

House Bill 2224

Frequently Asked Questions

June 26, 2026

A market-based approach to setting utility return on equity in Pennsylvania

House Bill 2224 would change the way Pennsylvania sets the return on equity that determines the profits utilities are allowed to earn. It would replace a Commission-set rate of return with a number that the market itself supplies.

The questions below are those we hear most often, grouped by topic. Use the contents list on the next page to jump straight to any answer.

A note on citations: Section references in this document – for example, Section 1382(e) – are to House Bill 2224 (“HB 2224”). Citations to existing Pennsylvania law are given in full statutory form (for example, 66 Pa.C.S. § 1301).

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Why today's authorized returns are too high

1. How is a utility's cost of equity determined today?

Today it's settled by litigation, not by a market. In a rate case, the utility's return on equity is set through a contested "battle of the experts" – hired witnesses on each side testify to the "right" number, and the Commission picks a figure from the range. The hearing has the form of an adversarial proceeding, but the match is wildly uneven: the utility has enormous sums riding on the outcome – every tenth of a point on its return is worth millions of dollars a year – so it fields more experts, better-paid experts, and more lawyers than the consumer advocates nominally set up to oppose it can hope to match. The result is less a fair fight than professional wrestling: a great show of struggle around an outcome the imbalance has largely decided in advance.

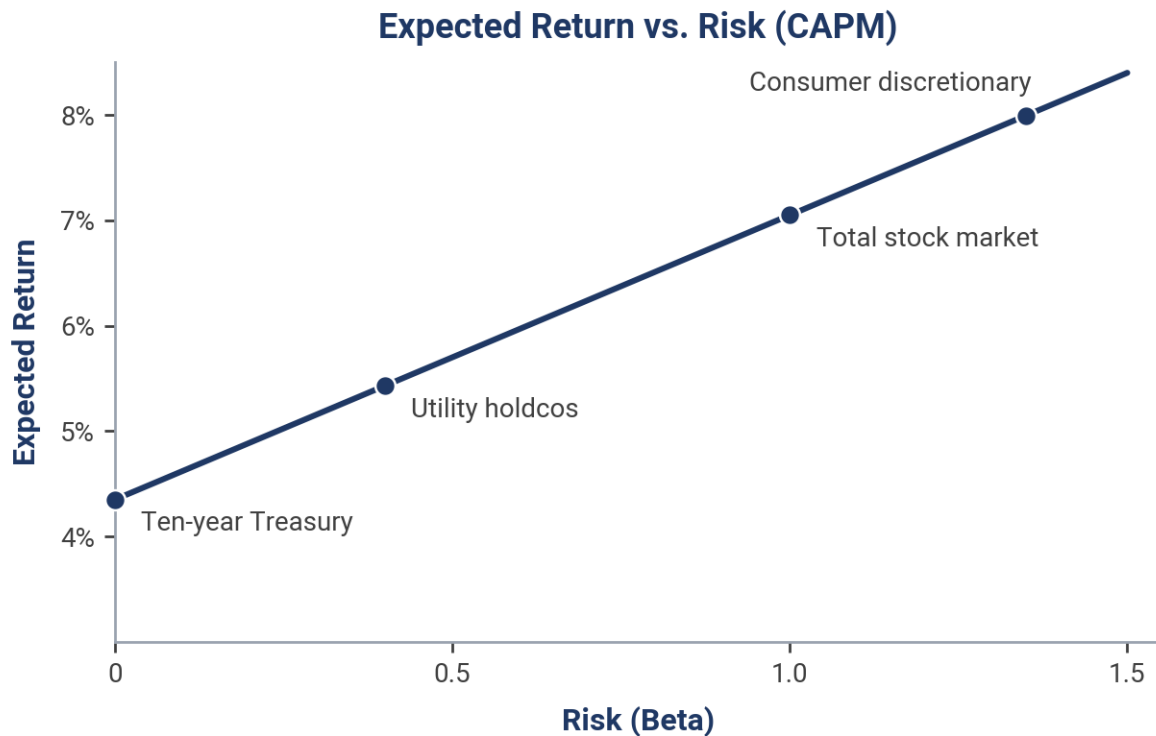
Within that process, the Commission uses two financial methodologies to justify the number: the Capital Asset Pricing Model (CAPM) and the Discounted Cash Flow model (DCF). In the balance of this section we explain why the Commission grossly misapplies both – applied properly, CAPM and DCF both point to a far lower cost of equity. We also explain why comparison to other states does no independent work at all: it serves only to reinforce the errors common to every return this process produces, since each state's figure emerges from the same flawed machinery.

2. What cost of equity *should* these methodologies yield?

Somewhat below 6% – far less than the Commission's roughly 10%+. Both methodologies rely on inputs as to which good minds can disagree, but the range for plausible dispute as to those inputs – and the resultant cost of equity they generate – is quite small, and does not extend anywhere close to the rate of return set by the Commission.

