A Market-Based Approach to Setting Utility Authorized Rate of Return

POLICY BRIEF · SEPTEMBER 2026

MarketClear
UTILITY POLICY RESEARCH

2.0x book value
Where utility stocks trade today

1.0x book value
Where they would trade at true cost of capital

$500 / year
Hidden cost per US household

THE PROBLEM: GOVERNMENT-SET PROFITS ARE SYSTEMATICALLY TOO HIGH

Regulated utilities are for-profit companies. Unique among industries, their profit is not set by competition — it is set by government officials. A commission approves an "authorized return on equity" (ROE), and the utility earns roughly that rate on every dollar of its cumulative net investment.

That process is prone to regulatory capture, and it consistently sets returns above utilities' true cost of capital. The market says so plainly: utility stocks trade at over two times book value, against the 1.0x that would result if they earned only their cost of capital. Investors are pricing in an excess return — one paid for by captive ratepayers.

Excessive returns impose a hidden tax of roughly $500 a year per US household, and distort utilities' incentives by rewarding capital spending whether or not it's efficient or needed.

THE SOLUTION: AUCTION THE RETURN, DON'T LITIGATE IT

Rather than have commissioners adjudicate a "fair" ROE through a battle of expert witnesses, the Fair Authorized Investment Returns (FAIR) Act uses capital markets to set that return directly:

- The utility's equity capital is offered to the market through a **structured, periodic auction**.
- The **clearing rate** — the lowest return at which the capital is fully subscribed — becomes the authorized return for the period.
- The result is a return that is *market-tested* rather than *model-assumed*.

A transparent, market-based default applies absent an auction, ensuring that utilities can always attract sufficient capital.

The FAIR Act is the natural next step in a broader shift from regulator-set to market-based prices. Wholesale power already clears in competitive markets, and utility debt is priced by bondholders, leaving ROE as the last major utility input still set by administrative judgment instead of price.

WHY IT'S THE RIGHT REFORM

- **Markets over administrative discretion.** A transparent, rules-based mechanism replaces a regulator's estimate of the "right" return with a price the market actually sets.
- **Lower bills for households.** Compressing excess returns flows directly through to customers — a concrete, measurable affordability gain.
- **Ends the build-more bonus.** When profit rises with spending regardless of need, utilities are paid to build rather than to serve customers well. A market-set return breaks that link.

THE QUESTIONS WE HEAR MOST

Will investors still show up? The clearing rate is, by definition, the return at which the auction is fully subscribed. The utility cannot be starved of capital, because the mechanism sets the return at whatever level attracts it.

Can a state do this? Courts ask whether the resulting return is adequate in its effect, not whether any particular formula produced it (*Hope*, 1944; *Bluefield*, 1923). A rate set by investors committing their own capital meets that standard more directly than an estimate produced by dueling witnesses.

READY TO ENACT — AND ALREADY ADVANCING

The FAIR Act is fully drafted and generalizable to any state — a library of model bills is available at **marketclear.org/resources**. MarketClear has worked directly with both executive and legislative offices to produce state-specific versions of varying length and detail.

PENNSYLVANIA
The House passed HB 2224 in June by a vote of 202–0, sending a market-based default return and competitive auction to the Senate.

NEW JERSEY
The Board of Public Utilities, in its governor-ordered review, has carried ROE reform into the next phase and names competitive auctions among the options under consideration.

NEW YORK
A11197 and S10424 likewise advance the model.

DELAWARE
The governor has asked the state's commission to weigh whether a competitive determination should replace a guaranteed return.