Aquila

A Tale of Two Utilities … But a Shared Concern

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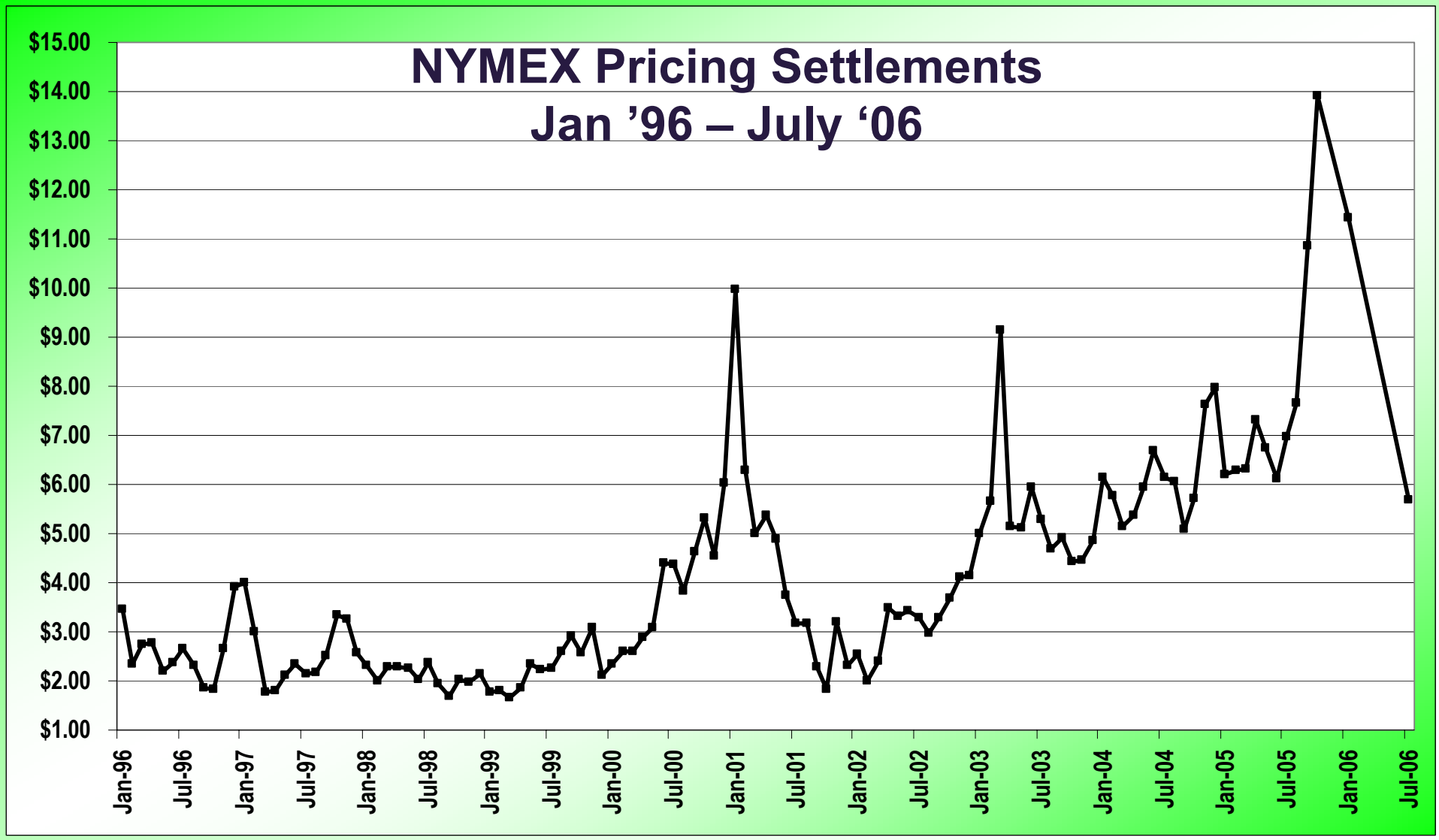
NYMEX Pricing Settlements
Jan '96 – July '06
$15.00
$14.00
$13.00
$12.00
$11.00
$10.00
$9.00
$8.00
$7.00
$6.00
$5.00
$4.00
$3.00
$2.00
$1.00
Jan-96
Jul-96
Jan-97
Jul-97
Jan-98
Jul-98
Jan-99
