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# The Fair Authorized Investment Returns Act

Proposed Federal Legislation to Align Authorized Returns on Equity with Market-Based Costs of Capital for FERC-Jurisdictional Public Utilities and Natural Gas Companies

*— WORKING DRAFT —*

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*This document contains (i) prefatory discussion intended to accompany the legislation but not form part of the enacted text, (ii) the bill text itself, and (iii) drafting notes flagging elements that may require further development. The mechanism established by this legislation may also be enacted at the state level for state-jurisdictional utility rates; Sections 5 and 6 include provisions to ensure that federal securities and holding company statutes do not impede such state enactments.*

# PREFATORY DISCUSSION

The American utility market rests on a social contract. The United States and state governments each sanction private, for-profit monopolies to provide the bulk of electricity and natural gas service. In return, these investor-owned utilities (IOUs) agree to deliver service and submit to cost-of-service regulation of their customer rates. At the federal level, the Federal Energy Regulatory Commission (FERC) regulates the rates of interstate electric transmission providers and natural gas pipeline companies under the Federal Power Act and the Natural Gas Act. For IOUs, the cost of service includes a reasonable profit, expressed as a return on the equity capital invested in the utility.

In principle, a utility's authorized rate of return must be "just and reasonable," sufficient to recover only the actual and prudent costs of providing service—including a fair return on invested capital. The constitutional standard, set forth in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), and *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923), entitles utilities to a return sufficient to attract capital under prevailing market conditions, i.e., the market-based cost of capital—but no more.

There is a persistent tension in this model. As investor-owned businesses, IOUs seek to maximize profits, which conflicts with regulators' obligation to achieve just and reasonable rates. Moreover, the ratemaking process is shaped by structural asymmetries in resources, information, and institutional position that favor utilities, a phenomenon well documented in the academic literature on regulatory capture and capital bias. As a result, authorized returns on equity have for decades substantially exceeded utilities' actual market-based cost of equity. Those excessive returns not only increase rates directly, but also encourage excessive rate base growth by rewarding additional capital investment at above-market returns.

In the FERC context, these dynamics are amplified by the formula rate mechanism, which embeds an authorized return on equity in a utility's rate without requiring periodic justification and places the burden of proving overcompensation on intervenors rather than the utility. FERC-authorized base ROEs currently cluster around 10 percent, well above what financial models indicate is necessary to attract capital. Moreover, FERC's existing methodology for setting authorized ROEs relies on a comparator-utility approach

that is inherently circular: it measures utilities' cost of equity by reference to the returns authorized for other utilities, rather than by reference to independent market data.

The current energy affordability crisis is the natural result of these too-high rates of return and the consequent inefficient deployment of capital. Approximately one quarter of U.S. households have been unable to pay their utility bill in full at least once over the past twelve months. Meanwhile, IOUs requested a record $31 billion in rate increases during 2025 alone—double the prior year.

Multiple lines of evidence indicate that authorized returns on equity systematically exceed utilities' actual cost of equity:

**Market signals.** Publicly traded utility holding companies typically trade at 2.0–2.3 times book value. As a matter of financial principle, a utility earning a return on equity equal to its cost of equity should trade at approximately book value. The persistent and substantial premium to book value is powerful evidence that authorized returns exceed what investors require.

**Financial models.** The Capital Asset Pricing Model (CAPM), applied to the low market beta of utility equities relative to broad market indices, suggests that a premium to the 10-Year Treasury risk-free rate of less than two percent is warranted. Discounted Cash Flow analysis leads to a similar conclusion. At a market equity risk premium of approximately [5.00] percent and a utility equity beta of approximately [0.35], the Capital Asset Pricing Model implies a utility equity risk premium of approximately [1.75] percent above the risk-free rate, supporting the [2.00] percentage point spread established by this Act.

**Wall Street forecasts.** Major asset managers project long-term returns for U.S. equities of approximately 6–7 percent. Utilities are lower risk than the market as a whole, implying a cost of equity at the lower end of—or below—that range.

**Academic consensus.** Multiple peer-reviewed studies confirm that returns authorized by state and federal utility commissions, including FERC, are substantially higher than utilities' actual cost of equity.

That the returns on equity FERC awards to utilities are broadly consistent with those awarded by state commissions does not dispel these concerns—it confirms them.

Consistently excessive returns reflect a rate-setting process in which regulators reference what other jurisdictions have awarded, producing a self-reinforcing cycle untethered from market fundamentals.

The solution is to harness market mechanisms in place of regulatory judgment wherever possible.

Market mechanisms already determine the cost of utility debt. When utilities issue bonds, regulators do not independently determine a "reasonable" yield—underwriters solicit bids, investors compete, and the utility accepts the lowest-cost terms available. Regulators then incorporate the embedded cost of that issuance into rates. The cost of equity should be discovered in the same way.

This legislation does precisely that. It establishes a transparent, formulaic default return on equity anchored to the 10-Year U.S. Treasury rate plus a fixed spread, with an annual reset mechanism. It then provides covered utilities that believe this default understates their true cost of equity with a single avenue of recourse: a competitive equity auction that produces a market-based determination of the cost of equity. This approach minimizes regulatory discretion, reduces the scope for regulatory capture, and ensures that ratepayers pay no more than what is necessary to attract capital.

To facilitate these auctions, this legislation also amends the Securities Act of 1933 to exempt the instruments thus offered, consistent with the exemptions already provided to other highly regulated entities. The legislation also amends the Public Utility Holding Company Act of 2005 to provide holding company carveouts for these non-voting instruments. These exemptions are extended to state-regulated utility issuances under qualifying state laws, ensuring that federal statutes do not impede state-level FAIR Act enactments.

### Scope of Coverage

This legislation covers two categories of FERC-jurisdictional entities: (1) electric public utilities subject to FPA § 205 cost-of-service rate review (16 U.S.C. § 824d), primarily transmission providers, and (2) interstate natural gas companies subject to NGA § 4 cost-of-service rate review (15 U.S.C. § 717c). Entities whose rates are authorized exclusively under FERC's market-based rate program (18 C.F.R. § 35.37) are excluded. Water utilities are not covered; FERC has no rate jurisdiction over investor-owned water utilities. Local distribution companies are not covered; local electric distribution companies are not subject to FPA § 205 rate jurisdiction, and local natural gas distribution companies are expressly excluded from NGA jurisdiction by 15 U.S.C. § 717(c). Even where a covered utility is subject to FPA or NGA jurisdiction, this legislation applies only to assets for which rates are subject to Commission review.

### Grid Operators vs. Transmission-Owning Utilities

This legislation applies to transmission-owning utilities, not to RTOs/ISOs. PJM, MISO, CAISO, ISO-NE, NYISO, and SPP are nonprofit or member-owned organizations with no shareholders and no authorized ROE in the equity-return framework this legislation addresses. The above-market returns targeted by this legislation flow to the investor-owned utilities that own transmission infrastructure and file formula rates with FERC.

## SECTION-BY-SECTION SUMMARY

**Section 1 — Short Title.** Cites this Act as the "Fair Authorized Investment Returns Act" or the "FAIR Act."

**Section 2 — Congressional Findings.** Establishes the factual and legal basis for the Act, including the FERC formula rate mechanism, incentive adders, evidence that authorized returns systematically exceed utilities' cost of equity, the constitutional adequacy of the default-plus-auction mechanism under Hope Natural Gas and Bluefield, and the rationale for including construction work in progress in rate base.

**Section 3 — Amendments to the Federal Power Act and Natural Gas Act.** Adds new provisions to both the FPA (16 U.S.C. § 824___) and the NGA (15 U.S.C. § 717___), organized as Parts I–VII:

**Part I — Definitions.** Establishes definitions applicable to the Act, including definitions for the regulated service corporation and regulated service LLC that together form the two-tier entity structure through which auction equity interests are issued. Covered utilities are defined by cross-reference to the Federal Power Act and Natural Gas Act; water utilities and local distribution companies are excluded. A "qualifying state law" definition is introduced to extend the Securities Act and PUHCA carveouts in Sections 5 and 6 to auction equity interests issued under state FAIR Act legislation.

