The Fading Utility

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Do you remember "utilities?" In the last century, they generated the power and provided the transmission, distribution and commodity sales that lit up our world.

When you flipped the switch, your only choice was to pay THE UTILITY, which controlled your power supply. They were accountable only to state regulators and the Federal Energy Regulatory Commission. You were the "rate payer" and they were not accountable to you. If you didn't like the service, you choices did not include "taking from a neighboring utility"—even when the neighbor might deliver power for one-third of your current charges.

Then, late in the 20th Century, Congress passed the Energy Policy Act and the restructuring of the electrical energy industry began.

Now, the deregulation pot is coming to full boil. But amid all the turmoil regarding stranded investments, predicted rate changes, independent system operators, company mergers, etc., etc., an amazing phenomena has been virtually ignored. The utility is fading into oblivion.

The large vertically integrated "power houses" are destined to become a thing of the past. The monopoly power utilities have enjoyed will be dissipated. But this power will not go quietly or painlessly. The death throes will not be a pretty sight.

Many utilities have made cosmetic changes. "Rate payers" have became *customers,* "cost" has turned into *price,* parts of "regulation" have become popularly termed *market forces*.

Some utilities have gone beyond a new lexicon and have made substantive motions. Much of the merger mania and the branding skirmishes have been prompted in large degree by the looming threats of

deregulation. Philadelphia Electric Company became PECO and is now part of Unicom. Baltimore Gas and Electric became BGE and has now been absorbed under another name. Mergers with sparkling new names are rampant. But it is more than a name change. The *utility* is being divided and, in many cases, obliterated. New companies are, and will continue to be, formed that have little in common with the utility of the past.

There is another, more subtle driver, to turn utilities into energy companies. Wall Street has gotten into the act. The financial wizards look with more favor on *energy companies.* Recognizing greater opportunity for growth in the unregulated world, when a utility moves aggressively into the unregulated arena, the utility graduates in Wall Street's eyes to an energy company. The multiples favor energy companies as much as four to one. Just compare Enron to Duke. Enron has been labeled an *energy* company, but Duke, which does much the same work as Enron, is still classified as a *utility*, since its unregulated business has yet to surpass its regulated business.

The literature has been full of discussions about the new private generating companies, the transmission companies, and the distribution companies; now fondly referred to as gencos, transcos and discos. Large users may use the old natural gas "well-head" approach and deal directly with gencos, then pay extra for transmission and distribution. For most consumers, however, gencos will have very little importance and receive negligible public awareness. As long as things work when the switch is flipped, few will care where the power is generated. The transcos, the big pipes and big wires, will be fully regulated and of minor interest unless a "not-in-my-backyard" (NIMBY) issue is raised. The discos will handle the small pipes and wires and suffer NIMBY issues on a smaller scale.

As shown in Figure 1, the only public interface left of the old utility will be commodity sales. But anybody and everybody will soon be able to sell kWhs. From all sides, stronger independent power producers, power marketers, and distributed generation people will make themselves known. Virtual "utilities," such as Electricity Choice will peddle power on the web. Other virtuals, such as Essential, will combine phone and electric bills.

This will, of course, not happen overnight and will vary considerably in pace and configuration from state to state. A few truly well-managed utilities have already shifted focus. As suggested above, Duke's

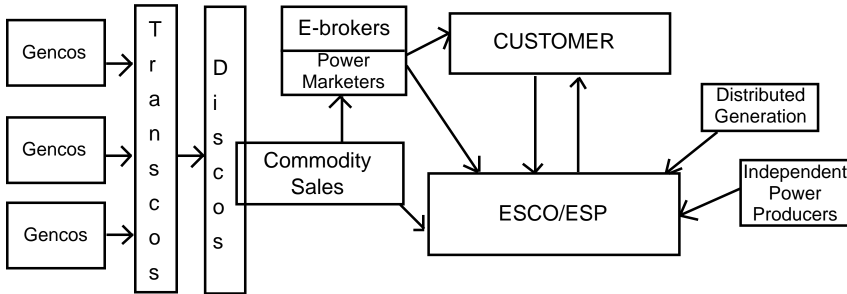

Figure 1. The New "Utility"

unregulated business will soon surpass its regulated business in dollar volume. The more likely survivors have already moved beyond their service territories in the US and are very active abroad.

In this new world, the first to topple will be those in denial. Close behind will be those who learned the talk and even walked the walk, but carried on business as usual. Among these "tyrannosaurus wrecks" will be the ones that thought about glaciers and other slow moving forces and figured they had lots of time. Some, looking at their (current) captive customer base, will tread water as they yearn for that retirement on the horizon.

When the dust settles, customer loyalty (if it exists at all) to the old utility regimes will most likely evaporate. The heads of these "cost-plus" giants, which have long been aided and abetted by PURPA—a federal law that too often provided incentives for inefficiency—will be like kings without thrones.

