

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION STAFF
RESPONSE TO DATA REQUEST

DATE PREPARED:	December 8, 2014	WITNESS:	David C. Parcell
DOCKET:	UE-140762, et al.	RESPONDER:	David C. Parcell
REQUESTER:	Pacific Power	TELEPHONE:	Thomas E. Schooley (360) 664-1307

50. Please confirm that the average return on equity for 2014 is 9.9 percent for all electric utility decisions listed in the survey for the period September 1, 2013, to September 1, 2014. If you dispute this average, please provide your alternative calculation.

RESPONSE:

The actual average is 9.9 percent.

Commission Watch

Risk Holds Sway

Interest rates not always controlling for return on equity.

BY PHILLIP S. CROSS

Last year in this column we highlighted several cases in which regulators had weighed in on whether to view low interest rates as a cyclic trend already anticipated by rate-making policy, or as an outright anomaly – a discontinuous event that warrants a special response. (See, *Commission Watch*, “Anomaly or New Normal?” *Pub. Utils. Fortnightly*, Nov. 2013, p. 26.)

Today, however, as the economy stays on its slow path toward recovery, the question may be receding in importance.

Consider the high-profile case handed down in June by the Federal Energy Regulatory Commission (FERC) concerning the base-level return on equity (ROE) for network electric transmission service provided in ISO New England. (*Dkt. No. EL11-66-001, Opin. No. 531, June 19, 2014, 147 FERC ¶ 61,234.*)

That case, brought by Massachusetts Attorney General Martha Coakley, had sought to bring rate relief to New England consumers by trimming back the then-applicable base level ROE of 11.4%. Among other arguments, the Coakley complaint had asked the commission to ignore assertions that the current interest rate climate was somehow anomalous and need not be a serious factor in judging a utility’s ability to attract capital.

When it finally got around to handing down its final order in the case, FERC did consent to grant at least some rate relief. It lowered the base-level ROE to 10.57%, though not quite as low as the 9.7% rate recommended by the administrative law judge. And in so doing, FERC replaced its prior, one-stage constant growth version of the Discounted Cash Flow (DCF) Model for electric utilities with the two-stage model that it had been using already

What’s interesting is how FERC dealt with claims that current low interest rates are anomalous.

for interstate natural gas pipelines. The two-stage model recognizes that, over the long run, utilities should not expect to receive an authorized rate of return that exceeds the long-term growth rate of the economy as a whole.

What’s interesting, however, is how FERC dealt with the discrete claim that current trends in interest rates are somehow anomalous, and thus should not be trusted as a reason for justifying lower transmission ROEs.

In a strictly legal sense, the FERC side-stepped the question. Yet, at the same time, it found that the unique risks of transmission investments gave reason not to go overly far in reducing the base level ROE. It set ROE at the 75th percentile – half way between the midpoint and highest proxy result of 35 out of the 38 DCF studies in evidence – suggesting that interest rates might not be quite high enough to assure

ready access to capital for transmission investment.

As FERC explained, firms investing in electric transmission infrastructure face such risks as project complexity, delays in transmission siting and permitting, and liquidity risk from financing projects that are large relative to the size of a company’s balance sheet. In fact, FERC noted that over the 24-month period from October 1, 2010, through September 30, 2012, approximately 85% to 91% of authorized ROEs granted by state regulators in retail rate cases fell in a range between 9.8% and 10.74%. As FERC explained, if ROEs were tied too closely to current interest rates, investors would simply choose to put their money elsewhere.

A similar sense seems to be becoming taking hold on the state level. In mid-August, the Florida Supreme Court upheld a rate order by the state public service commission (PSC) that had kept the authorized ROE for Florida Power & Light at 10% despite arguments by state’s Office of Public Counsel that current interest rates were too low to justify that figure. (*Citizens v. Fla. PSC, Fla. Sup. Ct. No. SC13-144, Aug. 28, 2014.*)

The court ruled that the PSC had taken OPC’s argument into account, but pointed also to evidence presented by FPL that its previous ROE of 10% was the “lowest of all Florida investor-owned utilities and among the lowest nationally, based on decisions rendered since the PSC’s last base rate proceeding.”

