



United States of America Before The Federal Energy Regulatory Commission

Statement of)
Policy on Electric)
Transmission Rates) Docket No. RM13-18-000
Of Return on Equity)
)

PETITION FOR STATEMENT OF POLICY

Pursuant to Rule 207(a)(4) and (5) of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission (“FERC” or the “Commission”), 18 C.F.R. § 385.207 (a)(4) and (5) (2012), WIRES¹ (or “Petitioner”) hereby petitions the Commission to institute an expedited generic proceeding and to provide such policy and clarifications as necessary to provide transmission owners and operators, transmission customers, electricity consumers, and the investment community with greater stability and predictability regarding regulated rates of return on equity (or “ROE”) for existing and future investments in high voltage electric transmission infrastructure. This Petition responds to important and unusual developments in

¹ WIRES (aka, the **W**orking group for Investment in **R**eliable and **E**conomic electric **S**ystems) is a national non-profit association of investor-, member-, and publicly-owned entities dedicated to promoting investment in a strong, well-planned, and environmentally beneficial high voltage electric transmission grid. Information about its principles and members is available on its website www.wiresgroup.com.

the capital markets, as well as changes in law, Commission policy, and national economic developments that have resulted in pending complaint proceedings² under the Federal Power Act (“FPA”) that will affect investor perceptions of transmission investments and therefore infrastructure investment itself.

Petitioner WIRES is filing for an expedited generic reexamination of the Commission’s approach to setting allowed base returns on equity because it is persuaded both that the issues are well understood and that resolution of the present uncertainties can be handled with dispatch. It therefore does not support a protracted Inquiry that would leave unaffected pending disputes over appropriate rates of return on equity for electric transmission. Petitioner also recognizes that, while administrative litigation is available to the Commission and stakeholders when more extensive exploration of individual factual circumstances surrounding specific investments is necessary, current disagreements over rates of return for transmission investments revolve around matters of methodology and general policy, which are potentially unsettling the investment picture. Single-issue contested cases may not provide the kind of precedent or certainty that would guide future investment in the transmission grid. Perhaps, the results would be quite the opposite. Moreover, litigation is usually a more expensive option for companies and customers. Petitioner asks the Commission to explore methodological options that will reduce or eliminate the uncertainties and risks to investors and to customers

² It is not Petitioner’s purpose or intention to argue the specific merits of pending FPA Section 205 or 206 cases before the Commission in other dockets. However, it is our contention that, taken as a whole, these cases raise immediate and pressing concerns about Commission policies toward transmission investment and about the ability of the Commission to address this spate of administrative litigation effectively, timely, and efficiently. This Petition does not in any way seek Commission review of equity return policies in areas other than the unique circumstances of electric transmission subject to FPA Part II.

and avoid potential reductions in investment in needed transmission facilities, higher costs, project delays, and disruption to infrastructure planning and growth.

For the reasons set forth herein, WIRES contends that the time is right for the Commission to reexamine how its prevailing Discounted Cash Flow (“DCF”) methodology is employed to arrive at appropriate rates of return on equity and the implication of DCF-related litigation and policies for investor behavior, the future of the nation’s transmission system, and the success of Commission policies that depend on the continued build-out and improvement of the transmission system. Petitioner therefore recommends a new policy that (1) standardizes selection of proxy groups; (2) denies complainants a hearing on rates of return for existing facilities unless it is shown that existing returns are at the extremes of the zone of reasonableness; (3) allows consideration of competing infrastructure investments of other industries; (4) permits use of other rate of return methodologies; and (5) supports use of more forward-looking data and modeling. In addition, this Petition urges the Commission to support consideration of a project’s actual and anticipated benefits when a complaint is filed against a rate of return on equity for an existing project.

Petitioner starts from the supposition that electric transmission investment is a special case in the emerging electric industry environment. Consistent and well-planned transmission investment year-in and year-out, guided by predictable Commission policies and driven by new technologies, evolving economics, and a mix of existing and emerging markets, should be the “new normal.” Transmission assets are long-lived, intergenerational investments. The physical transmission network of

AC and DC facilities is the indispensable platform upon which rests wholesale power markets of various designs. Despite the continuing challenges to its planning and siting, transmission is the “critical link” between generation and customers, and its vitality is key to FERC’s bulk power market policy objectives. The industry’s principal game-changing developments of the last two decades -- open access and comparability requirements, regional wholesale power markets, accelerating network integration, the arrival of non-utility transmission investors as well as utility diversification into commercial transmission, deployment of digital monitoring and control technologies, and new forms of renewable energy -- depend significantly on the adequacy and efficiency of the grid. In recognition of that fact, transmission has emerged as a separate business and profit center, even for many incumbent transmission providers whose transmission investments were historically the by-product of service to native load.