**Part II — Default Authorized Return on Equity.** Sets a default authorized return on equity equal to the 10-Year U.S. Treasury rate plus 200 basis points, reset annually. This formulaic default eliminates the need for contested rate-of-return proceedings in the ordinary course and anchors the authorized return to observable market data. Part II also permits a covered utility to procure third-party insurance to hedge material idiosyncratic risks, with the cost recoverable in rates subject to the Commission's determination of prudence. In the FERC context, the performance-based ratemaking provision governs return on equity incentive adders: they are permissible within the neutral-expected-value framework but not outside it. Part II further requires that, for purposes of applying the authorized return on equity, rate base reflect the full value of prudently invested capital—including construction work in progress—with the only exclusions being for capital not supplied by investors.

**Part III — Competitive Equity Auction.** Establishes a competitive equity auction through which the cost of equity for a covered utility may be determined on a market basis, whether initiated by the utility or ordered by the Commission. In the absence of an auction, the default return applies. The auction-clearing return—whether higher or lower than the default—determines the authorized return on equity for the regulated service.

Part III also establishes structural provisions to facilitate the auction process and ensure that auction-determined rates properly reflect the risk of the regulated service. These include the regulated service corporation and regulated service LLC structure, through which auction equity interests are issued and regulated service assets are held in a bankruptcy-remote entity; provisions for the assumption of allocated debt by the regulated service LLC at formation, with a transitional covered utility guaranty; and a requirement that rate base reflect the full value of prudently invested capital—including construction work in progress—to ensure alignment between rate base and actual invested equity.

**Part IV — Reporting and Transparency.** Directs the Commission to report annually to the relevant Congressional committees on authorized and actual returns on equity, auction results, and the impact on customer rates.

**Part V — Effective Date.** Takes effect upon enactment. The default authorized return applies to all covered utilities immediately; rate adjustments are implemented through the Part II(f) mechanism, with formula rate transitions governed by Section 4. No rate proceeding need be initiated as a precondition.

**Part VI — Applicability to Commission-Jurisdictional Rate Base.** Clarifies that the Act applies only to the portion of a covered utility's rate base subject to Commission jurisdiction. State-regulated distribution assets are unaffected.

**Part VII — Severability.** Standard severability clause.

**Section 4 — Formula Rate Transition.** Requires formula rates to update their ROE component to the default authorized return within 12 months of enactment, with a true-up adjustment to ensure ratepayers are made whole for the transition period between enactment and the formula rate amendment.

**Section 5 — Amendment to Securities Act of 1933.** Amends Securities Act § 3(a) to add new § 3(a)(2A), providing a registration exemption for auction equity interests issued under this Act and under qualifying state laws. The exemption is modeled on existing § 3(a)(2) (bank securities) and ensures that these highly regulated, non-voting instruments can be offered efficiently without SEC registration delays.

**Section 6 — Holding Company and Merger Review Carveouts.** Amends PUHCA 2005 and FPA § 203 to exempt auction equity interest acquisitions from holding company and merger review requirements, and to authorize regulated service LLC formations under Part III(k) without separate Commission approval. These carveouts extend to state-regulated utility issuances under qualifying state laws.

# BILL TEXT

## *The Fair Authorized Investment Returns Act*

To amend the Federal Power Act (16 U.S.C. § 824 et seq.) and the Natural Gas Act (15 U.S.C. § 717 et seq.) to establish a market-based mechanism for determining authorized returns on equity for FERC-jurisdictional public utilities and natural gas companies; to amend the Securities Act of 1933 to provide a registration exemption for auction equity interests; to provide holding company and merger review carveouts; and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

### Section 1. Short Title

This Act may be cited as the “Fair Authorized Investment Returns Act” or the “FAIR Act.”

### Section 2. Congressional Findings

Congress finds and declares all of the following:

**(a)** Investor-owned electric and natural gas utilities are entitled to a reasonable opportunity to earn a fair return on their invested capital, but ratepayers should not bear costs that exceed the level necessary to attract capital under prevailing market conditions. A return on equity authorized above the minimum rate of return necessary to attract capital investment results in charges to ratepayers that are unjust and unreasonable.

**(b)** Authorized returns on equity over and above the minimum rate of return necessary to attract capital investment—the cost of capital—harm ratepayers in multiple ways, including the direct cost of excess returns passed on to ratepayers, the incremental corporate income taxes owed on those excess returns, and the further costs that flow from the well-documented Averch-Johnson effect, by which too-high rates of return on equity create incentives for utilities to overinvest in capital assets.

**(c)** The Capital Asset Pricing Model, applied to the low market beta of regulated utility equities relative to broad market indices, suggests that a premium to the 10-

Year Treasury risk-free rate of less than two percent is warranted. Discounted Cash Flow analysis leads to a similar conclusion.

**(d)** The significant premium to book value at which the holding companies of most utilities trade provides further evidence that authorized returns on equity are above utilities' cost of equity. As a matter of financial principle, a utility earning a return on equity equal to its cost of equity should trade at approximately book value.

**(e)** That the returns on equity awarded to regulated utilities subject to the jurisdiction of the Commission are broadly consistent with those awarded by state commissions  does not dispel these concerns. Consistently excessive returns reflect a rate-setting process in which regulators reference what other jurisdictions have awarded, producing a self-reinforcing cycle untethered from market fundamentals.

**(f)** More broadly, these excessive returns and premium valuations are a predictable consequence of the well-documented phenomenon of regulatory capture and capital bias, as explored in the foundational work of George Stigler (Nobel Prize, 1982) and Jean Tirole (Nobel Prize, 2014). The regulated entities subject to Commission oversight can devote substantial resources to influencing regulatory outcomes that determine their profitability—including the hiring of experts to advance favorable interpretations of otherwise straightforward financial models, the maintenance of revolving-door employment relationships with former regulators, and extensive "educational" engagement with regulatory staff—while ratepayer interests are represented by comparatively limited resources. Process enhancements such as mandating more sophisticated analytical models will not resolve this imbalance, because the problem is not which analytical tools are used but how their inputs are chosen. The solution is to harness market mechanisms in place of regulatory judgment wherever possible.

**(g)** These excessive returns translate to a substantial burden upon ratepayers. Across the country, utilities earn excess profits that go beyond their entitled reasonable returns, amounting to approximately $500 extra per household annually.  Soaring rates place a growing share of households at risk of service disconnection. Businesses are also impacted, as high rates disadvantage them relative to competitors based elsewhere.

**(h)** The current process by which the Commission sets transmission and pipeline rates has historically been inaccessible and indecipherable to the public and often

runs contrary to the stated goals of ensuring affordable, safe, secure, and reliable utility service for residential and business consumers.

**(i)** The default authorized return established by this Act—equal to the 10-Year Treasury plus 200 basis points—is set at a level the Congress finds to be at or above the cost of equity for most covered utilities under prevailing market conditions, based on the financial evidence described in subsections (c) and (d). The 200 basis point premium is designed to ensure that, for the large majority of covered utilities in ordinary circumstances, the default authorized return is not confiscatory, while still representing a significant reduction from the historically excessive returns that the current regulatory process has produced. The Congress recognizes that market conditions may change over time and that what constitutes an adequate return will vary accordingly; this Act's annual reset mechanism ensures that the Treasury component of the default authorized return tracks prevailing market conditions.

**(j)** A competitive equity auction conducted pursuant to Part III of this Act that produces an authorized return on equity above the default authorized return does not by itself establish that the default authorized return is confiscatory or below the constitutional minimum. In the early period following enactment, auction-clearing returns may exceed the default authorized return in part because investors are unfamiliar with these instruments and require a premium return to compensate for that unfamiliarity—a premium that the Congress expects to decline as these instruments become established in the capital markets. Even in this transitional period, the availability of the auction mechanism ensures that no covered utility is required to operate under a return below what willing investors, in a competitive process, have determined to be adequate compensation for the associated risk. This Act's true-up provisions further ensure that any covered utility that conducts an auction is made whole for the period during which the default authorized return was in effect, so that no covered utility suffers a permanent confiscatory outcome.

