

**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; )  
Complainants, )

v. )

Midcontinent Independent System Operator, Inc.; )  
ALLETE, Inc. (for its operating division Minnesota Power, )  
Inc., and its wholly-owned subsidiary, Superior Water, Light )  
and Power Company) )  
Ameren Illinois Company; Ameren Missouri; )  
Ameren Transmission Company of Illinois; )  
American Transmission Company LLC; Cleco Power LLC; )  
Duke Energy Business Services, LLC )  
d/b/a Duke Energy Indiana, Inc.; )  
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, d/b/a ITC Transmission; )  
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; and )  
Southern Indiana Gas & Electric Company; )  
Respondents. )

Docket No. EL14-\_\_\_\_

**COMPLAINT OF THE ASSOCIATION OF BUSINESSES ADVOCATING TARIFF  
EQUITY, COALITION OF MISO TRANSMISSION CUSTOMERS, ILLINOIS  
INDUSTRIAL ENERGY CONSUMERS, INDIANA INDUSTRIAL ENERGY  
CONSUMERS, INC., MINNESOTA LARGE INDUSTRIAL GROUP, AND WISCONSIN  
INDUSTRIAL ENERGY GROUP**

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## I. INTRODUCTION

Pursuant to section 206 of the Federal Power Act ("FPA")<sup>1</sup> and Rule 206 of the Rules of Practice and Procedure of the Federal Energy Regulatory Commission ("Commission" or "FERC"),<sup>2</sup> the Association of Businesses Advocating Tariff Equity ("ABATE"); Coalition of MISO Transmission Customers ("CMTC"); Illinois Industrial Energy Consumers ("IIEC"); Indiana Industrial Energy Consumers, Inc. ("INDIEC"); Minnesota Large Industrial Group ("MLIG"); and Wisconsin Industrial Energy Group ("WIEG"); (collectively, "Joint Complainants") hereby file this Complaint against the Midcontinent Independent System Operator, Inc. ("MISO"); ALLETE, Inc. (for its operating division Minnesota Power, Inc. and its wholly-owned subsidiary Superior Water Light, and Power Company); Ameren Illinois Company; Ameren Missouri; Ameren Transmission Company of Illinois; American Transmission Company LLC ("ATC"); Cleco Power LLC ("CLECO"); Duke Energy Business Services, LLC d/b/a Duke Energy Indiana, Inc.; 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") d/b/a ITC Transmission; ITC Midwest LLC ("ITC Midwest"); Michigan Electric Transmission Company, LLC ("METC"); 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; and Southern Indiana Gas & Electric Company (collectively, "Respondents").

This Complaint seeks a Commission order reducing the base return on equity ("Base ROE") used in the MISO Transmission Owners' ("MISO TOs") and ATC's formula transmission

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<sup>1</sup> 16 U.S.C. § 824e.

<sup>2</sup> 18 C.F.R. § 385.206 (2010).

rates to 9.15 percent, instituting a capital structure in which the assumed equity component does not exceed 50 percent, and eliminating the ROE adders currently approved for ITC and METC, including those for being a member of a regional transmission organization ("RTO") (for ITC) and for being an independent transmission owner (for ITC and METC). Alternatively, Joint Complainants request that the Commission find that the Respondents' existing Base ROEs are unjust and unreasonable and assign all of the issues to a settlement judge for a settlement process, with a prescribed deadline for resolution, (e.g., no longer than 60 days) to determine the Respondents' just and reasonable Base ROE, and, if that process is unsuccessful, an evidentiary hearing.

## **II. COMMUNICATIONS**

All correspondence and communications to the Complainants in this docket should be addressed to the following individuals, whose names should be entered on the official service list maintained by the Secretary in connection with these proceedings:<sup>3</sup>

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<sup>3</sup> Waiver of Rule 203, 18 C.F.R. § 385.203 (2012) is requested, as necessary, to allow multiple persons to be included on the official service list on behalf of the Joint Complainants.

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### III. THE PARTIES

#### A. Joint Complainants

1. ABATE is a voluntary association of large industrial businesses that are located in and doing business in the state of Michigan. ABATE has been formed for the express purpose of participating in regulatory proceedings to protect the interests of businesses in connection with energy and utility matters. Members of ABATE consume substantial quantities of electricity and natural gas and, in Michigan alone, their combined gas and electric bills are approximately \$1.2 billion per year.

2. CMTC is a continuing *ad hoc* association of large industrial and commercial end-users of electricity in the Midwest operated for the purposes of representing the interests of industrial energy consumers before regulatory and legislative bodies. CMTC members have facilities throughout the MISO region. CMTC is a MISO Member.

3. IIEC is an association of large industrial customers in the State of Illinois. They are eligible to choose a retail supplier other than their electric utility under Illinois law and eligible for transmission service under the applicable RTO and ISO tariffs. They consume approximately 13 billion kWh of electricity and employ approximately 90,000 people in the State of Illinois. They have members served by Ameren Illinois, a member of MISO. They also have manufacturing facilities located within MISO.

4. INDIEC is a not-for-profit 501(C)(6) corporation incorporated and doing business in the State of Indiana. INDIEC was formed to provide large energy users an independent voice in regulatory and legislative matters that impact utility rates and energy policies. INDIEC's 25

member companies employ over 56,000 people in Indiana and their combined gas and electric bills are over \$901 million annually.

5. MLIG is a continuing *ad hoc* consortium of large industrial end-users of electricity in Minnesota, consuming more than 6.5 billion kWh of electricity each year and functioning to represent large industrial interests before regulatory and legislative bodies.

6. WIEG is a voluntary member association consisting of large industrial and commercial customers in the State of Wisconsin. As key drivers of economic growth and development throughout the state, WIEG members collectively employ close to 50,000 people in Wisconsin and consume 3.6 billion kWh of electricity each year.

**B. Respondents**

7. MISO is the independent body responsible for providing open access transmission service and monitoring the high voltage transmission system throughout the Midwest United States.

8. Ameren Illinois Company, Ameren Transmission Company of Illinois, and Ameren Missouri ("Ameren") are affiliates of Ameren Services Company and are transmission-owning members of MISO.

9. ATC owns and operates high-voltage electric transmission systems in Wisconsin, Michigan and portions of Illinois and Minnesota. ATC is a transmission-owning member of MISO.

10. CLECO is an investor-owned utility in Louisiana, and a transmission-owning member of MISO.

11. Duke Energy Services, LLC d/b/a Duke Energy Indiana, Inc. ("Duke") is a vertically-integrated electric utility that generates, transmits, distributes, and sells electricity in



Central, North Central and Southern Indiana, and is a subsidiary of Duke Energy Corporation.

Duke is a transmission-owning member of MISO.

12. Entergy Arkansas, Inc. ("EAI"), Entergy Gulf States Louisiana, LLC ("EGSL"), Entergy Louisiana, LLC ("ELL"), Entergy Mississippi, Inc. ("EMI"), Entergy New Orleans, Inc. ("ENO"), and Entergy Texas, Inc. ("ETI") (collectively, "Entergy Operating Companies") own and operate generation, transmission and distribution facilities in four states, including Arkansas, Louisiana, Mississippi, and Texas. The Operating Companies provide electric service to retail customers subject to state and local regulation, and transmit and sell power at wholesale, subject to FERC regulation. The Entergy Operating Companies are in the process of becoming transmission-owning members of MISO.

13. Indianapolis Power & Light Company ("IPL") is a public utility that owns and operates generating, transmission and distribution facilities in and around Indianapolis, Indiana. IPL is a transmission-owning member of MISO.

14. ITC; ITC Midwest; and METC (collectively, "ITC Subsidiaries") are subsidiaries of ITC Holdings, Corp., and are independent, stand-alone transmission companies engaged exclusively in the development, ownership and operation of facilities for the transmission of electric energy in interstate commerce. They are transmission-owning members of MISO.

15. MidAmerican Energy Company ("MidAmerican") is an electric and natural gas utility serving customers in the states of Iowa, Illinois, South Dakota, and Nebraska.

MidAmerican is a transmission-owning member of MISO.

16. Minnesota Power, Inc. ("MP") is a subsidiary of ALLETE and provides retail and wholesale electric service to customers in Northeastern Minnesota. MP is a transmission-owning member of MISO.

17. Montana-Dakota Utilities Co., a Division of MDU Resources Group, Inc. ("Montana-Dakota"), provides natural gas and/or electric service to parts of Montana, North Dakota, South Dakota, and Wyoming. Montana-Dakota is a transmission-owning member of MISO.

18. Northern Indiana Public Service Company ("NIPSCO") is a subsidiary of NiSource, Inc., a vertically-integrated Indiana corporation engaged in the generation, transmission and distribution of energy at wholesale and retail in Northwest Indiana. NIPSCO is a transmission-owning member of MISO.

19. Northern States Power Company-Minnesota ("NSPM") and Northern States Power Company-Wisconsin ("NSPW") are subsidiaries of Xcel Energy and own and operate electric transmission facilities in Minnesota and Wisconsin, respectively. NSPM and NSPW are transmission-owning members of MISO.

20. Otter Tail Power Company ("Otter Tail") owns transmission and generation facilities and serves loads in Western Minnesota, Eastern North Dakota and Northeastern South Dakota. Otter Tail is a transmission-owning member of MISO.

21. Southern Indiana Gas & Electric Company owns generation, transmission, and distribution facilities in the State of Indiana. Southern Indiana Gas & Electric Company is a transmission-owning member of MISO.

22. Superior Water, Light and Power Company ("SWL&P") is a subsidiary of ALLETE and provides electricity, water and natural gas in Superior, Wisconsin. SWL&P is a transmission-owning member of MISO.

#### IV. BACKGROUND

23. On December 3, 2001, MISO, in conjunction with the MISO TOs, filed a proposed revision to its Open Access Transmission Tariff ("OATT").<sup>4</sup> The proposal sought a 13.0 percent return on the common equity component for the formula calculation of the transmission service rates for the MISO rate zones for the participating MISO TOs. On January 30, 2002, the Commission accepted the 13.0 percent ROE proposal for filing, to be effective on February 1, 2002, subject to refund.<sup>5</sup> The Commission also set the matter for an expedited hearing.<sup>6</sup> MISO and the MISO TOs relied on Base ROE results from a regional, MISO-only proxy group that was developed by the expert who testified on their behalf, Dr. William Avera.<sup>7</sup>

24. On September 23, 2003, the Commission issued an Order adopting the Initial Decision approving a Base ROE of 12.38 percent for the MISO TOs.<sup>8</sup> On March 26, 2004 and again on June 3, 2005, the 12.38 percent Base ROE was affirmed by the Commission in Orders on Remand.<sup>9</sup> This 12.38 percent Base ROE continues to be the applicable ROE under Attachment O of the OATT for general use by the MISO TOs. All of the MISO TOs currently use this 12.38 percent Base ROE, with the exception of ATC.

25. The Base ROE currently in effect for ATC is 12.2 percent. This 12.2 percent Base ROE was established as part of a settlement agreement that was filed with the Commission

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<sup>4</sup> *Midwest Independent Transmission System Operator, Inc.*, Revisions to the MISO Open Access Transmission Tariff, Docket No. ER02-485-000 (Dec. 3, 2001) ("MISO ROE Filing").

<sup>5</sup> *Midwest Independent Transmission System Operator, Inc.*, 98 FERC ¶ 61,064, Order Accepting in Part and Rejecting in Part Proposed Tariff Changes and Establishing Hearing Procedures, Docket No. ER02-485-000 (Jan. 30, 2002).

<sup>6</sup> *Id.*

<sup>7</sup> MISO ROE Filing.

<sup>8</sup> *Midwest Independent Transmission System Operator, Inc.*, 100 FERC ¶ 61,292 (2003), *order denying reh'g*. 102 FERC ¶ 61,143 (2003).

<sup>9</sup> *Midwest Independent Transmission System Operator, Inc.*, 106 FERC ¶ 61,302 (2004) ("MISO Remand Order") (2004); *see also Midwest Independent Transmission System Operator, Inc.*, 111 FERC ¶ 61,355 (2005) (affirming 12.38% ROE, vacating the 50% adder included in the base ROE for turning over operational control of transmission facilities, and ordering MISO and the TOs to make refunds with interest for the 50 basis point adder).

on March 26, 2004.<sup>10</sup> The settlement agreement stated that "the Settlement Parties agree not to file a Section 206 complaint against ATCLLC which ... seeks to challenge the level of ROE and ROE structure..."<sup>11</sup> The settlement agreement further states that "the Settlement Agreement will terminate effective December 31, 2012" and that, "as of the date of termination," any Settlement Party will be able to file a Section 206 application under the Federal Power Act to change ATCLLC's rates."<sup>12</sup> The settlement agreement was accepted in its entirety by the Commission on May 6, 2004.<sup>13</sup>

26. The Base ROEs for all of the MISO TOs are fixed and do not change from year to year as do most other formula rate inputs. The fixed ROE may only be changed through a filing under Section 205 or Section 206 of the FPA, or by the Commission acting *sua sponte* under FPA Section 206.

27. In addition to the general Base ROE available to the MISO TOs, ITC and METC have in place ROE adders that increase their Base ROEs by 150 and 100 basis points, respectively. On December 24, 2002, ITC requested that the Commission approve a 100 basis point ROE adder because of ITC's independence.<sup>14</sup> ITC argued that, because it would be sold to "a wholly independent entity, not affiliated with any market participant," the Commission should grant its request for the 100 basis point adder.<sup>15</sup> The Commission approved ITC's ROE adder for independence on February 20, 2003.<sup>16</sup> METC also receives a 100 basis point adder for being a

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<sup>10</sup> *American Transmission Company LLC and Midwest Independent Transmission System Operator, Inc.*, Offer of Settlement and Settlement Agreement, Docket No. ER04-108-000 (Mar. 26, 2004).

<sup>11</sup> *Id.* at P 8.

<sup>12</sup> *Id.* at P 9.

<sup>13</sup> *American Transmission Company LLC and Midwest Independent Transmission System Operator, Inc.*, 107 FERC ¶ 61,117 at P 10 (May 6, 2004).

<sup>14</sup> *ITC Holdings Corporation, et al.*, Joint Application Seeking Authorization for Jurisdictional Facilities, Docket Nos. EC03-40-000 and ER03-343-000 at 56 (Dec. 24, 2002).

<sup>15</sup> *Id.* at 57.

<sup>16</sup> *ITC Holdings Corporation, et al.*, 102 FERC ¶ 61,182 (2003).

"stand-alone transmission company."<sup>17</sup> ITC also currently benefits from a 50 basis point ROE adder for ITC's "participation in Midwest ISO's RTO."<sup>18</sup> Notably, ITC Midwest, another subsidiary of ITC Holdings Corp., requested, but did not receive, adders for RTO participation and independence.<sup>19</sup> ITC Midwest's all-in ROE is currently 12.38 percent.

## **V. REQUEST FOR RELIEF**

28. Due to changes in the capital markets since the Base ROEs were last established, the Base ROEs are no longer just and reasonable. The attached Affidavit of Michael P. Gorman ("Gorman Affidavit") and exhibits demonstrate that the current Base ROEs are excessive and that a just and reasonable Base ROE for all MISO TOs would not exceed 9.15 percent. Based on this evidence, this Complaint provides sufficient evidence to demonstrate that the existing Base ROEs are unjust and unreasonable. Accordingly, the Commission should find that the current Base ROEs are no longer just and reasonable, and that the Base ROE proposed by the Joint Complainants is just and reasonable.

29. Additionally, some of the MISO TOs currently employ capital structures that are no longer just and reasonable. The Gorman Affidavit and exhibits support this conclusion. The Commission should find that capital structures with greater than 50 percent equity are no longer just and reasonable, and direct any MISO TOs with a higher percentage equity to submit compliance filings containing capital structures consistent with the revisions proposed in this Complaint.

30. Finally, the ROE incentive adders that are currently being applied to only two of the MISO TOs - ITC and METC - are no longer just and reasonable. The Commission should

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<sup>17</sup> *Michigan Electric Transmission Company, LLC and Midwest Independent Transmission System Operator, Inc.*, 116 FERC ¶ 61,164 at PP 17, 20-21 (2006).

<sup>18</sup> *International Transmission Company and Midwest Independent Transmission System Operator, Inc.*, 116 FERC ¶ 61,036 at P 36 (2006).

<sup>19</sup> *ITC Holdings Corp., et al.*, 121 FERC ¶ 61,229 at PP 39-45 (2007).

find that these ROE adders are unjust and unreasonable, and direct ITC and METC to submit compliance filings to remove the ROE adders from their formula rates.

31. As an alternative to ordering relief on the basis of this Joint Complaint, the Commission should establish expedited hearing and settlement procedures to address the ROE, capital structure, and ROE adder issues.

**VI. THE CURRENT BASE ROEs ARE UNJUST AND UNREASONABLE AND SHOULD BE ADJUSTED TO A JUST AND REASONABLE ROE OF 9.15 PERCENT.**

**A. Applicable Standards.**

32. All rates for jurisdictional service under the FPA must be just and reasonable.<sup>20</sup>

Where a complainant challenges a previously approved rate under Section 206 of the FPA and proposes a new one, the Commission must find that: (1) the existing rate is unjust and unreasonable; and (2) a proposed replacement rate is just and reasonable.<sup>21</sup> However, as the United States Court of Appeals for the District of Columbia has recently explained, a complainant need not propose a new just and reasonable rate.<sup>22</sup> Under FPA Section 206, a complainant need only demonstrate that the existing rate is unjust and unreasonable; it is up to the Commission to determine the new just and reasonable rate.<sup>23</sup> This Complaint provides sufficient evidence for the Commission to find that the existing Base ROEs are no longer just and reasonable and to find that the new rate proposed in this Complaint is just and reasonable.

33. In order for the Commission to find that the current Base ROE is no longer just and reasonable, the Commission does not need to find that the current Base ROE is completely

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<sup>20</sup> 16 U.S.C. §§ 824d and 824e.

<sup>21</sup> See, e.g., *Louisiana Pub. Serv. Comm'n v. Entergy Corp.*, 132 FERC ¶ 61,003 at P 28 (2010); *Atl. City Elec. Co. v. FERC*, 295 F.3d 1, 10 (D.C. Cir. 2002). Accord, *Cities of Bethany v. FERC*, 727 F.2d 1131, 1143-44 (D.C. Cir. 1984); see also *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 353 (1956).

<sup>22</sup> *Maryland Public Serv. Comm'n v. FERC*, 632 F.3d 1283, 1285, n. 1 (D.C. Cir. 2011).

<sup>23</sup> *Id.*

outside of the zone of reasonableness that was used in the initial setting of the ROE. In *Bangor Hydro Electric Co.*, issued on January 17, 2008,<sup>24</sup> the Commission expressly stated that the ROE is not exempt from review under section 206 even if the ROE falls within the zone of reasonableness.<sup>25</sup> As the Commission explained:

When the Commission identifies a "zone of reasonableness" in a particular case, it identifies a range that reflects the "substantial spread between what is unreasonable because it is too low and what is unreasonable because it is too high." However, not every rate within this "substantial spread" would necessarily be just and reasonable if charged. Certain rates, though within the zone, may not be just and reasonable given the circumstances of the case.<sup>26</sup>

Therefore, a complainant need not show that the current Base ROE falls outside of the zone of reasonableness in order to show that the current Base ROE is unjust and unreasonable.

34. A just and reasonable rate of return for a utility is one that does not exceed the level required to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital, and must be commensurate with returns on investments in enterprises with comparable risks.<sup>27</sup> In establishing a Base ROE, the Commission must reach a balance between ensuring that customers pay a just and reasonable rate and allowing regulated utilities to earn returns that are sufficient to continue their operations and attract capital.

35. The Commission has a well-developed policy for establishing a just and reasonable ROE for transmission service, based on applying a discounted cash flow ("DCF")

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<sup>24</sup> *Bangor Hydro*, 122 FERC ¶ 61,038 at P 10 (2008). "The Transmission Owners' argument amounts to a claim that their company-specific ROEs are exempt from review under section 206 because they fall within the zone of reasonableness established in Opinion No. 489. In making this argument, they advance the premise that every ROE within the "zone of reasonableness" is necessarily "just and reasonable." Although clever, this premise is unacceptable and without substantive merit; its force rests exclusively on the semantic connection between the phrases "zone of reasonableness" and "just and reasonable," and its plausibility is contingent on a fundamental misunderstanding of the Commission's statutorily-prescribed function of determining the just and reasonable rate.

<sup>25</sup> *Id.* at P 10 (citations omitted).

<sup>26</sup> *Id.* at P 11.

<sup>27</sup> See *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n of W. Va.*, 262 U.S. 679, 692-93 (1923).

analysis to a proxy group of comparable risk companies.<sup>28</sup> The purpose of the DCF analysis is to calculate the cash flow that investors expect to receive from their investment in the equity securities of a utility by summing their expected dividend yield ("d/p") and their expected return from growth ("g").<sup>29</sup> The Commission's one-step, constant growth DCF equation is generally stated as follows:

$Ke = (Do/Po) (1 + 0.5g) + g$ , where:

Ke = cost of equity;

Do = the current annualized dividend;

Po = stock price at the current time; and

g = the long-term annualized dividend growth rate.<sup>30</sup>

36. The Commission uses the DCF methodology to calculate the zone of reasonableness for the ROE. Under Commission precedent, the DCF methodology used to set the ROE for electric utilities includes the following steps: (1) the establishment of a proxy group of comparable companies with comparable risks; (2) the calculation of "high" and "low" dividend yields for each company in the proxy group using six months of data; (3) the calculation of a "high" and "low" growth rate for each company in the proxy group based on the most current five-year forecast of earnings growth published by Institutional Brokers for each company and the "sustainable" or "fundamental" earnings growth rate for each company; (4) summing the "low" dividend yield with the "low" growth rate and the "high" dividend yield with the "high" growth rate to calculate a DCF range for each utility in the proxy group; (5) determining the low-end DCF value for the proxy group and the high-end DCF value for the

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<sup>28</sup> See, e.g., *Northern Pass Transmission LLC*, 134 FERC ¶ 61,095 (2011); *Potomac Appalachian Transmission Highline, L.L.C. ("PATH")*, 133 FERC ¶ 61,152 (2010); *Atlantic Path 15, LLC*, 133 FERC ¶ 61,153 (2010) ("*Atlantic Path 15*"); *Southern Cal. Edison Co.*, 131 FERC ¶ 61,020 (2010); *Golden Spread Elec. Coop.*, 123 FERC ¶ 61,047 (2008).

<sup>29</sup> *Bangor Hydro*, 122 FERC ¶ 61,265 at P 7.

<sup>30</sup> See *Id.*



proxy group (these two values form the extremes of the zone of reasonableness); and (6) calculating the midpoint, median, or mean within the zone of reasonableness.<sup>31</sup>

37. The first step in performing a DCF analysis is to determine a proxy group of comparable companies that have publicly traded stock.<sup>32</sup> The Commission uses standard screening criteria to establish a proxy group of companies with comparable risks.<sup>33</sup> The Commission has approved the use of the following screening criteria for the selection of the proxy group: (1) electric utilities that are covered by the Value Line Investment Survey ("*Value Line*"); (2) electric utilities that are not currently involved in a major merger or acquisition; (3) electric utilities that pay common dividends; (4) electric utilities having an investment grade corporate credit rating within one "notch" of the utility whose rates are being challenged; and (5) electric utilities that are covered by at least two generally recognized utility industry analysts.<sup>34</sup> The Commission also supports the use of geographical proximity as a relevant factor where a party demonstrates that the regional companies have comparable risk to the TOs whose allowed ROE is being analyzed.<sup>35</sup>

38. Consistent with Commission policy, only DCF results meeting a minimum threshold value are used to determine the zone of reasonableness from which the Base ROE is established. The minimum threshold value is set at "about 100 basis points" above the corresponding long-term utility corporate bond rate.<sup>36</sup> Therefore, the Commission has found that it is reasonable to exclude any company whose low-end ROE does not exceed the average bond

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<sup>31</sup> See *Southern Cal. Edison Co.*, 92 FERC ¶ 61,070 (2000).

<sup>32</sup> See *id.*

<sup>33</sup> See, e.g., *Southern Cal. Edison Co.*, 131 FERC ¶ 61,020 at P 52 (2010); *Southern Cal. Edison Co.*, 122 FERC ¶ 61,187 at P 25 (2008).

<sup>34</sup> *Southern Cal. Edison Co.*, 131 FERC ¶ 61,020 at P 52 (2010); see, e.g., *Atl. Grid Operations A LLC, et al.*, 135 FERC ¶ 61,144 (2011); *N. Pass Transmission LLC*, 134 FERC ¶ 61,095 (2011); *RITELine Ill., LLC*, 137 FERC ¶ 61,039 at PP 66-67 (2011).

<sup>35</sup> See *Nevada Hydro Co., Inc.*, 133 FERC ¶ 61,155 at P 8.

<sup>36</sup> *Southern Cal. Edison Co.*, 131 FERC ¶ 61,020 at P 56 (2010).

yield by at least 100 basis points.<sup>37</sup> The Commission has also held that it is appropriate to exclude all companies with a growth rate greater than or equal to 13.3 percent.<sup>38</sup> The Commission further clarified its position regarding the elimination of outliers by stating that "the use of only one end of the DCF calculation would skew the Commission's DCF method. Therefore, when we eliminate either the high-end or low-end ROE outlier of a company, we have also eliminated the corresponding low-end or high-end ROE of that company."<sup>39</sup> The remaining values are then used to establish the zone of reasonableness and the just and reasonable ROE.

39. Under its DCF model, the Commission sets the appropriate ROE at the center of the properly derived range of DCF results. In setting the ROE for a single transmission owner, or in cases where a national proxy group is used, the Commission has found that the best measure of central tendency is the median.<sup>40</sup> In cases involving multiple transmission owners in a RTO that operates under a single transmission formula rate and involving the use of a regional proxy group to calculate ROE, the Commission has located the center at the midpoint of the range.<sup>41</sup> The Commission generally sets ROEs at the center of the range because, absent evidence to the contrary, the utility is assumed to be of average risk compared to the proxy group.<sup>42</sup> Consequently, given Mr. Gorman's use of a national proxy group, the use of the median

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<sup>37</sup> *Id.* at P 55.

<sup>38</sup> *Id.* at P 57. The Commission has also excluded DCF results above 17.7 percent, consistent with its decision in *ISO New England, Inc.*, 109 FERC ¶ 61,147 at P 205 (2004), *order on reh'g*, 110 FERC ¶ 61,111 (2005).

<sup>39</sup> *Id.* at P 59.

<sup>40</sup> *See, e.g., Atlantic Grid Operations A LLC*, 135 FERC ¶ 61,144 P 91 (2011) (finding that the "median of the DCF analysis is appropriate for establishing the Base ROE," and citing cases).

<sup>41</sup> *See, e.g., Midwest Independent Transmission System Operator, Inc.*, Order on Remand, 106 FERC ¶ 61,302, at P 11.

<sup>42</sup> *FPC v. Texaco, Inc.*, 417 U.S. 380, 399 (1974).

as the measure of central tendency is wholly appropriate and consistent with Commission precedent.<sup>43</sup>

**B. Joint Complainants' ROE Analysis.**

40. In order to determine whether the current Base ROE remains just and reasonable, Mr. Gorman performed a DCF analysis in compliance with the Commission's current policies. Mr. Gorman's analysis shows that applying the Commission's DCF model to determine a just and reasonable ROE, the zone of reasonableness has a range of median high and median low values between 7.97 percent and 10.33 percent. The midpoint of this median range is 9.15 percent.<sup>44</sup>

41. Mr. Gorman began his analysis by selecting both a national and regional group of proxy companies with risk profiles representative of the MISO TOs. Mr. Gorman's national approach resulted in a proxy group of 20 publicly traded holding companies whose utility subsidiaries operate throughout the country.<sup>45</sup> Mr. Gorman's regional approach resulted in a proxy group of seven publicly traded holding companies whose utility subsidiaries operate in MISO or own utilities that directly interconnect with any MISO TO and operate in the Eastern Interconnect.<sup>46</sup>

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<sup>43</sup> In setting the Base ROE for a single transmission owner, the Commission has found that the best measure of the center of the range is the median. *See, e.g., Atlantic Grid Operations A LLC*, 135 FERC ¶ 61,144 at P 91 (finding that the "median of the DCF analysis is appropriate for establishing the Base ROE"). The Commission deviated from using the median in the "unique circumstances" presented by the case for the setting of the current MISO TO ROEs only because the regional proxy group used in that proceeding consisted of a subset of the MISO TOs that would be subject to the ROE. MISO Remand Order, at PP 8-9 (noting the unusual circumstance that "the proxy group used to define the range of reasonableness in this case consists of a subset of the Midwest ISO TOs to which the ROE will apply"). The use of a median as the preferred measure of central tendency was recently affirmed by the U.S. Court of Appeals for the D.C. Circuit. *Southern Calif. Edison Co. v. FERC*, No. 11-1471 (D.C. Cir. May 10, 2103)(available at: <http://www.ferc.gov/legal/court-cases/opinions/2013/11-1471-opinion.pdf>). While the *Southern California Edison* decision involved a single utility, rather than a group of utilities, the reasoning behind the Court's affirmation is directly applicable here. With a well-populated national proxy group, the use of the median is required to minimize the impact of extreme values and give more consideration to each of the values in the proxy group. *See id.*, slip op. at 9 (citing *Transcontinental Gas Pipe Line Corp.*, 84 FERC ¶ 61,084 (1998)).