Capital Asset Pricing Model (CAPM)

CAPM's key insight is that markets price assets so that their prospective expected return is the sum of i) the "risk-free rate" and ii) compensation for non-diversifiable risk, known in finance as "beta".



The logic of CAPM is straightforward: Investors are risk averse. They will only accept risk if they are paid enough to do so. The higher the risk, the higher the return that investors require. The highest beta sector, Consumer Discretionary (e.g., automakers, cruise lines) must offer high expected returns to compensate for the losses and risk of bankruptcy they experience whenever there is a recession. Utilities are, of course, the lowest beta sector, as demand for their services is highly stable across the economic cycle. The safety of these “widows and orphans” businesses makes investors willing to invest even at much lower rates of return.

Applying CAPM is also quite simple. Its formula requires only basic arithmetic, using inputs for which there are readily available sources. Specifically, the calculation is:

$$\text{Expected return} = R_f + \beta(R_m - R_f)$$

Where:

- R_f = Risk-free rate, typically measured as the 10-year Treasury interest rate (~4.4% today)
- β = Beta of the investment. This is a simple calculation based on the past covariance of individual stocks to the overall market, published by well-known providers like Standard & Poor’s (S&P). For utility *operating* companies this is 0.3 or less, reflecting that utilities are the place investors hide during downturns because their regulated cash flows are so stable. (Note: The beta of publicly traded holding companies is higher, on the order of 0.4, because the holdcos have additional debt that make them riskier. Proper analysis adjusts

for this and other differences, as it is the regulated operating company whose cost of equity the PPUC is tasked with evaluating.)

- R_m = Expected return of the market. Sources vary on this input; a review of 46 leading investment banks and investment managers shows forecasts for ten-year equity market returns clustering between 6% and 7%. Alternatively, the Federal Reserve semi-annually publishes an estimate of the “equity risk premium”, or how much more investors expect to make by investing in stocks rather than in risk-free assets. Its most recent estimate was 2.8%, translating to an R_m of 7.2%.

Applying these inputs, we get that utility investors require a return of $4.4\% + (0.3 \times (7.2\% - 4.4\%)) = 5.2\%$.

Discounted Cash Flows (DCF)

As its name suggests, the DCF methodology entails i) projecting a business’s future cash flows and ii) discounting the value of each to the present, on the logic that a dollar of cash in the future is worth less than a dollar today. For electric utilities, which experienced flat demand from the mid-2000s to the early 2020s, and now are seeing rapid growth driven by data centers, the former requires a multi-stage model that incorporates rapid near-term growth and inevitably slower long-term growth. More on this below. The math of this does not lend itself to a short written explanation, but – properly done – DCF analysis returns a cost of equity somewhat under 6%.

3. How does the Commission use CAPM to derive a cost of equity so much higher?

By inflating each of the inputs answer 2 laid out. Recall the honest build: a risk-free rate near 4.4%, an operating-company beta around 0.3, and an equity risk premium under 3% – which together land close to 5.2%. The Commission’s own analyses reach 10.4 to 10.5%. It does not publish the inputs behind that figure, so the exact path is hidden, but three levers do the work, and the third does the most:

- **The risk-free rate.** Standard practice is to use today’s 10-year Treasury yield. The Commission instead runs an unusual proprietary method that blends actual yields from the prior two quarters with a forecast of the next four – and neither the forecast nor its source is disclosed. A modest thumb on the scale, but a thumb nonetheless.
- **Beta.** The operating-company beta is about 0.3, yet rate-case witnesses routinely put forward betas of 0.6 to 0.8. Two tricks manufacture the high number. First, witnesses use the holding company’s beta without stepping down to the regulated operating company, even though the parent carries extra debt, reinvestment risk, and unregulated businesses that make it riskier. Second, the betas used are almost always Value Line’s, whose published betas are mechanically adjusted toward the market average of 1.0 – an “adjustment” that, applied to the lowest-beta sector in the market, can only push the figure up.
- **The expected market return.** This lever matters most. Over the past 30 years U.S. stocks returned a little over 10% – a figure flattered by a one-time, decades-long slide in interest rates that no one expects to repeat. Not one of the 46 major banks and asset managers

reviewed forecasts a repeat; the most bullish is below 9%, and the average sits near 7%. Yet the Commission's report reaches for a Kroll equity-risk-premium estimate of 5%, which implies an expected market return of 9.4% – above every one of those forecasts. Pair an outlier market return with an inflated beta and the cost of equity balloons.

And here is the tell: Grant the Commission all of these moves at once – the current 4.45% risk-free rate, a 0.7 beta no honest analyst would assign a utility opco, and a 5% premium above every forecast on the street – and CAPM still produces only 7.95%. The Commission's figure is 10.42%. The remaining two and a half points correspond to no input we can identify; the published number simply cannot be reproduced from any combination of plausible – or even implausible – assumptions. That unbridgeable gap, more than any single input, is the signal that the result is being reverse-engineered to a conclusion rather than built up from the evidence.

