STATE OF NEW YORK
PUBLIC SERVICE COMMISSION

OPINION NO. 96-27

CASE 95-E-0673 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Electric Service.

CASE 95-G-0674 - Proceeding on Motion of the Commission as to the Rates, Charges, Rules and Regulations of Rochester Gas and Electric Corporation for Gas Service.

CASE 95-M-1196 - Petition of Rochester Gas and Electric Corporation for Permission to Defer Certain Amounts Pertaining to the Adoption of Statement of Financial Accounting Standards Number 112, Filed in Case 9187.

CASE 95-M-1197 - Petition of Rochester Gas and Electric Corporation for Permission to Defer Certain Amounts Pertaining to Payments Made to the New York State Department of Taxation in 1995 as a Result of a Gross Receipts Tax Audit of the Company for the Years 1991, 1992 and 1993, Filed in Case 9187.

CASE 95-M-1198 - Petition of Rochester Gas and Electric Corporation for Permission to Defer Certain Amounts Pertaining to the Development of a New Customer Information System, Filed in Case 9187.

OPINION AND ORDER CONCERNING REVENUE REQUIREMENT AND RATE DESIGN

Issued and Effective: September 26, 1996

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STATE OF NEW YORK
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OPINION NO. 96-27

OPINION AND ORDER CONCERNING
REVENUE REQUIREMENT AND RATE DESIGN

(Issued and Effective September 26, 1996)

BY THE COMMISSION:

INTRODUCTION

On June 27, 1996, we issued an abbreviated order[1] setting electric rates for Rochester Gas and Electric Corporation (RG&E or the company), which directed RG&E to decrease its base rate electric revenues by $7.1 million (1.0%) in the first rate year ending June 30, 1997, and $3.5 million (.5%) in each of the rate years ending June 30, 1998 and 1999. These decreases equal those set forth in the Settlement Agreement (Settlement) submitted on May 10, 1996.

This opinion explains the bases for the determinations and conclusions in the 1996 Rate Order. The procedural background and public comments are summarized first, followed by a discussion of the Settlement.

BACKGROUND SUMMARY

On July 28, 1995, RG&E filed proposed tariff changes to its electric and gas rate schedules to become effective August 28, 1995. The company proposed an electric revenue increase of $17,087,000 or 2.4% for the rate year July 1, 1996 through June 30, 1997. The tariff amendments for gas service were designed to be revenue-neutral.

Following the company's filing, an agreement resolving the issues in the then-pending investigation of RG&E's gas costs was executed. In that agreement, which we approved,[2] RG&E generally accepted a base rate freeze through June 30, 1998.

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[1] Cases 95-E-0673 and 95-G-0674, Order Approving Terms of Settlement Agreement with Changes (issued June 27, 1996), (the 1996 Rate Order).

[2] Case 94-G-1048 - Rochester Gas and Electric Corporation - Investigation of Pipeline Capacity; Case 94-G-0939 - Rochester Gas and Electric Corporation - Gas Cost Increases; Case 95-G-0109 - Rochester Gas and Electric Corporation - Gas Service Winter Billing; and Case 92-G-0741 - Rochester Gas and Electric Corporation - Gas Rates; Opinion No. 95-18 (issued October 27, 1995).

Accordingly, with minor exceptions, there are no gas-specific issues addressed in this proceeding.

Public statement hearings were held on September 14, 1995, and evidentiary hearings were held on eight days between December 6, 1995 and February 20, 1996, at which testimony concerning the proposed tariff changes was received from 33 RG&E employees and two consultants retained by the company, 21 staff witnesses, three Consumer Protection Board (CPB) witnesses, and three consultants retained by Multiple Intervenors. The record consists of approximately 2,900 pages of transcripts and 260 exhibits; transcript pages 2,123 through 2,165 and exhibits 159 and 208 through 212 have been afforded trade secret status.

At the public statement hearings held in Rochester and Canandaigua on September 14, 1995, approximately 30 individuals spoke, including customers, civic group representatives, and government spokespersons. Many commented on the agreement that had been recently negotiated in RG&E’s gas proceedings, which as noted, was later approved.[1]

A number of speakers were concerned that higher utility bills would cause unacceptable hardships on those who are either on fixed incomes or tight budgets such as the elderly, disabled, and young families. After observing that other areas have lower bills, several speakers attributed their higher rates to RG&E’s mismanagement. For example, they claimed that poor business judgment led to the purchase of excess gas pipeline capacity and cost overruns for an electric power plant. They encouraged the introduction of more competition in the utility industry to shift the costs of these mistakes from the ratepayers to the stockholders.

Finally, safety concerns were also raised. It was noted that the gas distribution system had few automatic shut-off valves that would stop the flow of gas in case of a main break.

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[1] The public comments pertaining to the gas agreement were considered by the Commission in the context of the gas proceeding.

Since RG&E's service territory sits atop a geological fault line, one speaker pointed out, the lack of such valves might wreak havoc in the event of a major shift. Another speaker observed that in his area the electric distribution system experiences power surges that have ruined a number of his appliances.

