



Missouri Public Service Commission

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May 18, 1987

FILED

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PUBLIC SERVICE COMMISSION

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Secretary

Missouri Public Service Commission

P.O. Box 360

Jefferson City, Missouri 65102

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

Dear Mr. Hubbs:

Enclosed for filing in the above-captioned case is an
original and fourteen (14) conformed copies of the Initial
Brief of the Staff of the Missouri Public Service Commission.
Copies have been sent this date to all parties of record.

Thank you for your cooperation in this matter.

Sincerely yours,

Mary Ann Young

Mary Ann Young
Deputy General Counsel

MAY:nsh

Enclosure

cc: All parties of record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

FILED

MAY 18 1987

PUBLIC SERVICE COMMISSION

In the matter of the investigation)
of steam service rendered by)
Kansas City Power & Light Company.)

Case No. HO-86-139

INITIAL BRIEF OF THE STAFF OF THE
MISSOURI PUBLIC SERVICE COMMISSION

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I. INTRODUCTION

The initial question to be resolved by the Commission is whether Kansas City Power & Light Company (KCPL) should be permitted to go out of the central steam distribution business under the terms of the Conversion Plan filed by the Company. Despite the style of the case as an investigation of the service rendered by the Company, the Commission should treat this case as an application for authority to discontinue steam utility service by Kansas City Power & Light Company, with an ancillary rate case filing. The discontinuance of a public utility service is a serious matter from both a regulatory and an economic standpoint. From a regulatory standpoint, the Commission should be concerned with the individual customers who will be directly affected by the proposed discontinuance. From an economic perspective, the Commission should be concerned with the effect of loss of one of three alternatives for utility heating service in the area in question.

Staff has closely scrutinized the Conversion Plan of the Company, and found it defective in many respects; therefore, the Staff recommends that the Commission not approve the Company's Conversion Plan in its current form. Staff does not believe that the Company has met the appropriate standard for approval of its request to discontinue utility service and has recommended denial because certain aspects of the plan are inappropriate and/or violate Commission rules.

Although steam operations represent only 2% of KCPL's business, the steam customers deserve full and adequate attention from the Company. Staff has not alleged any breach of duty to provide safe and adequate service to the steam customers; however, Staff's evidence does clearly show that management inattention and neglect have likely contributed to the current physical and financial status of steam operations, and reflect the Company's desire to get out of the steam business. The evidence raises a question of whether Company's Conversion Plan is intended less to resolve problems with the steam system than it is an effort to market off-peak electrical load. Also,

it has become clear that the Conversion Plan is motivated more by a desire for increased electric revenues than to ease the burden of transition on the customers.

Although there is no evidence that the Company performed any cost-benefit analysis, the Company has budgeted \$25 million for capital costs and the conversion plan may well cost the Company in excess of \$30,000,000 (\$23,000,000 for electric boilers, \$3,000,000 for electric distribution, \$1.5 million annually for the next three years for operation and maintenance of on-site boilers, and \$.5 million for energy audits). If the public convenience and necessity call for continuance of central steam service by either a new entity or KCPL, the Company should not be permitted to "buy out" its obligation to serve in this manner.

The Commission has the authority to deny KCPL's Conversion Plan and refuse to permit KCPL to discontinue central steam service to downtown Kansas City. In addition, the Commission has the authority to refrain from granting the Company a rate increase at this time, even though a traditional revenue requirement calculated for an ongoing business has been stipulated to by the Staff and Company, if a sufficient public interest would be served by withholding the increase, especially if abandonment is permitted.

The public interest requires that central steam service not be abandoned just because the Company wants out of the business when the best option for the customers may be continuation of steam service by some entity other than KCPL. Staff's position is that this option must be pursued before the Company is absolved of its public service obligation.

II. STANDARD OF PROOF

A. INTRODUCTION

The general rule for whether a public utility may abandon service can be stated as follows: a public utility

has no right to discontinue or abandon its service or any part of its property devoted to public use or to impair its ability to perform its public duties except with the consent of the state; and

the mere fact that the enterprise or a particular service is unprofitable does not justify the utility in ceasing or refusing to perform its duties.

(73B C.J.S. §9, p. 146). The requirement that a public utility must seek state authority to abandon and must continue to serve absent that authority seems well settled. The special legal status accepted by the utility which devotes its property to public use carries with it the obligation to provide service until authorized to discontinue service. Michigan Consolidated Gas Co. v. F.P.C., 283 F.2d 204, 214 (D.C. 1968).

The fact that a public utility must obtain regulatory authority prior to discontinuance carries with it the implicit power of the regulator to deny that authority. By the same token, it does not place unlimited discretion in the hands of the regulators. The establishment of the standards for granting abandonment are not as concise as the statement of the rule requiring regulatory approval. The majority of court cases and Missouri Commission cases involve abandonment of service by railroads, bus and truck companies. They establish some parameters for treatment of this issue.

B. FEDERAL CASES

Federal court decisions involving gas utilities have treated the question of abandonment as similar to the granting of a certificate of convenience and necessity. The courts look at whether the abandonment would be a disservice to the public. The primary decision is the Michigan Consolidated Gas case. The court ruled that under 15 U.S.C.A. §717f (b) of the Natural Gas Act no natural gas company could abandon all or any of its facilities or service without FPC approval based upon a finding that (1) the supply of gas was depleted, or (2) the present and future public convenience and necessity permit the abandonment. The court held the statute required that the public not be disserved. The factors it looked at were:

- (1) whether the utility could use the facilities to better advantage for other customers,
- (2) would service be more efficient, and

(3) was there sufficient gas available from other sources to serve abandoned customers.

Following this decision, the D.C. Court of Appeals stated that the burden of proof was on the company to show the public would not be disserved by the abandonment. The public interest was the ultimate concern and the FPC must consider all relevant facts to make a determination. Transcontinental Gas Pipe Line Corp. v. F.P.C., 488 F.2d 1325, 1328 (C.A.D.C. 1973).

C. MISSOURI CASES - GENERAL

The Missouri PSC has a long line of railroad abandonment cases where it has dealt with this problem. The Commission has also had some minor abandonment/discontinuance cases involving gas, electric and telephone utilities, and two steam abandonment cases. The Commission and the Missouri courts have adopted the general rule that a public utility may not abandon service without Commission approval. In a case involving a street railroad, the Missouri Supreme Court stated that it had been repeatedly held by that court that the Commission has the authority to grant or withhold the right and power to abandon a part or spur of a street railroad. (Cites omitted). State ex rel. City of Kirkwood v. P.S.C., 50 S.W.2d 114, 118 (Mo. 1932). The Commission has also stated this to be the rule. McFarlane v. Southwestern Bell, 10 Mo. P.S.C. (N.S.) 210, 217 (1962). The Commission chided the Kansas Gas and Electric Company for taking steps to discontinue service prior to filing its application for authority to do so. Re: Kansas Gas & Electric Co., 3 Mo. P.S.C. (N.S.) 170 (1951).

The court in City of Kirkwood stated that on appeal it would look to whether the Commission order "suberves" the public and is reasonable and lawful. To determine reasonableness, the question of the expenditures necessary to make improvements and cost of operating lines were "potent" factors. City of Kirkwood at 118.

The Commission has generally found that the standard of proof in cases involving applications for authority to discontinue

utility service is the converse of that applied in applications for a certificate of public convenience and necessity; that is, that the public convenience and necessity no longer require or demand provision of the utility service in question. The Commission has considered several factors in determining whether specific applications to discontinue service meet the standard and should be approved including: 1) whether the service is viable or not, 2) what the effect on customers will be if the discontinuance is approved - will the customers be as well or better off without the utility service? and 3) whether the Company has considered all alternatives to going out of the utility service business.

The Commission has looked at viability as a threshold question in terms of losses to the Company and demand for the service. The effect on customers of discontinuance of service has always been a primary factor considered by the Commission. The Commission has been concerned with whether acceptable alternative sources of service are available to the customers and in one case the Commission has authorized discontinuance only upon finding that all customers would be as well or better off with some alternatives than they were with the existing service. Finally, because of the significance of loss of a public utility service, the Commission has asked whether alternatives to going out of business are available and whether the Company has examined all alternatives for their customers in the context of the discontinuance.

Where the Commission finds some ongoing public need for the service, but the Company is experiencing losses on the operation, the Commission applies a balancing test to weigh the losses against the public benefit of continued service. The Commission has some discretion in this area to require a utility to continue to provide the service to the public, but the Courts have placed limits on that discretion.

The most elaborate discussion of the abandonment issue in relation to a railroad company was made by the Commission in 1916.

Re: Culver v. St. Joseph & Grand Island Rwy. Co., et al., 4 Mo. P.S.C. 381 (1916). The case involved a complaint by a farmer after a railroad discontinued service over a local route. First the Commission held that a public service corporation may always be required to perform its public duties, although it may suffer incidental loss, and that service may be abandoned when sanctioned by the state. The Commission held that abandonment could only occur where operation entails continuous financial loss, and even if operating at a loss, the service can be compelled if the public necessity requires. To abandon where there is a public necessity, the costs must be so great as to outweigh public benefit.

In a later case, the Commission reiterated that operation of service at a loss did not necessitate approval of a request for abandonment. Re: Missouri-Kansas-Texas Railroad Co., 8 Mo. P.S.C. (N.S.) 68, 79 (1958). The Commission stated the standard for their decision as follows.

The decisive issue to be solved is whether or not the public really needs the services these trains. The term "public convenience and necessity" is illusive and difficult to define but there are certain factors which can be used to determine what is necessary to ascertain the extent of service required to satisfy the needs of the public.

The Commission went on to list factors involved in looking at the public convenience and necessity:

- (1) character of population of territory served;
- (2) public patronage or lack thereof;
- (3) facilities remaining;
- (4) expense of operation as compared with revenue;
- (5) operations of utility (railroad) as a whole;

or, as restated:

- (1) cost of providing service;
- (2) use made by public;
- (3) availability and adequacy of alternatives;
- (4) loss on operation as compared to entire operation;
- (5) prospects of future use;
- (6) loss to company versus hardship to public;
- (7) size of places served;
- (8) efficiency of management;
- (9) all other factors bearing on the question of convenience and cost.

The Commission pointed out that the public interest involved was the entire public, not just a few individuals. The duty to serve is dependent on the character of the service required and public need for its performance. The same analysis and discussion of factors was made by the Commission in Re: St. Louis-San Francisco Railway Co., 17 Mo. P.S.C. (N.S.) 27, 30-31 (1972).

The Supreme Court of Missouri reversed a decision of the Commission which denied authority to discontinue service in a railroad case. State ex rel. Chicago, Rock Island and Pacific Railroad Co. v. P.S.C., 312 S.W.2d, 791 (1958). The Court upheld application of the balancing test of losses resulting from the operation against the public benefit or convenience. However, in the facts of the case, the Court held that the losses being sustained in the operation of two particular trains:

were so patently disproportionate to the public convenience and necessity then or thereafter to be served by them as to render the Order that they be continued unreasonable and arbitrary within the meaning of the public service commission statutes.

Id., 805.

The Commission has allowed abandonment of electric lines and gas service where continuation of the service would be unreasonable. In Re: Kansas Gas & Electric Co., supra, KGE sought authority to cease all service in Missouri and surrender all certificates of convenience and necessity. Over a number of years KGE had obtained several certificates to provide service to certain industrial customers who had operations in Missouri. The service included providing electricity to some residential customers.

The industries ceased operation and many residential customers had moved. KGE had sold its remaining lines to the remaining customers and placed their meters in Kansas. The Commission held that even though KGE had taken steps to abandon service without authority, there was no inconvenience to the public. The Commission granted the authority since the customers would not be deprived of service and since they had acquiesced in the abandonment.

In the Polo Gas case the Commission allowed the Company to abandon service where the supply of gas was not sufficient to provide safe and adequate service from the company's wells. Re: Polo Gas Service, Inc., 16 Mo. P.S.C. (N.S.) 158 (1971). The Commission stated it would be a disservice to the customers to require Polo to continue service since that was a physical and natural impossibility. The Commission did inquire as to all possible alternatives and did establish a transition period before final abandonment was approved.

In the Suburban Gas Co. case the Commission authorized a central propane system operator to discontinue service. Re: Suburban Gas Co., 13 Mo. P.S.C. (N.S.) 557 (1968). Suburban had lost many of its customers to unregulated propane distributors and planned residential development was not using propane but alternative sources of energy. The Commission found that for Suburban to continue in operation it would have to increase rates above those of competitors and it would lose more customers. Suburban had shown that it had operated at a loss and was only keeping rates down with assets of the parent corporation. The Commission found the public would not be adversely affected by the discontinuance since the corporate parent would provide service to Suburban's customers at the same rates.

D. MISSOURI CASES - STEAM SERVICE

The Commission has dealt with discontinuance of steam service in Re: St. Joseph Light & Power Co. (SJLP), 20 Mo. P.S.C. (N.S.) 279 (1975). In its Application, SJLP claimed that its steam facilities were in disrepair and needed improvements that the Company had been losing customers and was not earning a fair return on the steam facilities, and that steam heat was not competitive. Finally, St. Joseph argued it no longer had a franchise from the city for steam service.

The Commission found that many of SJLP's mains and lines were in disrepair but the system was viable and could be maintained without undue capital investment. The Commission found that St. Joseph's customers were willing to pay the expense of the service

into the foreseeable future. There had been heavy reliance on the system by the steam customers and the decline in the number of customers was due more to urban renewal than customer switching to other sources of energy.

The Commission refused to authorize abandonment in this case. The Commission stated that the total cost of providing heating by alternative sources had not been shown to be less expensive than steam in the immediate or long term future. The Commission denied the application, partly because the Company in calculating the effect on customers of a conversion to gas service did not consider the capital costs of the conversion. As long as customers were willing to pay necessary costs, the Commission stated, it would not authorize termination of service. The possibility of termination in the future was left open depending on the presentation of clear and convincing evidence of the costs involved.

Three years later, the Commission authorized SJLP to discontinue supplying steam service in downtown St. Joseph, once again applying the "reverse analysis of an application for a certificate of convenience and necessity." Re: St. Joseph Light and Power Co., 22 Mo. P.S.C. (N.S.) 180, 182 (1978). The Commission found that all customers but one had received an alternative source of heat, and that the last remaining customer had a suitable alternative available which was at a lower annual cost over the long run than steam service. The Commission also found that the operating costs of the steam system far exceeded revenues anticipated from the service, concluding that continuation was not economically feasible. Finally, the Commission found that discontinuance of service could work no hardship on the public and that the public convenience and necessity did not require continued operation of the steam system.

In the interim between the two applications for authority to discontinue service the Company was granted a significant increase in rates as a result of a Stipulation and Agreement entered into by the Staff and Company and approved by the Commission in SJLP's 1977 rate

case. 21 Mo. P.S.C. (N.S.) 466. (Case No. ER-77-107). This rate increase most likely contributed to the fact that the Company's customer level declined from 155 in 1974 to 16 in 1978 when the Company filed the second application for discontinuance of service.

E. OTHER STATES - STEAM SERVICE

Other jurisdictions have also dealt with abandonment of steam heat facilities.

In Montana, two companies sought to abandon steam heat facilities. Re: Montana States Power Co., 26 P.U.R. (N.S.) 336 (Mont. 1938); Re: Montana Power Co., 84 P.U.R. 447 (N.S.) (Mont. 1949). Both steam heat facilities were built and operated as a by-product of electric generating plants. Those local generating plants were bypassed and were no longer used to supply electricity; thus, the steam heat facilities must carry the cost of their own operations. The Montana PUC found in Montana States that the steam heat facilities had substantial losses and abandonment was not detrimental to the public welfare. The PUC found Montana States was not making a fair return on its steam facilities and its prospective business was highly unfavorable.

In Montana Power the PUC found that to maintain the system would require an 85 percent increase in rates. The loss of customers was continuing. The PUC stated that before a utility was allowed to abandon a facility, it should use every means, including rate increases, to avoid abandonment. In this case the rate increase was too high to be authorized or effective.

The Illinois Commission dealt with the issue in Re: Central Illinois Light Company, 10 P.U.R.3d 173 (Ill. 1955). There the steam heat was also a by-product of local electric generation which was now bypassed. Once the electric generation was gone, the Illinois Commission found that the steam heat facilities had substantial losses. These losses would require substantially higher rates to continue operation. The Commission authorized abandonment but

required the utility to provide propane storage for those customers switching to propane.

The Wyoming Commission addressed the issue in Re: Pacific Power & Light Co., 8 P.U.R.3d 452 (Wyo. 1955). Here also steam was a by-product of electric generation. The Commission found the cost of rehabilitation was too high and the system was continuing to lose customers. The system was impossible to repair and a rate increase of $4\frac{1}{2}$ times present rates would be required for reconstruction.

An Indiana case followed much the same factual situation. Re: Southern Indiana Gas & Electric Co., 61 P.U.R.3d 232 (Ind. 1965). There, the utility was multiservice, with steam heat a by-product of electric generation. Once the local generating facilities were bypassed, steam heat was left to pay for itself. The system was old and was continuing to operate at a loss and would need a 125 percent increase in rates to cover expenses. The Commission looked at future operations, replacement costs, continuing customer decline, the ability of the market to support the required rate increase, and the efforts the utility made to avoid abandonment. The efforts to avoid abandonment were the maintaining of noncompensatory rates over an extended period, and no customers had been refused service. The Commission found the utility had taken all reasonable steps to prevent abandonment. Finally, the Commission found that no substantial public need for the service was shown, and there was a less expensive alternative source of energy.

There have been three North Dakota Commission decisions regarding discontinuance or abandonment of steam heat utility service. In a 1975 Order, the Commission permitted Otter Tail Power Company to discontinue steam service in Jamestown, North Dakota upon a finding that the public convenience and necessity did not require continuance of the service. Re: Otter Tail Power Company, Case No. 8635 (1973) (unreported case, uncertified copy of Findings of Fact, Conclusions of Law and Order attached as Appendix A). The fact situation was similar to the cases previously discussed where steam was a by-product of

electric generation. The Company was experiencing losses and would have required a 21% rate increase to obtain a minimum rate of return on present investment, and a 156% increase to support a rehabilitation through installation of package boilers. No one objected to the abandonment of service, nor was the applicant's contention that it was not economically feasible to continue the service contested. A phase-out of the system was approved, with a compensation plan based upon "disconnect allowances" to be paid by the Company either to the City of Jamestown (which was apparently in the process of analyzing whether to establish a municipal steam heat utility) or to the individual customer. The compensation was in the total amount of \$465,000 to be divided among the 147 customers on the basis of annual steam heat consumption in a 1-year period.

In December of 1968 the Northern States Power Company filed applications with the Commission requesting authority to abandon steam utility operations in the cities of Fargo and Grand Forks, North Dakota. Re: Northern States Power Company, Case Nos. 7529 (Grand Forks) and 7529, Sub 1 (Fargo), 1969 (unreported cases, uncertified copy of Findings of Fact, Conclusions of Law and Order attached as Appendix B and Appendix C, respectively). Once again in both these cases steam was a by-product of electric generation which was no longer needed. In these cases the Commission also found that the public convenience and necessity did not require continuance of operations, that alternate means of heating were readily available to the steam heat users, and that no one objected to abandonment of the steam service, except for a request to extend the abandonment date for one year. The Commission found that significant out-of-pocket costs or losses would result from continuation of operations and that replacement of the source of steam generation would require a significant investment and rate increases of 180 to 192 percent. If such increases were granted, the rates would not be competitive with the alternate fuels available. Again in these instances, the Company

offered to contribute toward the cost of converting to an alternative method of space heating. The Company offered to pay:

- (1) two-thirds of the lowest competent bid for a gas fired boiler in the customers' building, including the cost of constructing an exhaust stack,
- (2) plus contribution for the higher fuel costs on a per boiler horse power unit basis, and
- (3) a percentage "bonus" if the conversions were completed in the first two years of the phase-out to offset the customers' fixed costs and maintenance costs associated with that early conversion.

The Oregon Commission authorized abandonment in similar circumstances. Re: Pacific Power & Light Co., 61 P.U.R.4th 498 (Or. 1984). The steam heat system was a by-product of now-bypassed electric generation plant. The system was old and inefficient. Reconstruction would be prohibitive and only a substantial rate increase would provide adequate revenues. The rate increase was not feasible. The utility agreed to a conversion committee to help phase out the steam heat system.

Most recently, the New York Public Service Commission dealt with the issue of steam operations in downtown Rochester on its own initiative. Re: Rochester Gas & Electric Corporation, Case Nos. 28316 and 28612. (Uncertified copy of Order Issued July 11, 1984 is attached hereto as Appendix D. The Commission found that abandonment was inevitable and that the Company should file a detailed plan for abandoning the system including the extent, if any, to which customers' conversion costs should be defrayed by the Company, accounting treatment of plant retirement, cost of removal and undepreciated investment. The Company alleged that its steam business could not be returned to economic viability due to loss of sales and the high cost of production of steam. The Staff of the Commission contended that steam system could be preserved by converting the generating station from gas/oil to coal and having customers sign

take-or-pay contracts at competitive rates. The Staff argued that unless rehabilitation took place, the system had lost its economic value, a process accelerated by the Company's release of its steam report and encouraging onsite alternatives for customers. The Staff argued for a rate freeze and contended that compensatory rates were not appropriate in the situation.

The Commission rejected the Staff's recommendation that a survey of customers as to interest in the take-or-pay contract service approach but accepted the Staff's recommendation concerning the setting of rates. The Commission stated "faced as we thus are with setting rates for reasonable phase-out period, we are willing to authorize only such revenues as may be necessary, given the existing number of customers, to cover the expenses incurred in providing service (supra, 19). The Commission permitted the Company to cover only out-of-pocket expenses.

In its Order Affirming Abandonment Date issued April 4, 1985, (uncertified copy attached as Appendix E) the Commission makes reference to the financial assistance plan filed by the Company. The chronology of the Rochester steam system transition to a user cooperative is summarized in the Direct Testimony of Staff Consultant Dahlen. (Ex. 28, p. 24-25).

F. CONCLUSION

In determining whether to permit Kansas City Power & Light Company to discontinue provision of central steam service in downtown Kansas City, Missouri, the Commission should determine whether the public convenience and necessity no longer require such service. If some need for continuation is shown, the Commission should weigh this against the financial losses suffered by the Company. Many other factors should be taken into account in reaching the final decision, including determinations as to the viability of continuation of the system (both present and future), whether all reasonable alternatives to discontinuance of service have been considered, whether the customers will be as well or better off with the alternatives

available to steam heat, management efficiency and all other factors relevant to this question. The Commission should also examine the Company's Conversion Plan for appropriateness, including consideration of Staff's position that the Plan violates the Commission's promotional practices rule and interferes with the customer's ability to make a sound economic choice of alternatives. The Staff has analyzed many of the factors applied in the cases discussed above in making its recommendation in this case.

