COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF THE UNION LIGHT, HEAT AND POWER COMPANY FOR APPROVAL OF FIXED BILL PROGRAM RIDERS APPLICABLE TO RESIDENTIAL CUSTOMERS	))))	CASE NO. 2004-00503

O R D E R

The Union Light, Heat and Power Company ("ULH&P") has proposed a fixed bill pilot program in which 1,000 residential customers could voluntarily participate the first year. Under the program, a customer's monthly bill would be fixed at a specific amount for a period of 12 months, based on current rates and the customer's historical usage, adjusted to reflect normal temperatures. The customer's fixed bill would also include a program fee intended to compensate ULH&P for its increased financial risks resulting from the program. There would be no true-up at the end of the 12 months, a feature which distinguishes a fixed bill program from a traditional budget billing plan. However, a customer's usage during the first 12 months of the program would form the basis for calculating the customer's fixed bill amount during the next 12 months. The Attorney General ("AG") was the only intervenor in this proceeding.

Having considered the proposal and all the evidence of record, the Commission finds that ULH&P's proposed fixed bill pilot program should be rejected for the following reasons: (1) the proposed program would eliminate the price signal that can influence customers' consumption; (2) there is little evidence of a need for or an interest in such a program; and (3) there is very little information available on the energy sales impacts and system demand impacts of other fixed bill programs.

BACKGROUND

After filing its application, ULH&P was subject to three rounds of discovery by Commission Staff and the AG. The parties agreed to file comments in lieu of a hearing. The evidentiary phase of this proceeding appeared to have concluded in April of 2005 upon the receipt of ULH&P's comments filed in reply to the AG's written comments. However, in May of 2005, ULH&P requested to reopen this case record so it could conduct further research into the level of customer interest in a fixed bill program.[1] That request was granted and ULH&P filed additional information on which the Staff and the AG issued their third and final data requests. The record is now complete and the matter is submitted for decision.

ULH&P premised its proposal on three basic goals: (1) responding to competition from non-regulated providers of heat-producing commodities; (2) eliminating customer uncertainty regarding the amount of their bills; and (3) increasing customer satisfaction. The proposed fixed bill program would be voluntary, available to 1,000 customers for the first year, and applicable to customers' gas and electric usage. After the first year, ULH&P proposed to market the program to roughly 50,000 customers while allowing the first 14,000 eligible customers who seek to enroll to participate in the program.[2] ULH&P

[1] ULH&P indicated that its request was based on the decision in Case No. 2004-00330, in which the Commission rejected the fixed bill proposal of East Kentucky Power Cooperative, Inc. ("East Kentucky Power").

[2] In response to a data request, ULH&P discounted maintaining the number of participants at 1,000 beyond the first year of the pilot, stating that it did not want to be put in a position of turning down customers who wished to take part in the program.

proposed to set the program fee annually on a customer-specific basis, while agreeing to cap it at 10 percent of the customer's bill. It also proposed that the profits and losses and incremental expenses of the program be treated "below the line" for regulatory purposes so that customers not participating in the program will not be affected by its costs. In support of its fixed bill proposal, ULH&P cited Administrative Case No. 384, in which the Commission reviewed natural gas pricing and procurement issues and stated that it would be willing to consider fixed bill programs.[3]

Under the program, a customer's historical usage (based on at least 12 months of data) would be adjusted to reflect normal temperature conditions. The "normalized" annual consumption would then be used to calculate the customer's fixed annual bill, which would be divided by 12 to derive the monthly bill. This amount, which would be based on ULH&P's existing rates, would then be increased by the program fee. This fee is intended to protect ULH&P from the uncertainties and risks of abnormal weather, potential changes in costs and changes in customer usage not related to weather.

ULH&P identified the various payment options it currently offers customers and stated its belief that the fixed bill program would complement those programs. Like many other major utilities, ULH&P allows customers to pay their bills at "pay stations," typically retailers who offer extended operating hours. It also offers an e-bill option and an automatic bank draft option. In addition, for a transaction fee, customers can pay by electronic check or credit card. ULH&P presently offers two budget billing programs: an annual plan, in which the customer's bill is trued-up in the 12th month; and a quarterly

[3] Administrative Case No. 384, An Investigation of Increasing Wholesale Natural Prices and the Impact of Such Increases on the Retail Customers Served by Kentucky's Jurisdictional Natural Gas Distribution Companies, Order dated July 17, 2001.

plan, in which the bill is adjusted every 3 months. Under the quarterly plan, any credit or balance owed at the end of the 12th month is rolled over into the following 12 months.

