BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the matter of the investigation of steam service rendered by Kansas City Power & Light Company	)))	Case No. HO-86-139

APPLICANT'S INITIAL BRIEF

KANSAS CITY POWER & LIGHT COMPANY

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INDEX

I.

INTRODUCTION TO THE ISSUES

This case presents the Commission with a just and reasonable conclusion to the inexorable journey that KCPL's central station steam distribution system has been on for more than ten years. Since Case No. 18.433 (1976), this Commission, Staff, Kansas City, Jackson County and the rest of KCPL's customers have been aware that more and more of Grand Avenue Station costs would be shifted from electric customers to steam customers

> ...until the day would come that the plant would be used exclusively for producing steam heat. (Report and Order, Case No. ER-77-118, p. 59)

That day came in 1985, when the electric generating facilities at Grand Avenue were retired. The Commission in Case No. EO-85-185 agreed that the costs of Grand Avenue should now be borne by the steam customers, and noted that

> ...steam users have been on notice of the future 100 percent allocation of Grand Avenue to steam service since 1977... (Report and Order, p. 234)

Steam customers have known for many years that their steam rates would rise as Grand Avenue became solely dedicated to steam service. As the steam rates increased substantially throughout the late 1970's and into the 1980's, more and more of the existing customers made the decision to convert to electric or gas sources of heat, and many potential customers made the economic decision to go to other sources of heat in the first place. KCPL attempted in vain to staunch the flow of customers leaving the system by requesting steam rates below cost. It was successful, however, in negotiating a contract with a very large, high load factor customer, Corn Products Company (CPC), which for a few years in the early 1980s appeared to be the answer for the general viability of the system. (Ex. 12, Sched. 1, p. 1) Although the CPC agreement brought the total steam operations back into profitability, it did <u>nothing</u> to make downtown steam service more competitive with gas and electric alternatives, and the downtown steam system continued to lose present and potential customers to those alternatives. Even the short-term general viability of the system was lost in 1985 when CPC sold its facilities to a firm which had a much smaller steam demand. KCPL was once more placed in a situation where it had a $1.5 million operating loss on steam operations in 1986. (Tr. 108)

KCPL again reviewed its options in 1985. It searched for potential large industrial steam customers, and found no interest due to the capital costs of running long steam lines from the existing system to the potential customers. (Tr. 144) It studied alternative methods of providing central station steam service, and found none which could compete effectively with electricity or gas. (Ex. 12, Sched. 1) Grand Avenue and the steam distribution system were labor-intensive and aging, and the cost of replacing these facilities would drive the generally non-competitive steam price even higher. (Ibid.)

KCPL couldn't find any central station steam distribution alternative that would maintain, much less enhance, the competitive situation between steam, electricity and gas. Even Staff's hypothetical efficient system would require a hefty rate increase over current levels once it was installed, and it would take several years to be installed. In the meantime, steam rates under Staff's hypothetical system would have to increase by as much as about 60% to recover costs. (See Section II.A.3, infra.) The conclusion was, and is, inescapable: central station steam distribution service in Kansas City isn't viable.

KCPL thus proposes the phased abandonment of its present steam distribution service through 1990. In order to avoid undue and unreasonable financial hardship to its remaining customers, it is requesting permission to offer alternative boiler or electric space heating equipment at no initial capital cost to the customers.

Staff opposes virtually every element of KCPL's proposal. Staff argues that since other cities have viable district steam heating systems, so can Kansas City. The issue of viability is generally addressed in Section III of this brief, and the essential response to this argument is that the competitive advantage between gas and steam is the exact reverse in one of the cities touted by Staff (St. Louis), and Staff has not shown the relative competitive positions of gas, electricity and steam in its other examples. It is the price of the product vis a vis other alternatives that determines its success (Tr. 251), and in Kansas City, steam priced even under $10 per mlb simply isn't low enough to hold onto all of the existing customers. (Ex. 34, Sched. 1-4)

Staff also argues that KCPL should put the system up for bids, and that this exercise would demonstrate the viability of the system. KCPL has always acknowledged that sale of the system could be a logical way out, but has declined to do so for several reasons. A sale of the system will not change the relative competitive economics between gas, electricity and steam. Both KCPL's and Staff's cases indicate that steam rates will not go down after a sale. If a purchaser wishes to recover its costs, rates must go up, and the history of the steam system shows that customers leave when there are more economic alternatives available, even though KCPL's service has generated very few complaints. A sale would only substitute a new operator, it will not change the fundamental situation. And if the new owner is required to abandon steam service in the future, it is pure conjecture as to whether compensation would be offered by this owner to the few remaining customers--KCPL is offering alternative heating systems to all steam customers now. Finally, Staff witnesses surmise that a new owner may have to be substantially unregulated in order to make a success of the steam system. (See, e.g. Ex.28, p. 47) Whether the benefits of continued steam service in an unregulated environment outweigh the potential customer harm of withdrawn Commission supervision is something that this Commission must weigh.

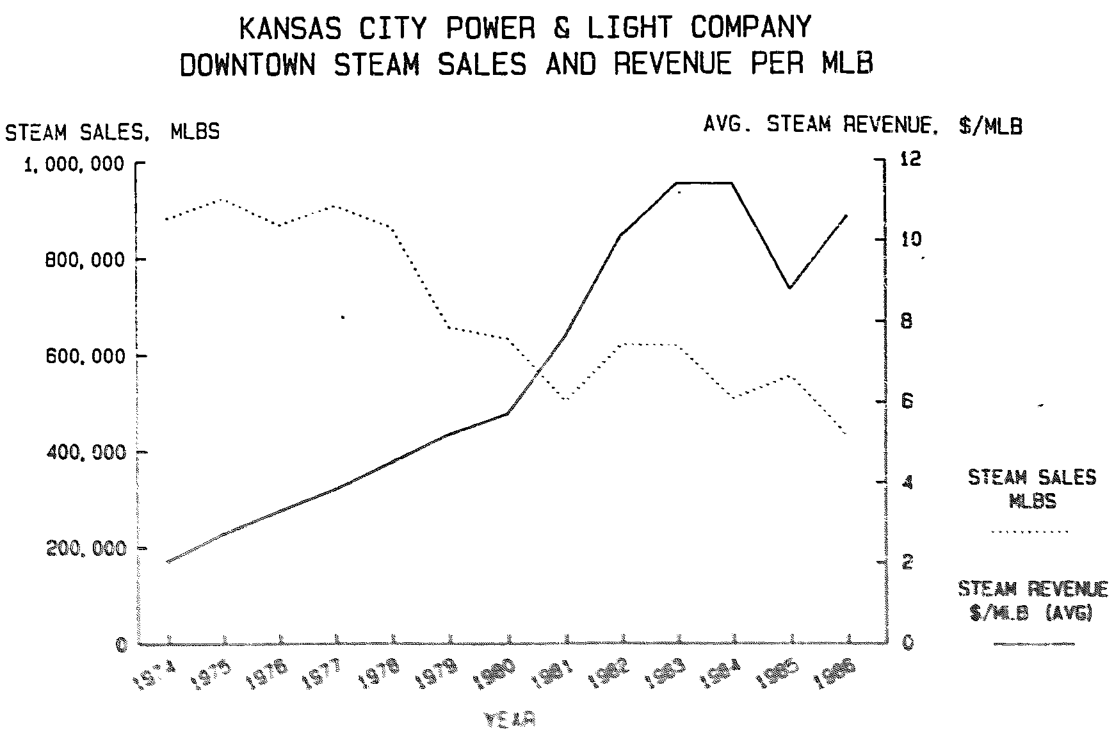
The two major questions for Commission determination are (a) should KCPL be allowed to terminate central station steam distribution service, and, if so, (b) should KCPL be allowed to offer alternative electric boilers and electric space heating equipment to its customers? KCPL believes that these questions should be answered in the affirmative. KCPL has done everything reasonably possible to continue steam service to date; it is now time to recognize the current and future economic realities and to authorize termination of steam service.

II.

PROBLEM AND RESPONSE -- HISTORY OF STEAM SERVICE AND KCPL'S DOWNTOWN STEAM SERVICE PLANT

KCPL and its predecessor companies have provided central station steam distribution service to downtown Kansas City for over 80 years, with Grand Avenue Station supplying steam for about the past 60 years. Supplying the steam system was always a minor part of Grand Avenues' role. Until the retirement of the electrical facilities at Grand Avenue in 1985, it was primarily an electric generating plant, and the great majority of its costs were allocated to electric service. Since electricity is no longer produced at Grand Avenue, the costs of producing steam there are now shifted entirely to the steam customers. The Commission approved this 100% cost allocation to steam customers in Case No. EO-85-185 (Report and Order, pp. 232-235).

The shifting of Grand Avenue costs from electric customers to steam customers, reflecting the changing use of the plant, has been occurring for more than a decade. In Case No. 18,463 and succeeding rate cases, KCPL proposed and the Commission accepted allocation methodologies which gradually shifted cost responsibility to the steam customers as Grand Avenues' electric role decreased. Even with this gradual increased allocation of costs to steam service, the price of steam rose dramatically. In the period of 1977 through 1982, KCPL was granted steam rate increases of 11% (1977), 6% (1978), 10% (1980) and 19% (1982), or a cumulative increase of 54%. (Ex. 44, Scheds. 7-3, 7-4) Even with these substantial increases, KCPL did not cover its steam operating costs between 1978 and 1983. (Ex. 44, Sched. 5-2) Although KCPL attempted to keep steam service competitive with electric and gas options by pricing steam service below cost, more and more steam customers were opting for gas and electric because these alternatives were more economical. And many steam customers were lost to the downtown wrecking ball. The following graph shows the decline in steam sales over the past years along with the increasing average cost of steam. The trend is clear: as prices continue to increase customers and sales continue to decline.



SOURCE: EX. 34, SCHED. 1-4

But KCPL did much more than keep rates below cost in attempting to make the steam system viable. It provided steam rate analyses to potential customers and customer support services (see generally Section III.D., infra). Most importantly, it did not allow <u>service</u> to deteriorate. The record of this case discloses only one significant customer complaint regarding adequacy of service (Tr. 244), and there is no complaint about the safety of steam service. This is an exemplary service record. However, good service and below-cost rates did not ensure the viability of the steam system, and KCPL thus started in the late 1970's to formally study the steam distribution business and its possible future. The first formal study was completed in 1981. This study made various short and long term recommendations, and many of them, such as resolution of steam losses and centralization of management, were quickly implemented. The 1981 study was built upon in the next year by KCPL's Long Range Steam Heat Planning Study. Both of these studies recognized that acquiring a large, high load factor customer could be one way back to total profitable operation. (Ex. 34, Scheds. 3-4) And KCPL was able in 1982 to secure CPC as a customer. The agreement with CPC had the effect of tripling KCPL's annual steam sales. CPC's load, along with no change in electric/steam allocation factors in Case No. ER-83-49, allowed KCPL to withdraw its then-pending steam rate case, Case No. HR-83-245. (Ex. 12, Sched. 1, p. 1.2)

KCPL believed that with the signing of the CPC agreement in late 1982, the viability of its steam system was greatly improved. The proof that the addition of a large load factor customer was the best hope for the continuation of the system is found in the profitable state of steam operations for 1984 and 1985.