<sup>44</sup> Affidavit of Michael P. Gorman at 32 ("Gorman Affidavit").

<sup>45</sup> *Id.* at Exhibit MPG-4.

<sup>46</sup> *Id.* at Exhibit MPG-5.

42. Mr. Gorman ensured that all of the companies in his national proxy group met the following criteria: (1) the company must be a domestic publicly traded electric utility followed by the Value Line Investment Survey ("Value Line"); (2) the company must own transmission assets; (3) the company must have an S&P bond rating in the range of BBB- to A+, which is one notch above and below the MISO TO range; (4) the company must not have been known to be a party to significant merger and acquisition activity in the past twelve months; (5) the company must have consistently paid dividends for two years without any cuts to the dividends; and (6) the company must have at least two growth rate estimates available from [www.reuters.com](http://www.reuters.com) (I/B/E/S).<sup>47</sup>

43. The companies in Mr. Gorman's regional proxy group meet the following criteria: (1) the company must be a transmission owner in MISO or be a non-MISO investor-owned utility that directly interconnects with a MISO TO that operates in the Eastern U.S. interconnect; (2) the company must be a domestic publicly traded electric utility followed by Value Line; (3) the company must have an S&P bond rating in the range of BBB- to A+, which is one notch above and below the MISO TO range; (4) the company must not have been known to be a party to significant merger and acquisition activity in the past twelve months; (5) the company must have consistently paid dividends for two years without any cuts to the dividends; and (6) the company must have at least two growth rate estimates available from [www.reuters.com](http://www.reuters.com) (I/B/E/S).<sup>48</sup>

44. In making his ROE recommendation, Mr. Gorman relied on the national proxy group, consistent with recent Commission precedent.<sup>49</sup> The Commission has accepted the use of national proxy groups as the default proxy group, unless sufficient evidence is provided to

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<sup>47</sup> *Id.* at 25.

<sup>48</sup> *Id.* at 26.

<sup>49</sup> *Id.* at 25.

support the use of a regional proxy group.<sup>50</sup> Using a national proxy group with reasonable risk characteristics that are similar to the MISO TOs provides a broad-based national group against which the MISO TOs compete for capital to fund infrastructure investments. Setting the MISO TOs' ROE equal to the returns that investors demand of other companies of comparable risk will ensure that the MISO TOs' ROE is just and reasonable and will support the MISO TOs' ability to access capital under reasonable terms and conditions.<sup>51</sup>

45. The application of Mr. Gorman's Commission-approved criteria results in a national proxy group comprised of the following 20 utilities: American Electric Power Company, Inc.; Consolidated Edison, Inc.; Dominion Resources, Inc.; Duke Energy Corporation; Edison International; FirstEnergy Corp.; Great Plains Energy Inc.; NextEra Energy, Inc.; Northeast Utilities; Pepco Holdings, Inc.; PG&E Corporation; Pinnacle West Capital Corporation; PNM Resources, Inc.; Portland General Electric Corporation; Public Service Enterprise Group Incorporated; SCANA Corporation; Southern Company; UIL Holdings Corporation; Westar Energy, Inc.; and Xcel Energy Inc.<sup>52</sup> During the analytical process, Consolidated Edison, Edison International, FirstEnergy Corp., Public Service Enterprise Group, and Westar Energy were eliminated as outliers, consistent with Commission policy, because of their abnormally low DCF estimates.<sup>53</sup> Because the low-end cost of equity estimates were excluded for these companies, the high-end estimates were also excluded, consistent with Commission precedent. The Commission has determined that "the use of only one end of the DCF calculation would skew the Commission's DCF method. Therefore, when we eliminate the high-end or low-end ROE outlier of a company, we have also eliminated the corresponding low-

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<sup>50</sup> See *Atlantic Path 15*, 133 FERC ¶ 61,153; *Southern Cal. Edison Co.*, 131 FERC ¶ 61,020.

<sup>51</sup> See Gorman Affidavit at 32.

<sup>52</sup> *Id.* at Exhibit MPG-5.

<sup>53</sup> *Id.* at 32.

end or high-end ROE of that company."<sup>54</sup> The selection of the proxy group is consistent with the Commission's established rules, and the selected proxy group entities are similar in risk to the Respondent utilities.

46. The application of Mr. Gorman's Commission-approved criteria also results in a regional proxy group comprised of the following seven utilities: American Electric Power Company, Inc.; Duke Energy Corporation; FirstEnergy Corp.; Great Plains Energy Inc.; Southern Company; Westar Energy, Inc.; and Xcel Energy Inc.<sup>55</sup> During the analytical process, FirstEnergy Corp. and Westar Energy were eliminated as outliers, consistent with Commission policy, because of their abnormally low DCF estimate.<sup>56</sup> Again, because the low-end cost of equity estimate was excluded for FirstEnergy Corp. and Westar Energy, the high-end estimates were also excluded, consistent with Commission precedent. The Commission has determined that "the use of only one end of the DCF calculation would skew the Commission's DCF method. Therefore, when we eliminate the high-end or low-end ROE outlier of a company, we have also eliminated the corresponding low-end or high-end ROE of that company."<sup>57</sup> The selection of the proxy group is consistent with the Commission's established rules, and the selected proxy group entities are similar in risk to the Respondent utilities.

47. When Mr. Gorman developed the proxy groups, he considered all of the parent companies of the MISO TOs. However, only two of the MISO TO parent companies met the proxy group selection criteria. Ameren, ALLETE, CLECO, and Otter Tail Power were excluded because they failed to have at least two independent analysts responding to their consensus

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<sup>54</sup> *Southern Cal. Edison Co.*, 131 FERC ¶ 61,020 at P 56.

<sup>55</sup> *Id.* at Exhibit MPG-4.

<sup>56</sup> *Id.* at 33.

<sup>57</sup> *Southern Cal. Edison Co.*, 131 FERC ¶ 61,020 at P 56.

analysts' growth projections.<sup>58</sup> AES Corp. was excluded because of merger activity and a bond rating below investment grade.<sup>59</sup> Berkshire Hathaway was excluded because it is not followed by Value Line.<sup>60</sup> International Transmission Company and Entergy Corp. were excluded because they are currently involved in merger and acquisition activity.<sup>61</sup> NiSource was excluded because it does not have two analysts' growth rates published in Reuters.<sup>62</sup> Finally, MDU Resources was not included because it is not listed as an electric utility by Value Line.<sup>63</sup> Both NiSource and MDU Resources were included in the diversified natural gas industry by Value Line.<sup>64</sup>

48. Mr. Gorman derived stockholders' required rate of return for the proxy group using the Commission's constant-growth DCF model. Mr. Gorman's analysis consisted of the following steps: (1) calculating the high and low dividend yields for each proxy group company over a recent 6-month period; (2) relying on both consensus analysts' growth rate projections and sustainable growth rate estimates; (3) calculating a DCF return for each proxy group company; (4) eliminating outlier DCF estimates consistent with Commission precedent; (5) calculating the median of the high and low DCF estimates to form the zone of reasonableness; and (6) calculating the median from the zone of reasonableness to provide the recommended ROE value for the MISO TOs of 9.15 percent.<sup>65</sup>

49. Mr. Gorman began his DCF analysis by deriving the inputs for the constant-growth DCF model, including a current stock price, expected dividend, and expected growth rate

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<sup>58</sup> Gorman Affidavit at 28.

<sup>59</sup> *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.* at 29.

in dividends.<sup>66</sup> Mr. Gorman reviewed the weekly dividend yield for each of the companies in the proxy groups over a 26-week period ending October 1, 2013.<sup>67</sup> He calculated the high and low dividend yield based on the most recently paid dividend and high and low stock price for each week.<sup>68</sup> Over the six month period, Mr. Gorman measured the high and low dividend yield for each of the proxy group companies, consistent with the Commission's standard DCF methodology.<sup>69</sup>

50. For the growth rates needed for his DCF analysis, Mr. Gorman relied on Reuters' published consensus analysts' growth rates (I/B/E/S) and an internal or sustainable growth rate based on Value Line current and projected data for the proxy group companies.<sup>70</sup> A sustainable growth rate (B x R) is based on the percentage of a utility's earnings that is retained and reinvested in utility plant and equipment and growth produced by selling stock at prices above book value.<sup>71</sup>

51. The internal growth methodology is tied to the percentage of earnings that are retained by the company and not paid out as dividends.<sup>72</sup> The earnings retention ratio is equal to 1 minus the dividend payout ratio.<sup>73</sup> As the payout ratio falls, the earnings retention ratio rises.<sup>74</sup> An increased earnings retention ratio fuels stronger growth because the business funds more investments with retained earnings.<sup>75</sup> In Mr. Gorman's analysis, the data used to estimate the long-term sustainable growth rate was based on each proxy group company's current market-to-book ratio and Value Line's 3- to 5-year projections of earnings, dividends, earned returns on

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<sup>66</sup> *Id.* at 30.

<sup>67</sup> *Id.*

<sup>68</sup> *Id.*

<sup>69</sup> *Id.*

<sup>70</sup> *Id.*

<sup>71</sup> *Id.*

<sup>72</sup> *Id.* at 31.

<sup>73</sup> *Id.*

<sup>74</sup> *Id.*

<sup>75</sup> *Id.*



book equity, and stock issuances.<sup>76</sup> The growth rates for Mr. Gorman's national proxy group average ranged from 3.56 percent to 5.30 percent, and the growth rates for his regional proxy group average ranged from 3.18 percent to 4.55 percent.

52. In order to calculate his adjusted dividend yield, Mr. Gorman relied on his six-month high and six-month low dividend yield estimate and adjusted it by one half the projected growth rate, consistent with Commission precedent. Next, Mr. Gorman had to adjust his DCF results to eliminate outliers in accordance with Commission precedent. As a result, Mr. Gorman excluded companies that had low-end DCF results of 6.39 percent and below. Using this outlier criteria, Mr. Gorman eliminated the low and high DCF estimates for Consolidated Edison, Inc.; Edison International; FirstEnergy Corp.; Public Service Enterprise Group Incorporated; and Westar Energy, Inc. from his results.

53. Per Commission precedent, only DCF results meeting a minimum threshold value are used to determine the zone of reasonableness from which the Base ROE is established. The minimum threshold value is set at "about 100 basis points" above the corresponding long-term utility corporate bond rate.<sup>77</sup> Therefore, the Commission has found that it is reasonable to exclude any company whose low-end ROE does not exceed the average bond yield by at least 100 basis points.<sup>78</sup> In setting the minimum threshold value, Mr. Gorman relied on the highest Baa-rated utility bond over the last 26-week period as reported by Moody's in its Credit Trends data source, which was 5.39 percent.<sup>79</sup> Mr. Gorman then added 100 basis points to reach a minimum threshold value of 6.39 percent.<sup>80</sup> Mr. Gorman also excluded the high-end DCF

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<sup>76</sup> *Id.*

<sup>77</sup> *Southern Cal. Edison Co.*, 131 FERC ¶ 61,020 at P 56.

<sup>78</sup> *Id.* at P 55.

<sup>79</sup> Gorman Affidavit at 32.

<sup>80</sup> *Id.*

estimate of each company whose low-end estimate was excluded as an outlier.<sup>81</sup> The Commission has recognized that "when we eliminate either the high-end or low-end ROE outlier of a company, we have also eliminated the corresponding low-end or high-end ROE of that company."<sup>82</sup>

54. Mr. Gorman's DCF analysis resulted in a zone of reasonableness with a range of high and low median values of 7.97 percent to 10.33 percent for Mr. Gorman's national proxy group.<sup>83</sup> The midpoint of the median range is 9.15 percent, which is the just and reasonable ROE that should be accepted by the Commission.<sup>84</sup>

55. Mr. Gorman's results for his regional proxy group were similar to those of his national proxy group.<sup>85</sup> Excluding outliers in the same manner explained above (only First Energy Corp. and Westar Energy, Inc. was excluded), Mr. Gorman's regional proxy group produced a zone of reasonableness of 6.75 percent to 10.62 percent.<sup>86</sup> The midpoint of the zone of reasonableness, based on a DCF analysis using a regional proxy group, is 8.69 percent.<sup>87</sup>

### **C. Joint Complainants' Risk Premium Studies.**

56. In addition to performing the Commission's DCF analysis, Mr. Gorman also performed two risk premium studies to address the reasonableness of his DCF results and further demonstrate that the current ROEs for the MISO TOs are unjust and unreasonable.<sup>88</sup> The two risk premium studies performed by Mr. Gorman were a bond yield plus risk premium study and a capital asset pricing model ("CAPM") study.<sup>89</sup>

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<sup>81</sup> *Id.*

<sup>82</sup> *Southern Cal. Edison Co.*, 131 FERC ¶ 61,020 at P 58.

<sup>83</sup> Gorman Affidavit at 32.

<sup>84</sup> *Id.*

<sup>85</sup> *Id.* at 33.

<sup>86</sup> *Id.*

<sup>87</sup> *Id.*

<sup>88</sup> *Id.* at 34-35.

<sup>89</sup> *Id.* at 35.

## 1. Bond Yield Plus Risk Premium Model

57. The bond yield plus risk premium model is based on the theory that investors require a higher return when they assume greater risk.<sup>90</sup> Common equity investments have greater risk than bonds because bondholders assume priority over common equity investors in bankruptcy proceedings, and the coupon payments on bonds represent contractual obligations.<sup>91</sup> In contrast, companies are not obligated to pay dividends or guarantee returns on common equity investments.<sup>92</sup> Therefore, common equity securities are considered to be riskier than bond securities.<sup>93</sup>

58. Mr. Gorman's risk premium model is based on two estimates of an equity risk premium.<sup>94</sup> First, Mr. Gorman estimated the difference between the required return on utility common equity investments and U.S. Treasury bonds.<sup>95</sup> The difference between these two values is the risk premium.<sup>96</sup> Mr. Gorman estimated the risk premium annually for each year from 1986 through June 2013.<sup>97</sup> The common equity required returns used by Mr. Gorman were based on regulatory commission-authorized returns for electric utility companies, which are typically based on expert witnesses' estimates of the contemporary investor-required return.<sup>98</sup> He selected the period 1986 through June 2013 because public utility stocks consistently traded at a premium during that time period, which indicates that the commission-authorized returns on equity were received positively by the market.<sup>99</sup>

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<sup>90</sup> *Id.*

<sup>91</sup> *Id.*

<sup>92</sup> *Id.*

<sup>93</sup> *Id.*

<sup>94</sup> *Id.*

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

<sup>97</sup> *Id.*

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

59. Mr. Gorman's second risk premium estimate was based on the difference between regulatory commission-authorized returns on common equity and contemporary "A" rated utility bond yields.<sup>100</sup> Over the 1986 to June 2013 time period, regulatory commission-authorized returns were sufficient to support market prices that at least exceeded book value, indicating that regulatory commission-authorized returns on common equity supported a utility's ability to issue additional common stock without diluting existing shares.<sup>101</sup> Further, the fact that the returns were sufficient to support market prices that at least exceeded book value demonstrates that utilities were able to access equity markets without a detrimental impact on current shareholders.<sup>102</sup>

60. Based on his analysis, Mr. Gorman found that the average indicated equity risk premium over U.S. Treasury bond yields has been 5.35 percent.<sup>103</sup> Twenty-two of Mr. Gorman's twenty-eight observations indicated that risk premiums fall in the range of 4.41 percent to 6.31 percent.<sup>104</sup> Because the risk premium can vary depending upon market conditions and investor perceptions of risk, Mr. Gorman believes that using an estimated range of risk premiums results in the best method to measure the current return on common equity.<sup>105</sup>

61. Mr. Gorman's analysis also indicated an average equity risk premium over contemporary Moody's utility bond yields of 3.94 percent.<sup>106</sup> Mr. Gorman calculated that the risk premium estimates primarily fell in the range of 3.03 percent to 4.89 percent.<sup>107</sup>

62. Next, Mr. Gorman chose the risk premium that was used to estimate the cost of common equity in this proceeding.<sup>108</sup> In doing so, Mr. Gorman noted that the equity risk

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<sup>100</sup> *Id.* at 36.

<sup>101</sup> *Id.*

<sup>102</sup> *Id.*

<sup>103</sup> *Id.*

<sup>104</sup> *Id.*

<sup>105</sup> *Id.*

<sup>106</sup> *Id.*

<sup>107</sup> *Id.*

premium should reflect the relative market perception of risk in the utility industry today.<sup>109</sup> In order to comply with this directive, Mr. Gorman looked at the yield spread between utility bonds and Treasury bonds over the last 34 years.<sup>110</sup> Mr. Gorman found that the average utility bond yield spreads over Treasury bonds for "A" and "Baa" rated utility bonds was 1.55 percent and 1.96 percent, respectively.<sup>111</sup> The utility bond yield spreads over Treasury bonds for "A" and "Baa" rated utilities through June 2013 are 1.06 percent and 1.58 percent, respectively.<sup>112</sup>

63. A current 13-week average "A" rated utility bond yield of 4.73 percent compared to the current Treasury bond yield of 3.73 percent implies a yield spread of 1.00 percent.<sup>113</sup> This current utility bond yield spread is lower than the 34-year average spread for "A" utility bonds of 1.52 percent and "Baa" utility bonds of 1.96 percent.<sup>114</sup>

64. The fact that current utility bond yield spreads over Treasury bond yields are below historical averages is "clear evidence that the market considers the utility industry to be a relatively low-risk and safe investment."<sup>115</sup> According to Mr. Gorman, the below-average spreads suggest that the market is demanding average to below-average premiums to invest in utility stocks relative to lower-risk Treasury investments.<sup>116</sup> This finding demonstrates that the risk of utility securities is considered low, and investors are paying premiums for utility security investments.<sup>117</sup> Based on this assessment, Mr. Gorman believes that an equity risk premium for utility equities relative to Treasury and utility bonds should generally be consistent with the

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<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> *Id.*

<sup>111</sup> *Id.* at 37.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

average equity risk premium measured over the historical time period.<sup>118</sup> However, Mr. Gorman notes that because the Federal Reserve is currently continuing its interventions in long-term bond markets by purchasing Treasury and collateralized mortgage agreements, there is some uncertainty and higher risk associated with fixed income securities.<sup>119</sup> Because of the risk of future interest rates, Mr. Gorman recommends a risk premium between the median and high-end of his estimated range.<sup>120</sup>

65. Mr. Gorman estimated the cost of common equity with the bond yield plus risk premium model by using the two risk premium estimates above: 1) above Treasury bond yields and 2) above utility bond yields.<sup>121</sup> First, Mr. Gorman added a projected long-term Treasury bond yield to his estimated equity risk premium over Treasury yields.<sup>122</sup> The 13-week average 30-year Treasury bond yield, ending October 11, 2013, was 3.73 percent.<sup>123</sup> *Blue Chip Financial Forecasts* projects the 30-year Treasury bond yield to be 4.20 percent and the 10-year Treasury bond yield to be 3.30 percent.<sup>124</sup> Using the projected 30-year bond yield of 4.20 percent and a Treasury bond risk premium of 4.41 percent to 6.31 percent, as developed above, results in an estimated common equity return in the range of 8.61 percent to 10.51 percent.<sup>125</sup>

66. In Mr. Gorman's second risk premium estimate, he added his equity risk premium over utility bond yields to a current 13-week average yield on "Baa" rated utility bonds for the period ending October 11, 2013 of 5.25 percent.<sup>126</sup> Adding the utility equity risk premium of 3.03 percent to 4.89 percent, as developed above, to a "Baa" rated bond yield of 5.25 percent

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<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

<sup>120</sup> *Id.* at 37-38.

<sup>121</sup> *Id.* at 38.

<sup>122</sup> *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

produces an estimated common equity return in the range of 8.28 percent to 10.14 percent.<sup>127</sup> Therefore, Mr. Gorman's risk premium analyses produce a return estimate of 8.28 percent to 10.51 percent, which supports the recommended 9.15 percent ROE result from Mr. Gorman's DCF analysis.<sup>128</sup>

## 2. Capital Asset Pricing Model

67. The CAPM is based upon the theory that the market-required rate of return for a security is equal to the risk-free rate plus a risk premium associated with the specific security. This relationship is expressed mathematically as follows:

$R_i = R_f + B_i \times (R_m - R_f)$  where:

$R_i$  = Required return for stock i

$R_f$  = Risk-free rate

$R_m$  = Expected return for the market portfolio

$B_i$  = Beta - Measure of the risk for stock.<sup>129</sup>

68. The stock-specific risk term in the above equation is beta, which represents the investment risk that cannot be diversified away when the security is held in a diversified portfolio.<sup>130</sup> When stocks are held in a diversified portfolio, firm-specific risks can be eliminated by balancing the portfolio with securities that react in the opposite direction to firm-specific risk factor (e.g., business cycle, competition, product mix, and production limitations).<sup>131</sup>

69. The risks that cannot be eliminated when held in a diversified portfolio are non-diversifiable risks.<sup>132</sup> Non-diversifiable risks are related to the market in general and are referred

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<sup>127</sup> *Id.*

<sup>128</sup> *Id.*

<sup>129</sup> *Id.* at 39.

<sup>130</sup> *Id.*

<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

to as systematic risks; risks that can be eliminated by diversification are non-systematic risks.<sup>133</sup> Generally, systematic risks are market risks, and non-systematic risks are business risks.<sup>134</sup> The CAPM theory suggests that the market will not compensate investors for assuming risks that can be diversified away, which means that investors will only be compensated for systematic, or non-diversifiable risks.<sup>135</sup> The beta is a measure of the systematic or non-diversifiable risks.<sup>136</sup>

70. The CAPM requires an estimate of the market risk-free rate, the company's beta, and the market risk premium.<sup>137</sup> In order to approximate the market risk-free rate, Mr. Gorman again relied on the *Blue Chip Financial Forecasts'* projected Treasury bond yield of 4.20 percent.<sup>138</sup> Mr. Gorman chose this estimate because Treasury securities are backed by the full faith and credit of the United States government, which means long-term treasury bonds are considered to have negligible risk.<sup>139</sup> Additionally, Mr. Gorman notes that long-term treasury bonds have an investment horizon similar to that of common stock, so investor-anticipated long-run inflation expectations are reflected in both common stock required returns and long-term bond yields.<sup>140</sup> Therefore, the nominal risk-free rate (or expected inflation rate and real risk-free rate) included in a long-term bond yield is a reasonable estimate of the nominal risk-free rate included in common stock returns.<sup>141</sup>

71. Mr. Gorman notes that U.S. Treasury bond yields do include risk premiums related to unanticipated future inflation and interest rates, so a U.S. Treasury bond yield is not a

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<sup>133</sup> *Id.*

<sup>134</sup> *Id.*

<sup>135</sup> *Id.*

<sup>136</sup> *Id.*

<sup>137</sup> *Id.* at 40.

<sup>138</sup> *Id.*

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> *Id.*



true risk-free rate.<sup>142</sup> Risk premiums related to unanticipated inflation and interest rates are systematic or market risks.<sup>143</sup> Consequently, for companies with betas less than 1.0, using the U.S. Treasury bond yield as a proxy for the risk-free rate in a CAPM analysis can overstate the estimate of the CAPM return.<sup>144</sup>

72. For the beta component of the CAPM analysis, Mr. Gorman used the beta estimates published by Value Line.<sup>145</sup> Mr. Gorman found that the average beta estimates for his regional and national proxy groups were 0.69 and 0.71, respectively.<sup>146</sup>

73. Mr. Gorman derived two market risk premium estimates: 1) a forward-looking estimate and 2) an estimate based on a long-term historical average.<sup>147</sup> The forward-looking estimate was derived by estimating the expected return on the market (as represented by the S&P 500) and subtracting the risk-free rate of return from this estimate.<sup>148</sup> Mr. Gorman estimated the expected return on the S&P 500 by adding an expected inflation rate to the long-term historical arithmetic average real return on the market.<sup>149</sup> The real return on the market represents the achieved return above the inflation rate.<sup>150</sup>

74. Morningstar's *Stocks, Bonds, Bills and Inflation 2013 Classic Yearbook* estimates the historical arithmetic average real market return over the period 1926 to 2012 as 8.7 percent.<sup>151</sup> A current consensus analysts' inflation projection, as measured by the Consumer Price Index ("CPI"), is 2.3 percent.<sup>152</sup> Using these estimates, Mr. Gorman calculated the

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<sup>142</sup> *Id.*

<sup>143</sup> *Id.* at 40-41.

<sup>144</sup> *Id.* at 41.

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Id.*

<sup>152</sup> *Id.*

expected market return as 11.20 percent.<sup>153</sup> The market risk premium then is the difference between the 11.20 percent expected market return and the 4.20 percent risk-free rate estimate, or 7.00 percent.<sup>154</sup>

75. The historical estimate of the market risk premium was also estimated by Morningstar in *Stocks, Bonds, Bills and Inflation 2013 Classis Yearbook*.<sup>155</sup> Over the period 1926 through 2012, Morningstar's study estimated that the arithmetic average of the achieved total return on the S&P 500 was 11.8 percent, and the total return on long-term U.S. Treasury bonds was 6.1 percent.<sup>156</sup> The indicated market risk premium is 5.7 percent. The average of Mr. Gorman's market risk premium estimates is 6.4 percent.<sup>157</sup>

76. Morningstar's analysis indicates that a market risk premium falls somewhere in the range of 6.0 percent to 6.7 percent.<sup>158</sup> Mr. Gorman's risk premium falls in the 5.7 percent to 7.1 percent range.<sup>159</sup> Mr. Gorman's average market risk premium of 6.4 percent is in the middle of Morningstar's range.<sup>160</sup>

77. Morningstar also estimates a forward-looking market risk premium based on actual achieved data from the historical period of 1926 through 2012.<sup>161</sup> Using this data, Morningstar estimates a market risk premium derived from the total return on large company stocks (S&P 500), less the income return on U.S. Treasury bonds.<sup>162</sup> The total return includes capital appreciation, dividend or coupon reinvestment returns, and annual yields received from

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<sup>153</sup> *Id.*

<sup>154</sup> *Id.*

<sup>155</sup> *Id.* at 42.

<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

coupons and/or dividend payments.<sup>163</sup> In contrast, the income return only reflects the income return received from dividend payments or coupon yields.<sup>164</sup> Morningstar argues that the income return is the only true risk-free rate associated with U.S. Treasury bonds and is the best approximation of a truly risk-free rate.<sup>165</sup> Mr. Gorman disagrees with Morningstar's assessment because "it does not reflect a true investment option available to the marketplace and therefore does not produce a legitimate estimate of the expected premium of investing in the stock market versus that of Treasury bonds."<sup>166</sup> Nevertheless, Mr. Gorman used Morningstar's conclusion to show the reasonableness of his market risk premium estimates.<sup>167</sup>

78. Morningstar's range is based on several methodologies.<sup>168</sup> First, Morningstar estimates a market risk premium of 6.7 percent based on the difference between the total market return on common stocks (S&P 500) less the income return on Treasury bond investments.<sup>169</sup> Second, Morningstar found that if the New York Stock Exchange ("NYSE") was used as the market index rather than the S&P 500, that the market risk premium would be 6.5 percent, not 6.7 percent.<sup>170</sup> Third, if only the two deciles of the largest companies included in the NYSE were considered, the market risk premium would be 6.0 percent.<sup>171</sup>

79. Finally, Morningstar found that the 6.7 percent market risk premium based on the S&P 500 was influenced by an abnormal expansion of price-to-earnings ("P/E") ratios relative to earnings and dividend growth during the period 1980 through 2001.<sup>172</sup> Morningstar believes

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<sup>163</sup> *Id.*

<sup>164</sup> *Id.*

<sup>165</sup> *Id.* at 42-43.

<sup>166</sup> *Id.* at 43.

<sup>167</sup> *Id.*

<sup>168</sup> *Id.*

<sup>169</sup> *Id.*

<sup>170</sup> *Id.*

<sup>171</sup> *Id.*

<sup>172</sup> *Id.*

the abnormal P/E expansion is not sustainable.<sup>173</sup> Therefore, Morningstar adjusted the market risk premium estimate to normalize the growth in the P/E ratio to be more in line with the growth in dividends and earnings.<sup>174</sup> Based on this alternative methodology, Morningstar published a long-horizon supply-side market risk premium of 6.0 percent.<sup>175</sup> In order to remain conservative, Mr. Gorman used the higher 6.7 percent market risk premium in his CAPM analysis as opposed to the 6.4 percent that he independently calculated.<sup>176</sup>

80. Based on Morningstar's market risk premium of 6.7 percent, a risk-free rate of return of 4.20 percent, and a beta of 0.71, Mr. Gorman's CAPM analysis produced a return of 8.94 percent.<sup>177</sup> Using a beta range of 0.55 to 0.95 indicates a CAPM in the range of 7.89 percent to 10.57 percent, which supports the recommended 9.15 percent ROE result from Mr. Gorman's DCF analysis.<sup>178</sup>

**D. The Current Base ROEs Are Unjust And Unreasonable.**

81. The DCF analysis performed by Mr. Gorman shows that as a result of significantly changed economic circumstances since the Base ROEs were first established: (1) the current Base ROEs are unjust and unreasonable; and (2) the just and reasonable Base ROE for all assets should be set no higher than 9.15 percent.<sup>179</sup>

82. Maintaining the Base ROEs at current levels would result in the continuation of a substantial overpayment to the MISO TOs from their customers.<sup>180</sup> The Joint Complainants calculate that, based on the current rate base levels provided in the MISO TOs' most recent formula rate updates, electric consumers are overcompensating the MISO TOs by approximately

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<sup>173</sup> *Id.*

<sup>174</sup> *Id.*

<sup>175</sup> *Id.*

<sup>176</sup> *Id.* at 44.