**(k)** The default authorized return and the competitive equity auction mechanism, taken together, satisfy the constitutional standard articulated in *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), and *Bluefield Waterworks & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923), by ensuring that every covered utility has both a presumptively adequate default return and an opportunity to demonstrate, through competitive market evidence, that a higher return is required. Sealed-bid uniform-price auctions

are widely used in capital markets, including for the issuance of U.S. Treasury securities, and the competitive pricing mechanism established by this Act is functionally equivalent to processes that operate successfully in debt and equity markets worldwide. Sealed-bid uniform-price auctions are also the mechanism by which the Federal Communications Commission allocates electromagnetic spectrum and by which regional transmission organizations such as PJM Interconnection and ISO New England procure electric generation capacity. The application of this well-established mechanism to the determination of utility equity costs is novel, but the mechanism itself is proven across multiple regulated markets.

**(l)** Regulation is a substitute for competition. When competitive markets exist and function effectively, regulatory judgment is unnecessary; market prices provide all the information required to protect consumers. Regulatory discretion is warranted only when objective market data are unavailable. In the case of utility debt, commissions do not convene adjudicatory proceedings to determine a "reasonable" bond yield; they incorporate the market-determined coupon rate because a competitive debt market provides reliable evidence of the cost of debt. This Act applies the same principle to equity: where a competitive auction can provide direct, transaction-level evidence of the return investors require to supply equity capital to a regulated utility, that evidence is superior to any estimate produced by expert testimony applying contested financial models. A covered utility is no more entitled to demand a judicially supervised determination of its equity cost than it is to demand such a determination of its debt cost. Congress has previously established formulaic rate structures, including avoided-cost requirements under the Public Utility Regulatory Policies Act of 1978. This Act follows established precedent in codifying a formulaic approach that reduces regulatory discretion while preserving the Commission's authority over implementation, auction administration, and ratemaking mechanics.

**(m)** Covered utilities, as recipients of federally and state-granted monopoly privileges to provide transmission, wholesale power, or interstate gas services, have accepted obligations of transparency and public accountability that are not imposed on ordinary private enterprises. The disclosure requirements that attend a securities offering conducted pursuant to this Act serve the public interest by making the financial condition, operations, and risks of covered utilities more transparent to regulators, ratepayers, and the public at large. Such transparency is itself consistent with, and supportive of, effective cost-of-service regulation, and

the Congress finds that the public benefit of enhanced utility disclosure is substantial. It is the intent of this Act that all reasonable costs incurred by a covered utility in connection with a competitive equity auction, including any registration and offering costs, management time reasonably allocable to the auction process, and professional fees, be recoverable in rates as set forth in Part III. The Congress further finds that such costs are expected to be substantially less than the expert testimony, legal, and other costs currently incurred by covered utilities and ratepayers in litigating return-on-equity determinations in administrative rate proceedings.

**(n)** This Act does not require covered utilities to issue equity. Unless the covered utility elects otherwise, auction equity interests issued pursuant to this Act do not carry voting rights with respect to the affairs of the covered utility or any regulated service corporation or regulated service LLC, and do not otherwise entitle holders to participate in the governance of the covered utility. Moreover, the Act does not compel dilution of the covered utility's ownership interest in its regulated services. The covered utility is permitted to subscribe for the full amount offered in any auction conducted for any of its regulated services.

**(o)** Any impact of a lower authorized return on equity on credit ratings can, if necessary, be offset by adjusting the authorized debt-to-equity ratio applicable to each regulated service. Under this Act, the authorized capital structure is determined at the level of each regulated service rather than at the level of the covered utility as a whole, and it is the intent of this Act that the Commission set and adjust such capital structure as may be necessary to maintain financial soundness and continued access to capital markets. The Congress further finds that credit rating agencies evaluate regulated utilities on a multi-factor basis in which the authorized return on equity is one input among many, and that the entity structure established by this Act—including bankruptcy remoteness, ring-fencing, and dedicated revenue streams—is designed to strengthen the credit profile of the regulated service relative to the covered utility's unsegregated balance sheet.

**(p)** The competitive equity auction mechanism established by this Act is designed to discover the return investors require on each regulated service's capital. The auction equity interest is economically similar to tracking stock—an instrument familiar to institutional investors—and the predictability of regulated utility revenue streams makes this instrument well suited to certain investors, including pension funds and insurance companies. For those investors to provide price signals that

are accurate, the rate base to which the authorized return on equity is applied must correspond to the capital that investors have supplied. Under current regulatory practice, certain prudent investments—most notably construction work in progress—are routinely excluded from a utility's rate base until the associated assets are placed in service, even though investors have already committed capital to finance those projects. This exclusion creates a divergence between rate base and actual invested capital that distorts the auction signal: investors who cannot predict the magnitude of the exclusion at the time they bid cannot accurately price the effective return on their capital, introducing noise and uncertainty that increases the cost of equity for ratepayers. The exclusion of construction work in progress from rate base also creates a systematic bias in utility capital allocation. Because utilities earn no cash return on capital invested in projects that have not yet been placed in service, they face a financial incentive to favor projects that can be completed quickly over projects that may deliver greater long-term value to the public but require longer construction periods. Large-scale transmission infrastructure, grid modernization programs, and generation projects essential to the energy transition are disproportionately disadvantaged by this incentive structure. Including construction work in progress in rate base eliminates this bias and ensures that capital allocation decisions are driven by the long-term public interest rather than by the timing of regulatory cost recovery. This Act accordingly requires that rate base reflect the full value of prudently invested capital, with the sole exclusions being for capital that is not supplied by investors—namely, accumulated deferred income taxes, customer deposits, and customer advances for construction.

**(q)** The Congress finds that ratepayers will benefit from this Act beginning immediately upon enactment. The formation of regulated service corporations and regulated service LLCs will require a transitional period during which a covered utility's existing capital structure is restructured. During this transitional period, certain costs—including any guaranty fee payable to the covered utility in connection with debt assumed by a regulated service LLC—will modestly reduce the savings that ratepayers would otherwise realize. These transitional costs are expected to be small relative to the savings from lower authorized returns on equity and to diminish over time as assumed indebtedness matures and is refinanced at the regulated service LLC level without a covered utility guaranty. Similarly, the expansion of rate base required by Part II(i) to reflect all prudently invested capital, including construction work in progress, viewed in isolation, increases the dollar

amount to which the authorized return is applied; but the authorized return itself is reduced by a substantially greater magnitude, such that the product of the two—which determines the total return component of rates—is lower under this Act than under current practice. The Congress recognizes that the day-one net savings may be smaller for covered utilities with unusually large construction work in progress balances than for those without, and that the magnitude of net savings will vary over time with the pace of utility capital investment; in no case, however, will the combined effect increase the total return component of rates above what current practice would produce for the same utility. The long-run benefits of aligned capital allocation incentives, as described in finding (p), supplement these immediate rate savings. So too do the progressively lower auction-clearing returns the Congress anticipates as investors become more familiar with the instruments auctioned.

**(r)** The restructuring authority established by this Act, including the authority to require assumption of allocated indebtedness by a regulated service LLC notwithstanding contrary provisions of existing debt instruments, is a legitimate exercise of Congress's commerce power and of its authority under the Federal Power Act and the Natural Gas Act, in furtherance of the public interest in affordable and reliable utility service. The contractual impairment, if any, is reasonable and narrowly tailored: requiring individual bondholder consent for a credit-neutral restructuring would create a holdup problem enabling bondholders to extract rents from ratepayers without bearing additional risk. Moreover, this Act prospectively requires all new long-term indebtedness to include transfer covenants, so that the override applies only to legacy obligations—a diminishing pool that will be eliminated through ordinary refinancing cycles.

**(s)** The Commission administers most transmission rates through formula rates under 18 C.F.R. Part 35, which allow covered utilities to recover their stated cost of service, including an embedded return on equity, without filing a full rate case annually. Under current Commission practice, intervenors—not utilities—bear the burden of proving that costs in a formula rate are imprudent. This inverted burden reinforces upward bias in authorized returns on equity and makes meaningful rate discipline difficult. The Commission's existing methodology for setting authorized ROEs relies on a comparator-utility approach that is inherently circular: it measures utilities' cost of equity by reference to the returns authorized for other utilities, rather than by reference to independent market data. The circularity of this approach was highlighted in Emera Maine v. FERC, 854 F.3d 9 (D.C. Cir. 2017), and in the Commission's subsequent Opinion No. 569-A, in which the Commission

adopted a revised methodology that, while an improvement, continues to rely on comparator-utility inputs.