Jul-99
Jan-00
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Jan-01
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Jan-02
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Jan-05
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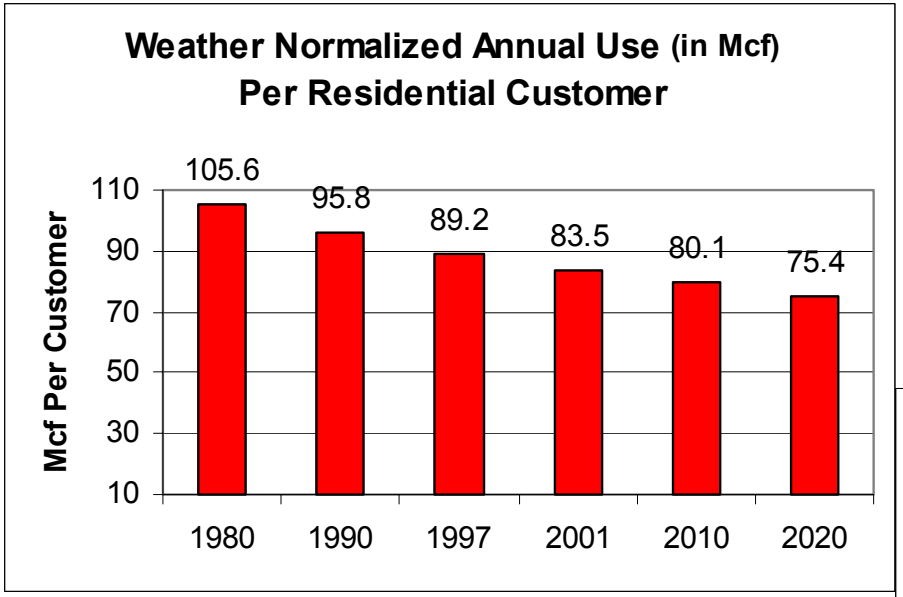
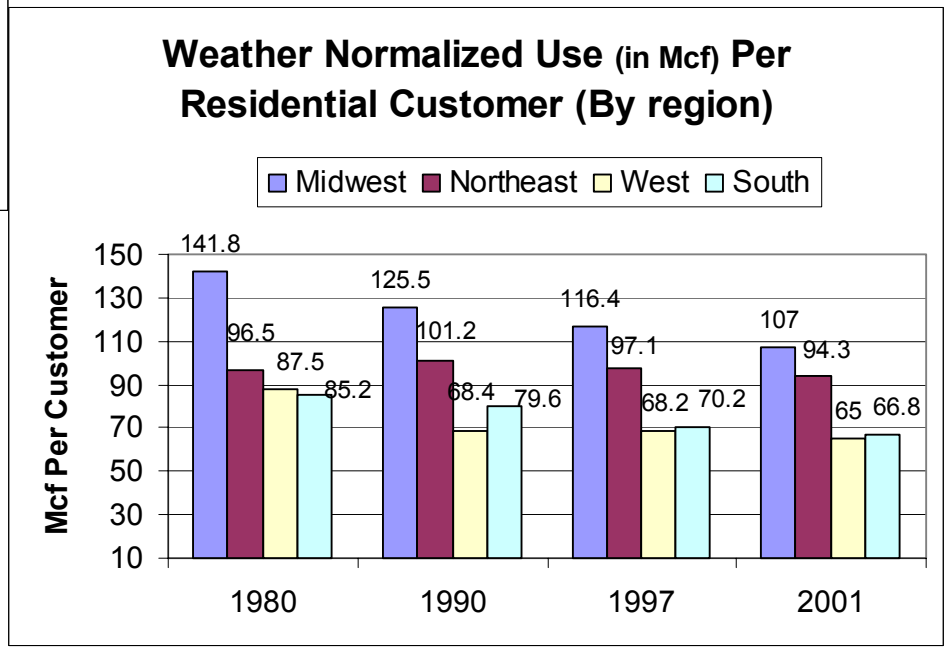
Jan-06
Jul-06

