

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of Tariff Revisions Filed by Aquila,)
Inc. d/b/a Aquila Networks-MPS and Aquila) **Case No. EO-2007-0395**
Networks-L& P Designed to Continue and Expand) Tariff No. JE-2007-0739
its Fixed Bill Pilot Program)

PUBLIC COUNSEL’S POST-HEARING BRIEF

INTRODUCTION

This brief will address the issues as listed in the List of Issues filed by Public Counsel on October 23, 2007. Public Counsel submits that approval of the proposed expansion of the fixed bill pilot program to all of the customers of Aquila, Inc. would not be in the public interest for all the reasons stated herein. Public Counsel recommends that the tariffs be rejected.

ISSUES

1. Should Aquila’s Fixed Bill Pilot Program (Tariff No. JE-2007-0739) comprised of three (3) tariff sheets be found to be just and reasonable, in the public interest and approved by the Commission?

This issue is the ultimate conclusion that the Commission must answer. The more granular issues that follow, and the evidence of record concerning them, demonstrate that the Commission must conclude that the tariff sheets should not be found to be just and reasonable or in the public interest. This type of “all you can eat” rate design discourages energy conservation and, while there may be a very small percentage of Aquila customers that would take advantage of it, is likely to cause adverse impacts on non-participating Aquila customers and the public in general because of the load building effects.

2. Should the proposed pilot program be made available to all eligible Aquila customers for a five year pilot time period?

No. Pilot programs should be more limited in scope and duration than Aquila's proposal to make this program available to all of its qualifying residential customers for a five year period. Aquila has already conducted a pilot program for two and a half years in its St. Joseph Light and Power service territory, and has paid little attention to the results of that pilot in designing the program under consideration here. In fact, there is little reason to call this program a pilot. It will be offered to all Aquila customers, in both Missouri service territories, and will run at least five years. A pilot is typically limited in number of customers, geographic area, or duration. This program is not limited at all in the first two respects, and is quite long in duration compared to most pilot programs. If the Commission decides to approve the program despite the overwhelming evidence against approval, it should limit it to no more than three years, in a limited geographical area, and for a limited number of participants.

There is not a huge demand for this program. 31,500 solicitations were sent out in the SJLP pilot in the first two years, and 1193 customers accepted. (Transcript, page 119). That is only a 3.8 percent take rate, marginal at best. Aquila tries to somehow manipulate the numbers to claim a take rate of seven percent, but that number is simply wrong. In addition, in the proposed program Aquila would increase the program fee from eight percent to twelve percent, likely reducing the take rate even below the 3.8 percent in the SJLP pilot.

3. Is the proposed below-the-line accounting treatment appropriate for the proposed program?

No. Aquila witness Dennis Odell denies that Aquila is seeking to offer the fixed bill program as a non-regulated program (Exhibit 2, Odell Surrebuttal, pages 8-9). Below the line accounting treatment is not appropriate for regulated retail services offered by utilities that are regulated by the Commission. (Exhibit 4, Kind Rebuttal, page 16).

Public Counsel witness Kind testified that:

Aquila's decision to modify its fixed bill program and offer it as a non-regulated service with below-the-line accounting treatment brings with it the obligation for the Company to comply with a number of requirements in the Affiliate Transactions rule (4 CSR 240-20.015) and the Utility Promotional Practices rule (4 CSR 240-14). For example, subsection (2)(F) of the Affiliate Transactions rule (4 CSR 240-20.015) requires a utility to clearly advise its customers in all of its marketing communications that this program is not regulated by the Missouri Commission.

Aquila has not committed to advising customers that the program is not regulated by the Commission, and indeed refuses to concede that it is not regulated. Furthermore, services provided by the "regulated" entity (the portion of Aquila's operations that are recorded above-the-line for ratemaking purposes) to the "non-regulated" entity (the below-the-line operations) must be priced at the higher of cost or market in order to comply with 4 CSR 240-20.015(2)(A)2. Examples of such services are customer bill preparation and delivery. In his Direct Testimony, Aquila witness Odell admits that the proposed fixed bill program is a "competitive billing option" (Exhibit 1, Odell Direct, page 6) but there is no description of how the affiliate transactions needed to offer this "competitive billing option" will be carried out to protect customers of the regulated utility from subsidizing Aquila's non-regulated operations.

