



US Electric Utilities & IPPs

**MISO Transmission Wins Round One**

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**FERC ALJ issues Initial Decision for 10.32% base ROE vs UBSe mtm 9.74%**

The FERC Administrative Law Judge (ALJ) issued an [Initial Decision \(ID\)](#) a day early in the 1<sup>st</sup> MISO ROE complaint (EL14-12-002) for a 10.32% base ROE vs the currently authorized 12.38% (12.2% for American Transmission Co). The ID applies the same "upper midpoint" methodology used in the Coakley I case (Opinion 531) based on the need for a higher outcome vs straight midpoint due to "anomalous" economic conditions. Notably, the zone of reasonableness derived from a July mark-to-market of the "two-step" DCF methodology with 5-yr IBES proxy group growth rates is higher than we expected at 7.23% (PEG) to 11.35% (TE). In comparison, our [11/13 note "Transmission Received"](#), we calculated a zone of 6.31% (PEG) to 11.07% (PNM) with an upper midpoint of 9.74% based on a Nov mtm. The ALJ specifically includes TE despite possible distortion from the NMGC transaction and then-pending coal sale, whereas we exclude it. Furthermore, the ALJ notes that 10.32% is higher than 56 of 59 state-auth ROEs studied. Capital structure and incentives are not being considered.

**ALJ says anomalous market conditions are continuing**

The ALJ concludes that "anomalous market conditions existed during the study period and that these conditions make it more difficult to determine whether the Midpoint will produce a Base ROE that appropriately reflects the Transmission Owner's risks".

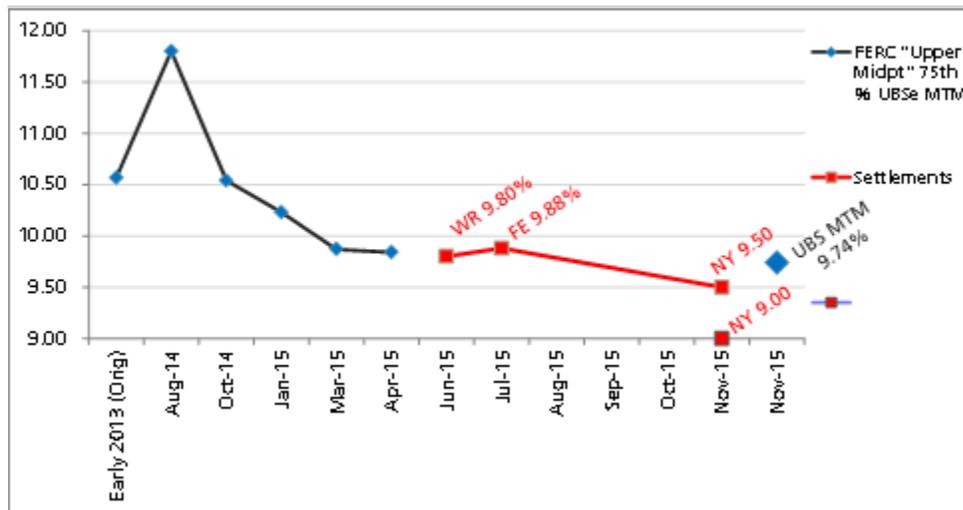
**Final decision could be lower as possible policy changes are incorporated**

Aside from the higher-than-expected outcome using an unchanged methodology, we continue to note that the methodology itself is currently being reconsidered. As we noted in [12/1 "Reading the Tea Leaves in DC"](#), initial FERC decisions typically rely on prior precedent (but not always), with policy changes flowing in afterward through the comment and final decision process at the Commissioner level. Since both MISO complaints were filed post-Coakley, this case may be regarded as an appropriate forum for FERC to address more recent issues during the next phase of comment submissions and deliberation. Chief among these issues is Commissioner Honorable's seeming doubts (expressed to multiple parties) on whether "anomalous market conditions" remain pertinent, especially considering rising interest rates. In conjunction with the recent (November) NY Transco uncontested settlement at 9.0% for longer-dated Indian Point contingency projects (see chart below), this may suggest some risk of reversion in the ROE methodology is already being factored into industry assumptions.