Surveys repeatedly inform us that utility-specific customer loyalty is shaky—and getting weaker. A 1999 survey performed by RKS Research & Consulting, a market research and opinion polling organization, found an active group of customers seeking new energy suppliers. After surveying 904 businesses and 401 key accounts (large, multi-location accounts), RKS reported that six in ten key accounts and four in ten U.S. businesses have changed or have been re-evaluating their product or service suppliers in just the past year. Part of this review process has been prompted by the pursuit of services as well as cost improvements.

RKS offered one critical survey finding: *service ranked ahead of price.* Of the 15 provider attributes scored, respondents ranked reliable supply, 24-hour customer service and power delivery ahead of low prices. A "nationally known brand" ranked last.

THE NEW SERVICE ERA

This paradigm quake opens a whole new world for *service* firms willing to provide power of quality, useful information and customer-responsive services. The findings from the RKS survey and others spell out exciting opportunities for firms who have already established themselves in service—*and information*. Energy service providers (ESPs) and energy service companies (ESCOs), who are capable of providing energy supply as well as demand efficiencies, are in a prime position to be the "utility" of the future.

Some of today's fading utilities are keenly aware of the opportunities inherent in the ESP/ESCO model. Over half of the investor owned utilities in the US have self-proclaimed ESCOs. Figure 2 reveals the likely future of Con Edison as depicted by Ms. Mary Jane McCartney, senior vice president of that firm.

In this scenario, the ESCO service would include commodity sales, aggregation and ancillary services such as engineering and demand side management. McCartney also suggests that the transmission and distribution (T&D) box "could be where utilities end up."

Behind the scenes, trends already suggest that the power manufacturing industry will continue to consolidate and get bigger. Ultimately,

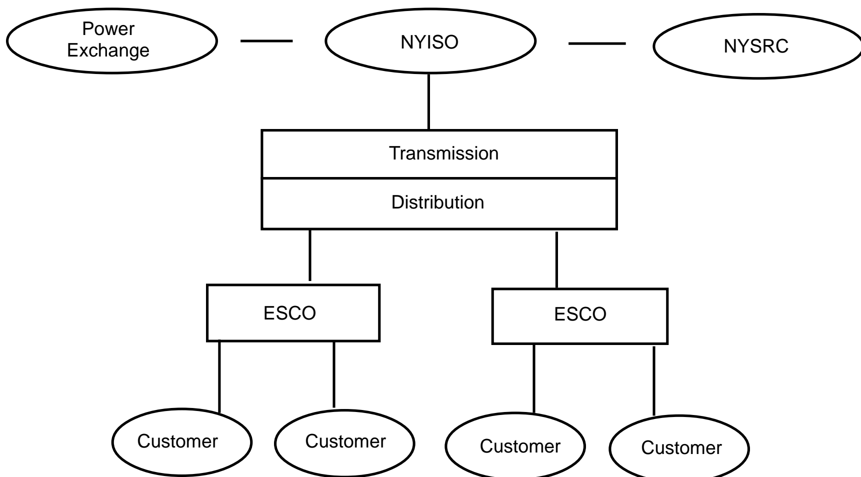

Figure 2. Con Edison's Prospective Configuration

big power is apt to be in the hands of 6-8 companies in the US—while the T&D strategy would appear to be moving toward diversification. For example, the high band-width communications networks installed in the 1970s may now serve as the foundation for related services, such as telephone, cable, security services and rapid internet access.

Communications and its demands are becoming a huge burden—and a tremendous opportunity—for the reinvented utility. UK power company CEOs report information costs in the past five years have been triple the amount they expected to spend and heavy expenditures are still needed to keep on top of rampant communications/knowledge needs. Right up there with the CFOs and COOs, many are predicting a new knowledge management function to oversee the information deluge.

The above scenario, of course, assumes some smart "utility" leaders will be moving aggressively to take advantage of the current restructuring confusion so they can jack up their ESCOs, slip the utility remains underneath, and be well positioned when the opportunity arises. In areas, however, where denial is the mode a major void is apt to occur.

THE VOID

To fill this void, three things are apt to happen. First, the regulators, who cannot stand even a momentary vacuum, will move in to be sure all folks are being serviced. Second, a well positioned new ESCO (with utility origins) will acquire the local foundering utility.

Third, the service/information firms will seize the opportunity and are apt to out-flank and out-serve the resident (dying) utility, particularly if they also recognize the multiple sources of power available to them and realize they can simply take a customer totally off line. And most of all, if they also accept the customers' desires to outsource all but their core businesses. As Figure 3 (page 31) suggests, this new ESP/ESCO might be configured as a resource broker.