The viability of the system brought about by CPC was short-lived. CPC sold its facilities to National Starch in 1985. KCPL successfully negotiated a five-year steam contract with National Starch, but only for about one fourth of the anticipated annual steam load of the CPC agreement. This reduction in load once again resulted in operating losses for the steam system. Indeed, National Starch may not remain a steam customer through 1990. Although the cost of steam to National Starch is only about $6 per mlb, (Tr. 164) (as compared to about $10.50 for downtown customers, Tr. 241), National Starch has stated that the cost of steam is <u>now</u> too high, and is actively studying steam alternatives. (Tr 357) Obviously, the loss of National Starch as a customer would greatly increase operating losses and accelerate the demise of the steam system.

KCPl did not wait for the sale to National Starch to become final before it began investigating possible solutions to the problems once again confronting the steam system. In August, 1984, KCPL initiated its study which resulted in the Downtown Steam System Conversion Study in early 1986. The Study examined in depth various alternatives for continuing central station steam distribution service, along with alternatives for steam production on the customer's premises. The Downtown Steam Service Plan, which KCPL has presented to the Commission for approval in this case, is based upon the Study's findings. (Ex. 12, Sched. 1)

The Plan has two major elements: a gradual abandonment of central station steam distribution service; and the offering of alternative electric boiler or electric space heating equipment at no initial capital cost to its present steam customers. KCPL proposes to phase-out Grand Avenue steam service by December 31, 1990, which coincides with the expiration of the full term of the National Starch agreement. KCPL has filed proposed rules and regulations which divide its steam service territory into logical parcels, or phases, and assigns dates to each phase after which steam service will no longer required to be furnished. Note that the date is <u>not</u> when steam service <u>will</u> be terminated to that phase; KCPL has stated that it will work with the steam customers during this phase-out period to accommodate customers to the extent practicable, but Grand Avenue steam distribution service will not be offered at all after December 31, 1990.

As the phase-out progresses, KCPL will offer to the existing steam customer the option of either receiving steam service from an on-site electric boiler, or of becoming an electric space heating customer. If the customer chooses space heating equipment, and it is more expensive than the corresponding boiler, the customer will in that case reimburse KCPL for the difference in the capital cost. The Plan provides that KCPL will own, install and maintain the electric steam boilers, and those customers will continue to be steam customers served under the applicable steam service tariffs. KCPL will own and install the electric space heating equipment, but those customers will be responsible for maintenance and will be billed under the applicable electric tariff. As of January 1, 1996, all boiler customers will become electric customers of KCPL and will be served under the applicable electric energy rate. KCPL as well will continue to offer energy use studies at the premises of each steam customer. Most of the customers have already taken advantage of this audit offer and have had their audits completed. (Ex. 15, p. 7)

In conjunction with the Plan, KCPL also filed tariffs designed to increase steam heat revenues by about $5.8 million. KCPL and Staff have stipulated to a revenue deficiency dollar amount of about $3.2 million, although Staff does not recommend a rate increase in this case. (Ex. 1, p. 10) KCPL proposes three steam rate alternatives, depending on the Commission's disposition of the Plan: (1) should the Commission accept the Plan (termination of service and offer of equipment), KCPL proposes that this $3.2 million increase be phased-in with four equal percentage annual increases of about 13.5% per year, with no deferral or carrying cost recovery; (2) should the Commission reject the Plan, but authorize steam service termination before 1991, KCPL is willing to forego the $3.2 million rate increase in order to compensate its customers to the extent permitted for the costs they may incur in converting to a new heating source; and

(3) should the Commission reject the Plan in its entirety, KCPL will continue to operate the steam system in the interim, and requests that the $3.2 million be immediately reflected in rates.

III.

TERMINATION OF CENTRAL STATION STEAM DISTRIBUTION SERVICE

Hearing Memorandum: pp. 2-6

KCPL:	Witnesses:	Beaudoin (Tr. 81-139); Mandacina (Tr. 141-194); Graham (Tr. 197-232); Levesque (Tr. 340-348)
	Exhibits:	12 (Beaudoin Direct), 13 (Beaudoin Rebuttal), 14 (Mandacina Direct), 15 (Graham Direct), 16 (Graham Rebuttal), 35 (Levesque Rebuttal), 36
Staff:	Witnesses:	Featherstone (Tr. 233-270); Dahlen (Tr. 271-310); Miller (Tr. 310-337); Fuller (Tr. 338-339); Oligschlaeger (Tr. 350-361); Tooey (Tr. 362-365); Haskamp (Tr. 365-385); Cox (Tr. 386-390); Bernsen (Tr. 390-402)
	Exhibits:	17 (Featherstone Direct), 18 (Featherstone Rebuttal), 19 (Featherstone Surrebuttal), 20, 21, 22, 23, 24, 25, 26, 27, 28 (Dahlen Direct), 29 (Dahlen Rebuttal) 30 (Dahlen Surrebuttal), 31 (Miller Direct), 32 (Miller Rebuttal), 33 (Miller Surrebuttal), 34 (Fuller Direct), 37 (Oligschlaeger Direct), 38 (Oligschlaeger Schedules), 39 (Oligschlaeger Rebuttal), 40 (Oligschlaeger Surrebuttal) 41 (Tooey Direct), 42 (Haskamp Direct), 43 (Haskamp Surrebuttal), 44 (Cox Direct), 45 (Bernsen Direct)
Customer Intervenors:	Witness:	Mauro (Tr. 414-454)
	Exhibits:	47, 49 (Mauro Direct)

Issues:

A. <u>Viability of the Steam System.</u>

KCPL believes that regulated central station steam distribution service in downtown Kansas City is not economically viable, whether the service is provided by KCPL or another entity. Assuming that the system could be sold, such a sale will not significantly affect the relative competitive positions of steam, electricity and gas heating options.

Staff contends that KCPL has not made a clear showing regarding the viability of the steam system, and did not pursue all alternatives, such as system sale or natural gas.

Customer Intervenors support discontinuance of central station steam distribution heating.

State of Missouri requests that "adequate time" be given steam customers to convert to alternative heating sources if the steam system is allowed to be abandoned, and that no steam customers be required to terminate steam service until the date established for complete termination of steam service.

Kansas City and Jackson County support the Staff.

B. Management Actions and Steam Marketing.

Staff faults KCPL for certain management actions which took place prior to 1982, and for not maintaining a steam marketing "presence". Staff could not quantify the rate impact of any of its criticisms.

KCPL believes that it has properly devoted the necessary amount of management attention and control to its steam operations, and that it has allocated adequate and appropriate attention to current and potential steam customers. Even with the improbable assumption that all existing electric and gas customers within KCPL's steam service territory would become steam customers, steam sales would increase less than 30%, but would require capital additions of over $3 million.

A. THE PUBLIC CONVENIENCE AND NECESSITY DOES NOT REQUIRE CONTINUATION OF STEAM DISTRIBUTION SERVICE

Certainly one of the facts the Commission should consider in passing upon KCPL's Plan is its effect on present steam customers. KCPL is proposing to terminate a method of steam service which has been offered for 80 years, and its steam customers' reaction to such a termination is a factor to be weighed in the decision. In this regard, the steam customers' reaction to the Plan is truly noteworthy. Not one customer has specifically complained about the effects the proposed termination of steam distribution service would have on it!.

The record is replete with the communications of KCPL to its steam customers about its Plan to terminate steam distribution service. (See, e.g., Ex. 15, pp. 2-6) There can be no question that the steam customers have been clearly told about the proposed termination. Yet, at the local public hearing on March 30, not one steam customer spoke. For whatever reason, no customer felt sufficiently against the Plan to voice disapproval.

Fourteen steam customers have intervened in these proceedings. Eleven of them support the Plan. (Ex. 48) The State of Missouri has not taken a position one way or the other on termination of steam service. (Ex. 1, p. 3) Kansas City has stated that it supports the Staff position, but has not provided its specific reasoning for such support. Jackson County supports the Staff, because it fears that otherwise there may not be "a customer base available for any other entity or governmental body which may wish to operate a steam--central district steam heating system in downtown Kansas City, either as presently operated or with the addition of waste energy..." (Tr. 79)

The two political subdivision intervenors which oppose the Plan presented no evidence to support or explain their position; the eleven non-governmental intervenors did present evidence, stating their reasons for supporting the Plan. This constitutes phenomenal acceptance of the Plan by the affected customers who have no ulterior agenda, such as trash disposal. The evidence clearly shows that the public convenience and necessity will <u>not</u> be unduly and unreasonably inconvenienced by the termination of steam distribution service.

B. STEAM DISTRIBUTION SERVICE IS NO LONGER VIABLE IN DOWNTOWN KANSAS CITY

1. <u>The Present Situation</u>.

A decade ago, KCPL had 248 customers, and sold 908,454 mlbs. of steam at an average price of $3.83 per mlb. (Ex. 34, Sched. 1-4) Since then, downtown customers and sales have declined by about 50%, while the price of steam almost trebled. (Ibid.) In the period of 1982-86, 8 customers converted to electric heat, 27 converted to gas, and 49 customers closed their businesses or lost their buildings. (Ex. 34, Sched. 1-5) Customers continued to leave the system even in the period of 1982-4 when KCPL obtained CPC as a customer and withdrew its then-pending steam rate case. The average cost per mlb. of steam in 1986 is actually less in nominal terms than it was in 1983, yet there were 51 fewer customers in 1986. (Ex. 34, Sched. 1-4)

The steam plant, both generation and distribution, is old. Grand Avenue's boilers are labor-intensive and ill-suited to efficiently produce the relatively small amounts of steam required by the steam customers. The miles of steam distribution lines include much pipe that is 60 to 80 years old, and require ever-increasing levels of maintenance and repair. (Ex. 12, p. 6)

Steam loss percentages rose from about 30% in 1978 to 45% in 1981, but declined to 22%-27% from 1983 forward as steam distribution maintenance expense rose from about $236,000 to over $900,000 per year. (Ex. 34, Scheds. 1-4; p. 17)

But KCPL's steam ratepayers were insulated from these increased costs. The last time KCPL increased base steam rates was in Case No. HR-82-67. The test year used in that case was 1981 (Report and Order, Case No. ER-82-66, p. 4), and although the specific amount of distribution maintenance allowed is not reflected in the orders, actual 1981 distribution maintenance expense was $236,127, almost $700,000 <u>less</u> than the 1986 level (Ex. 34, p. 17). The 1982 rates reflects steam percentage losses of 30% (Tr. 255), which is only slightly above present levels. The ultimate result of these factors is that KCPL has supplied adequate and reliable steam service far below its true cost for many years. No service complaints were voiced during the local public hearing, and the record discloses only one customer, out of the many that left, who mentioned service as a major factor in converting to an alternative heating source.

