

# Stakeholder Concerns and Balancing Interests

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# Stakeholders

- Government
- Utilities
- Environmental Groups
- Competitors
- Consumers

# Government

- **PSC Primary Goal: “Public Interest”**
  - **Just and Reasonable rates**
  - **Safe and Adequate Service**
  - **Environmental Justice**
  - **Balance Stakeholders’ interests**
- **Ensure that utilities have an opportunity to earn a fair return on the capital**
- **No undue rate discrimination**
- **Rate stability (and) affordability**
- **Address needs of customers**
- **Public Acceptance; Public Relations**
- **Economic Development**

## Government (contd)

- **Ensure that utilities have an opportunity to earn a fair return on the capital**
  - Lower rate of return -- lower rates -- customers see lower bills
  - Higher rate of return -- higher rates -- customers see higher bills
- **However, if returns are low, utility will have difficulty raising capital**
- **Also, higher regulatory risk can raise cost of money, thus leading to higher ultimate cost to customers**
- **Inadequate capital can hurt utility ability to invest in infrastructure that could adversely impact service quality (e.g., reliability)**
- **Poor service quality leads to higher customer costs in terms of lost production and comfort**
- **Challenge is to find the “right” return**

## Government (contd)

- **Ensure rates are not unduly discriminatory**
  - rates should have relationship to cost causation
  - rates should cover at least marginal cost for efficiency purpose
  - rates could be different based on factors such as Time-of-use, voltage level, season etc
  - rates could be structured to accomplish policy goals (e.g., for economic development, low-income customers); however, basic economic principles should not be compromised that could lead to inefficiencies

## Government (contd)

- **Rate Stability and Affordability are important factors**
  - **Customers generally prefer stable rates in order to plan their budgets; frequently varying rates disrupt certainty expectation and could lead an increase in risk**
  - **If rates are not affordable, customer welfare is adversely impacted**
  - **Could lead to “discrimination”**

## Government (contd)

### ● Public Acceptance

- is extremely important for the system to work
- lack of acceptance could lead to interference from politicians; and could lead to the development of sub-optimal solutions
- customer dissatisfaction will increase costs
- lack of acceptance will divert precious resources away from productive activities

## Other Government Entities

- **Taxes:** Fair tax policy; should improve economic efficiency, not distort rational economic activities
- **Economic Development:** energy rates should not be a barrier for economic development
- **Social Services:** Address the needs of people who cannot afford energy services
- **Environmental:** Ensure environmental justice; address pollution issues
- **Research:** Conduct research in activities that would improve the production and consumption of energy

# Utilities

- **Regulatory Certainty**
- **Transparent and Fair practices in decision making by regulators**
- **Adequate return on capital; no confiscation of property**
- **Minimal Regulatory Intrusion**
- **Flexibility in modifying policies**
- **Ability to deal with labor in a fair manner**
- **Public Image**
- **Threat of competition**
- **Survival**

## Utilities (contd)

- **Regulatory Certainty is important for long term planning**
- **Constantly changing policies lead to uncertainty and increase in costs unnecessarily**
- **There should be flexibility given to utility in accomplishing objectives**
- **Too much micro-management from regulators could lead to inefficiencies**
- **Setting up expectations apriori is better than after the fact prudence reviews**

## Utilities (contd)

- There should be transparency in regulatory decision making process
- The decisions should be logical, fair and understandable
- The expectations from utilities should be reasonable and realistic
- Utilities should have a fair opportunity to question Commission decisions

## Utilities (contd)

- **Employees are the primary asset for any enterprise**
- **Improvements in labor productivity is key to enhanced efficiency and lower costs**
- **Management should have flexibility in managing its work force; of course, employees should be protected through fair labor practices**
- **Government interference in the day to day management leads to sub-optimal solutions**

## Utilities (contd)

- Threat of competitors “eating your lunch” is typically a great motivating force to enhance efficiency and productivity
- Goal should be to increase the pie as opposed to simply getting stuck in a zero sum game
- The temptation could be, however, to seek protections from competition to maintain turf and survive
- Also, barriers are erected for competitors, primarily through unfair means.

