

# Alternative Ratemaking: The Unintended and Unrecognized Shift of Investment Risk from Shareholders to Customers

**Wired Group**

*Reducing the Cost of the Energy Transition*

NASUCA Accounting and Finance Committee Meeting

Webcast

July 31, 2025

# Storyline

- Ratemaking “innovations” to reduce regulatory lag involve unintended consequences that favor shareholder interests over customer interests.
- These innovations are being adopted by more and more states. They practically eliminate cost disallowance risk, thereby shifting investment risk from shareholders to customers.
- Case Study and ‘Proof Points’
- What Regulators, Staff, and Intervenors can do

# Ratemaking “Innovations”

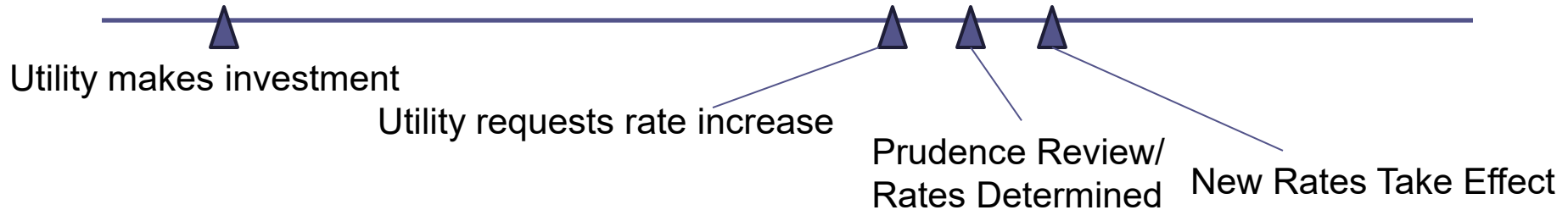
- Innovations to reduce regulatory lag practically eliminate cost disallowance risk<sup>1</sup>
  - Future Test Years
  - Multiple Future Test Years (Multi-year Rate Plans)
  - Rider cost recovery
- Annual cost reconciliations: Eliminate utility incentives to reduce spending between rate cases (IL, OH)<sup>2</sup>

Advance  
regulatory  
review of  
investment  
plans

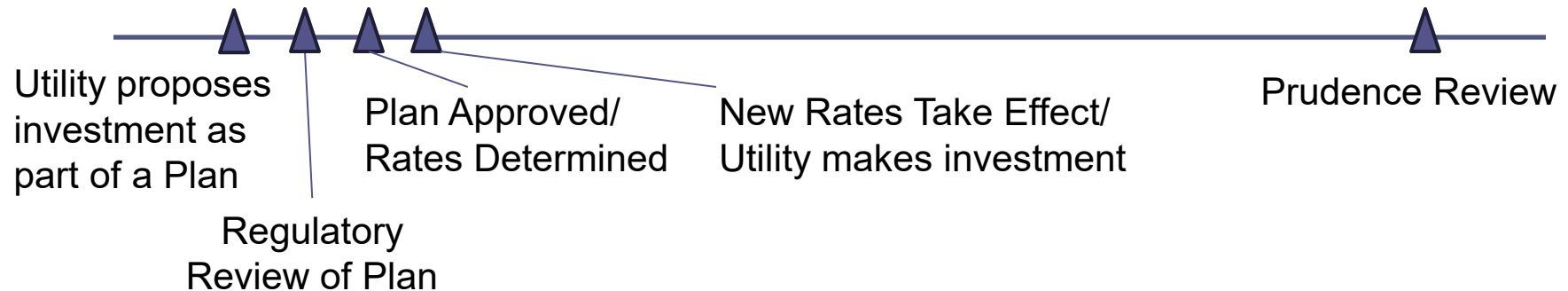
- 1) Alvarez, Costello, Ericson and Stephens. *Alternative ratemaking: a prerequisite for grid modernization or a shift in risk from shareholders to customers?* Electricity Journal 35 (2022), 107200.
- 2) Initially piloted in Maryland, but prohibited by Maryland law in 2025 session (SB937/HB1035).

