COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF EAST KENTUCKY POWER COOPERATIVE, INC., INTER-COUNTY ENERGY COOPERATIVE CORPORATION, NOLIN RURAL ELECTRIC COOPERATIVE CORPORATION, AND SALT RIVER ELECTRIC COOPERATIVE CORPORATION, FOR AUTHORITY TO IMPLEMENT A FIXED BILL PILOT PROGRAM	)	CASE NO. 2004-00330

O R D E R

On August 20, 2004, East Kentucky Power Cooperative, Inc. (“East Kentucky”) and three of its member distribution cooperatives, Inter-County Energy Cooperative Corporation, Nolin Rural Electric Cooperative Corporation, and Salt River Electric Cooperative Corporation (collectively “Joint Applicants”), filed an application for approval of a pilot fixed bill program. Under the program, a limited number of residential customers could choose to pay a pre-determined, fixed amount each month for service over the next 12 months. The fixed amount paid would vary for each customer based on that customer’s prior consumption adjusted to reflect normal weather.

Intervention was requested by, and granted to, the Office of the Attorney General (“AG”). The Joint Applicants responded to two data requests issued by the AG, and three data requests issued by Commission Staff. The parties agreed to file written comments in lieu of a hearing. Those comments have been filed, and the case now stands submitted for a decision.

BACKGROUND

The Joint Applicants premise their proposal on three basic goals: (1) eliminating uncertainty for customers regarding the amount of their bills; (2) improved customer satisfaction; and (3) improved system load factor. According to the Joint Applicants, some customers have been dissatisfied with the budget billing programs that are available to them because those programs require an end of the year reconciliation, or true-up payment, in month 12 if the budget amount paid for 12 months is less than the amount otherwise due based on actual usage and actual rates. The fixed bill program requires no true-up or reconciliation between the fixed amount paid for 12 months and the amount that would have been paid based on actual consumption and actual rates.

Under the program, a customer's historical annual usage is determined based on a minimum of 12 months actual experience. The historic annual usage is then adjusted to reflect normal weather and temperature conditions. This yields a normalized annual usage which is divided by 12 and then applied to current rates to derive the customer's monthly fixed bill. This amount is then increased by a risk factor premium which is intended to protect the Joint Applicants from the uncertainties and risks of abnormal weather, changes in rates, and changes in customer usage levels not related to weather. Although there is no end of the year true-up payment required, a customer's actual usage during the first 12 months under the pilot program will be recognized when calculating the customer's fixed bill amount for the next 12 months.

The Joint Applicants cited other fixed bill programs, most notably those of Georgia Power, Duke Power, Progress Energy, and Gulf Power, in support of their proposal. These other utilities had between 1 year and 3 years experience with fixed bill programs at the time East Kentucky filed this case. The citations to these other utilities' fixed bill programs primarily referenced the number of participants in each pilot and how those numbers greatly increased once the programs were made available to more customers.

Due to a claim of confidentiality for certain information, the Joint Applicants did not disclose the changes in customer usage or system-wide demand for any of these other utilities except Gulf Power. For the first year of Gulf Power's pilot program, energy usage increased by 8 percent, while most of the increase in demand occurred in shoulder and off-peak periods rather than on-peak periods. Such increases in energy sales without an increase in peak demand results in a higher load factor, which means the utility system generates more electricity while operating at the same capacity.

DISCUSSION

The AG opposes the program, citing three arguments. First, he argues that a fixed bill offering is a price-based product, which in a deregulated electric market would properly place the full risk of the offer on the seller. However, in a regulated electric market, as in Kentucky, the AG argues that the utility seller is never fully at risk because it always has the authority to seek an increase in rates. The AG notes that East Kentucky expects to add generating capacity over the next several years and that this will increase the likelihood that East Kentucky will be seeking rate increases. In a test year in which weather or other factors cause fixed bill customers to use more electricity than normal, the AG argues, East Kentucky will suffer a revenue deficiency, which will have to be made up through the rates charged to the nonparticipating customers.

Second, the AG argues that the risk factor premium will provide the utility a greater margin than that provided by standard cost-of-service rates whenever a fixed bill customer does not consume more than the normalized usage level. The utility keeps this extra profit, the AG claims, over and above the cost to serve the customer. Only if the fixed bill customer's actual usage is substantially greater than the normalized usage will the utility lose money, according to the AG. While losses and profits under the program are intended to balance over time, nothing prevents the utility from seeking a rate increase at a time of under-earning. Therefore, losses on the fixed bill program could result in increased rates for other customers. Because of this potential, the AG argues that the ratepayers will bear all of the program's risk.

Third, the AG argues that a fixed bill program encourages wasteful consumption. The AG notes that what evidence there is on other programs shows that consumption increases in the first year of the program and that the promotional information touts this as one of the benefits of the program. The AG states that the Joint Applicants have not provided sufficient detail as to the type of change in consumption that is expected to occur to allay the concerns that wasteful consumption is what gives rise to the anticipated improvement in system load factor. Given East Kentucky's present and projected need for additional generating capacity, the AG argues against pursuing a program that might exacerbate that need.

