Challenges in Energy Financing (or *"Profiles In Courage"* for Utility Regulators)

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CHANGES IN CLIMATE & INFORMATION TECHNOLOGIES:
WHO'S DRIVING UTILITY POLICY?
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DISCLAIMERS, ETC.

- I am not a financial analyst, nor do I play one on television. . .
- I am a former regulator whose forte is listening to what others say, usually in jargon . . .
- Then explaining what is said into plain English and, if necessary, into “regulatory speak” to regulators

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Overview

- A brief description of the mess we are in
- In the face of this crisis, the options utility regulators face and the painful choices that confront them
- My recommendations
- Feedback and critique of my assessment and recommendations

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The Crisis Situation Today (Gross But True Generalizations)

- Volume of capital available for borrowing has shrunk significantly
- Bad news for a capital intensive industry such as electric utility sector
- One unnamed investment banker: *"These are the most extraordinary and scary times I have seen in my 27 years as a banker."*
- Crisis arrives at worst time since sector in need of capital to finance build out and modernization of power delivery infrastructure
- Competition for available capital will be fierce, and cost of capital will remain high
- Quality of utility regulation will be key to maintaining sector's competitiveness
- If market perceives quality of regulation to be poor, capital will migrate elsewhere

What Do We Mean By "Poor Quality" Regulation?

- Refusal to understand that the paradigm has been significantly altered
- Persistence of regulatory lag and unwillingness to allow accelerated or timely recovery of costs
- Authorizing equity rates of return that have only marginal nexus to actual market conditions
- Unreasonably restraining rate levels to accommodate public constituencies

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Recommended Actions for Regulators

- Open and maintain an ongoing dialogue with your utilities
- Understand the financial circumstances they operate in
- If you don’t understand, get someone to explain to you
- Build trust, if not yet there

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Additional Measures Bolstering Utility Competitiveness In Capital Markets

- Consistent with state law, utilize tools to accelerate cost recovery and reduce risk of underrecovery
  - CWIP in rate base
  - Regulatory predeterminations of prudence
  - Passthrough of targeted costs or capital expenditures
  - Forward looking test year
  - More frequent rate cases
- "Be realistic" about return on equity -- don't be slave to formulaic outcomes that have unrealistic effects
- Be mindful of "earned return" versus "allowed return" – avoid giving with one hand and taking away with another

If None of This Advice Is Heeded . . .

- The world will not end.
- But utilities may be unable to secure needed financing to modernize or maintain facilities
- Capital expenditure programs will be deferred (already happening at points throughout the country)
- When economic recovery arrives and demand picks up, utilities at risk of having inadequate infrastructure

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Lesson for Regulators: Exhibit a "Profile in Courage"

- Regulators forced to make decisions that are unpopular, particularly if public perceives rates are rising in this economically distressed environment
- Avoid the "easy way out" – this only passes the buck to successors
- Spend time consensus building with all of your stakeholders and the public
- Repeatedly explain your decisions to the public – designate knowledgeable staff to assist
- Educate the public to understand the difficult choices you need to make
- In the end, the public may not like the decisions, but will understand their wisdom – most likely after you are gone!

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