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UNITED STATES OF AMERICA 151 FERC ¶ 63,008
FEDERAL ENERGY REGULATORY COMMISSION

Entergy Arkansas, Inc.	Docket Nos.	ER13-1508-001
Entergy Gulf States Louisiana, L.L.C.		ER13-1509-001
Entergy Louisiana, LLC		ER13-1510-001
Entergy Mississippi, Inc.		ER13-1511-001
Entergy New Orleans, Inc.		ER13-1512-001
Entergy Texas, Inc.		ER13-1513-001

INITIAL DECISION

(Issued May 12, 2015)

APPEARANCES

Jennifer A. Morrissey, Esq., *Presley R. Reed, Esq.*, and *David S. Schaffer, Esq.* on behalf of Council of the City of New Orleans.

Michael R. Fontham, Esq., *Dana Shelton, Esq.*, and *Noel Darce, Esq.* on behalf of Louisiana Public Service Commission.

Jennifer Amerkhall, Esq., *Andrea J. Weinstein*, and *Steven J. Ross, Esq.* on behalf of the Entergy Companies.

James Keegan, Esq. and *Patricia Hurt, Esq.* on behalf of Federal Energy Regulatory Commission Trial Staff.

KAREN V. JOHNSON, Presiding Administrative Law Judge

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I. INTRODUCTION AND PROCEDURAL HISTORY

1. On May 17, 2013, Entergy Services, Inc. (Entergy or ESI), as an agent and on behalf of the Entergy Operating Companies (Operating Companies), submitted a tariff pursuant to Section 205 of the Federal Power Act (FPA). This tariff was designed to govern cost-based unit power sales and sales of designated power purchases (Unit Power Sales Tariff) between Entergy Arkansas, Inc. (EAI) and its Operating company affiliates. The tariff was set to be effective once Entergy Arkansas withdraws from the Entergy System Agreement (System Agreement) and joins the Midcontinent System Operator, Inc. (MISO), effective December 18, 2013 and December 19, 2013, consecutively.

2. For over fifty years, the Entergy Operating Companies have formed a single system administered by the Entergy System Agreement. The System Agreement is a Commission approved tariff among Entergy Systems Inc. and the six Entergy Operating Company subsidiaries of Entergy Corporation. The agreement governs energy exchange transactions between the Operating Companies, providing the basis for planning and operating generation and bulk transmission facilities on an integrated, single-system basis. The System Agreement contains seven service schedules, including Service Schedule 4, Unit Power Purchase (MSS-4). Service Schedule MSS-4 governs the unit purchases and sales between the Operating Companies, setting forth a formula rate that calculates the payments for monthly capacity and energy that the selling Operating Company would charge to the purchasing Operating Company.

3. On February 2, 2009, Entergy Arkansas and Entergy Mississippi (EMI) filed Notices of Cancellation to terminate their participation in the Entergy System Agreement, effective December 18, 2013 and November 7, 2015, respectively. The Commission accepted these notices on November 19, 2009.

4. On April 25, 2011, the other Operating Companies announced a proposal to join MISO, with a target implementation date of December 19, 2013, to coincide with Entergy Arkansas's withdrawal from the System Agreement. In Docket No. ER13-432-000, Entergy filed amendments to the System Agreement to facilitate that MISO integration. The amendments included removal of all references to Entergy Arkansas from the System Agreement. Entergy also committed to make an FPA section 205 filing by mid-2013 to establish an "MSS-4-like" rate schedule to govern ongoing sales

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of energy and capacity between Entergy Arkansas and the Operating Companies within the System Agreement at cost-based rates. Entergy's filing in Docket No. ER13-432-000 is pending before the Commission.

5. Prior to its withdrawal from the System Agreement, Entergy Arkansas was selling power and associated energy to Entergy Louisiana (ELL) and Entergy New Orleans (ENO), under terms pursuant to MSS-4. Since Entergy Arkansas is no longer a member of the System Agreement, MSS-4 may not govern unit power sales to, and purchases from, the remaining Operating companies. For such transactions to continue, Entergy Services filed the Unit Power Sales Tariff at issue in this proceeding. These sales will come under the proposed tariff when either the buyer or seller actually leaves the System Agreement.

6. All of the Operating Companies, except Entergy New Orleans, have also given notice to leave the System Agreement. On October 18, 2013, Entergy Texas (ETI) submitted a notice to withdraw from the System Agreement in Docket No. ER14-128-000, with a requested effective date of October 18, 2018. On February 14, 2014, Entergy Louisiana and Entergy Gulf States Louisiana (EGSL) submitted, in Docket Nos. ER14-1328-000 and ER14-1329-000, respectively, notices to withdraw from the System Agreement, with a requested effective date of February 14, 2019. Entergy Texas, Entergy Louisiana, and Entergy Gulf States Louisiana currently make MSS-4 sales. Entergy intends this tariff to establish a general rate schedule through which an Operating Company under the System Agreement may transact with a non-member Operating Company.

7. Each Operating Company is now a separately designated member of MISO. The tariff in this proceeding will pass through MISO's ancillary services charges and credits, uplift charges and credits, and administrative charges. MSS-4 has been similarly amended to provide a pass through of MISO charges.

8. The Louisiana Public Service Commission (LPSC) and the Council of the City of New Orleans (the Council) protested Entergy's filing of the Unit Power Sales Tariff, contending that this service is different from the Service Schedule MSS-4 service in that it includes new additional unsupported MISO pass through costs that were not part of the Service Schedule MSS-4 formula. They also opposed the 11 percent return on equity (ROE) reflected in the tariff.

9. In the Hearing Order issued December 16, 2013, the Commission accepted Entergy's proposed tariff effective December 19, 2013, subject to refund, and

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established settlement and hearing procedures.[1] By order dated December 31, 2013, the Chief Judge appointed Judge Michael Haubner as the Settlement Judge. As a result of subsequent settlement conferences, Entergy Services, on June 12, 2014, filed a Partial Settlement Agreement that resolved the issue of the MISO charges, and all the disputes in this proceeding. However, the parties were unable to agree on the ROE to be specified in the Unit Power Sales Tariff formula. On the same date, Entergy went on to file an unopposed Motion to Sever Issue for Hearing. In the motion, Entergy requested severance of the issue regarding the proposed ROE from all other issues in this proceeding. On June 16, 2014, the Chief Administrative Law Judge severed the ROE issue for hearing before the Presiding Judge.

10. The Presiding Judge held a prehearing conference on July 1, 2014, during which counsel for Entergy motioned to brief the issue as to whether the instant proceeding was to address the ROE for only new transactions under the Unit Power Sales Tariff, or existing transactions as well. Entergy's motion was granted and LPSC, Entergy and Commission Trial Staff (Staff) filed briefs. On July 23, 2014, the Presiding Judge issued an Order Regarding the Scope of the Proceeding. The Presiding Judge found that the Commission's Hearing Order did not limit the scope of the proceeding, nor distinguish between existing and future contracts, but set for hearing Entergy's proposed tariff in its entirety.

11. On August 27, 2014, Entergy filed the joint Direct Testimony and Exhibits of its witnesses Dr. William E. Avera and Adrien M. McKenzie, (Exs. ESI-100- ESI-112).[2] Dr. Avera supports an ROE of 10.66 percent. On October 9, 2014, LPSC filed the Answering Testimony and Exhibits of its witnesses Richard A. Baudino (Exs. LC-1 – LC-13) and Lane Kollen (Exs. LC-14 – LC-16). Witness Baudino recommends an ROE of 9.00 percent. Also on October 9, 2014, Staff filed the Answering Testimony and Exhibits of witnesses John K. Sammon (Exs. S-1 – S-3) and Douglas Green (Exs. S-4 – S-6). Mr. Green recommends an ROE of 8.95 percent.

