UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Association of Businesses Advocating Tariff Equity, *et. al.*	)	
	)	
v.	)	Docket No. EL14-12-003
	)	
Midcontinent Independent System Operator, Inc., *et. al.*	)	

REQUEST FOR REHEARING OF THE ORGANIZATION OF MISO STATES

Pursuant to Section 313 of the Federal Power Act ("FPA"), 16 U.S.C. § 825*l*(a), and Rule 713 of the Federal Energy Regulatory Commission's ("Commission" or "FERC") Rules of Practice and Procedure, 18 C.F.R. § 385.713, the Organization of MISO States, Inc. ("OMS")[1] hereby respectfully request rehearing of the Commission's September 28, 2016, Order on Initial Decision("Opinion No. 551")[2] regarding the complaint filed by the Association of Businesses Advocating Tariff Equality, *et al*. ("Complainants")[3] challenging the Midcontinent Independent System Operator, Inc.

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[1] OMS files this Request for Rehearing because it is consistent with the policy positions approved by a majority of its Board of Directors. The Manitoba Public Utilities Board, the Wisconsin Public Service Commission, and the Louisiana Public Service Commission abstained. Nothing in this Request for Rehearing should be read as assertions or arguments by state Commission members of OMS applicable to state ROE proceedings. Individual state commissions have their own proceedings and applicable precedent guiding state ROE determinations.

[2] *Association of Businesses Advocating Tariff Equity, et al., v. Midcontinent Independent System Operator, Inc., et al.*, 156 FERC ¶ 61,234 ("Opinion No. 551").

[3] The Joint Complainants include the Association of Businesses Advocating Tariff Equity ("ABATE"), Coalition of MISO Transmission Customers ("CMTC"), Illinois Industrial Energy Consumers ("IIEC"), Indiana Industrial Energy Consumers, Inc. ("INDIEC"), Minnesota Large Industrial Group ("MLIG"), and Wisconsin Industrial Energy Group ("WIEG").

Transmission Owners' (the "MISO TOs")[4] Return on Equity ("ROE") as unjust and unreasonable. OMS respectfully submits that Opinion No. 551 erred in several material respects, as discussed below.

I. BACKGROUND

On November 12, 2013, Complainants filed a complaint alleging, among other things, that the current base ROE of the MISO TOs is unjust and unreasonable. On October 16, 2014, the Commission set for hearing the issue of whether MISO TOs' base ROE is unjust and unreasonable and established the refund effective date at November 12, 2013.[5] On December 22, 2015 the Presiding Judge issued an Initial Decision[6] finding, inter alia, that MISO TOs' existing 12.38% base ROE is unjust and unreasonable and should be reduced to 10.32%, the midpoint of the upper half of the Discounted Cash Flow ("DCF") range ("Upper Midpoint"). The Presiding Judge also prescribed refunds, with interest, for the period from November 12, 2013 through February 11, 2015. OMS and other parties filed briefs on exceptions and opposing exceptions. On September 28,

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[4] MISO TOs named in the complaint are: ALLETE, Inc. (for its operating division Minnesota Power, Inc. and its wholly-owned subsidiary Superior Water Light, & Power Company); Ameren Illinois Company; Union Electric Company (identified as Ameren Missouri); Ameren Transmission Company of Illinois; American Transmission Company LLC ("ATC"); 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, and 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 Vectran Energy Delivery of Indiana, Inc.

[5] Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc. 149 FERC ¶ 61,049, at P 188 (2014).

[6] Ass'n of Bus. Advocating Tariff Equity v. Midcontinent Indep. System Operator, Inc., 153 FERC ¶ 63,027 (2015) ("Initial Decision").

2016 the Commission issued Opinion No. 551, which affirmed the majority of the Initial Decision's findings.

This request for rehearing addresses various aspects of Opinion No. 551 that are unlawful or the product of arbitrary and capricious decision-making. Particularly, OMS is concerned about the implications in this and future ROE proceedings of a presumption that capital market conditions will remain anomalous for as long as the conditions found to be anomalous in Op. No.531, *et al*[7] remain unchanged or similar. Such presumption effectively results in an arbitrary and capricious departure from long standing precedent relying on the DCF model in favor of benchmarks that the Commission has found to be inferior to the DCF model. In addition, because the Commission is automatically placing the base ROE at the Upper Midpoint in instances where the midpoint of the DCF is inconsistent with the results of these inferior benchmarks, the Commission's new ratemaking approach does not accurately reflect the cost of equity of a group of utilities. In this particular case, the 10.32% base ROE overcompensates the MISO TOs and results in exploitation of customers. As such, the Commission's approval of a 10.32% base ROE for the MISO TOs is unlawful.

II. STATEMENT OF ISSUES AND SPECIFICATION OF ERRORS

Pursuant to 16 U.S.C. § 825*l*(a) and 18 C.F.R. § 385.713(c)(1)(2), OMS respectfully requests rehearing of the Commission's disposition of the following issues:

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[7] *Martha Coakley, Mass. Atty. 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), *pet'n for review pending sub nom. Braintree Elec. Light Dept., et al v. FERC,* D.C. Cir. Docket No. 15-1119.

1. The Commission erred by finding that capital market conditions were anomalous during the study period without record evidence to support such finding and, instead, establishing a conclusive presumption that market factors found anomalous in Opinion No. 531 render market conditions anomalous in this (and seemingly future) ROE proceedings, regardless of duration. *See* 5 U.S.C. § 706(2)(E); *Sithe/Independence Power Partners, L.P. v. FERC*, 165 F.3d 944 (D.C. Cir. 1999) (holding that an agency "must be able to demonstrate that it has made a reasoned decision based upon substantial evidence in the record."); *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006) (holding that an agency's decision is arbitrary and capricious if its explanation for the decision "runs counter to the evidence before the agency").

2. The Commission erred by finding that purported anomalous capital market conditions rendered the DCF outputs unreliable without record evidence showing how such conditions actually impacted the DCF model and, instead, establishing a presumption that market anomalies impact the DCF model unless the DCF results are corroborated by alternative benchmarks. *See* 5 U.S.C. § 706(2)(E); *Sithe/Independence Power Partners, L.P. v. FERC*, 165 F.3d 944 (D.C. Cir. 1999) (holding that an agency "must be able to demonstrate that it has made a reasoned decision based upon substantial evidence in the record."); *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006) (holding that an agency's decision is arbitrary and capricious if its explanation for the decision "runs counter to the evidence before the agency").

3. The Commission erred by departing, without reasoned explanation, from precedent relying on the DCF model as a method reflecting investors' expectations and, instead, relying on alternative benchmarks previously found to be inferior to the DCF model. *See* 5 U.S.C. § 706(2)(E); *F.C.C. v. Fox Television Stations, Inc., 556 U.S. 502, 503 (2009)* (holding that when agency action represents a change in administrative policy, then the agency must display awareness that it is changing position and show that there are good reasons for the new policy); *Williams Gas Processing-Gulf Coast Co., L.P. v. F.E.R.C.,* 475 F.3d 319 (D.C. Cir. 2006) (holding that an agency is free to discard precedents or practices that it no longer believes are correct, but if an agency decides to change course, it must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored); *Pub. Serv. Comm'n of N.Y. v. FERC,* 813 F.2d 451, 451 (D.C. Cir. 1987) (holding that FERC bears the burden of explaining the reasonableness of any departure from a long-standing practice, and that any facts underlying its explanation must be supported by substantial evidence); *Sithe/Independence Power Partners, L.P. v. FERC*, 165 F.3d 944 (D.C. Cir. 1999) (holding that an agency "must be able to demonstrate that it has made a reasoned decision based upon substantial evidence in the record."); *Tenn. Gas Pipeline Co. v. FERC*, 926 F.2d 1206, 1211 (D.C. Cir. 1991) (holding that if markets are unable to promptly reflect widely publicized information such as interest rates, the DCF theory collapses); *Transcon. Gas Pipeline Corp*., 60 FERC ¶ 61,246 at 61,825 (1992) (holding that the DCF model accounts for all the

risk factors perceived by investors); *Boston Edison Co. v. FERC,* 885 F.2d 962 (1st Cir. 1989) (affirming Commission's exclusive reliance on DCF).

4. The Commission erred by effectively imposing on Complainants and supporting intervenors the burden of proving that market conditions are *not* anomalous and that the DCF model is *not* rendered unrepresentative by purported anomalous market conditions. In doing so, the Commission acted against court precedent and rejected, without explanation, the Initial Decision's finding that imposing such burden would be improper (I.D. at 122). *National Motor Freight Traffic Ass'n v. U. S.*, 242 F. Supp. 601, 605 (1965) (holding that the burden of proof lies upon him who affirms, not him who denies, citing *Philadelphia Co. v. Securities and Exchange Commission, 84 U.S.* App. D.C. 73, 83, 175 F.2d 808, 818 (1949)).

5. The Commission erred by dismissing compelling evidence showing the significant flaws in Dr. Avera's Capital Asset Pricing Model ("CAPM"), risk premium, and expected earnings analyses, and by relying on the inflated results of these flawed benchmarks to place the base ROE at the Upper Midpoint. *See* 5 U.S.C. § 706(2)(E). *See Sithe/Independence Power Partners, L.P. v. FERC*, 165 F.3d 944 (D.C. Cir. 1999) (holding that an agency "must be able to demonstrate that it has made a reasoned decision based upon substantial evidence in the record."); *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006) (holding that an agency's decision is arbitrary and capricious if its explanation for the decision "runs counter to the evidence before the agency").

6. The Commission erred by finding that the risks of investing in transmission are "at least as great" as the risks of investing in state-regulated integrated utilities without record evidence to support such a broad finding, and by relying on Ms. Lapson's flawed state-authorized ROE analysis based on that erroneous premise. *See* 5 U.S.C. § 706(2)(E). *See Sithe/Independence Power Partners, L.P. v. FERC*, 165 F.3d 944 (D.C. Cir. 1999) (holding that an agency "must be able to demonstrate that it has made a reasoned decision based upon substantial evidence in the record.").

7. The Commission erred by placing the base ROE above the midpoint to incentivize construction of riskier transmission projects, and by dismissing without explanation OMS's arguments concerning the appropriate type of proceeding to address the returns necessary to build riskier transmission projects. *See* 5 U.S.C. § 706(2)(E); *Sithe/Independence Power Partners, L.P. v. FERC*, 165 F.3d 944 (D.C. Cir. 1999) (holding that an agency "must be able to demonstrate that it has made a reasoned decision based upon substantial evidence in the record."); *NorAm Gas Transmission Co. v. F.E.R.C.,* 148 F.3d 1158 (D.C. Cir. 1998) (holding that an agency has a duty to consider the contentions of a party and failure to do so is arbitrary and capricious); *PSEG Energy Res. Trade LLC v. FERC*, 665 F.3d 203 (D.C. Cir. 2011) (holding that an agency's "failure to respond meaningfully to objections raised by a party renders its decision arbitrary and capricious.").

8. The Commission erred by finding that there is no need for record evidence to support the specific upward adjustment above the midpoint because such "exactitude" is not required in determining the appropriate placement of the base ROE, and by subsequently placing the base ROE at a point above the cost of equity results of almost every single study and benchmark on the record. *See* 16 U.S.C. §§ 824d, 824e; 5 U.S.C. § 706(2)(E); *See Sithe/Independence Power Partners, L.P. v. FERC*, 165 F.3d 944 (D.C. Cir. 1999) (holding that an agency "must be able to demonstrate that it has made a reasoned decision based upon substantial evidence in the record."); *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006) (holding that an agency's decision is arbitrary and capricious if its explanation for the decision "runs counter to the evidence before the agency"); *Federal Power Commission v. Hope Natural Gas Co*., 320 U.S. 591 (1944) (holding that just and reasonable rates require balancing of the investor and the customer interests); *Bluefield Waterworks & Imp. Co. v. Public Service Commission of W. Va.*, 262 U.S. 679 (1923) (holding that while utilities have a right to just and reasonable returns, they don't have a constitutional right to profits); *Pub. Sys. v. FERC,* 606 F.2d 973, 979 n.27 (D.C. Cir. 1979) (holding that the Federal Power Act is intended to be a consumer protection statute); *Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1 of Snohomish Cnty., Wash.,* 554 U.S. 527, 564 (2008) (holding that Congress enacted the FPA precisely because it concluded that regulation was necessary to protect consumers from deficient markets). *See FPC v. Texaco Inc.,* 417 U.S. 380, 399, 94 S.Ct. 2315, 2327, 41 L.Ed.2d 141 (1974) (holding that "the [Natural Gas] Act makes unlawful all rates which are not just and reasonable, and does not say a little unlawfulness is permitted").

III. ARGUMENT

A. The Commission Erred by Finding that Capital Market Conditions Were Anomalous During the Study Period.

Opinion No. 551 affirmed the Initial Decision's finding that capital market conditions were anomalous during the study period.[8] On the basis of this erroneous finding, the Commission questioned the ability of the midpoint of the DCF range to meet the *Hope* and *Bluefield* requirements[9] and decided to consider the results of various alternative benchmarks and ROE calculation methods.[10]

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[8] Op. No. 551 at P 119.

[9] *Id.* at P 124.

[10] *Id.* at P 125.

The finding of anomalous capital market conditions is in error because it relies on two conclusive presumptions that operate, improperly, to place on Complainants and supporting intervenors the burden of proving in future ROE proceedings that these presumptions do not operate. Specifically, the Commission established: (1) a presumption that market conditions are "anomalous" for as long as the interest rate and yield levels found anomalous in Opinion No. 531 persist; and (2) a presumption that, due to the purportedly anomalous capital market conditions, inputs to the DCF model are distorted and DCF results are not reliable, unless corroborated by alternative benchmarks.

By establishing these conclusive presumptions, the Commission is in fact requiring complainants in this and future ROE complaint proceedings to demonstrate, beyond a reasonable doubt,[11] that market conditions are *not* anomalous or, if they have been found to be anomalous, that these conditions do *not* render an ROE based on the DCF midpoint confiscatory. On the other hand, respondents need only to show that capital market conditions are similar to those found anomalous in Opinion No. 531. This approach is inappropriate. Opinion No. 531 established an exception to FERC's policy of placing the base ROE at the DCF midpoint. It did not establish a new policy supporting placement of the base ROE at the Upper Midpoint unless doing so is proven to be unjust and unreasonable.

