Backgrounder: Return on Equity Proposals

Protecting Water Infrastructure Capital for Reliable Service and Public Health

Background on Proposals to Suppress ROE

- **Political Pressures & Scapegoating:** Widespread public frustration over rising home energy costs and broader cost-of-living increases has triggered intense political pressure to lower utility bills. As a result, Return on Equity (ROE) is increasingly being targeted as a political scapegoat.
- **Nature of the Proposals:** Across several states, proposals have emerged to cap, freeze or drastically reduce utility ROEs, overhaul regulatory business models, or replace traditional expert-led rate cases with untested legislative mandates.
- **Mischaracterization of ROE:** Rhetoric often misrepresents ROE as “excessive corporate profit,” an “unnecessary margin,” or a “pile of idle cash.” In reality, ROE is the essential financial metric that determines whether a utility can attract private investment capital in competitive national and global markets.
- **Erosion of Regulatory Stability:** Traditionally, rate-setting has been treated as an objective, technical process governed by independent state utility commissions. Bypassing this process for short-term political wins threatens the long-standing “regulatory compact” and damages the predictability required to attract long-term capital.

Five Reasons Why Suppressing ROE is a Bad Idea

1 Reliable service and safe water require ongoing and strategic infrastructure investment.

Delivering safe water requires continuous capital to replace aging underground pipes, upgrade treatment facilities, strengthen cyber defenses and meet federal mandates like testing for emerging contaminants, full lead service line replacement and PFAS filtration down to non-detect levels. ROE is the financial tool that allows water companies to attract the capital required to fund these essential infrastructure projects.

2 Competitive ROE enables utilities to access necessary capital.

Private water companies must compete against all other industries to attract investors in national and global financial markets. Lowering ROE drives investors away to states or industries with more stable, predictable regulatory environments.

3

Suppressing ROE raises customer bills through higher borrowing costs.

When state policies unreasonably suppress returns, credit rating agencies observe weaker cash flows and downgrade the utility's credit rating. Because water providers have a legal obligation to meet safe drinking water standards, they must still borrow funds for required safety projects—but at higher interest rates due to downgraded credit. Customers ultimately pay for these elevated borrowing costs through higher bills, producing the exact opposite of the intended price relief.

4

Short-term political relief creates dangerous long-term liabilities.

A utility unable to attract low-cost capital is forced to space out or delay vital infrastructure modernizations. Further, utilities use earnings to fund capital investments, often at a higher level than earnings. Delaying capital expenditures does not eliminate costs; it simply shifts physical and financial liabilities into the future—surfacing as aging water mains left in the ground past their usable life, deferred cybersecurity upgrades, frequent main breaks, violations of federal and state safe drinking water standards, and costly emergency repairs.

5

Utility rate-setting belongs with independent expert regulators.

The traditional regulatory process at state public utility commissions is transparent, rigorous, and evidence-based, involving months of public litigation where independent consumer advocates and forensic auditors review every expense and investment. Politicizing rate-setting erodes regulatory stability, raising capital costs and leaving local communities with outdated infrastructure and higher long-term risks.