If transmission investment is allowed once again to decline for long periods and to cease competing to be the investment of choice by investors and customers, the economy will inevitably be robbed of the potential benefits of the stronger grid toward which policy makers have been working. It is therefore time to move past “zero-sum” transmission ratemaking disputes to more stable rates of return on equity and a more stable pattern of infrastructure investment that will sustain transmission’s diverse benefits as well as the Commission’s initiatives. For participants in the commercial transmission sector and their investors as well as for transmission in integrated markets, resource allocations are driven by available returns. This requires nothing less than a commitment to a steady regulatory risk

profile that maintains transmission's attractiveness to capital. This level of sustainability is now being jeopardized by the uncertainties surrounding allowed rates of return, such as the prospect of 200-300 basis point reductions in equity returns.

In WIRES' view, one key to sustaining transmission investment is rational application of the DCF methodology or such other methodologies as may appropriately fit the financial environment and Commission objectives. Fully acknowledging the Commission's responsibility to ensure that rates remain "just and reasonable" and fair to customers, it is also axiomatic that private investors must be attracted to regulated investment so that the stake that all customers and our entire economy³ have in the adequacy, resilience, and efficiency of the nation's high voltage transmission system is not undermined by short-term stratagems. In that spirit, Petitioner respectfully asks the Commission to promptly initiate a generic proceeding with the objectives of fostering an open discussion of the effects of declining rates of return for equity investments in electric transmission in the current economic environment and clarifying, by policy, the permissible application of the DCF methodology under the current economic conditions or the use of other rate of return methodologies that might better achieve sustained and sustainable levels of needed investment in the electric transmission system as an end result.

³ See, e.g., The Brattle Group, *Employment and Economic Benefits of Transmission Infrastructure Investment in the U.S. and Canada* (WIRES, 2011).

I. CORRESPONDENCE AND COMMUNICATIONS.

Communications, inquiries, and notices regarding this filing should be sent to:

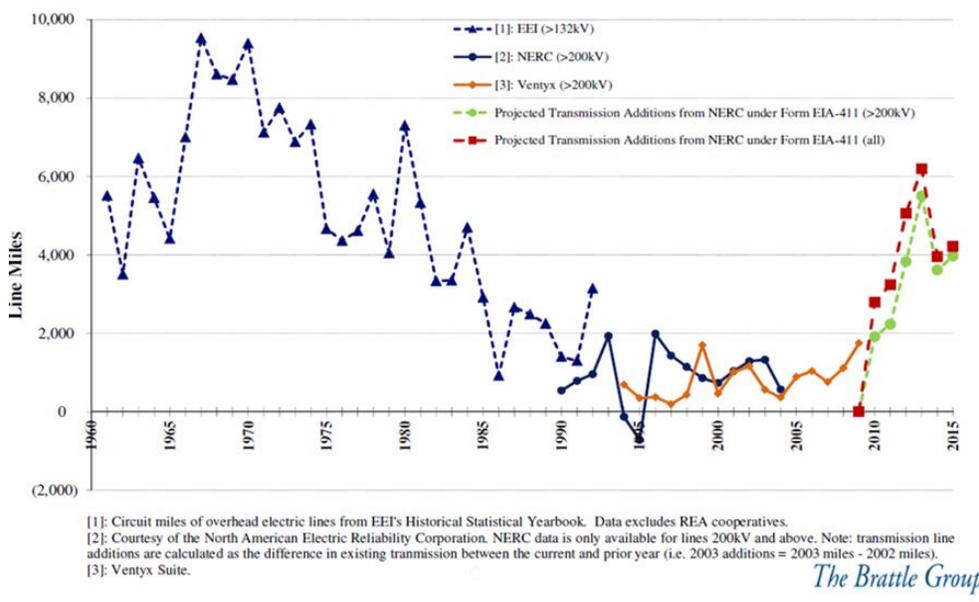
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II. BACKGROUND

During the past decade, the expansion and upgrade of the nation's high voltage transmission system has become an investment priority for the U.S. and, indeed, the North American electric power market. It is widely acknowledged that the nation will need to revitalize infrastructure investment over the coming two or more decades and that the high-voltage electric transmission system is among the foundational aspects of our economy that are in danger of being inadequate, vulnerable, outmoded, and incapable of serving the increasingly diverse and widely dispersed fleet of new generation technologies or meeting customers' needs.⁴ While considerable investment will be devoted to installing advanced digital technologies to enhance the efficiency, reliability, and power transfer capabilities of high voltage

⁴ See, e.g., The Brattle Group, *Transforming America's Power Industry: The Investment Challenge 2010-2030*, prepared for the Edison Foundation (2008); Bipartisan Policy Center Energy & Infrastructure Program, *Policies for a Modern and Reliable U.S. Electric Grid* (February 2013), <http://bipartisanpolicy.org/sites/default/files/Energy_Grid_Report.pdf> Center For American Progress, *The Clean Energy Agenda: A Comprehensive Approach to Building the Low-Carbon Economy* (September 2009); Susan F. Tierney, *A 21st Century "Interstate Electric Highway System" -- Connecting Consumers and Domestic Clean Power Supplies*, Analysis Group (2008); American Society of Civil Engineers, *Failure To Act: The Economic Impact of Current Investment in Electricity Infrastructure* (2012).

