147 FERC ¶ 61,240
UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Before Commissioners: Cheryl A. LaFleur, Acting Chairman;
Philip D. Moeller, John R. Norris,
and Tony Clark.

Southern California Edison Company — Docket No. ER08-375-006

ORDER ON REMAND

(Issued June 19, 2014)

1. This case is on partial remand from the United States Court of Appeals for the D.C. Circuit (D.C. Circuit) to address the Commission's decision to take official notice of the average yields on ten-year U.S. Treasury bonds to update Southern California Edison Company's (SoCal Edison) base Return on Equity (ROE) for the locked-in period March 1, 2008 through December 31, 2008 (Locked-In Period). The D.C. Circuit found a remand to be appropriate because the Commission had rejected SoCal Edison's proffered expert affidavit, filed on rehearing after the close of the briefing record, which challenged consideration of changes in ten-year U.S. Treasury bond yields during the "extreme" economic conditions that existed in 2008.[1] The D.C. Circuit stated that the Commission was obligated to consider and appropriately respond to SoCal Edison's effort "to parry the effect" of the official noticed information.[2]

2. Consistent with the order in *Martha Coakley, Mass. Attorney Gen., et al. v. Bangor Hydro-Electric Co., et al.* being issued concurrently today, in which the Commission is adopting a new approach for determining electric ROEs and no longer using U.S. Treasury bond yields to make post-hearing adjustments to ROEs,[3] we reverse our prior determination in this proceeding. Thus, we find that it is no longer appropriate to make a post-hearing adjustment to SoCal Edison's ROE based on the change in U.S. Treasury bond yields for the Locked-In Period.

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[1] *Southern California Edison Co. v. FERC*, 717 F.3d 177, 188 (D.C. Cir. 2013).

[2] *Id.*

[3] 147 FERC ¶ 61,234 (2014) (*Coakley*).

I. Background

3. On April 15, 2010, in Docket Nos. ER08-375-000 and ER08-375-001, the Commission issued an order approving a base ROE of 9.54 percent for three of SoCal Edison's transmission projects for the Locked-In Period.[4] This ROE determination was based upon a national proxy group, to which the Commission applied screening factors that it determined to be appropriate to the circumstances of the case and ensured that only companies of comparable risk were included. The Commission then performed a Discounted Cash Flow (DCF) analysis of each member of the proxy group, using financial data for the six-month period June through November 2007 (DCF Analysis Period). That analysis produced a zone of reasonableness for SoCal Edison of 7.80 percent to 16.19 percent. When the Commission applied the median to this calculation, it determined the base ROE for SoCal Edison to be 10.55 percent. Finally, consistent with our longstanding policy concerning the updating of ROEs, the Commission took official notice of the yields on ten-year constant maturity U.S. Treasury bonds during the DCF Analysis Period and the Locked-In Period. Finding that the average Treasury bond yields had dropped by 101 basis points during the Locked-In Period, the Commission reduced SoCal Edison's base ROE by that amount to 9.54 percent.[5]

4. On May 17, 2010, SoCal Edison filed a request for rehearing of the Commission's Paper Hearing Order, arguing, among other things, that the Commission erred by using its updating policy based on the change in ten-year bond yields.[6] SoCal Edison stated that applying the Commission's updating policy to its ROE calculation was not appropriate during the financial crisis of 2008 because the rates for U.S. Treasury bonds did not reflect the rising cost of equity capital required by investors who preferred the safety of investing in U.S. Treasury bonds.[7] Specifically, SoCal Edison argued that the change in the yields on ten-year bonds during this period was not rationally related to the change in debt costs for private investment grade utilities or privately-owned companies; rather, during 2008, these two rates were inversely related. SoCal Edison supported its rehearing arguments with a proffer of an affidavit by its expert witness. The witness stated that, while the yield on ten-year Treasury bonds dropped 101 basis points between the DCF Analysis Period and the Locked-In Period, the yield on Baa corporate bonds

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[4] *Southern California Edison Co.*, 131 FERC ¶ 61,020 (2010) (2010 Paper Hearing Order).

[5] *Id.* PP 99-102.

[6] SoCal Edison Request for Rehearing at 4-5, 15-30.