III. TERMINATION ISSUES

A. SUMMARY OF STAFF'S POSITION

Staff recommends that KCPL's termination plan be rejected because it does not meet the standard for authorization of discontinuance. Company has not made a clear showing that the public convenience and necessity do not require the steam system's continuation. The facts of this case show that it is not in the public interest, convenience and necessity to permit KCPL to abandon its steam utility service under the terms of the Conversion Plan filed by the Company. There are still over 120 customers whose convenience and need for heat are still served by central steam. This is evidenced by the fact that they still take steam service. The Company's two largest customers are participating in this case in opposition to discontinuance of the service, which demonstrates an ongoing need. And there is a serious question whether the other group of intervenor customers would support the Company's Plan without the "free boiler" option.

The Company may assert that its Conversion Plan is in the best interests of the Company (the 98% of its business that is electric) and its electric ratepayers. However, this case is an investigation into KCPL's steam operations and the Commission must focus on the effect of the plan on the steam customers, regardless of the fact that they represent only 2% of the Company's operations. Minority though they be, they are still entitled to the protection of this Commission.

KCPL has not made a clear showing regarding non-viability of the system, and did not fully investigate and evaluate available alternatives to discontinuance. Most notably, Company has refused, as a corporate policy, to pursue sale of the system to another entity and has, in fact, rejected any advances by interested purchasers. KCPL also refused to consider natural gas as an alternative for either its generating options or for an on-site heating option for its customers.

The provision of electric boilers and space heating equipment to steam customers is inappropriate both from a regulatory and economic perspective. The plan violates the Commission's rule on promotional practices in that it provides an inducement to the customers to select electric boiler heat in lieu of gas boiler heat in the event the steam system goes out of business. The plan also masks the true economic cost to its steam customers of conversion to electric heating. Absent this incentive, and presented with the requirement of selecting an option to central steam heat, customers would be able to make an economic choice which is best for their specific circumstances.

Also, the evidence does not show that the customers will be as well or better off without central steam service. In fact, if one discounts the provision of up-front capital costs and O&M costs of conversion to electric heat, the electric boiler alternative is the customers' most costly alternative to central steam. Finally, the provision of boilers is not an appropriate method of "compensating" customers for being forced off central steam heat. Although KCPL advocates its proposal to furnish the up-front costs of electric boilers as intended to ease the financial burden for its steam customers, in reality the proposal is nothing more than a business investment decision by the Company. The Company expects to recover the investment in the Conversion Plan fully through electric rates to be charged the customers once they convert.

Two other reasons for Staff's recommendation that the Conversion Plan be rejected are the Company's neglect of management of

the steam system and Company's actions or inactions in the marketing of steam. The failures in the areas of marketing and management have caused the decline in the steam system and the Company should not be rewarded by the Commission with perfunctory approval of the request to go out of the steam business along with a significant rate increase.

Although Staff is recommending that the Commission reject the Company's conversion plan, it is not proposing that KCPL be required to continue in the steam business indefinitely. The Company's neglect of the steam system and efforts to demarket steam heat in favor of electric heat have placed the steam system into a death spiral which KCPL probably could not reverse. The only likely salvation for the steam system is sale of the system to another entity with sufficient expertise and interest to revive the system. Staff believes it was improper for the Company to ignore this option and feels that the option must be considered before the Commission permits abandonment of central steam in downtown Kansas City, Missouri.

The major elements of Staff's recommendation outlined in this summary will be discussed individually in the following sections.

- B. KCPL SHOULD NOT BE PERMITTED TO GO OUT OF THE CENTRAL STEAM BUSINESS WITHOUT FIRST EXPLORING THE OPTION OF SALE OF THE SYSTEM TO ANOTHER ENTITY.

It is uncontroverted in the record that KCPL made a policy decision not to consider sale of the steam system even though a 1981 study by the Company recommended that the sale option be investigated. (Ex. 12, p. 14, l. 3-15, Tr. 159, 4-15, and Ex. 37, p. 40-41). The evidence also shows that KCPL received several inquiries from interested buyers in recent years, and that all such inquiries were greeted by a flat "no". (Tr. 159, 160, 164). As Mr. Mandacina testified, he had difficulty recalling the details of these contacts, but did remember that the conversations were very short because of the Company policy not to consider sale of the system. (Tr. 177-178).

On cross-examination, Company Witness Beaudoin testified that the Company took this position because the customers would not be better off under a new operator since they would have to raise rates

by approximately 70% to maintain a viable operation. (Tr. 102-103). The Staff's case, on the other hand, shows that it is not at all unlikely that a purchaser of the steam system could come in and commence operation, take some short term rehabilitation steps, commence an aggressive marketing campaign, and operate successfully without a rate increase. (Ex. 28, p. 21, l. 3-25). Staff Witness Dahlen testified as to certain areas where a new entity would likely be able to cut costs below those of KCPL and on cross-examination he testified as to other areas where costs could be reduced if the purchaser were a governmental entity. (Tr. 305-306).

It is Staff's position that none of the parties to this case can determine with certainty whether another entity can purchase and operate the system successfully. Certainly KCPL, with its track record of inefficient operation of the steam system, is not in a position to make this determination. By the same token, neither Staff, Commission nor intervenors can say with certainty what would happen if the Company were to solicit offers to purchase the system. Only by going through the sale option will this question be answered, and it will be answered by the marketplace. Staff can see no valid reason for the elimination of central steam service as an energy option for downtown Kansas City customers and the National Starch Company without first investigating this option. KCPL has certainly provided no valid reason to evade this option.

In addition, it is clear that the Company would not be harmed by going through the solicitation process. Company Witness Beaudoin testified that the process would neither be time-consuming nor costly to the Company. (Tr. 102).

In the event the Commission accepts Staff's recommendation and orders the Company to pursue the sale option, Staff has recommended several conditions be placed upon the Company. These include that the Company should solicit proposals for sale or other transfer of the system and conduct negotiations with prospective purchasers, and that KCPL present all proposals and the results of

negotiations to the Commission along with the Company's recommendations regarding those proposals. (Ex. 28, p. 17, l. 13-21). The approach recommended by Staff Consultant Witness Derick Dahlen states that the request for proposals should outline the requirements thereof, including proposer's qualifications, the sale price, the approach to providing steam service, steam rates to be charged, and disposition of Grand Avenue Station. In addition, it is stressed that although proposers should be given sufficient time to prepare their bids, the process should be conducted as expeditiously as possible. (Ex. 28, p. 22, l. 1-13). The Company did not directly respond to nor challenge the specifics of this recommendation.

C. KCPL HAS NOT SHOWN THAT THE STEAM SYSTEM IS NOT VIABLE.

In terms of the physical condition of the steam system, it is obvious that the system is capable of continuing to provide safe and adequate steam service at least until 1990 in its present physical condition. The Company's phase-out of service plan would have required them to continue serving some customers until that date, and their revised proposal does not specifically mention any phase-out dates, but does still request a termination date of 1990. (Ex. 13, p. 3, l. 1-12). The study conducted by Staff engineering consultants from HDR Techserv indicates that the low pressure distribution system is in poor condition, (Ex. 34, p. 16, l. 9-11) the high pressure distribution system is in relatively good condition, (Ex. 34, p. 15, l. 10-11) and the generating facilities are usable although oversized and inefficient. (Ex. 34, p. 13, l. 17- p. 14, l. 1).

Staff asserts that the only true test of viability of central steam for downtown Kansas City is to have the Company solicit proposals to purchase the system and determine whether entities with experience, expertise and interest in this area are willing to purchase the system and make a viable business of it. (Ex. 19, p. 2, l. 1-6, Ex. 40, p. 2, l. 23-27 and Ex. 30, p. 2, l. 20-24). As stated in the rebuttal testimony of Staff Witness Oligschlaeger,

the taking of bids for sale of the system would be a "market" test of the viability of steam service

in downtown Kansas City, and would insure that the heating options of steam customers in Kansas City are not prematurely foreclosed simply because KCPL wishes to increase its electric revenues.

(Ex. 40, p. 3, l. 9-13).

KCPL's poor record of management of the steam system shows that they are not a good judge of viability. The Company wants to sell electricity and get out of the steam business, and has had this intent for a number of years. Any lack of viability of the steam system is probably largely due to the Company's action and inaction. Their lack of planning, failure to deal with steam losses expeditiously and efficiently, and demarketing of steam have all contributed significantly to the current physical and financial condition of the steam operations.

Staff's evidence shows that other central district heating systems throughout the country are thriving, and that district heat is enjoying a revival in this country. (Ex. 28, p. 24-26; Ex. 18, Sch. 2). Staff Consultant Dahlen's prepared testimony listed nine major district heating systems that have been sold since 1979. In the majority of the sales, the systems had been experiencing significant load losses prior to the purchase. In the period subsequent to the purchase, the operations have been successful. (Ex. 28, p. 22-26). Staff Witness Featherstone's rebuttal testimony addresses the recent sale of the central district heating system in downtown St. Louis, Missouri, a transaction which was approved by this Commission. His rebuttal testimony contains information concerning the St. Louis system, and also two other systems owned by Catalyst Thermal and their load factor experiences as compared to KCPL. (Ex. 15, p. 2-6). Finally, Staff Witness Oligschlaeger's surrebuttal testimony makes reference to the recent sale of the Harrisburg, Pennsylvania steam system. (Ex. 40, p. 3, l. 4-9). There were six bidders interested in purchasing the facilities from Pennsylvania Power & Light. (supra, Sch. 1-1).

It is also a matter of record that KCPL received inquiries expressing interest in purchase of the system as referred to in

Schedule 32-2 of Exhibit 37. All this evidence shows that there is some potential for viability of the central steam system in Kansas City, Missouri. Finally, the Company itself acknowledged the value of a central steam system to the economic development of the downtown area in testimony filed by Company Witness Mandacina before this Commission in May of 1983. (Ex. 17, Schedule 4-5, l. 14-20). It is interesting to note that less than three years later the Company has apparently determined that the service is no longer so valuable.

Company Witnesses Mandacina cited to differences in natural gas prices and landfill costs (Tr. 152-153), but was unable to adequately explain why central steam is viable in these other locations, but not in downtown Kansas City. Staff's assessment of the situation is that the lack of viability argued by KCPL is merely a self-fulfilling prophesy based on the Company's intent to make central steam non-viable in downtown Kansas City.

The engineering study performed by Staff Consultant Witness Miller shows that a short-term rehabilitation program would cost approximately \$2.675 million. (Ex 31, p. 12, l. 14). The Company is willing to spend more than ten times that much to implement their conversion plan. (Page 2 hereof and Tr. 67).

D. THE EFFECT OF KCPL'S CONVERSION PLAN ON ITS CUSTOMERS WILL NOT LEAVE THEM AS WELL OR BETTER OFF AS WITH CENTRAL STEAM.

The termination of central steam service will be disruptive and inconvenient for KCPL's customers. Company does not deny this fact. (Ex. 12, p. 15, l. 3-6). Staff Consultant Witness Fuller has pointed out several inconveniences that could be avoided if central steam service was continued, including maintenance of heating equipment, management of personnel to operate and maintain equipment and the necessity of making fuel purchases. (Ex. 34, p. 9, l. 6-8). In addition, the rebuttal testimony of Staff Witness Featherstone includes a publication by Catalyst Thermal which outlines the benefits of district heating and cooling. (Ex. 18, Sch. 2-63 and 2-64). Certainly, some of those intangible benefits must be a significant factor in retaining some of the current customers, such as Kansas City

Southern Industries, whose Witness Albert Mauro testified that that Company had not even examined alternatives to central steam until the Company presented its conversion plan. (Tr. 421, l. 16-22). This is despite the fact that KCSI, according to Mr. Mauro, was constantly reviewing the energy needs and efficiency of their buildings. (Tr. 446-447).

There is contradictory evidence in the record as to the results of a comparison of costs of energy only without the capital cost of on-site boilers. It is Staff's position that even on an energy cost only basis electric boilers are the most expensive option for customers. (Tr. 506-507). However, Staff recommends, and Commission precedent would indicate, that the total conversion cost, including the capital expenditure and operation and maintenance of equipment be considered in determining the effect of discontinuance of utility service on customers. Re: St. Joseph Light & Power Co., 22 Mo. P.S.C. (N.S.) 180 (1978). Because of this precedent, along with the fact that the the provision of up-front capital costs of on-site boilers is a violation of the promotional practice rule, and the "masking" effect the offer of those up-front capital costs, Staff's analysis of the comparative costs and comparative positions in which the utility customers would be left includes the capital cost of electric boilers.

The testimony of Staff Consultant Witness Dahlen shows that the Company's plan to provide "free" boilers to the steam customers masks the true economic cost of the conversion to the customer. (Ex. 28, p. 12, l. 2-5). Because of this offer, the customer is unable to make a choice which considers all the factors of the conversion, including energy costs, capital costs, operation and maintenance costs, and other expenses which may be incurred as a result of the conversion. Mr. Dahlen analyzed the true costs including all these elements of central steam heat, on-site gas boilers, and on-site electric boilers. This analysis showed that the continuation of central steam service was the most economical for the

customers and on-site electric boilers was the most expensive alternative. (Ex. 28, p. 37, l. 16-25). Company Witness Levesque's rebuttal analysis also shows that the electric option is the most expensive of the three options studied - central steam, on-site gas boilers and on-site electric boilers. (Ex. 4 to Ex. 35 and Ex. 30, p. 15, l. 18-22).

Furthermore, it is not possible to quantify the intangible "costs" which will be imposed on the customers. These intangible costs are the converse of the intangible benefits described above. Thus, the Company cannot show that the customers as a group will be as well or better off without central steam service.

E. THE COMPANY HAS NOT EXAMINED ALL REASONABLE ALTERNATIVES TO DISCONTINUANCE OF CENTRAL STEAM SERVICE.

The steam conversion study presented by the Company with its direct testimony purports to analyze 29 alternatives and indicates that the Company's Conversion Plan is the one in the best long-term interest of the steam customers. (Ex 12, Sch 1, Revision to Report p. 1). The Staff's evidence shows several alternatives which were not considered by the Company and the record reveals several alternatives studied which were not reasonable or were not thoroughly examined. The most significant omission is the Company's refusal to consider the option to sell the system, which was addressed in Section F above.

The next most significant omission was the failure to consider natural gas, both for central steam generation and for on-site boilers for the customers. The Company's study of installing electric boilers at Grand Avenue Station shows a capital cost of approximately \$5.35 million. (Ex. 12, Sch. 1, p. 5.8). Staff Consultant Witness Miller's study shows that gas/oil fired package boilers at Grand Avenue would require a capital expenditure of \$3.2 million. (Ex 31, p. 6, l. 9-16). Staff asserts that it was not reasonable for the Company to eliminate natural gas as an option for supply of steam in light of current rates and supply factors, the higher capital and energy costs of electric boilers and the fact that the Grand Avenue Station boilers are currently run on natural gas.

Staff perceives this as one more instance of the Company's focus on making more money selling electricity to those customers than they can selling them steam.

KCPL's failure to consider gas fired on-site boilers for its customers was not in the best interest of its customers. The Company directed its energy audit consultant not to look at gas as an alternative, but only to examine the parameters for electric boilers. (Ex 42, p. 27, l.13-17). The Company openly admitted their reason for this approach when Company Witness Beaudoin stated "The Company doesn't offer gas." (Tr. 91). Staff Consultant Witness Dahlen's testimony shows that gas fired on-site boilers would be a better economic choice for the average customer than an electric on-site boiler. (Ex. 28, p. 37, l. 16-25).

Finally, some of the alternatives examined are of questionable appropriateness, such as the option of centralized electrode boilers which would serve several large customers near or adjacent to the government complex of buildings, but not to those government buildings. (Tr. 88-89) Another problem with this alternative was the intention to utilize an electrode boiler rather than a gas/oil fired boiler. (Tr. 91, l. 8-11).

F. KCPL HAS MISMANAGED ITS STEAM OPERATIONS

Staff's testimony shows clearly that KCPL has seriously neglected its steam operations over the years as examined from several perspectives. Staff Consultant Witness Fuller testified that the current physical condition of the steam distribution system is due to the Company's failure to implement a planned maintenance and replacement program for the steam pipes. (Ex 34, p. 20, l. 5-23). He also testified that the Company should have been examining options to the Grand Avenue Station boilers for steam generation in the same time frame that the Company was intending to phase out electric generation at Grand Avenue. (Id., p. 19, l. 17 - p. 20, l. 4). Mr. Fuller's testimony went virtually uncontested, and he was not cross-examined by the Company. (Tr. 339). Mr. Fuller also testified as to the

significant amount of steam losses experienced by the Company and the Company's inattention to these losses until they reached an unacceptable level. (Ex. 34, Sch. 1-31). Staff Witness Tooey analyzed the Company's experiences with losses on the customer's premises. (Ex. 44, p. 4, l. 1-2) Both these Witnesses addressed the cost of such losses to the Company. As stated by Mr. Fuller, "It takes as much fuel to generate a pound of steam lost as a pound sold." (Ex. 34, Sch. 1-31).

Company Witness Mandacina admitted that the Company experienced "higher steam losses resulting from inadequate maintenance." (Ex. 37, p. 14, l. 14-15). Company Vice-President J. R. Miller acknowledged that the steam system's "step-child" status as to operation and maintenance was "generally agreed". (supra, p. 10, l. 19-26). Staff Witness Bernsen interviewed Company officials who had been responsible for operation of the steam system in the early to mid 1980s and learned from those Company employees the very limited nature of management attention that has been given to the steam operations over the years. (Ex. 45, p. 8-9).

Shortcomings were also detected in the areas of long-range planning, maintenance activities and marketing efforts, as well as inattention to installation of management systems for the utility system. These are discussed in the direct testimony of Staff Witnesses Bernsen and Oligschlaeger (Ex. 45 and Ex. 37, p. 5-24) and Staff Consultant Witness Fuller (Ex. 34, p. 21, l. 18 - p. 22, l. 18 and Sch. 1-32 through 1-35).

- G. KCPL HAS NOT MADE AN EFFORT TO MARKET STEAM SERVICE ON ITS DOWNTOWN STEAM LOOP. IT HAS MARKETING STEAM AS A SECONDARY HEATING ALTERNATIVE TO ELECTRICITY AND SINCE 1980 HAS FOLLOWED A COURSE OF ACTION THAT CAN ONLY BE CHARACTERIZED AS DEMARKETING. FURTHERMORE, STAFF HAS PRESENTED EVIDENCE DEMONSTRATING THAT KCPL HAS BEEN ENGAGED IN DEMARKETING ACTIVITY SINCE 1972.

It is Staff's position that KCPL has not made an effort to market steam utility service on its downtown steam loop. Although KCPL improved the condition of its steam system in the early 1980s, Staff contends that KCPL continued to market steam as a secondary

alternative to electric heat. In fact, it was KCPL's policy to actively pursue off-peak electric load during this time frame. Since steam is one of three heating alternatives available in downtown Kansas City, it is imperative that it be marketed as vigorously as gas and electricity. Further, marketing is vital for the successful operation of a steam business. The expenses associated with administrative and general personnel, operating and maintenance personnel, distribution maintenance, return on investment, and depreciation are all essentially fixed. (Ex. 28, p. 12). Thus, additional sales are necessary to spread these fixed costs over more Mlbs. In short, an aggressive marketing program would have helped ensure the success and viability of downtown steam service in Kansas City.

The evidence presented in this case supports Staff's contention that KCPL has not vigorously marketed steam. KCPL did not have a formal steam department until 1982 and does not have any employees whose sole responsibility is to market steam. (Tr. 171). All of the other district heating systems surveyed by Staff have personnel responsible for marketing steam. (Ex. 28, p. 13). Twelve of these systems have personnel dedicated exclusively to the marketing of steam. (Id.). These twelve systems have an average of 1.8 employees whose sole function is to market steam. In contrast, it has always been KCPL's policy to use the same individuals to market both steam and electricity. (Ex. 42, p. 7).

Mr. Robert Graham, KCPL's Director of District Commercial Operations, gave the following answer to a Staff Data Request inquiring as to the type discussions KCPL has had with builders and developers regarding alternate heating sources in the post-1980 time frame:

There was usually discussion among the owners, developers and their consultants on their choice of heating energy. In all cases, KCPL provided rate schedules and, in some cases, actually did the rate calculation on whatever sources were being considered. In some cases the owner or his representative would want a comparison made of steam versus electric. In other cases the owner

or his consultant would have pretty much made up their mind before we had an opportunity to have any input.

(Ex. 21).

Mr. Graham testified that this answer contains a general description of KCPL's approach to marketing steam. (Tr. 208). In Staff's view, this is not an aggressive approach. It appears that KCPL's steam marketing effort consisted of no more than presenting customers with rate schedules and providing rate comparisons when requested by customers. If a potential customer appeared to have made up its mind, KCPL did not pursue the matter. Thus, many potential customers were not made aware of the intangible advantages of steam discussed in the testimony of Staff Consultant Philip E. Fuller. These intangible benefits include factors such as convenience, reliability, enhancement of the marketability of older buildings and architectural freedom in the design of new buildings. (Ex. 34, p. 9). Staff maintains that these are items that would be of interest to a builder or developer considering heating alternatives.

Staff's investigation in this case revealed that not only has KCPL deemphasized the marketing of steam service, since 1972 it has been engaged in activity that can only be termed demarketing. In a Memorandum to File, dated June 28, 1972, discussing possible service to the new Mercantile Bank Building, Mr. Graham stated that he told a consulting firm involved with construction of the building "that steam might not be available for this project and that they should very seriously consider going total electric." (Ex. 42, Schedule 8-3).

Mr. Graham filed rebuttal testimony stating that Staff has misinterpreted this memorandum. (Ex. 16, p. 7). However, attempts by Staff through Data Requests to get a clear explanation from Mr. Graham as to what he meant by his statement were unsuccessful. In a March 13, 1987, meeting with Staff, Mr. Graham stated that the statement could possibly have been in reference to some concerns KCPL had regarding the capacity of the steam distribution system and the impact Mercantile's line extension would have on the system. (Ex. 43,

p. 9). He also stated at this meeting that it was unlikely that there was a study, analysis or report documenting this. (Id.). It was later verified in a Data Request that no such documentation exists. (Id. at Schedule 4).

On April 3, 1987, Mr. Graham provided rebuttal testimony claiming that the statement in his 1972 memo was in reference to the fact that "[t]he old desuperheating stations used to supply low pressure steam were operating at or near their capacity." (Ex. 16, p. 7). Staff finds it noteworthy that Mr. Graham was unable to recall this at a meeting just three weeks prior to the filing of his rebuttal testimony and that KCPL produced no documentation supporting Mr. Graham's rebuttal testimony. Further, Staff was unable to find any documentation during its investigation indicating that KCPL was concerned about the system capacity of the desuperheating stations in 1972. It is only reasonable to expect that documentation would exist if there had been a legitimate concern about something as vital as the capacity of the system.

Staff believes the memorandum speaks for itself and provides evidence that KCPL was directing its marketing efforts toward electricity at the expense of steam as early as 1972.

