BEFORE THE
PUBLIC SERVICE COMMISSION OF WISCONSIN

Joint Application of Wisconsin Electric Power Company and Wisconsin Gas LLC for Authority to Adjust Electric, Natural Gas Rates and Steam Rates	Docket No. 5-UR-110

INITIAL BRIEF OF JOINT APPLICANTS

INTRODUCTION

The currently authorized rates of return on equity ("ROEs") for Wisconsin Electric and Wisconsin Gas (collectively, the "Companies" or "Joint Applicants") are 10.0% and 10.2%, respectively. The Commission most recently approved these ROEs in the Companies' 2020 test year rate settlement in Docket 5-UR-109 in December 2019, finding that each "strikes a reasonable balance between the needs of investors with the needs of consumers."[1] These ROEs are similar to those the Commission approved as just and reasonable terms in settlement agreements for other investor-owned electric and natural gas utilities late last year.[2] Since then, however, Joint Applicants and their customers have been hit by increasing inflation and capital costs, with no sign that conditions will be improving any time soon.

Public utility ROEs are an important factor that investors consider when making their investment decisions. They also send an important signal to the market as to "whether there is regulatory support for financial integrity, dividends, growth and fair compensation for business and financial risk."[3] Credit rating agencies also consider the authorized ROEs for regulated

1 *Final Decision*, Docket 5-UR-109 (PSC REF#: 381305) (Dec. 19, 2019) at 69.
2 *Final Decision*, Northern States Power Co.-Wis., Docket 4220-UR-125 (PSC REF#: 427625) (Dec. 20, 2021) (9.80% for 2022 and 10.0% for 2023); *Final Decision*, Madison Gas & Elec. Co., Docket 3270-UR-124 (PSC REF#: 427687) (Dec. 21, 2021) (9.80% for 2022); *Final Decision*, Wisconsin Power & Light Co., Docket 6680-UR-123 (PSC REF#: 427760) (Dec. 22, 2021) (10.00% for 2022 and 2023).
3 Direct-WEPCO/WG-Bulkley-8-9.

entities to be very important since: "(1) they help determine the cash flows and metrics of the regulated utility; and (2) they provide an indication of the degree of regulatory support for credit quality in the jurisdiction."[4]

WEC Energy Group has committed to reduce CO_2 emissions by 60% by 2025, 80% by 2030, and to achieve net carbon neutrality by 2050.[5] Wisconsin Electric is in the midst of a historic and capital-intensive transition of its generating fleet from older fossil technologies to utility scale renewable and storage technologies, which will require billions of dollars of new investment.[6]

Despite the current challenging economic conditions, and in the interest of maintaining affordable rates, the Companies are not seeking increases in their ROEs in test year 2023 despite clear evidence—in the form of increasing cost of equity model results produced by both the Companies and CUB—that the Companies' capital costs have increased significantly even in the short time since this proceeding began in April of this year.

Against this backdrop, the Commission should reject the invitation by Staff and CUB to <u>lower</u> the Companies' ROEs below levels the Commission found just and reasonable just last year, <u>before</u> inflation and increased interest rates took hold. Indeed, CUB would have the Commission dramatically reduce the Companies' ROEs to a level 80 basis points lower than the Commission has authorized for Wisconsin's investor-owned electric and gas utilities at any time in the last four decades, on a purportedly "gradual" drive towards a CUB-defined utility "cost of equity." In fact, lowering ROEs at this time would introduce real risk of financial harm to the Companies through reduced stock prices and downgraded credit ratings at a time when markets

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4 Direct-WEPCO/WG-Bulkley-9.
5 Direct-WEPCO/WG-Eidukas-s-4. All targets are relative to 2005 CO_2 emissions.
6 Direct-WEPCO/WG-Eidukas-5.

have deteriorated with inflation at a 40-year high and increased interest rates. It would also call into question this Commission's historical standing as supportive of the financial strength of the utilities it regulates. The Commission should reject these proposals to reduce Joint Applicants' ROEs because they ignore the current and expected financial market conditions that control the Companies' access to capital at reasonable costs. A punitive ROE decision would be detrimental to the Companies' efforts to advance major capital projects that advance an affordable, reliable and clean energy future for their customers.

The Commission should also reject, as it did over a decade ago, CUB's radical proposal to change the Commission's approach to determining returns on equity for Wisconsin utilities that fairly balance customer and shareholder interests. CUB's proposal would throw away the commonly accepted methodology used by the Companies and Staff in this case, an approach the Commission has relied upon in its ROE decisions for investor-owned electric and gas utilities for two decades with only one short interruption, as discussed below, for an approach that relies on subjectivity and arbitrariness under an ever-changing set of standards for ROEs.

This brief also presents Joint Applicants' position on two other disputed matters in this docket. First, Joint Applicants support the adoption of the electric revenue allocation proposed by Wisconsin Industrial Energy Group ("WIEG") and the Companies' natural gas revenue allocation. These revenue allocations represent balanced approaches that move Joint Applicants' rates toward their costs of service.

Second, two intervenors, Clean Wisconsin and Walnut Way, presented voluminous testimony on energy efficiency and the interests of low-income customers, respectively. The schedule in this proceeding did not allow Joint Applicants to evaluate and respond to these proposals. Clean Wisconsin's proposal for performance-based ratemaking in the context of energy efficiency should be addressed in Docket 5-EI-158. Wisconsin Electric is agreeable to an order point requiring it to confer and collaborate informally with Walnut Way between now and the Companies' next rate case on ways to address affordability assistance.

ROE STANDARD

Setting a reasonable ROE "involves a balancing of the investor and consumer interests."[7] The Commission must set a return "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital."[8] "Rates which are not sufficient to yield a reasonable return on the value of the property used at the time it is being used to render the service are unjust, unreasonable and confiscatory[.]"[9] *Hope* and *Bluefield* guide the establishment of a reasonable return and balancing the interests of customers and investors. These decisions require that authorized ROEs meet the following standards: "(1) consistency with other businesses having similar or comparable risks; (2) adequacy of the return to support credit quality and access to capital; and (3) that the result, as opposed to the methodology employed, is the controlling factor in arriving at just and reasonable rates."[10]

The Commission has explained its historical approach to setting ROEs in similar terms:

> The principal factor used to determine the appropriate return on equity is the investors' required return. Authorized returns of less than the investors' required return would fail to compensate capital providers for the risks they face when providing funds to the utility. Such sub-par returns would make it difficult for a utility to raise capital on an ongoing basis. On the other hand, authorized returns that exceed the investors' required return would provide windfalls to utility investors as they would receive returns that are in excess of the necessary level. Such high returns would be unfair to utility consumers who ultimately pay for those returns. In reaching its determination as to the appropriate ROE, the Commission must

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7 *Fed. Power Comm'n v. Hope Nat. Gas Co.*, 320 U.S. 591, 603 (1944) ("*Hope*").
8 *Id. citing South-western Bell Tel. Co. v. Pub. Serv. Comm'n*, 262 U.S. 276, 291 (1923) (J. Brandeis, concurring).
9 *Bluefield Waterworks & Imp. Co. v. Pub. Serv. Comm'n of W. Va.*, 262 U.S. 679, 690 (1923) ("*Bluefield*").
10 Direct-WEPCO/WG-Bulkley-7.

