Utility regulation

Utility regulation basics

There's no doubt that electricity is considered a vital service, essential in today's world. It is also part of a complex industry, one all the more perplexing with the energy crisis of 2000-2001 and aftermath.

Pacific Power is a **regulated, investor-owned, load-serving** electric utility. What does that mean, and how does it benefit customers?

Regulated

U.S. electric utility companies such as Pacific Power are subject to regulatory oversight at both the state and federal levels. Utility operations within each state are under the jurisdiction of state agencies known as Public Utility Commissions or Public Service Commissions, while interstate operations – primarily related to transmission and wholesale power transactions – are regulated by the Federal Energy Regulatory Commission (FERC) and others.

State commissions are made up of appointed or elected officials, assisted by a staff of utility experts. All of the states served by Pacific Power have appointed commissions. Commissions are charged with reviewing all utility expenditures before they can be passed on to customers in the form of rates. They also serve as watchdogs to ensure that utilities are responsive to customers' needs, and that service is adequate and reliable. Issues within state jurisdiction include:

- Prices charged to retail customers – what utility costs can be recovered through rates
- Services the utility can offer, such as pole attachment for cable and phone companies and the process to be charged for such services
- Standards to ensure utility safety and reliability
- Maximum return on equity that shareholders can earn
- Service area boundaries
- Bookkeeping methods
- Matters relating to financial reorganization
- Proposed purchases, sales or change in status of property
- Company mergers

Regulation evolved to balance the potential pitfalls of a natural monopoly business with strong consumer protection safeguards. In exchange for a franchised, monopoly service area, utilities accept an obligation to serve – meaning there must be adequate supply to meet customers' needs regardless of the cost. While there are no guarantees, utilities also are given the opportunity to recover their costs and earn a "fair and reasonable" return on their investments. Price changes take place only after extensive, public multi-month processes, called rate cases, where utility costs and operations are fully scrutinized. Only cost that pass regulatory muster are allowed into rates.

One size doesn't fit all

Not all utilities are subject to state regulation. Government-owned utilities, including peoples' and public utility districts and municipal power systems, are not under the jurisdiction of state utility commissions. They typically are self-regulated, with local boards setting their prices and service standards. Cooperatively owned utilities, including rural electrical authorities (REAs), are also self-regulating.

Investor-owned

The main distinction between an investor-owned utility (IOU) and a publicly-owned utility is how they are funded. IOUs are funded by a combination of bonded debt (mortgages) and the owners, or shareholders, who invest money by buying stock in an IOU. In exchange, the investors expect (but are not guaranteed) some return on that investment in the form of dividends paid and/or growth in share value. Public entities also must go to others for funding, but they go to the bond market, paying interest for the use of that money.

While debt (purchasing bonds) often has a lower cost than equities (stock), interest on debt must be paid regardless of the business situation. That is not the case with stocks, where the dividend can be lowered or cut altogether if necessary. Shareholders carefully watch the financial performance of their companies, however, and there is a strong incentive for IOUs to operate as efficiently as possible to maintain the balance between competitive prices to customers and stable to increasing returns for their shareholders.

IOUs share in risk

When things don't go well, such as what happened in 2000-2001 when wholesale energy prices skyrocketed, shareholders absorb much of the risk for investor-owned utilities. If state commissions don't allow IOUs full return of those increased costs in customer rates, shareholders must absorb excess costs. Public power entities don't have that cushion and must pass all increased costs directly through to customers.

The energy crisis provides a solid example of what an investor-owned utility must endure. During the crisis, Pacific Power and sister company Rocky Mountain Power together incurred excess net power costs of $1 billion in order to serve customers. The utility was only able to recover around $300 million of these costs, with shareholders absorbing around $700 million, with only a

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slim chance at best of any additional recovery. Public entities, with no shareholders to help shoulder the burden, passed their increased costs along to ratepayers in full. Seattle City Light had a 55 percent increase, Snohomish PUD had a 53 percent rate increase and Clark PUD had a 45 percent increase following the energy crisis.

Investor-owned utilities are tax-paying businesses that directly employ nearly 400,000 people in the U.S., thus enhancing the economic health of thousands of communities, and in some cases, acting as a primary place of employment. They are also a source of revenue and employment for other businesses in the community, as they depend on private companies for goods and services ranging from office supplies to complex generating equipment. IOUs serve nearly 74 percent of American consumers.

Load-serving

A load-serving utility such as Pacific Power is one that provides electric service to a retail customer base through its own distribution system. While still the norm, as the U.S. electric power industry has evolved, new "competitive" or "direct access" rules have been established in many states under which the "poles and wires" utility is eventually to be replaced as the power commodity supplier by new competitive players. The utility's obligation in these situations changes from supplying power to simply delivering it from an alternative supplier to the customer. Today's more open, competitive electricity market suppliers include non-utility producers and suppliers such as cogenerators, independent power producers, merchant generators and power marketers or traders.

As markets evolve and public policy changes, these entities may play an increasing role in generating and transferring electricity within the United States. Pacific Power supplements power supplies from its own fleet of generation stations with purchases from the entire range of independent power suppliers as well as from other traditional utilities. The company continues to consider options from these suppliers as it looks for the most cost-effective, reliable and environmentally sensitive way to meet its customers' needs into the future. As of now, Pacific Power continues to have its full, traditional obligation to provide its customers with safe, reliable economic service and the company's core dedication is first and foremost to meeting that obligation.

Benefits

Despite the obvious differences between investor-owned and publicly owned utilities, the debate continues as to which is better, more efficient, and ultimately, of the greatest benefit to the customers it serves. There is no doubt that public utility districts have their positive attributes, but it is clear that the IOUs also provide customers with great stability, reliability and value.

Being regulated allows an IOU like Pacific Power to maintain some of the lowest rates in the West and in the country, to provide quality and reliable service and, unlike the PUDs, to be the bearer and manager of risk. An IOU also brings to the table social and technological leadership and the capability to maintain the stability of and expand the electrical grid and build new generation as needed. Even more, IOUs contribute to the communities in which they serve though employing hundreds, sometimes thousands, of people, through the payment of taxes and fees, through shareholder-financed foundation grants for charities and community programs, through support with volunteerism and contributions and in leading the way in low-income assistance and environmentally sensitive investments and programs.

Even when the benefits have been weighed and the differences highlighted, investor-owned utilities and publicly owned or government-owned utilities share one common concern: continuing to provide the critical service of electricity to consumers and businesses into the future through sustainable, low-cost and reliable means.

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