Mr. Graham's memorandum is by no means the only evidence of KCPL's demarketing of steam. In a memorandum from Mr. J. M. Evans, KCPL's Director of System Planning to Mr. J. R. Miller, Vice President Administration, dated January 21, 1981, the possibility of serving the Jackson County Jail and Corn Products Corporation (hereinafter "CPC") with steam was discussed. (Ex. 22). Mr. Evans noted that Jackson County Jail could easily be served by existing facilities and further stated that he did "not believe service can be refused. This has been discussed with the Law Department and the Rates Department, and both concur with this opinion." (Id.). This indicates that KCPL considered not serving the Jackson County Jail and went as far as asking its Rates and Law Departments to explore the question of whether it could refuse steam service. This certainly is not the type

of approach one would expect from a company dedicated to marketing steam.

In discussing whether to serve CPC, Mr. Evans stated that "[n]ew market penetration together with this obligation to serve should be discouraged at this time." (Id.). KCPL's reluctance to serve CPC is confirmed by the following testimony of KCPL's Chief Executive Officer, Mr. Artnur Doyle, in Commission Case No. ER-83-49 wherein Mr. Doyle described KCPL's negotiations with CPC:

Our immediate reaction a couple of years ago was no way do we want to get involved in expanding our service area or taking on a large load of this magnitude, 250,000 lbs. per hour, added on to our existing steam heat load. They kept coming back. They said we'll build to you. But the discussions never got serious until last summer, when we said can you take an interruption; can you be an interruptible customer? And they went back to the drawing boards and came back and said, yes, we can. That's when the discussions got serious then. And we started negotiations.

(Ex. 43, Schedule 5-1).

Thus, again, KCPL demonstrated that its approach to steam was one of demarketing rather than marketing. This takes on great significance with a large baseload customer like CPC. The following testimony of Mr. Graham indicates the importance of a large baseload customer for KCPL's steam system:

- Q. What is the significance of having a large base load steam customer on a system such as Kansas City Power & Light Company's steam system?
- A. [Mr. Graham] Well, to give you base load, to give you load around the clock every day of the year. And this was very significant in that the operation of the plant was much more efficient. It brought the load levels up to where you could burn coal year round and lower your fuel costs significantly. You could spread the cost of operating the plant and the system over a greater number of pounds, therefore, reducing the cost for each pound.
- Q. So would you agree that a customer such as Corn Products was a very positive thing for the system as well as for the other customers of the system.
- A. Yes, I would.

(Tr. 209).

Despite the fact that connecting CPC would have increased the baseload of the steam system, KCPL discouraged the connection of CPC. CPC eventually became a steam customer of KCPL but only after it agreed to be an interruptible customer and pay the costs of connection to the system.

The fact that CPC was outside of KCPL's certificated steam territory indicates that not only was KCPL uninterested in adding customers within its service area, it was also reluctant to extend its service area to serve a large baseload steam user.

Mr. Evans concluded his memorandum by stating that "[u]ntil such time as the Company develops a strategy for the future of the existing steam system, it is System Plannings' recommendation that KCPL's obligation to provide steam service not be expanded." (Id.).

Mr. Evans' memorandum tends to contradict the testimony of Company Witness Mandacina who testified that he spent six or seven months in 1982 trying to secure CPC as a steam customer.

A further example of KCPL's unwillingness to extend steam service to new customers is provided in the testimony of Intervenor Witness Albert P. Mauro. Mr. Mauro testified that he was previously employed as the administrator of the Truman Medical Center. (Tr. 448). Mr. Mauro stated that in the course of his employment he inquired of KCPL as to whether Truman Medical Center could be connected to the steam system. (Id.). He was told by KCPL that it would be too costly to extend the system to Truman Medical Center. (Id.).

Staff also provided evidence indicating that KCPL considered not providing steam service to the new Vista Hotel. The Vista eventually became a KCPL steam customer. On February 15, 1980, Mr. Mike Reiter, a KCPL Service Engineer wrote the following memorandum to Mr. Lynn Freeman, KCPL's Superintendent of Electrical Engineering:

We have the capability of delivering a steam demand of 35,000 lbs./hr. to the [Vista] hotel from our 185# high pressure transmission line; but, the production of steam at Grand Avenue

Station could be a problem in the not too distant future. We have referred this problem to Leon Boyce and he has indicated that an executive policy decision will be necessary before any commitments can be made.

(Ex. 42, Schedule 10-3).

Thus, KCPL could not commit to serve the Vista absent an "executive policy decision". Staff submits that if an executive policy decision was required before a commitment to serve could be made, it follows that KCPL seriously considered not providing service to the Vista. Moreover, an earlier internal KCPL memorandum addressing an inquiry from the Vista regarding steam service states that "we would propose to answer [the Vista's inquiry] that we do not have the firm capability to serve this load." (Id. at Schedule 10-2). This was apparently before KCPL investigated whether it had the capacity to serve the Vista.

Despite this evidence, KCPL maintains that it has done nothing to discourage potential customers from receiving steam service. (Ex. 42, Schedule 11-2).

As a result of KCPL's efforts to demarket steam service, rumors began to circulate in downtown Kansas City that the future of central station steam service was in doubt. To alleviate these concerns, on May 5, 1982, Mr. J. A. Mayberry, KCPL's Vice President of Commercial Operations wrote a letter to the steam customers in which he stated:

Contrary to some rumors, KCPL has no plans to abandon or terminate its Downtown utility steam service. In fact, quite the opposite is true. Witness our recent commitments to supply utility steam service to the new Vista Hotel, as well as the new Jackson County Jail.

(Id. at Schedule 12-1).

Staff finds it ironic that KCPL pointed to the Vista Hotel and the Jackson County Jail as evidence of its commitment to steam service when the evidence demonstrates that KCPL considered not serving these customers.

In the early 1980's, the period when KCPL began to actively demarket steam, KCPL shifted its marketing emphasis to off-peak

electric sales. The following testimony of Mr. Graham illustrates the inherent conflict between the marketing of off-peak electricity and the marketing of steam service:

Q. Mr. Graham, just for the record would you briefly explain the term "electric load"?

A. [Mr. Graham] The electric load here we're talking about the demand on the electrical system.

Q. And would you explain the term "steam load"? Am I correct in saying that its demand on the steam system?

A. Yes.

Q. When is your period of peak steam load?

A. During the coldest part of the winter.

Q. And when is your period of off-peak electric load?

A. During the winter, some time -- not necessarily the same time. Probably our lowest peak demand on electrical system is in the fall or the spring.

Q. But the period of off-peak electrical load does overlap with your period of peak steam load?

A. That's correct.

Q. Am I correct then in stating that conversion of steam customers to electric customers would increase off-peak electric load?

A. If that were to occur, yes.

(Tr. 219, 220).

Thus, the marketing of off-peak electric sales is in direct conflict with the marketing of steam service. Staff does not mean to imply that there is anything improper with the marketing of off-peak electricity. However, Staff does not believe that off-peak electricity should be marketed in a manner that is detrimental to the steam system.

ECPL's Marketing Dimensions Report - Heating, prepared in February of 1983, stated that one of ECPL's marketing goals was to "[i]mplement strong and well directed marketing programs which will improve customer awareness and build off-peak electric heating sales in a timely and cost effective manner." (emphasis added). (Ex. 42,

Schedule 15-3). The report further stated that "[c]ommercial operations personnel are trained and will sell electric heating during all their contacts with builders, contractors, designers and, of course, with individual customers." (emphasis added) (Id. at Schedule 15-7). As stated earlier, the same KCPL personnel are responsible for the marketing of both steam and electricity.

Further, Revision One to the KCPLAN, prepared in February of 1984, states that the development of programs to encourage off-peak electrical usage was a fundamental goal of KCPL. (Ex. 24). Mr. Graham testified that KCPL's long term goals are contained in the KCPLAN. (Tr. 218).

One of the objectives stated in KCPL's Functional Plan for 1985-86 is the conversion of the "maximum number of steam customers to electric heat". (Ex. 42, Schedule 21-4). Mr. Graham testified that Functional Plans set "the goals and objectives that you're trying to accomplish." (Tr. 204). Thus, KCPL stated in a formal planning document that one of its objectives in the 1985-1986 time frame was to convert steam customers to electricity. Staff submits that this is clear evidence that KCPL's approach to steam service was one of demarketing.

KCPL's corporate policy of promoting off-peak electric use at the expense of steam is reflected in other KCPL documents. In an August 3, 1984 memorandum to various KCPL officials, including Mr. Doyle, Mr. Bernard J. Beaudoin, KCPL's Vice President, Finance, stated that "KCPL wants to retain the downtown steam customers as 'energy customers' of KCPL". (Ex. 25). To achieve this goal, Mr. Beaudoin recommended that the Commercial Operations Division undertake a "detailed marketing study of the downtown steam customers to develop a plan for converting these steam customers to electric energy as a primary source of their energy requirements." (Id.). Mr. Beaudoin also noted that "KCPL will no longer encourage the connection of 'new' steam customers to the downtown network." (Id.). It appears from Mr. Beaudoin's memo that KCPL was not interested in

devoting marketing attention to its steam customers until they were seen as having value to the electric operation.

Similarly, KCPL's Utility Steam Operations 1984 Progress Report, dated March 1985 stated that "[w]ith word that future sale of steam across the Missouri River was uncertain, the decision to no longer connect steam customers was implemented." (Ex. 38, Schedule 6-7).

Mr. Graham denied on cross-examination that KCPL's marketing effort was focused on off-peak electricity in the early 1980's. (Tr. 213, 214). However, he is contradicted by an answer he gave to a Staff Data Request wherein he stated that KCPL's marketing emphasis turned to electric heat during this time frame. (Ex. 42, Sch. 14-3).

Staff believes that KCPL's inadequate marketing of steam and the resulting rumors about the future of the steam system contributed to the decline in the number of steam customers from 1980 onward. KCPL's failure to market steam and its unwillingness to expand its steam system apparently raised questions in the minds of customers and potential customers about the viability of the system. The perception of KCPL's customers regarding the future and viability of the steam system undoubtedly affected their decisions about whether or not to remain steam customers. In short, KCPL's actions regarding the marketing of steam did nothing to instill customer confidence in the viability of the steam system. To the contrary, KCPL's demarketing efforts discouraged the connection of potential customers and caused uncertainty among existing customers regarding the future of the system. This provides a further example of KCPL's inattention and mismanagement of its steam system.

H. KCPL'S PROPOSED CONVERSION PLAN VIOLATES COMMISSION RULE 4 CSR 240-14.020, ENTITLED PROMOTIONAL PRACTICES. THE CONVERSION PLAN DOES NOT CONSTITUTE AN EXCEPTION TO THE RULE. SIMILARLY, THE PLAN PROPOSED BY KPL GAS SERVICE VIOLATES THE PROMOTIONAL PRACTICES RULE.

As the Commission is aware, KCPL has proposed to discontinue steam service in downtown Kansas City and to that end has introduced a

Conversion Plan that it claims alleviates the hardship that termination will cause its customers. The Conversion Plan proposes to discontinue central station steam service in 1990 and terminate all steam service by December 31, 1995. As part of its proposal, KCPL has proposed a phase-out plan and has offered to provide on-site heating equipment in the form of either electric steam boilers or electric space heating equipment. Under the proposal, steam customers that opt to have on-site electric boilers installed will continue to be treated as steam customers and served under the applicable steam tariffs until they purchase the equipment, or until December 31, 1995, when ownership passes to the customer. Therefore, KCPL's electric rates will not apply until ownership of the on-site electric boilers passes to the customer. Those customers that choose electric space heating equipment will be billed at the appropriate electric space heating rate when the equipment is installed. As part of its plan, KCPL installed test boilers on the premises of certain customers and contracted to have building energy use studies performed to determine the appropriate size of the on-site equipment.

It is Staff's position that the Conversion Plan violates the Commission's rule on Promotional Practices. Commission rule 4 CSR 240-14.010(5)(C) provides the following definition of a Promotional Practice:

[A]ny consideration offered or granted by a public utility or its affiliate to any person for the purpose, express or implied, of inducing such person to select or use the service or additional service of such utility, or to select or install any appliance or equipment designed to use such utility service.

The public utilities subject to the rule are gas and electric utilities. 4 CSR 240-14.010(1). Under the definition contained in 4 CSR 240-14.010(C), the rule also applies to affiliates of gas and electric utilities. An "affiliate" is defined as "any person who, directly or indirectly, controls or is controlled by or is under common control with, a public utility." 4 CSR 240-14.010(A). The rule defines "person" as "any individual, group, firm,

partnership, corporation, association or other organization". 4 CSR 240-14.010(E).

Under the definitions just cited, KCPL's steam system is clearly an affiliate and thus, subject to the rule. The steam operation is an affiliate because it is under the direct control of an electric utility, namely KCPL. (Ex. 49, p. 3). It is located in KCPL's Internal Services and Steam Operations Department and appears on KCPL's organizational chart under the Vice President of Operations. (Id.).

Staff maintains that KCPL's Conversion Plan violates sections 5 and 6 of 4 CSR 240-14.020. These provisions state:

(5) The provision of free, or less than cost or value wiring, piping, appliances or equipment to any other person is prohibited, provided that a utility, engaged in an appliance merchandising sales program, shall not be precluded from conducting legitimate closeouts of appliances, clearance sales and sales of damaged or returned appliances.

(6) The provision of free or less than cost or value, installation, operation, repair, modification or maintenance of appliances, equipment, wiring or piping of any other person is prohibited.

The Conversion Plan violates 4 CSR 240-14.020(5) since it would provide steam customers with free or less than cost or value electric equipment. It violates 4 CSR 240-14.020(6) since it would authorize the installation and maintenance of electric equipment at no cost to the steam customers. (Id., at 3).

KCPL's Conversion Plan is obviously designed to induce its steam customers to convert to electric heating. (Ex. 49, p. 4). KCPL's present steam customers will be required to seek a different source of heating if the present central station steam plant is phased out and retired as KCPL is proposing to do. The Conversion Plan promotes electric service by offering to supply, install and maintain electric equipment at no cost for these customers. (Id. at 4). Absent the Conversion Plan, each customer would have to investigate the alternate sources available to meet their heating requirements. The customer would be in the position of evaluating each option based

on the total cost of conversion and would not be induced toward the electric option. (Id.). Staff maintains that this is especially important in light of the fact that Staff's investigation revealed that electricity has the highest total cost of any alternative. (Ex. 28, p. 38).

KCPL claims that it is offering the Conversion Plan as a means of alleviating the financial burden to its steam customers of converting from central station steam service to an alternate heating source. (Ex. 15, p. 4). Staff submits that the evidence in this case demonstrates that this is not true. To the contrary, the evidence shows that the Conversion Plan is designed to induce KCPL's steam customers to choose electricity as an alternative heating source to steam. (Ex. 54, p. 2).

In other words, Staff believes that the Conversion Plan is, in reality, an investment strategy. (Id. at 3). This is indicated by a report entitled Conversion of Downtown Steam System dated August 28, 1984, which states:

The cost of installing electric boilers and the related wiring on the customer's property is in the order of \$6.35 million. The expansion of the electrical distribution system to carry this new load is in the order of \$3 million, making a total of \$9.35 million. This assumes that the company is willing, and could obtain commission approval, to pay for the installation of the customer utilization equipment. For this investment, the company can pick up a maximum of 100 MW of winter load and annual KWH sales of 177,000,000 KWH. The winter consumption would be 160,000,000 KWH. At the newly filed price of 3.25¢ per KWH, the winter revenue would be \$5,200,000. The summer consumption would be 16,000,000 KWH and at the filed water heating rate for 1985 of 5.91¢/KWH the revenue would be \$945,000. The steam distribution maintenance cost would also be eliminated. In 1983, this cost was \$720,000, and \$433,000 the first seven months of 1984. (emphasis added).

(Ex. 46).

Thus, KCPL, under the guise of the Conversion Plan, determined that it would make an initial investment of \$9.35 million in electrical equipment and electrical distribution system upgrades to receive what it believed would be approximately \$6.145 million in annual electric revenues.

Moreover, the evidence indicates that in 1984 KCPL believed that it had to do something to promote electricity over gas or face the possibility of losing these customers to KPL Gas Service. The Conversion of Downtown Steam System report expressed this concern when it stated:

The average price of steam on the KCPL downtown system is now about \$12/Mlb. At the present gas price, steam can be produced with a gas-fired boiler at a cost of under \$10/Mlb. The removal of electric generation from the Grand Avenue plant, and the necessary related increase, would drive the cost of steam even further above the competitive price. These facts make it apparent that we must find an alternate method of selling heat to these customers, or lose this business to the Gas Service Company over the long run. (emphasis added).

(Id.).

The report also addressed the question of whether KCPL could compete with KPL Gas Service if the steam customers had to bear the costs of converting to an alternate heating source. It stated:

It is estimated that these steam customers utilize only about 1,000 BTU/lb. At the \$12/Mlb price, it is equivalent to 4c/KWH electricity. This is energy only, with no capital costs or maintenance costs. The cost to convert a building from KCPL steam to natural gas would be about the same or less than converting to an electric boiler if the stack were not a problem. It would be nearly impossible to get a stack up and out of some buildings. The energy cost at \$4.80/MCF for natural gas at 80% efficiency is about \$6/Mlb, equivalent to electric boilers utilizing 2c/KWH electricity. It does not appear that we would be competitive in this market if the customer has to sustain any of the conversion costs and could overcome the stack problem. (emphasis added).

(Id.).

Mr. Graham testified that the conclusions expressed in the Conversion of Downtown Steam System Report have changed. (Tr. 412). He stated that the price of electricity has stabilized and the price of gas is rising. (Id.). Therefore, he said that he believes KCPL would be more competitive with KPL Gas Service today than it was when the report was prepared. Mr. Graham's testimony conveniently ignores the increase in rates that will be phased-in as a result of Wolf Creek. Customers exploring the alternative of installing electric

boilers or electric space heating equipment at their own expense would surely consider the cost of electricity.

The evidence is clear that KCPL believed that it was in danger of losing its steam customers to KPL Gas Service. Consequently, KCPL developed its plan to supply, install and maintain on-site electric equipment to serve the heating needs of its steam customers. This is confirmed by the minutes of a steam meeting held on August 31, 1984 which state:

The report of the Steam Committee on the Conversion of the Downtown Steam System dated August 24, 1984 was reviewed and discussed. It was decided that we should pursue a plan to convert the downtown steam system to steam and heat supplied by electricity.

. . . .

After discussing the probability of success with various marketing approaches, it was agreed that the market plan would include an arrangement wherein the company would supply and install all of the equipment at each customer location necessary to provide the heating or steam service. This concept allows the customer to be told that we are abandoning the steam distribution system, but continuing to supply steam service with company-supplied equipment. This plan would have to include a provision wherein the customer would be responsible for operating and maintaining the system, and would eventually take ownership of the equipment and be an electric heating customer rather than a steam customer. (emphasis added).

(Ex. 42, Schedule 27-3). As Staff has emphasized, this plan is in clear violation of the Commission's Promotional Practices rule.

Conspicuously absent in all these internal KCPL documents is any mention of a concern to alleviate the costs to its steam customers of converting to an alternate heating source. Instead, the emphasis is on retention of these customers by converting them to electric heat. Apparently KCPL is interested in helping its customers only if it ultimately receives a benefit for doing so. If KCPL's concern for its customers was genuine, it would be indifferent to the heating source its customers utilized as long as the alternative chosen was in the customer's best interest. Staff asserts that if KCPL was truly interested in alleviating the burden that abandonment of the steam system would cause its customers, it could simply provide each

customer with a cash outlay and allow them to spend it on the heating alternative that best suits their needs.

Another alternative KCPL could pursue if it was genuinely concerned about its customers would be to leave steam rates at their present level, thereby giving customers relief from the high cost of steam while allowing them time to examine the available alternatives. (Ex. 50, p. 4). Instead, KCPL is proposing to phase-in a steam rate increase of 13.5% per year over the next four years. The phase-in will have a significant effect on the steam customers that have chosen on-site electric boilers because they will pay higher operating costs as the steam rates increase. (Ex. 49, p. 11). When steam rates reach the point where they are higher than electric rates there will be a strong incentive to buy the boilers and be charged the electric rate. (Id.). Therefore, it is Staff's position that, if approved, this phased-in rate increase will provide steam customers with an inducement to purchase electric equipment prior to 1995, thereby ensuring that they will be charged electric rates.

As noted earlier, KCPL asserts that its Conversion Plan does not violate the Commission's Promotional Practices rule. (Ex. 1, p. 6). It further argues that in the event the Commission finds that the the plan violates the rule, the Commission should allow it as an exception because it was developed to address a unique situation, namely the phase out of central station steam service.

Staff maintains that KCPL should not be granted an exception to the Promotional Practices rule. A variance to the Promotional Practices rule can be granted in only one situation. This is provided for in 4 CSR 240-14.010(2) which states:

On written application of a utility and a showing that they are faced with unregulated competition the Commission may grant a departure from the rules contained in Chapter 14 to the extent requested. (emphasis added).

KCPL has not made a written application for a variance and has presented absolutely no evidence demonstrating that it is faced with unregulated competition for steam service in its certificated

area. Furthermore, the rule does not allow exceptions for "unique situations". Therefore, no exception is warranted.

In summary, Staff believes that KCPL's Conversion Plan is not motivated by a concern for steam customers and was designed by KCPL for the purpose of retaining steam customers as electric customers. Staff contends that if the electric alternative to steam were truly advantageous, there would be no need for KCPL to offer to supply and install electric equipment at no cost to the customers. Furthermore, as noted earlier, Staff believes that the electric alternative is the most expensive and that KCPL's Conversion Plan masks the true cost of this alternative. (Ex. 38, p. 28). The Conversion Plan is in clear violation of the Promotional Practices rule and the rule contains no provisions for a variance in a situation such as this.

KPL Gas Service has provided testimony requesting that if KCPL is authorized to offer free electric equipment, KPL Gas Service be authorized to make a similar offer. (Ex. 57, p. 2). The proposal of KPL Gas Service would allow it to provide on-site gas fired boilers and chillers and charge rates which are equivalent on a BTU basis to those set by the Commission for KCPL's steam service until 1995. (Id.). This proposal is very similar to KCPL's Conversion Plan and it is Staff's position that like the Conversion Plan, it is in violation of sections 5 and 6 of 4 CSR 240-14.020.

IV. RATE ISSUES

As stated in the introduction to this brief, the Commission is not bound to traditional ratemaking in this case. Traditional ratemaking assumes business as usual circumstances, and when the Commission encounters other than a business as usual case, and there is a sufficient public interest, alternatives to traditional ratemaking are appropriate. It is Staff's position that KCPL is not currently operating under business as usual circumstances, and will not be doing so under any alternative recommended by the parties to this case. As stated in the Hearing Memorandum, Staff and Company

have stipulated to a steam heat revenue deficiency based on a traditional revenue requirement basis for ongoing business in the amount of \$3,237,728 (rounded for purposes of discussion in this Brief to \$3.2 million). This number was stipulated to solely for purposes of arriving at a negotiated dollar value and does not constitute a Staff recommendation. (Ex. 1, p. 10).