transmission, the need for additional conventional transmission resources, estimated to exceed \$300 billion in the second and third decades of this century, is widely recognized.⁵ This recognition is the logical outcome of a quarter century of underinvestment in transmission, new technologies, and significant changes in the North American fuel supply. Despite efforts by Congress and regulators to address decades of uncoordinated permitting and planning regimes, the prognosis for healthy transmission investment is anything but clear. Following Order No. 888 in 1996, the nation's high voltage network, designed for an electricity marketplace dominated by incumbent load-serving entities and constrained monopoly service territories, has often underperformed or failed to keep up with the needs of a 21st Century bulk power system. The need for more transmission capacity has become evident. Despite the fact that the trend in investment has reversed itself, today's levels of investment still do not approach those of the mid-20th Century.



⁵ The job creation implications of the level of transmission manufacturing and construction needed to meet such investment goals is explored in The Brattle Group's *Employment and Economic Benefits of Transmission Infrastructure Investment in the U.S. and Canada* (WIRES, 2011).

Having experienced a historic surge in high voltage transmission investment in the decades immediately following World War II as emergency service and moving energy across service territory, state, and even regional boundaries became possible, the nation turned to expanding electric generation, especially from independent power producers who were deploying new natural gas turbine technologies. Competitive bulk power markets, transmission open access, regional grid management, the digital revolution, and cost-competitive renewable energy were barely on the horizon. Three, four, and in some cases five decades after our principal transmission facilities were built, the nation's grid now finds itself in a very different place technologically, institutionally, market-wise, and in terms of the policies and expectations placed on it. Micro-grids, distributed generation, and energy storage technologies represent new and potentially important competition for investors' resources.

To get to the energy future, we will have to address the stresses on the electrical system from the increasing demand for power and competitive bulk power markets as well as the prospect of major shifts in public policy toward alternative, often location-constrained, resources. These demands are here now and have regrettably coincided with the end of the useful lives of many transmission facilities. Moreover, the impacts of regional outages and wide-spread weather phenomena like Super Storm Sandy highlight in the cruelest possible way the need to invest in the transmission grid. A return to the days of declining transmission investment is certainly something to be avoided. It will help if large projects break

ground in the near future or if states or regions find ways to cooperate on planning, siting, and cost allocation. However, there is ample room for skepticism:

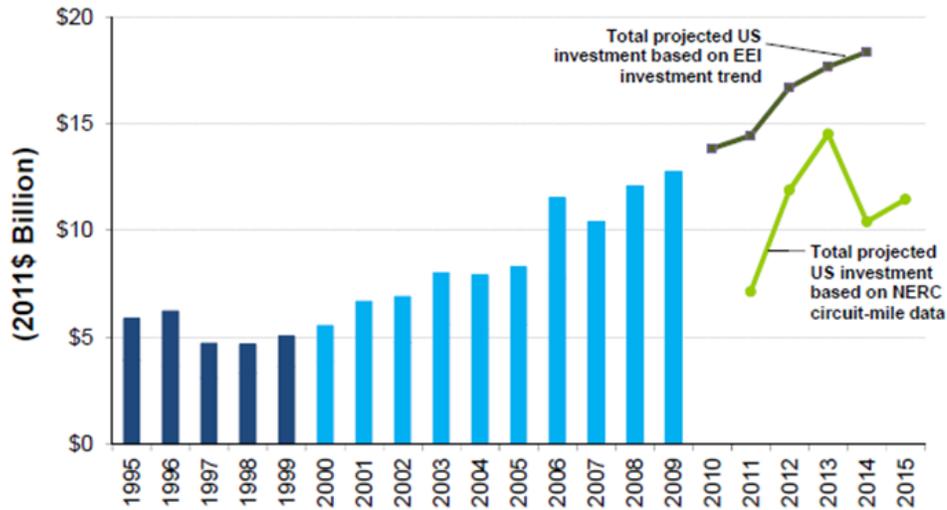
Realistically, less successful outcomes are entirely possible. Transmission expansion could falter for any of the customary reasons, not to mention some new or unforeseen problems. Another decade or two in which new transmission lags behind the need for new capacity will have dramatic consequences for the range of supply choices we can access. And now, more than ever, the more supply options we have the better.⁶

Petitioner WIRES simply points out that the Commission has an opportunity here to avoid creating yet another barrier to investment.

