

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UM 1415

In the Matter of the)	
)	
PUBLIC UTILITY COMMISSION OF)	OPENING COMMENTS ON THE STRAW
OREGON)	PROPOSAL OF INDUSTRIAL
)	CUSTOMERS OF NORTHWEST UTILITIES
Staff Investigation into Cost Methods for Use))	
<u>in Developing Electric Rate Spreads.</u>))	

I. INTRODUCTION

The Industrial Customers of Northwest Utilities (“ICNU”) submits these comments to the Public Utility Commission of Oregon (“OPUC” or the “Commission”) regarding the Commission’s draft straw proposal outlined in Order No. 11-255 in this docket. The straw proposal seeks to identify appropriate factors to consider when deciding whether to approve mandatory time-varying rates for electric service, and it seeks to establish a series of directives to guide utilities in proposing time-varied rates during the development of each utility’s Integrated Resource Plan.

II. BACKGROUND

The Commission has noted that time-varying rates have been at issue in numerous dockets, but there is no clear precedent establishing consistent, appropriate standards for considering their implementation. The Commission opened Docket UM 1415 in 2009 to address issues regarding rate spread and rate design. After a number of workshops, the parties reached agreement that the implementation of rate spread and rate design principles for a specific utility should be left to a general rate case. After concluding the workshops, the Commission Staff

moved to close the docket. Rather than close the docket, the Commission directed the parties to consider its straw proposal for mandatory time-varying rates. The straw proposal includes a detailed list of factors and requirements for developing time-varying rates. The Commission's order indicates a desire that the parties review and consider whether and how time-varying rates should be used in Oregon.

III. COMMENTS

In these Opening Comments, ICNU addresses both the Commission's proposed factors relevant to mandatory time-varying rates and the proposed directives to the utilities. ICNU believes that, while not exhaustive, the factors proposed by the Commission are well designed, and they may lead to the conclusion that imposing mandatory time-varied rates on industrial customers is not necessary or advisable. ICNU supports a careful, fact-based deliberation before any time-varied rates are adopted on a mandatory basis. In particular, the Commission should evaluate whether the potential benefits of time-varying rates outweigh the potential harms.

A. Factors for Evaluating Whether or Not to Approve a Proposed Time-varying Rate

1. The Amount of Demand-Side Resource and System Benefits that Can be Tapped Through a Time-varying Rate

ICNU believes that it is vital that any discussion of time-varying rates begin with a rigorous discussion of the quantifiable benefits that might be achieved through such a program. A time-varying rate is only proper when there is a positive relationship between the expected benefit and the expected cost.

Proponents of time-varying rates often broadly predict reductions in demand, but such general forecasts are an insufficient basis for designing a potentially costly and disruptive

new tariff. The level of actual benefits that may be accrued through time-varying rates is a product of the elasticity of substitution between two products: on-peak and off-peak electricity.^{1/} The lower the elasticity of substitution, the greater price differential will be required to prompt a customer to substitute goods. For electric consumers, actual peak energy savings will depend upon: 1) a customer's ability to substitute the less expensive alternative, and 2) the differential between the higher price of the preferred on-peak power and the lower price of the substitute off-peak power. These are highly technical questions that are dependent upon a multitude of factors, including weather, electric use patterns, wealth, education, and (in the case of industrial customers) the nature of the industrial process. No time-varying schedule should be implemented without a rigorous review of the elasticity of substitution of each class of potentially effected customer.

A commonly cited study done by the Electric Power Research Institute ("EPRI") indicated that, very generally, residential customers will respond to a price differential of 10% by reducing peak power use between 0.5% and 2.5%, whereas industrial customers respond to an equivalent differential by reducing peak use between 0.5 and 1.0%.^{2/} The EPRI study indicates that industrial customer ability to substitute is extremely inelastic, compared to that of residential customers. Further, because the time-varying rates in the study were voluntary, the industrial customers modeled were self selecting as particularly elastic industries.^{3/} In other words, the industrial customers captured in the study voluntarily joined time-varying rate tariffs because they expected to use their relatively high elasticity of substitution to realize savings on their

^{1/} *Customer Response to Electricity Prices: Information to Support Wholesale Price Forecasting and Market Analysis*, EPRI, Palo Alto, CA: 2001. 1005945.

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power bills. This means that the actual benefits realized if industrial customers were universally forced onto time of use billing would likely be far lower.

2. The Extent to Which an Optional Rate or Alternative Program can Achieve that Resource

It is vital to consider optional rates and other programs when considering time-varying rates, because these have been demonstrably more effective than mandatory rates in other jurisdictions. If time-varying rates are adopted, then they should not be mandatory. A number of utilities have implemented voluntary time-varying rate programs that are popular and effective because industrial customers with elastic demand are able to save on their power costs and reduce peak load while other industries remain on flat tariffs. This ensures that those industrial customers that cannot effectively change their behavior are not simply penalized with higher rates.