4. How does the Commission use DCF to derive a cost of equity so much higher?

By feeding it a growth rate no business could sustain. The Commission's DCF rests on the Gordon Growth Model, a one-line shortcut: cost of equity = dividend yield + growth rate. Its most recent electric-utility analysis averaged the dividend yields and five-year analyst growth rates of 28 companies – about 3.6% and 6.7% respectively – and added them to reach roughly 10.3%. To its credit, the Commission discloses these DCF inputs, so unlike the CAPM exercise this one can be checked directly.

The dividend yield is fine; the growth rate is the problem. The Gordon Growth Model is valid only when the growth rate is one the company can sustain in perpetuity – literally *forever* – and a 6.7% perpetual rate is impossible. The Congressional Budget Office projects long-run real GDP growth near 1.6%. Utilities today are roughly \$354 billion of U.S. output, about 1.2% of the economy. A business compounding at 6.7% a year – nearly 4.7% after inflation, almost three times the economy's growth – would, on that trajectory, become the entire U.S. economy by around 2170. It is the elementary error every finance student is warned against: nothing can outgrow the economy forever, because it would eventually *be* the economy.

If anything, mature sectors grow slower than GDP, not faster. Over the 20 years through 2024, U.S. electricity demand rose about 0.34% a year, as efficiency gains nearly offset population growth and electrification. Utilities are enjoying a genuine near-term surge as data centers arrive – but a surge is temporary by definition. The right tool for a business growing quickly now and slowly later is a multi-stage DCF that models both phases. Done that way, the analysis lands below 6% – essentially where CAPM lands, and nowhere near 10.3%. The Commission reaches double digits only by treating a five-year boom as if it would repeat, every year, forever.

5. Is there hard market evidence that today's returns are too high?

Yes – and unlike the CAPM and DCF arguments, this evidence depends on no model at all. It comes straight from the stock market. Begin with a principle regulatory economists have recognized for decades: if a regulator sets a utility's allowed return exactly equal to its cost of capital, the stock should trade right at book value – about 1.0 times the capital investors have put in. The logic is simple. Book value is the money investors contributed; if that money earns

precisely the return investors require, and no more, there is no reason to pay a premium for it, and price-to-book sits at 1.0.

Pennsylvania’s utilities are owned by publicly traded parents – Exelon, FirstEnergy, and PPL – and those parents trade at roughly 1.6 to 2.2 times book value. A dollar of utility equity that should be worth a dollar changes hands for \$1.60 to \$2.20. That premium is the market capitalizing an above-market return into the share price: investors bid the stock well above book precisely because the authorized return sits well above what they would actually require to hold the asset. In effect, the market is marking the Commission’s return to its own view of fair value – and the verdict is that it is far too generous.

The honest caveat is that none of these parents is a pure Pennsylvania play – each owns utilities in other states, and some non-utility businesses – so the multiple is a directional read rather than a Pennsylvania-only measurement. But the direction is not in doubt, and the magnitude is too large to explain away: a 60-to-120% premium over book is simply not what a fairly compensated, near-zero-risk business looks like. The market has been saying for years what the models also show – that authorized returns sit well above the cost of capital.

6. The Commission says its authorized rate of return is in line with what other states allow. Isn’t that good enough?

No.

First, the PPUC’s calculations place it above most other states, in a context where every basis point (hundredth of a percent) has material value to the utilities and real cost to consumers.

Second, the reasoning is circular. Authorized returns aren’t independent measurements; each state sets its number partly by looking at what other states have authorized. So the “national median” is just an average of figures that are all anchored to one another, ratcheting along together and untethered from any actual cost of capital. Matching the median proves you’re in the herd, not that the herd is right.

Finally, the Commission has increasingly relied on black-box settlements to resolve rate cases, rather than actually determine a specific ROE. The rates of return embedded in these settlements are significantly higher than the rate of return even the PPUC has deemed fair, and mean that Pennsylvania’s utility customers fund some of the highest returns in the country.

Why authorized returns matter

7. By how much do these too-high returns inflate what Pennsylvanians pay?

A great deal, and the mechanism is simple. Under cost-of-service regulation, the authorized return on equity is multiplied by the equity-financed portion of a utility’s rate base and folded into the revenue requirement that customers pay, so every basis point of excess return lands directly on bills.