12. On November 4, 2014, Entergy filed a motion to strike portions of Staff's testimony, contending that any testimony that goes beyond the single issue set for hearing regarding ROE percentage in the formula under this tariff is inconsistent with

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[1] *Entergy Arkansas, Inc.*, et al., 145 FERC ¶ 61,216 (2013).

[2] Dr. Avera assumed the testimony of McKenzie in response to Staff's December 15, 2014 motion to limit the presentation of testimony to a single witness. Entergy's DCF testimony will be referred to as that of witness Avera.

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the settlement in this proceeding. Staff and LPSC filed answers to the motion stating that Staff's testimony bears directly on the controversy of establishing an ROE for the Unit Power Sales Tariff, and is based on current reality. By order issued December 31, 2014, the Presiding Judge denied the motion to strike.

13. On November 7, 2014, LPSC filed the Cross-Answering Testimony and Exhibits of its witnesses Richard A. Baudino (Exs. LC-17 – LC-22). Witness Baudino updated his DCF analysis to reflect more recent data and to refine his analysis to take into account Staff witness Green's testimony. Mr. Baudino still recommends an ROE of 9.00 percent. On December 11, 2014, Entergy filed the Rebuttal Testimony and Exhibits of its witnesses (Exs. ESI-123 – ESI-144). Dr. Avera updated the results of his analyses and continues to seek a 10.66 percent ROE. Also on behalf of Entergy, Bruce M. Louiselle (Exs. ESI-113 – ESI-119), and Ellen Lapson (Exs. ESI-120 – ESI-122) filed Rebuttal Testimony and Exhibits.

14. The evidentiary hearing commenced on January 28, 2015, and ended on January 30, 2015.

15. On February 26, 2015, the parties to the proceeding submitted post-hearing initial briefs.

16. On March 23, 2015, the parties to the proceeding submitted post-hearing reply briefs.

17. On April 27, 2015, the Chief Administrative Law Judge issued an Order extending the issuance date of the Initial Decision from May 11, 2015 to May 15, 2015.

II. ISSUES

18. On January 12, 2015, Entergy Services, Inc., the Louisiana Public Service Commission, and Staff filed the following Joint Statement:

19. The sole issue in this proceeding is: "What is the just and reasonable return on equity ("ROE") component for use in Section 3.06 formula variable ("c") under the Unit Power Sales/Designated Power Purchases Tariff at issue in this proceeding?"

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20. Entergy Services, Inc. witness Dr. Avera recommends an ROE of 10.66%. Louisiana Public Service Commission witness Mr. Baudino recommends an ROE of 9.0%. Commission Trial Staff witness Mr. Green recommends an ROE of 8.95%.

III. ANALYSIS

21. The sole issue in this case is what is the just and reasonable return on equity to be used in a tariff that will govern sales among the Entergy Operating Companies, when one or more of them is not a party to the System Agreement. An ROE is just and reasonable when it satisfies the Supreme Court's long held standards established in *Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679 (1923) ("*Bluefield*") and *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 ("*Hope*"). That is, a company's ROE is just and reasonable if it enables that company to maintain its financial integrity, attract capital, and is commensurate with the cost of equity for companies with similar risk.

22. The guidance of *Bluefield* emphasizes that an ROE is set according to its particular use at its relevant time. Under the Supreme Court's holding in this case, the cost of equity is just and reasonable where it is "sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service." *Bluefield*, 320 U.S. at 690. What comprises a just and reasonable rate, the Court highlighted, "depends upon many circumstances and must be determined by the exercise of a fair and enlightened judgment, having regard to all relevant facts." *Id.* at 692. The Court went on to explain that the reasonableness of a return depends "upon circumstances, locality, and risk, and [] no proper rate can be established for all cases." *Bluefield*, 262 U.S. at 693, (citing *Willcox v. Consolidated Gas Co.*, 212 U.S. 19, 48-49 (1909)). In fact, the Court pointed out, a "rate of return may be reasonable at one time and become too high or too low by changes affecting opportunities for investment, the money market and business conditions generally." *Id.* at 693.

23. In *Hope*, the Supreme Court's decision echoed the considerations outlined in *Bluefield*, and reinforced that a just and reasonable return should be "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital… [and be] commensurate with returns on investments in other enterprises having corresponding risks." *Hope*, 320 U.S. at 603.[3]

[3] *See also Bluefield*, 262 U.S. at 690 ("The return should be reasonably sufficient to assure confidence in the financial soundness of the utility, and should be adequate, under

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24. In finding an appropriate ROE for an electric utility that meets the *Hope* and *Bluefield* standards, Commission precedent employs the Discounted Cash Flow (DCF) methodology. *See Southern Cal. Edison Co. v. FERC,* 717 F.3d 177, 179 (D.C. Cir. 2013) ("*Southern Cal Edison Co.*"). The Commission updated this method in its recent order in *Coakley v. Bangor Hydro-Electric Co., 147 F.E.R.C. ¶61,234*, *(2014), reh'g denied, 150 F.E.R.C. ¶61,165 (2015)* ("Opinion No. 531" or "*Coakley*"). In *Coakley*, the Commission's decision regarding the allowed ROE for the New England Transmission Owners (NETOs) of ISO New England, Inc (New England ISO), marked a transition from using a "one-step" DCF methodology to determine an electric utility's return, to employing the "two-step" approach it has traditionally reserved for natural gas and oil pipelines. *Coakley*, 147 FERC ¶ 61234, at P 39. While the one-step DCF method used only short-term growth rates, the two-step DCF methodology that will be utilized going forward accounts for both short and long-term growth estimates. *Id.*

25. In *Coakley*, the Commission first applied this two-step approach to the facts of the case before it. However, the Commission observed that unusual capital market conditions compelled an upward adjustment to the results of the DCF analysis, in order to arrive at an ROE that met the standards of *Hope* and *Bluefield*. *Id.* at 142. Rather than at the midpoint, the Commission set the NETOs rate of return halfway between the midpoint and the top of the zone of reasonableness. *Id.* Thus, the issue in this proceeding prompts an analysis in two parts. To determine the ROE for the tariff at issue in this case, it is necessary to first apply the Commission's two step DCF methodology to the facts present in the record. The next step is to evaluate whether any adjustment to the resulting ROE is needed, to be in compliance with the requirements of *Hope* and *Bluefield.*

A. What is the just and reasonable return on equity to be applied under the tariff at issue in this proceeding, using the Commission's two-step DCF methodology?

i. The Commission applies the DCF methodology in order to meet the standards of *Hope* and *Bluefield*.

26. To arrive at a just and reasonable return on equity, the Commission has long relied on the discounted cash flow model. *See Southern Cal Edison Co.,* 717 F.3d at

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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.").

179. This methodology identifies a reasonable zone from which the ROE can be chosen. *Id.* Because a utility's rate of return must attract capital, in accordance with *Hope* and *Bluefield*, the DCF methodology determines an ROE sufficient to attract equity investors based on their expectations of risk and return. *See, e.g., Canadian Ass'n of Petroleum Producers v. FERC*, 254 F.3d 289, 293 (D.C. Cir. 2001) (*CAPP v. FERC*). The Commission has outlined that "the DCF approach examines evidence regarding expectations of investors which are critical in determining the attractiveness of a company's securities… [For the Commission, the DCF] is a particularly helpful technique for determining the rates required to meet the *Hope* and *Bluefield* tests." Opinion No. 12, 3 FERC ¶ 61,045, at 61,133 (1978) (Opinion No. 12).