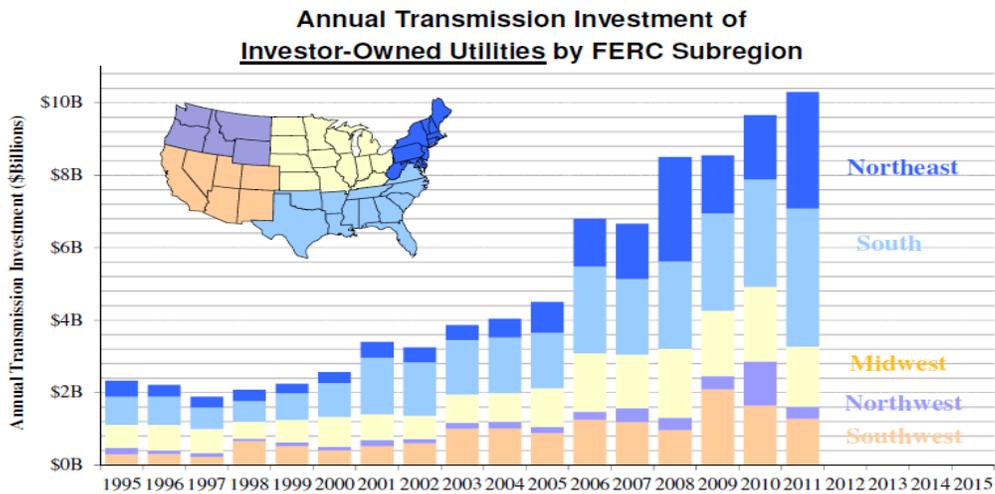
In sum, today's grid is expected to be ubiquitous, readily available to all customers (even as distributed power and micro-grids are being deployed), resilient and flexible, and supportive of both foreseeable and hard-to-predict alternative energy futures. Needless to say, the aging grid has trouble meeting such expectations, notwithstanding new levels of investment that may well peak this year at \$12-14 billion for FERC-jurisdictional and non-jurisdictional transmission.⁷

⁶ Fox-Penner, *Smart Power: Climate Change, the Smart Grid, and the Future of Electric Utilities* (Island Press, 2010) at 93.

⁷ Typically, transmission costs comprise less than 10% of retail rates. However, even with new and contemplated increases in investment, Petitioner believes that, even the most substantial increases in regulated transmission investment would rarely, if ever, result in transmission being more than one-fifth of retail rates regionally. Of course, the rate impact of regulated transmission investment on individual customers is reduced, perhaps dramatically, in relation to how broadly costs are shared. Moreover, adequate transmission enables more efficient use of generation resources; those savings will tend to offset, at least in part, any increases in transmission rates.



Source: The Brattle Group, *Employment and Economic Benefits of Transmission Infrastructure Investment in the U.S. and Canada*, prepared by J. Pfeifenberger and D. Hou for WIRES, May 2010.



Source: The Brattle Group's analysis of FERC Form 1 data compiled in Ventyx's Velocity Suite.

The Brattle Group

The Commission has elegantly articulated and, in many ways, driven many of these positive developments through its orders, beginning with transmission open access under Order No. 888, Order No. 2000 and RTO policies, interconnection

orders, incentive ratemaking decisions, renewable energy integration approaches, and so forth. It has set about making adjustments to regional transmission planning mechanisms to accommodate the changing fundamentals of the transmission business through Order Nos. 890 and 1000. Transmission lines are being planned to help satisfy public policies that aim to connect rich, domestic renewable resources that lack market access. However, although the basis for the resurgence of transmission investment primarily involves growing interest in location-constrained renewable energy, continuing reliability concerns, emerging monitoring and control technologies, and high and disparate electricity prices, a major and substantial impetus for new investment was supplied by federal regulatory initiatives promoting regionally competitive power markets and transmission open access. It is no accident that modernization and expansion of the nation's transmission system has coincided with implementation of the Energy Policy Act of 2005 and its directive to the Commission to provide "incentive-based rate treatments" for jurisdictional public utility transmission projects, including "a return on equity that attracts new investment in transmission facilities (including related transmission technologies)."⁸

The Commission fully understands that the transmission sector stands at a crossroad in its evolution and capital requirements. The adequacy and strength of the grid have never been more important to federal electricity policy goals,

⁸ FPA Section 219, 16 USC § 824. The Commission's admirable discharge of its statutory obligation in Order No. 679 and numerous individual cases has induced investors to commit billions of dollars in additional private capital to the sector, without abandoning its other, historical statutory duty to ensure rates remain "just and reasonable."

restoration of our nation's economic growth, or the emergence of 21st Century energy diversity. Balancing the traditional objectives of all public utility ratemaking beginning with *Hope*⁹ and *Bluefield*¹⁰ -- fairness, economic efficiency, the need to attract capital, and administrative efficiency¹¹ -- has never been more important to continuing, if not accelerating, the expansion and upgrade of the transmission grid.

Nevertheless, establishing an appropriate cost of equity in any individual case is especially fraught with difficulty.

Despite the apparent rigor and precision of the financial models used to estimate the cost of equity, much judgment is required in the application of these models. Seven-decimal point estimates based on elaborate modeling give a false air of precision. No single or group test is conclusive.¹²

Petitioner believes that the subjective judgments and evolving standards associated with application of DCF in litigated cases will significantly affect investor behavior and, if left to evolve solely through litigation, will add greater regulatory risk and uncertainty to the recognizable barriers that transmission development already faces.¹³ In short, uncertain risks and rewards for investors could have potentially significant intergenerational implications for the strength and quality of electric

⁹ *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 391 (1944).

