



D.C. Circuit Court of Appeals Decision Puts FERC's Revised Method for ROE Determinations In Question

AUGUST 10, 2022

[*Xena Burwell and Phil Mone*](#)

On August 9, 2022, the D.C. Circuit Court of Appeals issued an opinion, [*MISO Transmission Owners v. FERC*](#), finding that the Federal Energy Regulatory Commission's use of a "Risk Premium" model as one of the three models to determine a just and reasonable return on equity (ROE) for wholesale electric transmission rates was arbitrary and capricious. Thus, the court vacated the underlying orders (Opinion Nos. 569-A and 569-B) and remanded for FERC to reopen the proceedings.

Background

Since 2014, through multiple separate proceedings concerning the ROE used in wholesale electric transmission rates, FERC has issued several orders addressing its method for determining ROE, culminating in [*Opinion Nos. 569-A*](#). In that May 2020 order, the Commission adopted a new method for ROE determination, declaring that it would use an equally weighted average of the results of three models: the discounted cash flow (DCF) model, the Capital Assets Pricing Model (CAPM), and the Risk Premium model. Notably, use of the Risk Premium model represented a reversal of the Commission's prior rejection of the Risk Premium model in [*Opinion No. 569*](#).

Several aspects of Opinion No. 569-A (and Opinion No. 569-B, which essentially affirmed Opinion No. 569-A) were appealed separately by transmission owners and transmission customers, the latter of which included a challenge to the Commission's u-turn on the use of the Risk Premium model between its outright rejection in Opinion No. 569 and its incorporation into the ROE methodology through Opinion No. 569-A.

D.C. Circuit: FERC Failed to Provide a Reasoned Explanation For Its Use of The Risk-Premium Model

While noting that an agency is entitled to "change its mind," the D.C. Circuit vacated the Commission's orders adopting the new three-model method for determining ROE because it failed to offer a reasoned explanation for its decision to reintroduce Risk Premium model "after initially, and forcefully, rejecting it." The Court listed four concerns about the model that the Commission detailed in Opinion No. 569 when it rejected its use. The Court highlighted the fact that, in Opinion No. 569-A, FERC did not explain how its prior concerns with the Risk Premium model, noted in Opinion No. 569, were not still relevant. Particularly, the Commission had previously found the Risk Premium model flawed because FERC:

- Did not explain how its changes brought the analysis into line with general financial logic;
- Failed to adequately explain why it no longer mattered that investors don't use the Risk Premium model;
- Failed to address the Commission's own concerns about the model's circularity; and
- Failed to address previously expressed concerns about the overweighting of Risk-Premium theory.

Given the failures, the court held that FERC had adopted the Risk Premium model in an arbitrary and capricious fashion and, therefore the ROE produced by its utilization cannot stand. All of the challenged orders before the Commission were consequently vacated.

Next Steps and Implications

The ROE determination method "ball" is back in FERC's court. When FERC received a similar remand on its ROE determination method from the D.C. Circuit in [*Emera Maine v. FERC*](#) in April 2017, FERC took more than a year to issue an order addressing the remand, and that order, referred to as the "Coakley Briefing Order" merely proposed a new ROE determination method and sought briefs on the proposal. It took another year for FERC to issue an order adopting its new method, Opinion No. 569, and then it took another six months for it to make further substantial changes to it in Opinion No. 569-A, in May 2020. If

the Commission proceeds similarly, starting with a briefing order, it is likely to take more than a year for the Commission to establish an ROE determination method.

Given that the D.C. Circuit did not prohibit the Commission from using the Risk Premium model so long as the Commission offers a reasoned explanation for doing so in light of its rejection of the model in Opinion No. 569, the Commission has flexibility to use its three-model method, or a new method. However, FERC Chairman Glick dissented in part from Opinion 569-A, criticizing the Commission's use of the Risk Premium model. Further, the Chairman responded to the D.C. Circuit's decision posting on Twitter that "reversing FERC on the risk premium model is a big win for consumers." Thus, at this time, there may be little or no pathway, within FERC, for re-instatement of the Risk Premium model. Regardless, in the meantime, uncertainty pervades ROE at FERC. Transmission owners submitting rate filings have new flexibility in justifying their ROE proposals, and similarly, customers filing complaints concerning ROE have flexibility in supporting their cases and may feel emboldened in targeting ROEs justified using the Commission's three-model method.

For More Information

If you are interested in additional information on the implications of the D.C. Circuit's vacatur and remand, please contact [Phil Mone](#), [Xena Burwell](#), or any member of the firm's [Electric Practice](#).

Follow us on Twitter [@VanNessFeldman](#)

© 2022 Van Ness Feldman, LLP. All Rights Reserved. This document has been prepared by Van Ness Feldman for informational purposes only and is not a legal opinion, does not provide legal advice for any purpose, and neither creates nor constitutes evidence of an attorney-client relationship.