

Game Over: Regulatory Capture, Negotiation, and Utility Rate Cases in an Age of Disruption

By HEATHER PAYNE*

“Utilities are the least customer-friendly entities on the Earth, because they’re regulated monopolies If you have to fight for a customer, you’re going to do your best to serve your customer.”¹

Introduction

UTILITY RATEMAKING PROCEEDINGS at public utility commissions (“PUCs”) across the country are becoming the new battleground in the transition to clean energy. While technology has made alternative energy sources and strategies like demand response cheaper and more readily available,² utility operating and revenue models have not kept pace, including the legal and regulatory frameworks that govern

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1. Julia Pyper, *A Conversation with David Crane on Getting Fired from NRG and What’s Next for His Energy Plans*, GREENTECH MEDIA (Apr. 29, 2016) (emphasis added) (quoting David Crane, former chief executive officer of NRG Energy), http://www.greentechmedia.com/articles/read/A-Conversation-with-David-Crane?utm_source=daily&utm_medium=newsletter&utm_campaign=GTMDaily [https://perma.cc/VR4P-5BMX]. The rest of the paragraph is also instructive: “Wall Street is rewarding utilities for rate-based investments, not for engaging in competitive markets, said Crane. The rate base, meanwhile, has received hardly any reward.” *Id.* “Natural gas prices have plummeted from around \$13 per million [British Thermal Unit (“BTU”)] in June 2009 to \$2 per million BTU today, saving utilities billions on resource spending. But regulated utilities haven’t turned the precipitous drop in commodity prices into savings for customers; they’ve predominantly been investing those dollars back into the same poles and wires system they’ve been operating for decades, said Crane, who has called this strategy ‘shockingly stupid.’”

2. David Keith, *I Was Wrong About the Limits of Solar. PV is Becoming Dirt Cheap*, GREENTECH MEDIA (Apr. 28, 2016), <http://www.greentechmedia.com/articles/read/i-was-wrong-about-the-economic-limitations-of-solar-power> [https://perma.cc/4CH2-WXRV].

them.³ Current regulatory structures continue to maintain the status quo of incumbent utilities increasing their revenues and profits based on the traditional monopoly model, despite the emergence of performance-based regulatory models that incent deployment of private capital versus rate-based assets⁴ (potentially disrupting the entire construct of utilities as monopolies).⁵ Even arguably the most progressive performance-based model currently under consideration in the United States specifically allows for the continued protection of incumbent utility revenues and profits.⁶ This continued protection is in the name of maintaining financial outlooks, credit ratings, and access to the capital necessary to build the capabilities required to enable the transition to clean energy.⁷

One method utilities use to ensure continued revenue and profits is by increasing capital spend. Rate-based capital deployed by regulated utilities has doubled in the last decade.⁸ This spending is then recouped from ratepayers through ratemaking proceedings.⁹

This article provides a thorough examination of recent rate cases to demonstrate that utilities, public staff, and utility commissions, continue to play a “game.” For this game, each party demonstrates that their own objectives are met and that utility investments, with the corresponding rates necessary to support those investments, are prudent.

3. Michael O’Boyle, *Utilities in the Information Age: Moving from Construction to Optimization*, GREENTECH MEDIA (May 4, 2016), <http://www.greentechmedia.com/articles/read/utilities-in-the-information-age-moving-from-construction-to-optimization> [https://perma.cc/KRU5-3QK4]; see also Peter Bronski et al., *The Economics of Load Defection*, ROCKY MOUNTAIN INST. (Apr. 2015), https://www.rmi.org/wp-content/uploads/2017/04/2015-05_RMI-TheEconomicsOfLoadDefection-FullReport-1.pdf [https://perma.cc/2XPB-EW4L].

4. See Heather Payne, *RIO to REV: What U.S. Power Reform Should Learn from the U.K.*, 36 PAGE L. REV. 31, 32 (2015).

5. See *Monopoly*, ECON. ONLINE http://www.economicsonline.co.uk/Business_economics/Monopoly.html [https://perma.cc/WVW8-XMRJ].

6. See Heather Payne, *All of the Above: One Way State Regulatory Frameworks Impact the Utility of the Future*, 8 GEO. WASH. J. ENERGY & ENVTL. L. 78 (2017). New York’s Reforming the Energy Vision proceeding is arguably the most progressive performance-based model currently under consideration in the U.S.

7. *Id.*

8. See DELOITTE, FROM GROWTH TO MODERNIZATION: THE CHANGING CAPITAL FOCUS OF THE UTILITY SECTOR 15 (2016), <https://www2.deloitte.com/content/dam/Deloitte/us/Documents/energy-resources/us-er-from-growth-to-modernization.pdf> [https://perma.cc/F67F-FNBB].

9. See Kenneth Eisdorfer & Mark Hillman, *Why You Need to Keep an Eye on Electric Utility Rate Cases*, ACCENTURE OPERATIONS, <https://www.accenture.com/us-en/insight-spend-trends-keep-eye-on-electric-utility-rate-cases> [https://perma.cc/6DNF-DFTS].

The article starts with a discussion of regulatory capture theory. Then, an empirical study of investor-owned utility rate cases is presented to quantify this game between regulated utilities and regulators. Percentage-wise increases that utilities requested are compared to what they were finally granted by PUCs. Differences between settled and fully litigated rate cases are analyzed, as well as whether differences exist for vertically integrated utilities versus transmission and distribution (“T&D”) only utilities.

After discussing methodology, results, and a review of publicly available PUC staff recommendations, the article moves to proxies for utility responses to regulatory decisions. A review of the process and results through a regulatory negotiation lens follows. Then, the question presented is whether normal negotiation theory should apply to regulated monopolies. Answering “no,” the article responds with potential changes to the current regulatory framework to stop this game. Transparency, market solutions, additional public input, more stringent PUC processes, and additional judicial oversight could all play a part in reforming the current process. The article concludes with a discussion of potential next steps for regulators and further research.

I. Regulating Monopolies, Prudent Investment, and Regulatory Capture

Regulators have been attempting to determine the correct way to regulate monopolies since monopolies came into existence. Unfortunately, at least for the public, these attempts have not been universally successful. The goal seems relatively simple: remedy anti-competitive behavior.¹⁰ However, implementing this goal in practice has proven more challenging.

One way regulators have attempted to provide for the public interest is by implementing the prudent investment theory. Justice Brandeis originally articulated the theory in 1923 in his concurrence to *Southwestern Bell Telephone Co. v. Public Service Commission of Missouri*.¹¹ The prudent investment theory rests on the idea that:

[T]he owner’s investment [i]s the thing to be protected in rate making, rather than the ever changing value of the physical property of the utility. Thus, a rate of return sufficient to protect the

10. See Joel B. Eisen, *FERC’s Expansive Authority to Transform the Electric Grid*, 49 U.C. DAVIS L. REV. 1783, 1817 (2016) (“FERC’s authority to oversee markets for discrimination is directly comparable to the original goal of regulation: remedying anti-competitive behavior.”).

11. 262 U.S. 276, 289–312 (1923) (Brandeis, J., concurring).

owner's investment and attract new capital [i]s the object of regulation, rather than a cumbersome, time-wasting appraisal of the utility property.¹²

The prudent investment theory was adopted by the Supreme Court in *Federal Power Commission v. Hope Natural Gas Co.*, and was then adopted by PUCs around the country.¹³ As has been noted by the First Circuit:

Over the years, the Supreme Court applied various tests and standards to determine “just and reasonable” prices—concepts such as the fair-value test, the prudent-investment rule, and price caps. The constant underlying those standards was the idea that calculating the utility's cost “and then allowing a fair rate of return on it was a sensible way to identify a range of rates that would be just and reasonable to investors and ratepayers.” Under this rate-of-return model, a utility had a strong incentive to inflate its costs and to make costly but unnecessary investments, in order to raise its “rate base” and thus increase its incomes.¹⁴

Unfortunately, as shown in Section IV of this article, this study indicates that in addition to increasing capital spending for the purposes of inflating the rate base, utilities also inflate what they request in terms of authorized rate base increases and return on equity values.

While prudent investment theory has broadly governed utility ratemaking proceedings for the last seventy years since *Hope Natural Gas*, it is ill-equipped to deal with the game being played between utilities and regulators. The game is driven by the utilities' desire for increased capital spending to shield profits from decreasing electricity demand, increasingly distributed generation, and third-party capital. One reason the prudent investor theory is ill-equipped to counterbalance these desires is that it is too easily manipulated.¹⁵ This is especially an issue in complex rate cases dealing with hundreds of pages of testimony around how a revenue requirement or authorized return on equity (“ROE”) should be calculated, where anything and everything can be manipulated. Many investments can be deemed sufficient, prudent, and acceptable. When everything between 0% and

12. Albert L. Dietz, Jr., *Public Utilities—Rate Making—Prudent Investment Theory—Non Utility Functions*, 13 LA. L. REV. 617, 618 (1953) (emphasis omitted).

13. 320 U.S. 591, 603 (1944).

14. P.R. Tel. Co., Inc. v. Telecomms. Regulatory Bd. of P.R., 665 F.3d 309, 316 (1st Cir. 2011) (citations omitted). See also *A Pathway to the Distributed Grid*, SOLARCITY (Feb. 2016), http://www.solarcity.com/sites/default/files/SolarCity_Distributed_Grid-021016.pdf [https://perma.cc/S4GN-DYZJ].

15. See *Verizon Commc'ns, Inc. v. F.C.C.*, 535 U.S. 467, 486 (2002) (“[T]he prudent-investment rule in practice often being no match for the capacity of utilities having all the relevant information to manipulate the rate base and renegotiate the rate of return every time a rate was set.”).

100% (and sometimes even less than 0% or more than 100%) of what the utilities ask for can be granted, with essentially no judicial oversight of the decision, the regulatory system becomes the very definition of arbitrary and capricious.¹⁶ Regulatory capture worsens this potential for manipulation and lack of transparency.

Regulatory capture, often referred to as agency capture, is the theory that “organized interest groups successfully act to vindicate their goals through government policy at the expense of the public interest.”¹⁷ Put simply, regulatory capture describes “the process through which regulated monopolies end up manipulating the state agencies that [we]re [designed] to control them.”¹⁸ Regulatory capture is not a form of corruption or control, but rather an element of persuasion.¹⁹ “A regulator is ‘captured’ when he is in a constant state of ‘being persuaded’: persuaded based on a persuader’s identity rather than an argument’s merits.”²⁰ Regulatory capture can be understood through three considerations: the private interests of regulators and industry groups as described in Section A; the sources of regulatory capture as described in Section B; and the revolving door phenomenon as described in Section C.

A. Private Interests of Regulators and Industry Groups

Regulators have customarily been referred to as public servants or civil servants.²¹ “The traditional conceptualization of the regulatory process . . . is to think of regulators as public-minded” officials who make policy decisions in consideration of public interest.²² However, the regulatory capture theory suggests that regulators are often driven by narrow, self-interested goals, such as job-retention, self-gratification

16. See *P.R. Tel. Co.*, 665 F.3d at 319–20 (describing the extremely deferential standard of judicial review of agency decisions); see also Administrative Procedure Act, 5 U.S.C. § 706(2)(A) (requiring agency action to be set aside only if “arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law”).

