MarketClear
UTILITY POLICY RESEARCH

The Fair Authorized Investment Returns Act (FAIR Act)

The problem

Investor-owned utilities serve ~70% of U.S. electricity customers under a bargain: a state-granted monopoly in exchange for regulated rates. Under *Hope Natural Gas* (1944) and *Bluefield Waterworks* (1923), utilities are constitutionally entitled to a return on equity (ROE) sufficient to attract capital — but no more.

In practice, commissions routinely authorize ROEs around 10% even though every standard finance model implies a cost of equity 300–400 basis points lower. Under the Capital Asset Pricing Model, a utility beta of 0.35 and equity risk premium of 5% imply a 175-bp risk premium over Treasuries — roughly 6% today. The market confirms the gap. Utility stocks trade at 2.4x book value, mathematically possible only if expected returns persistently exceed the cost of equity.

The gap persists because ROE is determined in adversarial proceedings where utilities outspend ratepayer advocates by orders of magnitude on expert witnesses, commission-staff cultivation, and industry-sponsored "education". Economists have a name for the resulting tilt: regulatory capture. The cost: roughly $65 billion per year nationwide, or about $500 per household — with utilities filing a record $31 billion in rate-increase requests in 2025 alone.

What the FAIR Act does

The bill replaces administrative ROE determination with two market-based mechanisms.

1. **Formulaic default.** The authorized ROE is set at the 10-Year U.S. Treasury rate plus 2 percent, reset annually. The 200-bp spread, though below current authorized levels, exceeds the CAPM-implied risk premium for a typical utility (0.35 × 5% = 175 bp), so utilities are presumptively whole.
2. **Competitive equity auction.** A utility unsatisfied with the default may — or, on commission order, must — conduct a sealed-bid, Dutch-style auction of new equity. Qualified investors bid the lowest yield they will accept; the clearing return becomes the authorized ROE. The mechanism is well-tested: Treasury auctions and Google's IPO used similar formats.

Why it works

- **Treats equity like debt.** Utility debt is already sold into competitive markets, and the resulting yield flows directly into rates. Equity is the last piece of utility capital still set by administrative model rather than market transaction.
- **Collapses a contested model to a single observable.** Instead of regulators choosing among elastic estimates, the clearing bid is one transparent number.
- **Satisfies Hope and Bluefield by construction.** The auction reveals exactly the return investors require — neither confiscatory nor excessive. *Hope* endorses outcomes-based review, leaving regulators free to adopt market mechanisms.
- **Self-correcting.** If utility risk rises (e.g., AI-driven demand uncertainty, wildfire exposure), the next auction clears higher automatically. No re-litigation required.
- **International evidence.** U.K. regulators authorize ROEs 200–400 bp below U.S. levels without impairing service or capital formation.

Bottom line

The current system asks regulators to estimate the cost of equity through contested models in proceedings where information and resources favor the regulated firm. The FAIR Act asks investors directly — on the record, under competitive conditions. Households save roughly $500 a year, utilities receive exactly what they need to attract capital, and a half-century-old expert-witness ritual is replaced with a price.