



The Fair Authorized Investment Returns Act

Model Legislation — Short Form

— WORKING DRAFT — September 2026

This short-form version contains an abbreviated set of legislative findings and the codified text of the Fair Authorized Investment Returns Act, condensed for legislatures that favor shorter bills. It omits the prefatory discussion, which does not form part of the Act, and the full findings of the full model legislation, which set out the evidence and constitutional basis for the Act in greater depth and contain more detailed provisions that a state may elect to incorporate. Readers are encouraged to consult the full model legislation, available from MarketClear, in deciding which elements to adopt. Bracketed items are policy variables or state-specific citations.

Section 1. Legislative Findings

The [Legislature] finds and declares all of the following:

- (a) Investor-owned electric, gas, and water utilities are entitled to a reasonable opportunity to earn a fair return on 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 that minimum results in charges to ratepayers that are unjust and unreasonable.
- (b) Authorized returns above the cost of equity harm ratepayers directly, through the incremental income taxes owed on excess returns, and through the incentive to overinvest in capital assets that above-market returns create.
- (c) The Capital Asset Pricing Model, applied to the low market beta of regulated utility equities, indicates that a premium to the 10-Year Treasury of less than one percent is warranted, and discounted cash flow analysis leads to a similar conclusion. The substantial premium to book value at which utility holding companies trade confirms that authorized returns exceed the cost of equity, since a utility earning its cost of equity would trade at book value.
- (d) Regulation is a substitute for competition. Commissions do not adjudicate a “reasonable” bond yield; they accept the market-determined cost of debt because a competitive market supplies reliable evidence of it. Where a competitive auction can supply direct, transaction-level evidence of the return investors require to provide equity capital, that evidence is superior to any estimate produced by expert testimony, and a covered utility is no more entitled to a judicially supervised determination of its equity cost than of its debt cost.
- (e) The default authorized return of the 10-Year Treasury plus 200 basis points is set at a level the [Legislature] finds to be above the cost of equity for most covered utilities. The 200 basis point spread is deliberately conservative — set above the [Legislature]’s best estimate of the utility equity risk premium so as to encompass the range of reasonable estimates — so that the default is not confiscatory for the large majority of covered utilities while still substantially reducing the returns the current process produces. The [Legislature] intends to revisit the default spread in light of the auction-clearing spreads

reported under Part V, once the market for auction equity interests has matured. The Treasury component requires no such review: it resets annually and tracks market conditions automatically, while the spread changes only by act of the [Legislature].

(f) An auction that clears above the default authorized return does not establish that the default is confiscatory. In the period following enactment, auction-clearing returns may exceed the default in part because investors are unfamiliar with these instruments and require a premium that the [Legislature] expects to decline as the instruments become established. Even then, the availability of the auction 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, and the true-up under Part III(a) makes whole any covered utility that conducts an auction.

(g) The default authorized return and the competitive equity auction together satisfy the constitutional standard of *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), and *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923), by providing every covered utility 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 the mechanism by which U.S. Treasury securities are issued and by which PJM Interconnection procures generation capacity; the mechanism is proven, and only its application to utility equity is new.

(h) This [section/Act] does not require any covered utility to issue equity or accept dilution: a covered utility may subscribe for the full amount offered in any auction, and auction equity interests carry no voting rights unless the covered utility elects otherwise. Any effect of a lower authorized return on credit ratings can be offset by adjusting the authorized capital structure, which is determined for each regulated service.

Section 2. Codified Text. [Statutory provision] is added to [Title/Chapter], to read:

Part I. Definitions

For the purposes of this [section/Act], the following terms shall have the following meanings:

- (a) **“auction equity interest”** means a non-voting economic interest in a regulated service issued in a competitive equity auction under Part III, which bears the auction-clearing return and is distinct from the common equity in the regulated service.
- (b) **“common equity”** means the equity interest in a regulated service held by the covered utility, other than any auction equity interest.
- (c) **“covered utility”** means any investor-owned electric, gas, or water utility subject to the ratemaking jurisdiction of the [state utility commission].
- (d) **“regulated service”** means a category of utility service — such as electric distribution, gas distribution, or water service — for which the [state utility commission] determines an authorized return on equity. The [state utility commission] may treat more than one category as a single regulated service.

