

Living in a rapidly changing regulatory environment:

I know we should have a pricing strategy but what should it be?

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Session Purpose

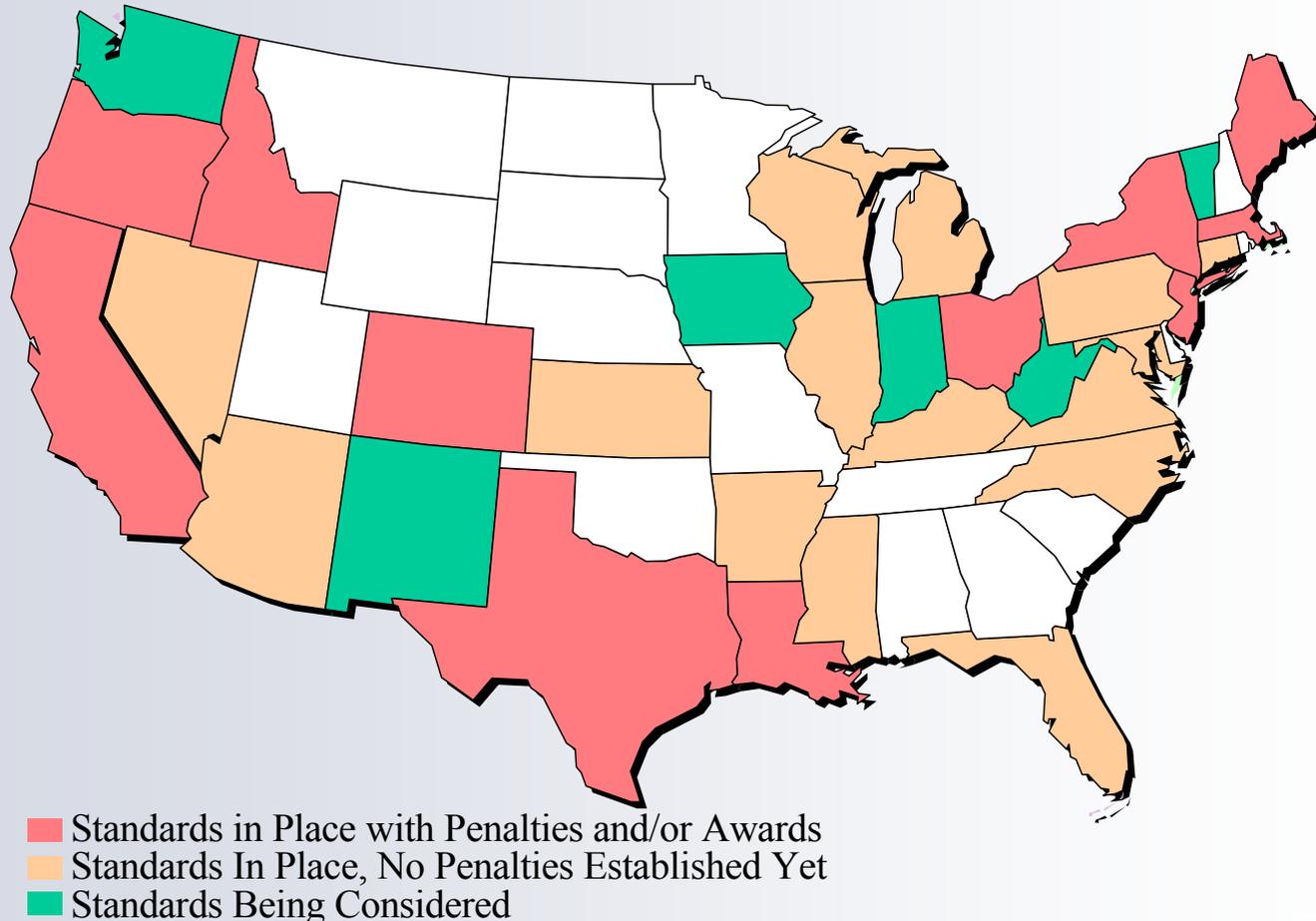
- Stimulate YOUR thinking and have a productive discussion.
- Give you a “heads up” on examples of possible new regulatory rules that are developing.
- Identify some issues you will likely face and pricing options to consider.

The New Regulatory Model

There are two major changes starting to shape our industry operating environment.

1. The speed and pressure for regulatory change is increasing.
2. There are two large structural changes occurring in our industry.

