

**This is a transcript of the Organized Money podcast episode (#18) “The Pocket Picking Machine”  
Discussion of Electric Utilities with Mark Ellis**

**David:** [00:00:00] Today, our episode is about electric utilities and why they charge too much and why they're generally terrible at what they do.

**Matt:** How dare you? PG& E is wonderful.

**David:** Except for burning down my state. Yeah, other than that.

**Matt:** Burning down California. You know, whatever. Everybody makes mistakes. A California utility company says it's equipment, it's own equipment, likely sparked one of the Los Angeles wildfires last month. Also, who in New York doesn't love Con Edison?

**David:** [00:00:30] Yeah. Everybody beats up on electricity companies, and mostly they beat them up for You know, how they respond to crisis, uh, Con Edison didn't have ladders stocked up in New York before the hurricane, the sparks flying in areas of California with just grub brush.

Usually we focus on that, but in today's episode, we're going to focus on a bit of a different thing, right?

**Matt:** Yeah. So, so everybody's got a story. Um, about their gas or electric utility, charging too much money, treating them [00:01:30] poorly. And now, and meanwhile, these, these companies, you know, their, their grids are falling apart and they say they have to replace it all for electrification, which is going to be super expensive.

So we want to answer the question, like, where'd all the money go? What's going

**David:** And amazingly, it's a really simple story. They've just convinced regulators and advocates with fake economic models to let them charge too much money and invest in stupid things. It's unbelievable that it's that simple, but it is.

So how that's what we're going to get into. I mean, uh, but it's, it's this small number of economists. It's a small number of models. It's this insular society. And that I use that word very, uh, deliberately, uh, that is jacking our electricity rates up.

**Matt:** Everyone is actually afraid. In this world of being out of the consensus, right?

It's a small group of people, actually, we're finding it's just two people who run a lot of set pricing for the whole industry. It's two experts and there's an, there's an emperor's new clothes vibe to it, right? So, so there's, there's just fancy people saying things that are obviously wrong, but these people are so fancy that everyone is scared to call them out.

**David:** Yeah. And we have a great guest to talk about this. He's a former utility executive. He's named Mark Ellis. He figured out this whole scam and he's going to tell it to us right now. It's called Organize Money. I'm[00:03:00]

**Matt:** Prospect Magazine. And I'm Matt Stoler. I write about monopolies in a newsletter called Big, and I'm the research director for a think tank called the American Economic Liberties Project.

**David:** On Organized Money, we're going to go beyond supply and demand curves and odes to visionary entrepreneurs and tell you how the business world really works.

**Matt:** We'll talk to business leaders, journalists, policymakers, people on the [00:03:00] front lines who are dealing with monopoly power, competing with it, winning, losing, but ultimately fighting

**David:** back. It's a podcast about all the money and power in the world.

**Theme:** And we know now that government by organized money is just as dangerous as government by organized mob.[00:03:30]

**David:** Mark Ellis, welcome to Organized Money. Thank

**Mark:** you. It's great to be

**David:** here. You were the chief of corporate strategy and chief economist at SEMPRA. Uh, you were a consultant at McKinsey and company and analyst at ExxonMobil, a engineer for SoCal Edison and Sanyo Electric. Uh, you have a master's from MIT's technology and policy program and a bachelor of science [00:04:00] in mechanical engineering from Harvard.

You are very. Impressive. An impressive man. Given that, that resume, it's interesting that we're having you on organized money on this show is that's about five, uh, uh, corporate actors that we, uh, uh, sometimes don't talk so highly about, um, so you currently you testify in front of state public utility commissions and, uh, in particular, you wrote this paper [00:04:30] about.

How, uh, electric utilities are, are too profitable and this is not new. Uh, we, we found a quote from, from Franklin Roosevelt in 1932 that says, uh, as always the public, the public is beginning to understand the need for reform after the same public has been fleeced out of millions of dollars. And, uh, I just want to start by asking you, how are we still in the same situation today, almost a hundred years later?

**Mark:** [00:05:00] That's a, that's a tough question. Why are we still in the same situation? You know, it's an institutional problem, right? So it has to do with the, the, the weakness of the regulators and the, you know, it's a concentrated benefits in sort of dissolved or disparate, you know, widespread costs. And so you have these concentrated benefits and utility shareholders.

And then the costs are spread out over all the customers.

**Matt:** Let's start with the basics. How does the electric utility sector in America work? What percentage of utilities are investor owned [00:05:30] versus publicly owned? How are utilities divided like generation versus transmission? Like just sort of like.

Utility 101 for our audience.

**Mark:** It's not just electric utilities. It's also gas. So gas utilities face the same type of regulation and the same type of excess returns. So for electricity, about 70 percent of the electricity is provided, provided by what are called investor owned utilities. And the other 30 percent is provided by public utilities, typically state and municipal local.[00:06:00]

Um, there are some federal utilities as well. Um, and this, what we're talking about today only applies to the investor owned utilities. And investor owned utilities provide 95 percent of the natural gas in the country. The basic principle or the basic idea goes back to Thomas Edison's day, um, is that utilities were long considered a natural monopoly.

In the very early days you had competing providers like running lines down the same street. And they felt like, Hey, that's a safety hazard and it's an inefficient use [00:06:30] of capital. Really each utility should have a dedicated service territory and they, we will give them a monopoly franchise. And in exchange for that monopoly franchise, they have a universal obligation to serve.