[7] *Id.* at 4-5.

increased by 102 basis points.[8] The witness also provided an updated DCF analysis for SoCal Edison using financial data for the last six months of the Locked-In Period, which showed that its ROE had increased slightly from the DCF Analysis Period to 10.74 percent.[9] Consequently, SoCal Edison asserted that changes in the average yield on ten-year bonds did not correspond with changes in capital costs for privately owned utilities, thus invalidating the use of these bonds as a proxy for the change in SoCal Edison's cost of equity.[10] Thus, SoCal Edison concluded that events during this period were so unique that applying the Commission's updating policy was arbitrary and capricious, and the Commission should not update its ROE in this case.

5. The Commission rejected SoCal Edison's proffer of expert witness testimony on the ground that the Commission does not permit new evidence at the rehearing stage of the proceeding, and the Commission denied SoCal Edison's request for rehearing in an order issued October 6, 2011.[11] The Commission found that despite the economic downturn during the ten-month period of 2008 that SoCal Edison's base ROE was in effect, SoCal Edison's ROE calculation should not be exempt from the updating procedures applied in similar ROE proceedings.[12] The Commission noted that its precedent requiring updating ROEs had been applied over the course of more than 25 years,[13] during which time the U.S. economy had experienced many fluctuations. The Commission found that while there may be some short-term positive or negative variations in the ten-year bond yield as compared to the utilities' cost of equity over certain limited periods, over time the ten-year bond index continued to be "a reliable barometer of overall market conditions."[14] Further, the Commission found that granting SoCal Edison's request to exclude its ROE calculation from the updating process because of "unique" circumstances would create the potential that any time the economy experienced a short-term anomaly, such as a downward trend, utilities might advance

[8] *Id.* at Hunt Aff. ¶ 6.

[9] *Id.* at Hunt Aff. ¶ 16.

[10] *Id*. at 20, 22, 25-27.

[11] *Southern California Edison Co.*, 137 FERC ¶ 61,016 (2011) (Rehearing Order).

[12] *Id.* P 31.

[13] *Id.* P 33 (citing *Nantahala Power and Light Co.*, Opinion No. 139, 19 FERC ¶ 61,152 (1982); *N.Y. State Elec. and Gas Corp.*, Opinion No. 254, 37 FERC ¶ 61,151 (1986); *Union Elec. Co.*, Opinion No. 279, 40 FERC ¶ 61,046 (1987) (*Union Electric*); *Boston Edison Co.*, Opinion No. 299, 42 FERC ¶ 61,374 (1988)).

[14] *Id.* P 33 (citing *Union Electric*, 40 FERC at 61,138).

similar arguments of unique circumstances and the Commission could be confronted with having to determine what defines a unique circumstance on a case-by-case basis.[15] The Commission also noted that the U.S. Court of Appeals for the First Circuit upheld the Commission's updating using ten-year U.S. Treasury bonds.[16]

II. <u>SoCal Edison's Appeal</u>

6. SoCal Edison appealed the Commission's orders in this proceeding, arguing in part that the Commission failed to consider SoCal Edison's proffer of evidence on rehearing that the economic crisis of 2008 rendered the Commission's updating policy unreasonable. The D.C. Circuit did not object to the Commission's general practice of taking official notice of the ten-year U.S. Treasury bond rate as a measure for updating SoCal Edison's ROE. However, the court stated that under the Administrative Procedure Act, if, after the close of the record, the Commission takes official notice of a fact outside the record, the Commission must allow a party the opportunity to challenge that fact.[17]

7. Thus, the D.C. Circuit found a remand to be appropriate, because the Commission had rejected SoCal Edison's proffered expert witness affidavit, filed on rehearing after the close of the briefing record, which challenged consideration of changes in ten-year U.S. Treasury bond yields during the "extreme" economic conditions that existed in 2008.[18] The D.C. Circuit stated:

> Although the Commission responded to SoCal Edison's objections at an abstract level, and noted [SoCal Edison's] argument that the corporate and Treasury bond 'rates were inversely related and, therefore, not rationally related,' it never confronted the gravity of the economic downturn or the magnitude of the yield spread as public and private bond rates moved in opposite directions. Under § 556(e), the Commission was obligated to consider and appropriately respond to SoCal Edison's effort 'to parry the effect' of the officially noticed information.[19]

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[15] *Id.* P 34.