27. Elements of the DCF formula reflect investor expectations. The DCF model is premised on the assumption that an investment in common stock is worth the present value of the infinite stream of expected dividends discounted at a market rate commensurate with the stock's risk. *Id.* With simplifying assumptions, the formula for the DCF model may be expressed as: P = D/k-g, where "P" is the price of the common stock, "D" is the current dividend, "k" is investors' required rate of return, and "g" is the expected growth rate in dividends. *Id.* Solving for "k", the Commission's formula for what is known as the constant growth DCF model can be expressed as follows: k=D/P (1+.5g) + g, with 1+.5g referring to the "adjusted dividend yield." *Coakley*, 147 FERC ¶ 61234, at P 15. The adjusted dividend yield increases the dividend yield by one half of the growth rate, and accounts for the fact that dividends are paid on a quarterly basis. *Id.* Thus, the DCF methodology discovers investors' required rate of return by determining the current dividend yield on the stock price and the expectation for future dividend growth.

28. If a non-publicly traded utility does not have a stock price or issue dividends– inputs into the DCF formula– the Commission develops a list of comparable publicly traded companies with similar risk profiles to serve as a proxy for the private utility in the DCF calculations. *CAPP v. FERC*, 254 F.3d at 293-4. In *Coakley*, the Commission outlined the selection criteria for companies to be included in the proxy group. For the DCF analysis, the proxy group must consist of (1) a national group of companies considered electric utilities by Value Line Investment Survey (Value Line); (2) companies with credit ratings no more than one notch above or below the utility, using both the Standard & Poor's (S&P) and Moody's Investors Service ratings (Moody's) – when both are available; (3) companies that pay dividends and have neither made nor announced a dividend cut during the six-month study period; (4) companies with no major merger activity during the six-month study period; and (5) companies whose DCF results pass threshold tests of economic logic. *Coakley*,

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147 FERC ¶ 61234, at P 27, 107. The DCF results of the companies in this proxy group establish a "zone of reasonableness" on which the Commission can base the utility's ROE. *Southern Cal Edison Co.,* 717 F.3d at 179.

29. Outliers from this zone must be eliminated. The Commission explained in *Coakley* that it is unnecessary to screen the proxy group for high end outliers, representing unsustainable growth, since the two-step DCF methodology assumes the long term growth rate for each company is equal to the GDP. *Coakley*, 147 FERC ¶ 61,234, at P 118. However, the Commission has flexibly applied a test for low end outliers. The Commission excludes from the proxy group any company whose low end ROE fails to exceed the average bond yield by 100 basis points, or is above the average bond yield, but low enough that an investor would consider the stock to yield essentially the same return as debt. *Coakley*, 147 FERC ¶ 61,234 at P 122.

30. Once the zone of reasonableness is established, the Commission places the ROE at a just and reasonable point within that zone. *Southern Cal Edison Co.,* 717 F.3d at 179. For a single utility, the Commission has long used the median of the zone to determine the return since it is the median that best represents the central tendency in a skewed distribution of ROE results. *Id.* 182. The median is chosen over the midpoint because the median is less affected extreme results of the DCF analysis than the midpoint. *Id.* The Commission has stated that the median "giv[es] consideration to more of the companies in the proxy group, rather than only those at the top and the bottom," and "will lessen the impact of any single proxy company whose ROE is atypically high or low." *Id.* (citing *Transcontinental Gas Pipe Line Corp.,* 84 FERC ¶ 61,084 (1998)). Conversely, the Commission has opted for the midpoint of the zone of reasonableness when selecting an ROE for a diverse group of utilities, to better reflect a range, rather than a central tendency. *Id.* at 183 (citing *Midwest Indep. Transmission Sys. Operator, Inc.,* 106 FERC ¶ 61,302, at ¶ 62,192 (2004)).

ii. Straightforward application of the DCF methodology in this case produces an ROE of 9.01%.

a. Entergy's Position

31. After performing the DCF calculations, Entergy supports an ROE of 10.66%. Entergy contends that, while Staff and LPSC relied on "mechanical application" of the DCF methodology to arrive at their recommended ROEs, Entergy's witness,

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Dr. Avera, arrived at his recommendation through comprehensive analysis guided by the Commission's precedent in *Coakley*. Entergy Initial Br. 2.

32. Entergy states that even though the Commission employs the DCF methodology to find an ROE acceptable under *Hope* and *Bluefield*, "it is the result reached not the method used that determines whether an ROE is just and reasonable." Ex. ESI-100 at 5:16-16. Although Entergy mentions limitations to the DCF methodology, Entergy sets out to follow the Commission DCF guidelines established in *Coakley*.

33. To establish a zone of reasonableness, Dr. Avera constructed a proxy group based on the risk profiles of all six Entergy Operating Companies. Dr. Avera selected a national proxy group of utilities that met four criteria: (1) companies that are included in the Electric Utility Industry group compiled by Value Line; (2) electric utilities that have paid dividends over the last six months and announced no dividend cut in that time; (3) no electric utilities participating in a major merger or acquisition; and (4) electric utilities with a corporate credit rating one notch above or below those of Entergy, according to S&P and Moody's. Entergy Initial Br. 31. In Dr. Avera's opinion, investors were likely to think that the group he chose had risks and prospects comparable to Entergy's. Entergy states that in contrast, witnesses for Staff and LPSC selected a proxy group for only Entergy Arkansas, rendering each of their proxy groups invalid. Entergy Initial Br. 31-2.

34. Entergy asserts that since the tariff at issue is a generic tariff that applies to all six of the Entergy Operating Companies, there is no basis for contending that the ROE in this proceeding applies only to EAI. Entergy Initial Br. 23. To support its assertion, Entergy first points out the fact that the Hearing Order established a separate docket for each of the Entergy Operating Companies company, which would not have been necessary if this case applied only to Entergy Arkansas. Entergy Initial Br. 24. Secondly, Entergy cites the Hearing Order as stating that the Tariff "will also govern any new agreements for capacity and energy sales between Entergy Arkansas and the other Operating Companies, and sales between other Operating Companies if and when they withdraw from the System Agreement." *Id.* (citing Hearing Order at P 3). Third, Entergy argues that a challenge to the generic tariff is wholly at odds with the Partial Settlement Agreement. Entergy Initial Br. 25. Entergy points out that Neither Trial Staff, the Commission, through the Hearing Order, nor the intervenors, through their protests, ever suggested that the Tariff should be modified to include individual ROEs as a response to the Partial Settlement Agreement. *Id.* Entergy explains that Trial Staff is now foreclosed from raising the issue of separately determined ROE's since Section II.(1) of the Partial Settlement Agreement provides

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that once the agreement is approved by the Commission, "any and all issues with respect to the [tariff] that were raised or could have been raised in this proceeding will be resolved with finality." Finally, Entergy points out that the Section II.(2) of the Partial Settlement Agreement stated that the tariff would cover "any *new transactions* if and when other Entergy Operating Companies depart from the System Agreement"- a statement reiterated by the Settlement Judge in the settlement certification, and in the Commission in the Settlement Order. Entergy Initial Br. 25 (citing Certification at P 7 and Settlement Order at P 2).

35. Entergy states that after performing his DCF calculations, Dr. Avera followed Commission guidance and removed outliers from the zone of reasonableness. Witness Avera only considered results at least 100 basis points above the six-month average yield for public utility bonds, discounting two low end values from his national proxy group as unreasonable. Dr. Avera eliminated FirstEnergy Corp whose DCF result was 3.64% because it fell below the average monthly yields on Moody's rated triple-B bonds, which was about 4.7%. Entergy Initial Br. 35. Dr. Avera also eliminated Entergy, whose result was 5.97%, even though this result was slightly more than 100 basis points above six-month average yield for public utility bonds. Dr. Avera discounted this result because it was significantly below the expected utility bond yield, which forecasts of both HIS Global Insight and the Energy Information Administration implied would be 6.8% for the period of 2015-2019.