**(t)** The Commission currently authorizes return on equity incentive adders that increase a covered utility's allowed return above its base ROE. These include a 50-basis-point adder for participation in a regional transmission organization or independent system operator, awarded regardless of whether participation is voluntary or state-mandated, and an Abandoned Plant Incentive that makes ratepayers the insurer of last resort for failed projects. These adders are layered on top of an already above-market base ROE. Nothing in this Act prevents the Commission from adopting performance-based adder programs consistent with Part II(h) of this Act; this finding addresses the existing practice of awarding adders that are not subject to a neutral-expected-value requirement.

## Section 3. Amendments to the Federal Power Act and Natural Gas Act. The Federal Power Act (16 U.S.C. § 824 et seq.) and the Natural Gas Act (15 U.S.C. § 717 et seq.) are each amended by adding, respectively, new 16 U.S.C. § 824___ and 15 U.S.C. § 717___, to read as follows:

### Part I. Definitions

For the purposes of this Act, the following terms shall have the following meanings:

**(a) "authorized return on equity"** means the rate of return on common equity authorized for ratemaking purposes.

**(b) "Commission"** means the Federal Energy Regulatory Commission.

**(c) "competitive equity auction"** means a process overseen by the Commission in accordance with this Act that provides a market-based determination of the cost of equity for a covered utility.

**(d) "covered utility"** means any entity that is (i) a "public utility" as defined in FPA § 201(e) (16 U.S.C. § 824(e)) subject to cost-of-service rate review under FPA § 205 (16 U.S.C. § 824d) with respect to at least one regulated service, or (ii) a "natural gas company" as defined in NGA § 2(6) (15 U.S.C. § 717a(6)) subject to cost-of-service rate review under NGA § 4 (15 U.S.C. § 717c) with respect to at least one regulated service. A covered utility does not include: (A) any entity whose rates for all services are authorized exclusively pursuant to the Commission's market-based rate program (18 C.F.R. § 35.37); (B) any rural electric cooperative; (C) any governmental entity; or (D) any federal power marketing agency.

*[Drafting note: Petroleum pipeline carriers regulated under 49 U.S.C. § 15701 et seq. are excluded; FERC's oil pipeline rate methodology is cost-indexed rather than cost-of-service and does not involve an authorized return on equity in the same sense as FPA and NGA regulation. Congress may wish to address petroleum pipeline ROE separately. Policymakers should also confirm that any entity whose rates are authorized exclusively under the Commission's market-based rate program (18 C.F.R. § 35.37) is properly excluded, and should review whether any hybrid entities—with both cost-of-service and market-based rate authorizations for different services—require special treatment.]*

**(e) "regulated service"** means a distinct category of utility service—such as electric transmission or interstate natural gas transportation—provided by a covered utility and for which the Commission determines an authorized return on equity. Where a covered utility provides both Commission-jurisdictional and non-Commission-jurisdictional services (e.g., both FERC-regulated transmission and state-regulated distribution), each Commission-jurisdictional service category shall be treated as a separate regulated service for purposes of this Act unless the Commission determines that consolidated treatment is appropriate. State-regulated distribution services are not a "regulated service" for purposes of this Act, regardless of whether the entity providing them is also a covered utility for other services.

**(f) "cost of equity"** means the minimum rate of return necessary to attract equity capital to invest in a specific regulated service.

**(g) "default authorized return"** means the authorized return on equity determined pursuant to Part II of this Act.

**(h) "10-Year Treasury"** means the Market Yield on U.S. Treasury Securities at 10-Year Constant Maturity, Quoted on an Investment Basis, as reported by the Federal Reserve System.

**(i) "rate period"** means the time period in which a covered utility collects rates that are authorized and approved by the Commission, including any period governed by a formula rate under 18 C.F.R. Part 35.

**(j) "auction-clearing return"** means the uniform rate of return established as the clearing price in a competitive equity auction conducted pursuant to Part III(e) of this Act.

**(k) "auction equity interest"** means an economic interest issued pursuant to a competitive equity auction under Part III of this Act. An auction equity interest

represents a participation in the financial performance of a specific regulated service, carries the auction-clearing return as adjusted pursuant to Part III(c), and is distinct from the covered utility's base common stock. The authorized return and financial performance of any auction equity interest shall be determined solely by reference to the regulated service to which it relates, and shall not be affected by the financial performance of, or returns applicable to, any other regulated service or any activity of the covered utility not subject to the jurisdiction of the Commission. Except where auction equity interests are issued by a regulated service corporation established pursuant to Part III(k), the risk profile of auction equity interests is not so limited: auction equity interests issued directly by the covered utility are obligations of the covered utility and are therefore subject to all risks applicable to the covered utility generally, including the risk of insolvency or bankruptcy of the covered utility. Where a covered utility has established a regulated service corporation and regulated service LLC pursuant to Part III(k) of this Act, auction equity interests shall be issued by such regulated service corporation rather than by the covered utility itself, and references in this definition to the "covered utility's base common stock" shall be construed to mean the stock of such regulated service corporation retained by the covered utility.

**(l) "regulated service corporation"** means a corporation organized under the laws of any State, formed or designated by a covered utility pursuant to Part III(k) of this Act, that (A) is treated as a corporation for federal income tax purposes and (B) conducts no activities other than holding a membership interest in a regulated service LLC and serving as the issuer of auction equity interests for the regulated service associated with that regulated service LLC.

**(m) "regulated service LLC"** means a wholly-owned limited liability company subsidiary of a regulated service corporation, formed or designated pursuant to Part III(k) of this Act, to hold assets, rights, franchises, and obligations associated with a regulated service. A regulated service LLC shall be treated as a disregarded entity for federal income tax purposes.

*[Drafting note: Policymakers should confirm that the enacting state's LLC statute permits a single-member LLC to be owned by a corporation and treated as a disregarded entity for federal income tax purposes without adverse state-tax consequences. Most states conform to federal check-the-box treatment, but a handful impose significant entity-level taxes on LLCs regardless of federal classification, or impose significant franchise taxes that could create friction with*

*the two-tier structure. Policymakers should also confirm that the state's LLC act does not impose restrictions on the formation of single-member LLCs for regulated utility purposes, and should review whether any applicable state public utility holding company statute requires approval of the interposition of a corporate subsidiary between the covered utility and the regulated service LLC, and whether the Section 6(c) FPA § 203 carveout in this Act displaces any such requirement for FERC-jurisdictional entities.]*

**(n) "qualifying state law"** means a state statute or commission regulation that establishes a competitive equity auction mechanism for a state-regulated utility's authorized return on equity, administered by the relevant state public utility commission, that is substantially similar to the mechanism established by this Act, including requirements that (i) the auction-clearing return reflect a competitive market-clearing price, (ii) auction equity interests not carry voting rights, and (iii) the issuing utility be subject to cost-of-service rate regulation by the state commission.

## Part II. Default Authorized Return on Equity

**(a) Default authorized return.** Unless an authorized return on equity is established pursuant to Part III of this Act, the Commission shall set the authorized return on a covered utility's common equity equal to the sum of (i) the 10-Year Treasury and (ii) 2.00 percent.

**(b) Annual reset.** The default authorized return shall be reset annually as of January 1 of each year to reflect the average of the 10-Year Treasury rate on the sixty (60) business days immediately prior to January 1 of that year. The Commission shall publish the reset default authorized return no later than December 15 of the preceding year.

**(c) Alternative benchmark.** Should publication of the 10-Year Treasury cease or be interrupted, the Commission shall identify and use for this calculation the alternative benchmark it determines to be the best substitute.

**(d) Burden of proof.** The burden of demonstrating that the default authorized return on equity is insufficient to attract capital shall rest exclusively with the covered utility. The default authorized return shall be presumed just and reasonable unless rebutted through the competitive equity auction process set forth in Part III of this Act.

**(e) Initial rate period.** For any rate period commencing between the effective date of this Act and the first reset date under subsection (b), the 10-Year Treasury component shall be determined using the averaging methodology prescribed in subsection (b), applied to the sixty (60) business days immediately preceding the effective date of this Act.