Specifically, if termination of service is contemplated or sale of the system is to be pursued, traditional ratemaking is not only not required but is inappropriate. This is true from a regulatory, economic/market, or practical viewpoint. From the regulatory standpoint, the Market Railway and Rochester Gas & Electric cases provide some precedent and guidance for situations where economics or utility actions have rendered traditional ratemaking principles inapplicable. The Market Railway case involved a street railroad which was experiencing severe losses under increased rates which had been approved by the Commission. The Commission found that the increased rates had resulted in reduced ridership and revenues and no improvement in the quality of service being offered. The Company was competing with a municipal railway system which charged lower rates. The Commission authorized a reduction in fares, and the Company appealed. The Supreme Court held that there was no violation of the due process clause when the Commission took into consideration the practical results of rates it set. The Court observed that the Company was up against a law of diminishing returns in that the greater amount it collected per ride the less it was collecting per car mile. It held that no injury was suffered if a rate was fixed for an experimental period which probably would produce a fair return on the present fair value of the property. As to this particular Company, the Court held "it seems doubtful whether any rate would yield appellant's operating expenses." Market St. Ry. Co. v. Railroad Commission of California, 324 U.S. 548, 65 S.Ct. 761, 780 (1945). In essence, the Court held that it was not inappropriate for regulators

to abandon traditional ratemaking principles when the alternative approach utilized did not place the Company in any worse position.

In the Rochester Gas & Electric rate case, the New York Public Service Commission acknowledged that sound marketing principles in the Market Street Railway decision permitted setting rates at a level which would recover out-of-pocket expenses during the termination phase-out period other than using traditional ratemaking principles. Re: Rochester Gas & Electric Corp., supra, 19. The Commission stated "this level of allowed rates is reasonable because it reflects the inevitable fate of the system while allowing the Company to recover its prudently incurred expenses." Id., 21. The Commission also stated that the consolidated company return resulting from the out-of-pocket rate was reasonable even under ongoing business criteria.

From an economic/market perspective, regulators, serving in the role of a quasi-surrogate for competition, should be guided in setting rates for utility operations which are being discontinued by the pricing which would be done in a competitive market. As stated in the Rebuttal Testimony of Staff Witness Curt Huttzell, "once a decision has been made to terminate a complete utility service within the next few years, the relevant costs for purposes of establishing reasonable rate levels are the costs which could be saved or avoided by shutting down the operation immediately." (Ex. 56, p. 7, l. 6-11). Dr. Huttzell's Surrebuttal Testimony also addresses specific expense items which should or should not be included in setting rates for a company that is going out of business. (Ex. 56, p. 5-7). This testimony went uncontroverted and Dr. Huttzell was not cross-examined by Company. (Tr. 525).

From a practical standpoint, this Commission should be aware that if it decides that the public interest requires the Company to investigate the sale of the system prior to approval of abandonment, a freezing of steam rates is a necessary corollary to maintaining sale as a valid option. Any significant increase in steam rates prior to

investigation of the sale option will jeopardize the likelihood that a buyer will be found for the system.

A. IF KCPL'S PLAN IS REJECTED

If the Commission rejects KCPL's conversion plan, it should not accept KCPL's proposal stated in Company Witness Beaudoin's rebuttal testimony that the \$3.2 million traditional revenue deficiency should be reflected in steam rates. (Ex. 13, p. 7; 1. 5-7).

The Commission should freeze steam rates in the event that it adopts Staff's recommendation and orders the Company to solicit interest in sale of the system. The freezing of steam rates in the event that sale of the system is to be pursued is absolutely essential to preserve the customer base and make the system as attractive as possible to interested buyers. Approval of a \$3.2 million revenue increase would be de facto approval of the plan, because the higher rates would force customers to leave the system for alternate heating sources. (Ex. 17, p. 36-37).

As stated above, the Commission is not bound to utilize traditional ratemaking, which is based on a business as usual status when the Company is not truly operating as usual. KCPL's actions toward getting out of the steam business have removed them from the business as usual category.

B. IF KCPL'S PLAN IS ACCEPTED AND THE COMPANY IS AUTHORIZED TO PHASE OUT STEAM SERVICE AND OFFER BOILERS

KCPL proposes to phase-in the \$3.2 million traditional revenue requirement in four 13.5% annual increments, with no deferral and no recovery of carrying charges. (Ex 1, p. 11).

In the event the Commission approves KCPL's intent to discontinue steam service and authorizes the Company to offer to provide the boilers consistent with the conversion plan, Staff recommends that the Commission reject the phased-in traditional revenue requirement increase recommended by the Company. (Ex. 53, p. 4). Traditional ratemaking calculations are not appropriate for an entity that is in the process of discontinuing operation as discussed

above. Instead, rates should be set at a level which will reflect the fact that steam operations are not an ongoing concern. These rates should permit only the recovery of prudent out-of-pocket expenses required to continue safe and adequate service. In the alternative, the Commission could set rates at a level which would maximize the Company's net income from the system or minimize net losses during the remainder of the phase out period. The data available in this case does not permit a calculation of appropriate rates under this scenario; therefore, the Commission should require KCPL to come forth with information and analysis which show the appropriate rates to be charged from now to the end of termination. (Ex. 17, p. 41-42).

C. IF KCPL IS ALLOWED TO PHASE OUT STEAM SERVICE, BUT NOT OFFER BOILERS

KCPL first stated its position under this scenario in the Hearing Memorandum (Ex. 1, p. 12) and restated that position in the Rebuttal Testimony of Company Witness Reaudoin. (Ex. 13, p. 3, 1. 1-7). KCPL has committed not to raise base steam rates from present levels if the Commission allows it to phase out steam service but does not permit the offer of the "free boilers" so long as termination of steam service is permitted on or before December 31, 1990. (Id.) Staff does not object to this approach. (Ex. 1, p. 12)

V. IF KCPL'S CONVERSION PLAN IS APPROVED, CUSTOMERS WHO RECEIVE ELECTRIC BOILERS SHOULD BE CHARGED THE APPROPRIATE ELECTRIC RATE. IF THE PROPOSAL OF KPL GAS SERVICE IS APPROVED, CUSTOMERS WHO RECEIVF ELECTRIC EQUIPMENT SHOULD BE CHARGED THE APPROPRIATE ELECTRIC RATE AND CUSTOMERS WHO RECEIVE GAS EQUIPMENT SHOULD BE CHARGED THE APPROPRIATE GAS RATE.

In the event that KCPL's proposed Conversion Plan is approved by the Commission, Staff maintains that the customers who receive electric boilers should pay the appropriate electric rate. Similarly, in the event the proposal of KPL Gas Service is approved, Staff believes that customers who receive electric equipment from KCPL should be charged the appropriate electric rate and customers who receive gas equipment from KPL Gas Service should be charged the appropriate gas rate.

Staff believes that the General Service Schedule (GS or GL), which offers a separately metered space heating rate, or the General Service--All Electric (GA) Schedule should be used for customers that opt for electric equipment. (Ex. 49, p. 9). The electric facilities and metering arrangement of each customer would determine which electric schedule would apply. (Id.). Steam rates are not appropriate for these customers because such rates reflect the cost of providing steam service from Grand Avenue Station through a central distribution system, not the cost of providing heat with electric boilers located on a customers premises. (Id. at 9). Staff believes that any electrical consumption on a customer's premises should be metered as such and billed from the appropriate electric tariff.

Staff also believes that it would be feasible to design a steam rate based on the cost of electric energy and the cost of an on-site boiler if KCPL's Conversion Plan is approved. (Id.). The recovery of the capital cost of the equipment, operation and maintenance expenses as well as the cost of energy would be included in this rate. (Id.). The capital costs could be amortized over a reasonable life to recover the cost of the equipment and the installation. (Id.).

If the proposal of KPL Gas Service is approved, Staff recommends that the appropriate gas and electric tariffs apply. Again, the steam rate would not be proper since it does not reflect the cost of providing steam service from an on-site boiler. (Ex. 49, p. 2).

VI. THE ENERGY AUDITS CONDUCTED BY KCPL VIOLATE THE PROMOTIONAL PRACTICES RULE.

As part of its Conversion Plan, KCPL performed energy audits on the premises of each steam customer that wanted one. KCPL claims that the purpose of the energy audits was to examine the heating system of each customer and look for improved energy management systems or conservation measures that might be implemented. (Ex. 15, p. 3). The total cost of these audits was \$413,940. (Ex. 54, p. 10).

If these costs were included in rates the cost of steam would increase \$.91 per Mlb. of steam sold. (Id.).

Staff's investigation revealed that the Energy Audits included:

- An identification of steam uses which might be converted to resistance heating or heat pump, thereby eliminating or reducing the requirement for on-site steam generation.
- A determination of the required capacity of an on-site electric steam boiler or other electric equipment.
- Provision of a schematic design for the installation of an on-site electric boiler.
- The furnishing of complete design services, preparation of drawings and specifications and checking shop drawings for the electric boiler installation.

(Ex. 42, Schedule 24-4).

Staff does not believe that the primary purpose of the energy audits was to seek conservation measures and improved energy management systems for KCPL's steam customers. (Ex. 54, p. 9). To the contrary, Staff believes that the energy audits were self serving in nature and constitute a violation of the Promotional Practices rule. More specifically, the energy audits violate the provision contained in CSR 240-14.020(2) which states:

The furnishing of consideration to any . . . person for work done or to be done on property not owned or otherwise possessed by the utility or its affiliate is prohibited except for studies to determine comparative capital costs and expenses to show the desirability or feasibility of selecting one form of energy over another.

The rule provides an exception for studies conducted to determine comparative capital costs and expenses to show the desirability or feasibility of selecting one form of energy over another. 4 CSR 240-14.020(2). Staff submits that the energy audits do not meet this exception because the evidence indicates that their intent was to induce steam customers to convert to electric heating. This is demonstrated by the fact that Energy Masters Corporation (hereinafter "EMC"), the company that performed the audits for KCPL,

was instructed by KCPL not to examine the comparative costs of gas as an alternative to steam. (Ex. 49, pp. 6, 7).

The rule provides a further exception in 4 CSR 240-14.010(G)(8) by allowing utilities to render technical or engineering assistance to the customers. However, it is Staff's position that the energy audits went beyond what is contemplated by this exception. (Ex. 50, p. 6). The type of assistance contemplated by 4 CSR 240-14.010(G)(8) involves assistance in determining a customers utility service needs or the answering of questions about equipment operation and load requirements. (Id.). It does not allow for the sizing of electrical equipment, provision of schematic designs for on-site electric boilers, and site preparation for electric equipment, all of which were included in the energy audits. (Id.).

As indicated earlier, Staff submits that the evidence in this case indicates that the energy audits were conducted for the purpose of inducing steam customers to select electricity as an alternative heating source to steam. This is supported by KCPL's response to Staff Data Request No. 622, wherein KCPL stated:

The intent of the Steam Conversion Plan was to retain all steam customers as heat customers. This could not be accomplished by furnishing gas boilers. Energy Masters was instructed to study electric alternatives only.

(Ex. 42, Schedule 25).

Further confirmation of this is contained in the testimony of Mr. Graham:

- Q. Was energy audits -- was Energy Masters, before they got involved in the energy audits, instructed to look at electric alternatives only?
- A. [Mr. Graham] Yes, they were.
- Q. In conjunction with the energy audits, were the customers given any information regarding the gas alternatives or on the cost of gas boilers?
- A. [Mr. Graham] No, they were not.
- Q. So then it is true that Energy Masters conducted each energy audit with instructions from KCPL that only electric alternatives

were to be examined for replacing the customers centrally supplied steam?

- A. It was our intention to be able to supply the customer with an alternate electrically driven system.

(Tr. 407, 408).

Thus, the term "energy audit" is misleading in light of the fact that EMC examined only electric alternatives.

Despite this evidence, KCPL continues to maintain that one of the primary purposes of conducting the energy audits was to provide steam customers with information on energy conservation. (Tr. 405). Staff finds this difficult to accept in light of the report on the energy audit of the Home Savings Building attached to Mr. Graham's testimony. (Ex. 15, Schedule 1). The 28 page report contains just 1 1/2 pages of energy conservation recommendations. The recommendations include things such as installation of storm sashes on windows, blocking up windows in elevator shafts, and cycling the toilet exhaust for "OFF" in the unoccupied mode. (Id. at Schedule 1, pp. 13, 14). Mr. Graham testified that these are representative of the type of conservation recommendations produced by the energy audits. (Tr. 405). Staff finds it noteworthy that the bulk of the report contains information of aid to KCPL's planned conversion of its steam customers to electric customers. (Ex. 54, p. 13).

It is inconceivable to Staff that KCPL would spend a total of \$413,940 to provide its customers with improved conservation measures and energy management systems. Staff believes that the Company used the energy audits to promote electricity as a replacement to steam service. (Id. at 10). The studies evaluated only the feasibility of using electricity and did not consider other energy alternatives. Furthermore, they provided KCPL with preliminary information for the sizing of electric boilers and electric heating equipment. This type of data is vital to the Conversion Plan since it gives KCPL insight on the configuration of the steam customers heating systems, thereby allowing KCPL to make more precise estimates about the size and cost of an electric boiler or electric space heating

equipment in a particular building. (Id. at 11). The data produced by the energy audits also enabled KCPL to estimate the amount of potential increased electric sales revenue that would result from the installation of electric equipment.

VII. THE TEST BOILER PROGRAM IMPLEMENTED BY KCPL VIOLATES THE PROMOTIONAL PRACTICES RULE.

KCPL conducted a test project for the purpose of establishing the operational feasibility of converting customers to on-site electric boiler steam supply. (Ex. 14, p. 8). The test project involved the installation of KCPL owned on-site electric boilers on the premises of five KCPL steam customers. KCPL stated that the test project provided it with experience in designing and installing the boilers as well as in determining customer acceptance of on-site electric boilers.

Staff believes that the test boiler program played the role of predecessor to the Conversion Plan and that it was undertaken for the same promotional and investment reasons as the Conversion Plan. (Ex. 54, p. 8). Therefore, Staff believes that provision and installation of these test boilers by KCPL to certain of its steam customers violates section 6 of 4 CSR 240-14.020. (Ex. 49, p. 6).

In the event that the Commission does not adopt the Conversion Plan, Staff believes that the customers who have had test boilers installed on their premises should be afforded the option of purchasing this equipment. (Id.). Customers who opt to purchase a test boiler should be charged the appropriate electric rate.

VIII. CONCLUSION

For all the reasons stated herein, Staff recommends that the Commission adopt Staff's position in this case.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that
copies of the foregoing
have been mailed or hand-
delivered to all parties of
record on this 18th day of

May, 1987

Mary Ann Young

BEFORE THE PUBLIC SERVICE COMMISSION

STATE OF NORTH DAKOTA

* * * * *

In the Matter of the Application of
 Otter Tail Power Company for Authority
 to Abandon Steam Heating Utility
 Service in the City of Jamestown,
 North Dakota.

Case No. 8635

FINDINGS OF FACT, CONCLUSIONSOF LAW, AND ORDER

On January 23, 1973, Otter Tail Power Company (Applicant) filed an application with this Commission requesting authority to discontinue its steam heating utility service in the City of Jamestown, North Dakota, on or before July 1, 1975. A hearing on said application was held in the Courthouse in Jamestown, North Dakota, on the 19th day of April, 1973, pursuant to notice given all interested parties as required by law. The following appearances were entered:

CYRUS A. FIELD, Field, Arvesen, Donoho, Lundeen & Hoff, Attorneys at Law, Fergus Falls, Minnesota, appearing for the Applicant.

RAY H. WALTON, State Capitol Building, Bismarck, North Dakota, appearing as Commerce Counsel for the North Dakota Public Service Commission.

HERMAN WEISS, Jamestown, North Dakota, appearing as attorney for the City of Jamestown.

DANIEL E. BUCHANAN, Jamestown, North Dakota, appearing as attorney for the Jamestown Steam Heat Patrons, Protestant.

WALLACE M. OWEN, State Capitol Building, Bismarck, North Dakota, Chief Engineer for the Public Service Commission.

ROY PAETZKE, State Capitol Building, Bismarck, North Dakota, Chief Accountant for the Public Service Commission.

After considering all relevant evidence of record, the Commission now makes and enters the following Findings of Fact, Conclusions of Law, and Order.

FINDINGS OF FACT

I.

The Applicant, Otter Tail Power Company, is a corporation authorized to transact business in the State of North Dakota and is providing service as a public utility producing and distributing steam for space heating in the City of Jamestown, North Dakota.

II.

The facilities owned and operated by the Applicant for the production and distribution of steam for space heating in Jamestown, North Dakota, are presently serving 147 customers located in 125 buildings.

III.

Applicant's steam production facilities to provide heating utility services are presently used jointly for its electric operations. The electric generating units in Jamestown are comparatively small in size and relatively inefficient by today's standards. The economics of electric generation with larger units at other locations in the Applicant's system (including the new large plant at Big Stone, South Dakota, which is scheduled to go into operation in 1975) and through interconnections with other utility systems make it economically infeasible to utilize the steam production facilities for generation of electric energy at Jamestown. . The economics of electric generation are further adversely affected by the need to meet certain air quality standards by July 1, 1975. Applicant plans to discontinue and phase out of operation the electric generating facilities in Jamestown by July 1, 1975.

IV.

Applicant's steam production facilities in Jamestown could not be operated on an economical basis to provide only steam heating utility service without incurring costs which would require prohibitive rates to heating users.

V.

It is not economically feasible for Applicant to replace present steam production facilities with a plant designed solely for the purpose of producing steam for the steam heating utility alone; and steam heating service could not be provided by the Applicant in the City of Jamestown at salable rates and produce

a reasonable return upon the investment necessary to provide such service. Alternate sources for space heating are available in the City of Jamestown.

VI.

Even under the present joint method of production of steam for both electric generation and space steam heating, the rates presently established and in force do not provide an adequate return on the investment required to provide said service. The testimony shows that Applicant is presently suffering a net operating loss from the operation of the steam heat utility and would need an increase in rates of approximately 21.3% in order to obtain a minimum rate of return on Applicant's present investment. The testimony further shows that upon the phasing out of the electric generating plant in Jamestown, if Applicant should make the necessary investment to furnish a steam production plant with what are called "package boilers" and then continue to operate the steam heat utility alone, together with the other necessary factors involved in the operation and maintenance of the steam heat utility, Applicant would need a rate increase to the steam users of 156% to provide a minimum rate of return upon the investment necessary to own and operate the steam heat utility. No one appearing at the hearing took issue with or contested the position of Applicant and the conclusion that it would not be economically feasible for Applicant to continue to operate a steam heating utility service and furnish central steam heat service to Jamestown after the phasing out of the electric generation facilities in 1975.

VII.

Public convenience and necessity do not require the continuance of Applicant's steam heating utility in Jamestown beyond the heating season of 1974 - 1975, or beyond July 1, 1975, as a deadline, or such earlier time as steam heat customers have completed arrangements for other means of space heating.

VIII.

The discontinuance of steam heating service in Jamestown will require the existing steam heat customers to obtain other sources of space heating, and the Applicant's plan that the actual discontinuance of service will not be finally effective until July 1, 1975, or such earlier date as the customers shall have obtained other sources of heating, will provide time for the customers to obtain such other sources of heating. To aid the steam heating customers in providing for other sources of heating, Applicant has offered to contribute to the cost thereof by making certain disconnect allowances. Otter Tail and the City of Jamestown have agreed that the aggregate total amount of disconnect allowances to the steam heat customers in Jamestown shall be the sum of \$465,000, this total amount to be divided among the steam heat customers on the basis of the annual steam consumption determined from billing records between July 1, 1971, and July 1, 1972. Otter Tail will make these payments directly to the City of Jamestown upon receipt of authorization from the individual steam heat customer to make payment to the City of Jamestown and release Otter Tail from any liability therefor upon making such payment. In the event that any steam heat customer does not authorize the payment to the City of Jamestown, Otter Tail

will make the payment to any such customer direct to the customer at the time of disconnection, and the amounts of such payments will be deducted from the total sum of \$465,000. The minimum payment to any one customer shall be the sum of \$700.

In addition to, and supplementing, the foregoing, Otter Tail and the City of Jamestown have entered into a Memorandum of Agreement, which has been received in evidence in this case as Delayed Exhibit No. 3, which Memorandum of Agreement is hereby referred to and incorporated herein by reference. Said Memorandum of Agreement, among other things, provides that, in the event the City establishes a Municipal Steam Heat Utility, Otter Tail will transfer and convey certain properties to the City, and the City will lease back certain properties to Otter Tail, and the City will purchase certain properties from Otter Tail, and Otter Tail will retain certain items of property, and that the parties will do and perform various matters and things as therein mutually agreed to, and at the times and for the considerations therein provided. Said Memorandum of Agreement also provides for certain details regarding payments, and reports of payments, of the disconnect allowances, and for certain advances thereof to the City at the times and all as therein provided. To carry out one of the provisions contained in said Memorandum of Agreement, if the City establishes a municipal steam heat utility, Otter Tail and the City will make a joint application to the Public Service Commission for authority to transfer the steam heat distribution system in Jamestown to the City for the nominal consideration of One Dollar and other good and valuable consideration.

From the foregoing Findings of Fact, the Commission makes the following:

CONCLUSIONS OF LAW

I.

This Commission has jurisdiction of the steam heat utility service provided by the Applicant at Jamestown, North Dakota.

II.

Public convenience and necessity do not require the continuance of the steam heating service of Otter Tail Power Company in Jamestown, North Dakota, beyond July 1, 1975; and the application of Otter Tail Power Company should be, and hereby is, granted.

ORDER

NOW, THEREFORE, IT IS ORDERED, That Otter Tail Power Company be, and hereby is, authorized to discontinue its public utility steam heating service in Jamestown, North Dakota, effective July 1, 1975, or at such earlier date as existing steam heat customers in Jamestown shall obtain other means of space heating.

IT IS FURTHER ORDERED, That Otter Tail Power Company, be, and hereby is, authorized to carry out the terms and conditions of the Memorandum of Agreement between Otter Tail and the City of Jamestown, which is referred to in Finding of Fact No. VIII, and which has been received in evidence in this case as Delayed Exhibit No. 3.

Dated at Bismarck, North Dakota, this ____ day of _____, 1973.

BY THE COMMISSION:

President

Commissioner

Commissioner

(SEAL)

ATTEST:

Secretary

PUBLIC SERVICE COMMISSION
STATE OF NORTH DAKOTA

In the matter of the application of)
Northern States Power Company for)
authority to abandon steam heating)
operations in Grand Forks, North Dakota.)

CASE NO. 7529

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

On December 19, 1968, Northern States Power Company (Applicant) filed an application with this Commission requesting authority to abandon steam heating utility operations in the cities of Fargo and Grand Forks, North Dakota. Hearings were held in Fargo on January 23 and March 5, 1969, and in Grand Forks on January 21 and March 6, 1969, pursuant to notice given interested parties as required by law.

On April 10, 1969, this Commission granted a motion of the Applicant to sever the application relating to steam heating service in Fargo from Case No. 7529 and an Order was subsequently issued which authorized the abandonment of the steam heating utility operations at Fargo.