36. Dr. Avera did not eliminate any values on the high end of his DCF analysis. Entergy Initial Br. 36. Entergy rejects Staff witness Mr. Green's proposed test for high end values as illogical because, according to Dr. Avera, the DCF model is concerned with investor expectations, which has no limits. Entergy Initial Br. 37.

37. Dr. Avera's application of the two-step DCF methodology produced a zone of reasonableness of 6.23 to 12.53, with a median at 8.79%. Entergy Initial Br. 38. Entergy asserts that Dr. Avera performed consistent with *Coakley* by undertaking additional analyses and gathering information from other ROE models to assess whether a return of 8.79% was consistent with *Hope* and *Bluefield*. Concluding this ROE was not consistent, Entergy states, Dr. Avera used his additional analyses and judgement to arrive at an ROE recommendation of 10.66%. This percentage represents the midpoint between the top and the median of the zone of reasonableness. Dr. Avera updated his analysis to reflect the most recently available information, yielding an updated zone of reasonableness of 6.20% to 11.58%, and a median of 9.10%. However, he maintains his ROE recommendation of 10.66%. Entergy Initial Br. 39

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b. LPSC's Position

38. LPSC supports an ROE of 9.0%. LPSC points out that, when all the rate of return experts in this case applied the DCF analysis and related Commission precedent, they produced analyses that support a 9% return. On the other hand, LPSC states, Entergy's argument for a higher ROE is based on error-ridden DCF studies presented by Dr. Avera, and the flawed application of other return on equity methods. LPSC Initial Br. 4.

39. LPSC witness, Mr. Baudino, stated that for purposes of this proceeding, he followed FERC's guidance as set forth Opinion No. 531 for selecting the group. Mr. Baudino testified that his first step in applying the DCF analysis was to select a group of publicly traded electric utility companies that met the following criteria: (1) Companies included in the Electric Utility Industry groups compiled by Value Line; (2) Electric utilities that paid common dividends over the last six months and have not announced a dividend cut since that time; (3) Electric utilities with no ongoing involvement in mergers and/or acquisitions; (4) Electric utilities that have been assigned a corporate credit rating from one notch below to one notch above EAI's utility's credit rating, considering both the S&P credit rating and the Moody's issuer rating. Ex. LC-1 at 23-4.

40. Mr. Baudino states that once he applied FERC's two-stage approach, he calculated the average, median, and midpoint ROE for the National Group. He reported that the average DCF result was 8.78%, the median DCF result in 9.01 % and the midpoint DCF result was 9.17%. Ex. LC-1 at 32. Mr. Baudino's application of the two-step DCF methodology produced a zone of reasonableness of 6.74 to 11.59, with a median at 9.01%. Ex. LC-5 at 1.

41. Mr. Baudino testified that Entergy's proposed tariff applies only when one or both of the operating companies are not in the System Agreement. Mr. Baudino stated that since as of this date Entergy Arkansas is the only operating company that has withdrawn from the System Agreement and is selling capacity to other operating companies, the return on equity in this proceeding should reflect EAI's credit profile. Mr. Baudino insists that the ROE should match the present application of the tariff. Mr. Baudino points out that it will be several years before Entergy's proposed Tariff would apply to the other Operating Companies, except for those transactions where EAI is selling capacity to ELL. Further, Mr. Baudino contends, these companies are presently buyers, not sellers, of capacity pursuant to the Entergy System Agreement

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Service Schedule MSS-4. Therefore, it is LPSC's position that it is reasonable to estimate only EAI's return on equity for purposes of this proceeding. Ex. LC-1 at 24-5.

42. LPSC contends that Dr. Avera's analyses contained a number of errors that produced inflated results. LPSC points out that Dr. Avera's DCF updates contained several mistakes, to which he conceded, that render his conclusions unreliable. LPSC Initial Br. 15-6. For example, LPSC points out, Dr. Avera's use of the 12.53% result for Portland General Electric turned out to result from an error. The IBES growth rate that Dr. Avera relied on included an erroneous input that was corrected after being brought to the attention of Reuters, which publishes the IBES growth rates in Yahoo! Finance. Tr. 192 (Avera). As a result of the correction, the growth rate for Portland General Electric was reduced from the 11.21% used by Dr. Avera, to 7.8%. With the correction, instead of 12.53%, the Portland General Electric result would have been 10.26%. LPSC Initial Br. 14.

43. LPSC also argues that Dr. Avera used in his DCF calculations an inconsistent mix of methodologies that inappropriately skewed his results upward. LPSC maintains that, for a single utility, the Commission requires that the median be used to determine the central tendency of results. LPSC points out that Dr. Avera followed this requirement in finding the central tendency of the entire proxy group, but switched to a midpoint approach when determining the central tendency of the upper half. LPSC Initial Br. 19-20. LPSC maintains that Dr. Avera's use of the midpoint gave a heavy weighting to an extreme outlier, the result for Portland General Electric, which stemmed from the IBES error in its growth estimate. LPSC points out that, as a result of this weighting, Dr. Avera's 10.66% recommendation was higher than 23 of the 24 utilities considered in his proxy group. LPSC Initial Br. 21.

44. LPSC also states that Dr. Avera misapplied the Commission's methodology in shaping his proxy group. LPSC asserts that Dr. Avera used inappropriate criteria to select his proxy group; Avera did not in fact follow the Commission's directive in *Coakley* to include companies in the proxy group that are one 'notch' higher or lower than the corporate credit ratings of the utility at issue. According to LPSC, Dr. Avera considered the full range of credit ratings of S&P and Moody's for all six Entergy Companies but their Moody's credit ratings vary. LPSC further contends that by including two Companies that are not currently sellers under the tariff in applying the credit ratings screen, Dr. Avera was able to include Companies in his proxy group and that had credit ratings of A3, a higher rating than Entergy Arkansas's. LPSC explains that if Avera had used only the credit ratings of Entergy as a whole, or of EAI, the

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only Company likely to make sales under the tariff for years, this would eliminate five Companies from his proxy group. LPSC Initial Br. 17.

c. Commission Staff's Position

45. Commission Staff supports an ROE of 8.95%. Staff witness, Mr. Green, testified that he used the Commission-required Discounted Cash Flow (DCF) method adopted in *Coakley*. Ex. S-4 at 10. Mr. Green stated that he used the following screening criteria to ensure that his proxy group had business operations, business risk, and financial risk characteristics most similar to Entergy Arkansas, while also being large enough to eliminate or significantly reduce measurement error. The criteria included companies that: (1) operate in the continental United States and are classified by Value Line as an electric utility company; (2) have an S&P rating of "BBB," and a Moody's credit rating within the "Baa" class of ratings; (3) has an S&P utility business risk profile of "excellent" or "strong," (4) has an S&P financial risk profile of "significant;" (5) are currently paying a dividend, have not cut their dividend level within the six-month data period for the DCF analysis, and for whom Value Line does not forecast a dividend cut; (6) has no announced or pending significant merger, acquisition or spin-off activity during the recent six-month data period used in the DCF analysis; (7) has a five-year earnings growth estimate reported by the Institutional Brokers' Estimate System (IBES) through Yahoo! Finance; (8) has a DCF result that exceeds the most recent six-month average yield on Moody's "Baa" Public Utility bonds by at least 100 basis points; and (9) has a DCF model growth rate (g) that is not higher than the proxy group's median average estimate of investors' true required return on equity (k). Ex. S-4 at 14-5.