17. Michael A. Livermore & Richard L. Revesz, *Regulatory Review, Capture, and Agency Inaction*, 101 GEO. L.J. 1337, 1340 (2013).

18. Ernesto Dal Bó, *Regulatory Capture: A Review*, 22 OXFORD REV. ECON. POL’Y 203, 203 (2006).

19. Scott Hempling, “Regulatory Capture”: *Sources and Solutions*, 1 EMORY CORP. GOVERNANCE & ACCOUNTABILITY REV. 23, 25 (2014).

20. *Id.*

21. Wentong Zheng, *The Revolving Door*, 90 NOTRE DAME L. REV. 1265, 1270 (2015).

22. *Id.*

from the exercise of power, new job placement after term of office, or post-government personal wealth.²³

These private interests either directly or indirectly influence regulators to build coalitions with certain individuals or groups of individuals, including industry groups or firms, within the industry being regulated.²⁴ If the regulators can create public policies or industry regulations that improve the utility positions of these groups of individuals or firms, the advantaged groups will support them and make resources available, furthering the regulators' self-interests.²⁵ Therefore, regulators will often overlook the public interest when formulating regulations and, instead, will consider the costs and benefits of forming and maintaining the coalitions necessary to keep them in office or enhance their wealth or power.²⁶ This results in the regulators being "captured" by the industry because, to further their own goals, the regulators must become persuaded by and appeal to the private interests of industry groups.

Certain industry groups are driven by similar narrow, self-interested goals as those of regulators. To fulfill their private interests, these industry groups seek to persuade regulators to act in the industry group's favor by appealing to the regulators' own private interests. The most obvious contribution an industry group may seek from regulators is some form of direct monetary subsidy.²⁷ However, most industry groups with the power to persuade governmental agencies do not use this power to simply obtain money but, instead, to gain advantages within the industry.²⁸ "The second major public resource [frequently] sought by an industry group is control over entry [of] new rivals" into the industry.²⁹ Regulatory bodies exercise various controls over entry in all fields of industry.³⁰ If an industry group has the ability to persuade regulators to control entry in their favor, then they most certainly will.

23. Michael E. Levine & Jennifer L. Forrence, *Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis*, 6 J.L., ECON., & ORG. 167, 169 (1990).

24. *Id.* at 169-70.

25. *Id.*

26. *Id.* at 170.

27. George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3, 4 (1971).

28. *Id.* at 4-5.

29. *Id.* at 5.

30. *Id.*

A third private interest industry groups seek is control over substitutes and complements within the industry.³¹ For example, a coal company may seek to suppress reliance on renewables while encouraging the burning of fossil fuels.

Lastly, a fourth class of regulation that an industry group may seek to control is price-fixing.³² With regulators on their side, an industry group could establish higher prices and, therefore, achieve higher rates of return.³³ For example, a utility company who has similarly captured its respective PUC could receive permission to set higher rates with a higher return on equity. While the private interests of regulators and industry groups are the driving factors behind regulatory capture, it is important to analyze the sources that lead to regulatory capture becoming a reality.

B. Sources of Regulatory Capture

A common contributor to regulatory capture is an agency's misconception that its purpose is to find a balance between the private interests and needs of consumers as well as industry groups.³⁴ This misunderstanding of the purpose of regulation as private interest balancing has five main problems that become the sources of regulatory capture: (1) ambiguity; (2) nearsightedness; (3) presumption of conflict; (4) passivity; and (5) legal looseness.³⁵

First, the suggestion that regulators should balance interests muddles regulation with ambiguities.³⁶ The phrase "balancing interests" suggests equivalence between consumers, shareholders, and industry. But equivalence is impossible amongst all of the ambiguities that arise when defining those groups. Consumers exist in many forms: large or small, industrial or residential, eastern or western, and today's or tomorrow's.³⁷ Consumer interests can be conflicting; for example, some consumers may be more interested in low electricity prices while others may be more interested in high quality.³⁸ Furthermore, industry investors also exist in several forms: buy-and-hold shareholders,

31. *Id.* at 6 (providing an example that a producer of butter would want to suppress the production of margarine and encourage the production of bread).

32. *Id.*

33. *Id.*

34. Hempling, *supra* note 19, at 29.

35. *Id.* at 29–30.

36. *Id.* at 29.

37. *Id.*

38. *Id.*

pension funds, hedge funds, short sellers, and bond holders.³⁹ Likewise, industry interests are also conflicting, for example, shareholder interest in this year's profits versus the next decade's profits.⁴⁰ Whichever way it is analyzed, perfectly balancing interests is not achievable. This often results in regulators favoring the industry groups that could further the regulators' own private interests.

Second, balancing private interests is nearsighted. A balance of private interests could be a reasonable goal of regulation if regulation were simply a bilateral commercial transaction between buyer and seller.⁴¹ However, this is rarely the case. Because utility regulation affects a vast range of transactions, "[t]he regulatory lens must be both wide-angle and long-distance."⁴² In the public utility field, regulated companies create, operate, and maintain the infrastructure supporting this country's economy.⁴³ Utility service also vastly affects various industries' production and consumption decisions.⁴⁴ For these types of industries, regulations greatly exceed the typical commercial transaction between buyer and seller.⁴⁵

Third, the notion of balancing private interests indicates a presumption of opposition.⁴⁶ However, the legitimate aims of consumers and industry groups are usually not in opposition—because high-quality performance and efficient consumption benefit all concerned groups.⁴⁷ Opposition in interests comes from certain groups' pursuit of illegitimate aims.⁴⁸ When regulators attempt to balance these interests, it results in compromises and deals through private interests, rather than advancing the public interest as a whole.

Fourth, when an agency tries to balance private interests, it is acting collectively as a passive body instead of the assertive body created to act with the public interest.⁴⁹ The agency ends up serving the concerned parties instead of the parties serving the agency's decisions.

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

45. See Coley Girouard, *How Do Electric Utilities Make Money?*, ADVANCED ENERGY ECON. (Apr. 23, 2015, 12:29 PM), <https://blog.aee.net/how-do-electric-utilities-make-money> [<https://perma.cc/XT45-NVDR>]. Utilities have "captive consumers" and must be more "carefully regulated" than traditional commercial relationships. *Id.*

46. Hempling, *supra* note 19, at 30.

47. *Id.*

48. *Id.*

49. *Id.*

Passivity undermines the agency's public interest purpose and, most of the time, results in the regulators being captured by appealing to the private interests of whichever industry group furthers their own private interests.⁵⁰

Lastly, attempting to balance private interests can result in legal looseness.⁵¹ Regulatory proceedings are "legal proceedings[] bounded by statutes and constitutional law that create rights and obligations."⁵² Regulators have the responsibility to define what are appropriate rights and obligations, and then to protect the rights and enforce the obligations on the appropriate parties.⁵³ Regulators often circumvent these legal tasks when they try to balance the private interests of consumers and industry groups.

When an agency or group of regulators attempts to balance private interests, they ultimately become victims of regulatory capture. Purposefully or inadvertently, captured regulators appeal to the private interests of the certain industry groups with the power to further the regulators' own private interests or goals. Once the private interests of the various involved parties and the sources of regulatory capture work together to effectively capture the regulators, a phenomenon known as the "revolving door" evolves.

C. The Revolving Door Phenomenon

The revolving door phenomenon refers to government officials (including regulators) leaving the government to work for the private sector industry that they regulated or vice versa.⁵⁴ The revolving door phenomenon results from, as well as furthers, regulatory capture. Transferring from industry to government may induce regulators to make decisions in favor of that industry because that regulator was "socialized" in the industry environment.⁵⁵ On the other hand, the possibility of post-regulatory employment could incent regulators to appeal to an industry group's interests to enhance their chances of future employment in the industry.⁵⁶ Industry socialization and future employment incentives are two mechanisms that work together to formulate the revolving door of regulators to and from government and

50. *See id.*

51. *Id.*

52. *Id.*

53. *Id.*

54. Zheng, *supra* note 21, at 1265.

55. Dal Bó, *supra* note 18, at 214.

56. *Id.*

industry. Two studies on the prevalence of the revolving door phenomenon, one conducted by Ross Eckert and the other by the Project on Government Oversight, help to demonstrate how often this occurs.⁵⁷

Eckert examined the career paths of 174 individual regulators who had been appointed to and confirmed to three different commissions.⁵⁸ He found that of those 174 individuals, 37 held pre-government jobs in the related industry private sector, and 72 took post-government jobs within the related industry private sector.⁵⁹ Of the 37 regulators who held pre-government industry jobs, half of them returned to similar positions upon leaving the government.⁶⁰

The Project on Government Oversight developed a report detailing the revolving door issues with the Securities and Exchange Commission (“SEC”).⁶¹ “The report identified 219 former SEC employees who filed nearly 800 post-government statements between 2006 and 2010 disclosing their representation of industry interests before the SEC within two years of leaving the SEC.”⁶² Those 219 former SEC employees were retained to represent multiple prestigious firms in the consulting, finance, and legal industries concerning a vast array of issues.⁶³

Regulatory capture and the revolving door phenomenon are prevalent in today’s society, at least on some level. Regulators and industry groups alike both appeal to each other’s private interests with the ultimate goal of furthering their own.

While often the perception, a state legislator in California recently noted that “the utilities have really been running the CPUC.”⁶⁴ This article aims to quantify the degree to which regulators and regu-

57. Zheng, *supra* note 21, at 1273.

58. *See id.* (focusing on the International Criminal Court (“ICC”), the Civil Aeronautics Board (“CAB”), and the Federal Communications Commission (“FCC”) by December 31, 1977).

59. *Id.*

60. *Id.* The seventeen who returned to industry are included as part of the seventy-two individuals who took post-government jobs in the related industry sector. Ross D. Eckert, *The Life Cycle of Regulatory Commissioners*, 24 J.L. & ECON. 113, 116–17 (1981).

61. Zheng, *supra* note 21, at 1273.

62. *Id.*

63. *Id.*

64. Debra Kahn, *Gov. Brown Proposes Overhaul of Utilities Commission*, E&E NEWS (June 27, 2016) (quoting Interview with Sen. Jerry Hill), <http://www.eenews.net/eenewspm/2016/06/27/stories/1060039478> [https://perma.cc/4BPS-66ST]. CPUC stands for the California Public Utilities Commission.

lated utilities play a game, perhaps to the detriment of the consuming public.

II. Regulatory Structure: Vertically Integrated and Restructured Markets

The electricity system in the United States is broadly broken into two categories: (1) states that have restructured their electricity system to some degree, and (2) states that continue to maintain vertically integrated utilities.⁶⁵ Vertically integrated utilities maintain a full monopoly structure, with no customer choice, and are regulated by a state's PUC.⁶⁶ In restructured states, utilities that own generation assets are often governed by wholesale market rules rather than the state's PUC.⁶⁷ These utilities are not monopolies because they are subject to competition among firms and specific generation assets. However, even in restructured markets, utilities that perform T&D functions are regulated monopolies. T&D functions remain under a regulated monopoly system under the logic that it simply does not make sense to open these functions to competition. There are significant capital costs associated with running wires, and having two or more sets of them to provide electrical service just does not make sense.⁶⁸

Regulated monopoly utilities, either vertically integrated ones or those who provide T&D service (either with or without another function), have their profits determined in a ratemaking proceeding.⁶⁹ Ratemaking proceedings are used to put the prudent investment theory into practice. They give a specific amount of revenue to the monopoly utility, and give investors an acceptable rate of return on the

65. A vertically-integrated utility is one that controls generation assets, transmission, distribution, and the retail experience with the customer. Utilities in restructured markets can be generation-only, T&D only, retail only, or some combination of the three.

