

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

Association of Businesses)	
Advocating Tariff Equity, <i>et al.</i>)	
)	
v.)	Docket No. EL14-12-003
)	
Midcontinent Independent System)	
Operator, Inc., <i>et al.</i>)	
)	
)	
Arkansas Electric Cooperative)	
Corporation, <i>et al.</i>)	
)	
v.)	Docket No. EL15-45-000
)	
ALLETE, Inc., <i>et al.</i>)	

**SUPPLEMENTAL COMMENTS OF
THE ORGANIZATION OF MISO STATES, INC.**

Pursuant to Rule 212 of the Federal Energy Regulatory Commission’s (“Commission” or “FERC”) Rules of Practice and Procedure,¹ and the Commission’s Briefing Order,² the Organization of MISO States, Inc. (“OMS”) hereby submits these supplemental comments concerning the justness and reasonableness of Return on Equity (“ROE”) that is established for all transmission owners on an RTO-wide basis.³

State and local regulators have a mandate to ensure that retail customers pay just and reasonable rates. Because of this mandate, state and local regulators often participate in FERC

¹ 18 C.F.R. § 385.212 (2018).

² *Ass’n of Bus. Advocating Tariff Equity v. Midcontinent Indep. Sys. Operator, Inc.*, 165 FERC ¶ 61,118 (2018) (“Briefing Order”).

³ OMS submits these supplemental comments after they were approved by a majority of its Board of Directors. The Manitoba Public Utilities Board and the Mississippi Public Service Commission abstained. The Illinois Commerce Commission voted no. Nothing in OMS’s supplemental comments should be read as assertions or arguments by state and local regulators members of OMS that are applicable to state and local return on equity proceedings. Individual state and local regulators have their own proceedings and applicable precedent guiding state and local return on equity determinations.

ROE proceedings to ensure that the wholesale rates passed through to retail customers are just and reasonable. As explained herein, RTO-wide ROEs severely impair the ability of state and local regulators to challenge the FERC-jurisdictional ROE of transmission utilities located in their respective states. This unnecessarily interferes with the state and local regulators' efforts to ensure that retail customers pay just and reasonable rates. Accordingly, OMS encourages the Commission to depart from RTO-wide ROEs and adopt a more granular approach to examining the risk profiles of utilities in future transmission rate proceedings.

I. SUPPLEMENTAL COMMENTS

In the Briefing Order, the Commission directed participants in the MISO ROE complaint proceedings to “submit briefs regarding the proposed approaches to the FPA section 206 inquiry and whether and how to apply them to the First and Second Complaints.”⁴ In response to this direction, OMS is submitting an Initial Brief jointly with the MISO Complainant-Aligned Parties that addresses application of the Commission’s new ROE framework to the ongoing MISO complaint proceedings. However, the Briefing Order also sought comments addressing “the justness and reasonableness of any aspect of the proposed methodology.”⁵ The related order in the New England proceedings, moreover, explained that the new ROE framework “reflects the Commission’s proposed policy for addressing this issue in the *future*, including in the proceedings currently pending before the Commission.”⁶ It is in this context that OMS submits these supplemental comments to address the justness and reasonableness of RTO-wide ROEs and requests that the Commission continue moving toward a more granular risk analysis in future proceedings that establish ROEs for electric utilities in MISO.

⁴ Briefing Order at P 62.

⁵ *Id.* P 20.

⁶ *Coakley v. Bangor Hydro-Elec. Co.*, 165 FERC ¶ 61,030, at P19 (2018) (emphasis added).

A. There is No Need to Perpetuate the MISO-Wide ROE.

The MISO-wide ROE stems from a 1999 stipulation that set a floor ROE for transmission owners joining MISO when it was first created.⁷ The rationale for the original RTO-wide ROE compromise was avoiding unnecessary litigation that could jeopardize formation of MISO. Those circumstances are no longer present. There is no need for the Commission to perpetuate a MISO-wide ROE going forward. Most RTOs and ISOs do not have region-wide base ROEs and there appear to be no regional differences that justify having an RTO-wide ROE in the MISO footprint.

B. A More Granular Look at the Risk Profile of Electric Utilities in ROE Determinations Requires Departure from RTO-Wide ROEs.

The Briefing Order describes the Commission's historic approach to account for a utility's risk profile by: (i) first including the proxy group companies with credit ratings similar to that of the subject utility, and (ii) subsequently adjusting, if necessary, the ROE within the zone of reasonableness that is derived from the proxy group if the record establishes "particular circumstances" increasing or decreasing the risk profile of the subject utility compared to companies in the proxy group.⁸ An RTO-wide ROE, however, does not result from proxy groups that appropriately reflect the risk-profile of individual transmission owners based on their own credit ratings, and efforts to adjust individual utilities' ROE in RTO-wide ROE proceedings have been rejected.