Pennsylvania’s four large electric utilities carry a combined rate base on the order of \$40 billion. Financed at roughly half equity, that is about \$20 billion earning the authorized return. The gap between today’s authorized returns – over 10% – and a market-based cost of equity of close to 6% is four percentage points. Four points on \$20 billion is roughly \$800 million a year; and because utilities also collect from customers the income taxes owed on those profits, the figure grossed up for taxes is closer to \$1.1 billion a year – paid by Pennsylvania electric ratepayers for returns above and beyond what investors require. That is before the state’s gas utilities, and before the compounding effect of capital bias described in the next answer. Across all utilities (the big four electrics, but also gas, water, and smaller electrics), the over-charge translates to over \$200 per Pennsylvania household – again, even before the capital bias discussed next.

8. What is “capital bias”?

Capital bias is the incentive a rate-of-return-regulated utility has to invest more than it needs to – to reach for the most capital-intensive way of meeting any given need – because it profits from the capital it deploys rather than from serving customers efficiently. The point is not new. In 1962, the economists Harvey Averch and Leland Johnson showed formally that a firm allowed to earn more than its cost of capital will over-invest, padding the rate base on which its return is calculated.

The incentive flows directly from how utility profits are determined: operating costs are passed straight through to customers, while every dollar of equity earns a Commission-set return well above what that capital costs to raise. Growing the capital base is simply how a utility earns more – whether or not consumers benefit. Investors understand this well, and utilities tout to Wall Street their success in sinking new capital into the ground. For instance, PPL Corporation, the parent of PPL Electric, bragged to investors this February that its \$23 billion 2026–2029 capital plan would drive average annual rate base growth of roughly 10.3%, underpinning its target of 6% to 8% annual earnings and dividend growth.

You can see this incentive in the data. From 2010 to 2025, Pennsylvania’s four big electric utilities grew the capital base on which they earn a guaranteed return from about \$14.6 billion to \$40.3 billion, up 177%, while the electricity they actually delivered fell about 5%.

Utility	Net plant (2010 → 2025)	Capital growth	Power delivered
PPL Electric	\$3.7bn → \$15.1bn	+304%	+1%
PECO	\$4.1bn → \$11.4bn	+179%	-9%
Duquesne Light	\$2.1bn → \$4.8bn	+131%	-13%
FirstEnergy (PA)	\$4.7bn → \$9.0bn	+94%	-3%
All four	\$14.6bn → \$40.3bn	+177%	-5%

Pennsylvania’s four largest electric utilities, 2010–2025. Net utility plant from FERC Form 1; volumes delivered from EIA-861.

That’s not investment chasing demand. It’s investment chasing return. Set the return on equity by the market rather than by administrative fiat, and the extra reward for piling on capital disappears:

investment decisions turn on whether the spending is actually needed – which is how every other industry already works.

Had the utilities' capital base simply kept pace with inflation over this period, during which power delivered declined by 5%, ratepayers would today be funding ~\$16 billion less, for a savings, inclusive of associated depreciation, of ~\$2.2 billion a year, or over \$400 per household – an amount even larger than the immediate savings to be achieved by resetting rate of return to market.

HB 2224 cannot immediately fix this, as past years' investments are already made, and ratepayers will be paying the price for decades. But a market-set rate of return on equity will remove the incentive for future gold-plating.

The default rate

9. Why is the proposed default rate the 10-year Treasury yield plus two percent?

As outlined in answer 2, the CAPM formula is the 10-year Treasury yield plus beta x market risk premium. The default rate was specifically designed to exceed the CAPM-derived cost of equity under any plausible inputs for beta and market risk premium. This is a deliberately generous presumption, so that no utility can credibly claim it is being shortchanged.

10. What if a utility's true cost of equity really is higher than the default?

Then it has a direct remedy: petition for a competitive equity auction under Section 1382(a) of HB 2224 and let investors set the rate. If the utility's cost of equity genuinely exceeds the default, the auction will clear higher, and that rate becomes the authorized return.

11. In recent years stocks have had double-digit returns. Would a return of roughly 6.5% be sufficient to attract capital?

Absolutely. Absent a change in underlying earnings power, past years' increases in stock prices translate to lower prospective returns. That's why the equity risk premium has declined, and why investment banks and large investors' forecasts of 5- to 10-year returns for all stocks cluster between 6% and 7%. Utilities are among the safest securities in the market. A 6.5% return on such low risk is highly appealing to many investors.

And again, any utility that disputes the adequacy of the default return can test the question in the market rather than argue about it.

The auction and the instrument

12. How does the auction work, end to end?

It's a sealed-bid, uniform-price auction – the same design used to sell U.S. Treasury securities and PJM capacity. The steps: (1) a utility petitions the Commission for an auction (Section

1382(a)), or the Commission orders one (Section 1382(b)); (2) an independent administrator offers a small slice of the regulated service's equity – an "auction equity interest" whose return tracks only that service; (3) qualified investors each submit the minimum return they would accept; (4) bids are ranked from lowest to highest and filled until the offered equity is allocated, with every winner receiving the same rate, equal to the highest accepted bid (Section 1382(e)); (5) the Commission certifies the result, and that "auction-clearing return" becomes the authorized ROE for the whole service, with customer rates trued up accordingly (Sections 1382(c) and 1381(f)). These five steps are the substance of it; the smaller tasks around them – qualifying the bidders, the offering and disclosure a private placement to those investors requires, and settling the winning bids – are routine administrator functions, none of them significant.