The Joint Applicants responded to the AG's first objection by stating that the fixed bill proposal is cost-based, and it is designed to recover all the costs now recovered under standard tariffed rates plus a premium to compensate for the risk assumed under the program. The Joint Applicants point out that those utilities with fixed bill programs are located in the south, southwest, or midwest, are not deregulated, and employ the principles of cost-based rates. The Joint Applicants also state that they have no intent to seek recovery of lost revenue if any does occur as a result of the pilot program

On the AG's second point, the Joint Applicants state that any excess margins will be short-term in nature and will be offset in the following year. This is because a fixed bill customer's actual consumption during the first 12 months of the program will be used to set the amount of the fixed bill in the second year, thereby eliminating the possibility of higher margins in the second year. On the other hand, the Joint Applicants state that if a fixed bill customer's usage exceeds the normalized level, the utility will under-collect compared to what a similar customer not served under the program would pay. Hence, according to the Joint Applicants, a fixed bill program does not place all the risk on ratepayers.

On the AG's third point, the Joint Applicants argue that, without empirical evidence from Kentucky customers, it is unknown whether a fixed bill will encourage wasteful consumption. It is for this reason that a limited pilot has been proposed. The Joint Applicants intend to analyze the results of the pilot to determine whether wasteful consumption did occur. The Joint Applicants point to the results of Gulf Power, which experienced no statistically significant change in peak demand, although overall energy usage did increase. While recognizing that this may not be the result in Kentucky, the Joint Applicants maintain that this experience should offer comfort to all parties that the program does not automatically result in higher peak demand.

<u>COMMISSION FINDINGS</u>

Based on the evidence of record and being otherwise sufficiently advised, the Commission finds that the Joint Applicants' fixed bill proposal appears to be an extraordinary response to a concern expressed by a limited number of their customers. The Joint Applicants have not surveyed their customers or performed any quantitative analysis to determine the level of demand or interest their customers have in a fixed bill program. If minimizing the amount of the true-up customers pay at the end of a budget year is an important goal of the Joint Applicants, there are other means available to achieve that goal. Budget billing plans with multiple adjustments during the budget year and levelized billing plans that eliminate the need for a year end true-up by employing a rolling average of historic usage are two means of addressing the issue of customers' true-up payments.

The Commission shares, to some extent, the AG's concerns about possible financial or rate impacts of a fixed bill program. East Kentucky's fuel costs as reflected in its monthly fuel adjustment clause rate have been increasing over the past few years. East Kentucky has also recently adopted a monthly environmental surcharge to be effective this summer. By using today's rates to calculate a fixed bill to be charged over the next 12 months, East Kentucky increases the likelihood of not recovering all its costs to serve fixed bill customers, even assuming their usage does not exceed normalized levels. Assurances offered by the Joint Applicants that they would not seek to recover related costs or losses, and the Commission's ability to fashion safeguards for the program tend to mitigate those concerns. However, if there is a major problem with this program, the Commission is always mindful that the Joint Applicants, as member-owned cooperatives, have no shareholders to absorb the costs or losses that might be incurred as a result of a fixed bill program.

The issue of greatest concern to the Commission is the potential impact a fixed bill program could have on energy consumption and demand. The limited results of the Gulf Power pilot program, contrary to the claims of the Joint Applicants, offer little comfort on this matter. An 8 percent increase in energy usage is much greater than what typically occurs due to normal growth. Particularly with East Kentucky's fuel costs increasing substantially in recent years, the merits of attempting to increase customer satisfaction by implementing a program that encourages customers to use more electricity, without sending proper pricing signals, are questionable.

While a few other utilities have implemented fixed bill programs, Gulf Power's is the only one for which information on changes in usage and demand is available. In addition, none of those other utilities, including Gulf Power, are exclusively winter peaking systems, as are the Joint Applicants. Therefore, the results of the programs of other utilities may be of little relevance to the Joint Applicants' situation. Whether those results could be relevant is not known, however, since they were not provided when requested, even though the consultant retained by the Joint Applicants to develop their fixed bill proposal was also a consultant to some of the other utilities. Without providing more information on the impacts that other fixed bill programs have had on energy usage and demand, the Joint Applicants have been unable to demonstrate that this program will not result in higher costs for all ratepayers.

The Commission takes administrative notice that East Kentucky currently has two cases pending to construct a total of over 950 Mw of capacity at a cost in excess of

$1.35 billion. This makes it highly questionable for East Kentucky to pursue a billing program that removes the link between the quantity of electricity that customers use and the cost of that electricity. With the impact of East Kentucky's recently approved environmental surcharge expected to increase customers' bills this summer, and with the forecast of a need for an additional rate increase later this decade to recover the cost of new capacity, East Kentucky's interest in pursuing a fixed bill program does not appear to be well founded.

Although the Joint Applicants point to the small size of the proposed pilot, it is the Commission's sense that a fixed bill program should not be pursued, regardless of its size, unless: (1) there is clear evidence of a demand for the program that cannot otherwise be addressed; and (2) meaningful results of other programs are available which demonstrate that the likely outcome will not adversely impact customers, in the short-run or the long-run, by creating a need for additional capacity or by increasing the utility's costs or reducing its revenues.

Although we are rejecting the fixed bill pilot program as proposed, we encourage the Joint Applicants to investigate other ways to address their customers' dissatisfaction with the current budget plans. The Commission is willing to consider proposals to modify existing budget billing plans by adopting semi-annual or quarterly adjustments, or by adopting levelized billing plans, to address ratepayer concerns about existing plans.

IT IS THEREFORE ORDERED that the fixed bill pilot program proposed by the Joint Applicants is denied.

Done at Frankfort, Kentucky, this 4th day of May, 2005.

By the Commission

ATTEST:

Executive Director