¹⁰ *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923).

¹¹ Bonbright, Danielsen, and Kamerschen, *Principles of Public Utility Rates* (1988), 382 et seq.; Fox-Penner, *Electric Utility Restructuring: A Guide to the Competitive Era* (1997), 309, passim.

¹² Bonbright et al. at 317.

¹³ WIRES is not alone in this view. See Edison Electric Institute, *Transmission Investment: Adequate Return and Regulatory Certainty Are Key* (June 6, 2013)

http://eei.org/ourissues/ElectricityTransmission/Documents/transmission_investment.pdf.

EEI raises for consideration several specific ways to achieve a more predictable and equitable application of DCF, many of which we find helpful. If the Commission grants this Petition, WIRES respectfully requests that the Commission take official notice of the EEI report.

service down the road and for the ability to integrate large amounts of domestic renewable resources into the system.

More specifically, evolving and unpredictable application of DCF and related rate components are creating, and are likely to continue to create, uncertainty in capital markets. Nothing is more likely to deter investors than the inability to foresee adequate returns or the *post hoc* revision of the regulatory bargains made with investors. In a traditional, more balkanized domestic energy environment of less risky regulated asset development, in a less globalized capital market, in an economy where there are fewer competing infrastructure needs than in the U.S. today, or in a sustainable interest rate environment that is not being significantly impacted by federal monetary policies, regulators could more easily set rates based primarily on the short-term system needs, customer rate levels, and a static ratemaking methodology. We merely raise for the Commission's consideration whether the times require consideration of other approaches.

The Commission's role in protecting customers from excessive rates remains critical, but Petitioner also emphasizes that the world in which the grid must be built and maintained has changed. It is therefore equally important that ratemaking be calibrated to account for the risks to customers, including intergenerational risks and inequities, of a future economy laboring with an inadequate electricity delivery system. As the Commission fully understands, transmission infrastructure is not a just-in-time inventory item but instead must be planned, permitted, and constructed over a period of many years. Any persistent uncertainty that rate regulation creates

will unsettle the recent progress made in transmission investment and drive capital to other parts of this or other economies.

II. DISCUSSION OF PETITION FOR POLICY CHANGES

A. Need for Prompt Action

Petitioner acknowledges that developments in the capital markets and federal monetary policy have reduced the cost of borrowing to levels not seen since the 1940's. The Federal Reserve's response to the nation's economic anemia, in the form of "quantitative easing" and large-scale purchases of mortgage-backed securities, has affected the cost of money, including utility bond yields and other non-Treasury debt instruments. A mechanical application of DCF might suggest lower equity returns under such circumstances, but the result is both bad policy and short-sighted economics. WIRES does not come to the Commission asking that such developments be ignored. This Petition does not simply ask for high returns on investment. What WIRES *does* request is the kind of certainty and rate stability that will sustain investment in the grid over the next two or more decades, during which time hundreds of billions of private investment dollars will be needed to make the grid as resilient, strong, extensive, and efficient as planners, engineers, and economists tell us it must become.

Current economic conditions, which are impacting the ROE DCF calculation in ways that create unreasonable end results, are likely to be transitory, potentially changing as swiftly as they arose.¹⁴ Significant indicators from the investor

¹⁴ For example, "Global Tumult Grips Markets", A1, <http://online.wsj.com/article/SB10001424127887324904004578539730750353330.html>; "Inflation Shield Loses Its Appeal", C1

community reflect a belief that a robust economic recovery is anticipated and, with that, a significant increase of long-term capital costs. As Standard & Poor's has suggested, we are emerging from an unusual financial crisis, and the future of capital markets is not entirely predictable.¹⁵ It is nevertheless self-evident that the cost of capital has nowhere to go but up. Moreover, unlike recent periods in American history dating back to the mid-20th Century, there is a widespread and pressing need for investment in domestic infrastructure of various kinds.¹⁶

Given the constraints on federal and state government spending, it is likely that the capital to resurrect bridges and roads, port facilities, water treatment facilities, and airports will increasingly come from private sources. Natural gas-based electric generation and extensive natural gas pipeline investment that provides access to new shale gas supplies will command significant private investment. Investors will therefore have extraordinary opportunities in the future to invest in relatively risk-neutral infrastructure facilities. It is therefore an appropriate time to re-think whether the mechanisms for establishing rates of

<http://online.wsj.com/article/SB10001424127887323495604578539190572130684.html?KEYWORDS=Inflation+Shield+Loses+Its+Appeal>, *Wall Street Journal* (June 12, 2013); "Markets Flinch as Fed Eyes Easy-Money End," A1, <http://online.wsj.com/article/SB10001424127887324577904578555562630037552.html>, *Wall Street Journal* (June 20, 2013).