<sup>177</sup> *Id.*

<sup>178</sup> *Id.*

<sup>179</sup> *Id.*

<sup>180</sup> *Id.* at 2.

\$327 million annually under the current Base ROEs, as compared to rates using Mr. Gorman's recommended Base ROE of 9.15%.<sup>181</sup> These overpayments are unjust and unreasonable because they are far in excess of what is "reasonably sufficient to assure confidence in the financial soundness of the utility [or, in this case, utilities] 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."<sup>182</sup> The Supreme Court has made it clear that not even "a little unlawfulness is permitted" in setting jurisdictional rates.<sup>183</sup> Rates incorporating the existing Base ROEs are leading to far more than "a little" overpayment.

**E. The Commission Should, At The Very Least, Set The Issues Of The Appropriate ROE For an Expedited Settlement Process and, If Necessary, Evidentiary Hearing Procedures.**

83. The Joint Complainants respectfully submit that ample evidence exists to show that the current Base ROEs are no longer just and reasonable, and that a Base ROE of 9.15 percent is just and reasonable. The Commission should issue an order so finding. At a minimum, however, the Commission should institute a proceeding under Section 206 of the FPA to investigate whether the Base ROEs are excessive and to determine a just and reasonable Base ROE.

84. The procedures should consist of two phases, consistent with recent proceedings in which utilities' ROEs were the subject of a complaint. First, parties should be directed to engage in settlement procedures with a Commission settlement judge, with a prescribed deadline (e.g., 60 days). Second, and if the settlement process does not produce a certified offer of settlement within a prescribed period of time, the new Base ROE should be determined through an evidentiary hearing.

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<sup>181</sup> *Id.*

<sup>182</sup> *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 692-693 (1923).

<sup>183</sup> *FPC v. Texaco, Inc.*, 417 U.S. at 399.

**F. The Commission Should Establish The Earliest Possible Refund Effective Date**

85. In cases where the Commission institutes an investigation on a complaint under Section 206 of the FPA, Section 206(b) requires the Commission to establish a refund effective date that is no earlier than the date the complaint was filed, but no later than five (5) months after the filing date.<sup>184</sup> In a prior complaint proceeding challenging the Base ROE in a formula transmission rate, the Commission explained that, consistent with its general policy of providing maximum protection to customers,<sup>185</sup> it would set the refund to become effective at the earliest date possible.<sup>186</sup> Given the Commission's general policy of providing maximum protection to customers, the Commission should establish the filing date of this Complaint as the refund effective date for the relief to be afforded the Joint Complainants in this proceeding.

**VII. MISO TO'S CAPITAL STRUCTURES IN EXCESS OF 50 PERCENT EQUITY ARE UNJUST AND UNREASONABLE**

**A. The Common Equity Ratio of the MISO TOs Does Not Reflect the Low Operating Risk of Transmission Operations.**

86. The common equity ratio of certain MISO TOs does not reflect the low operating risk of transmission operations. Transmission companies have low operating risk.<sup>187</sup> Credit rating agencies agree that a company that has a lower operating risk can finance with greater amounts of financial risk, while supporting an investment grade bond rating.<sup>188</sup> For example, S&P, in a Ratings Direct publication "Key Credit Factors: Business and Financial Risk in the Investor-Owned Utility Industry," explained the relationship between business and financial risk

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<sup>184</sup> 16 U.S.C. § 824e(b).

<sup>185</sup> See, e.g., *Old Dominion Electric Coop. and North Carolina Electric Membership Corp. v. Virginia Electric and Power Co.*, 133 FERC ¶ 61,009 at P 36 (2010) (citing *Seminole Elec. Coop., Inc. v. Fla. Power & Light Co.*, 65 FERC ¶ 61,413, at p. 63,139 (1993); *Canal Elec. Co.*, 46 FERC ¶ 61,153, at p. 61,539, *reh'g denied*, 47 FERC ¶ 61,275 (1989)).

<sup>186</sup> *Coakley et al. v. Bangor Hydro, et al.*, 139 FERC ¶ 61,090 at P 29.

<sup>187</sup> Gorman Affidavit at 9.

<sup>188</sup> *Id.* at 10-11.

in the credit rating process.<sup>189</sup> Specifically, S&P explained that utilities with stronger business profiles (scores of "Excellent" to "Strong") can have greater amounts of financial risk (financial risk profiles of "Intermediate," "Aggressive," and "Highly Leveraged") and still maintain an investment grade bond rating.<sup>190</sup> The same report illustrated that S&P considers the business risk and financial risk of a utility separately in assigning it a credit rating.<sup>191</sup>

87. S&P's rating criteria demonstrate the unreasonableness of a low-risk transmission electric utility financing itself with relatively little financial risk – *i.e.*, a high common equity ratio and no debt ratio.<sup>192</sup> Transmission owners should have a common equity ratio that is at least in line with the electric utility industry average because of the low operating or business risk of transmission operations.<sup>193</sup> A balanced capital structure for all MISO TOs will help maintain an investment grade bond rating while lowering the cost of transmission service.<sup>194</sup>

88. Mr. Gorman notes that "[w]hile an optimal capital structure can be difficult to establish, the MISO TOs with capital structures that are far greater equity weighted than the electric utility integrated utility capital structures certainly demonstrate that the capital structures appear to be excessively weighted with common equity."<sup>195</sup> Over the last five years, the actual common equity ratio for most MISO TOs has been 53 percent or less.<sup>196</sup> However, other MISO TOs have common equity ratios well in excess of 55 percent.<sup>197</sup> Over this same time period, the electric utility industry has been awarded capital structures with common equity ratios between

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<sup>189</sup> *Id.* at 11.

<sup>190</sup> *Id.*

<sup>191</sup> *Id.*

<sup>192</sup> *Id.*

<sup>193</sup> *Id.*

<sup>194</sup> *Id.*

<sup>195</sup> *Id.*

<sup>196</sup> *Id.* at 12.

<sup>197</sup> *Id.*

48 percent and 51 percent.<sup>198</sup> Further, Mr. Gorman's national proxy group had an average common equity ratio of 48.8 percent.<sup>199</sup> This common equity ratio supported a national proxy group average bond rating of BBB+.<sup>200</sup>

89. Credit rating agencies have determined that electric utility companies have had ample access to capital to support very large construction programs.<sup>201</sup> Additionally, the electric utility industry's bond rating has been a stable investment grade over the same time period.<sup>202</sup> The capital structures of the electric utility industry have supported their investment grade bond ratings and provided adequate access to capital to support large capital programs.<sup>203</sup> Importantly, these more balanced capital structures with more reasonable common equity ratios also produce lower overall cost of capital in rates to end-use customers relative to companies that have an excessive equity weighted capital structure.<sup>204</sup>

90. There is little difference in the bond rating for MISO companies with actual common equity ratios of 50 percent to 55 percent compared to MISO TOs with common equity ratios in excess of 55 percent.<sup>205</sup> For example, many MISO TOs with common equity ratios below 45 percent have bond ratings from S&P of BBB, which also represents the median bond rating for the MISO TOs with common equity ratios below 45 percent.<sup>206</sup> The median bond rating for companies with common equity ratios between 50 percent and 55 percent is BBB+, and the median bond rating for companies with common equity ratios above 55 percent is also

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<sup>198</sup> *Id.*

<sup>199</sup> *Id.*

<sup>200</sup> *Id.*

<sup>201</sup> *Id.*

<sup>202</sup> *Id.*

<sup>203</sup> *Id.*

<sup>204</sup> *Id.*

<sup>205</sup> *Id.* at 13.

<sup>206</sup> *Id.*



BBB+.<sup>207</sup> Mr. Gorman notes that "[a] one notch improvement in the bond rating for a significant increase in the common equity ratio results in an increased cost of capital and little benefit, if any, to end-use transmission customers."<sup>208</sup> Further, Mr. Gorman notes that ATC has the strongest bond rating, yet it also has the lowest actual common equity ratio of all the MISO TOs.<sup>209</sup> Based on a settlement proceeding, ATC's FERC formula common equity ratio of 50 percent is evidence that a reasonable capital structure will support strong credit for the MISO TOs.<sup>210</sup>

91. In addition, even if a transmission company had a slightly stronger bond rating, it is likely that its overall cost of capital would be higher if it has an excessive common equity ratio.<sup>211</sup> Mr. Gorman notes that the ITC Subsidiaries readily illustrate this point.<sup>212</sup> The ITC Subsidiaries have a bond rating of BBB+/A3 and a common equity ratio of 60 percent.<sup>213</sup> These MISO TOs have common equity ratios well in excess of other MISO TOs and other integrated electric utility companies.<sup>214</sup> However, their bond ratings are only marginally better (one to two notches) than most of the other MISO TOs. Currently, the interest rate advantage of this higher bond rating is approximately 50 basis points.<sup>215</sup> Over time, the advantage has averaged about 45 basis points.<sup>216</sup>

92. Using this information, Mr. Gorman developed a conservative estimate of the change in cost of capital if the ITC Subsidiaries' common equity ratios were reduced to 50

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<sup>207</sup> *Id.*

<sup>208</sup> *Id.*

<sup>209</sup> *Id.*

<sup>210</sup> *Id.*

<sup>211</sup> *Id.*

<sup>212</sup> *Id.*

<sup>213</sup> *Id.*

<sup>214</sup> *Id.* at 14.

<sup>215</sup> *Id.*

<sup>216</sup> *Id.*

percent and their bond rating declined by two notches.<sup>217</sup> With this decline in bond rating, Mr. Gorman assumed that the ITC Subsidiaries' embedded cost of debt would increase by 50 basis points.<sup>218</sup> The ITC Subsidiaries' current pre-tax rate of return ranges from 13.4 percent to 13.6 percent.<sup>219</sup> With these assumptions, the ITC Subsidiaries' pre-tax rate of return would decrease to 12.2 percent from 12.5 percent with a lower common equity ratio and higher cost of debt.<sup>220</sup> This pre-tax rate of return, when applied to the ITC Subsidiaries' transmission rate base (\$3.55 billion consolidated), equates to \$40.9 million per year of excess revenue requirements for transmission service.<sup>221</sup> Therefore, many of the MISO TOs are currently earning excess revenue requirements as a result of their capital structures that are unjust and unreasonable.<sup>222</sup> Limiting the common equity ratio significantly reduces the revenue requirement and the cost for transmission service.<sup>223</sup> At the same time, limiting the common equity ratio has only a minimal impact on the credit standing of TOs, if it has any impact on the credit standing at all.<sup>224</sup>

**B. The Evidence Supports a 50 Percent Common Equity Ratio in Order to Adequately Support a Strong Credit Standing for MISO TOs.**

93. Mr. Gorman notes that there is evidence that a 50 percent common equity ratio is adequate to support a strong credit standing for the transmission operations of the MISO TOs.<sup>225</sup> ATC entered into a settlement for ratemaking principles for its transmission operations that included a common equity ratio of 50 percent.<sup>226</sup> ATC has an A+ and a "Stable" credit rating by

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<sup>217</sup> *Id.*

<sup>218</sup> *Id.*

<sup>219</sup> *Id.*

<sup>220</sup> *Id.* at 14-15.

<sup>221</sup> *Id.* at 15.

<sup>222</sup> *Id.*

<sup>223</sup> *Id.*

<sup>224</sup> *Id.*

<sup>225</sup> *Id.* at 17.

<sup>226</sup> *Id.*

S&P.<sup>227</sup> In fact, ATC's bond rating was upgraded from A to A+ just a few months after its common equity ratio was set at 50 percent.<sup>228</sup> Since the ATC rate settlement went into effect, ATC has doubled the size of its gross investment in transmission plant (from \$1.77 billion in 2006 to \$3.85 billion at the end of 2012).<sup>229</sup> ATC's ratemaking agreement provides clear evidence that a common equity ratio cap of 50 percent will support a strong investment grade credit rating.<sup>230</sup> ATC's 50 percent common equity ratio also supported the TO's ability to fund significant investments in transmission infrastructure over the past seven years.<sup>231</sup>

94. Moreover, S&P has positively noted ATC's operating and financial risk.<sup>232</sup> Specifically, S&P rates ATC's business risk as "Excellent," its financial risk as "Intermediate," and its outlook as "Stable."<sup>233</sup> ATC's current Commission-approved common equity ratio of 50 percent, combined with ATC's strong credit rating, is clear evidence that a 50 percent common equity ratio will support strong credit and access to capital for other transmission electric utilities such as the MISO TOs.<sup>234</sup>

**C. The MISO TOs Have an Incentive to Increase Their Common Equity Ratios.**

95. Because the MISO TOs are currently earning above-market returns on common equity, they have an economic incentive to increase their utilization of equity capital to support their investment in transmission assets.<sup>235</sup> The customers of the MISO TOs have not been paying just and reasonable rates for transmission service because many of the MISO TOs' capital structures have been overly weighted with common equity, and the returns on equity have been

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<sup>227</sup> *Id.*

<sup>228</sup> *Id.*

<sup>229</sup> *Id.*

<sup>230</sup> *Id.*

<sup>231</sup> *Id.*

<sup>232</sup> *Id.* at 17-18.

<sup>233</sup> *Id.* at 18.

<sup>234</sup> *Id.*

<sup>235</sup> *Id.*

well in excess of current market costs.<sup>236</sup> Mr. Gorman has determined that as a result, "the balance in rate-setting for MISO TOs has been compromised."<sup>237</sup> A just and reasonable rate of return is one that is bounded on one end by investor interest, and on the other end by the public interest against excessive rates.<sup>238</sup> In order to accomplish this balanced objective, Mr. Gorman recommends that the Commission require the MISO TOs to manage their capital structures in a manner that minimizes their overall cost of capital, while supporting an investment grade bond rating.<sup>239</sup>

**D. Recommended Capital Structure Targets.**

96. Because of the low business risk that the MISO TOs face, Mr. Gorman recommends that the Commission implement a target capital structure for the MISO TOs.<sup>240</sup> Specifically, Mr. Gorman recommends a target capital structure that consists of a common equity ratio of 50 percent, which is just and reasonable in light of the business risk faced by the MISO TOs.<sup>241</sup> To the extent that an individual MISO TO has an equity ratio of 50 percent or less, the Commission should require that the TO file its rates with the Commission using its actual capital structure.<sup>242</sup> If a MISO TO has a common equity ratio in excess of 50 percent, then the Commission should require that the TO provide evidence to the Commission showing that its common equity ratio is just and reasonable and consistent with minimizing its cost of capital while preserving its investment grade bond rating.<sup>243</sup> Therefore, the Commission should adopt a 50 percent common equity ratio cap for all MISO TOs, without prejudice to individual MISO

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<sup>236</sup> *Id.*

<sup>237</sup> *Id.*

<sup>238</sup> *Id.* at 19.

<sup>239</sup> *Id.*

<sup>240</sup> *Id.*

<sup>241</sup> *Id.*

<sup>242</sup> *Id.*

<sup>243</sup> *Id.*

TOs having the ability to justify, on the basis of substantial evidence concerning their individual circumstance, that a higher equity ratio is just and reasonable.<sup>244</sup>

### VIII. ITC'S AND METC'S ROE ADDERS ARE NOT JUST AND REASONABLE

97. In addition to an excessive Base ROE, ITC and METC have in place ROE adders that are no longer just and reasonable. Specifically, ITC currently receives a 50 basis point adder for RTO membership, and ITC and METC each receive a 100 basis point adder for being independent transmission companies.<sup>245</sup> For the reasons discussed below, the Commission should reject ITC's and METC's ROE adders as unjust and unreasonable.

98. ITC's ROE adder for RTO membership and ITC's and METC's adders for being independent transmission companies are no longer necessary to promote the Commission's policy goals as they relate to RTO participation and transmission independence. "If the Commission contemplates increasing rates for the purpose of encouraging" a policy goal, then the Commission "must see to it that the increase is in fact needed, and is no more than is needed, for the purpose."<sup>246</sup> Therefore, a close nexus must exist between any basis point adders and the net benefits to customers that would not have been achieved absent the increase to the ROE. "There must be a 'quid pro quo' for the extra funding" and "there must be 'symmetry' between the funding and increase" in customer value.<sup>247</sup> The Commission must protect customers from paying substantially more than necessary to achieve the desired outcome.<sup>248</sup>

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<sup>244</sup> *Id.*

<sup>245</sup> *International Transmission Company and Midwest Independent Transmission System Operator, Inc.*, 116 FERC ¶ 61,036 at P 36; *ITC Holdings Corporation, et al.*, 102 FERC ¶ 61,182; *Michigan Electric Transmission Company, LLC*, 116 FERC ¶ 61,164 at PP 20-21.

<sup>246</sup> *City of Detroit v. FPC*, F.2d 810, 817 (D.C. Cir. 1955).

<sup>247</sup> *Pub. Serv. Comm'n v. FERC*, 589 F.2d 542, 552-53 (D.C. Cir. 1978) (remanding an order of the Federal Power Commission ("FPC") that provided an optional certificate program for natural gas producers that was designed to increase exploration and development of new gas sources).

<sup>248</sup> *City of Charlottesville v. FERC*, 661 F.2d 945, 950 (D.C. Cir. 1955) (quoting *City of Detroit v. FPC*, 230 F.2d 810 (D.C. Cir. 1955) (striking down the Commission's consolidated tax policy for gas pipelines that gave shareholders, rather than ratepayers, the benefits of consolidated tax savings resulting from production losses).

99. ITC and METC have been receiving the benefits of ROE adders for over a decade, and as a result, ITC and METC have recovered more than enough through their ROE adders to deliver the benefit of being independent transmission companies and, in ITC's case, the benefit of being a member of an RTO. Allowing ITC and METC to continue applying their ROE adders causes customers to pay higher transmission rates, while at the same time the customers are not receiving any incremental benefits to offset the higher costs.<sup>249</sup> At this point, the ROE adders are simply providing ITC and METC a windfall at the expense of customers. No other TOs in the MISO region receive these ROE adders, and there is no logical justification for allowing ITC and METC to continue applying the adders. In fact, subsequent to the Commission's acceptance of ROE adders for ITC and METC, ITC Midwest sought similar ROE adders. The Commission rejected ITC Midwest's request, notwithstanding that ITC Midwest's posture relative to independent transmission operations and RTO participation was substantially similar to that of the other ITC Subsidiaries.<sup>250</sup>

100. The Commission recognized that ROE incentive adders such as those enjoyed by ITC and METC were not meant to continue indefinitely. The Commission specifically stated in its Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid that "[a] public utility would qualify for the [50 point adder for RTO membership] as soon as it has transferred operational control of its transmission facilities to an approved and operating RTO, and would be authorized to receive the incentive for RTO participation until December 31, 2012."<sup>251</sup> The Commission also recognized that incentive adders for divesting transmission

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<sup>249</sup> Gorman Affidavit at 21-22.

<sup>250</sup> *ITC Holdings Corp.*, 121 FERC ¶ 61,229 at PP 39-45.

<sup>251</sup> Proposed Pricing Policy for Efficient Operation and Expansion of Transmission Grid, 102 FERC ¶ 61,032 at P 28 (2003).

facilities to an independent transmission company should also have an expiration.<sup>252</sup> Therefore, the Commission never determined or ordered that ROE incentive adders, such as those applied by ITC and METC, would continue indefinitely.

101. Additionally, there is no benefit to customers for continuing to pay incentive ROE adders to ITC and METC because: (1) ITC's and METC's bond ratings are generally consistent with the other MISO TOs bond ratings; and (2) credit analyst industry reports indicate that low-risk regulated utility operations, particularly low-industry-risk transmission operations, have ample access to low-cost capital to fund needed utility infrastructure investment.<sup>253</sup> Credit rating agencies have recognized that the market is embracing the electric utility industry providing it with ample access to low-cost capital to support large capital improvement programs.<sup>254</sup> Incentive ROE adders in this market are simply not necessary because of the strong market interest in the low-risk, stable investment characteristics of the electric utility investment.<sup>255</sup> In summary, credit rating analysts have recognized that setting rates based on adequate credit rating metrics provides ample access to capital for regulated utility operations, at a relatively low cost and in adequate supply to support large capital programs.<sup>256</sup> ROE adders are not needed to provide MISO TOs access to ample low cost capital; they serve no other purpose than to unjustifiably increase the rates charged to transmission users and should be discontinued.<sup>257</sup>

102. The incentive ROE adders applied by ITC and METC also do not encourage ITC and METC to manage their capital costs to reduce their overall rates of return.<sup>258</sup> Currently, ITC and METC are provided not only with excessive Base ROEs, but they are also maintaining

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<sup>252</sup> *Id.*

<sup>253</sup> Gorman Affidavit at 20.

<sup>254</sup> *Id.*

<sup>255</sup> *Id.*

<sup>256</sup> *Id.*

<sup>257</sup> *Id.* at 21.

<sup>258</sup> *Id.*

capital structures with far more common equity than necessary to maintain their current bond ratings.<sup>259</sup> Both ITC and METC have common equity ratios of 60 percent.<sup>260</sup> These common equity ratios, along with well above market authorized ROEs are producing substantially higher pre-tax rates of return than those of other MISO TOs.<sup>261</sup> Eliminating the ROE adders for these companies would produce lower pre-tax rates of return even if their cost of debt was increased to reflect a reduction in their bond ratings.<sup>262</sup> Assuming a 50 basis point increase in the embedded cost of debt, and reducing ITC's and METC's ROE down to the current MISO Base ROE of 12.38 percent would lower ITC's and METC's pre-tax rate of return from 15.55 percent and 15.32 percent down to 14.28 percent and 14.54 percent, respectively.<sup>263</sup> This would also reduce the revenue requirements for the two companies by approximately \$14.8 million and \$7.6 million, respectively.<sup>264</sup> Therefore, allowing ITC and METC to continue applying the ROE adders is unjust and unreasonable, and the Commission should determine that ITC and METC should no longer be able to further supplement their unjust and unreasonable Base ROEs with unjust and unreasonable ROE adders.

## **IX. RULE 206 REQUIREMENTS**

103. The Complainants hereby provide the further information required by Rule 206.<sup>265</sup>

### **A. Good Faith Estimate of Financial Impact or Harm (Rule 206(b)(4))**

104. For each one percentage point that the ROE for the MISO TOs is above the current market cost of equity, the MISO TOs' revenue requirement is overstated by about \$103

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<sup>259</sup> *Id.*

<sup>260</sup> *Id.*

<sup>261</sup> *Id.*

<sup>262</sup> *Id.*

<sup>263</sup> *Id.*

<sup>264</sup> *Id.*

<sup>265</sup> 18 C.F.R. § 385.206 ("Rule 206").



million per year.<sup>266</sup> The difference between transmission revenue based on a 12.38 percent/12.2 percent ROE and the 9.15 percent ROE recommended by M. Gorman is approximately \$327 million per year.<sup>267</sup> Additionally, with Mr. Gorman's proposed equity cap, the MISO TOs' revenue requirement is overstated by approximately \$50 million.<sup>268</sup> Eliminating ITC's and METC's ROE adders saves customers an additional \$14.8 million and \$7.6 million, respectively.<sup>269</sup> In total, the MISO TOs' revenue requirement is overstated by approximately \$400 million.<sup>270</sup>

**B. Operational or Nonfinancial Impacts (Rule 206(b)(5))**

105. The Joint Complainants are not aware of any specific practical, operational, or nonfinancial impacts resulting from the excessive ROE.

**C. Whether the Matters are Pending in Any Other FERC Proceeding or Other Forum (Rule 206(b)(6))**

106. Joint Complainants are not aware that any of the specific matters addressed in this Joint Complaint are pending in any other FERC proceeding or other forum. However, the Joint Complainants note that several petitions and complaints are pending with respect to ROEs generally and with respect to the ROEs of certain individual TOs in other regions.<sup>271</sup>

**D. Documents Supporting the Complaint (Rule 206(b)(8))**

107. In support of this Complaint, Joint Complainants have included the testimony and exhibits of Mr. Gorman.

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<sup>266</sup> Gorman Affidavit at Exhibit MPG-2.

<sup>267</sup> *Id.*

<sup>268</sup> *Id.*

<sup>269</sup> *Id.* at 21.

<sup>270</sup> Gorman Affidavit at 21 and Exhibit MPG-2.

<sup>271</sup> *E.g.*, WIRES Petition for Statement of Policy, Docket No. RM13-18-000 (June 26, 2013); *Martha Coakley, Attorney General of the Commonwealth of Massachusetts, et al. v. Bangor Hydro-Electric Company, et al.*, Complaint Challenging Base Return on Equity, Docket No. EL11-66-000 (Sept. 30, 2011); *The Municipal Electric Utilities Ass'n of New York v. Niagara Mohawk Power Corporation, et al.*, Complaint and Request for Fast Track Processing, EL13-16-000 (Nov. 2, 2012); *Delaware Division of the Public Advocate, et al. v. Baltimore Gas and Electric Company, et al.*, Complaint Challenging Base Return on Equity and Formula Transmission Rate Implementation Protocols, Docket No. EL13-48-000 (Feb. 27, 2013).

**E. Alternative Dispute Resolution (Rule 206(b)(9))**

108. On November 1, 2013, Joint Complainants notified MISO's General Counsel and counsel who frequently serve as lead counsel for the MISO TOs that this Joint Complaint would be filed on or about November 8, 2013. On November 8, Joint Complainants notified MISO's General Counsel and counsel who frequently serve as lead counsel for the MISO TOs that this Joint Complaint would be filed on November 12, 2013. Joint Complainants submit that it is unlikely that alternative dispute resolution procedures under the Commission's supervision would successfully resolve the issues raised in the Complaint until after a complaint had been filed and the Commission has established a refund effective date. The Joint Complainants are ready and willing to engage in settlement judge procedures for a limited time frame after the refund effective date is established. While the Joint Complainants hope this matter can be resolved through settlement, Joint Complainants are mindful that unproductive settlement discussions could serve to delay the adjustment of the Base ROE to a just and reasonable level, retroactive to the refund effective date.

**X. SERVICE AND NOTICE**

109. In accordance with Rule 206(c), Joint Complainants have served a copy of this Complaint upon the Respondents via electronic mail, through their counsel, simultaneous with the filing of the Complaint.

**XI. CONCLUSION**

110. The Joint Complainants request that the Commission: (1) find that the existing 12.38/12.2 percent Base ROEs are no longer just and reasonable, and that the Base ROE proposed by the Joint Complainants is just and reasonable; (2) find that capital structures with greater than 50 percent equity are no longer just and reasonable and direct any MISO TOs with a higher percentage equity to submit compliance filings containing capital structures consistent with the revisions proposed in this Complaint; (3) find that the ROE incentive adders applied by ITC and METC are no longer just and reasonable and direct ITC and METC to submit compliance filings to remove the ROE adders from their formula rates; (4) establish the filing date of this Complaint as the refund effective date; and (5) direct the MISO TOs to make tariff filings to change the stated Base ROE value to a just and reasonable Base ROE, as determined in this proceeding.

Respectfully Submitted,

ASSOCIATION OF BUSINESSES ADVOCATING TARIFF EQUITY

/s/ Robert A. W. Strong

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COALITION OF MISO TRANSMISSION CUSTOMERS

/s/ Robert A. Weishaar, Jr.

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Dated: November 12, 2013

**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; )  
Complainants, )

v. )

Midcontinent Independent System Operator, Inc.; )  
ALLETE, Inc. (for its operating division Minnesota Power, )  
Inc., and its wholly-owned subsidiary, Superior Water, Light )  
and Power Company) )  
Ameren Illinois Company; Ameren Missouri; )  
Ameren Transmission Company of Illinois; )  
American Transmission Company LLC; Cleco Power LLC; )  
Duke Energy Business Services, LLC )  
d/b/a Duke Energy Indiana, Inc.; )  
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, d/b/a ITC Transmission; )  
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; and )  
Southern Indiana Gas & Electric Company; )  
Respondents. )

Docket No. EL14-\_\_\_\_

**COMPLAINT OF THE ASSOCIATION OF BUSINESSES ADVOCATING TARIFF  
EQUITY, COALITION OF MISO TRANSMISSION CUSTOMERS, ILLINOIS  
INDUSTRIAL ENERGY CONSUMERS, INDIANA INDUSTRIAL ENERGY  
CONSUMERS, INC., MINNESOTA LARGE INDUSTRIAL GROUP, AND WISCONSIN  
INDUSTRIAL ENERGY GROUP**

## NOTICE OF COMPLAINT

( )

Take notice that on November 12, 2013, the Association of Businesses Advocating Tariff Equity ("ABATE"); Coalition of MISO Transmission Customers ("CMTC"); Illinois Industrial Energy Consumers ("IIEC"); Indiana Industrial Energy Consumers, Inc. ("INDIEC"); Minnesota Large Industrial Group ("MLIG"); and Wisconsin Industrial Energy Group ("WIEG") (collectively, "Joint Complainants") filed a formal Complaint against the Midcontinent Independent System Operator, Inc. ("MISO"); Ameren Illinois Company; Ameren Missouri; Ameren Transmission Company of Illinois; Ameren Transmission Company LLC; Cleco Power LLC; Duke Energy Indiana, Inc.; 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"); ITC Midwest LLC; Michigan Electric Transmission Company, LLC ("METC"); MidAmerican Energy Company; Minnesota Power; 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; and Superior Water, Light and Power Company (collectively, "Respondents") seeking an order reducing the base return on equity ("Base ROE") used in Respondents' formula transmission rates to 9.15 percent, capping the capital structure at 50 percent equity, and eliminating ROE adders currently applied to ITC's and METC's Base ROEs.