⁷ *Midwest Indep. Transmission Sys. Operator, Inc.*, 87 FERC ¶ 61,189 (1999).

⁸ Briefing Order at P 27.

1. RTO-Wide ROEs are Not Established by Using Proxy Groups with Risks Comparable to Individual Utilities within MISO.

The Commission describes the MISO TOs as having average risk in the aggregate and states that this fact is undisputed.⁹ However, the risk profile of the MISO TOs was litigated in these proceedings¹⁰ and the ALJ made no finding regarding whether the MISO TOs are of average, below-average, or above-average risk. The record demonstrates that the MISO TOs have risk that varies over a wide range.

There are transmission owners with below investment grade credit ratings and others with credit ratings at the top of the investment grade scale among the MISO TOs. In fact, the record in these proceedings establishes a risk range for the MISO TOs of S&P BB- to S&P AA and a comparable risk band (used in proxy group formation) of BBB- to AA+.¹¹ This is a very broad risk band that cannot appropriately represent the risk profile of each individual transmission owner in MISO. *Hope* and *Bluefield* require that the returns earned by rate-regulated utilities be commensurate with those received by other companies facing similar risks in the same

⁹ *Id.* P 58.

¹⁰ *See e.g.*, Joint Consumer Advocates, Direct Testimony of Stephen G. Hill, Docket No. EL14-12, Exh. No. JCA-1 at 2-3, 40-42 (February 23, 2015); Joint Consumer Advocates, Rebuttal Testimony of Stephen G. Hill, Docket No. EL14-12, Exh. No. JCA-11 at 44-47, 60-62 (July 17, 2015); Joint Complainants, Direct Testimony of Michael P. Gorman, Docket No. EL14-12, Exh. No. JC-1 at 19-21 (February 23, 2015); Joint Customer Interveners, Direct Testimony of J. Bertram Solomon, Docket No. EL14-12, Exh. No. JCI-1 at 32-33 (February 23, 2015); MISO TOs, Answering Testimony of Ellen Lapson, Docket No. EL14-12, Exh. No. MTO-16 at 11-12 (April 6, 2015); MISO TOs, Cross-Answering Testimony of Ellen Lapson, Docket No. EL14-12, Exh. No. MTO-39 at 41-44 (June 15, 2015), Joint Consumer Advocates, Direct Testimony of Stephen G. Hill, Docket No. EL15-45, Exh. No. JCA-1 at 48-53 (September 2, 2015); Joint Consumer Advocates, Rebuttal Testimony of Stephen G. Hill, Docket No. EL15-45, Exh. No. JCA-14 at 65-66, 85-88 (January 22, 2016); Trial Staff, Direct and Answering Testimony of Robert J. Keyton, Docket No. EL15-45, Exh. No. S-1 at 155-156 (November 23, 2015); Industrial Consumer Groups, Direct Testimony of Michael P. Gorman, Docket No. EL15-45, Exh. No. ICG-1 at 45 (September 2, 2015).

¹¹ MISO TOs, Cross-Answering Testimony of William E. Avera, Docket No. EL14-12-002, Exh. No. MTO-26 at 2 (June 15, 2015); MISO TOs, Update Testimony of Adrien M. McKenzie, Docket No. EL15-45-000, Exh. No. MTO-32 at 2 (January 29, 2016).

geographic area and time frame.¹² In this context, a utility with an S&P AA credit rating should not have its rate of return determined using a proxy group that includes companies with an S&P BBB- credit rating.

The Commission has recognized the diversity of risks embedded in an RTO-wide ROE and placed the ROE at the midpoint of the zone of reasonableness to account for this risk diversity.¹³ However, there is no correlation between the ends of the MISO TOs' risk-band and the ends of the cost-of-equity range established by the proxy group.¹⁴ The midpoint of the zone of reasonableness, therefore, does not address FERC's concern with appropriate compensation of all transmission owners when establishing an RTO-wide ROE for a group of utilities with diverse risk profiles.

RTO-wide ROEs will over-compensate some transmission owners and under-compensate others. While ratemaking is not a precise science, the Commission can improve the accuracy and precision of its ROE determinations by adopting a more granular risk analysis approach. OMS is concerned that over-compensated utilities under an RTO-wide ROE structure receive windfalls without any corresponding benefit to customers and that capital diverted to these low-risk high-

¹² *Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n*, 262 U.S. 679, 692 (1923) (the Supreme Court ruled that the returns a public utility earns must be "equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties. . . ."); *Fed. Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944) (ruling that "the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks").

¹³ *Midwest Indep. Transmission Sys. Operator, Inc.*, 106 FERC ¶ 61,302, at PP 9, 10 (2004).

