

Kind Rebuttal

Attachment 1

Fixed Bill

Is Fixed Bill Penetration Approaching the
“Tipping Point”?

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Agenda

- ❑ What is Fixed Bill and Target Market
- ❑ Why offer Fixed Bill
- ❑ Fixed Bill Expectations
- ❑ Product Design and Risk Management
- ❑ Fixed Bill Implementation Issues
- ❑ Additional Fixed Bill Products

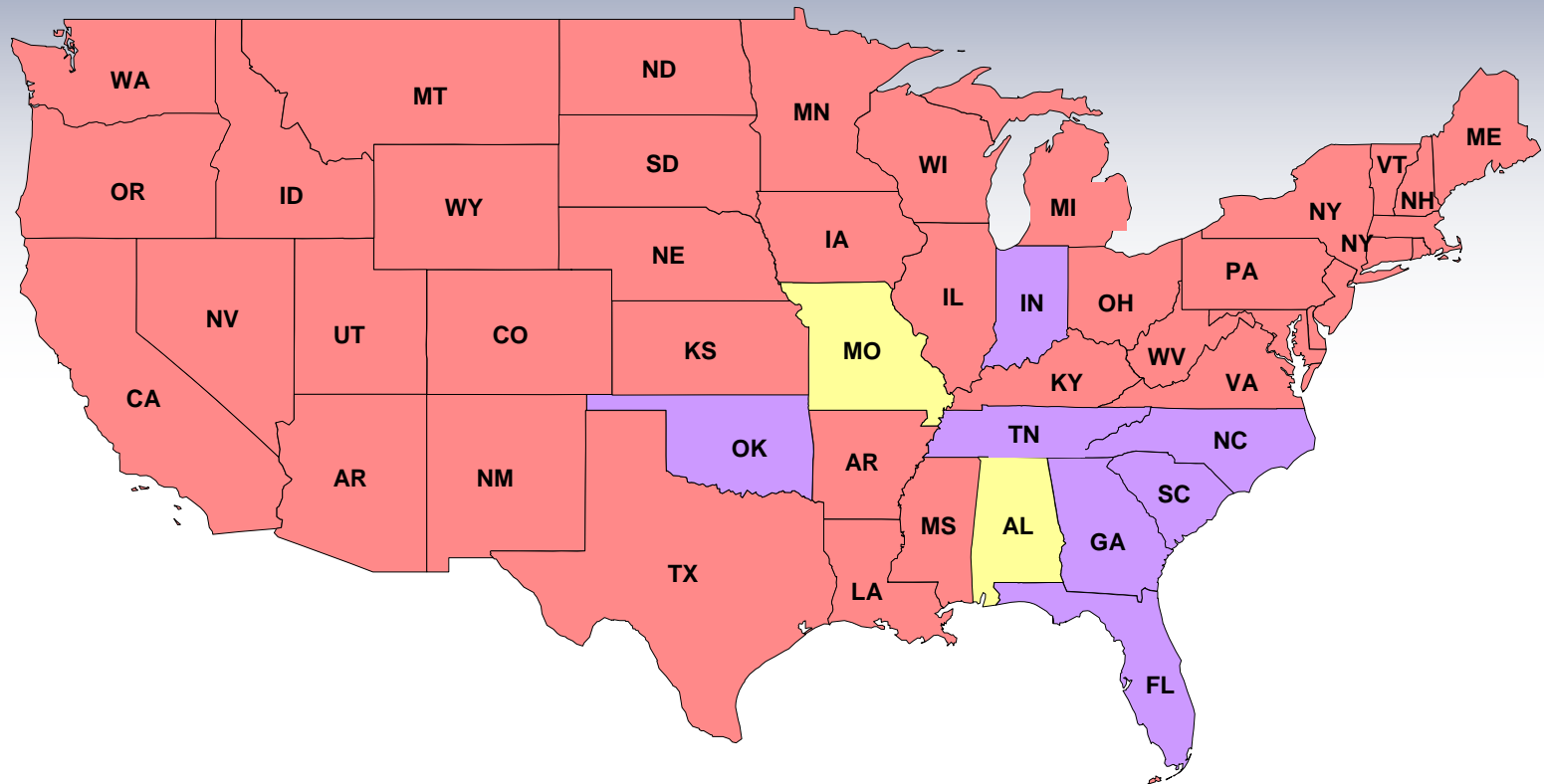
Customer Concerns and The Marketing Need