**Expect a positive reaction to initial decision, but long road remains into 2016**

We suspect shares of ITC, AEE, and other transmission exposed stories to MISO could react positively, however, we suspect many will reserve judgement for a full decision in mid-2016, given risk in change to methodology and prev commission concerns.

**Figure 1: Changes in UBSe FERC base ROE MtM and Recent Settlement ROEs**



Source: Company Filings, FactSet, Yahoo! Finance, UBS estimates

## Breaking down of the DCF methodology: ROEs coming in above our expectations

We show the Commission's DCF analysis in Figures 2 and 3 below – the first table includes all 42 utility companies considered in the analysis; whereas the second table is adjusted to exclude EIX, FE, ETR and MGE (as explained in more detail below). We also include the breakdown of our own analysis (published in the research note available at [this link](#)) from mid-November, in Figure 4. Back then, we had calculated a zone of 6.31% (PEG) to 11.07% (PNM) with an upper midpoint of 9.74%. The Commission's Initial Decision now, however, sets the zone b/w 7.23% (PEG) and 11.35% (TECO). – note that we had included TECO from our analysis given possible distortion from the NMGC transaction and then-pending coal sale.

### Company exclusions in final 'Adjusted' Peer group for ROE analysis

In its Initial Decision the Commission set out criteria to include/exclude utilities from the group, the factors included: (1) the utility's COE, (*Cost of Equity*), did not exceed the average yield of a specified class of public utility bonds by more than 100 basis points; (2) the utility did not have a credit rating within a specified range of bond ratings; (3) the utility was not among the companies followed as public utilities by Value Line; and (4) the utility engaged in major merger and/or acquisition activity during the six-month study period.

#### Comparing with our analysis

- Figure 2 below includes three proxy-group utilities with the lowest COEs, Edison International (4.38%), FirstEnergy (5.01%), and Entergy Corporation (5.36%) – however, the 100 basis-point screen means these three utilities were excluded from the final analysis; this is in-line with our own treatment of these companies in our Nov analysis.
- Further, MGE (lowest COE 6.85%) is also excluded because it does not have its own credit rating from either S&P or Moody's – note that *we had included* MGE in our Nov analysis.
- As mentioned above, we had included TECO from our analysis given possible distortion from the NMGC transaction and then-pending coal sale, whereas the Commission includes TECO in its analysis.

[Click on this link to view the full FERC Initial Decision.](#)

**When is to expect final order?** Note that the Commission estimates that it will issue a decision authorizing a Base ROE in this proceeding on or about October 21, 2016.

### **FERC Advisory Staff: don't draw too many conclusions from recent ROE deals**

The last case FERC Advisory Staff had a chance to opine on ROE methodology was the 2014 Coakley case that established the two-step methodology (based on long and short term growth weightings). When we met FERC staff in Nov, they cautioned in extrapolating too much information from recent uncontested settlements, since these deals often involve tradeoffs that usually suggest little in terms of ROE policy. As we recently wrote in our 11/13 note "Transmission Received", the NY Transco settlement in November implied a base ROE for Indian Point contingency projects up to \$228M, with a reduction to 9.0% for projects above the cap. This is notably below our latest mark to market of base ROEs that indicated only a 10 bps reduction since April to 9.74% and may suggest that the settling parties believe that the "anomalous market conditions" justifying the "upper midpoint" methodology in the 2014 New England case could be coming to an end in the next year or two.

### **Existing two-step methodology for growth rates could be under review**

Advisory Staff appears to be reviewing the appropriateness of using the IBES 5-year growth rate within the two-step methodology used to develop the proxy group. We note concern over the reliability of scarce/illiquid 5-year earnings projections and Staff appears to be considering a full range of options at this early stage of their review, including a dividend discount model, EBITDA projections, and a shorter (e.g., 3 years) IBES growth projection. We also note that cash flow measures tend to be less useful for fully regulated utilities that have revenue requirements set on planned ROE levels and accelerated depreciation based on government policy.