46. Staff asserts that Mr. Green's proxy group of ten companies is of a sufficient size to provide a basis for estimating Entergy Arkansas's ROE. Staff Initial Br. 16. Staff states that Mr. Green's analysis produces a reasonable range of ROEs from 6.82 percent to 10.22 percent, and his recommended ROE of 8.95 percent at the median. Staff Initial Br. 15.

47. Staff points out that since the risks associated with Entergy Arkansas's unit power sales is low, Mr. Green's recommended median ROE is generous for Energy Arkansas's unit power sales. Staff Initial Br. 16. Staff's states that its result is reasonable in that it yields a higher median (8.95 percent - Ex. S-4 at 2) than the median Entergy calculated in its own DCF analysis (8.79 percent - Ex. ESI-100 at 8). Thus, Staff, argues, its analysis is not a results-driven analysis, but it is the simple

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outcome of the DCF analysis the Commission adopted in *Coakley*. Staff Initial Br. 16.

d. Council's Position

48. Like LPSC, the Council points out that witnesses for Staff, LPSC, and even Entergy, each calculated an ROE guided by the Commission's recently revised methodology as outlined by *Coakley*, and derived a range of reasonableness with a median ROE falling within 15 basis points of one another: 8.95%, 9.01%, and 9.10%, respectively. Accordingly, the Council maintains that the record in this case demonstrates that an ROE within this 15 basis point range meets the Commission's criteria for a just and reasonable return. Council Initial Br. 4.

e. Determination

49. The just and reasonable return on equity to be applied under the tariff at issue in this proceeding is 9.01%. Application of the Commission's DCF methodology to the national proxy group for Entergy Arkansas, the only Operating Company currently making sales under this tariff, yields this percentage as the median of the zone of reasonableness. All three of the experts who performed DCF analyses in this case arrived at results within 15 basis points of each other around the 9% mark. Commission precedent acknowledges this median value as the just and reasonable rate of return for a single utility, in absence of unique circumstances presented in the record of a particular case.

50. To find the investor required rate of return under the Unit Power Sales Tariff, it is necessary to examine publicly traded companies with risk profiles similar to Entergy Arkansas, the only Company currently making sales under this tariff. The Presiding Judge agrees with the contentions of LPSC, Commission Staff, and the Council that Entergy's witness, Dr. Avera, erred in selecting a proxy group that was comparable to all six of the Operating Companies, as opposed to only Entergy Arkansas.

51. Entergy claims the tariff in this case is an umbrella tariff to cover sales by any Operating Company now and in the future. However, Entergy Arkansas is the only seller under this tariff now or for the foreseeable future. The only potential new sellers that will be covered by this tariff are Entergy Texas, which is not projected to leave the System Agreement for five years, and Entergy Mississippi, which will leave

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the System Agreement in November 2015, but will not be a seller under the tariff for the foreseeable future.

52. First, evaluating a reasonable return based on EAI follows the *Bluefield* requirement to establish an ROE grounded on the "circumstances, locality, and risk" of a particular case. *Bluefield*, 320 U.S. at 693. Developing an ROE for the Entergy Operating Companies as a group would produce an ROE based on factors that are not germane to the risks associated with the power sales made by Entergy Arkansas. Furthermore, basing the ROE on Entergy Arkansas, for now, also acknowledges the observation made in *Bluefield* that an ROE that may be reasonable today may later become too high or too low, due to changing market conditions. *Id.* at 693. The *Bluefield* court highlighted timing as an important factor in a return being just and reasonable. A reasonable return must be "sufficient to yield a reasonable return on the value of the property used *at the time it is being used to render the service*." *Bluefield*, 320 U.S. at 690 (emphasis added). It is unlikely that an ROE developed in this proceeding will precisely fit market conditions five years from now, when another company may start making sales under the tariff. In sum, the business and financial circumstances that are true for the Operating Companies as a group today may not necessarily be true for Entergy Arkansas alone, or for Entergy Texas or Entergy Mississippi in the future.

53. Entergy's arguments as to why the DCF study in this proceeding should consider the risk profiles of all six companies are unpersuasive. As Entergy points out, it is true that the other five operating companies may make sales under this tariff. However, this does not change the Council's observation that "should one of the other Operating Companies propose to make a sale under this tariff, it would have to file that Service Agreement with the Commission and, if Entergy found that the ROE developed in this case was inappropriate for that Operating Company, or that Operating Company and Entergy Arkansas, they could propose that it be amended at that time." Council Initial Br. 20.

54. Entergy goes on to argue that focusing on EAI in setting the ROE is contrary to the Hearing Order, but cites a portion of that order where the Commission merely summarizes Entergy's own position. Entergy also claims that the Partial Settlement Agreement foreclosed challenges to the tariff that could have been raised prior to the agreement. However, this provision referred to matters in this proceeding resolved by settlement negotiations, from which all issues regarding the ROE were clearly

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excepted. According to section II.(3) of the agreement, "the parties… agree that the stated ROE… is not determined in this Settlement and will be the subject of a separate hearing." Nothing in the Hearing Order or the Partial Settlement Agreement prohibits reexamining the ROE set under this tariff as new Operating Companies leave the System Agreement and begin making sales under the tariff.

55. Given that the risk profile of Entergy Arkansas is the only one being considered, the Presiding Judge agrees with LPSC that Entergy's selection criteria for its proxy group for the DCF analysis was inappropriate. If only Entergy Arkansas is making sales under the tariff for several years, it is incorrect to evaluate the proper return for these sales based on risk factors- such as credit rating- of companies that are not yet selling under the tariff. For example, the Commission's guidelines in *Coakley* specify creating a proxy group of companies that have corporate credit ratings that are one "notch" higher and lower than that of the utility at issue, according to both the S&P and Moody's corporate credit ratings. Although Entergy Arkansas's Moody's credit rating is Baa2, Dr. Avera included companies based on the credit ratings of Entergy Louisiana and Entergy Gulf States Louisiana, which have Moody's credit ratings of Baa1. By applying the Commission's rule to companies that are not sellers under the tariff, Witness Avera was able to include companies in his proxy group with credit ratings of A3, two "notches" above EAI's. Once the Commission's "one notch rule" is properly applied to the risk profile of Entergy Arkansas, the company immediately selling under the tariff, up to five companies would be eliminated from Dr. Avera's proxy group. This discrepancy illustrates that Entergy's proxy group is an unsuitable one on which to perform the Commission's DCF analysis. Because Entergy inappropriately based its proxy group on the risk profiles of all six Operating Companies, its proxy group does not provide a suitable DCF representation for the company that will be selling under the tariff. Since LPSC witness, Mr. Baudino, based his analysis on EAI alone, the Presiding Judge finds LPSC's proxy group to be foundational in this case. The Presiding Judge finds that LPSC's proxy group most closely follows the selection criteria articulated in *Coakley*.

56. Within LPSC's proxy group, Commission policy, affirmed by *Southern Cal Edison Co.*, dictates that the ROE for Entergy Arkansas, a single utility, is best established by the central tendency of the DCF results. In contrast to the Commission's use of the midpoint for the diverse group of utilities that were the NETOs in *Coakley*, the Commission's approach for a single utility such as Entergy Arkansas, has been to set the ROE at the median of the proxy group. Here, the median of LPSC's proxy group shows a value of 9.01%. Therefore, straightforward

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application of the DCF methodology to Entergy Arkansas's risk profile reveals 9.01% as investors' required rate of return.