66. Seth Blumsack, *Electricity Industry Structure and Regulation*, ENERGY MKTS., POL'Y, & REG. COURSE PAGE, <https://www.e-education.psu.edu/eme801/node/529> [https://perma.cc/KT75-2SD8].

67. The wholesale market rules are set by regional transmission organizations ("RTOs") or independent system operators ("ISOs). Each has its own set of dispatch rules, which govern the order in which generation assets are utilized. *A Brief Description of the Six Regional Transmission Organizations (RTOs)*, AM. PUB. POWER ASS'N (Feb. 2008), <http://www.publicpower.org/files>/PDFs/IssueBriefRTOs.pdf> [https://perma.cc/YSC8-KK4H].

68. Rob Day, *The Rise of Choices and the End of Natural Monopolies*, GREENTECH MEDIA (Mar. 30, 2015), <https://www.greentechmedia.com/articles/read/the-rise-of-choices-and-the-end-of-natural-monopolies> [https://perma.cc/6LV7-6LB6].

69. *Basic Ratemaking: Key Concepts*, MUNICIPALITY OF ANCHORAGE (Jan. 9, 2013), <https://www.muni.org/Departments/Mayor/Documents/TWPatchRCA.pdf> [https://perma.cc/2WZ5-2GPY].

capital they have invested in the monopoly business, while attempting to ensure that the amount reflects what would have been paid by a willing consumer for the service were there actually competition in the business.⁷⁰ Precisely because there is no competition, the amount authorized for the utility to spend—and the amount of profit they can obtain—is imprecise. Thus, state’s PUCs, and the public staffs associated with those PUCs that make recommendations to the PUCs, are working with incomplete information to attempt to construct a hypothetical situation that does not actually exist. A better way to determine revenue and profits has not yet been determined. However, the current process leaves much room for potential manipulation.

III. Quantifying the Game

In any given regulatory situation, regulated utilities will ask “for everything that they could possibly want, in recognition that they’re not going to get all of it.”⁷¹ In rate cases, this means maximizing profit: increasing the asset base and/or increasing the allowed return on equity. Utilities have also acknowledged that low-cost clean energy efforts are interfering with utility sales and profits.⁷²

In addition to the requests, one way the game occurs is through settlements that transpire between public staff and utilities during ratemaking proceedings. The utility asks for a rather large increase; public staff says that the request is too high and would be too expensive for the public. The utility and public staff negotiate to somewhere around half of what the utility requested and present this to the commission; the commission approves the new utility rate case.⁷³ This way, the utilities get an increase in profits, public staff can claim they are working for the public interest, commissioners claim they are doing their jobs, and the ratepayers continue to pay more.⁷⁴ This article

70. Of course, there are many pass-throughs (often taxes, pension expenses, energy efficiency program costs, environmental compliance costs, etc.) that the utility is also allowed to collect as part of ratemaking proceedings.

71. Jeff St. John, *California’s Solar Industry Fights Back on Net Metering 2.0*, GREENTECH MEDIA (Aug. 5, 2015) (quoting Interview with Robert Harris, Policy Dir. for Sunrun), <https://www.greentechmedia.com/articles/read/californias-solar-industry-fights-back-on-net-metering-2-0#gs.8Z0YcSo> [<https://perma.cc/4LFD-LDKZ>].

72. *Id.*

73. See *infra* Section IV. For example, see cases cited as Game Over Data-set, <http://www.law.unc.edu/documents/clear/publications/gameoverdataset.pdf> [<https://perma.cc/2VPQ-M65E>].

74. Peter H. Kind, *Pathway to a 21st Century Electric Utility*, CERES, at 5 (Nov. 2015), https://www.ceres.org/sites/default/files/reports/2017-03/Ceres_ElecUtilityIndustryMod_el_110615-rev2-1.pdf [<https://perma.cc/VF6V-XDNP>] (“[C]ustomers, rather than inves-

aims to quantify the extent to which this happens, and to quantify the differences, if any, between cases that are settled versus those that are fully litigated in PUCs.

A. Methodology

To quantify the game played by regulated utilities and regulators in ratemaking proceedings, this article analyzes the most recent completed electric (rather than steam or natural gas) rate cases with publicly available information (primarily from dockets on individual state PUC websites). Below is a comprehensive dataset of rate cases, including only the most recent completed rate case for a given utility and state, with data from 2002 to 2015.

This empirical study focuses only on investor owned utilities (“IOU”s). The utilities were then broken out into two groups: (1) vertically integrated utilities, and (2) T&D only utilities. Markets where residential customers have no retail choice, like California, were grouped into the vertically integrated group, whereas those with retail choice, like New York, were grouped into the T&D only group.⁷⁵ The data was also analyzed based on whether the rate case was settled or fully litigated before the relevant PUC.

Data collected and tallied included: (1) the requested rate change amount, (2) requested return on equity, (3) authorized rate change amount, (4) authorized return on equity, (5) date of filing, and (6) date the rate case completed.⁷⁶

The data excludes rate cases where not all the requisite information was publicly available and rate cases from municipal utilities and electric cooperatives.

tors, are bearing the near-term cost of disruption through increased utility rates, somewhat offset by lower fuel costs.”).

75. Different studies have characterized markets with some form of restructuring differently, typically adding states like California into a restructured category. *See, e.g.*, Bronski et al., *supra* note 3; Cameron Brooks, *The Periodic Table of the Electric Utility Landscape: A Series of Visual Tools for Enhanced Policy Analysis*, 28 *ELECTRICITY J.* 82 (2015). However, given that the monopoly part of the utility is what this article focuses on in this analysis, the states are based on whether they have retail choice, rather than whether they were restructured to remove most generation assets from a monopoly utility’s control.

76. The data-set in table form is available at <http://www.law.unc.edu/documents/clear/publications/gameoverdataset.pdf> [hereinafter *Game Over Data-set*] [<https://perma.cc/2VPQ-M65E>].

B. Utility Data

A total of 106 rate cases had the requisite information and were analyzed.⁷⁷ These were broken into the following subcategories⁷⁸:

Rate Cases	Settled	Fully Litigated
Vertically Integrated	40 (38%)	31 (29%)
T&D Only	20 (19%)	15 (14%)

IV. Results

Interestingly, there were similarities across the data, regardless of utility type or whether the rate case was settled or not. For example, average rate case duration (the length of time between initial filing and a final order or decision) stayed between 9 to 11.4 months across all four subcategories analyzed⁷⁹:

Average Rate Case Duration (Months)	Settled	Fully Litigated
Vertically Integrated	10.0	11.4
T&D Only	9.0	10.9

The shortest and longest times for each type of rate case were also similar⁸⁰:

Rate Case Duration, Minimum, Maximum (Months)	Settled	Fully Litigated
Vertically Integrated	5, 23	6, 18
T&D Only	1, 16	6, 20

As expected, fully litigated rate cases took, on average, longer than rate cases that settled. However, the longest rate case in the data set, by three months, was in a settled rate case for a vertically integrated utility.

A. Settlements vs. Fully Litigated Rate Cases

One measure of particular interest is whether consumers have a better outcome when cases are fully litigated (i.e., whether rates rise less in rate cases that were fully litigated rather than settled). How-

77. *See id.*

78. *See id.*

79. *See id.*

80. *See id.*

ever, the data is surprisingly constant. For the average authorized rate change, the data shows that, regardless of whether a rate case was settled or fully litigated, utilities were on average granted approximately half of what they requested.⁸¹

Authorized Rate Change Amount / Requested Rate Change Amount (%)	Settled	Fully Litigated
Vertically Integrated	57.9%	54.1%
T&D Only	51.0%	56.1%
Total	55.6%	54.7%

Settled rate cases end, on average, with the utility getting a slightly higher percentage of what they requested. While more research is needed to determine if rate cases for that particular utility or PUC tended to be higher or lower historically, overall it does not seem that the public receives much benefit from fully litigating rate cases versus settling them.

The ranges of the minimum and maximum authorized rate change amount divided by the requested rate change amount shows considerable variation across individual rate cases, where some utilities had their authorized rate change amount decreased rather than increased during the rate proceeding.⁸²

Authorized Rate Change Amount / Requested Rate Change Amount (%) (Minimum, Maximum)	Settled	Fully Litigated
Vertically Integrated	(-25%, 164%)	(-10%, 134%)
T&D Only	(0%, 96%)	(16%, 133%)

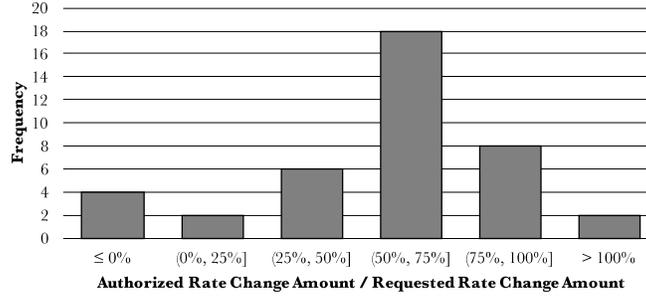
Four cases in the data set (two in the vertically integrated settled category, and one each in the fully litigated vertically integrated and fully litigated T&D categories) resulted in the commission giving the utility a higher authorized amount than they had requested. However, a histogram of the distribution of the rate cases demonstrates that

81. *See id.*

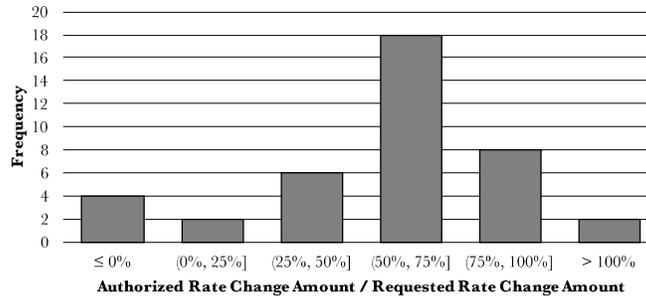
82. *See id.*

most cases are centered around the average, rather than having a widespread distribution.⁸³

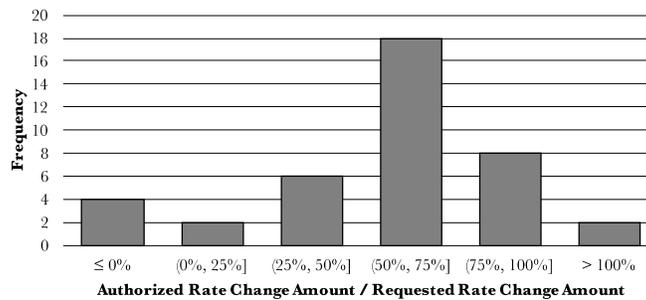
Vertically-Integrated Settled Cases



Vertically-Integrated Litigated Cases

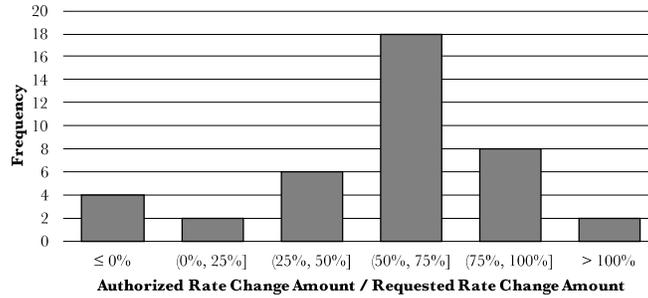


T&D Settled Cases



83. See *id.*

T&D Litigated Cases



B. Vertically Integrated Utilities vs. T&D Utilities

Another question was whether there were significant differences between vertically integrated utilities versus regulated T&D only utilities. The average results were fairly similar⁸⁴:

Authorized Rate Change Amount / Requested Rate Change Amount (%)	Settled	Fully Litigated	Total
Vertically Integrated	57.9%	54.1%	56.1%
T&D Only	51.0%	56.1%	53.2%

On average, vertically integrated utilities do tend to receive a higher percentage of authorized revenue than T&D only utilities.

