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# Fuel Cost Treatment Issues

Presented by

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Law Seminar – Managing the Modern Utility Rate  
Conference

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# Why is Fuel Costs Treatment Critical

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- ▲ Fuel Costs Comprise 25% - 60% of revenues from Residential, Commercial, and Industrial customers
- ▲ Largest operational expense
- ▲ Subject to unexpected cost swings

## Traditional Approaches for Fuel Costs Recovery

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- ▲ Monthly Fuel Adjustment factors
- ▲ Annual Fuel costs level with and with out true-up – Risk sharing?

# What do the Various Players Want

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- ▲ **Financial Community** - wants to see a recovery mechanism that assures recovery and closely match the time of costs occurrence and recovery. Risk sharing should be balanced between the customers and utility.
- ▲ **Customers** - prefer low costs and stable price signals – monthly factors tend to be volatile. Annual level with out true-up.
- ▲ **Utilities** - need adequate and timely recovery of fuel costs. Rewarded for good performance.
- ▲ **Regulators** - want ability to easily monitor fuel costs and conduct prudence reviews. Willing to allow symmetrical risk reward provisions – 10% of the risk coupled with 10% of the benefit for the utility.

# What Impacts Fuel Costs

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- ▲ Fuel Mix – Gas, Coal, Nuclear, Hydro, and renewable – some wind power is now coming in cheaper than gas (Austin Energy)
- ▲ Fuel Contracts – 100% covered or 80% covered 20% spot plus other financial hedges
- ▲ Purchase Power – Quantity and fuel type (need generally driven by native load growth)
- ▲ Coal – rail transportation and third world demand for coal
- ▲ Gas – Hurricanes in the gulf
- ▲ Environmental issues – coal, nuclear, gas, hydro, and other

# Impacts of High Fuel Costs

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- ▲ High fuel costs effects total usage – lowers kWh consumption thus earning are eroded because of dependence on volumetric price structures
- ▲ Customers' bill increase and bad debt expense increases
- ▲ Fuel costs recovery lags and utility becomes subject to downgrading or being placed on watch list by Financial Community – cost of capital is increased
- ▲ Customer complaints increase and Regulators concern increases – prudence reviews

## What others are doing

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- ▲ Georgia Power – 85% coal and nuclear 15% gas and purchases – Two fuel only cases in less than 18 months @ \$500M each raising fuel adder from 2.48¢ to just under 3.0¢
  - Annual factor – adjustments as needed
  - Includes Purchase Power less capacity
  - Retain 25% of margin from wholesale market sales
  - Less retail portion of gains from sale of emission allowances
  - Net gains and losses from hedging program
  - Carrying costs on over or under recovered fuel balances (less first \$15M)
  - Less other costs or credits determined by Commission

# What Others are Doing Continued

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- ▲ Colorado Springs Utility – Water, Gas, and Electric Muni. 52% coal, 30% gas, 13% renewable (hydro and wind), 5% purchases
  - ❑ Annual base level adjusted as management determines – balance between customers wanting to keep stable and Bond holders desire for monthly adjustments
  - ❑ Current base is 2.67¢ and ECA is projected to be .19 ¢
  - ❑ Utilizes balancing accounts and includes in next estimate
  - ❑ Uses forecasted sales and fuel expenses to determine ECA
  - ❑ Uses gas hedges for winter electric requirements considering hedging summer. Last years hedging had large savings for customers – placed hedges before Katrina

# What Others are Doing Continued

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- ▲ Public Service Company of New Mexico –  
Mostly Coal and Nuclear with small amount of  
gas and wind
  - ❑ No adder or adjustment – takes the risk of its fuel  
mix
  - ❑ Earning hurt last year from outages – relied more  
on gas and purchases

# What Others are Doing Continued

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- ▲ Nevada Power Company – Large amount of purchase power with high growth rate.
  - ❑ Uses annual energy filings to adjust recovery of fuel expense
  - ❑ Latest filing is for 9% increase to recover previously incurred costs and 14% for projected fuel costs increase for 2006 (\$264M)
  - ❑ Some increased risk as adjustments will not apply until later in 2006,

# What Others are Doing Continued

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- ▲ Arizona Public Service – About 80% coal and Nuclear and 20% gas. Purchase about 15% of their summer requirements. Two fuel filings at the Commission - \$80M surcharge for unrecovered fuel plus and \$409M rate case with 60% fuel related (\$246M)
  - Very high growth rate causing more reliance on gas generation and purchase power
  - Base Rate Power Supply Cost is 2.0743¢
  - Risk sharing at 90% customer 10% APS for fuel costs difference from base rate

## What Others are Doing – APS Continued

- ❑ Limit on PSA adjustor rate over the term of \$.004
- ❑ Use of a balancing account with interest for over and under recover of fuel expenses
- ❑ The use of a surcharge to clear the balancing account when the balance in the account is between \$50-\$100M
- ❑ Sharing on off-system sales margins
- ❑ Inclusion of hedging costs – APS retains 10% of gains and losses
- ❑ Limit of \$776.2M on annual fuel costs
- ▲ APS feels the \$.004 over the term change limit is too small and the annual limit of \$776.2 needs to be raised or dropped – projected to exceed by this summer.

# What Others are Doing – APS Continued

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- ▲ APS supports the \$.004 limit to the annual change in the PSA
- ▲ Downgraded once by S&P because of current fuel recovery delay

# What Others are Doing Continued

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- ▲ Public Service Company of Oklahoma – 50% coal 50% gas, slow growth. Increased customer bills 32% related to fuel under recovery
- ▲ Proposed rule changes to insure lowest cost power for customers – IPP and other (includes the utility) would bid for power requirements of one year or longer. Commission overview of future power and fuel supply contracting and planning

# Fuel Recovery Strategy for Next Rate Case

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- ▲ Balance the needs of the various players
  - Stability – monthly or annual with true-up?
  - Purchase Power recovery?
  - Establishment of base rate and prudence reviews?
  - Risk sharing approach – 90/10 split or no annual adjustment?
  - Sharing of gains and losses from financial hedging programs?
  - Ability to make mid-course adjustments?
- ▲ Make Fuel recovery a separate case?

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## BBCI Contact Information

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**Thanks for your  
time!**

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