The market sets the number; the Commission implements it.

13. Can auctioning just a small slice of equity really discover a meaningful price?

Yes – that is exactly what a uniform-price auction is built to do. The clearing price is the lowest return that attracts enough capital to fully subscribe the offering, which is the definition of the cost of equity. You don't need to sell the whole company to learn the price, any more than a blood test needs all of your blood: a properly designed sample reveals the number.

14. If you auction only a thin slice, won't that push the price up?

A small offering will clear modestly higher than a giant one, but the effect is tiny next to the gap between today's returns and a market rate. This dynamic is readily observable in the municipal bond market, which prices small issues every day. The bill also caps this risk: in a thinly subscribed, utility-initiated auction (one that fails the bill's five-bidder or 1.5× coverage thresholds, Section 1382(e)(7)), the result cannot be certified above the default plus two percentage points (Section 1382(e)(8)). So even a worst-case thin auction can't run away from a market number.

15. Could multiple utilities, or affiliates of a single utility, collude to pad the five-bidder count and force a high rate?

No, on several levels. Other regulated utilities can't bid at all (Section 1382(j)(3)). The utility's own affiliates may participate, but the Commission's rules are intended to count affiliated bidders – whether several entities of one holding company or several funds run by a single manager – as a single bidder for the participation test (its authority comes from Section 1382(g)(1)). Every bidder must certify it isn't coordinating (Section 1382(j)(2)), with disqualification for false certifications (Section 1382(j)(5)).

16. Could a utility's affiliates rig the clearing price upward?

No – the math forbids it. In a uniform-price auction, bids are filled from the lowest up, and the clearing rate is set by the last bid needed to fill the offering. An affiliate bidding high simply isn't filled, because its bid sits above the clearing price; an affiliate bidding low can only pull the clearing rate down. There is no strategy available to an affiliate that raises the price (Section 1382(e)(4)).

17. Could “pro-ratepayer” bidders lowball to drive the rate uneconomically low?

No. Every bidder certifies that its bid reflects solely its own assessment of the investment’s risk-adjusted return – not an attempt to suppress or inflate the result (Section 1382(j)(2)(i)) – enforced by disqualification (Section 1382(j)(5)).

18. Why can a Commission-initiated auction only push the return down, never up?

Either the utility or the Commission can call an auction – putting a slice of the utility’s equity out for competitive bid in place of the default rate. The Commission may initiate only if i) the utility has declined to request an auction itself and ii) the Commission has determined that the auction is likely to generate savings relative to the default rate that more than compensate for the effort and expense. If both conditions hold, a properly run auction should generate a result below the default rate. Section 1382(e)(10) is simply a failsafe to protect ratepayers against extraordinary events (e.g., a significant internet outage at the time of the auction).

19. Can small utilities realistically attract five bidders?

Yes. The taxable municipal market routinely draws competitive bids on small issues – roughly 45% of new taxable muni issues are \$5 million or less and still attract multiple bidders. A regulated equity stream with a predictable return is, if anything, easier to price than many of those.

20. What happens to a utility that can’t or won’t run an auction?

Nothing punitive: it simply takes the default return, at no cost, and its prudent investment stays in rate base earning that return. The auction is an option a utility uses when it believes it can prove a higher number – not a hoop every utility must jump through.

21. What exactly is being auctioned – and how does a utility auction equity in operations that cross state lines or aren’t a separate legal entity?

What’s sold is an “auction equity interest” – an economic interest whose return tracks only the Pennsylvania regulated service, insulated from everything else the company does (Sections 1380 and 1382(i)). Where a utility serves customers in more than one state, the interest is tied solely to its Pennsylvania operations, whose profits the PPUC already tracks – so no new accounting is required. This is a well-established structure: investors have long bought “letter stock” and tracking interests whose payoff is linked to a defined slice of a business, and the law on them is settled. Initially the interest is a direct obligation of the utility; the bill then provides for an eventual, orderly reorganization of the Pennsylvania operations of multi-state operating companies into a dedicated entity within five years (Section 1382(l)(6)) – for FirstEnergy, a natural extension of its 2024 Pennsylvania consolidation.

