Document Accession #: 20190410-5240   Filed Date: 04/10/2019

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Association of Businesses Advocating Tariff Equity Coalition of MISO Transmission Customers Illinois Industrial Energy Consumers Indiana Industrial Energy Consumers, Inc. Minnesota Large Industrial Group Wisconsin Industrial Energy Group v. Midcontinent Independent System Operator, Inc. ALLETE, Inc. Ameren Illinois Company Ameren Missouri Ameren Transmission Company of Illinois American Transmission Company LLC Cleco Power LLC Duke Energy Business Services, LLC 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 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 Southern Indiana Gas & Electric Company	Docket No. EL14-12-003
Arkansas Electric Cooperative Corporation Mississippi Delta Energy Agency Clarksdale Public Utilities Commission Public Service Commission of Yazoo City Hoosier Energy Rural Electric Cooperative, Inc. v.	Docket No. EL15-45-000

ALLETE, Inc.
Ameren Illinois Company
Ameren Missouri
Ameren Transmission Company of Illinois
American Transmission Company LLC
Cleco Power LLC
Duke Energy Business Services, LLC
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
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
Southern Indiana Gas & Electric Company

REPLY BRIEF OF
ALLIANT ENERGY CORPORATE SERVICES, INC.

Pursuant to the Federal Energy Regulatory Commission's ("FERC" or "Commission") Order Directing Briefs in the captioned proceedings,[1] and the Notice of Extension of Time issued on December 12, 2018, Alliant Energy Corporate Services, Inc. ("Alliant Energy") hereby submits this Reply Brief on behalf of Interstate Power and Light Company ("IPL") and Wisconsin Power and Light Company ("WPL") (collectively, "Alliant Energy Operating Companies") to address issues raised in initial briefs submitted by certain other parties.

[1] 165 FERC 61,118 (2018) (the "MISO TO Order").

I. INTRODUCTION

The Alliant Energy Operating Companies are regulated electric utilities engaged in providing retail electric service in Iowa and Wisconsin. Because they do not own transmission facilities, the Alliant Energy Operating Companies purchase transmission service from the Midcontinent Independent System Operator, Inc. ("MISO") at cost-based rates set forth in the MISO Open Access Transmission, Energy and Ancillary Services Tariff (the "MISO Tariff"). These proceedings were initiated to determine whether the rate of return on common equity (the "ROE") used by MISO transmission owners (the "MISO TOs") when setting rates for transmission service under the MISO Tariff is just and reasonable, and, if not, to determine the ROE to be used by the MISO TOs prospectively.

In the MISO TO Order, the FERC proposed to evaluate the reasonableness of the ROE being used by MISO TOs based on three financial models that can be used to produce zones of reasonableness: (1) a two-step discounted cash flow model ("DCF"), (2) a capital asset pricing model ("CAPM"), and (3) a forward-looking Expected Earnings model. Based on the composite results produced by those financial models and financial data for the period January 1, 2015 through June 30, 2015, the FERC made a preliminary determination that the pre-existing base ROE of 12.38% used by most MISO TOs was unjust and unreasonable (MISO TO Order at P 59).

The FERC then proposed to rely on these financial models plus a Risk Premium Analysis to determine the just and reasonable ROE for MISO TOs, exclusive of incentives. Based on consideration of those models, the FERC made a preliminary determination that the just and reasonable base ROE for the MISO TOs was 10.28% (MISO TO Order at P 60). However, before finalizing those decisions, the FERC asked parties to submit briefs on its proposed

approach to evaluating ROE to be used by TOs and on the results to be applied to the MISO TOs (MISO TO Order at P 62).

In an Initial Brief filed in response to the MISO TO Order, the Commission Trial Staff recommended that the Expected Earnings model be eliminated from the mix of financial models relied on by the FERC because it "is not a market-based method for estimating the cost of equity, but rather an accounting based measure," and "there is little evidence that the Expected Earnings approach is widely used by investors" (Commission Trial Staff Br. at 2; see also, 9-10). The MISO TOs submitted a Supplemental Brief in which they generally accepted the methodology proposed by the FERC, but argued that the group of proxy companies on which the Expected Earnings analysis of the FERC was based should include information relating to two high "outliers" (MISO TO Br. at 10).

The FERC acknowledged in the MISO TO Order that it was guided in setting a reasonable ROE for the MISO TOs by the well-known decisions by the U.S. Supreme Court in *Hope*[2] and *Bluefield*.[3] As the Supreme Court explained in *Bluefield* (262 U.S. at 692-3):

> The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate under efficient and economical management, to maintain and support its credit and enable it to raise the money necessary for the proper discharge of its public duties.

The Supreme Court subsequently explained in *Hope* (320 U.S. at 603) that:

> …the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

The FERC should continue to be mindful of these standards as it reviews the briefs that are filed in this proceeding.

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[2] *FPC v. Hope Natural Gas Company*, 320 U.S. 591 (1944).
[3] *Bluefield Waterworks Improvement Co. v. Public Service Commission of West Virginia,* 262 U.S. 679 (1923).