So anybody who wants to connect and is willing to pay the rate, you have to serve them. And you will be subject to what is called Cost of Service Regulation. Cost of Service Regulation basically is you can charge your actual costs to the customers. No more, no less, no [00:07:00] less because we want you to stay in business.

Um, but no more just because every, anything above your actual costs is just your, your, you know, you're extracting rent and not providing any incremental value. And that's the basic principle cost of service regulation.

**David:** Basic principle and the basic bargain kind of right. That's like, we're going to give you this market, a monopoly market, but we're going to regulate it pretty tightly.

And there's some specific language in that, right? It's, it's about, I remember the term is just and reasonable, right? And that [00:07:30] characterizes the prices.

**Mark:** Yeah. So just and reasonable. Is interpreted to mean, Oh, you can recover your costs, your actual costs. If it's more than it's not just and reasonable because you're not doing anything to earn that excess over your cost,

**David:** but funny story.

I read your paper that, uh, uh, says rate of return, uh, equals cost of capital is the name of the paper. We'll put it in the show notes. It's a, it's a porno. Just all porno, weirdly. So, so [00:08:00] you have this paper, rate of return equals cost of capital, and you had this incredible stat. In there over the last three years, rates for investor owned utilities went up 49 percent higher than the rate of inflation, whereas rates for publicly owned utilities have gone up 44 percent less.

That, that is absolutely [00:08:30] remarkable and, and, and kind of, I mean, is that normal that, that, that the, the utility investor own rates would, would be rising so quickly relative to public utilities?

**Mark:** No, that's not normal. Uh, if you look over long periods of time, the rates of both have tended to track general inflation over, you know, last 20, 30, 40 years.

And then, uh, more recently. Um, the rates have, have had this bifurcation in, in their trajectory.

**Matt:** Okay. So we'll get, I want to get to the, like, essentially the scam that you've [00:09:00] written about, you figured out, which is very cool. I'm a sort of connoisseur of scams. This one is like, Hmm, beautiful. But before we get there, let's do some more utilities.

One on one. Um, how do these prices get set? Right. So we talked about just and reasonable, uh, you know, the, uh, cost of service business model. But someone's got to set those prices or, you know, the utility's got to be clearly be involved, but maybe you could walk us through, actually, yeah, just how do these commissions work?

**Mark:** So basically, uh, commissions have two jobs. [00:09:30] They approve, uh, how much the utility is allowed to spend and then how much profit they make. So when you think about, okay, how does that affect rates? So that basically, however much they spend, they're allowed to recover in rates plus, plus a profit. And the profit is supposed to be just and reasonable.

**Matt:** Walk us through a rate case. Like the commission says, you know, Hey, we want to look at pricing or does the utility say we want to raise our prices and like what happens, right? What's the role of someone like you?

**Mark:** Yeah. So in a [00:10:00] typical rate case, the utility comes in and says, Hey, well, we want to increase our rates because our costs have gone up and sometimes it's at the discretion of the utility.

Sometimes it's just every three years you come in for a rate case. Um, so when the utility comes in, they say, here's our costs and the costs fall into two buckets. Basically, you can think of them as operating costs, like fuel, salaries, rent, purchased electricity, and then there's capital costs. So utilities in general are known to be a very capital intensive industry.

They invest in [00:10:30] long lived assets like transmission lines and power plants and distribution facilities and distribution lines and so forth. And for the operating costs, the general principle is Um, they're allowed to recover those costs in the year that they're incurred. So salaries, they add them up and they say, okay, whatever you expect your salaries to be over the next year, divide them by the number of kilowatt hours you plan to, you know, sell in the next year.

And that's how much you can recover in rates. But for long lived assets, they say you have to [00:11:00] amortize it over the life of the asset. And so they take that asset. And if it's safe, you know, 20 years, last 20 years, then every year they were for a billion dollars, it would be 50 million. They recover in the form of depreciation.

So they recover the return of capital. It's return of capital's depreciation. The utility says, wait a minute, I'm putting money out up front. And there's a time value of money. I deserve compensation for the time value of money. And we're all know, you know, we know about interest rates and we know about when we invest in the stock market, we have an expected [00:11:30] return.

We don't do it for nothing.

**Matt:** It's like they're making a loan. That's what you wrote in the paper. It's like utilities kind of

**David:** making a loan and they want their interest basically from the rate payer on, on how much time they're using to put it. Or,

**Matt:** or else though, though, like, why would you, if you're not going to get a return on it, we just put that billion dollars somewhere else.

Right. Was that kind of the principle? All right. Okay. But, but then in the process, so they, they want to get a return on that capital and they want to get a, they want to get their expenses paid. Uh, do other people come into the rate case and say, no, no, we want lower, you [00:12:00] know, or like, how, how does that, you know, what, what has it work?

**Mark:** A rate case, it's a legal proceeding with a court. And, uh, usually there's an, a, uh, administrative law judge who oversees the process and there's commissioners who approve the final decision, but is, is a process where the utility presents their application and their testimony, and then various parties can.

protested or provide commentary, either in support of or against the utilities filing. Usually it's in [00:12:30] opposition to it, and they typically fall into three categories. One is there are very common public advocates, either part of the Utilities Commission, either part of the Utilities Commission or part of the Attorney General's Office, or sometimes it's just a separate government agency whose job it is to watch out for the consumer interest.