- ❑ Some customers want to know exactly how much they will be paying for utilities – No Surprises!
- ❑ They want a totally fixed bill with no possible bump or additional, after-the-fact charge when costs are higher than had been expected as found with Budget Billing
- ❑ Many customers dislike their bills for energy subject to the weather
- ❑ They are better able to manage their energy bills if the bills are spread equally over the year rather than spiking in certain months

Fixed Bill: A Classic Win-Win Product on the Verge of Market Prominence/The “Tipping Point”

- ❑ Fixed Bill is an exciting and remarkable pricing innovation!
- ❑ Customer is offered a fixed price for an entire billing period **regardless** of underlying costs and usage changes
- ❑ Conceived through market research directed at mass markets
- ❑ Will capture a large market share AND
- ❑ Provides a healthy return to the provider!

Electric Utilities Commission Approval Status Map



■ Permanent Fixed Bill Tariff

■ Pilot Fixed Bill Tariff

■ Without Fixed Bill

Program Design

Target Customers

- ❑ Residential/small commercial/mid-size business
- ❑ At least one year history at current location
- ❑ Good credit history



Why Should Utilities Offer Fixed Bill?

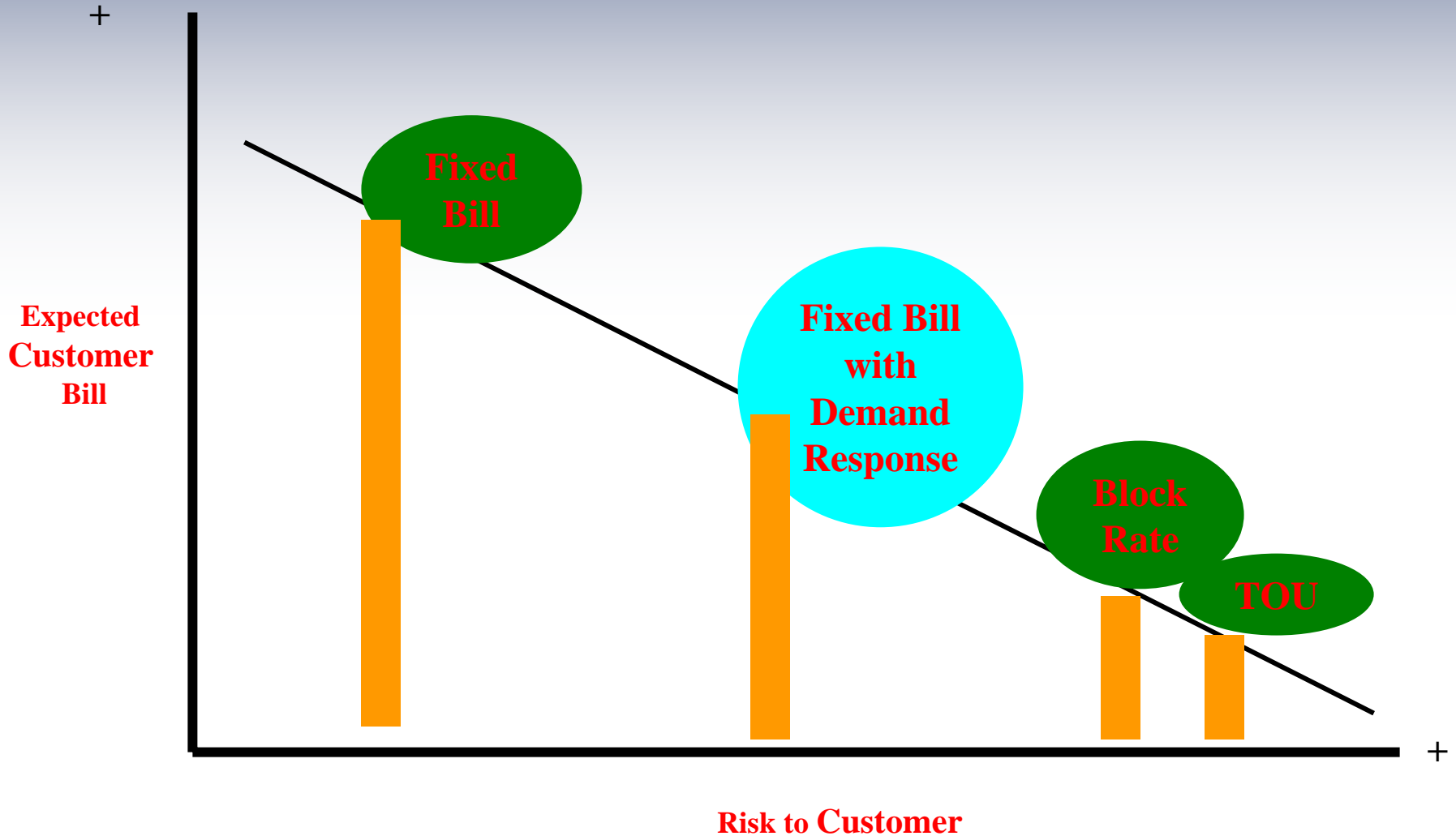
- ❑ Earnings

 - + \$1.3m EBIT per every 25,000

- ❑ Pricing product portfolio fit

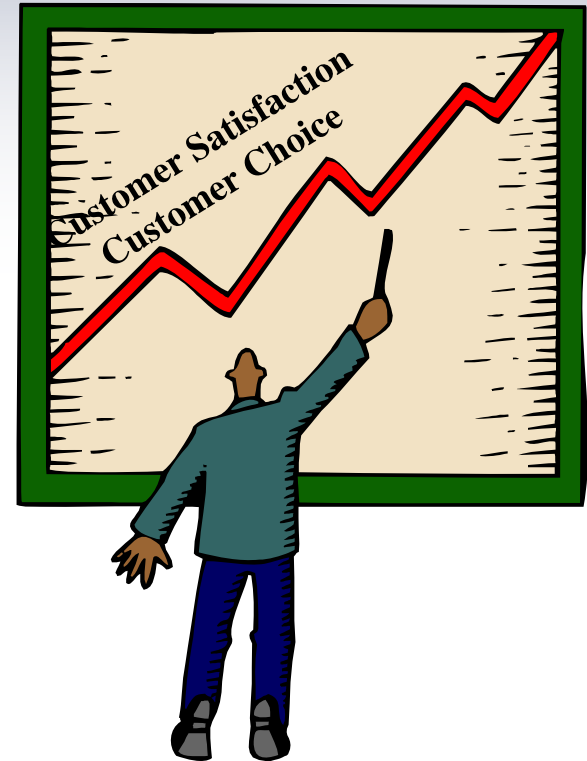


Pricing Portfolio and Customer Risk



Why Offer Fixed Bill?

- ❑ Customer satisfaction
 - High renewal rates
 - Penetration rates of 7-15%
- ✓ **95% of those surveyed said Flat Bill met/exceeded expectations**
- ✓ **71% of those surveyed said they are very “likely” to renew; 1% “unlikely”**

