

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

Arkansas Electric Cooperative Corp., *et al.*,  
Complainants,

v.

ALLETE, Inc., *et al.*,  
Respondents

Docket No. EL15-45-000

**PRE-HEARING BRIEF  
OF  
ORGANIZATION OF MISO STATES**

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

*Counsel for the Organization of MISO States*

**February 12, 2016**

**TABLE OF CONTENTS**

I. INTRODUCTION .....3

II. ARGUMENT.....4

    A. EVALUATION OF THE MISO TOs' BASE ROE.....4

        1. In determining the cost of common equity for the MISO TOs, what is the appropriate method for calculating dividend yields? .....4

        2. In determining the cost of common equity for the MISO TOs, what is (are) the acceptable source(s) of analyst growth rate data? .....5

        3. What are the relevant factors in determining the composition of the proxy group and how should they be applied? .....6

        4. What is the zone of reasonableness? .....7

        5. Is the MISO TOs' currently allowed Base ROE unjust and unreasonable?.....7

    B. PLACEMENT OF THE BASE ROE WITHIN THE ZONE OF REASONABLENESS .....8

        1. Were market conditions anomalous during the study period? .....8

            a) Differences between the Evidence in Case and the Record Available to FERC in Opinion No. 531.....9

            b) Federal Reserve policies do not dictate capital market conditions. ....11

            c) The reaction to the Federal Reserve increase of the federal funds target rate supports the new normal theory. ....12

        2. If capital market conditions were anomalous during the study period, which, if any, alternative benchmark estimates of the cost of equity should the Commission consider to evaluate the placement of the base ROE, and what is the proper application of such methods? .....13

        3. What, if any, other factors should the Commission consider in determining the just and reasonable base ROE for the MISO TOs? .....14

        4. Where in the zone of reasonableness should the Base ROE be placed? .....15

III. CONCLUSION.....15

**TABLE OF AUTHORITIES**

**CASES**

*Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm’n of W. Va.*,  
262 U.S. 679 (1923).....5

*FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944)..... 5

**FERC DECISIONS**

*Association of Businesses Advocating Tariff Equity, et al., v. Midcontinent Independent  
System Operator, Inc., et al.*, 148 FERC ¶ 61,049 (2014).....3, 13

*Martha Coakley, Massachusetts Attorney Gen., et al. v. Bangor Hydro-Elec. Co., et al.*,  
Opinion No. 531, 147 FERC ¶ 61,234 (2014), *on paper hearing*, Opinion No. 531-A,  
149 FERC ¶ 61,032 (2014), *on reh’g*, Opinion No. 531-B, 150 FERC ¶ 61,165 (2015);  
*petition for review pending*..... passim

*See Arkansas Electric Cooperative Corp., et al., v. ALLETE, Inc., et al.*,  
151 FERC ¶ 61,219 (2015).....3

**REGULATIONS**

18 C.F.R. § 385.705 (2015) ..... 1

## **GLOSSARY**

<u>Abbreviation</u>	<u>Full Term</u>
ATC	American Transmission Company
Base ROE	ROE prior to application of ROE-increasing incentives
DCF	Discounted Cash Flow
Fed	Federal Reserve System
FPA	Federal Power Act
IBES	Thompson Reuters' Institutional Brokers' Estimate System
ICG	Industrial Customer Group
JCA	Joint Consumer Advocates
JCI	Joint Complainants and Intervenor
MISO	Midcontinent Independent System Operator
MTO	MISO Transmission Owners
OMS	Organization of MISO States
ROE	Return on Equity
RPG	Ratepayer Protection Group
TO	Transmission Owner

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

Arkansas Electric Cooperative Corp., *et al.*,  
Complainants,

v.