Then sometimes there's the regulatory staff also can participate. And provide input in that process, provide testimony in that process. And then there are third party non, non government entities that can participate in these processes as well. [00:13:00] Typically consumer advocates, like third party consumer advocates, non profit consumer advocates, or environmental advocates tend to participate.

**Matt:** I, I, I went through one of these rape cases and I found that, that Walmart was participating in it. They were a big power buyer and they were saying, hey, uh, Pepco, because I looked at my own, I was like, I'm going to look at my own, you know, um, Utility which is pepco and they uh, walmart was like no pepco is asking for too much But then also the government services administrator the federal government was participating

**Mark:** Walmart, for [00:13:30] example is a consumer advocate.

They are a large consumer, but they're basically a consumer advocate.

**Matt:** They're just like me

**Mark:** Federal the federal government is the largest purchaser of electricity in the united states. So they are also Participating as a consumer advocate just for a particular consumer constituency.

**David:** That that's all very interesting that you have all these different participants with different perspectives, but what you lay out in this paper is that you don't actually need that because there's this basic principle in [00:14:00] finance that really should govern how the, the rate should be set. Right. And that is rate of return equals cost of capital, which is the name of the paper as well. So could you explain that concept

**Mark:** For the rate of return? Yeah, I would agree that you really don't need all these third parties intervening on the rate of return on other expenses.

You know, Walmart, for example, has a lot to say about rooftop solar.

David: Oh, sure.

Mark: Because they have a lot of roofs. Um, but on the rate of return. You know, one of, [00:14:30] one of the fallacies that the utilities have propagated that rate of return is more art than science and it's not.

**David:** And what do we mean when we say rate of return?

What do we mean?

**Mark:** So the rate of return I talked to before about, oh, then when they make a capital investment, they get to, they recover it over a number of years. And then, so there's the return of capital. Then there's a return on capital, which is the time value of money, like the interest rate. When that utility finances it, um, they use debt and equity.

Right. Like many companies, they will use a mix of debt and equity. And there's a longstanding principle that, [00:15:00] Hey, we want the utility to have a strong credit rating. And so they tend to have very conservative amount of debt. And there's good sort of from an investor perspective and from a public interest perspective, there's sound reasoning behind that.

You don't want these utilities taking on too much debt. And that's, that's a relatively straightforward process to figure out what the appropriate level of debt is. So they issue debt and then, you know, the, the rate of return or the, the, um, the return on capital for the debt is just the debt interest rate.

They go to market or they go to a bank and they [00:15:30] borrow money. And then in the contract, there is a interest rate associated with that. And then they're allowed to recover that in rates. Straightforward. The other part of it, it's typically utilities. They're around 50, 50 debt and equity. So that's for the 50 percent of debt they just look at the interest rate. But for the equity, there is no interest rate or rate to that that can just be observed. Um, like when you, you say, what's the cost of equity for any company for Apple?

Matt: That's like stock, right? You're talking about stock, right?

Mark: Stock is a form of [00:16:00] equity. So it's not directly observable, so you have to estimate it or calculate it.

But there are, um, very long standing principles of finance that literally a first year MBA, a first year finance student, undergrad, will learn these methodologies and models that are very simple. One of them you can

calculate in your head, the other one, you need a spreadsheet, but it's, it's literally just a few lines in a spreadsheet, um, to calculate.

So they're very straightforward models. You know, there's, [00:16:30] each of them has a few assumptions, but there's not a great deal of sort of dispute about what reasonable assumptions are for these,

**David:** Unless you're an investor owned utility, then there's quite a bit of dispute.

**Mark:** Yeah, and not only that, they introduced, they have their own bespoke, like they introduced models that are used nowhere else in finance.

**Matt:** Would it, would it be fair to say you, so the stock market kind of over the long term returns, what, like 7 percent return on equity? I mean, it's 10%, but then you [00:17:00] take out inflation and it's essentially like six, 7%, something like that.

**Mark:** So with inflation, uh, you know, there are many, virtually all the major financial institutions, JP Morgan, BlackRock and so forth, they actually annually or more frequently, they say, this is our expected return on the market. And it's around six to 7 percent right there. And that's with inflation, not after inflation with inflation, about six to 7%.

**David:** But then what you saw in, in looking at [00:17:30] the actual return on stock valuations of energy companies of, of investor owned utilities.

It's much higher than 6. 7%. Right.

**Mark:** So there's two different things. One is the authorized return.

**David:** Authorized return. You mean authorized by a public utility commission?

**Mark:** Yes. We talked before the return on capital. There's a return of capital, the return on capital. So these are, they're both collecting these in rates.

They're passing through, they pass through the depreciation, they pass through the interest. They [00:18:00] pass through the return on equity, which is determined by the regulator. And in principle, it should be because it's cost of service regulation. In principle, the authorized return that the regulator allows the utility recovering rates should be equal to the market based cost of equity.

In other words, what investors would demand on an investment elsewhere with comparable risk.

**David:** But it's, but it's much higher. It's what you're saying, what you're saying is for [00:18:30] utilities is much higher.

**Mark:** So the market as a whole, like I said, you can go look at BlackRock or JP Morgan at six to 7 percent utilities, universally utilities do not dispute this are lower risk than the market as a whole.