> balance the needs of investors with the needs of customers, with due consideration to economic and financial conditions, along with other public policy considerations.[11]

The Commission should apply this same standard in this case and approve as just and reasonable Joint Applicants' proposal to maintain their currently authorized ROEs of 10.0% for Wisconsin Electric and 10.2% for Wisconsin Gas.

I. JOINT APPLICANTS' REQUESTED ROES BALANCE THE INTERESTS OF CUSTOMERS AND INVESTORS.

In support of their proposal to maintain their current ROEs, the Companies sponsored the analysis and testimony of Ms. Ann Bulkley of The Brattle Group. Ms. Bulkley, a highly-experienced cost of capital analyst with over 100 rate cases under her belt,[12] presented a thorough cost of equity analysis using well-understood and widely-used cost of equity models. Her analysis confirmed that the Companies' investor-required returns are <u>higher</u> than their current ROEs and are likely to continue to increase in the near term when their new rates are in effect. The Commission should credit Ms. Bulkley's testimony and analysis and, as it did in Docket 5-UR-109, find ROEs of 10.0% for Wisconsin Electric and 10.2% for Wisconsin Gas to be just and reasonable.

A. Joint Applicants used well-accepted methodologies to show their requested ROEs are reasonable.

To determine a reasonable ROE, Ms. Bulkley relies on several well-accepted methodologies to define a range of ROEs. These analytical approaches include the Discount Cash Flow ("DCF") model, the Capital Asset Pricing Model ("CAPM"), the Empirical Capital

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11 *Final Decision*, *supra* fn. 1, at 68-70 (approving ROEs of 10.0% for Wisconsin Electric and 10.2% for Wisconsin Gas). As discussed below, this is the approach and standard the Commission has used consistently to set ROEs for investor-owned electric and natural gas utilities since 2003, with only two exceptions for test year 2008.

12 *See* Ex.-WEPCO/WG-Bulkley-1 (listing 104 rate cases where Ms. Bulkley submitted testimony about ROE, in addition to 15 other appearances before state regulatory bodies).

Asset Pricing Model ("ECAPM"), and the Bond Yield Risk Premium ("BYRP") model.[13] Each of these models relies on objective market data from proxy groups of publicly-traded companies with similar characteristics to Wisconsin Electric and Wisconsin Gas to estimate the ROE required by Joint Applicants' investors.[14] Ms. Bulkley also considered company-specific business and financial risk factors, as well as the capital structures of the proxy group, and forecasts of key economic indicators.[15] Developing an ROE is not a formulaic process which leads to strict mathematical solutions.[16] Rather, multiple quantitative models ultimately produce a range of reasonable results, which reflect the differing views of investors. Relying on only one model could bias the results and might not reflect the aggregate view of investors, particularly when relying on historic data to define the modeling inputs when estimating a dynamic and changing market.[17]

The DCF model was used by multiple witnesses in this proceeding, but, as Ms. Bulkley explains, it has as serious shortcoming: it can be sensitive to anomalous events in the historical data and the market price of utility stocks.[18] To temper some of the sensitivity in the model, Ms. Bulkley used multiple averaging periods for stock prices, adjusted dividend yields so as not to overstate aggregate dividends, used multiple expert forecasts of growth rates for the proxy group of utilities, and presented a range of results based on these assumptions.[19]

Ms. Bulkley also used risk-premium approaches, the CAPM and ECAPM, to help estimate a reasonable range of ROEs. Similar to her use of multiple assumptions in her DCF analysis, Ms. Bulkley also used multiple sources of data to develop a range of reasonable

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13 Direct-WEPCO/WG-Bulkley-3-4.
14 *Id.* at 4.
15 *Id.*
16 *Id.* at 31.
17 *Id.* at 31-33.
18 *Id.* at 35-36, 39.
19 *Id.* at 36-39

ROEs.[20] In both her CAPM and ECAPM models, Ms. Bulkley used three sources for her estimate of the risk-free rate: (1) the current 30-day average yield on 30-year U.S. Treasury bonds; (2) the projected average 30-year U.S. Treasury bond yields from the first quarter of 2022 through the first quarter of 2023; and (3) the projected average 30-year U.S. treasury bond yield for 2023 through 2027.[21] Because interest rates are currently rising, and expected to rise further, it is important to use projected yields for the risk-free rate to account for the market's expectations of rising rates.[22]

Finally, Ms. Bulkley used the BYRP approach to measure the residual risk associated with equity ownership over the return expected by bondholders.[23] This method rests on the fundamental principle that because returns to equity holders have greater risk than returns to bondholders, due to bondholders' priority over equity investors in bankruptcy proceedings, equity investors must be compensated to bear that risk.[24] The BYRP analysis is also relevant to investors, because investors review ROE decisions in other jurisdictions and consider those decisions as benchmarks for a reasonable level of equity returns for utilities of comparable risk.[25] By basing the BYRP analysis on U.S. Treasury yields and actual authorized returns, the BYRP method provides relevant information to assess the return expectations of investors.[26]

While this proceeding has been pending, global economic conditions, inflation, and interest rates have changed significantly. When Ms. Bulkley submitted her direct testimony in April, rising inflation had already induced the Federal Reserve to raise its federal funds rate target to 0.25 to 0.50 percent, and indicate it would continue to raise the target rate by between

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20 Direct-WEPCO/WG-Bulkley-39-44.
21 *Id.* at 40-41.
22 *Id.* at 41.
23 *Id.* at 45-50.
24 *Id.* at 45-46.
25 *Id.* at 47.
26 *Id.* at 45, 47.

25 and 50 basis points multiple times in 2022.[27] Since then, in response to worsening inflationary pressures, the Federal Reserve has actually raised its target more than 300 basis points, including a 75 basis point increase on September 21.[28] These dramatic increases are not captured by DCF models that rely on historical data, so it is necessary not only to update the DCF analysis (as Ms. Bulkley did) but also to evaluate models that respond directly to interest rates such as the CAPM and ECAPM, because these models better reflect expected market conditions faced by investors.[29] Ms. Bulkley's ROE analysis accounts for both current and expected economic conditions to ensure the results of her model are appropriate.

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27 Direct-WEPCO/WG-Bulkley-14-15.
28 Rebuttal-WEPCO/WG-Bulkley-16.
29 *Id.* at 20.