22. How does the auction ROE translate into the income and return-of-capital an investor actually receives?

The instrument is designed so the holder earns an expected rate of return equal to the clearing return (Section 1382(i)(1)(iii)). If the utility earns more or less than had been anticipated when the PPUC authorized its rates, distributions on the instrument are formulaically adjusted so that

holders bear the same risk as the utility’s own equity in that service. This ensures that the auction result is a valid demonstration of what investors require to be paid for this risk. Distributions also include a return of capital that tracks the depreciation of the underlying rate base (Section 1382(i)(1)(iv) and (i)(3)). In other words, the instrument behaves like an amortizing equity stake: holders earn the auction return on a declining balance and get their principal back as the assets depreciate.

23. Why buy the auction equity instead of the holding company that owns the utility?

Because the holding company doesn’t earn more – and per dollar invested, it earns less. When a utility runs an auction, the clearing return becomes the authorized ROE for the whole service: it applies to the utility’s common equity, not just the auctioned slice (Sections 1382(c)(2) and 1382(d)(2)). If PECO’s auction clears at 7%, Exelon earns 7% on its PECO equity too – there is no richer operating-company return hiding behind the holding company to capture.

Price settles the rest, and the price-to-book ratio is the key. A holding company that earns an above-market return on its book equity trades well above book value – Pennsylvania’s utility parents change hands at roughly 1.6 to 2.2 times book – because that excess return is capitalized into the share price. The return is earned on book, but the buyer pays the marked-up price: a 10% return on book bought at 2 times book is only about 5% on what the investor actually lays out. The auction interest, by contrast, is issued at book, so its clearing return is the investor’s real return – a 7% auction stake bought at book out-yields a holding-company stake bought at a premium for today’s high authorized return. That is why the price-to-book ratio means the operating-company auction interest pays an investor more, not less, than the holding company does.

	Holding-company share	Auction equity interest
Price paid per dollar of book value	2.0x	1.0x
Book equity behind a \$100 investment	\$50	\$100
Return earned on that book equity	10% (authorized)	7% (auction clearing)
Earnings on \$100 investment	\$5	\$7
Earnings yield on \$100 invested	5.0%	7.0%

Illustrative. Assumes a holding-company price-to-book of 2.0x – within the 1.6–2.2x range at which Pennsylvania’s utility parents trade – a 10% authorized return on equity, and a 7% auction-clearing return.

24. Won’t investors just go to other states that allow higher returns?

This misreads how the premium works – it is the same price-to-book effect as the last answer, now across state lines. When a regulator awards a return above the cost of capital, investors bid the stock up until the holding company trades above book value, and that richer price competes the buyer’s actual return back down toward the true cost of capital. So a “higher” authorized return in another state is mostly already capitalized into a higher share price; the marginal investor buying in today earns roughly the same modest effective yield – on the order of 5% – regardless of where the headline rate of return sits.

Auction equity issued at book delivers its clearing return undiluted, so a 7% auction stake stacks up well against the roughly 5% an investor actually pockets buying a richly valued utility elsewhere. Capital chases effective yield, not headline ROE – and on that score the auction competes just fine.

Legal, credit, and implementation

25. What do Hope and Bluefield require, and how does the auction satisfy them?

These two cases set the constitutional floor for a utility's return, and they define that floor entirely by reference to the market. *Bluefield Water Works & Improvement Co. v. Public Service Commission*, 262 U.S. 679 (1923), entitles a utility to a return "equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties," and sufficient to "maintain its credit and enable it to raise the money necessary for the proper discharge of its public duties" (id. at 692–93). *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), restated the same standard: the equity return should be "commensurate with returns on investments in other enterprises having corresponding risks" and "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital" (id. at 603). Both benchmarks – a comparable-risk return and the ability to attract capital – are external and market-defined. The Constitution guarantees a utility the cost of capital, and no more.

Just as important is what these cases do not require. *Hope* makes the end result, not the method, the constitutional touchstone: "it is the result reached not the method employed which is controlling," and "it is not theory but the impact of the rate order which counts" (320 U.S. at 602). A commission is therefore free to set aside the contested CAPM and DCF testimony that dominates today's proceedings and adopt a market mechanism instead, so long as the rate it produces is just and reasonable. Later decisions confirm how much room that leaves: regulators act within a "zone of reasonableness," and a rate within that zone "cannot properly be attacked as confiscatory" (*Permian Basin Area Rate Cases*, 390 U.S. 747, 770 (1968)); constitutional review turns on "rates, not methods" (*Verizon Communications Inc. v. FCC*, 535 U.S. 467, 500 (2002)).

The auction meets this standard more directly than the process it replaces. Where today's system infers the comparable-risk return from disputed models, the auction observes it – it asks the investors who actually supply utility equity what return they require. A return that clears a competitive auction is, by definition, "commensurate with returns on investments in other enterprises having corresponding risks" and sufficient to "attract capital," because capital was in fact attracted at that price. It is hard to imagine evidence more squarely on point than the market clearing. And the design protects the floor from the other direction: any utility that believes its true cost of equity exceeds the default may trigger an auction, so no utility is ever forced to operate below the return that willing investors have demonstrated they require – the precise injury *Hope* and *Bluefield* guard against.