Several additional concerns arise from Aquila's proposal to offer fixed billing as a non-regulated service with below-the-line accounting treatment. Public Counsel witness Kind identifies some of these in his testimony:

With below-the-line treatment of earning from this program, Aquila will have an incentive to impose high program fees upon those that use the fixed billing option. Participants in the current fixed-bill pilot program with above-the-line accounting treatment have been charged no more than a six percent program fee but Aquila is seeking to charge program fees as high as twelve percent to customers in the expanded program. There are no protections to insure that customers will not be induced to sign up for the new program through marketing tactics that take advantage of the limited ability of some utility customers to fully understand the implications of the choice they are making. Missouri customers have come to assume that the rates being charged by their utilities are reasonable since they have been reviewed by the Commission. The latitude that Aquila has for setting its own charges under the proposed tariff means that this would not be the case. (Exhibit 4, Kind Rebuttal, page 17).

Aquila, despite proposing that this program be accounted for below-the-line, is not aware of any other Missouri utility offers a regulated service for which the Missouri PSC has explicitly permitted it to use below-the-line accounting treatment. (Tr. 81)

Furthermore, the Commission should not rely on Aquila's analysis of similar programs in other states. This analysis, reflected in Schedule DO-3 to Aquila witness Odell's direct testimony (Exhibit 1) is haphazard at best. Mr. Odell had little or nothing to do with the preparation of Schedule DO-3.¹ Cross examination revealed one clear error (Exhibit 7 shows that Duke Power Carolinas have above-the-line accounting treatment and Schedule DO-3 shows below-the-line treatment) and one likely error (Exhibit 8 shows that – at least at the time of that tariff – the risk fee used by Duke Power Carolinas was much lower than what is shown on Schedule DO-3). The Commission should give no weight to Schedule DO-3. Mr Odell did not prepare the schedule, did not review the source documents on which it was based, and was unable to identify the cause of the errors on it. Although a hurried phone call during a break did suggest a possible reason for one of those errors and apparently did not identify any others,²

¹ Transcript 38-45

² Transcript, page 89.

under the circumstances, the Commission should not rely on Schedule DO-3. Furthermore, the results shown on Schedule DO-3 do not include some utilities with lower risk factors. For example, Exhibit 8 shows that Duke Energy Carolinas offers a fixed bill program with a 2.2 percent “risk fee” (a charge comparable to Aquila’s “risk factor”). This low risk factor was excluded from Schedule DO-3.

4. Are the provisions of the affiliate transactions rule applicable to the proposed program?

Yes, as Mr. Kind states at line 24 on page 16 of his testimony, “because of the below-the-line accounting treatment proposed by Aquila, this program is subject to the provisions of the Affiliate Transactions rule, the purpose of which is “to prevent regulated utilities from subsidizing their non-regulated operations.”

Aquila claims that this program is not subject to the Affiliate Transaction Rule because only one “business entity” is involved. The Affiliate Transaction Rule anticipates such a situation and states:

Affiliate transaction means any transaction for the provision, purchase or sale of any information, asset, product or service, or portion of any product or service, between a regulated electrical corporation and an affiliated entity, and shall include all transactions carried out between any unregulated business operation of a regulated electrical corporation and the regulated business operations of a electrical corporation.³

While Aquila somewhat casually refers to this as a “competitive” offering, it is clear that little analysis was done to determine whether it would really be subject to competition:

Q. And tell me why it's important that historical usage is used.

A. We use historical usage to ensure that we are accurately forecasting as much as is possible what -- what we would expect customers' usage to be in the future.

Q. So in order to properly run this program, it's important to know a customer's historical usage; is that correct?

³ 4 CSR 240-20.015(1)(B)

A. Right.

Q. Okay. Now, turning to page 6 of your direct testimony, and I believe Mr. -- Mr. Williams asked you some questions about this. You say that you do consider fixed bill a competitive billing option; is that correct?

A. That's right.

Q. If a competitor were to provide a competing product, would Aquila offer a customer's historical billing data to that competitor?

A. I've never even contemplated that. I don't know.

Q. Can you think --

A. I don't know what all the ramifications of doing that might be.

Q. Can you think of other situations in which Aquila has offered competitive billing data to other competitors?

A. Well, that's not an area of my responsibility, so I -- I'm not aware of any, but I wouldn't necessarily be either.

Q. Do you know whether or not you would need a release from each customer to release that information to a competitor?

A. No, I don't know the answer to that.

Q. Do you have an opinion as you sit there today on the stand under oath as to how likely it is that a competitor will come in and offer a competing service to this fixed bill option?

A. I only know that to the best of my knowledge, anyway, it has not happened to date.

(Transcript, pages 51-52).

