The Utility Business Model Going Forward: Policy, Perception, and Risk Considerations

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Characteristics of *Ancien Regime*

- Limited Upside Potential
- Asymmetric Downside Risks
  - E.g. Open Ended Obligation to Serve
- Absence of Meaningful Price Signals
- Limited Spectrum for Socializing/Privatizing Risks
- Bundled non-Discreet Services and Incentives

Critical Industry Changes

- Rapidly Changing Technology
- Changing Nature of Consumer Needs and Demands (e.g. varying reliability, back up, etc.)
- More Consumer Options
- More Diverse Resource Options (e.g. Distributed Generation)
- Greater Awareness of Externalities

Emergence of Competition and Unbundling

- Potential of Service Specific Focus:
  - Generation
    - micro/macro
    - renewable/non-renewable
    - capacity/energy
  - Transmission
  - Distribution
  - Energy sales
  - Metering and billing
  - Demand side services
    - demand response
    - energy efficiency

Customer Perceptions of Utility

- More Consistent with *Ancien Regime* than Current Reality
- Results in Undervaluing Core Services

Core vs. Non-Core Services

- Core: Transmission and Distribution
- Non-core: Everything else
- Who is Best Positioned to Perform/Manage Core Services?
- Who is Best Positioned to Perform/Manage non-Core Services?

Dangers of Mixing Core and non-Core Services

Erosion from Core Services Revenue Example: Net Metering

a. Inefficient Pricing of Distributed Generation
b. Treating More Costs as Fixed
c. Diluting Efficient and “Green” Price Signals
d. Socially Regressive Allocation of Revenue Responsibility
e. Inefficient Resource Allocation
f. Subsidizing Inefficiency

Misalignment of Risks and Rewards (Example: Smart Meters)

- Risks and Risk Allocation
- Technology Risks (Telephony Visits Electricity)
- Recovering Costs of Assets Whose Technological Obsolescence Occurs Prior to its Physical Demise
- Keeping Pace with Rapidly Changing Technology
- Lost Revenue Risks (Decoupling Sales and Revenues)
- Customer Resistance to Smart Meters

Risks and Risk Allocation cont’d

- Who is Best Equipped to Cope with Risks:
  - Utilities and Alternative Supplier Perspectives
  - Risk Minimization or Benefit Maximization
  - Regulatory Considerations (e.g. Depreciation Schedules) Recovery
  - Fear of Stranded Costs
  - Regulatory Pre-Approval
  - Symmetry Between Risk and Control (Socializing Risks)
  - Managers or Regulators Making Technology Choices
  - Agility in Responding to Change
  - Regulatory or Customer Focus
  - Best Positioned to Capture Supply Side Benefits?
  - Best Positioned to Capture Demand Side Benefits?
  - Best Positioned to Seize Innovation Opportunities?

Conclusion

- Greater Unbundling of Services
- Service Specific Focus
- Limit Utilities to Core Services
- Open Market for non-Core Services