So we would expect the authorized return. Their cost of equity is lower than the market. You can debate. Is it 1%, 2%, two and a half, whatever, but it's definitely lower than six to 7%. But the authorized return is routinely on the order of 9 to 10 percent, sometimes 11 percent. [00:19:00] And it's been like that for decades.

<Music>

**Matt:** Wow. I said, I said, wow, but it was half hearted because I knew I had to write a paper, like written about it. So wow. Oh my gosh. Right. But like, that is a big deal. How excessive is this amount, right? For a, you know, normal person, you know, how much more are you really paying because of this, [00:19:30] um, excessive, uh, You know, nerdy thing that we've been talking about.

**Mark:** So I, you know, there's different ways to calculate it. So, you know, one analysis in the paper, I say it's about 50 billion a year nationwide, 10 to 12 percent of the average bill. This is the excess profit, not the profit that they earned the excess amount. Right. You can also look at it in terms of the valuation implied in utility stock prices, and that's a trillion dollars.

So a trillion dollars is sort of what the, you know. The market expects [00:20:00] utility regulators to continue authorizing excess ROE, sort of. Indefinitely.

**Matt:** So they are worth a trillion dollars more than they would be if they were given a more reasonable rate of, so this is, this is a transfer of wealth. See, that felt more authentic wealth.

That was a **David:** real, well one, I, yeah, because I knew I don't read reports in advance. That's so, that's why it was a real, wow. That's

**Matt:** a hu that's, so there's this big transfer of wealth. How much is it per household? Uh,

**Mark:** 250 to \$300 per household

**David:** a year. Yeah. It's really, it's significant. [00:20:30] It's significant. And, and you say that this does other things because, um, you know, there are many things that utilities can do with their money, but they're probably incentivized to do the thing that's going to get them the highest rate of return.

And so you talk about capital bias in the paper. Um, so, so, I mean, talk about how that. This sort of calculation, what you call financial alchemy [00:21:00] biases us towards a certain type of activity by utilities over other utilities that they could be engaged in.

**Mark:** So essentially, because these rates of return are so much higher, right, basically for every dollar that they invest.

So if they were, if they invested a dollar and it was just earning their cost of equity. Then in their share price, it would just be worth a dollar, but because they're earning more than their cost of equity, every dollar that they invest is a multiple of that [00:21:30] currently at current, um, stock market valuations and authorized rates of return and sort of the implied cost of equity for every dollar of equity, shareholder equity that they invest turns into 2.

2. In their share price or their stock market value. So I say like, if somebody came to you and said, Hey, if I, if you give me a dollar, I'll put two or 2. 2 into your retirement account, I say there, I can predict the next two things that would come out of your mouth. The first one would [00:22:00] be, yes, I'd like to accept that offer.

And the second would be, am I limited to a dollar? Can I do 2? Can I do 10? Can I do a million dollars? And essentially that's the deal that utilities have. And so they're just normal human beings. Like they're going to keep investing until somebody says no. And you know, different regulators have different thresholds for saying no.

I live in California and their threshold for saying no is very, very high. Um, other states, [00:22:30] you know, say no earlier.

**Matt:** Who does the, you know, the ROE calculations, right? So it's not what, it's not the CEOs of these utilities. There's a certain group of economic experts who go to these, uh, commissions and they make an argument for this particular calculation.

Who, who is that?

**Mark:** Yeah. So you almost universally, they hire outside experts. And so I did a survey, like who are all the experts? This is in November of 23. And I was shocked. [00:23:00] It was basically, uh, all the utilities basically use four firms. And then there's one additional expert who was like the Godfather of all these people and he's retiring.

So he doesn't do a lot of work anymore, but 90 percent used four firms. And then within those four firms, two people did over 50 percent of the ROE testimony for all these, I think there was 63 total utilities in this sample, um, covering, you know, most of the major utilities in the investor in utilities in the United States.[00:23:30]

**Matt:** So two people, two people basically run utility policy in America is what you're saying to experts.

**Mark:** Yeah. And, and, you know, and then when you look, the people from the same firm, they have like, they have very similar playbooks. There's about, um, eight different kind of. Models and techniques that they use and then, you know, available in the toolkit and then each one will use four to six of them.

And so they just mix and match.

**David:** The absolutely amazing part of this is that they have their own society. [00:24:00] So, uh, there's this, uh, certification organization that they're part of, and it has like this Royal title, the society of utility regulatory financial analysts. You know, are they knighted that way? I don't know.

Um, but, uh. That's incredible that, yeah, there's like this, this set of, of secret people that are running this thing.

**Mark:** So it's interesting. The, the surf, the surface society of [00:24:30] utility regulatory financial analysts, they go by surfa. They don't train the utility experts, they train the intervener experts in the, in the experts who testify on behalf of the regulatory commissions and the consumer advocates.

**David:** That's the amazing thing. They're on both sides. They're, they're the, the ones that are, are the, the experts that are serving for the

**Matt:** work. Wait, so wait, they train the good, they train the good guys too. They train the like consumer advocates.

**Mark:** No, that's the primary responsibility is to train the good guys.

**Matt:** Oh my gosh. So, so the [00:25:00] people who are supposed to advocate for consumers are trained to advocate for utilities without knowing it.

**Mark:** Yes. And in fact, they run their, SERFA runs a training program at the NARUC, the National Association of Regulatory Utility Commissioners, the regulatory. Body it's that's where they run the training program.