ALLETE, Inc., *et al.*,  
Respondents

Docket No. EL15-45-000

**PRE-HEARING BRIEF  
OF  
ORGANIZATION OF MISO STATES**

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

Pursuant to Rule 705 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“FERC” or “Commission”), 18 C.F.R. § 385.705 (2015), and the Presiding Judge’s Order Establishing Procedural Schedule dated July 10, 2015, as modified by Order dated December 22, 2015, the Organization of MISO States (“OMS”)<sup>1</sup> respectfully submits this Pre-Hearing Brief in the above-captioned proceeding concerning the justness and reasonableness of the Base Return on Equity (“Base ROE”) for Transmission Owners (“TOs”) in the Midcontinent Independent Transmission System Operator, Inc. (“MISO”) region.

---

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

OMS is a non-profit, self-governing organization of representatives from each state with regulatory jurisdiction over electric utilities participating in the MISO. OMS is not sponsoring a witness in this proceeding or proposing a specific new Base ROE for the respondent MISO TOs.<sup>2</sup> The purpose of OMS' participation in this case is to support a process with policies that allow the Presiding Judge and the Commission to estimate the true cost of equity of the MISO TOs. As further explained in this Pre-Hearing Brief, there is substantial evidence for the Presiding Judge to find that: (1) the current Base ROEs for the MISO TOs are unjust and unreasonable; and (2) the just and reasonable Base ROE for the MISO TOs can be determined following the Commission's two-step Discounted Cash Flow ("DCF") methodology established in Opinion No. 531, *et al.*,<sup>3</sup> without resorting to other methodologies for estimating the cost of equity of the MISO TOs.

---

<sup>2</sup> The MISO TOs respondents in this complaint include: ALLETE, Inc. (for its operating division Minnesota Power, Inc., and its wholly-owned subsidiary, Superior Water, Light and Power Company), Ameren Illinois Company, Ameren Missouri, Ameren Transmission Company of Illinois, American Transmission Company LLC, Cleco Power LLC, Duke Energy Business Services, LLC, d/b/a Duke Energy Indiana, Entergy Arkansas, Inc., Entergy Gulf States Louisiana, LLC, Entergy Louisiana, LLC, Entergy Mississippi, Inc., Entergy New Orleans, Inc., Entergy Texas, Inc., Indianapolis Power & Light Company, International Transmission Company, d/b/a ITC Transmission, ITC Midwest LLC, Michigan Electric Transmission Company, LLC, MidAmerican Energy Company, Montana-Dakota Utilities Co., Northern Indiana Public Service Company, Northern States Power Company-Minnesota, Northern States Power Company-Wisconsin, Otter Tail Power Company, and Southern Indiana Gas & Electric Company.

<sup>3</sup> *Martha Coakley, Massachusetts Attorney Gen., et al. v. Bangor Hydro-Elec. Co., et al.*, Opinion No. 531, 147 FERC ¶ 61,234 (2014), *on paper hearing*, Opinion No. 531-A, 149 FERC ¶ 61,032 (2014), *on reh'g*, Opinion No. 531-B, 150 FERC ¶ 61,165 (2015); *petition for review pending*.

## I. INTRODUCTION

On February 12, 2015, the Joint Complainants and Intervenor (“JCI” or “Complainants”)<sup>4</sup> filed a complaint against the MISO TOs contending that the current 12.2 percent Base ROE for American Transmission Company (“ATC”) and the 12.38 percent Base ROE for other MISO TOs are unjust and unreasonable. Based on information available at the time JCI filed its complaint, JCI further contended that the Base ROE instead should be set at no higher than 8.67 percent.<sup>5</sup> In addition, JCI requested that this complaint proceeding be consolidated with an earlier complaint proceeding challenging the current Base ROE for the MISO TOs in Docket No. EL14-12-002.

By Order dated June 18, 2015, FERC set the merits of JCI’s complaint for investigation and trial-type hearing under Section 206 of the Federal Power Act (“FPA”).<sup>6</sup> FERC set a refund effective date of February 12, 2015 for the JCI complaint in this proceeding, whereas a refund effective date of November 12, 2013 was established in the earlier complaint proceeding in Docket No. EL14-12-002.<sup>7</sup> FERC left the decision of whether to consolidate this proceeding with the EL14-12-002 proceeding to the Chief Administrative Law Judge and, by Order dated June 24, 2015, the Chief Administrative Law Judge denied JCI’s request to consolidate proceedings. On July 20, 2015, the MISO TOs filed a request for rehearing of the Hearing Order, which is currently pending before FERC.