**(f) Rate adjustment.** Whenever the authorized return on equity for a regulated service changes pursuant to this Part or Part III, the Commission shall adjust the rates applicable to such regulated service to reflect the new authorized return on equity. Such adjustment shall be implemented through the mechanism the Commission determines to be most expedient, which may include but need not be limited to a surcharge or credit applied to existing formula rates or tariffs, an automatic rate adjustment mechanism, or incorporation into the covered utility's next general rate proceeding. The Commission shall implement any such adjustment no later than ninety (90) days after the change in authorized return on equity takes effect. Any such adjustment shall be limited to the change in authorized return on equity and shall not disturb any other component of the rates then in effect, except to the extent that such component must be adjusted as a mathematical consequence of the change in authorized return on equity.

**(g) Risk insurance.** Nothing in this Act shall preclude a covered utility from procuring third-party insurance to hedge material idiosyncratic risks, with the cost thereof recoverable in rates as an operating expense subject to the Commission's determination of prudence.

**(h) Performance-based ratemaking.** For purposes of this subsection, a "performance-based ratemaking plan" means a plan, mechanism, or order that adjusts the authorized return on equity of a covered utility based on measured utility performance against specified benchmarks; it does not include revenue decoupling mechanisms, formula rate plans, or other mechanisms that operate on revenue, cost recovery, or rate design without adjusting the authorized return on equity. Nothing in this Act shall preclude the Commission from establishing or maintaining a performance-based ratemaking plan for a covered utility, provided that (i) any such plan is designed so that the expected value of performance-based adjustments to the authorized return on equity is neutral and (ii) no such plan shall permit the aggregate effect of performance-based adjustments to increase the covered utility's realized return on equity for any regulated service by more than

[2.00] percentage points above the authorized return on equity for that regulated service as determined under this Act.

**(i) Rate base.** For purposes of determining the authorized return on equity for any regulated service of any covered utility under this Act, whether such return is determined under this Part or pursuant to a competitive equity auction under Part III, the Commission shall determine rate base so as to reflect the full value of all assets prudently invested by or on behalf of the covered utility for the benefit of the regulated service, including construction work in progress, net of accumulated depreciation. The only reductions to rate base shall be for capital that is not supplied by investors, which shall be limited to: (I) accumulated deferred income taxes, to the extent that deferred tax liabilities exceed deferred tax assets; (II) customer deposits; and (III) customer advances for construction. The Commission shall not exclude from the rate base of any regulated service any asset on the basis that it has not yet been placed in service, provided that the investment has been determined to be prudent and is being undertaken for the benefit of the regulated service. This subsection shall apply to every covered utility upon the effective date of this Act, without regard to whether a regulated service corporation or regulated service LLC has been formed pursuant to Part III(k), and shall govern any determination of the authorized return on equity made under this Act thereafter.

## Part III. Competitive Equity Auction

**(a) Utility-initiated auction.** Should a covered utility believe that its cost of equity exceeds the default authorized return, it may petition the Commission to oversee a competitive equity auction. This petition shall be deemed withdrawn, and the covered utility deemed to have accepted the default authorized return, if the covered utility fails to take all steps required to facilitate such auction, as set forth by the Commission, on the timeline prescribed for each such step. A petition under this subsection must be filed no later than [30] days after the later of (i) the effective date of this Act or (ii) the most recent reset of the default authorized return under Part II(b). Upon certification of the auction results by the Commission, the auction-clearing return shall become the authorized return on equity for the regulated service, and the Commission shall adjust customer rates in accordance with Part II(f) no later than ninety (90) days after such certification. The Commission shall also implement a true-up adjustment, calculated as the difference between (A) the revenue actually collected by the covered utility during the period from the filing of the petition through the date on which adjusted rates

take effect, and (B) the revenue that would have been collected during that period had the auction-clearing return been reflected in rates throughout. Interest on any such difference shall accrue at the auction-clearing return, calculated from the midpoint of such period. For the avoidance of doubt, any adjustment to customer rates required by the reset of the default authorized return under Part II(b) shall be implemented in accordance with Part II(f) independently of any auction petition, and the true-up under this subsection shall apply only to the period commencing on the date of the petition.

**(b) Commission-initiated auction.** The Commission may, on its own motion or upon petition by any state public utility commission, state consumer advocate, state attorney general, or the United States, order that a competitive equity auction be conducted for a covered utility if the Commission finds reasonable cause to believe that the default authorized return materially exceeds the covered utility's cost of equity for a regulated service. A commission-initiated auction under this subsection may be ordered no earlier than [30] days after the later of (i) the effective date of this Act or (ii) the most recent reset of the default authorized return under Part II(b), and no later than [60] days after such reset. Upon certification of the auction results, the auction-clearing return shall become the authorized return on equity for the regulated service, and the Commission shall adjust customer rates in accordance with Part II(f) no later than ninety (90) days after such certification. The Commission shall also implement a true-up adjustment, calculated as the difference between (A) the revenue actually collected by the covered utility during the period from January 1 of the year in which the auction is conducted through the date on which adjusted rates take effect, and (B) the revenue that would have been collected during that period had the auction-clearing return been reflected in rates throughout. Interest on any such difference shall accrue at the auction-clearing return, calculated from the midpoint of such period. Should the covered utility fail to take all steps required to facilitate an auction ordered pursuant to this subsection on the timeline prescribed by the Commission, the default authorized return for that regulated service shall be reduced by [0.10] percentage points, effective as of the date of such failure and continuing until the covered utility has complied. If the covered utility fails to facilitate a subsequent commission-initiated auction for the same regulated service, such reduction shall be cumulative. Upon compliance, any reduction under this paragraph shall cease to apply prospectively; no retroactive adjustment shall be made for any period during which the reduction was in effect.

**(c) Duration and effect.** Holders of auction equity interests issued pursuant to an auction shall receive the auction-clearing return, as adjusted for differences between realized and anticipated profits in a manner to be specified by the Commission in its order governing the auction, for the full duration of such interests. This rate of return, whether higher or lower than the default authorized return, shall determine the authorized return on equity for the regulated service, in accordance with subsection (d), until the following January 1, at which time the covered utility may elect that the default authorized return shall apply to the covered utility's common equity in the regulated service. Any such election shall not affect the return applicable to outstanding auction equity interests, which shall continue to receive the auction-clearing return for the full duration of such interests. Following such an election, the authorized return on equity for the regulated service shall be determined in accordance with subsection (d).

**(d) Multiple auctions.** Where different equity interests in a regulated service bear different authorized rates of return—whether because multiple auctions have been conducted at different times or because the covered utility has elected pursuant to subsection (c) that the default authorized return shall apply to its common equity—the authorized return on equity for the regulated service shall be the weighted average of the return applicable to each equity interest, weighted by its outstanding equity amount. For this purpose, the covered utility's common equity shall bear the auction-clearing return established in the most recent auction, or, following an election under subsection (c), the default authorized return. Where no auction equity interests remain outstanding, the default authorized return shall apply to the full equity component of the regulated service.

**(e) Auction mechanism.** The Commission shall oversee a sealed-bid competitive auction, to be administered independent of the covered utility. The Commission shall determine for each auction whether bids are to be expressed as an absolute number or as a premium to the 10-Year Treasury or another such index, with the applicable interest rate to be reset periodically. Qualified bidders shall bid the minimum target return on equity they require. Bids shall be ranked in ascending order and the Commission shall accept bids in that order until the total amount of equity offered in the auction has been fully allocated. All successful bidders shall receive the same rate of return, equal to the highest accepted bid. If the aggregate amount bid at the clearing rate exceeds the remaining amount of equity to be allocated, such bids shall be accepted on a pro rata basis. For the avoidance of

doubt, all bids submitted at returns below the clearing rate shall be accepted in full; the pro-rata reduction applies only to bids submitted at the clearing rate itself.

The amount of equity to be offered in each auction shall be the greater of (I) [2.5] percent of the equity component of the regulated service rate base and (II) the lesser of [$50,000,000] and [5] percent of the equity component of the regulated service rate base.

