April 24, 2025

To: Iowa Legislators
From: Former Iowa Utility Board/Commission Members

Re: *Return on Equity for Iowa's Investor Owned Utilities Should Better Serve Ratepayers*

A number of elements in the current omnibus energy bill (House File 834, Senate File 585) could negatively impact ratepayers. A weak Integrated Resource Planning process, transmission Right of First Refusal, and a legislative authorization for "innovative rates" for large users all have the potential to shift the risk/benefit ratemaking balance away from ratepayers and towards investors.

Perhaps the most fundamental issue to ratemaking, and the one we address here, is return on equity (ROE).

Iowa's two rate-regulated, investor-owned electric utilities (IOUs: Alliant Energy/Interstate Power and Light, MidAmerican Energy) create value for shareholders by earning a regulator-approved return on large capital investments in generation plants and the grid.

The rate of return (ROR) for Iowa's IOUs is approved by the Iowa Utilities Commission in contested dockets per Iowa Code Chapter 476. A central principle in utility ratemaking is that the ROR should mirror the cost of capital.

The cost of capital invested by IOUs includes two components: cost of debt and cost of equity. The cost of debt is relatively straightforward. The cost of equity is less so, as it reflects what investors expect to earn on their investment in company shares. The return on equity (ROE) is one of the most contested aspects of any rate case ruling, as it is a core element of shareholder profits and ratepayer costs.

As discussed in the paper referenced above and in this analysis, company market-to-book ratios near 1.0 would suggest that authorized returns reflect the utility cost of equity. Another metric for cost of equity is the long-term stock market return. The fact that industry-wide approved ROE levels in recent decades have been higher than anticipated market returns, and IOU company market-to-book ratios have been closer to 2.0, both suggest that approved ROEs have been significantly higher than utility cost of equity.

ROEs significantly above the cost of equity can induce a capital investment bias (or "capex bias") in utilities that can lead to overinvestment, and rates rising faster than inflation.

Iowa utility ROEs have been higher than national averages much of this century because, in 2001, the Legislature authorized Advanced Ratemaking Principles (ARP) dockets to provide an additional level of economic certainty to utilities considering major investments in alternate energy production facilities. The ARP statute freed regulators from “traditional ratemaking principles”, which has resulted in the granting of “premium” ROE levels often 1-2 percentage points above the national ROE average (which in recent years has hovered around 9.5%).

These high ROE levels mean higher profits for investors, and higher bills for ratepayers. The London Economics report (commissioned by the Legislature in 2023) suggests that “reevaluating the necessity for a higher ROE seems prudent” because large build-out has occurred, risks have come down, and many technologies are also eligible for federal tax credits.

In 2024, however, the Legislature expanded the list of technologies eligible for ARP dockets and “premium” ROEs to include nuclear energy and energy storage. The current bill expands definitions for ARP technologies, and declares it the intent of the state to develop nuclear power for both “local and regional electric needs”. With these changes, Iowa ratepayers could be paying some of the highest ROEs in the country for another round of very large utility investments.

We commend legislators for taking ratemaking reform seriously. To address the ROE issue (and its intersection with Integrated Resource Planning processes and ARP dockets) in a manner that protects ratepayers, *pausing the current legislation in favor of further analysis may be the better part of wisdom.*

If legislators are intent on acting now, we encourage the following actions:

1. Remove the authorization for “premium” levels of ROE entirely by removing the exemption from traditional ratemaking principles in ARP dockets.

2. Codify in law the principle that the rate of return for rate-regulated utilities ought to reflect the actual cost of capital, and charge regulators with pursuing that principle in all rate dockets.

Sincerely,

Richard W Lozier, Jr.	Member, Iowa Utilities Board, 2017 – 2023
Geri Huser	Chair, Iowa Utilities Board, 2015 - 2023
Sheila Tipton	Member, Iowa Utilities Board, 2013 – 2015
Darrell Hanson	Member, Iowa Utilities Board, 2007 – 2013
John R. Norris	Chair, Iowa Utilities Board, 2005 – 2009 Commissioner, Federal Energy Regulatory Commission, 2010 - 2014