---

<sup>4</sup> The Joint Complainants are Arkansas Electric Cooperative Corporation, Mississippi Delta Energy Agency, Clarksdale Public Utilities Commission of the City of Clarksdale (Mississippi), Public Service Commission of Yazoo City of the City of Yazoo City (Mississippi), and Hoosier Energy Rural Electric Cooperative, Inc. The supporting intervenor is South Mississippi Electric Power Association.

<sup>5</sup> See *Arkansas Electric Cooperative Corp., et al., v. ALLETE, Inc., et al.*, 151 FERC ¶ 61,219, at P 1 (2015) (“Hearing Order”).

<sup>6</sup> 16 U.S.C. § 824e (2012).

<sup>7</sup> See *Association of Businesses Advocating Tariff Equity, et al., v. Midcontinent Independent System Operator, Inc., et al.*, 148 FERC ¶ 61,049, at P 1 (2014).

## **II. ARGUMENT**

In this section of its Pre-Hearing Brief, OMS summarizes its position at this time on each of the contested issues enumerated in the Joint Statement of Contested Issues filed on February 9, 2016, in this proceeding.

### **A. EVALUATION OF THE MISO TOs' BASE ROE.**

#### **1. In determining the cost of common equity for the MISO TOs, what is the appropriate method for calculating dividend yields?**

The appropriate methodology for calculating a single dividend yield for each proxy group company is described in Opinion No. 531 as consisting of three steps: (1) averaging the high and low stock prices as reported by the New York Stock Exchange or NASDAQ Stock Exchange, for each of the six months in the study period; (2) dividing the company's indicated annual dividend for each of those months by its average stock price for each month (resulting in a monthly dividend yield for each month of the study period); and (3) averaging those monthly dividend yields.<sup>8</sup> With respect to the second step, the MISO TOs explain that they divided the most recent dividend declared in the six-month period by the corresponding average of the monthly low and high stock prices.<sup>9</sup> This approach is not consistent with the plain language of Opinion No. 531, which supports a methodology that divides the average high and low prices in each month by the declared dividend in effect during each such month.<sup>10</sup>

---

<sup>8</sup> See Opinion No. 531 at P 77

<sup>9</sup> Exh. No. MTO-1 at 84:1-6.

<sup>10</sup> See Opinion No. 531 at P 77 and n.135.

**2. In determining the cost of common equity for the MISO TOs, what is (are) the acceptable source(s) of analyst growth rate data?**

The appropriate source of short-term growth data to use in FERC ROE proceedings is Thomson Reuters' Institutional Brokers' Estimate System ("IBES"). The MISO TOs claim that their DCF analysis using short-term growth data published by Value Line Investment Survey ("Value Line") is less distorted by alleged anomalous capital market conditions because it is more congruent with the results of alternative benchmark methods.<sup>11</sup> Without specifically describing what aspects of the IBES data compilation methodology make it more prone to be affected by alleged anomalous capital market conditions than Value Line, the MISO TOs essentially propose using alternative price benchmarks on a case-by-case basis to test the soundness of IBES short-term growth data. This approach is inconsistent with Opinion No. 531, *et al.*, where FERC simply used these benchmarks as a tool to determine whether the midpoint of the DCF range resulted in an ROE that would meet the *Hope*<sup>12</sup> and *Bluefield*<sup>13</sup> standards.