Joint Complainants certify that copies of the Complaint were served on contacts for the Respondents.

Any person desiring to intervene or to protest this filing must file in accordance with Rules 211 and 214 of the Commission's Rules of Practice and Procedure (18 C.F.R. §§ 385.211 and 385.214). Protests will be considered by the Commission in determining the appropriate action to be taken, but will not serve to make protestants parties to the proceeding. Any person wishing to become a party must file a notice of intervention or motion to intervene, as appropriate. The Respondents' answers and all interventions or protests must be filed on or before the comment date. The Respondents' answers, motions to intervene, and protests must be served on the Joint Complainants.

The Commission encourages electronic submission of protests and interventions in lieu of paper using the "eFiling" link at <http://www.ferc.gov>. Persons unable to file electronically should submit an original and 14 copies of the protest or intervention to the Federal Energy Regulatory Commission, 888 First Street, N.E., Washington, D.C. 20426.

This filing is accessible on-line at <http://www.ferc.gov>, using the "eLibrary" link and is available for review in the Commission's Public Reference Room in Washington, D.C. There is an "eSubscription" link on the web site that enables subscribers to receive email notification when a document is added to a subscribed docket(s). For assistance with any FERC Online service, please email [FERCOnlineSupport@ferc.gov](mailto:FERCOnlineSupport@ferc.gov), or call (866) 208-3676 (toll free). For TTY, call (202) 502-8659.

Comment Date: 5:00 pm Eastern Time on (insert date).

Kimberly D. Bose  
Secretary



**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

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**Midcontinent Independent System  
Operator, Inc., et al.**

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**Docket No. EL14-\_\_\_\_ - \_\_\_\_\_**

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**Affidavit of Michael P. Gorman**

**I. INTRODUCTION**

1

2 **Q PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS.**

3 A My name is Michael P. Gorman. I am a consultant in the field of public utility  
4 regulation and a Managing Principal with Brubaker & Associates, Inc., energy,  
5 economic and regulatory consultants. My business address is 16690 Swingley  
6 Ridge Road, Suite 140, Chesterfield, MO 63017. Appendix A provides a  
7 description of my employment history and professional experience.

8 **Q ON WHOSE BEHALF ARE YOU PROVIDING THIS AFFIDAVIT?**

9 A I prepared this Affidavit on behalf of the Coalition of MISO Transmission  
10 Customers ("CMTC"), Association of Businesses Advocating Tariff Equity  
11 ("ABATE"), Illinois Industrial Energy Consumers ("IIEC"), Indiana Industrial  
12 Energy Consumers, Minnesota Large Industrial Group, ("MLIG") and Wisconsin  
13 Industrial Energy Group ("WIEG").

1                    **II. SUMMARY OF FINDINGS AND RECOMMENDATIONS**

2        **Q        PLEASE SUMMARIZE YOUR FINDINGS AND RECOMMENDATIONS.**

3        **A        My findings and recommendations are summarized as follows:**

4                    Return on Equity

- 5                    • The Midcontinent Independent System Operator (“MISO”)  
6                    Transmission Owners’ (“MISO TOs”) current allowed base return on  
7                    equity (“ROE”) is 12.38%, and 12.20% for American Transmission  
8                    Company per rate stipulation. These authorized base ROEs are  
9                    excessive relative to the current market cost of equity for the MISO  
10                    TOs.
- 11                    • The current market cost of equity for the MISO TOs is estimated to be  
12                    in the range of 7.97% to 10.33% (midpoint 9.15%) using the Federal  
13                    Energy Regulatory Commission's ("FERC" or "Commission")  
14                    Discounted Cash Flow (“DCF”) methodology applied to a National  
15                    proxy group. I also considered a Regional proxy group composed of  
16                    publicly traded electric utilities with transmission operations in or  
17                    directly connected to MISO and are in the Eastern Interconnect.  
18                    These proxy groups were selected using FERC proxy group risk  
19                    selection criteria. Two risk premium studies (a bond yield plus risk  
20                    premium method and the Capital Asset Pricing Model (“CAPM”)) were  
21                    used as checks on the DCF results and indicate the current market  
22                    cost of equity for MISO TOs is in the range of 7.89% to 10.51%. All of  
23                    these analyses demonstrate that the current 12.38%/12.20% base  
24                    ROE for MISO TOs is significantly in excess of current market costs.
- 25                    • Setting the MISO transmission rates using an excessive ROE  
26                    produces transmission rates that are not just and reasonable. For  
27                    each 1 percentage point the ROE is set above the current market cost  
28                    of equity, MISO TOs’ revenue requirement is overstated by  
29                    \$103 million per year. The MISO TOs’ base ROE of 12.38%/12.20%  
30                    is overstated by approximately 300 basis points. Reducing the  
31                    excessive base ROE for the MISO TOs would lower the MISO TOs’  
32                    revenue requirement by approximately \$327 million per year.

33                    Capital Structure

- 34                    • The current capital structure used to set transmission rates for several  
35                    of the MISO TOs is not reasonable. I recommend a capital structure  
36                    common equity limit of 50% for setting MISO formula rates. If a MISO  
37                    TO has a common equity ratio above 50%, it must prove to FERC its  
38                    capital structure is reasonable for setting rates. Absent this proof, a  
39                    capital structure consisting of no more than 50% common equity  
40                    should be used to set rates.

1           Incentive ROE Adders

- 2           • The incentive ROE adders approved for certain MISO TOs also are  
3           unnecessary and produce excessive transmission rates. MISO TOs'  
4           bond ratings and the low-risk nature of their operations provide them  
5           strong access to capital to fund large capital programs at low capital  
6           prices and on reasonable terms. Therefore, incentive ROE adders  
7           are not needed in order to support infrastructure investment.

8   **Q        ARE CURRENT MISO TRANSMISSION RATES JUST AND REASONABLE?**

9   A        No. MISO transmission rates should be set at just and reasonable levels. The  
10         authorized base ROE for MISO TOs includes returns of 12.38% and 12.20%.  
11         These base ROEs are about 2.5 percentage points above the current industry  
12         average authorized ROE for other electric utility companies. As outlined below,  
13         transmission electric operations are lower risk than integrated electric utility  
14         operations. Therefore, the large spread that exists between the MISO TO base  
15         ROE and the ROEs for integrated electric utilities provides evidence that the  
16         MISO TOs' authorized base ROEs are excessive.

17                 As shown on my Exhibit MPG-1, the original base ROE was set around  
18         2002. At that time, the industry average authorized ROE for electric utilities was  
19         around 11.20%. As such, at that time, the MISO TOs' base ROEs were about  
20         120 basis points above the electric utility industry average authorized ROE.  
21         However, the spread above the industry average ROE for MISO base ROE has  
22         further increased significantly over time. This occurred because authorized  
23         ROEs for integrated electric utility companies have declined with the decline in  
24         capital market costs over this time period.

25                 Currently, the industry average authorized ROE for electric utilities is  
26         around 9.8% (excluding certain authorized returns in the Commonwealth of  
27         Virginia that are calculated as prescribed by statute), which is about 260/240

1 basis points below the base ROE of 12.38%/12.20%, which continues to be used  
2 to set MISO TOs' transmission rates. This excessive ROE for setting  
3 transmission rates substantially increases transmission cost of service and  
4 imposes significant cost burdens on end-use customers.

5 **Q HOW DOES THIS ABOVE-MARKET ROE IMPACT MISO TOs'**  
6 **TRANSMISSION RATES?**

7 A As outlined on my Exhibit MPG-2, reducing the MISO TOs' base ROE to 9.15%  
8 based on current application of FERC's DCF methodology, from the current base  
9 ROE of 12.38%/12.20%, will lower the MISO TOs' revenue requirement by \$327  
10 million per year. For each 100 basis points the base ROE exceeds the MISO  
11 TOs' cost of equity, the revenue requirement is overstated by \$103 million.  
12 Unwarranted ROE incentive adders will add to this revenue requirement excess.

13 As such, continuing to authorize a base ROE well in excess of MISO TOs'  
14 current market cost of equity substantially inflates the MISO TOs' transmission  
15 revenue requirement, and results in a significant unjustified increase in MISO TO  
16 rates. This in turn causes harm to customers of the MISO TOs because they are  
17 paying an unjust and unreasonable rate for transmission service. This  
18 unreasonable and inflated transmission rate is ultimately passed on to retail end-  
19 use customers.

20 **III. ELECTRIC UTILITY INDUSTRY MARKET OUTLOOK**

21 **Q PLEASE DESCRIBE THIS SECTION OF YOUR TESTIMONY.**

22 A I begin my estimate of a fair ROE for the MISO TOs by reviewing the market's  
23 assessment of electric utility industry investment risk, credit standing, and stock  
24 price performance in general. I used this information to gauge the market's

1 perception of the risk characteristics of electric utility investments in general,  
2 which is then used to produce a refined estimate of the market's return  
3 requirement for assuming investment risk similar to the MISO TOs.

4 Based on the assessments described below, I find the credit rating  
5 outlook of the industry to be strong and supportive of the industry's financial  
6 integrity, the industry has ample access to low-cost capital to support rate base  
7 investments, and electric utilities' stocks have exhibited strong and stable price  
8 performance over the last several years.

9 Moreover, the electric utility industry in general is in a large capital  
10 expenditure portion of its cycle, which is creating significant demands for external  
11 capital in order to support large capital improvement programs. Credit rating  
12 agencies and market participants have embraced the utilities' need for significant  
13 amounts of external capital by meeting the capital market demands of electric  
14 utilities at near historical low capital market costs. All of this supports my  
15 conclusion that the MISO TOs have sufficient access to capital to support major  
16 capital programs, and relatively moderate capital costs are currently available  
17 and expected to be available for the next several years.

18 Based on this review of credit outlooks and stock price performance, I  
19 conclude that the market continues to embrace the electric utility industry as a  
20 safe-haven investment, and views utility equity and debt investments as low-risk  
21 securities.

22 **Q PLEASE DESCRIBE ELECTRIC UTILITIES' CREDIT RATING OUTLOOK.**

23 **A** Electric utilities' credit rating outlook has improved over the recent past and is  
24 stable. Standard & Poor's ("S&P") recently provided an assessment of the credit  
25 rating of U.S. electric utilities. S&P's commentary included the following:



1 \* \* \*

2 **Strong Liquidity Conditions to Prevail**

3 Fitch expects the power and gas utility sectors to continue to enjoy  
4 strong capital market access. Low interest rates due to  
5 accommodative monetary policies by the Fed continue to bring  
6 down the cost of debt for companies, which represents a  
7 significant expense item for the capital-intensive utility sector.  
8 Since 2006, interest expense has declined almost 150 bps for the  
9 typical utility holding company as financing costs for new debt  
10 issuance is at historic lows and these companies have  
11 unprecedented access to the capital and bank markets.<sup>2</sup>

12 The Edison Electric Institute (“EEI”) also opined as follows:

13 **Steady Industry Fundamentals**

14 Indeed, broad global macroeconomic forces have been the  
15 principle [sic] driver of utility stock returns in recent years, relative  
16 to other market sectors. Investors now take mostly as a given the  
17 industry’s reasonably strong business fundamentals. Utilities are  
18 undertaking sizeable and wide-ranging capital investment  
19 programs that include distribution network upgrades, Smart Grid  
20 investments, a significant boost in the pace of transmission  
21 investment, rising emissions-related capex driven by the need to  
22 comply with EPA regulations, and generation investments in  
23 select power markets.

24 \* \* \*

25 Credit analysts are generally positive on the industry’s ability to  
26 finance an aggressive pace of investment, noting that while it is  
27 now cash flow negative on an annual operating basis, its balance  
28 sheets are generally strong and utilities have access to a diverse  
29 range of funding sources. The industry weathered the storm of  
30 the 2008/2009 financial crisis by postponing optional capex  
31 projects and finding cost savings where possible without  
32 jeopardizing service quality. Today’s economic backdrop is much  
33 improved from that period, and with interest rates at multi-decade  
34 lows and investors of all types hungry for yield, the capital markets  
35 are wide open for most economic sectors, including utilities. The  
36 execution risk inherent in managing large, complex construction  
37 projects in a way that addresses the interests of both shareholders  
38 and regulators seems far more pronounced than financing risk.<sup>3</sup>

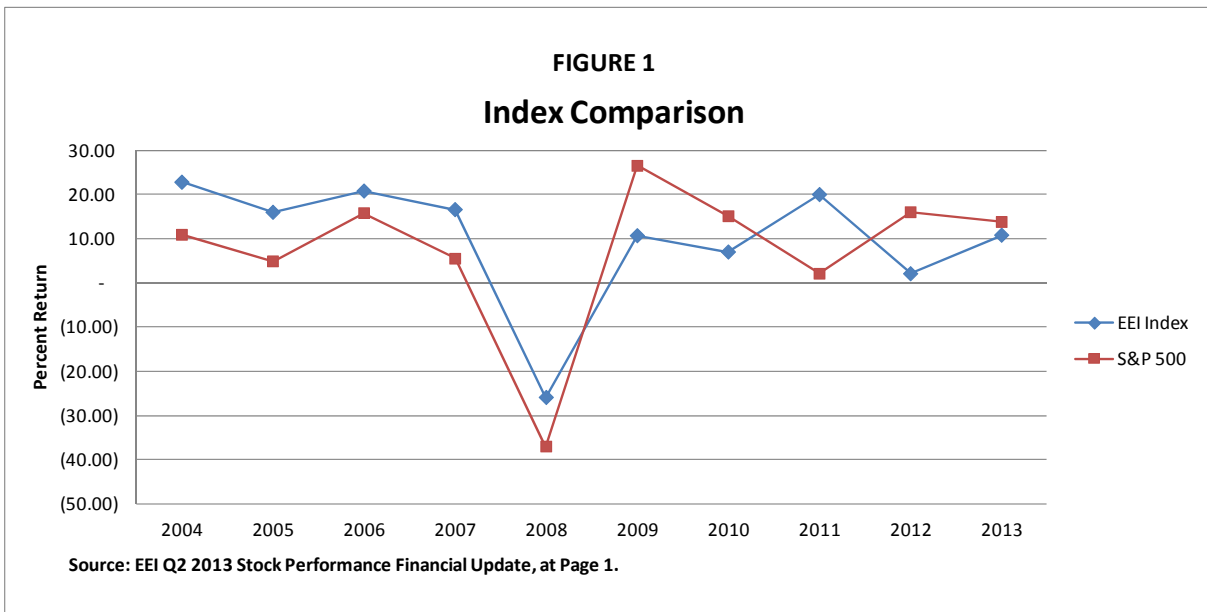
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<sup>2</sup>*FitchRatings*: “2013 Outlook: Utilities, Power, and Gas,” December 7, 2012 at 1, 6-7 and 10, emphasis added.

<sup>3</sup>*EEI Q3 2012 Financial Update* “Stock Performance” at 5, emphasis added.

1 **Q PLEASE DESCRIBE ELECTRIC UTILITY STOCK PRICE PERFORMANCE**  
 2 **OVER THE LAST SEVERAL YEARS.**

3 A As shown in the graph below, the EEI has recorded electric utility stock price  
 4 performance compared to the market. The EEI data show that its Electric Utility  
 5 Index has outperformed the market in downturns and generally trailed the market  
 6 during recovery. This supports my conclusion that utility stock investments are  
 7 regarded by market participants as a moderate to low-risk investment.



8 EEI describes electric utility stock price/valuation as sustainable:

9 **Mixed Valuation Signals**

10 The broad market’s gains during Q3 along with the EEI  
 11 Index’s flat performance removed some of the richness to  
 12 utility share valuations that several analysts noted at the  
 13 end of Q2. Indeed, the magnitude of underperformance  
 14 for the first nine months of 2012 is similar to that which  
 15 occurred during the same period of 2009, after markets  
 16 bottomed and then recovered from the losses produced by  
 17 the financial crisis. As the market recovery continued in  
 18 2010, with 14% to 17% gains, the staid utility sector’s 7%  
 19 return could not keep pace. Yet when 2011 produced  
 20 worries of economic slowdown, the worsening of the  
 21 European debt crisis and the summer’s woefully  
 22 memorable deficit gridlock and S&P downgrade of U.S.  
 23 Treasury debt in August — along with sharply falling



1 interest rates — the EEI Index powered forward with a  
2 20% return against single-digit gains across the broader  
3 markets.

4 With the industry business models now set on regulated or  
5 mostly regulated structures, and with slow growth in  
6 earnings and dividends as the main appeal for investors,  
7 such periodic reversals of fortune, driven by changing  
8 economic prospects and investor sentiments, seem likely  
9 to continue. Interest rates are now at multi-decade lows  
10 and while analysts still cite utility price/earnings ratios as  
11 above average, 4% dividend yields give utility shares  
12 considerable price support relative to the lower yields  
13 available from bonds.<sup>4</sup>

14 **Q WHAT ARE THE IMPORTANT TAKEAWAY POINTS FROM THIS**  
15 **ASSESSMENT OF ELECTRIC UTILITY INDUSTRY CREDIT AND**  
16 **INVESTMENT RISK OUTLOOKS?**

17 A Credit rating agencies consider the electric utility industry to be stable and  
18 believe investors will continue to provide an abundance of capital to support  
19 utilities' large capital programs and at moderate capital costs. All of this supports  
20 the continued belief that electric utility investments are generally regarded as  
21 safe-haven or low-risk investments, and the market embraces low-risk  
22 investments – like utility investments. The demand for low-risk investments will  
23 provide funding for electric utilities in general.

24 **Q HOW DOES THE BUSINESS RISK OF THE TRANSMISSION FUNCTION**  
25 **COMPARE TO INTEGRATED ELECTRIC UTILITIES?**

26 A The transmission operating risk function is commonly known to carry the least  
27 amount of business risk of the three electric utility functions. This is evident by  
28 credit analysts' reports on transmission-only companies. For example, in its

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<sup>4</sup>*Id.* at 6, emphasis added.

1 most recent report covering International Transmission Company (“ITC”), S&P  
2 states that:

3 Its “excellent” business risk profile reflects ITC Transmission’s  
4 exclusive focus on the relatively low-risk electric transmission  
5 business and the highly supportive rate regulation by the FERC.<sup>5</sup>

6 S&P also notes that ITC enjoys highly supportive, forward-looking rate  
7 regulation by the FERC and it has no commodity risk exposures.

8 Further evidence can be found in S&P’s most recent report covering  
9 American Transmission Company (“ATC”). S&P goes on to state that:

10 The excellent business profile reflects FERC’s highly supportive  
11 regulatory rate construct. FERC is the sole rate regulator for ATC.  
12 As a pure electric transmission owner, ATC is exposed to  
13 considerably less operational risk than is a vertically integrated  
14 utility.<sup>6</sup>

15 S&P reiterates this assessment that the business risk of a transmission  
16 company is very low in its report on ATC, another pure-play transmission  
17 company. As noted below, S&P’s assessment of ATC is that its business risk  
18 reflects very low operating risk, supported by formulaic and constructive rate-  
19 setting practices by the FERC, which provide timely recovery of cost of service,  
20 and the company has no cost recovery exposure:

21 **Q SHOULD THE LOW OPERATING RISK OF A MISO TO BE CONSIDERED IN**  
22 **DEVELOPING A REASONABLE CAPITAL STRUCTURE FOR SETTING**  
23 **TRANSMISSION RATES?**

24 **A** Yes. Credit rating agencies clearly note that a company that has lower operating  
25 risk can finance with greater amounts of financial risk and still support an

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<sup>5</sup>*Standard & Poor’s RatingsDirect Summary*: “International Transmission Co.,” June 28, 2013 at 4.

<sup>6</sup>*Standard & Poor’s RatingsDirect Summary*: “American Transmission Co.,” June 5, 2013 at 3, emphasis added.

1 investment grade bond rating. For example, S&P in a *RatingsDirect* publication  
2 “Key Credit Factors: Business and Financial Risk in the Investor-Owned Utility  
3 Industry,” illustrates the relationship between business and financial risk in the  
4 credit rating process.

5 S&P notes that utilities with stronger business profiles (scores of  
6 “Excellent” to “Strong”) can have greater amounts of financial risk (financial risk  
7 profiles of “Intermediate,” “Aggressive” and “Highly Leveraged”) and still maintain  
8 an investment grade bond rating. Conversely, companies that have greater  
9 business risk (i.e., lower business profile scores), must finance with less financial  
10 risk in order to maintain an investment grade bond rating.

11 This same report illustrates that S&P considers separately the business  
12 risk and financial risk of a utility in assigning it a credit rating.<sup>7</sup>

13 S&P’s ratings criteria illustrate the unreasonableness of a low-risk  
14 transmission electric utility financing itself with relatively little financial risk (a high  
15 common equity ratio and no debt ratio). Because of the low operating or  
16 business risk nature of transmission operations, transmission entities should  
17 have a common equity ratio at least no higher than the electric utility industry  
18 averages. A balanced capital structure for all MISO TOs will maintain an  
19 investment grade bond rating, and lower the cost of transmission service.

20 While an optimal capital structure can be difficult to establish, the MISO  
21 TOs with capital structures that are far greater equity weighted than the electric  
22 utility integrated utility capital structures certainly demonstrate that the capital  
23 structures appear to be excessively weighted with common equity.

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<sup>7</sup>*Standard & Poor’s RatingsDirect Key Credit Factors: “Business and Financial Risk in the Investor-Owned Utility Industry,”* November 26, 2008.

1 **IV. THE EQUITY COMPONENT OF CERTAIN MISO TOs'**  
2 **CAPITAL STRUCTURE IS UNREASONABLY HIGH**

3 **Q WHY DO YOU BELIEVE THAT SOME MISO TOs HAVE CAPITAL**  
4 **STRUCTURES WITH EXCESSIVE AMOUNTS OF COMMON EQUITY?**

5 A As shown on my Exhibit MPG-3, over the last five years, the actual common  
6 equity ratio for most MISO TOs has been 53% or less. However, other MISO  
7 TOs have common equity ratios well in excess of 55%. In comparison, over this  
8 same time period, the electric utility industry has been awarded capital structures  
9 with common equity ratios between 48% and 51%.<sup>8</sup> Further, the National proxy  
10 group average common equity ratio is 48.8%, and that supports a proxy group  
11 average bond rating of "BBB+."

12 As noted above, credit rating agencies have noted that electric utility  
13 companies have had ample access to capital to support very large construction  
14 programs. Further, the electric utility industry's bond rating has been a stable  
15 investment grade over this same time period.

16 The capital structures of the electric utility industry have supported their  
17 investment grade bond ratings, and provided ample access to capital to support  
18 large capital programs. Importantly, these more balanced capital structures with  
19 more reasonable common equity ratios also produce lower overall cost of capital  
20 in rates to end-use customers relative to companies that have an excessive  
21 equity weighted capital structure.

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<sup>8</sup>RRA Regulatory Focus – Major Rate Case Decisions, January-June 2013, July 9, 2013  
at 4.

1 **Q DO THE MISO TOs WITH LARGER COMMON EQUITY RATIOS HAVE**  
2 **STRONGER BOND RATINGS?**

3 A As shown on the attached Exhibit MPG-3, there is little difference in the bond  
4 rating for MISO companies with actual common equity ratios of 50% to 55%  
5 compared to MISO TOs which have common equity ratios in excess of 55%.

6 For example, as shown on Exhibit MPG-3, many companies that have  
7 common equity ratios below 45% have bond ratings from S&P of “BBB.” The  
8 median bond rating for companies with common equity ratios of less than 45% is  
9 “BBB.” The median bond rating for companies with common equity ratios of 50%  
10 to 55% is “BBB+,” and the median bond rating for companies with common  
11 equity ratios above 55% is also “BBB+.”

12 A one notch improvement in the bond rating for a significant increase in  
13 the common equity ratio results in an increased cost of capital and little benefit, if  
14 any, to end-use transmission customers.

15 Further, the MISO TO with the strongest bond rating is ATC. That  
16 company also has the lowest actual common equity ratio of all the MISO TOs.  
17 Based on a settlement proceeding, its FERC formula common equity ratio of  
18 50% is also clear evidence of a reasonable capital structure that will support  
19 strong credit for the MISO TOs.

20 **Q WOULD A MISO TO’S OVERALL COST OF CAPITAL BE REDUCED IF IT**  
21 **HAS A HIGHER COMMON EQUITY RATIO AND STRONGER BOND RATING?**

22 A No. Even if a transmission company had a slightly stronger bond rating, it is  
23 likely its overall cost of capital would still be higher if the common equity ratio is  
24 excessive. This can be illustrated by measuring the revenue impact on ITC  
25 affiliates – bond rating of “BBB+/A3” and common equity ratio of 60%. These

1 MISO TO companies have common equity ratios well above those of other MISO  
2 TOs and integrated electric utility companies. However, their bond ratings are  
3 only marginally better, one to two notches better than most of the other MISO  
4 TOs. Specifically, ITC subsidiaries have corporate credit ratings of "A3," where  
5 most MISO TOs have bond ratings of "Baa2."

6 Currently, the interest rate advantage of this higher bond rating is  
7 approximately 50 basis points. Over time, the advantage has averaged about 45  
8 basis points. The only time where there is a clear much stronger interest rate  
9 advantage is during periods of significant market distress such as 2008 and 2009  
10 during the financial crisis just passed.

11 The question then arises, does the increased cost of capital produce  
12 enough benefits to customers to justify a higher cost of service to provide greater  
13 assurance that the company is going to be able to attract capital during  
14 significant financial market stress events that occur very infrequently?

15 I have developed a conservative estimate of the change in cost of capital  
16 if the ITC subsidiaries' common equity ratios were reduced and their bond rating  
17 declined by two notches to "Baa2."

18 In this example, I assume the ITC subsidiaries' common equity ratio  
19 would be reduced from 60% to 50% and their bond rating would be reduced from  
20 "A3" down to "Baa2." With this decline in bond rating, I assume that the ITC  
21 subsidiaries' embedded cost of debt would increase by 50 basis points, which is  
22 the current spread between "A" and "Baa" utility bond yields, and no change to  
23 the base ROE.

24 The ITC subsidiaries' current pre-tax rate of return ranges from 13.4% to  
25 13.6%. With these assumptions, the ITC subsidiaries' pre-tax rate of return  
26 would decrease to 12.2% from 12.5% with a lower common equity ratio and

1 higher cost of debt. This pre-tax rate of return applied to ITC's subsidiaries'  
2 transmission rate base (\$3.55 billion consolidated) equates to \$40.9 million per  
3 year of excess revenue requirements for transmission service.

4 As such, limiting the common equity ratio significantly reduces the  
5 revenue requirement and cost for transmission service, while at the same time  
6 having only minimal impact on the credit standing of the transmission company, if  
7 it has any impact on the credit standing at all.

8 **Q ARE THERE OTHER ISSUES RELATED TO A REASONABLE CAPITAL**  
9 **STRUCTURE TO SETTING MISO TOs' RATES?**

10 A Yes. Use of a hypothetical capital structure or an excessive equity weighted  
11 capital structure may not be fully reflected in the overall cost of capital for the  
12 utility. This can be true if an equity rich capital structure is not offset in part by a  
13 strong bond rating.

14 An important example is capital structures used to set ITC Holdings Corp.  
15 transmission affiliate FERC transmission rates. The bond ratings for these  
16 companies do not reflect the equity rich capital structure used to set their rates.  
17 Specifically, the S&P bond ratings for the utility affiliates reflect a consolidated  
18 financial profile of their parent company, ITC Holdings Corp. S&P rates ITC  
19 Holdings Corp. and all of its utility subsidiaries as a highly leveraged company.  
20 As part of its financial risk assessment of ITC Holdings Corp., ITC, ITC Midwest  
21 and Michigan Electric Transmission Company ("METC"), S&P notes the  
22 company's objective to maintain an adjusted debt to total capital structure of  
23 about 70%. Hence, the bond ratings of these companies reflect a common

1 equity ratio of around 30%, not the 60% used to set ITC's and METC's FERC  
2 transmission rates.<sup>9</sup>

3 S&P's assessment of the ITC subsidiaries' financial risk is clear by a  
4 comparison of the amount of common equity recorded on ITC Holdings Corp.'s  
5 consolidated balance sheet (approximately \$1.4 billion), to the amount of  
6 common equity recorded on each of the four ITC Holdings Corp. subsidiary  
7 companies' FERC Form 1s.

8 The combined common equity at year-end 2012 recorded on ITC  
9 Midwest, ITC Great Plains, ITC, and METC was \$2.19 billion. There is about  
10 twice as much common equity recorded on the affiliates' FERC Form 1 balance  
11 sheet than recorded in the consolidated financial statements for ITC Holdings  
12 Corp.

13 Because ITC Holdings Corp.'s consolidated common equity ratio is  
14 around 36%, it is certainly understandable why S&P considers the financial risk  
15 of ITC Holdings Corp. and all of its utility subsidiaries to be highly leveraged, and  
16 regards their total debt ratio to be around 60%, rather than the 40% ratio used to  
17 set rates for the ITC Holdings Corp. subsidiaries.