During the evidentiary hearings, the only party, other than the company, to address every major issue in these proceedings was staff. It recommended a two-year rate plan that decreased RG&E's electric revenues by $21.3 million for the rate year ending June 30, 1997 and by $20.7 million for the rate year ending June 30, 1998. These rate reductions, achieved by spreading staff's one-year revenue requirement adjustments over a two-year period, represented decreases of approximately 3.0% in each of the two rate years covered by staff's multi-year rate plan. Alternatively, staff's one-year rate plan would decrease the company's revenues by $39.4 million or 5.6% for the rate year ending June 30, 1997.

Pursuant to our rules for settlements (16 NYCRR § 3.9), RG&E, by letters dated January 6, 1995 and September 22, 1995, notified all parties to its two most recently concluded rate cases of impending settlement negotiations intended to produce a comprehensive electric and gas rate settlement. Settlement negotiations were conducted by the parties, and, on November 16, 1995, an executed "Settlement Agreement - Demand Side Management Issues" (DSM Settlement) was filed. It was then adopted.[1] In addition, the parties continued their negotiations, which ultimately led to the submission of the Settlement on May 10, 1996. The Settlement is intended to resolve all of the outstanding issues in the instant proceedings.

[1] Cases 95-E-0673 and 95-G-0674, Opinion No. 95-20 (issued December 27, 1995).

THE SETTLEMENT

The Settlement was signed by staff, the company, CPB, Multiple Intervenors, the New York State Department of Law, Pace Energy Project/Natural Resources Defense Council (Pace/NRDC), and Charles A. Straka.[1] A copy of the Settlement is attached. One party, Jerome P. Bowe, opposes the Settlement.

The agreement on electric rates has several elements. First, effective as of July 1, 1996, the company would reduce its base rate revenues by 1.0% ($7.1 million) as compared with the base rate revenues that would have been produced by the electric rates then in effect. Similar reductions, each of 0.5% ($3.5 million), would be implemented effective July 1, 1997 and July 1, 1998, respectively. In addition, effective July 1, 1996 the Fuel Cost Adjustment Mechanism (FAC) would be eliminated (except in one respect discussed below), and fuel costs would be incorporated into base rates. The allowance for fuel costs would be lower than the cost of fuel reflected in the then effective rates, and this means that, overall, RG&E's revenues would decline by an amount greater than the specified base rate revenue reductions. According to RG&E, the total first-year reductions could be approximately 2.5% for residential customers and 4.5% for non-residential customers.

The projected fuel costs comprise the cost of fossil and nuclear fuels, and the cost of purchased power including the Kamine/Besicorp Allegany L.P. (Kamine) purchases at a cost rate of $.02 per kWh, the approximate rate RG&E is currently obligated to pay during the pendency of litigation involving Kamine. A Kamine Cost Adjustment Mechanism (KCAM) would be implemented to recover increases in Kamine purchased power costs above the $.02 rate if RG&E were obligated to pay more. At the full contract rate, Kamine would be entitled to prices as high as $.0865 per

[1] Mr. Straka is an individual customer who intervened in the proceeding. He expresses reservations about one matter--the Ginna Steam Generator Replacement Project--that is subsumed in the Settlement.

kWh, which could result in a $27.0 million increase in revenues (4.0%) in 1996 at full capacity. However, the Settlement sets limits on the amount of recovery in rates. The KCAM is more fully discussed infra.

The Settlement also eliminates the Electric Revenue Adjustment Mechanism (ERAM) that had been instituted in the settlement agreement adopted in Opinion No. 93-19 (1993 Settlement). Except for the 1995 incentives that the company is entitled to pursuant to the 1993 Settlement, no ERAM balances would remain. The 1995 incentives would be recoverable through June 30, 2001, subject to certain limits described below in the carry-forward discussion. The incentives could be employed to offset penalties that may be incurred by RG&E under the Service Quality Performance Program and any non-recoverable DSM program expenses that may be due customers. Excess amounts due customers would be carried forward and considered in future rate proceedings.

A second adjustment mechanism included in the Settlement is designed to protect the company against certain cost increases resulting from (1) any new governmental generic mandates (such as our decision in the Competitive Opportunities case[1]) or (2) catastrophic events, defined as "an event that triggers the designation of part of the [c]ompany's service territory as a disaster area or as being under a state of emergency."[2] If the costs associated with any single mandate or catastrophic event exceed a threshold of 3.0% of "actual regulatory electric common earnings" during any rate year, such costs may be deferred for future recovery.[3] Conversely, if any

[1] Cases 94-E-0952 et al., In the Matter of Competitive Opportunities Regarding Electric Service, Opinion No. 96-12 (issued May 20, 1996).

[2] Settlement, par. 17, n. 23.

[3] Three percent of electric common equity earnings is approximately $2.2 million.

mandate reduces costs by more than 3.0%, the savings are to be deferred and passed back to consumers. The recovery and the pass-back of any deferred cost increases or reductions are subject to various provisions that limit the impact of such recovery or pass-back in any one rate year and that provide for carrying forward (for future recovery or pass-back) any amounts not recovered or passed back during the three-year period covered by the Settlement itself.

With respect to both the KCAM and the adjustment mechanism for generic mandates and catastrophic events, the Settlement provides for our review to ensure that any increased costs sought to be recovered are based on prudent conduct and are reasonable.

Over the entire three-year term of the Settlement, if RG&E achieves a return on common equity in excess of 11.2%, the excess is to be shared equally between the company and its customers, with the customers' share being used to write down RG&E's $673 million net investment (exclusive of fuel and construction work in progress) in nuclear assets. According to the Settlement, the company or any party would have the right to petition for relief: (1) if the achieved return on equity fell below 8.5% or increased above 14.5%, (2) if pre-tax interest coverage fell below 2.5x, or (3) if fuel cost changes exceeded 10% of the electric common equity earnings.