At the hearings held in Grand Forks, the following appearances were made:

R. W. WHEELER, Attorney at Law, P. O. Box 1, Bismarck, North Dakota, appearing for the Applicant.

GENE R. SOMMERS, Attorney at Law, 414 Nicollet Mall, Minneapolis, Minnesota, appearing for the Applicant.

ROBERT VAALER, OF Stokes, Vaaler, Gillig, Warcup & Woutat, 503 Valley Bank Building, Grand Forks, North Dakota, appearing for Grand Forks Glass & Paint Company, First Federal Savings & Loan Association, Ryan Hotel, E. J. Lander Company, and other steam heat users appearing in opposition to the application.

DENNIS TANGEN, 603 Maple Avenue, Grand Forks, North Dakota, appearing for Peavey Company.

WALLACE M. OWEN, Chief Engineer, State Capitol Building, Bismarck, North Dakota, appearing for the Public Service Commission.

ROY PASTER, Chief Accountant, State Capitol Building, Bismarck, North Dakota, appearing for the Public Service Commission.

After considering all relevant evidence of record, the Commission now makes the following:

FINDINGS OF FACT

I

That the Applicant, Northern States Power Company, is a public utility engaged in providing electric, steam heating, and natural gas service to consumers in Grand Forks, North Dakota.

II

That the facilities owned and operated by the Applicant for the generation and distribution of steam heat in Grand Forks presently serve 172 customers located in 129 different buildings in the business district of that city.

III

That the steam heating service was initiated by the Applicant in Grand Forks approximately 70 years ago and that about seventy-five per cent (75%) of the steam distribution system was installed at the time the service was commenced with an addition made in 1954 constituting about twenty-five per cent (25%) of the entire distribution system.

IV

That the Applicant's Grand Forks plant is used jointly to produce steam for the generation of electricity for their electric utility service and for their steam heating operation, and that the steam for the steam heating utility service is bled off from steam turbines used to generate electricity.

V

That the Grand Forks plant utilizes three steam boilers, two of which are 58 years old and one of which is 41 years of age; that the plant has a generating capacity of 20,100 kilowatts and because of its relative inefficiency is used to produce less than 25% of the electric energy requirements of the Applicant's Grand Forks Division; and, that the other electric energy requirements of the Grand Forks Division are supplied from large, efficient electric generating facilities in the Twin City, Minnesota, area via connecting high voltage transmission lines.

VI

That the Applicant has in operation and under construction large high efficiency electric generating facilities which are connected with the Grand Forks Division by high voltage transmission lines; that two additional high voltage transmission lines will be completed in 1970 to provide alternate connections of the Grand Forks Division to the rest of the Northern States Power Company system;

and that this system of generating and transmission facilities will provide a reliable source of electric energy capable of meeting the foreseeable demand of the Grand Forks Division at a reduced cost of operation.

VII

That upon completion in 1971 of construction and testing of new transmission and generating facilities the electrical generating facilities at Grand Forks will no longer be necessary for the Applicant's electric service in the Grand Forks Division and the discontinuance of this generating operation will not then impair the reliability of electric service to said division.

VIII

That the Applicant's investment in the Grand Forks steam plant and the cost of operating the same are allocated between the Applicant's electric utility operations and its steam heat utility services for rate making purposes; and that upon abandonment of the electric generating operation of the Grand Forks steam plant all remaining investment and costs of operation will be steam utility investment and costs alone.

IX

That the Applicant's net investment in steam heating utility properties in Grand Forks is less than \$200,000 and its existing rates produce approximately \$166,000 in gross revenues annually.

X

That in the event that the Applicant was required to continue the operation of the Grand Forks steam heat utility after termination of the joint use of steam generating facilities, it would be necessary to rehabilitate its steam distribution system and either modify or replace the steam production facilities; that the Applicant estimated that their investment in steam distribution facilities, after rehabilitation, would be \$351,500; that the Applicant estimated that if they were to retain and modify existing boilers for steam heat utility service their investment for steam heat utility service would be \$753,100, including the rehabilitated distribution system; that the Applicant estimated that if they were to install new package boilers for steam production their investment for steam utility service would be \$1,044,000; that the Protestant's study indicated an estimated investment, after rehabilitation of steam distribution system and the installation of package boilers, of \$782,300; and that the investment necessary to continue steam heat service in Grand Forks will range from \$753,100 to \$1,044,000.

XI

That if the Applicant were to modify existing steam production facilities or install package boilers to generate steam for steam heating services only and rehabilitate its steam distribution system in Grand Forks, N. Dak., the increased fixed costs and operation expenses associated therewith would require an increase in steam heating rates; that the Applicant's studies indicated that, depending on the basis of rehabilitation, rates for steam heat service would have to be increased from 205 to 224%; that the Protestant's study indicated that rates for steam heat service would have to be increased 148%; and that the rates for steam heat service in Grand Forks after rehabilitation would be increased at least 148% and possibly as much as 224%.

XII

That other methods of space heating are readily available to steam heat users in Grand Forks, North Dakota, including fuel oil, natural gas and electricity; that it was estimated by the Protestant that conversion from steam heat to natural gas space heating would result in increased costs of heating to the individual customer in the range of 70 to 80%; that it was estimated by the Applicant that conversion to natural gas would result in an increase in fuel costs alone of 13%; and that the lowest estimated increase in cost of heating with steam heat is almost double the highest estimate of record for cost of heating after conversion to another form of space heating and that, therefore, it would appear that steam heating service even at the lowest rates suggested would not be competitive with other forms of space heating available in Grand Forks.

XIII

That it was estimated by the Applicant that if they were required to continue the operation of existing steam production plant in Grand Forks after termination of electric generation in 1971, they would sustain out-of-pocket losses approximating \$350,000 per year.

XIV

That the city of Grand Forks has approved the Applicant's plan for disposition of its steam distribution facilities should this application be granted.

XV

That the Applicant offers each of its steam heat customers in Grand Forks, North Dakota, a contribution toward the cost of converting to an alternate method of space heating in the amount of two-thirds of the lowest competent bid

for installation of a firm gas-fired boiler in the customer's building (but in no case more than the actual cost of the conversion) including the cost of constructing an exhaust stack when necessary, plus

- a. An additional contribution to offset higher fuel costs sustained by customers converting in 1969 or 1970 by reason of conversion, in the amount of \$8.00 per boiler horse power per year or a minimum of \$80.00 per year, plus
- b. An additional 20% of said conversion cost if the conversion is completed in 1969, or 10% if completed in 1970, which amounts are intended to offset the customer's annual fixed charge and maintenance costs associated with early conversion.

to eliminate any economic advantage in waiting until the last year, 1971, for conversion and to encourage an orderly termination of service.

XVI

That public convenience and necessity do not require the continuation of the Applicant's steam heating operation in Grand Forks, North Dakota, beyond the heating season of 1970-1971.

CONCLUSIONS OF LAW

I

That this Commission has jurisdiction of the steam heat utility service provided by the Applicant in Grand Forks, North Dakota, and the issues raised by the instant application.

II

That the application of Northern States Power Company should be granted.

ORDER

NOW, THEREFORE, IT IS ORDERED that Northern States Power Company be, and hereby is authorized to terminate its steam heating utility service in Grand Forks, North Dakota, on August 31, 1971, or at any earlier date when all existing Grand Forks steam heating customers shall have converted to other means of space heating.

IT IS FURTHER ORDERED that Northern States Power Company be, and hereby is, authorized to proceed with conversion of steam heat customers in Grand Forks, North Dakota, in accordance with their plan of contributions for conversion as set forth in Findings of Fact No. IV.

Dated at Bismarck, North Dakota, this 22nd day of July, 1969.

(S E A L)

PUBLIC SERVICE COMMISSION:

BRUCE BAKER

President

EDWARD A. BAKER

Commissioner

WILLIAM J. BAKER

Commissioner

ATTEST:

Edna C. Olson
Secretary

PUBLIC SERVICE COMMISSION

STATE OF NORTH DAKOTA

In the matter of the application of)
 Northern States Power Company for)
 authority to abandon steam heating)
 operations in Fargo, North Dakota.)

CASE NO. 7529, Sub 1FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER

On December 19, 1968, Northern States Power Company filed an application with this Commission requesting authority to abandon steam heating utility operations in the cities of Fargo and Grand Forks, North Dakota. Hearings were held in Fargo on January 23, and March 5, 1969, and in Grand Forks on January 21, and March 6, 1969, pursuant to notice given interested parties as required by law.

On April 10, 1969, this Commission granted a motion of the applicant to sever the application relating to steam heating service in Fargo from Case No. 7529; Case No. 7529, Sub 1 was assigned to the application to abandon such service to Fargo.

At the hearings held in Fargo, the following appearances were made:

R. W. WHEELER, Attorney at Law, P. O. Box 1, Bismarck, North Dakota, appearing for the applicant.

GENE R. SOMMERS, Attorney at Law, 414 Nicollet Mall, Minneapolis, Minnesota, appearing for the applicant.

WALLACE M. OWEN, Chief Engineer, State Capitol Building, Bismarck, North Dakota, appearing for the Public Service Commission.

ROY PARTZKE, Chief Accountant, State Capitol Building, Bismarck, North Dakota, appearing for the Public Service Commission.

WILLIAM SCHLOSSMAN, 305 Black Building, Fargo, North Dakota, appearing for George M. Black Company, Graver Hotel Company, and Northland Development Company.

M. J. SHANN, 305 Second Avenue North, Fargo, North Dakota, appearing for the Merchants National Bank and Trust Company of Fargo.

PAUL GREYER, Fargo, North Dakota, appearing for Greyer Investment Company.

HAROLD C. MEYER, 207 15th Avenue North, Fargo, North Dakota, appearing for Model Laundry and Cleaners.

ED P. POWERS, 402 Broadway, Fargo, North Dakota, appearing for Gardner Hotel.

The Commission having considered the evidence, now makes the following:

FINDINGS OF FACT

I.

That the applicant, Northern States Power Company, is a public utility engaged in providing electric, steam heating, and natural gas service to consumers in Fargo, North Dakota.

II

That steam heating service was initiated by the applicant in Fargo in 1890; and that present steam generating facilities, used for both electric and steam heating utility operations of the company, were installed in 1915.

III

That the Fargo Steam Plant, with a 23,900 kilowatt capacity, is principally employed at the present time to meet only peak demands for electric energy in the Fargo division and that because of its inefficiency it is used to provide only 10 to 15 per cent of the total kilowatt hour requirements of the Fargo division.

IV

That the applicant has in operation and under construction large high efficiency electric generating facilities which are connected with the Fargo division by high voltage transmission lines; that two additional high voltage transmission lines will be completed in 1970 to provide alternate connections of the Fargo division to the rest of the Northern States Power Company system; and that this continuation of generating and transmission facilities will provide a reliable source of electric energy capable of meeting the foreseeable demand on the Fargo division at a reduced cost of operation.

V

That upon completion in 1971 of construction and testing of new transmission and generating facilities the electrical generating facilities at Fargo will no longer be necessary for the applicant's electric service in the Fargo division and the discontinuance of this generating operation will not impair the reliability of service in the Fargo division.

VI

That the investment of the applicant in the Fargo steam plant and the cost of operating the same are allocated between the company's electric utility operations and its steam heat utility services in Fargo for rate making purposes; and that upon abandonment of the electric generating operation of the Fargo steam plant all remaining investment and costs of operation will be steam heat utility investment and costs alone.

VII

That the applicant's steam distribution system in Fargo consists of wood-log insulated iron pipe varying in size from two inches to fourteen inches, installed in 1890; and that the wood-log insulation has rotted away and the cast iron piping has sustained substantial deterioration due to continual corrosion.

VIII

That if the applicant were to continue steam heating service in Fargo, North Dakota, using the existing Fargo steam plant exclusively for that purpose and rehabilitating the steam distribution system, it would result in a net investment in the steam heat utility of approximately \$900,000 for rate making purposes.

IX

That if the applicant were to replace the existing steam generating facilities in Fargo with packaged boilers to generate steam for heating only and to rehabilitate the steam distribution system, it would necessitate an investment in the steam heat utility at Fargo of approximately \$1,250,000 for rate making purposes.

X

That applicant's present net investment in its steam heat utility property for rate making purposes, including both Fargo and Grand Forks, is less than \$300,000, and that their return on said investment for the combined operations of Fargo and Grand Forks was shown as 5.1% on a test year basis whereas the year ended September 30, 1968, showed a loss of \$17,800 on the combined operation.

XI

That the applicant, if it were to continue steam heat service as stated in Finding VIII, would require an increase of 192% in its rates for Fargo steam heating service in order to realize a 7% rate of return on its investment; and that if they were to continue said service as stated in Finding IX they would require a 180% increase in rates to realize a 7% rate of return on its investment; and that in either event the required rates would not be competitive with alternate available fuels.

XII

That applicant serves 137 steam customers in Fargo; and that the installation of 94 boilers would be necessary to convert these customers to a different method of space heating.

XIII

That alternate means of space heating are readily available to steam heat users in Fargo, North Dakota, including fuel oil, natural gas and electricity.

XIV

That the city of Fargo has approved the applicant's plan for disposition of its steam distribution system should this application be granted.

XV

That the Fargo steam plant is located in the heart of the business district of the city. This area is particularly sensitive to fly ash, smoke, coal dust and unpleasant odors which of necessity emanate from such a coal burning plant.

XVI

That no steam heat user in Fargo, North Dakota resists the abandonment of steam heat service in that city on the basis of the facts presented by the applicant, but several customers want the proposed abandonment date postponed from August 31, 1971, to August 31, 1972, in order to give them more time to complete conversion to another method of space heating.

XVII

That the applicant, if required to continue the operation of the existing steam production plant and distribution system in Fargo after the shut down of the electric generation thereof, would experience an out-of-pocket cost or loss of approximately \$750,000.

XVIII

That the applicant offers each of its steam heat customers a contribution toward the cost of converting to an alternate method of space heating in the amount of two-thirds of the lowest competent bid for installation of a firm gas-fired boiler in the customer's building (but in no case more than the actual cost of the conversion) including the cost of constructing an exhaust stack when necessary, plus

- a. An additional contribution to offset higher fuel costs sustained by customers converting in 1969 or 1970 by reason of conversion, in the amount of \$8.00 per boiler horse power per year or a minimum of \$80.00 per year, plus
- b. An additional 20% of said conversion cost if the conversion is completed in 1969, or 10% if completed in 1970, which amounts are intended to offset the customer's annual fixed charge and maintenance costs associated with early conversion.

to eliminate any economic advantage in waiting until the last year, 1971, for conversion and to encourage an orderly termination of service.

XIX

That there are fifteen mechanical contractors in the Fargo area capable of converting buildings heated by the applicant's steam service to some other means of space heating.

XX

That public convenience and necessity do not require the continuation of the applicant's steam heating operation in Fargo, North Dakota, beyond the heating season of 1970-1971.

From the foregoing findings of fact, the Commission makes the following:

CONCLUSIONS OF LAW

I

That this Commission has jurisdiction of the steam heat utility service provided by the applicant in Fargo, North Dakota, and the issues raised by the instant application

II

That the application of Northern States Power Company should be granted.

O R D E R

NOW, THEREFORE, IT IS ORDERED that Northern States Power Company be, and hereby is authorized to terminate its steam heating utility service in Fargo, North Dakota, on August 31, 1971, or at any earlier date when all existing Fargo steam heating customers shall have converted to other means of space heating.

IT IS FURTHER ORDERED that Northern States Power Company be, and hereby is, authorized to proceed with conversion of steam heat customers in Fargo, North Dakota, in accordance with their plan of contributions for conversion as set forth in Findings of Fact No. XVIII.

Dated at Bismarck, North Dakota, this 22nd day of April, 1969.

PUBLIC SERVICE COMMISSION:

(S E A L)

BRUCE HAGEN

President

RICHARD A. ELKIN

Commissioner

ATTEST:

Edna Olson

BEN J. WOLF

Commissioner

Secretary

BUY NORTH DAKOTA PRODUCTS

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

OPINION NO. 84-19

- CASE 28316 - ROCHESTER GAS AND ELECTRIC CORPORATION -
Steam Rates - Expanded Proceeding
- CASE 28612 - ROCHESTER GAS AND ELECTRIC CORPORATION -
Steam Rates

OPINION AND ORDER CONCERNING STEAM
SERVICE AND DETERMINING REVENUE REQUIREMENT

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MAY 11 1987

COMMISSION COUNSEL
PUBLIC SERVICE COMMISSION

Issued: July 11, 1984

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

OPINION NO. 84-19

CASE 28316 - ROCHESTER GAS AND ELECTRIC CORPORATION -
Steam Rates - Expanded Proceeding

CASE 28612 - ROCHESTER GAS AND ELECTRIC CORPORATION -
Steam Rates

OPINION AND ORDER CONCERNING STEAM
SERVICE AND DETERMINING REVENUE REQUIREMENT

Issued: July 11, 1984

CASES 28316 and 28612

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

APPEARANCES

Joel Blau, Esq. and Steven Blow, Esq., Staff Counsel, Three Empire State Plaza, Albany, New York 12223, for the Staff of the Department of Public Service.

Nixon, Hargrave, Devans & Doyle (by Richard N. George, Robert L. Daileader and Stanley W. Widger, Esqs., of Counsel), Lincoln First Tower, P. O. Box 1051, Rochester, New York 14603, for Rochester Gas and Electric Corporation.

Algird F. White, Jr., One Steuben Place, Box 314, Albany, New York 12201, for Multiple Intervenors.

Bond Schoeneck & King (by William P. Burrows, Esq., of Counsel), One Lincoln Center, Syracuse, New York 13202, for Lincoln First Bank, N.A.

David Thurston, Pro Se and Harris, Beach, Wilcox, Rubin & Levey (by Thomas M. Hampson, Esq., of Counsel), Two State Street, Rochester, New York 14614.

Harris, Beach, Wilcox, Rubin & Levey (by Angela Panzarella, Esq., of Counsel), Two State Street, Rochester, New York 14614, for Sibleys, Associated Dry Goods.

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

COMMISSIONERS:

Paul L. Gioia, Chairman
Edward P. Larkin
Carmel Carrington Marr
Harold A. Jerry, Jr.
Anne F. Mead
Rosemary S. Pooler

CASE 28316 - ROCHESTER GAS AND ELECTRIC CORPORATION -
Steam Rates - Expanded Proceeding

CASE 28612 - ROCHESTER GAS AND ELECTRIC CORPORATION -
Steam Rates

OPINION NO. 84-19

OPINION AND ORDER CONCERNING STEAM
SERVICE AND DETERMINING REVENUE REQUIREMENT

(Issued July 11, 1984)

BY THE COMMISSION:

INTRODUCTION

By order issued April 15, 1983 in Case 28316--part of the last Rochester Gas and Electric Corporation (RG&E or the company) combined gas and electric rate case--an expanded proceeding was initiated to consider the prospects for steam service. Later, on July 18, 1983, we authorized, as part of the RG&E general rate increase, a \$1,718,000 temporary steam rate increase, subject to refund or reparations.^{1/} The rates were made temporary because of the continued pendency of the expanded proceeding, and they were set so as to provide less than a full return on investment in order to discourage further the departure of customers while the

1/ Cases 28311, et al., Rochester Gas and Electric Corporation,
Opinion No. 83-13 (issued July 18, 1983), mimeo pp. 76-74.

CASES 28316 and 28612

system's future was being considered. (Upon reconsideration, on December 12, 1983, an additional \$169,000 was authorized to insure an opportunity to recover operating costs, interest payments and preferred dividends.^{1/})

In August, 1983, RG&E filed, in Case 28612, for an additional \$5,460,000 increase (since updated to \$5,961,000) above the temporary steam rates. Consequently, this proceeding comprises Cases 28316 and 28612 and at issue is the proper level of rates in the former as well as the subsequent request in the latter.

A prehearing conference was held in Albany on May 12, 1983 and a public statement session was held in Rochester on June 16, 1983; on that date as well the RG&E personnel responsible for the long-range plan for the district steam system (the Steam Report) were cross-examined. An additional conference of the parties was held in Albany on July 29, 1983.

Evidentiary hearings, presided over by Administrative Law Judge David Schechter, were held in Henrietta on December 5, 6 and 7, 1983 and a record consisting of 910 transcript pages and 37 exhibits--numbered 150 through 186--was compiled. Initial briefs were filed by the company, Department of Public Service staff (staff), Multiple Intervenor (MI), and the Lincoln First Bank; RG&E and staff filed replies. Judge Schechter's recommended decision was issued on April 6, 1984. Briefs on exceptions were filed by RG&E, staff and David Thurston, pro se, while replies were submitted by RG&E and staff.

1/Cases 28313, et al., supra, Order Granting In Part And Denying In Part Petitions For Rehearing (issued December 12, 1983).

BACKGROUND

RG&E began steam service to downtown Rochester in 1889 and in the 1920's offered service to industrial customers in the separate westside district. Downtown is served by Station 3 (Beebee Old House) and Station 8, while westside customers are served by Station 9. The system is an open loop system, that is, it lacks a condensate return to retrieve condensed steam for reuse; a more efficient closed loop system is not considered feasible and has not been proposed by any party. The system peaks of 617 customers and 4,090,576 Mlbs.^{1/} of annual sales were reached in 1956 and 1972, respectively. By August, 1983, the system had declined to 171 customers and 1,227,500 Mlbs. in annual sales.

The decline of the steam system started in the 1970's with the loss of eighty customers to urban renewal projects and was hastened by the 1973 OPEC oil embargo--which, coincidentally, followed RG&E's conversion of ten steam-producing facilities from coal to oil or gas--and the 1978 oil price increases. The company responded, it says, by seeking gradual increases in steam revenues rather than a full return; by reducing the cost of service by converting three oil-fired boilers to gas; by deferring a steam rate filing scheduled for 1981; and by proposing to revise the steam transfer credit to allocate Beebee Station operating and maintenance costs to the electric department.

In 1979, we ordered a comprehensive review of RG&E's steam operations but the studies originally contemplated were not completed. In closing the proceeding on August 27, 1983, however, we directed the company to file a

1/An Mlb. equals 1,000 pounds of steam.

long-range plan that would examine, among other things, the possibility of converting Beebee Station to coal, scaling-down the system, and eliminating one or both of the steam districts. The Steam Report was submitted on January 24, 1983, but inasmuch as the report could not be adequately considered within the context of the then pending rate case, this expanded proceeding was initiated and, as noted before, temporary steam rates were put in place.

THE COMPANY'S STEAM REPORT

The company noted in its initial brief that its "conclusion that its district steam business could not be returned to economic viability and the coal conversion project [Beebee Station] should not be pursued is based on a projected cost of RG&E steam compared to the cost of the customer's on-site production of steam assuming the customer installs a gas-fired boiler."^{1/} The cost per Mlb. for customer-provided steam (excluding the cost of converting) was found to be:

1983:	\$11.53 to \$13.40
1984:	\$13.41 to \$15.62
1985:	\$14.60 to \$16.77
1986:	\$15.91 to \$18.40

When compared to its "base case" analysis, which assumed 1983 sales of 1,150,000 Mlbs. and 1,000,000 Mlbs. of sales in 1984 and thereafter,^{2/} the company found the cost

1/RG&E's Initial Brief, p. 26.