C. Return on Equity

Another measure of the game is return on equity (“ROE”). Traditionally, ROE was based on the actual cost of capital to build infrastructure.⁸⁵ However, even with historically low interest rates, PUC-approved ROE figures for utilities have been relatively high.⁸⁶ While

84. See *id.*

85. See Girouard, *supra* note 45.

86. Thomas R. Kuhn, President of Edison Elec. Inst., The Promise of Tomorrow: Electric Power Industry Outlook, 2016 Wall Street Briefing (Feb. 10, 2016), in EDISON ELECTRIC INST., at 2, available at https://web.archive.org/web/20160702023958/http://www.eei.org/resourcesandmedia/industrydataanalysis/industryfinancialanalysis/Documents/Wall_Street_Briefing.pdf [<https://perma.cc/QM44-ZTLV>] (“[T]he spread between our average state-level return on equity and the 10-year Treasury has grown steadily for more than 20 years.”); see also Robert Walton, *EEL: Utilities Moving From Coal, Toward Gas & Renewables Regardless of CPP Stay*, UTILITY DIVE (Feb. 12, 2016), <http://www.utilitydive.com/news/eei->

perhaps not apparent to many ratepayers, ROE is another part of the game, as increased ROEs allow for greater monopoly utility profits.⁸⁷

1. ROE Results

To quantify how ROE changes were finalized in rate cases, the difference between what utilities were granted (authorized ROE) and what they requested (requested ROE) was calculated. The different utility types were then compared. For vertically integrated settled rate cases, the utility requested an ROE that was on average seventy-three basis points higher than what the commission authorized.⁸⁸

Authorized ROE – Requested ROE (Basis Points)	Settled	Fully Litigated	Total
Vertically Integrated	-73	-63	-68
T&D Only	-90	-87	-89

It appears that vertically integrated utilities were more likely on average to get closer to the ROE they requested than T&D only utilities. This was especially the case in fully litigated rate cases where the difference between what the utilities requested and what they received was the smallest. Given that each percent of ROE can mean a significant amount of profit to the utility, this difference may be significant.

utilities-moving-from-coal-toward-gas-renewables-regardless-of-cpp/413822/ [https://perma.cc/NPU3-DX9B].

87. See Girouard, *supra* note 45. For example, in its most recent rate case, Consolidated Edison requested to increase their ROE to 9.75%, from 9.0%, while arguing that they really should be getting 10.3%. *Direct Testimony—Accounting Panel*, CONSOLIDATED EDISON CO. N.Y., INC. 1, 12 (2016), <https://legacyold.coned.com/2016-rate-filing/pdf/testimony-exhibits-gas/02-accounting-testimony-final.pdf> [https://perma.cc/TL9V-D5F7]. FPL also asked for a 11.5 percent authorized return on equity (currently 10.5 percent). To justify the increase, FPL says their current rates are 20 percent lower than the state average and 30 percent lower than the national average. *Docket Digest: News and Insights into the Latest Advanced Energy Dockets*, ADVANCED ENERGY ECON. (Jan. 25, 2016), https://info.aee.net/docket-digest-1-25-16?ecid=ACsprvuqRuAiGIJTrFgVbCApCDeAf7EaCYIH8y5F6o9SMoYxGj97Acs-gFIQLicNVAutmda3ucoO&utm_campaign=PowerSuite+Newsletter&utm_source=HS_email&utm_medium=email&utm_content=25585146&_hsenc=p2ANqtz-pc66J7P69zwRIICGtaxhmSCTCfdQenVDWeTRDIvTHCGDePjxluRvVd145RhsmThg-BtagKG-fW_nFVadhSWZJ7TCG4Q&_hsmi=25585146 [https://perma.cc/2L2Y-7ZBH].

88. See Game Over Data-set, *supra* note 76.

The difference in the average is not as great for settled rate cases versus fully litigated rate cases. However, utilities did get closer to their requested ROEs in fully litigated cases.⁸⁹

Authorized ROE – Requested ROE (Basis Points)	Settled	Fully Litigated
Vertically Integrated	-73	-63
T&D Only	-90	-87
Total	-78	-70

Looking at the average of all rate cases, the difference between what ROE was requested and what was authorized is slightly larger for settled cases. If a utility realizes they are unlikely to obtain an ROE closer to what they requested even when going through a fully litigated rate case, this may suggest that there may not be a benefit to contesting rate cases. However, the important difference highlighted with ROE data is how much better vertically integrated utilities appear to do than T&D only utilities.

2. ROE Variances

This is not to imply that some utilities did not get exactly what they wanted in terms of authorized ROE; they did.⁹⁰

Authorized ROE – Requested ROE (Minimum in Basis Points, Maximum in Basis Points)	Settled	Fully Litigated
Vertically Integrated	-200, 0	-275, 143
T&D Only	-143, 0	-129, 0

At least one utility in each sample group has a difference of zero between what they requested and what was authorized, indicating that they received the ROE level requested. However, there were obviously some cases where utilities had requested ROE levels far above what ended up being authorized, and only one where a utility commission granted a higher ROE than the company was requesting.

89. *See id.*

90. *See id.*

V. Staff Recommendations vs. Commission Authorized Rates

While not all rate cases have staff recommendations associated with them, those that do provide additional insight into the ratemaking process, as the staff is typically more focused on the consumer and often provides an in-depth analysis of what staff feels the utility needs to continue to be profitable.⁹¹ Fifty-one of the cases in this study had publicly-available staff recommendations, which breakdown into the following categories⁹²:

Cases with Staff Recommendations	Settled	Fully Litigated
Vertically Integrated	22 (43%)	19 (37%)
T&D Only	5 (10%)	5 (10%)

Vertically integrated cases make up a slightly higher percentage of this data set, accounting for eighty percent of the individual staff recommendations available.

As predicted, staff recommendations were generally more protective of ratepayers than the final commission decision, with thirty-six staff recommendations arguing for a lower rate change amount than the commission eventually ordered. Looking at the staff recommended rate change amount/requested rate change amount, as a percentage, and comparing that with what ended up being authorized, there is a marked difference between the average staff recommendation in three of the groups and what was finally agreed upon; for fully litigated rate cases for T&D only utilities, the average staff recommendation and the average commission decision were remarkably close. Reviewing the authorized rate change percentages for these fifty-one rate cases, the results are as follows⁹³:

91. Analysis contained in this section of the article.

92. See Game Over Data-set, *supra* note 76, at 23–38.

93. *Id.*

Staff Recommended Rate Change Amount / Requested Rate Change Amount, Authorized Rate Change Amount / Requested Rate Change Amount (%)	Settled	Fully Litigated
Vertically Integrated	34.1%, 48.8%	40.4%, 53.5%
T&D Only	32.1%, 68.6%	61.8%, 59.8%

The staff recommendations around ROE were similar to the authorized rate change percentages. The averages in each of the four subgroups indicate that the staff recommended a lower ROE than what the commission eventually ordered (the average staff recommendation is further from what was requested than is the average final commission order). The ROE data from fifty-one rate cases with publicly available staff recommendations are as follows⁹⁴:

Staff Recommended ROE – Requested ROE, Authorized ROE – Requested ROE (in Basis Points)	Settled	Fully Litigated
Vertically Integrated	-109, -85	-96, -61
T&D Only	-134, -109	-77, -74

The average final result is close to the average staff recommendation for fully litigated T&D only rate cases, which is also the only place where the average staff recommendation and the average commission decision are also very close. These results support the hypothesis that the staff is generally at the other end of the game from the regulated monopoly because their recommendations are farther away from what the utility requested, with the final commission decision between the two.

VI. Utility Responses

Given how often utilities do not receive their requested rate change amount or ROE, it might be assumed that they would be discouraged by the results.⁹⁵ To quantify how utilities and their investors

94. *Id.*

95. *See supra* Section IV.

reacted to rate case decisions, this article looks at two measures: (1) comments from earnings calls; and (2) stock price. These measures may indicate if utilities and their investors were expecting the average outcomes given based on playing the game.

A. Earnings Calls

The comments below are from the first quarterly or annual earnings calls, used by utilities to communicate with their investors, which occurred after a rate case decision. While not a statistically significant sample, especially as not all investor-owned utilities hold analyst calls, the message to investors around rate case proceedings in sampled transcripts were quite positive:

- For a settled rate case where the authorized rate case change was six percent of requested and the ROE 0.80 lower than requested⁹⁶:

Meanwhile, a billion plus transmission build is well under way with two of the lines completed in May and we filed an application this week for recovery under the rider approved as part of the Oklahoma rate case settlement. On the subject of the rate settlement, we remain on plan overall but our initial expectation for '12 was for a larger rate increase. However, the first quarter ground on, with our decision we began to plan for a potential modest increase. We lowered our base capital spending and operating plans that quarter to mitigate future regulatory lag. While we were reluctant to accept the settlement, we believe that accepting the 10.2 ROE and getting a rider for SPP transmission project, positions us for the future. The future including escalating environmental spend and continued transmission expansion. And given the circumstances we believe the settlement was in the best interest for the company.⁹⁷

96. Okla. Gas & Electric, Okla. Corp. Comm'n, Cause No. PUD 201100087, at 3, 15 (July 9, 2012), <http://imaging.occeweb.com/AP/Orders/OCC4306839.PDF> [<https://perma.cc/H666-Z7S9>].

97. Peter Delaney, Opening Remarks at the OGE Energy Corporation's Second Quarter 2012 Earnings Conference Call (Aug. 2, 2012, 9:00 AM), *in* SEEKING ALPHA, <http://seekingalpha.com/article/774991-oge-energy-ceo-discusses-q2-2012-results-earnings-call-transcript?page=2> [<https://perma.cc/KB8N-P4QN>] (transcript titled *OGE Energy's CEO Discusses Q2 2012 Results – Earnings Call Transcript*).