The Settlement resolves a number of accounting and other ratemaking issues. There is a schedule of required amortizations (par. 11 and Schedule B), and there is a provision that preserves RG&E's right to recover incentive amounts attributable to the 1993 Settlement (par. 13). There is a provision that requires RG&E to absorb all flexible pricing discounts on sales of electricity prior to July 1, 1999, the end of the third rate year (par. 15). The benefit of any gain on RG&E's sale of the Jefferson Road property is deemed to have been passed back to ratepayers during the term of the Settlement (par. 25). RG&E agrees, but only for the time being, not to reallocate any depreciation reserves between gas and electric accounts, between common and electric accounts, or between different functional groups of electric accounts (par. 26), and it agrees to use a remaining life depreciation method for its Beebe Station and for two hydroelectric plants and to "apply a systematic and rational method to achieve an annual depreciation expense equal to $82,842,000" (par. 27). RG&E is relieved of all non-statutory obligations to spend monies on research and development during the term of the Settlement (par. 30). It is permitted, at its option, to book costs associated with Ginna Station maintenance outages on a levelized basis, and such costs are deemed to have been recovered from ratepayers on a levelized basis (par. 31). Payments by RG&E to the New York State Energy Research and Development Authority are deemed prepayments, and no amortization of such payments is to be recognized during the Settlement period (par. 32). The $19.2 million of "mirror" Construction Work in Progress is to be eliminated from the balance sheet as of the effective date of the Settlement (par. 33). RG&E's proposals for increased nuclear decommissioning accruals are to be adopted (par. 34 and Schedule C), and RG&E's petitions for deferral and recovery of certain amounts in Cases 95-M-1196, 95-M-1197 and 95-M-1198 are to be granted (par. 35).

For carry-forward balances, other than Kamine balances, that are remaining at the end of the Settlement period, RG&E would be entitled to recover the first $10 million and 80% of any amount in excess of $10 million. The manner of recovery would be determined in a future rate proceeding.

The Settlement provides for an across-the-board percentage revenue allocation to all service classifications. With respect to the rate design, monthly customer charges for SC No. 1 - Residential, SC No. 4 - Residential Time of Use (TOU), and SC No. 2 - Small Use General would be increased by $1.00 in the first year and by $1.50 in each of the second and third rate years, with corresponding decreases in energy rates. For

SC No. 4 and SC No. 9 - Large General TOU, the difference between peak and shoulder period energy charges would be eliminated over three years, and for SC No. 8 - Large General Service TOU, the difference between the peak and shoulder period energy charges would be eliminated as of the beginning of the third rate year. Finally, the company would be permitted to expand SC No. 10 and SC No. 11, both flex-rate classes, (1) to make them available to all non-residential classes, and (2) to modify the required energy audits to comply with new criteria (set forth in Schedule E of the Settlement).

With respect to demand side management (DSM), the Settlement specifies that new plans are to be established for the period January 1, 1997 through June 30, 1998 and July 1, 1998 through June 30, 1999. Total funding for both such plans is to be $17.5 million ($10.5 million for the first 18 months and $7 million for the last 12 months), and the Large Customer Credit Program, entitling SC No. 8 customers to opt out of the DSM program and receive a bill credit, is to be continued.

The Settlement also provides for a low-income assistance program costing a total of approximately $1.5 million for three years, all of which is to be recovered from other residential customers, which in the third year would cost the average residential customers about $0.15 per month.

The low-income program includes: (1) an arrearage forgiveness component, which encourages participants with an incentive to pay their bill and receive forgiveness for a portion of their arrears; (2) an education component, which requires participation in an energy efficiency education program and DSM measures in an effort to reduce energy consumption; and (3) a budget management training program, which participants must agree to attend. Customers who participate in the low-income program are protected from collection activities.

The Settlement also provides for the establishment of a service quality program under which penalties, equivalent to a total of 46 basis points of return on equity, may be assessed for sub-standard performance.

A number of typical boiler plate provisions have been included in the Settlement. The Settlement contains clauses that describe a procedure for dispute resolution, and that hold the Settlement non-severable and non-precedential. In addition, the Settlement recognizes that we reserve the right to act on rates if the return on equity is unreasonable, inadequate or excessive for the provision of safe and adequate service.

The Settlement would also be subject to modification to comply with our decision in the Competitive Opportunities Proceeding.[1]

Finally, with respect to the gas rate filing, there are three items that the Settlement mentions. First, RG&E had been directed to submit testimony in its next gas rate filing on the effectiveness of an implementation plan required pursuant to our order.[2] The Settlement acknowledges that the company has presented the required material, which describes the quality of its customer service and the level of customer satisfaction. In addition, testimony was presented setting forth the measures undertaken by the company in furtherance of and consistent with the implementation plan. No issues had been raised during the hearing pertaining to the company's compliance with the order.

Second, pursuant to 16 NYCRR §270.55, RG&E would be permitted to update its gas factor of adjustment, which it will do at the completion of these proceedings. Again, no party had opposed this update during the hearings.