After adjusting for changes in inflation, interest rates, and the stock market, Ms. Bulkley's analysis as of August 31, 2022 is summarized in this chart:[30]

Constant Growth DCF			
	Min Gwth Rate	Mean Gwth Rate	Max Gwth Rate
30-Day Average	8.10%	9.16%	10.14%
90-Day Average	8.09%	9.26%	10.17%
180-Day Average	8.25%	9.34%	10.10%
Constant Growth Average	8.15%	9.25%	10.14%
CAPM			
	Current 30-Day Avg Treasury Bond Yield	Near-Term Forecast 30-Yr Treasury Bond Yield	Long-Term Foreast 30-Yr Treasury Bond Yield
Value Line Beta	12.30%	12.37%	12.41%
Bloomberg Beta	11.79%	11.88%	11.93%
Long-term Avg. Beta	10.92%	11.04%	11.11%
ECAPM			
Value Line Beta	12.71%	12.76%	12.79%
Bloomberg Beta	12.32%	12.39%	12.43%
Long-term Avg. Beta	11.67%	11.76%	11.82%
Bond Yield Plus Risk Premium			
	Current 30-Day Avg Treasury Bond Yield	Near-Term Forecast 30-Yr Treasury Bond Yield	Long-Term Foreast 30-Yr Treasury Bond Yield
US Elec & Gas Utilties	9.86%	10.05%	10.16%
WI Elec & Gas Utilities	10.44%	10.63%	10.75%

These results show that Joint Applicants' current ROEs (10.0% for Wisconsin Electric and 10.2% for Wisconsin Gas) are reasonable—and could significantly understate investors' required returns as interest rates continue to rise.[31]

The cost of capital represents an opportunity cost to investors. If higher returns are available for other investments of comparable risk, investors have an incentive to direct their

30 Rebuttal-WEPCO/WG-Bulkley-21, Figure 6.
31 *Id.* at 21-22.

capital to those investments.[32] If the Commission adopts an ROE significantly below authorized ROEs for other public utilities it would inhibit Joint Applicants' ability to attract capital for investment in Wisconsin. Joint Applicants' ability to attract capital is particularly important now, when they are investing billions of dollars to shift to renewable energy.

B. The Commission, FERC, NARUC, and Commissions across the country have accepted the same methodologies sponsored by Joint Applicants when setting a just and reasonable ROE.

The methodologies Joint Applicants used to develop their proposed ROEs are accepted throughout the country. As Mr. Adams testified on behalf of Commission Staff, "the Commission has indicated that market models should not be applied mechanistically, but that they should be used as one piece of information in determining the appropriate return on equity."[33] That approach—reviewing multiple models and examining their assumptions thoroughly—is consistent with Joint Applicants' robust analysis, the ROE-setting standard this Commission has historically applied, and the analysis required by regulatory agencies nationwide.

For example, the Washington Utilities and Transportation Commission "places value on each of the methodologies used to calculate the cost of equity and does not find it appropriate to select a single method as being the most accurate or instructive."[34] Using multiple models is helpful, particularly in a rapidly changing economy, because "[f]inancial circumstances are constantly shifting and changing" and "a robust and diverse record of evidence based on a variety of analytics and cost of capital methodologies" helps regulators evaluate the range of

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32 Direct-WEPCO/WG-Bulkley-9.

33 Direct-PSC-Adams-14.

34 Direct-WEPCO/WG-Bulkley-34 *quoting Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-130043, Order 05, n. 89 (Dec. 4, 2013).

potential ROEs required by investors.[35] Other commissions agree and consider multiple models when determining an appropriate ROE, including the Michigan Public Service Commission,[36] the Minnesota Public Utilities Commission,[37] the Iowa Utilities Board,[38] and the New Jersey Board of Public Utilities.[39] Ms. Bulkley's analysis is also consistent with FERC's approach to setting ROEs.[40]

The National Association of Regulatory Utility Commissioners ("NARUC") also endorses multiple models for evaluating an appropriate ROE. A recent report prepared for NARUC by former Michigan Public Service Commission Chair John D. Quackenbush[41] titled "Cost of Capital and Capital Markets: A Primer for Utility Regulators"[42] explains the value of using multiple models in setting an ROE:

> The goal of all cost of equity models is to capture the realities of the capital marketplace and each model does so from a different perspective. Because these financial models are simplifications of the real world, the ROE results are estimates rather than exact discernments of ultimate truth. Ideally, the model results will corroborate each other but may not in practice. Different estimates resulting from different models can usefully frame, bracket, or define a range or zone of estimates.
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> ….

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35 *Id. quoting Wash. Utils. & Transp. Comm'n v. PacifiCorp*, Docket UE-100749, Order 06, ¶ 91 (March 25, 2011).

36 Michigan Public Service Commission Order, DTE Gas Company, Case No. U-18999, September 13, 2018, at 45-47.

37 Minnesota Public Utilities Commission, Docket No. G011/GR-17-563, Findings of Fact, Conclusions and Order, at 27; Docket No. E015/GR-16-664, Findings of Fact, Conclusions and Order, at 60-61.

38 Iowa Utilities Board, Iowa-American Water Company, RPU-2016-0002, Final Decision and Order issued February 27, 2017, at 35.

39 NJBPU Docket No. ER12111052, OAL Docket No. PUC16310-12, Order Adopting Initial Decision with Modifications and Clarifications, March 18, 2015, at 71.

40 Rebuttal-WEPCO/WG-Bulkley-51; Surrebuttal-CUB-Kihm-9-10 (admitting FERC uses the CAPM and DCF models).

41 Mr. Quackenbush is a former member of NARUC and former Chair of the Michigan Public Service Commission, a former Managing Director and Senior Investment Analyst at UBS Global Asset Management, and a former Senior Financial Analyst at the Illinois Commerce Commission. Mr. Quackenbush is also a Chartered Financial Analyst and earned an MBA with a concentration in Finance from Michigan State University. Ex.-WEPCO/WG-Bulkley-22, at 5.

42 The complete report was submitted as Ex.-WEPCO/WG-Bulkley-22.

> There is no single cost of equity model that is best in all circumstances. Investors, investment bankers, and corporate financial professionals use multiple models when evaluating the cost of equity. Likewise, it is desirable for regulators to also use multiple models when evaluating the cost of equity.[43]

The NARUC report goes on to endorse consideration of the several methodologies used by Joint Applicants in this case, including the Discounted Cash Flow Model, the Capital Asset Pricing Model, and the Risk Premium Method.[44] By considering the results of these different methods—as Joint Applicants have—this Commission can better understand the ROE needed to ensure safe, reliable, and affordable utility service.[45]

II. STAFF'S ANALYSIS IS IN ERROR AND ITS CONCLUSIONS ARE CONTRARY TO CURRENT ECONOMIC CONDITIONS.

Although Staff used multiple models and a range of data consistent with the Commission's historical approach, and similar to Joint Applicants' own analysis, Staff's implementation of those models contained errors and must be adjusted for higher inflation and rising interest rates.

Staff recommends reducing Wisconsin Electric's by 20 basis points, to 9.80%, and Wisconsin Gas' ROE by 40 basis points, also to 9.80%. This recommendation is contrary to everything we know about current and near-term financial market conditions. It is based in large part on DCF model results that are so low that they approach the Companies' cost of debt and are therefore not credible. After adjusting for the current market conditions Joint Applicants are operating in with much higher inflation and rising interest rates, Staff's own analysis supports

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43 Ex.-WEPCO/WG-Bulkley-22, at 16.
44 *Id.* at 16-19.
45 *Id.* at 23.

maintaining Joint Applicants' current ROEs of 10.0% for Wisconsin Electric and 10.2% for Wisconsin Gas.