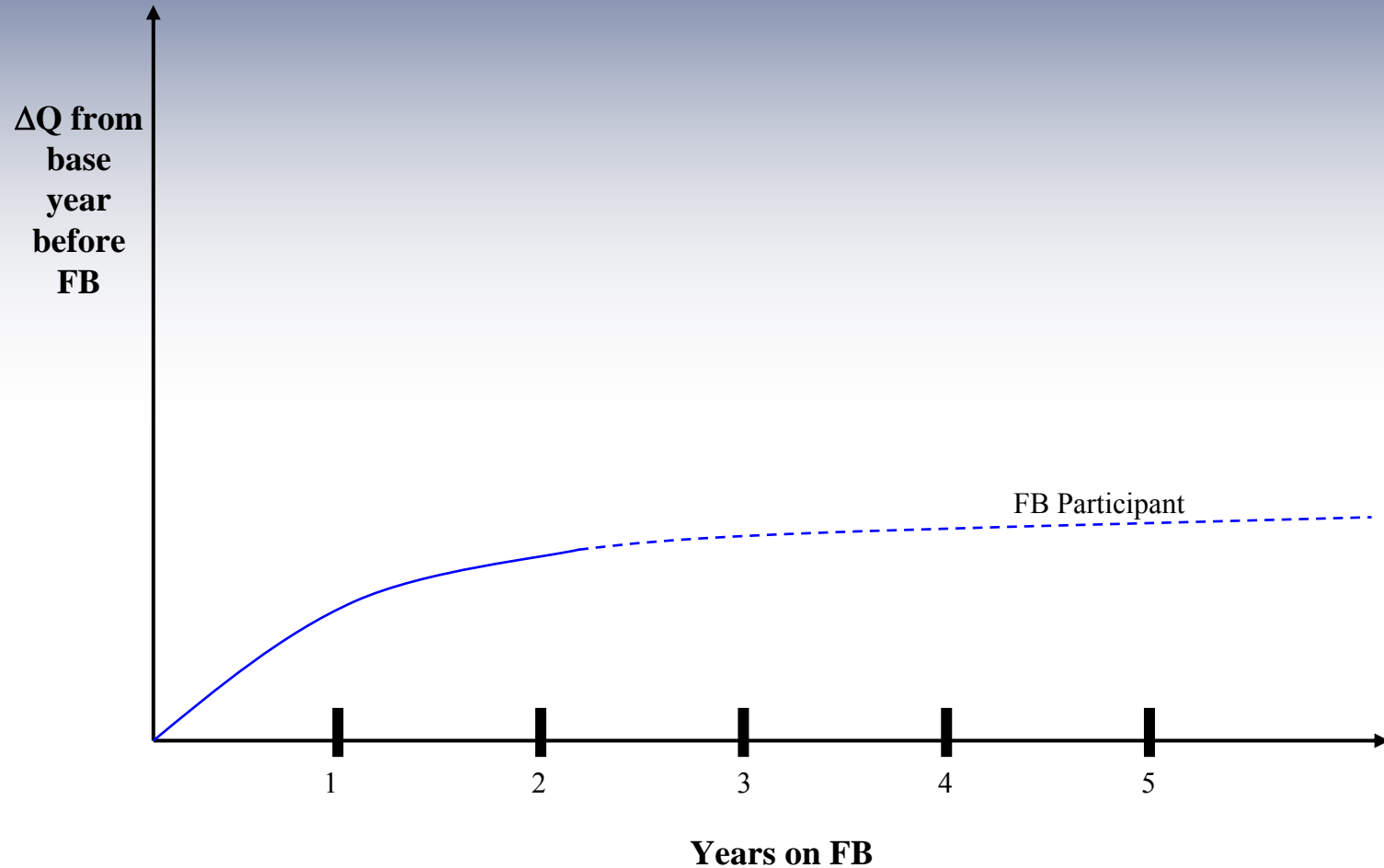


Why Offer Fixed Bill? *Growth!*

- ❑ Additional profitable kWh's
 - + shoulder and off-peak



Fixed Bill Changes in kWh Usage

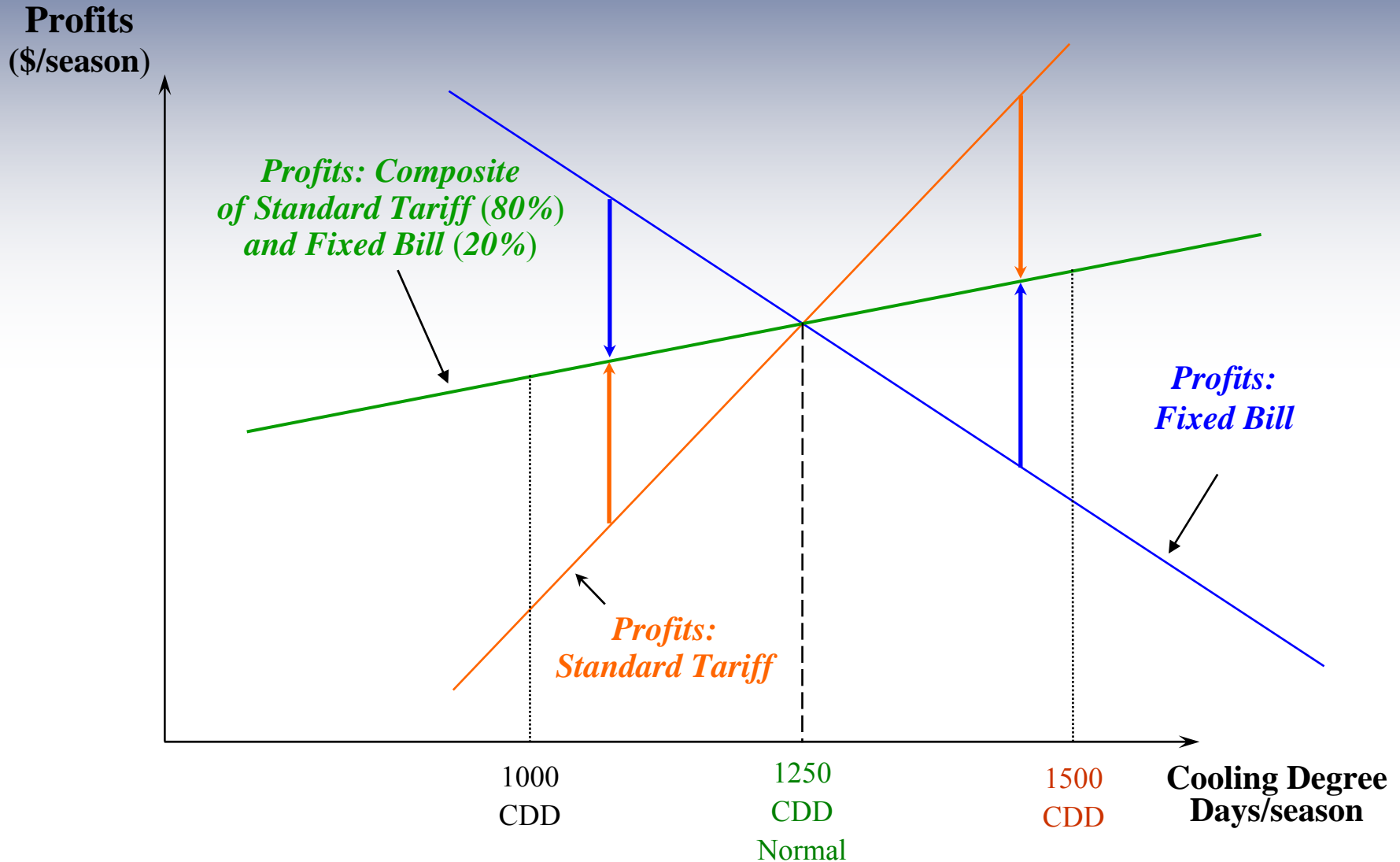


What to Expect from Fixed Bill?

- ❑ Healthy kWh growth mostly off-peak
 - Small CP effects
- ❑ High customer satisfaction and renewal
- ❑ Reduced deferral payments and bad debt
- ❑ Good penetration rates with attractive premiums
- ❑ Strong interest from budget pay customers
- ❑ Manageable risks
 - Natural hedge

Manageable Risks – Natural Hedge

Joint Profits from Standard Tariff plus some Fixed Bill Customer



Bill Offer Computation Factors

Goal: Manage & control exposure while providing your customers what they want!

- ❑ Weather normalization
- ❑ Predict quantity change
- ❑ Risk premium
- ❑ Develop billing algorithm and software
- ❑ Track and recalibrate model (this optimizes product value)
 - Consider segmentation



FlatBill Costing Methodology

- ❑ *Expected* change in the customer's usage is incorporated into a **quantity adjustment** to the individual customer's normal-weather usage forecast under the standard tariff; then this usage is billed at the standard tariff
- ❑ *Risk of departure* from those expected values are incorporated in the **risk premium**

Billing Offer System