Part II. Default Authorized Return on Equity

(a) Default authorized return. Unless an authorized return on equity is established under Part III, the authorized return on the common equity in each regulated service shall equal the sum of (i) the 10-Year Treasury – the market yield on U.S. Treasury securities at 10-year constant maturity as reported by the Federal Reserve System, or any successor series – and (ii) 2.00 percent (together, the “default authorized return”; the 2.00 percent component is the “default spread”). Preferred stock and other fixed-return securities are not equity for purposes of this [section/Act] and shall continue to be recovered at embedded cost.

(b) Annual reset. The 10-Year Treasury component of the default authorized return shall be redetermined as of each January 1 as the average of the 10-Year Treasury over the sixty (60) business days preceding that date, and for the period from the effective date of this [section/Act] to the first January 1 thereafter, over the sixty (60) business days preceding the effective date.

(c) Presumption and burden. The default authorized return is presumed just and reasonable. The burden of demonstrating that it is insufficient to attract capital rests exclusively with the covered utility and may be carried only through a competitive equity auction.

(d) Rate adjustment. Whenever the authorized return on equity for a regulated service changes under this Part or Part III, the [state utility commission] shall, within ninety (90) days, adjust the rates for that regulated service through the mechanism it determines most expedient, without disturbing any other component of rates except as a mathematical consequence of the change.

(e) Rate base. For purposes of applying the authorized return on equity, rate base shall reflect the full value of all capital prudently invested for the benefit of the regulated service, including construction work in progress, net of accumulated depreciation, reduced only by capital not supplied by investors: accumulated deferred income taxes, customer deposits, customer advances for construction, and contributions in aid of construction.

(f) Performance-based ratemaking. Nothing in this [section/Act] precludes a performance-based ratemaking plan, provided that adjustments under the plan (i) have an expected value of zero; (ii) do not exceed, in either direction and in any rate period, [2.00] percent of the equity component of the regulated service rate base; and (iii) are implemented through revenue and not through any change to the authorized return on equity, the default spread, or the auction-clearing spread.

Part III. Competitive Equity Auction

(a) Petition. A covered utility that believes its cost of equity for a regulated service exceeds the default authorized return may, during the thirty (30) days following the effective date of this [section/Act] or any subsequent January 1, petition the [state utility commission] for an auction under this Part. Upon certification of the results, the auction-clearing return becomes the authorized return on equity for the regulated service, rates shall be adjusted under Part II(d), and the [state utility commission] shall implement a true-up, with interest at the auction-clearing return, for the period from the filing of the petition until adjusted rates take effect.

(b) Duration. Holders of auction equity interests receive the auction-clearing return for the life of their interests. The auction-clearing return applies to the common equity in the regulated service until the following January 1, when the default authorized return applies unless a new auction is conducted. Where equity interests in a regulated service bear different returns, the authorized return on equity for the regulated service is the weighted average of those returns by outstanding equity amount.

(c) Mechanism. Each auction shall be a sealed-bid auction conducted by an independent auction administrator under rules adopted by the [state utility commission]. Bids shall be expressed as a spread to the 10-Year Treasury and ranked in ascending order; bids shall be accepted in that order until the amount offered is allocated; all successful bidders shall receive the highest accepted spread (the “auction-clearing spread”), with bids at that spread accepted pro rata; the “auction-clearing return” is the sum of the 10-Year Treasury, as reset under Part II(b), and the auction-clearing spread. The amount offered shall be the greatest of (i) [\$5,000,000], (ii) [2.5] percent of the equity component of the regulated service rate base, and (iii) the lesser of [\$50,000,000] and [5] percent of that equity component, but not more than [25] percent of that equity component.

(d) Certification. The [state utility commission] shall certify an auction if at least [5] bidders unaffiliated with the covered utility submitted bids and their aggregate bids were at least [1.5] times the amount offered. If those thresholds are not met, the result shall be certified only if the auction-clearing spread does not exceed the default spread by more than [2.00] percentage points, and in that case the auction-clearing return applies only to the auction equity interests actually issued, the default authorized return continuing to apply to the common equity; otherwise the result is void.