¹⁵ Standard and Poor's, "U.S. Economic Forecast: Like A Box of Chocolates," *Ratings Direct* (Feb. 19, 2013),

<http://www.standardandpoors.com/ratings/articles/en/us/?articleType=HTML&assetID=1245347996359>.

¹⁶ The American Society of Civil Engineers ("ASCE") recently rated our domestic electric transmission system a D+ and predicted a sizable underinvestment in the grid in this decade, costing average consumers and households billions of dollars and lowering the American standard of living. ASCE, *Failure To Act: The Economic Impact of Current Investment Trends in Electricity Infrastructure* (2012), http://www.asce.org/uploadedFiles/Infrastructure/Failure_to_Act/SCE41%20report_Final-Lores.pdf. Other critical elements of our domestic infrastructure fared no better, and often did worse than transmission in the eyes of ASCE. See ASCE, *2013 Report Card for America's infrastructure* (2013), <http://www.infrastructurereportcard.org/>.

return on equity for transmission investment and the uncertainties that result in recurrent litigation on the issue places the regulated transmission sector at an inherent competitive disadvantage in domestic and global capital markets. Petitioner urges the Commission to think about whether this could increasingly become the case. Such a realization argues for greater consistency in regulatory policy.

Rate-setting may be as much art as science, but investments in infrastructure that will support the power system for a half-century represent a long-term bargain between investors and the public. That bargain should be sustained, especially where rates for existing projects fall well within the “zone of reasonableness” where earnings may properly fluctuate without being deemed excessive to customers or confiscatory for utilities, in terms used by *Hope* and *Bluefield*. When approved equity returns are challenged as unjust and unreasonable, changes should not be readily entertained unless the facts indicate that the underlying bargain between transmission owners and customers is contrary to the public interest. Once built, transmission assets stand ready upon demand to provide service and help execute public policy. These investments comprise one of the few major infrastructure networks that have historically been funded with private capital. We contend that this places upon regulators a special obligation to be consistent.

Petitioner does not, and indeed cannot, argue the merits of the pending challenges to returns on equity. It nevertheless points out that having the current debate over equity returns for transmission in the context of case-by-case litigation

has already affected, and will continue to affect, investor perceptions¹⁷ and behaviors and consequently their decisions to invest. Pending litigation may also create more delay, uncertainty, and administrative burdens for the Commission itself and the industry than would a generic Inquiry into whether DCF continues to be the single most appropriate method of computing an equity return and, if it is, whether DCF components should be changed to recognize the state of the current economy. While establishing just and reasonable rates can be a fact-intensive process, the issues facing the Commission today with respect to how best to advance its pro-transmission policies by establishing a stable ratemaking regime involve principally matters of judgment, policy, and methodological guidance and regularity.

An expedited generic proceeding would afford all affected stakeholders an adequate opportunity to inform the Commission on the most acceptable resolution to the return on equity issue. Cyclical rate levels and regulatory determinations that could plunge allowed returns 200-300 basis points are simply not compatible with the long-term development of the transmission system. Prompt action by the Commission through a Statement of Policy could avert any deleterious effects from the current uncertainty over base rates of return on equity.

¹⁷ The market appears persuaded that there is a need for more transmission and that the sector's credit needs must be supported. Analysts find transmission attractive in part because FERC ROE's are traditionally higher than those granted by state regulators for other utility assets and ventures. Petitioner believes the investment community is, or will soon become, apprehensive about the prospect of declining transmission-related ROEs and other regulatory uncertainties. *See, e.g.*, Moody's Investor Service, Special Comment, "May The FERC Be With You: FERC Remains Supportive of Electric Transmission Investment, but Regulatory Risks Are Growing," May 9, 2013. *See* announcement at http://www.moodys.com/research/Moodys-Despite-pressures-FERC-likely-to-remain-supportive-of-transmission--PR_272807, http://www.moodys.com/research/May-The-FERC-Be-With-You-FERC-Remains-Supportive-of--PBC_153066.

WIRES does not seek a generic rate of return for transmission. Nevertheless, it is time for the Commission to opine with greater specificity about the proper application of elements of the DCF methodology in the current capital market environment or other ROE methodologies in transmission cases, thereby ensuring an investment climate that meets all aspects of the *Hope* and *Bluefield* criteria. Because we expect that the Commission will receive substantial comments almost immediately in such a proceeding, the Petitioner asks only that it consider them as quickly as possible and help move all parties beyond this debate as it implements Order No. 1000.