# How Advance Review of Investment Plans Practically Eliminates Cost Disallowance Risk

## Traditional ratemaking timeline



## Ratemaking timeline with advance investment plan review



# Epidemic Adoption of Ratemaking “Innovations” that Shift Risk from Shareholders to Customers

State or Utility	Year	Future Test Yrs or Multiple FTYs	Annual Cost Reconciliation
Maryland	2020	X	X <sup>1</sup>
Pepco (District of Columbia)	2021	X	
Florida Power & Light	2021	X	
Washington (legislated)	2021	X	
Illinois (legislated)	2022	X	X
Duke Energy (NC)	2023	X	
Ohio (legislated)	2025	X	X
Missouri (legislated)	2025	X	
ConEd	2025	Proposed	

1) Prohibited by Maryland legislature in 2025 (SB 937/HB 1035)

# Case Study: BGE & Baltimore Peninsula

- 2016: Anchored by Under Armour campus plans for 10,000 employees, developer announces redevelopment of a former industrial site (skyscrapers, retail, residences – 4 M sq. ft. by 2025)
- 2017: Under Armour's fortunes turn. Campus plans dramatically scaled back, as are developer's plans. Latest count: 1,500 employees, 280k sq. ft. of office space
- 2019 (unrelated): Under pressure from the MD legislature, the MD PSC agrees to pilot multi-year ratemaking. BGE immediately files a multi-year investment plan w/massive increases in rate base, including \$30 million for initial phases of new infrastructure (substations, circuits, service lines, etc.) for Baltimore Peninsula\* (MD PSC 9645).
- 2020: As experts for the Office of People's Counsel (OPC), we recommended capital spending plan cuts that the MD PSC rejected. We also identified the loss of disallowance risk as an issue in multi-year ratemaking and proposed a distribution investment planning process with intervenor participation to address this loss (also rejected).

# Case Study (continued)

- 2020: Pandemic dramatically reduces demand for office space.
- 2023: BGE submits its second multi-year investment plan with even greater capital spending increases, including \$50 million in additional infrastructure for anticipated Baltimore Peninsula development (MD PSC 9692). Our testimony on behalf of OPC again identifies issues with multi-year ratemaking, again proposes distribution investment planning controls, and again proposes capital plan cuts (citing BGE's unnecessary Baltimore Peninsula infrastructure plans as an example). MD PSC again rejects all our recommendations, but jump starts its investigation into multi-year ratemaking (MD PSC 9618).
- 2024: BGE continues with Baltimore Peninsula infrastructure upgrades as part of the capital spending plan the MD PSC approved despite lack of development.
- 2025: Only a tiny fraction of the development envisioned for the Baltimore Peninsula has been completed. Maryland legislature outlaws the most egregious aspects of multi-year ratemaking in Maryland – the Annual (cost) Reconciliation process (SB 937/HB 1035).