Under the scenario depicted in Figure 3, the question arises regarding the traditional ESCO services of guaranteed energy savings. As the ESCO broadens its service base to capture this new opportunity, it will be doing more, but guaranteeing less. *Energy efficiency* will probably become a piece of a much larger offering, and the savings will be used to buy down part of the costs. The morphing ESCOs will become big, di-

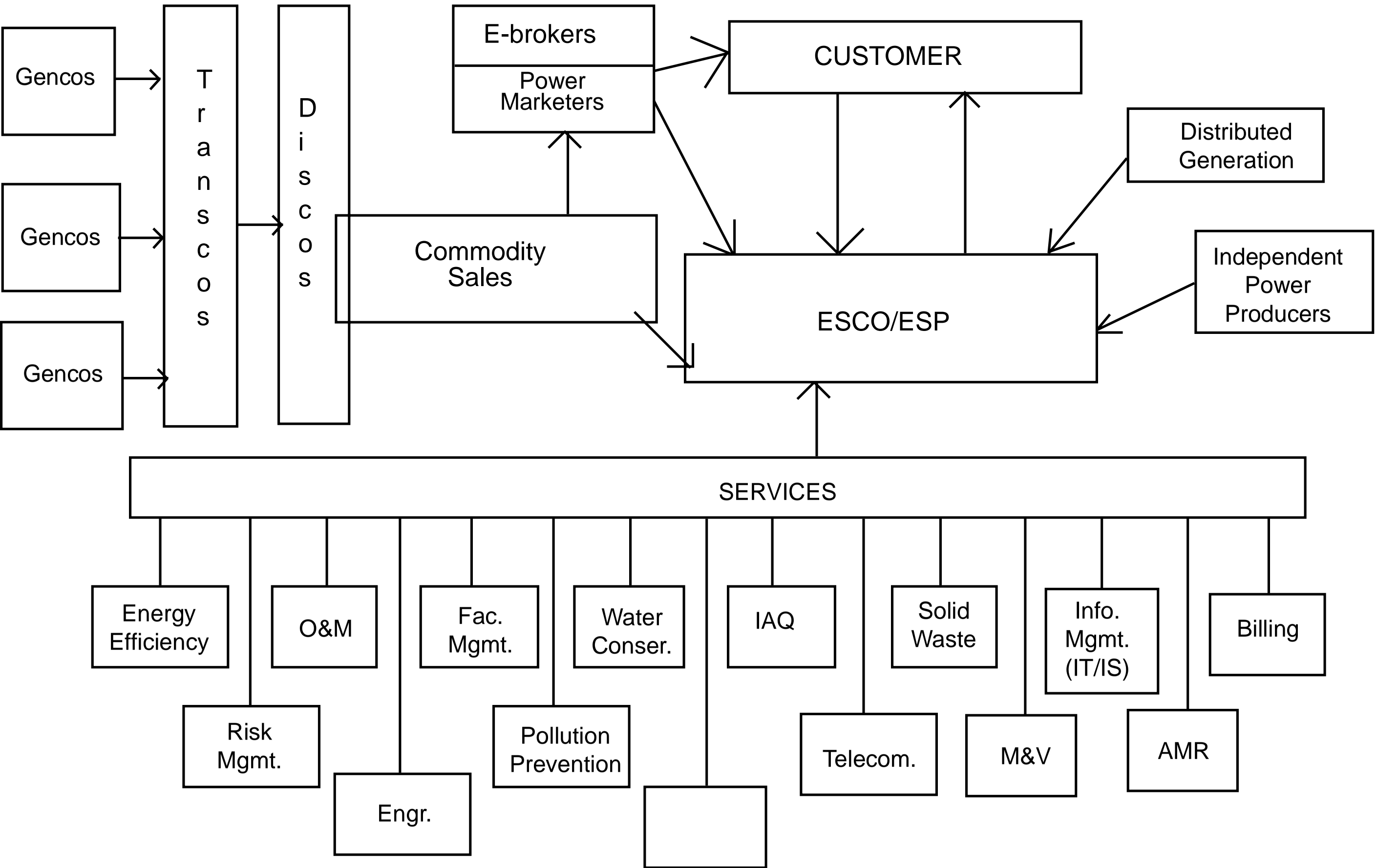

Figure 3. ESCO/ESP as Resource Broker.

versified service brokers. "Energy" is apt to fade from the generic description of the industry and from company titles. Energy supply and end use efficiency services will be part of a multi-service organization. As utilities fade into the history books, the ESP is apt to emerge as the "Essential" Services Provider.

ABOUT THE AUTHOR

Shirley Hansen is increasingly active in the international ESCO world, having now worked in 22 countries in the past seven years. But she finds time to keep tabs on ESCO activities in the U.S. and is particularly intrigued by the "rereg" scene and its impact on ESCOs. Shirley is executive vice president of Kiona International and CEO of Hansen Associates. Both firms specialize in all facts of performance contracting.

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