

STATE OF MISSOURI
PUBLIC SERVICE COMMISSION

At a Session of the Public Service
Commission held at its office
in Jefferson City on the 28th
day of May, 1993.

In the matter of the application of Missouri	)	
Public Service for a variance from provisions	)	
of 4 CSR 240-14 with regard to Osage Valley	)	<u>CASE NO. EO-93-227</u>
Electric Cooperative in one subdivision in	)	
Cass County, Missouri.	)	

ORDER DENYING VARIANCE

On January 27, 1993, Missouri Public Service (MPS), a division of UtiliCorp United Inc., filed an application requesting a variance from the Commission's Utility Promotional Practices rule, 4 CSR 240-14.010 et seq., to allow MPS to offer a rebate of up to \$300 for the installation of a heat pump and a rebate of up to \$100 for the installation of an electric water heater to Mr. Jerry McCulloh of McCulloh Builders, developer of 20 lots in the Garden West Subdivision located in the northwest section of Garden City, Cass County, Missouri. On February 3, 1993, Osage Valley Electric Cooperative (Osage) filed an Application To Participate As Non-Party And Suggestions to the Commission in support of its application.

MPS is a public utility subject to the jurisdiction of the Commission pursuant to Chapters 386 and 393, RSMo 1986 as amended, and engages in the business of supplying electricity and natural gas in parts of Missouri, with its principal place of business located at 10700 East 350 Highway, Kansas City, Missouri 64138. Osage is a rural electric cooperative organized pursuant to Chapter 394, RSMo 1986 as amended, and provides electric service in portions of MPS's electric service area. Osage, unlike MPS, is not regulated by the Commission as to its rates, charges, or terms and conditions of service.

The Commission's Utility Promotional Practices rules generally prohibit regulated gas and electric utilities from competing for new customers

by offering inducements which are free or less than actual cost or actual value. However, 4 CSR 240-14.010(2) provides that the Commission may grant a variance to a utility from the Promotional Practices rules for good cause shown. As good cause for the requested variance, MPS states that it is faced with unregulated competition by Osage, and that it could face customer growth stagnation in this area without the variance. MPS contends that in its experience Osage is aggressive in competing for new customers in the area where MPS and Osage both provide service, and that Osage has a policy to provide a rebate of \$300 for the installation of a heat pump and a rebate of \$100 for the installation of an electric water heater as incentives to induce developers and potential customers to receive electric service from Osage. MPS claims that the developer is making the decision concerning the electric supplier for the Garden West Subdivision principally on his ability to obtain the rebate inducements from Osage.

With its application, MPS has attached as Attachment No. 2 a financial analysis for extending service to the Garden West Subdivision, which indicates that, utilizing the MPS rules and regulations pertaining to its extension policy, this subdivision exceeds MPS guidelines for extending service even when the cost of the rebates is included. Also included in its application as Attachment No. 1 is a comparison of the estimated annual electric bills for potential customers receiving service from either MPS or Osage, which indicates that the estimated annual electric bill for a customer receiving service from MPS would be \$227 less than Osage.

MPS maintains that good cause exists to grant the variance because prospective customers will benefit through immediate savings, as well as through the receipt of long-term benefits from the effect of using more efficient equipment since the incentives in most instances are tied to more efficient utilization equipment, and existing customers will benefit through more efficient utilization of generation, transmission, and distribution facilities already in

place to serve these areas, and through the addition of new customers which are more efficient energy users (i.e., higher load factor) when compared to the average existing customer. Improving the system load factor, according to MPS, will benefit all parties.

The Staff of the Commission filed its recommendation on April 15, 1993. The application of MPS was reviewed by the Economic Analysis, Financial Analysis, Accounting, and Energy Departments of the Commission, and memoranda from the Accounting and Energy Departments were attached to the Staff's recommendation. Staff recommended disapproval of MPS's application.

By way of background, Staff indicates that the developer is planning a 20 lot expansion of an existing residential subdivision, the Garden West Subdivision. The houses on the first 40 lots of the subdivision have underground utilities, and are being provided with electric service by MPS and natural gas service by Gas Service. The developer contacted Gas Service and inquired about extending natural gas service to the newly-planned lots 41 through 60, but when informed that a refundable contribution would be necessary to perform the extension, the developer apparently decided to make the homes all-electric since the electric facilities could be placed in the ground at no additional cost to him. Documents filed by Osage in this case state that Osage has made no proposal to extend service to the subdivision, and the developer has made no request for service from Osage. However, Osage's nearest facilities are approximately .3 of a mile away, and could be extended on short notice.

