

## FERC Judge Issues Initial Decision Reducing Transmission Owners' Return on Equity

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On August 6, 2013, Federal Energy Regulatory Commission (FERC) Administrative Law Judge, Michael J. Cianci, Jr., certified to FERC his much-anticipated initial decision in the complaint proceeding involving the return on equity (ROE) component for rates recovered by New England Transmission Owners (NETOs) through ISO New England Inc.'s (ISO-NE) Open Access Transmission Tariff (OATT). The complaint, brought by state attorneys general and other state and consumer interests throughout New England (Complainants), was the first in a series of complaints brought in the past two years against various transmission owners around the country alleging that ROEs established before the 2008 financial crisis and subsequent drop in interest rates were no longer just and reasonable. As a result, this proceeding has been closely watched by the industry as a bellwether for the other pending ROE complaints and possible future complaints of a similar nature. In his initial decision, Judge Cianci determined (i) that the NETOs existing ROE of 11.14% is no longer just and reasonable; (ii) an ROE of 10.6% would be just and reasonable during the locked-in period (October 1, 2011 – December 31, 2012); and (iii) an ROE of 9.7% should be utilized prospectively for the NETOs.

### PRINCIPAL FINDINGS OF INITIAL DECISION

#### Section 206 Burden of Proof

A key threshold issue litigated in the proceeding was whether Complainants satisfied their burden under Federal Power Act (FPA) Section 206 to prove the existing ROE unjust and unreasonable. In what is likely to be a controversial holding, Judge Cianci rejected the NETOs' position that the current ROE of 11.14% should be retained because it falls within the broad range zone of reasonableness of even the Complainants' current DCF analysis. Instead, Judge Cianci noted a "substantial change in market conditions" since the NETOs' 11.14% was adopted and was persuaded by Complainants' arguments that creating a broad "zone of immunity for NETOs would be bad precedent."

The initial decision did not establish a bright line test for determining when an existing ROE, particularly one that falls within a zone of reasonableness established by a current DCF analysis, is or has become unjust or unreasonable within the meaning of FPA Section 206.

#### Establishing the Just and Reasonable ROE

After finding the existing ROE to be unjust and unreasonable, Judge Cianci ultimately adopted as most persuasive the analysis prepared by the NETOs' expert witness which determined the midpoint ROE using a national proxy group of comparable utilities. NETOs' analysis established (i) 10.6% as the just and reasonable ROE for the locked in refund period; and (ii) 9.7% as the just and reasonable ROE for the prospective period.



## Policy Arguments Against Strict Application of FERC's DCF Methodology to Transmission Investment

The initial decision reserved for FERC review the arguments submitted by the NETOs that anomalous market conditions are responsible for the current low ROEs produced by FERC's traditional DCF analysis, and that public policies favoring transmission development should be considered in establishing the just and reasonable ROE. Judge Cianci found that "policy objectives should be left to the discretion of the Commission" and noted that FERC "at its discretion may consider the use of the alternative methodologies in this particular case ... to meet ... legal and policy considerations."

### IMPLICATIONS

The initial decision leaves unanswered the specific demonstration a complainant must show to satisfy the FPA Section 206 burden that a transmission owner's current ROE level is unjust and unreasonable. However, we must point out that in this case, the difference between the just and reasonable ROE identified in the initial decision for the locked in period is only 0.54% lower than the 11.14% ROE that Judge Cianci found to be unjust and unreasonable, suggesting that, at least in Judge Cianci's view, the section 206 burden is a low hurdle with respect to ROE. The initial decision also neglects to consider the extent to which public policy considerations should factor into a determination of the just and reasonable ROE. These issues will likely be revisited by FERC in its order on the initial decision.

Parties to the proceeding have 30 days from the date of the initial decision to file briefs on exceptions, and 20 days thereafter to file briefs opposing exceptions. We do not anticipate that FERC will act on the initial decision before the spring of 2014.

### FOR MORE INFORMATION

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