26 States Have Service Reliability Standards – With Penalties and/or Rewards



Source: *Managing the New Financial & Regulatory Risks of Electric Distribution System Reliability*
By Michael Mount, George Fitzpatrick, & Richard Wight – April 2004

The Speed and Pressure for Regulatory Change is Increasing

26 states have service reliability standards compared to only 3 in 1996

Not meeting the standards can get expensive:

- \$20 million – poor vegetation mgt. Penalty
- \$25 - \$100 penalty per customer for poor reliability
- A utility requested \$133 million, got \$43 million

Two Large Structural Changes are Occurring

1. Growing use of reliability and service quality metrics in PBR regulation.
 - Less concern about deregulation, more about how to “***change the Regulatory rules on R.O.E.***”.
 - **IOU concerns:**
 - Does the risk of large penalties and negative public opinion outweigh any financial rewards?
 - How to show regulators they are doing a good job now.
 - **Regulator concerns**
 - Increasing “prudent utility” investment in facilities & infrastructure to avoid shortages & blackouts.
 - Holding rates low.

Two Large Structural Changes are Occurring

2. Growing recognition among regulators that there are 2 types of services: essential and optional, and that both types can be provided by regulated IOUs.

- Essential utility services – basic electric service
- Fully regulated IOU service providers are providing customer-driven voluntary/optional products and services.
 - FlatBill
 - Green pricing
 - TOU
 - Outdoor Lighting

Three Implications

1. New regulatory body responsibilities.
2. Increased emphasis on performance standards & service quality.
3. New IOU game plan needed – being proactive is essential to your success.

1. New Regulatory Body Responsibilities

- IS their role to act as a fiduciary for all customers – not just special interest or vocal customer groups.
- IS their role to recognize the difference between “essential” services and “voluntary” services [i.e., outdoor lighting]
 - That all customers do not value the same services
 - That customers can determine for themselves what is “in their own best interests” regarding voluntary services

1. New Regulatory Body Responsibilities

- IS their role to ensure that “basic essential” services are cost-based while permitting “voluntary” services to be value or market-based.
 - To encourage utilities to offer pricing options and other voluntary services that customers [not the “rule makers”] value.
- NOT their role to determine what voluntary services are provided at what price provided they are not subsidized from essential services.

2. Increased Emphasis On Performance Standards

Performance standards criteria:

- Reliability
 - What is “acceptable” or “prudent”
 - What will customers pay more for
- Customer Satisfaction
 - What is “desired” or “good”
- Customer Service Quality
 - What is “improvement,” “acceptable” or “prudent”
 - What will customers pay more for

3. New IOU game plan needed – being proactive is essential to your success

■ **Internally**

- Begin the education & team building process NOW.
- Educate all senior management [not just Regulatory] on why this “new regulatory model” is a strategic issue with big potential risks & opportunities.
- Build a team including T&D operations, Customer Service, Accounting/Financial, Regulatory, Marketing, & Corporate Communications.
- Remember it takes time to build the “customer choices and service quality team”, get any needed information, & develop organizational buy-in.

3. New IOU game plan needed – being proactive is essential to your success

■ **With the regulatory bodies**

- Begin showing them what customers need & value based on sound research.
- Demonstrate that you are working hard to:
 - Prudently improve service infrastructure, service quality, and deliver value to customers.
 - Offer optional pricing & service choices that customers need and value and track satisfaction scores to prove it.
 - Prudently provide cost effective & quality essential services.
- Tell regulators you recognize the service quality - ROE linkage and want to help develop reasonable service quality standards that include adequate incentives for the company.

Should you be concerned?

- 1. YES, assuming \$100 million or so is significant to your company.**
- 2. WHY, because the game is changing.**
 - The N.E. Blackout & de-regulation raised awareness of the need for continuing investment in reliability improvement.
 - Regulators are becoming more active in establishing service quality standards, & financial consequences – both reward & penalty.
 - Regulators are turning more to BIG penalties to get utility management attention.

What type information is needed?

1. Solid data that can be used to track

- ✓ Operational results – SAIDI, SAIFI, & Customer Service Requests & Transactions
- ✓ Financial/Economic needs – T&D & Customer Service investment & O&M expenses
- ✓ Customer attitudes, needs, & values – what they think about your service [customer satisfaction], what service they need, value, & perceive to be “fair” or “reasonable”.

2. If you don't have solid data – get it now.

3. If you have data and don't know how to use it to deploy assets & set strategy - get help.

Your Pricing Strategy Options



Traditional or Value Based?

You Have Two Options

1. Continue in the traditional manner – prices based on costs

OR

2. Develop a blended strategy that encompasses both traditional pricing products AND customer or value based optional pricing products

An Example of Pricing Opportunities and Solutions

Case Study: Georgia Power

FlatBill™



Electric Utility Atmosphere Georgia Power Company

- Competitive electric suppliers since 1978
- Sufficient base load capacity
- Short run marginal cost < average embedded
- Competitive pressure increasing from Muni & Coop/EMC suppliers

Why Offer Pricing Options Especially like FlatBill?

- Reinventing the business paradigm... GIVE CUSTOMERS WHAT THEY WANT. They'll pay for it!
- "...we cannot succeed without a commitment to innovation and a willingness to explore new opportunities. Our customers will expect more, and we will be aggressive in anticipating and surpassing their expectations..."

Allen Franklin - President and CEO

The Product ...

