

Comments on Price Caps and Service Quality

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Measuring Service Quality

- Frequency and duration of outages.
- Time required to bring service back to affected customers.
- Customer service measures such as response times in call centers, meeting appointments, etc.
- Perhaps non-outage disturbances such as voltage deviations.

Do Price Caps Lead to Degraded Service Quality

- Clearly, this is a common perception.
- Even in the UK, where they have over a decade of experience with price caps, they are still very concerned with service quality as evidenced by ongoing work at Ofgem.
- However, according to Ofgem, service quality has steadily improved as measured by frequency and duration of outages over the last decade.

Service Quality Can be Degraded under Rate-of-Return

- In Trinidad and Tobago, where ROR is still employed, service quality for both the water utility and electric utility are quite poor.
- In South Africa under ROR, there are still parts of the country where service quality is poor or in danger of sliding quickly.
- The common thread is that regulators and government have a desire to keep rates low, and this often leads to the cutting of costs related to service quality.

Incentives for Service Quality under Price Caps

- Clearly under price caps, utilities will have great incentives to cut their costs including costs associated with service quality.
 - Both capital costs and O&M costs can be targets
- However, there is a countervailing incentive to maintain service quality with respect to maintaining service because there is a strong incentive to expand kWh sold!

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• UK experience

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Price Caps on What Service?

- The problem must be defined carefully.
 - Price caps on energy only?
 - Price caps on wires only?
 - Price caps on metering and billing?
 - Price caps on the entire bundled product or partially bundled product?

Price Caps on Energy Only

- California...Enough said!
- Capping prices on energy only can have provide incentives to utilities to keep these costs down.
- However, the main idea behind price caps is to keep down controllable costs.
- If the service provider does not own the generation assets, it must hedge in some way to stay under the cap.
- If it cannot hedge well, service quality is a controllable cost that may take the hit to make up for "losses" in energy purchasing.

Price Caps on Wires Only

- This is the practice in the UK with respect to price caps.
- Wires companies face a price cap on a per kWh basis for wires services.
- Both the incentive to expand kWh throughput, and therefore good service quality, exists alongside the incentives to cut costs related to service quality in terms of interruptions.
 - This incentive has been strong in the UK price regime.

Price Caps on Wires Only

- A problem exists in that capped prices are sensitive to load forecasts into the future.
- When these do not materialize, the utility has a great incentive to cut costs related to service quality.
 - The recent experience in Brazil during their hydro crisis left many distribution utilities without sufficient revenues.

Price Caps on Bundled Services

- Many of the same incentives exist as with energy or wires only applications of price caps.
- One could imagine accounting separations are more easily blurred and cross-subsidies between different parts of the business could be used to make up for insufficient revenues in one part of the business.

Potential Solutions

- Stay with rate-of-return/cost-of-service regulation.
- Move toward revenue cap regulation for the wires part of the supply chain.
- Separate out service quality from price caps or ROR and institute penalties for not meeting targets.
- Benchmarking for use in penalties and publication to “shame” utilities into better quality

Rate-of-Return

- While utilities have no incentive to cut costs in theory, in practice with regulatory lag they do have this incentive.
- While the incentives may not be as strong as under price caps, the regulator must monitor service quality and perhaps institute a penalty/reward scheme.

Revenue Caps

- Revenue caps would avoid the kinds of problems seen in Brazil with respect to insufficient revenues on the wires part of the business.
- The UK price caps even now incorporate an element of revenue caps.
- However, Ofgem also recognized in its last review that revenue caps dull the incentive for throughput and consequently service quality.

Separating Service Quality from Price Caps or ROR

- As has been done in the UK, deduct from allowed revenues when targets are not met.
 - 2% of allowed revenue to be deducted if targets are not met.
 - Capital not spent on service quality related services, but accounted for in prices to be refunded up to 0.5% of the capital amount.
- For other service measure, financial compensation can be paid directly to customers.
 - Missed service calls, power not being restored within a certain period of time, etc.

Benchmarking

- Can be used to set the standard to compare utilities with one another and penalties/rewards can be based on this.
- Can be used as information to publish the performance of the to bring to public attention poor performing utilities.