2/The company made other assumptions it terms conservative, namely that customers would not reduce their individual requirements and that the cost of converting Beebee Station would be only \$25 million. In addition, the company ignored the tax benefits to customers for converting.

CASES 28316 and 28612

of RG&E steam per Mlb. exceeded the customer's alternatives by:

1983:	\$3.77 to \$5.70
1984:	\$5.62 to \$7.96
1985:	\$7.16 to \$9.09
1986:	\$7.58 to \$9.78 (Beebee Station not converted)
1986:	\$5.45 to \$7.65 (Beebee Station converted and amortization of cost included)
1986:	\$4.46 to \$6.66 (Beebee Station converted but amortization not included)

The second step of the company's analysis was to determine the period required for customers to recover, from the savings they would enjoy by reason of leaving RG&E's system and installing their own facilities, their costs of conversion. Assuming Beebee Station were converted to coal but that the costs of doing so were not recovered from steam customers--i.e., the scenario most favorable to continuing RG&E's steam service--the company found that all 193 customers then on-line would recover their cost of converting to gas-fired boilers within a three- to six-year period and that 123 of the 193 would recover from one to nearly six times their investment within three years.

The company also submitted a "probable case" scenario based on the assertedly more realistic assumption that annual sales would decline after 1984 at a rate of 250,000 Mlbs. per year. As a consequence, the customers' savings from leaving the system would increase dramatically--\$3.81 per Mlb. in 1984; \$11.99 per Mlb. in 1985; and a range of \$29.31 to \$37.31 per Mlb. in 1986 depending on the status

CASES 28316 and 28612

of Beebee Station--and the payback period for the investment needed to leave would shorten correspondingly. Accordingly, the company concluded the conversion of Beebee Station would not make RG&E steam rates competitive and the project should not be undertaken.

The company also found the conversion of Beebee Station would not be worthwhile for the electric department, for it would provide cost savings of only \$25.8 million in 1982 dollars as opposed to a conversion cost, also in 1982 dollars, of \$25 to \$33 million. Again, the company based its calculations on assumptions it considered conservative or most favorable to conversion.

Finally, the company, as noted in its initial brief, considered other means of controlling costs, such as reducing the number of boilers on standby, but found the potential benefits limited. As for distribution losses, it found that installing a condensate return system or reinsulating would require a "massive construction project, the costs of which would offset the fuel cost savings."^{1/} RG&E reported also that eliminating individual lines, while reducing distribution losses, would reduce sales, and therefore it concluded a reduction in system size would not necessarily benefit the system.

In sum, RG&E concluded there was no available option that would make company steam competitive with the customers' alternatives. It thus found it appropriate to inform customers that they should convert to alternatives as soon as possible. At the same time, assertedly in the interests of providing customer flexibility and ensuring the orderly phase-out of the system, the company said it was willing to continue providing service, but at compensatory rates, while customers assessed their options and prepared to leave the system.

STAFF'S PROPOSAL

Long-Range Prospects

Staff contends the steam system can be preserved. It maintains costs per unit can be decreased by increasing sales and that fuel costs can be reduced by converting Beebe Station to coal. It would require conversion, however, only if a survey of current and former customers revealed that a prerequisite load could be attained by offering take-or-pay contracts at competitive rates. Competitive rates, it believes, could be offered by deferring some expenses now and recovering them later, after the Beebe Station conversion.

Staff notes the underpinning of its proposal is a present worth analysis of revenue requirements for the period 1984 to 1998, which suggests savings of \$48 million if customers use company-supplied steam. Moreover, staff maintains conversion of Beebe Station is more advantageous to electric customers than the two alternatives held out by the company; i.e., using the station only to enhance electric reliability or retiring the units in question and installing new transmission capacity. Staff argues conversion holds a \$58 to \$63 million benefit over the first alternative and has a \$52 to \$57 million advantage over the latter.

Current Rates

Essential to staff's plan is the setting of currently competitive rates. It proposes the temporary rates now in effect be made permanent and frozen at that level until the company secures an adequate number of commitments to take-or-pay contracts or until the company presents an orderly phase-out or abandonment plan.

Staff maintains that (in the absence of resuscitative measures) RG&E's steam system has lost its economic value and that by releasing the steam report and encouraging on-site alternatives the company has accelerated revenue and sales attrition. Consequently, though staff believes the 9% increase in the last case for variable costs, interest payments and preferred dividends was warranted, it opposes a 35% increase for variable costs in the rate year because it believes the company should bear the burden of its intended cessation of steam service. For the same reasons, it opposes the company's requested 59% increase to fully compensatory rates.

Staff argues the rate freeze is not unjust or illegal because "[r]egulation does not assure that a utility will make a profit. . . [and] [t]he possible loss of monopoly power and consequent loss of economic value is a recognized risk of investing in utilities."^{1/} Further, it contends that compensatory rates are not warranted because a similarly situated unregulated company, with no opportunity to provide subsidies from its monopoly gas and electric operations, would be content to recover variable costs and a contribution to fixed costs. It also views application of the Public Service Law §79(1) requirement that "just and reasonable" rates include a return sufficient to attract capital for continued service as illogical when the company envisions the termination of service in 1986. As for §85 of the Public Service Law, which requires "due regard" for the steam system's original cost less depreciation, staff sees it as inapplicable where the system has no real value. Finally, it characterizes the company's plan as a de facto abandonment, a condition which, it says, permits less than compensatory rates.

^{1/}Staff's Initial Brief, p. 17.

PLANNING FOR THE SYSTEM

Recommended Decision

The Judge, in discussing the survey designed to determine customer interest in take-or-pay contracts and thereby determine the likelihood of the plan's success, concluded that "while at this juncture the feasibility of the Staff proposal is in serious doubt in light of the very cogent factual impediments to which RG&E points, any resolution of such doubts in advance of that survey would be less than conclusive and, as such, fall short of public interest considerations."^{1/} He therefore recommends that the survey be conducted.

The impediments noted by the company and cited by the Judge are varied; they are here briefly listed. First, the company alleged that staff's present worth discounting masks the effect of interest on the deferral account balance and that the amount steam customers would have to repay for the underpriced service they received in the initial years is \$17.1 million rather than the \$11.6 million computed by staff. Second, coal burning limitations in the Department of Environmental Conservation (DEC) permit would offset the estimated cost saving.^{2/} Third, staff's pricing plan might prevent further erosion of the customer base but would not lead former customers to return. Fourth, in RG&E's view, staff has allocated too great a portion of the Beebe Station conversion costs to the electric department. Fifth, take-or-pay contracts are of questionable validity and offer little protection in the event the system fails, and staff has failed to address the case of non-contract

^{1/}R.D., p. 61.

^{2/}It should be noted that the parties agree that the shutdown of the system and likely conversion of customers to natural gas would not significantly increase ambient pollutant levels.

customers. Sixth, significant additional costs, such as the possibility of requiring new mains, installing services and meters, and the tax treatment of the deferred expenses, have been ignored. Seventh, a significantly higher discount rate is warranted for assessing risk. Finally, other risks, including declines in sales levels, financing difficulties and timing problems, have been overlooked.

Judge Schechter disagreed as to the limitations imposed by the DEC coal permit and found as well that take-or-pay contracts are allowed where there is a reasonable opportunity to recover the deferred costs. He agreed, however, with the company that present worth discounting is an inaccurate measure of costs and that staff's view of cost savings from conversion are optimistic. In addition, he considered valid the company's criticisms concerning staff's pricing proposals, the efficacy of take-or-pay contracts and the failure to reflect some additional costs. Nevertheless, he concluded "only the survey can either confirm or negate the doubts,"^{1/} and, as noted, he recommends the survey be conducted.

Mr. Thurston's Comments

Mr. Thurston's brief on exceptions notes that a study of district heating in Rochester is currently being carried out through the New York State Energy Research and Development Authority (NYSERDA) and that, as a result, negotiations to purchase the system have been suspended. Central to Mr. Thurston's comments is a claim that tension between the company and staff has needlessly delayed a resolution, and that customers have little faith in either as a result. Mr. Thurston believes a smaller workable system can be salvaged and operated privately. Thus, he recommends we adopt a "fish or cut bait" approach and encourage RG&E to come to terms with prospective operators of a deregulated system.

Company's Exception:

RG&E, restating many of its earlier arguments, contends the survey to determine the attractiveness of take-or-pay contracts should not be conducted. It argues that staff's economic analysis is flawed, and that the take-or-pay contract idea has been inadequately examined. For example, it goes on, little thought has been given to what would happen after the contracts expire, to how to collect from customers who move outside the state or whose facilities are destroyed or condemned, or to how to reconcile the tension between contracting and non-contracting customers. RG&E questions as well the legality of deferring the recovery of legitimate expenses and also of requiring the company to invest massive sums of money--\$34 million, it says--in a failing business. It objects also to the inordinate length of time required to implement a plan that will not likely work, especially when customers need immediate answers to assess their situation. Finally, RG&E argues the survey idea is unfocused and customers will be unwilling to commit themselves when it is apparent the system is uneconomic.

Staff replies the survey is an essential first step to restructuring the system, and it points, as evidence of the worth of a survey, to the company's financial support for a NYSERDA study to determine the future of district heating in Rochester. It defends the legality of its proposal and responds to the company's challenges to its economic analysis. Finally, it concludes that only a survey can resolve the question of how many customers and how much load could be expected if staff's proposal were adopted.

Staff's Exceptions

Staff excepts to the Judge's endorsement of several of the company's criticisms of its proposal. It argues that present worth discounting "takes inflation and interest rates into account and allows a stream of different year's dollars to be summed and appropriately compared with an alternative stream of different year's dollars."^{1/} Therefore, it contends, contrary to the Judge, the effect of inflation is not masked by present worth discounting.

With respect to the Judge's finding that staff overestimated the benefits of converting Beebee Station because it ignored the need for additional transmission capacity, staff contends the company did not establish a need for a transmission line into downtown Rochester. In addition, staff argues that even if a line were needed, conversion would still bring significant benefits.

Last, responding to the Judge's comment that its timetable was overly optimistic, staff says its only concern is finding a viable approach that may "be begun immediately and be carried out expeditiously."^{2/} It requests that we decide whether a survey is needed before considering other issues.

The company responds that present worth discounting is appropriate where the relevant inquiry is the comparison of differing revenue streams, but that is not the case here. It says the critical issue here is how much will be at risk when the take-or-pay contracts expire in 1988. With respect to the need for transmission capacity into downtown Rochester, the company says the benefit of the coal conversion to the electric department is considerably lower than the \$41

1/Staff's Brief on Exceptions, p. 9.

2/Id., p. 11.

million suggested by staff because the units projected to produce 200,000 MWh annually are old and will also be required to produce send-out steam; RG&E considers 20,000 MWh more likely. As for the staff request to determine the desirability of the survey before examining the other problems with its proposal, RG&E contends such a strategy will result in wasted time and money. Finally, RG&E asserts an inconsistency exists between staff's proposed rate freeze and the attempt to put off resolution of other issues.

Discussion

Judge Schechter recommends the survey be conducted, despite the problems with staff's analysis, because he believes it is in the public interest to discover whether customers are willing to commit themselves to long-term take-or-pay contracts. But we are unpersuaded that conducting such a survey now would make sense.

It is abundantly clear that the system's decline is becoming more rapid. In August, 1983, there were 171 customers being served and less than a year later--despite rates below the level suggested by normal ratemaking--there are only 115 customers on-line and 27 others have set a date certain for leaving the system. Correspondingly, the most recent forecast of annual sales is approximately one-half the original rate year projection and the continuing loss of customers ensures that sales levels will fall even further. Given these circumstances, it seems the survey would merely delay the inevitable while sending the wrong signals to the customers remaining on-line. District heating may have a future in Rochester as a customer-owned enterprise and NYSDERDA is studying that possibility, among others, but a traditional regulated steam system appears unworkable.

Given that conclusion, the "fish or cut bait" approach is warranted and attention should be shifted from bailing out the system to finding a reasonable method of terminating regulated steam service. Accordingly, the company is directed to submit, within thirty days, a detailed plan for abandoning the system by a specific date or phasing it out step by step. The proposal should examine, among other things, the extent, if any, to which customers' conversion costs would be defrayed and the accounting treatment of such items as plant retirement, cost of removal and undepreciated investment. Following our review of the company's proposed plan and any comments by intervenors or customers, we shall determine the next steps toward an orderly termination of the company's steam business.

RATES

Recommended Decision

Judge Schechter concluded the only issues ripe for resolution in this case pertain to the permanent rate levels to be adopted for Case 28316 and Case 28612. In his estimation, the central issues are: "1) Is the utility now entitled to a 'full' return on its steam plant investment, as RG&E urges?; and 2) Should such investment now be deemed valueless for ratemaking purposes, as Staff urges?"^{1/} He answered both questions negatively, the first on the grounds that "RG&E's position overlooks its own assessment of the steam department's prospects"^{2/} and the second because staff's view "fails to accord 'due regard' to the applicable original cost concept and its argument that the system has no value is unpersuasive."^{3/}

1/R.D., p. 63.

2/Id.

3/Id.

On the basis of his reading of the temporary rate order in Case 28316, the Judge found that we did not "foreclose permanent steam rates reflecting a return on an original cost less depreciation basis."^{1/} He concluded that we contemplated neither a normal nor a zero return but considered a less than normal return proper for an indisputedly failing business. He characterized a full return on the steam plant as "patently unwarranted" given the company's own perception that staff's remedial measures are futile. Nevertheless, he believed a positive return on steam plant is required inasmuch as the plant "has some value considering that service, as necessary, will continue to be rendered to remaining steam customers through 1986."^{2/}

In so finding, the Judge rejected staff's rate freeze proposal and decided that the company should recover, in addition to its variable costs, some return on investment. Starting with the DCF-derived companywide equity allowance, he fashioned a formula that is supposed to recognize the "negative growth" of the steam department while reflecting a "remaining three year life." Specifically, he would disregard the growth component, divide the yield by the number of years remaining and then subtract that figure from the yield to determine the equity allowance. For Case 28316, the calculations are: $10.3\% \text{ yield} \div \text{by } 3 \text{ years} = 3.4\%$; $10.3\% - 3.4\% = 6.9\%$. That 6.9% equity return would produce an overall return on steam plant of 8.47% and a \$2.64 million permanent rate increase. Accordingly, he found reparations were required to increase revenues to that level.

^{1/}Id., p. 66.

^{2/}Id.

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In making his calculation, the Judge relied on the uncontested steam revenue and expense projections in Case 28316 rather than on current data. He held the cases cited by the company supporting the use of current data were inapposite, for they antedated the fully forecasted rate year technique and, moreover, he saw the company's position as inconsistent with its refusal to extend the original suspension period to consider the rate effects of the Steam Report.

For Case 28612, he recommends the same approach. The calculations, using Judge Vernieu's recommended decision, are: $11.9\% \text{ yield} \times 2/3$ (reflects fact that two of the three remaining years of operation will be completed) = 7.93% ; $11.9\% - 7.9\% = 3.97\%$. The result is a \$4.309 million increase (above the temporary rates set in Case 28316).

Company's Exceptions

RG&E argues the Judge erred in recommending that rates in Case 28316 be set using the rate case data available as of July, 1983. It reasserts its position that we are bound here by New York Telephone Company v. Public Service Commission,^{1/} which requires the use of actual data where available, and contends it is immaterial that the case was decided before the move to a fully forecasted rate year. It opines that we must search for the most accurate data for setting rates, and it cites for further support the Policy Statement on Test Periods in Major Rate Proceedings. Accordingly, it urges that actual data--which reflect sales below those forecast in Case 28316--be employed to prevent an undercollection of revenue.

In response, staff argues the company is estopped from claiming an entitlement to rate relief and reparations based on updates because the company's refusal to extend the suspension period precluded the timely consideration of steam rates. Further, staff says the issue here relates to reparations, which are discretionary and not mandatory, and we are not required to allow retroactive reparations even if we set higher permanent rates prospectively.

RG&E excepts also to the Judge using a reduced return on equity for the steam department." It contends granting a return "less than the risk-free cost of money is confiscatory"^{1/} and that setting a different rate for steam is inconsistent with the practice of setting an overall rate of return for combination utilities.^{2/} Finally, it posits that the recommendation overlooks the fact that the 15.1% return on equity was intended to reflect the return needed on all operations and it contends a low return on steam plant requires a correspondingly higher return on gas and electric plant.

Staff does not answer this exception directly but says that the steam system is moribund while the gas and electric systems are "ongoing entities." The main thrust of staff's response is its speculation that the company was holding back for its reply brief on exceptions its argument regarding entitlement to fully compensatory rates, in which case, staff noted, it would request that the argument be disregarded or that staff be granted leave to reply.^{3/}

1/RG&E's Brief on Exceptions, p. 33.

2/For this practice, it cites Case 27276, Consolidated Edison Company of New York, Inc., Opinion No. 78-27, 18 NY PSC 1764 (1978).

3/See discussion infra, regarding this issue.

Staff's Exceptions^{1/}

Staff objects to the Judge's compromise position that allows a return on steam plant. It contends, first, that it is improper to use a traditional DCF model, which contemplates a stream of dividends, when no dividends can be assumed. Moreover, it argues it is unrealistic to set rates on the premise of a 1986 shutdown without recommending a formal abandonment proceeding. Further, it posits that increasing rates will undermine the survey and that, in any event, there is no justification for rates higher than variable costs, which it characterizes as the minimal point at which a competitive firm would continue to provide service. In this regard, it asserts that it is "questionable whether RG&E would have been inclined to 'phase out' its steam service if it did not also have a franchised monopoly in the provision of the closest substitute--natural gas."^{2/}

Thus, staff renews its claim that a rate freeze is in order. It argues that in Case 28316 the company's variable costs (including depreciation, a return on working capital, interest payments and preferred dividends) were met, and that is all that is required. As for Case 28612, staff contends a rate freeze is in order as well because the Steam Report accelerated the decline of the system and the company should "bear the consequences of presenting an ill-conceived long-range plan rather than seeking a more orderly transition."^{3/} As a result, staff proposes a freeze until the company presents a detailed plan for either maintaining or abandoning the system.

^{1/}The Genesee Hospital and Xerox Corporation, both major steam users, also have submitted letters objecting to the recommended rate increase.

^{2/}Staff's Brief on Exceptions, p. 8.

^{3/}Id., p. 7.

RG&E submits, concerning the rate issues, three replies. It contends the Steam Report cannot be blamed for the accelerated decline of the steam system; that it is entitled to fully compensatory rates; and that it should not be required to undertake more studies if staff's plan is rejected.

Discussion

In determining the level of rates--both prospectively and for the time temporary rates have been in effect--we start by recognizing that a large number of the company's steam customers have left the system over the past two years, that, more recently, the rate of departure has increased dramatically, that the system can no longer survive economically, and that abandonment is inevitable after a reasonable phase-out period. In such circumstances, we are not obligated (and it would not be feasible) to follow traditional ratemaking principles and provide the company the level of expenses or return required by an on-going concern. This is particularly so here, where the company has failed to acknowledge that the system is no longer economically viable or to take steps to petition for its eventual abandonment.

Faced as we thus are with setting rates for a reasonable phase-out period, we are willing to authorize only such revenues as may be necessary, given the existing number of customers, to cover the expenses incurred in providing service. Further, we believe it reasonable to moderate any rate increases during the phase-out period, for we are reluctant to impose on the relatively few remaining customers the burden of paying the full costs of a steam system built to meet the needs of approximately 650 customers.

CASES 28316 and 28612

At the same time, we are mindful that the phase-out period should be limited in duration (consistent with the need of the existing customers to convert to alternate energy sources), and we recognize that meeting even out-of-pocket operating expenses may require authorizing a significant increase in the rates charged during that period. Indeed, such an increase will avoid the improper price signals which might result from keeping rates artificially low, and it will thus encourage customers to leave the system during the phase-out period.

With these considerations in mind, we conclude that the temporary rates set in Case 28316 should be made permanent and that, in Case 28612, the company should be allowed to recover its out-of-pocket expenses, which requires a rate increase of approximately 32%. These conclusions are discussed in turn.

1. Case 28316

When temporary rates were set in this case, the steam system had lost a number of customers and its future was dim. Accordingly, we expanded the on-going investigation of the system's prospects and requested that the issue of abandonment be considered.^{1/} That investigation has now revealed that the economic decline of the system is irreversible and that abandonment within approximately a year to 18 months is inevitable. Accordingly, we find the level of temporary rates--designed to recover the system's variable costs--may be made permanent, for the steam system was and is in a de facto phase-out period leading to abandonment, and that under such circumstances, a return on the steam investment is not reasonable or feasible.^{2/} As a result, neither reparations nor refunds are warranted under the circumstances.

1/Case 28316, Order Granting in Part and Denying in Part Petitions for Rehearing (issued December 12, 1983), mimeo p. 10.

2/See, Market Street Railway Co. v. California Railroad Commission, 174 U.S. 548 (1944).

2. Case 28612

In the rate year, it is likely, given recent indications, that customers will depart at an increasing rate, especially given the significant rate increase that is needed. Further, because of the small number of customers, the steam system is not economically viable and should be phased out over a reasonable period. As a result, we find, consistent with the Market Street Railway decision, supra, as well as sound marketing principles, that during the phase-out period, the level of rates should be set so as to be sufficient to allow recovery only of out-of-pocket expenses.

This level of allowed rates is reasonable because it reflects the inevitable fate of the system while allowing the company to recover its prudently incurred expenses. Moreover, it recognizes the economic burden placed on the remaining customers, who may also face expenses of converting to alternative energy sources. Finally, RG&E's resulting return, as computed on a consolidated company basis, is reasonable even under business-as-usual criteria.^{1/}

CONCLUSION

Our resolution of the issues presented in these cases leads us to conclude that Rochester Gas and Electric Corporation requires, prospectively, \$3,170,000 in additional annual revenues from steam service, over the amount produced by the temporary rates now in effect, as set forth in Appendix A. The approximately 32% increase comprises a

^{1/}In addition, recent updates suggest a reduced allocation of employees to the steam department and a corresponding reduction in its expenses. And because our income tax expense for the steam department has been computed without recognition of the interest deductions related to the investment in steam facilities, RG&E's shareholders will benefit accordingly. Thus, the company will be provided some return on its investment even with respect to the steam department standing alone.

\$2,729,000 increase in base rates and a \$441,000 increase in fuel adjustment revenues resulting from a change in the factor of adjustment.

The Commission orders:

1. Rochester Gas and Electric Corporation (the company) is directed to cancel the tariff leaves and supplements listed in Appendix B on or before July 15, 1984.