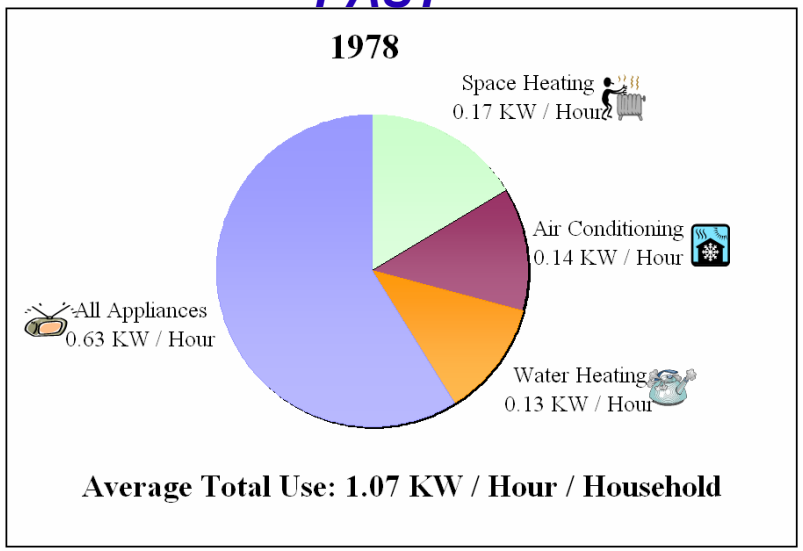
Weather Normalized Declining UPC



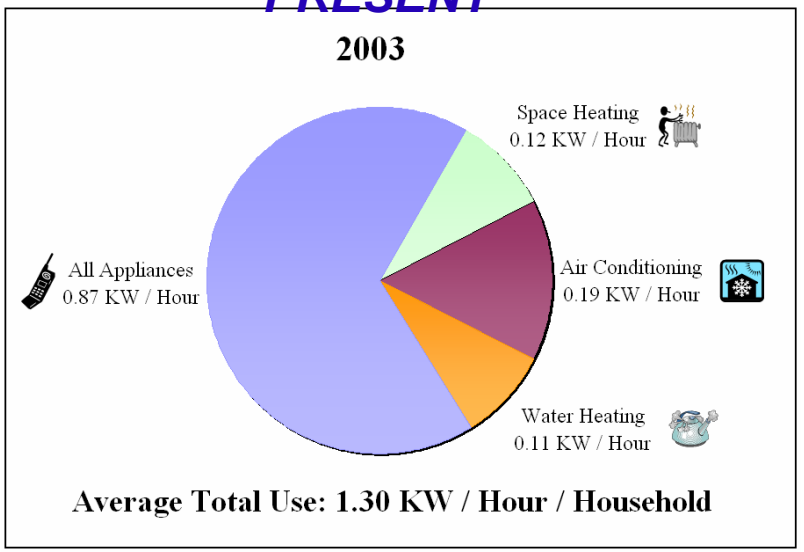


Electricity Use in the Typical U.S. Home

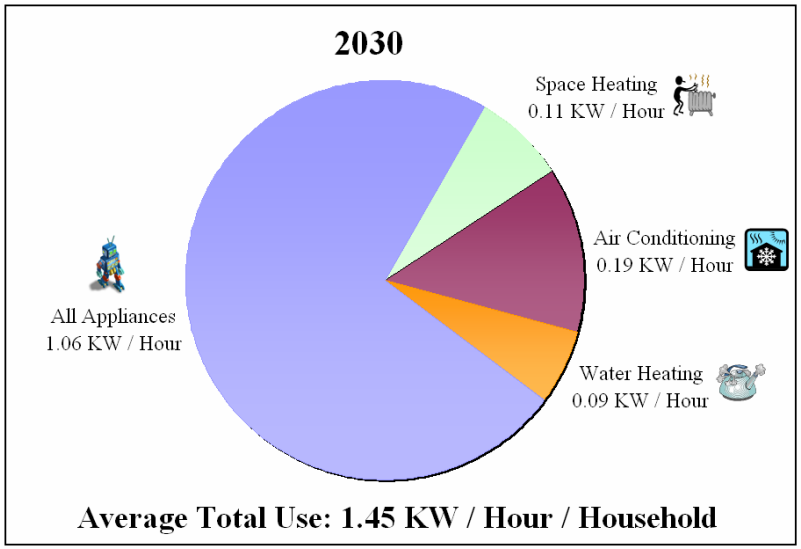