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<sup>9</sup>*Standard & Poor's Ratings Direct*. "Summary: ITC Holdings Corp.," June 28, 2013; *Standard & Poor's Ratings Direct*. "Summary: International Transmission Co.," June 28, 2013; *Standard & Poor's Ratings Direct*. "Summary: ITC Midwest LLC," June 28, 2013; and *Standard & Poor's Ratings Direct*. "Summary: Michigan Electric Transmission Co.," June 28, 2013.



1 Q IS THERE EVIDENCE THAT A 50% COMMON EQUITY RATIO WILL BE  
2 ADEQUATE TO SUPPORT A STRONG CREDIT STANDING FOR  
3 TRANSMISSION OPERATIONS OF A MISO TO?

4 A Yes. ATC entered into a settlement for ratemaking principles for its transmission  
5 operations. Those ratemaking principles include a common equity ratio of 50%.<sup>10</sup>  
6 ATC has an “A+” and “Stable” credit rating by S&P. ATC’s bond rating is the  
7 strongest of the MISO TOs. Indeed, ATC’s bond rating was upgraded to “A+”  
8 from “A” on July 18, 2005, just several months after the rate settlement principles  
9 were adopted. In that upgrade, S&P stated that:

10 The corporate credit rating was raised to reflect ATC’s excellent  
11 business profile, supportive regulation, and a strong financial  
12 position.<sup>11</sup>

13 Since the ATC rate settlement went into effect, ATC has doubled the size  
14 of its gross investment in transmission plant – from \$1.77 billion in 2006 to \$3.85  
15 billion at year-end 2012. Clearly, ATC’s ratemaking agreement is clear evidence  
16 that a common equity ratio cap of 50% will support a strong investment grade  
17 credit rating and supported a transmission utility’s ability to fund significant  
18 investments in transmission infrastructure over the seven years.

19 Moreover, S&P has noted positively ATC operating and financial risk:

20 **RATIONALE**

21 **Business Risk: Excellent**

- 22
- 23 • Very low operating risk
  - 24 • A formulaic, forward-looking rate-setting structure
  - 25 under the Federal Energy Regulatory Commission
  - 26 (FERC)
  - 27 • Timely recovery of costs and expenditures
  - No commodity exposure

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<sup>10</sup>FERC Docket Nos. ER04-108-000, ER04-108-001 and ER04-108-002, May 6, 2004.

<sup>11</sup>*Standard & Poor’s RatingsDirect Research Update*: “American Transmission Co.’s Corporate Credit Rating Is Raised To ‘A+’; Outlook Stable,” July 18, 2005 at 2.

1                                   **Financial Risk: Intermediate**

- 2                                   • A commitment to financial measures appropriate for a  
3                                   strong investment-grade rating  
4                                   • Sustainable and highly predictable cash flow and  
5                                   leverage measures  
6                                   • Elevated capital spending plans over the intermediate  
7                                   term

8                                   **Outlook: Stable**

9                                   The stable outlook reflects U.S. electricity transmitter  
10                                  American Transmission Co.'s (ATC) straightforward and  
11                                  proven low-risk business model, a highly constructive  
12                                  regulatory scheme, and very predictable cash flow from a  
13                                  reliable transmission network. The stable outlook also  
14                                  reflects Standard & Poor's baseline forecast that adjusted  
15                                  FFO to debt will approximate 19% and adjusted debt to  
16                                  total capital 55% to 56% over the intermediate term.<sup>12</sup>

17                                  ATC's current FERC rate-setting agreement is clear evidence that a 50%  
18                                  common equity ratio will support strong credit and access to capital for a low-risk  
19                                  transmission electric utility.

20    **Q     DO YOU BELIEVE THE MISO TOs HAVE AN INCENTIVE TO INCREASE**  
21                                  **THEIR COMMON EQUITY RATIOS?**

22    A     Yes. Because FERC has awarded above-market returns on common equity for  
23                                  MISO TOs, they have had an economic incentive to increase their utilization of  
24                                  equity capital in supporting their investment in transmission assets. As a result,  
25                                  customers of MISO TOs have not received just and reasonable prices because  
26                                  the capital structures were overly weighted with common equity, and the ROEs  
27                                  were well in excess of current market costs. Therefore, I believe that the balance  
28                                  in rate-setting for MISO TOs has been compromised.

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<sup>12</sup>Standard & Poor's RatingsDirect Summary. "American Transmission Co.," June 5, 2013 at 2.

1           As noted below, a just and reasonable rate of return is one that is  
2           bounded on one end by investor interest, and on the other end by public interest  
3           against excessive rates. In order to accomplish this balanced perspective, I  
4           recommend the Commission authorize MISO TOs a market-based fair  
5           compensation given current capital market costs, and require MISO TOs to  
6           manage their capital structures in a manner that minimizes their overall cost of  
7           capital, while supporting an investment grade bond rating.

8   **Q   DO YOU RECOMMEND THE FERC ESTABLISH CAPITAL STRUCTURE**  
9   **TARGETS FOR MISO TOs?**

10  **A**   Yes. Recognizing their low business risk, I recommend the Commission  
11           implement a target capital structure for MISO TOs. This target capital structure  
12           should consist of a common equity ratio of 50% as a cap.

13           To the extent a MISO TO has an equity ratio at or below the cap, it can  
14           file its rates using its actual capital structure. If the MISO TO has a common  
15           equity ratio in excess of the cap, it must provide evidence to the FERC that the  
16           equity ratio is just and reasonable, and consistent with minimizing its cost of  
17           capital while preserving its investment grade bond rating.

18           As such, I recommend a common equity ratio cap be established by  
19           FERC as a standard above which utilities have the obligation to prove the  
20           reasonableness of their actual capital structure. At this time, I recommend a  
21           common equity ratio cap of 50%, which is about equal to the electric industry  
22           average common equity ratio approved by regulatory commissions.

1

**V. INCENTIVE ROE ADDERS**

2 Q

3

4

**SHOULD THE COMMISSION INVESTIGATE THE REASONABLENESS OF CONTINUING TO PROVIDE ROE ADDERS TO ENCOURAGE CERTAIN QUALIFYING TRANSMISSION INVESTMENT?**

5 A

6

7

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9

Yes. The Commission should investigate the ROE adders approved for ITC and METC, which were originally approved for having joined a Regional Transmission Organization, for being an independent transmission owner, or other specific incentives. There is no benefit to customers for continuing to pay an incentive ROE adder, for the following reasons:

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1. ITC's and METC's bond rating is generally consistent with other MISO TOs' bond ratings.

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2. Credit analyst industry reports indicate that low-risk regulated utility operations, particularly low-industry-risk transmission operations, have ample access to low-cost capital to fund needed utility infrastructure investment. Credit rating agencies have recognized that the market is embracing the electric utility industry and providing it with ample access to low-cost capital to support large capital improvement programs. Incentive ROE adders in this market simply are not necessary because of the strong market interest in the low-risk stable investment characteristics of electric utility investment.

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This access to ample low-cost capital for the electric utility industry is discussed in more detail below. In summary, credit rating agencies clearly have recognized that setting rates based on adequate credit rating metrics provides ample access to capital at regulated utility operations, at a relatively low cost and in adequate supply to support large capital programs. This ample access to low-cost capital persists even in recognition of reduced ROEs awarded to regulated utility operations.

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29

Credit analysts and market participants recognize the ROEs awarded relate to current market cost of capital, which trend in line with utility bond yields and cost of capital, all of which have declined materially over the last few years.

1 ROE adders are not needed to provide MISO TOs access to ample low-  
2 cost capital; they simply serve no purpose other than to unjustifiably increase the  
3 rates charged to transmission users. As such, an ROE adder is producing higher  
4 cost transmission rates, with no offsetting service benefits. Again, these ROE  
5 adders should be discontinued.

6 **Q HAVE THE INCENTIVE ROEs PROVIDED ITC AND METC**  
7 **ENCOURAGEMENT TO MANAGE THEIR CAPITAL COSTS TO REDUCE**  
8 **THEIR OVERALL RATE OF RETURN?**

9 A No. These companies not only are provided significantly above market  
10 authorized ROEs, but they are also maintaining capital structures with far more  
11 common equity than necessary to maintain their current bond ratings. Both ITC  
12 and METC have common equity ratios of 60%. These excessive common equity  
13 ratios, along with the well above market authorized ROEs are producing  
14 substantially higher pre-tax rates of return than those of other MISO TOs.

15 Eliminating the ROE incentives for these companies would produce lower  
16 pre-tax rates of return even if their cost of debt was increased to reflect a  
17 reduction in their bond ratings. Assuming a 50 basis point increase in the  
18 embedded cost of debt, and reducing their ROE down to the current MISO base  
19 ROE of 12.38% would lower ITC's and METC's pre-tax rate of return from  
20 15.55% and 15.32%, down to 14.28% and 14.54%, respectively. Eliminating  
21 these incentive ROEs would reduce the revenue requirements from these two  
22 companies by approximately \$14.8 million and \$7.6 million, respectively.

23 The ROE adders are not needed to ensure these companies can attract  
24 capital to support capital investment, and are not needed to support investment

1 grade bond ratings. As such, customers are receiving little benefit at much  
2 higher cost as a result of unnecessary ROE adders.

3 I would note that certain transmission investors are willing to make  
4 significant investments in transmission plant without ROE adders. For example,  
5 the ATC FERC rate settlement with stakeholders excludes ROE adders in setting  
6 ATC's rates.

7 **Q HAS THE FERC RULED THAT TRANSMISSION RATES MUST BE JUST AND**  
8 **REASONABLE AFTER INCLUDING ROE ADDERS?**

9 A Yes. The FERC stated that it would permit incentive ROEs only if they result in  
10 just and reasonable rates, and that even with an incentive ROE, the overall rate  
11 of return must be within the zone of reasonableness.<sup>13</sup> Based on these  
12 standards, I recommend the Commission consider whether the incentive ROEs  
13 are necessary in order to accomplish benefits to customers that justify the cost,  
14 and to determine whether the incentive adders are just and reasonable. Based  
15 on the market access to low-cost capital for low-risk regulated electric utility plant  
16 investment, I believe the ROE incentives are no longer needed or necessary.  
17 Therefore, continuing to permit ROE adders would result in rates which are not  
18 just and reasonable.

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<sup>13</sup>121 FERC ¶ 61, 229, Order Authorizing Disposition of Jurisdictional Facilities, Accepting Proposed Rates and Jurisdictional Agreements Subject to Conditions, and Dismissing Complaint, December 3, 2007.

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## **VI. RETURN ON EQUITY**

**Q PLEASE DESCRIBE WHAT IS MEANT BY A “UTILITY’S COST OF COMMON EQUITY.”**

A A utility’s cost of common equity is the return investors require on an investment in the utility’s common stock. Investors expect to achieve their return requirement from receiving dividends and stock price appreciation.

**Q PLEASE DESCRIBE THE FRAMEWORK FOR DETERMINING A REGULATED UTILITY’S COST OF COMMON EQUITY.**

A In general, determining a fair cost of common equity for a regulated utility has been framed by decisions of the FERC and U.S. Supreme Court: Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm’n of W. Va., 262 U.S. 679 (1923) and Fed. Power Comm’n v. Hope Natural Gas Co., 320 U.S. 591 (1944). In recent filings before the Commission, the FERC Staff recognized the FERC finding that a just and reasonable rate is one that is “bounded on one end by investor interest, and the other by the public interest against excessive rates.”<sup>14</sup>

The U.S. Supreme Court decisions provide the general standards to be considered in establishing the cost of common equity for a public utility. Those general standards provide that the authorized return should: (1) be sufficient to maintain financial integrity; (2) attract capital under reasonable terms; and (3) be commensurate with returns investors could earn by investing in other enterprises of comparable risk.

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<sup>14</sup>*Maine Public Utilities Commission v. Federal Energy Regulatory Commission*, 520 F.3d 464, 471 (D.C. Cir. 2008) citing *Pacific Gas & Electric Co. v. FERC*, 306 F. 3d 1112, 1116 (D.C. Cir. 2002).

1   **Q     PLEASE DESCRIBE THE METHODS YOU USED TO ESTIMATE THE MISO**  
2   **TOs' CURRENT MARKET COST OF EQUITY.**

3   A     I primarily relied on a FERC standard DCF methodology. I also conducted a risk  
4         premium and CAPM to provide additional estimates of the current market cost of  
5         equity. I will use these risk premium approaches to both show the  
6         reasonableness of my FERC model DCF return estimates, and to show how  
7         excessive the current MISO TO base ROE of 12.38%/12.20% is relative to  
8         current market costs of capital.

9   **VI.A. Proxy Group**

10  **Q     HOW DID YOU SELECT UTILITY PROXY GROUPS?**

11  A     The proxy group used to estimate a fair ROE for the MISO TOs should include  
12         companies that have comparable investment risk characteristics to the MISO  
13         TOs. I relied on the FERC risk selection criteria to develop a National proxy  
14         group that reflects this comparable investment risk objective.

15             A National proxy group with reasonable risk characteristics similar to  
16         MISO TOs provides a broad-based national group for which MISO TOs compete  
17         for capital to fund infrastructure investments. Setting the MISO TOs' authorized  
18         ROE equal to the returns that investors demand of other companies of  
19         comparable risk will ensure MISO TOs are being authorized ROEs that are fair  
20         and reasonable and will support MISO TOs' ability to access capital under  
21         reasonable terms and conditions.

22             I also developed a Regional proxy group of electric utilities that own and  
23         operate transmission assets. The Regional proxy group was selected to directly  
24         measure the market-required returns for publicly traded companies that own  
25         MISO TOs or have TOs directly interconnected to MISO.



1 I provide primary reliance on the National proxy group in estimating my  
2 fair ROE for the MISO TOs in this case. I rely on the Regional proxy group as a  
3 means of testing the accuracy of my return estimates based on the National  
4 proxy group. The combination of these two groups helps to provide additional  
5 information to more accurately estimate a fair ROE for the MISO TOs in this  
6 case.

7 **Q HOW DID YOU SELECT COMPANIES TO INCLUDE IN YOUR NATIONAL**  
8 **PROXY GROUP?**

9 A The National proxy group was selected based on the following criteria:

- 10 1. Started with domestic publicly traded electric utilities followed by *The Value*  
11 *Line Investment Survey* within its Electric Utility Industry.
- 12 2. Limited the number of electric utilities in the group to those that own  
13 transmission assets.
- 14 3. Included those companies that had an S&P bond rating in the range of  
15 “BBB-” to “A+” – the MISO TO range plus or minus one rating notch.<sup>15</sup>
- 16 4. Excluded any company known to be a party to significant Merger and  
17 Acquisition activity in the past 12 months.
- 18 5. Included only those companies that have consistently paid dividends for two  
19 years without any cuts to the dividends.
- 20 6. Included only those companies that had at least two growth rate estimates  
21 available from www.reuters.com (I/B/E/S).

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<sup>15</sup>FERC precedent typically excludes below investment grade companies from the development of a proxy group. While one notch below the minimum bond rating of the MISO TOs (“BBB-”) would indicate a non-investment grade bond rating (“BB+”) other selection criteria have eliminated the inclusion of any non-investment grade bond rating for my proxy group. As such, I have utilized the FERC standard practice of plus or minus 1 notch rating to the proxy group credit ratings of the transmission-owning entities, but have also developed a proxy group which does not contradict FERC’s precedent to exclude non-investment grade companies from the proxy group. (*Portland Natural Gas Transmission System*, Opinion No. 510, 134 FERC ¶ 61,129 at n. 301).

1    **Q     PLEASE DESCRIBE HOW YOU SELECTED COMPANIES TO INCLUDE IN**  
2    **YOUR REGIONAL PROXY GROUP.**

3    A     The Regional proxy group companies were selected based on the following  
4    criteria:

- 5       1. Included transmission owners in MISO.
- 6       2. Included all non-MISO investor-owned utilities that directly interconnect with a  
7       MISO transmission owner and that operate in the Eastern U.S. Interconnect.
- 8       3. Identified the publicly traded parent companies (“Public Companies”) of the  
9       transmission owners included in 2 above.
- 10      4. Excluded Public Companies that were not followed as Electric Utilities by *The*  
11      *Value Line Investment Survey* within the Electric Utility Industry.
- 12      5. Included only Public Companies that had S&P bond ratings in the range of  
13      “BBB-” to “A+” – the range of MISO TOs’ corporate bond ratings, plus or  
14      minus one notch.
- 15      6. Excluded any Public Company known to be a party to significant Merger and  
16      Acquisition activity in the past 12 months.<sup>16</sup>
- 17      7. Included only those Public Companies that have consistently paid dividends  
18      for the last two years without any cuts to the dividends.
- 19      8. Included only those companies that had at least two growth rate estimates  
20      available from www.reuters.com (I/B/E/S).

21   **Q     ARE THESE PROXY GROUP SELECTION CRITERIA REASONABLY**  
22   **CONSISTENT WITH OTHER FERC DECISIONS FOR SELECTING A PROXY**  
23   **GROUP TO ESTIMATE A TRANSMISSION OWNER’S FAIR ROE?**

24   A     Yes.<sup>17</sup>

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<sup>16</sup>*Id.*

<sup>17</sup>*Southern Cal. Edison Co.*, 131 FERC ¶ 61,020 at P 52 (2010); *Atl. Grid Operations A LLC, et al.*, 135 FERC ¶ 61,144 (2011); *N. Pass Transmission LLC*, 134 FERC ¶ 61,095 (2011); *RITELine Ill., LLC*, 137 FERC ¶ 61,039 at PP 66-67 (2011).

1 **Q HOW DID YOU IDENTIFY THE INVESTMENT RISK CHARACTERISTICS OF**  
2 **THE ELECTRIC OPERATING COMPANIES THAT OWN TRANSMISSION**  
3 **ASSETS THAT ARE IN OR ARE CONNECTED TO MISO?**

4 A The first assessment was made of all the electric utilities that own transmission  
5 assets that operated in MISO or were interconnected with MISO-owning  
6 companies. This group was also limited to only companies that operated in the  
7 Eastern Interconnect.

8 As shown on my Exhibit MPG-3, the bond rating for the companies  
9 generally fell within a broad category of "BBB-" and "A+" from S&P. The average  
10 S&P bond rating was "BBB+."

11 **Q PLEASE DESCRIBE YOUR NATIONAL PROXY GROUP.**

12 A The National proxy group is shown in Exhibit MPG-4. This proxy group has an  
13 average corporate credit rating from S&P of "BBB+." No proxy company with a  
14 below investment grade bond rating was included in the proxy group. These  
15 bond ratings are comparable to the MISO TOs' average bond rating.

16 **Q PLEASE DESCRIBE HOW YOUR REGIONAL PROXY GROUP RISK**  
17 **COMPARES TO THE MISO TOs' CREDIT RATING RANGE.**

18 A The Regional proxy group is shown in Exhibit MPG-5. This proxy group has  
19 average corporate credit ratings from S&P of "BBB+." No proxy company with a  
20 below investment grade bond rating was included in the proxy group. These  
21 proxy group average bond ratings are comparable to the MISO TOs' average  
22 bond rating.

1    **Q     WERE THE PARENT COMPANIES OF THE MISO TOs CONSIDERED IN**  
2    **FORMING YOUR REGIONAL PROXY GROUP?**

3    A     Yes. All the publicly traded parent companies of the MISO TOs were originally  
4    included in the universe of companies considered for inclusion in the Regional  
5    and National proxy groups. However, only two parent companies of MISO TOs  
6    met the proxy group risk selection criteria. Specifically, the following parent  
7    companies of MISO TOs were eliminated from the proxy groups because they  
8    failed the following risk selection criteria.

- 9           1. Ameren, Allete, CLECO and Otter Tail Power were excluded because they  
10          failed to have at least two independent analysts' coverage which responded  
11          to consensus analysts' growth surveys by Reuters.
- 12          2. Berkshire Hathaway, NiSource and MDU Resources were excluded because  
13          they are not included in the Electric Utility Industry by *The Value Line*  
14          *Investment Survey*. NiSource and MDU Resources were included in the  
15          diversified natural gas industry.
- 16          3. International Transmission Company and Entergy Corp. were excluded  
17          because they are currently involved in merger and acquisition activity.
- 18          4. Vectren was excluded because it does not have at least two analysts'  
19          coverage that responded to consensus analysts' growth rate surveys by  
20          Reuters.

21                 The two parent companies of MISO TOs that were included in the proxy  
22    groups include Xcel and Duke Energy. I would note that these parent companies  
23    include ownership and operating companies that operate inside and outside  
24    MISO.

25    **VI.B. Discounted Cash Flow ("DCF") Model**

26    **Q     PLEASE DESCRIBE THE DCF MODEL.**

27    A     The DCF model posits that a stock price is valued by summing the present value  
28    of expected future cash flows discounted at the investor's required rate of return  
29    or cost of capital. This model is expressed mathematically as follows:

1 
$$P_0 = \frac{D_1}{(1+K)^1} + \frac{D_2}{(1+K)^2} + \dots + \frac{D_\infty}{(1+K)^\infty} \text{ where} \quad \text{(Equation 1)}$$

2

3  $P_0$  = Current stock price  
 4  $D$  = Dividends in periods 1 -  $\infty$   
 5  $K$  = Investor's required return

6 This model can be rearranged in order to estimate the discount rate or  
 7 investor-required return, "K." If it is reasonable to assume that earnings and  
 8 dividends will grow at a constant rate, then Equation 1 can be rearranged as  
 9 follows:

10 
$$K = D_1/P_0 + G \quad \text{(Equation 2)}$$

11  $K$  = Investor's required return  
 12  $D_1$  = Dividend in first year  
 13  $P_0$  = Current stock price  
 14  $G$  = Expected constant dividend growth rate

15 Equation 2 is referred to as the annual "constant growth" DCF model.

16 **Q PLEASE DESCRIBE HOW YOU CONDUCTED YOUR DCF ANALYSIS.**

17 **A** My DCF analysis was constructed using the general academic framework of a  
 18 DCF model described above. However, the model was conformed to comply  
 19 with the FERC approved methodology for conducting a DCF study. This  
 20 included the following:

- 21 1. Calculating the high and low dividend yields over a recent six-month period;
- 22 2. Relying on both consensus analysts' growth rate projections and sustainable  
23 growth rate estimates;
- 24 3. Calculating a proxy group DCF return;
- 25 4. Identifying outlier DCF estimates using FERC practices;
- 26 5. Calculating extreme high and extreme low DCF return estimates (excluding  
27 outliers) based on the parameters described above; and
- 28 6. Establishing a median estimate from the proxy group studies to support a  
29 current market DCF return for the MISO TOs.

1 **Q PLEASE DESCRIBE HOW YOU DEVELOPED THE DIVIDEND YIELD FOR**  
2 **YOUR DCF STUDY.**

3 A I reviewed the weekly dividend yield for each of the companies in the proxy  
4 groups over a 26-week period ending October 1, 2013. I calculated the weekly  
5 high and low dividend yield based on the most recently paid dividend and high  
6 and low stock price for that week. Over that six-month period, then I measured  
7 the high and low dividend yield for each of the companies in the proxy groups.  
8 This practice is consistent with the FERC standard methodology for conducting  
9 DCF studies.

10 **Q WHAT GROWTH RATES HAVE YOU USED IN YOUR CONSTANT GROWTH**  
11 **DCF MODEL?**

12 A A summary of the growth rates used in my analysis is shown on my Exhibit  
13 MPG-6 for my National proxy group and my Exhibit MPG-7 for my Regional  
14 proxy group. These growth rates include Reuters' published consensus analysts'  
15 growth rate (I/B/E/S),<sup>18</sup> and an internal or sustainable growth rate based on *Value*  
16 *Line* current and projected data for the companies in the proxy groups.

17 **Q PLEASE DESCRIBE HOW YOU ESTIMATED A SUSTAINABLE LONG-TERM**  
18 **EARNINGS RETENTION (“B”) TIMES EARNED RETURN ON EQUITY (“R”),**  
19 **OR (“B x R”), GROWTH RATE.**

20 A A sustainable growth rate is based on the percentage of the utility's earnings that  
21 is retained and reinvested in utility plant and equipment, and growth produced by  
22 selling stock at prices above book value.

---

<sup>18</sup>Online on October 15, 2013, and the most recent *Value Line* reports for the proxy companies.

1           The internal growth methodology is tied to the percentage of earnings  
2 retained in the company and not paid out as dividends. The earnings retention  
3 ratio is 1 minus the dividend payout ratio. As the payout ratio declines, the  
4 earnings retention ratio increases. An increased earnings retention ratio will fuel  
5 stronger growth because the business funds more investments with retained  
6 earnings.

7           The B x R growth rates for the National proxy group and Regional proxy  
8 group are developed on my Exhibit MPG-8 and Exhibit MPG-9, respectively. The  
9 data used to estimate the long-term sustainable growth rate is based on the  
10 Company's current market to book ratio and on *Value Line's* three- to five-year  
11 projections of earnings, dividends, earned returns on book equity, and stock  
12 issuances.

13 **Q       PLEASE DESCRIBE THE GROWTH RATES USED IN YOUR DCF STUDIES.**

14 A       As shown in Exhibit MPG-6, the growth rates for the National proxy group  
15 average range from a high of 5.30% to a low of 3.56%. As shown in Exhibit  
16 MPG-7, the growth rates for the Regional proxy group average ranged from a  
17 high of 4.55% to a low of 3.18%.

18 **Q       PLEASE DESCRIBE HOW YOU CALCULATED YOUR ADJUSTED DIVIDEND  
19 YIELD.**

20 A       I relied on my six-month high and low dividend yield estimate and adjusted it by  
21 one-half the projected growth rate. ( $D_0 * (1 + 1/2g)$ ). This is consistent with  
22 historical FERC precedent.

1 **Q WHAT IS THE NATIONAL PROXY GROUP DCF ESTIMATE?**

2 A As shown on my Exhibit MPG-10, the National proxy group average and median  
3 DCF estimates are 9.83%/9.69% on the high end and 7.27%/7.41% on the low  
4 end, respectively.

5 **Q DID YOU ADJUST YOUR DCF RESULTS FOR OUTLIER DCF ESTIMATES?**

6 A Yes. I excluded companies that had low-end results of 6.39% or less as outliers.  
7 For each excluded company, both the low-end result and the high-end results  
8 were excluded. As a result, I excluded the low and high DCF estimates for  
9 Consolidated Edison, Inc.; Edison International; FirstEnergy Corp; Public Service  
10 Enterprise Group Incorporated; and Westar Energy, Inc. from the results.

11 In identifying low outliers, I relied on the highest "Baa" utility bond yield  
12 (5.39%) over the last 26-week period reported (Exhibit MPG-16) by Moody's in its  
13 Credit Trends data source plus added 100 basis points. This produced a low  
14 outlier benchmark of 6.39%. If a company had an outlier DCF estimate, I  
15 excluded it from both low-end and high-end DCF estimates.

16 **Q WHAT ARE THE RESULTS OF YOUR NATIONAL PROXY GROUP AFTER**  
17 **EXCLUSION OF OUTLIER RESULTS?**

18 A The DCF results for the National proxy group after excluding outliers, are 11.88%  
19 on the extreme high-end and 6.75% on the extreme low-end, respectively. The  
20 median of the high and low estimates, excluding outliers, is 7.97% to 10.33%.  
21 The median best reflects the central tendency of the proxy group. The midpoint  
22 of the median range is 9.15%.



1 **Q WHAT IS THE REGIONAL PROXY GROUP DCF ESTIMATE?**

2 A As shown on my Exhibit MPG-11, the Regional proxy group average and median  
3 are 9.45%/9.28% on the high end, and 7.13%/6.85% on the low end,  
4 respectively.

5 **Q DID YOU ADJUST YOUR REGIONAL PROXY GROUP DCF RESULTS TO**  
6 **REMOVE DCF OUTLIERS?**

7 A Yes. I used the same low-end outlier parameter of 6.39% discussed above in my  
8 National proxy group. With this as the benchmark, I excluded DCF results for  
9 FirstEnergy Corp and Westar Energy. With FirstEnergy's and Westar's DCF  
10 results excluded from both the high-end and low-end estimates, the Regional  
11 proxy group average and median results excluding outliers were 9.73%/9.73%  
12 and 7.67%/7.97%, respectively. The extreme high and low DCF estimates in this  
13 group were 10.62% to 6.75%.

14 **Q PLEASE SUMMARIZE THE RESULTS OF YOUR DCF STUDIES.**

15 A My DCF study results are summarized in Table 1 below.

<b><u>Description</u></b>	<b><u>National Proxy Group (Outliers Removed)</u></b>	<b><u>Regional Proxy Group (Outliers Removed)</u></b>
High	10.33%	9.73%
Low	7.97%	7.97%
Extreme High/Median	11.88%/10.33%	10.62%/9.73%
Extreme Low/Median	6.75%/7.97%	6.75%/7.67%

1           As shown in Table 1 above under the National column, the range of DCF  
2 estimates falls in the range of 10.33% to 7.97%, with a midpoint estimate of  
3 9.15%. This is the range and midpoint estimate of my National proxy group and  
4 estimated ROE for the MISO TOs using methodologies consistent with FERC  
5 recent precedent.

6           My Regional proxy group produces a similar result to my National proxy  
7 group. For the Regional proxy group, the range is 10.62% to 6.75%, with a  
8 midpoint estimate of 8.69%.

#### 9 **VI.C. Risk Premium Studies**

10 **Q    DID YOU CONDUCT RISK PREMIUM STUDIES IN ADDITION TO YOUR FERC**  
11 **DCF METHODOLOGY?**

12 **A**Yes. The risk premium studies are being used to support the reasonableness of  
13 my ROE estimate based on my DCF analyses constructed in FERC  
14 methodology, and also to demonstrate that the 12.38%/12.20% current

1 authorized ROE for the MISO TOs substantially exceeds the current market cost  
2 of equity.