Third, the Settlement allows the company to eliminate the refund/surcharge procedure for revenues collected on sales to dual-fuel customers as provided in Rule 4.H.10 of the gas tariff.

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[1] Cases 94-E-0952 et al., supra, Opinion No. 96-12.

[2] Case 95-G-0109, Rochester Gas and Electric Corporation, Order Directing Company Responses to Staff's Report and Requiring a Hearing (issued April 21, 1995).

There are about 20 customers that have dual-fuel capability and there is no evidence of growth in the area of dual-fuel customers. Elimination of the procedure, it was claimed, would relieve RG&E of the administrative burden of forecasting and tracking the sales to dual-fuel customers. No party had opposed the elimination of this procedure during the hearings.

COMMENTS OF THE PARTIES

Staff

In staff's view, the Settlement can be expected to "provide rate predictability and stability, and enhance RG&E's ability to offer competitively priced electricity and services." Staff views the base rate reductions and the elimination of the FAC as both favorable to customers and consistent with the movement toward a competitive environment. It believes the KCAM puts ratepayers in a better position than they would be in without such provisions and constitutes a fair and equitable solution of a very complicated and volatile issue.

Staff notes that the Settlement contains several provisions under which amounts due ratepayers under either this agreement or the 1993 Settlement will be carried forward to future periods. Pointing out that RG&E's right to recover amounts due it under these provisions is limited by various netting requirements and by the 80%-of-amounts-over-$10 million proviso, staff says these provisions "will both preserve and minimize the impact of" the performance mechanisms in this Settlement and the 1993 Settlement. It also notes that the Settlement provides that some $25 million claimed by RG&E to be due it under the ERAM and the flexible rate sharing provisions of the 1993 Settlement are "eliminated" and that with only limited exceptions, future true-ups and reconciliations will not be permitted.

Staff calls attention to the provision under which earnings in excess of 11.2% on common equity are subject to sharing, noting, inter alia, that it compares favorably with the currently effective sharing threshold of 14.5%. Staff also notes that the customers’ share of any "excess" earnings will be used to reduce the $673 million net investment (exclusive of fuel and construction work in progress) in nuclear assets, thereby reducing a potential future obligation faced by customers and complementing the industry’s movement toward a competitive market for generation.

Staff says the provisions of the Settlement concerning recovery of the costs associated with regulatory mandates and catastrophic events "strike a reasonable balance between the utility’s need for relief from potentially large, uncontrollable costs and the ratepayers’ desire for rate stability and certainty." Similarly, staff views the provisions that define the circumstances under which parties may seek relief from the Settlement as "intended to provide a reasonable range of financial parameters . . . ."

Staff defends the revenue allocation provision as reasonable in the face of what it describes as "significant disagreement among the parties over revenue allocation methodology." It notes that the uniform allocation, coupled with the rate design features of the Settlement (which generally involve increases in fixed charges and reductions in energy charges), "will result in real bill decreases for most ratepayers over the life of the [Settlement]." Staff adds that the rate design modifications "are supported by relevant cost studies, offer real bill decreases for the vast majority of RG&E’s customers, and produce acceptable levels of bill increases for all other customers." It also notes that these modifications will better position RG&E for the emerging competitive marketplace.

Referring to the service quality (or reliability) provisions of the Settlement, staff notes that they provide only for penalties, not for positive incentives that could increase rates, and that they address concerns that increased competitive pressure might have an adverse impact on reliability. With respect to DSM, staff says the Settlement is reasonable and "provides flexibility for RG&E to adopt its . . . program to changing needs." As for the low-income program, staff states that it is reasonable, similar to programs recently approved for other utilities, and in the public interest. Staff notes that there appear to be approximately 19,000 RG&E customers who could meet the program's eligibility requirements and that the program targets 1000 of these customers.

Staff turns next to what it regards as the "favorable" depreciation provisions in the Settlement, noting that it had objected to the reallocations of depreciation reserves proposed by RG&E because those reallocations would have increased the transmission and distribution rate base to the possible detriment of future customers, who would not necessarily have reaped the benefit of a lower production (or generation) rate base, because future prices for generation are expected to be market-based, not regulated.

Staff also points with favor to the increased level of nuclear decommissioning accruals reflected in the Settlement, noting that future accrual and funding needs will be correspondingly lower. In addition, it expresses support for liberalization of the SC No. 10 and SC No. 11 (flexible rate) eligibility requirements; the gas tariff changes; the proviso with regard to the possible necessity for modification of the Settlement to reflect the decision in the Competitive Opportunities Proceeding;[1] and the parties' acknowledgement of our right to amend the Settlement should unforeseen circumstances warrant.

RG&E

RG&E describes the Settlement as "a comprehensive resolution that is intended to form the core of the [c]ompany's relationship with its customers--and with the Commission--for the

[1] Cases 94-E-0952 et al., supra, Opinion No. 96-12.

next three years." RG&E says the agreement addresses four key issues:

1. Maintaining reasonable rates that are affordable, stable and competitive.

2. Managing risks, particularly those outside RG&E's control, in such a way as not to impose an unfair burden on either the company or its customers.

3. Making the transition to a more competitive market both by taking further steps in that direction and by maintaining flexibility to implement additional competitive measures as necessary.