*Bottom line, we suspect a review of ROE methodology in the next case could be all-encompassing rather than simply re-running current metrics for the utility peer group, with shifts to the input variables as well as qualifications on which entities are included.*

### **Commission dynamics are evolving too into 2016**

We remain focused on whether the newest members to FERC Chairman Bay and Commissioner Honorable will succeed in pushing for lower ROEs through a straight midpoint methodology in arguing that anomalous market conditions no longer apply. We suspect timing of any decision remains critical with Commissioner Clark rolling off the commission in late 2016. We flag the commission is now 3:1 D's vs. R's following the rolling off of Moeller; we would not expect a new appointee until the next administration, given the trades necessary to appoint new commissioners. |

### **We still expect more focus on distribution**

While a focus on authorized ROEs remains quite relevant, we continue to see the logjam in awarding projects in a FERC-1000 world as significantly impeding execution of capex. We flag few new projects have materialized, largely driving down expectations on spend from many industry peers.

**Figure 2: FERC Mark-to-Market ROE Calculation (Commission's Initial Decision): All peer cos. -> Not used for analysis**

Line	Company	Ticker	Unadjusted Dividend Yield	Growth Rates		Adjusted Dividend Yield	DCF Results	
				Short-Term Yahoo! Finance	Long-Term GDP Composite			
1	Edison International	EIX	2.66%	0.37%	4.30%	1.70%	2.68%	4.38%
2	FirstEnergy Corp.	FE	3.97%	-0.64%	4.30%	1.02%	3.99%	5.01%
3	Entergy Corp.	ETR	4.21%	-0.48%	4.30%	1.13%	4.23%	5.36%
4	Until Corporation	UTL	4.02%	1.90%	4.30%	2.72%	4.07%	6.79%
5	MGE Energy	MGE	2.67%	4.00%	4.30%	4.13%	2.73%	6.96%
6	Public Service Enterprise Group	PEG	3.74%	2.95%	4.30%	3.43%	3.80%	7.23%
7	Consolidated Edison, Inc.	ED	4.14%	2.38%	4.30%	3.04%	4.20%	7.24%
8	OGE Energy Corp.	OGE	3.09%	4.00%	4.30%	4.13%	3.15%	7.28%
9	IDACORP Inc.	IDA	3.04%	4.00%	4.30%	4.21%	3.10%	7.31%
10	PPL Corporation	PPL	4.39%	2.23%	4.30%	2.94%	4.45%	7.39%
11	CenterPoint Energy, Inc.	CNP	4.69%	1.91%	4.30%	2.73%	4.75%	7.48%
12	Westar Energy Inc.	WR	3.74%	3.40%	4.30%	3.73%	3.81%	7.54%
13	Portland General Electric Co.	POR	3.11%	4.70%	4.30%	4.60%	3.18%	7.78%
14	DTE Energy Co.	DTE	3.38%	4.51%	4.30%	4.47%	3.48%	7.93%
15	PG&E Corp.	PCG	3.39%	4.71%	4.30%	4.60%	3.47%	8.07%
16	SCANA Corp.	SCG	3.91%	4.30%	4.30%	4.33%	3.99%	8.32%
17	The Southern Co.	SO	4.62%	3.32%	4.30%	3.67%	4.70%	8.37%
18	Xcel Energy Inc.	XEL	3.68%	4.69%	4.30%	4.63%	3.77%	8.40%
19	NorthWestern Corp.	NWE	3.60%	5.00%	4.30%	4.80%	3.69%	8.46%
20	Duke Energy Corp.	DUK	4.05%	4.49%	4.30%	4.46%	4.14%	8.60%
21	American Electric Power Co. Inc.	AEP	3.68%	5.08%	4.30%	4.85%	3.77%	8.62%
22	NexEra Energy, Inc.	NEE	2.94%	6.27%	4.30%	5.65%	3.02%	8.67%
23	Vectren Corp.	VVC	3.46%	5.50%	4.30%	5.13%	3.53%	8.68%
24	Alliant Energy Corp.	LNT	3.50%	5.45%	4.30%	5.10%	3.59%	8.69%
25	Avista Corp.	AVA	3.93%	5.00%	4.30%	4.80%	4.02%	8.82%
26	Pinnacle West Capital Corp.	PNW	3.74%	5.30%	4.30%	5.00%	3.83%	8.83%
27	Empire District Electric Co.	EDE	4.12%	5.00%	4.30%	4.80%	4.22%	9.02%
28	Dominion Resources, Inc.	D	3.58%	5.89%	4.30%	5.40%	3.68%	9.08%
29	Eversource Energy	ES	3.27%	6.00%	4.30%	5.87%	3.37%	9.24%
30	El Paso Electric Co.	EE	3.01%	7.00%	4.30%	6.14%	3.10%	9.24%
31	Ameren Corp.	AEE	3.91%	5.85%	4.30%	5.37%	4.01%	9.38%
32	CMS Energy Corp.	CMS	3.35%	6.73%	4.30%	5.96%	3.45%	9.41%
33	ALLETE Inc.	ALE	3.85%	6.00%	4.30%	5.47%	3.96%	9.43%
34	Sempra Energy	SRE	2.59%	7.93%	4.30%	6.76%	2.68%	9.44%
35	Great Plains Energy, Inc.	GXP	3.65%	6.37%	4.30%	5.72%	3.75%	9.47%
36	Black Hills Corp.	BKH	3.28%	7.00%	4.30%	6.14%	3.38%	9.52%
37	Otter Tail Corp.	OTTR	4.06%	6.00%	4.30%	5.47%	4.17%	9.64%
38	Exelon	EXC	3.64%	6.81%	4.30%	6.01%	3.75%	9.76%
39	PNM Resources	PNM	2.85%	8.56%	4.30%	7.18%	2.95%	10.13%
40	UIL Holdings	UIL	3.59%	7.79%	4.30%	6.67%	3.71%	10.38%
41	ITC Holdings Corp.	ITC	1.76%	11.66%	4.30%	9.26%	1.84%	11.10%
42	TECO Energy	TE	4.61%	7.68%	4.30%	6.59%	4.76%	11.35%
Moody's Public Utility Bond Yields		Baa					Low:	4.38%
Six-month avg. ending June 30, 2015		4.65%					High:	11.35%
							Midpoint:	7.87%
							Midpoint Top Half of Zone:	9.61%

