

Lower Return on Equity for Wildfire Capital Expenditures

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The Problem:

From 2019 to 2024, California authorized investor-owned utilities (IOUs) to collect more than \$40 billion in wildfire related costs. Roughly 60% (\$26.6 billion) of these authorized costs are attributable to pre-catastrophe wildfire mitigation costs (including operational costs like tree trimming and capital investments like undergrounding lines) and 40% (\$13.6 billion) to post-catastrophe liability costs (including insurance premiums and catastrophic event costs).²

- **Wildfire costs now account for 14-19% of a residential customer bill, increasing the average customer's annual bill by roughly \$250-\$500.³ Wildfire costs have been the single largest driver of investor-owned utility rate increases over the past five years.⁴**

2024 Year-End Wildfire Related Revenue Requirement ¹		
Utility	Wildfire Cost	% of Total Costs
PG&E	\$5.4 billion	27%
SCE	\$2.9 billion	17%
SDG&E	\$0.685 billion	17%

Regulated Monopoly Economics: Return on Equity (ROE)

Regulated monopoly utilities are legally entitled to earn a “reasonable” rate of return on the value of the assets (i.e. CapEx) they deploy to provide service to the public.⁵ The California Public Utilities Commission (CPUC) determines this reasonable rate of return for all energy utilities through a proceeding every three years. The CPUC sets the return on capital by calculating a weighted average return for both debt and equity (typically around 50/50). The debt piece is mostly outside of the utility's control; it is the rate banks charge to lend money to the utility. The equity piece is the amount of profit shareholders earn for investing in the utility. For most companies in the economy, the return on equity depends on how well the company performs (e.g. how many iPhones can you sell and at what profit margin?). However, without regulation, monopolies could set whatever price they want. Regulators therefore set the ROE for utilities at a level that is both reasonable and sufficient to allow the utility to raise capital from investors (i.e. Wall Street).

¹ Revenue Requirement is the total cost of utility service for a given year. The authorized revenue requirement is divided among customer sales to determine rates. SB 695 Report at p. 36.

² Sieren-Smith, Bridget, *2025 Senate Bill 695 Report*, California Public Utilities Commission, Sept. 2025 (“SB695 Report”) at pp. 28-29.

³ Estimate at year-end 2024. SB695 Report, Table 12 at p.38.

⁴ Wiser, Ryan, et. al., *Factors influencing recent trends in retail electricity prices in the United States*, The Electricity Journal, Vol.38:4, December 2025, p. 7 (estimating that wildfire mitigation and liability accounted for the single largest driver of cost increases at 4.3 c/kWh increase compared to residential rates of 35-45 c/kWh).

⁵ *Bluefield Water Works v. Public Service Comm'n*, 262 U.S. 679 (1923).

Utility	Debt	Equity (ROE)	Prior ROE	2026 Avg. CoC
PG&E	5.04%	9.98%	10.28%	7.61%
SCE	4.71%	10.03%	10.33%	7.59%
SDG&E	4.59%	9.93%	10.23%	7.41%

In the most recent cost of capital proceeding, the CPUC authorized a slight reduction in ROE to just under 10%.⁶ The CPUC then calculated the average cost of debt and equity (the “cost of capital” or “CoC”) at 7.41-7.61%. This means that all undepreciated capital assets (i.e. rate base) will cost ratepayers roughly 7.5% in financing costs. This cost of capital generally applies to all of the undepreciated assets (the “rate base”) of the utility.

The Opportunity: OpEx vs. CapEx

After many years of massive increases in spending on wildfire maintenance costs like tree trimming, utilities are shifting strategies to invest in longer term infrastructure projects like undergrounding to reduce wildfires. As this shift from short term to long term costs happens, an opportunity exists to lower the costs to customers by reducing the profit utilities earn on long term wildfire mitigation infrastructure.