The U.S. Court of Appeals for the D.C. Circuit has ruled that the burden of proof lies on the party that affirms (here MISO TOs affirming that market conditions are

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[11] This is because any reasonable doubt could raise a "concern" that capital market conditions are anomalous and that the DCF results may be affected by such purported market anomalies.

anomalous or that the DCF inputs are distorted) not in the party that denies.[12] Consistent with this precedent and with Commissioner Honorable's concurrence in Opinion 531-B,[13] the Initial Decision found that the MISO TOs bear the burden of proving that capital market conditions are anomalous because it would be "improper" to force complainants and aligned parties to prove a negative.[14] Opinion No. 551 does not directly address this finding, but appears to have summarily affirmed it.[15] Yet, the establishment of these presumptions runs directly contrary to the Presiding Judge's finding.

Assuming that the Commission agrees with the Presiding Judge that it would be improper to force complainants to prove a negative, the Commission should grant rehearing regarding the conclusive presumptions it has established vis-à-vis the existence of anomalous capital market conditions and the impacts of these purportedly anomalous conditions on the DCF model. As such, the Commission should base its decision on evidence provided by MISO TOs on the existence of anomalous market conditions and the impact of those conditions on the DCF model.

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[12] *National Motor Freight Traffic Ass'n v. U. S.*, 242 F. Supp. 601, 605 (1965) (holding that the burden of proof lies upon him who affirms, not him who denies citing *Philadelphia Co. v. Securities and Exchange Commission, 84 U.S.* App. D.C. 73, 83, 175 F.2d, 808, 818 (1949)).

[13] Op. No. 531-B, concurring statement of Commissioner Colette D. Honorable stating that "[k]eeping in mind the delicate balance that the Commission must strike when weighing investor and consumer interests, it is important to note that the finding of anomalous market conditions in Opinion No. 531 did not create a bright line test nor did it create a presumption that market conditions will be found to be anomalous going forward. The anomalous, or unusual, market conditions that were found in the original order to justify the placement of the base ROE above the central tendency of the zone of reasonableness were, by definition, atypical. Any public utility that seeks to rely upon anomalous market conditions to justify placement of its base ROE in the upper end of the zone of reasonableness will be tasked with demonstrating, in each case, that market conditions are indeed anomalous and that the adequacy of a base ROE set at the midpoint of the zone of reasonableness should be scrutinized. The utility should expect a rigorous analysis of the record when it attempts to make such a demonstration."

[14] I.D. at 122 (citing to *National Motor Freight Traffic Ass'n v. United States*, 242 F.Supp. 601, 605 (D.D.C. 1965).

[15] Op. No. 551 at P 10.

1. The Commission erred by establishing a conclusive presumption that market conditions are anomalous as long as interest rates and yields remain at levels found anomalous in Opinion No. 531.

The Commission erred in establishing a conclusive presumption that, for so long as interest rate and bond yield levels are similar to those that prevailed during the Opinion No. 531 study period, capital market conditions remain "anomalous," regardless of the duration of the market conditions. Specifically, the Commission stated that:

> … evidence in the record regarding historically low interest rates and Treasury bond yields as well as the Federal Reserve's large and persistent intervention in markets for debt securities ***are sufficient*** to find that current capital market conditions are anomalous….. while Complainants provide evidence that interest rates have been trending downwards, the current levels may be so low as to cause irregularities in the outputs of the DCF. Despite such yields remaining low for several years, we find that they are anomalous and could distort the results of the DCF model.[16]
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> … As described above, we find that the relevant anomalous capital market conditions cited in Opinion No. 531 ***are still present*** in this proceeding…[17]

In establishing this conclusive presumption and relying on it as the basis for questioning the DCF results, the Commission departed without reasonable explanation from long-standing precedent that advocates for the use of the DCF model to calculate the cost of equity of utilities.

The Commission has consistently relied on the DCF model to calculate the cost of equity of utilities.[18] In Opinion No. 531, the Commission recognized its long standing

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[16] Op. No. 551 at P 124 (emphasis added).

[17] *Id.* at P 125.

[18] *See, e.g., Boston Edison Co. v. FERC,* 885 F.2d 962 (1st Cir. 1989) (affirming Commission's exclusive reliance on DCF); *Midwest Indep. Transmission Sys. Operator, Inc.*, 99 FERC ¶ 63,011, P 24-25, *aff'd*, 100 FERC ¶ 61,292 (2002), *reh'g denied*, 102 FERC ¶ 61,143 (2003), *on remand*, 106 FERC ¶ 61,302 (2004) ("*MISO*"), *aff'd in part sub nom. Pub. Serv. Comm'n of Ky. v. FERC*, 397 F.3d 1004 (D.C. Cir.) ("*PSCKY*"), *on remand*, 111 FERC ¶ 61,355 (2005) (exclusive reliance on DCF to set ROE).

reliance in the DCF model,[19] affirmed its reliance on the DCF model going forward (as modified),[20] but created an exception where market anomalies raise a concern that the DCF outputs may not be reliable.[21] Opinion No. 551 expands this exception to make it the rule for as long as interest rates and bond yields remain at levels comparable to those that prevailed during the Opinion No. 531 study period.[22] In other words, the Commission established a presumption that market conditions will be deemed "anomalous" for as long as interest rates and bond yields remain at the levels found anomalous in Opinion No. 531, regardless of how long those conditions persist.

Evidence in the record here shows that low-rate/low-yield conditions have prevailed for a considerable period of time (beginning even before the EL11-66 study period).[23] Further, the record shows that the "accommodative" Federal Reserve policies that were claimed to have caused these anomalous conditions are not going to change significantly any time soon and may indeed remain accommodative for a long period of time.[24] Without a foreseeable end to the market factors that were deemed to provide "sufficient" proof of a market anomaly, the Commission has *de facto* renounced reliance on the results of the DCF model. Instead, the Commission has chosen to rely on previously rejected "alternative" cost of equity methods and on extrinsic evidence

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[19] Op. No. 531 at P14, n6.

[20] *Id.* at P 41.

[21] *Id.* at PP 41, 145.

[22] Op. No. 551 at PP 124, 125.

[23] *See, e.g.,* S-2 at Schedule No. 1 (bond yields); JCA 11 at 17.

[24] *See, e.g.,* Exh. No. S-10 (the January 2015 minutes of the Federal Open Market Committee include the following statement: "[w]hen the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent. The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run.").

previously found to be unreliable.[25] Such an unexplained departure from precedent is arbitrary and capricious.[26]

Market conditions that have lasted for several years already and that are not expected to change in the foreseeable future cannot reasonably be considered "unusual" or "anomalous." Opinion No. 551 narrowly focuses on the absolute level of interest rates and bond yields (as artificial results from Federal Reserve policies), without considering whether the persistence of those conditions has caused investors to adjust their expectations or return requirements. If we assume that investors are reasonable and generally informed about market conditions and trends, it would be arbitrary to find that they have not accounted for persistent low yields and interest rates in their investment decisions. Indeed, the U.S. Court of Appeals for the D.C. Circuit has found that the stock market assimilates interest rate information "with lightning speed"[27] and that "[i]f the market is in fact unable to promptly reflect information so widely publicized as risk-free interest rates, DCF theory collapses."[28] In fact, the Commission itself has previously

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[25] *See, e.g., Montaup Elec. Co.*, 38 FERC ¶ 61,252 at 61,869 n. 101 (1987) ("[A] risk-premium analysis can accentuate erratic market conditions and tends to over-emphasize recent market changes").

[26] *See Williams Gas Processing-Gulf Coast Co., L.P. v. F.E.R.C.,* 475 F.3d 319 (D.C. Cir. 2006) (holding that an agency is free to discard precedents or practices that it no longer believes are correct, but if an agency decides to change course, it must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored); *F.C.C. v. Fox Television Stations, Inc., 556 U.S. 502, 503 (2009) (holding that when agency action represents a change in administrative policy, then the agency must display awareness that it is changing position and show that there are good reasons for the new policy); Pub. Serv. Comm'n of N.Y. v. FERC,* 813 F.2d 451, 451 (D.C. Cir. 1987) (holding that FERC bears the burden of explaining the reasonableness of any departure from a long-standing practice, and that any facts underlying its explanation must be supported by substantial evidence); *Sithe/Independence Power Partners, L.P. v. FERC*, 165 F.3d 944 (D.C. Cir. 1999) (holding that an agency "must be able to demonstrate that it has made a reasoned decision based upon substantial evidence in the record.")

[27] *Tenn. Gas Pipeline Co. v. FERC*, 926 F.2d 1206, 1211 (D.C. Cir. 1991) ("*Tennessee*").

[28] *Id*. at 27

found that the DCF model properly takes into account the various risk factors perceived by investors.[29]

Accepting that investors have already taken these persistent low-rate/low-yield conditions into account in making their investment decisions, the question then becomes whether investors expect market conditions to change in the foreseeable future in a manner that would negatively impact their investment strategies with respect to the MISO TOs. The record does not support a finding that investors expect market conditions to change in the near future. As the record shows, it is unknown whether the Federal Reserve will take action to increase interest rates and any such action, if taken, will be gradual.[30] Under these circumstances, it would be illogical for investors to change their investment positions/strategies in the expectation that, at some undefined point in the future, the Federal Reserve may (or may not) change its current policy. By refusing to acknowledge that the duration of market conditions matters to investors, the Commission engaged in arbitrary and capricious decision-making and departed, without reasonable explanation, from precedent relying on the DCF as a methodology that reflects investors' expectations.

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[29] *Transcon. Gas Pipeline Corp*., 60 FERC ¶ 61,246 at 61,825 (1992).

[30] *See, e.g,* Exh. No. S-10 (the January 2015 minutes of the Federal Open Market Committee include the following statement: "[w]hen the Committee decides to begin to remove policy accommodation, it will take a balanced approach consistent with its longer-run goals of maximum employment and inflation of 2 percent. The Committee currently anticipates that, even after employment and inflation are near mandate-consistent levels, economic conditions may, for some time, warrant keeping the target federal funds rate below levels the Committee views as normal in the longer run.").

2. The Commission erred by establishing a conclusive presumption that anomalous capital market conditions render the DCF outputs unreliable unless confirmed by alternative benchmarks.

The Commission erred in concluding that the DCF is subject to model risk of providing "unreliable outputs" in the presence of anomalous capital market conditions, while finding that there is no need to show a causal link between the specific capital market conditions purported to be anomalous and the inputs to the DCF analysis.[31] The Commission does not explain: (1) how the DCF, as a theoretical model, can be affected by low yields and interest rates; (2) why, if these conditions bring down the cost of raising capital (as the Initial Decision found)[32] the MISO TOs' cost of equity is not also at the lower level depicted in the DCF results; and (3) why, if these anomalous conditions affect the DCF model, they don't also affect the results of the alternative benchmarks and studies relied upon by the Commission (*i.e.* risk premium, expected earnings, CAPM, and state-authorized ROE determinations). Instead, the Commission arbitrarily establishes a conclusive presumption that market anomalies render the DCF results unreliable unless corroborated by alternative benchmarks.

The DCF formula has only two inputs – dividend yield and growth rate.[33] The record does not prove that the specific market conditions the Commission found anomalous actually impact the DCF model. The Presiding Judge's theory for why purportedly anomalous conditions affect DCF results (*i.e.,* that low bond yields pushed yield-seeking investors toward utility equities, driving up utility stock prices and

[31] Op. No. 551 at P 125.
[32] I.D. at 215.
[33] Op. No. 531 at P 145, n. 285.

depressing dividend yields)[34] was unsupported, but at least sought to establish a linkage between anomalous market conditions and DCF model risk. The Commission rejected the Presiding Judge's linkage theory[35] but without offering an alternative explanation (indeed, without addressing the evidence that *disproved* the purported linkage).[36] Instead, the Commission simply presumed that any market anomaly affects the DCF, unless the alternative benchmarks indicate otherwise.[37] Thus, the Commission stated that it "has not required a mathematical demonstration of how each anomalous capital market condition specifically distorts the DCF analysis and it is uncertain whether such an analysis is even possible given the complexities of capital markets and how various phenomena could affect the DCF methodology results."[38]

In short, the Commission abandoned its previous reliance on the DCF midpoint based on the belief that prevailing market conditions have distorted the DCF results, but the Commission then contends that the mechanism through which that distortion occurs *cannot be explained*. If the Commission is unable even to explain the mechanism by which DCF results have been distorted, it cannot lawfully base a decision of such importance—abandonment of the DCF method in favor of previously discredited alternatives—on the purported operation of the mechanism's model risk. To do so is inarguably arbitrary and capricious.

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[34] I.D. at PP 151, 216.
[35] Op. No. 551 at PP 123, 127.
[36] *Id.* at P 125.
[37] *Id.*
[38] *Id.*

The Commission's finding of anomalous market conditions is premised in its entirety on three specific factors—low interest rates, low bond yields and the accommodative policies of the Federal Reserve.[39] If these conditions are actually distorting DCF results, the mechanism by which that occurs should be explicable; and once the distortion mechanism (assuming there is one) is understood, it should be possible to arrive at an ROE determination that correctly adjusts for the distortion while maintaining the integrity of the DCF methodology. That approach would be far more consistent with reasoned decision-making than embracing the alternative methods and benchmarks that the Commission previously rejected as inferior to the DCF.[40] The unreasonableness of the latter approach is rendered even clearer by considering that these newly rehabilitated alternative methods *also* are likely to be distorted by the same conditions claimed to undermine the DCF results. It is a fiction to assume that "model risk" triggered by anomalous market conditions is unique to the DCF. And if anomalous market conditions do in fact distort all benchmarks to a certain degree, what basis is there for the Commission to place heavy reliance on MISO TO witness Avera's risk premium and expected earnings benchmarks?[41] The possibility that those results also may be flawed by distortion is not considered in Opinion No. 551.

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[39] *Id.* at 124.

[40] *Orange and Rockland Utilities, Inc.*, 44 FERC ¶ 61,253, at 61,952 (1988) (expected return on book equity does not represent investors' required return on market-priced equity); ITC Holdings Corp., 121 FERC ¶ 61,229 at P 43 (2007) (CAPM methodology, alone, inappropriate for determining the ROE); Consumers Energy Co., Opinion No. 429, 85 FERC ¶ 61,100 at p. 61,361 (1998); *Montaup Elec. Co.*, 38 FERC ¶ 61,252 at 61,869 n. 101 (1984) ("[A] risk-premium analysis can accentuate erratic market conditions and tends to over-emphasize recent market changes").

[41] Op. No. 551 at P 280.