So customers were provided reliable steam service priced below cost for many years, but <u>still</u> left the steam system. Why? Staff would have the Commission believe that the customers left because they didn't understand the "intangible" benefits of steam service, or because they heard rumors about the demise of the steam system. Yet, Staff witness after Staff witness had to admit that with one exception (and that being a customer dissatisfied with service reliability), they knew of <u>no</u> customer who left the system for a reason other than economics. (Tr. 247-250; 276; 352, 392) Every customer who left the system had to consider the cost and the space requirements of the alternative heating source-- thus, every customer who left <u>specifically</u> decided that the <u>"intangible"</u> benefits of steam service were outweighed by the <u>economic</u> benefits of the alternative source.

Staff's own interviews with steam customers show <u>the</u> reason why they leave the system--another heating source is cheaper. One

Kansas City Place chose electric over gas as a heating source purely on economic considerations, and thought that the present cost of steam was "outrageous". (Tr. 247-8) The Rodeway Inn, the only customer to have mentioned service as a major reason for leaving the system, calculated that steam cost $609 per room per year, but that the energy cost of gas heating at an affiliated hotel in Kansas City was only $292 per room per year. (Tr. 248) Tower Properties performed a comparative economic analysis of the total cost (capital and O&M) of steam, gas and electric heating for one of its buildings, and found that gas cost $33,000 less per year than steam. (Tr. 250) National Starch, KCPL's largest steam customer, believes that it can generate its own steam for less than the cost of the steam it buys from KCPL. (Tr. 357-8)

Staff agrees with KCPL that the marketability of steam depends in large measure on the relative economics of steam and its alternatives. (Tr. 251) Recent history shows that steam at $8.90 to $11.44 over the past five years (Ex. 34, Sched. 1-4) couldn't retain customers, and if the price is increased 66%, as justified by the stipulated revenue deficiency, steam would be even more uneconomic. Steam, now and in the future, cannot be produced by KCPL at a competitive price which will allow it to retain present customers and, as discussed below, it is highly unlikely that a new steam supplier could do so either.

2. Staff's "Industry Comparisons" Have Not Been Shown to be Applicable to Kansas City

Staff's case is replete with references to other district steam heating systems which are profitable and are not losing customers. But Staff has failed to provide the requisite comparative link between those other systems and the specific competitive situation in Kansas City (with one exception which is addressed shortly). The relative economics of the various heating alternatives has been recognized by Staff to be one of the factors which determines the viability of steam (Tr. 251), yet Staff provided no information which shows that its "comparative" systems operate in a competitive energy environment similar to that in Kansas City.

In order to prove that its comparison systems have any relevancy to the Kansas City situation, Staff needed to provide the costs of the competing energy sources--steam, gas and electricity. Staff provided one piece -- steam prices--but neglected to provide the other pieces of the economic puzzle. Without this information, Staff's comparison systems have no demonstrated correlation to the viability of district steam heating in Kansas City. The one partial exception to this lack of comparative evidence is for the City of St. Louis. Exhibit 19, Schedule 2-14 compares the cost of steam service to the cost of an in-building boiler using gas in St. Louis. That graph indicates that in 1987, steam enjoys about a $4 per mlb. cost advantage over an in-building gas boiler--this is the reverse of the historical and present Kansas City situation. This data makes it easy to understand why district heating can be viable in St. Louis, where it is cheaper than on-site gas boilers, but not viable in Kansas City.

In summary, the competitive situation in St. Louis seems to be the reverse of the situation in Kansas City. No further conclusions can be drawn from Staff's evidence because information regarding the competitive economics of gas, electricity and steam hasn't been presented.

3. Staff's Hypothetical District Steam Heating Scenarios Do Not Show That Kansas City Can Support a District Heating System

a. The price of steam under Staff's short term scenario is 50% or more over the present price.

Since the actual history and current circumstances of district steam heating in Kansas City inescapably show that such a system is no longer viable, Staff has attempted to evade reality by constructing a hypothetical district steam system, and has submitted testimony that steam can be supplied in Kansas City for

$7.24 to $14.43 per mlb in 1987. (Ex. 28, p. 33; Ex. 30, p. 10) Staff has devised what it calls a "long term" and a "short term" rehabilitation scenario, and has calculated a price of steam associated with each scenario from 1987 through 2006. (Ex. 28, Scheds. 5-7) These scenarios are flawed in many respects, and the authors of the scenarios admitted that most of the numbers used in pricing steam for the short term rehabilitation scenario are simply wrong--they are understated and do not track the scenario elements. (Tr. 290; 314) For whatever reason, Staff's consultants did not attempt to correct these acknowledged errors, and essentially admitted that they really had no idea of what the cost of steam could be under their short term rehabilitation scenario. (Ibid.) One obvious reason why Staff let stand its admittedly erroneous studies is that, if they were corrected, Staff would demolish its own assertion that district steam heat in Kansas City is viable.

To understand why this failure to correct acknowledged flaws in Staff's short-term rehabilitation scenario dooms Staff's premise that district steam is viable in Kansas City, it must be remembered that Staff has presupposed that any purchaser would <u>first</u> implement the short-term rehabilitation program, and then as steam sales and profitability increase, the long-term scenario elements would be implemented. (Ex. 31, p. 12) Obviously, Staff was required to show that the price associated with its short-term scenario was less than the present price of steam, in order to assert that the purchaser could increase sales and profitability. And it did so by taking its long term scenario, which purportedly reflected the decreases in expense associated with new boilers and new high pressure piping, and decreased the capital investment to the level calculated for the short term scenario. The level of capital investment is the <u>only</u> difference between the short term and long term scenarios. Staff's short term scenario prices reflect the best of both worlds--the lower operating and maintenance expenses associated with new boilers and distribution lines, but none of the investment costs which made the decreases in expenses possible.

Staff's case for the viability of Kansas City district steam heating rests entirely on the premise that a purchaser could operate under Staff's short term scenario for up to five years (Tr. 300), and maintain at least the present level of sales. (Ex. 28, Scheds. 5-7) Obviously, if the short term scenario results in a price greater than the present price of steam, it is extremely unlikely that sales would even remain constant. Although Staff declined to correct its short term analysis, KCPL did so and presented the corrections in Mr. Levesque's rebuttal testimony (Ex. 35).

A review of the surrebuttal testimony of Staff's consultants reveals only two short term scenario correction items that the consultants disgaree with: gas prices and the inclusion of KCPL's present net investment in the capital cost. Mr. Levesque calculated that Staff's short term scenario would result in a present price of steam of $19.33 per mlb (exclusive of gross receipts taxes). (Ex. 35; App. A, Ex. 3, p. 8) Mr. Levesque further calculated the incremental effects of all of his corrections, and the net effect of correcting for gas price forecast and present net investment is $5.53 per mlb. (Ibid) Thus, even assuming for the sake of argument that Staff's consultants are correct in their criticisms of these two corrections, the price of steam under Staff's short term scenario is $13.80, and when gross receipts taxes are figured in, <u>the cost of steam to the customers under Staff's short term scenario is $15.33, almost 50% higher than present rates!</u> This is not at all surprising, since Staff and KCPL have stipulated to a current revenue deficiency of 66%. With the need to increase rates 50-66% immediately, it is simply beyond the realm of possibility that a purchaser can maintain the present level of sales, build profitability and segue in five years into a scenario that requires a capital expenditure of an additional $13 million.

Staff's own case confirms that, regardless of <u>who</u> operates the steam system in Kansas City, rates must increase tremendously. Customers have been defecting when steam rates were below $10;

there will certainly be many more leaving if rates increase 50% or more. Simply put, the real price of steam, be it produced by KCPL or a hypothetical purchaser, is not sufficiently competitive with other heating alternatives. Steam service is not viable in Kansas City if the price is anywhere near its cost of production. Staff's long term scenario is really irrelevant, because there won't be enough customers to support the system when the long-term scenario is to be implemented in the 1990's.

Staff may argue that a purchaser can defer recovery of a portion of these short term scenario costs to future years, and thus the price of steam in the short run could be less than, say, $15 per mlb. A purchaser could do that, but the possibility of recovering such a deferral in the future must be weighed against the probable amount of sales then existing to support recovery. Evidence and history strongly suggest that this deferral will turn into an irrevocable loss as more and more customers leave.

b. Staff's scenarios contain numerous errors and questionable assumptions.

A few of the weaknesses in Staff's scenarios have been mentioned above, such as the questionable assumption that steam sales will remain at present levels even though in the short term (up to five years) the cost of producing steam is at least 50% higher than present rates (even after excluding from consideration the underforecast of gas prices and the exclusion of all KCPL steam system net investment). Mr. Levesque's rebuttal testimony (Exhibit 35) corrects most of these errors, and his analysis does not need to be repeated here. While only three of the more substantial failures will be discussed here, KCPL stands behind all of Mr. Levesque's work.

The first failure is inherent in the way Staff put together its hypothetical purchaser case. Staff's premise is that a purchaser of KCPL's system can successfully operate a district steam system in Kansas City. Staff envisions that this purchaser would first implement a short term scenario--stabilize and increase sales, make some capital investments and minimize expenses. The purchaser would then make a transition into a long term scenario--replace boilers and distribution pipes. But Staff's pricing of these scenarios does not correspond to this transition process. Staff calculated (erroneously) the cost of steam for twenty years from 1987 for both the short term and long term scenarios. It is obvious that the short term scenario will not last for twenty years, and it is equally obvious that the long term scenario will not start in 1987. Yet Staff has not presented a pricing analysis that reflects any transition from short term to long term scenario--the pricing analyses are entirely separate. The Commission is not presented with any sort of probative evidence that even a hypothetical operator can produce steam in Kansas City at a price generally competitive (that is, under $10 per mlb) with other heating options in the short run, nor do Staff's pricing analyses show any recouping of the portion of the $3 million short term scenario capital investment which is not recovered at the time that the long term scenario is implemented. There simply is no evidence to allow the Commission to find that Staff's scenarios are feasible.