❑ Create billing computation formula:

A_i = Weather normalized kWh monthly history for each individual customer i

B = Moral hazard %

C = Risk premium %

D = Expected % natural kWh growth/customer

E = Standard rate otherwise applicable, including any and all clauses such as fuel (exclude taxes and local franchise fees)

$$\sum_{i=\text{January}}^{\text{December}} \left\{ \left[A_i \times (1 + B) \right] \times (1 + D) \times E \right\} \times (1 + C)$$

Risks of Departure from Expected Case

- ❑ **Price response** may be different from prediction
- ❑ **Natural growth** may be different from predicted
- ❑ **Weather** may be extreme
- ❑ **Modeling** recognizes that we may not fully capture customers' behavior
 - Includes any possible “selection bias”
- ❑ **Regulated prices and fuel cost forecasts** may change before end of contract period

Fixed Bill Risk

	1st Year	Cumulative Over 5 Years	Any One Year
Expected Penetration =	9%	15%	
Expected EBIT =	\$1M	\$10.8M	
Worst Case EBIT =			(\$5.5M)
Best Case EBIT =			\$11.5M
Net Present Value =		\$7.8M	
Net Profit Likelihood =	68%	85%	

How to Manage Financial Issues

- ❑ Financial Hedges or Natural Hedge
 - Option premium in Fixed Bill
- ❑ Premium flexibility
 - Segmentation
- ❑ Rollout timing with phases
- ❑ Tracking and reporting software
- ❑ “Above-the-line or below” accounting