The Commission's presumption that anomalous capital market conditions render the DCF results unrepresentative is also at odds with the Initial Decision's finding that the MISO TOs' costs of raising capital are indeed low. While the Initial Decision found that, as a result of falling interest rates and dividend yields, the cost to electric utilities of raising capital by issuing stock is low,[42] it reasoned that the cost of common equity for utilities was not necessarily low because: (1) investors are buying utility stock just for the yield and don't care about the growth, so they are ready to divest their long-term positions as soon as normalization begins and short-term rates allow; and (2) the proxy group prices included in the DCF analysis reflect only what investors are paying to get the yield.[43] While rejecting the Presiding Judge's theory,[44] the Commission offers no alternative explanation that would rebut the logical conclusion that the consequence of having low interest rates and yields is that the MISO TOs' cost of equity is *actually low*. Indeed, rather than "distorting" the DCF results, these conditions actually serve to push down the cost of raising capital, including equity capital, and the DCF model results *accurately reflect this fact*.

B. The Commission Erred by Reversing the Initial Decision's Appropriate Rejection of Dr. Avera's Flawed Expected Earnings Analysis.

The Initial Decision rejected Dr. Avera's expected earnings analysis, Exhibit No. MTO-31, on the grounds that its reliance on the book earnings of regulated utility parent firms (rather than the book earnings of a comparable sample of competitive-sector firms)

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[42] I.D. at P 215.
[43] I.D. at PP 141, 151, 210 and 216 .
[44] Op. No. 551 at PP 123, 127.

is inconsistent with Dr. Roger Morin's treatise *New Regulatory Finance*.[45] Opinion No. 551, however reversed the Initial Decision on this point, reasoning that Dr. Morin only recommended against using *historical* utility-parent book returns, whereas Exhibit No. MTO-31 reflects *forecast* utility-parent book returns.[46] The Commission's reversal is in error because it departs, without reasonable explanation, from FERC precedent in several respects, as OMS details below.

1 Distinction between accounting and required returns.

The Commission has recognized that the allowed rate of return should be set at the rate of return investors require *on their investment*, not at the rate investors expect the company to earn on *book* common equity.[47] Dr. Morin, on whose guidance the Commission relies,[48] has opined that the fundamental problem with analysis of return on book equity (whether historical or forward-looking) is that accounting returns are inherently disconnected from the cost of equity.[49] Because of this disconnect, Dr. Morin's qualified support for a method based on accounting returns is premised on his expectation that the distinction between returns on book equity and the return investors require on market-priced equity will be accounted for in composing the comparable earnings proxy group.[50]

2 Market-to-book ratio.

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[45] I.D. at P 323.

[46] Op. No. 551 at PP 231-32.

[47] *Orange and Rockland Utilities, Inc.*, 44 FERC ¶ 61,253, at 61,952 (1988).

[48] Opinion No. 531 at n.294 (stating explicit reliance in Dr. Morin's guidance on expected earnings analysis).

[49] New Regulatory Finance at 393.

[50] *Id*. at 381.

The Commission has held that "when the price-to-book ratio is greater than one, the rate of return that investors expect [the company] to earn on common equity is greater than the rate of return investors require from their investment in [the company's] common stock."[51] This precedent is consistent with Dr. Morin's guidance.[52] Exhibit No. MTO-31 relies on proxies with market-to-book ratios that far exceed 1.0. Because stock prices for the companies included in Exhibit No. MTO-31 are so much higher than their book value, [53] investors *cannot* expect to earn a similar return on their investment. Investors must expect to earn a return on the market price paid for those companies and this return is well *below* the level indicated by Exhibit No. MTO-31.

3 Skewed range of distribution.

The Commission has held that reliance on the midpoint may be *inappropriate* when there is an egregious distortion caused by the highest and/or lowest number.[54] In order to determine whether there is a distortion, the Commission has looked at the change in each value of a proxy group to the next value.[55] If the three highest values above the midpoint exceed the midpoint by a far greater margin than the margin between the midpoint and the three lowest values below the midpoint, then the distribution is skewed.[56] The 11.99% midpoint of Exhibit No. MTO-31, on which Opinion No. 531

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[51] *Orange and Rockland Utilities, Inc.*, 44 FERC ¶ 61,253, at 61,952 (1988).

[52] New Regulatory Finance at 387.

[53] JCA-24.

[54] *Midwest Independent Transmission System Operator, Inc.,* 106 FERC ¶ 61302 at P 12 (2004) ("*MISO*").

[55] *Id.*

[56] *Id.*

heavily relies,[57] is *not* fairly representative of the proxy group's expected earnings on book equity. As the table below shows, the average of the margins between the midpoint and the three highest above-midpoint values is 99 basis points, almost *twice* the corresponding average for the below-the-midpoint values (54 basis points). Consistent with the Commission's ruling in *MISO*, then, reliance on the midpoint of Dr. Avera's expected earnings analysis is not appropriate. Using the median is more appropriate in this case because the midpoint is determined using two extreme numbers that are unlikely to be representative of the cost of equity,[58] while the median is determined by representative "central tendency" numbers.[59]

Margins Below the Midpoint				**Margins Above the Midpoint**		
Proxy	**Value**	**Margin (bp)**		**Proxy**	**Value**	**Margin (bp)**
GXP	7.61%	NA		LNT	12.14%	33
DUK	8.08%	**47**		NEE	12.44%	30
BKH	8.67%	**59**		CNP	12.73%	29
EDE	8.67%	0		SRE	12.84%	11
IDA	8.67%	0		OTTR	13.37%	**53**
FE	8.69%	2		SO	13.73%	36
ED	9.14%	45		CMS	13.94%	21
AVA	9.15%	1		VVC	15.21%	**127**
ETR	9.15%	0		ITC	16.37%	**116**
EE	9.19%	4				
POR	9.32%	13				
WR	9.62%	30				
PNM	9.66%	4				
ALE	9.73%	7				
AEE	9.73%	0				

57 Op. No. 551 at P 280.

58 The midpoint is calculated by adding the highest and the lowest number in a proxy group (excluding outliers) and dividing the resulting number by two.

59 The median is the middle number between the highest and the lowest number in a proxy group.

PNW	9.73%	0				
PCG	9.79%	6				
SCG	9.79%	0				
NEW	10.20%	41				
ES	10.21%	1				
XEL	10.22%	1				
DTE	10.31%	9				
AEP	10.71%	40				
PEG	10.74%	3				
TE	11.15%	41				
OGE	11.26%	11				
EIX	**11.81%**	**55**				

If the Commission is to rely on Dr. Avera's flawed expected earning analysis, it should at least use the median, not the midpoint, of Exhibit MTO-31 (*i.e.* 9.995%). This value is below the DCF Upper Midpoint. If the Commission eliminates ITC Holdings as an outlier, as it should,[60] the median of the expected earnings range would be 9.79%. This number is considerably below the Upper Midpoint and closer to the 9.4% representing the 75th percentile.

C. Opinion No. 551 Erred by Relying on Dr. Avera's Flawed Risk Premium Analysis.

Prior to Opinion No. 531, the Commission refused to rely on risk-premium analyses.[61] In Opinion No. 531, the Commission placed limited reliance on this method for the sole purpose of determining whether the midpoint of the DCF range comports with the *Hope* and *Bluefield* standards.[62] In Opinion No. 551, however, the Commission relied on Dr. Avera's risk premium analysis to justify a base ROE of 10.32% when most

60 ITC's 2.88 market-to-book ratio shown in JCA-24 is a clear high-end outlier.

61 *See*, *e.g.*, *System Energy Resources, Inc.*, 92 FERC P 61119 at 61446 (2000).

62 Op. No. 531 at P 145.

of the evidence and alternative benchmarks in the record point to a lower base ROE.[63] The Commission's reliance on the risk premium method constitutes departure from long-standing precedent that is arbitrary and capricious because it is not adequately or cogently explained.

In Opinion No. 551, the Commission stated that the risk premium analysis is a "helpful indicator" of how investors' required returns have been impacted by the current interest rate environment.[64] However, reliance on a risk premium study—which inherently assumes a linear relationship between bond yields and the cost of equity—is incompatible with the "anomalous market conditions" predicate for considering non-DCF methods.[65] In fact, the Commission itself found in Opinion No. 531 that the relationship between equity costs and Treasury bond yields has become unreliable in "both . . . magnitude and direction," such that reliance on such trends can no longer be trusted to "produce a rational result."[66] Moreover, relying on an analysis that incorporates ROE determinations from a period when the Commission was applying the single-stage DCF

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[63] *See* Opinion No. 551 P 280.

[64] Op. No. 551 at P 173. This analysis first calculates the risk premiums by subtracting the average bond yield for each year of the study period (*i.e.* 2006-2014) from the average of ROEs authorized by the Commission during each same year, and then averaging the calculated risk premiums. The risk premiums are then added to the average six-month historical yield on triple B utility bonds to estimate the cost of equity. See MTO-1 at 101-102.

[65] Ms. Lapson's explanation regarding anomalous capital market conditions is that, because the accommodative actions of the Federal Reserve have driven yields on bonds down, investors are purchasing utility stock as a "bond substitute" artificially driving utility stock yields down and prices up. (*See* MTO-16 at 22:6-12). Ms. Lapson also stated that investors buy utility stock because "[they had] nowhere else to go." (*See* Tr. at 435: 2-8). The purported artificiality of utility stock yields is in fact key to the Initial Decision's finding of anomalous capital market conditions. (*See* I.D. at PP 158 & 223). The risk premium analysis calculates a premium return required by investors in utility stock to bond returns. If indeed investors are purchasing utility stocks as bond substitutes, the premium should not be nearly as great as calculated in Exhibit MTO-29.

[66] Op. No. 531 P 159.

method—a method the Commission no longer accepts—unreasonably perpetuates the erroneous results produced by the past method.

If the Commission nevertheless holds fast to relying on a risk premium study, the 10.36% cost of equity resulting from MTO-29 cannot be used as a benchmark because it is flawed on numerous grounds. First, Dr. Avera's risk premium analysis included fifteen cases involving ROE incentive adders that simply reiterated a set of base ROEs between 11.14% and 12.38% that had already been approved.[67] Adding in these high base ROEs multiple times in calculating bond-stock risk premiums artificially inflates the results of the analysis.[68] Second, Opinion No. 551 rejected OMS's argument that it was improper to include risk premium values originating in FERC decisions in which the ROE was not determined on the merits, but was rather the product of settlement or was simply mentioned (but not re-determined) in the context of deciding whether to allow an ROE incentive adder.[69] The Commission claimed that such data inputs "[do] not affect the reliability of a risk premium analysis," but that assertion is patently wrong; including these values simply increases the calculated premium without providing additional information about the level of actual ROE determinations.[70] Third, and particularly troublesome, is the Commission's finding that it is appropriate for Dr. Avera's risk premium analysis to use the very 12.38% base ROE that Opinion No. 551 finds unjust and unreasonable for the MISO TOs.[71] OMS seeks rehearing of this erroneous finding

[67] Attachment 1 to OMS Brief on Exceptions.
[68] OMS Brief on Exceptions at 32.
[69] Op. No. 551 at P 198.
[70] *Id.*
[71] *Id.*

because, as demonstrated in Appendix 1 to OMS's Brief on Exceptions in this proceeding, the results of the risk premium analysis change greatly if the repeated data points having no true bearing on cost of equity determinations are eliminated. Indeed, OMS calculated that even a partial correction of Dr. Avera's risk premium analysis would produce a cost of equity of 9.94%,[72]—a value well below the 10.36% calculated by Dr. Avera[73] and well below the 10.32% base ROE awarded in Opinion No. 531. This difference belies the Commission's claim that including the repeated data points does not "affect" the reliability of the risk-premium analysis.[74] There is a very significant impact of including those data points: doing so introduces a demonstrated upward bias.[75]

A further flaw in MTO-29 is the lack of synchronism between ROE decisions and the bond yields with which they are compared to determine the premium. Past findings as to the cost of equity must be compared with yields that are contemporaneous with the ROE determination. MTO-29, however, violates this basic principle. In Opinion No. 551, the Commission agreed with OMS that Dr. Avera's risk premium analysis required certain synchronizing corrections to the data points, but ruled that OMS had not demonstrated that any such corrections would materially affect the results of the MISO TOs' risk premium analysis.[76] Leaving aside whether it was OMS's task to do so, the fact is that synchronizing the data points in Attachment 1 to the OMS Brief on Exceptions has a very significant effect on the results of the risk-premium-indicated cost of equity;

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[72] OMS Brief on Exceptions, Attachment 1 at 1.

[73] MTO-29.

[74] Op. No. 551 at P 198.

[75] OMS Brief on Exceptions at 32.

[76] Op. No. 551 at P 199.

indeed such adjusted results are *below* the 10.32% base ROE awarded in Opinion No. 551. This can be shown by the example of properly synchronizing the ROE decision and the bond yields for the *ITC Holdings* case.[77] If the premium-measurement date is corrected from "Jun-13" to September 2002 (when the Commission found the 12.38% to be just and reasonable),[78] the Baa utility bond yield properly used for measuring the premium is the contemporaneous 8.02%, not the much lower utility bond yield of 2013.[79] Using an average bond yield correctly synchronized with the ROE award date, and carrying that correction through pages 1 and 3 of Exhibit No. MTO-29, greatly shrinks the calculated premium and results in a cost of equity of 10.06%.[80] The same sort of synchronizing correction also should be made to the two other data points in Exhibit No. MTO-29 that likewise rely on the 12.38% outcome from Docket No. ER02-485, while erroneously comparing it to bond yields of a later year.[81] With that further adjustment, flowed through Exhibit No. MTO-29, the risk-premium-indicated ROE drops to 9.89%[82]—again, a result substantially below the 10.32% base ROE awarded by the Commission. Further adjustments that are fully justified as synchronizing corrections to the Exhibit MTO-29 data points would reduce the risk-premium-indicated ROE *even further*. These would include:

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[77] *ITC Holdings Corp.*, 143 FERC ¶ 61,257 (2013), *on reh'g,* 146 FERC ¶ 61,111 at P 25 (2014).

[78] Op. No. 551 P 2 (reciting this history).

[79] JC-2 line 17.

[80] *See* OMS Attachment 1 herein.

[81] Data points identified on MTO-29 at 5 as "May-11 EL10-80 Ameren" and "Jun-12 ER12-1593 DATC Midwest Holdings".

[82] *See* OMS Attachment 2 herein.

- Conforming the dating of the three Southern California Edison decisions to the methodology used for all other companies. With no explanation, Exhibit No. MTO-29 dates those decisions based on the effective period of the resulting rates, whereas all other data points in Exhibit No. MTO-29 are dated based on the decision-issuance date. The risk premium calculated from these decisions should be based on the decision-issuance date and bond yields contemporaneous with that date.