Like Joint Applicants, Commission Staff "took into consideration various theoretical relationships that provide information regarding the equity return expected by investors in the applicants' common stock and acknowledged by other utility jurisdictions nationally."[46] Staff's models, again like Joint Applicants' models, included both a DCF approach and a risk premium approach[47] and presented a simple average of authorized ROEs nationally over the last four fiscal quarters through June, 2022, and by the Commission for large investor-owned utilities over the last three years.[48] As Mr. Adams notes, the average ROE authorized by the Commission over last three years is 9.98%—but that's before rising inflation and interest rates this year.

Commission Staff employed two versions of the DCF model, a one-stage or constant growth rate model like Joint Applicants, and a two-stage model that relied on a long-term growth rate of only 2.5%.[49] According to Staff's DCF analysis, the market expects annual returns of only 5.85% to 8.26% for Wisconsin Electric and 5.75% to 9.6% for Wisconsin Gas.[50]

As Ms. Bulkley explained in her rebuttal testimony, there are material errors in Staff's analysis, including:

- The 2.5% long-term growth rate in Staff's two-stage DCF models is based solely on Commission Staff's use of such a rate in prior cases,[51] is lower than the historical average GDP growth, and fails to account for current inflation.[52]
- Errors in the use of short-term growth rates.
- Excluding from its average DCF result the results of its one-stage model that used EPS growth rates.

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46 Direct-PSC-Adams-13.
47 *Id.* at 13-17 (DCF); 17-19 (interest rate premium model).
48 *Id.* at 19-20.
49 *Id.* at 15.
50 *Id.* at 16.
51 *See* Surrebuttal-PSC-Adams-2-3 (providing no justification for such a rate besides that it "has also been utilized by Commission Staff for analysis in past rate cases under varying macroeconomic conditions.").
52 Rebuttal-WEPCO/WG-Bulkley-31.

- Using an incorrect dividend yield.[53]

Mr. Adams acknowledges that his DCF results, which rely on past market data, should be considered in the context of rising rates,[54] but still contends that Joint Applicants' ROEs should be reduced from currently authorized rates.[55] Considering that the Commission last found Joint Applicants' current ROEs just and reasonable in late 2019, when interest rates were one hundred basis points lower,[56] there is no financial basis to reduce Joint Applicants' ROEs.

Nor do Staff's other models support a reduction of Joint Applicants' ROEs. As Mr. Adams acknowledges, the interest rate premium model "provides an additional measure of the risk premium required by equity investors in comparison to other investment options[.]"[57] Mr. Adams' own analysis of average risk premiums "supports an ROE range of 10.52 percent to 11.07 percent" for Wisconsin Electric, and "an ROE range of 10.41 percent to 10.96 percent" for Wisconsin Gas.[58] And after weighting the average to account for rising interest rates, Mr. Adams' ranges increase to "support an ROE range of 10.65 percent to 11.12 percent" for Wisconsin Electric, and "an ROE range of 10.60 percent to 11.07 percent" for Wisconsin Gas.[59]

When evaluating Commission Staff's analysis, the Commission should weigh the interest rate premium models more heavily than the DCF model, because the DCF model is slow to respond to rising interest rates. The Pennsylvania Public Utility Commission recognized this lag in a May 2022 decision:

> To help control rising inflation, the Federal Open Market Committee has signaled that it is ending its policies to maintain low interest

53 Rebuttal-WEPCO/WG-Bulkley-25-26.
54 Direct-PSC-Adams-18 ("Recognizing the potential impact of recent upward trends on the model output … ")
55 *Id.* at 21.
56 Rebuttal-WEPCO/WG-Bulkley-33-34 (the average treasury bond yield was 2.18% when the Commission approved Joint Applicants' current ROE; as of September 14, 2022, the average was 3.20%, which does not account for subsequent action by the Federal Reserve).
57 Direct-PSC-Adams-17.
58 *Id.* at 18-19.
59 *Id.* at 19.

> rates. Because the DCF model does not directly account for interest rates, consequently, it is slow to respond to interest rate changes. However, [the] CAPM model uses forecasted yields on ten-year Treasury bonds, and accordingly, its methodology captures forward looking changes in interest rates.[60]

Based on "a range of reasonableness for the ROE … from 8.90% [DCF] to 9.89% [CAPM]" the Pennsylvania Commission chose an ROE of 9.75%[61]—much closer to the analysis that includes current interest-rate expectations than the DCF analysis that does not. Interest rates have gone up more since May, making it more reasonable to rely on risk premium models, like Mr. Adams' risk premium model and Ms. Bulkley's CAPM and ECAPM models. Staff's analysis therefore readily supports maintaining Joint Applicants' ROEs at the same level the Commission approved in late 2019, when interest rates were much lower.

III. CUB'S PROPOSAL TO RADICALLY CHANGE THE COMMISSION'S HISTORICAL ROE APPROACH IS WITHOUT MERIT AND WOULD HARM UTILTIES AND THEIR CUSTOMERS.

A. CUB proposes a radical departure from the Commission's historical approach to setting ROEs.

CUB urges the Commission to dramatically reduce Wisconsin Electric's ROE by 100 basis points and Wisconsin Gas' ROE by 120 basis points. More than that, CUB asks the Commission to abandon its historical approach to establishing the ROE based on an approach former staff member Dr. Steven Kihm has been advocating—both as a staff member and as a consultant—for decades.[62] His approach was referenced by the Commission in only two rate

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60 Rebuttal-WEPCO/WG-Bulkley-34 *quoting* Pennsylvania Public Utility Commission, Docket Nos. R-2021-3027385 and R-2021-3027386, Opinion and Order, May 12, 2022, at 154-155.

61 *Id.* at 35 *quoting* Pennsylvania Public Utility Commission, Docket Nos. R-2021-3027385 and R-2021-3027386, Opinion and Order, May 12, 2022, at 177-178.

62 *See* Direct-CUB-Kihm-18-19 (arguing a lower ROE is acceptable, because it was acceptable in 1980s when he was first a member of Commission Staff); *see also* Surrebuttal-CUB-Kihm-2 (arguing about a practice of Commission staff during his second stint on Staff in the 1990s); *id.* at 2-3 (citing an article he wrote for *Public Utilities Fortnightly* seemingly from the 1990s).

cases for test year 2008 in which Dr. Kihm was Staff's ROE witness, and never before or since. Under Dr. Kihm's approach, the Commission would set ROE in three steps:

1. Determine the cost of equity (distinct from ROE) based on the models.
2. Determine a higher ROE based on an undefined, unannounced, and seemingly infinitely flexible set of performance factors.
3. Consider whether to moderate the change in the utility's ROE in the interest of gradualism.

CUB's proposed approach is so far out of the mainstream that CUB can identify no other state commission that follows anything like it, despite Dr. Kihm's long-term advocacy for it.