B. Does direct application of the Commission's two-step DCF methodology satisfy the requirements of *Hope* and *Bluefield*?

i. In *Coakley*, the Commission determined that, due to anomalous market conditions, the result of the DCF analysis needed to be adjusted in order to meet the requirements of *Hope* and *Bluefield*.

57. Although results of the DCF analysis aim to determine investors' required rate of return, placement of the ROE within the zone of reasonableness is ultimately driven by the obligation to satisfy the requirements of *Hope* and *Bluefield*. *Coakley*, 147 FERC ¶ 61234, at P 143. More than just the results of mechanical calculations, a utility's ROE must be "reasonably sufficient to assure confidence in the financial soundness of the utility and should be adequate, under efficient and economical management, to maintain its credit and enable it to raise the money necessary for the proper discharge of its public duties." *Bluefield*, 262 U.S. at 693; *see also Hope*, 320 U.S. at 603.

58. In *Coakley*, the Commission acknowledged its usual method of setting the ROE at the median of the zone of reasonableness for a single utility and at the midpoint for a diverse group of utilities, but chose to diverge from this practice in order to better achieve the just and reasonable standards of *Hope* and *Bluefield*. *Coakley*, 147 FERC ¶ 61234, at P 144. Because the record in *Coakley* indicated the presence of unusual capital market conditions, cited to by both sides of the proceeding, the Commission tentatively approved placement of the NETOs' base ROE at the midpoint of the upper end of the zone of reasonableness. The approved ROE was 10.57%.[4] *Id*. at P 142.

59. The Commission explained that the unique capital market conditions reflected in the record at the time the DCF calculations were performed discouraged confidence that the midpoint of these results would meet the capital attraction standards of *Hope* and *Bluefield*. *Id*. at P 145. This lack of confidence, driven by the circumstances, prompted exploration of alternative ROE benchmark methodologies that would shed light on the appropriateness of employing the midpoint of the DCF results to set the

[4] This percentage was subject to determination of the appropriate long term growth rate, given the Commission's adoption of the two-step methodology.

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ROE. *Id.* These benchmarks included Capital Asset Pricing Model ("CAPM"), risk premium analysis, expected earnings analysis, and state commission-approved ROEs. *Id.* at P 146. The Commission emphasized that its study of other ROE calculation methods did not represent its departure from the DCF methodology, but was a means to inform placement of the ROE within the DCF zone of reasonableness, when the appropriateness of the Commission's usual placement at the midpoint is defeated by record evidence. *Id.*

60. On rehearing in *Coakley*, the Commission solidified that its decision to raise its placement of the NETOs' ROE was based on the record in that case. *Coakley,* 150 FERC ¶ 61,165 (2015) at P 36. Importantly, Commissioner Colette D. Honorable in her concurrence emphasized that,

> …the finding of "anomalous market conditions" in Opinion No. 531 did not create a bright line test nor did it create a presumption that market conditions will be found to be anomalous going forward. The anomalous, or unusual, market conditions that were found in the original order to justify the placement of the base ROE above the central tendency of the zone of reasonableness were, by definition, atypical. Any public utility that seeks to rely upon anomalous market conditions to justify placement of its base ROE in the upper end of the zone of reasonableness will be tasked with demonstrating, in each case, that market conditions are indeed anomalous and that the adequacy of a base ROE set at the midpoint of the zone of reasonableness should be scrutinized. The utility should expect a rigorous analysis of the record when it attempts to make such a demonstration. *Id.* (concurring opinion on rehearing).

61. Commissioner Honorable clearly references the high burden of proof required in order for the Commission to deviate from its precedential treatment of the ROE within the zone of reasonableness.

ii. Despite the Commission's decision in *Coakley*, straightforward application of the DCF methodology in this case meets the standards of *Hope* and *Bluefield*.

a. Entergy's Position

62. Entergy asserts that Dr. Avera's ROE recommendation of 10.66% was based on review of other models considered by the Commission in establishing an ROE within the DCF zone of reasonableness in *Coakley*. Entergy Initial Br. 11-12.

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Entergy also contends that LPSC and Staff are attempting to substitute a mechanical, rule-based methodology for the reasoned evaluation undertaken by the Commission and followed by Dr. Avera. Entergy points out that the Commission, in *Coakley*, noted that there may be different points in the zone of reasonableness that produce a reasonable ROE. Entergy Initial Br. 12 (citing *Coakley,* 147 FERC ¶ 61234 at P 151 n.306).

63. To rebut the contentions from LPSC and Staff that anomalous economic conditions cited in *Coakley* are no longer present, Entergy sponsored the testimony of Ellen Lapson, a Chartered Financial Analyst and founder and principal of Lapson Advisory. Entergy Initial Br. 13. Ms. Lapson testified that current monetary and financial conditions were unchanged from the conditions discussed in *Coakley*, and they remain distorted by massive monetary operations of the Federal Reserve System and U.S. Treasury. Entergy Initial Br. 13. Ms. Lapson testified that low interest rates do not reflect normal market conditions, but instead reflect the massive intervention by the Federal Reserve that has driven an excess monetary supply into the bond markets and thereby suppressed interest rates. Entergy Initial Br. 19-20. Ms. Lapson also testified that global disturbances in international "hot spots" and concerns about the global economy also produce investor flight from risk. She continues that, flight from geo-political risk has contributed, along with ultra-low interest rates, to raising the prices and suppress the yields of utility bonds and equities, prolonging the disruption of the investment environment. Ex. ESI-120 at 7:17-8:7. Ms. Lapson concluded that, as long as these conditions persist, "the anomalous or aberrational capital market conditions that the Commission found in Opinion No. 531 remain very much in effect." *Id.* at 10:17-11:3.

64. Ms. Lapson testified that although the Federal Reserve scaled back its purchase of debt securities by October 2014, it still continues to hold an unprecedented amount of debt securities on its balance sheet, reinvesting in new bond purchases with the stated intention to maintain its holdings at the level of $4.5 trillion." Entergy Initial Br. 15.

65. Entergy argues that the anomalous DCF results "that prompted the Commission to approve an ROE at the middle of the top end of the DCF zone in Opinion No. 531" are evident today. Therefore, Dr. Avera's recommendation appropriately falls within the upper end of the zone of reasonableness determined by applying the two-step DCF methodology. Entergy Initial Br. 10. Entergy contends that although Dr. Avera's recommendation of 10.66% is slightly above the midpoint

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of the upper half of the zone of reasonableness, parties may recommend different points within the zone. Entergy Initial Br. 10 n.1 (citing *Coakley* at P 151 n.306)

66. Entergy argues that the Commission's discussion of turbulent economic conditions was an underpinning but not the basis for the holding in *Coakley*. Instead, Entergy contends, the reason that the Commission approved an ROE from the upper end of the DCF range was because the DCF midpoint produced anomalous results that did not reflect "the equity returns necessary to meet the *Hope* and *Bluefield* capital attraction standards." Entergy Initial Br. (citing *Coakley* at P 145).

67. Entergy challenges LPSC's belief that because Dr. Avera's starting point was the DCF median, then the median of the upper end of the range is a better indicator of the central tendency of that range, as opposed to Dr. Avera's use of the midpoint. Entergy reinforces that Dr. Avera's ROE recommendation of a 10.66% ROE was based on a comprehensive review of the results of the other models that were carefully considered by the Commission in establishing a fair and reasonable ROE from within the DCF zone of reasonableness in *Coakley*. Entergy contends that, in contrast, the 9.7% value representing the "median of the upper end" represents LPSC's attempt to substitute a mechanical, rule-based methodology for the reasoned evaluation undertaken by the Commission and followed by Dr. Avera. Entergy Initial Br. 11-2.