Source: FERC

Figure 3: FERC Mark-to-Market ROE Calculations: *Adjusted for exclusions -> this is reflected in formal ALJ rec*

Line	Company	Ticker	Un-adjusted Dividend Yield	Growth Rates			Adjusted Dividend Yield	DCF Results
				Short-Term Yahoo! Finance	Long-Term GDP	Composite		
1	Public Service Enterprise Group	PEG	3.74%	2.95%	4.39%	3.43%	3.80%	7.23%
2	Consolidated Edison, Inc.	ED	4.14%	2.38%	4.39%	3.04%	4.20%	7.24%
3	OGE Energy Corp.	OGE	3.09%	4.00%	4.39%	4.13%	3.15%	7.28%
4	IDACORP Inc.	IDA	3.04%	4.00%	4.39%	4.21%	3.10%	7.31%
5	PPL Corporation	PPL	4.39%	2.23%	4.39%	2.94%	4.45%	7.39%
6	CenterPoint Energy, Inc.	CNP	4.69%	1.91%	4.39%	2.73%	4.75%	7.48%
7	Westar Energy Inc.	WR	3.74%	3.40%	4.39%	3.73%	3.81%	7.54%
8	Portland General Electric Co.	POR	3.11%	4.70%	4.39%	4.60%	3.18%	7.78%
9	DTE Energy Co.	DTE	3.38%	4.51%	4.39%	4.47%	3.46%	7.93%
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13	Xcel Energy Inc.	XEL	3.68%	4.69%	4.39%	4.63%	3.77%	8.40%
14	NorthWestern Corp.	NWE	3.60%	5.00%	4.39%	4.80%	3.69%	8.49%
15	Duke Energy Corp.	DUK	4.05%	4.49%	4.39%	4.46%	4.14%	8.60%
16	American Electric Power	AEP	3.68%	5.08%	4.39%	4.85%	3.77%	8.62%
17	NextEra Energy, Inc.	NEE	2.94%	6.27%	4.39%	5.65%	3.02%	8.67%
18	Vectren Corp.	VVC	3.46%	5.50%	4.39%	5.13%	3.55%	8.68%
19	Alliant Energy Corp.	LNT	3.50%	5.45%	4.39%	5.10%	3.59%	8.69%
20	Avista Corp.	AVA	3.93%	5.00%	4.39%	4.80%	4.02%	8.82%
21	Pinnacle West Capital Corp.	PNW	3.74%	5.30%	4.39%	5.00%	3.83%	8.83%
22	Empire District Electric Co.	EDE	4.12%	5.00%	4.39%	4.80%	4.22%	9.02%
23	Dominion Resources, Inc.	D	3.58%	5.89%	4.39%	5.40%	3.68%	9.08%
24	Eversource Energy	ES	3.27%	6.60%	4.39%	5.87%	3.37%	9.24%
25	El Paso Electric Co.	EE	3.01%	7.00%	4.39%	6.14%	3.10%	9.24%
26	Ameren Corp.	AEE	3.91%	5.85%	4.39%	5.37%	4.01%	9.38%
27	CMS Energy Corp.	CMS	3.33%	6.73%	4.39%	5.96%	3.45%	9.41%
28	ALLETE Inc.	ALE	3.83%	6.00%	4.39%	5.47%	3.96%	9.43%
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31	Black Hills Corp.	BKH	3.28%	7.00%	4.39%	6.14%	3.38%	9.52%
32	Otter Tail Corp.	OTTR	4.06%	6.00%	4.39%	5.47%	4.17%	9.64%
33	Exelon	EXC	3.64%	6.81%	4.39%	6.01%	3.75%	9.76%
34	PNM Resources	PNM	2.83%	8.56%	4.39%	7.18%	2.95%	10.13%
35	UIL Holdings	UIL	3.59%	7.79%	4.39%	6.67%	3.71%	10.38%
36	ITC Holdings Corp.	ITC	1.76%	11.66%	4.39%	9.26%	1.84%	11.10%
37	TECO Energy	TE	4.61%	7.68%	4.39%	6.59%	4.76%	11.35%
Moody's Public Utility Bond Yields		Baa					Low:	7.23%
Six-month avg. ending June 30, 2015		4.63%					High:	11.35%
							Midpoint	9.29%
							Middle Top Half of Zone:	10.32%