Mr. Odell's responses to the questions above show another way in which this program would violate the affiliate transactions rule. Since Aquila is seeking to offer this program as a below-the-line non-regulated program, it must comply with section (2)(B) of the affiliate transaction rule which prohibits the regulated utility from providing "any preferential service, information or treatment to an affiliated entity" (the non-regulated part of Aquila that would offer the proposed program). Mr. Odell's statements above that Aquila might not offer the historical customer data necessary to implement the program to a potential competitor. Without a commitment by Aquila to not provide any preferential treatment to the affiliated non-regulated part of the Company that would offer the service the Commission must find that the proposed fixed bill program is in violation of section (2)(B) of the affiliate transaction rule (4 CSR 240-20.015).

5. Are the provisions of the promotional practices rule applicable to the proposed program?

Yes. The most troubling aspect of the program is its load-building impact. At a time when most utilities are actively looking for ways to encourage energy efficiency, it is difficult to fathom why Aquila is so set on this load-building program. Aquila itself even has other programs that are designed to encourage efficiency; the Fixed Bill proposal under consideration here runs counter to all these efficiency efforts. As Mr. Kind points out in his testimony,

Aquila estimates that the majority of the kWh savings that are achieved by its Residential Lighting Program over a five year period will be lost in just the **first** year of the Company's proposed fixed bill "pilot" program. Aquila's response to OPC DR No. 2052 (see Attachment 3) shows that the "first year impact" of "Increased Usage by Customers Selecting Fixed Bill" (shown in Line 10 on the second page of Attachment 3) is expected to be 9,416 MWhs (9,416,000 kWhs). Since 9,416,000 kWhs is 71.46% of 13,185,742 kWhs (See Attachment 2 for this calculation) Aquila is projecting that well over 2/3 of the savings achieved by the Residential Lighting Program during its first five years of operation will be wiped out by the load growth expected from just the first year of the expanded fixed bill program! (Exhibit 4, Kind Rebuttal, pages 6-7).

Even though Aquila tried to back away from characterizing the load-building as a major issue at hearing,⁴ its own planning documents show that system load impacts will be a major issue. (Exhibit 12).

And Public Counsel witness kind calculated the expected load growth in the residential customer class demand:

According to the load growth projections in Aquila's most recent IRP filing in Case No. EO-2007-0298, Aquila's load is expected to grow at an average rate of 2.5% over the next 20 years. When the expected growth for the residential class of .386%, the total load growth for the residential class would increase from about 2.5% to 2.86% when the full load growth impacts of the first year of implementation are taken into account. (Exhibit 4, Kind Rebuttal, page 8).

⁴ Transcript, page 61.

Mr. Kind states that: “4 CSR 240-14.020 contains a list of “Prohibited Promotional Practices” which cannot be offered ‘for the purpose of inducing any person to...use additional service of the utility’” and that “one of the ten prohibited promotional practices [4 CSR 240-14.020(1)(J)] pertains directly to a fixed bill type of service offering. (Exhibit 4, Kind Rebuttal, page 19).

It is very important to note that Mr. Odell did not disagree with the calculations that Mr. Kind presented in his testimony on the load-building effects of the proposed program – the quantitative analysis of the proposed program. (Transcript, pages 69-70). Mr. Odell only disagreed with Mr. Kind’s **qualitative** descriptions of the load-building impacts; he simply took issue with the adjectives used by Mr. Kind to describe the numbers, not the numbers themselves.

Although Mr. Odell would not concede that increasing capacity was a significant factor driving Aquila’s recent rate increases, he did concede it was a factor, and was unable to identify any other factor as more significant. Exhibit 9 shows that the need for “new capacity to serve increased demand” was indeed a significant factor in Case No. ER-2007-0002. Mr. Odell admitted that there is nothing in the program that will insulate nonparticipating customers from any adverse impacts due to Aquila’s need to increase capacity. (Tr. 57-58). But the only analysis (Exhibit 4, Kind Rebuttal, Attachment 3; Tr. 60; Exhibit 11) that Aquila has done on load-building shows that there will be a significant increase in usage due to the proposed fixed bill program.

