

**MEMORANDUM**

**TO:** NEPOOL Transmission Committee  
**FROM:** Eric Runge, NEPOOL Counsel  
**DATE:** April 24, 2016  
**RE:** Appeals Court Decision on FERC ROE Orders in FERC Docket No. EL11-66

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On April 14, 2017, the U.S. Federal Court of Appeals for the District of Columbia Circuit issued an opinion in *Emera Maine, et al v. FERC*.<sup>1</sup> The ROE Opinion vacates and remands a series of Federal Energy Regulatory Commission (FERC) orders, which had lowered the base return on equity (Base ROE) approved for New England incumbent transmission owners (Transmission Owners) from 11.14 percent to 10.57 percent.<sup>2</sup> The court held that FERC failed to find the then-existing ROE was unjust and unreasonable before setting a new Base ROE, and also failed to properly explain how its new Base ROE was just and reasonable. In addition to having implications for the ongoing ROE proceedings in New England, this decision provides clarity regarding FERC’s ratemaking obligations under section 206 of the Federal Power Act (FPA).

If you have any questions about this memo or its subject, please contact Eric Runge, 617-345-4735, [ekrunge@daypitney.com](mailto:ekrunge@daypitney.com).

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In 2011, pursuant to FPA section 206, the Massachusetts Attorney General’s office and other stakeholders (Customers) filed a complaint at FERC challenging the Transmission Owners’ Base ROE.<sup>3</sup> Customers alleged that the 11.14 percent Base ROE had become unjust and unreasonable given the changes in the capital markets.<sup>4</sup> After a hearing, the presiding Administrative Law Judge (ALJ) established a zone of reasonableness of 6.1 percent to 13.2 percent, concluded that the 11.14 percent ROE was unjust unreasonable, and – using the midpoint of the newly determined zone of reasonableness – set Transmission Owners’ Base ROE at 9.7 percent.<sup>5</sup>

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<sup>1</sup> *Emera Maine, et al v. FERC*, No. 15-1118 (Apr. 14, 2017) (“ROE Opinion”).

<sup>2</sup> *Coakley, Mass. Att’y Gen. v. Bangor Hydro-Elec. Co.*, Opinion No. 531, Docket No. EL11-66-001, 147 FERC ¶ 61,234 (2014) (“Opinion No. 531”); *order on paper hearing*, Opinion No. 531-A, Docket No. EL11-66-001, 149 FERC ¶ 61,032 (2014) (“Opinion No. 531-A”); *order on reh’g*, Opinion No. 531-B, Docket Nos. EL11-66-002 and EL11-66-003, 150 FERC ¶ 61,165 (2015) (“Opinion No. 531-B”).

<sup>3</sup> Formal Complaint of Massachusetts Attorney General, Docket No. EL11-66-000 (Sept. 30, 2011).

<sup>4</sup> See ROE Opinion at 7.

<sup>5</sup> *Id.*

On review of the ALJ Decision, the Commission adopted a new two-step discounted cash flow methodology for determining the just and reasonable ROE<sup>6</sup> and created a new zone of reasonableness of 7.03 percent to 11.74 percent.<sup>7</sup> FERC chose not to set the Base ROE at the midpoint of the zone of reasonableness because of “anomalous capital market conditions,”<sup>8</sup> and instead set Transmission Owners’ Base ROE at the midpoint of the upper half of the zone of reasonableness – 10.57 percent. Before establishing this new Base ROE the FERC did not first make a finding that the existing 11.14 percent Base ROE, which was within the zone of reasonableness was unjust and unreasonable. Instead the FERC appeared to assume that because it had determined that 10.57 percent was the just and reasonable ROE, 11.14 percent was unjust and unreasonable.<sup>9</sup>

On appeal, Transmission Owners argued that FPA section 206 requires an initial finding that the existing rate is unjust and unreasonable before the Commission can set a new rate. In response, FERC stated that its analysis determining the new Base ROE was just and reasonable also demonstrated that the prior Base ROE was unjust and unreasonable. In essence the FERC conducted the two-step analysis in one step.<sup>10</sup> Customers, on the other hand, argued that FERC failed to set forth a rational connection between the record evidence and its placement of the Base ROE at the midpoint of the *upper half* of the zone of reasonableness, instead of setting the Base ROE at the midpoint of the entire range of the zone, consistent with precedent.