The Commission shall certify the results of an auction if (I) at least [5] qualified bidders submitted bids and (II) the aggregate equity amount bid by all qualified bidders was at least [1.5] times the total equity amount offered in the auction. If either threshold is not met in a utility-initiated auction under subsection (a), the auction result shall nonetheless be certified if the auction-clearing return does not exceed the default authorized return by more than [2.00] percentage points; otherwise, the auction result shall be void and the default authorized return shall apply. If either threshold is not met in a commission-initiated auction under subsection (b), the auction result shall be void and the default authorized return shall continue to apply. In any commission-initiated auction under subsection (b), regardless of whether the participation thresholds are met, the auction result shall be binding only if the auction-clearing return is less than the default authorized return; if the auction-clearing return equals or exceeds the default authorized return, the default authorized return shall continue to apply. If the aggregate equity amount bid in an auction is less than the total equity amount offered, the auction-clearing return shall apply to the equity amount actually subscribed and the default authorized return shall apply to the remainder, with the authorized return on equity for the regulated service determined in accordance with subsection (d).

All reasonable costs incurred by a covered utility in connection with a competitive equity auction under this Part, whether initiated by the covered utility under subsection (a) or ordered by the Commission under subsection (b), including costs of any required securities registration or offering preparation, reasonable management time allocable to the auction, and professional fees, shall be treated as prudently incurred costs for ratemaking purposes and shall be recoverable in rates.

**(f) Commission authority and regulations.** Any auction shall be conducted by an independent auction administrator pursuant to guidelines promulgated by the Commission. The Commission shall assess administrator qualifications based on capability and relevant expertise and shall not require prior service as auction

administrator as a prerequisite for eligibility. The Commission may adopt regulations as necessary to implement the competitive equity auction process, including rules governing what constitutes a complete application, the form and timing of the bidder qualification process, and consumer protection provisions. Such regulations shall require the independent auction administrator to disclose to all qualified bidders, in advance of each auction, the conditions under which the auction result will be binding, including whether the auction is utility-initiated or commission-initiated and the consequences thereof for bid acceptance.

**(g) Securities law compliance.** The economic interests offered pursuant to this Part may constitute securities within the meaning of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended. Auction equity interests issued pursuant to this Part are exempt from registration under the Securities Act of 1933 by operation of Section 5 of this Act (which amends Securities Act § 3(a) to add new § 3(a)(2A)). The Commission shall, as part of its implementing regulations, address: (i) ongoing disclosure obligations applicable to the covered utility and to holders of auction equity interests; and (ii) the duties and requisite expertise of the independent auction administrator required under subsection (f). Nothing in this subsection shall be construed to confer upon the Commission any authority to regulate securities except as expressly provided in Section 5 of this Act.

**(h) Instrument design.** The covered utility need not offer its common stock for sale in the auction, but the auction equity interests offered shall, in the judgment of the Commission, provide prospective investors:

> (i) economically equivalent position to that of the covered utility's equity interest in the regulated service—being the covered utility's common stock where auction equity interests are issued directly by the covered utility, or the covered utility's retained stock interest in the regulated service corporation where such interests are issued by a regulated service corporation established pursuant to Part III(k);
>
> (ii) adequate protections against dilution or impairment of value through related-party transactions or other transfers involving the corporation's parent holding company;
>
> (iii) prospective periodic distributions calibrated so that, if the covered utility's realized profits of the regulated service in each period equal those embedded by the Commission in the rates approved to achieve the

authorized return on equity, holders of auction equity interests will realize an internal rate of return equal to the auction-clearing return, taking into account all periodic distributions and any return of equity capital over the life of the interests;

(iv) a stated initial equity amount per auction equity interest equal to the purchase price paid by the winning bidder in the auction, with such equity amount to be returned to holders over the life of the interests at a rate and on a schedule consistent with the Commission's treatment of rate base depreciation and amortization for the regulated service for ratemaking purposes, such that as the equity component of the regulated service rate base is reduced through depreciation and amortization, a commensurate portion of the initial equity amount is returned to holders; and

*[Drafting note: The return-of-capital schedule is intentionally tied to the commission's treatment of depreciation and amortization for ratemaking purposes, which may change over time. The commission's implementing regulations under Part III(f) should require auction disclosure documents to state that the depreciation and amortization schedule is subject to prospective adjustment in subsequent rate proceedings, and that such adjustments will affect the timing of return of capital to holders of auction equity interests.]*

(v) a specification, to be set forth in the instrument terms and confirmed in the Commission's order governing the auction, of how shortfalls and excesses in realized profits of the regulated service relative to the earnings embedded in approved rates are to be allocated as between (A) holders of auction equity interests and (B) the covered utility's common equity, and, in the event of multiple outstanding series of auction equity interests, among such series. Such specification shall provide that any shortfall or excess in realized profits of the regulated service shall be allocated among all equity interests in the regulated service—including the covered utility's common equity and each outstanding series of auction equity interests—in proportion to the earnings that each such interest would have received had realized profits been exactly equal to the earnings embedded in approved rates. No interest shall have priority over any other in such allocation. For the avoidance of doubt: (I) each interest participates in shortfalls as well as excesses; (II) there is no seniority or preference among auction equity

interests of different series or between auction equity interests and the covered utility's common equity with respect to the allocation of shortfalls or excesses; and (III) by way of illustration, if a single series of auction equity interests would have been credited $X, and the covered utility's common equity would have been credited $Y, had earnings been exactly as forecast, but realized profits are $Z, then the auction equity interest series shall be credited $Z × X / (X + Y) and the covered utility's common equity shall be credited $Z × Y / (X + Y). Where multiple series of auction equity interests are outstanding, the same proportionate allocation applies among all series and common equity, based on each interest's forecast-earnings share.

The Commission's order governing each auction shall specify the initial equity amount per auction equity interest, the formula for calculating periodic distributions by applying the auction-clearing return to the outstanding equity balance for each period, and the schedule for return of equity capital, all in a manner consistent with subparagraphs (iii) and (iv) of this subsection and designed to ensure that, if the covered utility's realized profits of the regulated service in each period equal those embedded in the rates approved to achieve the authorized return on equity, holders of auction equity interests will realize an internal rate of return equal to the auction-clearing return.

Each series of auction equity interests shall be redeemed at its then-current book value at the earlier of (I) [40] years from the date of issuance or (II) the end of the first fiscal quarter in which the outstanding equity amount of such series is less than [5] percent of the initial equity amount at issuance. The covered utility or regulated service corporation, as applicable, shall fund such redemption, whether through retained earnings, a capital contribution from the covered utility's parent company, or any other source of equity capital. Upon such redemption, the equity represented by the redeemed series shall revert to the covered utility's common equity in the regulated service. The Commission may defer the mandatory redemption date by up to [2] years upon a showing by the covered utility that immediate redemption would materially impair its financial condition.

In the event of any merger, acquisition, or change of control of the covered utility or, where applicable, the regulated service corporation, the successor entity shall assume all obligations to holders of outstanding auction equity interests on terms no less favorable than those in effect immediately prior to such transaction. No

such transaction shall be consummated without a determination by the Commission that the rights of holders of auction equity interests will be adequately preserved. The Commission may require the terms of each series of auction equity interests to include a provision entitling holders to redemption at then-current book value upon any change of control, at the option of the holder.

In the event of the insolvency or dissolution of a regulated service corporation or regulated service LLC, or the permanent discontinuation of the regulated service to which auction equity interests relate, outstanding auction equity interests shall participate in any distribution of remaining assets on a pari passu basis with the covered utility's common equity in the regulated service, in proportion to their respective outstanding equity amounts, in accordance with subparagraph (v) of this subsection. Nothing in this paragraph shall be construed to create any priority or preference in favor of, or against, holders of auction equity interests relative to the covered utility's common equity.

**(i) Participants.** The auction shall be open, at minimum, to all accredited investors as that term is defined under applicable federal securities law, or any successor provision. Each qualified bidder shall, as a condition of participation, certify in writing to the independent auction administrator that: (i) the bidder is submitting its bid based solely on its own assessment of the risk-adjusted financial return of the auction equity interest, and not for the purpose of, or with the effect of, artificially suppressing or inflating the auction-clearing return; and (ii) the bidder is not acting in concert with any other bidder or with the covered utility or any of its affiliates with respect to the formulation of its bid. Any bidder that is itself an investor-owned electric or natural gas utility subject to cost-of-service regulation by any state or federal regulatory authority, or a holding company that directly or indirectly controls such a utility, shall be ineligible to participate as a bidder, except that the covered utility, its parent company, and any affiliates may participate as bidders, subject to any existing code of conduct policies for affiliate transactions and any further eligibility requirements established by the Commission to prohibit inappropriate preferential treatment in the bidding process. This exclusion shall not apply to any registered investment company, investment adviser, or other institutional investor whose ownership of any such utility is solely as a passive investor in diversified portfolios. Holdings by such institutional investors in auction equity interests issued pursuant to this Act shall not be counted toward any investment limitation applicable to ownership of the covered utility or its common equity under applicable federal law. The Commission shall promulgate rules to implement the

exclusion and certification requirements of this subsection, including procedures for investigation and disqualification of bidders who submit false certifications or who are found to have violated the prohibition on coordinated bidding.