4. Ensuring continued quality of service and responsiveness to customer needs.

On the rate issue, the company says that "the rate reductions and corresponding revenue decreases that will result from operation of the Settlement are well within the parameters established by the parties' positions at the close of the record in these proceedings" and that the elimination of the FAC will help to stabilize rates and lead to greater customer certainty about electricity costs.

Under the heading "Risk," RG&E addresses the provisions of the Settlement that deal with the Kamine litigation, generic mandates and catastrophic events, and possible major fluctuations in return on equity, interest coverage or fuel costs. RG&E says the Settlement "places appropriate emphasis on achieving the best possible [Kamine] litigation result or the lowest cost settlement," noting that "the [S]ettlement deals effectively with the unfortunate results of a misguided governmental policy that has proven immensely destructive to other New York utilities and their customers." It calls attention to the limitations on deferral and recovery of increased or reduced costs attributable to generic mandates or catastrophic events, observing that "the company is protected against only the most serious unforeseeable and unforeseen costs." It adds that the Settlement does not provide for automatic relief in the event of dramatic changes in return on equity, coverage, or fuel costs, but only for an opportunity to seek such relief.

RG&E says the Settlement will further the transition to a competitive market by being expressly subject to the decision in the Competitive Opportunities case, by moving usage rates closer to marginal costs, by expanding the availability of negotiated service contracts (flexible rates), and by reducing administrative burdens. The company emphasizes that by stipulating that all lost margins on pre-July 1, 1999 sales under flexible rate contracts will be deemed to have been recovered, it "effectively gave up, as part of the overall compromise inherent in the Settlement, the [c]ompany's entitlement, under the 1993 Settlement, to 70% of the lost margins." This concession, says RG&E, (1) should allay the concerns of residential customers that they may be harmed by increased competition and (2) will impose "additional self-discipline on the [c]ompany's efforts to respond to the marketplace."

Turning to the issues of service quality and responsiveness to customer needs, RG&E says, first, that it believes the transition to competition should diminish the need for regulation in these areas. Nevertheless, the company supports the service quality program specified in the Settlement, noting that it "represents a good faith compromise of opposing positions . . . ." Similarly, according to the company, the agreed-upon DSM program "reflects numerous compromises in the positions of various Parties." RG&E makes clear that, in its view, "assistance for low-income customers is primarily a social program that should be carried out by the State and funded by taxes," but it notes that it "has agreed in the [S]ettlement to a major expansion of its current assistance program."

Overall, RG&E describes the Settlement as achieving "a desirable result--multi-year rate reductions--in a manner that balances the interests of customers and shareholders while preparing both for the rigors of a more competitive market." The company says that the fact that numerous parties who often are adversaries were able to reach agreement is a strong indication that the Settlement is "balanced and fair."

Multiple Intervenors

Multiple Intervenors urges approval of the Settlement, stating that the agreement "provides some measure of much-needed rate relief . . .," will facilitate the transition to competition, and "represents a diligently-negotiated and equitable resolution of [the] issues by parties with very diverse interests." Multiple Intervenors says that the agreed-upon rate reductions are not a "panacea" but represent a step in the right direction. Multiple Intervenors is particularly pleased with the SC No. 8 rate design change and with continuation of the Large Customer Credit Program, under which SC No. 8 customers can reduce their electric bills by opting out of RG&E’s DSM program.

Multiple Intervenors identifies several ways in which it believes the Settlement will improve RG&E’s ability to operate in a competitive environment. Apart from the rate changes already noted, Multiple Intervenors points to the provisions that (1) eliminate the FAC, (2) reject RG&E’s proposal to reallocate its depreciation reserves, and (3) ensure that the decision in the Competitive Opportunities case will be given full effect.

Multiple Intervenors emphasizes the divergent interests of the various parties and the fact that only one party (Mr. Bowe) has indicated an intention to oppose approval of the Settlement. Multiple Intervenors says the Settlement process "has worked as intended, with each of the parties agreeing to numerous compromises in exchange for the right to help craft the regime which, subject to resolution of the Competitive

Opportunities proceeding, will govern RG&E's rates through June 30, 1999."

<u>Pace/NRDC</u>

Pace/NRDC supports the Settlement, explaining that the key ingredients, from its perspective, are the provisions pertaining to the DSM program, the provision that energy audits continue to be a condition of eligibility for SC No. 10 or SC No. 11, flex-rate service, and the uniform revenue allocation provision. Pace/NRDC calls attention to various aspects of the agreement on DSM[1] and states that "these elements will create a viable, although not robust, DSM program." Pace/NRDC also calls attention to a feature of the Settlement that requires RG&E to solicit DSM proposals from its largest customers before acquiring new generating capacity, commenting that in this respect the Settlement "puts DSM and supply-side increments on a level playing field and provides large customers and energy service companies an opportunity to obtain some financial assistance from the company for making energy efficient investments." Pace/NRDC notes that continuation of the Large Customer Credit Program "is less objectionable because these customers will have an opportunity to participate in the DSM RFP if they so choose."

Pace/NRDC notes that the Settlement reduces the detail that need be included in the reports of energy audits of SC No. 10 and SC No. 11 customers, but it maintains that "[n]onetheless, the report retains all the information necessary for the company and the customer to understand available energy efficiency opportunities and the bill reductions those investments could provide."

[1] <u>I.e.</u>, the budget, the 14 gWh target for annual energy savings, the requirement that RG&E achieve 80% of that target in order to fully recover its program costs, and the requirement that the program address residential customers and, if feasible, low-income customers.