ULH&P cited survey results from J.D. Power and Associates ("J.D. Power") which show that, in 2004, approximately 17 percent of utility customers nationally were on some type of level payment plan. It also cited the enrollment and renewal success of fixed bill programs offered by Georgia Power, Duke Power, and Progress Energy as well as a survey of employees of its affiliate, Public Service Indiana ("PSI"), who participated in a small fixed bill pilot in 1996, as evidence of support for a fixed bill program. It noted that if the fixed bill program resulted in greater customer satisfaction, that would positively effect its ranking against the utilities with whom it competes in annual J.D. Power customer satisfaction surveys.

The information available on existing fixed bill programs of the utilities previously identified primarily references the number of participants in the pilots and how those numbers increased once the utilities were authorized to offer their programs on a wider basis. Due to confidentiality restrictions, ULH&P did not provide information on the changes in customer usage or system-wide demand for any of the utilities with fixed bill programs except for Gulf Power. The first year results of Gulf Power's pilot program showed that energy consumption increased by 8 percent, while most of the increase in demand occurred in shoulder and off-peak periods rather than on-peak periods.

DISCUSSION

The AG's Position

The AG opposed the program based on several arguments. First, he argued 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 argued that such a program provides monopoly protection for a pricing product that is offered as an optional billing program. The AG contended that a fixed bill is not really a billing option, but a new rate that compensates the utility for the management of the usage/financial risk of the customer taking gas or electric service.

The AG also argued that the program fee operates to provide a greater margin than that provided by standard cost-of-service rates due to the proposed program fee. The utility keeps this extra profit, the AG claimed, over and above the cost to serve the customer. The AG argued that it is anti-competitive to provide a regulated utility, such as ULH&P, the ability to charge a regulated rate for risk management services that are not inherently monopolistic by nature.

The AG claimed the program runs counter to specific statutory provisions which encourage reduced usage through demand side management and make price signals so remote as to be meaningless. He also claimed that the increase in usage has the potential to reduce off-system electric sales, which would benefit program participants at the expense of non-participants.

Although strongly opposed to the program, the AG, in his final comments filed July 29, 2005, identified specific conditions which he believed should be imposed if the Commission chooses to approve a pilot. Those conditions include: (1) that ULH&P, as a regulated utility subject to KRS 278.160, should not be allowed to determine the amount of the proposed program fee and that the fee should be set by the Commission; (2) that annual re-enrollment be required, rather than it be automatic that a customer remains with the program; (3) that the penalities of the program should be made as prominent as the benefits in the advertising and solicitation; and (4) that clear data showing the costs and benefits of participation should be required to be provided to participants.

ULH&P's Position

ULH&P argued that its fixed bill proposal is cost-based, reflecting all the costs of its standard tariffed rates, plus a premium to compensate it for the risk it assumes under the program. It claimed that its main objective is to provide customers with greater choices in terms of billing/payment options. ULH&P emphasized the fact that, as an investor-owned utility, it does not present the same concerns as those identified in the Commission's Order denying East Kentucky Power's request to implement a fixed bill pilot program.[4]

ULH&P pointed out that the revenues and expenses of the pilot program would be recorded "below the line" for regulatory purposes. It stated that any excess profits will be short-term in nature and will be offset in the following year. This is because the program will reflect a customer's consumption in the first year in setting the fixed bill amount in the second year, therefore, eliminating the possibility of higher profits in the second year. It argued that the impacts on energy and demand for the program will not be so significant as to be a cause for concern, particularly since it is not planning to add electric generating capacity in the near future, as is East Kentucky Power.

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[4] Case No. 2004-00330, 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, Order dated May 4, 2005.