The second failure has to do with forecasted gas prices used in Staff's scenarios. They are predicated on a July 1986 DRI forecast. (Ex. 30, p. 7) KCPL presented a March 1987 forecast which reflected events which occurred subsequent to July 1986. The difference between the two forecasts in 1987 is about $1.50 per mmbtu. (Ibid.) Staff attempts to justify its continued reliance on the July 1986 forecast by stating that the forecast is slightly below the present cost of transportation gas (Tr. 278), and that transportation gas price forecasts were used in the scenarios. (Ex. 30, p. 8) Staff misstates its own case. Staff used the July 1986 DRI forecast, which Staff consultant Dahlen admitted was a forecast of tariff gas prices (that is, gas purchased directly from KPL Gas Service) (Tr. 281), rather than a forecast of transportation gas prices (that is, gas purchased from a supplier and then transported over pipelines to KCPL). How Staff can claim that a forecast of tariff gas prices is actually a forecast of transportation gas prices remains unclear. But it is quite apparent that Staff was forced to make such claim because the July 1986 forecast of tariff gas is seriously below the current level of $3.28 per mcf (Tr. 509)--more than 30% under the current price, although the forecast Staff uses is not even a year old.

The accuracy of the July 1986 forecast, either for tariff or transportation gas, was put into serious question by two facts brought out in cross examination. The first fact is that Williams Natural Gas, KPL Gas Service's supplier, recently raised its price to KPL by $0.49 per mcf (Tr. 281) which, as the Commission knows, led KPL to receive a retail gas rate increase last month. The second fact is that, although KCPL has been receiving transportation gas since only March 12, 1987 (Tr. 308), it has received notice from its gas transporter that its transportation agreement is cancelled as of May 1, 1987. (Ex. 36) Mr. Dahlen was unable to say if and under what terms and conditions KCPL may obtain a replacement transportation agreement. (Tr. 309-310) Since the pricing, and even the very availability, of transportation gas after April 30, 1987, is unknown, it is of the highest speculation to claim to forecast steam prices for the next twenty years on out-of-date gas forecasts. From all indications in the record, Staff's gas price forecast substantially underestimates the cost of gas, whether tariff or transportation.

The third failure has to do with the fact that both the long term and short term scenarios assume that the purchaser has acquired KCPL's steam system for free. Staff asserts that the cost of the system is a "sunk cost" for KCPL, and apparently KCPL shouldn't receive anything for its investment and steam customer base. Further, Staff argues that since KCPL is willing to make up to $23 million in capital investment to "abandon" the steam system, this shows that the system has no value to KCPL. These arguments are ill-founded.

KCPL is not incurring costs to terminate steam distribution service; rather, it proposes to invest capital required to convert these KCPL steam customers to KCPL electric customers. It is the customer base which is of premier value to KCPL. Mr. Beaudoin of the Company repeatedly stated so (e.g., Tr. 92), and Mr. Haskamp of the Staff actually quantified in a way the value of these customers to KCPL--as electric customers. (Ex. 54; 55) In the long-run, KCPL calculates that the off-peak electric heating rate contribution to fixed costs will approximate this capital investment. (Tr. 124)

There are many ways to value a business, such as market valuation, income stream, replacement value, etc. (Tr. 283) To the extent that a purchaser pays a price for the system, it must recover these purchase costs through rates. Staff's pricing analyses are therefore further understated to the extent its hypothetical purchaser pays a price for the system and customers.

c. Staff has not shown that it is legal to burn gas in its long term scenario.

Staff's long term scenario assumes that gas-fired boilers capable of putting out 400 mlbs of steam per hour will be installed at Grand Avenue (Ex. 31, Sched. 1-17) to replace the existing boilers. However, Staff nowhere considers the prohibitions against burning natural gas or petroleum in new power plants or major fuel burning installations contained in the Powerplant and Industrial Fuel Use Act, 42 USCA 8301 et seq. The Act generally allows the continued use of oil and gas in units existing prior to 1978, unless an order or rule prohibiting such use is issued. KCPL may burn gas in the existing boilers at Grand Avenue, because no order or rule specifically prohibiting this use has been issued. 42 USCA 8341-3. However, the Act generally prohibits the use of gas or oil in units constructed after November 9, 1978, unless the unit falls within certain statutory exemptions. Thus neither KCPL nor any other operator may use gas-fired boilers unless an exemption from the Act's prohibitions can be claimed. 1/

42 USCA 8322 specifies the permanent exemptions to the general prohibition against burning gas and petroleum. The ones that could conceivably be available to a purchaser of the system are in sections 8322(a)(1)(A) and (D). The first exemption is if the cost of using coal "substantially exceed[s]" the cost of using imported petroleum as a primary energy source during the useful life of the installation. The second exemption requires a showing that the use of coal or alternate fuel would not allow the petitioner to obtain adequate capital for the financing of the installation. Staff has not demonstrated that either of these exemptions could be proved; it is thus mere conjecture on Staff's part that a hypothetical operator, or KCPL for that matter, could operate new gas boilers to supply the steam system. Staff's case does not in any way demonstrate that a new operator could even operate new gas boilers to supply the system, much less do it profitably.

C. A SALE OF THE SYSTEM GIVES NO ASSURANCE THAT THE SYSTEM WILL BECOME VIABLE.

Staff believes that the viability of the system can only be measured by whether the system can be sold. KCPL disagrees. Viability can be assessed by a review of the past operating history and estimation of future rates which must be charged.

1/ 42 USCA 8312 prohibits natural gas or petroleum to be used as a primary energy source in a "new major fuel-burning installation consisting of a boiler". "New" means that construction or acquisition began on or after November 9, 1978, and "major fuel-burning installation" is defined as a unit which is capable of burning 100 mmbtu's of fuel per hour, or two or more units which in the aggregate have a design capability of burning 250 mmbtu's of fuel per hour. Staff's three gas-fired boilers constitute a "new major fuel-burning installation". Steam has about 1164 btu/lb (Ex. 34, Sched 4-4). Assuming 100% efficiency, and neglecting the existing enthalpy of water before it is converted to steam, the boilers would need to consume about 466 mmbtu per hour to produce their design capability of 400 mlbs of steam per hour. (400,000 lbs of steam per hour x 1164 btu per pound of steam = 465.6 mmbtu per hour)

This review shows that KCPL has supplied reliable, adequate and safe steam, at rates below cost, and still has lost customers, sales and money for more than a decade because of competition. Whether or not KCPL operates the system, a rate increase of about 50% (or more) is needed right now to recover the cost of supplying steam. (<u>See</u>, Section III.B.3.a., <u>supra</u>) This rate increase will certainly exacerbate the competitive disadvantage steam presently suffers, and the inescapable conclusion is that steam distribution service's future in Kansas City is short and dark.

The Commission should also give consideration to two other factors. The first factor is, what is the effect on steam customers if KCPL is correct and steam service isn't viable?

> ...as a Commission, you'd have to ask yourself whether that prospective buyer, even if he's willing to but at a price that we're willing to sell it, will, in fact, provide steam at a rate that is compensatory and economical to the customer. We believe that, even if the system is sold, the new buyer will have to raise rates. And, at that point, the gas company and the electric company will be in there competing; and he will not have 130 customers to deal with by the time he's bought the system.
>
> We believe it's inevitable that the number of customers will drop off in the system...But we're aware there are other customers that are just waiting on the sidelines to determine whether the Commission is going to approve our plan or not, and they may go off the system anyway. So I couldn't guarantee to a new buyer that he'd have 130 customers after I sold the system to him. And, if he loses customers, as you know, that changes the economics drastically of the system. (Tr. 128-9, Beaudoin answer to a question from Judge Fischer)

If the purchaser goes out of business, the remaining steam customers will have to obtain an alternate heating source. Under KCPL's Plan, the steam customers can obtain electric heating equipment at no initial capital cost; there is no telling what, if any, compensation they would get from a purchaser of the steam system.

The second consideration is the level of deregulation Staff sees as necessary to the viability of a new operator. Staff consultants have recommended the unrestricted entry of district heating suppliers, allowing these suppliers to sign up customers under contracts with a specified term and pricing mechanism, having the commission <u>not</u> change the contract rates if they become unjust or unreasonable, allowing a purchaser to serve only some of the steam customers and not imposing a public utility obligation to serve any customers. (Ex. 28, p. 47; Ex. 13, Sched. 1) This required deregulation--abandonment of the Commission's oversight role--underscores the fact that public utility steam distribution service isn't viable in Kansas City.

One of the options which might present itself to the Commission is to authorize the abandonment of the system, but make that authorization contingent on seeking proposals to purchase the system. Aside from the fundamental problem that the system's fate cannot be salvaged, putting off termination will not keep the remaining customers on the steam lines as the proposal process unfolds.

> And so, if you made a decision to delay or defer, we might make a decision to delay or defer. We might also decide to go ahead anyway, based upon the realities of what we see as life before us. (Tr. 442, Mauro cross-examination)

> And we have many decisions put to us in business--they ask us to defer decisions, based upon some potential, coming down on the line. And we have to make decisions on a business-like basis on a day-to-day basis. (Tr. 428, Mauro cross-examination)

If the Commission declines to authorize the termination of steam distribution service, KCPL will continue in the interim to operate the system while assessing the Commission's Report and Order. KCPL has fulfilled its statutory obligation to provide safe and adequate steam service (Sections 393.130 and 393.290, RSMo 1978), and will continue to do so for as long as it is charged with that obligation.

D. STAFF'S CRITICISMS OF KCPL STEAM MANAGEMENT AND MARKETING ARE BASELESS AND IRRELEVANT.

1. Staff failed to show how or to what extent the utilization of other management techniques by KCPL in its steam operations could have changed the present economics of steam service in downtown Kansas City.

Although Staff has submitted much testimony concerning alleged management failures of KCPL prior to 1982, Staff has failed to show the relevance of these asserted weaknesses to the core issues in this case. As discussed below, Staff has not shown that these alleged failures had any impact whatsoever on customer losses, and Staff neglected to quantify whatever adverse rate impact these might have been. Indeed, Staff admitted that steam rates would have been higher had KCPL increased distribution O&M expense prior to 1982.

It is interesting to note that during the late 1970's and early 1980's, KCPL was before the Commission in six steam rate cases; yet in none of these cases did the Staff ever bring up the issue of inadequate management attention by KCPL concerning the steam operations. Now, five years after these alleged management failures were corrected, the Staff raises the issue for the first time. Staff Witness Tooey testified the Staff has no criticisms of KCPL's management after 1982. (Tr. 364) It is also significant that the Staff presented no evidence of any customers leaving the system during this period in question because of any type of mismanagement. The customers' departure was always a matter of economics.

Staff witness Bernsen correctly pointed out that until 1982, the management of the steam system was largely decentralized. (Ex. 45, p. 8) KCPL's T&D System Operations Department managed both the Company's electrical and steam operations. As Staff witness Bernsen stated in her direct testimony, this department spent approximately 10% of its time on the Company's steam operations, even though this operation produced only 2% of the Company's revenues. (Ex. 45, p. 8) Staff contends 10% of the time of the system operations was inadequate, but Witness Bernsen was unable to say how much time would have been adequate. (Tr. 393; 399)

Primarily, the Staff criticized the Company's long-range planning and maintenance of the steam system. The Staff contended that had the system's piping been systematically replaced over the years, the system would not need to be retired today. Staff could not quantify the cost of such a program or estimate its impact on present rates. (Tr. 353) Witness Featherstone did concede that rates would be higher today if such a program were undertaken (Tr.