- For a settled rate case where the authorized rate case change was eighty-nine percent of requested and the ROE 0.60 lower than requested⁹⁸:

Though we were disappointed with certain aspects of the rate case orders, we executed on our commitment and achieved positive outcomes which we believe position us to maintain reliable service to our customers and reduce regulatory lag. Total annual revenue increase is nearly \$150 million with a weighted return on equity of 9.6%.⁹⁹

- For a fully litigated rate case where the authorized rate case change amount was fifty-four percent of requested and the ROE 0.87 lower than requested¹⁰⁰:

The West Virginia rate case outcome met our expectations of improved revenues to support the quality of service to our customers and improvement in the recurrent expectations with investments made at APCO. The order authorized an increase in rate with an ROE of 9.75% with additional revenues for vegetation management, confirmation of the base rate transfer of the Mitchell plant, resolution of the consolidated tax issue, among other areas that really set a positive tone for the future.¹⁰¹

98. KCP&L Greater Mo. Operations Co., Mo. Pub. Serv. Comm'n Order, Case No. 010912174-1 (Jan. 9, 2013), <https://psc.mo.gov/CMSInternetData/ON/Orders/2013/010912174-1.htm> [<https://perma.cc/T26J-STWH>].

99. Terry D. Bassham, Presentation at the Great Plains Energy Incorporated 2012 Fourth Quarter Year-End Earnings Call (Mar. 1, 2013, 9:00 AM), in SEEKING ALPHA, <http://seekingalpha.com/article/1240121-great-plains-energy-incorporated-management-discusses-q4-2012-results-earnings-call-transcript?page=3> [<https://perma.cc/WY48-PGD2>] (transcript titled *Great Plains Energy Incorporated Management Discusses Q4 2012 Results – Earnings Call Transcript*).

100. Appalachian Power Co., W. Va. Pub. Serv. Comm'n Order, Case Nos. 14-1152-E-42T & 14-1151-E-D, 25 (May 26, 2015), <http://www.psc.state.wv.us/scripts/WebDocket/ViewDocument.cfm?CaseActivityID=425587&NotType=%27WebDocket%27> [<https://perma.cc/S4UT-X5SV>].

101. Nicholas Akins, Opening Remarks at the American Electric Power Second Quarter 2015 Earnings Call (Jul. 23, 2015, 9:00 AM), in SEEKING ALPHA, <http://seekingalpha.com/article/3352095-american-electric-power-companys-aep-ceo-nicholas-akins-on-q2-2015-results-earnings-call-transcript?page=2> [<https://perma.cc/8BGE-LK3M>] (transcript titled *American Electric Power Company's (AEP) CEO Nicholas Akins on Q2 2015 Results – Earnings Call Transcript*).

- In a fully litigated rate case where the authorized rate case change was seventy-three percent of requested and the ROE 0.30 lower than requested¹⁰²:

[T]he Michigan Commission issued a final order to increase retail of electric rates by \$9.2 million annually effective on June 27 of this year. The new electric rates . . . reflect the substantial investments we've made in reliability, renewable energy, and environmental upgrades.¹⁰³

- In a settled rate case where the authorized rate case change was a decrease of below the current revenue and where the company had requested an increase and the ROE was 0.42 lower than requested¹⁰⁴:

In Colorado, the Commission approved our three-year electric regulatory plan. This constructive multiyear settlement provides rate certainty for our customers and revenue certainty for the company. This represents the second multiyear plan we have implemented in our Colorado electric business and we believe that this agreement can serve as blueprint for our pending natural gas rate case.¹⁰⁵

- In a litigated rate case where the authorized rate case change was sixty percent of requested and the ROE was 0.53 lower

102. Wis. Elec. Power Co., Mich. Pub. Serv. Comm'n Order, Case No. U-16830, 1-2 (Oct. 31, 2012), http://www.michigan.gov/documents/mpsc/u-16830_10-31-2012_566163_7.pdf [<https://perma.cc/MX6X-Y28V>].

103. Gale Klappa, Presentation at the Wisconsin Energy's Conference Call Reviewing the 2012 Second Quarter Results (Aug. 1, 2012, 2:00 PM), in SEEKING ALPHA, <http://seekingalpha.com/article/771871-wisconsin-energys-ceo-discusses-q2-2012-results-earnings-call-transcript?page=4> [<https://perma.cc/39E4-ZF8C>] (transcript titled *Wisconsin Energy's CEO Discusses Q2 2012 Results – Earnings Call Transcript*).

104. Pub. Serv. Co. of Colo., Colo. P.U.C. Dec. No. C15-0292, Docket No. 14AL-0660E, 2-3 (Feb. 24, 2015), <https://www.xcelenergy.com/staticfiles/xcel-responsive/Company/Rates%20&%20Regulations/Regulatory%20Filings/CO-Filing-CACJA-Attachment-MAM-2.pdf> [<https://perma.cc/8W5C-2JBQ>].

105. Benjamin G.S. Fowke, Presentation at the Xcel Energy's First Quarter 2015 Earnings Conference Call (Apr. 30, 2015, 10:00 AM), in SEEKING ALPHA, <https://seekingalpha.com/article/3124116-xcel-energy-xel-benjamin-g-s-fowke-on-q1-2015-results-earnings-call-transcript> [<https://perma.cc/2ENR-GFAW>] (transcript titled *Xcel Energy (XEL) Benjamin G. S. Fowke on Q1 2015 Results – Earnings Call Transcript*).

than requested¹⁰⁶: “[W]e believe the final result was a reasonable outcome.”¹⁰⁷

Therefore, while this is not a statistically valid sample, it seems that utilities anticipate receiving around the averages listed above. Based on the earnings calls, the utilities appear to use something like the averages found in the previous section to plan their revenue forecasts, and, therefore, are not expressing dismay to the investor community when they receive only a portion of what they requested.

B. Investor Sentiment

As most investor-owned utilities are publicly traded,¹⁰⁸ one measure of investor reaction to rate case decisions is the difference between the stock price at the open of the market on the date the rate case decision was announced and the close of the market three months later.¹⁰⁹ The difference in stock price may indicate whether investors thought utilities could continue to be profitable given the regulatory environment:

Average % Change in Stock Price	Settled	Fully Litigated	Total
Vertically Integrated	3.0%	3.3%	3.1%
T&D Only	2.8%	-2.1%	0.7%

106. N. States Power Co., Minn. P.U.C. Order, Docket No. E-002/GR-13-868, 7 (May 8, 2015), <https://www.edockets.state.mn.us/EFiling/edockets/searchDocuments.do?method=showPop&documentId={F0F2C116-A233-426F-8726-FCB2FD40A1A1}&documentTitle=20155-110264-01> [<https://perma.cc/7X96-TRJ8>]. Calculations are available on Game Over Data-set, *supra* note 76, at 13.

107. See Fowke, *supra* note 105, at 2.

108. See generally *Utilities Stocks on U.S. Exchanges*, INVESTSNIPS, <http://investsnips.com/complete-list-of-utilities-listed-on-u-s-exchanges/> [<https://perma.cc/ZHT9-BH6Z>] (providing links to Large-Cap Utility Stocks, Mid-Cap Utility Stocks, and Small-Cap Utility Stocks); *The 122 Largest Electric Utilities in America*, MEGAWATT MEDIA, <http://negawattmedia.com/JustRight/images/utilities%20122%20largest.pdf> [<https://perma.cc/KZB6-REKY>].

109. I acknowledge that this is an imperfect metric, as many factors can influence the stock price of a particular company. Additionally, some energy companies are owned by much larger conglomerates, which may blunt the impact of individual rate case decisions on the stock price of the publicly-traded parent company. For example, MidAmerican, NV Energy, and PacifiCorp are owned by Berkshire Hathaway. Also, for some rate case proceedings which completed less than three months before this study, the date of June 3, 2016, was used as the end of the period.

The same is true when looking across rate cases that are settled versus those that are fully litigated in total:

Average % Change in Stock Price	Settled	Fully Litigated
Vertically Integrated	3.0%	3.3%
T&D Only	2.8%	-2.1%
Total	3.0%	1.5%

As this data shows, while investors may not be, on average, excited when a rate case concludes, it does not seem that investors are expecting anything other than the status quo for the game to play out exactly as it currently is and has been. The market does not seem to punish utilities when they receive around half of what they are asking for. It seems as though these results were expected if neither utilities nor investors are upset by the general outcome of rate cases.

VII. Regulatory Negotiation Theory: Is This What We Would Expect? And Does It Matter?

Philip Harter proposed the first detailed process of regulatory negotiation in 1982.¹¹⁰ He outlined various factors and components that he believed were necessary for successful regulatory negotiations.¹¹¹ However, the potential positives and negatives of regulatory negotiation have changed over the years, and several studies represent how these changes affect the expected negotiation outcomes. Today, the expected outcomes of regulatory negotiation can be analyzed using the following: (1) Philip Harter's initial view of the process in 1982; and (2) empirical studies representing the changes in advantages and disadvantages associated with the outcomes of regulatory negotiations.

A. Philip Harter's Initial Proposal of Regulatory Negotiation

While Harter proposed multiple criteria for successful regulatory negotiation, eight of the criteria endorsed by the Administrative Conference of the United States seem especially relevant to regulatory ne-

110. See William Funk, *Bargaining Toward the New Millennium: Regulatory Negotiation and the Subversion of the Public Interest*, 46 DUKE L.J. 1351, 1351 (1997).

111. See generally Philip J. Harter, *Negotiating Regulations: A Cure for Malaise*, 71 GEO. L.J. 1 (1982) (discussing all the variables Harter believed were necessary for successful regulatory negotiations).

gotiation.¹¹² First, people will come to the bargaining table only if they believe a negotiation will produce an outcome as good as, or better than, other available methods of pursuing their own best interests.¹¹³ Second, the relative power of the parties determines the acceptability of negotiation as a dispute resolution—negotiations will only proceed if the parties are interdependent.¹¹⁴

Third, the number of parties must be limited to a workable number: fifteen parties is considered the rough maximum number of participants that can work together effectively in a negotiated rulemaking.¹¹⁵ Fourth, the issues must be evident and the parties must be ready to address them.¹¹⁶ Fifth, if values are incontrovertible, compromises and collaborative problem solving is unlikely.¹¹⁷ Sixth, there must be two or more issues on the table so that parties can maximize their overall interests by bundling or trading issues.¹¹⁸ Seventh, it is necessary to create a deadline.¹¹⁹ Without a deadline, parties may purposefully delay or fail to reach an agreement.¹²⁰ Finally, there must be a method of implementing the final agreements so that parties believe their participation was worthwhile.¹²¹

In addition to the aforementioned criteria of success, Harter believed that negotiation has several advantages over the typical adversarial process.¹²² For instance, the parties can participate “directly and immediately” in the decisions by sharing and concurring, rather than “participate” by relaying information that the decision-maker considers when making the decision.¹²³ Participants in negotiations can make substantive decisions, instead of simply acting as experts in the decision-making process.¹²⁴ Negotiation can be less expensive than a normal adversary process because it reduces the need for defensive research in anticipation of adversarial arguments.¹²⁵ For Harter, the primary benefit of regulatory negotiation is that participants can focus

112. See Lawrence Susskind & Gerard McMahon, *The Theory and Practice of Negotiated Rulemaking*, 3 YALE J. ON REG. 133, 138–39 (1985).