Fixed Bill Implementation Issues

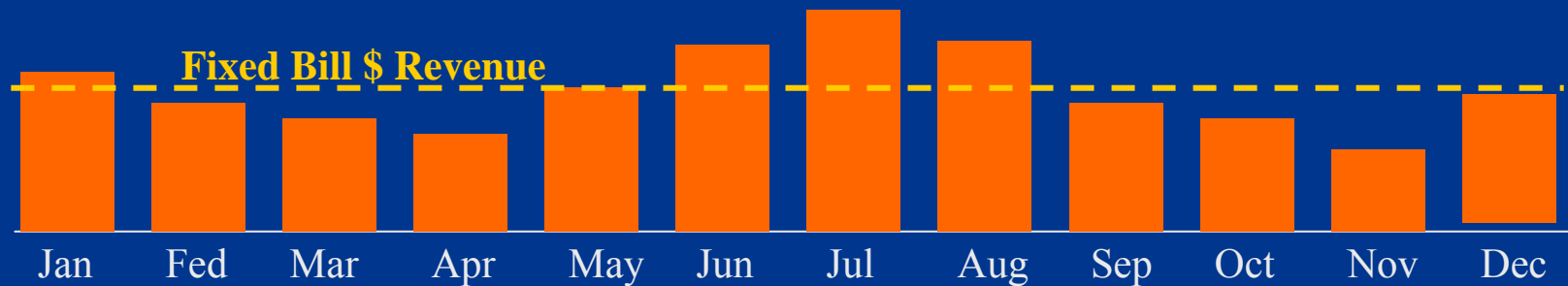
- ❑ Cash flow and time value of money
- ❑ Product appeal and penetration
 - Greatest with summer offering for summer peaking utility
- ❑ Deferred credit resource?
- ❑ Bad credit resource?

Fixed Bill Implementation Issues

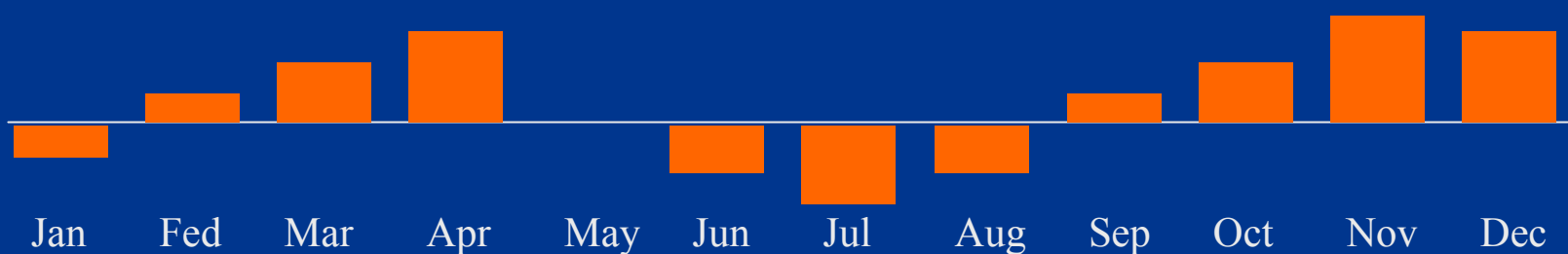
Seasonality: “Keep the Faith”

Summer Peaking Utility

**Typical \$ Revenue per Customer
With Traditional Residential Tariff**



**\$ Revenue Variance Between Fixed Bill and Traditional Tariff
Weather Normal**



Fixed Bill Implementation Issues

- ❑ Pilot or permanent initial rollout
- ❑ System load impacts
- ❑ Financial impacts
- ❑ Product design
 - Bill algorithm and seamless software for offer
 - Weather Normalization
 - Risk coverage and premium
 - Quantity change
 - Tariff design
 - Eligibility
 - Force majeure
 - Early termination
 - Budget billing
 - Goodness of fit
 - History and credit

Fixed Bill Implementation Issues

- ❑ Accounting
 - Above or below
- ❑ Regulatory approval
- ❑ Target Marketing
- ❑ Risk Management Committee and Hedging
- ❑ Dedicated Staff
 - Renewals
 - Recalibration
 - Segmentation
- ❑ Tracking software
 - Reporting
 - Algorithm enhancement

