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COMMITTEE: ENVIRONMENT AND TRANSPORTATION

TESTIMONY ON: EQUITY MARKET RETURN

POSITION: OPPOSE

HEARING DATE: FEBRUARY 24 AT 1:00 PM

WASHINGTON GAS RESPECTFULLY SUBMITS THIS STATEMENT IN **OPPOSITION** TO **HOUSE BILL 981 – INVESTOR-OWNED PUBLIC SERVICE COMPANIES - BASE RATE PROCEEDING - EQUITY MARKET RETURN**

Purpose of HB 981

HB 981 proposes to require the Public Service Commission, in a base rate proceeding, to forecast a “current average expected 10-year United States equity market return” to serve as the baseline equity return awarded to a public service company. The bill also would authorize the Commission to adjust rates based on the agency’s forecasted equity market return.

Bill Summary

The primary concept in the bill appears to be based upon a discredited theory of an activist named Mark Ellis whose theory has never been adopted by any state legislature and, in fact, has been rejected by the four state utility regulatory commissions that have considered it. If enacted into law, *HB 981 will likely increase Maryland utilities’ costs of capital, which will be passed onto customers and occasion judicial appeals to Commission ROE determinations.*

Bill Background

HB 981 appears to be derived from a policy brief authored by Mark Ellis, titled “*Rate of Return Equals Cost of Capital*,” published by the American Economic Liberties Project in 2025. Mr. Ellis theorizes that public service commissions have for decades approved excessive utility rates of return (ROR) because of “regulatory capture,” meaning regulators have been duplicitously diverted from their mission to protect the public interest in favor of the interests of utilities. Mr. Ellis’s proof of excessive utility ROR is a comparison between a 10-year average of awarded utility returns on equity (ROE) of 9.65% and multiple investment firm equity market return forecasts for the same period of 6.7%.

HB 981 would direct the Commission to forecast its own 10-year equity market return, using multiple sources. The Commission could then, presumably, adjust a utility's rates by up to the difference between traditional ROE comparable risk results and the Commission's forecasted 10-year equity market return.

Bill Analysis

The equity market approach to utility risk assessment is legally dubious. For more than 100 years utility regulators have followed the United States Supreme Court's ruling in *Bluefield Water Works v. Public Service Commission* that utility rates that are too low are unjust, unreasonable and confiscatory, and their enforcement deprives a utility of Constitutional property rights. There must be enough revenue for operating expenses and for the capital costs of the business.

In 1944 the Supreme Court issued another seminal ruling in *Federal Power Commission v. Hope Natural Gas Company*, establishing that regulated prices must be set at levels that give the regulated utility a reasonable opportunity to recover the costs of investments. The *Hope* decision also requires that ROE should be commensurate with the return on investment (ROI) for *other firms with similar risks*. *Hope* further requires that ROI should assure the financial integrity of the utility to maintain credit and to attract capital.

Together, *Bluefield* and *Hope* form the bedrock principles upon which utility rates are made: Approved rates must cover operating expenses and capital costs, and the approved return must maintain credit and attract capital in line with similar risk companies.

HB 981 would ignore *Bluefield* and *Hope* in favor of a 10-year *forecast* of equity market returns—which equity markets are left undefined—by the Commission, and the projected returns would be averaged and used as the ceiling under which Maryland utilities' ROE and derivative rates are established. Here are specific legal concerns with this unusual approach:

- Using a *10-year forecast* of the equity market (or markets) to set ROE violates *Hope's* requirement that the Commission approve ROE commensurate with the ROI for *other firms with similar risks*. There are more than 4,000 publicly traded companies in the US. They do not all exhibit comparable risk to Maryland utilities.
- Applying a formulaic adjustment founded on dissimilar firm returns exacerbates the delta between comparable risk-based ROE and a 10-year forecast.
- Rates established on ROI for dissimilar companies cannot be guaranteed to cover the utility's operating expenses and capital costs, which is unconstitutional under *Bluefield*.
- A 10-year equity market return *forecast* violates the ratemaking concept of "*known and measurable*" adjustments employed by the Commission. Any deviation from actual costs that underlie rates must be *definitive and quantifiable* with reasonable accuracy. A 10-year forecast of the stock market does not qualify as known or measurable.

- The equity market forecast approach virtually assures Constitutional challenges to Commission ROE awards.

The equity market approach will lead to increased risk and higher costs of capital. If the Commission is forced into a statutorily-derived ROE constraint that ignores investor expectations, the likely result includes increased regulatory risk, higher required returns, diminished credit quality, and higher long-run financing costs. These increased costs will be borne by customers, in direct contravention of the affordability aims of the State.

The equity market approach is unproven and unadopted. Because Mr. Ellis’s market-wide equities forecast approach does not compare utility risk to comparable firms’ risk as required by the Supreme Court, his approach has not been adopted by any state legislature or state commission. In fact, in the four states—California, Georgia, North Carolina and Virginia—and seven cases where Mr. Ellis’s theory has been submitted, the theory has been rejected or ignored seven times out of seven.