- Tying the numerous "PSE&G" 11.18% data points in MTO-29 back to the September 2008 decision in Docket No. ER08-1233 that underlies them all, and comparing that to bond yields contemporaneous with the corrected date.[83]

- Tying its numerous New England 11.14% data points back to the October 2006 issuance date of the decision (Opinion No. 489) that underlies them all, and comparing that with bond yields contemporaneous with the corrected date.[84]

These synchronizing adjustments—merely correcting dates, as the Commission recognized to be conceptually sound—produce a risk premium-based ROE that is greatly lower than the 10.32% base ROE awarded by the Commission in Opinion No. 551. Furthermore, implementing these adjustments requires no judgment or discretion; the

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[83] This decision is referenced in MTO-29, but not recognized there as the source and date of all of the referenced 11.18% findings for cases involving that company. The contemporaneous Baa utility bond yield is 7.25% as shown in JC-2, line 23.

[84] The contemporaneous Baa utility bond yield is 6.32% as shown in JC-2, line 21.

results flow clearly and directly, as a matter of straightforward mathematics,[85] from the application of undisputed data. There is therefore no valid reason at this point for the Commission to refuse to implement the adjustments. Failure to do so would leave in place an ROE award that is demonstrably unjust and unreasonable, and on that basis would be arbitrary, capricious and an abuse of agency discretion.

D. The Commission Erred by Relying on Dr. Avera's Flawed CAPM Analysis and Placing the Base ROE Above This Already Inflated Benchmark.

Opinion No. 551 relies on Dr. Avera's CAPM analysis (Exhibit No. MTO-30)[86] as a credible indicator of the cost of equity.[87] The Commission erred by accepting this flawed analysis that uses an inflated estimate of diversified-portfolio stock returns, and erroneously applies an incomplete size adjustment. The Commission erred further by placing the base ROE above the 10.06% cost of equity resulting from Dr. Avera's already inflated CAPM analysis.

The Commission has previously rejected the use of the CAPM methodology to determine ROE because beta, its risk measure, does not fully reflect the differences in relative risk among companies.[88] In Opinion No. 531, upon finding anomalous capital market conditions, the Commission created an exception and decided to rely on the CAPM as a benchmark to determine whether the midpoint of the DCF meets the *Hope*

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[85] The necessary arithmetic includes application of the same Excel regression function that was used in generating page 6 of Exhibit MTO-29.

[86] MTO-30 has two pages, with page 1 looking to historical bond yields and page 2 looking to projected bond yields. The Presiding Judge rightly rejected reliance on page 2; MISO TOs did not take exception to that determination; and Opinion No. 551 likewise looks only to page 1 of MTO-30. Accordingly, we will refer to MTO-30 page 1 as simply "Exhibit No. MTO-30."

[87] Op. No. 551 at 172.

[88] *Xcel Energy Services, Inc.*, 122 FERC ¶ 61,098 at P 73 (2008), and *Consumers Energy Co.*, Opinion No. 429, 85 FERC ¶ 61,100 at 61,361-62 (1998).

and *Bluefield* Standards. Even if the Commission relies on the CAPM as a benchmark, the analysis still needs to be conducted appropriately. Opinion No. 551 erred by overlooking the following fatal flaws in Dr. Avera's CAPM, rendering it unreliable as a benchmark:

1 Erroneous reliance on a composite of Value Line and IBES short-term rates.

As Opinion No. 551 observes, the CAPM method proceeds from the premise that the market-required rate of return for a security is equal to the risk-free rate, plus a risk premium associated with the specific security.[89] Although the application of the CAPM method is a multi-step process, Dr. Avera started by calculating an expected market return on a fixed portfolio of approximately 400 companies using a DCF analysis.[90] Dr. Avera added the weighted average dividend for those companies (2.4%) to the average of the weighted average growth rates projected for the companies by the Institutional Brokers' Estimate System ("IBES") and Value Line (8.9%), producing an expected portfolio return of 11.3%.[91]

The DCF analysis Dr. Avera performed to calculate the CAPM expected portfolio return—unlike the methodology the Commission relied on in Opinion No. 531—uses a composite of Value Line and IBES short term rates. On exceptions from the Initial Decision, OMS argued that this significant difference in methodology rendered Dr. Avera's CAPM analysis unreliable for the same reasons the Initial Decision determined that the use of Value Line short-term growth rates in the primary DCF study was

[89] Opinion No. 551 P 138; *see also* ID at P 259, quoting JC-9 at 41:2-10.
[90] I.D. P 260.
[91] *Id.*

inappropriate.[92] Opinion No. 551 dismissed this concern, stating that the use of growth rate data in the CAPM analysis is "fundamentally different" from how growth data is used in the DCF model "because it is intended to provide a less precise cost of equity estimate than the DCF model."[93] According to the Commission, such a degree of precision is less essential in the CAPM analysis "because that analysis is but one of multiple pieces of evidence corroborating the results of our DCF analysis."[94]

It is arbitrary and capricious to require a lower degree of precision in analyses that are essentially form the premise for rejecting the results of the more precise DCF method, even if the CAPM is just one of several analyses. An analysis used to challenge the DCF results should be superior, not inferior, to the DCF model.

2 Erroneous calculation of expected market returns using a one-step DCF analysis.

The DCF analysis that Dr. Avera used to calculate the CAPM expected portfolio return uses short-term growth rates forecasted by IBES and Value Line, weighted 100%, rather than a two-thirds, one-third weighting of short and long-term forecasted growth rates, as in the Commission's two-stage DCF method. On exceptions, OMS demonstrated that such an approach is flawed because it assumes that growth rates that were estimated for the next five years (as forecasted for the 400-stock portfolio used in the analysis) will continue forever, a premise that is implausible.[95] OMS acknowledged that Opinion No. 531-B addressed this issue and found that while an individual company cannot sustain

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[92] OMS Brief on Exceptions at 37.
[93] Op. No. 551 at P 169.
[94] *Id.*
[95] OMS Brief on Exceptions at 34.

high short-term rates in perpetuity, the same cannot be said for a stock index like the S&P 500 that is frequently updated to contain only companies with high market capitalization.[96] OMS nevertheless explained that such a finding should not apply to Dr. Avera's CAPM in this case for the following reasons: (1) Dr. Avera did not use the S&P 500 portfolio itself, but rather a fixed portfolio of 400 stocks;[97] (2) by rejecting Dr. Avera's non-utility DCF analysis for its failure to incorporate a second-stage growth factor, the Initial Decision recognized that, over time, each company in Dr. Avera's portfolio will see its rate of growth trend downward toward the long-term Gross Domestic Product ("GDP") growth rate;[98] and (3) the beta component of the CAPM formulation does not serve the same purpose as the long-term growth-rate component of the two-step DCF analysis.

Opinion No. 551 agreed with OMS that beta does not serve the same function as the long-term growth rate component of the DCF, but ruled that a two-step DCF is not necessary to develop the market-risk premium in a CAPM analysis because the rationale that applies to a DCF study conducted on a group of utilities does not necessarily apply to a DCF study conducted on companies in the S&P 500.[99] The Commission further agreed with OMS that it is unrealistic and unsustainable for high short-term growth rates of an individual company to continue in perpetuity, but ruled that this flaw is overcome by the regular updates to the S&P 500 to include companies with high capitalizations.[100] Even

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[96] *Id.* at 35 (citing I.D. at P 304 and Opinion No. 531-B at P113).
[97] *Id.*
[98] *Id.* at 36.
[99] Op. No. 551 at P 170.
[100] *Id.*

assuming that the S&P 500 could sustain long-term growth essentially unconstrained by GDP (a dubious proposition at best),[101] MTO-30 used a *fixed portfolio* of 400 companies. These companies were selected because they had dividend paying stocks included in the S&P 500, but they should not be confused with the S&P 500 itself. The Commission dismissed OMS's exceptions on this issue, ruling that, because the companies were selected from the S&P 500 index, they had a high market capitalization at that time.[102] The Commission's reasoning is flawed for a number of reasons.

(i) *High capitalization does not insulate companies from the limitation of GDP growth.*

There is no basis in the record, or in logic, for the Commission to find that high capitalization protects the earnings growth rates of individual firms from trending downward toward the long-term GDP growth rate. Given Opinion No. 551's recognition that, in general, "high short-term growth rates for an individual company" cannot sustainably continue over the long term,[103] it follows that high short-term growth rates for a fixed portfolio of individual companies likewise cannot sustain high short-term growth rates over the long term. Moreover, both logic and the record show that large firms find it more difficult than small firms to continue growing over time at high rates. All else equal, a firm initially valued at $600 billion with a constant P/E ratio of 15 would have to grow its annual earnings by almost $64 billion in order to sustain 10% growth over ten

[101] JCI-4 at 48.
[102] Op. No. 551 at P 170.
[103] *Id.*

years.[104] In contrast, a firm initially valued at $6 billion with the same P/E ratio would have to grow its annual earnings by only about $0.64 billion in order to sustain the same growth over ten years. In a competitive economy, growth opportunities worth $60 billion per year are not easy to find. Indeed, if the fixed-portfolio of high capitalization firms could all continue growing indefinitely at the short-term rates relied upon in Exhibit MTO-30, they would grow larger than the entire economy in short order. Each high capitalization company included in Dr. Avera's fixed portfolio must therefore be expected to see its growth rate trend downward toward the long-term GDP growth rate, and the fixed portfolio's rate of growth therefore must likewise trend downward toward the long-term GDP growth rate.

(ii) *Three witnesses explained why not using long-term growth rate is an error.*

Joint Customer Intervenors' Witness Solomon explained that the high-market-capitalization companies that constitute the Exhibit MTO-30 fixed portfolio are even more likely than the typical "individual company" to see their rates of growth trend toward that of the overall economy.[105] Similarly, Complainants' Witness Gorman testified that "a reasonable projected return on the market should reflect the expectation of non-constant growth," and supported finding the sustainable market-wide growth rate by applying a GDP constraint at one-third weighting.[106] More generally, Joint Consumer Advocates' ("JCA") Witness Hill testified that analysts' short-term growth expectations

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[104] Arithmetically, $600 billion market capitalization*($1/15 earnings/$1 price earnings)=$40 billion annual earnings; 10% annual growth compounded over ten years implies that earnings multiply by almost 2.6 over that period; and($40 billion * 2.6) - $40 billion = $64 billion.

[105] JCI-4 at 48.

[106] JC-9 at 18:11-19:6.

overstate long-term sustainable growth for S&P 500 companies, and that a two-stage methodology would produce a more realistic CAPM equity market return.[107] Opinion No. 551 does not even discuss, much less provide a reasoned explanation for disregarding, these witnesses' testimony on this crucial point. The Commission's failure to address the testimony highlighting this flaw in the MISO TOs' CAPM evidence, and its reliance on Dr. Avera's CAPM study notwithstanding the flaw, was arbitrary and capricious and not the product of reasoned decision-making.

(iii) *Investment community sources in the record use GDP-constrained calculations.*

Pacific Investment Management Company, LLC ("PIMCO") (one of the largest investment-management firms in the U.S., overseeing more than a trillion dollars of investment) relies on, and provides to investors, equity risk premiums that compare debt interest rates to equity returns that embody country-specific cyclically adjusted earnings yields in which expected earnings growth is based on per capita real GDP growth estimates.[108] Applying that more realistic approach, PIMCO anticipates a 10-year return on U.S. equities of 4.5%,[109] far below the 11.3% market return presented in Exhibit MTO-30. Comparing the projected 10-year return for the S&P 500 to inflation-protected 10-year Treasuries, PIMCO calculates a forward-looking[110] U.S. equity risk premium of 3.9%.[111] This is in line with the 4.0% historical average,[112] and is less than half of the

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[107] JCA-11 at 28:16-29:28.

[108] S-11 at 17.

[109] *Id*. at 6.

[110] *Id.* at 9.

[111] *Id.* at 10.

[112] *Id.* at 4-5.

8.6% equity risk premium claimed in Exhibit MTO-30. Similarly, as of the study period, both the American Appraisal Risk Premium Quarterly and a leading Professor of Finance calculated a forward-looking equity risk premium of 6.0%,[113] and Duff & Phelps calculated a forward-looking equity risk premium of 5.0%.[114] Thus, the GDP growth-unconstrained Market Return and resulting Risk Premium presented in Exhibit MTO-30 are both drastically out of line with the forecasts forward-looking (and historical)[115] investment-community sources.

Any CAPM premised on a DCF analysis of such a portfolio should apply a two-stage DCF analysis. Applying this necessary adjustment to Exhibit MTO-30 would produce a portfolio-wide growth rate of 7.4%.[116] Flowing that change through Exhibit MTO-30 lowers its risk premium to 7.1% and lowers its implied cost of equity range to 6.60%–11.18%, with a midpoint of 8.89%.[117]

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[113] JCI-4 at 46:12-20.

[114] JCI-4 at 47:1-5.

[115] JCA-1 at 21:21-27; JCI-4 at 44-45.

[116] MTO-30 first-stage growth rate is 8.9% (see column associated with note “b”), and the second-stage growth rate is 4.39%, Opinion No. 551 P 21. Applying the 2/3 weighting that Opinion No. 551 applies to the first stage, (8.9%+8.9%+4.39%)/3 = 7.4%.

[117] Because flowing this change through MTO-30 affects all proxies’ “Unadjusted Ke” in the same proportionate way, and the size adjustment is additive (or subtractive) and not affected by this change, the effect of this adjustment on the Exh. MTO-30 midpoint can be found by simply applying it to the two proxies that form its range. For Duke Energy Corp., a risk premium of 7.10% multiplied by its 0.6 beta produces an Unadjusted Ke of 6.96%, and subtracting a 0.36% size adjustment produces a range bottom of 6.60%. For Black Hills, a risk premium of 7.10% multiplied by its 0.95 beta produces an Unadjusted Ke of 9.44%, and adding a 1.74% size adjustment produces a range top of 11.18%. Parallel calculations applied to the entire proxy group would produce a median of 8.93%, which is a better distillation of the adjusted CAPM indicator.