Finally, Pace/NRDC defends the across-the-board revenue allocation feature of the Settlement, contending that "[a]ny decision on inter-class reallocation of revenues will be better informed if it follows, rather than precedes," the decision in the Competitive Opportunities case.

CPB

CPB states that the Settlement satisfies the criteria for approval spelled out in the settlement rules and that the broad interests represented by the signatory parties "clearly indicate that the Settlement is in the public interest." CPB notes that compared to the results of the last RG&E rate case, where the company asked for a $22.4 million increase and was granted an $18.5 million increase, the outcome envisioned in the Settlement is very favorable from CPB's perspective. CPB also notes with approval the provisions of the Settlement that (1) eliminate the FAC and the ERAM, (2) limit incentive awards, and (3) require RG&E to absorb flexible rate discounts.

Noting that the Settlement calls for increases in the minimum charge for SC No. 1 customers, CPB expresses reservations about the cost allocations that underlie these increases, but acknowledges that low-use customers might have fared worse in a litigated proceeding.

Finally, CPB endorses the DSM and low-income programs contained in the Settlement.

Mr. Straka

Mr. Straka endorses the Settlement as "a fair compromise" and expresses hope that it will "free both company and PSC personnel to work on the planning and implementation of the Competitive Opportunities Proceeding's forthcoming transition guideline." Apart from his comments on the Settlement, Mr. Straka also emphasizes the need to reduce utility tax burdens. As noted above, Mr. Straka expresses concern about the

Ginna Steam Generator Replacement Project, urging that we "review the prudency of this investment."

Mr. Bowe

Mr. Bowe is the only party who opposes the Settlement. Asserting that RG&E's rates are "at least 50 percent higher than the national average," he claims the rate reductions specified in the Settlement are far too small (he says RG&E "should cut its rates by 5% per year . . . for the next two years" and then "by 2% per year until they reach national parity") and could easily be erased by resolution of the Kamine litigation. He further contends that the Ginna Steam Generator Replacement Project may have been imprudent and may add to RG&E's stranded investments in generation assets. He also objects to the fact that analyses of the costs and benefits of the Ginna construction were granted trade secret status.

Mr. Bowe also calls attention to a charitable contribution to the Rochester Philharmonic that the company originally sought to charge to ratepayers; he argues that "the company has continually been trying to sweep this misclassified donation under the rug" and that "[t]hese actions by the company impeach the credibility of all the data they supply and the credibility of the entire regulatory process." Mr. Bowe further claims that "RG&E willfully obfuscates and manipulates information, and he suspects an ulterior motive in RG&E's willingness to recede from its litigation position "in the face of the Competitive Opportunities agreement." He also complains that "[t]here was no local professional representation of commercial and residential ratepayers" and that "the company treats the regulation process like it was a game," ignoring that "the outcome of these proceedings will have a profound effect" on the economic life of the community.

DISCUSSION

We have evaluated the Settlement in light of all the evidence, arguments and comments. Based on our review, we conclude that the terms of the Settlement, except as noted below, are consistent with the public interest and produce rates that are just and reasonable. The Settlement reflects agreement by normally adversarial parties, and, except as noted below, fairly balances protection of ratepayers and the long-term viability of the utility. For example, the elimination of the FCA and the ERAM should enhance rate predictability and stability, and should encourage management to control costs to the extent the flow-through aspects of these mechanisms will no longer be available. Moreover, the service quality performance program should promote improvements in reliability and customer service. The Settlement also protects ratepayers from deterioration in service if catastrophic events, government mandates, or financial extremes threaten the company’s operations.

As noted in the 1996 Rate Order, we did not adopt the Kamine Cost Adjustment Mechanism, the Gas Factor of Adjustment provision, nor the Refund/Surcharge mechanism for dual-fuel customers. When a settlement agreement is modified, we try to remand the case for further consideration by the parties. By refraining from adopting the above noted features of the Settlement, we are not rejecting the company’s claim to recover certain costs. Instead, we are altering the process for considering these issues. In addition, we have concluded that the results of the Settlement are supported by the record in this case. Moreover, given that the rates were designed for an effective date of July 1, 1996, a remand could not have been accomplished consistent with that date. For these reasons, a departure from our remand practice was warranted.

As to overall revenue requirements, we agree with the company that the rate reductions and corresponding revenue decreases under the Settlement are well within the range of litigated outcomes considering the record as a whole in these proceedings. Based on our review of the parties' litigating positions a revenue reduction of up to $34 million for the year ending June 30, 1997 is amply supported. Under the Settlement, the company's revenues are reduced by approximately $30.6 million over the three-year period ending June 30, 1999. Thus, the rates we are approving are just and reasonable.

With respect to the return on equity, the Settlement provides that any return in excess of 11.2% will be shared with the customers. This reduces the existing sharing threshold of 14.5%. However, the customers' portion of the sharing will be used to offset the cost of $673 million of net nuclear assets (exclusive of fuel and construction work in progress) that may be recoverable from ratepayers in the future. These provisions will mitigate the sunk investment in nuclear facilities and thus facilitate the movement toward a competitive market for electric generation.