26. Will this invite years of costly litigation? If so, will ratepayers end up footing the bill?

The bill has been carefully architected to withstand any legal challenge – but utilities will be highly tempted to bring one nonetheless. A switch to market-set returns is existential: utilities nationwide reap excess profits (profits above the market cost of equity) to the tune of tens of billions of dollars each year. Accordingly, a utility may decide that even a longshot challenge is worth the gamble.

The Commission and the legislature can change this calculus. The Commission can already deny recovery of imprudently incurred costs, and the legislature can go further – barring utilities from recovering the costs of an unsuccessful challenge and adopting a loser-pays rule so a utility that sues and loses bears the Commonwealth’s costs. The threat of ratepayer-funded litigation is a reason to draft those protections in, not a reason to leave returns inflated.

Importantly, even a drawn-out challenge need not delay relief. Because the reform is self-executing and applies immediately on enactment (Section 1381(j)), a utility would have to win a preliminary injunction to pause the savings while the case proceeds. Such an injunction is a longshot for the reasons detailed in the previous answer.

27. Will a lower return on equity hurt utilities’ credit ratings?

A lower ROE on its own would pressure the cash-flow ratios the agencies watch – but the Commission keeps the offsetting lever.

The Commission already has full authority over each utility’s authorized debt/equity mix under its standing power to set a just and reasonable rate of return (66 Pa.C.S. § 1301), which HB 2224 preserves (Section 1381(j)(4)). As the table below shows, a modest shift toward equity holds the cash-flow ratios the agencies watch constant – or, for some, improves them – while also strengthening the debt-to-capitalization ratio. In practice the required shift is even smaller, because a credit rating turns on a utility’s overall financial profile, not on any single ratio: it is fine for some metrics to move slightly one way so long as others move to offset. The table’s case, in which every metric holds or improves, is therefore more conservative than a stable rating actually requires. A higher proportion of equity does modestly increase funding costs, but that effect is insignificant relative to the savings from a lower return on equity.

	10% ROE	7% ROE	7% ROE, lower debt
Capital structure			
Debt (\$M)	500	500	411
Equity (\$M)	500	500	589
Equity / Capitalization	50%	50%	58.9%
Credit metrics			
FFO / Debt	24.8%	21% ↓	27.4% ↑
Debt / EBITDA	3.2×	3.7× ↓	3.0× ↑

EBIT / Interest	3.8x	3.0x ↓	3.8x ✓
Debt / Capitalization	50.0%	50.0%	41.1% ↑
Financing costs			
Debt interest	\$25.0	\$25.0	\$20.6
Equity return (pre-tax)	\$50.0	\$35.0	\$41.2
Corporate income tax	\$19.9	\$13.9	\$16.4
Total cost of capital	\$94.9	\$73.9	\$78.2
Ratepayer savings	—	\$21.0	\$16.7

Assumptions: 5% cost of debt, 6% annual depreciation, 28.5% combined corporate income tax rate, 70% tax deferral.

28. Is the implementation timeline realistic?

Yes, because the default is a formula, not a proceeding. The Commission issues an order setting each utility’s return to the default within 60 days and adjusts customer rates within 120 days, with a true-up plus interest for the gap (Section 1381(j)). No hearings, no testimony, no rate case – just a calculation the statute spells out. The auction, runs on its own separate clock, and only when a utility or the Commission asks for one.

29. Does the Commission have to stand up an auction for every utility at once?

No. The default applies automatically and immediately, by formula; auctions are triggered one at a time, only on a petition from a utility or a motion by the Commission (Section 1382). The Commission builds the auction machinery once and uses it as cases arise – it doesn’t have to run dozens of simultaneous auctions on day one.

30. Who actually runs the auction, and who pays for it?

An independent administrator selected by the Commission runs it (Section 1382(e), (g)) – not the utility, which would benefit from poor auction participation and the resultant high return. The utility’s reasonable auction costs are recoverable in rates as prudently incurred (Section 1382(f)). These costs should be quite modest and are dwarfed not only by the ratepayer savings a lower authorized return produces, but also by the avoided costs of the current rate-setting process, with its myriad lawyers and witnesses.

The parties involved and the broader fight

31. Who opposes this reform?

First and foremost, the utilities. Persuading regulators to award them a high rate of return is the primary tool by which they achieve profit for their shareholders; persuading those same regulators to let them invest ever more at that inflated return ranks a distant second. Nothing else matters. A market price for equity threatens the whole arrangement, so this is, for them, an existential fight. But it is their fight, not yours.

Second, some regulators. It is natural for those who have devoted much time and care to the present system to become convinced of its value, and to be initially skeptical of any proposed change. Other regulators are intrigued by the prospect of delegating to the market a process they know they are poorly positioned to oversee; we recently briefed one state commission at the invitation of its chair, and will be briefing others shortly. And notably, many *former* regulators – including a number of former state commission chairs – have endorsed this reform.