Participants in FERC ROE proceedings should not be allowed to pick and choose whatever data source for short-term growth estimates is used in the context of the Opinion No. 531 two-stage DCF method, particularly when the Commission clearly stated a policy preference for IBES short-term growth data. In Opinion No. 531, FERC specifically stated that "the Commission has long relied on IBES growth projections as evidence of the growth rates expected by the investment community."<sup>14</sup> In rejecting a rehearing petitioner's complaint that IBES included only one analyst's growth estimate for a member of the proxy group, the

---

<sup>11</sup> Exh. No. MTO-1 at 11:10-12.

<sup>12</sup> *Bluefield Waterworks & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679 (1923) ("Bluefield").

<sup>13</sup> *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944) ("Hope").

<sup>14</sup> Opinion No. 531 at P 89.

Commission referred to “years of established Commission precedent approving the use of IBES short-term growth projections in the two-step DCF methodology.”<sup>15</sup>

Finally, the MISO TOs list some differences that, in their opinion, make Value Line a better data source<sup>16</sup> but, at the same time, claim that IBES and Value line are “comparable”<sup>17</sup> short-term growth data sources. The truth is that Value Line and IBES are not comparable data sources. The Presiding Judge should not allow the MISO TOs to deviate from FERC’s express preference for IBES short-term growth data on the ground that the Value Line-based DCF range is more in line with the results of alternative benchmarks.

**3. What are the relevant factors in determining the composition of the proxy group and how should they be applied?**

OMS takes no position as to the specific factors that are relevant in determining the composition of the proxy group at this time. OMS notes, however, that in Exh. No. MTO-5, the MISO TOs deviated from the Commission’s low-end outlier test by eliminating proxy group companies with costs of equity far above the applicable historical bond yield plus 100 basis points.<sup>18</sup> The MISO TOs claimed that anomalous capital market conditions warranted their proposed “flexible” application of the 100 basis point rule.<sup>19</sup> However, FERC did not find this same level of flexibility was warranted in Opinion No. 531, *et al.*, after determining that capital market conditions were anomalous during the study period in that case.<sup>20</sup>

---

<sup>15</sup> Opinion No. 531-B at P 71.

<sup>16</sup> Exh. No. MTO-1 at 31:20-23, 32:1-6.

<sup>17</sup> Exh. No. MTO-1 at 30:20.

<sup>18</sup> See Exh No. MTO-1 at 90:12-14, Exh. No. MTO-5 at 1-2, and Exh. No. MTO-22 at 24:5-11.

<sup>19</sup> Exh. No. MTO-1 at 28:3-10 and MTO-22 at 24:5-17.

<sup>20</sup> Opinion No. 531 at P 123 (although PSE&G was excluded from the proxy group, the Commission explained that it was a single point above the 100 basis point threshold).

#### **4. What is the zone of reasonableness?**

OMS is not sponsoring a witness recommending a specific zone of reasonableness to be adopted in this proceeding. The Presiding Judge should, however, adopt a zone of reasonableness resulting from an IBES-based DCF analysis.

#### **5. Is the MISO TOs' currently allowed Base ROE unjust and unreasonable?**

The current 12.38 percent Base ROE for the MISO TOs and the 12.2 percent Base ROE for ATC are unjust and unreasonable as demonstrated by the various DCF analyses filed in this case.

Six witnesses in this proceeding conducted DCF analyses on the MISO TOs' cost of equity following the two- step DCF methodology established by the Commission in Opinion No. 531, *et al.* The DCF analyses rely on IBES short-term growth data, with the exception of one DCF analysis prepared by the MISO TOs' witness Mr. McKenzie, which relies on Value Line short-term growth data. As further explained herein, the Commission has expressed a policy preference for the use of IBES short-term growth data in DCF analyses.

In the instant case, all the DCF analyses that relied on IBES short-term growth data, including Mr. McKenzie's IBES-based DCF analysis,<sup>21</sup> result in a zone of reasonableness below the current Base ROE for the MISO TOs. Mr. McKenzie's Value Line-based DCF analysis results in a zone of reasonableness below the 12.38 percent Base ROE for the MISO TOs, with ATC's 12.2 percent Base ROE at the top of the zone of reasonableness. As shown in the table below, the current Base ROEs for the MISO TOs are either above or at the very top of the zone

---

<sup>21</sup> See Exh. No. MTO-5, as adjusted by Exh. No. MTO-33.

of reasonableness resulting from every DCF analysis presented as evidence in this proceeding, A Base ROE that is above or at the top of the zone of reasonableness is unjust and unreasonable.