Mr. Straka and Mr. Bowe question the prudence of replacing the steam generators at the Ginna nuclear power plant, and Mr. Bowe objects to the fact that trade secret status had been granted to certain analyses of the Ginna construction.[1]

In 1992, RG&E determined that the output of the Ginna plant had diminished and projected that further decrease would occur because the company was required to plug corroded steam generator tubes. The company initiated the steam generator project, which was designed to replace the steam generators, including the tubes in their entirety, and to increase the plant output back to its design level. Installation of the new steam generators was completed in June of this year. It should also be noted that steam generator replacement project was dealt with in the company's 1993 Settlement, which states:

> Subject to the prudence of RG&E's decision to replace the steam generators, the company

[1] Cases 95-E-0673 and 95-G-0674, Fourth Procedural Ruling (issued March 1, 1996).

> will be permitted to include the capital costs of the replacement in rate base . . . .[1]

Much of the evidence concerning the costs and benefits of the steam generator replacement was granted trade secret status by the administrative law judge because a knowledge of Ginna's fixed and variable costs would give competitors an unfair advantage in developing power bids and could harm RG&E and undermine competition. Mr. Bowe and Mr. Straka were given the opportunity to receive the protected material provided they signed a confidentiality agreement; neither signed. Staff, the only other party to present evidence on the Ginna steam generator replacement, did not assert imprudence.

Inasmuch as no facts have been presented by either Mr. Bowe or Mr. Straka that suggest imprudence, a prudence review of the Ginna steam generator replacement is not warranted at this time. It should be noted that the Settlement does not preclude such a review in the future if the need arises. Likewise, Mr. Bowe's unsupported request to remove the trade secret protection from the analyses of the Ginna generator reconstruction is denied. He has not demonstrated good cause for reversing the administrative law judge's initial determination that trade secret protection is appropriate.

The low-income program may not meet the cost effectiveness criterion we adopted in a previous decision.[2] None of the parties suggest that the low-income program will "ultimately, if not immediately, yield benefits commensurate with its costs."[3] Nevertheless, the Settlement requires the company

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[1] Cases 92-E-0739 et al., supra, Opinion No. 93-19, mimeo p. 25, Appendix A.

[2] Case 94-E-0334, Consolidated Edison Company of New York, Inc. - Rates, Opinion No. 95-3 (issued April 6, 1995), Appendix A, mimeo p. 29, and Appendix D, mimeo pp. 7-9.

[3] Id.

to evaluate the cost-effectiveness of the program and report its finding before the end of the Settlement period. Inasmuch as this program will be used to gather data to evaluate its overall effectiveness, the low-income program will be approved. We emphasize that it is a pilot program that may be substantially modified based upon a review of the information gathered.

With respect to the $10,200 charitable contribution to the Rochester Philharmonic, although the total dollar amount of the item is small, the use of ratepayer money to support charitable donations has been the subject of much controversy and has been held illegal by the Court of Appeals.[1] Although no overall income statement is included with the Settlement, during the hearings RG&E acknowledged the concern and agreed to charge the charitable contribution below the line. Mr. Bowe's claim that this error cast doubt on the company's entire presentation is not supported by any factual demonstration of similar errors. His argument, therefore, will be given little weight.

As far as the revenue allocation and rate design are concerned, the Settlement will more closely align rates with marginal costs. This realignment is an important step in preparing RG&E and its customers for the increasing competitive environment facing the industry. On the record, RG&E, staff, and Multiple Intervenors generally agreed that, as the company moves to a more competitive environment, the cornerstone of electric rate designs will be to approximate marginal cost in pricing.

Marginal cost-based pricing rests on the sound economic principle that efficient resource allocation is enhanced by pricing goods and services as closely as reasonably achievable to marginal costs. It has been our long-standing policy to price electricity such that consumers pay for the cost their consumption imposes on the utility so that scarce resources are

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[1] <u>Matter of Cahill v. Public Service Commission</u>, 76 NY2d 102 (1990).

efficiently allocated. The Settlement moves rate designs closer to this goal.

Pursuant to the Settlement, the monthly residential customer charge would ultimately be increased from the current $9.00 to $13.00 by the beginning of the third year. The customer charge, however, would still be below the marginal customer cost of about $16.70 per month calculated by RG&E using the methods described in the January 1992, Electric Utility Cost Allocation Manual of the National Association of Regulatory Utility Commissioners.

The Settlement also provides for the elimination of the peak and shoulder-peak rate differentials for SC No. 8 and SC No. 9. The current SC No. 8 peak period energy charges are 73% to 80% above the shoulder-peak energy charges, depending on the voltage level. The small differential between SC No. 8 peak period marginal energy costs and the shoulder-peak period energy costs (6% to 7%) no longer warrants such a large variation between the peak and shoulder peak energy rates. A similar situation exists for SC No. 9.

As we noted in the 1996 Rate Order, the terms of the Settlement, for the most part, are consistent with the public interest, producing rates that are just and reasonable and within the range of reasonable results likely to have resulted in a litigated proceeding. However, two aspects of the Settlement were not adopted--the proposed KCAM and changes related to the gas tariffs.

RG&E points out that it is currently involved in litigation in several forums pertaining to its power purchase from facilities owned by Kamine. While this litigation is pending the company is purchasing power from Kamine under RG&E’s SC No. 5 buy-back rate for energy at approximately $.02 per kWh. As noted above, if Kamine were allowed to charge the full authorized rates under the power purchase agreement, it would currently be entitled to approximately $.08 per kWh. The Kamine project has a nominal capacity rating of 55 MW and is capable of producing approximately 481,000 kWh annually. For 1996, the difference in the two rates translates into approximately $27 million in revenues at full capacity.