*[Drafting note: Congress should confirm that the investment limitation carveout in this subsection adequately addresses all applicable federal investment limits. Section 6 of this Act provides explicit carveouts under PUHCA 2005 (42 U.S.C. § 16451(8)) and FPA § 203 (16 U.S.C. § 824b). Policymakers should also review whether the covered utility's state of incorporation or the states in which it operates impose separate investment thresholds for aggregate ownership of investor-owned utilities by portfolio investors, and whether an additional carveout—or a reference to this Act in the relevant state statutes—is needed to ensure that institutional investors in auction equity interests are not inadvertently subject to state-level utility ownership approval requirements.]*

**(j) Misconduct and risk attribution.** Where the Commission or a court of competent jurisdiction has made a formal finding that a covered utility has engaged in unlawful or imprudent conduct that has materially increased the covered utility's cost of equity for a regulated service, the Commission may, in its discretion, exclude the portion of any increase in the authorized return on equity for such regulated service that is attributable to such conduct from the return applicable to the covered utility's common equity. No auction equity interest, whether issued before or after such finding, shall be subject to this exclusion; all auction equity interests shall continue to bear the auction-clearing return established in the auction in which they were issued without reduction on account of any exclusion under this subsection, it being the intent of this subsection that only the covered utility's common equity shall bear the financial consequences of such exclusion. Nothing in this subsection shall limit the authority of the Commission to impose penalties, disallowances, or other remedies available under applicable law.

**(k) Regulated service corporation and regulated service LLC — formation, priority, and transition.**

(i) A covered utility may, at any time before or after conducting a competitive equity auction, form a regulated service corporation and a regulated service LLC for a regulated service. The regulated service corporation shall be a wholly-owned subsidiary of the covered utility, organized as a corporation under the laws of any State, and treated as a corporation for federal income tax purposes. The regulated service LLC shall be a wholly-owned subsidiary

of the regulated service corporation, organized as a limited liability company, and treated as a disregarded entity for federal income tax purposes. The regulated service LLC shall hold all material assets, rights, franchises, and obligations associated with the regulated service. The regulated service corporation shall serve as the issuer of auction equity interests for that regulated service. Formation of a regulated service corporation and regulated service LLC is not a prerequisite to conducting an auction under this Part, and the absence of such entities shall not impair the validity of auction equity interests issued by the covered utility.

(ii) In any competitive equity auction conducted before a regulated service corporation and regulated service LLC have been established, the Commission shall require the covered utility to disclose to all qualified bidders that auction equity interests are being issued as direct obligations of the covered utility and are subject to the risks of any insolvency, bankruptcy, or restructuring proceedings affecting the covered utility or its affiliates. The Commission shall specify the form and content of such disclosure as part of its implementing regulations under subsection (f).

(iii) Each covered utility shall ensure that all long-term indebtedness with a stated maturity greater than one year issued or incurred on or after the effective date of this Act, whether in the form of bonds, notes, debentures, or otherwise, includes a covenant expressly permitting the covered utility to transfer the assets, franchises, rights, and obligations associated with each regulated service to a regulated service corporation or regulated service LLC without such transfer constituting a default, event of default, or breach under such indebtedness. The Commission shall not approve any long-term debt financing by a covered utility that does not include such a covenant. For the avoidance of doubt, nothing in this subsection requires a covered utility to restructure, refinance, or assign any indebtedness outstanding as of the effective date of this Act in advance of the formation of a regulated service LLC pursuant to subsection (k); the allocation and assumption of existing indebtedness upon formation of a regulated service LLC shall be governed by subparagraph (vi)(B) of this subsection.

(iv) Each covered utility that has not yet established a regulated service corporation and regulated service LLC shall use commercially reasonable efforts to do so no later than five (5) years after the effective date of this Act,

or five (5) years after the date of the covered utility's first competitive equity auction, whichever is later. The Commission may extend this period upon a showing by the covered utility of good cause, which may include the inability to obtain required bondholder or creditor consents despite commercially reasonable efforts.

(v) Where a covered utility has established a regulated service corporation and regulated service LLC, each such entity shall be structured and operated as a bankruptcy-remote special-purpose entity, in compliance with standards to be established by the Commission by regulation, which shall include at minimum: (A) maintenance of books of account, bank accounts, and financial records separate from those of the covered utility and any affiliate; (B) prohibition on commingling of assets; (C) a requirement that the organizational documents of the regulated service LLC include at least one independent manager whose affirmative consent is required for any voluntary bankruptcy filing by the regulated service LLC or the regulated service corporation; (D) a covenant by the covered utility not to cause or encourage any involuntary bankruptcy filing against the regulated service corporation or the regulated service LLC; and (E) restrictions on indebtedness of the regulated service corporation and the regulated service LLC except as approved by the Commission. The regulated service corporation shall conduct no activities other than holding a membership interest in the regulated service LLC and serving as the issuer of auction equity interests, and shall hold no assets other than its membership interest in the regulated service LLC and any cash or other assets incidental thereto. Formation of both the regulated service corporation and the regulated service LLC shall require such approvals as may be required under applicable law, including any required approval under the applicable FPA or NGA provisions and the formation carveout provided by Section 6(c) of this Act. Where assets are associated with more than one regulated service, such assets may be held by the regulated service LLC as co-owner with one or more other regulated service LLCs, with each LLC's interest proportionally allocated in a manner approved by the Commission for ratemaking purposes.

(vi) Capital structure and indebtedness of the regulated service LLC.

(A) Each regulated service LLC shall maintain a capital structure for the regulated service consistent with the capital structure authorized by the Commission for ratemaking purposes, including both debt and equity components. The equity component of the regulated service to which the authorized return on equity applies shall consist of the regulated service corporation's equity interest in the regulated service LLC, as funded by the proceeds of auction equity interests and the covered utility's retained interest. Interest on indebtedness of the regulated service LLC shall be treated as a cost of the regulated service for ratemaking purposes.

(B) Upon formation of a regulated service LLC, the Commission shall determine the portion of the covered utility's outstanding indebtedness that is allocable to the regulated service, applying the methodology it uses or would use to allocate the covered utility's capital structure among regulated services for ratemaking purposes. The regulated service LLC shall assume such allocated indebtedness as primary obligor, and the covered utility shall provide an unconditional and irrevocable guaranty of all assumed indebtedness for the remaining term of each such obligation. Such assumption shall not constitute a default, acceleration event, assignment, or breach under any such indebtedness, notwithstanding any provision of the applicable instrument to the contrary.

(C) Following formation, the regulated service LLC shall issue its own debt to finance the debt component of its capital structure. Such debt shall be secured by the regulated service assets held by the regulated service LLC and shall not require a guaranty by the covered utility unless the Commission determines, upon a showing by the covered utility, that a guaranty is necessary to obtain financing on terms consistent with the public interest. Any such guaranty shall be limited in scope and duration to the minimum the Commission determines to be necessary.

(D) For any period during which the covered utility guarantees indebtedness of a regulated service LLC, the covered utility shall be entitled to a guaranty fee, recoverable in rates as a cost of the regulated service. The guaranty fee shall be set by reference to the cost of obtaining a comparable unconditional irrevocable financial guaranty from an unaffiliated financial institution, as determined by one or more bona fide quotes solicited by the Commission or its assign. The Commission shall set the guaranty fee at or

below the lowest such quote. The guaranty fee shall terminate with respect to each obligation upon the earlier of (I) the maturity or refinancing of such obligation without a covered utility guaranty, or (II) the release of the covered utility's guaranty with respect to such obligation.

(E) The rate base of the regulated service LLC shall be determined in accordance with Part II(i) (relating to rate base). For the avoidance of doubt, the principles of Part II(i) apply equally to a regulated service whose assets are held by a regulated service LLC and to a regulated service whose assets are held directly by the covered utility.