**Matt:** Well, I'm like a it's like a where corruption civilly is like that is

**David:** just

**Matt:** like

**David:** and okay So the other part of this is that they use you mentioned these models, right? and in the paper you talk about four [00:25:30] different models and you say there are two of these that Are not used anywhere else in finance to any degree, like talk about how these models are like almost bespoke.

As you say, they're just designed to screw rate payers basically.

**Mark:** So the whole idea is the rate of return, the return on equity should be equal to the market based cost of equity. So you, you would in principle, okay, I look to the market. These two models are based on looking [00:26:00] either directly or indirectly.

At the authorized returns that other commissions have authorized. So it's only, only if the regulator is doing their job, is it a proxy for the market, but it is. But on its face

**David:** not the market. So so the society of we're taking your electric bill money has Models the models of the society are the model is based on how much money we usually get and [00:26:30] and and and Extract from you and how we're much we're going to get and extract from you in the future

**Matt:** It is it is the Emperor's new clothes like parable right there

**Mark:** the federal regulator Did this whole rate of return sort of let's revisit our process, you know, in the early 20, like about in the last three or four years, and they rightly, they said, you know, those two models, those defy general financial logic because they said they're circular.

They don't estimate a cost of equity.

**David:** This is the Federal Energy [00:27:00] Regulatory Commission saying the thing that is used primarily to determine electricity rates defies general financial logic.

**Mark:** So, uh, here's the thing is, here's the thing. And they said, you know, the, you can use these two other models. And the two other models are basically the ones that are taught in first year finance called the CAPM and the discounted cashflow, CAPM and DCF.

Those are the ones you can use. And then they said, and here's how we recommend you implement them. And they, so they, they said the, the risk premium and the expected earnings, they're, [00:27:30] they're, um, defy general financial logic and they produce systematically upwardly biased results. And they said, okay, these other models, you can continue implementing them, but how you implement them produces the same results as the systematically upwardly biased results.

Right. They never connected the dots. And I literally just an hour ago, got off the phone with a FERC lawyer who was involved in that proceeding. And I said that to him, I said, nobody connected the dots. And he's like, Oh, nobody ever put that together. [00:28:00] This is a lawyer for the FERC on that proceeding.

**David:** I feel like the society for grabbing as much electricity money as we can has figured that out.

And they looked into it.

**Matt:** So I wrote a piece based on your, um, report, which I thought was great. And since I steal all my ideas, I stole yours. And I got a, um, one of the consumer advocates. Wrote back and we got into a conversation and he was like, look at all this bad stuff that the utilities are doing.

And I was like, then I looked at his ROE that his, [00:28:30] you know, his group put forward and it was, you know, it was like nine, nine and half percent or something. And I, so I asked him, I said, why? It's, it doesn't sound like the utilities are the problem here or the only problem you're the problem. Like you put a very high early in there.

You asked for really rates that were too high. Why? And I was nicer about it than what I'm saying. You know, I was, and he responded, he's very honest. He was like, yeah, I know, but we can't find an expert who will bring the, we're, we're afraid of being out of the consensus and we can't find [00:29:00] an expert who will give a more reasonable like calculation.

And I thought that was really interesting because it's, you know, we talk. Well, in a, in a other podcast, we talked about, um, norms, right? And like, this isn't in the law is not bad here. The law is fine. This is just kind of like vibes based rate making, right? And he's just, his answer essentially was, I know this is wrong.

That's what the vibes are,

**David:** right?

**Mark:** Yeah. The FERC lawyer said the exact [00:29:30] same thing. He said, Oh, they just put a finger in the air. And I'm like, they're really, they're making decisions that cost customers billions of dollars a year by putting a finger in the air. Like I was just the, the rationale that these, whether it's a regulator or consumer

advocate gives, Oh, we can never go on a, in, into a proceeding with a number that low because we'd lose credibility.

**David:** That's the amazing thing. Like, everyone has to be part of this herd that is giving the wrong information, and if somebody steps outside the [00:30:00] herd and gives accurate information, I'd be like, oh, I don't know what to do about this. Well, they'll just

**Matt:** throw it out. I mean, in the rate docket I looked at, they said, well, we throw out the high and the low estimates.

Right. And it's sort of like, wait, what if it's correct? What if it's the right estimate? Yeah, exactly. But let's, let's go into the, the other, we've talked a lot about how consumers are getting harmed, but there is this over investment problem. And I want to talk a little bit about that because one of the things that I think we've seen is [00:30:30] utilities, you know, their infrastructure is often ancient.

Uh, they don't take care of the infrastructure. They're constantly setting California on fire. Um, and like, like, it doesn't seem like they're doing a lot of investing and it also is very, you know, now everyone's saying when I say everyone, I mean, you know, CNBC, they're like, we have to totally upgrade the electrical grid because AI is going to change the world, you know, and Clippy, we need more Clippy.

I

**David:** was just going to say, even without them, uh, you know, there's an energy [00:31:00] transition going on. There are things that need to be connected to the grid. So

**Matt:** your, your argument is, well, they're over investing so that they can get. You know, higher rates so they can pay off those investments. Right. But then, then most people are saying, well, they're not putting enough into the grid.

Right. What, how do you reconcile that?

**Mark:** That's a good question. You know, and it's going to vary by state. Right. So, you know, they will invest as much as they they're allowed to invest. And then also in the things that the regulator [00:31:30] wants them to invest in. So I think it's not controversial to say that the regulators probably under emphasized.