3 Erroneous incomplete application of size adjustment.

Dr. Avera's CAPM methodology includes a generally upwards "size adjustment," without which the Exhibit MTO-30 midpoint would be 8.6%.[118] The rationale for justifying this upward adjustment is the claim that "differences in investors' required rate of return that are related to firm size are not fully captured by beta."[119] Joint Consumer Advocates' Witnesses Hill[120] and Complainants' Witness Gorman,[121] however, demonstrated that, to accurately infer the required return *for utilities* from betas, it is best to either consider the size adjustment and the industry adjustment together, or consider neither, whereas considering the size adjustment without the industry adjustment distorts the relationship to the point where the result is less reliable than if neither adjustment had been made. Opinion No. 551 asserts that it would be inappropriate to add an industry risk premium to the CAPM analysis because the proxy group betas themselves already capture industry risk and required returns.[122] The Commission, however, fails to explain why the proxy group betas already capture industry risk and required returns completely, but do *not* capture size-related risk and required returns. In short, a reasonably-applied CAPM methodology points to a base ROE below 9.0%. *A fortiori*, that alternate benchmark cannot support a base ROE of 10.32%.

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118 The average of the two "Unadjusted Ke" values calculated in note 117 above is 8.6%, and represents the midpoint of Exh. MTO-30 adjusted to reflect a GDP growth constraint and remove the "size adjustment."

119 Op. No. 551 P 140.

120 JCA-11 at 29-33.

121 JC-9 at 20-21.

122 Op. No. 551 P 166.

E. The Commission Erred by Relying on Ms. Lapson's Flawed State ROE Analysis to Place the Base ROE Above the DCF Midpoint.

The Commission erred by concluding that "the state-authorized ROE study presented by MISO TO witness Ellen Lapson corroborates the view that a conventional application of the DCF methodology produces results that do not satisfy *Hope* and *Bluefield*."[123] To support this conclusion, the Commission relied on the erroneous finding that investing in MISO TOs' Commission-regulated electric transmission entails risks that are "at least as great" as those faced by investors in integrated electric utilities.[124] That finding itself is flawed and unsupportable, for the following reasons.

1 The Commission's risk-comparability finding was in error.

OMS explained on exceptions that evidence in the record does not support a finding that investors in the MISO TOs' transmission business face risks at least as great as those of the state-regulated integrated utilities, particularly generation.[125] Opinion No. 551, however, disregards the arguments of OMS and others on this point and relies, instead, on Ms. Lapson's testimony regarding: (1) a purported similarity in the siting hurdles and development risks faced by transmission and generation; and (2) the MISO TOs' high capital expenditure ("CAPEX") levels.[126]

Ms. Lapson's high-level comparison of transmission and generation siting and development risks cannot reasonably be relied upon as the basis for a broad conclusion that investments in integrated utilities entail risks that are similar to those faced by

[123] Op. No. 551 at P 250.
[124] *Id.*
[125] OMS Brief on Exceptions at 41.
[126] Op. No. 551 at PP 253, 254.

transmission developers. Even if one were to take Ms. Lapson's high-level risk assessment on its face, the reality is that generation is subject to competition, while transmission (recognized to be a natural monopoly) is not. This means that the revenue stream available to generation investors is volatile (depending on market prices for energy and capacity), while the revenue stream of transmission investments is highly predictable, especially where the assets are under formula rate. This fact by itself should have been sufficient for the Commission to eschew such a broad finding. In addition, Joint Consumer Advocates' Witness Hill's testimony directly contradicts that of Ms. Lapson's on this point. As JCA Witness Hill explained, the investment community perceives investments in transmission as involving lower risks than investments in fully integrated utilities with generation assets.[127] The Initial Decision discounted Mr. Hill's proof on this point based essentially on Ms. Lapson's discussion of the MISO TOs' CAPEX commitments,[128] testimony which the Commission also relied on in Opinion No. 551.[129]

It was in error for the Commission to rely on Ms. Lapson's testimony concerning the MISO TOs' CAPEX levels as a factor justifying an upward ROE adjustment beyond the DCF midpoint. Evidence in the record shows that the MISO TOs' ratio of CAPEX to operating cash flows is similar to that of utilities in the proxy group.[130] This means that state regulated integrated utilities with transmission and generation assets have the same

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[127] JCA-1 at 35:17-22.

[128] I.D. at PP 384-395.

[129] Op. No. 551 at PP 253 and 254.

[130] JCA-11 at 59: 4-12 (Mr. Hill explains that according to Table 3 of Exhibit No. MTO-16 at 35, the median MISO TOs' capital expenditures were 104% of operating cashflow while the same parameter for the national proxy group of utilities was 105%).

CAPEX to cashflow risks as the MISO TOs, in addition to all of the unique risks associated with generation investments. As such, the MISO TOs' CAPEX levels do not support a finding that investment risks associated with integrated utilities and the MISO TOs are similar, or a decision to place the base ROE above the midpoint.

Most importantly, the level of return required by investors is commensurate with the level of risks they undertake.[131] Therefore, utilities with similarly situated risk profiles (*i.e.* transmission utilities and integrated utilities) require similar returns. Even if the Commission's risk comparison finding was germane, it is unjust and unreasonable to place the base ROE above the ROE that states have approved for integrated utilities, which are purportedly facing similar risks. Nearly 90 percent of the state-authorized ROEs for integrated utilities are below the established 10.32% base ROE[132] and all the state-authorized ROEs for distribution-only utilities are below the 10.32% base ROE. If one were to accept the Commission's risk comparability finding, it follows that the approved 10.32% base ROE does not comply with the *Hope* and *Bluefield* requirement that the return of a utility be commensurate with the return earned by entities with a similar risk profile.

2 <u>The Commission's finding that the downward trajectory of state ROEs did not affect the reliability of Ms. Lapson's state-authorized ROE study was in error</u>.

Opinion No. 551 erroneously finds that OMS's proof concerning the downward trajectory of state-authorized ROEs is not enough, in and of itself, to overcome the fact that the DCF midpoint is below the "vast majority" of the state-authorized ROEs that

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[131] MTO-16 at 13: 1-8, and 46:12-17; OMS-16; Tr.355: 20-24; Tr.356: 1-20.
[132] Exh. No. MTO-42 at 4.

became effective during Ms. Lapson's study period (*i.e.* April 1, 2013 through March 31, 2015).[133] This finding fails to recognize that, unlike the DCF model, Ms. Lapson's state-authorized ROE study is not limited to the most current 6-month data; rather, it includes data from a two-year study period. Given the downward trajectory of state-authorized ROEs, a more recent study period would show lower ROE averages,[134] while a longer study period (including less recent data) would show higher ROE averages. As a result, Ms. Lapson's state-authorized ROE study with a two-year study period overstates the cost of equity. This overstatement is particularly relevant when considering the close clustering of the mean (9.45%), median (9.55%), and midpoint (9.41%) of the state-authorized ROEs for distribution only utilities,[135] and the midpoint of the Initial Decision's DCF (9.29%). Further, the difference in study periods renders a comparison between the results of Ms. Lapson's state-authorized ROE study and the results of the conventional DCF essentially meaningless.

3 <u>The Commission's failure to consider the risk-reducing attributes of formula rates was in error</u>.

As Mr. Solomon explained, while state commission rate proceedings often result in regulatory lags that can cause integrated utilities to earn less than their state-authorized ROEs,[136] the MISO TOs' wholesale formula rates provide for timely recovery of their actual costs of service, including FERC-authorized ROEs, through their Attachment O

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[133] Op. No. 551 at P 251.

[134] JC-26

[135] I.D. at P 400.

[136] JCI-4 at 33:22-34:12 (discussing JCI-7 at 110-113 and showing that the average of state-authorized ROEs approved in 2013 was 9.84%, whereas the average base ROE earned by the utilities receiving those authorizations in 2014 was only 8.61%).

charges.[137] FERC Trial Staff put on the record a Moody's Investor's Service Report explaining that mechanisms allowing for timely cost recovery "offset falling ROEs."[138]

Opinion No. 551 affirmed the Initial Decision's finding that the use of formula rates "does not warrant a lower base ROE."[139] The Commission reasoned that "[t]o the extent that formula rates reduce risks, they would… improve credit ratings. This would in turn affect the DCF proxy group based on screens requiring a group of similarly-rated utilities, diminishing the ROE produced by the DCF analysis."[140] In other words, the Commission's justification for not considering the risk-reducing attributes of formula rates is that any such risk-reduction is already reflected in the choice of DCF proxy group. The Commission's apparent concern is that an adjustment based on the risk-reducing effects of a formula rate would reduce the ROE twice.[141] This erroneous reasoning ignores that OMS and other parties are not offering this evidence to challenge the results of the DCF, but as a factor to consider when determining if the midpoint of the DCF meets the *Hope* and *Bluefield* standards.

To the point, if the Commission is no longer relying on DCF results and is instead relying on extrinsic factors, it should take into account the risk-mitigating attributes of formula rates, particularly in determining whether Ms. Lapson's state-authorized ROE study for integrated utilities supports placing the base ROE at the Upper Midpoint. The importance of taking this factor into account is heightened by the Commission's

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[137] JCI-1 at 32-33; JCI-4 at 33:14-21; JCA-1 at 40; JCA-11 at 49; and JCA-13.
[138] S-3 at 14.
[139] Op. No. 551 at P 297.
[140] *Id.*
[141] Op. No. 551 at PP 288, 297.

acceptance of evidence concerning the MISO TOs' CAPEX forecasts as a risk-*heightening* factor,[142] even though the MISO TOs' CAPEX levels are not abnormal among public utilities.[143] Yet, the Commission made no attempt to explain why the risk-increasing attributes of CAPEX are not factored into the proxy-group credit rating risk assessment, while the risk-mitigating attributes of formula-rates are. It is arbitrary and capricious for the Commission to consider only risk-increasing factors but to reject evidence of the risk-reducing attributes of formula rates. Similarly, the Commission has failed to explain why the risk-increasing attributes of CAPEX are relevant in establishing the risk comparability between transmission and state-regulated assets, while the risk-reducing attributes of formula rates are not. On that basis, the Commission's reliance on Ms. Lapson's state ROE study is unsupported by a reasoned evaluation of the evidence in the record, and therefore is arbitrary and capricious.

F. The Commission Erred by Relying on Conjectures About the Impact of a Lower ROE on New Transmission Investments to Place the Base ROE Above the Midpoint.

A further reason the Commission cites for rejecting use of the DCF midpoint is that "an overly large ROE reduction will reduce MISO TOs' ability to fund new transmission investment with the profits from their existing operations."[144] The record provides no support for that finding. Even assuming a utility would fund a significant transmission project from free cash flow (highly unlikely),[145] reducing the base ROE to

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[142] Op. No. 551 at PP 253 and 254.

[143] JCA-11 at 59: 4-12.

[144] Op. No. 551 at P 262.

[145] The Commission cannot expect that developers finance new transmission investments using only (or primarily) profits from operation of existing transmission assets. Such an approach would prevent non-

the DCF midpoint would at most eliminate whatever cash flow benefits are attributable to an excessive ROE, but that is not a benefit to which the TOs can claim an entitlement.

Neither does the record support a claim that the MISO TOs' access to external capital would be impaired by setting the base ROE at the DCF midpoint.[146] A change in cash flow might affect a utility's access to capital only in the most extreme situations—for example, where cash flow becomes insufficient to pay interest on debt already outstanding—but there is no suggestion here that resetting the base ROE to the DCF midpoint would have that effect.

On the contrary, evidence in the record shows that: (1) credit rating agencies see investments in electric utilities as stable, despite ROE reductions;[147] (2) the level of capital investments in the utility industry doubled during a time of increasing rate case activity and declining authorized ROEs;[148] and (3) there are plenty of developers on MISO's Qualified Developer list willing to participate in competitive transmission

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incumbent developers (with no transmission assets in MISO) from competing in regional or inter-regional processes to build new transmission, contrary to the goals of Order No. 1000.

[146] Op. No. 551 at P 262 ("an overly large ROE reduction could cause MISO TOs' credit ratings and/or other measures of financial health to deteriorate, impairing their ability to raise external capital to fund new transmission facilities").

[147] S-3 at 14 (the Moody's Investors Service Report dated March 10, 2015 states that utilities' cashflows are somewhat insulated from lower ROEs because the utilities' net income represents between 30%-40% of utilities' cash flow, "so lower authorized returns won't necessarily affect cash flow or key financial credit ratios, especially when the denominator (equity) is rising."); MTO-16 at 62:6-8 (Ms. Lapson recognizes that credit rating agencies frequently assert that they do not base their ratings or their ratings upgrades or downgrades simply on ROE decisions). Ms. Lapson asserts, however, that for those MISO Transmission Owners with large CAPEX budgets, weaker internal cash flow measures following a reduced ROE determination *could* trigger a negative credit watch status or a downgrade. However, consistent with the Commission's findings in Op. No. 551 concerning formula rates and capital structures, the specific risks associated with the purported high CAPEX levels of certain MISO TOs (including potential cash flow reductions) are accounted for in the Commission's credit rating screens used for the formation of the DCF proxy group. As such, the high CAPEX levels of some MISO TOs deserve no separate consideration in deciding where to place the base ROE within the DCF zone of reasonableness. Further, as explained by Mr. Hill, the MISO TOs' CAPEX levels are not significantly higher than those of the utilities in the proxy group (*see* JCA-11 at 59: 4-7).

[148] JC-1 at 11: 12-14.

processes to build MEPs and MVPs despite the proceedings to reduce the base ROE of the MISO TOs.[149]

Nevertheless, the Commission accepted Ms. Lapson's speculation that a radical reduction in MISO TOs' base ROE "***could*** cause investors to shift their capital to state-regulated utilities, which ***may*** have a similar risk to MISO TOs and, as discussed above, ***may*** earn an ROE greater than the midpoint of the zone of reasonableness, making them significantly more attractive investments."[150] The Commission also relied on Ms. Lapson's testimony about a UBS report noting a "***perception***" that investors were already beginning to react to the potential for lower base ROEs by shifting their investment capital to state-regulated electric and gas retail distribution investments.[151] Similarly, MISO TO Witness Kramer merely speculates that reducing the base ROE to the midpoint of the DCF range "***could*** reduce the capital available to invest in larger and more widely beneficial transmission projects."[152] All that this evidence shows is that investors may (or may not) react negatively to a large reduction of the base ROE.

