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MEMO TO THE CEO

Increasing the Perceived Value of Our Service

TO: BILL BIGWIG, CEO, LOCAL UTILITY POWER & LIGHT CORP. (LUP&L)

FROM: SAM SOUNDBITE, VP, CORPORATE COMMUNICATIONS, LUP&L

Bill, I know you spend a lot of time with the financial community, which is keenly interested in our P/E ratio—the ratio of our stock price to our earnings. In my group, we spend a lot of time working on a less commonly known but no less important ratio—our P/V ratio, that is, our price/value ratio, or the amount of value our customers say they receive for the amount of money they send us each month.

Our customers give us a below-average P/V ratio—they know they are paying us more money each month, but feel they are receiving less and less value from us. We know that our most recent price increase widened that gap between our price and our value, and the near-annual price increases we are planning over the next 10 years likely will widen it even further.

Our P/V ratio is a qualitative reflection of our standing with our customers and other stakeholders. Ultimately, our P/V ratio will affect our P/E ratio, for better or worse. There are a number of ways we could improve our P/V ratio, which should bolster our P/E ratio as well. Increasing the value we provide to customers can head off negative events at the PUC and among our employees and investors.

But we can't increase the perceived value of our service just by rolling out a new set of ads or launching a new communications campaign that is all "spin" but no substance. We need to start by asking ourselves harder, more basic, strategic questions about our vision, mission, and goals, such as: Why are we in business? What is our purpose? What unique role do we fill? How could we provide greater value to customers?

Yes, I know—it sounds like a full employment act for consultants. And yes, I've had more than my fair share of those guys! And no, I'm definitely not proposing we put all of our various operations and projects on "hold" so we can spend a lot of time sitting in rooms trading platitudes.

We can do a lot of the heavy lifting ourselves, without the help of high-priced consultants. And the good news is our employees want to do that heavy lifting. Our price increases have demoralized them; they're tired of being unable to answer their friends and neighbors who ask, "What? Another price increase?" Our employees want to restore our good name in the community. They want to feel good about working for LUP&L, the way they used to.

Having a robust internal conversation about our vision, mission, and goals is the first step forward. Other utilities that have had these internal conversations are the ones with higher P/V scores, fewer problems with customers, more engaged employees, and less-troubled relations with their regulators. Knowing what they are about and why they exist has helped guide these utilities' efforts to achieve better alignment with their various stakeholder groups. That alignment makes a variety of other good things possible.

Once those critical internal discussions are under way, we can move to the issue of whether we should change our approach to communicating with our customers about our price increases. All utilities face the same sets of problems: large construction programs, soaring fuel and capital costs, new environmental regulations, and an aging workforce. Yet some utilities clearly are doing a better job than others in »

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managing these issues without damaging their customer satisfaction scores.

Our Problem

We can't get out of our predicament just by making some tactical changes to our communications. Periodically, we do need to make tactical adjustments to our communications, but we face deeper problems. Here's what our market research tells us:

- customers don't trust us the way they once did;
- customers no longer see us as a positive force in the local community;
- customers are not hearing (or believing) our messages;
- customers don't understand why we're trying to raise prices when our stock price is so high and we've reported record earnings; and
- customers feel it is unfair for LUP&L executives (including you and me) to get big bonuses when we are reducing staff, unemployment is rising, and the local economy is in recession.

As we have discussed, our continued ability to run our business more or less as we see fit depends on the support, or at least acquiescence, of customers, communities, elected officials, and employees. Regulators won't get deeply involved in our business if we don't give them a reason to get deeply involved. Regulators are getting very antsy these days; some have tried to impose "command and control" decisions on utilities that sharply limit operational flexibility.

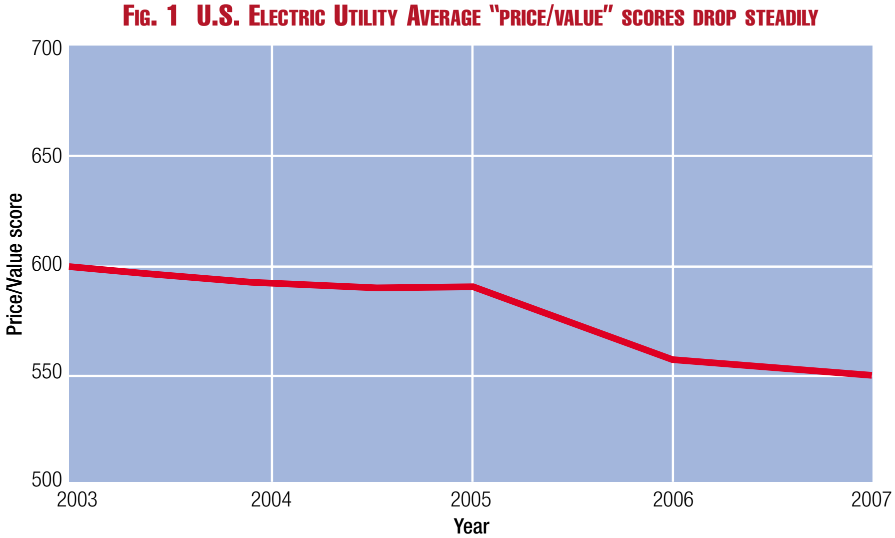
Every time we go in for a rate case, we give regulators and our distracters an opportunity to take potshots at us. Every person who shows up at a PUC hearing should be seen as a potential threat to our organizational independence. LUP&L needs to keep as many people as possible out of that PUC hearing room. We can do that by increasing the value we provide to our customers.