ULH&P claimed that its consumer research, conducted in June of this year after the record was re-opened, supports that its customers favor a fixed bill program. Its conclusions, based on this research were: (1) a fixed bill program offers a viable option for a portion of its customers who prefer predictable monthly payments without a true-up at the end of the year; (2) customers think that a premium in the range of 5-10 percent is fair and appropriate; and (3) even customers who don't prefer the fixed bill option recognize its benefits and believe that it should be offered to other customers.

ANALYSIS

It appears that ULH&P wishes to implement a fixed bill program primarily to be able to offer customers greater choice and flexibility in billing options. However, contrary to its claims, the information provided on the PSI pilot and the consumer research it conducted in June of this year, do not demonstrate that there is a demand for, or a significant interest in, a fixed bill program. While there are many details in the research questions and the answers, the summary data table provided by ULH&P sums up the overall results. In ranking its standard bill, annual budget bill, its quarterly budget bill and its fixed bill proposal, the fixed bill proposal ranked last (although it was not far behind the quarterly budget plan).

Although its application emphasized the need to respond to competition from non-regulated providers of heat-producing commodities as a reason for proposing a fixed bill program, ULH&P's data responses indicated that its "competition" was based mainly on the advertisements of propane and heating oil dealers who offer fixed or level billing plans. It provided no evidence that it was losing customers to these competitors for heating load because of the competitors' billing plans.

ULH&P's application also emphasized that eliminating uncertainty for customers regarding the amounts of their bills was a motive for proposing a fixed bill program. However, other than eliminating the year-end true-up payment that is included in budget payment plans, the certainty offered by a fixed bill program is no greater than that of a budget plan. If minimizing or eliminating the true–up customers pay at the end of a budget year is important to ULH&P, there are other means of meeting that objective. For example, levelized billing plans, which are offered by many utilities, eliminate the customer's true-up payment. These plans use a rolling average approach, so the amount due each month changes slightly; however, this approach totally eliminates the need for a true-up.

The Commission shares, to a limited extent, the AG's concerns about possible financial or rate impacts of a fixed bill program. The fact that the revenues and expenses would be recorded "below the line" largely mitigates those concerns. We also share the AG's concerns about the impact that increased electricity usage from a fixed bill program could have on ULH&P's ability to make off-system electric sales, particularly when the outcome of Case No. 2003-00252,[5] in which ULH&P's acquisition of 1,105 Mw of generation was approved, contained provisions allowing customers to share in the profits from such off-system sales.

[5] Case No. 2003-00252, Application of The Union Light, Heat and Power Company for a Certificate of Public Convenience and Necessity to Acquire Certain Generation Resources and Related Property; for Approval of Certain Purchase Power Agreements; for Approval of Certain Accounting Treatment; and for Approval of Deviation from Requirements of KRS 278.2207 and 278.2213(6).

An issue of great significance, in the Commission's view, is the potential impact a fixed bill program could have on energy consumption and demand. The limited results of the Gulf Power pilot program offer little comfort on this issue. An 8 percent increase in energy usage is much greater than what occurs due to typical consumption growth.

While several utilities have implemented fixed bill programs, Gulf Power's is the only one on which any usage or demand results are available. Without providing more information on the impacts that other fixed bill programs have had on energy usage and demand, ULH&P has done little to alleviate the very legitimate concern that such a program could have negative consequences. Particularly with ULH&P's electric rate freeze scheduled to expire at the end of 2006 and with natural gas costs at record levels, hoping to increase customer satisfaction by implementing a program that could encourage customers to use greater amounts of electricity or natural gas appears to be misguided.

CONCLUSION

It is questionable for ULH&P to pursue a program that removes the customer's direct link between the amount of electricity and natural gas used and the cost of that usage. Although ULH&P points to the small size of the proposed pilot, it is the Commission's belief that programs such as this should not be pursued, regardless of their size, unless (1) there is clear evidence of a demand for the program that cannot be addressed otherwise and (2) meaningful results of other programs are available which demonstrate that the expected outcome will not adversely affect customers, in the short run or the long run, by creating a need for additional capacity and/or increases in rates.

IT IS THEREFORE ORDERED that the fixed bill pilot program proposed by ULH&P is denied.

Done at Frankfort, Kentucky, this 26th day of October, 2005.

By the Commission

ATTEST:

Executive Director