The Commission cannot lawfully place the base ROE of the MISO TOs above the midpoint based on conjectures about how the market may react to a large ROE reduction. Indeed, the Supreme Court has ruled that "[t]he Commission cannot confine its enquiries to… conjectures about the prospective response of capital markets."[153] Relying on such conjectures is particularly unsuitable in this case because, as the MISO TOs recognize,

[149] OMS-1.
[150] Op. No. 551 at P 262 (emphasis added).
[151] *Id.*
[152] MTO-21 at 26:18-20 (emphasis added).
[153] *In re Permian Basin Area Rate Cases,* 390 U.S. 747, 791 (1968).

investors in new transmission projects are not solely driven by the base ROE, but also by FERC- approved transmission rate incentives.[154] Moreover, the DCF and other empirical analyses presented in the record and relied upon in Opinion No. 551 reflect a study period (November 2014 through April 2015) that post-dates the Commission's June 2014 issuance of Opinion No. 531, which materially reduced the only other RTO-wide base ROE. If the conjecture that ROE regulation significantly dissuades investment had any factual basis, those analyses as presented in this case would have indicated higher capital costs than the similar analyses rejected in Opinion Nos. 531 and 531-B. Instead, the opposite is true: after Opinion No. 531 reminded investors that Federal Power Act Section 206 remains in the statute books, the indicated cost of transmission equity declined.

G. The Commission Erred by Relying on the Magnitude of the Rate Reduction as a Reason for Placing the Base ROE Above the Midpoint of the DCF Range.

Given the speculative character of the record evidence suggesting that "too big" an ROE reduction would impair transmission investment, the conclusion becomes inescapable that what drove the Commission to set the base ROE well above the DCF midpoint was simply the magnitude of the ROE reduction itself. To the extent the Commission's action was driven by the bare fact of a significant (but appropriate) reduction, its reliance on that factor was error, for several reasons. First, the Commission failed to explain why a reduction of 206 basis points (*i.e.* from 12.38% to 10.32%) would be acceptable to investors while a reduction of 309 basis points (*i.e.* from 12.38% to

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[154] MTO-1 at 104:22-26, 105:1-5, 111:13-17.

9.29%) would not. To be sure, the record contained no evidence to that effect for the simple reason that the ultimate outcome (10.32%) was not known when the record was developed. Second, significant reductions and rate increases are not unprecedented. The Commission has approved return reductions greater than 175 basis points and even greater than 309 basis points in the past.[155] The Commission also has approved settlements that included significant ROE reductions after Opinion No. 531 was issued, which is important not because a settlement is a determination of ROE on the merits (they aren't) but because the utilities that were parties to those settlements must have determined that significant ROE reductions would not adversely affect their access to capital at reasonable costs. [156] The Commission has also approved rate *increases* greater than 175 basis points.[157] Third, the magnitude of a rate reduction has no bearing on the

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[155] *See, e.g., Overthrust Pipeline Co.,* 53 FERC ¶ 61,118, 61,372 (1990) (approving an ROE reduction of 280 basis points); *Kinder Morgan Interstate Gas Transmission LLC,* 133 FERC ¶ 61,157, PP 5, 6, 8 (2010) (provisionally finding that an over 1,000 basis point reduction of Kinder Morgan's ROE could be justified based on preliminary Commission findings and instituting Natural Gas Act section 5 proceedings. Ultimately, a 27 percent reduction of rates was agreed upon by the parties and accepted by FERC. *See* Initial Comments of the Commission Trial Staff in Support of Settlement, Docket No. RP11-1494-000, at 4 (May 16, 2011) (Accession No. 20110516- 5122)).

[156] *See, e.g., Municipal Electric Utilities Association of New York v. Niagara Mohawk Power Corporation and New York Independent System Operator, Inc.,* 151 FERC ¶ 61,121 (2015) and Complaint of the Municipal Electric Utility Association of New York and Request for Fast Tracking Processing, Docket No. EL13-16-000, at 2 (Nov. 11, 2012) (Accession No. 20121102-5192) (approving a Base ROE of 9.8 percent, a reduction of 170 basis points from initial 11.5 percent Base ROE); *PJM Interconnection, L.L.C., et al.,* 151 FERC ¶ 61,029 (2015) and PJM Interconnection, L.L.C., Duke Energy, Ohio, Inc., Duke Energy Kentucky, Inc. Settlement Agreement, Docket Nos. ER12-91-000 *et al*., and ER12-92-000 *et al.,* at 13 (Oct. 30, 2014) (Accession No. 20141030-5068) (approving a Base ROE of 10.88 percent, a phased-in reduction of 150 basis points from initial 12.38 percent Base ROE); *MidAmerican Central California Transco, LLC,* 151 FERC ¶ 61,251 (2015) and Offer of Settlement and Stipulation of MidAmerican Central California Transco, LLC, Docket No. ER14-1661-000, at 4, (Apr. 8, 2015) (Accession No. 20150408-5208) (approving a Base ROE of 9.8 percent, a reduction of 100 basis points from initial 10.8 percent Base ROE); and *ATX Southwest, LLC,* 155 FERC ¶ 61,143 (2016) and Request for Transmission Rate Incentives and Transmission Formula Rate Filing of ATX Southwest, LLC, Docket No. ER15-1809-000 at 4, (May 28, 2015) (Accession No. 20150528-5334) (approving a Base ROE of 9.9 percent, a reduction of 100 basis points from initial 10.9 percent Base ROE).

[157] *See e.g., Midwest Indep. Transmission Sys. Operator, Inc*., 100 FERC ¶ 61,292, (2002) (approving an ROE increase of 238 basis points for the MISO TOs).

reasonableness of the rate itself. It simply shows the disparity between a reasonable rate and the current rate, such that the more unreasonable the current rate is, the larger the reduction that is necessary to comply with the FPA requirement to set a just and reasonable rate. From this perspective, considering the magnitude of the rate reduction as evidence that supports a higher ROE inherently favors utilities with higher ROEs as a starting point. In other words, contrary to the law, it would favor those utilities with the most unjust and unreasonable rates. Such a result cannot be thought permissible under the FPA.

Finally, it is implicit but undeniable that mitigating an ROE decrease based simply on the size of the unmitigated reduction has the effect of leaving in place some measure of excessive charges. The decisional law is clear, however, that the FPA does not make room for a little bit of unjustness and unreasonableness in rates.[158]

H. The Commission Erred by Rejecting, Without Explanation, OMS's Arguments Concerning Transmission Rate Incentives and, Instead, Placing the Base ROE Above the Midpoint to Incentivize Construction of Riskier Transmission Projects.

The Commission erred by affirming, without discussion, the Initial Decision's findings regarding the appropriateness of setting the base ROE above the midpoint in order to incentivize investment in riskier transmission projects.[159] MISO TO Witness Kramer testified that placing the base ROE at the points proposed by Complainants and supporting intervenors would "result in greater focus on development of baseline

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[158] *See FPC v. Texaco Inc.,* 417 U.S. 380, 399, 94 S.Ct. 2315, 2327, 41 L.Ed.2d 141 (1974) (holding that "the [Natural Gas] Act makes unlawful all rates which are not just and reasonable, and does not say a little unlawfulness is permitted").

[159] Op. No. 551 at P 10.

reliability projects and other local projects in lieu of Market Efficiency Projects ("MEPs") or Multi Value Projects ("MVPs") that present ***greater risk*** due to their larger scales, greater cost, broader scope, and greater likelihood of involvement by multiple owners and multiple state regulatory authorities."[160] As OMS explained, however, *Hope* and *Bluefield* do not require placing the base ROE at a point that incentivizes the construction of riskier transmission projects.[161] The base ROE must allow the MISO TOs to attract enough capital to discharge their "public duties."[162] The MISO TOs have no obligation/duty to build risky MVPs and MEPs. In fact, the premise of Mr. Kramer's testimony is that the MISO TOs have a choice between building local, less risky transmission projects or investing in "greater risk" MVPs and MEPs. If there is a choice, there is no obligation/duty to build one type over the other.

The way to incentivize these greater risk investments (promoting greater efficiencies and other policy objectives) is through Section 219 proceedings. The Commission has explained that, "[i]n contrast to a base-level ROE that reflects the financial and regulatory risks of an investment, an 'incentive' has been more typically associated with specific basis point additions to a base ROE to satisfy discrete policy objectives."[163] From this perspective, to the extent a specific transmission project presents risk that exceeds the company-wide business and financial risk already

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[160] MTO-21 at 28:7-10 (emphasis added).
[161] OMS Brief on Exceptions at 47-51.
[162] *Bluefield* at 693.
[163] Order No. 679-A at Page 12, n.19.

addressed in the base ROE, the developer should be required to demonstrate those higher risks to FERC and interested stakeholders in a Section 219 proceeding.[164]

The Commission erred by affirming, without explanation,[165] the Initial Decision's dismissal of OMS's argument that, based on the availability of Section 219 incentives, the riskiness of transmission projects should not be a factor in setting the base ROE. The Presiding Judge rejected OMS's argument on the basis that taking the availability of incentives into account would be "inappropriate" in light of the Commission's ruling in paragraph 156 of Opinion No. 531.[166] In that paragraph, the Commission responded to arguments raised in the EL16-66 proceeding that: (1) the DCF methodology is designed to attract investment and that ROE adders are available if the base ROE fails in that respect; and (2) policy considerations for placing the base ROE above the midpoint are only appropriate when the Commission considers rate incentives.

Here, though, OMS is not arguing that the base ROE must be placed at the DCF midpoint even if such placement fails to meet the *Hope* and *Bluefield* standards, nor is OMS arguing that placing the base ROE above the midpoint is appropriate only through Section 219 incentives. OMS recognizes that, at all events, the base ROE must satisfy *Hope* and *Bluefield,* and that the Commission has the authority to place the base ROE above the DCF midpoint if doing so is necessary to meet the *Hope* and *Bluefield* standards. OMS's real concern is that placing the base ROE above the midpoint to support investment in new riskier transmission projects will overcompensate both

[164] OMS Brief on Exceptions at 50.
[165] Op. No. 551 at P 10.
[166] I.D. at P 378.

existing transmission and mostly new transmission. The Commission did not address this concern in Opinion No. 531, *et al,* nor did it do so here.

In MISO, the same base ROE applies to both existing transmission and new transmission (unlike in other RTOs/ISOs). In recognition of that structure, OMS explained on exceptions that, if the base ROE were bumped up above the DCF midpoint in order to satisfy the higher returns required by investors in riskier new transmission projects, a transmission owner would be overcompensated for its existing transmission assets, which do not face the "greater risks" described by MISO TO Witness Kramer.[167] Such overcompensation violates the *Hope* and *Bluefield* standards because the return is not commensurate with the risks borne by the utility and, as such, results in exploitation of customers.

Furthermore, a higher ROE will not necessarily support the development of MVPs and MEPs in MISO and, indeed, may impede such development. It is undisputed that, all things being equal, investors demand higher returns to undertake greater risks and will accept lower returns when undertaking lower risks.[168] This premise leads to the conclusion that—contrary to Mr. Kramer's assertions[169]—a higher base ROE will *not* prompt investors to undertake riskier MVPs and MEPs if they can choose to build less risky transmission projects that pay the same base ROE. Regardless of how high the base ROE is set, investors will always opt for the lower risk/same return alternative. The only outcome of placing the base ROE above the midpoint to incentivize construction of

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[167] OMS Brief on Exceptions at 50 at 51.

[168] MTO-16 at 13: 1-8, and 46:12-17; OMS-16; Tr.355: 20-24; Tr.356: 1-20.

[169] MTO-21 at 28: 7-10.

riskier new transmission is that transmission owners will be overcompensated on the bulk of their assets.

At the same time, this overcompensation may operate to impede the competitive development of MEPs and MVPs in MISO. This is so for at least two reasons. First, non-incumbent transmission developers (without transmission assets in MISO) would not have access to the same return windfalls on existing transmission and normal-risk new transmission investments to finance riskier transmission projects that the MISO TOs would have. As such, the overcompensation described above may deter entry and produce *less* competition in transmission planning and development than would otherwise be the case. Second, because total ROE cannot be greater than the top of the DCF range, placing the ROE at the Upper Midpoint limits the Commission's flexibility to approve ROE adders.[170] This limitation on flexibility, while providing no benefits to consumers, could prove to be problematic as the Commission attempts to encourage development of large regional and inter-regional projects having demonstrable, unique risks.[171]

Rather than addressing these fundamental issues head-on, the Commission instead chose the easier route of affirming the Initial Decision's finding that OMS had not proved

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[170] Consistent with FERC precedent, the total ROE of a utility (including base ROEs and incentive adders) must stay within the DCF zone of reasonableness. *See, e.g.,* Opinion No. 531 at P 164; Order No. 679-A at P 15; *Midcontinent Indep. Sys. Operator, Inc*., 150 FERC ¶ 61,004, P 2 (2015) ; *Midcontinent Indep. Sys. Operator, Inc*., 150 FERC ¶ 61,252, P 41 (2015); *Trans Bay Cable LLC,* 145 FERC ¶ 61,151, P 19 (2013); *Pac. Gas & Elec. Co.,* 141 FERC ¶ 61,168, PP 4, 26 (2012); *Atl. Path 15, LLC,* 135 FERC ¶ 61,037, P 20 (2011).

[171] The top of the zone of reasonableness established in Op. No. 551 is 11.35%. This means that there is a little over 100 basis points for ROE incentive adders. If we deduct the 50 basis points for unnecessary RTO participation adders, this leaves the Commission with a margin of about 50 basis points to incentivize development of transmission projects with demonstrated risks that cannot be mitigated through other transmission rate incentives.

the existence of these construction-deterring risks.[172] What the Commission failed to appreciate, though, is that it was unnecessary for OMS to prove the existence of these risks because the MISO TOs, through their witness Mr. Kramer, had already conceded their existence.[173] Mr. Kramer's testimony was admitted into evidence and the Presiding Judge relied on it to find that a base ROE at the midpoint could impair transmission investments.[174]

While OMS supports the greater benefits that can be accomplished with certain regional and inter-regional transmission projects, the way to realize these benefits is not by approving a base ROE above the midpoint. OMS is concerned that such unlawful overcompensation of most transmission investments in MISO will have negative (unintended) consequences for FERC and state policies. For example, overcompensation would result in shifting capital away from other electric infrastructure investments (*e.g.,* generation) necessary to support the long-term reliability of the grid, while providing no offsetting benefit to consumers. Such a policy also would allow the MISO TOs to bypass the Commission's scrutiny of project-specific risks and prevent challenges to the level of compensation for those greater risks by customers, state commissions, and consumer advocates. The Commission's rejection without explanation of OMS's exception on this critical point was arbitrary and capricious, and the resulting overcompensation of existing transmission and most new transmission investments is unlawful.

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[172] Op. No. 551 at P 10; and I.D. at P 477.
[173] MTO-21 at 28:4-10.
[174] I.D. at P 462.

I. The Commission Erred by Placing the Base ROE at the Upper Midpoint without Considering Record Evidence Showing that the Upper Midpoint is Unjust and Unreasonable.