While time-varying pricing can reduce peak loads, it does not directly lower overall energy use. While customers may engage in some conservation to avoid punitive peak prices, direct utility-sponsored conservation programs reduce both peak and overall electric use and are therefore preferable to punitive pricing. Industrial customers are highly motivated to engage in successful conservation. The Commission should thoroughly investigate the effectiveness of voluntary options before imposing mandatory time-varying rates.

3. The Impact of the Proposed Rate on Customers

Industrial customers have unique energy needs. A mandatory time-varying rate could severely harm many industrial customers who do not have the option of shifting production to times when rates are lower. Industrial customers already face very high rates due to marginal cost pricing. Industries that cannot shift load would be forced to pay even higher

costs or cease to do business in Oregon. Other industrial customers would need to move their production to graveyard shifts in order to avoid punitive peak pricing. Any benefit from lower than standard nighttime rates would be offset by the added employee costs of graveyard operations and higher accident rates.

4. The Means Available to Mitigate Impacts on Customers

If industrial time-varying rates were adopted in Oregon, they should be voluntary. This would enable industrial customers with elastic demand to benefit from lower rates while contributing to a lower peak demand. Additionally, a time-varying rate should include a bill ceiling like that which was offered to residential customers during the first 12 months of service.

Other mechanisms could be included to protect industrial customers. One example of a successful system offers industrial customers a variable power rate for a small percentage of the customer's power requirements. The customer's base load is served at a flat rate, but when electric use varies from the base load, the customer is charged (or credited) at a rate determined by the time of use. The combination of a reliable base charge and credit when the customer conserves energy protects the industrial customer and prevents utility manipulation of prices and revenue neutrality for the utility.

5. The Direct Costs of Implementing Time-varying Rate

Time-varying rates often require that a customer's meter be read several times a day, rather than once per month. This can only be accomplished if customers have Advanced Metering Infrastructure ("AMI" or "smart meters") that communicate remotely with the utility. PGE's Q1 Compliance Filing in Docket UE 189 indicates that the total cost of the yet unfinished

AMI installation has reached \$149,966,000.^{4/} It is unclear that even with the AMI system in place whether PGE has the capacity to receive and analyze the volume of data that a time-varying program would produce. This means that more expenses would likely be incurred and would need to be balanced against any potential benefits. PacifiCorp customers could be forced to bear a heavier burden to install the technology, because the utility's service area is more rural and AMI is not generally installed.

Any cost analysis must include the cost of installing the meters, because AMI metering is a constituent part of time-varying service. A time-varying rate that does not create a benefit greater than both the ongoing costs to customers and utilities (including the cost of the infrastructure) does not make sense to implement.

6. The Ability to Explain and Communicate the Rate to Customers

Time-varying rates can be confusing to customers who have had flat rates (or for some customer classes, peak and off-peak rates) for many years. The utilities will face a major communication and customer relations issue if time-varying rates are implemented without a well-designed communication plan.

7. The Cost Differential Between the Relevant Time Periods, How Robust the Cost Studies Are, and Whether Customer Response to the Time-varying Rate is Expected to Affect the Cost Differential Over Time

A clear and consistent time-varying costing pattern must exist for time-varying rates to make sense, and rates must be based on this data. In 2002, the Washington Utilities and Transportation Commission ("WUTC") found that the large-scale time-varying rate program established by Puget Sound Energy ("PSE") was not "fair, just, and reasonable" and terminated

^{4/} AMI Project Quarterly Status Update Q1 2011, Docket No. UE 189 at 1 (May 12, 2011).

the program early.^{5/} The closing report, ordered by the WUTC, indicated that in no scenario did the program produce benefits that outweighed the costs of resources or the cost to participants.^{6/} WUTC Staff and Public Counsel stressed in the report that one of the reasons for the massive failure of the program was that it was instituted without pilot programs that differentiated between customers based on the customers' individual power use profiles, robust cost studies, or rigorous statistical analysis of pilot data.^{7/}

Some proponents of time-varying rates appear to believe that the rate differential should be as high as necessary to force customers to respond to price signals. For instance, in one California pilot program, the time-varying rates for critical peak days were set at 59¢/kWh during peak periods and 9¢/kWh off-peak, which produced a -10% change in peak demand. This kind of rate-based hijacking is antithetical to the principles of cost-based ratemaking, which state that rate design should flow from cost studies, rather having cost allocation dictated by rate design.