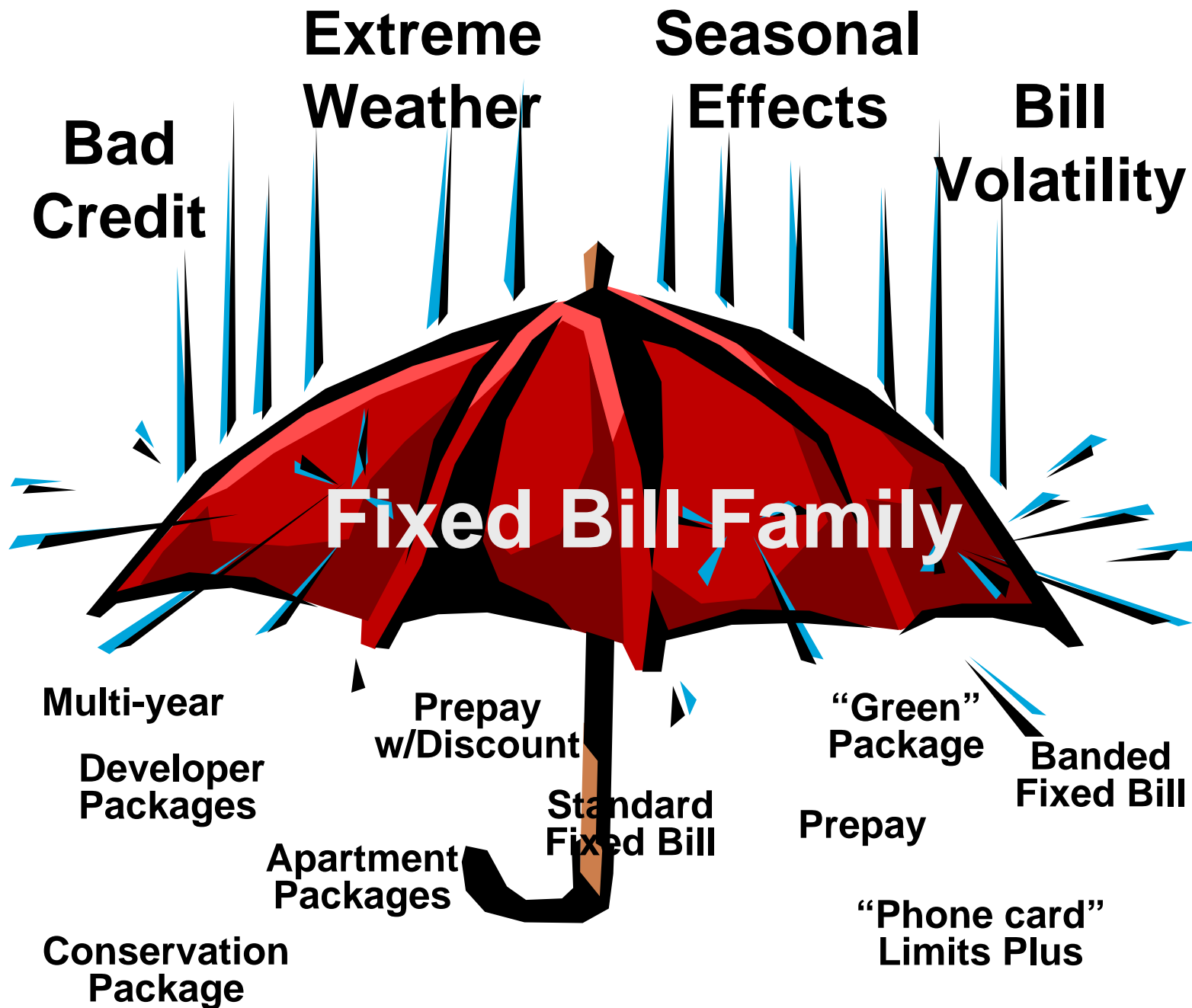
Implementation Challenge: How to Win Approval?

❑ Internal Approval:

- Need a methodology and price components that are sound, reasonable and explainable
- Matches Company Risk Appetite including risk management committee
- Business Model with forecasts, budget, and tracking
- Regulatory approval and reporting

❑ Regulatory Approval:

- Risk to non-participants
- Conservation and Clean Air
- Tracking and Reporting



Fixed Bill for Small to Mid-Size Business Customers



Marketing Basis

- ❑ Business customers want pricing choices
- ❑ Most business customers want simplicity and predictability
- ❑ Customers appreciate self design feature-
Improves customer satisfaction
- ❑ Weather impacts, business impacts, and energy cost changes insured and guaranteed below ceiling
- ❑ Eliminates demand feature of traditional tariffs

Principles of Fixed Bill For Business

- ❑ Target market: small and medium size business customers
- ❑ Provides customers with
 - A constant bill amount with no true-up when usage remains below ceiling