Wildfire safety investment and maybe overemphasized AV charging or connecting distributed resources or things like that. So they're investing in those things and not the things that maybe if you were to step back and like, what's really best for society, that's what we should be investing in. So I think there's an element of that.

Um, You know, I haven't, I, to be honest, I said, there's, there's two things you, [00:32:00] uh, regulators do. They, they, uh, approve how much the utility can spend and then how much profit they make. The, how much they can spend is really complicated. How much profit they make is really simple. I'm focusing on the simple part.

**Matt:** Well, so, so we don't have an answer here, but I mean, I could, I could imagine a couple of, of scenarios. I've seen a lot of articles that say that. But, you know, we pay utilities in the U S pay 30 to 40 to 50 percent more than utilities in other countries to build the same transmission lines or power sources or whatever.

[00:32:30] And one of the things that your paper implies is that they want to overpay because if they overpay, they make more money.

**David:** They're incentivized for getting it back. Yeah,

**Matt:** right. And there, there are different ways to incentivize these utilities, but there's an issue. I don't want to just say, Oh, consumers are getting harmed because I am a heartless, evil person.

And I liked that. I get off on that. Um, but, but there are practical problems aside from that, which is that the. You know, [00:33:00] the actual utility grid is not functioning very well, even though you have this overinvestment.

**David:** Yeah. No, no. But I, I want to ask about these public utility commissions because, you know, you mentioned that, uh, they're using some of the same, uh, uh, people in this society, uh, they're, they're basically dealing with the same assumptions, same models and everything is this because you could look at it one way as being about capture.

Uh, that, that they, they just [00:33:30] have the sort of same mindset as the utilities themselves. You could call it a story of money in politics. If they're elected, uh, public utility commissioners, maybe electricity companies are their donors. Or you could call it more just A fear of stepping outside the box. So, I mean, I, I'm wondering where you see it.

Is this corruption or is this just.

**Mark:** Technically capture is corruption. Like when you capture is a form of corruption, it's just not the bribery kind, [00:34:00] but it is a form of corruption because they're, it's a dereliction of their regulatory, you know, their, their regulatory authority. Um, I don't think these people are like.

Uh, like they're, they're bad people. I just think that the, the incentive structure is wrong. Right. And also I think, you know, people are cognitively lazy. So this, you know, this Maryland person that, that Matt spoke with. I have, you know, I have, um, Submitted proposals to them to try to help them [00:34:30] ROE and they don't want my help.

I have made presentations to their, their organization, the NASUCA, National Association of State Utility Consumer Advocates. Laying all this stuff out in the paper and nobody follows up with me. Like they just, they Are comfortable with the status quo. I think there's just a, you know, this is maybe a harsh thing to say, but I don't think, you know, our state commissions are necessarily attracting the, the highest caliber of people and giving them the right incentives to actually do their job the way [00:35:00] it's supposed to be done.

**David:** They're also outgunned, right? I mean, they, they don't, they don't have. They don't have the same amount of money as an investor on utility does. They

**Mark:** don't, but they, you know, for example, they don't prioritize well. You know, I'm like, they're saying like, look, if you were to focus on rate of return, that's a billion dollars a year savings in your state.

Right. And it's like, you should really focus on that. And they're like, no, we've got this 100, 000 line item. We're going to focus on that. And that's just playing. The utilities love that.[00:35:30]

**David:** Mark, you. You actually give some solutions to the problem and in the paper, uh, you've made a few recommendations here and the biggest one being, you know, kind of throw out these models, look at financial reality, right? I mean, talk about the sort of recommendations that you put forward in this paper.

**Mark:** Yeah.

So the first one is, you know, just codify it so that [00:36:00] this rate of return equals cost of capital. It's a long standing sort of legal precedent from, from the Supreme Court, but it's actually not in legislation anywhere. So just put it in law, right? So that nobody can, you know, wiggle out of that. And then I think as you put it in law, like codify how to do it.

So it shouldn't just be this free for all and let utilities introduce these crazy models, like specify, these are the models that are acceptable. These are the assumptions and put it in the hands of the regulator. [00:36:30] Take it out of the hands, get rid of these dueling experts and. Um, just put it in the hands of the regulator.

So that would sort of codified put in the hands of the regulator. Um, I have a number of recommendations about how the intervener and advocacy community can do a lot better. You know, um, that community, you know, like Matt said, they have a lot of competing interests, right? Oh, rooftop solar may have a different interest than low income.

They have a different interest than large consumer. Everybody wants lower rates. And so I think there's a huge opportunity [00:37:00] there. I'm also just being more strategic, like most of them because they're experts are these surfer trained, right. Who are just parroting. They don't realize how much value is at stake here.

And I think they need to get smarter on that and realize like, no, this is actually moves the needle. And you know, one, one of my friends who's, who's involved in this space, he says, you know, rate of return is the skeleton key for everything you want to do on utility reform and utility accountability. And I agree.

So I think there's an opportunity just for them to be more strategic and also to [00:37:30] collaborate.

**David:** Well, you had this side note that, um, I thought was incredible that I did not know that lobbying expenses are something that utilities can recoup by passing through to rates. So the customers in some states, the customers are paying for the people who are trying to jack their rates up.

