

## FERC Clarifies ROE Policy for Electric Transmission Projects

November 22, 2010

On November 18, the Federal Energy Regulatory Commission (FERC) issued orders clarifying aspects of its policy on Return on Equity (ROE) determinations for electric transmission projects. FERC clarified its policy through orders on rehearing requests in four separate proceedings that concerned up-front rate incentives for new transmission facilities: *Potomac-Appalachian Transmission Highline, L.L.C.*, 133 FERC ¶ 61,152 (2010); *Atlantic Path 15, LLC*, 133 FERC ¶ 61,153 (2010); *Startrans IO, L.L.C.*, 133 FERC ¶ 61,154 (2010); and *Nevada Hydro Co., Inc.*, 133 FERC ¶ 61,155 (2010).

In the rehearing requests, the parties had contested recent orders in which FERC appeared to mandate that the proxy group used in the development of an applicant's ROE must be composed of companies in geographic proximity to the applicant.

In its November 18 orders, FERC clarified that it would not mandate that a proxy group be composed of companies in the same geographic region as the filing company. Although geographic proximity may be a relevant factor in identifying companies with comparable risks, FERC stated that it is not the sole basis for inclusion of companies in a proxy group. The focus should be on whether a proxy group includes companies of comparable business or financial risk to that of the filing company. FERC added that the question of which companies should be included in a proxy group is properly resolved based on the facts and circumstances of each case. In some cases, a filing company may rely solely on companies in its region to form a proxy group and to perform its DCF analysis, after demonstrating that these companies have comparable risk to the filing company. In other cases, a filing company may identify companies with comparable risk by looking beyond its geographic region.

In addition, the rehearing requests asked for clarification of FERC's prior statements that the use of an established proxy group will allow for an up-front determination of the appropriate ROE for entities seeking general rate changes and those seeking incentive rates. Parties requesting rehearing argued that FERC should not require an up-front ROE determination in all cases. FERC clarified that the decision to require an up-front ROE determination will depend on the facts and circumstances of each individual case.

FERC also addressed several other ROE-related issues in the *Potomac-Appalachian Transmission Highline (PATH)* case. For example, FERC found that corporate credit ratings are a reasonable measure to use to screen for investment risk in incentive ROE cases and that the median—rather than the midpoint—of the range of returns of the proxy group should be used to determine PATH's base ROE.

If you have any questions or would like more information on any of the issues discussed in the LawFlash, please contact any of the following Morgan Lewis attorneys:

**Washington, D.C.**

John D. McGrane	202.739.5621	<a href="mailto:jmcgrane@morganlewis.com">jmcgrane@morganlewis.com</a>
Floyd L. Norton, IV	202.739.5620	<a href="mailto:fnorton@morganlewis.com">fnorton@morganlewis.com</a>
Joseph W. Lowell	202.739.5384	<a href="mailto:jlowell@morganlewis.com">jlowell@morganlewis.com</a>

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