(e) Participants. Each auction shall be open, at minimum, to all accredited investors. Investor-owned utilities subject to cost-of-service regulation, and their holding companies, may not bid, except that the covered utility and its affiliates may subscribe for any or all of the amount offered, subject to the [state utility commission]’s affiliate rules; their bids shall not count toward the thresholds in subsection (d).

(f) Instrument. Auction equity interests shall, as the [state utility commission] determines, (i) place holders in an economic position equivalent to the common equity in the regulated service, with protection against dilution and related-party transfers; (ii) provide distributions calibrated so that, if realized profits equal those embedded in rates, holders earn the auction-clearing return, with capital returned on the schedule of rate-base depreciation and amortization; and (iii) allocate any shortfall or excess in realized profits among all equity interests in proportion to forecast earnings, with no priority among them. Any successor upon a change of control shall assume all obligations to holders.

(g) Misconduct. Where the [state utility commission] or a court has formally found that a covered utility’s unlawful or imprudent conduct materially increased its cost of equity for a regulated service, the [state utility commission] may exclude, as a disallowance for imprudence, the attributable portion of any increase in the authorized return from the return on the common equity. No auction equity interest is subject to such an exclusion: interests issued before the finding bear a spread that did not reflect the conduct, and interests issued after it bear one that does.

(h) Subsidiaries. A covered utility may, with the approval of the [state utility commission], hold a regulated service in a bankruptcy-remote subsidiary and issue auction equity interests through it, and the [state utility commission] may condition a covered utility's eligibility to petition under subsection (a) on its having done so. All long-term indebtedness issued by a covered utility after the effective date of this [section/Act] shall permit such a transfer without default.

(i) Securities law. Each auction shall be structured to qualify for an exemption from registration under federal and applicable state securities laws, unless the [state utility commission] determines prospectively that a registered offering is reasonably expected to reduce the auction-clearing spread by more than its cost and delay. All reasonable costs of an auction, including securities compliance, shall be recoverable in rates.

Part IV. Costs of Unsuccessful Challenges

(a) No covered utility may recover in rates any expense of an unsuccessful challenge, in any forum, to the validity, constitutionality, or enforceability of this [section/Act]. Pending final resolution, no such expense may be included in rates. Where a challenge succeeds in part, the [state utility commission] shall disallow the portion attributable to the unsuccessful claims.

(b) When a challenge has been fully and finally resolved against the covered utility, the court shall, on motion, award the [State] its reasonable attorney fees, expert witness fees, and costs of defense, with interest at [the rate applicable to judgments], unless it finds that the covered utility's position was substantially justified. Any such award shall be borne by shareholders and shall not be recovered in rates.

(c) Nothing in this Part limits judicial review of any order of the [state utility commission] on grounds other than the validity of this [section/Act].

Part V. Reporting

Not later than [January 15] of each year, the [state utility commission] shall report to the [Governor] and the [Legislature], and publish on its website, (1) each covered utility's requested and authorized return on equity, rate of return, and capitalization mix; (2) the results of all competitive equity auctions in the preceding five years; (3) an analysis of auction-clearing spreads against the default spread, including the extent to which they reflect investor unfamiliarity with auction equity interests, and any recommendation for legislative adjustment of the default spread; (4) the effect of this [section/Act] on customer rates by class; and (5) disallowances and awards under Part IV.

Part VI. General Provisions

(a) Effective date. This [section/Act] takes effect upon enactment. The default authorized return applies to each covered utility as of the effective date, and rates shall be adjusted under Part II(d) without the initiation of a rate proceeding under [cite to state statute governing base rate proceedings].

(b) Scope. This [section/Act] applies only to the portion of a covered utility's rate base subject to the ratemaking jurisdiction of the [state utility commission], which shall allocate rate base between state and federal jurisdiction as necessary.

(c) Severability. If any provision of this [section/Act], or its application to any person or circumstance, is held invalid, the remainder shall not be affected.