The court added that, according to other testimony presented in the rate case, the OPC’s recommendations would weaken FPL’s financial strength,

(Cont. on page 22)

Phillip S. Cross is *Fortnightly’s* legal editor, and serves on the editorial staff of *PUR’s Utility Regulatory News*, reporting weekly on state rate-making and regulatory decisions.

Fig. 1 2014 RATE CASE STUDY

State	Company	Utility Type	Case, Docket or Decision No.	Application Date	Order Date	Test-year End Date	Increase (Decrease) Requested (\$Million)	Increase (Decrease) Granted (\$Million)	Previously Authorized ROE Rate (% - Common Equity)	Newly Authorized ROE Rate (% - Common Equity)
AL	Alabama Gas Corp.	Gas	18046 & 18328	1/10/13	12/20/13	NA	1	1	13.40	10.80 ²
AK	Arkansas Oklahoma Gas	Gas	13-078-U, 314 PUR4th 498	10/14/13	7/25/14	12/31/13	5.70	4.20	9.90	93.00
AK	Entergy Arkansas, Inc.	Electric	13-028-U	3/1/13	8/15/14	12/31/12	179.5	86	10.20	9.50 ^r
AK	SourceGas Arkansas, Inc.	Gas	13-079-U	9/9/13	7/7/14	9/30/13	18.7	13.8	9.45	9.30
CA	Southwest Gas Co.	Gas	D.14-06-028	12/20/12	6/12/14	12/31/14	11.6	7.1	9.35	10.10
CO	Atmos Energy Corp.	Gas	13AL-0496G	5/8/13	3/16/14	12/31/12	10.5	1.3	8.44	8.07
CO	Public Service Company of Colorado	Gas	12AL-1268G	12/12/12	12/23/13	9/30/12	151.3	65.8	8.08	7.53
DC	Potomac Electric Power Co.	Electric	F.C. 1107, Order No. 17424, 313 PUR4th 340	3/8/13	3/26/14	12/31/12	44.8	23.45	9.50	9.40
DE	Delmarva Power & Light Co.	Electric	13-115	3/22/13	8/5/14	12/31/12	42	15.096	9.75	9.70 ^t
DE	Delmarva Power & Light Co.	Gas	12-546	12/7/12	11/22/13	6/30/12	12	6.8	10.00	9.75 ³
FL	Gulf Power Co.	Electric	130140-EI	7/12/13	12/19/13	12/31/14	90.8	55 ⁴	10.25	10.25
FL	Tampa Electric Co.	Electric	130040-EI	4/5/13	9/30/13	12/31/14	134.8	70 ⁵	11.25	10.25
GA	Georgia Power Co.	Electric	36989	6/28/13	12/23/13	7/31/14	482.2	110 ⁶	11.15	10.95
ID	Rocky Mountain Power Co.	Electric	PAC-E-13-04	3/1/13	10/24/13	12/31/12	15	2.0 ⁷	9.80	9.80
IL	AMEREN Illinois Co.	Electric	13-0301	4/19/13	12/9/13	12/31/12	[30]	[45] ⁸	9.71	8.72
IL	AMEREN Illinois Co.	Gas	13-0192	1/25/13	12/18/13	12/31/11	50.1	32	9.06	9.08
IL	Commonwealth Edison Co.	Electric	13-0318	4/29/13	12/18/13	12/31/12	353	341	9.71	8.72
IN	Indiana Natural Gas Corp.	Gas	44453, 314 PUR4th 483	1/30/14	7/30/14	8/31/13	0.519	0.384	10.10	10.10
IA	MidAmerican Energy Co.	Electric	RPU-2013-0004, 311 PUR4th 425	5/17/13	3/17/14	12/31/12	135.6 ⁹	135.6 ⁹	10.00 ¹⁰	10.00 ¹⁰
KS	Kansas Power & Light Co.	Electric	14-KCPE-272-RTS	12/9/13	7/17/14	12/31/11	11.5	11.5	9.50	9.50
KS	Westar Energy	Electric	13-WSEE-629-RTS	4/15/13	11/21/13	3/1/11	31.7	30.7	10.00	10.00 ¹¹
KY	Atmos Energy Corp.	Gas	2013-00148	5/13/13	4/22/14	11/30/14	13.4	8.55	--	9.80
KY	Columbia Gas of Kentucky, Inc.	Gas	2013-00167	4/29/13	12/31/13	--	16.6	7.66	--	10.13
LA	Cleco Power LLC	Electric	U-32779	4/19/13	6/27/14	6/30/15	(6.90)	(34.40)	10.70 ¹²	10.00 ¹²
LA	Cleco Power LLC	Electric	U-33036	10/31/13	6/27/14	6/30/13	NA	NA	10.70 ¹²	10.70 ¹²
LA	Entergy Gulf States LA, LLC	Electric	U-32707	2/15/13	12/4/13	6/30/12	24.457	0	10.65	9.95
LA	Entergy Louisiana, LLC - Algiers	Electric	UD-13-01	3/28/13	7/10/14	6/30/12	12.935	10.196	10.25	9.95
LA	Entergy Louisiana, LLC - (ELL)	Electric	U-32708	2/15/13	12/4/13	6/30/12	144.462	30.0 ¹³	10.25	9.95
LA	Southwestern Electric Power Co.	Electric	U-32220	1/26/12	7/14/14	12/31/11	14	14	--	10.00