With the exception two rate cases for test year 2008, the Commission has determined ROE based on the types of analyses presented by the Companies and the Commission staff in this case, using cost of equity models and establishing investor required returns based on financial market conditions and authorized returns for other utilities in Wisconsin and nationally. Since 2003, except for those two test year 2008 rate cases, the Commission has determined ROE by the approach it articulated in its 2019 Order in Joint Applicants' most recent rate settlement in Docket 5-UR-109:

> <u>The principal factor used to determine the appropriate return on equity is the investors' required return</u>. Authorized returns less than the investors' required return would fail to compensate capital providers for the risks they face when providing funds to the utility. Such sub-par returns would make it difficult for a utility to raise capital on an ongoing basis. On the other hand, authorized returns that exceed the investors' required return would provide windfalls to utility investors as they would receive returns that are in excess of the necessary level. Such high returns would be unfair to utility consumers who ultimately are responsible for paying for those returns.
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> If the investors' required return could be measured precisely, setting the authorized return would be straightforward. Because that return cannot be measured precisely, determining the appropriate return on equity is typically one of the most contested issues in a rate proceeding such as this one. In this proceeding the applicant proposed that its authorized return be increased from the 12.00 percent level approved in the prior proceeding to 12.50 percent.

> WIEG suggested that the return should be decreased. WIEG recommended that the return on equity be set no higher than 11.10 percent. The Commission staff suggested that the appropriate return on equity be set somewhere in the range from 10.00 to 11.50 percent.
>
> In reaching its determination as to the appropriate return on equity the Commission must balance the needs of investors with the needs of consumers. That balance is struck most reasonably in this proceeding by authorizing a return on equity capital equal to that established in the prior proceeding. A 12.00 percent return should allow the applicant to attract capital at reasonable terms without unduly burdening consumers with excessive financing costs.[63]

The Commission followed this approach consistently until 2007, when it used Dr. Kihm's approach in a pair of test year 2008 electric and natural gas investor-owned utility rate cases.[64] Dr. Kihm was Staff's ROE witness in the MGE case and drafted the relevant portion of the Commission's order.[65] CUB's claim that the Commission's "acceptance" of the Kihm approach has never been "reversed or overturned"[66] is not true. To the contrary, the Commission has never relied on that approach since. In fact, in MGE's and NSPW's very next rate cases, the Commission returned to its historical "principal factor" approach to establishing ROEs that balance the interests of both customers and investors "with due consideration to economic and financial conditions along with public policy considerations":

> The principal factor used to determine the appropriate return on equity is the investors' required return. Authorized returns less than the investors' required return would fail to compensate capital providers for the risks they face when providing funds to the utility. Such sub-par returns would make it difficult for a utility to raise capital on an ongoing basis. On the other hand, authorized returns that exceed the investors' required return would be unfair to utility consumers who ultimately pay for those returns.

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63 *Final Decision*, Wisconsin Public Service Corp., Docket 6690-UR-115, 2003 WL 23145651, (Dec. 19, 2003) (emphasis added).

64 *Final Decision*, Madison Gas & Elec., Docket 3270-UR-115, 2007 WL 4632120 (Dec. 14, 2007); *Final Decision*, Northern States Power Co.-Wis., Docket 4220-UR-115, 2008 WL 183239 (Jan. 8, 2008). The Commission did not use the Kihm approach before or after these two decisions.

65 Transcript of Party Hearing Session on October 5, 2022 ("Hr'g Tr.") at 308:11-15.

66 Surrebuttal-CUB-Singletary-14.

> In reaching its determination as to the appropriate return on equity, the Commission must balance the needs of investors with the needs of consumers, with due consideration to economic and financial conditions along with public policy considerations. If the appropriate return on equity could be measured precisely, setting the authorized return on equity would be straightforward. Because that return cannot be measured precisely, determining the appropriate return on equity is typically one of the most contested issues in a rate proceeding. In this proceeding MGE proposed its authorized return remain at 10.80 percent. CUB recommended that the return on equity be capped at 10.0 percent. Commission staff suggested that the appropriate return on equity be set somewhere in the range from 10.00 to 10.80 percent.
>
> Given the above-mentioned considerations, balance is struck most reasonably in this proceeding by authorizing a return on equity equal to 10.40 percent for MGE. The 10.40 percent return should allow the applicant to attract capital at reasonable terms without burdening consumers with excessive financing costs.[67]

As shown in the table below, the Commission has continued to use its historical "principal factor" approach without interruption to this day:[68]

PSCW ROE APPROACH
Electric and Natural Gas IOUs, 2003 to present

Year	Utility	Docket	ROE Approach
2003	WPSC	6690-UR-115	Principal Factor
	WPL	6680-UR-113	Principal Factor
2004	MGE	3270-UR-112	Principal Factor
	WPSC	6690-UR-116	Principal Factor
	MGE	3270-UR-113	Principal Factor
2005	WPL	6680-UR-114	Principal Factor
	MGE	3270-UR-114	Principal Factor
	WPSC	6690-UR-117	Principal Factor
2006	NSPW	4220-UR-114	Principal Factor
	WE	5-UR-102	Principal Factor
2007	WPSC	6690-UR-118	Principal Factor
	WPL	6680-UR-115	Principal Factor
2008	MGE	3270-UR-115	Kihm
	NSPW	4220-UR-115	Kihm

67 *Final Decision*, Madison Gas & Elec. Co., Docket 3270-UR-116, 2009 WL 5412860 (Dec. 22, 2009); *Final Decision*, Northern States Power Co.-Wis., Docket 4220-UR-116, 2009 WL 5412862 (December 22, 2009).

68 This table was developed from Commission orders available on Westlaw and ERF in which the Commission decided ROE, including settlements where the Commission expressly authorized the settled ROE. The Table does not include settlement or other orders in which the Commission did not address ROE.

	WE	5-UR-103	Principal Factor
2009	WE	5-UR-104	Principal Factor
	WPL	6680-UR-117	Principal Factor
	MGE	3270-UR-116	Principal Factor
	NSPW	4220-UR-116	Principal Factor
2011	MGE	3270-UR-117	Principal Factor
	NSPW	4220-UR-117	Principal Factor
	WPSC	6690-UR-120	Principal Factor
2013	WPSC	6690-UR-122	Principal Factor
	NSPW	4220-UR-119	Principal Factor
2014	WPSC	6690-UR-123	Principal Factor
2015	WPSC	6690-UR-124	Principal Factor
	NSPW	4420-UR-121	Principal Factor
2016	CWPC	1330-ER-103	Principal Factor
	MGE	3270-UR-121	Principal Factor
	WPL	6680-UR-120	Principal Factor
2017	SWLP	5820-UR-114	Principal Factor
	NSPW	4220-UR-123	Principal Factor
2018	NCPC	4190-ER-107	Principal Factor
	MGE	3270-UR-122	Principal Factor
	SWLP	5820-UR-115	Principal Factor
2019	WE	5-UR-109	Principal Factor
	WPSC	6690-UR-127	Principal Factor
	NSPW	4420-UR-124	Principal Factor
	WPL	6680-UR-121	Principal Factor
2020	WPL	6680-UR-122	Principal Factor
	MGE	3270-UR-123	Principal Factor
2021	CWP	1330-UR-104	Principal Factor
	NSPW	4220-UR-125	Principal Factor
	MGE	3270-UR-124	Principal Factor
	WPL	6680-UR-123	Principal Factor

Dr. Kihm's approach is the anomaly and was only used by the Commission when he drafted the orders himself.