Mr. Kind testified about Aquila’s continuing need for capacity:

Utility’s that propose fixed bill type programs often try to minimize the load building impacts by asserting that the impacts are either completely or mostly off-peak. In today’s environment, it’s difficult to see why load growth of any type would be beneficial from a customer perspective especially for a utility like Aquila that is extremely short on the supply-side resources that will be needed to serve the growing needs of its customers over the next 10 years. Aquila’s

response to OPC DR No. 2048 (see Attachment 4) shows on the third page of the response that its shortfall of generating capacity ranges from a low of 244.9 MWs in 2010 (when Iatan 2 is expected to go on line) to a high of 799.5 MWs in 2017. Given Aquila's chronic shortage of intermediate and baseload generation resources in recent times, it can be assumed that Aquila will also have a significant shortage of reasonably priced energy to serve its customers needs over the next 10 years. Of course, as some type of carbon regulation becomes increasing likely, it will become more and more important to reduce off peak energy usage as well as peak demands in order to hold down the costs of serving electric customers since off-peak loads are generally served by carbon-intensive coal generating units. (Exhibit 4, Kind Rebuttal, pages 7-8).

Finally, despite the fact that Aquila concedes that there will be load-building effects, Aquila is unwilling to commit to hold customers harmless from these load-building effects. (Tr. 59-60). Aquila's unwillingness to make a hold harmless commitment seems unwarranted in light of its assertion that "Below-the-line accounting is being requested to ensure that the customers who are not eligible or who do not choose to participate in the Fixed Bill product do not subsidize those customers who do choose to purchase this product." (Exhibit 1, Odell Direct, page 8).

Other state commissions have addressed the question of whether fixed bill programs are appropriate. A recent decision of the Kentucky Public Service Commission held:

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. (Kentucky Public Service Commission Case No. 2004-00330, Order issued May 4, 2005, page 7).

The Kentucky Commission also held, in the same order, that a fixed bill program is particularly inappropriate for a utility with a need for substantial new generation:

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.** (*Ibid.*, pages 7-8; emphasis added).

6. Would approval of the proposal outside of a rate case constitute single issue ratemaking?

Yes, Aquila's proposal could have a substantial impact on its earnings. Indeed, that is why Aquila is offering it system-wide with a twelve percent program fee. It is anticipated to be a modest, but still significant, additional source of revenue above what the Commission found just and reasonable in Aquila's last rate case (Case No. ER-2007-0004). Allowing a utility to impose additional charges on its customers and achieve additional revenues without examining all relevant factors is single issue ratemaking. In Missouri, single issue ratemaking is prohibited:

Missouri's prohibition against single-issue ratemaking bars the Commission from allowing a public utility to change an existing rate without consideration of all relevant factors such as operating expenses, revenues, and rates of return.

...

The rationale behind the single-issue ratemaking prohibition is to prevent the Commission from allowing a utility to "raise rates to cover increased costs in one area without realizing there were counterbalancing savings in another area."⁵

As Mr. Kind notes, Aquila "should propose this program in a rate case where 'all relevant factors' can be taken into account so rates will be set at a level that is just and reasonable when all relevant factors are taken into account in the ratemaking process." (Exhibit 4, Kind Rebuttal, page 20). Several of these factors identified by Mr. Kind are: "changes in risk, increases in normalized revenues, and expense reductions such as reduced bad debt expense associated with the fixed bill program." (*Ibid.*).

Aquila's best estimate for revenues from this program is \$182,404 for 2008, \$474,996 for 2009, and \$699,996 for 2010. (Exhibit 5). And its expected costs are \$252,950 for each of those years. (Exhibit 6). It is solidly positive after the first year, and profits of nearly a half million dollars are expected by the third year. Aquila makes no bones about the profit motive driving this offering. When asked whether Aquila expected costs and revenues to be roughly equal over the life of the program, Mr. Odell readily conceded that profits are expected:

Q. So you're saying you anticipate it will be a wash?

A. No. I'm saying that in the past two years it's been roughly a wash.

Q. And if you increase the cost to -- or the premium to 12 percent as opposed to 8 percent, then you'll anticipate that it will no longer just be a wash?

A. I would expect and certainly hope that over the course of years, that we would end up with more revenue than we would have cost, certainly. In any given year, that certainly could vary. (Transcript, pages 24-25).

There are likely to be customers that stay on the program despite increases, because – once they initially sign up – customers are stuck in the program unless they affirmatively opt out:

Q. For the customers that do participate, if their usage does not grow in the latter years of their participation, and you yet continue to charge them the 6 percent growth factor, will Aquila's revenues and earnings from those customers increase?

⁵ State ex rel. Sprint Spectrum L.P. v. Mo. PSC, 112 S.W.3d 20, 28 (Mo. Ct. App. 2003)

A. In the event that customers would continue to stay on the program in that scenario, which I don't consider to be likely, then -- then, yes, that's the way the math would work.

Q. Now, for a customer who signed up for the first year, how do they -- how do they opt out? Is there a negative check-off? Do they have to affirmatively sign up for succeeding years, or do they have to affirmatively opt out?