68. Entergy states that since the Commission determined that alternative ROE benchmarks provide important guidance in evaluating a fair ROE from within the DCF zone of reasonableness, Dr. Avera, consistent with that guidance, presented the results from the risk premium model, the CAPM, and the expected earnings approach. Entergy Initial Br. 40. In addition to the specific analyses the Commission referenced in *Coakley*, Dr. Avera also implemented additional methods in order to further support his ROE recommendation of 10.66%. Entergy Initial Br. 46.

69. Entergy contends that there were several problems with the other parties' assertion that, even if anomalous conditions persist, the adjustment to the DCF results adopted in *Coakley* was only to incent new transmission investment. Entergy insists that (1) the Commission never said that the adjustments to its DCF approach would apply only to transmission facilities, (2) the ROE guidance applied to existing transmission facilities, some of which are every bit as old or older than Entergy's generators, and (3) the issue of transmission-specific ROE incentives was addressed directly by the Commission and did not influence the ROE methodology adopted by the Commission. Entergy Initial Br. 4.

70. Finally, Entergy argues that although Staff and LPSC suggested that there should be no DCF adjustment because Entergy bears little risk in connection with the sales made under the Tariff, the Commission does not adjust ROE determinations based on the risk perceived with a particular transaction or rate schedule, except in very unusual circumstances, which are not present here.

b. LPSC's Position

71. LPSC disputes Entergy's contention that the anomalous economic circumstances that the Commission found in *Coakley* still exist today. LPSC explains that the time referred to in *Coakley* was 2011-early 2013, and that the same economic circumstances that existed at that time do not prevail today. LPSC Initial Br. 30.

72. LPSC argues that even if investors are likely to expect higher interests rates because of actions of the Federal Reserve, the DCF analysis incorporates securities prices, which reflect any investor expectations regarding future interest rates. LPSC argues that although the Federal Reserve stated that its holdings of longer-term securities should maintain downward pressure on longer-term interest rates, investors in securities markets pay attention to the actions and impacts of the Federal Reserve, and the price of securities and interest rates reflect their knowledge, information and expectations. LPSC Initial Br. 31. Therefore, LPSC states, it would be inappropriate to adjust the DCF results upward when they already reflect investor expectations regarding future changes to the economy. *Id.*

73. LPSC points out that Entergy witness, Dr. Avera, cites the same recent economic trends as Mr. Green and Mr. Baudino, but reaches the opposite conclusion -- that the same anomalous circumstances that existed in Opinion No. 531 continue to exist today. LPSC argues, however, Dr. Avera operates on a false assumption that investors are not acting with knowledge of these economic conditions and that stock prices do not reflect investors' knowledge. LPSC argues that this position conflicts with basic economic theory that investors act with knowledge of current conditions and events and markets efficiently reflect that knowledge. *Id.*

74. LPSC also argues that there were several flaws with Witness Avera's calculations of alternative ROE benchmarks he employed. LPSC states that Dr. Avera's risk premium approach produced inflated results through a circular analysis using a flawed data set, his CAPM approach employed a faulty DCF analysis

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and was biased by a mismatch of data, and his "expected earnings" approach has little relationship to investor ROE requirements. LPSC Initial Br. 23, 25, 27.

75. LPSC states that although, in *Coakley*, the Commission relied on Ms. Lapson's testimony regarding investors' perception of unique risks of transmission investment, Ms. Lapson has not here presented as detailed testimony regarding risks associated with ownership of generating assets or identified specific evidence as to how investors perceive those risks. LPSC Initial Br. 37. LPSC points out that Ms. Lapson's two line testimony regarding risk in this case contrasts starkly with her extensive, detailed documented testimony regarding risk in Opinion No. 531. LPSC Initial Br. 38

76. Lastly, LPSC argues that the risks FERC cited, with respect to transmission infrastructure, are not present with respect to capacity charges for unit sales under Entergy's proposed tariff. LPSC insists that sales under the proposed tariff are much lower risk since they only involve generation sales and purchases between Entergy's operating companies. Thus, for LPSC, the risk associated with such transactions bear no resemblance whatsoever to those presented by FERC in Opinion No. 531. LPSC Initial Br. 40.

c. Commission Staff's Position

77. Staff contends that there is no record evidence that the anomalous market conditions cited in *Coakley* exist in this case. Staff states that an ROE based on the median of the range is sufficient for Entergy Arkansas to attract capital, and therefore, reflects a reasonable return. Staff Initial Br. 22. Staff continues that current market conditions are not anomalous, so no ROE placement in the upper half of the zone of reasonableness is warranted. Staff Initial Br. 24.

78. Staff explains that a more reasonable interpretation of the Commission's finding in *Coakley* is that the two-step DCF methodology applies to all electric public utilities but that anomalous market conditions must be determined on a case by case basis. Staff Initial Br. 27.

79. Staff takes issue with the fact that Entergy claims its risk premium analysis yields an ROE of 10.61 percent, its CAPM average result is 11.77 percent, and its average risk premium for state ROE is 11.29 percent. Staff points out that Entergy's average risk premium was developed, not using ROE results developed based on a record, but almost entirely settlement ROE results, which are unreliable since they are driven by trade-offs in settlements. Staff Initial Br. 20 (citing TR. 214:17 – 220:1).

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80. Staff insists that there is no reason to adopt a return on equity halfway between the midpoint of the zone of reasonableness and the top of that zone, as in *Coakley*, because of the limited risks associated with the facilities in this proceeding, compared to investments in transmission facilities. Staff Initial Br. 6.

d. Council's Position

81. The Council states that the record in this proceeding demonstrates that, giving full consideration to the relevant facts and circumstances of this case, an ROE at the median of the range of reasonableness satisfies the requirements of *Hope* and *Bluefield*. Council Initial Br. 3.

82. The Council contends that although Entergy's witnesses expounded extensively on the factors and conditions that the Commission found compelling in Opinion No. 531 when it tentatively approved a base ROE of 10.57% to be applied to transmission transactions under ISO New England's tariff, Entergy failed to demonstrate that any of those same factors and conditions are present or relevant in this case. The Council further argues that Entergy failed to provide any evidence (1) that the requirements of *Bluefield* and *Hope* are not met by a straightforward application of the ROE methodology; or (2) that the particular circumstances of this case warrant any upwards adjustment to the median ROE similar to what the Commission allowed in *Coakley*, much less an upwards adjustment of more than 150 basis points from the median to 10.66%. Council Initial Br. 4

83. Finally, the Council states that the limited scope of application of the tariff at issue in this case is a relevant factor, since the policy considerations and the business and financial risks associated with transmission relevant in Opinion No. 531 are not present here. Instead, the Council explains, the tariff at issue here that will govern only a handful of affiliate transactions that have little, if any impact, on investment decisions made by investors in Entergy. The Council thus contends that any upward adjustment to the median ROE would be unwarranted, inappropriate, and would result in unjust and unreasonable rates under the UP Tariff. *Id.*

e. Determination

84. Direct application of the DCF methodology in this case, which yields a recommended return of 9.01%, is consistent with *Hope* and *Bluefield*. In *Coakley*, the

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Commission's goal was to find a just and reasonable rate for the NETOs that met the capital attraction standards of *Hope* and *Bluefield*. The Commission found evidence in the record that indicated that for the particular case before it, following its usual precedent of setting the ROE at the midpoint of the zone of reasonableness for a diverse group of utilities would not achieve this goal. *Coakley*, 147 FERC ¶ 61234, at P 142. In contrast to *Coakley*, where the record demonstrated unique capital market conditions that impacted investors' required rate of return for ISO New England, here the record does not show that Entergy Arkansas's ROE has been similarly affected. Entergy has not met its burden to show that a unique environment specifically impacts EAI, its investors, and the rate of return they require. Because evidence in the record does not demonstrate that unusual capital market conditions are in effect in this particular case, straightforward application of the Commission's DCF methodology, would be consistent with *Hope* and *Bluefield*. Thus, placing the ROE at the median of the zone of reasonableness is sufficient to meet these standards.