3 I performed two risk premium studies. The first was a bond yield plus risk  
4 premium study, and the second was a CAPM.

5 **Q PLEASE DESCRIBE YOUR BOND YIELD PLUS RISK PREMIUM MODEL.**

6 A This model is based on the principle that investors require a higher return to  
7 assume greater risk. Common equity investments have greater risk than bonds  
8 because bonds have more security of payment in bankruptcy proceedings than  
9 common equity and the coupon payments on bonds represent contractual  
10 obligations. In contrast, companies are not required to pay dividends or  
11 guarantee returns on common equity investments. Therefore, common equity  
12 securities are considered to be more risky than bond securities.

13 This risk premium model is based on two estimates of an equity risk  
14 premium. First, I estimated the difference between the required return on utility  
15 common equity investments and U.S. Treasury bonds. The difference between  
16 the required return on common equity and the Treasury bond yield is the risk  
17 premium. I estimated the risk premium on an annual basis for each year over the  
18 period 1986 through June 2013. The common equity required returns were  
19 based on regulatory commission-authorized returns for electric utility companies.  
20 Authorized returns are typically based on expert witnesses' estimates of the  
21 contemporary investor-required return. I selected the period 1986 through June  
22 2013 because public utility stocks consistently traded at a premium to book value  
23 during that period. This is illustrated in Exhibit MPG-12, which shows that market  
24 to book ratio since 1986 was consistently above 1.0. This is an indication that  
25 the commission-authorized ROEs were positively received by the market.

1           The second equity risk premium estimate is based on the difference  
2           between regulatory commission-authorized returns on common equity and  
3           contemporary "A" rated utility bond yields. Over this period, regulatory  
4           authorized returns were sufficient to support market prices that at least exceeded  
5           book value. This is an indication that regulatory authorized returns on common  
6           equity supported a utility's ability to issue additional common stock without  
7           diluting existing shares. It further demonstrates that utilities were able to access  
8           equity markets without a detrimental impact on current shareholders.

9           Based on this analysis, as shown in Exhibit MPG-13, the average  
10          indicated equity risk premium over U.S. Treasury bond yields has been 5.35%.  
11          Of the 28 observations, 22 indicated risk premiums fall in the range of 4.41% to  
12          6.31%. Since the risk premium can vary depending upon market conditions and  
13          changing investor risk perceptions, I believe using an estimated range of risk  
14          premiums provides the best method to measure the current return on common  
15          equity using this methodology.

16          As shown in Exhibit MPG-14, the average indicated equity risk premium  
17          over contemporary Moody's utility bond yields was 3.94% over the period 1986  
18          through June 2013. The indicated equity risk premium estimates based on this  
19          analysis primarily fall in the range of 3.03% to 4.89% over this time period.

20   **Q    WHAT RISK PREMIUM HAVE YOU USED TO ESTIMATE A COST OF**  
21   **COMMON EQUITY IN THIS PROCEEDING?**

22   **A**The equity risk premium should reflect the relative market perception of risk in  
23   the utility industry today. I have gauged investor perceptions in utility risk today  
24   in Exhibit MPG-15. On that exhibit, I show the yield spread between utility bonds  
25   and Treasury bonds over the last 34 years.

1           As shown on this exhibit, the average utility bond yield spreads over  
2 Treasury bonds for “A” and “Baa” rated utility bonds for this historical period are  
3 1.55% and 1.96%, respectively. The utility bond yield spreads over Treasury  
4 bonds for “A” and “Baa” rated utilities through June 2013 are 1.06% and 1.58%,  
5 respectively.

6           A current 13-week average “A” rated utility bond yield of 4.73%, when  
7 compared to the current 13-week average Treasury bond yield of 3.73% as  
8 shown in Exhibit MPG-16, implies a yield spread of around 1.00%. This current  
9 utility bond yield spread is lower than the 34-year average spread for “A” utility  
10 bonds of 1.55%. Similarly, the current spread for the “Baa” utility yields of 1.52%  
11 is lower than the 34-year average spread of 1.96%.

12           Current utility bond yield spreads over Treasury are below long-term  
13 historical averages. This is clear evidence that the market considers the utility  
14 industry to be a relatively low-risk and safe investment. The below-average  
15 spreads of utility bond yields relative to Treasury yields suggests the market is  
16 demanding average to below-average premiums to invest in utility stocks relative  
17 to lower-risk Treasury investments. This is clear evidence that the risk of utility  
18 securities is considered low, and investors are paying premiums for utility  
19 security investments. Based on this assessment, I believe an equity risk  
20 premium for utility equities relative to Treasury and utility bonds should be  
21 generally consistent with the average equity risk premium measured over the  
22 historical time period. However, because the Federal Reserve is currently  
23 continuing its interventions in long-term bond markets by purchasing Treasury  
24 and collateralized mortgage agreements, there is some uncertainty and higher  
25 risk associated with fixed income securities. Because of the risk of future interest

1 rates, I will recommend a risk premium between the median and high-end of my  
2 estimated range.

3 **Q HOW DID YOU ESTIMATE THE COST OF COMMON EQUITY WITH THIS**  
4 **RISK PREMIUM MODEL?**

5 A I made two risk premium estimates: 1) above Treasury bond yields and 2) above  
6 utility bond yields. First, I added a projected long-term Treasury bond yield to my  
7 estimated equity risk premium over Treasury yields. The 13-week average  
8 30-year Treasury bond yield, ending October 11, 2013 was 3.73%, as shown in  
9 Exhibit MPG-16. *Blue Chip Financial Forecasts* projects the 30-year Treasury  
10 bond yield to be 4.20%, and a 10-year Treasury bond yield to be 3.30%.<sup>19</sup> Using  
11 the projected 30-year bond yield of 4.20%, and a Treasury bond risk premium of  
12 4.41% to 6.31%, as developed above, produces an estimated common equity  
13 return in the range of 8.61% (4.20% + 4.41%) to 10.51% (4.20% + 6.31%).

14 In my second risk premium estimate, I added my equity risk premium over  
15 utility bond yields to a current 13-week average yield on “Baa” rated utility bonds  
16 for the period ending October 11, 2013 of 5.25%. Adding the utility equity risk  
17 premium of 3.03% to 4.89%, as developed above, to a “Baa” rated bond yield of  
18 5.25% produces a cost of equity in the range of 8.28% (5.25% + 3.03%) to  
19 10.14% (5.25% + 4.89%).

20 My risk premium analyses produce a return estimate of 8.28% to 10.51%.

---

<sup>19</sup>*Blue Chip Financial Forecasts*, October 1, 2013 at 2.

1 **VI.D. Capital Asset Pricing Model (“CAPM”)**

2 **Q PLEASE DESCRIBE THE CAPM.**

3 A The CAPM method of analysis is based upon the theory that the market-required  
4 rate of return for a security is equal to the risk-free rate, plus a risk premium  
5 associated with the specific security. This relationship between risk and return  
6 can be expressed mathematically as follows:

7 
$$R_i = R_f + B_i \times (R_m - R_f) \text{ where:}$$

8  $R_i$  = Required return for stock i

9  $R_f$  = Risk-free rate

10  $R_m$  = Expected return for the market portfolio

11  $B_i$  = Beta - Measure of the risk for stock

12 The stock-specific risk term in the above equation is beta. Beta  
13 represents the investment risk that cannot be diversified away when the security  
14 is held in a diversified portfolio. When stocks are held in a diversified portfolio,  
15 firm-specific risks can be eliminated by balancing the portfolio with securities that  
16 react in the opposite direction to firm-specific risk factors (e.g., business cycle,  
17 competition, product mix, and production limitations).

18 The risks that cannot be eliminated when held in a diversified portfolio are  
19 non-diversifiable risks. Non-diversifiable risks are related to the market in  
20 general and are referred to as systematic risks. Risks that can be eliminated by  
21 diversification are regarded as non-systematic risks. In a broad sense,  
22 systematic risks are market risks, and non-systematic risks are business risks.  
23 The CAPM theory suggests that the market will not compensate investors for  
24 assuming risks that can be diversified away. Therefore, the only risk that  
25 investors will be compensated for are systematic or non-diversifiable risks. The  
26 beta is a measure of the systematic or non-diversifiable risks.

1 **Q PLEASE DESCRIBE THE INPUTS TO YOUR CAPM.**

2 A The CAPM requires an estimate of the market risk-free rate, the company's beta,  
3 and the market risk premium.

4 **Q WHAT DID YOU USE AS AN ESTIMATE OF THE MARKET RISK-FREE**  
5 **RATE?**

6 A As previously noted, *Blue Chip Financial Forecasts'* projected 30-year Treasury  
7 bond yield is 4.20%.<sup>20</sup> The current 30-year Treasury bond yield is 3.73% and  
8 3.50%, as shown in Exhibit MPG-16, for the last 13 and 26 weeks, respectively.  
9 To produce a conservative estimate, I used *Blue Chip Financial Forecasts'*  
10 projected 30-year Treasury bond yield of 4.20% for my CAPM analysis.

11 **Q WHY DID YOU USE LONG-TERM TREASURY BOND YIELDS AS AN**  
12 **ESTIMATE OF THE RISK-FREE RATE?**

13 A Treasury securities are backed by the full faith and credit of the United States  
14 government, so long-term Treasury bonds are considered to have negligible  
15 credit risk. Also, long-term Treasury bonds have an investment horizon similar to  
16 that of common stock. As a result, investor-anticipated long-run inflation  
17 expectations are reflected in both common-stock required returns and long-term  
18 bond yields. Therefore, the nominal risk-free rate (or expected inflation rate and  
19 real risk-free rate) included in a long-term bond yield is a reasonable estimate of  
20 the nominal risk-free rate included in common stock returns.

21 Treasury bond yields, however, do include risk premiums related to  
22 unanticipated future inflation and interest rates. A Treasury bond yield is not a  
23 risk-free rate. Risk premiums related to unanticipated inflation and interest rates

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<sup>20</sup>*Blue Chip Financial Forecasts*, October 1, 2013 at 2.



1 are systematic or market risks. Consequently, for companies with betas less  
2 than 1.0, using the Treasury bond yield as a proxy for the risk-free rate in the  
3 CAPM analysis can produce an overstated estimate of the CAPM return.

4 **Q WHAT BETA DID YOU USE IN YOUR ANALYSIS?**

5 A As shown in my Exhibit MPG-17 and Exhibit MPG-18, the National and Regional  
6 proxy group average *Value Line* beta estimates are 0.71 and 0.69, respectively.

7 **Q HOW DID YOU DERIVE YOUR MARKET RISK PREMIUM ESTIMATE?**

8 A I derived two market risk premium estimates, a forward-looking estimate and one  
9 based on a long-term historical average.

10 The forward-looking estimate was derived by estimating the expected  
11 return on the market (as represented by the S&P 500) and subtracting the risk-  
12 free rate from this estimate. I estimated the expected return on the S&P 500 by  
13 adding an expected inflation rate to the long-term historical arithmetic average  
14 real return on the market. The real return on the market represents the achieved  
15 return above the rate of inflation.

16 Morningstar's *Stocks, Bonds, Bills and Inflation 2013 Classic Yearbook*  
17 estimates the historical arithmetic average real market return over the period  
18 1926 to 2012 as 8.7%.<sup>21</sup> A current consensus analysts' inflation projection, as  
19 measured by the Consumer Price Index, is 2.3%.<sup>22</sup> Using these estimates, the  
20 expected market return is 11.20%.<sup>23</sup> The market risk premium then is the  
21 difference between the 11.20% expected market return, and my 4.20% risk-free  
22 rate estimate, or approximately 7.00%.

---

<sup>21</sup> *Morningstar, Inc., Ibbotson S&P 2013 Classic Yearbook* at 88.

<sup>22</sup> *Blue Chip Financial Forecasts*, October 1, 2013 at 2.

<sup>23</sup>  $\{ [(1 + 0.087) * (1 + 0.022)] - 1 \} * 100$ .

1           The historical estimate of the market risk premium was also estimated by  
2 Morningstar in *Stocks, Bonds, Bills and Inflation 2013 Classic Yearbook*. Over  
3 the period 1926 through 2012, Morningstar's study estimated that the arithmetic  
4 average of the achieved total return on the S&P 500 was 11.8%,<sup>24</sup> and the total  
5 return on long-term Treasury bonds was 6.1%.<sup>25</sup> The indicated market risk  
6 premium is 5.7% (11.8% - 6.1% = 5.7%). The average of my market risk  
7 premium estimates is 6.4% (7.0% to 5.7%).

8 **Q   HOW DOES YOUR ESTIMATED MARKET RISK PREMIUM RANGE**  
9 **COMPARE TO THAT ESTIMATED BY MORNINGSTAR?**

10 A   Morningstar's analysis indicates that a market risk premium falls somewhere in  
11 the range of 6.0% to 6.7%. My market risk premium falls in the range of 5.7% to  
12 7.0%. My average market risk premium of 6.4% is in the middle of Morningstar's  
13 range.

14           Morningstar estimates a forward-looking market risk premium based on  
15 actual achieved data from the historical period of 1926 through 2012. Using this  
16 data, Morningstar estimates a market risk premium derived from the total return  
17 on large company stocks (S&P 500), less the income return on Treasury bonds.  
18 The total return includes capital appreciation, dividend or coupon reinvestment  
19 returns, and annual yields received from coupons and/or dividend payments.  
20 The income return, in contrast, only reflects the income return received from  
21 dividend payments or coupon yields. Morningstar argues that the income return  
22 is the only true risk-free rate associated with Treasury bonds and is the best

---

<sup>24</sup> *Morningstar, Inc. Ibbotson S&P 500 2013 Classic Yearbook* at 87.

<sup>25</sup> *Id.*

1 approximation of a truly risk-free rate.<sup>26</sup> I disagree with this assessment from  
2 Morningstar, because it does not reflect a true investment option available to the  
3 marketplace and therefore does not produce a legitimate estimate of the  
4 expected premium of investing in the stock market versus that of Treasury  
5 bonds. Nevertheless, I will use Morningstar's conclusion to show the  
6 reasonableness of my market risk premium estimates.

7 Morningstar's range is based on several methodologies. First,  
8 Morningstar estimates a market risk premium of 6.7% based on the difference  
9 between the total market return on common stocks (S&P 500) less the income  
10 return on Treasury bond investments. Second, Morningstar found that if the New  
11 York Stock Exchange (the "NYSE") was used as the market index rather than the  
12 S&P 500, that the market risk premium would be 6.5%, not 6.7%. Third, if only  
13 the two deciles of the largest companies included in the NYSE were considered,  
14 the market risk premium would be 6.0%.<sup>27</sup>

15 Finally, Morningstar found that the 6.7% market risk premium based on  
16 the S&P 500 was influenced by an abnormal expansion of price-to-earnings  
17 ("P/E") ratios relative to earnings and dividend growth during the period 1980  
18 through 2001. Morningstar believes this abnormal P/E expansion is not  
19 sustainable.<sup>28</sup> Therefore, Morningstar adjusted this market risk premium  
20 estimate to normalize the growth in the P/E ratio to be more in line with the  
21 growth in dividends and earnings. Based on this alternative methodology,  
22 Morningstar published a long-horizon supply-side market risk premium of 6.0%.<sup>29</sup>

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<sup>26</sup>*Morningstar, Inc., Ibbotson SBBi 2013 Valuation Yearbook* at 55.

<sup>27</sup>Morningstar observes that the S&P 500 and the NYSE Decile 1-2 are both large capitalization benchmarks. *Id.* at 54.

<sup>28</sup>*Morningstar, Inc., Ibbotson SBBi 2013 Valuation Yearbook* at 54.

<sup>29</sup>*Id.*

1           To again be conservative in the CAPM estimate, I will use the higher  
2           6.7% market risk premium in my CAPM study as opposed to the 6.4% that I  
3           calculated independently.

4   **Q     WHAT ARE THE RESULTS OF YOUR CAPM ANALYSIS?**

5   A     As shown in Exhibit MPG-19, based on Morningstar's market risk premium of  
6           6.7%, a risk-free rate of 4.20%, and a beta of 0.71, my CAPM analysis produces  
7           a return of 8.94%. Using a beta range of 0.55 to 0.95 indicates a CAPM in the  
8           range of 7.89% to 10.57%.

9   **VI.E. Return on Equity Summary**

10 **Q     BASED ON THE RESULTS OF YOUR RETURN ON COMMON EQUITY**  
11 **ANALYSES DESCRIBED ABOVE, WHAT RETURN ON COMMON EQUITY DO**  
12 **YOU RECOMMEND?**

13 A     Based on my FERC method DCF analyses, I estimate a current market cost of  
14           equity of 9.15%. This DCF ROE estimated range is supported as reasonable by  
15           the indicated range of both my risk premium (8.28% to 10.51%) and CAPM  
16           return studies (7.89% to 10.57%).

17 **Q     DOES THIS CONCLUDE YOUR AFFIDAVIT?**

18 A     Yes.

**UNITED STATES OF AMERICA  
BEFORE THE  
FEDERAL ENERGY REGULATORY COMMISSION**

<b>Midcontinent Independent System Operator, Inc.</b>	) ) ) ) )	<b>Docket No.</b> _____
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**Affidavit of Michael P. Gorman**


ST LOUIS, MISSOURI )                      ss:

BEFORE ME, the undersigned authority, personally appeared Michael P. Gorman, who after being by me first duly sworn, deposes and says that the facts stated herein are true based on personal knowledge:

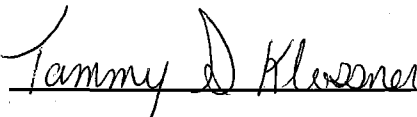
I hereby affirm that the foregoing is true and correct to the best of my knowledge and belief. If called to testify in this matter, I would testify as set forth herein.

Further affiant says not.

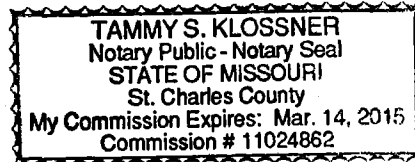
Michael P. Gorman  
Affiant



Subscribed and sworn to before me by Mr. Michael P. Gorman, who is known to me this 6th day of November, 2013.

  
\_\_\_\_\_

Notary Public



My Commission Expires: March 14, 2015

**Qualifications of Michael P. Gorman**

1 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A Michael P. Gorman. My business address is 16690 Swingley Ridge Road,  
3 Suite 140, Chesterfield, MO 63017.

4 **Q PLEASE STATE YOUR OCCUPATION.**

5 A I am a consultant in the field of public utility regulation and a Managing Principal  
6 with Brubaker & Associates, Inc., energy, economic and regulatory consultants.

7 **Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND WORK**  
8 **EXPERIENCE.**

9 A In 1983 I received a Bachelors of Science Degree in Electrical Engineering from  
10 Southern Illinois University, and in 1986, I received a Masters Degree in  
11 Business Administration with a concentration in Finance from the University of  
12 Illinois at Springfield. I have also completed several graduate level economics  
13 courses.

14 In August of 1983, I accepted an analyst position with the Illinois  
15 Commerce Commission ("ICC"). In this position, I performed a variety of anal-  
16 yses for both formal and informal investigations before the ICC, including:  
17 marginal cost of energy, central dispatch, avoided cost of energy, annual system  
18 production costs, and working capital. In October of 1986, I was promoted to the  
19 position of Senior Analyst. In this position, I assumed the additional respon-  
20 sibilities of technical leader on projects, and my areas of responsibility were  
21 expanded to include utility financial modeling and financial analyses.

1           In 1987, I was promoted to Director of the Financial Analysis Department.  
2           In this position, I was responsible for all financial analyses conducted by the staff.  
3           Among other things, I conducted analyses and sponsored testimony before the  
4           ICC on rate of return, financial integrity, financial modeling and related issues. I  
5           also supervised the development of all Staff analyses and testimony on these  
6           same issues. In addition, I supervised the Staff's review and recommendations  
7           to the Commission concerning utility plans to issue debt and equity securities.

8           In August of 1989, I accepted a position with Merrill-Lynch as a financial  
9           consultant. After receiving all required securities licenses, I worked with indi-  
10          vidual investors and small businesses in evaluating and selecting investments  
11          suitable to their requirements.

12          In September of 1990, I accepted a position with Drazen-Brubaker &  
13          Associates, Inc. In April 1995, the firm of Brubaker & Associates, Inc. ("BAI")  
14          was formed. It includes most of the former DBA principals and Staff. Since  
15          1990, I have performed various analyses and sponsored testimony on cost of  
16          capital, cost/benefits of utility mergers and acquisitions, utility reorganizations,  
17          level of operating expenses and rate base, cost of service studies, and analyses  
18          relating industrial jobs and economic development. I also participated in a study  
19          used to revise the financial policy for the municipal utility in Kansas City, Kansas.

20          At BAI, I also have extensive experience working with large energy users  
21          to distribute and critically evaluate responses to requests for proposals ("RFPs")  
22          for electric, steam, and gas energy supply from competitive energy suppliers.  
23          These analyses include the evaluation of gas supply and delivery charges,  
24          cogeneration and/or combined cycle unit feasibility studies, and the evaluation of  
25          third-party asset/supply management agreements. I have also analyzed

1 commodity pricing indices and forward pricing methods for third party supply  
2 agreements, and have also conducted regional electric market price forecasts.

3 In addition to our main office in St. Louis, the firm also has branch offices  
4 in Phoenix, Arizona and Corpus Christi, Texas.

5 **Q HAVE YOU EVER TESTIFIED BEFORE A REGULATORY BODY?**

6 A Yes. I have sponsored testimony on cost of capital, revenue requirements, cost  
7 of service and other issues before the Federal Energy Regulatory Commission  
8 and numerous state regulatory commissions including: Arkansas, Arizona,  
9 California, Colorado, Delaware, Florida, Georgia, Idaho, Illinois, Indiana, Iowa,  
10 Kansas, Louisiana, Michigan, Missouri, Montana, New Jersey, New Mexico, New  
11 York, North Carolina, Oklahoma, Oregon, South Carolina, Tennessee, Texas,  
12 Utah, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming, and  
13 before the provincial regulatory boards in Alberta and Nova Scotia, Canada. I  
14 have also sponsored testimony before the Board of Public Utilities in Kansas  
15 City, Kansas; presented rate setting position reports to the regulatory board of  
16 the municipal utility in Austin, Texas, and Salt River Project, Arizona, on behalf of  
17 industrial customers; and negotiated rate disputes for industrial customers of the  
18 Municipal Electric Authority of Georgia in the LaGrange, Georgia district.

19 **Q PLEASE DESCRIBE ANY PROFESSIONAL REGISTRATIONS OR**  
20 **ORGANIZATIONS TO WHICH YOU BELONG.**

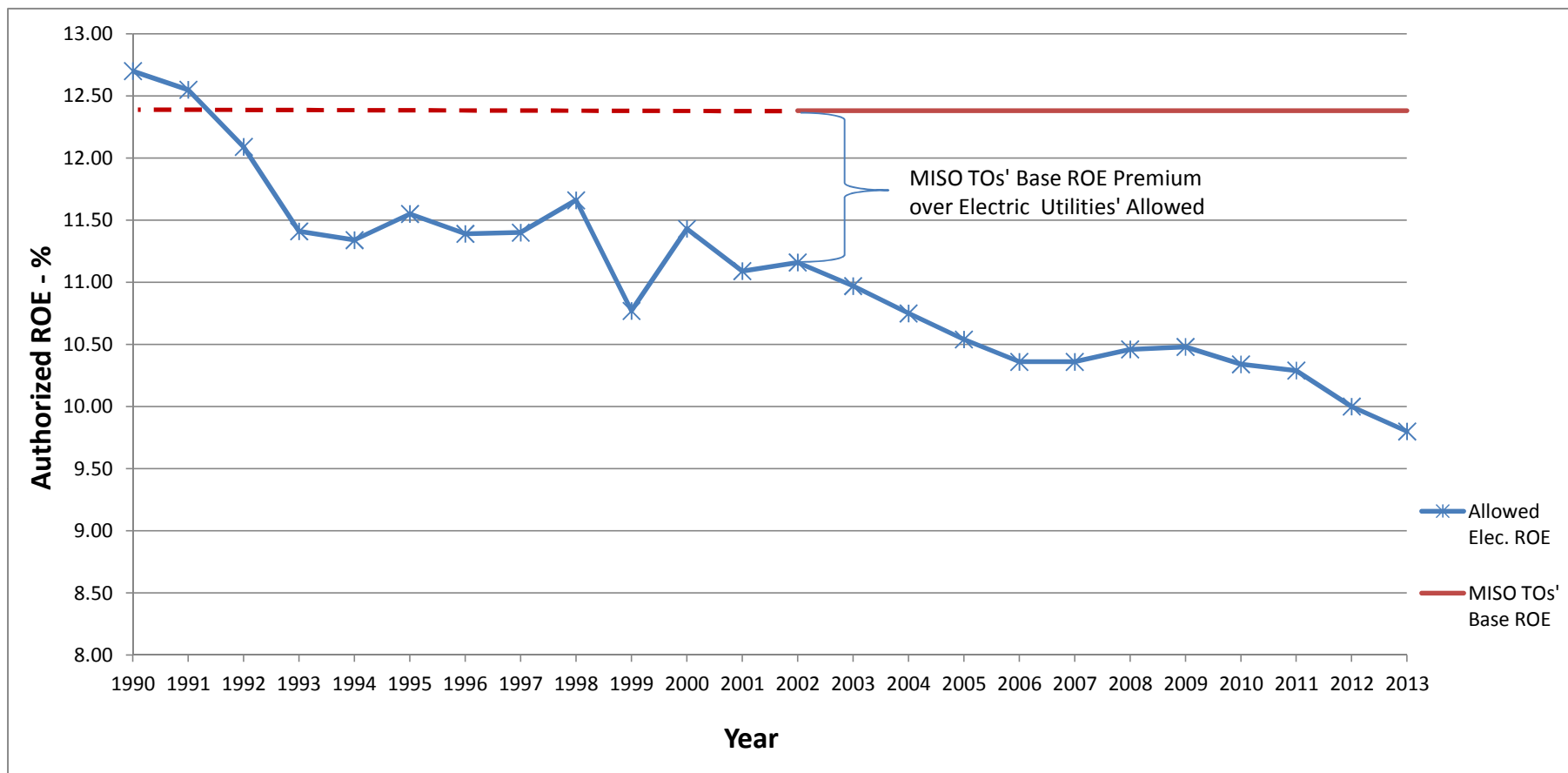
21 A I earned the designation of Chartered Financial Analyst ("CFA") from the CFA  
22 Institute. The CFA charter was awarded after successfully completing three  
23 examinations which covered the subject areas of financial accounting,



1 economics, fixed income and equity valuation and professional and ethical  
2 conduct. I am a member of the CFA Institute's Financial Analyst Society.

## Midcontinent ISO

### Comparison of MISO TOs' Base ROE with Authorized Electric ROEs



Source:

Regulatory Research Associates, Regulatory Focus: Major Rate Case Decisions--January-June 2013, July 9, 2013.

## Midcontinent ISO

### Revenue Requirements Impact

<u>Line</u>	<u>Transmission Owner</u>	<u>Current Revenue Requirement Base ROE*</u> (1)	<u>Reduce Base ROE to 9.15%</u> (2)	<u>Limit Common Equity Ratio to 50% &amp; 9.15% Base ROE</u> (3)	<u>1% Base ROE Reduction</u> (4)
1	ITC	\$ 163,609,272	\$ 126,741,556	\$ 114,909,780	\$ 152,195,119
2	METC	\$ 140,007,366	\$ 109,026,772	\$ 99,713,320	\$ 130,415,851
3	Northern States Power Co.	\$ 244,961,051	\$ 192,261,985	\$ 185,433,186	\$ 228,645,551
4	Northern Indiana Public Service Company	\$ 56,295,185	\$ 44,219,426	\$ 41,144,802	\$ 52,556,560
5	Duke Energy Indiana	\$ 64,206,059	\$ 50,548,830	\$ 50,598,380	\$ 59,977,815
6	Southern Indiana Gas & Electric	\$ 37,064,851	\$ 29,107,477	\$ 27,920,217	\$ 34,601,267
7	Minnesota Power (ALLETE)	\$ 31,611,847	\$ 24,630,875	\$ 23,368,849	\$ 29,450,555
8	ITC Midwest	\$ 207,707,862	\$ 160,829,794	\$ 145,707,141	\$ 193,194,528
9	Ameren Illinois	\$ 84,885,407	\$ 68,100,464	\$ 69,084,219	\$ 79,688,830
10	Ameren Missouri	\$ 49,618,888	\$ 39,426,722	\$ 38,966,871	\$ 46,463,419
11	Otter Tail Power	\$ 27,259,656	\$ 21,528,486	\$ 20,812,933	\$ 25,485,300
12	Indianapolis Power & Light	\$ 11,933,986	\$ 9,678,175	\$ 10,165,017	\$ 11,235,592
13	MDU Resources	\$ 10,653,902	\$ 8,462,208	\$ 8,339,966	\$ 9,975,359
14	MidAmerican Energy Co.	\$ 64,914,497	\$ 50,619,104	\$ 48,878,851	\$ 60,488,679
15	American Transmission Company, LLC	<u>\$ 339,041,427</u>	<u>\$ 271,146,541</u>	<u>\$ 271,146,541</u>	<u>\$ 316,780,809</u>
16	<b>Total Revenue Requirement</b>	\$ 1,533,771,257	\$ 1,206,328,418	\$ 1,156,190,073	\$ 1,431,155,235
17	<b>Change</b>		\$ 327,442,839	\$ 377,581,183	\$ 102,616,022

Source & Note:

June 2013 Attachment-O Filing. Downloaded from  
www.misoenergy.org on September 23, 2013.