Source: Fortnightly research, Phillip S. Cross

FIG. 1 2014 RATE CASE STUDY

State	Company	Utility Type	Case, Docket or Decision No.	Application Date	Order Date	Test-year End Date	Increase (Decrease) Requested (\$Million)	Increase (Decrease) Granted (\$Million)	Previously Authorized ROE Rate (% - Common Equity)	Newly Authorized ROE Rate (% - Common Equity)
ME	Bangor Gas Co.	Gas	2012-00598	11/26/12	9/8/14	9/30/12	--	8.7 ¹⁵	15.00 ¹⁶	8.45
ME	Northern Utilities Inc.	Gas	2012-00133, 311 PUR4th 251	17	12/27/13	12/31/12	4.578	3.44	9.90	9.75 ¹⁸
MD	Baltimore Gas & Electric Co.	Electric	9326, 311 PUR4th 29	5/17/13	12/13/13	7/30/13	82.8	33.6	9.75	9.75
MD	Baltimore Gas & Electric Co.	Gas	9326, 311 PUR4th 29	5/17/13	12/13/13	7/30/13	24.2	12.5	9.60	9.60
MD	Columbia Gas of Maryland	Gas	9316	2/27/13	9/23/13	3/31/13	5.3	3.6	--	9.60
MD	Potomac Electric Power Co.	Electric	9336, 314 PUR4th 165	12/4/13	7/2/14	9/31/13	43.3	8.754	9.36	9.62
MA	Bay State Gas Co.	Gas	DPU 13-75	4/16/13	2/28/14	12/31/12	30	19.3	9.45	9.55
MA	Fitchburg Gas & Electric Light Co.	Electric	DPU 13-90	7/15/13	5/30/14	12/31/12	6.7	5.4	9.20	9.70
MI	Michigan Gas Utilities Corp.	Gas	U-17273	6/7/13	10/25/13	12/31/14	8.036	4.499	10.75	10.25
MI	Northern States Power Co.	Gas	U-17488	12/6/13	5/13/14	12/31/14	0.527	0.5	10.40	10.20
MI	Upper Peninsula Power Co.	Electric	U-17274	6/28/13	11/14/13	12/31/14	7.883	5.819	10.20	10.15
MN	CenterPoint Energy	Gas	G008/ GR-13-316	8/2/13	6/9/14	9/30/14	44.3	32.9	10.24	9.59
MN	Mississippi River Gas, LLC	Gas	2013-UN-104	5/10/13	7/21/14	--	1.64	1.55	--	7.16 ¹⁹
MO	Missouri Gas Enegy	Gas	GR-2014-0007, 314 PUR4th 130	9/16/13	4/23/14	*	17	7.8	10.00	*
MT	Montana Dakota Utilities	Gas	72546	9/26/12	12/12/13	12/31/11	3.457	1.525	12.00	*
NV	Sierra Pacific Power Co.	Electric	13-06002	6/4/13	3/3/14	12/31/12	(4.694)	(39.056)	10.10	9.80
NV	Sierra Pacific Power Co.	Gas	13-06003	6/4/13	3/3/14	12/31/12	5.956	3.917	10.00	9.70
NJ	Atlantic City Electric Co.	Electric	ER14030245	3/14/14	8/20/14	12/31/13	61.7	19.1	--	9.75
NM	Southwestern Public Service Co.	Electric	12-00350-UT	12/12/12	3/26/14	12/31/14	--	33.1	10.18	9.96
NY	Consolidated Edison Co.	Electric	13-E-0030	1/25/13	2/21/14	6/30/12	--	200.17 ²⁰	10.16	9.20
NY	Consolidated Edison Co.	Gas	13-G-0031	1/25/13	2/21/14	6/30/12	--	67.0 ²¹	9.60	9.30
NY	National Fuel Gas Corp.	Gas	13-G-0138	4/19/13 ²²	5/8/14	9/30/12	0	(7.5) ²³	9.10	9.10
NC	Duke Energy Carolinas LLC	Electric	E-7, Sub 1026, 309 PUR4th 79	7/1/11	10/23/13	12/31/10	646	309	--	10.50
NC	Duke Energy Carolinas LLC	Electric	E-7, Sub 1026, 308 PUR4th 1	2/4/13	9/24/13	6/30/13	446	234.5	10.50	10.20 ²⁴
NC	Piedmont Natural Gas Co., Inc.	Gas	G-9, Sub 631	5/31/13	12/17/13	2/28/13	79.8	30.7	10.60	10.00
ND	Montana-Dakota Utilities Co.	Gas	PUE-13-803	9/18/13	4/9/14	7/6/05	6.8	4.2	11.33	10.00
ND	Northern States Power Co.	Electric	PU-12-813	12/18/12	2/26/14	7/5/05	16.9	7.30 ²⁵	10.40	9.75 ²⁵
OH	Duke Energy Ohio, Inc.	Gas	12-1685-GA-AIR	7/9/12	11/13/13	12/31/12	44.6	0	10.04	9.84
OK	Oklahoma Natural Gas Co.	Gas	Order No. 628742	3/14/14	8/5/14	12/31/13 ²⁶	--	13.7	--	*
OR	PacifiCorp	Electric	UE-263	3/1/13	12/18/13	12/31/14	56	23.7	9.80	9.80

