination by Commission to be unduly discriminatory, in violation of Federal Power Act, if the entity claiming discrimination is not similarly situated to others); *Sacramento Municipal Utility Dist. v. F.E.R.C.*, 474 F.3d 797, 804 (2007) (holding that a successor agreement that the California Independent System Operator Corporation had negotiated with one local utility, but not another, for long-term firm transmission service was not undue discrimination because the utilities were not similarly situated).

comparison before, when it ruled that New England TOs did not suffer undue discrimination or face capital market deprivation by dint of receiving an ROE lower than that of the MISO TOs.¹⁰⁷ For many years following the rulings that established the MISO TOs' current Base ROEs, the MISO TOs continued to enjoy Base ROEs above 12%, while the New England TOs received 11.14%. The MISO TOs were not heard comparing their Base ROEs to the Base ROE of the New England TOs back then. They should not be heard making such a comparison now.

The purported inability of the MISO TOs to compete with the New England TOs, if their Base ROE is set anywhere below 10.57 percent, is unsubstantiated. There are many electric utilities with Base ROEs lower than the ones currently allowed for the MISO TOs and the New England TOs.¹⁰⁸ If the MISO TOs' line of argument were followed to its conclusion, the roughly 180-basis point differential between the current Base ROE of the MISO TOs and the New England TOs would be placing *the New England TOs* at competitive disadvantage in attracting capital in the national financial markets, a factor that might form the basis for the New England TOs to seek an ROE increase; followed by a corresponding ROE increase request from the MISO TOs, and so on. Clearly, setting ROEs based on a "highest common denominator" approach very quickly produces excessive and exploitative results.

¹⁰⁷ *Bangor Hydro-Elec. Co.*, Opinion No. 489, 117 FERC ¶ 61,129, at P 74, (2006), *on reh'g*, 122 FERC ¶ 61,265 (2008), *clarified*, 124 FERC ¶ 61,136 (2008), *review denied sub nom. Conn. Dep't of Pub. Util. Control v. FERC*, 593 F.3d 30 (D.C. Cir. 2010) (ruling that "a base-level ROE should be determined in this case using the Commission's long-established DCF methodology, without specific reference to an ROE result established for another public utility RTO in a proceeding in which a different proxy group, separate input values, and other data for a prior, distinguishable period were relied upon by the Commission.").

¹⁰⁸ *See, e.g.*, Base ROE of 9.8 percent for MidAmerican Central California Transco, LLC accepted as part of a settlement by Letter Order dated June 22, 2015, and Docket No. ER14-1661-000; the Base ROE of 9.8 percent for Niagara Mohawk Power Corporation accepted as part of a settlement by Letter Order dated May 13, 2015, Docket Nos. EL13-16-000, *et al.*, EL14-29-000, *et al.*, and EL12-101-000, *et al.*; and the Base ROE of 10 percent for PNM placed in interim effect by Chief Judge Order, *Public Service Company of New Mexico*, 150 FERC ¶ 63,012 (2015).

The Base ROE established in this proceeding must represent the real cost of equity of the MISO TOs, whatever that number is. It should not be set with the goal of placing the MISO TOs and all other transmission owners across the nation in the same exact “competitive position” for attracting capital, without regard to differences in their risks or other relevant factors. If the Base ROE is set at a level that meets the *Hope* and *Bluefield* standards, the MISO TOs will be in a position to attract capital at reasonable cost, regardless of any Base ROEs the Commission approves for other utilities.

(f) What is the appropriate upper-end of the zone of reasonableness?

In Opinion No. 531, *et al.*, the Commission reaffirmed its policy that the upper-end of the zone of reasonableness caps the total ROE (Base ROE plus ROE incentive adders) that utilities can be allowed to collect.¹⁰⁹ Further, in the October Order, the Commission specifically acknowledged that the upper end of the zone of reasonableness established in this proceeding may affect the ability of the MISO TOs to implement the full amount of incentive ROE adders previously granted by the Commission.¹¹⁰

The MISO TOs argue that the upper-end of the zone of reasonableness should be established at 16.17 percent.¹¹¹ This proposed cap is at least 390 basis points higher than the upper end of the zone of reasonableness resulting from all the IBES-based DCF analyses presented in this proceeding¹¹² and 395 basis points higher than the top end of the updated Value

¹⁰⁹ Opinion No. 531 at P 164.

¹¹⁰ October Order at P 205.

¹¹¹ See MISO TOs' I.B. at 121.

¹¹² The highest upper end of the zone of reasonableness is 12.27 percent; Exh. No. MTO-28 at 1.

Line-based DCF analysis of Dr. Avera.¹¹³ Furthermore, on the one hand, the MISO TOs claim that the difference between the midpoints resulting from IBES-based DCF analyses and the midpoints resulting from their alternative cost of equity benchmarks supports a finding that the IBES short-term growth data is skewed.¹¹⁴ On the other hand, the MISO TOs propose an upper end of the zone of reasonableness, which is significantly more distant from the upper ends resulting from their own alternative benchmarks than the upper ends resulting from the IBES-based DCF analyses in this proceeding. This fact is illustrated in the table below.