PAST



PRESENT

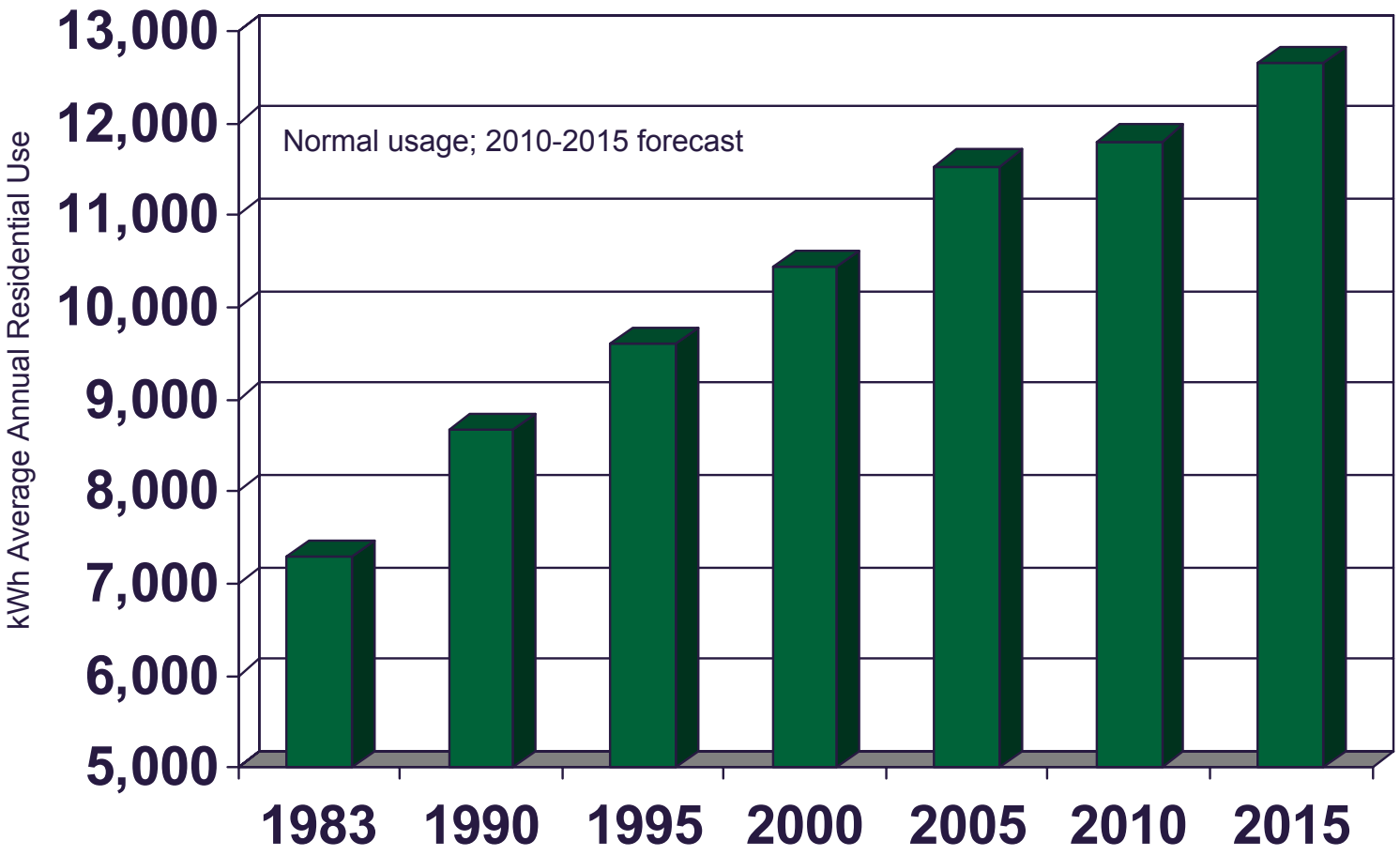


FUTURE



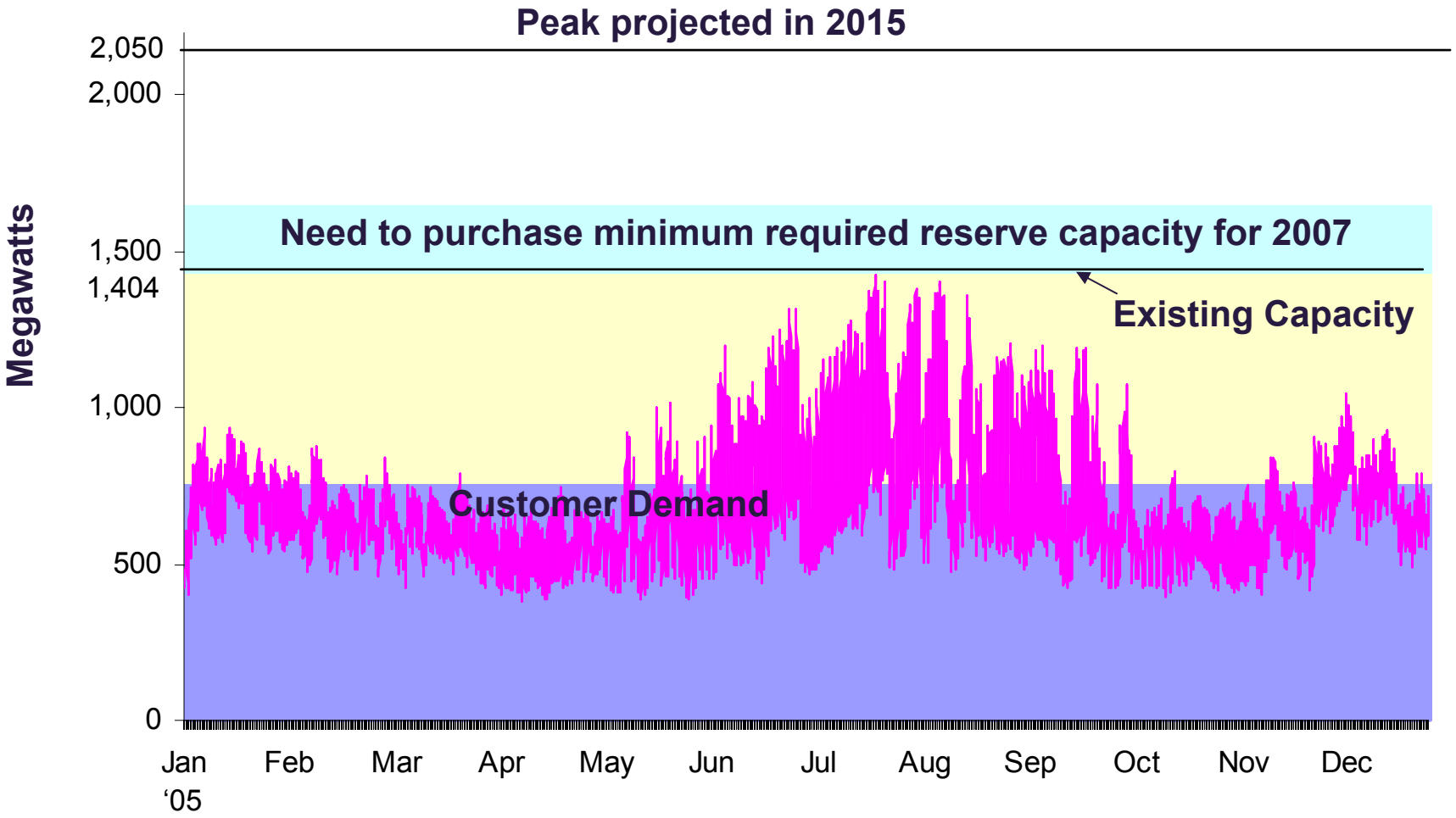
Source: EEI – "Rising Electricity Prices: A National Perspective;" June 2006