In support of its recommendation that MPS's variance request be denied, Staff made a number of observations summarized as follows:

- (1) Many previously-granted variances dealt only with the need to waive costs beyond that which was allowed by existing tariffs. Since MPS's current tariffs already permit MPS to install all the necessary electrical facilities underground without a contribution from the developer, the requested

variance would merely provide an additional profit to the developer for choosing the installation of certain appliances, which is precisely the type of inducement that the promotional practices rules were originally established to prevent;

(2) There is nothing to suggest that Osage is a serious contender for this 20 lot expansion as no formal request has been made to Osage or formal offer extended by Osage, and MPS is already physically serving the subdivision;

(3) Choosing high efficiency equipment would be a good business decision with or without the rebate because it would be a good selling point, as would the selection of service from MPS where the potential future utility cost savings would also be a good selling point;

(4) There is no need for MPS to provide rebates to developers to increase capacity on its system, as aggressive recruitment of load will shorten the time when MPS will need to secure additional supply through purchased power, generation or both;

(5) The Staff reluctantly recommended approval of a similar application in Case No. EO-92-274 based on its understanding that the Commission believed that allowing variances would encourage Osage and MPS to enter into a territorial agreement. Staff points out that to date no territorial agreement has been filed, and that the granting of this variance may have the result of making Osage more willing to negotiate, but MPS less so.

The standards governing the grant of a variance from the promotional practices rules are set forth in Rule 4 CSR 240-14.030(1) as follows:

All promotional practices of a public utility or its affiliate shall be just and reasonable, reasonable as a business practice, economically feasible and compensatory and reasonably calculated to benefit both the utility and its customers.

Rule 4 CSR 240-14.030(1).

Upon review of MPS's application and attachments, and Staff's recommendation, the Commission finds that MPS has not met its burden of

demonstrating good cause under rule 4 CSR 240-14.010(2) sufficient to grant the requested variance. Previously the Commission has granted a number of variances on a case-by-case basis for the purpose of encouraging the rapid development of territorial agreements. In a similar case involving MPS and Osage, Case No. EO-92-274, the Commission granted the requested variance even though the Staff's recommendation of approval contained several reservations. In its decision the Commission determined that granting of the variance would encourage territorial agreements, and ordered MPS to pursue discussions of territorial agreements with all of its competing electrical cooperatives. Approximately one year has elapsed since the decision in Case No. EO-92-274, yet there has been no showing by MPS in its application of how the grant of an additional variance will encourage the establishment of a territorial agreement, when a prior variance involving the same parties and granted for the same purpose apparently failed to do so.

Although the Commission has granted variances in the past for the purpose of encouraging territorial agreements, the Commission has also signaled in recent cases its reluctance to grant variances where the showing of a real competitive threat is meager. As perhaps presaged by the dissent in Case No. EO-93-186, the Commission in Case No. EO-93-266, although granting the variance requested, indicated its unwillingness to continue to grant variances where the good cause showing offered by the applicant is marginal. In that decision the Commission noted the inadequacy of the applicant's showing of a competitive threat by the unregulated electrical cooperative, and stated: "[T]he Commission will no longer accept a showing of good cause premised on assumptions, implications, or unfounded potentialities," Case No. EO-93-266 at 3, and later in the decision, "The Commission has no future intention of giving carte blanche approval of variances of this type without a clear and substantial good cause showing by the utility of the need for and feasibility of such a variance." Case No. EO-93-266 at 4.

In the present case MPS has merely alleged its understanding that Osage has a policy of offering rebates on the installation of heat pumps and electric water heaters as an inducement to potential customers. There is no indication of any direct contact or exchange of offers or requests between Osage and the developers of this particular subdivision. The application of MPS simply lacks any evidence or showing of a credible competitive threat to MPS from Osage.

In the long-term it is not effective for either regulated electrical corporations or rural electrical cooperatives to engage in the sort of promotional practices which have recently been presented to the Commission in the form of variance requests. There is a finite amount of land suitable for development requiring electric service. In exchange for its investment in electrical plant the utility or cooperative is in effect given a monopoly over its service area, as an electrical customer cannot switch electric suppliers in the same way as he could switch long-distance telephone companies, but must comply with a complicated statutory scheme for change of electric suppliers, with no guarantee that the change will be allowed. See for example Sections 393.106.2 and 394.080.5, RSMo Cum. Supp. 1992. Although an electrical supplier can anticipate a future revenue stream once it has been selected as the supplier for a given customer, it must also factor in the initial cost of the necessary electrical facilities and the future repair and upkeep of those facilities as well as the impact of the new load on its overall generating capacity.