¹¹³ The MISO TOs' updated Value Line-based DCF study results in an upper end of the zone of reasonableness of 12.22 percent; Exh. No. MTO-28 at 2.

¹¹⁴ See MISO TOs' I.B. at 9-10.

MISO TOs' ALTERNATIVE BENCHMARKS (Upper-end)		DISPARITY WITH IBES-BASED 11.55 % CAP¹¹⁵ (Basis point)	DISPARITY WITH PROPOSED 16.17% CAP (Basis point)
CAPM Historical (Answering Testimony) ¹¹⁶	12.85%	- 130	+332
CAPM Prospective (Answering Testimony) ¹¹⁷	12.99%	- 144	+318
CAPM Historical (Cross-Answering Testimony) ¹¹⁸	12.61%	- 106	+ 356
CAPM Prospective (Cross-Answering Testimony) ¹¹⁹	12.69%	-114	+348
State ROE ¹²⁰	12.50%	-95	+367
ECAPM Historical (Answering Testimony) ¹²¹	13.08%	-153	+309
ECAPM Prospective (Answering Testimony) ¹²²	13.18%	-163	+299
ECAPM Historical (Cross-Answering Testimony) ¹²³	12.72%	-117	+345
ECAPM Prospective (Cross-Answering Testimony) ¹²⁴	12.78%	-123	+339
DCF Non-Utilities Group (Answering Testimony) ¹²⁵	12.86%	-131	+331
DCF Non-Utilities Group (Cross-answering Testimony) ¹²⁶	12.74%	-119	+343

¹¹⁵ The comparison reflects distance between the upper end resulting from each benchmark and the highest upper end of the zone of reasonableness resulting from IBES-based DCF studies sponsored by Complainants and supporting intervenors; Exh. No. JCA-6 at 1.

¹¹⁶ Exh. No. MTO-7 at 1.

¹¹⁷ Exh. No. MTO-7 at 2.

¹¹⁸ Exh. No. MTO-30 at 1.

¹¹⁹ Exh. No. MTO-30 at 2.

¹²⁰ Exh. No. MTO-9 and Exh. No. MTO-32.

¹²¹ Exh. No. MTO-11 at 1.

¹²² Exh. No. MTO-11 at 2.

¹²³ Exh. No. MTO-34 at 1.

¹²⁴ Exh. No. MTO-34 at 2.

¹²⁵ Exh. No. MTO-13.

The MISO TOs should not be permitted to use alternative benchmarks to challenge the midpoint of the IBES-based DCF results while disregarding them for other purposes. If the MISO TOs' alternative benchmarks are deemed germane in this proceeding, then it follows that those benchmarks provide additional support for the conclusion that the 16.17 percent upper end to the zone of reasonableness proposed by the MISO TOs is unjust and unreasonable.

The Presiding Judge should reject the MISO TOs proposal to establish a zone of reasonableness with an upper end of 16.17 percent. OMS respectfully submits that an appropriate upper-end value to be adopted for the purpose of capping the total ROE allowed for any particular MISO TO or transmission project is between 10.92 percent and 11.55 percent.¹²⁷

3. Is a base ROE derived from financial data for the refund period's last six months (August, 2014 through January, 2015) more reasonably representative of the MISO TOs' cost of equity capital during the entire fifteen-month refund period than a base ROE derived from financial data from January through June, 2015, which includes data for more than four months after the refund period?

OMS does not advocate a position on this issue in this proceeding.

¹²⁶ Exh. No. MTO-36.

¹²⁷ This range represents the highest and lowest upper ends of the zone of reasonableness resulting from the IBES-based DCF studies in this proceeding prepared by the Complainants and supporting intervenors. *See* the discussion in OMS I.B. at 41-42.

III. CONCLUSION

For the reasons stated in this Reply Brief and in OMS' Initial Brief filed on September 21, 2015 in this proceeding, the Presiding Judge should (i) find that the MISO TOs' current Base ROEs are unjust and unreasonable, and (ii) establish a new ROE that is within the range of midpoints produced by the IBES-based DCF analyses submitted by the Complainants and supporting intervenors.

Respectfully submitted,

/s/ Andrea I. Sarmentero Garzón
Gary J. Newell
Andrea I. Sarmentero Garzón

Attorneys for the Organization of
MISO States

Law Offices of:
Jennings, Strouss & Salmon, PLC
1350 I Street, N.W.
Suite 810
Washington, DC 20005-3305

Dated: October 13, 2015

CERTIFICATE OF SERVICE

I hereby certify that I have this day served the foregoing document upon each person designated on the official service list compiled by the Secretary of the Federal Energy Regulatory Commission in this proceeding.

Dated at Washington, D.C. this 13th day of October, 2015.

/s/ Christine Amoonarquah
Christine Amoonarquah
Legal Assistant
Jennings, Strouss & Salmon, P.L.C.
1350 I Street, NW, Suite 810
Washington, D.C. 20005-3305
(202) 464-0571
camoonarquah@jsslaw.com