The Ellis theory does not appear to have been peer reviewed by certified financial analysts or regulatory experts, such as the Society of Utility Regulatory Financial Analysts (SURFA). SURFA is a non-profit society whose officers and many of its board members serve as professional staff at utility commissions across the country. SURFA’s mission is “appraising risk and reflectively determining an appropriate level of profitability or rate of return on investment in regulated and non-regulated industries.” Mr. Ellis has not submitted his theory to the Certified Rate of Return Analysts at SURFA, which he describes as co-opted by utilities.

The equity market approach is falsely predicated. Mr. Ellis opines that utilities exercise “regulatory capture” to control ROE outcomes at state commissions. Regulatory capture, according to Mr. Ellis, is a “corrosive and consequential, form of corruption.” There is no evidence to back up Mr. Ellis’s corruption and conspiracy claims, and if he is correct the following national and state institutions have been hoodwinked by public utilities, leading to inflated ROE awards:

- United States Supreme Court + combined federal and state judicial systems
- All relevant federal regulators which set ROE levels (*e.g.*, FERC, FCC, ICC)
- All 50 state utility commissions which set ROE levels, including the Commission
- All 50 state consumer advocates, including Maryland OPC
- National Association of Regulatory Utility Commissioners (NARUC)

The simpler explanation is that these institutions, including the Commission and OPC, have properly followed *Hope* and *Bluefield*. The Commission’s and OPC’s adherence to *Hope* and *Bluefield* is seen in a 2015 decision from the Appellate Court of Maryland (formerly the Court of Special Appeals). In that case the court affirmed a Commission ROE award for Pepco that was expressly based on the tenets of *Hope* and *Bluefield*.¹ The court further noted that OPC’s witness explained the three standards for determining an appropriate ROE: (i) earnings must be

¹ *Maryland Office of People's Counsel v. Maryland Public Service Com'n*, 226 Md.App. 176 (2015).

commensurate with the returns on investments in other enterprises having corresponding risks; (ii) earnings must be sufficient to assure confidence in the financial integrity of the enterprise; and (iii) earnings must allow the utility to attract capital.

Following Supreme Court ROE precedent is not evidence of regulatory capture, however defined. The Committee should reject claims to the contrary and decline to advance HB 981.

About Washington Gas

Washington Gas Light Company provides safe, reliable natural gas service to more than 1.2 million customers in Maryland, Virginia, and the District of Columbia. WGL has been providing energy to residential, commercial, government, and industrial customers for more than 177 years, and currently serves nearly 520,000 Maryland customers in Montgomery, Prince George's, Charles, St. Mary's, Frederick, and Calvert Counties. The Company employs over 600 employees in Maryland, and hundreds of outside contractors, plumbers, union workers, and other skilled tradespeople. The Company strives to improve the quality of life in our communities by maintaining a locally-based workforce, working with suppliers that represent and reflect the communities we serve, and giving back through its charitable contributions and employee volunteer activities. The Company, together with other natural gas distribution utilities, are responsible for delivering the primary source of heat to Maryland residential energy consumers, serving approximately one half of all Maryland households while providing critical energy services to residential, commercial, and industrial customers at one-third the cost of electricity on a per unit basis.

Contact:

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ATTACHMENT A

Virginia State Corporation Commission. Case No. PUR-2025-00058, *Application of Virginia Electric and Power Company, for a 2025 biennial review of the rates, terms and conditions for the provision of generation, distribution and transmission services pursuant to § 56-585.1 A of the Code of Virginia*. Errata Testimony of Mark E. Ellis, at 3. July 24, 2025.

Virginia PUR-2025-00058, Order at 5, 7. November 25, 2025.

Georgia Public Service Commission Docket No. 44280; *Georgia Interfaith Power Light Direct Testimony of Mark Ellis at 7*. October 20, 2022

Georgia Public Service Commission Docket No. 44280; *Order Adopting Settlement Agreement as Modified at 8, 9*. November 30, 2022

Public Utilities Commission of the State of California Docket No. 22-04-008; *The Protect Our Communities Reply Brief at 4*; April 20, 2022

Public Utilities Commission of the State of California Docket No. 22-04-008; *ALJ Phase 2 Decision at 2*; October 17, 2024

CA PUC 25-03-010; *Decision Addressing Test Year 2026 Cost of Capital for PG&E, SCG, SCE, and SDGE at 1, 11-16, 51-53*; 12/22/2025

NC Utilities Commission Docket No. E-7, Sub 1276; *Direct Testimony and Exhibits of Mark Ellis on Behalf of North Carolina Justice Center at 8*; July 19, 2023

NC Utilities Commission Docket No. E-7, Sub 1276; *Supplemental Proposed Order of the Public Staff at 8*; November 6, 2023

NC Utilities Commission Docket No. E-2, Sub 1300; *Direct Testimony and Exhibits of Mark Ellis on Behalf of North Carolina Justice Center at 10*; May 3, 2023

NC Utilities Commission Docket No. E-2, Sub 1300; *Supplemental Proposed Order of the Public Staff at 9-10*; July, 31, 2023