Source: Fortnightly research, Phillip S. Gross

Fig. 1

2014 RATE CASE STUDY

State	Company	Utility Type	Case, Docket or Decision No.	Application Date	Order Date	Test-year End Date	Increase (Decrease) Requested (\$Million)	Increase (Decrease) Granted (\$Million)	Previously Authorized ROE Rate (% - Common Equity)	Newly Authorized ROE Rate (% - Common Equity)
OR	Portland General Electric Co.	Electric	UE-262	2/15/13	12/9/13	12/31/14	104.8	63.36	--	9.75
PA	Duquesne Light Co.	Electric	R-2013-2372129	8/2/13	4/23/14	4/30/15	76.3	48	--	*
PA	Peoples TWP, LLC	Gas	R-2013-2355886	4/30/13	12/19/13	1/31/15	18.66	13.8	--	*
PA	Pike County Power & Light Co.	Gas	R-2013-2397353	1/17/14	8/24/14	9/30/13	0.151	0.1	--	*
PA	Pike County Power & Light Co.	Gas	R-2013-2397353	1/17/14	9/11/14	9/30/13	1.7	1.25	--	*
QUE	Gaz Metro	Gas	R-3827-2013	5/22/14		9/30/13	59.65	48.67	8.90	8.90
SC	Duke Energy Carolinas, LLC	Electric	2013-59-E, 308 PUR4th 474	3/18/13	9/18/13	6/30/12	220	118.622 ²⁷	10.50	10.20
SD	Black Hills Power, Inc.	Electric	EL12-061	12/17/12	9/19/13	6/30/12	13.7	8.8	*	*
SD	Montana-Dakota Utilities Co.	Gas	NG12-008	12/21/12	11/5/13	6/30/12	1.5	0.9	*	*
TX	Entergy Texas	Electric	41791	9/25/13	5/6/14	3/31/13	38.6	18.5	9.80	9.80
TX	Southwestern Electric Power Co. (SWEPCO)	Electric	40443	7/27/12	3/6/14	12/31/11	83.4	48.3	10.33	9.65
UT	Questar Gas Co.	Gas	13-057-05, 312 PUR4th 307	7/1/13	2/21/11	12/31/14	18.96	7.614	10.35	9.85
UT	Rocky Mountain Power Co.	Electric	13-035-184	1/13/14	8/29/14	6/30/15	76.3	4.2 ²⁸	9.80	9.80
VT	Green Mountain Power Corp.	Electric	8190, 8191	12/20/13	8/25/14	12/30/13	0.180	8.827 ²⁹	--	9.60
VA	Kentucky Utilities Co.	Electric	PUE-2013-00013 ³⁰	4/1/13	11/26/13	12/31/12	6.5	4.7	10.30	10.00 ³¹
VA	Roanoke Gas Co.	Gas	PUE-2013-00076	9/13/13	5/9/14	6/30/13	1.66	0.887	9.75	9.75
VA	Virginia Electric & Power Co.	Electric	PUE-2013-00020, 309 PUR4th 471	3/28/13	11/26/13	12/31/12	0	0	10.90 ³⁰	10.00 ³⁰
WI	Northern States Power Co.-Wisconsin	Electric	4220-UR-119	6/1/13	12/20/13	12/31/14	40	20	10.40	10.20
WI	Northern States Power Co.-Wisconsin	Gas	4220-UR-119	6/1/13	12/20/13	12/31/14	4.7	0	10.40	10.20
WI	Wisconsin Power & Light Co.	Electric	6680-UR-119	3/9/14	7/17/14	12/31/15	0	0 ³²	10.40	10.40