Customers Continue to Use More

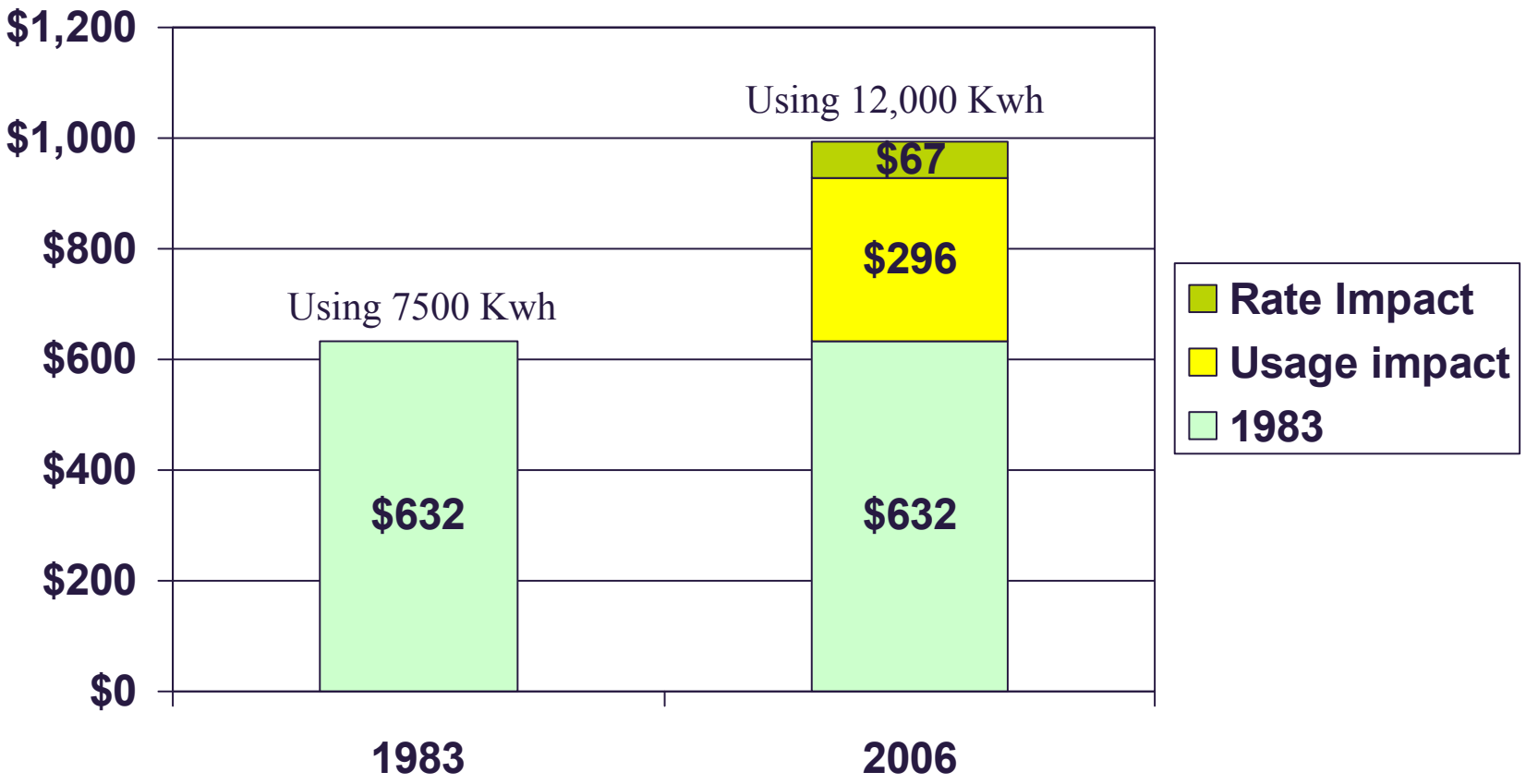


Average normal residential electric use up 58% since 1983

Power Supply Barely Meets Current Peak Demand



Average Annual MPS Residential Bill Analysis



Objectives

- Provide customers with opportunity to manage their own bills
- Ensure that utilities are “neutral”
- Minimize need for regulatory commission intervention

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Nebraska Annual Price Option

Annual Price Option

- Initially offered as an experiment in Lincoln, NE in response to request from City Council (1998)
- Filed for and received approval from the Nebraska Public Service Commission to implement a statewide pilot program for the first time this year

Annual Price Option

- Allows customers to lock in the price of gas for November 1, 2006 to October 31, 2007
- Fixed price election replaces PGA; all other rate components stay the same
- Designed similar to the existing Lincoln program
- Has an enrollment cap of 39,000
- Allows customer an option in taking control of utility bill

Annual Price Option

- Annual Price Option **IS**
  - A program for customers who want a stable gas price
- Annual Price Option is **NOT**
  - A supplier choice program
  - A guarantee of savings

Annual Price Option

Selected Lincoln Customer/Fixed Bill vs. Utility Rate

Actual Experience

Annual Bill Differentials	Customers
1999: ($37.75)*	1,215
2000: ($1.51)	906
2001: $125.08	1,979
2002: ($84.33)	5,418
2003: $60.33	10,911
2004: ($7.26)	17,090
2005: $38.78	24,969

*Bracketed numbers indicate fixed was higher than traditional utility PGA

Missouri Fixed Bill Pilot

Missouri Fixed Bill Pilot

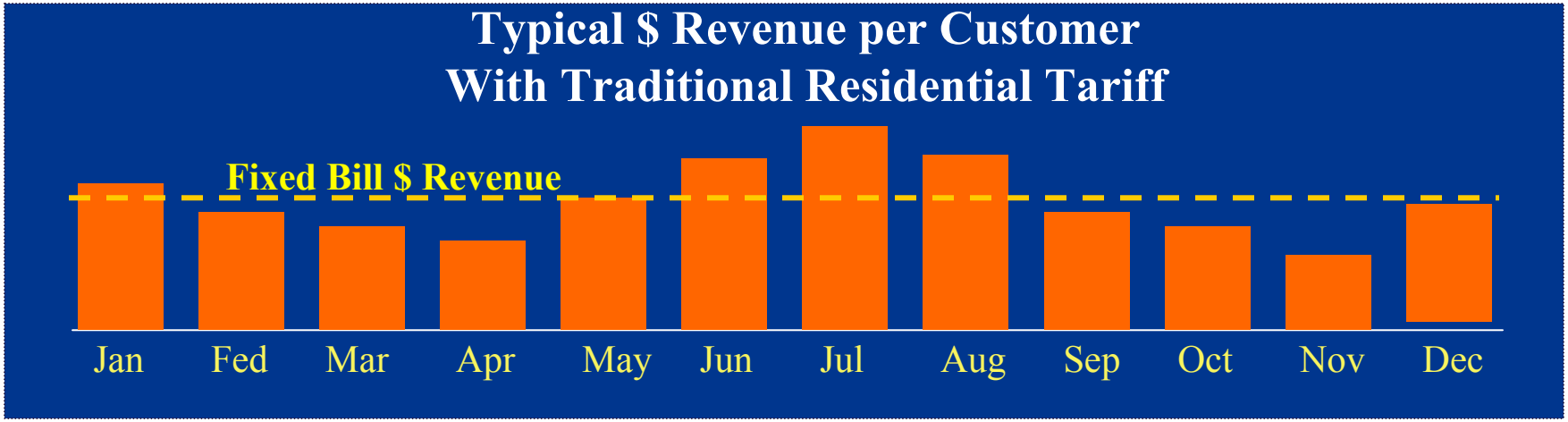
- Customer is offered a fixed price for an entire billing period **regardless** of underlying costs and usage changes
- Unlike budget bill, there is no reconciliation
- Customer retains benefits of conservation in future billing periods