B. A “Look Under The Hood” At the DCF Methodology

The Commission should craft a Statement of Policy¹⁸ governing the selection of proxy groups whose publicly traded stock performance is taken as comparable or representative of a company’s risk profile. The disagreements over techniques and rationales for eliminating high and low proxies, over excluding companies outside of a region or an organized market, or over some other geographic or economic disability should indicate to the Commission that such issues invite subjectivity and lead to evolving and therefore unpredictable standards. In addition, determining growth rates is particularly difficult in the current prevailing financial market conditions. The peculiar current state of today’s capital markets, which are so heavily influenced by unprecedented government monetary policies, argues for an

¹⁸ WIRES believes there is a binding norm obtained through rulemaking that would do more to ensure consistency than a policy statement. However, the need to address this particular matter within a short period of time and the familiarity of Commission staff and industry parties with the issues argue for a short comment period, followed by a Statement of Policy. Such action would shed light on the Commission’s intentions going forward while preserving its flexibility in the face of changing facts and events.

approach to developing the components of a DCF analysis that diminishes debate over financial market cycles and instead promotes stability in allowed returns that evens out the potholes in the markets. The concept of a zone of reasonableness is itself an acknowledgment that the Commission's informed judgment¹⁹ and attention to end results²⁰ plays a large role in ascertaining whether rates meet the just and reasonable standard. If, as the Petitioner strongly contends, the growth and future adequacy and security of the transmission grid are central to Commission policy and the long-run economic welfare of customers generally, then the Commission has a compelling interest in creating a predictable and stable rate regime that will help ensure consistent levels of transmission investment. In setting just and reasonable rates, the Commission must take into account the impact on public policy.²¹ The Commission should consider at this time whether the results of the DCF analysis will adequately satisfy its transmission policy objectives and provide utilities with returns on equity that will fairly compensate investors for their investment, attract new capital, and sustain the financial integrity of the utility.²²

¹⁹ "It is clear that determining the cost of capital is not an exact science. It is based on as objective and comparable data as possible, but experience and judgment must be used in drawing conclusions." Phillips, *The Regulation of Public Utilities: Theory and Practice* (Public Utilities Reports Inc., 1984), at 363.

²⁰ *Federal Power Comm. v. Hope Natural Gas Co.*, 320 U.S. 591, esp. 603 (1942). *Hope* stands for the proposition that "it is the end result that is important and not the methods used to arrive at the rates. The test of reasonableness should be evaluated on the results it produces, and its [sic] reasonableness and fairness to ratepayers and investors." Bonbright et al., *Principles of Public Utility Rates*, at 317.

²¹ See, *Permian Basin Area Rate Cases*, 390 U.S. 747, 791-92 (1968).

²² The Commission has recognized the need to adapt its policies to new circumstances in order "to ensure that [the policies] provide the correct regulatory incentives to achieve the Commission's policy goals and objectives." *Certification of New Interstate Natural Gas Pipeline Facilities*, 88 FERC ¶ 61,227 at 61,744 (1999).

In that light, Petitioners urge the Commission to takes steps to maintain allowed returns at levels that (1) exceed returns for competing (regulated and unregulated) infrastructure investments, including returns allowed by state regulatory agencies for investments in non-transmission utility assets²³ and (2) serve the Commission’s strategic goal of a stronger and more extensive transmission system.

Consequently, we propose that the Commission adopt policies that:

- Standardize the selection of proxy groups of comparable risk companies to ensure low-end and high-end proportionality and elimination of extremely high or low proxy returns²⁴ and the inexplicable differences between establishment of allowed returns for single utilities versus returns for transmission providers within organized markets;
- Deny a hearing on any rate of return complaint under FPA Section 206 unless and until a complainant has demonstrated that the existing rate falls within, say, the upper tenth percentile of a newly determined zone of reasonableness under DCF or another methodology, in the interest of

²³ The Commission’s implementation of Congress’ directive to provide incentives for transmission development was intended to distinguish this from other investment needs and opportunities. *Promoting Transmission Investment Through Pricing Reform*, Order No. 679, 71 Fed. Reg. 43294 (2006), FERC Stats. & Regs. ¶ 31,222 (2006).

²⁴ The courts may have settled, at least for the moment, the debate about whether the Commission is permitted to use the median versus the mid-point in the zone of reasonableness for selecting a single utility’s allowed return, *Southern California Edison v. FERC*, No. 11-1471, (D.C. Circuit, May 10, 2013), although this does not appear to foreclose setting allowed returns higher or lower in the zone of reasonableness if the Commission explains the “end result” it is seeking to achieve by doing so. The Commission nevertheless has before it on remand the issue of whether it “confronted the gravity” of recent economic conditions or properly employed bond market indices as a barometer of overall market conditions. Petitioner WIRES would much rather have the Commission be clear and prescriptive in its use of DCF than to have returns hinge on *post hoc* court interpretations.

minimizing the effects of extreme high or low risk proxies and preserving the financial bargains underlying existing investments ;

- Permit consideration of the earned returns on other infrastructure investments that require large capital outlays, like natural gas pipelines;
- Permit use of other methodologies²⁵ if they are shown to better reflect current financial market conditions and afford greater predictability in setting returns, or at least use these other methodologies as benchmarks on the reasonableness of the DCF approach or to help determine where in the range of reasonableness to set the ROE; and
- Support the use of forward-looking financial data and modeling projections as opposed to historical data, especially when market conditions are volatile or anomalous such as those being experienced now.