113. See *id.* at 139.

114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.*

118. See *id.* at 139–40.

119. *Id.* at 140.

120. *Id.*

121. *Id.*

122. See Harter, *supra* note 111, at 28.

123. *Id.*

124. *Id.*

125. *Id.*

solely on their respective interests, without having to advocate and maintain positions before a decision-maker.¹²⁶ Harter points out that “[r]ulemaking by negotiation can reduce the time and cost of developing regulations by emphasizing practical and empirical concerns rather than theoretical predictions.”¹²⁷

Over the years since Harter’s initial proposals on regulatory negotiation, many analysts have performed empirical studies to discover the actual advantages and disadvantages brought by the outcomes of negotiated rulemakings.

B. Empirical Studies of Regulatory Negotiation

Early empirical evidence of regulatory negotiation outcomes began to emerge in the late 1980’s and 1990’s.¹²⁸ Most of these studies ignored advocates’ theoretical claims that regulatory negotiation would improve rule quality and increase legitimacy, and instead they focused on factors such as time, cost, and litigation rates.¹²⁹ The Environmental Protection Agency (“EPA”) produced one of the first studies, which examined the first seven regulatory negotiations in which the EPA took part.¹³⁰ The study concluded that negotiated rulemakings took approximately half the time and money to perform than was ordinarily spent to collect and analyze data and to respond to public comments.¹³¹ However, it was acknowledged that this data was inconclusive to whether negotiation resulted in a net saving of resources.¹³² In 1997, Cary Coglianese analyzed thirty-five negotiated rulemakings to determine whether the regulatory negotiation process achieved the instrumental goals of reducing both rulemaking time and legal challenges to agency rules.¹³³ He concluded that negotiated rulemaking resulted in only a small savings in time compared to conventional rulemaking.¹³⁴ Regulatory negotiation came out to be 2.8 years, or 1013 days, while conventional rulemaking resulted in 3.0 years, or 1108 days.¹³⁵ Coglianese further concluded that regulatory negotia-

126. *Id.* at 29.

127. *Id.* at 30.

128. See Jody Freeman & Laura I. Langbein, *Regulatory Negotiation and the Legitimacy Benefit*, 9 N.Y.U. ENVTL. L. J. 60, 75 (2000).

129. *Id.*

130. *Id.* at 61, 75.

131. *Id.* at 75.

132. *Id.* at 75–76.

133. See generally Cary Coglianese, *Assessing Consensus: The Promise and Performance of Negotiated Rulemaking*, 46 DUKE L.J. 1255 (1997).

134. See *id.* at 1282–84.

135. See *id.*

tion actually resulted in higher rates of litigation.¹³⁶ Conventional rulemaking produced a baseline frequency of litigation around twenty-six percent, with major rules promulgated by the EPA slightly higher at thirty-five percent.¹³⁷ However, regulatory negotiation rulemaking by the EPA had a fifty percent rate of litigation.¹³⁸

Unlike the aforementioned studies, Kerwin and Langbein introduced a more detailed, two-phase empirical study of regulatory negotiation to try to discover the true outcomes.¹³⁹ In phase I, Kerwin and Langbein interviewed by phone over one hundred negotiated rulemaking participants.¹⁴⁰ They questioned the participants on several topics, including their decision to participate in the negotiation, how the issues were established, how conflicts were resolved, the extent of how and what they learned, and the reasons for, and extent of, satisfaction with the final rule produced.¹⁴¹ Overall, participants rated the process and their personal experience with regulatory negotiation as strongly and widely positive, with the benefits outweighing the costs.¹⁴²

In the second phase of the study, Kerwin and Langbein compared regulatory negotiation to conventional rulemaking, specifically whether regulatory negotiation reduces conflict, is fairer to the regulated parties, can settle more complex rules, and is more costly than conventional rulemaking.¹⁴³ First, they concluded that, overall, negotiated rulemaking is more consensual and reduces conflict more than conventional rulemaking.¹⁴⁴ Second, the results support the conclusion that regulatory negotiation is at least as fair, if not more fair, than conventional rulemaking.¹⁴⁵ Third, the results suggest that the agency is equally responsive to participants whether engaging in negotiated or conventional rulemaking.¹⁴⁶ Fourth, they conclude that complex rules are more likely to be settled through negotiated rulemaking.¹⁴⁷ Lastly, the study's results suggest that regulatory negotiation is no

136. *See id.* at 1298–1301.

137. *See id.*

138. *See id.* at 1301–02.

139. *See* Freeman & Langbein, *supra* note 128, at 78.

140. *Id.* at 79.

141. *Id.* at 79–80.

142. *See id.* at 82–104, for a detailed breakdown of the percentages associated with each part of the process.

143. *Id.* at 105.

144. *Id.* at 109–13.

145. *See* Freeman & Langbein, *supra* note 128, at 114.

146. *Id.* at 115.

147. *Id.* at 117–19.

more costly than conventional rulemaking.¹⁴⁸ Overall, both phase I and phase II of Kerwin and Langbein's study suggest that regulatory negotiation is superior to conventional rulemaking.¹⁴⁹

While there is still an ongoing dispute as to whether regulatory negotiation or conventional rulemaking is more efficient overall, the real question is whether these theories should hold true for regulated monopolies.

C. Should Normal Regulatory Negotiation Theories Apply to Regulated Monopolies? And Does It Matter?

There are several reasons why what occurs during rate cases (and the resulting impact to the electricity consuming public) is important and why normal negotiation theory should not apply. The first is the basic tenet of monopolies: utilities should only request what they need, given that they have no competition; a monopolistic utility company should not attempt to gain more for investors than completely necessary.¹⁵⁰ However, given Harter's conditions for regulatory negotiation, it seems that regulated monopoly utilities would certainly ask for more than they need, both in terms of authorized return and ROE.¹⁵¹ If this were not the case, and utilities actually required everything they were asking for in rate cases, we should expect significant deterioration of the grid, lack of capital expenditures, and rolling blackout and brownouts due to the inability to attract investors.¹⁵²

However, the American public has experienced nothing of the sort—indicating that monopoly utilities have been able to meet customer requirements and obtain sufficient investor capital despite the lower-than-requested revenue and lower-than-requested ROE.¹⁵³

148. *Id.* at 120–21.

149. *Id.* at 121.

150. See Kimberly Amadeo, *How Monopolies Impact the Economy*, BALANCE (Oct. 21, 2017), <https://www.thebalance.com/monopoly-4-reasons-it-s-bad-and-its-history-3305945> [https://perma.cc/7P36-38CN].

151. The empirical data presented earlier in this article also suggest that is the case.

152. Investors anticipate certain results from rate cases. Less than expected returns would likely cause investors to abandon the companies. See *supra* Section VI(B). Insufficient financial support may lead to a lack of available capital to invest in needed infrastructure causing utilities to fail. See also Girouard, *supra* note 45.

153. According to the North American Electric Reliability Corporation (“NERC”), the bulk power system “provided an adequate level of reliability” during 2016, including no category 4 or 5 events, a decline in protection system misoperation, an improvement in frequency response, no loss of load events from cyber or physical attacks, and an improvement in resiliency to severe weather. *State of Reliability 2017*, N. AM. ELECTRIC RELIABILITY CORP. (June 2017), <http://www.nerc.com/pa/RAPA/PA/Performance%20Analysis%20>

The second reason why what happens during rate cases is important—and why normal negotiation theory should not apply—is the lack of meaningful public participation in the process. Rate cases tend to be so complex that meaningful public dialog is impossible, which leads to situations where agency capture is more likely to occur.

Third, rate cases utilize resources. These resources include PUC staff and commission time. Other resources include lawyers for the utility and intervenors. Generally, intervenors are entities other than the utilities and PUC staff, such as consumer advocates (e.g., AARP); environmental groups; groups of high usage users (e.g., a consortium of industrial customers); or individual companies (e.g., Walmart) and municipalities (e.g., New York City). Longer rate cases may make more sense from an expenditure perspective. However, these are only in the ratepayer interest if there is sufficient data and performance mechanisms in place to ensure the monopoly utility performs as required.¹⁵⁴ Further, this may be a significant outlay of resources in relation to availability, especially for intervenors, and also for PUC staff with some dockets.¹⁵⁵ Efficiency would argue for rate cases to be done in the most resource-efficient manner that protects the public interest. However, given these results, it appears that utilities are consistently requesting more than they need—both in authorized return and ROE.

The question then becomes how to stop the game and allow ratepayers to benefit. One place to start would be by recognizing that regulatory negotiation theory should not apply to regulated monopolies.

VIII. Potential Solutions

Let's all be honest: “[t]here’s nothing we can offer utilities that’s better than what they have now, which is a complete monopoly.”¹⁵⁶ Any customer-based and customer-facing solution could easily be in

DL/SOR_2017_MASTER_20170613.pdf [https://perma.cc/227R-TW2G]. The one area that went the wrong way was transmission outages caused by human error. *Id.* at vi.

154. See Payne, *supra* note 4, at 38–43.

155. Charlie Harak, John Howat & Olivia Wein, *A Consumer’s Guide to Intervening in State Public Utility Proceedings*, NAT’L CONSUMER L. CTR., at iii (Mar. 2004), https://www.nclc.org/images/pdf/energy_utility_telecom/additional_resources/consumers_guide.pdf [https://perma.cc/HG2T-AVM9] (“Clearly, participation before PUCs requires time and financial resources, and a working knowledge of the legal rules and political dynamics that drive PUC decision-making.”).

156. Katherine Tweed, *David Crane’s 5 ‘Easy’ Steps to Tackling Climate Change*, GREENTECH MEDIA (Nov. 12, 2015), http://www.greentechmedia.com/articles/read/david-cranes-5-steps-to-tackle-climate-change?utm_source=daily&utm_medium=newsletter&utm_campaign=GTMDaily [https://perma.cc/ZR4U-4NSH].

opposition to the profit expected by the investors of investor-owned utilities. In addition to not wanting to change, the industry acknowledges that it is unprepared to deal with—much less accept or welcome—changing business models. Over eighty percent of industry experts surveyed said that the industry was not prepared for changes in utility business models and increasing distributed generation, with the most pessimistic group being investor-owned utilities.¹⁵⁷ However,

[t]here are two Americas when it comes to grid modernization. On the one hand, there are states that are moving toward more open market solutions with shared ownership, community choice models, auctions (like California's recent demand response auction), consumer data policies and bring-your-own-device programs. And on the other hand, there are states that are more inclined toward expanding the vertical integration model with, for example, utility ownership of rooftop solar. We expect . . . more examples of these two pathways, especially with respect to rate reform, distributed energy and system operations.¹⁵⁸

Despite the two Americas, there are potential solutions that could help stop the game in each regulatory model.