We need to care about what our customers and communities think about us. Everyone understands this is true for investors, but less well recognized is how the views of other stakeholders affect our business. Look what happened in Texas when TXU announced plans to build a dozen new coal-fired power plants, ignoring public opinion and the views of local elected officials. That public-relations flap knocked several billion dollars off TXU's market capitalization. In Missouri, Aquila bought endless grief upon itself when it decided to build a power plant without engaging the public or its regulators in a discussion about whether it was needed and where it should be sited. In recent years, several IOUs have had to defend parts of their service area from threats of municipalization that were driven by years of high rates, low reliability, poor service, or customer conflict.

It is noteworthy that U.S. residential utility customers in general perceive a steady decline in the value of service provided by their electric utilities over the last five years (*see Fig. 1, below*). This is a harbinger of future trouble. The industry's declining P/V scores are mostly the result of repeated price increases that have not been offset, in the customer's mind, by increases to the value of electric utility service. Unfortunately, our P/V scores have declined along with the industry average.

Despite this generalized industry downturn on Price/Value perceptions, a select few utilities have actually increased their P/V scores in recent years. What's their secret? In general, they have had an open and ongoing conversation with their customers, captured with market research, which kept the utilities informed about the dynamic needs and expectations of their customers. And then those utilities developed, delivered, and positioned programs, products, and services that responded to those needs. It's not magic, nor is it a coincidence.

Fig. 1 U.S. Electric Utility Average "Price/Value" scores drop steadily



Our Solution

We need to work harder to show our customers that we are providing them with greater value. We need to make "value" a rallying cry for the entire organization. Utilities that successfully have positioned themselves as their customer's trusted energy advisor have been able to offset the negative effects of price increases. Our customers and communities, by contrast, don't see us as a partner or trusted advisor. At best we are seen as a large, far-removed, » faceless institution, rather like the U.S. Postal Service.

Next year, when we expect to file another rate case, I'd like your support to change some of the ways we have been communicating with customers. It's pretty clear that our last price increase communication campaign was a mixed success: We scored a few victories and dodged a few bullets, but on the whole we could have done better.

Here's how I'd like to revamp our approach to communications in advance of next year's rate case:

- Increase our market research and message-testing efforts. Some utilities have found that customers don't object as much to price increases if they can be tied to things they care about, like improving reliability or reducing our impact on the environment.
- More consistently use everyday terms that customers understand, like "prices," and stop distinguishing between "base rates" and "fuel costs" in our external communications.
- Develop a new message to show customers that we are good stewards of their money. We have tried to convey that with the phrase, "We haven't raised rates since 1992," but that message doesn't resonate. We also will stop comparing changes in our prices over time to changes in the Consumer Price Index, or the price of select consumer goods like gasoline, tomatoes, and movie tickets. That doesn't resonate with customers either.
- Focus our communications on ways customers can lower their monthly energy bills and steps they can take to offset our planned price increases. Customers want to be empowered.
- Feature more people and more art in our ads; scale back the amount of copy and detail.
- Emphasize the non-price features of our service, like bill-payment options, energy-efficiency programs, demand-response pilots, pricing options, CFL discounts, customer assistance programs, renewable power, and our employee volunteerism.
- Begin our communications campaign earlier. In fact, given our capital construction plans we should be talking to customers on a monthly basis about ways they could use energy more efficiently and lower their bills.
- Focus our messaging: Let's pick one horse and ride it. I think "value" should be our rallying cry, but we need to hear that from customers.
- More effectively use our Speaker's Bureau and our employees' social networks to communicate with the community.
- Make our customer programs more readily visible on our website. Conduct usability testing with our customers before we go public with any web site redesign.
- Improve the quality of our energy information graphics and calculators translating the kWh and therm consumption of various household appliances into dollars and cents. We need to speak to customers in language they understand. I recommend we model our efforts on what Ameren has done with its interactive energy house graphic: *http://www.ameren.com/Residential/ADC_EnergyHouse.asp*

I know we don't get a "do over" for the decisions leading up to our last communications campaign. In retrospect I think we let our internal concerns about factual accuracy, context, costs, or our own preferences override what our customers expect from us, or in some cases are telling us directly.

As part of your executive team, I share responsibility for those past decisions. But our capital program is such that we will be raising prices on a near-annual basis for the next 10 years. Implementing the changes I recommend should allow us to maintain our customer satisfaction scores, position us more favorably with our major stakeholders, and potentially head off future problems at the PUC. It's a comparatively small investment in strategic risk management. I hope you and the Board agree. ■

John Egan is founder and principal of Egan Energy Communications, which works with utilities to improve the impact and lower the cost of their stakeholder communications. A former research director at E SOURCE, media relations supervisor at Salt River Project, and reporter at The Energy Daily, John can be reached at 720-949-4906 or johnegan1959@gmail.com. His LinkedIn profile can be viewed at http://www.linkedin.com/in/EganEnergyCommunications.