**Matt:** It's

**David:** unbelievable. And that, that's something we could get rid of pretty quickly.

**Matt:** Yeah. And we've done polling on it. It's that's very [00:38:00] unpopular. People do not like that, which is surprising. I love that we have to do polling on something. So obviously again, some states, they're not allowed to do that. Okay.

So you've recently testified on private equity in the utility space. Now I read your testimony, part of it because a lot of it, the good parts were redacted. What, you know, top line, what did you find?

**Mark:** There are not a lot of, um, M and a transactions and utilities. Cause once the utility has that, that business, like it's just a, it's a, it's a pocket picking machine, right?

It's a [00:38:30] customer pocket picking machine. You don't have to go from one to

**David:** one. Usually you merge to reduce the number of competitors in a market. This is already reduced.

**Mark:** Utility is actually not very concentrated because everybody's hoarding what they have. Like it's just, it's such a good thing.

**Matt:** It's just, it's a machine where you put a dollar in and you get 2 out, right?

Yeah. Why would you sell that?

**Mark:** So in any event, there is a utility that's up for sale. Uh, it's, it's called Elite and it's the parent of Minnesota Power and it's being [00:39:00] bought, um, by two parties, GI, Global Infrastructure Partners, which, um, through the course of this acquisition was, uh, is, was acquired by BlackRock and then, um, CPP, it was, it's a Canadian.

Philly where the Canadian pension fund. So they're buying elite and the elite is basically it's Minnesota power. And then a few other businesses, but Minnesota power is the bulk. It's like the crown jewel. And it's the main thing that you're buying elite, you're buying Minnesota power. And, um, and what [00:39:30] I was particularly interested in testifying in this case, because transactions sort of make it undeniable sort of what this, this rent seeking that's going on, because, you know, basically.

Um, in my testimony, I say, Hey, Minnesota powers has a, has a, um, has a, a rate base of. Three billion, half equity, half debt. So one and a half billion of equity. That's their actual investor, how much they have invested. But when you read through all the public documents about the, about, you know, the [00:40:00] valuation of GIP, CPP, how much they're paying, they're saying, well, we're valuing it at three billion.

So again, it's this two to one, right? They're, they're valuing it. And so you think to yourself, well, wait, what's going on here? You know, first is what is elite? What did elite shareholders do to deserve this one and a half billion? They have a one and a half billion invested. They're going to get 3 billion.

So they get a one out billion dollar windfall. What do they do to earn it? And you think to yourself, well, it's not anything they did in the past. Cause the ROE was already compensation for. [00:40:30] Investing in the past. It's not anything they're doing in the future because they're selling, they're not doing anything in the future.

So all it is, it's just a reflection of sort of, they have this pocket picking machine and GIP saying, I'm willing to pay you one and a half billion dollars twice what you paid to step into your shoes. Now think about that. So to earn their money, right. They have to, you know, earn not just the one and a half, but the three.

So they have to, for them to make a return on [00:41:00] their investment, they have to grow this thing even faster. And it's a completely unearned windfall. Elite shareholders have done nothing to earn this.

**Matt:** So they're just, it's just a bet on corruption. There's a typical kind of left wing view that utilities should just be owned by the state, right?

Or through co ops or some other, you know, municipalities. And there's a, there's a case for that, right? We have a lot of. Publicly owned co op or publicly owned utilities, and they, they generally don't over invest. They're generally, you know, the prices haven't increased, [00:41:30] uh, nearly as dramatically and so on and so forth.

You have actually identified a different way to address the problem. And I'm reading a little bit more than your paper, but it's just based on our conversations, which is to actually bring in large investors to put money directly into the underlying assets. Right. So, so not going through the utility company itself, but to say, I want that guaranteed return on equity myself, and I'm willing to enter in and, and pay for it, like, and kind of run an auction or something.[00:42:00]

Um, like I, as a, you know, I'd love a 7 percent guaranteed return. I'm sure, you know, I don't have an. I don't have an infrastructure team working for me to figure out how to do that, but I'm sure that there are, you know, private equity guys or, or people in, in, in infrastructure shops or just, you know, wall street is a lot of people in it that would love that guaranteed return.

Um, is this viable? How would this new financing model work? Um, it seems like a win win.

**Mark:** Yeah. [00:42:30] So I'll step back. Thanks. So there's a longstanding. Regulatory principle, regulation is a surrogate for competition. So implicit in that is where you can have competition, you should, and it's a very common thing in regulation.

So, you know. California's RPS, Renewable Portfolio Standard, basically the utilities were prohibited from building the plants, the new power plants. Um, they had to go to the market and have competing bidders build the plants. So this idea of like, hey, [00:43:00] utilities should use competition where they can, that's a longstanding regulatory principle.

So the, the idea is, you know, if you look at the regular utility model, it was like, oh, you're a natural monopoly for operating. And they bolted onto that and a monopoly for financing, but only the equity for the debt, they go to market, you know, they're just saying, Oh, I'm just going to go to my parent. And, you know, they're charging you 6 percent and I'm going to pack loads.

Like you go to the market and either you issue bonds or you have competing banks and, [00:43:30] you know, you use market forces to get you the best rate on the debt. You know, equity had this weird thing. It's like. No, it's just this negotiation between you and the regulator and, you know, some, um, unwitting sort of collaborators, right, in this whole process.