The Appeals Court decided against the FERC on both petitions. First, the court explained that section 206 requires FERC to determine whether an existing rate is “unjust, unreasonable, unduly discriminatory or preferential . . . .”<sup>11</sup> before setting a new rate. Only *after* having made that determination may FERC then exercise its section 206 authority to impose a new rate.<sup>12</sup> In this case the FERC failed to make the prerequisite first finding that the existing 11.14 percent Base ROE was unjust and unreasonable, and therefore the FERC was not justified in setting any new rate. As the court explained, “FERC bore the burden of making an explicit finding that the existing ROE was unlawful before it was authorized to set a new lawful ROE.”<sup>13</sup> The court concluded that FERC “failed to articulate a satisfactory explanation” for its actions because it

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<sup>6</sup> See Opinion No. 531, 147 FERC ¶ 61,234 at PP 7–9, 13–41 (adopting the methodology historically used to set ROEs for natural gas and oil pipelines).

<sup>7</sup> ROE Opinion at 7.

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

<sup>9</sup> *Id.* at 9, 17.

<sup>10</sup> *Id.* at 17.

<sup>11</sup> *Id.* at 15 (citing 16 U.S.C. § 824e(a)).

<sup>12</sup> *Id.* (citing *Atl. City Elec. Co. v. FERC*, 295 F.3d 1, 10 (D.C. Cir. 2002); *Cities of Bethany v. FERC*, 727 F.2d 1131, 1143 (D.C. Cir. 1984)).

<sup>13</sup> *Id.* at 24 (citing *Atl. City Elec.*, 295 F.3d at 9–10; *Ala. Power v. FERC*, 993 F.2d 1557, 1571 (D.C. Cir. 1993)).

“never actually explained how the existing ROE was unjust and unreasonable.”<sup>14</sup> In short, FERC’s one-step reasoning effectively eliminated section 206’s statutory directive that existing rates be found unlawful before FERC establishes new rates.<sup>15</sup>

The Court then turned to the Customers’ petition and decided that the FERC improperly set the new rate because it abandoned, without sufficient justification, “its traditional use of the midpoint of the zone of reasonableness in setting Transmission Owners’ base ROE.”<sup>16</sup> The “anomalous capital market conditions” reviewed by the Commission only demonstrated that the Base ROE should be somewhere above the 9.39 percent midpoint of the zone of reasonableness.<sup>17</sup> The court stated that FERC failed to explain how picking the midpoint of the upper half of the zone of reasonableness was just and reasonable.<sup>18</sup> FERC’s “conclusory reasoning,” according to the court, “failed to establish a ‘rational connection’ between the record evidence and its decision.”<sup>19</sup>

As noted above, this case provides clarity regarding FERC’s dual burden in section 206 proceedings. Going forward, FERC – once it has a quorum with at least three Commissioners – will need to make an appropriate finding regarding the 11.14 percent Base ROE and then articulate its reasoning for any new Base ROE. This case will have implications for the three other active ROE complaint proceedings that are at least in part premised on the FERC orders that were vacated by the Opinion.<sup>20</sup> This case now goes back to FERC for further proceedings consistent with the Court’s decision. There is no statutory or court-ordered deadline for the FERC to issue an order on remand, so Base ROE uncertainty for New England regional transmission rates will remain the case for the near term.

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<sup>14</sup> *Id.* at 4, 24.

<sup>15</sup> *Id.* at 25.

<sup>16</sup> *Id.* at 26.

<sup>17</sup> *Id.* at 27-28.

<sup>18</sup> *Id.* at 28.

<sup>19</sup> *Id.* at 31-32 (citing *FERC v. Elec. Power Supply Ass’n*, 136 S. Ct. 760, 782 (2016)).

<sup>20</sup> See FERC Docket Nos. EL13-33, EL14-86, and EL16-64.