# Consumers

- **Customer Types**
  - **Domestic**
  - **Commercial**
  - **Industrial**
  - **Agricultural**
  - **Religious, Non-profit**
- **Low Rates and Good Service are primary expectations**
- **“Choice” of providers a recent phenomenon**

## Consumers (contd)

- **Rates**
  - **Low**
  - **Fair**
  - **Competitive**
  - **Affordable**
  - **Understandable**
  - **Stable**

## Consumers (contd)

- **Service**
  - **Universal**
  - **Access**
  - **Installation of new service**
  - **Reliable**
  - **Quick Repairs**
  - **Customer service (billing, metering, collections, customer representative courtesy)**

# Environmental Groups

- **Issues:**

- **Public Goods**
- **Siting new generation facilities**
- **Siting new transmission facilities**
- **Retiring generation facilities**
- **Nuclear Plants**
- **Overhead vs underground distribution lines**
- **Promotion of demand-side management programs**
- **Process for decision making**
- **Funding Source for advocacy**

## Environmental Groups (contd)

- **Public Goods**

- **Concept not well understood**
- **Little appreciation for how decisions should be made in order to procure the right amount**
- **Few processes in place to address the issue in a comprehensive manner**
- **Lack of adequate public involvement**
- **Lack of adequate funding to address the issue**

## Environmental Groups (contd)

- Quantifying costs for improving environment relatively easy; quantifying benefits more difficult; cost benefit analysis involves judgement
- Customers want better environment; however may not be willing to pay
- Economic Development vs Environment debate

## Competitors

- Fair and clear rules for doing business
- No abuse of market power by any player
- Level Playing Field for all players
- Adequate Information flow to facilitate competitive market
- Liquidity in the market
- Minimal government intrusion

## Balancing Interests

- **Customers vs Investors**
  - **Customers: Domestic vs Business vs Agricultural;**
  - **Economic vs Policy goals**
  - **Investors: Fixed Income vs Equity holders**
- **Supply vs Demand Side Management**
- **Labor vs Management**
- **Regulation vs Competition**

## Balancing Interests (contd)

- **Customers vs Investors:**
  - **Utility need for higher revenue vs customers' need for lower rates**
  - **Adequate return for investors**
  - **Regulatory Certainty for investors**
  - **Just and Reasonable rates; Safe and Adequate Service for customers**
  - **Affordability for customers**
  - **Certainty and Stability in rates**

# Balancing Interests (contd)

## Investors

- **Bondholders vs Equity holders**
  - **Moral hazard concerns: Equity holders select Board of Directors. BOD oversees management. They may act in a manner beneficial to shareholders at the expense of bondholders**
- **Bond covenants and other special protections incorporated for bondholders so as not to increase their risk**
- **Interest in maintaining “investment grade” bond ratings**
- **“Junk” bond rating increases cost of money that ultimately customers have to pay**
- **Junk rating also makes it difficult to raise capital**
- **Optimal bond rating criteria is a controversial factor in decision making**

## Balancing Interests (contd)

### Investors

- Reaction from financial markets an important factor
- Company should be able to raise financing to invest in infrastructure
- Interest in keeping the company viable to provide adequate service
- Bankruptcy is quite disruptive and not a preferred solution

# Balancing Interests (contd)

## Investors

- **Determining a fair rate of return**
  - generally controversial topic
- **Cost of money**
  - Weighted Average Cost of Capital (WACC)
  - Capital Structure (Debt, Equity ratios)
  - Cost of different elements of capital
  - Cost of debt more certain
  - Cost of equity involves modeling, analysis, and judgement (different methods to determine cost of equity include DCF, CAPM etc.)
  - Lot of money riding on this determination

# Balancing Interests (contd)

## Investors

- **Regulators provide only an opportunity to earn an allowed rate of return**
- **Actual rate of return may be higher or lower than allowed return**
- **Incentives to utilities**
  - allowed rate of return
  - sharing between customers and shareholders of the “excess” earnings beyond a threshold
  - extra incentives for specific policy goals
- **Regulators balance incentives for cutting costs to improve utility productivity vs maintaining service quality to customers**
- **Watch out for perverse incentives**

# Balancing Interests (contd)

## Customers

- **Interclass revenue allocation**
  - **Revenue Allocation determines impact on customers among different service classes**
  - **Cost causation a primary factor for utility cost allocation**
  - **Determine “rate of return” by service class to determine if each customer class is paying its “fair” share**
  - **Minimize cross subsidies between customer classes**
    - **historically large business customers subsidized domestic customers; but with increased competitive markets in a globalization era, cross subsidies are being phased out**
  - **Social goals vs economic efficiency**
  - **Marginal vs Embedded cost**