Part of the problem with MPS's application is that many of the arguments it makes in support thereof are double-edged, with a different picture presented depending on a turn of the kaleidoscope. In a case such as the present one the true winner is the developer, who can play one energy supplier off another to get the best deal. Thus, the value of the new load has been decreased by the amount of the rebates, as those costs must be recouped -- in the case of a regulated electric utility, either from the stockholders, the ratepayers, or

both -- prior to the recovery of any profit or sharing of fixed costs of service. Although the addition of load, particularly load which is likely to be balanced between the various seasons, as in the case of all-electric homes, may benefit current ratepayers because of the possibility of improving economies of scale and spreading fixed costs, other factors must be taken into consideration. As mentioned above, the new revenue stream must be balanced against the initial and maintenance cost of the required facilities and the size of the generation capacity necessary. While the addition of 20 residential customers in one subdivision is not likely to require the building of a new power plant or the purchase of power from another source, the impact of a policy of aggressive recruitment of load might need to be considered.

MPS contends that prospective customers will benefit in the short-term through immediate savings and in the long-term through the use of efficient equipment, and presumably, by paying less for their electricity needs than would be the case with Osage as the supplier. However, there is no guarantee that the savings on the cost of the appliances would be passed on to the purchasers of the homes; the developer could just as easily pocket the difference as profit. In addition, this promotional practice discriminates against the builder of a single home on a single lot versus the developer of multiple lots. This discrimination may be justifiable because of the larger potential load, but an individual choosing to build on a single lot may nevertheless be subsidizing individuals who choose to buy a home in a subdivision where multiple lots have been developed simultaneously.

With respect to the efficiency of the equipment and resulting benefit therefrom, this is an assumption the Commission is being asked to make with insufficient information. There is no evidence of who will make the decision as to the type or brand of appliance selected for the rebate. More particularly, there is no indication that the selected appliances must meet a certain energy

efficiency level. In addition the question of the general desirability of encouraging the use of energy-efficient appliances must be divorced from the question of whether MPS should be providing the incentive for their use under these circumstances.

MPS also maintains that existing customers will benefit from the more efficient use of facilities already in place to serve the area in question. Undoubtedly it would be more efficient for MPS to serve the remainder of a subdivision in which it already has a presence. However, this is but one factor which should be examined in determining the appropriateness of a variance and is not dispositive. Furthermore, in the event that Osage is selected as the supplier for the new homes in this subdivision, Osage's facilities are only .3 of a mile away, and such an extension would not be unduly detrimental to the public interest, even though not as efficient as an extension of MPS's facilities would be.

In order for the Commission to conclude that the variance requested in this case is in the public interest it is required to make a number of assumptions and engage in a number of suppositions. This is something the Commission is no longer inclined to do. The Commission reiterates its belief that in the long-term territorial agreements are in the best interest of both regulated electric utilities and electric cooperatives. Territorial agreements would provide stability, the potential for growth, and cumulative cost savings of promotional practices over the years. Nevertheless, the Commission also stresses its willingness to approve variances from the Commission's promotional practices rules in appropriate cases.

The present application, however, does not constitute an appropriate case. There is virtually no evidence to support the threshold issue of whether MPS has been faced with a genuine competitive threat from Osage. The benefits described as flowing to the utility and its customers are conclusory, implying

that potential load growth will always justify a variance where a utility has facilities nearby. Some of the benefits purported to inure to the prospective new customers of MPS are illusory, assuming that benefits to new customers are within the scope of the standard for variances. Also of concern is whether a promotional practice such as the granting of a direct rebate is just when offered to only one particular developer, and if not, whether the practice as a whole is reasonable when applied to the entire class of developers. For all of the foregoing reasons, the Commission deems it inadvisable to grant the requested variance.

IT IS THEREFORE ORDERED:

1. That the application for a variance from compliance with the Commission's Utility Promotional Practices rule, 4 CSR 240-14.010 et seq., filed by Missouri Public Service on January 27, 1993 is hereby denied for the reasons set forth above.

2. That the application to participate as a non-party filed by Osage Valley Electric Cooperative on February 3, 1993 is hereby denied as moot.

3. That this Order shall become effective on June 8, 1993.

BY THE COMMISSION

Brent Stewart

Brent Stewart
Executive Secretary

(S E A L)

Mueller, Chm., Perkins, Kincheloe,
and Crumpton, CC., Concur.
McClure, C., Absent.