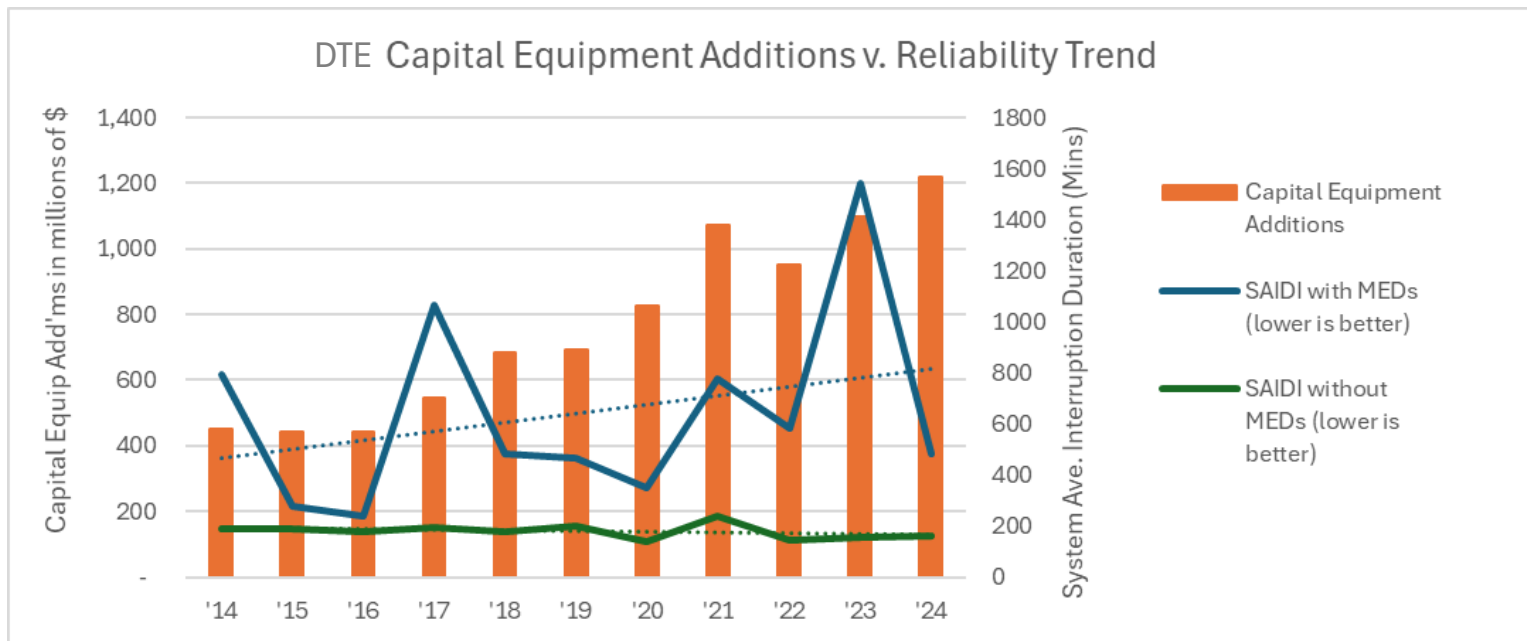
# Proof Point: Utility investment rewards increasingly seen to exceed investment risks

- Ratemaking innovations approved for one utility or commodity are quickly seized by other utilities/commodities as precedents
- Private Equity amassing shares and taking board positions (Example: Elliott Mgmt./Eversource)
- Private Equity buying utilities outright (Example: Blackstone's acquisition of TNMP)
- Multi-state and multi-nation holding co's are on an E, G, & W utility buying spree (National Grid, Iberdrola, Algonquin, Fortis, Enbridge, AEP)
- Media and others overstating the need for capital spending increases (Examples: Market monitor and Ohio Manufacturers Association argue capacity risk in MISO and PJM overblown, driving up auction prices)
- Bribery scandals in recent years in Illinois and Ohio legislatures



