

The Strategic Value of a 'Get No Worse' Scenario

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Published as a post in Energy Central's
[Energy Pulse](#), February 2, 2007



How much reliability and customer satisfaction is enough? As utilities struggle with this question, they face one of the central decisions in asset management. Because once spending has been optimized to achieve the best performance for the least cost along a complete array of possible cost-versus-service quality options, the real question is which point to choose on that continuum.

Previously, I have suggested a three-way approach to the question:

- Trending ☞ Make sure service quality indicators are not trending worse.
- Benchmarking ☞ Make sure performance and spending are in line with peers.
- Modeling ☞ Make sure a good forecast pro forma model predicts that the planned level of spending maintains service quality.

Ultimately, I contend, while the first two cannot be ignored, the third way is the best approach, and can best be integrated with detailed plans to achieve the desired combination of service and cost. In this article, I elaborate on how valuable it is to be starting from that point - a good forecast model of what it takes to maintain service levels - and where to go from there.

I call the starting point the 'Get No Worse' scenario. If a company can look at the next five to 10 years, by jurisdiction or however it is compelled by regulators or customer focus to view itself, and see what level of spending, when optimized, would be required to maintain the existing level of service, then it can use that fact as a basic platform for looking at its strategic asset management options.

Clearly, the forecast model needs to accomplish one or two more feats of prediction for this to work: It must accurately describe the 'delta' or change in spending required to achieve a given amount of improved service, and also how much worse service would get for a given amount of spending cuts. If the model had been used

to trace out the whole set of combinations of service and cost, then this is already done. But most companies will find that their planning processes do not deal well with a continuous set of plans, so the best way to plan will probably be to develop three options:

- Get No Worse -- Spend what it takes, optimally, to maintain service levels.
- Get Better ☐ Improve service by 'x' per year.
- Spend Less ☐ Cut the budget by \$X million per year.

And what should we use for 'x' and \$X? The first one, the service improvement, needs to be worked out based on a number of considerations, including those first two factors. Is the current service level considered much worse than what it used to be or what others experience? Is there some societal or local push to achieve higher reliability/service due to increased technology, dependence on continuous power or economic development? In any event, it is likely that the improvement should be in the low single digits per year, (e.g., 2 to 5 percent), unless the situation is a 'get well' from a previous downfall. Anything more than that will probably cost more than customers are willing to pay and would risk overshooting the target.

The only exceptions I can think of are situations in which service deteriorated gradually and imperceptibly over many years until some noticeable event drew attention to the deficit. In gas, it would be one or more explosions due to deterioration, and in electric service it would be really poor performance in a storm or heat wave. In such cases, the 'get well' program will be called for, probably with specific recommendations from a third-party auditor, and the rate of change for a few years will be significantly higher.

Clearly, if a company operates in more than one jurisdiction or reporting region, the planning needs to take place by region/entity, since the public dialogue must take place along those lines. That is one of the reasons why so many multi-state utility holding companies have reorganized away from strong centrally controlled organizations to ones that are split along jurisdictional lines. If date-certain Federal deregulation had taken place, it would have been another story, but with the states calling the shots (and in some cases, the cities), the smart companies have responded accordingly.

As for the \$X budget cut that number usually comes from an identified shortfall in available funds, examples of which are numerous:

- A major project that occurs rarely, like a new baseload generation plant, major transmission line, new customer information system, etc.

- An overrun on a major project (remember nuclear plants after Three Mile Island?)
- A debt/equity or coverage limit that must be met (especially in public power)
- An unfavorable rate decision (where the deterioration in service quality is the consequence that needs to be spelled out and planned for)
- The loss of a major customer or revenue stream, such as one or more major wholesale customers, service lines, etc.

An organization generally cannot embark on serious cost cutting that will impact service without an understandable reason driving the change, a 'burning platform,' to use the consultants' favorite phrase. With such a driver identified and quantified, the utility can put itself through the steps of planning for how it might attempt to generate the needed funds internally through budget cuts that affect service. Of course, if there are budget cuts that can be done through mere efficiency improvement, they would come first.

The point is, in a large organization the planning process itself must be planned, and choosing the right scenarios is a key decision in that process. I suggest that using the 'Get No Worse' scenario as a platform for strategic planning in the utility environment will serve companies well in designing plans that can be executed smartly in today's regulatory climate.