A. Market Solutions

Further implementing market solutions certainly could be one potential solution. “Competitive markets, not monopoly structures, provide the best incentives to identify what customers want”¹⁵⁹ Additionally, on the granted ROE versus requested ROE metric, the difference was significant between vertically integrated utilities and T&D only utilities. This could indicate that market forces better meet customer needs where only T&D is regulated, but generation and re-

157. Nicholas Rinaldi, *Are Utilities Prepared for a Next-Gen Power Grid? Survey Says 'Not So Much'*, GREENTECH MEDIA (Jan. 14, 2016), http://www.greentechmedia.com/squared/read/Are-Utilities-Prepared-for-a-Next-Gen-Power-Grid-Survey-Says-Not-So-Much?utm_source=squared&utm_medium=weeklyPromo&utm_campaign=GTMSquared [https://perma.cc/EKW3-SJUK].

158. *Nine from January 201*, WHY 9? (E9 Energy Insight, Boulder, Colo.), Feb. 2, 2016, at 8 (on file with author); see also Bronski et al., *supra* note 3, at 13 (“The electricity system is at a metaphorical fork in the road. Down one path are pricing structures, business models, and regulatory environments that favor non-exporting solar and solar-plus-battery systems. When economic and other conditions reach the right tipping point, this trajectory favors true grid defection. . . . Down another path are pricing structures, business models, and regulatory environments in which distributed energy resources such as solar PV and batteries—and their inherent benefits and costs—are appropriately valued as part of an integrated grid.”).

159. REV4NY, *Richard Kaufmann's REV4NY Exchange 2015 Keynote*, YOUTUBE (Dec. 29, 2015), <https://www.youtube.com/watch?v=D52TxVEoyS0> [https://perma.cc/6HEH-FXU2] (recording of Richard Kauffman's Keynote given on Sep. 24, 2015).

tail operations are competitive. Given that T&D only utilities also obtain a lower percentage of their requested revenue, based on this article's set of data, markets seem to be a positive influence on the game.

New York's Reforming the Energy Vision ("NY REV") process aims, in part, to increase competition and decrease the revenue T&D utilities earn from regulated businesses. NY REV's focus on the market—to stop the game and provide customers with value—is indicated by the movement towards: (1) locational marginal pricing for distributed resources; (2) the ability to aggregate distributed resources and sell those resources into the wholesale market; and (3) the call for more private capital rather than rate-based capital in addition to revenue changes.¹⁶⁰

Similarly, California is undergoing a regulatory reform process that works to ensure third parties know where distributed resources have the highest value to the grid. California is actively determining ways that those resources can be deployed, as they will be a lower-cost alternative to utilities continuing business-as-usual.¹⁶¹ Ordinarily, reducing capital spending would negatively impact the utilities' rate base and, therefore, their profit. To blunt utility objection, the California PUC has suggested giving the utilities some profit on third party assets, as that would still be cheaper than having the utilities continue their infrastructure spend.¹⁶² These examples demonstrate how markets could minimize the game. However, as noted by one commenter, "it's still regulators driving the effort, with the utilities in their usual high-inertia, reactive mode."¹⁶³

The difference between markets and vertically integrated utilities also shows up in generation choices. Southern Company ("South-

160. Robert Walton, *New York REV Orders Promise Growth for Diverse Set of Distributed Resources*, UTILITY DIVE (Mar. 15, 2017), <http://www.utilitydive.com/news/new-york-rev-orders-promise-growth-for-diverse-set-of-distributed-resources/438044/> [<https://perma.cc/9WPM-7J8N>]; *REV Demo Projects*, N.Y. ST.: REFORMING THE ENERGY VISION, <https://rev.ny.gov/rev-demo-projects-1> [<https://perma.cc/9QZ4-ME6U>]; *About REV*, N.Y. ST.: REFORMING THE ENERGY VISION, <https://rev.ny.gov/about/> [<https://perma.cc/9P2A-Q6D4>].

161. SOLARCITY, A PATHWAY TO THE DISTRIBUTED GRID 6 (Feb. 2016), http://www.solarcity.com/sites/default/files/SolarCity_Distributed_Grid-021016.pdf [<https://perma.cc/U3GM-CGCF>].

162. *See id.* at 19.

163. Eric Wesoff, *TFC Wants to Design Its Own 21st Century Utility—and It's Starting With GridPoint*, GREENTECH MEDIA (Nov. 16, 2015) http://www.greentechmedia.com/articles/read/TFC-Wants-to-Design-its-Own-21st-Century-Utility-And-Its-Starting-With-GridPoint?utm_source=daily&utm_medium=newsletter&utm_campaign=GTMDaily [<https://perma.cc/KMD4-K2ZT>].

ern”), for example, is building two new reactors, although merchant nuclear generators are shutting down reactors with years, and sometimes decades, remaining on their operating licenses because they are simply unprofitable.¹⁶⁴ Along with investments in carbon capture and sequestration (“CCS”), another technology with no market support but government subsidies, vertically integrated utilities are making generation decisions that will saddle their ratepayers with billions in expenses for decades to come.¹⁶⁵ Those in deregulated markets are not making the same decisions.

In a Wall Street Journal interview, Thomas Fanning, the chief executive officer of Southern, and David Crane, the former chief executive officer of NRG Energy, Inc., discussed their differing approaches to clean energy.¹⁶⁶ There, Mr. Crane highlighted that Southern’s work with nuclear and CCS “essentially demonstrated that those two technologies are not cost effective.”¹⁶⁷ Mr. Crane also noted that diversification of generation portfolios work for vertically integrated utilities because they get “cost basis passed through the public service commissions of various states.”¹⁶⁸

Albeit not always in the way utilities want, another recent example showing that markets work is the combined requests of American Electric Power and First Energy to the Ohio PUC. Although operating in a deregulated market where generation and T&D operations were separated by a firewall, the firms found themselves in a bind (profit-wise) on the deregulated generation side.¹⁶⁹ Realizing that their coal plants were less profitable than the natural gas capacity coming online in the area where wholesale electricity is coordinated by PJM (a regional transmission organization), both companies requested profit

164. See *Plant Vogtle Over Budget and Behind Schedule*, WJBF NEWS CHANNEL 6 (July 10, 2017, 7:41 AM), <http://wjbf.com/2017/07/10/plant-vogtle-over-budget-and-behind-schedule/> [hereinafter *Plant Vogtle*] [<https://perma.cc/3WDC-W7HD>]; Timothy Cama, *Two Ohio Coal Plants to Close*, THE HILL (Mar. 20, 2017, 4:39 PM), <http://thehill.com/policy/energy-environment/324857-two-ohio-coal-plants-to-close> [<https://perma.cc/Z86S-NSJV>].

165. Henry Fountain, *In Blow to ‘Clean Coal,’ Flawed Plant Will Burn Gas Instead*, N.Y. TIMES (June 28, 2017), <https://www.nytimes.com/2017/06/28/climate/kemper-coal-mississippi-clean-coal-project.html> [<https://perma.cc/MEE7-2VXE>].

166. *Two Utilities, Two Approaches to Clean Energy*, WALL STREET J. (Apr. 12, 2016, 7:22 PM), <http://www.wsj.com/articles/two-utilities-two-approaches-to-clean-energy-1460503343> [<https://perma.cc/GW7Q-X8L2>].

167. *Id.*

168. *Id.*

169. Jeffrey Tomich, *Regulators Approve Plans to Ensure Plants’ Profitability*, ENERGYWIRE (Apr. 1, 2016), <http://www.eenews.net/energywire/2016/04/01/stories/1060034923> [<https://perma.cc/WD77-RBMT>].

guarantees for their generation business.¹⁷⁰ Essentially, this required their T&D customers to make their generation assets profitable when they otherwise would not be.¹⁷¹ While the PUC acknowledged that “[g]enerators that not long ago sought the upside of free markets have come scrambling back seeking protection from regulators,” the PUC has nonetheless agreed to guarantee profitability for the deregulated generation assets by adding a rider to every T&D customer’s bill, making up the expected difference between what it will take to operate the legacy plants and what those plants will be able to sell their power at on the wholesale market.¹⁷² The PUC made this decision, even though it acknowledged that low natural gas and wholesale electricity prices were good for consumers.¹⁷³

This turn of events—deregulated utilities arguing that they may request to be re-regulated in order to obtain guaranteed profits, rather than letting markets work—is not how we have typically thought of regulation. “Now, conservationists are arguing for market competition while utilities struggle to protect their monopolies. Environmentalists are seeking a level playing field, while power companies ask for bailouts.”¹⁷⁴ However, this example demonstrates that market forces can provide potential solutions, at least in generation. For the game to stop in regulated portions of the utility business, more work needs to be done. That is especially true for vertically integrated utilities, which have no market forces driving change.

B. Vertically Integrated Utilities: Where Market Solutions Will Not Work

“Decades ago, state or local utilities controlled their own power plants, transmission lines, and delivery systems, operating as vertically integrated monopolies in confined geographic areas.”¹⁷⁵ While this situation no longer exists in much of the country where deregulation

170. *Id.*

171. See *id.*

172. *Id.*

173. *Id.* The PUCO also noted that “[w]hile such low prices present benefits for consumers, they present challenges for those providing utility services.” *Id.*

174. Dick Munson, As Utilities Embrace Change, FirstEnergy’s Strategy Is Resistance and Protectionism, GREENTECH MEDIA (Aug. 21, 2015), http://www.greentechmedia.com/articles/read/as-utilities-embrace-change-firstenergys-strategy-is-resistance-and-protect?utm_source=SmartGrid&utm_medium=headline&utm_campaign=GTMDaily [https://perma.cc/AZ46-N67 F].

175. Elta Kolo & Andrew Mulherkar, SCOTUS Decision Results in \$200M Impact on Demand Response in 2016, GREENTECH MEDIA (Jan. 26, 2016), <http://www.greentechmedia.com/articles/read/scotus-decision-to-make-a-200-million-impact-on-a-diversifying-dr-in>

and wholesale markets allow market forces to set prices, vertically integrated utilities still exist in parts of the country, and state PUCs still determine, often with little public input, the utilities' profits as well as the assets used to calculate those profits.¹⁷⁶

One reason traditionally given for vertically integrated utilities—and, therefore, for the slower rate of change or adoption of market reforms in those territories—is lower electricity rates.¹⁷⁷ However, these rates do not take the externalities of historically high coal generation into account.¹⁷⁸ Even where utilities are gradually transitioning to lower percentages of coal generation, the costs of historic coal use, such as the cleanup of coal ash ponds and groundwater contamination, will be borne by ratepayers.¹⁷⁹ For investor-owned utilities, this really is the best of all possible worlds, as investors shoulder none of the potential costs. And, as shown in the data in Section IV, vertically integrated utilities get a slightly higher percentage of their requested rate case amount and, on average, do get closer to their requested ROE than T&D only utilities. These comparisons demonstrate that the game is likely both well-understood and mutually acceptable to vertically integrated utilities and their regulators.

How, then, to change the game in this situation? Absent prompting from regulators, it is unlikely that utilities and the financial markets that support them will readily accept any change that leads to lower returns. Without markets to spur change, more customer involvement, or a change in regulatory acceptance of the game, it would seem unlikely that movement would occur.

Integrated resource plans (“IRP”s), required by many states for monopoly utilities, could be reformed to include more public disclosure of policy decisions and more public input, specifically around what assumptions are being made (which typically benefit the utility)

dustry?utm_source=daily&utm_medium=newsletter&utm_campaign=GTMDaily [https://perma.cc/8G3E-NAMP].