Witness	DCF Zone of Reasonableness	Midpoint
M. Gorman (ICG) // IBES	6.71% to 10.63% <sup>22</sup>	8.67%
S. Hill (JCA) // IBES	6.76% to 10.73% <sup>23</sup>	8.74%
B. Solomon (JCI) // IBES	6.77% to 10.70% <sup>24</sup>	8.73%
D. Parcell (RPG) // IBES	6.75% to 10.68% <sup>25</sup>	8.72%
R. Keyton (FERC Staff) // IBES	6.82% to 10.73% <sup>26</sup>	8.78%
W. McKenzie (MISO TOs) // IBES	6.95% to 10.70% <sup>27</sup>	8.82%
W. McKenzie // Value Line	6.94% to 12.29% <sup>28</sup>	9.62%

## **B. PLACEMENT OF THE BASE ROE WITHIN THE ZONE OF REASONABLENESS**

### **1. Were market conditions anomalous during the study period?**

The MISO TOs failed to prove that capital market conditions were anomalous during the particular study period in this case. In essence, the MISO TOs argue that capital market conditions are anomalous because bond yields and interest rates in the study period of this case are similar to those the Commission found anomalous in Opinion No. 531.<sup>29</sup> The MISO TOs oppose the Complainants and supporting participants'<sup>30</sup> new normal theory arguing that the Federal Reserve's policies continue to be simulative despite the onset of the "normalization" policy in December 2015 and that, until the normalization process is well advanced, capital

<sup>22</sup> Industrial Customer Group ("ICG"). See Exh. No. ICG-6 at 1, as adjusted by Exh. No. ICG-25 at 1.

<sup>23</sup> Joint Consumer Advocates ("JCA"). See Exh. No. JCA-6, as adjusted by Exh. No. JCA-34.

<sup>24</sup> See Exh. No. JCI-2 at 1, as adjusted by Exh. No. JCI-8 at 1.

<sup>25</sup> See Exh. No. RPG-7, as adjusted by Exh. No. RPG-31.

<sup>26</sup> See Exh. No. S-2 at 7, as adjusted by Exh. No. S-5 at 6.

<sup>27</sup> See Exh. No. MTO-5 at 1, as adjusted by Exh. No. MTO-33 at 1.

<sup>28</sup> See Exh. No. MTO-5 at 2, as adjusted by Exh. No. MTO-33 at 2.

<sup>29</sup> Exh. No. MTO-1 at 102-103, and Exh. No. MTO-16 at 16.

<sup>30</sup> ICG, JCA, RPG, and Staff .

market conditions will continue to be anomalous.<sup>31</sup> The Presiding Judge should reject these arguments because: (1) there are many important differences between the market conditions as presented in the record of the EL11-66 case and the market conditions as presented in the pre-filed evidence in this case; (ii) the Federal Reserve’s policies are just one of many factors with influence over capital market conditions; and (iii) even if the Federal Reserve’s policies were determinative of overall capital market conditions, the documented reaction of investors following the onset of the Federal Reserve “normalization” process supports the new normal theory.

a) Differences between the Evidence in Case and the Record Available to FERC in Opinion No. 531.

The record in EL11-66, which led to the Commission’s finding that capital market conditions were anomalous in Opinion No. 531, *et al.*, differs from the evidence presented in this case in several respects:

- In this case, there is a lack of consensus regarding the existence of anomalous capital market conditions. In Opinion No. 531, the Commission stated that participants on both sides of the ROE issue argued that unique capital market conditions impacted the level of equity return that the transmission owners in New England require to meet the capital attraction standards of *Hope* and *Bluefield*.<sup>32</sup> In the instant proceeding, however, there is no such consensus. Indeed, only the MISO TOs claim that anomalous capital market conditions exist. Even FERC’s own Trial Staff disagrees with the MISO TOs’ position. Claims about the purportedly “anomalous”

---

<sup>31</sup> Exh. No. MTO-22 at 23:7-16, and Exh. No. MTO-25 at 23-24.