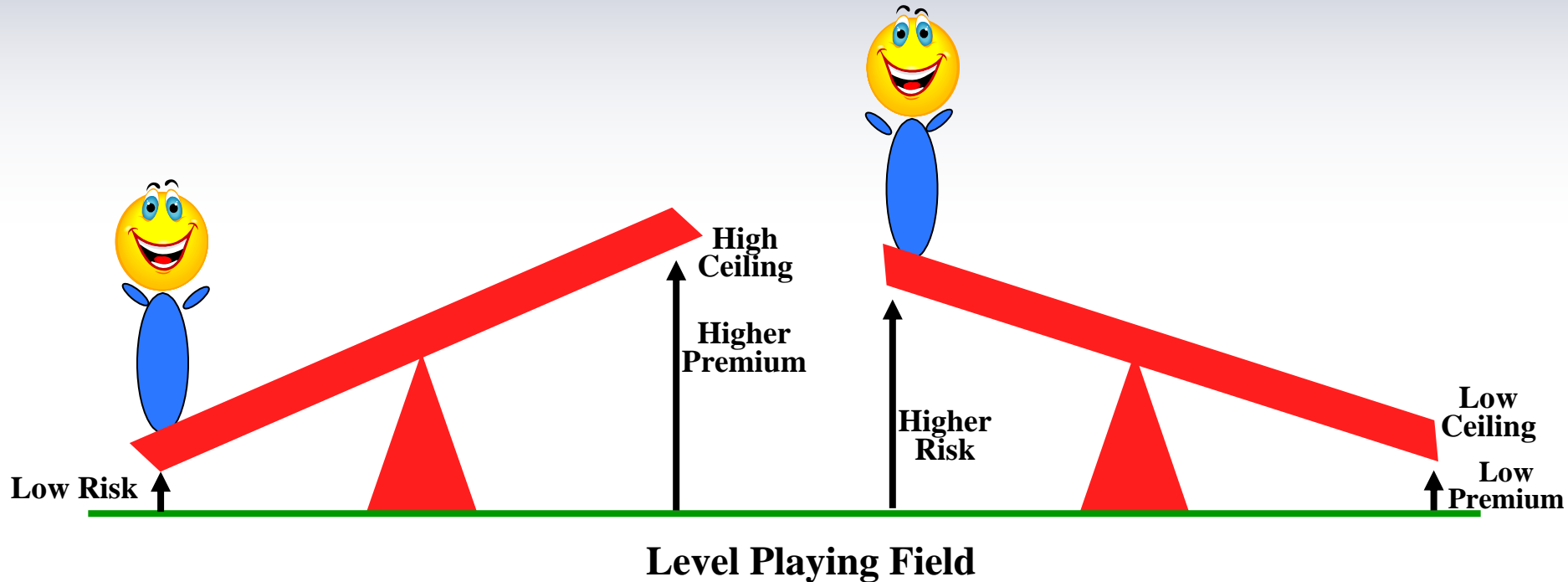
Design Challenges

- ❑ Three Major Challenges
 - Risk Premium for usage below ceiling
 - Prices for any use above ceilings
 - Ceiling choices

Ceiling Choice Trade-offs

**Customer Wanting Low Risk
okay with Higher Prices**

**Customer Wanting Lower
Prices okay with Higher Risk**



Fixed Bill For Business Offer Example

	Ceiling Choices		
	Annual Average: 10,000 kWh/month		
Number of Ceilings	Low 12,000 kWh	Moderate 15,000 kWh	High 17,000 kWh
Annual	\$1000	\$1100	\$1200
Seasonal	\$900	\$950	\$1050
Monthly	\$800	\$850	\$980

Structure

- ❑ Fixed Bill For Business offer fixed \$ amount—usage above ceiling on an incremental usage basis
- ❑ Excess kWh billed using flat TOU ¢/kWh; 30 cents/kWh on peak and 10 cents/kWh off peak
- ❑ No demand charge
- ❑ Initial size limitations
- ❑ kWh ceiling only; no kW ceiling
- ❑ Certain SIC Codes will find more appealing
- ❑ At least 12 months history
- ❑ Product encourages meter measurement software (Energy Direct/ Pulse option)
- ❑ 1 year contract—early termination rules
- ❑ Below-the-line (Risk Premium) risk treatment instead of Above-the-line
- ❑ Abuse provision

Time Line

- ❑ December 2005 – Initial Tariff Design
- ❑ January 2006 – Market Research
- ❑ February 2006 – PSC Request
- ❑ May 2006 – PSC approval
- ❑ June 2006 – Solicit Pilot Participants
- ❑ August 1, 2006 – Pilot Launch

Vice President of Marketing

I'd just like to take a moment to sincerely thank you for all your efforts on behalf of the customers.

I like to especially thank you for the Flat Bill Plan.

I live on a fixed income, my home is totally electric and it's a constant struggle for me to handle my bill! If you check your records, you'll see what I mean!

May God richly bless you, your co-workers, and each of your loved ones.
Have a wonderful day!