Sample FlatBill Offer

- * Past 12 month energy usage.....\$1150
- * Weather Normalize usage.....\$1100
- * Customer Behavior Adder.....\$1130
- * Risk Adder.....\$1200

Offer = \$100/month

Customer Value:

Protects customers from any variation in their electric bill. This includes protection from weather, energy/fuel prices, and even customer behavior.

Utility Value:

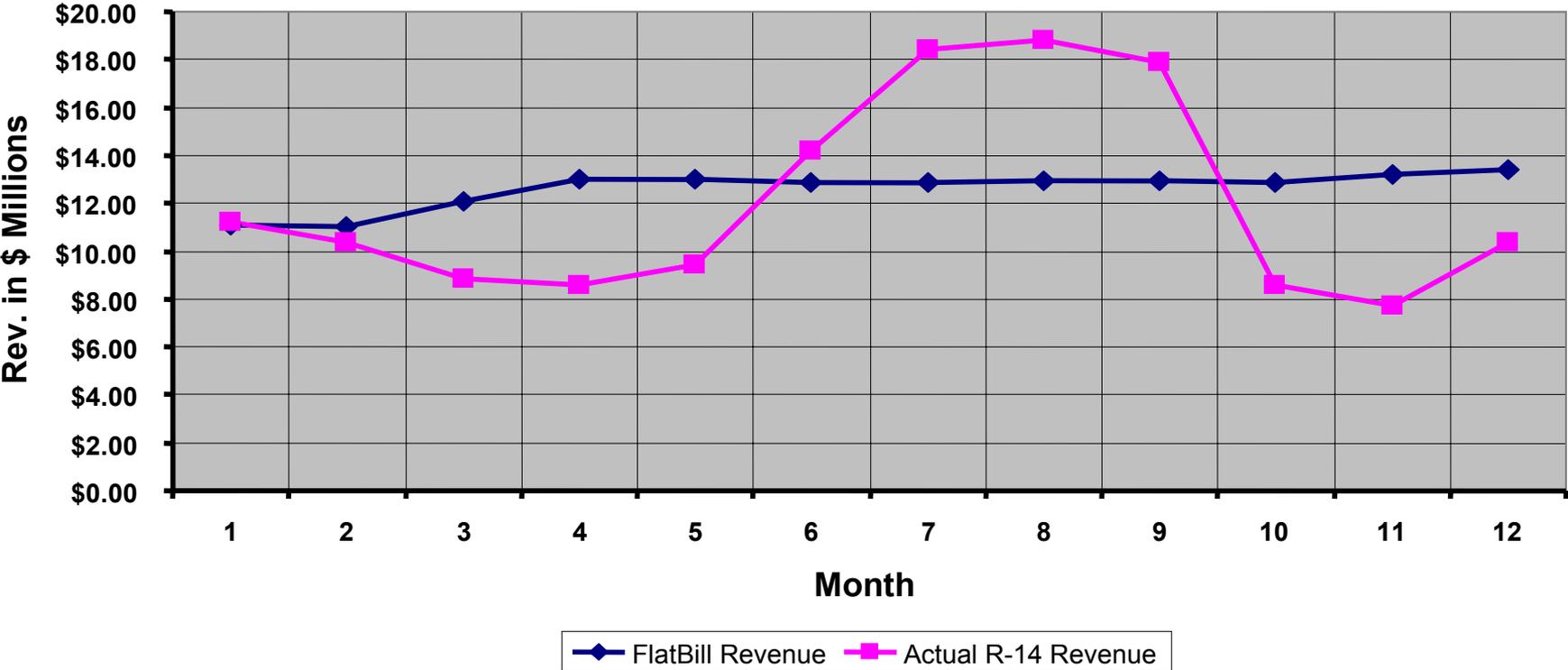
Improves customer service, stabilizes revenue and reduces administration costs.

The bottom line...GA Power

- Georgia Power's success with *FlatBill* has encouraged all Southern Company operating companies to file for open or pilot tariffs.
 - Alabama Power has signed up several thousand
 - Gulf Power has received PSC approval
- A new revenue source was right under their noses... all they had to do was give customers what they wanted. And, customers were willing to pay a premium for it!

The bottom line...GA Power

2003 FlatBill Vs. Regular Rate Revenue
138,000 Residential Customers Avg. for the Year



The bottom line...GA Power

- 2002 State-wide rollout exceeded goal by 155%
- Reduced acquisition cost per customer by 25%
- Over 90% of customers satisfied with plan
 - 60% Very satisfied
- 90% Would recommend plan to friends/family
- Re-enrollment of customers at 90+%

Your Action Items

1. Begin preparing for the “new regulatory rules” in your organization NOW
 - Change IS coming & it takes time to adapt to a “new game”.
2. Learn what your customers VALUE and need concerning pricing options and service quality.
3. Develop a strategy to offer more pricing options.
 - Customers value choices & will pay for them

Your Comments, Questions, and Discussion



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