Source: FERC

## Our ROE estimates from Mid-November analysis

In the table below, we show our peer group analysis from mid Nov ([read report here](#)) used for calculating FERC formula ROE. At the bottom of the table, we highlight the low-end ROE, high-end, midpoint (average of low and high), the upper midpoint (average of the midpoint and the high), and our calculation of the true "75<sup>th</sup> percentile" as determined by ranking all results (excluding companies involved in M&A or anything unusual that may skew the data).

Figure 4: FERC Mark-to-Market ROE Calculation (UBSe Prepared Nov 12th)

Company	Tickers	LT GDP		6 Mo. Avg			ROE	ROERank	Excluded (UBSe)	S&P Rating	Moody's Rating
		IB/E/S 5Yr	Growth	Composite	Adj Div	Yield					
UIL Holdings	UIL	8.84	4.39	7.36	3.71	11.07			M&A	BBB	Baa2
PNM Resources	PNM	9.41	4.39	7.74	3.15	10.89	100%			BBB	Baa2
Sempra	SRE	9.35	4.39	7.70	2.88	10.58	97%			BBB+	Baa1
Wisconsin Energy	WEC	7.55	4.39	6.50	3.76	10.25			M&A	A-	A3
TECO Energy	TE	6.78	4.39	5.98	4.22	10.20			M&A	BBB+	Baa3
Otter Tail	OTTR	6.00	4.39	5.46	4.72	10.18	94%			BBB	Baa2
Ameren	AEE	6.35	4.39	5.70	4.25	9.94	90%			BBB+	Baa3
NorthWestern	NWE	6.81	4.39	6.00	3.78	9.78	87%			BBB	Baa1
PPL Corp	PPL	4.87	4.39	4.71	4.88	9.59			M&A	BBB	Baa3
Empire District Elec.	EDE	5.00	4.39	4.80	4.73	9.53	84%			BBB	N/A
EI Paso Electric	EE	7.00	4.39	6.13	3.37	9.50	81%			BBB	Baa1
CMS Energy	CMS	6.72	4.39	5.94	3.52	9.47	77%			BBB+	Baa2
Eversource	ES	6.57	4.39	5.84	3.55	9.40	74%			A	N/A
ALLETE	ALE	5.50	4.39	5.13	4.23	9.35	71%			BBB+	Baa1
PG&E	PCG	5.94	4.39	5.42	3.66	9.08	68%			BBB	Baa1
NextEra Energy	NEE	6.90	4.39	6.06	3.01	9.07			M&A	A-	Baa1
Avista	AVA	5.00	4.39	4.80	4.24	9.03	65%			BBB	Baa3
Southern Company	SO	3.73	4.39	3.95	5.01	8.96			M&A	A	Baa1
Pinnacle West Capital	PNW	5.15	4.39	4.89	4.05	8.94	61%			A-	Baa3
Great Plains Energy	GXP	5.23	4.39	4.95	3.97	8.92	58%			BBB+	Baa2