\*The current base ROE for MISO is 12.38% except for ATC. ATC's current base ROE is 12.20%

## Midcontinent ISO

**MISO Transmission Owners**  
(Investor Owned Operating Subsidiaries)

Common Equity Ratio Group	Parent Company Ticker	Operating Company in MISO	Credit Ratings <sup>1</sup> S&P	Common Equity Ratio <sup>2</sup>					FERC Attachment-O Common Equity Ratio <sup>3/a</sup> 6/30/2013
				6/30/2013	12/31/2012	12/31/2011	12/31/2010	12/31/2009	
Below 50%	ETR	Entergy New Orleans, Inc.	BBB	38.42%	47.51%	49.30%	50.61%	41.67%	N/A
	ETR	Entergy Arkansas, Inc.	BBB	41.29%	45.09%	45.59%	44.92%	44.86%	N/A
	AES	Indianapolis Power & Light Company	BBB-	42.09%	43.47%	42.99%	43.28%	43.08%	43.51%
	ETR	Entergy Mississippi, Inc.	BBB	43.07%	41.80%	46.14%	45.20%	43.47%	N/A
	ETR	Entergy Gulf States Louisiana, L.L.C.	BBB	46.97%	49.87%	48.76%	51.04%	46.65%	N/A
	-	American Transmission Company, LLC	A+	38.31%	37.74%	39.43%	37.38%	41.86%	50.00%
	ETR	Entergy Texas, Inc.	BBB	48.28%	47.94%	49.23%	49.17%	50.75%	N/A
	Average		BBB	42.63%	44.78%	45.92%	45.94%	44.62%	46.75%
	Median		BBB	42.09%	45.09%	46.14%	45.20%	43.47%	46.75%
Between 50% and 55%	ETR	Entergy Louisiana, LLC	BBB	50.12%	52.84%	54.27%	52.28%	49.08%	N/A
	AEE	Ameren Missouri	BBB	50.87%	51.23%	51.53%	52.26%	50.81%	51.18%
	CNL	Cleco Power LLC	BBB+	51.08%	50.29%	48.08%	47.33%	45.45%	N/A
	DUK	Duke Energy Business Services, LLC. (d/b/a Duke Energy Indiana, Inc.)	BBB+	51.11%	49.42%	50.06%	50.90%	48.90%	49.91%
	XEL	Northern States Power Company - MN	A-	51.74%	52.10%	52.05%	51.14%	51.80%	53.69%
	OTTR	Otter Tail Power Company	BBB	52.27%	51.98%	50.28%	51.12%	48.11%	53.83%
	AEE	Ameren Transmission Company of Illinois	N/A	52.28%	46.01%	63.04%	N/A	N/A	55.95%
	BRK.A	MidAmerican Energy Company	A-	52.53%	52.35%	50.81%	50.34%	50.31%	53.08%
	ALE	Minnesota Power	N/A	54.13%	55.30%	56.92%	56.82%	58.65%	55.02%
	VVC	Southern Indiana Gas & Electric Company (Vectren)	A-	54.36%	52.34%	50.95%	49.33%	48.33%	54.39%
	Average		BBB+	52.05%	51.39%	52.80%	51.28%	50.16%	53.38%
	Median		BBB+	52.00%	52.04%	51.24%	51.12%	49.08%	53.76%
Higher than 55%	XEL	Northern States Power Company - WI	A-	55.18%	50.56%	54.59%	55.42%	56.29%	53.69%
	AEE	Ameren Illinois Company	BBB	57.23%	56.58%	58.41%	57.58%	N/A	52.98%
	NI	Northern Indiana Public Service Company	BBB-	59.95%	58.46%	60.49%	59.41%	58.18%	59.29%
	ITC <sup>b</sup>	Michigan Electric Transmission Company, LLC	BBB+	60.00%	60.03%	59.85%	60.90%	59.89%	60.00%
	ITC <sup>b</sup>	ITC Midwest LLC	BBB+	60.01%	60.03%	59.99%	59.99%	59.99%	60.00%
	ITC <sup>b</sup>	International Transmission Company	BBB+	60.03%	59.97%	60.03%	60.04%	59.99%	60.00%
	ALE	Superior Water, Light and Power Company	N/A	60.18%	55.83%	55.42%	56.59%	56.60%	55.02%
	MDU	Montana-Dakota Utilities Co. (division of MDU Resources Group, Inc.)	BBB+	88.35%	87.63%	90.32%	89.44%	89.62%	51.25%
		Average		BBB+	62.62%	61.14%	62.39%	62.42%	62.94%
	Median		BBB+	60.01%	59.21%	59.92%	59.70%	59.89%	57.15%
MISO Operating Company Average			BBB+	52.79%	52.65%	53.94%	53.44%	52.36%	
MISO Operating Company Range ( low / high )			BBB- / A+						

## Sources and Notes:

<sup>1</sup> SNL Financial<sup>2</sup> FERC Form-1 and FERC Form-3Q, downloaded from SNL Financial<sup>3</sup> June 2013 Attachment-O Filing. Downloaded from www.misoenergy.org on September 23, 2013.<sup>a</sup> N/A: Entergy and Cleco have not submitted Attachment O filings as of now, but are recognized as MISO Transmission Owners.<sup>b</sup> The parent company - ITC Holdings Corp. is a highly leveraged company and the operating subsidiaries' bond ratings are impacted by the parent company's leverage.

# Midcontinent ISO

## National Proxy Group

Line	Company	Credit Ratings <sup>1</sup>	Common Equity Ratios		S&P Business
		S&P (1)	SNL <sup>1</sup> (2)	Value Line <sup>2</sup> (3)	Risk Score <sup>3</sup> (4)
1	American Electric Power Company, Inc.	BBB	44.3%	49.4%	Excellent
2	Consolidated Edison, Inc.	A-	51.2%	54.1%	Excellent
3	Dominion Resources, Inc.	A-	32.6%	38.2%	Excellent
4	Duke Energy Corporation	BBB+	50.1%	52.9%	Excellent
5	Edison International	BBB-	45.8%	46.2%	Strong
6	FirstEnergy Corp.	BBB-	40.6%	46.3%	Strong
7	Great Plains Energy Inc.	BBB	46.9%	54.4%	Excellent
8	NextEra Energy, Inc.	A-	37.0%	40.9%	Strong
9	Northeast Utilities	A-	49.7%	55.4%	Excellent
10	Pepco Holdings, Inc.	BBB+	44.4%	52.7%	Excellent
11	PG&E Corporation	BBB	48.7%	50.4%	Strong
12	Pinnacle West Capital Corporation	BBB+	52.9%	55.4%	Excellent
13	PNM Resources, Inc.	BBB	45.5%	48.7%	Excellent
14	Portland General Electric Company	BBB	51.1%	52.9%	Excellent
15	Public Service Enterprise Group Incorporated	BBB+	56.7%	61.7%	Excellent
16	SCANA Corporation	BBB+	42.0%	45.6%	Excellent
17	Southern Company	A	43.8%	47.3%	Excellent
18	UIL Holdings Corporation	BBB	37.8%	41.1%	Excellent
19	Westar Energy, Inc.	BBB	45.4%	48.8%	Excellent
20	Xcel Energy Inc.	A-	44.6%	46.7%	Excellent
21	<b>Average</b>	<b>BBB+</b>	<b>45.6%</b>	<b>49.5%</b>	<b>Excellent</b>
22	<b>MISO TO Group Average</b>	<b>BBB+</b>			
23	<b>MISO TO Range ( low / high )</b>	<b>BBB- / A+</b>			

Sources:

<sup>1</sup> SNL Financial, Downloaded on October 15, 2013.

<sup>2</sup> *The Value Line Investment Survey*, August 2, August 23, and September 20, 2013.

<sup>3</sup> *S&P RatingsDirect*: "U.S. Regulated Utilities, Strongest To Weakest," July 30, 2013.

# Midcontinent ISO

## Regional Proxy Group

<u>Line</u>	<u>Company</u>	<u>Credit Ratings<sup>1</sup></u>	<u>Common Equity Ratios</u>		<u>S&amp;P Business</u>
		<u>S&amp;P</u> (1)	<u>SNL<sup>1</sup></u> (2)	<u>Value Line<sup>2</sup></u> (3)	<u>Risk Score<sup>3</sup></u> (4)
1	American Electric Power Company, Inc.	BBB	44.3%	49.4%	Excellent
2	Duke Energy Corporation	BBB+	50.1%	52.9%	Excellent
3	FirstEnergy Corp.	BBB-	40.6%	46.3%	Strong
4	Great Plains Energy Inc.	BBB	46.9%	54.4%	Excellent
5	Southern Company	A	43.8%	47.3%	Excellent
6	Westar Energy, Inc.	BBB	45.4%	48.8%	Excellent
7	Xcel Energy Inc.	A-	44.6%	46.7%	Excellent
8	<b>Average</b>	<b>BBB+</b>	<b>45.1%</b>	<b>49.4%</b>	<b>Excellent</b>
9	<b>MISO TO Group Average</b>	<b>BBB+</b>			
10	<b>MISO TO Range ( low / high )</b>	<b>BBB- / A+</b>			

Sources:

<sup>1</sup> SNL Financial, Downloaded on October 15, 2013.

<sup>2</sup> *The Value Line Investment Survey*, August 2, August 23, and September 20, 2013.

<sup>3</sup> *S&P RatingsDirect*: "U.S. Regulated Utilities, Strongest To Weakest," July 30, 2013.

## Midcontinent ISO

### Growth Rates (National Proxy Group)

<u>Line</u>	<u>Company</u>	<u>Reuters<sup>1</sup></u> <u>(I/B/E/S)</u> <u>(1)</u>	<u>Sustainable</u> <u>Growth<sup>2</sup></u> <u>(B x R)</u> <u>(2)</u>	<u>Average</u> <u>(3)</u>	<u>High</u> <u>(5)</u>	<u>Low</u> <u>(6)</u>
1	American Electric Power Company, Inc.	4.25%	4.25%	4.25%	4.25%	4.25%
2	Consolidated Edison, Inc.	1.78%	3.47%	2.63%	3.47%	1.78%
3	Dominion Resources, Inc.	6.78%	7.54%	7.16%	7.54%	6.78%
4	Duke Energy Corporation	3.85%	2.64%	3.25%	3.85%	2.64%
5	Edison International	1.42%	6.02%	3.72%	6.02%	1.42%
6	FirstEnergy Corp.	1.95%	1.04%	1.50%	1.95%	1.04%
7	Great Plains Energy Inc.	6.43%	3.26%	4.85%	6.43%	3.26%
8	NextEra Energy, Inc.	6.23%	7.29%	6.76%	7.29%	6.23%
9	Northeast Utilities	7.19%	4.38%	5.79%	7.19%	4.38%
10	Pepco Holdings, Inc.	3.82%	2.62%	3.22%	3.82%	2.62%
11	PG&E Corporation	3.37%	3.51%	3.44%	3.51%	3.37%
12	Pinnacle West Capital Corporation	4.72%	4.42%	4.57%	4.72%	4.42%
13	PNM Resources, Inc.	6.43%	4.62%	5.52%	6.43%	4.62%
14	Portland General Electric Company	6.22%	4.92%	5.57%	6.22%	4.92%
15	Public Service Enterprise Group Incorporated	0.67%	4.55%	2.61%	4.55%	0.67%
16	SCANA Corporation	4.73%	6.70%	5.71%	6.70%	4.73%
17	Southern Company	4.54%	5.28%	4.91%	5.28%	4.54%
18	UIL Holdings Corporation	6.64%	3.00%	4.82%	6.64%	3.00%
19	Westar Energy, Inc.	1.87%	4.61%	3.24%	4.61%	1.87%
20	Xcel Energy Inc.	5.45%	4.65%	5.05%	5.45%	4.65%
21	<b>Average</b>	<b>4.42%</b>	<b>4.44%</b>	<b>4.43%</b>	<b>5.30%</b>	<b>3.56%</b>
22	<b>Median</b>	<b>4.63%</b>	<b>4.48%</b>	<b>4.69%</b>		

Sources:

<sup>1</sup> Reuters, <http://www.reuters.com/>, downloaded on October 15, 2013.

<sup>2</sup> Exhibit MPG-8, page 1.

## Midcontinent ISO

### Growth Rates (National Proxy Group)

<u>Line</u>	<u>Company</u>	Reuters <sup>1</sup>	
		<u>I/B/E/S</u> (1)	<u>Number of</u> <u>Analysts Reporting</u> (2)
1	American Electric Power Company, Inc.	4.25%	6
2	Consolidated Edison, Inc.	1.78%	3
3	Dominion Resources, Inc.	6.78%	4
4	Duke Energy Corporation	3.85%	7
5	Edison International	1.42%	6
6	FirstEnergy Corp.	1.95%	6
7	Great Plains Energy Inc.	6.43%	3
8	NextEra Energy, Inc.	6.23%	5
9	Northeast Utilities	7.19%	6
10	Pepco Holdings, Inc.	3.82%	5
11	PG&E Corporation	3.37%	4
12	Pinnacle West Capital Corporation	4.72%	4
13	PNM Resources, Inc.	6.43%	3
14	Portland General Electric Company	6.22%	4
15	Public Service Enterprise Group Incorporated	0.67%	4
16	SCANA Corporation	4.73%	3
17	Southern Company	4.54%	6
18	UIL Holdings Corporation	6.64%	6
19	Westar Energy, Inc.	1.87%	3
20	Xcel Energy Inc.	5.45%	5
<b>21</b>	<b>Average</b>	<b>4.42%</b>	<b>5</b>

Sources:

<sup>1</sup> Reuters, <http://www.reuters.com/>, downloaded on October 15, 2013.



# Midcontinent ISO

## Growth Rates (Regional Proxy Group)

<u>Line</u>	<u>Company</u>	<u>Reuters<sup>1</sup></u> <u>(I/B/E/S)</u> <u>(1)</u>	<u>Sustainable</u> <u>Growth<sup>2</sup></u> <u>(B x R)</u> <u>(2)</u>	<u>Average</u> <u>(3)</u>	<u>High</u> <u>(5)</u>	<u>Low</u> <u>(6)</u>
1	American Electric Power Company, Inc.	4.25%	4.25%	4.25%	4.25%	4.25%
2	Duke Energy Corporation	3.85%	2.64%	3.25%	3.85%	2.64%
3	FirstEnergy Corp.	1.95%	1.04%	1.50%	1.95%	1.04%
4	Great Plains Energy Inc.	6.43%	3.26%	4.85%	6.43%	3.26%
5	Southern Company	4.54%	5.28%	4.91%	5.28%	4.54%
6	Westar Energy, Inc.	1.87%	4.61%	3.24%	4.61%	1.87%
7	Xcel Energy Inc.	5.45%	4.65%	5.05%	5.45%	4.65%
8	<b>Average</b>	<b>4.05%</b>	<b>3.68%</b>	<b>3.86%</b>	<b>4.55%</b>	<b>3.18%</b>
9	<b>Median</b>	<b>4.25%</b>	<b>4.25%</b>	<b>4.25%</b>		

Sources:

<sup>1</sup> Reuters, <http://www.reuters.com/>, downloaded on October 15, 2013.

<sup>2</sup> Exhibit MPG-9, page 1.

## Midcontinent ISO

### Growth Rates (Regional Proxy Group)

<u>Line</u>	<u>Company</u>	<u>Reuters<sup>1</sup></u>	
		<u>I/B/E/S</u> (1)	<u>Number of</u> <u>Analysts Reporting</u> (2)
1	American Electric Power Company, Inc.	4.25%	6
2	Duke Energy Corporation	3.85%	7
3	FirstEnergy Corp.	1.95%	6
4	Great Plains Energy Inc.	6.43%	3
5	Southern Company	4.54%	6
6	Westar Energy, Inc.	1.87%	3
7	Xcel Energy Inc.	5.45%	5
8	<b>Average</b>	<b>4.05%</b>	<b>5</b>

Sources:

<sup>1</sup> Reuters, <http://www.reuters.com/>, downloaded on October 15, 2013.

## Midcontinent ISO

### Sustainable Growth Rate ( B x R ) (National Proxy Group)

Line	Company	3 to 5 Year Projections										Sustainable Growth Rate
		Dividends	Earnings	Book Value	Book Value	ROE	Adjustment	Adjusted	Payout	Retention	Internal	
		Per Share	Per Share	Per Share	Growth	ROE	Factor	ROE	Ratio	Rate	Growth Rate	
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1	American Electric Power Company, Inc.	\$2.30	\$3.75	\$38.00	3.91%	9.87%	1.02	10.06%	61.33%	38.67%	3.89%	4.25%
2	Consolidated Edison, Inc.	\$2.62	\$4.25	\$47.75	3.33%	8.90%	1.02	9.05%	61.65%	38.35%	3.47%	3.47%
3	Dominion Resources, Inc.	\$2.70	\$3.75	\$25.50	6.80%	14.71%	1.03	15.19%	72.00%	28.00%	4.25%	7.54%
4	Duke Energy Corporation	\$3.35	\$5.00	\$63.75	1.89%	7.84%	1.01	7.92%	67.00%	33.00%	2.61%	2.64%
5	Edison International	\$1.80	\$4.00	\$37.50	5.31%	10.67%	1.03	10.94%	45.00%	55.00%	6.02%	6.02%
6	FirstEnergy Corp.	\$2.20	\$2.50	\$33.00	1.07%	7.58%	1.01	7.62%	88.00%	12.00%	0.91%	1.04%
7	Great Plains Energy Inc.	\$1.20	\$2.00	\$25.00	2.82%	8.00%	1.01	8.11%	60.00%	40.00%	3.24%	3.26%
8	NextEra Energy, Inc.	\$3.60	\$6.50	\$52.75	6.84%	12.32%	1.03	12.73%	55.38%	44.62%	5.68%	7.29%
9	Northeast Utilities	\$1.80	\$3.25	\$34.75	3.39%	9.35%	1.02	9.51%	55.38%	44.62%	4.24%	4.38%
10	Pepco Holdings, Inc.	\$1.16	\$1.70	\$21.50	2.15%	7.91%	1.01	7.99%	68.24%	31.76%	2.54%	2.62%
11	PG&E Corporation	\$2.10	\$3.00	\$35.25	3.04%	8.51%	1.01	8.64%	70.00%	30.00%	2.59%	3.51%
12	Pinnacle West Capital Corporation	\$2.60	\$4.25	\$43.25	3.62%	9.83%	1.02	10.00%	61.18%	38.82%	3.88%	4.42%
13	PNM Resources, Inc.	\$1.08	\$2.15	\$23.60	3.31%	9.11%	1.02	9.26%	50.23%	49.77%	4.61%	4.62%
14	Portland General Electric Company	\$1.25	\$2.25	\$26.75	3.18%	8.41%	1.02	8.54%	55.56%	44.44%	3.80%	4.92%
15	Public Service Enterprise Group Incorporated	\$1.55	\$2.75	\$27.00	4.85%	10.19%	1.02	10.43%	56.36%	43.64%	4.55%	4.55%
16	SCANA Corporation	\$2.25	\$4.00	\$40.75	5.30%	9.82%	1.03	10.07%	56.25%	43.75%	4.41%	6.70%
17	Southern Company	\$2.30	\$3.25	\$25.75	4.07%	12.62%	1.02	12.87%	70.77%	29.23%	3.76%	5.28%
18	UIL Holdings Corporation	\$1.73	\$2.55	\$28.45	5.32%	8.96%	1.03	9.20%	67.84%	32.16%	2.96%	3.00%
19	Westar Energy, Inc.	\$1.52	\$2.70	\$29.65	5.31%	9.11%	1.03	9.34%	56.30%	43.70%	4.08%	4.61%
20	Xcel Energy Inc.	\$1.35	\$2.25	\$23.00	4.80%	9.78%	1.02	10.01%	60.00%	40.00%	4.00%	4.65%
21	<b>Average</b>	<b>\$2.02</b>	<b>\$3.29</b>	<b>\$34.15</b>	<b>4.02%</b>	<b>9.67%</b>	<b>1.02</b>	<b>9.87%</b>	<b>61.92%</b>	<b>38.08%</b>	<b>3.78%</b>	<b>4.44%</b>

Sources and Notes:

Cols. (1), (2) and (3): *The Value Line Investment Survey*, August 2, August 23, and September 20, 2013.

Col. (4): [ Col. (3) / Page 2 Col. (2) ] ^ (1/5) - 1.

Col. (5): Col. (2) / Col. (3).

Col. (6): [ 2 \* (1 + Col. (4)) ] / (2 + Col. (4)).

Col. (7): Col. (6) \* Col. (5).

Col. (8): Col. (1) / Col. (2).

Col. (9): 1 - Col. (8).

Col. (10): Col. (9) \* Col. (7).

Col. (11): Col. (10) + Page 2 Col. (9).

## Midcontinent ISO

### Sustainable Growth Rate ( B x R ) (National Proxy Group)

Line	Company	26-Week	2012	Market	Common Shares		Growth	S Factor <sup>3</sup>	V Factor <sup>4</sup>	S * V <sup>5</sup>
		Average	Book Value	to Book	Outstanding (in Millions) <sup>2</sup>					
		Stock Price <sup>1</sup>	Per Share <sup>2</sup>	Ratio	2012	3-5 Years	(6)	(7)	(8)	(9)
		(1)	(2)	(3)	(4)	(5)				
1	American Electric Power Company, Inc.	\$45.75	\$31.37	1.46	485.67	505.00	0.78%	1.14%	31.43%	0.36%
2	Consolidated Edison, Inc.	\$58.34	\$40.53	1.44	292.87	293.00	0.01%	0.01%	30.53%	0.00%
3	Dominion Resources, Inc.	\$59.06	\$18.35	3.22	576.00	620.00	1.48%	4.77%	68.93%	3.29%
4	Duke Energy Corporation	\$69.00	\$58.04	1.19	704.00	710.00	0.17%	0.20%	15.89%	0.03%
5	Edison International	\$47.94	\$28.95	1.66	325.81	325.81	0.00%	0.00%	39.61%	0.00%
6	FirstEnergy Corp.	\$39.29	\$31.29	1.26	418.22	429.00	0.51%	0.64%	20.35%	0.13%
7	Great Plains Energy Inc.	\$23.00	\$21.75	1.06	153.53	156.00	0.32%	0.34%	5.44%	0.02%
8	NextEra Energy, Inc.	\$80.95	\$37.90	2.14	424.00	455.00	1.42%	3.04%	53.18%	1.61%
9	Northeast Utilities	\$42.54	\$29.41	1.45	314.05	319.00	0.31%	0.45%	30.87%	0.14%
10	Pepco Holdings, Inc.	\$20.13	\$19.33	1.04	230.02	255.00	2.08%	2.17%	3.95%	0.09%
11	PG&E Corporation	\$44.43	\$30.35	1.46	430.72	475.00	1.98%	2.89%	31.68%	0.92%
12	Pinnacle West Capital Corporation	\$56.78	\$36.20	1.57	109.74	115.00	0.94%	1.48%	36.24%	0.53%
13	PNM Resources, Inc.	\$22.73	\$20.05	1.13	79.65	80.00	0.09%	0.10%	11.78%	0.01%
14	Portland General Electric Company	\$30.33	\$22.87	1.33	75.56	89.50	3.44%	4.57%	24.58%	1.12%
15	Public Service Enterprise Group Incorporated	\$33.50	\$21.31	1.57	505.89	506.00	0.00%	0.01%	36.39%	0.00%
16	SCANA Corporation	\$49.85	\$31.47	1.58	132.00	160.00	3.92%	6.21%	36.88%	2.29%
17	Southern Company	\$44.02	\$21.09	2.09	867.77	930.00	1.39%	2.91%	52.09%	1.52%
18	UIL Holdings Corporation	\$39.01	\$21.95	1.78	50.87	51.00	0.05%	0.09%	43.73%	0.04%
19	Westar Energy, Inc.	\$32.15	\$22.89	1.40	126.50	135.00	1.31%	1.84%	28.80%	0.53%
20	Xcel Energy Inc.	\$29.00	\$18.19	1.59	487.96	515.00	1.08%	1.73%	37.28%	0.64%
21	<b>Average</b>	<b>\$43.39</b>	<b>\$28.16</b>	<b>1.57</b>	<b>339.54</b>	<b>356.22</b>	<b>1.07%</b>	<b>1.73%</b>	<b>31.98%</b>	<b>0.66%</b>

Sources and Notes:

<sup>1</sup> SNL Financial, downloaded on October 15, 2013.

<sup>2</sup> *The Value Line Investment Survey*, August 2, August 23, and September 20, 2013.

<sup>3</sup> Expected Growth in the Number of Shares, Column (3) \* Column (6).

<sup>4</sup> Expected Profit of Stock Investment, [ 1 - 1 / Column (3) ].

## Midcontinent ISO

### Sustainable Growth Rate ( B x R )

(Regional Proxy Group)

<u>Line</u>	<u>Company</u>	<u>3 to 5 Year Projections</u>										<u>Sustainable Growth Rate</u>
		<u>Dividends</u>	<u>Earnings</u>	<u>Book Value</u>	<u>Book Value</u>		<u>Adjustment</u>	<u>Adjusted</u>	<u>Payout</u>	<u>Retention</u>	<u>Internal</u>	
		<u>Per Share</u>	<u>Per Share</u>	<u>Per Share</u>	<u>Growth</u>	<u>ROE</u>	<u>Factor</u>	<u>ROE</u>	<u>Ratio</u>	<u>Rate</u>	<u>Growth Rate</u>	
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
1	American Electric Power Company, Inc.	\$2.30	\$3.75	\$38.00	3.91%	9.87%	1.02	10.06%	61.33%	38.67%	3.89%	4.25%
2	Duke Energy Corporation	\$3.35	\$5.00	\$63.75	1.89%	7.84%	1.01	7.92%	67.00%	33.00%	2.61%	2.64%
3	FirstEnergy Corp.	\$2.20	\$2.50	\$33.00	1.07%	7.58%	1.01	7.62%	88.00%	12.00%	0.91%	1.04%
4	Great Plains Energy Inc.	\$1.20	\$2.00	\$25.00	2.82%	8.00%	1.01	8.11%	60.00%	40.00%	3.24%	3.26%
5	Southern Company	\$2.30	\$3.25	\$25.75	4.07%	12.62%	1.02	12.87%	70.77%	29.23%	3.76%	5.28%
6	Westar Energy, Inc.	\$1.52	\$2.70	\$29.65	5.31%	9.11%	1.03	9.34%	56.30%	43.70%	4.08%	4.61%
7	Xcel Energy Inc.	\$1.35	\$2.25	\$23.00	4.80%	9.78%	1.02	10.01%	60.00%	40.00%	4.00%	4.65%
8	<b>Average</b>	<b>\$2.03</b>	<b>\$3.06</b>	<b>\$34.02</b>	<b>3.41%</b>	<b>9.26%</b>	<b>1.02</b>	<b>9.42%</b>	<b>66.20%</b>	<b>33.80%</b>	<b>3.22%</b>	<b>3.68%</b>

Sources and Notes:

Cols. (1), (2) and (3): *The Value Line Investment Survey*, August 2, August 23, and September 20, 2013.

Col. (4): [ Col. (3) / Page 2 Col. (2) ] ^ (1/5) - 1.

Col. (5): Col. (2) / Col. (3).

Col. (6): [ 2 \* (1 + Col. (4)) ] / (2 + Col. (4)).

Col. (7): Col. (6) \* Col. (5).

Col. (8): Col. (1) / Col. (2).

Col. (9): 1 - Col. (8).

Col. (10): Col. (9) \* Col. (7).

Col. (11): Col. (10) + Page 2 Col. (9).

## Midcontinent ISO

### Sustainable Growth Rate ( B x R ) (Regional Proxy Group)

<u>Line</u>	<u>Company</u>	<u>26-Week</u>	<u>2012</u>	<u>Market</u>	<u>Common Shares</u>		<u>Growth</u>	<u>S Factor</u> <sup>3</sup>	<u>V Factor</u> <sup>4</sup>	<u>S * V</u> <sup>5</sup>
		<u>Average</u>	<u>Book Value</u>	<u>to Book</u>	<u>Outstanding (in Millions)</u> <sup>2</sup>					
		<u>Stock Price</u> <sup>1</sup>	<u>Per Share</u> <sup>2</sup>	<u>Ratio</u>	<u>2012</u>	<u>3-5 Years</u>	<u>(6)</u>	<u>(7)</u>	<u>(8)</u>	<u>(9)</u>
		(1)	(2)	(3)	(4)	(5)				
1	American Electric Power Company, Inc.	\$45.75	\$31.37	1.46	485.67	505.00	0.78%	1.14%	31.43%	0.36%
2	Duke Energy Corporation	\$69.00	\$58.04	1.19	704.00	710.00	0.17%	0.20%	15.89%	0.03%
3	FirstEnergy Corp.	\$39.29	\$31.29	1.26	418.22	429.00	0.51%	0.64%	20.35%	0.13%
4	Great Plains Energy Inc.	\$23.00	\$21.75	1.06	153.53	156.00	0.32%	0.34%	5.44%	0.02%
5	Southern Company	\$44.02	\$21.09	2.09	867.77	930.00	1.39%	2.91%	52.09%	1.52%
6	Westar Energy, Inc.	\$32.15	\$22.89	1.40	126.50	135.00	1.31%	1.84%	28.80%	0.53%
7	Xcel Energy Inc.	\$29.00	\$18.19	1.59	487.96	515.00	1.08%	1.73%	37.28%	0.64%
8	<b>Average</b>	<b>\$40.32</b>	<b>\$29.23</b>	<b>1.44</b>	<b>463.38</b>	<b>482.86</b>	<b>0.80%</b>	<b>1.26%</b>	<b>27.33%</b>	<b>0.46%</b>

## Sources and Notes:

<sup>1</sup> SNL Financial, downloaded on October 15, 2013.<sup>2</sup> *The Value Line Investment Survey*, August 2, August 23, and September 20, 2013.<sup>3</sup> Expected Growth in the Number of Shares, Column (3) \* Column (6).<sup>4</sup> Expected Profit of Stock Investment, [ 1 - 1 / Column (3) ].