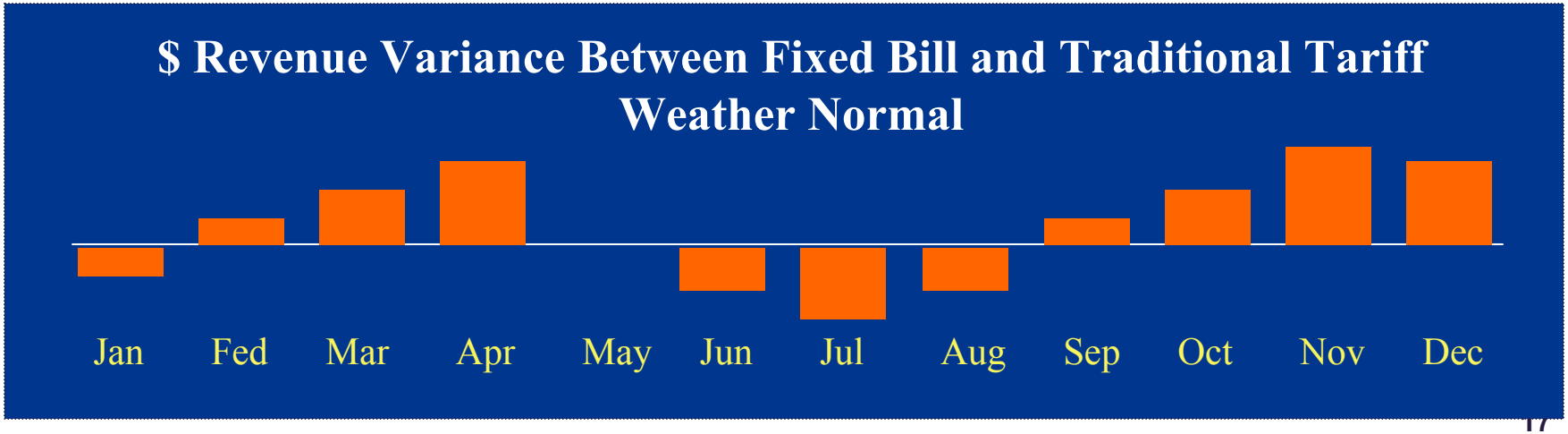
Program Design

- **Target Customers**
  - St. Joe area Residential in the pilot
  - Small commercial a future possibility
  - At least one year usage history at premise
  - Good credit but may be ideal for bad credit

Fixed Bill Operational Issues

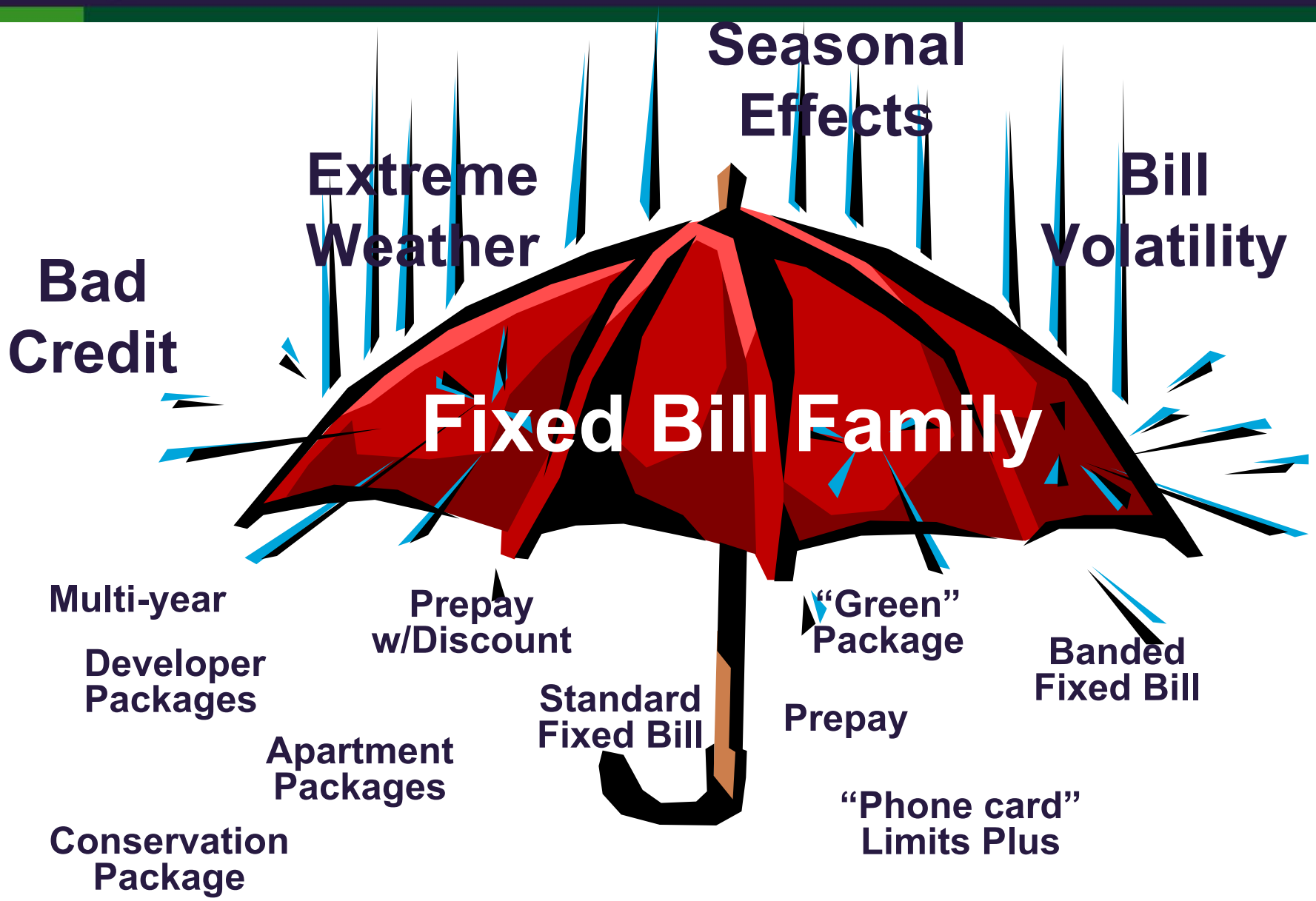
Seasonality: "Keep the Faith" **Summer Peaking Utility**





