CINERGY®

Cinergy Corp.
139 East Fourth Street
Rm 25 AT II
P.O. Box 960
Cincinnati, OH 45201-0960
tel 513.287.3601
fax 513.287.3810
jfinnigan@cinergy.com

John J. Finnigan, Jr.
Senior Counsel

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PUBLIC SERVICE COMMISSION

VIA OVERNIGHT DELIVERY

April 19, 2005

Ms. Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, Kentucky 40602-0615

Re: 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

Dear Ms. O'Donnell:

Enclosed please find an original and 12 copies of The Union Light, Heat and Power Company's Reply Comments, which are being submitting for filing in the above-referenced case. Please return the two extra copies to me file-stamped in the enclosed overnight mail envelope.

If you have any questions, please feel free to contact me at (513) 287-3601.

Sincerely,

John J. Finnigan, Jr.
Senior Counsel

JJF/sew

cc: Hon. Elizabeth E. Blackford (with enclosures)

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

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APR 20 2005
PUBLIC SERVICE COMMISSION

In the Matter of:	)	
	)	
Application of The Union Light, Heat and Power Company for Approval of Fixed Bill Program Riders Applicable to Residential Customers	))))	Case No. 2004-00503

REPLY COMMENTS OF
THE UNION LIGHT, HEAT AND POWER COMPANY

In this proceeding, ULH&P applied for approval of a three-year fixed bill pilot program. The purpose of the service offering is to give customers the peace of mind of a level bill with no annual true-up; to provide ULH&P with an opportunity to recover its costs; and to avoid shifting program costs to non-fixed bill customers. ULH&P supported its proposal with a detailed application explaining the program's terms and conditions. Additionally, ULH&P filed supporting testimony of Michael Goldenberg, Thomas L. Osterhus, Todd W. Arnold and Jeffrey L. Pipher. The Attorney General intervened and the Commission established a procedural schedule. ULH&P responded to two rounds of data requests from Commission Staff and the Attorney General.

The Attorney General filed comments opposing ULH&P's proposed new fixed bill offering. The Attorney General's comments criticize ULH&P's fixed bill proposal as improperly offering a non-cost-based service; providing improper subsidies to its non-regulated activities; and as inconsistent with demand side management principles. ULH&P respectfully submits the following reply comments in support of its application for approval of a fixed bill service.

1. The Commission has Jurisdiction under KRS 278.030 to Approve YFB Pricing as a Just and Reasonable Cost-Based Offering.

ULH&P seeks the Commission's approval to offer *Your FixedBill* (YFB) as a cost-based service offering, with below-the-line accounting to avoid shifting YFB costs to non-YFB customers. Some state commissions have approved fixed bill offerings as a cost-based, fully regulated service, and some state commissions have approved below-the-line fixed bill offerings. Below-the-line accounting conforms with the Commission's stated intent to avoid shifting YFB costs to non-YFB customers.

ULH&P will charge a program fee to participating customers. The program fee does not, however, make YFB a non-regulated offering for which ULH&P has unlimited pricing discretion. To the contrary, the program fee is capped at 10%,[1] and simply covers the costs which ULH&P will incur by offering YFB. The Attorney General incorrectly describes YFB as permitting ULH&P "to dictate its own level of profit, within certain parameters...despite the fact that Kentucky is a regulated state."[2] ULH&P has clearly established that YFB is a cost-based service. ULH&P explained:

> The return assumed for the program is the same rate of return on investment implicit in ULH&P's most recent rate case. However, there are several additional risks and costs attributable to the program beyond those implicit in the tariffs, and hence, the company has proposed that those costs and risks be captured as part of the 10% program fee cap. Currently, ULH&P does not know the nature, extent or quantification for all of the program risks and costs. Further, ULH&P does not believe that these costs and risks are completely knowable in advance, without direct program experience.[3]

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1 *In the Matter of Application of The Union Light, Heat and Power Company for Approval of Fixed Bill Program Riders Applicable to Residential Customers,* Case No. 2004-00503 (Application at 7).

2 *Id.* (Comments of the Attorney General at 1).

3 *Id.* (ULH&P Response to AG-DR-01-044). Even assuming that ULH&P had proposed YFB as a non-cost-based service, the Commission would have had jurisdiction to approve the offering under its general jurisdiction over the justness and reasonableness of a utility's rates, because the Commission has

ULH&P explained in its application that the program fee covers the costs that ULH&P incur for "weather, usage, price fluctuation risk, and administrative cost risks…."[4] ULH&P quantified the expected program costs, which are substantial.[5] Several other state commissions have approved similar offerings in fully regulated states.[6] ULH&P's proposed program fee is comparable to the program fees charged by other utilities for this service.[7] Even the Attorney General's comments appear to admit that YFB is a cost-based service when he admits that the program fee "compensates the utility for the assumption of those risks."[8]

ULH&P's consultant (Christensen Associates) projected a total risk premium for the Company of 16%, inclusive of administrative costs, increased usage and program risks, which is higher than ULH&P's total risk premium proposal of 15% (increased usage of 5% plus 10% for all program costs and risks). Further, ULH&P's consultant reconciled the differences between their 16% recommendation for ULH&P vs. their 12% recommendation for EKPC (2% fee plus 10% usage) as arising primarily from cost of capital differences and the fact that all of ULH&P's program costs are recovered from YFB customers only.