255), and Staff Witness Cox testified that had steam rates been higher, steam would have been less competitive with other energy sources. (Tr 389) The fact is that the steam market couldn't bear the replacement costs in the 1970's, and it can't bear those costs today.

The Staff made an issue over the high level of steam losses during the late 1970's; however, the large part of those losses were on the customer's premises and beyond the control of KCPL. (Tr. 149) The Staff presented no evidence that any of the steam customers left the system because of any steam losses. Staff also conceded that in past rate cases, losses below the actual levels were reflected in the rates and thus the customers have <u>not</u> paid for losses in excess of 30%. (Tr. 254)

In summary, the Staff contends that KCPL mismanaged the steam system by not spending enough time and money on the system in the 1970's and early 1980's. However, Staff fails entirely to show that this alleged mismanagement (a) adversely affected the quality of steam service, (b) caused a decline in steam customers or sales, or (c) caused steam rates, both then and now, to be unjust or unreasonable. KCPL believes that it dedicated the appropriate amount of resources necessary to maintain the system in working order by repairing leaks as they occurred and at the same time, keeping the rates as low as possible in order to maintain a competitive heating system. Importantly, there have been very few service complaints; whatever KCPL's real management failures may have been, they did <u>not</u> affect the reliability, adequacy and safety of steam service. Even with the low rates maintained by KCPL, customers were lost to other competitive heating sources. KCPL believes that had the Staff's hindsight management position been implemented, the steam operation could not have survived the high rates which would have been necessary to recover such costs.

2. There is no evidence that establishing a marketing "presence" would have stopped steam sales declines or have attracted other customers.

The Staff contends that the Company did not aggressively market steam and thus has fewer steam customers today than should have been reasonably expected. However, there is no evidence from the Staff that any steam customer left the system for any reason other than rates (with the exception of Roadway, which also stated that its gas heating system was less expensive than steam. (Tr. 248))

KCPL witness Graham testified that KCPL gave the downtown customers information about both the electric and steam options and let the customer make the choice. (Ex. 16, p. 2) The Staff criticizes KCPL for taking this approach; however, Witness Haskamp acknowledged that Kansas Power and Light takes the same approach in the areas in which it markets both electricity and gas. (Tr. 376) Mr. Graham testified that KCPL was always in competition with gas and, therefore, marketed the best economic choice (electricity or steam) for a particular customer. (Tr.. 216)

The Staff appears to contend that KCPL should have in all events promoted steam, even if it was not the most economical or best long-term option for the customer. The Staff seems to believe that all customers in the downtown area would have chosen steam had they known the "intangibles" of steam, but nowhere is there any evidence that the building owners in the area did not know of these intangibles. In fact, Staff Witness Haskamp conceded that in Staff's interviews with architects and builders in Kansas City, no architect or builder indicated they were unaware of the attributes of steam heating. (Tr. 385)

In truth, each and every one of Staff's "intangible" benefits of steam--no boiler costs, no space taken up by boilers or flues, no combustion waste products--must have been explicitly considered by every customer who decided to use an alternative heating source. Each building owner had to know the cost of buying and operating the gas or electric boiler and how much space such an installation would take before committing to such an alternative heating source. Thus, there was no reason to continually market steam "intangibles"--they were readily apparent to the building owner considering its heating alternative.

Both Staff Witness Featherstone and Staff Witness Haskamp believe the proper marketing approach which KCPL should have pursued is the maintaining of a "presence", yet these witnesses explained that such a "presence" consisted merely of working with developers, being there on a day-to-day basis, seeing what is going on in the downtown community, <u>all</u> of which KCPL does on a regular basis. (Tr. 243 and 368)

KCPL has for several years had concerns about the long-term viability of the steam system, as evidenced from several of the memos produced by the Staff. In 1972, KCPL had concerns about connecting the new Mercantile Building. Grand Avenue Station, at that time, was used primarily for electric generation. The system was or near its limits on that date and the old desuperheating stations were operating at or near their capacity. It was necessary to consult the operating personnel concerning such restriction before committing to new customers. (Ex 16, p. 7) The Staff alleges that these concerns were "demarketing", even though the rate analysis for the Mercantile Building indicated that electricity would be cheaper than steam as a heating source. As Mr. Graham testified, KCPL could hardly recommend to a customer that he choose the steam heating system which was most expensive to own and operate. (Tr. 216)

KCPL also had concerns about committing to serve other new buildings, given the age of the system, and KCPL certainly had justifiable concerns about the expense and technology of building a pipeline across the Missouri River to serve CPC. KCPL made sure it could fulfill its commitment to serve before extending service to customers, but it <u>never</u> refused service to any customers within its service territory.

The Staff criticizes KCPL for suggesting electric energy as an alternative to steam as steam became more expensive. As KCPL Witness Graham testified, KCPL always tried to be competitive against gas. As the cost of steam was higher than electric, KCPL emphasized the electric option. (Tr. 216) Factors other than price, especially in new buildings, also influenced customers to consider sources other than steam. The improvements in heating and cooling systems allow the utilization of heat that is generated in the core of the building to offset losses in infiltration and fresh air requirements. (Tr. 216-217)

Staff argues that the mere filing of this case before the Commission was "demarketing" of steam; however, Staff concedes that KCPL had an obligation to tell its customers about the condition of the system and specifically its plans for the system when they were finalized, and they presented no evidence that any customers left the system due to the Company's Plan. (Tr. 359) To the contrary, the dwindling number of customers was due in large part to demolition of many buildings in the area coupled with the advanced technology of heating systems in the new buildings which made electricity and gas more attractive for heating.

The Staff repeatedly criticized KCPL for its lack of a marketing department dedicated solely to the marketing of steam. Yet even if the unrealistic assumption were made that <u>all</u> customers in the downtown steam service territory were connected to the steam system for heating, sales would increase less than 30%, and the average price of steam would <u>still</u> only be marginally competitive with electricity and gas. And connecting all of these customers would require about $3 million in capital additions. (Ex. 16, pp. 2-3)

Extension of the steam system beyond the present service territory boundaries is not feasible. Staff Witness Miller estimated that high pressure piping extension costs would be approximately $455 per foot, and such costs assume that the system does not have to be extended across bridges, highways or other difficult terrain. (Ex. 31, Sched. 1-5) Witness Dahlen stated that at Mr. Miller's estimated cost extension of the system, even a one-tenth of a mile extension would result in costs of approximately $240,240. (Tr. [illegible]) This cost must be borne either by the utility or the customer; the potential customer load isn't sufficient for the utility to bear such costs, and the price of steam doesn't justify the payment of line extension costs by the [illegible] potential customers. The buildings adjacent to the steam service territory are small retail and office-type buildings without the load to justify even a rather short extension. Any larger potential customers are on the other side of the freeway loop. (Ex. 16, p. 6) Intervenor Witness Mauro testified that when he was involved with Truman Medical Center, he explored the possibility of connecting to the steam system, but found the cost prohibitive. (Tr. 448 and 449) KCPL Witness Mandacina testified that when CPC sold its facilities, inquiries were made to several companies north of the river about the possibility of taking steam from the Corn Product's pipeline; however, none were interested when they determined the cost of extending the line to their facilities. (Tr. 145) History proves that there is little, if any, prospect in expanding the steam system.

Staff appears to argue KCPL has driven customers from the steam distribution system, through a lack of marketing efforts, because of KCPL's desire to terminate steam distribution service. If it indeed were KCPL's intent to lose steam customers and sales, it is very difficult to understand why KCPL would be content with merely "demarketing" steam service and continually pass up the opportunity to increase steam rates far above KCPL's requested levels. Certainly, higher rates woud have been the ultimate "demarketing" tool.

For the period 1977 through 1982, KCPL filed for and was granted five steam rate increases. Staff's rate increase recommendation during this period aggregated <u>$1.6 million more</u> than CPL requested. (Ex. 44, Sched. 6-1) KCPL could have easily filed to recover Staff's revenue recommendations, and could have agreed to Staff's electric/steam allocation methodologies had it really been KCPL's desire to accelerate the demise of the steam distribution system.

There is thus a fundamental contradiction in what Staff asserts KCPL was trying to do (justify termination of the steam system) and what KCPL actually did (keep rates below the true cost of service). There is only one answer to this--KCPL did not "demarket" steam service; rather, it adopted a forthright and truthful marketing approach and kept rates below cost for years in an ultimately vain attempt to preserve steam distribution service.

In summary, the Staff would have the Commission believe that an intense marketing effort could save the Kansas City steam system. As evidence of such, they cited the St. Louis system and other systems which are part of a much larger downtown area and which provide chilled water as well. Staff presented <u>no</u> evidence or examples that a marketing effort could save a steam distribution system with the same characteristics of the Kansas City steam system. Even Staff Witness Dahlen couldn't state that KCPL would have had more customers, or sales, or a lower cost per Mlb. today if a more aggressive marketing program had been implemented. (Ex. 28, p. 14) Staff's case, then, rests upon bare speculations and ungrounded assertions. In sharp contrast, KCPL presented evidence that even <u>if every building in the steam service territory used steam, the system still could not effectively compete against electricity and gas options</u>, and that there is little hope of attracting customers outside the present steam service territory. Staff's "demarketing" argument must therefore be dismissed.

E. KCPL HAS CLEARLY SATISFIED THE LEGAL CRITERIA FOR TERMINATION OF SERVICE

A review of service termination cases in Missouri and other jurisdictions discloses that two criteria are generally used to determine whether service may be abandoned:

1. The service is operating at a loss, and there is no reasonable prospect of avoiding continued losses;
2. The public in general will not be unduly and unreasonably inconvenienced.

In <u>St. Joseph Light & Power Co.</u>, Case No. [illegible]-78-160, 22 Mo. P.S.C. (NS) 160 (1978), this Commission authorized the utility to abandon steam service in St. Joseph. The utility had only two customers at that time, so there was no hope of operating the system at a profit. The Commission found that all but one of the customers had obtained alternative heating sources, and the remaining customer would be provided with a heating source at a lower total cost. The Commission concluded:

> When the continued operation of a steam heating plant can only be accomplished at a net operating loss and the public convenience and necessity no longer requires the operation of that plant, a company's proposed termination of service should be authorized. (Id. at 182)

There have been several railroad cases decided by the Commission dealing with abandonment of rail services. For example, in Chicago, Burlington & Quincy Railroad Co., Case No. 13,877, 8 Mo. P.S.C. (NS) 85 (1958), the Commission allowed a discontinuance of unprofitable railroad passenger service where it found that there was no reasonable prospect of avoiding continued losses in the future and where the public, in general, would not be unduly and unreasonably inconvenienced (Id. at 93). The Commission recognized that isolated or localized hardships or inconveniences are not sufficient to block termination--it is only when the general public would suffer undue and unreasonable inconvenience that termination will not be authorized.