And that's just, you know, maybe there was a justification that back in Edison's day where like capital markets were not as sophisticated and we didn't, you know, and, and it was hard to raise large amounts of capital, but for today, like we can slice and dice, you know, capital, [00:44:00] the capital structure in an infinite number of ways.

So that was really the motivation is like, well, why do they have this monopoly? It's just. They should go to market.

**David:** This is a lot of this episode is what I would call a breaking plates episode that people will be listening to this and just breaking plates. There's just all this anger and, uh, frustration around the issue.

Um, but I think what it shows is, is there's this. Power in just explaining the basic facts [00:44:30] and and that's I think what your paper does it just explains there's a financial reality here and and there's a set of rules that are being played by that are completely at odds with that reality and I'm wondering if you think just having that knowledge is enough power itself to maybe shame the nerds, uh, into changing this system.

**Mark:** I, I don't think shame is enough. They're pretty shameless already. Uh, I'd mentioned Narek [00:45:00] before, right? So Narek, they have an annual meeting and you can go on their annual meeting and like, who are the sponsors? Who is the lead sponsor for the Narek annual meeting?

The Edison Electric Institute, the utilities trade group, I mean, I don't know how you can get more shameless than that. So, so I, I think though that there's just so much, the utilities, you know, when you think about utility reform, it's typically, it's like, um, you know, [00:45:30] consumer groups, sometimes. You know, consumer environmental versus utilities and wall street and like, that's just a non starter and you can shame them all you want.

I don't think you'd, and I think in on, um, in utilities and electric utilities in particular, the utilities have co opted the environmental movement, but that's a discussion for another story. Like they, they basically have convinced them that no, they need the ROE, high ROEs for the energy transition. So environmental groups are not big.

Advocates on like, they don't, they don't make a big stink about typically don't make a [00:46:00] big stink about ROE. They don't care too much. So I think though, uh, if you can peel off some of the investor community, people who, Oh, I can make money by going on the other side of the utilities that I think is the linchpin,

**Matt:** thank you so much, Mark.

And, um, I sense a deep rage underneath the very nerdy exterior. The, the, and I, and I respect that tremendously. Yeah. So yeah,

**Mark:** yeah. I just find this, I [00:46:30] had this thing about abuse of power. People who are in positions of authority, like they have, they're entrusted with responsibility. And when they say it's like, no, this is my privilege.

I just think like you undermine. So much in society, like it's just a, and particularly like I got in, I've been working the utility industry. My very first job was a seasonal waterworks labor for LADWP. I was 18 years old. And I'm just like, these people, they, one, they kind of keep society running and we don't even like, we don't even realize it.

They're [00:47:00] like down there keeping everything going. But then you have these people who are running it who are just like, yeah, this is my tool to just rip customers, rip the public off. The

**Matt:** pocket

**Mark:** picking machine.

**Matt:** Uh, well listen, thanks for coming. We really appreciate it and good luck. Uh, we're cheering for you and we'll do, I'll do what we can to help you.

**Mark:** You know, it's my pleasure.

**Matt:** Well, so I've, I've known Mark, I guess, six [00:47:30] months or a year or so. And he, he approached me because he was interested in, he's interested in monopolies and competition, as you can tell. And he laid out this, basically the story that he told us and said, here's what's going on. It's this small group of experts, the evil nerds, right?

Who run the world in my corner of his corner of the world. And I thought. This is exactly like what happened with antitrust, where you had a small group of annoying experts who said, we don't have a monopoly problem. Everything is great. And Hey, they had running antitrust into the ground [00:48:00] since the 1980s.

And I was like, this is the same thing.

**David:** And I'll extend it even more. They use fake models of the world. That don't correspond to how things actually happen in order to do it. Uh, the fact that they're, they're using these bespoke models that the national energy regulator literally called garbage, and yet they're still using them is, is it's

**Matt:** just an incredible story.

I think in some ways it is the story of modern, uh, modern America because, or the modern American economy, [00:48:30] because you can find analogies to this in every, pretty much every sector, right? You work in antitrust and you see, cause antitrust is across sectors, but you could go into healthcare and I'm sure you would find certain calculations for Medicare reimbursements or, or, or PBMs or whatever.

And you'd find similar nerds who are doing the consensus thing. upcoding,

**David:** right? I mean, the fact that you take a customer code and make your patient look sicker so you can get more reimbursement, that the whole value based care model, [00:49:00] uh, right there is, is exactly an example of this. And it's hundreds of billions of dollars.

**Matt:** I mean, I was told about a spectrum auction that was, that was organized by Nobel prize winning Uh, economist who was also kind of working for private equity firms that were like going into the auction and meanwhile working for the organization, the FCC that was structuring the auction. And it's like, there's a small group of auction experts.

And so it's like [00:49:30] there, there are, you go around and they also do energy stuff, like not in the utilities, but it's like you go around America and what you will find, the reason you, you know, you find something that's irrational. And often what you will find is there's a small group of credentialed, certified people who are like, don't touch our models.

Our models are beautiful and it's screwing everything up.

**David:** I think there is value in just saying, just lifting the curtain on, on the evil nerds and, and just saying you're, you're [00:50:00] ridiculous. So, uh, well that was great. Uh, I hope you enjoy, uh, hope you enjoyed the episode and next week. You're really going to enjoy it because we are going to bring on the former chair of the federal trade commission, Lena Kahn, to talk to us about all things antitrust.

And, uh, it should be a great one. Don't want to miss it.

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