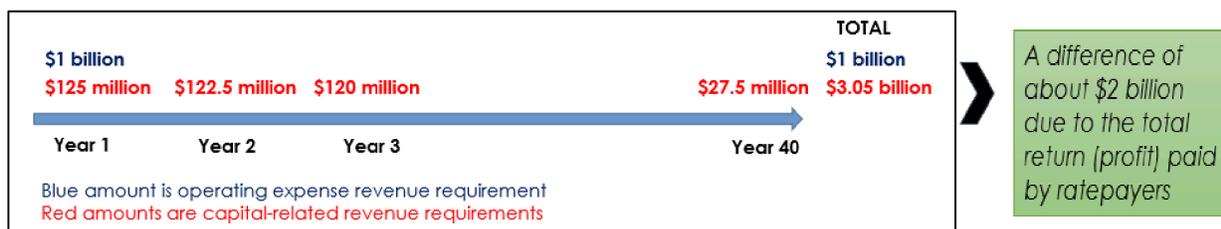
The vast majority of wildfire expenses over the past five years have been operational costs (OpEx) like vegetation management. These are passthrough costs that do not earn the utility a profit. Utilities typically recover these costs over just a few years in short-term tracking accounts called “memorandum accounts” that the California Public Utilities Commission (CPUC) approves. When the commission approves these memorandum accounts, they are quickly added to rates, causing them to spike. When they expire, customers see an immediate decrease in rates. Many wildfire-related memorandum accounts began expiring in 2024, which has caused some customer rates to decrease in 2025 and 2026. This variability can result in large up and down swings in customer rates from year to year from OpEx.

In contrast, capital expenditures (CapEx) are spread out over time. Once regulators approve a capital expenditure, the utility amortizes it over the useful life of the asset. Customers pay for CapEx in two ways: (1) depreciation expense, which is a portion of the amount invested by the utility amortized over the life of the asset (“recovery of capital”), and (2) debt and equity costs, which are the financing costs for the undepreciated portion of the asset (“recovery on capital”). This dynamic is similar to how a bank recovers a home mortgage loan from a borrower: part of the monthly payment goes toward (1) principal, and the other part goes toward (2) interest. This means that annual CapEx costs are lower but spread out over time with higher financing costs.

These two types of spending - OpEx and CapEx - impact customer rates in different ways. If a utility spends \$1 billion in CapEx and \$1 billion in OpEx in the same year, the CapEx spending will have a much lower immediate impact on rates, but customers will pay for it over the entire life of the asset (i.e. decades). The OpEx, on the other hand, will impact customers immediately, but it will come out of rates quickly. The CPUC recently provided a helpful illustration of this dynamic showing that a hypothetical \$1 billion CapEx could end up costing ratepayers more than \$3 billion over the life of the asset.⁷

⁶ D.25-12-043; [CPUC Cost of Capital Decision](#), Dec. 2025.

⁷ SB695 Report, Figure 1 at p.14.



This tradeoff between OpEx and CapEx does not necessarily mean that CapEx is bad for ratepayers. In the context of wildfire mitigation, paying for capital projects like line undergrounding eliminates much of the need for ongoing maintenance like tree trimming, while also essentially eliminating the risk of ignition for the buried line. Nevertheless, the utility’s profit motive in shifting from OpEx to CapEx spending raises concerns among regulators and the public that the company may be “goldplating” their spending decisions (i.e. purposefully choosing higher cost capital projects to boost earnings).

As utilities catch up on deferred vegetation management expenses, ratepayer costs for those ongoing OpEx costs should decrease, but they will not go away entirely. Utilities are therefore looking to shift to more “permanent” solutions by spending more on CapEx wildfire projects. In other words, **utilities are in the process of adjusting the ratio of wildfire-related spending from more OpEx spending on wildfire mitigation like tree trimming toward more CapEx spending like undergrounding.**⁸ This shift could lock-in CapEx costs for decades and increase overall costs to ratepayers.

A Potential Policy Solution:

The CPUC could authorize a split return on equity (ROE) with a lower return on wildfire capital expenditures (CapEx).