2. The company is authorized to file amendments to its steam tariff schedule designed to produce additional annual revenues in Case 28612 in an amount and manner consistent with the foregoing Opinion. The company shall serve copies of its compliance filing on all parties listing appearances in these proceedings. Any comments on the compliance filing must be received at the Commission's offices within ten days of service of the company's proposed amendments. Amendments specified in the compliance filing shall not become effective on a permanent basis until approved by the Commission. The company is authorized to file the amendments on or after July 16, 1984 to go into effect on not less than one day's notice, subject to refund if any showing is made that the new rates are not in full compliance with this Opinion and Order. The requirement of §80(10) of the Public Service Law to newspaper publication of the amendments authorized in this paragraph is waived, provided the company notifies each customer affected by the compliance filing.

3. The company is directed to file, within thirty days of the date of this Opinion and Order, a proposed plan for abandoning the steam system by October 1, 1985. The

plan shall examine, among other things, the issue of customer assistance and the accounting treatment of such items as plant retirement, cost of removal and undepreciated investment. Copies of the plan shall be served individually on all remaining customers and on all parties listing appearances in these proceedings. The period for comment shall be two weeks from service.

4. The temporary rates set on July 18, 1983 in Case 28316 and revised through rehearing on December 12, 1983 shall be made permanent for the period they will have been in effect.

5. Except as here granted, all exceptions to the Administrative Law Judges' recommended decisions in Cases 28609, et al. (insofar as pertinent to steam service) and Case 28316 are denied.

6. Except as here modified, the recommended decisions of the Administrative Law Judges are adopted as part of this Opinion and Order.

7. These proceedings are continued.

By the Commission,

(SIGNED)

JOHN J. KELLIHER
Secretary

ROCHESTER GAS AND ELECTRIC CORPORATION

Steam Department Income Statement and Rate of Return Per Commission 12 Months Ended July 31, 1985 (000's)

	Per ALJ Before Rate Increase	Commission Adjustments	As Adjusted	Increase Per Commission	Per Commission
<u>Revenues</u>	\$10,266	1) \$ 150	\$10,416	\$2,729	\$13,145
Customer					
Total Revenues	<u>10,266</u>	<u>150</u>	<u>10,416</u>	<u>2,729</u>	<u>13,145</u>
<u>Expenses</u>	10,023	2) (19)	10,004		10,004
Depreciation	611		611		611
Amortization	5		5		5
Taxes - Local, State, Other	<u>2,370</u>	3) <u>(259)</u>	<u>2,111</u>	6) <u>184</u>	<u>2,295</u>
Operating Income Before Federal Income Taxes	(2,743)	428	(2,315)	2,545	230
Federal Income Taxes Payable	(1,517)	4) 498	(1,019)	7) 1,171	152
Investment Tax Credit Adjustment					
Provision for Deferred Income Taxes - Net	78		78		78
Interperiod Tax Allocation	<u>12</u>	5) <u>(12)</u>	<u>(941)</u>	<u>1,171</u>	<u>230</u>
Total Federal Income Taxes	(1,427)	486	(941)	1,171	230
Operating Income	(1,316)	(58)	(1,374)	1,374	0
Adjustment for Allowance for Funds Used During Construction	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Balance for Return	<u>\$ (1,316)</u>	<u>-</u>	<u>\$ (1,374)</u>	<u>-</u>	<u>\$ 0</u>
Average Rate Base	<u>\$11,568</u>		<u>\$11,568</u>		<u>\$11,568</u>
Rate of Return	(11.38%)		(11.88%)		0.0%

CASES 28316 and 28612

APPENDIX A
Page 1 of 3

ROCHESTER GAS AND ELECTRIC CORPORATIONSteam Department
Explanation of Commission Adjustments
(000's)1) Revenues

a) To reflect existing factor of adjustment (1.1809) in base tariff revenues; plus revenue tax gross-up.	\$	(115)	
b) To reflect proposed factor of adjustment (1.3153) in determining PCA revenues; plus revenue tax gross-up.		<u>265</u>	<u>\$ 150</u>

2) Expenses

To eliminate 1985 estimated wage increase reflected by ALJ (2 months)			<u>\$ (19)</u>
---	--	--	----------------

3) Taxes - Local, State, Other

a) Property Taxes - to reflect decrease in rate year property taxes per letter from RG&E dated June 12, 1984.	\$	(269)	
b) Revenue Taxes - impact on adjustments 1a and 1b above.		<u>10</u>	<u>\$ (259)</u>

4) Federal Income Taxes Payable

Operating Income Before F.I.T. (column 3) \$ (2,315)

F.I.T. deductions consistent with no return:

Deferred Fuel	\$ (98)		
Taxes Capitalized	(8)		
Additional Deductible Property Taxes	42		
Pensions Capitalized	(6)		
Accounting Cost Capitalized	(11)		
Additional Deductible Depreciation	103		
Cost of Removal	(17)		
Taxes Deferred Amortized	9		
Date of Taxable Status	84		
ITC Basis Adjustment	<u>2</u>		
Taxable Income		<u>100</u>	
		\$ (2,215)	
Tax at 46%		\$ (1,019)	
Less Amount per ALJ		<u>(1,517)</u>	<u>\$ 498</u>

ROCHESTER GAS AND ELECTRIC CORPORATION

Steam Department
Explanation of Commission Adjustments
(000's)

5) Interperiod Tax Allocation

To reflect flow through of capitalized
overheads.

\$ (12)

6) Revenue Taxes at 6.75%.

\$ 184

7) Federal Income Taxes Payable:
Operating income before F.I.T. at 46%

\$1,171

ROCHESTER GAS AND ELECTRIC CORPORATION

Amendments to Schedule P.S.C. No. 4 - Steam

Twelfth Revised Leaf No. 23

Fourteenth Revised Leaf No. 24

Nineteenth Revised Leaf No. 17

Supplements Nos. 25 and 26

Appendix E
RECEIVED
4/8/85

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

At a session of the Public Service
Commission held in the City of
Albany on April 3, 1985.

COMMISSIONERS PRESENT:

Paul L. Gioia, Chairman
Edward P. Larkin
Carmel Carrington Marr
Harold A. Jerry, Jr.
Anne F. Mead
Rosemary S. Pooler

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CASE 28316 - ROCHESTER GAS AND ELECTRIC CORPORATION -
Steam Rates - Expanded Proceeding

CASE 28612 - ROCHESTER GAS AND ELECTRIC CORPORATION -
Steam Rates

ORDER AFFIRMING ABANDONMENT DATE

(Issued April 4, 1985)

BY THE COMMISSION:

INTRODUCTION

By our Opinion No. 34-19,^{1/} we required, among other things, that Rochester Gas and Electric Corporation (RG&E or the company) file, by August 10, 1984, a plan for abandoning its steam system on October 1, 1985. (The company's steam service had been steadily losing customers and we determined that such service could no longer be provided at reasonable rates and that the termination of regulated steam service was therefore appropriate.^{2/}) RG&E

1/Cases 28316, et al., Rochester Gas and Electric Corporation - Steam Rates, Opinion No. 34-19 (issued July 11, 1984).

2/The history of the company's steam business and the prospects for future steam service are discussed at pages 3-6 of Opinion No. 34-19.

filed the plan on August 9, 1984, and twenty parties commented on it by October 15, 1984, the deadline for comments.^{1/} At our session of January 30, 1985, we considered a plan that provided for financial assistance to the company's steam customers if they chose to convert to gas service. We also, at that time, affirmed that RG&E would be authorized to abandon the system in October, 1985. Interested parties were notified of our decision by letter dated February 12, 1985; the letter also provided that comments on the financial assistance plan would be accepted through March 11, 1985.

Several letters concerning various aspects of the financial assistance plan have been received and are being reviewed by our Power Division; they are not considered here. Letters commenting on the abandonment date have also been received from various parties; these entities seek an extension of the authorized October 1 abandonment date.^{2/} Their comments are discussed below, after consideration of a legal issue posed by Multiple Intervenors.

THE AUTHORITY FOR THE COMMISSION'S ACTION

Multiple Intervenors (MI) claims we must conduct an abandonment proceeding before allowing a public utility to abandon service. It says that requirement may be inferred from our duty to assure adequate service (Public Service Law §§79 and 80) and Spring Brook Water Co. v. Village of Hudson Falls^{3/} and that our action here was improper, for the

^{1/}The comment period was originally to expire on August 24, 1984 but two extensions of that deadline were granted at the request of various commentators.

^{2/}The Appendix contains a list of parties submitting recent comments on RG&E's steam system. Only comments on the abandonment date are discussed below.

^{3/}269 AD 313 (3d Dept. 1945).

subject of abandonment of the system was not considered in the hearings. MI says even RG&E contested our authority to require an abandonment and that our action here denied MI due process.

Staff replies that we had expanded the scope of Case 28316 "to encompass a full consideration of the company's plans for its steam department" and that the claim that MI has been denied due process is "preposterous" for, as a party to Case 28316, it was well aware of the purpose and schedule of that proceeding.

While MI has shown that we have a duty to insure adequate service at just and reasonable charges, it has not shown that we must conduct an "abandonment proceeding" in circumstances such as this. Indeed, RG&E's steam customers have made their arguments through written filings, and the Public Service Law does not require a formal hearing in this instance. Additionally, MI's citation of Spring Brook is inapposite, for that case held that a company may not cease rendering service without our consent and that we are "entitled" to inquire into the issue of whether sufficient grounds exist to justify abandonment of service. Here, we considered various alternatives for the steam system and concluded that the company should be permitted to abandon the system because it is currently uneconomic. That is all that is required; this aspect of MI's petition is denied.

THE TIMING OF THE ABANDONMENT

MI claims our selection of October 1, 1985 as the date on or after which the company may abandon the system is without record support and is therefore arbitrary and capricious. It notes it had suggested, in comments on the

proposed plan, an April 1, 1986 abandonment date and that we have not explained our implicit rejection of that proposal. The abandonment on October 1, 1985, it goes on, was never discussed on the record.

As for the merits, MI contends most customers would need significantly more time to convert to an alternative system. In a similar vein, the other comments generally urge that the abandonment date be extended. (Most comments advocate that the extension be for one year, to October 1, 1986.) The commentators also suggest that extension of the abandonment date would allow alternative steam service options--which they support--time to become viable, and they argue that they lack the time and resources to convert to alternative energy sources by October 1, 1985.

Staff replies, and claims the selection of the October 1, 1985 date "carefully balanced RG&E's right to rate relief against its customers' need to convert from steam to another energy source. . . ." It urges us to reaffirm the October 1 date.

The petitioners have presented no reason for us to reconsider our decision to authorize an October 1, 1985 abandonment date. First, the February 12 letter sought comments on the financial assistance plan, not on the abandonment date. The comments thus are unsolicited and untimely. We announced the October 1, 1985 date in our July 11, 1984 opinion, and the proper method for challenging that date was to submit petitions for rehearing--within the thirty-day time limit--of that opinion. Second, we considered and explicitly rejected, at our January 30, 1985 session, similar arguments that we should extend the abandonment date. The arguments raised here are no different and are unsupported by analyses of why the abandonment date need be

extended (e.g., a showing--instead of bare assertion--that conversion is not practicable within that time). Finally, our decision, while dictated by fundamental marketing principles, to deny the company a conventional return on its steam investment contemplated that the company would be allowed to abandon the system after a reasonable transition period.

Notwithstanding the foregoing, the company remains free, of course, to negotiate with its customers--with whose needs it is familiar--concerning an extension of the termination date. If, following such negotiations, the company concludes it is prepared to maintain service for a temporary period beyond October 1, it is free to do so. For now, however, we see no need to reconsider our original determination that RG&E is authorized to cease providing steam service on October 1, 1985.

The Commission orders:

1. The petitions for an extension of the previously authorized steam system abandonment date of October 1, 1985 are denied.
2. These proceedings are continued.

By the Commission,

(SIGNED)

JOHN J. KELLNER
Secretary

APPENDIX

PARTIES COMMENTING ON THE
STEAM ABANDONMENT PLAN

Assemblywoman Pinny Cooke
Assemblyman David F. Gantt
Chase Lincoln First Bank, N.A.
St. Luke's Episcopal Church
New York State Energy Research and
Development Authority
The Temple Building
Lowell Colvin, Inc.
Mr. David Thurston
Mr. Jack Rubens
City of Rochester
Monroe County
Rochester Community Savings Bank
Xerox Corporation
The Genesee Hospital
Berghash Realty Company, Inc.
Monroe Reprographics, Inc.
P.S. Prince Corporation
Rochester District Heating Cooperative
Multiple Intervenors
Department of Public Service Staff
Rochester Optical Manufacturing Co., Inc.
Sibley Real Estate Services, Inc.
Sibley's, A Division of Associated Dry Goods
RG&E
Department of the Navy
YMCA of Rochester and Monroe County
Christ Church
Executive Office Building

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

OPINION NO. 84-19

- CASE 28316 - ROCHESTER GAS AND ELECTRIC CORPORATION -
Steam Rates - Expanded Proceeding
- CASE 28612 - ROCHESTER GAS AND ELECTRIC CORPORATION -
Steam Rates

OPINION AND ORDER CONCERNING STEAM
SERVICE AND DETERMINING REVENUE REQUIREMENT

Issued: July 11, 1934

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STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

APPEARANCES

Joel Blau, Esq. and Steven Blow, Esq., Staff Counsel, Three Empire State Plaza, Albany, New York 12223, for the Staff of the Department of Public Service.

Nixon, Hargrave, Devans & Doyle (by Richard N. George, Robert L. Daileader and Stanley W. Widger, Esqs., of Counsel), Lincoln First Tower, P. O. Box 1051, Rochester, New York 14603, for Rochester Gas and Electric Corporation.

Algird F. White, Jr., One Steuben Place, Box 314, Albany, New York 12201, for Multiple Intervenors.

Bond Schoeneck & King (by William P. Burrows, Esq., of Counsel), One Lincoln Center, Syracuse, New York 13202, for Lincoln First Bank, N.A.

David Thurston, Pro Se and Harris, Beach, Wilcox, Rubin & Levey (by Thomas M. Hampson, Esq., of Counsel), Two State Street, Rochester, New York 14614.

Harris, Beach, Wilcox, Rubin & Levey (by Angela Panzarella, Esq., of Counsel), Two State Street, Rochester, New York 14614, for Sibleys, Associated Dry Goods.

STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

COMMISSIONERS:

Paul L. Gloia, Chairman
Edward P. Larkin
Carmel Carrington Marr
Harold A. Jerry, Jr.
Anne F. Mead
Rosemary S. Pooler

CASE 28316 - ROCHESTER GAS AND ELECTRIC CORPORATION -
Steam Rates - Expanded Proceeding

CASE 28612 - ROCHESTER GAS AND ELECTRIC CORPORATION -
Steam Rates

OPINION NO. 84-19

OPINION AND ORDER CONCERNING STEAM
SERVICE AND DETERMINING REVENUE REQUIREMENT

(Issued July 11, 1984)

BY THE COMMISSION:

INTRODUCTION

By order issued April 15, 1983 in Case 28316--part of the last Rochester Gas and Electric Corporation (RG&E or the company) combined gas and electric rate case--an expanded proceeding was initiated to consider the prospects for steam service. Later, on July 18, 1983, we authorized, as part of the RG&E general rate increase, a \$1,718,000 temporary steam rate increase, subject to refund or reparations.^{1/} The rates were made temporary because of the continued pendency of the expanded proceeding, and they were set so as to provide less than a full return on investment in order to discourage further the departure of customers while the

1/Cases 28313, et al., Rochester Gas and Electric Corporation,
Opinion No. 83-13 (issued July 18, 1983), mimeo pp. 76-74.

CASES 28316 and 28612

system's future was being considered. (Upon reconsideration, on December 12, 1983, an additional \$169,000 was authorized to insure an opportunity to recover operating costs, interest payments and preferred dividends.^{1/})

In August, 1983, RG&E filed, in Case 28612, for an additional \$5,460,000 increase (since updated to \$5,961,000) above the temporary steam rates. Consequently, this proceeding comprises Cases 28316 and 28612 and at issue is the proper level of rates in the former as well as the subsequent request in the latter.

A prehearing conference was held in Albany on May 12, 1983 and a public statement session was held in Rochester on June 16, 1983; on that date as well the RG&E personnel responsible for the long-range plan for the district steam system (the Steam Report) were cross-examined. An additional conference of the parties was held in Albany on July 29, 1983.

Evidentiary hearings, presided over by Administrative Law Judge David Schechter, were held in Henrietta on December 5, 6 and 7, 1983 and a record consisting of 910 transcript pages and 37 exhibits--numbered 150 through 186--was compiled. Initial briefs were filed by the company, Department of Public Service staff (staff), Multiple Intervenors (MI), and the Lincoln First Bank; RG&E and staff filed replies. Judge Schechter's recommended decision was issued on April 6, 1984. Briefs on exceptions were filed by RG&E, staff and David Thurston, pro se, while replies were submitted by RG&E and staff.

1/Cases 28313, et al., supra, Order Granting In Part And Denying In Part Petitions For Rehearing (Issued December 12, 1983).

BACKGROUND

RG&E began steam service to downtown Rochester in 1889 and in the 1920's offered service to industrial customers in the separate westside district. Downtown is served by Station 3 (Beebee Old House) and Station 8, while westside customers are served by Station 9. The system is an open loop system, that is, it lacks a condensate return to retrieve condensed steam for reuse; a more efficient closed loop system is not considered feasible and has not been proposed by any party. The system peaks of 617 customers and 4,090,576 Mlbs.^{1/} of annual sales were reached in 1956 and 1972, respectively. By August, 1983, the system had declined to 171 customers and 1,227,500 Mlbs. in annual sales.

The decline of the steam system started in the 1970's with the loss of eighty customers to urban renewal projects and was hastened by the 1973 OPEC oil embargo--which, coincidentally, followed RG&E's conversion of ten steam-producing facilities from coal to oil or gas--and the 1978 oil price increases. The company responded, it says, by seeking gradual increases in steam revenues rather than a full return; by reducing the cost of service by converting three oil-fired boilers to gas; by deferring a steam rate filing scheduled for 1981; and by proposing to revise the steam transfer credit to allocate Beebee Station operating and maintenance costs to the electric department.

In 1979, we ordered a comprehensive review of RG&E's steam operations but the studies originally contemplated were not completed. In closing the proceeding on August 27, 1983, however, we directed the company to file a

1/An Mlb. equals 1,000 pounds of steam.

long-range plan that would examine, among other things, the possibility of converting Beebee Station to coal, scaling-down the system, and eliminating one or both of the steam districts. The Steam Report was submitted on January 24, 1983, but inasmuch as the report could not be adequately considered within the context of the then pending rate case, this expanded proceeding was initiated and, as noted before, temporary steam rates were put in place.

THE COMPANY'S STEAM REPORT

The company noted in its initial brief that its "conclusion that its district steam business could not be returned to economic viability and the coal conversion project [Beebee Station] should not be pursued is based on a projected cost of RG&E steam compared to the cost of the customer's on-site production of steam assuming the customer installs a gas-fired boiler."^{1/} The cost per Mlb. for customer-provided steam (excluding the cost of converting) was found to be:

1983:	\$11.53 to \$13.40
1984:	\$13.41 to \$15.62
1985:	\$14.60 to \$16.77
1986:	\$15.91 to \$18.40

When compared to its "base case" analysis, which assumed 1983 sales of 1,150,000 Mlbs. and 1,000,000 Mlbs. of sales in 1984 and thereafter,^{2/} the company found the cost

1/RG&E's Initial Brief, p. 26.

2/The company made other assumptions it terms conservative, namely that customers would not reduce their individual requirements and that the cost of converting Beebee Station would be only \$25 million. In addition, the company ignored the tax benefits to customers for converting.

CASES 28316 and 28612

of RG&E steam per Mlb. exceeded the customer's alternatives by:

1983:	\$3.77 to \$5.70
1984:	\$5.62 to \$7.96
1985:	\$7.16 to \$9.09
1986:	\$7.58 to \$9.78 (Beebee Station not converted)
1986:	\$5.45 to \$7.65 (Beebee Station converted and amortization of cost included)
1986:	\$4.46 to \$6.66 (Beebee Station converted but amortization not included)

The second step of the company's analysis was to determine the period required for customers to recover, from the savings they would enjoy by reason of leaving RG&E's system and installing their own facilities, their costs of conversion. Assuming Beebee Station were converted to coal but that the costs of doing so were not recovered from steam customers--i.e., the scenario most favorable to continuing RG&E's steam service--the company found that all 193 customers then on-line would recover their cost of converting to gas-fired boilers within a three- to six-year period and that 123 of the 193 would recover from one to nearly six times their investment within three years.

The company also submitted a "probable case" scenario based on the assertedly more realistic assumption that annual sales would decline after 1984 at a rate of 250,000 Mlbs. per year. As a consequence, the customers' savings from leaving the system would increase dramatically--\$3.81 per Mlb. in 1984; \$11.99 per Mlb. in 1985; and a range of \$29.31 to \$37.31 per Mlb. in 1986 depending on the status

CASES 28316 and 28612

of Beebee Station--and the payback period for the investment needed to leave would shorten correspondingly. Accordingly, the company concluded the conversion of Beebee Station would not make RG&E steam rates competitive and the project should not be undertaken.

The company also found the conversion of Beebee Station would not be worthwhile for the electric department, for it would provide cost savings of only \$25.8 million in 1982 dollars as opposed to a conversion cost, also in 1982 dollars, of \$25 to \$33 million. Again, the company based its calculations on assumptions it considered conservative or most favorable to conversion.

Finally, the company, as noted in its initial brief, considered other means of controlling costs, such as reducing the number of boilers on standby, but found the potential benefits limited. As for distribution losses, it found that installing a condensate return system or reinsulating would require a "massive construction project, the costs of which would offset the fuel cost savings."^{1/} RG&E reported also that eliminating individual lines, while reducing distribution losses, would reduce sales, and therefore it concluded a reduction in system size would not necessarily benefit the system.

In sum, RG&E concluded there was no available option that would make company steam competitive with the customers' alternatives. It thus found it appropriate to inform customers that they should convert to alternatives as soon as possible. At the same time, assertedly in the interests of providing customer flexibility and ensuring the orderly phase-out of the system, the company said it was willing to continue providing service, but at compensatory rates, while customers assessed their options and prepared to leave the system.

STAFF'S PROPOSAL

Long-Range Prospects

Staff contends the steam system can be preserved. It maintains costs per unit can be decreased by increasing sales and that fuel costs can be reduced by converting Beebe Station to coal. It would require conversion, however, only if a survey of current and former customers revealed that a prerequisite load could be attained by offering take-or-pay contracts at competitive rates. Competitive rates, it believes, could be offered by deferring some expenses now and recovering them later, after the Beebe Station conversion.

Staff notes the underpinning of its proposal is a present worth analysis of revenue requirements for the period 1984 to 1998, which suggests savings of \$48 million if customers use company-supplied steam. Moreover, staff maintains conversion of Beebe Station is more advantageous to electric customers than the two alternatives held out by the company; i.e., using the station only to enhance electric reliability or retiring the units in question and installing new transmission capacity. Staff argues conversion holds a \$58 to \$63 million benefit over the first alternative and has a \$52 to \$57 million advantage over the latter.