<sup>32</sup> Opinion No. 531 at P 145.

state of market conditions must, therefore, be carefully scrutinized by the Presiding Judge in this case and cannot be assumed as a matter of consensus.

- Historic bond yield information is now part of the evidence offered in the instant proceeding. The record in the EL11-66 proceeding lacked complete information regarding historical cycles of bond yields.<sup>33</sup> In this case, FERC Staff presented historic bond yield information showing that, for a considerable period in the past, bond yields were lower than they were during the study period in this proceeding. This information is relevant in determining investors' expectations, as explained by Mr. Hill in his rebuttal testimony,<sup>34</sup> and refutes the MISO TOs' claim that low bond yields during the study period were unprecedented.
- The Federal Reserve Quantitative Easing program has terminated. In the EL11-66 proceeding, the New England TOs argued that after the Federal Reserve's termination of its Quantitative Easing program, interest rates would rise to more "normal" levels and bond levels would increase.<sup>35</sup> Contrary to their assertions, the record in this proceeding shows that since the Federal Reserve ended its Quantitative Easing program in October 2014, bond yields have not gone up significantly.<sup>36</sup> In fact, the MISO TOs rely on the similar bond yields present during the EL11-66 study period and bond yields in the study period of this proceeding to assert that anomalous capital market conditions persist.<sup>37</sup>

---

<sup>33</sup> Exh. No. S-1 at 89: 8-11.

<sup>34</sup> Exh. No. JCI-4 at 38-39.

<sup>35</sup> Opinion No. 531 at P 130.

<sup>36</sup> Exh. No. S-1 at 90:8-15.

<sup>37</sup> Exh. No. MTO-16 at 27.

- Bond yields have been low for the past four years and are expected to continue to be low for the next decade. In the record considered in Opinion No. 531, there was still great uncertainty as to whether, and for how long, they would remain low. In this case, the pre-filed evidence includes opinions by various prestigious economists predicting that interest rates are likely to remain low for the next decade given various factors, including global economic trends.<sup>38</sup> If the issues in this case are analyzed based on the premise that investors are rational, it follows that they should have accounted for these persistent market conditions in the price they are willing to pay for stock.

b) Federal Reserve policies do not dictate capital market conditions.

Federal Reserve policies do not dictate long-term bond prices and yields, nor do they dictate utility stock prices and dividend yields. Long-term bond and utility stock prices and yields are determined by thousands of participants in open competitive markets and affected by a variety of macroeconomic factors.<sup>39</sup> While the Federal Reserve's actions may influence long-term bond and utility stock prices and yields, it is not a direct cause-effect impact on capital markets. It would be erroneous find that solely the Federal Reserve's actions rendered capital market conditions anomalous to the point where such anomaly will persist for as long as the Federal Reserve continues any aspect of its accommodative monetary policies. There are many factors that shape capital market conditions.<sup>40</sup> For example, the MISO TOs claim that the Federal Reserve holding of a \$4.24 trillion portfolio of high quality bonds reduced the trading supply of

---

<sup>38</sup> See, e.g., Exh. No. JCI-4 at 40-42.

<sup>39</sup> Exh. No. JCI-4 at 49: 15-20.