WI	Wisconsin Power & Light Co.	Gas	6680-UR-119	3/9/14	7/17/14	12/31/15	[5.0]	[5.0]	10.40	10.40
WI	Wisconsin Public Service Corp.	Electric	6690-UR-122	3/29/13	12/18/13	12/31/14	71.108	9.835	10.30	10.20
WI	Wisconsin Public Service Corp.	Gas	6690-UR-122	3/29/13	12/18/13	12/31/14	19.010	3.996	10.30	10.20
WY	Cheyenne Light, Fuel & Power	Electric	D-20003-132-ER13	12/2/13	7/31/14	6/30/13		8.4	9.60	9.90
WY	Cheyenne Light, Fuel & Power	Gas	D-30005-182-GR13	12/2/13	7/31/14	6/20/13	1.63	0.06	9.60	9.90

Source: Fortnightly Research, Philip S. Cross

HOW THE SURVEY WAS CONDUCTED

As in prior years this year's survey covers cost of equity capital determinations by state public utility commissions (PUCs) during the period September 1, 2013 through September 1, 2014. The survey methodology remains similar to past years – requests for information on the results of recent rate proceedings were sent to both regulators and utility financial officials. In addition, direct examination of the commission rate orders, when available, provides additional information. The traditional cost-of-service rate case remains as the most obvious source of information on how utility regulators view the issue of shareholder earnings requirements. Nevertheless, performance-based rate plans, periodic earnings reviews, and special proceedings to determine revenue requirements for restructured electric “delivery-only” utility operations also contain findings about the appropriate ROE for utilities and are reported herein. Explanatory notes accompany most entries, and citations are provided for orders published in *Public Utilities Reports, Fourth Series (PUR4th)*.—PC

resulting in further degradation of credit and downgrades to ratings, and would revive investor perceptions of regulatory risk, which would increase the cost of capital and decrease the availability of such capital.

Other recent rate orders at the retail level suggest also that evaluations of risk – whether industry wide or specific to the company – can play at least an equal role in ROE determinations as does the current level of interest rates. Consider two recent orders from much earlier in the year: one from the District of Columbia, the other from Utah.