> That certain individuals will be greatly inconvenienced by the discontinuance of the trains in question cannot be dnied. However, such service cannot be continued when the cost of rendering it results in such a loss as is shown in this case. [$132,00 per year] (Ibid.)

In the preceding sections of this brief, KCPL has shown that the evidence overwhelmingly proves that KCPL has been providing safe and adequate steam service at a loss for many years, but still has been losing customers. Continuation of steam service, whether by KCPL or another, is not viable. And only two of KCPL's present steam customers have voiced objection, and that was only to the general proposition of termination of steam service. KCPL has therefore satisfied the Commission's criteria for service termination.

There have been other steam system terminations authorized by regulatory commissions across the country. Although the decisions aren't controlling, they are of interest because KCPL's present situation is so much like the situations which warranted termination in other cases. For example, in Re Southern Indiana

Gas & Electric Co., 61 PUR 3d 232 (Ind. PSC, 1965), the utility petitioned to abandon steam service in Evansville. The decision recited that the steam system was old and operating at a current loss, due in part because electricity was no longer being generated by the plant supplying steam. Rates would have to increase 150% to cover costs, and would have to increase an additional 330% if the system were to be replaced. The commission found that there had been no affirmative efforts to attract new customers. Customers had declined from 400 to 260. The commission found that the utility's efforts to avoid abandonment were to keep rates low for years, and that the utility never refused service (these were among KCPL's efforts as well). The decision also noted that the increase in customer heating costs due to the proposed abandonment, including capital, operating and maintenance expenses, were less than the 150% steam rate increase. The commission authorized abandonment, and gave the steam customers less than two years to make alternative heating arrangements.

In Re Pacific Power & Light, 61 PUR 4th 498 (Ore. PUC 1984), the utility filed tariffs to phase-out its heating system within one year, but subsequently agreed to an eleven month extension. As in all of these cases, steam was a byproduct of an electric generation plant and the distribution system was old and inefficient. To reconstruct the system would have made the cost of heating with steam prohibitive. The system was operating at a loss, and would continue to do so without a substantial rate increase. Several large customers had left the system, and several others were in the process of doing so. The Commission therefore authorized the abandonment of the system.

Pacific Power & Light also abandoned its steam system in Casper, Wyoming. Re Pacific Power & Light, 8 PUR 3d 452 (Wyo. PSC, 1955). The plant which generated the steam no longer was used for electric production, and the distribution system had deteriorated to the point where it had to be entirely replaced.

Rates would have to increase 450%, and the company had already been losing customers to gas. Abandonment was therefore authorized.

The Vermont Public Service Board in Re Gas Company of Vermont, 49 PUR 4th 460 (1982), summarized the criteria this way:

> Essentially, [abandonment criteria] are a matter of economics: Can the system be refurbished and repaired so that it provides adequate and safe service at a price that is competitive, and does an alternative exist for the service...If an alternative exists for the utility's product, [the utility's] rates must also be competitive or the utility will lose its customer base, thus creating additional expense for other customers and eventually leading to bankruptcy. (Id. at 462)

In conclusion, KCPL has proved that steam distribution service in Kansas City has not been able in the past to keep its customer base in the face of competition from other energy sources, and steam will become even less competitive if rates are increased to cover the actual cost of steam service (whether provided by KCPL or another entity). No customer has specifically complained about the proposed termination of steam distribution service to it, and thus there is no demonstrated undue adverse impact upon the general public convenience. KCPL's compensation plan, discussed below, offers an alternative heating option that is ultimately priced well below the proposed steam rate levels. Therefore, KCPL has met its burden of proof, and should be allowed to terminate central station steam distribution service.

F. KCPL WILL ACCOMMODATE TO THE EXTENT PRACTICABLE EACH CUSTOMER'S SITUATION AS THE PHASE-OUT PROGRESSES

KCPL has filed proposed rules and regulations dividing its steam service territory into eleven phases, or districts, and has assigned to each phase a date after which KCPL would be no longer required to provide steam distribution service. KCPL may continue to provide distribution service after that date, and will to the extent it remains practicable to do so to accommodate customer conversion plans. However, KCPL still wishes to phase-out its distribution service for a variety of engineering and economic reasons. Losses can be reduced more effectively by first converting customers located on ends of steam laterals. Conversion of the customers located in the initial five phases will allow crews to disconnect the oldest and most leaky steam pipes from the system, thereby reducing system losses. Throughout the conversion process, the operating reliability of the remaining steam system needs to be maintained. The removal of steam line connections has to be carefully sequenced to protect the integrity of operations for the remaining customers. The phased conversion allows KCPL the time to construct whatever electrical facilities may be necessary for the boilers. The Plan's conversion schedule is a careful balancing of the customer's needs, the design and installation of the boilers and associated electrical facilities, minimization of traffic disruptions and completing all conversion work by December 31, 1990. (Ex. 14, pp. 15-18)

IV

CUSTOMER COMPENSATION FOR TERMINATION OF THE STEAM DISTRIBUTION SYSTEM AND PROPOSED STEAM RATES

KCPL:	Witnesses:	Beaudoin (Tr. 81-139; 455-478); Graham (Tr. 197-232)
	Exhibits:	12 (Beaudoin Direct), 13 (Beaudoin Rebuttal), 14 (Mandacina Direct), 15 (Graham Direct)
Staff:	Witnesses:	Ketter (Tr. 480-501); Featherstone (Tr. 504-516); Haskamp (Tr. 517-521)
	Exhibits:	17 (Featherstone Direct), 18 (Featherstone Reubttal), 53 (Featherstone Surrebuttal), 28 (Dahlen Direct), 49 (Ketter Direct), 50 (Ketter Rebuttal), 51 (Ketter surrebuttal), 52, 54 (Haskamp Rebuttal), 55 (Tooey Rebuttal), 56 (Huttsell Rebuttal)
KPL:	Witness:	Lennan (Tr. 526-534)
	Exhibit:	57 (Lennan Dirct)
Customer Intervenors:	Witness:	Mauro (Tr. 414-454)
	Exhibit:	48 (Mauro Direct)

Issues:

A. <u>Offer of alternative electric boilers or electric space heating equipment.</u>

KCPL proposes to offer to its existing steam customers the option of acquiring at no initial capital cost an electric boiler or alternative electric space heating equipment; however, should the space heating equipment option be chosen, and the cost is more than the equivalent electric boiler, the customer must reimburse KCPL for the difference. KCPL will own, install and maintain the boilers, and such customers will be billed under the steam rates. KCPL will own and install the electric space heating equipment, but the customer will be responsible for maintenance and will be billed under the electric rates. As of December 31, 1995, title to the boilers and equipment will pass to the customers, and all will be billed under the electric rates. Customers can purchase the boilers and equipment prior to December 31, 1995 at its depreciated original cost.

Staff, KPL and Jackson County oppose this offer, contending that it violates promotional practices and constitutes undue and unjust discrimination.

Customer Intervenors support KCPL's offer.

B. <u>Energy Audits</u>

KCPL has completed energy audits for most of its steam customers, and proposes to continue this offer to the rest of the customers.

Staff and Jackson County contend that these energy audits violate promotional practices rules.

C. Steam Rate Proposals

1. If the Plan is approved in whole (termination of service and offer of boilers and electric equipment).

KCPL proposes that the $3.2 million stipulated revenue deficiency be phased into steam rates in four equal annual percentage increases of 13.5% each, with no deferral or carrying charge recovery. KCPL proposes that those customers still on the steam distribution system and those with electric boilers be charged the steam rate; however, KCPL has no objection to customers who have boilers being charged under the electric rates.

Staff does not propose any specific rate level in this situation, but recommends without quantification that nontradition ratemaking be employed. Staff also opposes charging steam rates to customers with boilers. Jackson County concurs with Staff, and Customer Intervenors do "not disagree" with Staff.

2. If the Plan is rejected, but KCPL is allowed to terminate steam distribution service by 1991.

KCPL commits not to raise base steam rates from their present levels, as a type of compensation to steam customers who must convert to another heating source.

No other party objects to this freeze.

3. If KCPL is not authorized to terminate steam service.

KCPL will continue to operate the system in the interim, and proposes that the entire $3.2 million revenue deficiency be immediately recovered in rates.

Staff opposes any rate increase, contending that "higher rates will likely force customers to leave the system." Jackson County and Customer Intervenors also oppose a rate increase.

D. Test Boilers

Should the Commission not authorize KCPL to offer electric boilers, KCPL will offer to either sell the five test boiler installations to the customers or to reconnect them to the steam distribution system (assuming that the Commission as well does not authorize termination of the system). KCPL does not believe that its test boiler program violates promotional practice rules.

Staff contends in the Hearing Memorandum that the test boiler project violates promotional practices.

E. Gas-fired Boilers and Chillers

KPL proposes, if the Plan is accepted, to offer to install on-site gas boilers and chillers and to charge rates equivalent on a BTU basis to those set by the Commission for steam service.

Staff opposes this proposal as a violation of promotional pracatices.

KCPL does not oppose KPL being authorized to offer free gas boilers, and KCPL being authorized to offer its electric equipment options, to all of KCPL's present steam customers. In that event, the customers who choose the KPL offer should be charged under gas tariffs, and those who choose the KCPL offer should be charged under electric tariffs. KPL's present offer does not appear to be cost-based, and it is inappropriate for the Commission to approve KPL's approval outside of a KPL tariff filing. Further, KCPL is not proposing to offer air conditioning equipment to the steam customers, and thus KPL's proposal to offer chillers is unwarranted.

KCPL has attempted to accommodate the interests of its customers and intervenors in developing and presenting its case to the Commission, such as not insisting on a firm cut-off date for each phase of termination, and suggesting that KPL be allowed to offer free gas boilers to KCPL's steam customers, and volunteering to forego a rate increase if it is allowed to terminate steam distribution service but not to offer electric boilers. In making these accommodations, the issues of customer compensation, steam rates, the rates to be charged customers with electric boilers, energy audits and the test boiler program became somewhat intertwined. They are therefore discussed in this Brief in a way that logically follows this interdependent relationship.

A. KCPL'S OFFER OF ALTERNATIVE ELECTRIC BOILERS OR SPACE HEATING EQUIPMENT IS REASONABLE COMPENSATION, SPECIFICALLY TAILORED TO EACH CUSTOMER'S NEEDS.

KCPL has always recognized that termination of steam distribution service has the potential of causing some inconvenience or hardship to its remaining downtown steam customers. KCPL thus included two elements of compensation in its Plan: provision of electric boilers or alternative space heating equipment at no initial capital cost, and phase-in of a steam rate increase over four years, with no deferral or carrying cost recovery. (Ex. 12, p. 15) KCPL believes that its Plan is a fair approach to compensation for existing steam customers, since it gives the customers the precise heating equipment needed to supply their needs.