<sup>40</sup> See, e.g., Exh. No. S-1 at 34-36 (discussing the role of the global economy on capital market conditions); Exh. No. JCI-4 at 42:15-18 (explaining that various domestic and international factors play a role in shaping capital market conditions); and Exh. No. ICG-15 at 23 (explaining the impact of inflation outlooks on interest rates).

high-quality, low-risk instruments in the market, in turn increasing the prices of long-term bonds and artificially declining yields.<sup>41</sup> However, the pre-filed evidence in this case shows that, parallel to the Federal Reserve purchase of long-term government debt, the Federal government increased the issuance of debt by over \$8 trillion, providing investors with ample opportunity to invest in U.S. government securities.<sup>42</sup> In fact, according to at least one investment bank, if the Federal Reserve allowed all of its treasuries to mature in 2016, in order to run off its balance sheet, 10-year yields would not rise significantly.<sup>43</sup> The MISO TOs' theory that the Federal Reserve's purchase of long-term debt causes long-term bond prices to rise and yields to drop, is simply unsupported by pre-filed empirical evidence, which shows that there was no trading shortage of government debt.

c) The reaction to the Federal Reserve increase of the federal funds target rate supports the new normal theory.

The MISO TOs admit that the Federal Reserve's increase of the federal funds target rate constituted the onset of the "normalization" of monetary policies.<sup>44</sup> Previously, in the EL14-12 proceeding, the MISO TOs represented to the Presiding Judge that investors expected capital market conditions to change significantly with the onset of the normalization process and that investors seeking only yield would quickly divest their utility stock when normalization begins.<sup>45</sup> Indeed, the Initial Decision in the EL14-12-002 case relied on these assertions by the MISO

---

<sup>41</sup> Exh. No. MTO-16 at 32: 4-10.

<sup>42</sup> See, e.g., Exh. No. JCI-4 at 48:10-21

<sup>43</sup> Exh. No. JCA-14 at 77-78.

<sup>44</sup> Exh. No. MTO-22 at 23:10

<sup>45</sup> See, e.g., EL14-12-002 Case, Exh. No. MTO-39 at 24:7-10 and 26:1-4.

TOs.<sup>46</sup> However, the pre-filed evidence in this case shows that the onset of the normalization process did not result in a mass exodus of investors away from utility stocks as the MISO TOs predicted.<sup>47</sup> In fact, the market reaction to the increase of the federal funds target rate supports a finding that investors consider current market conditions as the new normal and do not expect capital market conditions to change much in the near future. The MISO TOs argue that despite the Federal Reserve onset of normalization policies, capital market conditions continue to be anomalous because low short-term interest rates still provide an ongoing incentive for investors seeking a short-term yield to invest in longer-term utility bonds and dividend-yielding utility equities as a *temporary* yield opportunity.<sup>48</sup> The MISO TOs' interpretation of the facts, however, assumes that: (1) investors perceive low short-term rates to be temporary; and (2) there is a trading shortage of long-term debt. As explained herein, the Presiding Judge has been presented with sufficient evidence rebutting these assumptions.

**2. If capital market conditions were anomalous during the study period, which, if any, alternative benchmark estimates of the cost of equity should the Commission consider to evaluate the placement of the base ROE, and what is the proper application of such methods?**

The MISO TOs failed to prove that capital market conditions are anomalous. For this reason, the Presiding Judge need not consider other benchmarks to determine if the midpoint of the DCF zone meets the *Hope* and *Bluefield* standards.

Should the Presiding Judge find that capital market conditions were anomalous during the study period, Mr. Hill's calculation of state-approved ROEs for distribution facilities would be

---

<sup>46</sup> See, e.g., *Assn. of Businesses Advocating Tariff Equity, et al. v. Midcontinent Indep. Sys. Operator, Inc., et al.*, 153 FERC ¶ 63,027 at P 154 (2015).

<sup>47</sup> See, e.g., Exh. No. RPG-9 at 46-47; and Exh. No. JCA-14 at 19-22.