There are also many others whose preconceptions make them initially skeptical; their concerns quickly fade as they dive into the substance.

On the left, some in the environmental movement have seen utilities as allies in the push for green investment, and some in the “abundance” camp have taken at face value utilities’ warnings that a lower return will starve the grid of capital. But as they have dug in, both groups have come to appreciate that the warning has things backwards. An above-market return doesn’t fund the energy transition; it taxes it – raising the cost of every dollar of new infrastructure and routing the surplus to shareholders – while a market-set return, by definition, still clears at the level needed to attract capital. Moreover, today’s high rate of return rewards utilities equally for critical investment and for pouring the same amount of cash into the ground and cementing it over; only by right-sizing rate of return can other reforms, such as performance-based ratemaking, effectively motivate utilities to deploy capital more efficiently.

On the right, some initially hear any concern about utility profits as an attack on business and the profit motive, both ordinarily forces for good. But that instinct gives way upon closer inspection, because a regulated monopoly is not a market player earning profits in open competition; it is the beneficiary of an insider arrangement in which a government body hands it above-market returns at captive customers’ expense. Defending that is not defending free enterprise – it is defending its opposite.

32. Wait! I thought utilities were real businesses. Don’t they manage for revenue and expenses like other companies?

No – not the way a competitive business does. A regulated utility isn’t an ordinary company; it is a creature of the state, whose profits are a function of a special regulatory calculus.

Expenses are passed straight through to customers, so long as they are “reasonably incurred” – in practice, a low bar. As a practical matter, utilities have little reason to control costs; while they may occasionally make a show of opposing a specific regulator-directed expense, the reality is that they have little reason to care.

Likewise, a utility has essentially no control of revenue. It does not set its own prices. What marketing it does to influence customer demand is Commission-directed; often this is messaging to encourage consumers to be energy efficient (i.e., *reduce demand*).

What instead determines utility profit is the authorized rate of return multiplied by the quantity of equity capital invested. Both are decided by the Commission. Neither has any real relationship to how well a utility manages its operations. Indeed, as discussed in [What is “capital bias”](#), utilities are motivated to deploy capital inefficiently, so that more is required.

CEOs of real businesses grow profits by building better products at lower cost. Utility CEOs grow profit one way – by persuading regulators to allow a higher return on ever more capital. HB 2224 is pro-market and pro-free-enterprise; it is only “anti” the handful of firms whose excess profits depend on gaming the regulatory process.

33. Who is the “vendor” the commissioners’ letter references?

The “vendor” is MarketClear Utility Policy Research, a non-profit, bipartisan research organization pursuing 501(c)(3) status. MarketClear developed this reform, drafted the model legislation behind HB 2224, and authored this FAQ. We invite you to learn more about us and our work at marketclear.org.

MarketClear’s leadership and advisors are all unpaid, and until recently were funding the costs of this effort out of their own pockets. It is revealing that the publicly traded holding companies, whose CEOs earn eight figures, even as they profess their devotion to the public interest, would immediately seek to discredit our work as that of a vendor out to make a buck. In fact, our commitment to this work reflects that, with one exception, all of us – including several former state commission chairs – have devoted our careers to the utility industry and come to believe that reform is essential.

34. Are other states pursuing this reform?

Yes. Many.

This Monday, Delaware Governor Matt Meyer asked the Public Advocate to file a petition with the state’s Public Service Commission to revisit rate of return and consider “competitive determination” (i.e., auction).

Previously, New Jersey Governor Mikie Sherrill’s Executive Order 1 tasked the New Jersey Board of Public Utilities with revisiting utilities’ business model. At the first public meeting of that study, Bob Brabston, the board’s executive director, framed the key objective as restoring rate of return to the cost of equity. At the most recent public meeting, on June 15, multiple participants advocated the use of auctions to determine rate of return.

In New York, Assemblymember Shrestha and Senator Mayer have introduced bills that closely track HB 2224. Both acknowledged when introducing their bills that doing so this year was symbolic, given the legislative calendar. But they will be reintroducing the bills next year, and several groups are already planning efforts to support their enactment.

These are all “blue” states, as are others where bills will be introduced next year, though we do not wish to get ahead of the legislative sponsors by naming them. This is a function of who first championed our work and their relationships. Our conversations with conservative groups began too late for the 2026 legislative calendar, but we are told that bills will be introduced in a number of “red” states in 2027.

All of the above discusses reform initiated by elected leaders. But there is also keen interest among regulators. We recently briefed one state’s commission, at the invitation of its chair; we

do not disclose the state as we (perhaps incorrectly) do not believe the meeting was a matter of public record. We will be briefing other commissions shortly.