C. An Additional Rate-stabilizing Consideration

Rates of return on equity for electric utilities were developed historically under a mechanistic formula without regard to the importance of the need to stimulate unusually high levels of transmission investment, compared to other components of the electric system. The “capital attraction” test of utility ratemaking

²⁵ For comparisons of various returns methodologies, see e.g., Bonbright et al. at 314-332; *Discussion of the Return on Equity and Performance Indicators of Entergy Mississippi Inc. and Mississippi Power Company*, Prepared for Mississippi Public Service Commission, March 8, 2013, http://www.psc.state.ms.us/InsiteConnect/InSiteView.aspx?model=INSITE_CONNECT&queue=CTS_ARCHIVEQ&docid=304271. See also Mark Ciolek, Wallace Jones, and Dr. William Wilson, *Utility Ratemaking & ROE: Rethinking the Tools of the Trade -- The industry requires new analytical tools to incorporate the realities of today's higher risk operating and investment environment into the equity allowance process*, PUBLIC UTILITIES FORTNIGHTLY, Oct. 2003, at 24, <http://www.fortnightly.com/fortnightly/2003/10-0/commission-watch?page=0%2C0>.

did not originally hinge on whether investors or utilities might decide to invest or not to invest in transformational aspects of the industry or in assets that enable new technologies, competitive markets, or access to clean energy supplies. Setting allowed returns was instead a fundamental matter of ensuring reliability benefits to captive customers of individual transmission providers, not necessarily supporting diverse regional or system benefits. The Commission has helped create the conditions for a more integrated and dynamic electrical system based on open access transmission and regional power markets, and states have used public policy to encourage greater resource diversity. These efforts have placed unprecedented pressure on the industry to make needed capital investments in transmission, which is the critical link to these objectives.

Petitioner contends that challenges to existing or proposed rates of return need not be resolved simply on the basis of a mechanical application of the DCF model. Regulation should maintain a reasonable relationship between a project's (or group of projects') long-term benefits, including those that planners and regulators expect and those that flow from evolving grid operations, and the costs customers pay for securing those benefits through new transmission facilities or upgrades. Transmission benefits should therefore be part of any consideration of whether customers have been, or are likely to be, harmed by an existing allowed return.²⁶

²⁶ The industry, spurred by state clean energy standards and integrated resource planning, EPAct 2005, and Order No. 1000, has achieved an improved understanding of transmission's diverse benefits in the course of its planning and cost allocation work. Many benefits, once thought intangible, remote, or matters of speculation, are now better understood by planners and engineers. New tools and techniques enable planners to calculate or estimate a variety of beneficial attributes of projects. See The Brattle Group, *The Benefits of Electric Transmission: Identifying and Analyzing the*

It is worth asking whether a mechanistic approach, like DCF, which has served so well historically to measure return on equities in a constrained monopoly service environment, can always produce reasonable end results when the affected facilities will serve diverse regional or even national wholesale power markets over a period of decades. The DCF analysis is a snapshot that can be skewed by the state of the current economy or federal monetary or other volatile and unusual circumstances, thereby producing either unreasonably and artificially low returns or, in periods of dramatic inflation, unnecessarily high returns. A valuable way to avoid unforeseeable or anomalous results is to take a longer view of the value of transmission projects. To our knowledge, no pending Section 206 complaints against current rates of return attempt to place the costs of transmission to customers (and ROEs in particular) in the context of whether the benefits of transmission to particular customer groups or regional economies have been, or will be, delivered as contemplated or calculated in the planning process. Use of such a value proposition or measure of performance could militate against the extremes.²⁷

It should therefore be Commission policy that any request to revise existing rates of return downward should be supported in part by a showing that the actual, demonstrable, or foreseeable benefits of an existing project or group of projects are significantly less than the benefits to the system or the public that were expected when the projects were authorized and constructed.

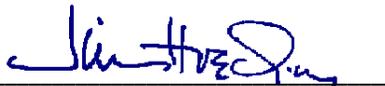
Value of Investments (WIRES, 2013), forthcoming in July. (WIRES will ensure the Commission is provided with this study upon its completion).

²⁷ We are not suggesting a performance-based regulatory regime, as that is necessarily beyond the scope of the brief generic reassessment that this Petition recommends.

IV. CONCLUSION AND RECOMMENDATION

Petitioner WIRES respectfully requests that a generic proceeding be instituted consistent with this Petition as soon as possible and be concluded with a Statement of Policy **not later than** the end of 2013. In the interest of timeliness, a 30-day comment period is recommended. The Commission will undoubtedly be asked to consider the record supporting or opposing specific equity returns in contested cases during the coming months, making expedition even more important and a protracted Inquiry less useful to the Commission and the industry. If the Commission grants this Petition and initiates a generic proceeding, we recommend that it hold the rate of return aspects of individual initial rate and complaint cases in abeyance as it contemplates action in this area.

Respectfully Submitted,



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