85. The Commission in *Coakley* expressed concern that the "anomalous market conditions" presented in the record showed that setting the ROE at the midpoint for New England ISO would fail to meet the capital attraction standards of *Hope* and *Bluefield*. *Coakley*, 147 FERC ¶ 61234, at 145. In its decision, the Commission specifically relied on the record's indication that historically low bond yields and risks involved in electric transmission infrastructure investment influenced the ROE placement that would be sufficient to meet *Hope* and *Bluefield* requirements. *Id.* at P 145 n.285; P 149-150. However, the intention of *Coakley* was not to mark a new period of "anomalous conditions" during which all ROE's would benefit from an upward adjustment from the Commission's precedential placement within the zone of reasonableness. Instead, the Commission, and Commissioner Honorable's concurrence, made clear that any ROE adjustment would be made on a case by case basis. *Coakley,* 150 FERC ¶ 61,165 (2015). Further, the Commissioner also made it apparent that in making its case for a modification, a utility must meet a high burden of proof. *Id.*

86. Here, Entergy did not meet this burden to develop a record showing that the rate of return required by Entergy Arkansas's investors has been similarly impacted by anomalous market conditions. In contrast to the robust and detailed analytics put forth in the *Coakley* record, Entergy relied on relatively anemic claims to support its bid for an ROE placement in the top half of the zone of reasonableness. Whereas the record in *Coakley* examined analysts' reports from UBS, Credit Suisse, Goldman Sachs, Brean Murray, Carret & Co., and Deutsche Bank, the evidence presented by Entergy proved to be superficial. *Coakley,* 150 FERC ¶ 61,165, at P 51.

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87. For example, in *Coakley*, with regard to risks affecting transmission infrastructure investment, specific to the NETOs' cost of capital, ISO New England's witness provided a UBS Investment Research sector comment stating a belief that companies will redeploy capital elsewhere if transmission returns are materially reduced. 147 FERC ¶ 61234, at 150 n.301. In contrast, Entergy's witness, Dr. Avera, merely referenced general interest rate trends (Ex. ESI-100 at 16, Figure ESI-2), while Witness Lapson offered a similarly generic chart depicting her computation of the "velocity of money." (Ex. ESI-122). None of Entergy's support for its position analyzed how these general observations of market activity affected Entergy Arkansas's risk and the ROE it would require to attract capital. In fact, while Witness Lapson saw that the appropriate risk to consider in this case is the risk of owning generation assets, she failed to show evidence addressing how the current economic environment influences investment in generation assets. Tr. 39:4-13 (Lapson).

88. Not only did Entergy fail to establish a record demonstrating that a higher placement of its ROE is justified in this case, but it also has not controverted the Commission's long standing presumption that the straightforward application of the DCF methodology is consistent with *Hope* and *Bluefield*. As explained in Opinion No. 12, the Commission relies on the DCF approach for insight regarding investor expectations, a critical factor in attracting capital in satisfaction of *Hope* and *Bluefield* requirements. Entergy largely ignores the value of the DCF method itself and merely uses the DCF outcome as a reference for the non-precedential methodologies it relies on instead. Witness Avera interprets the Commission's approach to the DCF in *Coakley* as looking at the "end result" and "if the end result is such that it reflects the anomalous capital market relationships, you should reference other methods." Tr. 140:5-11. If the Commission were to ignore everything about the DCF but its outcome, it would be disregarding the DCF practice itself and be changing its preferred methodology to the alternatives referenced in *Coakley*. Yet the Commission explicitly emphasized that "in considering…other methodologies, [it does] not depart from [its] use of the DCF methodology." 147 FERC ¶ 61234, at 146. To look at the end result only is to solely rely on alternative measures, and do away with what the DCF methodology reveals about investor expectations, contrary to the Commission's reliance on this method in meeting requirements of *Hope* and *Bluefield*.

89. In its arguments regarding market conditions, Entergy continues to ignore the utility of the DCF model. For example, Entergy cites investor expectations associated with actions of the Federal Reserve as having significant impact on whether a finding of anomalous market conditions may be found in the record of this case. While Staff

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witness, Mr. Green, pointed out that the Federal Reserve began to pare back its purchases of securities in the beginning of 2014, Ms. Lapson emphasized that the Federal Reserve continues to hold an unprecedented amount of debt securities on its balance sheet. Ex. S-4 at 58:11-2; ESI-120 at 14:1-10. However, these activities alone do not form a basis for an increased ROE in this case. The Presiding Judge agrees with LPSC's observation that investors in securities markets pay attention to the actions and pronouncements of the Federal Reserve and the associated impact on the economic climate. These monetary policies, and other economic activity Entergy references to illustrate anomalous market conditions, may have far reaching implications, but they are public and ongoing; they are not unique. Investors necessarily act with knowledge of these happenings, and the DCF methodology reflects this knowledge. Investor expectations are already reflected in the stock prices and dividend growth rates applied in the DCF analysis. Therefore, the DCF methodology is an adequate tool in arriving at an ROE that meets the capital attraction standards of *Hope* and *Bluefield*.

90. The overall flaw in Entergy's argument is that it neglects the just and reasonable standpoint articulated in *Bluefield* that no proper rate can be established for all cases. *Bluefield*, 262 U.S. at 693. That is, a just and reasonable ROE must be determined on a case by case basis. Entergy's experts rely too heavily on assessments of market conditions that date back to the *Coakley* case. In arguing their case they refer back to those same conditions with generality, and fail to analyze the impact on this tariff in particular. *See generally* Ex. ESI-100 at 14. However, the period with which *Coakley* dealt dated back to 2011 to early 2013, far removed from the time in the future when the sales under this tariff will occur. It is clearly inappropriate to base this tariff on the circumstances of a completely different type of entity during a significantly different and earlier economic time.

91. Entergy incorrectly interpreted the Commission's method in *Coakley* as using alternative benchmarks to evaluate whether the ROE produced by the DCF analysis was consistent with *Hope* and *Bluefield*. The Commission's presumption is that the DCF meets these standards. However, in *Coakley*, it was the *record*, showing anomalous market conditions that inspired lack of confidence in the precedential placement of the ROE within the DCF results. This apprehension then prompted an exploration of alternative benchmarks. The Presiding Judge finds that since the record of this case fails to show a unique market environment affecting Entergy Arkansas, the Commission should have every confidence in the results of the applied DCF methodology in this case. Thus, there is no reason to deviate from the DCF approach, into exploration of the non-precedential methods discussed by the parties.

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IV. ORDER

92. WHEREFORE, based upon due consideration of the evidence presented, it is the determination of the Presiding Judge that Entergy has failed to carry its burden to prove that its proposed rate of return to be applied on the Unit Power Sales Tariff is just and reasonable. The Presiding Judge finds further that Entergy's proposed ROE should be modified to 9.01% consistent with the findings in this Initial Decision, in order to meet the just and reasonable standard set by the Commission. The omission from this Initial Decision of any argument raised by the participants in this proceeding at the hearing or in their briefs does not mean that it has not been considered; rather, it has been evaluated and found to either lack merit or significance such that inclusion would only tend to protract this Initial Decision without altering its substance or effect. Accordingly, all arguments made by the participants in this proceeding which have not been specifically discussed or adopted by this decision have been considered and are rejected.

Karen V. Johnson
Presiding Administrative Law Judge

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