On the record, RG&E emphatically stated that it was ordered over strenuous objections to enter into the power purchase agreement with Kamine. Consequently, the company claimed that it is entitled to every penny it pays for power from Kamine. Moreover, RG&E argued it could have elected to sit back and pass through Kamine costs at the full rates, but RG&E took the aggressive litigation posture that resulted in lower payments, which are only one-fourth of the power purchase agreement amount, so long as the recent court order remains in effect. The company points out that Kamine is continuously seeking relief from the court order and there is certainly the potential that, at any time, Kamine might succeed in obtaining such relief.

Generally, the KCAM would limit the rate impact of additional Kamine power costs to those that the customers would have paid under the full contract rates. In the first rate year, any Kamine-related costs would not be allowed to increase average electric bills for any rate class above their level in the rate year ending June 30, 1996. In addition, the KCAM would gradually introduce into the rates increases for Kamine-related costs. To the extent that a KCAM precludes the recovery of Kamine-related costs during the Settlement period, portions of those costs may be carried forward.

Furthermore, the KCAM was designed to have no effect on the timing or nature of any agreement that might be achieved in the Kamine litigation.

The Settlement would allow RG&E to recover certain costs associated with an adverse judicial determination or a settlement/buy-out. The recovery would be accomplished via the KCAM. The company requested trade secret status for the details of the KCAM and the corresponding comments of the parties because it claimed that knowledge of such information could provide

Kamine and other adverse parties to the litigation with a strategic advantage. To reveal such information, RG&E states, would provide adverse parties with a starting point for litigation and/or settlement demands. No party opposed the company's request; confidential status was granted by the Administrative Law Judge on May 24, 1996.[1]

Generally, the Settlement's Kamine provisions would provide for rate stability, promote gradualism in the recovery of Kamine costs, and guarantee, at minimum, that revenues would not rise above those collected in the first rate year at the rates then in effect. Further, the Settlement would preserve our right to review the prudence of RG&E's actions with respect to Kamine. However, the Settlement would treat the KCAM as a trade secret. In the 1996 Rate Order we acknowledged that the interest in protecting the terms of this mechanism was understandable, but we found an overriding interest that the public know the reasons for and the extent of any possible future electric rate changes. In these circumstances, and given the proposed elimination of the fuel adjustment clause, we did not approve the KCAM and stated that the recovery of any additional Kamine payments as a result of pending litigation and/or negotiations would be subject to our review and approval. Pending the company petitioning for the recovery of additional Kamine revenues and a final decision on such a petition, the company was permitted to recover Kamine costs at the current $.02 per kWh level called for under the Settlement. A decision on any RG&E request for additional Kamine revenues will be rendered expeditiously.

Also we noted in the 1996 Rate Order that the Settlement contains provisions that would modify the Gas Factor of Adjustment and eliminate the refund/surcharge mechanism for dual fuel customers. Although no party in the instant proceedings opposed these terms, we are not satisfied all the

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[1] Cases 95-E-0673 and 95-G-0674, Eighth Procedural Ruling (issued May 24, 1996).

parties to the gas settlement agreement, approved in October 1995, are aware of the gas provisions in the Settlement, and we questioned whether the gas provisions in the Settlement are consistent with the provisions of the prior gas settlement agreement.[1] Accordingly, we declined to decide the two referenced gas aspects of the Settlement. However, we also stated that we would be willing to consider these proposals, after an appropriate notice and comment opportunity, should RG&E see fit to seek such consideration by a separate petition, which would be due within 30 days of this decision.[2]

We conclude that the terms of the Settlement are reasonable and in the public interest with the exceptions previously noted.

The Commission orders:

1. The order issued in these proceedings on June 27, 1996 is incorporated as part of this opinion and order.

2. Rochester Gas and Electric Corporation is authorized to use Account 186, Miscellaneous Deferred Debits, and Account 253, Other Deferred Credits, to record the principal amount and carrying charges, if any, for items which deferred accounting has been provided for in the Settlement Agreement. The associated federal income tax impacts shall be recorded in accordance with the Commission's interim policy regarding Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes, unless modified by the Commission in

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[1] In the absence of the gas settlement, for example, the proposed factor of adjustment change would ordinarily produce base rate changes and increases in base rate revenues. But such revenue increases are not permissible under the terms of the approved gas settlement agreement. Cases 94-G-1048 et al., Rochester Gas and Electric Corporation - Gas Pipeline Capacity Investigation, Gas Cost Increases, Winter Billing, and Gas Rates, Opinion No. 95-18 (issued October 27, 1995), mimeo p. 14.

[2] By petition dated August 14, 1996, RG&E seeks reconsideration of these matters.

Case 92-M-1005. The amounts deferred for each item shall be recorded in a separate subaccount and the company shall maintain proper and easily accessible supporting documentation for each entry made. The period of amortization for each item shall be as detailed in the Settlement Agreement, or as otherwise authorized by the Commission.

3. Cases 95-M-1197 and 95-M-1198 are closed.

4. Cases 95-E-0673, 95-G-0674 and 95-M-1196 are continued.

By the Commission,

(SIGNED) John C. Crary
Secretary

APPENDIX