## Proof Point: Any excuse to spend capital will do . . .

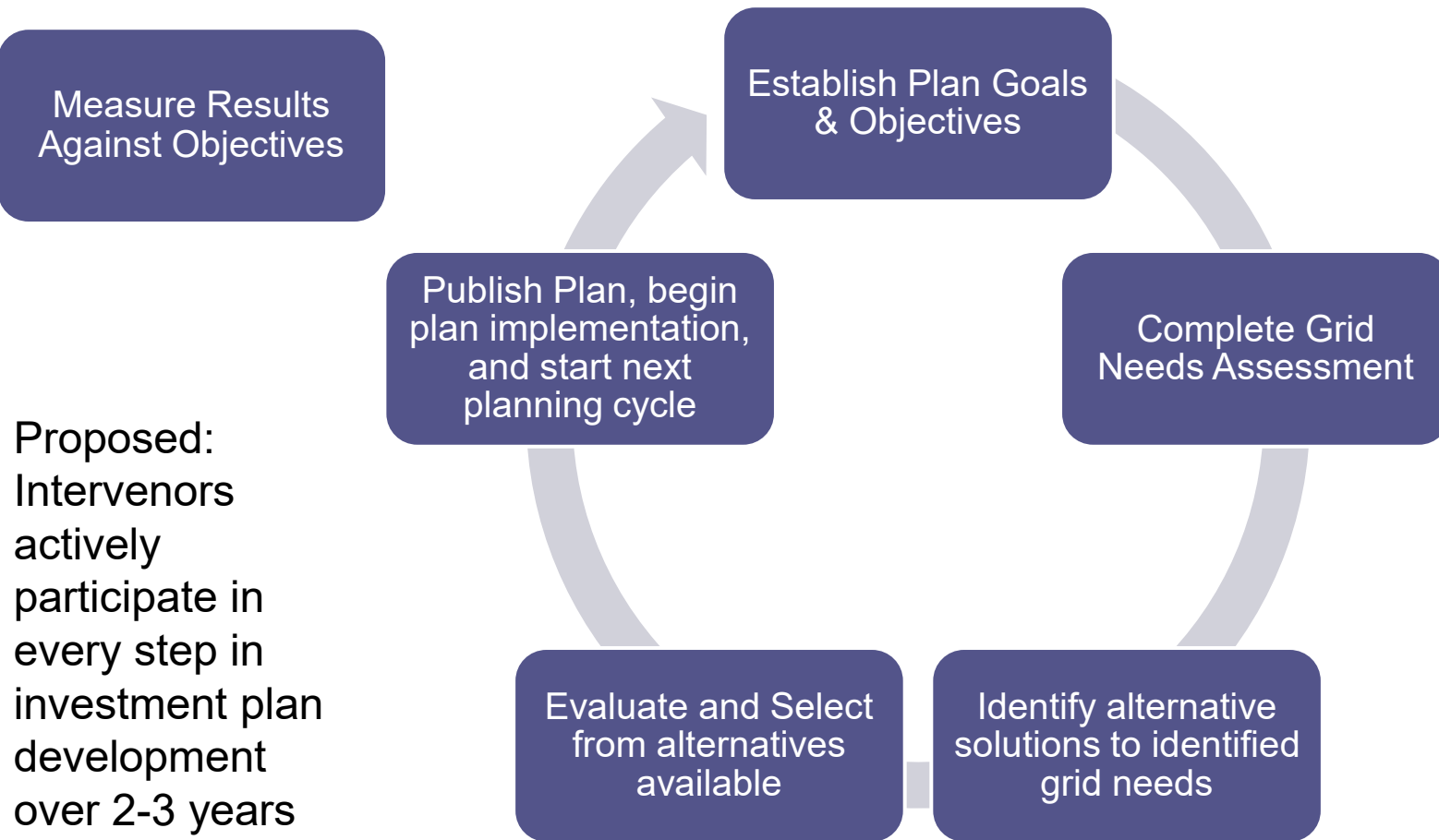
- Natural Gas: Safety/Environmental issues w/leaks
- Electric: Safety issues with wildfires
- Electric: Capacity (EVs, HPs, DER, Data centers)
- Electric: Reliability and Resilience
- Water: Flint Michigan debacle



# What should we be doing regarding ratemaking “innovations” that shift risk to customers?

- Federal/National
  - Reinstate PUHCA of 1935 prohibitions against cross-state ownership?
  - FTC or FERC petitions? Overturn SCOTUS’s Citizens United decision?
  - NASUCA/NARUC/NCSL Resolutions or Committees to investigate?
- State
  - Reinstate traditional ratemaking?
  - Limit ratemaking innovations to specific spending types (via riders)?
  - Increase Staff and advocate resources and independence?
  - Relieve restrictions on Staff and advocate legislative lobbying?
  - Restrict utility lobbying, PAC donations, and associated cost recovery?
  - Intervenor participation in the development of utility investment plans?
  - Pursue Risk-informed Benefit-Cost Analysis for discretionary spending?

# NARUC-NASEO Joint Task Force on Comprehensive Electricity Planning -- DISTRIBUTION<sup>1</sup>



1. Jade Cohort Roadmap. Available at <https://www.naruc.org/committees/task-forces-working-groups/retired-task-forces/task-force-on-comprehensive-electricity-planning/resources-for-action/roadmaps/>