Current Status of Fixed Bill Status

- Fixed Bill program year 1 began June 2005
- 16,000 randomly selected eligible customer received Fixed Bill offer
  - 541 accepted Fixed Bill offer – 3.38% acceptance rate
- Fixed Bill generated extremely low number of customer service calls –
- Over 93% of Fixed Bill customers chose to renew for year 2
  - Supports customers desire to receive predictability and “no surprise billing.”
  - Year 2 offers were on average 2.46% less than their year 1 fixed amount (adjusted for rate increases)
- Fixed Bill offered to additional 15,500 eligible regular tariff residential customers
  - 652 accepted Fixed Bill offer – 4.20% acceptance rate
- Total current participation in Fixed Bill program stands at 7% acceptance rate of customers receiving an offer


Seasonal Effects
Extreme Weather
Bill Volatility
Bad Credit
Fixed Bill Family
Multi-year
Developer Packages
Apartment Packages
Conservation Package
Prepay w/Discount
Standard Fixed Bill
"Green" Package
Prepay
"Phone card" Limits Plus
Banded Fixed Bill

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Revenue Decoupling
Gas Utilities

Define Decoupling and It's Purpose

Decoupling is a regulatory mechanism to encourage utilities to promote demand reduction by ensuring that utilities have a reasonable opportunity to earn the same revenues that they would under conventional regulation.

Decoupling – Causes of Changes in Sales Volumes (i.e., Declining Use per Customer)

Long-term trends:

- More efficient appliances
- More efficient construction
- Warming trend in weather

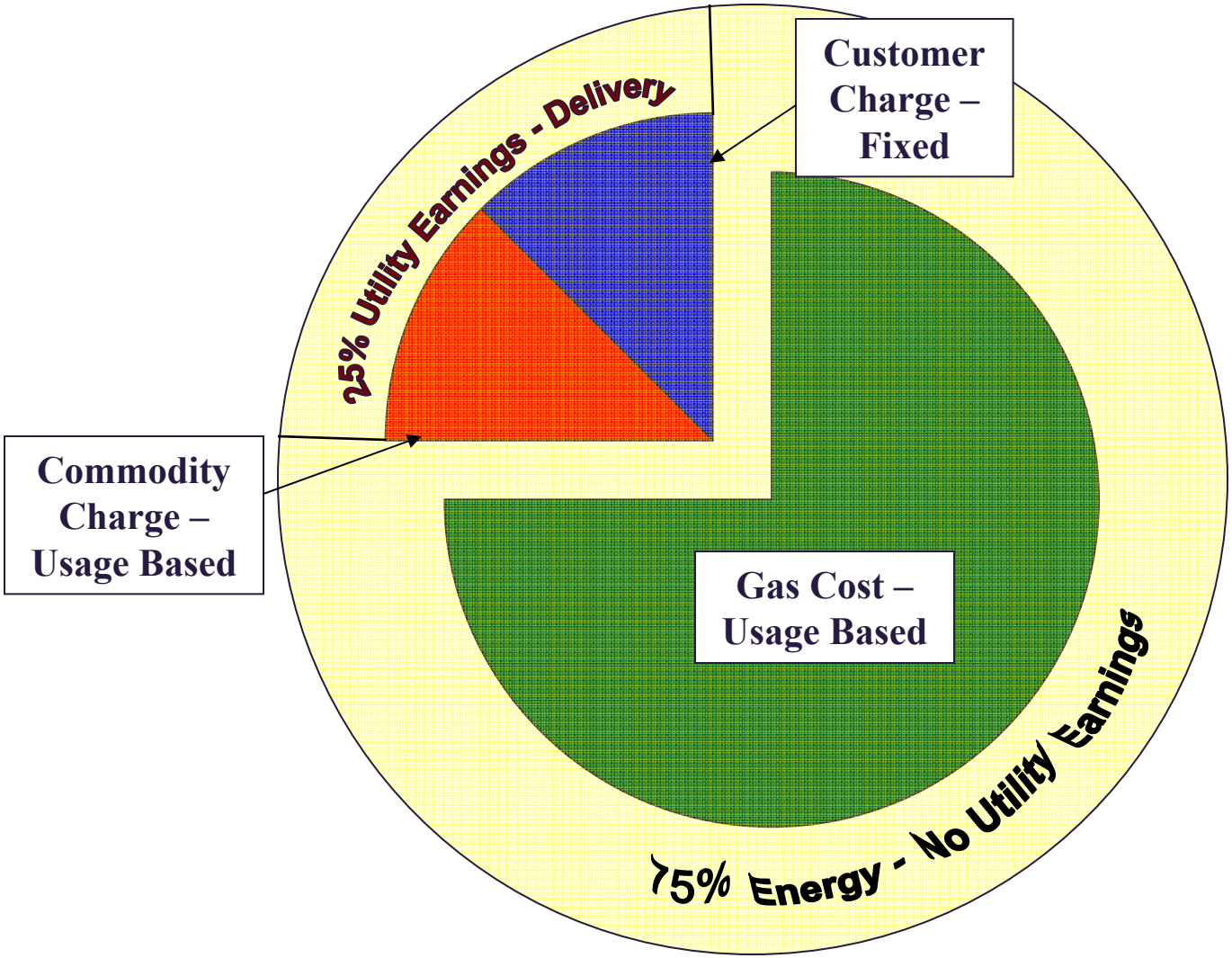
More recently:

- High gas prices by historical standards

What Are the Benefits of Decoupling?