While ULH&P will account for YFB below-the-line, this does not change the nature of the service as a cost-based service. The service is still based on ULH&P's

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approved other utility service offerings which are not strictly cost-based, such as an earnings sharing mechanism.

4 *Id.* (Application at 5).

5 *Id.* (ULH&P Responses to KyPSC-DR-001(a) and KyPSC-DR-01-008(c)).

6 *Id.* (ULH&P Responses to AG-DR-01-31 through AG-DR-01-035). The Attorney General incorrectly refers to Indiana (one of the states which has approved fixed bill service) as a deregulated state. (Comments of the Attorney General at 2).

7 *Id.* (Attachment KyPSC-DR-01-12(c). Other companies offer fixed bill service at the same risk premium which ULH&P proposes to charge. Additionally, ULH&P's proposed 5% usage adder is smaller then every other company's known usage adder. *Id.*

8 *Id.* (Comments of the Attorney General at 2).

costs. Some other state commissions which have approved fixed bill service have approved it as a below-the-line service.[9] Additionally, ULH&P has complied with the Commission's stated preference by offering the service in a manner where non-fixed bill customers would be protected against incurring YFB costs.[10] Clearly the Commission has jurisdiction to approve YFB. The Attorney General's comments that the Commission has no jurisdiction to approve YFB are without merit.

2. <u>ULH&P's Proposed Below-the-Line Accounting for YFB Avoids Improper Subsidies</u>.

The Attorney General argues that YFB violates KRS 278.2201 by allowing ULH&P's regulated operations to subsidize its non-regulated activities.[11] The Attorney General's argument is without merit. An improper subsidy would occur if ULH&P improperly allocated costs between its regulated and non-regulated (or an affiliate's non-regulated) activities.[12] No such improper cost allocation will occur under YFB's fixed program. Instead, ULH&P will allocate to the proper accounts all costs and revenues associated with the fixed bill program. ULH&P has submitted examples of its proposed accounting treatment for various transactions associated with fixed bill service.[13] These sample accounting entries demonstrate that ULH&P will properly allocate the costs and revenues for gas and electric service for YFB customers, in accordance with KRS

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9 *Id.* (Attachment KyPSC-DR-012(c).

10 *In the Matter of an Investigation of Increasing Wholesale Natural Gas Prices and the Impacts of Such Increases on the Retail Customers Served by Kentucky's Jurisdictional Natural Gas Distribution Companies,* Administrative Case No. 384 (Order dated July 17, 2001) at 7.

11 *In the Matter of Application of The Union Light, Heat and Power Company for Approval of Fixed Bill Program Riders Applicable to Residential Customers,* Case No. 2004-00503 (Comments of the Attorney General at 3).

12 KRS 278.2203.

13 *In the Matter of Application of The Union Light, Heat and Power Company for Approval of Fixed Bill Program Riders Applicable to Residential Customers,* Case No. 2004-00503. (*See, e.g.,* ULH&P Response to KyPSC-DR-02-001).

278.2201 through KRS 278.2219. ULH&P has proposed YFB as a below-the-line service to protect non-YFB customers from paying for YFB costs/risks. The Commission should overrule the Attorney General's objection that YFB creates improper subsidies.

3. The Commission Should not Reject YFB Based on Demand Side Management Principles

The Attorney General asserts that the Commission should reject YFB because it is inconsistent with demand side management principles. The Attorney General asserts that one of the "primary draws" for YFB is that it diminishes the customer's need to conserve usage. ULH&P disagrees. The primary purpose of YFB is to provide the customer with a new billing option providing level billing with no true-up. If the customer increases his usage, such increases will be reflected in the customer's future YFB program fee. If the customer drastically increases his usage, the customer is at risk for being removed from the program. ULH&P addressed the concern about possible conflicts with demand side management in the following response to data requests:

> The pursuit of demand side management should not preclude the establishment of other utility programs that bring valuable benefits to customers, For example, bringing new industrial and commercial concerns to Kentucky is contrary to Kentucky's demand side management, but brings the benefit of economic development. Similarly, the proliferation of new homes, home appliances, and computers has brought great advancement to the comfort, quality and culture of our lives, but uses more electricity.
>
> DSM is a beneficial and admirable goal to pursue but it is not the only goal worth pursuing. Rather,

> providing voluntary billing options that are valuable to and popular with ULH&P's customers is also a worthy goal.[14]

The Commission therefore should reject the Attorney General's argument that the Commission should reject YFB because it conflicts with demand side management principles.