Alliant Energy	LNT	5.40	4.39	5.06	3.81	8.87	55%			A-	Baa1
Dominion Resources	D	5.41	4.39	5.07	3.77	8.84	52%			A-	Baa2
Exelon	EXC	5.03	4.39	4.81	3.99	8.81			M&A	BBB	Baa2
Vectren	VVC	5.00	4.39	4.80	3.80	8.59	48%			A-	N/A
ITC Holdings	ITC	7.42	4.39	6.41	2.18	8.58	45%			A-	N/A
SCANA	SCG	4.45	4.39	4.43	4.15	8.58	42%			BBB+	Baa3
American Electric Po.	AEP	4.63	4.39	4.55	3.95	8.50	39%			BBB	Baa1
DTE Energy	DTE	4.94	4.39	4.75	3.70	8.45	35%			BBB+	A3
Xcel Energy	XEL	4.68	4.39	4.58	3.80	8.38	32%			A-	A3
Duke Energy	DUK	3.27	4.39	3.64	4.55	8.19	29%			BBB+	A3
Westar Energy	WR	3.90	4.39	4.06	3.97	8.04	26%			BBB+	Baa3
Hawaiian Electric	HE	3.20	4.39	3.60	4.25	7.84			M&A	BBB-	N/A
Black Hills Corp	BKH	3.48	4.39	3.78	3.83	7.61			M&A	BBB	N/A
Portland General Ele.	POR	3.92	4.39	4.08	3.41	7.49	23%			BBB	Baa2
Consolidated Edison	ED	2.72	4.39	3.28	4.19	7.47	19%			A-	WR
IDACORP	IDA	4.00	4.39	4.13	3.22	7.35	16%			BBB	Baa2
MGE Energy	MGEE	4.00	4.39	4.13	3.03	7.16	13%			AA-	N/A
CenterPoint Energy	CNP	0.45	4.39	1.76	5.28	7.04	10%			A-	N/A
OGE Energy	OGE	2.40	4.39	3.06	3.65	6.71	6%			A-	A3
PSE&G	PEG	1.54	4.39	2.49	3.82	6.31	3%			BBB+	Baa2
Cleco	CNL	N/A	4.39	N/A	N/A	N/A			M&A	BBB+	Baa1
FirstEnergy	FE	(0.64)	4.39	1.04	4.38	5.42			ROE	BBB-	Baa3
PEPCO Holdings	POM	4.33	4.39	4.35	4.25	8.60			M&A/ROE	BBB+	Baa3
Edison International	EIX	(0.44)	4.39	1.17	2.81	3.99			ROE	BBB+	A2
Entergy	ETR	(2.61)	4.39	-0.28	4.80	4.52			ROE	BBB	Baa3
Integrus Energy Group	TEG	N/A	4.39	N/A	N/A	N/A			M&A	A-	Baa1
UNS Energy Group	UNS	N/A	4.39	N/A	N/A	N/A			M&A	N/A	Baa1
CH Energy Group	N/A	N/A	4.39	N/A	N/A	N/A			M&A	N/A	N/A
NV Energy	N/A	N/A	4.39	N/A	N/A	N/A			M&A	N/A	N/A

Zone of Reasonableness (MTM)	Low	Midpoint	75th Percentile	Midpt of Upper	High
12-Nov-15	6.31	8.60	9.41	9.74	10.89
Prior calc (Sept 28, 2015)	6.75	9.18	9.24	10.39	11.61

Source: Company Filings, FactSet, Yahoo! Finance, and UBS Estimates