A. They would need to opt out. They would be presumed to stay on the program in the second year. They would receive a new -- a new bill offer which they would have an opportunity to review, and if they -- if they choose not to participate in the program, they would send us a card in telling us that.

Q. But if they do nothing, they're automatically reenrolled --

A. That's correct.

Q. -- regardless of what the premium is or the growth is?

A. That's correct.

(Transcript, page 36).

7. Is the tariff language that permits Aquila to set fixed bills based on the “expected” level of rates lawful and in the public interest?

No. If the Commission approves a tariff that allows the regulated utility to set rates for fixed bill customers based on the utility’s “expected energy price structure” it will no longer be fulfilling its responsibility to ensure that the utility is charging just and reasonable rates. Furthermore, the Commission is not allowed to abdicate its responsibility to set a fixed rate for a service, and allow a utility to determine what rate is applicable.⁶

In addition, the annual fixed bill formula in the tariff includes the item “energy price” which is defined as the “expected energy price structure...” Given the definition of this item, Aquila has latitude to calculate bills based not on currently tariffed rates but on its expectations of future tariffed rates over the year that the annual bill would cover. In other words, Aquila can make its own assessment of the level of any general rate increase that it expects to receive in the upcoming year and the level of FAC charges that will be in effect for the upcoming year and incorporate its expectations into the annual bill calculation. (Exhibit 4, Kind Rebuttal, page 16).

⁶ State ex rel. Util. Consumers Council of Mo., Inc. v. Mo. Pub. Serv. Comm'n, 585 S.W.2d 41, 56-58 (Mo.banc 1979).

8. If the Commission approves the proposed fixed bill program, what should the cap on program fees be?

The cap on program fees should not be raised from the eight percent level that exists for the current pilot. The clear purpose of the proposed program is to increase earnings. In the “first pilot” (the limited SJLP pilot), Aquila never even charged a program fee of eight percent, but instead charged six percent. (Transcript, page 53). And Aquila’s analysis of the observed value for SJLP shows that customer usage increased by only 2.37 percent, and that all Missouri customers are expected to behave like SJLP customers.⁷ There is no reason whatsoever to raise it above eight percent.

9. If the Commission approves the proposed fixed bill program, should the tariff include a “kWh growth factor”?

No. As Public Counsel witness Kind states:

If, contrary to the recommendation of OPC, the Commission decides to approve this proposal, it should not permit Aquila to have a growth adjustment adder as part of its tariff because this adder insulates Aquila from the adverse financial impacts of the load growth of fixed bill customers, thereby removing any incentive for Aquila to take steps to minimize this load growth. (Exhibit 4, Kind Rebuttal, page 2).

As discussed above, it is the load-building aspect of the program and the resulting harm to all Aquila customers that is the most troubling aspect. The Commission should remove the disincentive to minimize load growth that it create by the kWh growth factor..

10. Should the Commission consider Great Plains Energy’s proposed acquisition of Aquila in deciding whether to approve the tariffs?

⁷ Exhibit 14, page 12.

Yes. It would not be fair to potential fixed bill program participants to make such a program available to all of Aquila's Missouri residential customers without at least some indication that Great Plains may have an interest in continuing the program. While this is perhaps the least significant issue, it nevertheless must be decided against Aquila. There is nothing in the record that indicates that Aquila even bothered to discuss this program with Great Plains, and so there is certainly a risk that the program would be discontinued if the Great Plains/Aquila merger is completed.

CONCLUSION

For all the reasons stated herein, Public Counsel requests that the Commission reject the proposed expansion of the fixed bill pilot program to all of the customers of Aquila, Inc.

Respectfully submitted,

OFFICE OF THE PUBLIC COUNSEL

/s/ Lewis R. Mills, Jr.

By: _____

Lewis R. Mills, Jr. (#35275)

Public Counsel

P O Box 2230

Jefferson City, MO 65102

(573) 751-1304

(573) 751-5562 FAX

lewis.mills@ded.mo.gov

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to the following this 11th day of December 2007:

Office General Counsel
Missouri Public Service Commission
200 Madison Street, Suite 800
PO Box 360
Jefferson City MO 65102
GenCounsel@psc.mo.gov

Nathan Williams
Missouri Public Service Commission
200 Madison Street, Suite 800
PO Box 360
Jefferson City MO 65102
Nathan.Williams@psc.mo.gov

Paul A Boudreau
Aquila Networks
312 East Capitol Avenue
PO Box 456
Jefferson City MO 65102
PaulB@brydonlaw.com

/s/ **Lewis R. Mills, Jr.**