KCPL's offer of equipment has been criticized on various grounds, but examination shows that these criticisms do not justify rejection of the offer.

1. <u>The Promotional Practices Rules Should Not Be Found to Prohibit the Offer.</u>

One of the objections raised against KCPL's offer is that it violates the Commission's promotional practice rules, 4 CSR 240-14.010 et seq. KCPL doesn't believe that its offer is a promotional practice, much less a prohibited one.

A "promotional practice" is defined to be any consideration offered "for the purpose, express or implied, of inducing such person to select or use the service or additional service" of the utility. 4 CSR 240-14.010(5)(G) The purpose behind KCPL's equipment offer is not one of inducement; rather, it is to provide some <u>recompense to customers of KCPL whose steam distribution service is being terminated</u>. The equipment offer is not open to anyone other than current steam customers. The equipment would be sized, based upon the results of the energy audits, to satisfactorily serve the customers' premises. And since the customers who choose boilers would, under the Plan, be charged steam rates, there would be no discrimination between customers who are converted early and those who are converted later in, say, 1990.

Staff uses the fact that KCPL is applying to terminate steam distribution service to argue that "traditional ratemaking principles" should be abandoned by the Commission in setting steam rates. (Ex. 17, p. 42) KCPL believes that this same argument--unusual circumstances--applies equally as well to the appropriate method of compensating KCPL's steam customers for the unusual inconvenience of switching from one form of heating supply to another. (Ex. 13, pp. 1-2) If the Commission should find that the ordinary application of the promotional practices rules would prohibit this extraordinary offer, KCPL believes that it has shown good cause why it should be allowed to make the offer, and requests an exemption from the rules.

KCPL has also been criticized for not offering gas boilers as well to its steam customers. KCPL has not kept secret its desire to convert its steam customers to electric customers, and the benefits of doing so. (<u>See</u>, Ex. 15, pp. 9-10, regarding the benefits of obtaining this off-peak load) These customers are valuable to KCPL as energy customers, and KCPL wishes to retain them. However, this desire cannot obscure the main purpose of the equipment offer, which is to help steam customers convert to an alternative heating source.

KCPL has no objection to KPL Gas Service offering free gas boilers to KCPL's steam customers. So as to put both offers on an even footing and to allow customers to make their choice based on the "real" cost, both energy companies should charge the applicable electric or gas energy rate. Since KCPL and KPL would then be competing on the proverbial level playing field, the promotional practices rules should not be found to apply.

KCPL does, however, object to KPL Gas Service's proposal to offer gas boilers and chillers to KCPL's steam heat customers and to charge the BTU equivalent of the steam rates. First, KPL's offer has not been demonstrated to be cost-based, and there are no unusual, extenuating circumstances affecting KPL (such as termination of a service to existing KPL customers) to justify its offer. Second, KPL's proposal goes far beyond the scope of KCPL's offer, because KPL includes air conditioning equipment in its proposal. There certainly has been no adequate explanation of why KPL wishes to link both heating and cooling equipment or why such a linkage is appropriate.

It is not unheard of for a utility that desires to terminate steam distribution service to offer compensation to its steam customers in terms of another energy service it offers. For example, Staff consultant Dahlen recites with apparent approval the offer Northern States Power made to its Fargo, ND, steam customers when it terminated steam service--the customers were reimbursed up to two-thirds of the cost of a gas boiler, and received a fuel subsidy besides. (Ex. 28, p. 44) Mr. Beaudoin pointed out that NSP provides gas distribution service to Fargo (Tr. 472), and perhaps also electricity. So, NSP was authorized to provide a compensation package to its steam customers which favored natural gas, and was not required to offer a comparable package for those customers who may have wanted to go with electricity. Staff saw nothing wrong with this selective compensation approach when NSP used it, but opposes this same approach by KCPL.

2. The <u>Real</u> Cost of KCPL's Boiler Offer to its Customers Is <u>Simply</u> The Energy Cost.

Staff devotes considerable testimony to devise the "real" cost of these electric boilers to KCPL's customers. (<u>See</u>, e.g., Ex. 28, pp. 33-39) These strenuous efforts were needed to attempt to inflate what the <u>actual</u> cost of KCPL's Plan is to its steam customers who accept the offer of electric boilers or space heating equipment.

All of Staff's testimony cannot change the <u>real</u> cost under the Plan to KCPL's steam customers who choose electric boilers--it is simply, and <u>only</u>, the cost of steam under the steam tariffs until the customers assume ownership of the boilers. The capital costs, and the operations and maintenance expenses are borne by KCPL until the customer assumes ownership of the boiler. The steam rates proposed by KCPL do not contain any allowance for these boiler costs, and they will be recovered on a prospective basis, if at all, after 1990 when the $3.2 million revenue deficiency in this case is finally phased-in. Thus, all of Staff's calculations of the costs of the "typical" electric boiler installation are irrelevant, because the steam customers aren't being asked to pay those costs. Further, Staff's calculations of the costs of "typical" electric and gas boiler installations are misleading, since Staff's consultants agreed with KCPL that the costs of such installations depend on the characteristics of the individual site. (Tr. 278; 325; Ex. 35, pp. 8-10) There is no such thing as a "typical" installation; each customer must make its own choice based on its own unique situation and perception of future energy conditions.

KCPL's Plan certainly allows the steam customers to make a "good economic decision" among alternative heating systems; the customer can readily compare the costs it will pay under KCPL's Plan (that is, steam rates until 1995, with the level of steam rates fixed until 1991) with costs it will pay if it chooses to go with electric space heating (that is, electric rates, which have been fixed through 1995, plus maintenance expenses) or with gas (capital costs and operations and maintenance expenses). Why a customer cannot make an informed decision with this complete package of information has not been, and cannot be, explained by the Staff. Certainly, the eleven Customer Intervenors were able to make their choice without difficulty, and the rest of KCPL's steam customers will have all the necessary information they need to make their choice after the Commission issues its order authorizing termination.

Staff apparently feels that KCPL's offer of electric boilers constitutes sharp dealing with its steam customers, in that the energy cost of steam is less than the electric energy cost needed to operate a corresponding boiler. This criticism is truly unfounded. Exhibit 51, Schedule 1 purports to show that the four test boiler customers would have all paid less under steam rates than under the corresponding electric rates. Unfortunately, Staff did not prepare this schedule so that one could directly compare the monthly steam bill with the monthly electric billing. However, if one multiplies the monthly Kwh consumption by the cost per Kwh, a meaningful comparison between the monthly steam and electric billings can be made as follows: based on <u>Staff's own evidence</u> for its 1986-7 heating season, Stanley Sargent and Upsher Labs would have paid about the same under the electric tariffs; McWhirter would have paid about $5 more under the electric tariffs; and Home Savings would have paid around $14 <u>less</u> under the electric tariffs. Thus, under the Plan and the present levels of steam and electric rates, customers who choose electric boilers would pay about the same amount whether they are billed on the electric or steam rates. But this rough parity will not exist in the future. It has been shown above that regardless of who operates the steam distribution system, steam rates must increase 50%-66% immdiately to cover costs. And under KCPL's Plan, steam rates will increase by 13.3% per year over the next four years. In sharp contrast, electric rates have been fixed by Commission order to increase 2% this year and 2.21% next year; even in nominal terms, electric rates will be lower in <u>1989</u> than they were in <u>1986</u>. (Tr. 490) And retail gas rates have just increased by more than 10%. All of the evidence points to the fact that as time goes by, electricity will become more the energy of choice for heating needs. KCPL thus is not saddling its steam customers with an uneconomic heating choice.

KCPL has stated that it has no objection to charging electric boiler customers the applicable electric rate rather than the steam rate, and the preceding paragraph shows that it will be in the customers' advantage over time for this to be done. KCPL's Plan not only addresses the needs of the steam customers, but it makes good economic sense as well. KCPL is not "paying" any amount to terminate its steam distribution business, other than the time cost of the capital invested in boilers and space heating equipment (Tr. 92-3).

B. KCPL'S STEAM RATE PROPOSALS ARE JUST AND REASONABLE.

1. KCPL's Rate Request is Dependent on the Commission's Decision Concerning Termination of Steam Distribution Service

KCPL's steam rate increase proposal, originally at $5.8 million, was not the main reason why KCPL filed its Plan; the central purpose has always been to obtain approval to terminate steam distribution service. KCPL has no desire to serve indefinitely at a loss, but in the context of this case KCPL agreed to stipulate to a Staff-calculated revenue deficiency of $3.2 million. By doing so, KCPL caused the rate increase to become a side issue--still important, to be sure, but much easier to deal with after the Commission determines whether to allow termination of steam distribution service.

All that needs to be said about the $3.2 million revenue deficiency stipulation is this: both KCPL and Staff agree that this is KCPL's present steam heat revenue deficiency, based on traditional revenue requirement principles, and the evidence supporting the reasonableness of the stipulated amount is contained in Exhibits 2 through 15. The Commission can therefore find, based on substantial and competent evidence, that KCPL's steam revenue deficiency is $3.2 million (an increase over present rates of about [illegible]%).

KCPL's steam rate recommendations are dependent on the Commission's decision regarding termnation of steam distribution service. If the Commission should approve KCPL's Plan in full, one of the elements of compensation KCPL is willing to provide to its steam customers is that steam rates will gradually increase over four years, as the present revenue deficiency is phased in without deferrals or the recovery of any carrying charges. (Ex. 12, p. 15) In order to minimize rate disparities between steam customers who have converted and those who have not done so, KCPL has proposed that all steam customers, those still on the distribution system and those who have accepted boilers, be charged steam rates. However, KCPL does not object if the Commission determines that the customers who chose electric boilers should be billed under the electric tariffs.

If the Commission approves KCPL's request to terminate steam service by 1991, but does not authorize KCPL to offer electric boilers and space heating equipment, KCPL is willing to forego any steam rate increase for the remaining lifetime of steam distribution service as a type of compensation to the steam customers. As the Hearing Memorandum notes, no party opposes this proposal.

If the Commission rejects KCPL's request to terminate steam distribution service, KCPL will continue to operate the steam system in the interim while it studies the Commission's Report and Order and reviews possible courses of action. It is speculative at this point to suggest what KCPL might do in such a situation, other than to continue operating the steam system. It would be "business as usual", and the rates would still be over $3 million less than the cost of service. KCPL thus proposes in such a situation that the entire stipulated revenue deficiency be reflected in rates to be set in this case.

Staff opposes the phase-in of a rate increase if the Plan is accepted, essentially arguing that a utility that is terminating its business has somehow forfeited the right to any return of or on its remaining investment. (Ex. 17, p. 42) Staff has pointed to no authority supporting this startling assertion, and KCPL has not found any case which has even mentioned this novel way of excluding prudent investment from rates. Indeed, Staff's suggestion is contrary to the Commission's rate setting obligations.