176. See Heather Payne, *A Long Slog: What a Ten Year Hydroelectric Relicensing Process Demonstrates About Public Participation and Administrative Regulation Theories*, 53 *IDAHO L. REV.* 41, 43 (2017).

177. Diane Cherry, *Full Q&A with North Carolina Utilities Commissioner Don Bailey!*, N.C. ST. U. INST. FOR EMERGING ISSUES (Jan. 26, 2016), <https://iei.ncsu.edu/wp-content/uploads/2016/01/Full-Text-Comm.-Don-Bailey-QA.pdf> [https://perma.cc/78FV-S9ZM].

178. See *The True Cost of Fossil Fuels*, SKEPTICAL SCIENCE, <https://skeptical-science.com/renewable-energy-is-too-expensive.htm> [https://perma.cc/Q7PJ-2K7N].

179. See Joe Romm, *Life-Cycle study: Accounting for total harm from coal would add “close to 17.8¢/kWh of electricity generated,”* THINKPROGRESS (Feb. 16, 2011, 2:30 PM), <https://thinkprogress.org/life-cycle-study-accounting-for-total-harm-from-coal-would-add-close-to-17-8-kwh-of-electricity-6e2ca8efc44a/> [https://perma.cc/85HV-3HHG].

and what alternatives are available. This could also require additional public data disclosure, including of data that monopolies have traditionally viewed as confidential. By enabling a more transparent process, IRP reforms could change how decisions are made, at least lessening the impact of the game during later ratemaking proceedings.

By accepting the hypothesis that regulatory negotiation theory should not apply to regulated monopolies, completely stopping negotiations could be one method that could change the game. This could take the form of requiring all information to be available to public staff and to give them enough time to review the data provided by the utility. This could also include an independent manager, an individual or a team who would have access to all the data and have project management and financial expertise. Independent managers, in addition to public staff, could counter the utility's explanation of policy and expenditures. If this were to fall to public staff, their recommendation could actually go into effect, rather than what happens now where it is simply a starting place from which the utility negotiates towards its preferred outcome. For example, two independent managers have been employed by the Georgia Public Service Commission to specifically follow the new Vogtle reactor project, and they indicated far earlier than the utility that there were both major cost overrun and schedule concerns.¹⁸⁰ One of the current disparities is around operational data. Increasing the access to this data for public staff, independent managers, intervenors and the public could decrease this disparity.¹⁸¹

180. Kristi E. Swartz, *Warnings on Vogtle Go Back to Its Inception*, E&E NEWS (July 24, 2017) <https://www.eenews.net/energywire/2017/07/24/stories/1060057754> [<https://perma.cc/WJ7R-LQCL>]; see also *Plant Vogtle*, *supra* note 164; see also *Cama*, *supra* note 164.

181. Current utility business models are being threatened by distributed energy resources. While it would be most beneficial for customers to have these cited where they would also be the most beneficial to the grid, utilities are attempting to block access to this grid-level information, likely because they understand others can make the investments and solve potential grid problems more cheaply, which would, in turn, continue to erode the new capital assets being added to the rate base, further decreasing their profits. See Herman K. Trabish, *Have California's Efforts to Value Distributed Resources Hit a Roadblock?*, UTILITY DIVE (Mar. 21, 2017), <http://www.utilitydive.com/news/have-californias-efforts-to-value-distributed-resources-hit-a-roadblock/438400/> [hereinafter *California's Efforts*] [<https://perma.cc/URP8-2KC9>] ("What the tool does not yet do is 'proactively identify those [DER] values across the entire distribution and transmission system,' Monbouquette said. 'They have to be input.'"); O'Boyle, *supra* note 3 ("Today's technologies and big data fundamentally change the suite of options for delivering an affordable, reliable[,] and clean electric system. As power system optimization options proliferate, regulators find themselves in an era of rising information asymmetry vis-à-vis the utility."); Herman K. Trabish, *How California's biggest utilities plan to integrate distributed resources*, UTILITY DIVE (July

Another thing that could change the thinking around whether negotiation theory should apply to regulated monopolies is additional judicial oversight.

C. Additional Judicial Oversight

Another way that the game could be stopped, in both vertically integrated and deregulated markets, is with additional judicial oversight. This would not be completely without precedent; in *Bluefield Water Works & Improvement Co. v. Public Service Commission*, the Supreme Court did not shy away from actually determining an appropriate rate of return.¹⁸² Perhaps most interestingly, the Court said that utilities are entitled to a return:

[E]qual to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties; but it has no constitutional right to profits such as are realized or anticipated in highly profitable enterprises or speculative ventures.¹⁸³

Now, of course, regulated monopolies earn a steadily higher rate of return for their investors than non-monopoly industrial conglomerates, their closest kin, which is precisely why so many retirees on fixed incomes own utility stocks.

While *Federal Power Commission v. Hope Natural Gas Company* seemed to limit the scope of the federal courts' judicial inquiry in such cases, at least to some degree, this does not mean that state courts could not assume a more inquisitive stance when rate cases are challenged.¹⁸⁴ Indeed, more vigorous oversight to ensure that regulated monopoly utilities are not expecting "profits such as are realized or anticipated in highly profitable enterprises or speculative ventures" seems to be warranted.¹⁸⁵

One word of caution, however, on this path forward: many administrative law judges, or state judges whom sit for anything other

7, 2015), <http://www.utilitydive.com/news/how-californias-biggest-utilities-plan-to-integrate-distributed-resources/401805/> [hereinafter *Plan to Integrate Distributed Resources*] [<https://perma.cc/9CH3-SVG7>] ("Each utility was required to provide an Integration Capacity Analysis to 'specify how much DER hosting capacity may be available on the distribution network.' This must be a granular analysis and documented 'down to the line section or node level' or 'on a select set of representative circuits, including all related line sections.'").

182. 262 U.S. 679, 694–95 (1923).

183. *Id.* at 692–93.

184. 320 U.S. 591, 602–03 (1944).

185. *Bluefield Water Works & Improvement Co.*, 262 U.S. at 692–93.

than a retention election, may feel pressured by the significant political sway of incumbent utilities, especially as many vertically integrated utilities lobby extensively to protect their monopoly status. In a heavily politicized environment, a change to how Article III judges review cases may be the only path forward, albeit one unlikely to open in the near term.

Additionally, of course, this would only apply when an attorney general or an intervenor decided to litigate, which, based on the rate cases presented earlier, is about forty three percent of the time.¹⁸⁶ Without a contested case, judicial review would be impossible.

Conclusion

Current regulatory frameworks are not sufficiently protective of the public interest.¹⁸⁷ Regulated monopoly utilities continue to request ever-increasing amounts of spending and get approximately half of what they ask for.¹⁸⁸ Meanwhile utility customers, who do not have a choice other than grid defection, continue to pay more.¹⁸⁹ While the theory of regulatory negotiation appears to currently apply to ratemaking proceedings and PUCs demonstrate some amount of agency capture, both should be stopped. A better regulatory framework must be found for regulated monopolies. Competition for generation assets has decreased the price of generation substantially for consumers in markets where that competition has been allowed.

Some states are forming plans to allow more competition for capital into their regulated utilities. Both California and New York have dockets underway that would aid transparency and lower costs by mandating the regulated utility not only put out a specific need, but rather define the problem, including how much it would cost the incumbent utility to solve using their preferred solution.¹⁹⁰ Therefore, if

186. See *supra* table accompanying note 78.

187. "I think it's really important people understand that the biggest threat to consumers are these utilities that want to continue to hold on to their monopoly and dig their heels in on their practices." Julia Pyper, *Deep Politics, Dark Money and Fraud Join the Solar Party*, GREENTECH MEDIA (June 17, 2016), <https://www.greentechmedia.com/articles/read/deep-politics-dark-money-and-fraud-join-the-solar-party#gs.8UV9Rag> [https://perma.cc/7RW5-EC5B].

188. Julia Pyper, *Georgia Power's Rooftop Solar Program Signs Up Only 5 Customers*, GREENTECH MEDIA (June 17, 2016), http://www.greentechmedia.com/articles/read/Georgia-Powers-Rooftop-Solar-Program-Signs-Up-Only-Five-Customers?utm_source=daily&utm_medium=newsletter&utm_campaign=GTMDaily [https://perma.cc/DG2C-3EVT].

189. See *id.*

190. See *California's Efforts*, *supra* note 181; O'Boyle, *supra* note 3; *Plan to Integrate Distributed Resources*, *supra* note 181; Sara Baldwin Auck, *New York Regulators Issue Three Milestone*

third parties (and non-rate-based capital) can solve the problem more cheaply, there will be both sufficient data to know that and a regulatory process to ensure it happens. Whether these will prove to be transparent enough and ultimately meaningful remains to be seen, but the incumbent utilities are trying to keep much of the data that would operationalize the process out of the public sphere.

This article does not seek to determine what the correct amount would be, or specify a formula, for example, about how that could be determined. The average of around half seems to be sufficiently protective, but this article does not opine on what the level should be. Whether that is an additional fifty percent reduction, which would indicate utilities are requesting four times as much as they really need to run their business, or another amount is beyond the scope of this article. However, with the advent of more transparent programs to deploy non-rate-based assets to meet T&D needs, it may well be that utilities may find it harder to request a higher amount than necessary, as third parties, given access to that transparent data and the problem to solve, may find less expensive ways to meet the need, thereby decreasing revenue (and profit) going to the utility.¹⁹¹ So, with sufficient transparency, there is a motivation for the utility not to inflate costs as significantly.

Although there is skepticism that PUCs will require changes in regulatory structure and expectations,¹⁹² only time will tell if regulators are strong enough to require the necessary disclosures to enable third party capital into the most monopolistic part of the system. Absent market forces, additional transparency, meaningful public participation or judicial oversight, the only way to stop the game may be to reform the prudent investment theory.¹⁹³

REV Orders, but More Work Remains, GREENTECH MEDIA (Mar. 15, 2017), <https://www.greentechmedia.com/articles/read/New-York-Utility-Reformation-Is-Hard> [<https://perma.cc/A8BQ-M9TW>].

191. And the capital potentially isn't required if you have DER. Julia Pyper, *Californians Just Saved \$192 Million Thanks to Efficiency and Rooftop Solar*, GREENTECH MEDIA (May 31, 2016), http://www.greentechmedia.com/articles/read/Californians-Just-Saved-192-Million-Thanks-to-Efficiency-and-Rooftop-Solar?utm_source=gridEdge&utm_medium=newsletter&utm_campaign=GTMGridEdge [<https://perma.cc/WS4C-KAFP>].

192. Kahn, *supra* note 64 (“We see where the utilities have really been running the CPUC”).

193. Indeed, FERC has largely abandoned these traditional forms of rate setting. Kolo & Mulherkar, *supra* note 175 (“Independent power plants now abound, and almost all electricity flows not through ‘the local power networks of the past,’ but instead through an interconnected ‘grid’ of near-nationwide scope. [. . .] In this new world, FERC often forgoes the cost-based rate setting traditionally used to prevent monopolistic pricing.”).