<sup>48</sup> Exh. No. MTO-25 at 24: 6-8.

a benchmark to consider.<sup>49</sup> To be clear, OMS does not agree with the Commission's finding that investing in distribution assets is less risky than investing in transmission assets.<sup>50</sup> However, if the Presiding Judge is to apply this erroneous FERC finding as a benchmark to adjust the midpoint of the DCF upwards, then the appropriate risk comparison is between investments in distribution assets and investments in transmission assets. In Opinion No. 531, FERC did not compare the risks associated with investing in transmission assets with those of investing in integrated utilities with generation assets.<sup>51</sup> Ms. Lapson's state ROE analysis is inconsistent with the risk comparison described in Opinion No. 531 because she studied the state-approved ROEs for integrated utilities. Further, there is simply no rational justification for adjusting upwards the midpoint of the DCF on the basis of comparing risks that the MISO TOs themselves claim to be similar.<sup>52</sup> Such adjustment does not compensate for the additional risks investors assume, it simply provides a premium for investing in transmission assets while diverting away capital necessary for investments in state-jurisdictional electric assets, such as generation and distribution.

**3. What, if any, other factors should the Commission consider in determining the just and reasonable base ROE for the MISO TOs?**

In determining the appropriate Base ROE for the MISO TOs, the Presiding Judge should consider the availability of transmission rate incentives and formula rates to the MISO TOs. Both transmission rate incentives and formula rates mitigate investment risks relevant to determining the appropriate Base ROE for the MISO TOs. OMS is not claiming that a downward adjustment

---

<sup>49</sup> Exh. No. JCA-14 at 88:22-27.

<sup>50</sup> Opinion No. 531 at P 149.

<sup>51</sup> Indeed, Ms. Lapson specifically included Virginia cases including surcharge riders for generation assets. *See* Exh. No. RPG-9 at 50:3-8.

<sup>52</sup> Exh. No. MTO-16 at 60:21-22 and 61:1.

of the midpoint of the DCF range is appropriate on account of mitigated investment risks. Rather, OMS' point is that mitigation of the MISO TOs' investment risks through transmission rate incentives and formula rates supports a finding that a Base ROE at the midpoint of the DCF range meets the *Hope* and *Bluefield* standards.

#### **4. Where in the zone of reasonableness should the Base ROE be placed?**

The Base ROE for the MISO TOs should be placed at the midpoint of the zone of reasonableness resulting from an IBES-based DCF analysis. Should the Presiding Judge find that anomalous capital market conditions existed during the study period, the Base ROE need not be placed at the midpoint of the upper half of the zone of reasonableness. To protect consumers from unjust and unreasonable rates resulting from an excessive Base ROE, the Presiding Judge could and should place the Base ROE for the MISO TOs at whichever point of central tendency<sup>53</sup> in the upper-half of the zone is closest to the midpoint of the IBES-based DCF analyses and other acceptable benchmarks.

### **III. CONCLUSION**

WHEREFORE, for the aforementioned reasons, OMS respectfully requests that the Presiding Judge issue an initial decision finding that: (1) the MISO TOs' current 12.38 percent and 12.2 percent Base ROEs are unjust and unreasonable; (2) the appropriate application of the Opinion No. 531 DCF methodology requires the use of IBES short-term growth data, consistent with FERC precedent; (3) capital market conditions were not anomalous during the study period and, therefore, FERC need not consider alternative methodologies for estimating the cost of

---

<sup>53</sup> Opinion No. 531-B at P 55 (explaining that in cases involving the placement of the Base ROE above the central tendency of the zone of reasonableness, the Commission has used the central tendency of the top half of the zone).

equity of the MISO TOs; (4) formula rates and transmission rate incentives mitigate investment risks relevant to determining the Base ROE for the MISO TOs and support placing the Base ROE at the midpoint of the DCF range; and (5) placing the Base ROE for the MISO TOs at the midpoint of the upper-half of the DCF zone over-compensates investors for the risks associated with investing in transmission infrastructure and may accordingly displace investments in other necessary electric infrastructure, such as distribution or generation.

Respectfully submitted,

/s/ Andrea I. Sarmentero Garzón

Deborah A. Swanstrom  
Andrea I. Sarmentero Garzón

Counsel for the Organization of  
MISO States

Dated: February 12, 2016

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 12<sup>th</sup> day of February, 2016.

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