4. ULH&P will Fully Inform Customers About YFB.

ULH&P has developed a proposed direct mail piece (Attachment MG-1 to Mr. Goldenberg's testimony) to inform eligible customers about YFB.[15] ULH&P's purpose in offering the fixed bill program is to enhance customer satisfaction by providing a new billing option. ULH&P would not serve this purpose by using vague or misleading customer communications, because this would ultimately produce dissatisfied customers. ULH&P has studied the fixed bill programs offered by other utilities across the country. ULH&P also retained Christensen Associates and Direct Options to assist in developing the program. ULH&P has attempted to take the best practices developed by Christensen Associates, Direct Options and these other utilities in designing the fixed bill program, including customer communications. Cinergy also conducted a pilot study to investigate this service offering.

ULH&P has put this information to good use in designing YFB, including the direct mail piece. ULH&P continuously strives to improve on these types of customer communications and is always willing to entertain suggestions in this regard. Attachment MG-1 clearly explains the terms and conditions of YFB. It is unlikely that customers would be confused by ULH&P's customer communication and YFB service offering.

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14 *Id.* (ULH&P Response to AG-DR-01-049).
15 *Id.* (Direct Testimony of Michael Goldenberg, Attachment MG-1).

The Commission should therefore reject the Attorney General's argument concerning the YFB customer communications.

5. <u>The Commission Should Approve YFB Because it Benefits Customers by Providing a New Billing Option Which: (a) Gives Customers the Peace of Mind of Even Billing; (b) Increases Customer Satisfaction; and (c) Does not Increase Costs for Customers Not Choosing this Option</u>.

The Commission would allow ULH&P to offer customers several benefits if the Commission approves ULH&P's application. YFB will provide residential customers with the option to pay the same amount each month for twelve (12) consecutive months regardless of the impact of weather, usage or cost fluctuations without any end of period reconciliation or true-up. Such fixed bill offerings have been approved for utilities in other states, and have seen both very high customer acceptance and ongoing customer satisfaction. YFB benefits a large cross-section of customers, including those who like surety, risk-averse customers and those who cannot financially manage large swings in their monthly bills.

ULH&P's research indicates that budget billing is a popular billing option, but that a segment of customers want the option for level billing without an annual true-up. Budget billing is the most popular billing option aside from simply paying each monthly bill as it becomes due.[16] The 1996 study of budget bill concluded, however, that some participants dislike the uncertainty of the annual true-up.[17] The Cinergy/PSI internal pilot fixed bill program demonstrated that customers who participated in the pilot program were overall satisfied or very satisfied with the service.[18] This accords with information

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16 *Id.* (ULH&P Response to AG-DR-01-026).
17 *Id.* (ULH&P Response to AG-DR-01-027).
18 *Id.* (ULH&P Response to KyPSC-DR-01-007, Attachment KyPSC-DR-01-007).

ULH&P has received from Christensen Associates and from other utilities offering fixed bill programs.

YFB is a voluntary billing option which provides customers with a new choice for paying their utility bills. Non-participating customers are protected against paying for YFB program costs because ULH&P will account for YFB below-the-line. One of the principal goals of utility service is to provide customer benefits, that is, economic activities which are aimed at satisfying customers. Regulatory policies should be judged on whether they lead to benefits (*e.g.*, better quality, service innovation, etc.) to customers. ULH&P submits that YFB fits this criterion because it is an innovative billing option and it should be approved.

CONCLUSION

Based on the foregoing, ULH&P respectfully requests that the Commission approve its application to offer a three-year pilot fixed bill service.

THE UNION LIGHT, HEAT AND POWER COMPANY

John J. Finnigan, Jr.
Senior Counsel
The Union Light, Heat and Power Company
2500 Atrium II
P.O. Box 960
Cincinnati, OH 45201-0969
(513) 287-3601
Fax: (513) 287-3810

CERTIFICATE OF SERVICE

I hereby give notice that on this ~~20th~~ 19th day of April, 2005, I have served a copy of the foregoing Reply Comments of The Union Light, Heat and Power Company to to the Initial Request for Information of the Attorney General to Union Light Heat and Power by hand delivery or overnight mail, postage prepaid to the parties listed below.

John J. Finnigan, Jr.

Elizabeth E. Blackford
Assistant Attorney General
1024 Capital Center Drive
Frankfort, Kentucky 40601