The Commission must establish rates that are just and reasonable, Section 393.130 RSMo 1978, and in doing so must balance the interests of ratepayers and shareholders. Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591. There are no allowed exemptions from these requirements. Staff has not shown that its suggestion that KCPL recover only unquantified "prudent out-of-pocket expenses" is either just and reasonable or represents a proper balancing of investor and ratepayer interests It cannot be denied that KCPL's investment in Grand Avenue and the steam distribution system is prudent investment that is used and useful until the last customer is disconnected from the system; what can be the justification for the blanket exclusion of this investment from rates? How does setting a termination date 3 1/2 years in the future so fundamentally change the nature of the investment or the service now being rendered to steam customers that rates can no longer reflect the investment and operating costs necessary to serve the customers? Staff has provided no answer, much less a persuasive answer, to these questions. Until it does, its investment exclusion proposal must be rejected.

KCPL believes that its phase-in proposal establishes rate increases that are below the stipulated reasonable level of $3.2 million. The fact that KCPL is willing to accept rates that are below the just and reasonable level does not permit the Commission to set rates that are even lower. Utilities Operating Co. v. King, 143 So. 2d 854, 45 PUR 3d 439 (Fla, 1962). The interests of the ratepayers are more than amply taken into account in the phase-in. First, rates will not increase to even the level necessary in 1987 until 1990. Second, there will undoubtedly be customer attrition over the next few years as customers choose between electric and gas options; the phase-in does not take into consideration the probable sales decreases which will increase the per unit cost of service until the system is terminated. KCPL's phase-in is more than fair to its steam customers, and should be accepted if the Plan is approved.

It is undisputed that KCPL failed by $1.5 million in 1986 to recover its "out-of-pocket" operating costs. Under KCPL's proposed phase in, rates will rise in the first year by less than $700,000 (13.5%). If the Staff's "out-of-pocket" theory is accepted, then rates should increase on the basis of the record by twice the amount KCPL has asked for in the first year of the phase-in! KCPL's phase-in rates thus produce rate levels below Staff's "out-of-pocket" theory, and should be accepted by the Commission in all events should the Plan be approved.

Staff also opposes any rate increase if KCPL is not authorized to terminate steam distribution service. This opposition is tied to its proposal that KCPL look for purchasers of the steam system; a rate increase would most probably lead to customers leaving the system. Staff's opposition is untenable. If the Commission does not authorize KCPL to abandon steam service, KCPL retains its public utility duty to serve, and also retains its Constitutional right to just and reasonable rates for that service. In the short term, KCPL will be able to recover increased revenues caused by a rate increase in this case. (Tr. 456) There is a time lag between the time increased rates are authorized and additional customers leaving the system because of it, and it is during that period that KCPL will have the opportunity to earn the $3.2 million revenue increase stipulated to in this case. (Ibid.)

2. <u>KCPL's Plan is not affected by APB Opinion No. 30</u>.

An accounting question which was unanswered during the hearing was whether KCPL's proposal to terminate steam distribution service was affected by any FASB or APB Opinion. APB Opinion No. 30 deals with the income statement presentation of the discontinued operation of a business. FASB Statement No. 14 contains a list of criteria which determines the applicability of

Opinion No. 30, and KCPL's steam operation does not meet any of the criteria. Thus, steam operations proposed to be terminated by KCPL does not constitute a business segment for reporting purposes, and Opinion No. 30 does not apply.

C. KCPL'S ENERGY AUDITS AND TEST BOILER PROGRAM DO NOT VIOLATE PROMOTIONAL PRACTICE RULES

1. <u>KCPL's Energy Audits Are Specifically Exempted From the Promotional Practice Rules</u>.

Staff raises the issue that KCPL's energy audits performed on steam customer premises violate the promotional practice rules. This issue is mostly moot, since 93 out of a possible 121 audits have been completed (Ex. 15, p. 7) and none of the costs of the audits is included in the stipulated revenue deficiency of $3.2 million. However, the Staff's tortured reasoning and application of the rules should be reviewed and rejected by the Commission to avoid a similar future issue.

From the very first announcement in 1985 of its intention to offer energy audits to its steam customers, KCPL has been forthright in stating the purposes of the audits: (a) a review of the customer's billings and present steam heating system; (b) providing customer measures that would improve the building's energy systems; and (c) develop preliminary plans regarding installation of electric boilers. (Ex. 15, p. 3) KCPL, in the interest of management efficiency, decided to combine the customer energy conservation work with gathering preliminary data regarding installation of electric boilers. The combination was done to save time and money; if the Commission approves the Plan, KCPL can now more quickly implement the conversion of those customers who accept the offer. (Tr. 412) Thus, most of the audit report contains energy conservation information of interest to the customer, and the rest of the report contains information of use to KCPL in the event that the Commission approves the Plan.

Although the specific energy conservation recommendations span a few pages of each audit report, most of the information in the audit was compiled in support of the conservation recommendations. (Tr. 411) And nowhere in the audit is there any indication of how much electricity the electric boiler will consume, or how much the electricity is estimated to cost, or anything regarding other operations and maintenance expenses associated with the electric boiler. (Tr. 494)

Staff's direct testimony (Ex. 49, p. 6) contended that these audits were a prohibited promotional practice because they "focus on inducing steam customers to select an electric alternative." It is difficult to imagine a weaker "inducement" than these audits. They give no information regarding the costs to the customer of choosing an electric boiler under the Plan--they are completely silent on the projected amount and cost of electricity necessary for the boiler. Indeed, the only costs these audits present are the costs for the boilers to be offered under the Plan--costs which KCPL will shoulder!

Therefore, it was Staff's direct testimony position that audits which told the steam customers nothing about the costs they would incur under KCPL's Plan were an "inducement" to select the boiler offered by the Plan. Staff perhaps realized that its direct testimony position was unsupportable, and raised a new argument in rebuttal--the audits were a violation of promotional practices rules because they constituted a "consideration" given to the building owners to allow KCPL to perform "work done on property not owned by the utility." (Ex. 50, pp. 5-6) In essence, Staff was now arguing that KCPL was offering energy audits to customers so KCPL could enter the buildings and do some preliminary design work in the anticipation that its Plan would be approved by the Commission. There's absolutely no evidence to support this accusation, and it has to be rejected.

It appears from Staff testimony that it's permissible to perform an energy conservation audit for customers, and indeed such is excluded from the definition of promotional practice in 4 CSR 240-14.010(1)(G)8. And although Staff was unsure (Tr. 493), there's nothing in the promotional practices rules that prohibit a utility from being permitted to enter a customer's premises and take measurements that would be helpful to the utility. But somehow, if KCPL combines the energy audit and measurements into one document, KCPL has violated promotional practices rules. Staff's argument is illogical.

It's KCPL's position that these energy conservation audits are excluded from the definition of promotional practices and, in any event, weren't done for the purpose of "inducing" steam customers to select the electric boiler option under the Plan.

2. <u>Staff has admitted that the test boiler program doesn't violate promotional practice rules.</u>

This issue is interesting because the Staff witness repudiates the Staff position that KCPL's test boiler program violates promotional practice rules.

Mr. Mandacina explained that KCPL initiated a test boiler project to gain experience in designing and installing electric boilers in differing physical settings and gauging customer acceptance. (Ex. 14, p. 8) Five boilers were installed, and these test customers were charged, per Staff request, at the steam rate. (Tr. 189) These customers have no ownership interest in the boilers; they merely accept and pay for the steam that is produced.

In the Hearing Memorandum (Ex. 1, p. 154), Staff takes the position that this test boiler program violates the promotional practice rules, and that if KCPL's Plan isn't accepted, then KCPL should offer to sell the boilers to the affected customers. However, Staff's promotional prctices witness, Mr. Ketter, testified that the test boiler project <u>didn't</u> violate any promotional practices:

> Q. Mr. Ketter, at the time of the December 1984 meeting, did you think that there was a promotional practice problem with the concept of cutting off leaky laterals and installing electric boilers on customer sites?
>
> A. <u>No, I did not. I do not.</u>.....So that the equipment was not going to be provided to or given to the customer in that scenario, as I recall.
>
> ***
>
> Q. Suppose, Mr. Ketter, the Commission rejects KCPL's proposal to terminate central station steam service. Do you think it would be a violation of promotional practices if KCPL

continued to own, operate, and maintain the five boilers that are presently at the five customers' premises?

A. One moment, please.

Q. Sure.

A. The promotional practice rule, again, [prohibits] the provision of that equipment to the customer. And if it would remain the property of the company, it is my opinion it would not conflict. (Tr. 484-5, emphasis added)

KCPL has always retained ownership of the test boilers. KCPL has not offered to give the boilers to the test customers; only if the Plan is approved by the Commission will KCPL make such an offer. By the Staff's own testimony, then, the test boiler program has not violated the promotional practices rules.

V.

CONCLUSION

Central station steam distribution service is not viable in Kansas City. KCPL has presented a Plan which recognizes this fact and provides a suitable alternative for its remaining steam customes. It should be approved by the Commission as presented.

Respectfully submitted,

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APPENDIX A

PROCEDURAL HISTORY

In its Report and Order in Case Nos. EO-85-185 and EO-85-224, the Commission established Case No. HO-86-139, and directed that KCPL file its steam service plan in that docket on or before May 1, 1986. KCPL requested an extension of time to June 1, 1986, for this filing in its Application for Rehearing, and filed its Downtown Steam Service Plan by letter dated May 30, 1986.

Pursuant to the Commission's June 27, 1986 Order, KCPL filed on July 7, 1986 proposed revised tariffs containing (i) Revised Rate Schedules of increased steam service rates, (ii) as an alternative thereto, Phase-in Rate Schedules of increase steam service rates, (iii) a Conversion Schedule dividing KCPL's steam service territory into various distribution areas and assigning a date certain to each area when steam service from Grand Avenue Station will no longer be required to be provided, and (iv) revised General Rules and Regulations Applying to Steam Service. The schedules of rates and general rules and regulations bore a proposed effective date of January 1, 1987. On August 25, 1986, the Commission issued its Suspension Order and Notice of Proceedings, suspending the effective date of the tariffs to May 1, 1987 and setting a procedural schedule.

An early prehearing conference was held on October 1 and 21, 1986. The prehearing conference was convened on March 23, 1987, and a local public hearing was held on March 30, 1987. Formal evidentiary hearings took place the week of April 6, 1987. By Order dated April 17, the Commission suspended the proposed tariffs an additional six months to November 1, 1987.

CERTIFICATE OF SERVICE

I hereby certify that a copy of the above and foregoing document was mailed, postage prepaid, this 15th day of May, 1987, to:

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