- **Remove the throughput incentive**, removing a barrier to utility support of energy efficiency programs; **break connection** between sales and profits
- Not atypical for 50-70% of utility margin (earnings) to be sales dependent
- **Reduce utility earnings volatility** due to weather, business cycle, conservation, or other factors that are included within the mechanism

Decoupling – Customer Energy Bill



What's Influencing Behavior: How Do Utilities Make $?

- Under traditional rate-of-return (ROR) regulation:

  Price = Revenue Requirement / Sales

- But,

  Actual Revenues = Price * Quantity

- And, therefore:

  Utility Profit = *Actual* Revenues – *Actual* Costs

- **Under traditional regulation a reduction in quantity of energy sold will result in reduced earnings**

Decoupling – How it Works

- Create a system that holds the company harmless (i.e., no effect on profits) for reductions in sales due to customer efficiency
- Replaces traditional ratemaking with a formula that determines how ***revenues*** will change over time
- The company, knowing what revenue levels to expect, is then free to take reasonable actions to help customer reduce demand

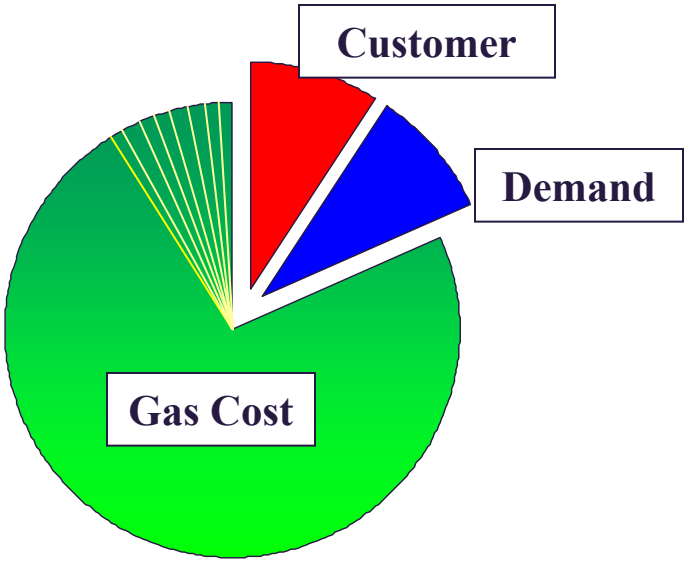
Regulatory Solutions

- Rate Design
  - Severs relationship between revenues and sales volume
  - Sets allowed revenue/margin per customer
  - Real time solution
  - Generally not a lot of tracking and administration
- Lost Base Revenue Adjustments (LRAs) / Trackers
  - Replaces revenues lost due to energy efficiency
  - Measures energy savings from energy efficiency used to compute lost revenues
  - Subsequently recovered through adjustment mechanism

Decoupling Examples

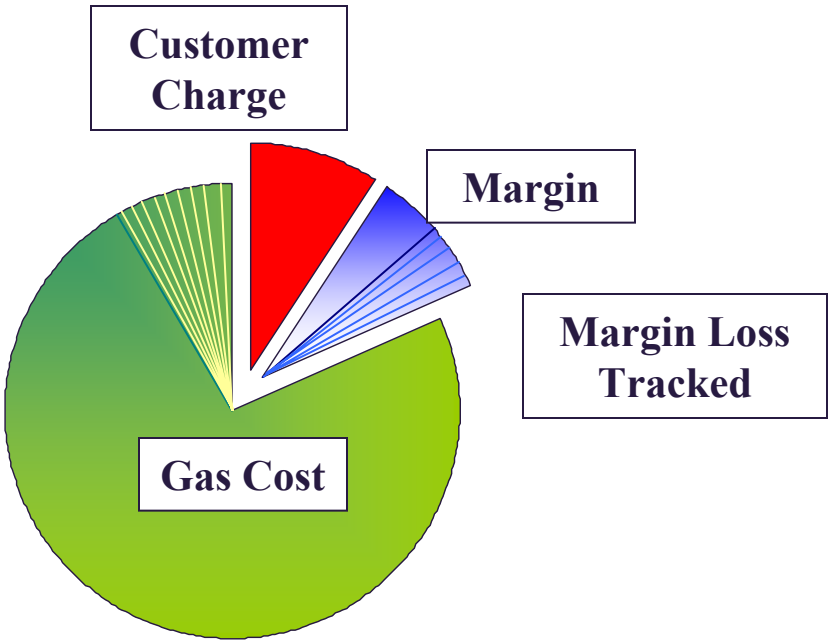
- Aquila Iowa rate design proposal
- Reduced usage tracker mechanism

Decoupling – Aquila Iowa Rate Design Proposal



- Combined fixed charge component keyed to demand customer places on Aquila's distribution system (i.e., large house pays more than smaller house)
- Combined fixed charge recovers:
  - Operations and maintenance expense
  - Return
  - Taxes
- Customer energy efficiency efforts (shaded area) reduces gas consumption and gas bill, but not utility earnings
- Aquila continues to make a significant investment in energy efficiency in Iowa

Decoupling – Oregon (Cascade NG) Approach



- Shaded area represents energy efficiency impacting utility earnings (margin) and energy usage
- Regulatory mechanism tracks lost margin from energy efficiency (utility earnings) for later recovery
- "Public Purpose Surcharge (.75% of revenues)"; commitment to spend no less than $500,000 on DSM and low-income assistance plans
- Since 75% of customer bill is gas cost, customer still benefits from energy efficiency, even with tracker mechanism in place

Questions?