In the first case the D.C. PSC held that then-recent increases in interest rates did not necessarily warrant a higher ROE. (*Potomac Elec. Pwr. Co., F.C. 1103, Order 174214, Mar. 26, 2014, 313 PUR4th 340.*)

But it did set ROE above the mid-point of the range of reasonableness, pointing to other factors that had affected company risk, including a commission-imposed requirement for PEPSCO to improve the reliability of its system, and its ongoing aggressive construction program aimed at upgrading the replacing aging infrastructure.

In the second case, involving Questar, a natural gas local distribution company operating in Utah, the state

PSC dropped the authorized ROE from 10.35% to 9.85%. (*Questar Gas Co., Dkt. No. 13-057-05, Feb. 21, 2014, 312 PUR4th 307.*)

And while the Utah commission did cite historically low capital costs as one reason, it found that the utility's risk profile was very probably somewhat lower than before when the higher ROE had been set. The PSC pointed to regulatory adjustments, approved in recent years, including a mechanism for decoupling revenues from rates, plus a cost-balancing account for demand-side management, and a cost tracker for new infrastructure investment. ■

Notes:

*Settlement agreement, ROE not specified.

1. Utility operates under a rate stabilization and equalization plan – an alternative rate-making mechanism that provides for periodic automatic adjustment to retail rates to maintain ROE within a specified range.
2. The rate of 10.80% will apply to FY 2015 and forward. A “transition” ROE of 11.45% applies to FY 2014. Company is allowed to earn an additional five basis points on the 10.80% rate, depending on performance with certain metrics regarding customer satisfaction.
3. Settlement agreement, with ROE not specified. Parties agreed to use rate of 9.75% for reporting purposes and for calculating various accounting metrics, such as Allowance for Funds Used During Construction, Construction Work in

- Progress, and carrying costs for regulatory assets.
4. Cumulative increase over two-year period.
5. Cumulative increase over three-year period.
6. Cumulative increase over three-year period.
7. Settlement agreement reached pursuant to request by utility, as alternative to a full, formal rate case.
8. Update to annual formula rate plan.
9. Phased in over a three-year period.
10. Earnings sharing rate plan.
11. Abbreviated rate case procedure. Adopts authorized ROE from prior rate order, without any additional findings.
12. Target ROE under formula rate plan.
13. Granted rate increase capped at \$30M, with a \$10M increase granted for December 2014, and any remaining increases capped over an extension period to a 3-year formula rate plan.
14. Extension to formula rate plan.
15. Figure shown is the base revenue requirement under a seven-year formula rate plan.
16. Figure shown part of original rate plan approved in 1998.
17. Application following expiration of rate freeze period.
18. Figure shown is an “implied” ROE, under a “black box” settlement that states revenue based on a pretax weighted cost of capital of 11.75%.
19. Figure shown presented in approved settlement as calculated base on agreed rate increase.
20. Total increase under a two-year rate plan.
21. Total increase under three-year rate plan.
22. Examination of rates per petition by commission staff.
23. One-time “pass back” rate adjustment, applied to reduce deferred account balance under current rate plan. Rates frozen thru 9/30/2015.
24. Order on remand from state supreme court affirming initial rate case order of Jan. 27, 2012, Docket E-7, Sub 989.
25. Multi-year rate settlement. Figures shown represent rate increase and applicable ROE for 2013 rate period. Order also authorizes an additional rate increases for 2014 (\$9.3 million; 10.00% ROE), and for 2015 (\$10 million; 10.00% ROE).
26. Calculation is for performance-based rate plan for 2013 rate year.
27. Company allowed rate increases for year one (\$80.391 million, beginning 9/18/13) and for year two and beyond (\$38.231 million, beginning 9/18/14).
28. Two-step increase: \$35 million on 9/1/14, and \$19.2 million (conditional) on 9/1/15.
29. Annual rate review under alternative rate plan.
30. Biennial earnings review.
31. Approved stipulation lists no ROE figure. Commission accepts proposal to adopt 10% ROE for future earnings tests, beginning with calendar year 2013 operating results.
32. Rate freeze is adopted through 2016.