II. DISCUSSION

A. The Expected Earnings Approach Should Be Eliminated.

The FERC explained in the Appendix to the MISO TO Order that the Expected Earnings approach relies on estimates of earnings on book value, as reflected in analysts' earnings forecasts for each company. The FERC sought to justify its use of the Expected Earnings method in this proceeding on the basis that:

> The return on book equity that investors expect to receive from a group of companies with risks comparable to those of a particular utility are relevant to determining that utility's cost of equity, because those returns on book equity help investors determine the opportunity cost of investing in that particular utility instead of other companies of comparable risk.

Notwithstanding the FERC's endorsement of the Expected Earnings methodology, the Commission Trial Staff has properly recommended that the FERC eliminate its use of a forward-looking Expected Earnings approach. As the Commission Trial Staff noted, the FERC has traditionally relied on market-based approaches for determining allowable ROE's for regulated companies. Moreover, the other three financial models that the FERC relied on in the MISO TO Order are all market-based models. These market-based financial models appropriately enable the FERC to determine the ROE that will meet the test of *Hope* and *Bluefield* of assuring confidence in the financial soundness of each utility and enabling it to attract capital as needed without unduly burdening consumers. See, e.g., *Generic Determination of Rate of Return on Common Equity for Public Utilities,* Order No. 489, FERC Stats. & Regs., Regulations Preambles ¶ 30,795 at 30,993 (1988).

In contrast, the Expected Earnings approach "provides an accounting-based approach that uses investment analyst estimates of return (net earnings) on book value" (MISO TO Briefing Order at P 36). Because this method is based solely on investor expectations without explicit consideration of regulatory principles, there is no assurance that the expected ROE resulting

from that methodology will meet the standards for a just and reasonable ROE set forth in *Hope* and *Bluefield*. Accordingly, the use of an accounting-based methodology to determine a just and reasonable ROE would be an unjustified departure from the FERC's long-standing practice.

Even if the use of a forward-looking Expected Earnings approach is warranted, the FERC's implementation of the Expected Earnings methodology is unreliable. The affidavit of FERC Trial Staff Witness Robert J. Keyton states that the expected returns on book value used by the FERC in applying the Expected Earnings methodology were all produced by a single analyst (Keyton Aff. At P 21). There is nothing in the record to demonstrate the accuracy of the work by this analyst who prepared the data relied on by the FERC, or to explain how he developed his calculations of expected earnings. In *Ass'n of Businesses Advocating Tariff Equity,* Opinion No. 551, 156 FERC ¶ 61,234 at P 62 (2016), the FERC appropriately rejected the use of growth estimates prepared by a single analyst because they do not constitute consensus estimates. For similar reasons, the FERC should refrain from use of a financial model in this proceeding which relies on data that has not been shown to be reliable.

Moreover, Alliant Energy is unaware of any evidence to indicate that earnings forecasts of utilities that are prepared by individual financial analysts are consistent with the expectations of actual investors whose financial resources are at risk. Under such circumstances, the FERC cannot assure participants in these proceedings that the forecasts of earnings used to implement the Expected Earnings methodology are reliable, consistent with the expectations of actual investors, and appropriate for use in this proceeding.

It is also significant that substantially all of the MISO TOs derive a portion of their earnings from the distribution and sale of electricity to retail electric consumers at rates which are determined by state regulatory authorities. The earnings an investor expects to receive on the

book value of a particular utility stock presumably reflects both the ROE established by the FERC for the portion of a utility's business within its jurisdiction and the ROE adopted by state regulatory authorities when setting rates for retail electric service which are not regulated by the FERC.

However, the FERC stated in the MISO TO Order at fn. 67 that it intends to disregard the level of state ROEs when determining the zone of reasonableness except "to the extent that the record adequately demonstrates that investors are using it to inform their investment decisions." Although state-determined ROEs are clearly relevant to expectations of investors in most utility common stocks, there is nothing in the MISO TO Order to confirm that the FERC has considered state-determined ROEs affecting the earnings of the MISO TOs. It is therefore evident that the expectations of utility earnings as determined by financial analysts may be very different from expectations of utility earnings held by investors in utility stocks which reflect consideration of both the ROE allowed by the FERC and ROEs allowed by state regulators.

For these reasons, the FERC should accept the recommendation of the Commission Trial Staff not to include the Expected Earnings approach in its new ROE methodology.

B. The FERC Properly Excluded "High Outliers" From Its Calculations.

For the purpose of its analyses, the FERC first identified a group of "proxy companies" which met the following criteria, presumably because they have risk profiles comparable to those of the MISO TOs (MISO TO Order at P 50):

> (1) companies that are considered to be electric utilities by Value Line; (2) companies with credit ratings no more than one notch above or below the credit ratings of the MISO TOs; (3) companies that pay dividends and have neither made nor announced a dividend cut during the six month study period; (4) companies with no significant merger activity during the six-month study period; and (5) companies whose ROE results pass a threshold test of economic logic.