To address the significant cost pressure facing ratepayers and promote long-term affordability without limiting needed wildfire-related investments, regulators could establish a lower return on equity (ROE) solely for capital expenditures that are included in the utilities’ wildfire management plans. This change would significantly lower the financing cost for wildfire-related mitigation at a time when costs are shifting from short-term OpEx to longer term CapEx. A split ROE that lowers the return on wildfire CapEx could still pass the legal requirement that ROE be “reasonable” if the CPUC’s decision includes evidence that links investments made in wildfire mitigation with a reduction in the utility’s catastrophe-related

⁸ See, 2021 Q2 PG&E Earnings [Transcript](#). “A safer, permanent fix was a better [operational] expense to capital shift, which makes it safer and more affordable for the people that we serve.”

liability risk.⁹ Put another way, one of the biggest concerns from Wall Street is that utilities will cause a destructive wildfire. Regulators could therefore reasonably authorize a lower return on wildfire capital expenditures because the utility receives an implicit return on its investment in wildfire ignition reductions that is not present in typical utility investment decisions. Establishing a split ROE for Wildfire CapEx could offer the following features:

- Near term rate reductions with long term savings: Providing support for utilities to reduce OpEx spending on wildfire mitigation will result in immediate rate relief because those passthrough costs will fall out of rates quickly. However, converting operational spending to capital spending risks locking in high rates for decades. Lowering the ROE on wildfire CapEx continues to support the transition from OpEx to CapEx, but at a much lower “financing” cost to ratepayers.
- Balance investment and profits during the climate crisis: Wildfire mitigation is a critical utility task, and utilities should not be punished for investing the capital necessary to protect communities from utility-caused wildfires. However, many stakeholders oppose utility shareholders profiting from the climate crisis and have advocated for large reductions in utility profits across the board. A lower ROE for wildfire related CapEx could strike a fair balance between utility financing needs and utility profits.
- Offset utility credit rating impacts: Reductions in ROE can lead to adverse impacts to utility credit ratings, which in turn can increase borrowing costs or restrict access to capital. On the other hand, utility credit ratings can benefit if wildfire CapEx projects reduce potential liability. The split ROE proposed here applies *only* to wildfire projects, thereby protecting the ROE for standard infrastructure to maintain market confidence. Moreover, the benefits of projects that lower wildfire risks would at least in part offset the adverse impacts to credit ratings from reduced earnings on those projects.
- Increase trust that utility wildfire investments are not “goldplating”: The nature of monopoly utility regulation makes regulators and the public wary of utility motivations when the end result is a sustained increase in capital spending. On the other hand, shifting utility wildfire spending from OpEx to CapEx in some circumstances could be both safer and more cost effective in the long run. Lowering, but not eliminating, ROE for wildfire CapEx will allow utilities to more credibly argue that the project costs are truly necessary and cost effective.

⁹ Regulators must allow a public utility to earn a return on the capital assets that it deploys for public use. *Bluefield Water Works & Improvement Co. v. Public Serv. Comm'n*, 262 U.S. 679 (1923). However, in determining just and reasonable rates, courts will assess the “total effect” or “end result” of the authorized rates rather than any specific formula. *Federal Power Com. v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). With regard to the cost of capital, as with other aspects of ratemaking, there is a “zone of reasonableness” that strikes a fair balance between the financial interests of the company and the public interest. *Farmers Union Cent. Exchange, Inc. v. Federal Energy Regulatory Com.*, 734 F.2d 1486, 1502 (D.C. Cir. 1984)(citing *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968)). Courts have upheld split levels of return on equity where the agency demonstrated a link or nexus between the specific investments and the alternative return on equity. *Conn. Dep't of Pub. Util. Control v. FERC*, 593 F.3d 30 (D.C. Cir. 2010)(upholding FERC’s decision to offer a bonus ROE for transmission projects completed within a specific time period).