# Risk-informed Benefit Calculation (CPUC R.20-07-013)\* as Part of Benefit-Cost Analysis

Equation for determining the value (benefit) of a risk reduction *in dollars*

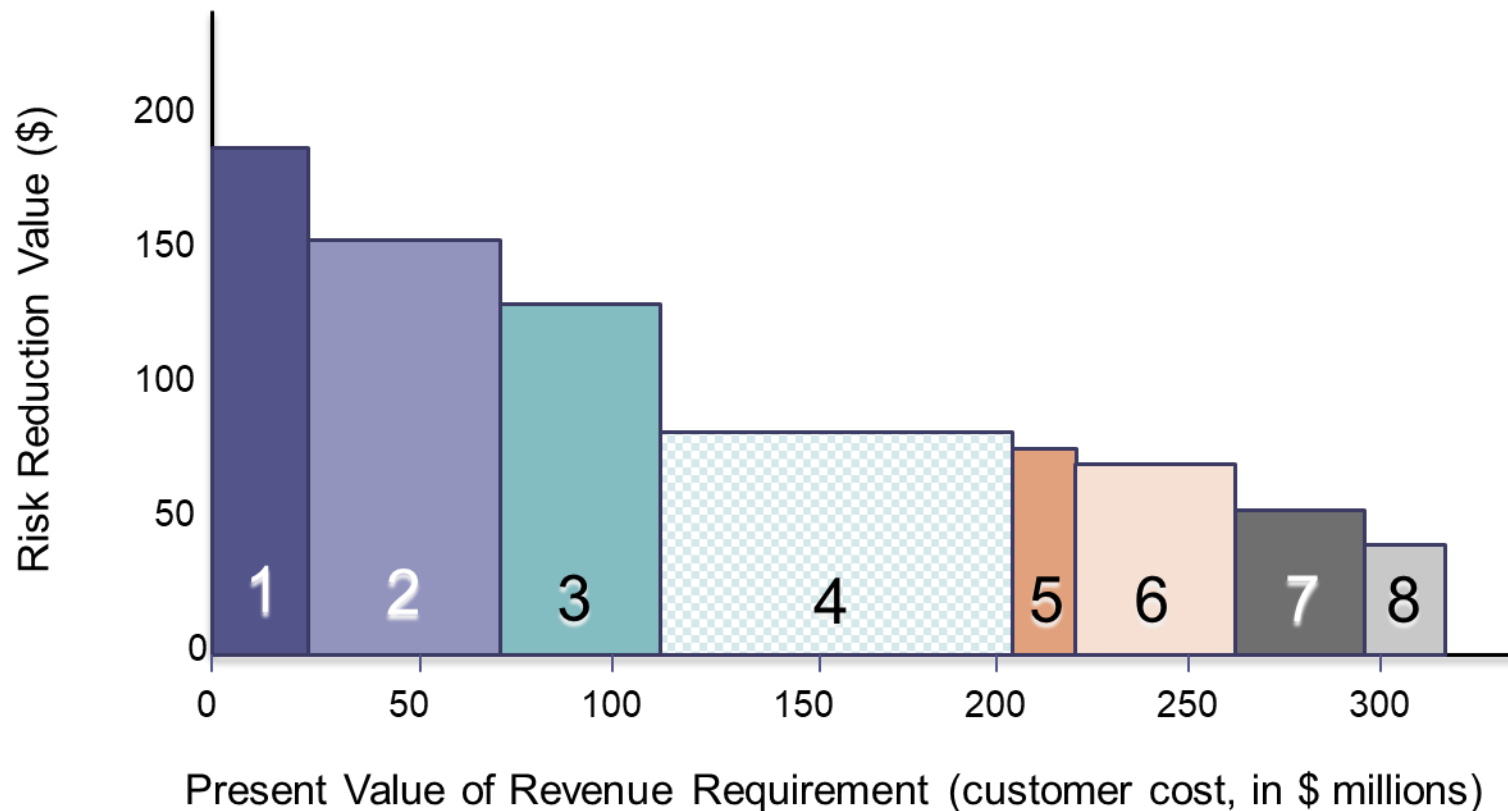
$$\begin{array}{ccccccc} \text{Annual} & & \text{Annual} & & \text{Reduction in} & & \text{Consequence} \\ \text{Value of} & & \text{Adverse} & & \text{probability \%} & & \text{of the} \\ \text{Risk} & = & \text{Event} & \times & \text{as a result of} & \times & \text{Adverse} \\ \text{Reduction} & & \text{probability} & & \text{investment} & & \text{Event (in \$)} \\ \text{(in \$)} & & \% & & & & \end{array}$$

(Best applied to investment proposals that are discretionary as to whether, when, how, or to what geographic extent they should be made)

\*Decision 22-12-027 dated December 15, 2022. Appendix A, Item 13, page A-13

# Risk-informed Decision-Making

Sample Portfolio Developed via Risk-Informed Decision Support  
(each box represents a potential project or program)



Thank You!

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