B. Dr. Kihm's cost of equity estimate is far too low to be credible.

The linchpin of CUB's approach is the notion that utility ROEs are higher than the utility cost of equity, and that the Commission should embark on an effort to drive utility ROEs down to Dr. Kihm's calculation of that cost; unless, apparently, the utility can provide a basis for obtaining a "premium" return.[69] In this case, Dr. Kihm opines that Joint Applicants' costs of

[69] Direct-CUB-Singletary-8-9; Surrebuttal-CUB-Singletary-14-17; Hr'g Tr. at 341:4-9.

equity are in the range of 6.3% to 7.8% based on his application of the DCF and CAPM models.[70] Dr. Kihm argues that these returns are in line with the estimated long-run market return on the S&P 500 Index of 8.3%,[71] but even at the top level he is using the wrong data. For large companies, like Joint Applicants, the average market return from 1926–2021 was actually 12.34%, and this average has *increased* from 2009 to 2021 to 16.55%.[72] Looking at analogous returns—as *Hope* and *Bluefield* require—shows that Joint Applicants' requested ROEs of 10.0% and 10.2% are reasonable and should be approved.

The details of Dr. Kihm's analysis fare no better. First, the long-term historical average for the risk premium between bonds and equities is 7.46%[73] and there is an inverse relationship between the risk premium and interest rates on bonds.[74] Said a different way, because interest rates are low relative to where they have been historically (albeit now rising significantly) the risk premium should be <u>higher</u> than the historical average.[75] Yet, Dr. Kihm's analysis implies a market risk premium <u>130 to over 300 basis points lower</u> than the historical average.[76] Dr. Kihm does not (and cannot) explain why his analysis implies investors have suddenly decided to accept returns much closer to the cost of debt than they have previously.

Second, Dr. Kihm's disregard of earnings growth, and his focus exclusively on dividends, is inconsistent with the academic literature and the practice of actual stock analysts.[77] Earnings are the most important variable in valuing a security, and investment analysts themselves report

70 Direct-CUB-Kihm-71-72; Surrebuttal-CUB-Kihm-5-6 (updated numbers, as referenced in the text).
71 Direct-CUB-Kihm-49.
72 Rebuttal-WEPCO/WG-Bulkley-52 (using data published by Kroll, a source Dr. Kihm also references as authoritative, to demonstrate the analogous returns).
73 Rebuttal-WEPCO/WG-Bulkley-54 (again citing data from Kroll).
74 Direct-WEPCO/WG-Bulkley-46 (explaining that when interest rates rise, the risk premium goes down).
75 Rebuttal-WEPCO/WG-Bulkley-53-54.
76 *Id.* at 54 (Figure 11 demonstrates the market risk premium Dr. Kihm's analysis implies).
77 *Id.* at 54-55.

relying predominantly on earnings projections to value stocks.[78] Dr. Kihm's assertions of analyst "bias" are antiquated and do not account for modern changes to the industry or recent research.[79] Investors are looking at overall earnings growth; the models used to establish ROEs should not ignore this data out of hand.

Finally, Dr. Kihm's use of spot pricing for interest rates is also suspect and unsupported. In the short time between Dr. Kihm's direct testimony, which was filed on September 9, and his surrebuttal testimony filed on October 3, he was forced to revise his "spot" estimate of Treasury bond rates upward by 100 basis points to 3.9%.[80] Between Joint Applicants' direct testimony, filed in April, and September 30, the yield on the 30-year Treasury bond increased <u>160 basis points</u>.[81] For support in using "spot" estimates, Dr. Kihm points to a "study" he submitted to *Public Utilities Fortnightly*, which claims that spot estimates better predict future dividend yields and interest rates than professional forecasts.[82] But when the Federal Reserve Bank of San Francisco compared spot prices to professional forecasts, they came to a different conclusion: spot prices were not better than professional forecasts.[83] The vast majority of market professionals and investors use averages and forecasts,[84] and the only support Dr. Kihm has for his position is his say-so.[85] When setting a forward-looking ROE, the Commission should rely on forward-looking analyses of interest rates, not the spot price whenever Dr. Kihm last updated his analysis.

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78 *Id.* at 55 *citing* Stanley B. Block, *A Study of Financial Analysts: Practice and Theory*, Financial Analysts Journal (July/August 1999).

79 *Id. quoting* Armen Hovakimian and Ekkachai Saenyasiri, *Conflicts of Interest and Analyst Behavior: Evidence from Recent Changes in Regulation*, Financial Analysts Journal, Vol. 66, No. 4, July/August 2010, at 195.

80 Surrebuttal-CUB-Kihm-5.

81 Sur-surrebuttal-WEPCO/WG-Bulkley-7.

82 Surrebuttal-CUB-Kihm-3-4.

83 Sur-surrebuttal-WEPCO/WG-Bulkley-7.

84 Rebuttal-WEPCO/WG-Bulkley-56-57; Sur-surrebutal-WEPCO/WG-Bulkley-6-8.

85 *See* Surrebuttal-CUB-Kihm-2-4.

C. CUB's flawed proposal is also half-baked.

CUB skipped the second step of its proposed approach. It identified a cost of equity calculated by Dr. Kihm (6.3% to 7.8%)[86] and then proposed "gradual" adjustments to the Companies' ROEs of 100 basis points for Wisconsin Electric and 120 basis points to Wisconsin Gas. CUB failed to actually identify what the Companies' ROEs are.

Although Mr. Singletary purported to analyze Wisconsin Electric's performance based on three self-selected (and admittedly inadequate)[87] metrics, he did not identify a target ROE, presumably located somewhere between Dr. Kihm's cost of equity and the Companies' current ROEs, toward which the Commission is supposed to gradually adjust. He made no analysis of Wisconsin Gas's "performance" whatsoever.

