

# MarketClear

May 29, 2026

New Jersey Board of Public Utilities  
44 South Clinton Avenue  
P.O. Box 350  
Trenton, NJ 08625-0350

## **Re: Comments on the Board's Review of the Utility Business Model Pursuant to Executive Order No. 1 (Docket No. E026040117)**

Dear Commissioners:

MarketClear Utility Policy Research appreciates the opportunity to comment on the Board's review of the electric distribution utility business model under Executive Order No. 1. MarketClear is a research organization focused on competitive, market-based approaches to setting the regulated utility cost of capital, and has supported policymakers pursuing such reforms in several states. We direct these comments to a single variable that sits at the center of the affordability question the Board has been asked to examine: the authorized return on equity ("ROE") embedded in the rates of New Jersey's electric distribution utilities. We respectfully submit that authorized ROEs are materially higher than the cost of capital they are meant to approximate, that the resulting cost to customers is large and recurring, and that the most durable remedy is not a refinement of existing methodology but a competitive mechanism for setting the return directly.

### **1. The authorized return on equity is significantly higher than the cost of capital.**

The governing legal standard is well settled. Under *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), utility rates must be "just and reasonable," and the return to equity owners should be "commensurate with returns on investments in other enterprises having corresponding risks." That standard is, in substance, a description of the Capital Asset Pricing Model ("CAPM"), which calibrates the return investors require to the systematic risk of the investment.

Applying CAPM with current market inputs is straightforward. The yield on the 10-year U.S. Treasury is approximately 4.43%. Regulated electric distribution operating companies are among the lowest-risk enterprises in the economy, with observed operating-company betas on the order of 0.35. Mainstream estimates of the equity market risk premium range from roughly 2% to 5%. Those inputs imply a cost of equity between approximately 5.13% and 6.18%. Independent discounted-cash-flow analysis, anchored to the dividend yields and sustainable growth rates of the utility barometer group, points to the same general range.

By contrast, the Board has recently authorized returns on equity of 9.6% – to Public Service Electric and Gas (October 2024) and to Atlantic City Electric (November 2025). Jersey Central Power & Light’s most recent base-rate settlement (February 2024) was resolved on a “black box” basis that did not state an explicit ROE, but was negotiated against the same benchmark. A 9.6% authorized return exceeds even the most generous CAPM estimate above by more than three percentage points. That gap is the subject of the remainder of these comments.

## **2. The excess return imposes a substantial, recurring cost on New Jersey households.**

The cost of an inflated return can be quantified conservatively. Measured against the top of the CAPM range above – 6.18%, the most generous estimate of the cost of equity, and therefore the smallest defensible gap – the 9.6% authorized return is 3.42 percentage points too high.

**First**, because the equity return is recovered from customers on a pre-tax basis, the 3.42-point excess must be grossed up for corporate income tax. At a combined federal and New Jersey corporate rate of approximately 30%, a 3.42-point after-tax excess corresponds to a pre-tax excess of roughly 4.9% of equity rate base.

**Second**, New Jersey’s electric distribution utilities together maintain an electric distribution rate base on the order of \$18 billion, of which approximately 53% – roughly \$9.5 billion – is funded by equity. Applying the 4.9% pre-tax excess to that equity base translates to \$465 million in additional revenue requirement every year.

**Third**, spread across New Jersey’s approximately 3.5 million households, that excess is equivalent to roughly \$133 per household per year – borne, in practice, by residential and business customers alike, year after year, for as long as the excess persists.

This calculation is deliberately conservative, anchored on the most generous estimate of the cost of equity in the range above. Using the midpoint of that range would imply a gap approaching four percentage points and a correspondingly larger cost.

## **3. Beyond their direct cost, inflated returns distort capital-investment incentives.**

An authorized return set above the cost of capital does more than transfer money from customers to holding companies; it changes utility behavior. So long as a utility is permitted to earn more on rate base than investors require, every additional dollar of rate base creates value for shareholders. This gives utilities a standing incentive to favor capital-intensive solutions, to gold-plate projects, and – often unconsciously – to deprioritize the efficiency of capital spending.

The capital markets price this incentive directly. Public Service Enterprise Group – the parent of PSE&G, and the most New-Jersey-concentrated of these holding companies, so that its

market valuation most directly reflects the State's regulatory environment — trades at a price-to-book multiple of approximately 2.3x. Each dollar of book equity its utility deploys is therefore valued by the market at more than two dollars. A regulated asset base would trade near book value if the authorized return equaled the cost of capital; a multiple well above book is direct market evidence that authorized returns exceed it.

The incentive shows up in the rate base itself. Public Service Electric and Gas's distribution rate base grew from \$9.5 billion at its 2018 base-rate case to \$17.8 billion at its 2024 case — nearly doubling in six years — even as total electricity consumption in New Jersey was essentially flat, and indeed slightly lower, over the same period. Capital deployment on that scale, decoupled from any growth in the volume of service delivered, is precisely what an above-market return predicts.

#### **4. This outcome is structural, and is not a criticism of the Board or its staff.**

We do not offer these observations as a criticism of the Board. Too-high authorized returns, and the costs they impose, are the predictable result of a process in which utilities and their retained experts inevitably have an outsized voice — a function of the resources they can bring to bear and the powerful financial stake they hold in the outcome. The same dynamics, and the same results, are visible across other jurisdictions. They are reinforced by the analytical framework common to New Jersey and other jurisdictions, in which the cost of equity is estimated from a national proxy group of comparable regulated utilities and cross-checked against the returns those utilities have recently been authorized to earn elsewhere. Because every commission draws on the same peer set — companies that themselves operate under the prevailing returns — the process is inherently self-referential and tends to perpetuate the very returns that should be under scrutiny.

#### **5. The remedy lies in revisiting first principles: determine the return competitively.**

For these reasons, we respectfully submit that the solution to too-high authorized ROEs is not a methodological adjustment or additional financial training for commission staff. However refined, any estimation process will remain subject to the same imbalance of resources and advocacy, and will continue to rely on the judgment of a contested proceeding rather than the discipline of a market.

The more fundamental insight is captured in the long-standing observation that regulation is a surrogate for competition — and, like any surrogate, an imperfect one. When rate-of-return regulation was devised, there was no practical way to observe the market-clearing cost of utility equity. That is no longer true. Capital markets have matured to the point where the proper authorized return can be discovered directly, and at low cost, through a competitive auction: investors are invited to bid the return at which they will supply equity capital to fund

the utility's rate base, and the clearing rate becomes the authorized ROE. The required return is then observed rather than estimated, and the informational advantage that utilities hold in a contested proceeding ceases to matter. New Jersey already relies on precisely this logic to procure generation supply for its customers through the annual Basic Generation Service auction.

This approach is not merely theoretical. A number of states are now moving to determine the cost of equity competitively – and several are among New Jersey's immediate neighbors. Pennsylvania (House Bill 2224) and New York (the Fair Authorized Investment Returns Act, Senate Bill S10424 and Assembly Bill A11197) are each actively considering legislation built on the same design: a formula-based default return pegged to the 10-year Treasury plus a fixed spread of two percentage points, coupled with a competitive equity auction through which the market sets the cost of equity directly. A third neighboring state is pursuing a comparable reform within its executive branch, in work that is not yet public. We encourage the Board to evaluate a competitive, auction-based mechanism for determining the authorized return on equity as part of this proceeding. MarketClear would be glad to support the Board and its staff in that work.

We appreciate the Board's leadership on these issues and the opportunity to comment.

Respectfully submitted,

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