Before conducting the expected earnings analysis based on this group of proxy companies, the FERC eliminated the results for two high "outliers," which included ITC Holdings Corp., because of the substantial disparity between their expected earnings and the median ROE under the proposed methodology of all the companies otherwise includable in the proxy group (MISO TO Order at P 55).

The FERC explained in the MISO TO Order at P 54 that it's test for "high-end outliers" is intended to "identify those companies whose cost of equity under the model in question is so far above the cost of equity of a typical proxy company as to suggest that it is the result of atypical circumstances not representative of the risk profile of a more normal utility." The MISO TOs argued that "the Commission's proxy group criteria are designed to identify the *entire population* of utilities deemed to be of comparable risk to the MISO Transmission Owners," and therefore that the method used by the FERC to identify these outliers was misplaced (MISO TO Br. at 10).

The MISO TOs acknowledge that the purpose of excluding estimates associated with "outliers" is "to exclude estimates that are clearly illogical for use as a basis for establishing the zone of reasonableness" (MISO TO Br. at 11). Although the MISO TOs would prefer to have ITC Holdings included in the proxy group, they repeatedly emphasized that ITC Holdings is different from the other companies within the proxy group because "during the study period, ITC Holdings was the nation's only publicly traded, 'pure play' electric transmission company" (MISO TO Br. at 19; see also 25).

As a "pure play" electric transmission company, ITC Midwest is not faced with generation market risks comparable to those facing most of the proxy companies. Moreover, the ROE that the FERC determines is just and reasonable for the MISO TOs will be applied to the

entire rate base of each of transmission company subsidiaries of ITC Holdings. The transmission company subsidiaries of ITC Holdings are also eligible to enjoy elevated ROEs based on ROE incentives granted by the FERC to transmission companies. In contrast, most of the proxy companies rely in part on ROEs established by state regulatory authorities. Finally, the transmission company subsidiaries of ITC Holdings utilize an elevated common equity ratio of 60 percent, which is above other MISO transmission companies. It is therefore evident that the risk profile of ITC Holdings is not representative of the risk profile of a more normal utility. Under such circumstances, it would have been illogical for the FERC to include ITC Holdings in the proxy group used to discern a just and reasonable ROE for the MISO TOs.

The MISO TOs also claim that it was improper for the FERC to omit ITC Holdings from the group of proxy companies used in the Expected Earnings analysis because (MISO TO Br. at 18-19):

> ITC Holdings' 16.37 percent Expected Earnings estimate…is not "*per se* illogical," and is within the bounds of ROE ranges the Commission has accepted in past cases. Moreover, ITC Holdings owns three of the MISO Transmission Owners, ITC, ITC Midwest, and Michigan Electric Transmission Company.

Contrary to the claim by the MISO TOs, the FERC properly omitted ITC Holdings from the group of proxy companies used to implement the Expected Earnings methodology precisely due to the reasons cited by the MISO TOs. Because economic conditions change over time, the range of ROEs that the FERC has accepted in past cases is not indicative of expectations of investors for the future that are used in implementation of a forward-looking Expected Earnings methodology. Moreover, it would be totally illogical for the FERC to set the ROE for the MISO TOs (including the subsidiaries of ITC Holdings) in part on the basis of earnings that investors in ITC Holdings expect to enjoy in the future. In *Orange & Rockland Utilities, Inc.,* 44 FERC ¶ 61,253 at 61,952 (1988), the FERC properly rejected the use of an expected earnings

methodology in which the allowed ROE was based on the earnings that investors expected to realize from the subject company because "O&R's circular approach to a rate of return determination would perpetuate whatever level of earnings is currently anticipated by investors."

For reasons discussed above, the FERC should eliminate the Expected Earnings methodology from the collection of financial models used to determine the ROE for the MISO TOs. However, if the FERC continues to rely on the Expected Earnings methodology, it should exclude the results of high outliers from the results for proxy companies used to implement the Expected Earnings methodology.

CONCLUSIONS

For the reasons discussed in the Initial Brief of the Commission Trial Staff and herein, the Commission should not include the Expected Earnings approach in its new methodology for determining the appropriate base ROE for the MISO TOs. In the event that the FERC continues to rely on the Expected Earnings approach, despite its flaws, the FERC should omit high outliers from the group of proxy companies used to implement that approach on the basis that the experience of those companies is not indicative of returns that the MISO TOs might expect to receive.

Respectfully submitted,

Alliant Energy Corporate Services, Inc.

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April 10, 2019

CERTIFICATE OF SERVICE

In accordance with 18 C.F.R. § 385.2010, I hereby certify that I have on this 10th day of April, 2019, caused a copy of the foregoing to be sent to each person designated on the official service list compiled by the Secretary of the Commission.

__*/s/ Cortlandt C. Choate, Jr.*___

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Document Content(s)

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