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RI House Corporations Committee
Rhode Island State House
82 Smith Street
Providence, RI 02903

RE: H7887 AN ACT RELATING TO PUBLIC UTILITIES AND CARRIERS -- PUBLIC UTILITIES COMMISSION

Dear Members of the House Corporations Committee:

Our firm writes in support of H7887. This testimony is not delivered on behalf of any clients.

The Narragansett Electric Company (NEC, now dba "RI Energy") is chartered to exercise the power of eminent domain to take land and exercise a monopoly over our electric and gas energy systems as long as its plans are approved as being in the "public interest." An Act to Incorporate United Electric Power Company, S 400 Jan. Sess. 1956 (March 23, 1956). RI Energy is a private company that seeks to exercises its monopoly control for the benefit of its shareholders and it must be effectively regulated to ensure proper to service of the public interest as required by its charter. In the absence of adequate regulation its incentive is to profit its shareholders.

We strongly encourage the general assembly to look to experts for guidance on the subject of utility rate regulation. For a good analysis of return on equity we especially refer you to the Regulatory Assistance Projects report entitled *Improving Utility Performance Incentives in the United States A Policy, Legal and Financial Framework for Utility Business Model Reform* (Oct. 2023).[1] The report is summarized in its pertinent part, in the Foreword.

> This report shows that, with respect to return on equity (ROE), typical regulatory practices have not caught up with a modern understanding of finance. Alfred Kahn clearly explained in 1970 why the "cost of equity" *as viewed by investors* and the "return on equity" *as set by regulators* in a rate case are fundamentally two different concepts.[1] Commissions may conflate these in a way that obscures pivotal incentives implicit in setting the ROE. Fifty years on, we want to shine a light on this key distinction. Similarly, utilities sometimes assert that a lower ROE increases risk. But again, a close look shows that while a lower ROE may modestly increase risk to bondholders, the predominant impact is a lower *expected value* for *existing* shareholders, which has little to do with *risk*. More simply, a lower ROE makes rates more affordable for customers but, all else being equal, decreases an investor-owned utility's stock price, thus lowering the wealth of *existing* shareholders.

On page 17, it further explains a fundamental neglect of utility rate regulation:

> Because many commissions do not distinguish between the cost of equity and ROE, the entire corporate finance structure, the one that reveals the potential for investor value creation to be reflected in utility stock prices, becomes obscured to the point that researchers in this field cannot untangle what regulators are actually doing. In 1994, Myers and Borucki concluded that, while regulators claimed to be setting returns on equity at the cost of equity, the two researchers could find no evidence to support that assertion. Rather, they found that authorized returns on equity exceeded properly estimated costs of equity "for virtually all utilities." This suggests that regulators have either incorrectly estimated the cost of equity or have misstated what the cost of equity truly represents. More recently in 2019, Carnegie-Mellon University researchers Rode and Fishbeck concluded, after investigating four decades of industrywide authorized returns on equity:
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> It would appear that regulators are authorizing excessive returns on equity

[1] https://www.raponline.org/wp-content/uploads/2023/10/rap-improving-utility-performance-incentives-in-the-united-states-2023-october.pdf

> to utility investors and that these excess returns translate into tangible profits for utility firms.
>
> If regulators actually had been setting returns on equity at the properly estimated cost of equity, as frequently claimed, then such authorized returns would not be excessive. (internal citations omitted)

Another good synopsis of the growing concerns about monopoly utilities and the extent of their control over our energy future is *Upcharge: Hidden Cost of Utility Monopoly Power*, The Institute for Local Self Reliance (May 30, 2024) (https://ilsr.org/articles/report-upcharge-electric-utility-monopoly/). It's executive summary puts it this way:

> The costs of electric utility monopoly power are staggering. By hindering clean energy investment of their competitors, investor-owned utilities block rapid and affordable climate solutions that can create thousands of good jobs. Carbon pollution from utility power plants has juiced record storms and wildfires causing widespread destruction of homes and costing thousands of lives. The total health costs from electricity pollution are staggering – – equal to the price paid for all electricity sold each year — and include a lifetime sentence of asthma for millions of children. Utilities have hiked electricity prices to record levels in many regions, triggering a debilitating routine of shutoffs for many families. These lasting impacts cost all of us, even as they compound longstanding disproportionate health and economic harms for people of color and those with low incomes.
>
> The root cause is for-profit ownership of the exclusive, public franchise to deliver electricity to U.S. customers. Driven by a profit motive to overbuild and own everything and exacerbated by mergers that make them too big for effective regulatory oversight, investor-owned utilities have entrenched their monopoly power. The distribution monopoly grants utilities gatekeeping power over transmission, generation, energy efficiency, and data. With regulators outgunned by the utilities they are supposed to oversee, the failures of the monopoly utility system illustrate the failure of private monopoly control over a public service.

p. 7. Rhode Island's report on transforming our power sector raised the same kinds of concerns about the utility business model.

> In the traditional regulatory model, electric utilities earn a return on investments based largely on the cumulative depreciated cost of the prudent capital investments. This model may exert a "capital bias" on the utility to deploy capital-intensive solutions. This occurs because the primary financial means through which the utility can grow its business and enhance earnings for shareholders is to invest in capital projects. This bias, created by the regulatory framework rather than by the utility itself, discourages the utility from seeking more efficient solutions that do not depend on large capital investments.

Transforming the Power Sector Phase 1 Report (Nov. 2017 - https://ripuc.ri.gov/sites/g/files/xkgbur841/files/utilityinfo/electric/PST-Report_Nov_8.pdf), at p. 16.

Please pass H7887 to help control utility profits and better ensure protection of our public interest.

Sincerely,

Seth H. Handy