Rather than sending a strong signal to markets and investors that Wisconsin remains a jurisdiction supportive of its utilities' financial strength, which would in turn allow Joint Applicants to continue to attract capital at reasonable cost, CUB's recommendation leaves unanswered what factors CUB would have the Commission consider should it adopt this new ROE approach. Mr. Singletary suggests that the factors could be any number of the dozens of the utility "performance" "metrics" set forth in a report from Michigan.[88] The inadequacy of Mr. Singletary's approach in this case is illustrated by the much broader set of considerations the Commission considered in the case he claims to rely on for precedent. The test year 2008 MGE rate case that CUB relies on identified the following factors: "the need to: provide economic incentives; maintain rate stability; price utility services in keeping with those observed in other industries; consider consumer interests; consider existing investors; and recognize managerial

[86] Surebuttal-CUB-Kihm-5-6 (updated numbers).
[87] Hr'g Tr. at 345:5-16 (Mr. Singletary admitting his performance metrics are not comprehensive).
[88] Ex.-CUB-Singletary-1.

efficiency."[89] Mr. Singletary fails to consider any of these factors, with the possible exception of "consumer interests," and then only partially. What factors would guide this process, and whether and to what extent they could change from rate case to rate case, remain unanswered questions.[90]

The Commission should reject CUB's proposal to radically change the way the Commission has determined utility ROEs for decades. Having the Commission apply various as-yet-unannounced factors to establish ROEs would invite litigation among the parties to each case as to the factors chosen and how they are applied. Ever-changing standards would allow subjectivity to rule. The Commission should instead review Joint Applicants' record evidence of market cost of equity and other information supplied by the Companies' and Staff's financial experts and find reasonable the Companies' proposal to maintain their current ROEs despite strong evidence of increased costs of equity.

D. Adopting CUB's approach would also have significant negative effects for Joint Applicants, their customers, other utilities, and the transition to renewable energy.

The harm that would be caused by CUB's proposed approach is not conjectural or unfounded. If the Commission adopts CUB's radical proposal to set ROEs based on a biased "cost of equity" analysis and an undefined set of utility performance (or other) factors, it will harm not only Joint Applicants, but all investor-owned utilities in Wisconsin. That's because, as Ms. Bulkley testifies, an important factor in credit ratings is the regulatory framework for the utility.[91] Both S&P and Moody's consider the regulatory framework in establishing credit ratings, with Moody's incorporating regulatory risk as 50% of its overall assessment of financial

89 Ex.-CUB-Singletary-5, at 12.
90 Hr'g Tr. 345:5-346:25 (Mr. Singletary criticizing the "very narrow scope" of his own criteria).
91 Direct-WEPCO/WG-Bulkley-52-53.

risk, and S&P calling the regulatory environment a "significant aspect" of credit ratings.[92] Although Joint Applicants will continue to raise capital to maintain infrastructure and service to customers (because they have to), a reduction in their ROE in today's challenging economy would be seen as a material weakening of their financial strength that could warrant a downgrade of their credit ratings. There are numerous examples of credit rating agencies revising their outlooks downward, and the cost of debt increasing for the affected utilities.[93] Accepting CUB's proposal to slash ROE based on an entirely new standard—which would presumably apply to all Wisconsin utilities—would break from the Commission's consistent support for utilities' capital needs.[94] CUB's own witnesses acknowledge the risk to credit ratings and that a deterioration in credit ratings would increase costs for Joint Applicants and their customers.[95]

Adopting CUB's proposal would also harm current equity investors and imperil Joint Applicants' ability to raise additional equity investment. Dr. Kihm's theory that any ROE authorized will meet the capital attraction standard is untested, and contrary to basic logic.[96] It is irrational to suggest that equity investors would accept the risk of holding equity at a return that is below the return on debt, which is paid out ahead of equity in the case of the dissolution or bankruptcy of a company, or that the investor would accept an equity return that is below the return on a risk-free asset.[97]

Trading a reduced ROE for slightly lower rates and increased debt costs would transfer value from current shareholders—which include many Wisconsin residents, retirees, and pension funds—to large out-of-state banks.[98]

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92 Direct-WEPCO/WG-Bulkley-52-53.
93 Rebuttal-WEPCO/WG-Bulkley-44-47.
94 *See* Direct-WEPCO/WG-Bulkely-54-57.
95 Direct-CUB-Kihm-84.
96 Rebuttal-WEPCO/WG-Bulkley-40.
97 *Id.*
98 Direct-CUB-Kihm-26 (admitting his approach would cause capital losses to current investors).

Recent action by the Arizona Corporation Commission demonstrates the harm that can be caused by significant reductions to authorized ROEs. Last October—prior to the significant increases in interest rates currently facing Joint Applicants—the Arizona commission set Arizona Public Service's ("APS") ROE at 8.7%.[99] This decision almost immediately destroyed 24% of the market value of APS's parent company and led APS to defer all equity issuances until the conclusion of APS's next rate case to limit dilution and further erosion of the utility's stock price.[100] This example directly undermines Dr. Kihm's theory that utilities will always be able to raise capital regardless of the authorized ROE.

Equity analysts also immediately noted that the action against APS was indicative of a negative regulatory environment in Arizona. One analyst informed its clients that, "the Arizona Corporation Commission is now confirmed to be the single most value destructive regulatory environment in the country as far as investor-owned utilities are concerned."[101] And S&P Global Market Intelligence's Regulatory Research Associates ("RRA") reported that the decision "was among the lowest ROEs RRA had encountered in its coverage of vertically integrated electric utilities in the past 30 years."[102] Dr. Kihm's position that such warnings would have no effect on the Companies' ability to raise new capital at reasonable cost ignores these warnings and the potential effects on the utility and ultimately their customers, and does not even consider the harm that would be caused to *other* utilities in Wisconsin if the Commission accepted his proposals. As Ms. Bulkley testifies, multiple utilities have experienced significant declines in their stock price as a result of reductions in their authorized ROEs.[103]

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99 Rebuttal-WEPCO/WG-Bulkley-47; Ex.-WEPCO/WG-Bulkley-20. The Arizona commission also denied recovery of certain capital costs associated with pollution controls.

100 Rebuttal-WEPCO/WG-Bulkley-47; *see also* Sur-surrebuttal-WEPCO/WG-Bulkley-6.

101 Direct-WEPCO/WG-Bulkley-10-11.

102 *Id.* at 11.

103 Rebuttal-WEPCO/WG-Bulkley-44-48; Ex.-WEPCO/WG-Bulkley-21 (showing the market reaction to reductions in ROE and the subsequent downgrades by ratings agencies).

CUB's proposal also ignores the practical implications of adopting its radical departure from the Commission's traditional approach to determining ROEs. Joint Applicants are in the midst of a historic, capital-intensive shift to renewable energy. Wisconsin Electric's Generation Reshaping Plan includes nearly $1 billion in investments in renewable generation through the end of test year 2023.[104] CUB's own witnesses acknowledge their recommendations—if adopted by the Commission—would increase the cost of debt and harm investors.[105] Like APS did when hit with a 8.7% ROE in a lower interest environment, setting Joint Applicants' ROE at 9.0% could require Joint Applicants to reconsider the level of capital investment they are able to make in renewable energy.[106] The Commission should decline CUB's proposal to harm current investors and imperil Joint Applicants' ability to attract the capital necessary to lead Wisconsin to a cleaner energy future.

IV. THE COMMISSION SHOULD ADOPT REVENUE ALLOCATIONS CONSISTENT WITH THE COMPANIES' BASE COST OF SERVICE STUDIES.

As this docket has developed, the economy has worsened. Today, Joint Applicants and their customers face historic inflation and the potential of a serious economic recession. These conditions face residential, commercial and industrial customers alike. Considering the worsening economic conditions, and the testimony from WIEG, Walmart, Roundy's, and Staff, Joint Applicants support an approach to revenue allocation that adheres closely to the average increases from the Cost of Service Studies ("COSS") developed by Joint Applicants and Commission Staff.[107]

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104 Direct-WEPCO/WG-Eidukas-5.
105 Direct-CUB-Kihm-26; Surrebuttal-CUB-Kihm-13-14.
106 Rebuttal-WEPCO/WG-Bulkley-47-48.
107 Surrebuttal-Nelson-3-4.