Current Rates

Essential to staff's plan is the setting of currently competitive rates. It proposes the temporary rates now in effect be made permanent and frozen at that level until the company secures an adequate number of commitments to take-or-pay contracts or until the company presents an orderly phase-out or abandonment plan.

Staff maintains that (in the absence of resuscitative measures) RG&E's steam system has lost its economic value and that by releasing the steam report and encouraging on-site alternatives the company has accelerated revenue and sales attrition. Consequently, though staff believes the 9% increase in the last case for variable costs, interest payments and preferred dividends was warranted, it opposes a 35% increase for variable costs in the rate year because it believes the company should bear the burden of its intended cessation of steam service. For the same reasons, it opposes the company's requested 59% increase to fully compensatory rates.

Staff argues the rate freeze is not unjust or illegal because "[r]egulation does not assure that a utility will make a profit. . .[and] [t]he possible loss of monopoly power and consequent loss of economic value is a recognized risk of investing in utilities."^{1/} Further, it contends that compensatory rates are not warranted because a similarly situated unregulated company, with no opportunity to provide subsidies from its monopoly gas and electric operations, would be content to recover variable costs and a contribution to fixed costs. It also views application of the Public Service Law §79(1) requirement that "just and reasonable" rates include a return sufficient to attract capital for continued service as illogical when the company envisions the termination of service in 1986. As for §85 of the Public Service Law, which requires "due regard" for the steam system's original cost less depreciation, staff sees it as inapplicable where the system has no real value. Finally, it characterizes the company's plan as a de facto abandonment, a condition which, it says, permits less than compensatory rates.

1/Staff's Initial Brief, p. 17.

PLANNING FOR THE SYSTEM

Recommended Decision

The Judge, in discussing the survey designed to determine customer interest in take-or-pay contracts and thereby determine the likelihood of the plan's success, concluded that "while at this juncture the feasibility of the Staff proposal is in serious doubt in light of the very cogent factual impediments to which RG&E points, any resolution of such doubts in advance of that survey would be less than conclusive and, as such, fall short of public interest considerations."^{1/} He therefore recommends that the survey be conducted.

The impediments noted by the company and cited by the Judge are varied; they are here briefly listed. First, the company alleged that staff's present worth discounting masks the effect of interest on the deferral account balance and that the amount steam customers would have to repay for the underpriced service they received in the initial years is \$17.1 million rather than the \$11.6 million computed by staff. Second, coal burning limitations in the Department of Environmental Conservation (DEC) permit would offset the estimated cost saving.^{2/} Third, staff's pricing plan might prevent further erosion of the customer base but would not lead former customers to return. Fourth, in RG&E's view, staff has allocated too great a portion of the Beebe Station conversion costs to the electric department. Fifth, take-or-pay contracts are of questionable validity and offer little protection in the event the system fails, and staff has failed to address the case of non-contract

^{1/}N.D., p. 61.

^{2/}It should be noted that the parties agree that the shutdown of the system and likely conversion of customers to natural gas would not significantly increase ambient pollutant levels.

customers. Sixth, significant additional costs, such as the possibility of requiring new mains, installing services and meters, and the tax treatment of the deferred expenses, have been ignored. Seventh, a significantly higher discount rate is warranted for assessing risk. Finally, other risks, including declines in sales levels, financing difficulties and timing problems, have been overlooked.

Judge Schechter disagreed as to the limitations imposed by the DEC coal permit and found as well that take-or-pay contracts are allowed where there is a reasonable opportunity to recover the deferred costs. He agreed, however, with the company that present worth discounting is an inaccurate measure of costs and that staff's view of cost savings from conversion are optimistic. In addition, he considered valid the company's criticisms concerning staff's pricing proposals, the efficacy of take-or-pay contracts and the failure to reflect some additional costs. Nevertheless, he concluded "only the survey can either confirm or negate the doubts,"^{1/} and, as noted, he recommends the survey be conducted.

Mr. Thurston's Comments

Mr. Thurston's brief on exceptions notes that a study of district heating in Rochester is currently being carried out through the New York State Energy Research and Development Authority (NYSERDA) and that, as a result, negotiations to purchase the system have been suspended. Central to Mr. Thurston's comments is a claim that tension between the company and staff has needlessly delayed a resolution, and that customers have little faith in either as a result. Mr. Thurston believes a smaller workable system can be salvaged and operated privately. Thus, he recommends we adopt a "fish or cut bait" approach and encourage RG&E to come to terms with prospective operators of a deregulated system.

Company's Exceptions

RG&E, restating many of its earlier arguments, contends the survey to determine the attractiveness of take-or-pay contracts should not be conducted. It argues that staff's economic analysis is flawed, and that the take-or-pay contract idea has been inadequately examined. For example, it goes on, little thought has been given to what would happen after the contracts expire, to how to collect from customers who move outside the state or whose facilities are destroyed or condemned, or to how to reconcile the tension between contracting and non-contracting customers. RG&E questions as well the legality of deferring the recovery of legitimate expenses and also of requiring the company to invest massive sums of money--\$34 million, it says--in a failing business. It objects also to the inordinate length of time required to implement a plan that will not likely work, especially when customers need immediate answers to assess their situation. Finally, RG&E argues the survey idea is unfocused and customers will be unwilling to commit themselves when it is apparent the system is uneconomic.

Staff replies the survey is an essential first step to restructuring the system, and it points, as evidence of the worth of a survey, to the company's financial support for a NYSERDA study to determine the future of district heating in Rochester. It defends the legality of its proposal and responds to the company's challenges to its economic analysis. Finally, it concludes that only a survey can resolve the question of how many customers and how much load could be expected if staff's proposal were adopted.

Staff's Exceptions

Staff excepts to the Judge's endorsement of several of the company's criticisms of its proposal. It argues that present worth discounting "takes inflation and interest rates into account and allows a stream of different year's dollars to be summed and appropriately compared with an alternative stream of different year's dollars."^{1/} Therefore, it contends, contrary to the Judge, the effect of inflation is not masked by present worth discounting.

With respect to the Judge's finding that staff overestimated the benefits of converting Beebe Station because it ignored the need for additional transmission capacity, staff contends the company did not establish a need for a transmission line into downtown Rochester. In addition, staff argues that even if a line were needed, conversion would still bring significant benefits.

Last, responding to the Judge's comment that its timetable was overly optimistic, staff says its only concern is finding a viable approach that may "be begun immediately and be carried out expeditiously."^{2/} It requests that we decide whether a survey is needed before considering other issues.

The company responds that present worth discounting is appropriate where the relevant inquiry is the comparison of differing revenue streams, but that is not the case here. It says the critical issue here is how much will be at risk when the take-or-pay contracts expire in 1988. With respect to the need for transmission capacity into downtown Rochester, the company says the benefit of the coal conversion to the electric department is considerably lower than the \$41

1/Staff's Brief on Exceptions, p. 9.

2/Id., p. 11.

million suggested by staff because the units projected to produce 200,000 MWh annually are old and will also be required to produce send-out steam; RG&E considers 20,000 MWh more likely. As for the staff request to determine the desirability of the survey before examining the other problems with its proposal, RG&E contends such a strategy will result in wasted time and money. Finally, RG&E asserts an inconsistency exists between staff's proposed rate freeze and the attempt to put off resolution of other issues.

Discussion

Judge Schechter recommends the survey be conducted, despite the problems with staff's analysis, because he believes it is in the public interest to discover whether customers are willing to commit themselves to long-term take-or-pay contracts. But we are unpersuaded that conducting such a survey now would make sense.

It is abundantly clear that the system's decline is becoming more rapid. In August, 1983, there were 171 customers being served and less than a year later--despite rates below the level suggested by normal ratemaking--there are only 115 customers on-line and 27 others have set a date certain for leaving the system. Correspondingly, the most recent forecast of annual sales is approximately one-half the original rate year projection and the continuing loss of customers ensures that sales levels will fall even further. Given these circumstances, it seems the survey would merely delay the inevitable while sending the wrong signals to the customers remaining on-line. District heating may have a future in Rochester as a customer-owned enterprise and NYSDORA is studying that possibility, among others, but a traditional regulated steam system appears unworkable.

Given that conclusion, the "fish or cut bait" approach is warranted and attention should be shifted from bailing out the system to finding a reasonable method of terminating regulated steam service. Accordingly, the company is directed to submit, within thirty days, a detailed plan for abandoning the system by a specific date or phasing it out step by step. The proposal should examine, among other things, the extent, if any, to which customers' conversion costs would be defrayed and the accounting treatment of such items as plant retirement, cost of removal and undepreciated investment. Following our review of the company's proposed plan and any comments by intervenors or customers, we shall determine the next steps toward an orderly termination of the company's steam business.

RATES

Recommended Decision

Judge Schechter concluded the only issues ripe for resolution in this case pertain to the permanent rate levels to be adopted for Case 28316 and Case 28612. In his estimation, the central issues are: "1) Is the utility now entitled to a 'full' return on its steam plant investment, as RG&E urges?; and 2) Should such investment now be deemed valueless for ratemaking purposes, as Staff urges?"^{1/} He answered both questions negatively, the first on the grounds that "RG&E's position overlooks its own assessment of the steam department's prospects"^{2/} and the second because staff's view "fails to accord 'due regard' to the applicable original cost concept and its argument that the system has no value is unpersuasive."^{3/}

^{1/}N.D., p. 63.

^{2/}Id.

^{3/}Id.

CASES 28316 and 28612

On the basis of his reading of the temporary rate order in Case 28316, the Judge found that we did not "foreclose permanent steam rates reflecting a return on an original cost less depreciation basis."^{1/} He concluded that we contemplated neither a normal nor a zero return but considered a less than normal return proper for an indisputably failing business. He characterized a full return on the steam plant as "patently unwarranted" given the company's own perception that staff's remedial measures are futile. Nevertheless, he believed a positive return on steam plant is required inasmuch as the plant "has some value considering that service, as necessary, will continue to be rendered to remaining steam customers through 1986."^{2/}

In so finding, the Judge rejected staff's rate freeze proposal and decided that the company should recover, in addition to its variable costs, some return on investment. Starting with the DCF-derived companywide equity allowance, he fashioned a formula that is supposed to recognize the "negative growth" of the steam department while reflecting a "remaining three year life." Specifically, he would disregard the growth component, divide the yield by the number of years remaining and then subtract that figure from the yield to determine the equity allowance. For Case 28316, the calculations are: $10.3\% \text{ yield} \div \text{by } 3 \text{ years} = 3.4\%$; $10.3\% - 3.4\% = 6.9\%$. That 6.9% equity return would produce an overall return on steam plant of 8.47% and a \$2.64 million permanent rate increase. Accordingly, he found reparations were required to increase revenues to that level.

^{1/}Id., p. 66.

^{2/}Id.

CASES 28316 and 28612

In making his calculation, the Judge relied on the uncontested steam revenue and expense projections in Case 28316 rather than on current data. He held the cases cited by the company supporting the use of current data were inapposite, for they antedated the fully forecasted rate year technique and, moreover, he saw the company's position as inconsistent with its refusal to extend the original suspension period to consider the rate effects of the Steam Report.

For Case 28612, he recommends the same approach. The calculations, using Judge Vernieu's recommended decision, are: $11.9\% \text{ yield} \times 2/3$ (reflects fact that two of the three remaining years of operation will be completed) = 7.93% ; $11.9\% - 7.9\% = 3.97\%$. The result is a \$4.309 million increase (above the temporary rates set in Case 28316).

Company's Exceptions

RG&E argues the Judge erred in recommending that rates in Case 28316 be set using the rate case data available as of July, 1983. It reasserts its position that we are bound here by New York Telephone Company v. Public Service Commission,^{1/} which requires the use of actual data where available, and contends it is immaterial that the case was decided before the move to a fully forecasted rate year. It opines that we must search for the most accurate data for setting rates, and it cites for further support the Policy Statement on Test Periods in Major Rate Proceedings. Accordingly, it urges that actual data--which reflect sales below those forecast in Case 28316--be employed to prevent an undercollection of revenue.

1/3 N.Y. 2114 (1971).

In response, staff argues the company is estopped from claiming an entitlement to rate relief and reparations based on updates because the company's refusal to extend the suspension period precluded the timely consideration of steam rates. Further, staff says the issue here relates to reparations, which are discretionary and not mandatory, and we are not required to allow retroactive reparations even if we set higher permanent rates prospectively.

RG&E excepts also to the Judge using a reduced return on equity for the steam department. It contends granting a return "less than the risk-free cost of money is confiscatory"^{1/} and that setting a different rate for steam is inconsistent with the practice of setting an overall rate of return for combination utilities.^{2/} Finally, it posits that the recommendation overlooks the fact that the 15.1% return on equity was intended to reflect the return needed on all operations and it contends a low return on steam plant requires a correspondingly higher return on gas and electric plant.

Staff does not answer this exception directly but says that the steam system is moribund while the gas and electric systems are "ongoing entities." The main thrust of staff's response is its speculation that the company was holding back for its reply brief on exceptions its argument regarding entitlement to fully compensatory rates, in which case, staff noted, it would request that the argument be disregarded or that staff be granted leave to reply.^{3/}

1/ RG&E's Brief on Exceptions, p. 33.

2/ For this practice, it cites Case 17276, Consolidated Edison Company of New York, Inc., Opinion No. 78-27, 18 NY FSC 1764 (1978).

3/ See discussion *infra*, regarding this issue.

Staff's Exceptions^{1/}

Staff objects to the Judge's compromise position that allows a return on steam plant. It contends, first, that it is improper to use a traditional DCF model, which contemplates a stream of dividends, when no dividends can be assumed. Moreover, it argues it is unrealistic to set rates on the premise of a 1986 shutdown without recommending a formal abandonment proceeding. Further, it posits that increasing rates will undermine the survey and that, in any event, there is no justification for rates higher than variable costs, which it characterizes as the minimal point at which a competitive firm would continue to provide service. In this regard, it asserts that it is "questionable whether RG&E would have been inclined to 'phase out' its steam service if it did not also have a franchised monopoly in the provision of the closest substitute--natural gas."^{2/}

Thus, staff renews its claim that a rate freeze is in order. It argues that in Case 28316 the company's variable costs (including depreciation, a return on working capital, interest payments and preferred dividends) were met, and that is all that is required. As for Case 28612, staff contends a rate freeze is in order as well because the Steam Report accelerated the decline of the system and the company should "bear the consequences of presenting an ill-conceived long-range plan rather than seeking a more orderly transition."^{3/} As a result, staff proposes a freeze until the company presents a detailed plan for either maintaining or abandoning the system.

^{1/}The Genesee Hospital and Xerox Corporation, both major steam users, also have submitted letters objecting to the recommended rate increase.

^{2/}Staff's Brief on Exceptions, p. 8.

^{3/}Id., p. 7.

RG&E submits, concerning the rate issues, three replies. It contends the Steam Report cannot be blamed for the accelerated decline of the steam system; that it is entitled to fully compensatory rates; and that it should not be required to undertake more studies if staff's plan is rejected.

Discussion

In determining the level of rates--both prospectively and for the time temporary rates have been in effect--we start by recognizing that a large number of the company's steam customers have left the system over the past two years, that, more recently, the rate of departure has increased dramatically, that the system can no longer survive economically, and that abandonment is inevitable after a reasonable phase-out period. In such circumstances, we are not obligated (and it would not be feasible) to follow traditional ratemaking principles and provide the company the level of expenses or return required by an on-going concern. This is particularly so here, where the company has failed to acknowledge that the system is no longer economically viable or to take steps to petition for its eventual abandonment.

Faced as we thus are with setting rates for a reasonable phase-out period, we are willing to authorize only such revenues as may be necessary, given the existing number of customers, to cover the expenses incurred in providing service. Further, we believe it reasonable to moderate any rate increases during the phase-out period, for we are reluctant to impose on the relatively few remaining customers the burden of paying the full costs of a steam system built to meet the needs of approximately 650 customers.

CASES 28316 and 28612

At the same time, we are mindful that the phase-out period should be limited in duration (consistent with the need of the existing customers to convert to alternate energy sources), and we recognize that meeting even out-of-pocket operating expenses may require authorizing a significant increase in the rates charged during that period. Indeed, such an increase will avoid the improper price signals which might result from keeping rates artificially low, and it will thus encourage customers to leave the system during the phase-out period.

With these considerations in mind, we conclude that the temporary rates set in Case 28316 should be made permanent and that, in Case 28612, the company should be allowed to recover its out-of-pocket expenses, which requires a rate increase of approximately 32%. These conclusions are discussed in turn.

1. Case 28316

When temporary rates were set in this case, the steam system had lost a number of customers and its future was dim. Accordingly, we expanded the on-going investigation of the system's prospects and requested that the issue of abandonment be considered.^{1/} That investigation has now revealed that the economic decline of the system is irreversible and that abandonment within approximately a year to 18 months is inevitable. Accordingly, we find the level of temporary rates--designed to recover the system's variable costs--may be made permanent, for the steam system was and is in a de facto phase-out period leading to abandonment, and that under such circumstances, a return on the steam investment is not reasonable or feasible.^{2/} As a result, neither reparations nor refunds are warranted under the circumstances.

1/Case 28316, Order Granting in Part and Denying in Part Petitions for Rehearing (issued December 12, 1983), mimeo p. 16.

2/See, Market Street Railway Co. v. California Railroad Commission, 324 U.S. 548 (1944).

2. Case 28612

In the rate year, it is likely, given recent indications, that customers will depart at an increasing rate, especially given the significant rate increase that is needed. Further, because of the small number of customers, the steam system is not economically viable and should be phased out over a reasonable period. As a result, we find, consistent with the Market Street Railway decision, supra, as well as sound marketing principles, that during the phase-out period, the level of rates should be set so as to be sufficient to allow recovery only of out-of-pocket expenses.

This level of allowed rates is reasonable because it reflects the inevitable fate of the system while allowing the company to recover its prudently incurred expenses. Moreover, it recognizes the economic burden placed on the remaining customers, who may also face expenses of converting to alternative energy sources. Finally, RG&E's resulting return, as computed on a consolidated company basis, is reasonable even under business-as-usual criteria.^{1/}

CONCLUSION

Our resolution of the issues presented in these cases leads us to conclude that Rochester Gas and Electric Corporation requires, prospectively, \$3,170,000 in additional annual revenues from steam service, over the amount produced by the temporary rates now in effect, as set forth in Appendix A. The approximately 32% increase comprises a

^{1/}In addition, recent updates suggest a reduced allocation of employees to the steam department and a corresponding reduction in its expenses. And because our income tax expense for the steam department has been computed without recognition of the interest deductions related to the investment in steam facilities, RG&E's shareholders will benefit accordingly. Thus, the company will be provided some return on its investment even with respect to the steam department standing alone.

CASES 28316 and 28612

\$2,729,000 increase in base rates and a \$441,000 increase in fuel adjustment revenues resulting from a change in the factor of adjustment.

The Commission orders:

1. Rochester Gas and Electric Corporation (the company) is directed to cancel the tariff leaves and supplements listed in Appendix B on or before July 15, 1984.

2. The company is authorized to file amendments to its steam tariff schedule designed to produce additional annual revenues in Case 28612 in an amount and manner consistent with the foregoing Opinion. The company shall serve copies of its compliance filing on all parties listing appearances in these proceedings. Any comments on the compliance filing must be received at the Commission's offices within ten days of service of the company's proposed amendments. Amendments specified in the compliance filing shall not become effective on a permanent basis until approved by the Commission. The company is authorized to file the amendments on or after July 16, 1984 to go into effect on not less than one day's notice, subject to refund if any showing is made that the new rates are not in full compliance with this Opinion and Order. The requirement of §80(10) of the Public Service Law to newspaper publication of the amendments authorized in this paragraph is waived, provided the company notifies each customer affected by the compliance filing.

3. The company is directed to file, within thirty days of the date of this Opinion and Order, a proposed plan for abandoning the steam system by October 1, 1985. The

CASES 28316 and 28612

plan shall examine, among other things, the issue of customer assistance and the accounting treatment of such items as plant retirement, cost of removal and undepreciated investment. Copies of the plan shall be served individually on all remaining customers and on all parties listing appearances in these proceedings. The period for comment shall be two weeks from service.

4. The temporary rates set on July 18, 1983 in Case 28316 and revised through rehearing on December 12, 1983 shall be made permanent for the period they will have been in effect.

5. Except as here granted, all exceptions to the Administrative Law Judges' recommended decisions in Cases 28609, et al. (insofar as pertinent to steam service) and Case 28316 are denied.

6. Except as here modified, the recommended decisions of the Administrative Law Judges are adopted as part of this Opinion and Order.

7. These proceedings are continued.

By the Commission,

(SIGNED)

JOHN J. KELLIHER
Secretary

ROCHESTER GAS AND ELECTRIC CORPORATIONSteam Department
Explanation of Commission Adjustments
(000's)1) Revenues

a) To reflect existing factor of adjustment (1.1809) in base tariff revenues; plus revenue tax gross-up.	\$	(115)	
b) To reflect proposed factor of adjustment (1.3153) in determining FCA revenues; plus revenue tax gross-up.		<u>265</u>	<u>\$ 150</u>

2) Expenses

To eliminate 1985 estimated wage increase reflected by ALJ (2 months)			<u>\$ (19)</u>
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3) Taxes - Local, State, Other

a) Property Taxes - to reflect decrease in rate year property taxes per letter from RG&E dated June 12, 1984.	\$	(269)	
b) Revenue Taxes - impact on adjustments 1a and 1b above.		<u>10</u>	<u>\$ (259)</u>

4) Federal Income Taxes Payable

Operating Income Before F.I.T. (column 3)	\$	(2,315)
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F.I.T. deductions consistent with no return:

Deferred Fuel	\$ (98)	
Taxes Capitalized	(8)	
Additional Deductible Property Taxes	42	
Pensions Capitalized	(6)	
Accounting Cost Capitalized	(11)	
Additional Deductible Depreciation	103	
Cost of Removal	(17)	
Taxes Deferred Amortized	9	
Date of Taxable Status	84	
ITC Basis Adjustment	<u>2</u>	<u>100</u>
Taxable Income		<u>\$ (2,215)</u>
Tax at 46%	\$	(1,019)
Less Amount per ALJ		<u>(1,517)</u>
		<u>\$ 498</u>

ROCHESTER GAS AND ELECTRIC CORPORATION

Steam Department
Explanation of Commission Adjustments
(000's)

5) Interperiod Tax Allocation

To reflect flow through of capitalized
overheads.

\$ (12)

6) Revenue Taxes at 6.75%.

\$ 184

7) Federal Income Taxes Payable:
Operating income before F.I.T. at 46%

\$1,171

ROCHESTER GAS AND ELECTRIC CORPORATION

Amendments to Schedule P.S.C. No. 4 - Steam

Twelfth Revised Leaf No. 23

Fourteenth Revised Leaf No. 24

Nineteenth Revised Leaf No. 17

Supplements Nos. 25 and 26