



Keeping the Lights On:

Funding Infrastructure of Public Power Utilities

The age-old debate on how to appropriately price services provided by public electric utilities is amplified in the current period of increased customer consciousness, technological change, flat-to-declining demand for electricity and public policy.

Indeed, various views, interests and prerogatives contribute to the conversation. Some are more applicable to the reality of how public power utilities design, build and finance infrastructure than others.

One viewpoint suggests that public power utilities should recover costs, including fixed infrastructure costs, from customers in the same way as private sector for-profit entities, such as oil refineries, airlines, hotels and big box stores. This suggestion overlooks one critical and differentiating point – *the utility’s obligation to serve*. Public power utilities do not share the same business model as private for-profit entities. The former are owned and operated by local governments and tend to focus on obtaining only enough revenues necessary to deliver safe, affordable, reliable power to their communities. In contrast, the primary goal of for-profit organizations is to make money, to the benefits of their owners. Accordingly, public power utilities and for-profit organizations have different goals and missions, and therefore will behave differently.

Public power utilities have an obligation to serve because they provide fundamental services, such as electricity, natural gas,

water and local phone service. These services have long been deemed necessities that benefit society by the courts and policy makers. The obligation to serve means that a public utility must provide service to any customer in its service area who asks for the service, can pay for the service, and agrees to the utility’s rules and regulations. This is true whether it is expensive or inexpensive for the utility to serve the customer. In fact, the establishment of public power utilities was driven in large part by the fact that serving smaller communities was expensive, and not particularly financially attractive to privately held electricity companies. At the same time, the utility is responsible for the safe, reliable operation of its area. Importantly, this includes ensuring that there is enough infrastructure and supply to always meet customer needs. The utility, in many ways, provides an insurance policy for society, providing a safety net for customers when it is needed most. Because utilities have the obligation to serve, they can not just cease to exist, nor do we want them to. They must be in

operation (and in good financial health) to serve the public good.

In contrast, private sector for-profit entities do not have an obligation to serve. Their services have not been deemed necessities by the courts and policy makers, nor are they obligated to provide service to any customer in its territory, regardless of the cost associated to serve that customer (inexpensive or costly). Private sector for-profit entities are not required to maintain infrastructure and supply to meet customer's needs. Private entities are free to exist wherever they choose and serve whomever they choose. And, if market fundamentals do not support their operations, they can choose to close up shop.

In addition to having different business objectives, public power utilities and private for-profit entities have different business models. With respect to infrastructure, it is not necessarily appropriate for public utilities to recover infrastructure costs (fixed costs) one unit at a time in the same manner that private entities recover them, as some advocates would suggest. They reason that because economic theory suggests that all costs are variable in the long run, all utility costs – including infrastructure – should be priced based on long-run equilibrium marginal costs (i.e., recovered on a volumetric kWh basis as opposed to a fixed basis). They liken this to a private entity recovering their infrastructure costs one barrel, room, nail or widget at a time. While long-run economic theory is clearly an advantageous tool for understanding systems and dynamics, it should not be conflated with rate making. Rates are based on a snapshot in time, intended to recover costs incurred for serving customers over a certain period of time – typically there here and now. That period of time includes payment for infrastructure investments. Strict application of long run economic theory to rate making misses the fact that we're living in a single point in time today. As Keynes famously said:

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The long run is a misleading guide to current affairs. In the long run we are all dead. Economists set themselves too easy, too useless a task if in tempestuous seasons they can only tell us that when the storm is past the ocean is flat again.



The point is that at this very moment, we are not in long-run equilibrium, nor are the rates that are being developed to reflect a certain period. We are not currently experiencing long-run marginal costs, and we never will. The long-run never actually happens as we are in a constant state of short-run reality.

In summary, public power utilities are unique. Moreover, electric utility rate making, which includes the recovery of infrastructure costs, should not be based on inappropriate comparisons of such private sector for-profit entities. The reasons are obvious. Public utilities and private sector for-profit entities operate under very different paradigms. Public power utilities have an obligation to serve, which includes building and maintaining appropriate infrastructure and ensuring adequate supply for customers. Rates paid by customers must be adequate to cover the costs of the public power utility and should be designed to reflect a certain period of time. Sound rate making is needed today and into the future to ensure the financial health of our public power utilities. Doing so helps to ensure that public power entities continue to provide access to communities, both urban and rural, to have safe, affordable, reliable power.

