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UTILITY POLICY RESEARCH

Does cutting prices raise prices?

The claim is every bit as silly as it sounds

A recent article in *Daily Energy Insider* carries the headline “Utility ROE caps could backfire on customers by raising costs.” It deploys a great deal of sophisticated-sounding vocabulary — “return on equity,” “credit quality,” “cash flows.” Translated into plain English, however, the article’s claim is quite simple: high utility profits keep customer costs low.

Apparently, utilities *don’t actually want* to earn returns higher than those forecast for the overall stock market. They are reluctantly shouldering the burden of excessive profits in order to protect their customers.

When a utility lobbyist hands you an article like this, two things are being communicated:

- They think you are stupid.
- They are counting on you not to check the facts.

No, higher profits to utility holding companies don’t help consumers

Credit ratings

The article claims that high utility profits are necessary to protect utilities’ credit ratings.

There is a kernel of truth here. Lenders evaluate utility credit risk in part by the ratio of borrowings to operating income, so all else equal, lower utility income would indeed put modest upward pressure on borrowing costs.

But there is a straightforward fix. Even with lower utility income, the debt-to-income ratio can be held constant by modestly reducing borrowing. That reduction in turn improves the utility’s debt-to-equity ratio — the other key metric of credit risk — making lenders even safer than before.

Combining lower utility profits with a corresponding adjustment in the capital structure has three effects:

- Ratepayers pay less.
- Lenders are as safe as before, or safer, on every relevant metric.
- Utility holding companies earn less.

It is the third of these — and only the third — that utilities’ “experts” are actually worried about.

Equity available for future investment

The article also claims that if utility profits are reduced, there will not be capital to fund new investments. In the abstract, that claim makes sense: if utility investors do not earn a fair return,

they will not invest. But it has no relevance to the policy proposal at the center of the current debate.

That proposal is to set utilities' authorized rate of return through *auctions*, in which investors bid for the right to provide capital. By definition, the rate of return that clears the auction is one at which the winning bidders are happy to invest. That will always be true. If interest rates rise, the auction-clearing rate will rise with them — but at the right price, investors will always be glad to invest.

Yes, the auction-set rate of return will be substantially lower than what emerges from today's utility-dominated rate cases. But there is no reason to shed tears for the holding companies. They were never entitled to the returns they have pressured regulators into granting in the first place.

The evidence from elsewhere disproves the fearmongering

Connecticut

The article quotes the Consumer Energy Alliance (whose backers it does not name), claiming that "Connecticut is the prime example of an organized campaign to lower utility return on equity to a point where it chills investment… Harmful regulatory decisions caused all five of the state's regulated utilities to have their credit ratings cut, leading Bank of America to declare Connecticut 'probably the worst regulatory environment in the country.' Prices for Connecticut customers rose during this time and are among the highest retail electricity rates in the country."

Utilities and their "experts" make claims like these because they count on lawmakers not checking the facts. The actual record:

1. **Connecticut's authorized rates of return are roughly in line with the rest of the country.** United Illuminating was set at 8.80%; Yankee Gas at 9.48%; the others at similar levels. These are not punitive numbers — they are at or near the low end of a national distribution that runs from roughly 9% to 10%. The "Connecticut savaged ROE" narrative is not accurate.
2. **The actual concern was storm-cost recovery, not authorized ROE.** Eversource and UI faced hundreds of millions of dollars in accumulated storm-cost claims from Tropical Storm Isaias and subsequent events. PURA's prudence review of those claims — verifying that what utilities want to bill ratepayers was actually incurred and reasonably spent — is exactly the kind of scrutiny ratepayer protection requires. Rating agencies dislike that scrutiny because it creates cash flow timing risk for utilities, and they label it "regulatory uncertainty." But fast, generous approval of every utility cost claim is what utilities want, not what ratepayers should want. None of this is about authorized ROE — which is what the article claims to be about. Blaming the credit downgrades on ROE is like blaming PG&E's bankruptcy on high authorized returns rather than on wildfires.
3. **Everything else the article says about Connecticut is also wrong.** Specifically:

- **Investment was never "chilled."** Utility holding companies asked for higher returns, but they nonetheless gladly invested at the 8.8% and 9%-plus returns on offer — both of which significantly exceed what the underlying risk warrants.
- **Regulated utilities did not all see their credit ratings cut.** United Illuminating, whose authorized return was reduced to 8.80%, was not downgraded. Neither was its parent, Avangrid. Neither was Connecticut Water, nor its parent SJW Group. If the downgrade story were really about Connecticut's regulatory environment, every Connecticut utility would have been hit. They were not.
- **Bank of America did not declare Connecticut "probably the worst."** It quoted an industry-paid rating agency. The chain runs Fitch (paid by the utilities it rates) → a Bank of America sell-side research note quoting Fitch → Avangrid's litigation letter quoting BofA → the press calling it "Bank of America's view." That is a single industry-aligned voice recycled three times, not three independent observations.
- **True but misleading: Connecticut prices did rise — in line with the national average.** The increase was driven almost entirely by wholesale energy procurement costs that utilities pass through dollar-for-dollar and on which they earn no return. Connecticut has had retail rates near the national top for years; all six New England states plus New York consistently rank in the top 10, because of ISO-NE wholesale market design and pipeline constraints — not because of authorized ROE. CT was a top-5 high-rate state under the previous regulatory regime and remains one today.

When the "experts" have to misrepresent the record to make their case, that is the takeaway: they have no valid arguments left.

United Kingdom

Connecticut is an outlier only in having weathered some unusually expensive storms; its authorized returns are broadly in line with national averages. A more useful test of what happens when authorized returns are reduced is the United Kingdom. There, regulators set utility returns on equity roughly two to four percentage points below the levels granted in the United States — a gap consistent with what an auction-based mechanism is expected to deliver here.

UK utilities nonetheless continue to:

- Attract investors.
- Build infrastructure.
- Borrow at low cost.
- Keep the lights on.

There is only one difference between American and British utility customers: the latter save hundreds of dollars each year that, in the U.S., flow as inflated profits to utility holding companies. That is the entire policy question.