# Balancing Interests (contd)

## Customers

- **Rate Design**
  - Rates should be designed so utility revenue requirement is met
  - Avoid rate shocks; stability and continuity preferred
  - Gradual changes are better accepted
  - Cost causation still a driving factor in determining rates
  - Domestic: Fixed customer charge and volumetric usage charge
  - Business: Customer charge, demand charge and energy charge

# Balancing Interests (contd)

## Customers

- **Rate Design (contd)**
  - **Undue discrimination should be prohibited**
  - **Due discrimination is allowed: Differentiation based on**
    - **Time of Day**
    - **Season**
    - **Load Factor**
    - **Voltage**
    - **End Use**
  - **Flat vs declining block vs inclining block rates send different signals**
  - **Reflect Marginal costs where possible**

# Balancing Interests (contd)

## Customers

- **Rate Design (contd)**
  - **Appropriate cost studies, data very important in helping design rates**
  - **Need for trust and confidence in data for all stakeholders**
  - **Customer (accurate) metering essential to facilitate measurement of usage**
  - **Tariff pricing and customer knowledge of tariff prices essential for customer to respond to price signals**
  - **Without proper price signals, consumption would be uneconomic**
  - **Aid customer in how to modify usage - to benefit both customer and system**

# Balancing Interests (contd)

## Customers

- **Price vs Service Quality**
  - **Service Quality:**
    - **Reliability** (frequency and duration of outages, voltage fluctuations etc)
    - **Customer Service** (accurate billing, accurate meter reading, ease of bill payment, courtesy of utility employees, dispute resolution process etc.)
  - **High price but low service quality not acceptable**
  - **Decision makers have to decide optimal relationship between quality and price; mix may vary among customer classes**

# Balancing Interests (contd)

## Customers: Policy Goals

- **Business Customer needs**
  - **With competition in global markets, businesses have to be competitive**
  - **Energy a primary cost component for many businesses**
  - **If energy prices high, it could make their products less competitive**
  - **Using business customers to subsidize other customers may not be sustainable in the long run, they will leave the utility system completely thus adversely impacting all customers**

# Balancing Interests (contd)

## Customers: Policy Goals

- **Business Customer needs (contd)**
  - Policy goals could include retention, expansion, and attraction of load for economic development and better utilization of system
  - Lower rates for businesses could potentially mean higher rates for others; but it could also lead to higher employment
  - Some evaluate the tradeoff as having a job and paying higher rates vs not having a job and paying lower rates
  - Rates should at least cover marginal costs for economic efficiency
  - Incentives should be structured that would provide signals that would benefit both business customers, utility and its other customers

# Balancing Interests (contd)

## Customers: Policy Goals

- **Low-Income Customer needs**
  - Energy is an essential vital commodity and should be universally available
  - Customers should be able to access and afford energy
  - Energy burden could be measured as a percentage of customer income
  - High energy burden takes a customer's income away from spending on other essential needs
  - Subsidies appropriate to ensure a minimum standard of living
  - Form of subsidy important: Energy vouchers vs rate discounts
  - Different forms of subsidies provide different signals
  - Ensure that economic efficiency principles are not compromised

## Balancing Interests (contd)

### Supply vs DSM

- Supply and Demand Side Management are two ways to meet growing customer usage
- DSM includes peak shaving, load shifting, valley filling, energy efficiency activities
- Balance Supply vs DSM: how to do it somewhat controversial
- Sell more vs sell less concepts could provide conflicting incentive signals

## Balancing Interests (contd)

### Supply vs DSM

- Incorporation of DSM in the planning process important
- Cost-benefit analysis is critical
- Identifying costs easier than quantifying benefits
- Addressing environmental and other externalities a challenge sometimes
- Who pays for DSM costs?: “Participants” vs “non-participants” debate

## Balancing Interests (contd) Labor vs Management

- Generally relationship between management and labor should be left to those parties
- Regulatory involvement should be minimal
- Other agencies address the safety and welfare aspects of employees
- However, regulators should be ready to evaluate if there are allegations of mismanagement that would harm employees or customers

# Balancing Interests (contd) Competition vs Regulation

- Role of government vs role of competitive market
- What products should be regulated and what products should be in the competitive arena?
- How do we make that decision?
- How do we facilitate the development of a competitive market?
- How do we ensure that there is sufficient “workable” competition in the market before regulation is relaxed?
- How do we continue to monitor the market for market power abuses?
- What systems and mechanisms are needed to evaluate that the market is “working” for the benefit of customers?