¹⁴ For example, the initial IBES-based DCF analysis submitted by the MISO TOs in the MISO I Complaint proceeding (Docket No. EL14-12) included the high-end outlier return for Ameren Corp. (11.47%) and the low-end outlier for Edison International (6.60%) after eliminating low-end outliers [MISO TOs, Answering Testimony of William E. Avera, Docket No. EL14-12-002, Exh. No. MTO-5 at 1 (April 6, 2015)]. These two outliers within the IBES-based DCF range defined the resulting midpoint (9.03%) [*id.*, Exh. No. MTO-5 at 1]. However, the credit rating for both DCF proxy group outliers was S&P BBB+ [*Id.*, Exh. No. MTO-4 at 1], and the risk band establishing the ends of the credit rating spectrum among the MISO TOs is S&P BB- to AA [*Id.* Exh. No. MTO-4 at 2]. The risk profile of the proxy company COE outliers do not correspond to the lower and upper ends of the MISO TOs' risk band.

return utilities may diminish the funding that is available for necessary electric utility investments, including investments in generation assets, distribution assets, and new regional/interregional transmission projects. At the same time, under-compensated utilities are not incentivized to invest beyond compliance with mandatory reliability and resiliency standards, which could ultimately result in increased overall costs to customers.

2. Adjusting the ROE of Individual Utilities in RTO-Wide ROE Determinations is Difficult.

Once a proxy group that lacks credit-rating comparability is established, proving that the risks faced by an individual transmission owner (among a group of utilities) are higher or lower than those faced by companies in the proxy group through a comparative risk analysis is more difficult. This is because the formation of the proxy group implicitly establishes a presumption that proxy companies represent the risk-profile of each and all of the utilities in the RTO. For example, OMS and others requested adjustments in these proceedings to the base ROE of certain MISO TOs based on their equity-rich capital structures.¹⁵ The Commission rejected these proposed capital structure adjustments and stated that:

Complainants' position fails to take into account the fact that our criteria for selecting members of the proxy group are intended to produce a proxy group made up of companies of similar risk. Those criteria include screens to ensure that the proxy group contains only utilities *with similar credit ratings to the utility at issue*. To the extent that a higher percentage equity in the capital structure reduces a utility's risk, as Complainants and Joint Consumer Advocates assert, then the utility's credit rating would be correspondingly higher than that of a utility with a typical capital structure. The resulting higher credit ratings of members of the proxy group would reduce the calculated ROE, because higher-rated companies generally have lower ROEs. Consequently, additional reductions to the ROEs that are proposed by

¹⁵ Joint Complainants, Direct Testimony of Michael P. Gorman, Docket No. EL14-12, Exh. No. JC-1 at 19-21 (February 23, 2015).

Complainants essentially reduce the ROE twice for featuring equity-rich capital structures.¹⁶

The Commission essentially presumed that the credit ratings of companies in the proxy group represent the credit ratings of the utilities for which adjustments were sought.¹⁷ However, the ITC Holding affiliates that Mr. Gorman identified as having an excessive equity ratio all had S&P A- credit ratings,¹⁸ while companies in the proxy group had credit ratings as low as S&P BBB-.¹⁹ This presumption of proxy group risk comparability makes it extremely difficult for parties in an RTO-wide ROE proceeding to pursue individual adjustments.

¹⁶ *Ass'n of Bus. Advocating Tariff Equity*, Opinion No. 551, 156 FERC ¶ 61,234, at P 288 (2016) (emphasis added).

¹⁷ Joint Complainants, Direct Testimony of Michael P. Gorman, Docket No. EL14-12, Exh. No. JC-3 (February 23, 2015) (showing rich equity ratios above proposed threshold for several MISO transmission owners such as International Transmission Company, ITC Midwest, LLC, or Michigan Electric Transmission Company, LLC).

¹⁸ MISO TOs, Cross-Answering Testimony of William E. Avera, Docket No. EL14-12-002, Exh. No. MTO-26 at 2 (June 15, 2015); MISO TOs, Updated Testimony of Adrien M. McKenzie, Docket No. EL15-45-000, Exh. No. MTO-32 at 2 (January 29, 2016).

¹⁹ *Id.*, Exh. No. MTO-26, at 1; Exh. No. MTO-32, at 1.

II. CONCLUSION

WHEREFORE, for the reasons stated herein, OMS requests that, as the Commission looks at establishing a new ROE framework applicable to future proceedings, it consider: (1) abandoning the RTO-wide ROE approach, and (2) pursuing a more granular risk analysis of individual transmission owners.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have on this date caused a copy of the foregoing document to be served on each person included on the official service list maintained for this proceeding by the Commission's Secretary, by electronic mail or such other means as a party may have requested, in accordance with Rule 2010 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 385.2010.

Dated this 13th day of February, 2019 at Washington, D.C.

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