The Commission erred in placing the base ROE at the Upper Midpoint without record evidence to support such a significant increase above the midpoint of the DCF range.[175] OMS argued on exceptions that the Commission cannot rely on alternative benchmarks and other evidence in the record to determine whether the midpoint of the DCF range satisfies the *Hope* and *Bluefield* standards and then reject consideration of the same benchmarks and evidence to determine whether the base ROE set by the Commission (here the Upper Midpoint) in fact meets the *Hope* and *Bluefield* standards.[176] Opinion No. 551 rejected OMS's position is that alternative benchmarks and evidence in the record point to a base ROE below the Upper Midpoint, ruling that the midpoints of the MISO TOs' risk premium (10.36%) and expected earnings (11.99%) analyses justified placing the base ROE at the Upper Midpoint.[177] The Commission, however, failed to acknowledge that: (1) most benchmarks and alternative studies in the record point to a lower base ROE; (2) upon performing date adjustments to Dr. Avera's risk premium analysis as explained in section C herein, the resulting cost of equity falls below the 10.32% base ROE; and, (3) upon performing necessary adjustments to the expected earnings analysis as explained in section B herein, the resulting cost of equity also falls below the 10.32% base ROE. The table below compares the 10.32% base ROE with

[175] Op. No. 551 at P. 67
[176] OMS Brief on Exceptions at 28-29.
[177] Op. No. 551 at P 280.

alternative benchmarks and studies in the record, as well as adjusted benchmarks proposed by OMS.

Study/ Benchmark	Cost of Equity	Difference with 10.32% (bp.)
Avera's CAPM[178]	10.06%	- 26
Gorman's CAPM[179]	9.23%	- 109
Hill's CAPM[180]	9.22%	-110
OMS Adjusted CAPM [181]	8.6%	-172
Avera's Risk Premium[182]	10.36%	+4
Hill's Risk Premium[183]	10%	-32
OMS Partially Adjusted Risk Premium[184]	9.89%	-43
Avera's Expected Earnings[185]	11.99%	+ 167
OMS Adjusted Expected Earnings[186]	9.79%	-53
State-Authorized ROEs (all-electric)[187]	9.84%	-48
Adjusted State-Authorized ROEs (all-electric)[188]	9.58%	-74
State-Authorized ROEs (integrated)[189]	10.23%	- 9
State-Authorized ROEs (distribution)[190]	9.41%	-91

The base ROE set by the Commission is higher than all other stated values, except for two flawed alternative benchmarks and studies in the record. As such, the 10.32%

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[178] MTO-30.

[179] JC-29.

[180] JCA-23.

[181] Adjusted CAPM using two-stage DCF for calculating expected market returns used in CAPM and eliminating size adjustment as explained in Section D herein.

[182] MTO-29.

[183] JCA-24 (median value used).

[184] Adjusted as invited by Op. No. 551 at 199 to use yield contemporaneous with date when ROE determination made, as explained in Section C herein.

[185] MTO-31.

[186] Adjusted Risk Premium by using median instead of midpoint to correct distribution irregularities and eliminating ITC holdings as an outlier as explained in Section B herein.

[187] MTO-39 at 53, table 8, and at 62, n 61.

[188] JC 26 (using most recent state-authorized ROE data in the record and within the DCF study period).

[189] MTO-39 at 53, table 8, and at 62, n 61.

[190] I.D. at P 400.

base ROE is clearly excessive and is in violation of the *Hope* and *Bluefield* standards. In Opinion No. 531, Commissioner Norris correctly stated in his partial dissent that:

> In future ROE cases, if parties wish to argue for an upward adjustment, they should make their case for the appropriate level of the adjustment. The Commission should then determine whether or not the record evidence in each individual proceeding warrants an adjustment, and if so, to what level.

To balance the interests of consumers and investors as required in *Hope* and *Bluefield*, the Commission cannot and should not systematically adopt the Upper Midpoint upon finding that the DCF inputs may be distorted by market anomalies. The record must support the level of any upward adjustment.[191] In this proceeding, the record does not show that the MISO TOs require an upward adjustment all the way to the Upper Midpoint, as shown above. Opinion No. 551 response to arguments that there is no evidence to support the specific upward adjustment is as follows:

> Such ***exactitude*** has never been required in determining the appropriate placement of ROEs within the zone of reasonableness or for determining the appropriate size of ***incentives***. The Commission maintains discretion to use its judgment in weighing factors specific to a given proceeding to determine where within the zone of reasonableness the final base ROE should be placed.[192]

The Commission does *not* have the discretion under the Federal Power Act to set a rate without any record support as to its justness and reasonableness. This approach is simply arbitrary and capricious, and is in violation of the Commission's statutory mandate to establish just and reasonable rates. Such "exactitude" is required by the Federal Power

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[191] *See, e.g., Sithe/Independence Power Partners, L.P. v. FERC*, 165 F.3d 944 (D.C. Cir. 1999) (holding that an agency "must be able to demonstrate that it has made a reasoned decision based upon substantial evidence in the record."); *National Fuel Gas Supply Corp. v. FERC*, 468 F.3d 831 (D.C. Cir. 2006) (holding that an agency's decision is arbitrary and capricious if its explanation for the decision "runs counter to the evidence before the agency").

[192] Op. No. 551 at P 277 (emphasis added).

Act,[193] and by court precedent[194] in order to protect customers, because a small difference in the base ROE has great financial implications for consumers. The Commission's "discretion" in this matter is tied to a reasonable assessment of evidence in the record. Further, the reference to incentives in the paragraph above should be clarified. As the Commission has recognized, the base ROE is not an incentive.[195] Using the base ROE to provide a generic incentive to all existing and new transmission without any correlation to corresponding risks will lead to overcompensation and exploitation of customers, as explained in section H herein.

Opinion No. 551 rejects the 75th percentile approach on the grounds that the Commission has previously used "measures of central tendency" in cases involving the placement of the base ROE above the central tendency of the zone of reasonableness.[196] This justification does not exclude the use of the 75th percentile approach because it is basically the median of the upper half of the DCF range. As such, this approach is a "measure of central tendency." Moreover, if the Commission was free to replace its decision to use the midpoint in setting the first generally-applicable MISO base ROE with use of the Upper Midpoint, then it was equally free to use the midpoint of any other

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[193] 16 U.S.C. §§ 824d, 824e; 5 U.S.C. § 706(2)(E) (2012).

[194] *See, e.g. Federal Power Commission v. Hope Natural Gas Co*., 320 U.S. 591 (1944) (holding that just and reasonable rates require balancing of the investor and the customer interests); *Bluefield Waterworks & Imp. Co. v. Public Service Commission of W. Va.*, 262 U.S. 679 (1923) (holding that while utilities have a right to just and reasonable returns, they don't have a constitutional right to profits); *FPC v. Texaco Inc.,* 417 U.S. 380, 399, 94 S.Ct. 2315, 2327, 41 L.Ed.2d 141 (1974) (holding that "the [Natural Gas] Act makes unlawful all rates which are not just and reasonable, and does not say a little unlawfulness is permitted"); *Morgan Stanley Capital Grp. Inc. v. Pub. Util. Dist. No. 1 of Snohomish Cnty., Wash.,* 554 U.S. 527, 564 (2008) (holding that Congress enacted the FPA precisely because it concluded that regulation was necessary to protect consumers from deficient markets); *Pub. Sys. v. FERC,* 606 F.2d 973, 979 n.27 (D.C. Cir. 1979) (holding that the Federal Power Act is intended to be a consumer protection statute).

[195] Order No. 679-A at P 15.

[196] Op. No. 551 at P 276.

subdivision of the entire DCF range, and thus remained free to place the base ROE anywhere within that range.

The Commission then proceeded to justify using the Upper Midpoint based on its policy to use the midpoint for a region-wide group of utilities such as the MISO TOs.[197] However, the *SoCal Order* cited in support of this policy refers to instances where the Commission places the base ROE at the central tendency of the DCF range, not above it. Opinion No. 551 broadly states that the determination in that case "is not altered" by the use of the Upper Midpoint[198] without any further reasoning or explanation. This explanation does not support the use of the Upper Midpoint. The range of values between the top and the bottom level of the DCF range is significantly broader than the range of values between the midpoint and the top of the DCF range. It is arbitrary and capricious for the Commission to dismiss concerns of overcompensation and exploitation of customers with a broad statement advocating for the mechanical application of the Upper Midpoint as a mathematical value, regardless of the evidence in the record pointing to a value below the Upper Midpoint. The Commission's preference for a mathematical point as a matter of general policy is no substitute for an obligation to place the base ROE at a point that satisfies the *Hope* and *Bluefield* requirements.

Finally, the automatic application of the Upper Midpoint advocated in Opinion No. 551 appears to contradict the Commission's express invitation in Opinion No. 531 to "support *any* ROE that is within the DCF derived zone of reasonableness." This open invitation confirms that the Commission policy on the use of the midpoint does not

[197] *Id.* (citing to *SoCal Edison*, 131 FERC ¶ 61,020 at P 93 ("SoCal Order"), aff'd in relevant part, *S. Cal. Edison Co. v. FERC*, 717 F.3d 177 at 185-87).
[198] Op. No. 551 at P 278.

foreclose consideration of other points within the DCF range. In fact, the Commission has placed ROEs at many different case-specific places within the DCF-derived zone.[199] Adopting an approach whereby only the Upper Midpoint is a valid placement of the base ROE for multiple utilities above the DCF midpoint[200] appears to contradict this precedent.

IV. <u>CONCLUSION</u>

WHEREFORE, OMS respectfully requests that the Commission grant this request for rehearing and reverse certain aspects of Opinion No. 551 as set forth herein.

Respectfully submitted,

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Counsel to the Organization of MISO States

Dated: October 28, 2016

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[199] *See, e.g.*, Portland Natural Gas Transmission System, Opinion No. 524, 142 FERC ¶ 61,197 P 382 (2013) (setting the ROE at the very top of the zone, because company-specific risk was not adequately captured by the DCF study); System Energy Resources, Inc., Opinion No. 446-A; 96 FERC ¶61,165 at pp. 61,732-33 (2001) (defining the zone of reasonableness as 10.42% to 11.3%, and setting refund-period and prospective ROEs of 10.58% and 10.94%, based on treasury yield trends applied to a finding of 10.8%; none of the latter three figures represents the midpoint of the defined zone).

[200] Op. No. 551 at P 572.

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 28th day of October, 2016.

/s/ Emily Ray
Emily Ray
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OMS Attachment 1: Adjustment 1 to MTO-29

Dating Corrected as to ITC Holdings (Page 5, "Jun-13" in original)

HISTORICAL BOND YIELDS

Current Equity Risk Premium	
(a) Average Yield Over Study Period	6.11%
(b) Baa Utility Bond Yield - Historical	4.55%
Change in Bond Yield	-1.56%
(c) Risk Premium/Interest Rate Relationship	-0.5221
Adjustment to Average Risk Premium	0.82%
(a) Average Risk Premium over Study Period	4.70%
Adjusted Risk Premium	**5.51%**

Implied Cost of Equity	
(b) Baa Utility Bond Yield - Historical	4.55%
Adjusted Equity Risk Premium	5.51%
Risk Premium Cost of Equity	**10.06%**

(a) See OMS Attachment 1, p.2
(b) Six-month average yield for Nov. 2014 - Apr. 2015 based on data from Moody's Investors Service, www.moodys.credittrends.com.
(c) See OMS Attachment 1, p.5

Dating Corrected as to ITC Holdings (Page 5, "Jun-13" MTO-29)

IMPLIED RISK PREMIUM

	(a)	(b), (b')	
	Average		
	Base	**BBB Utility**	**Risk**
Year	**ROE**	**Bond Yield**	**Premium**
2002	12.38%	8.02%	4.36%
2006	11.01%	6.32%	4.69%
2007	10.96%	6.33%	4.63%
2008	10.83%	7.25%	3.58%
2009	10.85%	7.06%	3.79%
2010	10.59%	5.98%	4.62%
2011	10.68%	5.57%	5.12%
2012	10.82%	4.86%	5.97%
2013	9.85%	4.98%	4.87%
2014	10.15%	4.80%	5.35%
		6.11%	4.70%

(a) OMS Attachment 1 pp.3-4
(b) Moody's Investors Service, www.credittrends.com (MTO-29).
(b') Exh. No. JC-2 line 17, citing Mergent Bond Record (for year 2002).