(vii) Upon establishment of a regulated service corporation and regulated service LLC, the regulated service corporation shall become the issuer of all subsequent auction equity interests for the applicable regulated service. The Commission may, on such terms as it determines to be in the public interest, authorize the covered utility to offer holders of outstanding auction equity interests the option to convert their interests to equivalent interests issued by the regulated service corporation.

(viii) Notwithstanding the foregoing provisions of this subsection, a covered utility that (A) provides only one regulated service subject to the jurisdiction of the Commission, or whose multiple categories of service have been determined by the Commission to warrant consolidated treatment as a single regulated service pursuant to Part I(e), and (B) does not engage in any material business activity other than the provision of that regulated service shall not be required to form a regulated service corporation or regulated service LLC. Such a covered utility may issue auction equity interests directly, and all references in this Act to a regulated service corporation or regulated service LLC shall, as applied to such a covered utility, be construed as references to the covered utility itself.

## Part IV. Reporting and Transparency

**(a)** Not later than [January 31] of each year, the Commission shall submit to the Committee on Energy and Commerce of the House of Representatives, the Committee on Natural Resources of the House of Representatives, the Committee on Energy and Natural Resources of the Senate, and the Committee on Commerce,

Science, and Transportation of the Senate a report on the implementation of this Act. Such report shall include, but need not be limited to, the following:

(1) each covered utility's requested return on equity, rate of return, and capitalization mix proposed as part of its most recent rate amendment application, together with the corresponding data for the preceding three rate amendment applications;

(2) the actual return on equity, rate of return, and capitalization mix authorized by the Commission for each covered utility in the most recent three rate amendment proceedings;

(3) the results of any competitive equity auctions conducted pursuant to this Act for the previous five calendar years;

(4) an analysis of the impact on average customer rates, broken down by customer class, resulting from implementation of this Act;

(5) a description, in clear and accessible language, of how authorized returns on equity have changed, reflect new circumstances, or remained the same during the previous year;

(6) all data used for calculations under this Act that is not publicly available, together with an explanation of why it was necessary to use such non-public data; and

(7) a summary of any enforcement actions taken.

**(b)** The annual report shall be published online on the Commission's website and made publicly available.

## Part V. Effective Date

This Act shall take effect upon enactment. The default authorized return established by Part II shall apply to each covered utility as of the effective date, and the Commission shall adjust the rates of each covered utility to reflect the default authorized return in accordance with Part II(f). For covered utilities that recover costs through formula rates, Section 4 shall govern the timing and mechanics of such adjustment. Nothing in this Part shall be construed to require the initiation of a rate proceeding under FPA § 205 (16 U.S.C. § 824d) or NGA § 4 (15 U.S.C. § 717c) as a precondition to the application of this Act to any covered utility.

### Part VI. Applicability to Commission-Jurisdictional Rate Base

This Act shall apply only to the portion of a covered utility's rate base that is subject to the ratemaking jurisdiction of the Commission. Nothing in this Act shall be construed to apply to, modify, or otherwise affect the return on equity applicable to any facilities, assets, or services for which the rate of return is determined by a state public utility commission or any other state regulatory authority. To the extent that a covered utility's rate base includes both Commission-jurisdictional and state-jurisdictional components, the Commission shall establish procedures to allocate the rate base between those components, consistent with the Commission's existing cost allocation and jurisdictional separation methodology. The authorized return on equity determined under this Act shall be applied solely to the Commission-jurisdictional component.

### Part VII. Severability

If any provision of this Act, or the application thereof to any person or circumstance, is held invalid, the remainder of this Act and the application of such provision to other persons or circumstances shall not be affected thereby.

## Section 4. Formula Rate Transition

For each covered utility that recovers costs through a formula rate (18 C.F.R. Part 35), the formula rate shall be deemed amended, effective on the first January 1 occurring no earlier than [12] months after the effective date of this Act, to replace the ROE component with the default authorized return then in effect under Part II(a) and (b) of this Act. The Commission shall issue implementing regulations within [180] days of enactment governing the mechanics of formula rate updates pursuant to this Section, including transition provisions for formula rates currently pending before the Commission, notice-and-comment procedures consistent with 5 U.S.C. § 553, and procedures for covered utilities to petition for a competitive equity auction in lieu of applying the default. Upon the effective date of the formula rate amendment under this Section, the Commission shall implement a true-up adjustment for each covered utility, calculated as the difference between (A) the revenue actually collected by the covered utility during the period from the effective date of this Act through the date the amended formula rate takes effect, and (B) the revenue that would have been collected during that period had the default

authorized return been reflected in the formula rate throughout. Interest on any such difference shall accrue at the default authorized return, calculated from the midpoint of such period. The true-up adjustment shall be implemented through the mechanism the Commission determines to be most expedient pursuant to Part II(f).

## Section 5. Amendment to Securities Act of 1933

Section 3(a) of the Securities Act of 1933 (15 U.S.C. § 77c(a)) is amended by inserting after paragraph (2) the following new paragraph:

"(2A) Auction equity interests issued by regulated utilities under FAIR Act legislation. Any auction equity interest issued by: (i) a covered utility, as defined in the Fair Authorized Investment Returns Act, pursuant to that Act; or (ii) a state-regulated utility pursuant to a qualifying state law, as defined in that Act; provided in each case that: (A) the issuing entity is subject to cost-of-service rate regulation with respect to the regulated service from which distributions on the auction equity interest are derived, whether by the Federal Energy Regulatory Commission or by a state public utility commission; (B) the auction equity interest does not carry voting rights with respect to the management or affairs of the issuing entity; (C) the auction is conducted in accordance with applicable federal or state law and regulations; and (D) the issuing entity provides to each purchaser, prior to sale, a disclosure document prescribed by the applicable regulatory authority that sets forth, at a minimum, the offering size, the auction-clearing return, the issuer's most recent annual regulatory filing, the risk factors associated with the non-voting and non-guaranteed nature of the interest, and the terms of the distribution mechanism."

This amendment does not exempt covered utilities or state-regulated utilities from applicable reporting, anti-fraud, or other non-registration provisions of the Securities Act of 1933 or the Securities Exchange Act of 1934. Nothing in this Section preempts the authority of the Securities and Exchange Commission to adopt rules regarding disclosure obligations applicable to auction equity interests issued under this Act.

## Section 6. Holding Company and Merger Review Carveouts

(a) Public Utility Holding Company Act of 2005. Section 1262(8) of the Energy Policy Act of 2005 (42 U.S.C. § 16451(8)) is amended by adding the following at the end: "Notwithstanding the foregoing, a person that holds auction equity interests issued pursuant to the Fair Authorized Investment Returns Act or pursuant to a

qualifying state law, as defined in that Act, shall not be deemed a 'holding company' solely by reason of such holdings, provided that such auction equity interests do not carry voting rights with respect to the management or affairs of the public-utility company that issued them."

(b) Federal Power Act Section 203—Securities Acquisitions. Section 203(a) of the Federal Power Act (16 U.S.C. § 824b(a)) is amended by adding the following at the end: "The acquisition of auction equity interests issued pursuant to the Fair Authorized Investment Returns Act or pursuant to a qualifying state law, as defined in that Act, shall not, solely by reason of such acquisition, constitute an acquisition of facilities, securities, or controlling interest requiring Commission authorization under this section, provided that such auction equity interests do not carry voting rights with respect to the management or affairs of the public utility."

(c) Federal Power Act Section 203—Entity Formation. Section 203(a) of the Federal Power Act (16 U.S.C. § 824b(a)) is further amended by adding the following: "The formation of a regulated service corporation or regulated service LLC pursuant to Part III(k) of the Fair Authorized Investment Returns Act, and the transfer of regulated assets from a covered utility to a regulated service LLC in connection therewith, are hereby authorized by Congress and shall not require separate Commission authorization under this section. This authorization does not exempt the regulated service corporation or regulated service LLC from any other applicable requirement of this Act."

Nothing in this Section exempts any acquisition of common equity, voting preferred stock, or any other voting security of a covered utility from applicable requirements under FPA § 203 (16 U.S.C. § 824b) or PUHCA 2005 (42 U.S.C. §§ 16451–16463).