Wisconsin Electric's initial revenue allocation departed from its traditional COSS and—if adopted—would have produced lower revenue allocations for residential customers, stretching the cost-causation principle in favor of an artificially low increase for residential customers. Joint Applicants believed a lesser increase for residential customers was appropriate when their revenue allocation and rate-design testimony was filed this past spring. But with approaching economic uncertainty, Joint Applicants now recommend that the Commission adopt a more balanced approach to electric revenue allocation consistent with the Companies' base COSS, namely the approach proposed by WIEG witness Kavita Maini.[108]

As explained by Joint Applicants' witness Aaron Nelson, the electric revenue allocation of both Staff and WIEG are substantially similar and "provide a more moderate and reasoned approach that would move the electric revenue allocation towards Wisconsin Electric's base case COSS results (COSS Method 4)."[109] These allocations temper rate impacts to the residential class by assigning costs in a more balanced and equitable way than CUB proposes.[110] While the allocation CUB proposes strongly favors the residential class, neither Staff's nor WIEG's favors <u>any</u> class. In fact, WIEG's proposal allocates a 5% increase to the industrial class despite its preferred COSS results supporting a 5% decrease.[111] For these reasons, Wisconsin Electric supports the adoption of WIEG's proposed revenue allocation.[112]

The Commission should also take a balanced approach to natural gas revenue allocation. Joint Applicants continue to believe their natural gas revenue allocation balances the principles

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108 Surrebuttal-Nelson-3-4.

109 Surrebuttal-WEPCO/WG-Nelson-5.

110 CUB's proposal is for the Commission to consider just three of the six COSS that Staff requested—the three that most benefit residential customers. Wisconsin Electric does not agree with CUB that the Commission should disregard half of the COSS models requested by Staff.

111 Surrebuttal-WEPCO/WG-Nelson-7.

112 *Id.*

of ratemaking—tempering the cost-causation principle with gradualism—the best,[113] and WIEG agrees that Joint Applicants' natural gas revenue allocation and rate design is reasonable.[114] The revenue allocation developed by Staff[115] is supported by CUB,[116] and Joint Applicants do not oppose following the revenue allocation and rate design developed by Staff.

V. CLEAN WISCONSIN'S AND WALNUT WAY'S PROPOSALS NEED ADDITIONAL DEVELOPMENT AND COLLABORATION.

Intervenors Clean Wisconsin and Walnut Way have each submitted novel proposals in this docket that deserve additional time for consideration, development, and collaboration among the stakeholders. Clean Wisconsin advocates for a performance-based ratemaking mechanism to incentivize Wisconsin Electric to invest in energy efficiency and conservation measures at a level well in excess of what is required by Act 141.[117] Joint Applicants not only fully comply with their statutory obligations to pursue energy efficiency and conservation measures,[118] they offer additional voluntary programs that further Wisconsin's energy efficiency and conservation goals,[119] and are actively participating in workshops on performance-based ratemaking in Docket 5-EI-158.[120] Clean Wisconsin's request for additional spending is significant,[121] and should not be decided in this docket, prior to the completion of the ongoing stakeholder process.[122]

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113 Direct-WEPCO/WG-Korducki-4-6; Rebuttal-WEPCO/WG-Korducki-1-2; Rebuttal-WEPCO/WG-Stasik-6-8.
114 Surrebuttal-WIEG-Bauer-2-3.
115 Direct-PSC-Eiter-5-9; Ex.-PSC-Eiter-1, Sch. 3; Ex.-PSC-Eiter-2, Sch. 3.
116 Rebuttal-CUB-Singletary-27.
117 Direct-CW-Lane-7; Rebuttal-WEPCO/WG-Eidukas-8-10.
118 *See* Direct-PSC-Horrie-2.
119 *See* Direct-CW-Lane-15-16.
120 *See* Direct-CW-Lane-35 (acknowledging the Commission is actively engaged in stakeholder process considering performance-based ratemaking in Docket 5-EI-158).
121 Direct-CW-Lane-9, 26 (describing proposal to spend an additional $52.8 million over four years, larger in total than Wisconsin Electric's annual contribution to Focus on Energy).
122 Joint Applicants do not know what the result of that process will be and so cannot determine whether it will comply with the intent of the Legislature in establishing the Focus on Energy program under Wis. Stat. § 196.374. In general, Joint Applicants support deferring significant policy determinations to the Legislature.

Similarly, Walnut Way submitted a broad range of policy ideas to the Commission in its direct testimony. Joint Applicants are sensitive to the challenges facing low-income residents of not only the Lindsay Heights neighborhood where Walnut Way is located, but throughout their service territories—particularly with economic headwinds increasing. But in the two weeks between intervenor direct testimony and Joint Applicants' rebuttal testimony, it was not possible to digest, analyze, and respond to Walnut Way's proposals.[123] Joint Applicants simply need more time, and to begin a constructive dialogue, to give Walnut Way's proposals the consideration they deserve. Joint Applicants commit to engaging[124] with Walnut Way—and other organizations and individuals—to address affordability assistance.

CONCLUSION

For these reasons, Joint Applicants urge the Commission to find that their currently authorized ROEs of 10.0% for Wisconsin Electric and 10.2% for Wisconsin Gas continue to balance the interests of customers and investors and should remain their authorized ROEs for 2023 and 2024. The Commission should adopt WIEG's proposed electric revenue allocation and Joint Applicants' proposed natural gas revenue allocation. The Commission should take no action on Clean Wisconsin's energy efficiency proposals in this docket. Finally, Joint Applicants would accept (although it is not necessary) an order point requiring the Companies to confer and collaborate informally with Walnut Way between now and the Companies' next rate case on ways to address affordability assistance.

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[123] Joint Applicants oppose Walnut Way's request for funding from electric rates. The issues raised by Walnut Way are within its currently established and funded goals and are not appropriate to be funded through rates.

[124] Joint Applicants do not believe an order point is necessary and opening a formal docket is premature.

Respectfully submitted this 12th day of October, 2022.

Catherine Phillips
State Bar No. 1025503

Electronically signed by
Catherine Phillips

WEC Energy Group Inc.
231 West Michigan Street
Milwaukee, WI 53203
Attorney for Joint Applicants

Bradley D. Jackson
State Bar No. 1005468
Joe Wilson
State Bar No. 1052468
James E. Goldschmidt
State Bar No. 1090060
Patrick J. Proctor-Brown
State Bar No. 1091326
Lauren N. Zenk
State Bar No. 1115872

Electronically signed by
Bradley D. Jackson

QUARLES & BRADY LLP
411 East Wisconsin Avenue
Milwaukee, WI 53202
Attorneys for Joint Applicants