Dating Corrected as to ITC Holdings (Page 5, "Jun-13" in MTO-29)

ALLOWED ROE

Date	Docket No.	Utility	ROE
Sep-02	ER12-2681	ITC Holdings	12.38%
Apr-06	ER05-515	Baltimore Gas & Elec.	10.80%
Apr-06	ER05-515	Baltimore Gas & Elec.	11.30%
Oct-06	ER04-157	Bangor Hydro-Elec. Co.	11.14%
Nov-06	ER05-925	Westar Energy Inc.	10.80%
May-07	ER07-284	San Diego Gas & Elec.	11.35%
Aug-07	ER06-787	Idaho Power Co.	10.70%
Sep-07	ER06-1320	Wisconsin Elec. Pwr. Co.	11.00%
Nov-07	ER08-10	Pepco Holdings, Inc.	10.80%
Jan-08	ER07-583	Commonwealth Edison Co.	11.00%
Feb-08	ER08-374	Atlantic Path 15	10.65%
Mar-08	ER08-396	Westar Energy Inc.	10.80%
Mar-08	ER08-413	Startrans IO, LLC	10.65%
Apr-08	EL05-19	Southwestern Public Service	9.33%
Apr-08	ER08-92	Virginia Elec. & Power Co.	10.90%
May-08	EL06-109	Duquesne Light Co.	10.90%
Jun-08	ER07-549	NSTAR Elec. Co.	10.90%
Jul-08	ER08-375	So. Cal Edison (a)	9.54%
Jul-08	ER07-562	Trans-Allegheny	11.20%
Jul-08	ER07-1142	Arizona Public Service Co.	10.75%
Aug-08	ER08-1207	Virginia Elec. & Power Co.	10.90%
Aug-08	ER08-686	Pepco Holdings, Inc.	11.30%
Sep-08	ER08-1233	Public Service Elec. & Gas	11.18%
Oct-08	ER08-1423	Pepco Holdings, Inc.	10.80%
Oct-08	EL08-74	Central Maine Power Co.	11.14%
Oct-08	ER08-1402	Duquesne Light Co.	10.90%
Nov-08	ER08-1548	Northeast Utils Service Co.	11.14%
Nov-08	EL08-77	Central Maine Power Co.	11.14%
Dec-08	ER09-14	NSTAR Elec. Co.	11.14%
Dec-08	ER09-35/36	Tallgrass / Prairie Wind	10.80%
Dec-08	ER07-694	New England Pwr. Co.	11.14%
Feb-09	ER08-1584	Black Hills Power Co.	10.80%
Mar-09	ER09-75	Pioneer Transmission	10.54%
Mar-09	ER09-548	ITC Great Plains	10.66%
Mar-09	ER09-249	Public Service Elec. & Gas	11.18%
Apr-09	ER09-681	Green Power Express	10.78%
May-09	ER09-745	Baltimore Gas & Elec.	11.30%
Jun-09	ER08-552	Niagara Mohawk Pwr. Co.	11.00%
Jun-09	ER07-1069	AEP - SPP Zone	10.70%
Jun-09	ER08-1457	PPL Elec. Utilities Corp.	11.10%
Jun-09	ER08-1457	PPL Elec. Utilities Corp.	11.14%
Jun-09	ER08-1457	PPL Elec. Utilities Corp.	11.18%
Jun-09	ER08-281	Oklahoma Gas & Elec.	10.60%
Aug-09	ER09-187	So. Cal Edison (b)	10.04%

ALLOWED ROE

Date	Docket No.	Utility	ROE
Aug-09	ER07-1344	Westar Energy Inc.	10.80%
Nov-09	ER08-1588	Kentucky Utilities Co.	11.00%
Nov-09	ER09-1762	Westar Energy Inc.	10.80%
Dec-09	ER08-313	Southwestern Public Service Co.	10.77%
Jan-10	ER09-628	National Grid Generation LLC	10.75%
Sep-10	ER10-160	So. Cal Edison (c)	10.33%
Oct-10	ER08-1329	AEP - PJM Zone	10.99%
Dec-10	ER10-230	Kansas City Power & Light Co.	10.60%
Dec-10	ER11-1952	So. Cal Edison	10.30%
Feb-11	ER11-2377	Northern Pass Transmission	10.40%
Apr-11	ER10-355	AEP Transcos - PJM	10.99%
Apr-11	ER10-355	AEP Transcos - SPP	10.70%
May-11	EL10-80	Ameren	12.38%
May-11	EL11-13	Atlantic Grid Operations	10.09%
Jun-11	ER11-3352	PJM & PSE&G	11.18%
Aug-11	ER10-992	Northern States Power Co.	10.20%
Oct-11	ER10-1377	Northern States Power Co. (MN)	10.40%
Oct-11	ER11-2895	Duke Energy Carolinas	10.20%
Oct-11	ER11-4069	RITELine	9.93%
Oct-11	ER10-516	South Carolina Elec. & Gas	10.55%
Dec-11	ER12-296	PJM & PSE&G	11.18%
Feb-12	ER08-386	PATH	10.40%
Jun-12	ER11-2853	Public Service Co. of Colorado	10.10%
Jun-12	ER11-2853	Public Service Co. of Colorado	10.40%
Jun-12	ER12-1593	DATC Midwest Holdings	12.38%
May-13	ER12-778	Puget Sound Energy	9.80%
May-13	ER12-778	Puget Sound Energy - PSANI	10.30%
May-13	ER11-3643	PacifiCorp	9.80%
May-13	ER11-2560	Entergy Arkansas	10.20%
May-13	ER12-2554	Transource Missouri	9.80%
N/A	ER12-2681	ITC Holdings - Date Corrected to 2002	N/A
Aug-13	ER12-1650	Maine Public Service Co.	9.75%
Nov-13	ER11-3697	So. Cal Edison	9.30%
May-14	ER13-941	San Diego Gas & Electric	9.55%
May-14	ER14-1608	Public Service Electric & Gas	11.18%
Jun-14	EL11-66	Bangor Hydro-Elec. Co.	10.57%
Oct-14	ER12-1589	Public Service Co. of Colorado	9.72%
Oct-14	EL13-86	Public Service Co. of Colorado	9.72%

(a) Order issued April 15, 2010, with ROE applied for March 1, 2008 through December 31, 2008.
(b) Order issued April 19, 2012, with ROE applied for January 1, 2009 through May 31, 2010.
(c) Order issued April 19, 2012, with ROE applied for June 1, 2010 through December 31, 2010.

Dating Corrected as to ITC Holdings (Page 5, "Jun-13" in original)

REGRESSION RESULTS

Regression Statistics	
Multiple R	0.81528
R Square	0.66469
Adjusted R Square	0.62277
Standard Error	0.00431
Observations	10

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	0.000294	0.000294449	15.85834832	0.004048913
Residual	8	0.000149	1.85674E-05		
Total	9	0.000443			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	0.07890	0.00813	9.702136996	1.06332E-05	0.06015	0.09765	0.06015	0.09765
X Variable 1	-0.52210	0.13111	-3.982254176	0.004048913	-0.82444	-0.21977	-0.82444	-0.21977

OMS Attachment 2:
Adjustment 2 to MTO-29

Dating Corrected as to Ameren, DATC Midwest Holdings & ITC Holdings
(Page 5,"May-11," "Jun-12," and "Jun-13" in original)

HISTORICAL BOND YIELDS

Current Equity Risk Premium

(a)	Average Yield Over Study Period	6.11%
(b)	Baa Utility Bond Yield - Historical	4.55%
	Change in Bond Yield	-1.56%
(c)	Risk Premium/Interest Rate Relationship	-0.4536
	Adjustment to Average Risk Premium	0.71%
(a)	Average Risk Premium over Study Period	4.63%
	Adjusted Risk Premium	**5.34%**

Implied Cost of Equity

(b)	Baa Utility Bond Yield - Historical	4.55%
	Adjusted Equity Risk Premium	5.34%
	Risk Premium Cost of Equity	**9.89%**

(a) See OMS Attachment 2, p. 2
(b) Six-month average yield for Nov. 2014 - Apr. 2015 based on data from Moody's Investors Service, www.moodys.credittrends.com.
(c) See OMS Attachment 2, p. 5

Dating Corrected as to Ameren, DATC Midwest Holdings & ITC Holdings (Page 5,"May-11," "Jun-12," and "Jun-13" in MTO-29)

IMPLIED RISK PREMIUM

	(a)	(b), (b')	
Year	**Average Base ROE**	**BBB Utility Bond Yield**	**Risk Premium**
2002	12.38%	8.02%	4.36%
2006	11.01%	6.32%	4.69%
2007	10.96%	6.33%	4.63%
2008	10.83%	7.25%	3.58%
2009	10.85%	7.06%	3.79%
2010	10.59%	5.98%	4.61%
2011	10.53%	5.57%	4.96%
2012	10.30%	4.86%	5.44%
2013	9.85%	4.98%	4.87%
2014	10.15%	4.80%	5.35%
		6.12%	4.63%

(a) OMS-2, pp.3-4

(b) Moody's Investors Service, www.credittrends.com (MTO-29).

(b') Exh. No. JC-2 line 17, citing Mergent Bond Record (for year 2002).

Dating Corrected as to Ameren, DATC Midwest Holdings & ITC Holdings
(Page 5,"May-11," "Jun-12," and "Jun-13" in MTO-29)

ALLOWED ROE

Date	Docket No.	Utility	ROE
Sep-02	EL10-80	Ameren	12.38%
Sep-02	ER12-1593	DATC Midwest Holdings	12.38%
Sep-02	ER12-2681	ITC Holdings	12.38%
Apr-06	ER05-515	Baltimore Gas & Elec.	10.80%
Apr-06	ER05-515	Baltimore Gas & Elec.	11.30%
Oct-06	ER04-157	Bangor Hydro-Elec. Co.	11.14%
Nov-06	ER05-925	Westar Energy Inc.	10.80%
May-07	ER07-284	San Diego Gas & Elec.	11.35%
Aug-07	ER06-787	Idaho Power Co.	10.70%
Sep-07	ER06-1320	Wisconsin Elec. Pwr. Co.	11.00%
Nov-07	ER08-10	Pepco Holdings, Inc.	10.80%
Jan-08	ER07-583	Commonwealth Edison Co.	11.00%
Feb-08	ER08-374	Atlantic Path 15	10.65%
Mar-08	ER08-396	Westar Energy Inc.	10.80%
Mar-08	ER08-413	Startrans IO, LLC	10.65%
Apr-08	EL05-19	Southwestern Public Service	9.33%
Apr-08	ER08-92	Virginia Elec. & Power Co.	10.90%
May-08	EL06-109	Duquesne Light Co.	10.90%
Jun-08	ER07-549	NSTAR Elec. Co.	10.90%
Jul-08	ER08-375	So. Cal Edison (a)	9.54%
Jul-08	ER07-562	Trans-Allegheny	11.20%
Jul-08	ER07-1142	Arizona Public Service Co.	10.75%
Aug-08	ER08-1207	Virginia Elec. & Power Co.	10.90%
Aug-08	ER08-686	Pepco Holdings, Inc.	11.30%
Sep-08	ER08-1233	Public Service Elec. & Gas	11.18%
Oct-08	ER08-1423	Pepco Holdings, Inc.	10.80%
Oct-08	EL08-74	Central Maine Power Co.	11.14%
Oct-08	ER08-1402	Duquesne Light Co.	10.90%
Nov-08	ER08-1548	Northeast Utils Service Co.	11.14%
Nov-08	EL08-77	Central Maine Power Co.	11.14%
Dec-08	ER09-14	NSTAR Elec. Co.	11.14%
Dec-08	ER09-35/36	Tallgrass / Prairie Wind	10.80%
Dec-08	ER07-694	New England Pwr. Co.	11.14%
Feb-09	ER08-1584	Black Hills Power Co.	10.80%
Mar-09	ER09-75	Pioneer Transmission	10.54%
Mar-09	ER09-548	ITC Great Plains	10.66%
Mar-09	ER09-249	Public Service Elec. & Gas	11.18%
Apr-09	ER09-681	Green Power Express	10.78%
May-09	ER09-745	Baltimore Gas & Elec.	11.30%
Jun-09	ER08-552	Niagara Mohawk Pwr. Co.	11.00%
Jun-09	ER07-1069	AEP - SPP Zone	10.70%
Jun-09	ER08-1457	PPL Elec. Utilities Corp.	11.10%
Jun-09	ER08-1457	PPL Elec. Utilities Corp.	11.14%
Jun-09	ER08-1457	PPL Elec. Utilities Corp.	11.18%
Jun-09	ER08-281	Oklahoma Gas & Elec.	10.60%
Aug-09	ER09-187	So. Cal Edison (b)	10.04%

ALLOWED ROE

Date	Docket No.	Utility	ROE
Aug-09	ER07-1344	Westar Energy Inc.	10.80%
Nov-09	ER08-1588	Kentucky Utilities Co.	11.00%
Nov-09	ER09-1762	Westar Energy Inc.	10.80%
Dec-09	ER08-313	Southwestern Public Service Co.	10.77%
Jan-10	ER09-628	National Grid Generation LLC	10.75%
Sep-10	ER10-160	So. Cal Edison (c)	10.33%
Oct-10	ER08-1329	AEP - PJM Zone	10.99%
Dec-10	ER10-230	Kansas City Power & Light Co.	10.60%
Dec-10	ER11-1952	So. Cal Edison	10.30%
Feb-11	ER11-2377	Northern Pass Transmission	10.40%
Apr-11	ER10-355	AEP Transcos - PJM	10.99%
Apr-11	ER10-355	AEP Transcos - SPP	10.70%
N/A	EL10-80	Ameren - Date Corrected to 2002	N/A
May-11	EL11-13	Atlantic Grid Operations	10.09%
Jun-11	ER11-3352	PJM & PSE&G	11.18%
Aug-11	ER10-992	Northern States Power Co.	10.20%
Oct-11	ER10-1377	Northern States Power Co. (MN)	10.40%
Oct-11	ER11-2895	Duke Energy Carolinas	10.20%
Oct-11	ER11-4069	RITELine	9.93%
Oct-11	ER10-516	South Carolina Elec. & Gas	10.55%
Dec-11	ER12-296	PJM & PSE&G	11.18%
Feb-12	ER08-386	PATH	10.40%
Jun-12	ER11-2853	Public Service Co. of Colorado	10.10%
Jun-12	ER11-2853	Public Service Co. of Colorado	10.40%
N/A	ER12-1593	DATC Midwest Holdings - Date Correc	N/A
May-13	ER12-778	Puget Sound Energy	9.80%
May-13	ER12-778	Puget Sound Energy - PSANI	10.30%
May-13	ER11-3643	PacifiCorp	9.80%
May-13	ER11-2560	Entergy Arkansas	10.20%
May-13	ER12-2554	Transource Missouri	9.80%
N/A	ER12-2681	ITC Holdings - Date Corrected to 2002	N/A
Aug-13	ER12-1650	Maine Public Service Co.	9.75%
Nov-13	ER11-3697	So. Cal Edison	9.30%
May-14	ER13-941	San Diego Gas & Electric	9.55%
May-14	ER14-1608	Public Service Electric & Gas	11.18%
Jun-14	EL11-66	Bangor Hydro-Elec. Co.	10.57%
Oct-14	ER12-1589	Public Service Co. of Colorado	9.72%
Oct-14	EL13-86	Public Service Co. of Colorado	9.72%

(a) Order issued April 15, 2010, with ROE applied for March 1, 2008 through December 31, 2008.
(b) Order issued April 19, 2012, with ROE applied for January 1, 2009 through May 31, 2010.
(c) Order issued April 19, 2012, with ROE applied for June 1, 2010 through December 31, 2010.

Dating Corrected as to Ameren, DATC Midwest Holdings & ITC Holdings
(Page 5,"May-11," "Jun-12," and "Jun-13" in original)

REGRESSION RESULTS

Regression Statistics	
Multiple R	0.82946
R Square	0.68801
Adjusted R Square	0.64901
Standard Error	0.00355
Observations	10

ANOVA

	df	*SS*	*MS*	*F*	*Significance F*
Regression	1	0.000222	0.000222261	17.64163448	0.002995717
Residual	8	0.000101	1.25987E-05		
Total	9	0.000323			

	Coefficients	*Standard Error*	*t Stat*	*P-value*	*Lower 95%*	*Upper 95%*	*Lower 95.0%*	*Upper 95.0%*
Intercept	0.07404	0.00670	11.05236776	4.00262E-06	0.05859	0.08948	0.05859	0.08948
X Variable 1	-0.45361	0.10800	-4.200194576	0.002995717	-0.70265	-0.20457	-0.70265	-0.20457