[16] *Id.* P 35 (citing *Boston Edison Co. v. FERC,* 885 F.2d 962 (1st Cir. 1989)).

[17] *Southern California Edison Co. v. FERC*, 717 F.3d at 187.

[18] *Id.* at 188.

[19] *Id.* (internal citations omitted).

III. Commission Determination

8. The Commission's policy in public utility ROE cases, as explained in *Coakley*, has been to establish a just and reasonable ROE, within a zone of reasonableness, based upon test-period evidence.[20] However, because capital market conditions can change between the date the utility files its case-in-chief and the date the Commission issues a final decision, the Commission's practice has been to update the ROE within the zone of reasonableness at the time of the final decision to reflect those capital market changes.[21] The Commission's long-standing practice has been to base this post-hearing adjustment on the change in U.S. Treasury bond yields during the same time period.[22] Today, the Commission is changing that practice.

9. The premise underlying the use of U.S. Treasury bonds for the post-hearing ROE adjustment is that changes in ROE over time track changes in U.S. Treasury bond yields. However, while U.S. Treasury bond yields are an important indicator of capital market conditions and therefore inform our determination of an appropriate base ROE, the capital market conditions since the 2008 market collapse and the record in this proceeding have shown that there is not a direct correlation between changes in U.S. Treasury bond yields and changes in ROE. Therefore, the premise underlying the Commission's use of U.S. Treasury bond yields for post-hearing ROE adjustments is not always accurate. In this case, the expert testimony provided by SoCal Edison in its rehearing request indicates that, as U.S. Treasury bond yields decreased during the Locked-In Period, DCF results increased somewhat, indicating an inverse relationship between U.S. Treasury bond yields and utility ROEs.[23] Similarly, the Commission finds today in *Coakley* that U.S. Treasury bond yields do not provide a reliable and consistent metric for tracking changes in ROE after the close of the record in a case.[24] Accordingly, the Commission concludes that, rather than updating ROEs by taking official notice of post-hearing changes in U.S. Treasury bond yields, a more reasonable approach is to

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[20] *Coakley*, 147 FERC ¶ 61,234 at P 158.

[21] *E.g.*, *Southern California Edison Co.*, 131 FERC ¶ 61,020, at P 100 (2010) (citing *City of Vernon, Cal.*, Opinion No. 479, 111 FERC ¶ 61,092 (2005*); Jersey Cent. Power & Light Co.*, Opinion No. 408, 77 FERC ¶ 61,001 (1996)).

[22] *E.g., Ill. Power Co.*, 15 FERC ¶ 61,050, at 61,095 (1981); *see also Union Elec. Co. v. FERC*, 890 F.2d 1193 (D.C. Cir. 1989) (affirming the Commission's use of U.S. Treasury bond yields to make post-hearing adjustments within the range of reasonableness).

[23] *Southern California Edison Co. v. FERC*, 717 F.3d at 187-88.

[24] *Coakley*, 147 FERC ¶ 61,234 at P 161.

allow the participants in a rate case to present the most recent financial data available at the time of the hearing, including post-test period financial data then available. This approach will enable the utility's ROE to be determined based on the most recent financial information available at the time of the hearing, consistent with the due process rights of the participants.[25]

10. In this case, SoCal Edison has contended that its capital costs did not change significantly during the Locked-In Period as compared to the DCF Analysis Period used to determine its 10.55 percent base ROE. Therefore, SoCal Edison requests that we set its ROE at 10.55 percent, without any updating.

11. We reverse our prior determination in our earlier orders in this proceeding and find that it is no longer appropriate to base a post-hearing adjustment to SoCal Edison's ROE on the change in U.S. Treasury bond yields for the Locked-In Period from March 1, 2008 through December 31, 2008. Instead, we approve a base ROE for SoCal Edison for the Locked-In Period of 10.55 percent.

The Commission orders:

To the extent SoCal Edison made refunds based on the prior orders in this proceeding finding that its ROE should be adjusted based on the change in U.S. Treasury bond yields, we hereby authorize SoCal Edison to impose a surcharge to recover those refunds, with interest calculated in accordance with 18 C.F.R. § 35.19a (2013).

By the Commission.

(S E A L)

Kimberly D. Bose,
Secretary.

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[25] *Id.*