## Midcontinent ISO

### Constant Growth DCF Model (National Proxy Group)

<u>Line</u>	<u>Company</u>	<u>26-Week Dividend Yield<sup>1</sup></u>		<u>Adjusted Dividend Yield</u>		<u>Growth Rates<sup>2</sup></u>		<u>Cost of Equity</u>	
		<u>Low</u> (1)	<u>High</u> (2)	<u>Low</u> (3)	<u>High</u> (4)	<u>Low</u> (5)	<u>High</u> (6)	<u>Low</u> (7)	<u>High</u> (8)
1	American Electric Power Company, Inc.	3.64%	4.69%	3.72%	4.79%	4.25%	4.25%	7.97%	9.04%
2	Consolidated Edison, Inc.	3.84%	4.53%	3.88%	4.61%	1.78%	3.47%	5.66%	8.08%
3	Dominion Resources, Inc.	3.51%	4.18%	3.63%	4.34%	6.78%	7.54%	10.41%	11.88%
4	Duke Energy Corporation	4.05%	4.86%	4.11%	4.96%	2.64%	3.85%	6.75%	8.81%
5	Edison International	2.49%	3.05%	2.51%	3.14%	1.42%	6.02%	3.93%	9.16%
6	FirstEnergy Corp.	4.70%	6.20%	4.73%	6.26%	1.04%	1.95%	5.77%	8.21%
7	Great Plains Energy Inc.	3.53%	4.05%	3.59%	4.19%	3.26%	6.43%	6.85%	10.62%
8	NextEra Energy, Inc.	2.99%	3.53%	3.08%	3.66%	6.23%	7.29%	9.31%	10.95%
9	Northeast Utilities	3.22%	3.74%	3.29%	3.87%	4.38%	7.19%	7.67%	11.06%
10	Pepco Holdings, Inc.	4.75%	5.99%	4.82%	6.10%	2.62%	3.82%	7.44%	9.92%
11	PG&E Corporation	3.75%	4.56%	3.82%	4.64%	3.37%	3.51%	7.19%	8.14%
12	Pinnacle West Capital Corporation	3.52%	4.23%	3.60%	4.33%	4.42%	4.72%	8.02%	9.05%
13	PNM Resources, Inc.	2.71%	3.13%	2.77%	3.23%	4.62%	6.43%	7.39%	9.66%
14	Portland General Electric Company	3.28%	3.99%	3.36%	4.11%	4.92%	6.22%	8.28%	10.33%
15	Public Service Enterprise Group Incorporated	3.89%	4.64%	3.90%	4.75%	0.67%	4.55%	4.57%	9.30%
16	SCANA Corporation	3.73%	4.54%	3.82%	4.69%	4.73%	6.70%	8.55%	11.39%
17	Southern Company	4.02%	5.03%	4.11%	5.16%	4.54%	5.28%	8.65%	10.44%
18	UIL Holdings Corporation	4.10%	4.78%	4.16%	4.94%	3.00%	6.64%	7.16%	11.58%
19	Westar Energy, Inc.	3.89%	4.57%	3.93%	4.67%	1.87%	4.61%	5.80%	9.28%
20	Xcel Energy Inc.	3.40%	4.16%	3.48%	4.28%	4.65%	5.45%	8.13%	9.73%
21	<b>Average</b>	<b>3.65%</b>	<b>4.42%</b>	<b>3.71%</b>	<b>4.54%</b>	<b>3.56%</b>	<b>5.30%</b>	<b>7.27%</b>	<b>9.83%</b>
22	<b>Median</b>					<b>3.81%</b>	<b>5.36%</b>	<b>7.41%</b>	<b>9.69%</b>
23	<b>Average Excluding Outliers</b>							<b>7.98%</b>	<b>10.17%</b>
24	<b>Median Excluding Outliers</b>							<b>7.97%</b>	<b>10.33%</b>
25	<b>Midpoint of the Medians</b>							<b>9.15%</b>	
	<b>Excluding Outliers</b>								
26	<b>Highest Extreme</b>								<b>11.88%</b>
27	<b>Lowest Extreme</b>							<b>6.75%</b>	
28	<b>Average</b>							<b>9.32%</b>	

Sources:

<sup>1</sup> SNL Financial.<sup>2</sup> Exhibit MPG-6.

## Midcontinent ISO

### Constant Growth DCF Model (Regional Proxy Group)

<u>Line</u>	<u>Company</u>	<u>26-Week Dividend Yield<sup>1</sup></u>		<u>Adjusted Dividend Yield</u>		<u>Growth Rates<sup>2</sup></u>		<u>Cost of Equity</u>	
		<u>Low</u> (1)	<u>High</u> (2)	<u>Low</u> (3)	<u>High</u> (4)	<u>Low</u> (5)	<u>High</u> (6)	<u>Low</u> (7)	<u>High</u> (8)
1	American Electric Power Company, Inc.	3.64%	4.69%	3.72%	4.79%	4.25%	4.25%	7.97%	9.04%
2	Duke Energy Corporation	4.05%	4.86%	4.11%	4.96%	2.64%	3.85%	6.75%	8.81%
3	FirstEnergy Corp.	4.70%	6.20%	4.73%	6.26%	1.04%	1.95%	5.77%	8.21%
4	Great Plains Energy Inc.	3.53%	4.05%	3.59%	4.19%	3.26%	6.43%	6.85%	10.62%
5	Southern Company	4.02%	5.03%	4.11%	5.16%	4.54%	5.28%	8.65%	10.44%
6	Westar Energy, Inc.	3.89%	4.57%	3.93%	4.67%	1.87%	4.61%	5.80%	9.28%
7	Xcel Energy Inc.	3.40%	4.16%	3.48%	4.28%	4.65%	5.45%	8.13%	9.73%
8	<b>Average</b>	<b>3.89%</b>	<b>4.80%</b>	<b>3.95%</b>	<b>4.90%</b>	<b>3.18%</b>	<b>4.55%</b>	<b>7.13%</b>	<b>9.45%</b>
9	<b>Median</b>					<b>3.26%</b>	<b>4.61%</b>	<b>6.85%</b>	<b>9.28%</b>
10	<b>Average Excluding Outliers</b>							<b>7.67%</b>	<b>9.73%</b>
11	<b>Median Excluding Outliers</b>							<b>7.97%</b>	<b>9.73%</b>
12	<b>Midpoint of the Medians</b>								<b>8.85%</b>
	<b><u>Excluding Outliers</u></b>								
13	<b>Highest Extreme</b>								<b>10.62%</b>
14	<b>Lowest Extreme</b>							<b>6.75%</b>	
15	<b>Average</b>								<b>8.68%</b>

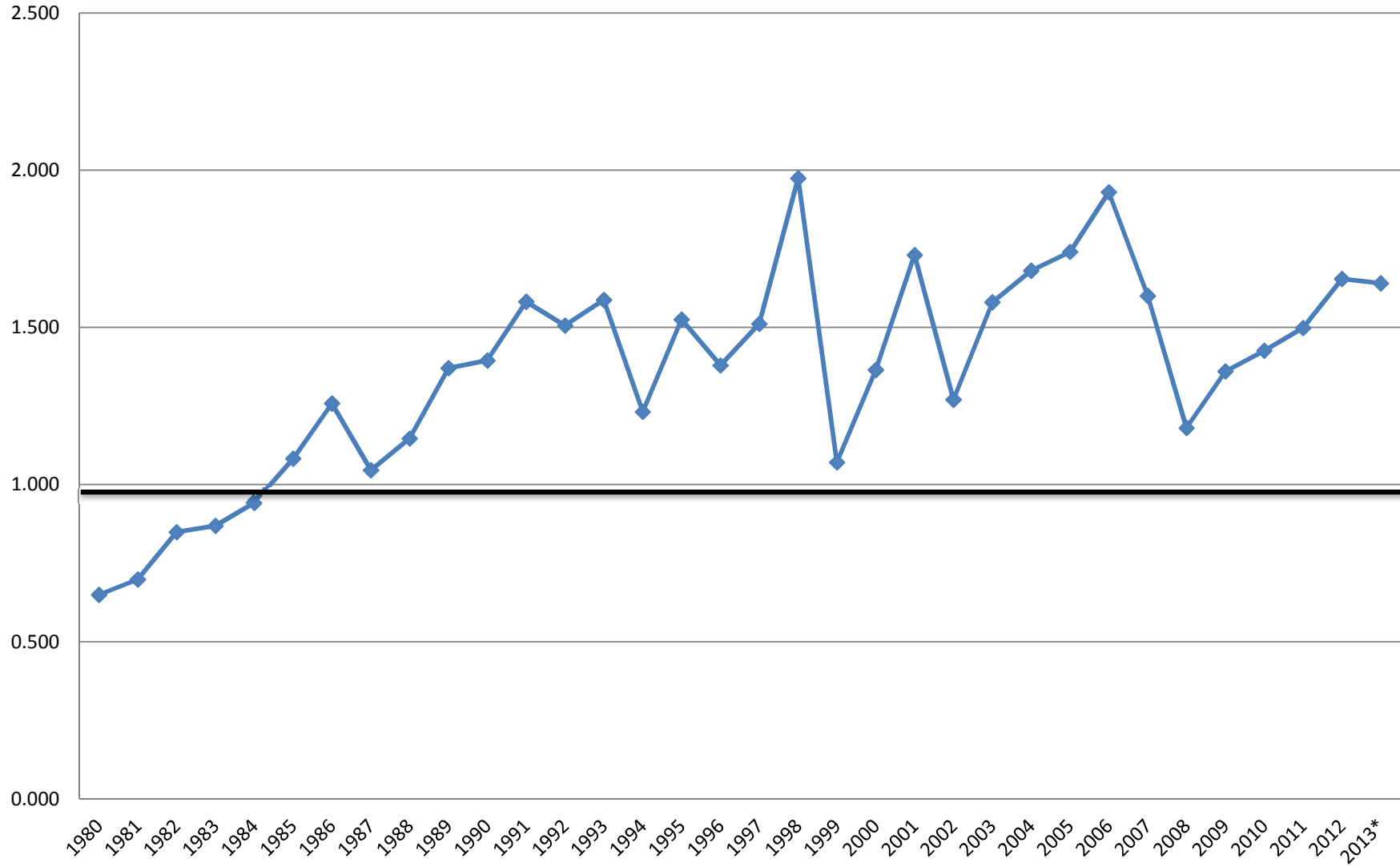
Sources:

<sup>1</sup> SNL Financial.<sup>2</sup> Exhibit MPG-7.



# Midcontinent ISO

## Common Stock Market/Book Ratio



\* Jan - Jun 2013

# Midcontinent ISO

## Equity Risk Premium - Treasury Bond

<u>Line</u>	<u>Year</u>	<u>Authorized Electric Returns<sup>1</sup></u> (1)	<u>Treasury Bond Yield<sup>2</sup></u> (2)	<u>Indicated Risk Premium</u> (3)
1	1986	13.93%	7.80%	6.13%
2	1987	12.99%	8.58%	4.41%
3	1988	12.79%	8.96%	3.83%
4	1989	12.97%	8.45%	4.52%
5	1990	12.70%	8.61%	4.09%
6	1991	12.55%	8.14%	4.41%
7	1992	12.09%	7.67%	4.42%
8	1993	11.41%	6.60%	4.81%
9	1994	11.34%	7.37%	3.97%
10	1995	11.55%	6.88%	4.67%
11	1996	11.39%	6.70%	4.69%
12	1997	11.40%	6.61%	4.79%
13	1998	11.66%	5.58%	6.08%
14	1999	10.77%	5.87%	4.90%
15	2000	11.43%	5.94%	5.49%
16	2001	11.09%	5.49%	5.60%
17	2002	11.16%	5.43%	5.73%
18	2003	10.97%	4.96%	6.01%
19	2004	10.75%	5.05%	5.70%
20	2005	10.54%	4.65%	5.89%
21	2006	10.36%	4.99%	5.37%
22	2007	10.36%	4.83%	5.53%
23	2008	10.46%	4.28%	6.18%
24	2009	10.48%	4.07%	6.41%
25	2010	10.34%	4.25%	6.09%
26	2011	10.22%	3.91%	6.31%
27	2012	10.01%	2.92%	7.09%
28	2013 <sup>3</sup>	9.80%	3.14%	6.66%
29	<b>Average</b>	<b>11.34%</b>	<b>5.99%</b>	<b>5.35%</b>

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Sources & Notes:

<sup>1</sup> Regulatory Research Associates, Inc., *Regulatory Focus*, Jan. 85 - Dec. 06, and October 8, 2013, excluding the Virginia cases, which are subject to a 200 basis point adjustment for certain generation assets.

<sup>2</sup> St. Louis Federal Reserve: Economic Research, <http://research.stlouisfed.org/>. The yields from 2002 to 2005 represent the 20-Year Treasury yields obtained from the Federal Reserve Bank.

<sup>3</sup> The data includes the period Jan - Jun 2013.

# Midcontinent ISO

## Equity Risk Premium - Utility Bond

<u>Line</u>	<u>Year</u>	<u>Authorized Electric Returns<sup>1</sup></u> (1)	<u>Average "A" Rated Utility Bond Yield<sup>2</sup></u> (2)	<u>Indicated Risk Premium</u> (3)
1	1986	13.93%	9.58%	4.35%
2	1987	12.99%	10.10%	2.89%
3	1988	12.79%	10.49%	2.30%
4	1989	12.97%	9.77%	3.20%
5	1990	12.70%	9.86%	2.84%
6	1991	12.55%	9.36%	3.19%
7	1992	12.09%	8.69%	3.40%
8	1993	11.41%	7.59%	3.82%
9	1994	11.34%	8.31%	3.03%
10	1995	11.55%	7.89%	3.66%
11	1996	11.39%	7.75%	3.64%
12	1997	11.40%	7.60%	3.80%
13	1998	11.66%	7.04%	4.62%
14	1999	10.77%	7.62%	3.15%
15	2000	11.43%	8.24%	3.19%
16	2001	11.09%	7.76%	3.33%
17	2002	11.16%	7.37%	3.79%
18	2003	10.97%	6.58%	4.39%
19	2004	10.75%	6.16%	4.59%
20	2005	10.54%	5.65%	4.89%
21	2006	10.36%	6.07%	4.29%
22	2007	10.36%	6.07%	4.29%
23	2008	10.46%	6.53%	3.93%
24	2009	10.48%	6.04%	4.44%
25	2010	10.34%	5.46%	4.88%
26	2011	10.22%	5.04%	5.18%
27	2012	10.01%	4.13%	5.88%
28	2013 <sup>3</sup>	9.80%	4.20%	5.60%
29	<b>Average</b>	<b>11.34%</b>	<b>7.39%</b>	<b>3.95%</b>

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Sources & Notes:

<sup>1</sup> Regulatory Research Associates, Inc., *Regulatory Focus*, Jan. 85 - Dec. 06, and October 8, 2013, excluding the Virginia cases, which are subject to a 200 basis point adjustment for certain generation assets.

<sup>2</sup> Mergent Public Utility Manual, Mergent Weekly News Reports, 2003. The utility yields for the period 2001-2009 were obtained from the Mergent Bond Record. The utility yields from 2010-2011 were obtained from <http://credittrends.moodys.com/>.

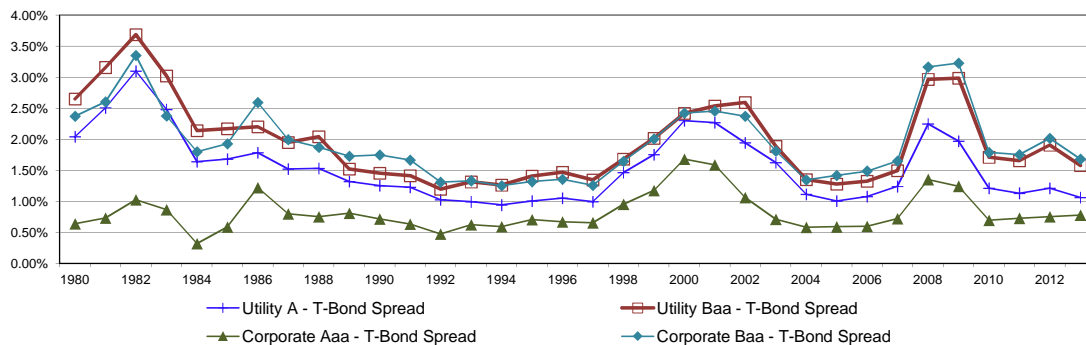
<sup>3</sup> The data includes the period Jan - Jun 2013.

# Midcontinent ISO

## Bond Yield Spreads

Line	Year	Public Utility Bond					Corporate Bond				Utility to Corporate	
		T-Bond Yield <sup>1</sup> (1)	A <sup>2</sup> (2)	Baa <sup>2</sup> (3)	A-T-Bond Spread (4)	Baa-T-Bond Spread (5)	Aaa <sup>1</sup> (6)	Baa <sup>1</sup> (7)	Aaa-T-Bond Spread (8)	Baa-T-Bond Spread (9)	Baa Spread (10)	A - Aaa Spread (11)
1	1980	11.30%	13.34%	13.95%	2.04%	2.65%	11.94%	13.67%	0.64%	2.37%	0.28%	1.40%
2	1981	13.44%	15.95%	16.60%	2.51%	3.16%	14.17%	16.04%	0.73%	2.60%	0.56%	1.78%
3	1982	12.76%	15.86%	16.45%	3.10%	3.69%	13.79%	16.11%	1.03%	3.35%	0.34%	2.07%
4	1983	11.18%	13.66%	14.20%	2.48%	3.02%	12.04%	13.55%	0.86%	2.38%	0.65%	1.62%
5	1984	12.39%	14.03%	14.53%	1.64%	2.14%	12.71%	14.19%	0.32%	1.80%	0.34%	1.32%
6	1985	10.79%	12.47%	12.96%	1.68%	2.17%	11.37%	12.72%	0.58%	1.93%	0.24%	1.10%
7	1986	7.80%	9.58%	10.00%	1.78%	2.20%	9.02%	10.39%	1.22%	2.59%	-0.39%	0.56%
8	1987	8.58%	10.10%	10.53%	1.52%	1.95%	9.38%	10.58%	0.80%	2.00%	-0.05%	0.72%
9	1988	8.96%	10.49%	11.00%	1.53%	2.04%	9.71%	10.83%	0.75%	1.87%	0.17%	0.78%
10	1989	8.45%	9.77%	9.97%	1.32%	1.52%	9.26%	10.18%	0.81%	1.73%	-0.21%	0.51%
11	1990	8.61%	9.86%	10.06%	1.25%	1.45%	9.32%	10.36%	0.71%	1.75%	-0.29%	0.54%
12	1991	8.14%	9.36%	9.55%	1.22%	1.41%	8.77%	9.80%	0.63%	1.67%	-0.25%	0.59%
13	1992	7.67%	8.69%	8.86%	1.02%	1.19%	8.14%	8.98%	0.47%	1.31%	-0.12%	0.55%
14	1993	6.60%	7.59%	7.91%	0.99%	1.31%	7.22%	7.93%	0.62%	1.33%	-0.02%	0.37%
15	1994	7.37%	8.31%	8.63%	0.94%	1.26%	7.96%	8.62%	0.59%	1.25%	0.01%	0.35%
16	1995	6.88%	7.89%	8.29%	1.01%	1.41%	7.59%	8.20%	0.71%	1.32%	0.09%	0.30%
17	1996	6.70%	7.75%	8.17%	1.05%	1.47%	7.37%	8.05%	0.67%	1.35%	0.12%	0.38%
18	1997	6.61%	7.60%	7.95%	0.99%	1.34%	7.26%	7.86%	0.66%	1.26%	0.09%	0.34%
19	1998	5.58%	7.04%	7.26%	1.46%	1.68%	6.53%	7.22%	0.95%	1.64%	0.04%	0.51%
20	1999	5.87%	7.62%	7.88%	1.75%	2.01%	7.04%	7.87%	1.18%	2.01%	0.01%	0.58%
21	2000	5.94%	8.24%	8.36%	2.30%	2.42%	7.62%	8.36%	1.68%	2.42%	-0.01%	0.62%
22	2001	5.49%	7.76%	8.03%	2.27%	2.54%	7.08%	7.95%	1.59%	2.45%	0.08%	0.68%
23	2002	5.43%	7.37%	8.02%	1.94%	2.59%	6.49%	7.80%	1.06%	2.37%	0.22%	0.88%
24	2003	4.96%	6.58%	6.84%	1.62%	1.89%	5.67%	6.77%	0.71%	1.81%	0.08%	0.91%
25	2004	5.05%	6.16%	6.40%	1.11%	1.35%	5.63%	6.39%	0.58%	1.35%	0.00%	0.53%
26	2005	4.65%	5.65%	5.93%	1.00%	1.28%	5.24%	6.06%	0.59%	1.42%	-0.14%	0.41%
27	2006	4.99%	6.07%	6.32%	1.08%	1.32%	5.59%	6.48%	0.60%	1.49%	-0.16%	0.48%
28	2007	4.83%	6.07%	6.33%	1.24%	1.50%	5.56%	6.48%	0.72%	1.65%	-0.15%	0.52%
29	2008	4.28%	6.53%	7.25%	2.25%	2.97%	5.63%	7.45%	1.35%	3.17%	-0.20%	0.90%
30	2009	4.07%	6.04%	7.06%	1.97%	2.99%	5.31%	7.30%	1.24%	3.23%	-0.24%	0.72%
31	2010	4.25%	5.46%	5.96%	1.21%	1.71%	4.94%	6.04%	0.69%	1.79%	-0.08%	0.52%
32	2011	3.91%	5.04%	5.56%	1.13%	1.65%	4.64%	5.66%	0.73%	1.75%	-0.10%	0.40%
33	2012	2.92%	4.13%	4.83%	1.21%	1.91%	3.67%	4.94%	0.75%	2.01%	-0.11%	0.46%
34	2013 <sup>3</sup>	3.14%	4.20%	4.72%	1.06%	1.58%	3.92%	4.82%	0.78%	1.68%	-0.10%	0.28%
35	<b>Average</b>	<b>7.05%</b>	<b>8.60%</b>	<b>9.01%</b>	<b>1.55%</b>	<b>1.96%</b>	<b>7.87%</b>	<b>8.99%</b>	<b>0.82%</b>	<b>1.94%</b>	<b>0.02%</b>	<b>0.73%</b>

**Yield Spreads**  
Treasury Vs. Corporate & Treasury Vs. Utility



**Sources & Notes:**

<sup>1</sup> St. Louis Federal Reserve: Economic Research, <http://research.stlouisfed.org/>.

<sup>2</sup> Mergent Public Utility Manual, Mergent Weekly News Reports, 2003. The utility yields for the period 2001-2009 were obtained from the Mergent Bond Record. The utility yields from 2010-2011 were obtained from <http://credittrends.moodys.com/>.

<sup>3</sup> The data includes the period Jan - Jun 2013.

# Midcontinent ISO

## Treasury and Utility Bond Yields

<u>Line</u>	<u>Date</u>	<u>Treasury Bond Yield<sup>1</sup></u> (1)	<u>"A" Rated Utility Bond Yield<sup>2</sup></u> (2)	<u>"Baa" Rated Utility Bond Yield<sup>2</sup></u> (3)
1	10/11/13	3.74%	4.77%	5.24%
2	10/04/13	3.73%	4.77%	5.27%
3	09/27/13	3.68%	4.73%	5.23%
4	09/20/13	3.77%	4.79%	5.27%
5	09/13/13	3.84%	4.85%	5.37%
6	09/06/13	3.87%	4.86%	5.37%
7	08/30/13	3.70%	4.67%	5.17%
8	08/23/13	3.80%	4.79%	5.32%
9	08/16/13	3.86%	4.83%	5.39%
10	08/09/13	3.63%	4.61%	5.17%
11	08/02/13	3.69%	4.63%	5.18%
12	07/26/13	3.61%	4.62%	5.13%
13	07/19/13	3.56%	4.62%	5.12%
14	07/12/13	3.64%	4.76%	5.28%
15	07/05/13	3.68%	4.82%	5.38%
16	06/28/13	3.52%	4.67%	5.23%
17	06/21/13	3.56%	4.72%	5.28%
18	06/14/13	3.28%	4.42%	4.98%
19	06/07/13	3.33%	4.43%	4.96%
20	05/31/13	3.30%	4.36%	4.86%
21	05/24/13	3.18%	4.22%	4.69%
22	05/17/13	3.17%	4.21%	4.69%
23	05/10/13	3.10%	4.16%	4.64%
24	05/03/13	2.96%	4.03%	4.51%
25	04/26/13	2.87%	3.93%	4.41%
26	04/19/13	2.88%	3.96%	4.43%
27	<b>26 week Average</b>	<b>3.50%</b>	<b>4.55%</b>	<b>5.06%</b>
28	<b>13 week Average</b>	<b>3.73%</b>	<b>4.73%</b>	<b>5.25%</b>
29	<b>Spread To Treasury - 26 weeks</b>		<b>1.05%</b>	<b>1.56%</b>
30	<b>Spread To Treasury - 13 weeks</b>		<b>1.00%</b>	<b>1.52%</b>

Sources:

<sup>1</sup> St. Louis Federal Reserve: Economic Research, <http://research.stlouisfed.org>.

<sup>2</sup><http://credittrends.moodys.com/>.

# Midcontinent ISO

## Value Line Beta (National Proxy Group)

<u>Line</u>	<u>Company</u>	<u>Beta</u>
1	American Electric Power Company, Inc.	0.70
2	Consolidated Edison, Inc.	0.60
3	Dominion Resources, Inc.	0.70
4	Duke Energy Corporation	0.60
5	Edison International	0.75
6	FirstEnergy Corp.	0.80
7	Great Plains Energy Inc.	0.80
8	NextEra Energy, Inc.	0.70
9	Northeast Utilities	0.75
10	Pepco Holdings, Inc.	0.75
11	PG&E Corporation	0.55
12	Pinnacle West Capital Corporation	0.70
13	PNM Resources, Inc.	0.95
14	Portland General Electric Company	0.75
15	Public Service Enterprise Group Incorporated	0.75
16	SCANA Corporation	0.65
17	Southern Company	0.55
18	UIL Holdings Corporation	0.75
19	Westar Energy, Inc.	0.75
20	Xcel Energy Inc.	0.60
21	<b>Average</b>	<b>0.71</b>
22	<b>Range</b>	<b>0.55 - 0.95</b>

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Source:  
*The Value Line Investment Survey*,  
 August 2, August 23, and September 20, 2013.

# Midcontinent ISO

## Value Line Beta (Regional Proxy Group)

<u>Line</u>	<u>Company</u>	<u>Beta</u>
1	American Electric Power Company, Inc.	0.70
2	Duke Energy Corporation	0.60
3	FirstEnergy Corp.	0.80
4	Great Plains Energy Inc.	0.80
5	Southern Company	0.55
6	Westar Energy, Inc.	0.75
7	Xcel Energy Inc.	0.60
8	<b>Average</b>	<b>0.69</b>
9	<b>Range</b>	<b>0.55 - 0.80</b>

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Source:

*The Value Line Investment Survey,*  
August 2, August 23, and September 20, 2013.

# Midcontinent ISO

## CAPM Return

<u>Line</u>	<u>Description</u>	<u>Average Beta (1)</u>	<u>Low Beta (2)</u>	<u>High Beta (3)</u>
1	Risk-Free Rate <sup>1</sup>	4.20%	4.20%	4.20%
2	Risk Premium <sup>2</sup>	6.70%	6.70%	6.70%
3	Beta <sup>3</sup>	0.71	0.55	0.95
4	<b>CAPM</b>	<b>8.94%</b>	<b>7.89%</b>	<b>10.57%</b>

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Sources:

<sup>1</sup> *Blue Chip Financial Forecasts*; October 1, 2013, at 2.

<sup>2</sup> Morningstar, Inc. *Ibbotson SBBI 2013 Classic Yearbook* at 88, and Morningstar, Inc. *Ibbotson SBBI 2013 Valuation Yearbook* at 54 and 66.

<sup>3</sup> Exhibit MPG-17.



## **CERTIFICATE OF SERVICE**

I hereby certify that I have this day served, via electronic mail, the foregoing upon each person on the attached service list.

Dated at Washington, D.C. this 12th day of November, 2013.

/s/ Robert A. Weishaar, Jr.

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