Some effective time-varying rates are designed to be revenue-neutral within customer classes. In these cases, unexpected overcollections or shortfalls are subsequently credited or surcharged across the class. This ensures that time-varying rates would be driven by customer response and actual costs. In any event, the Commission should ensure that any time-varying rate program is revenue neutral for the utility.

^{5/} WUTC v. PSE, Docket No. UE-011570, 14th Supplemental Order at 7 (Nov. 15, 2002).

^{6/} Docket No. UE-011570, Time-of-Use Compliance Filing at 2 (July 1, 2003).

^{7/} Id. at 17.

8. Other Factors That Should be Considered by the Commission

In addition to the factors identified by the Commission, ICNU proposes that rigorous analysis of time-varying rates should also include the following factors:

- *How will differently-situated customers be affected by the proposal?*

Time-varying rates do not offer benefits unless they are closely tailored to the actual needs and power uses of customers. Time-varying rates will have divergent impacts on differently-situated customers. Unlike residential customers, whose electrical use is predictably dominated by heating, lighting, and air conditioning, industrial power use varies dramatically between industries. This means that some industries could benefit under a well-designed, voluntary program while others would need the ability to opt-out in order to maintain economic viability.

- *What Actual Costs will the Proposal Attempt to Recover?*

A time-varying rate should reflect not only the current market price of electricity, but also the substantial investment that customers already have in utility plant. Generating facilities are more economical over time. Plant that has been depreciated provides electricity to customers at a rate well below market. Customers should benefit from this investment, so a time-varying rate must account for this asset.

- *Will the Proposal Create Revenue Instability, Leading to Higher Costs of Capital?*

Depending on rate design and demand charges, a time-varying rate can result in a utility recovering a large amount of costs through a limited number of hours. This can lead to revenue and cash instability for utilities. As the utilities regularly point out in their rate

case filings, revenue instability can theoretically lead to higher cost of capital and negatively impact customers.

- *Does the Proposal Create a Danger of Windfall Revenue for the Utility at the Expense of the Customers?*

Any load shifting has a cost to the customers who must alter their behaviors. Some of these costs, such as increased accident rates for industries operating at night, are easy to quantify. Others, such as the inconvenience to a worker who sees her family less because she is working a night shift, are not. The utility, however, bears none of these costs. On the other hand, particularly during times of high energy prices, a utility that sees a load shift to off-peak hours derives a significant financial benefit. This is one reason the WUTC Staff recommended against the PSE time-varying rate, noting that at market prices at that time, PSE could sell every kWh that a customer shifted in the on-peak market and buy it back during off-peak, realizing a margin of 5.1¢/kWh.^{8/}

If a time-varying rate is considered, it is vital that, following ratemaking principles, the customers who pay the costs of shifting load use receive the entire benefit through their rates, rather than allowing utilities to capture a windfall.

B. Proposed Directives to the Utilities

The Commission proposes three directives to the utilities that include: 1) a detailed cost of service study that differentiates costs by hour, day, week, month, and season as well as seasonal on and off-peak and cost-of-peak-hour by month of the year; 2) workshops at

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the beginning of the IRP process to discuss the factors identified by this docket; and 3) inclusion in a utility's IRP of a discussion of whether or not a time-varying rate should be included.^{9/}

ICNU believes that a rigorous, fact-based analysis of any time-varying proposal is important to assure that it accurately reflects the utility's cost of service and is neither punitive nor unfair to individual customers, and so is encouraged by the process outlined by the Commission, if time-varying rates were to be considered. However, ICNU believes that other processes may be more appropriate for analysis than an IRP proceeding. For instance, utilities could be required to develop and implement pilot programs to test assumptions related to time-varying rates. By testing the assumptions underlying such programs, the Commission may avoid unintended consequences.

IV. CONCLUSION

ICNU appreciates the opportunity to submit these Opening Comments and looks forward to participating in the workshop and in the second round of commentary in this docket.

Dated this 8th day of September, 2011.

Respectfully submitted,

DAVISON VAN CLEVE, P.C.

/s/ S. Bradley Van Cleve

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Of Attorneys for Industrial Customers

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^{9/} OPUC Docket No. UM 1415, Order No. 11-255 at App. A.

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/s/ S. Bradley Van Cleve

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Of Attorneys for Industrial Customers

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^{9/} OPUC Docket No. UM 1415, Order No. 11-255 at App. A.

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September 8, 2011

Via Electronic and U.S. Mail

Public Utility Commission
Attn: Filing Center
550 Capitol St. NE #215
P.O. Box 2148
Salem, OR 97308-2148

Re: In the Matter of the PUBLIC UTILITY COMMISSION OF OREGON
Staff Investigation into Cost Methods for Use in Developing Electric Rate
Spreads
Docket No. UM 1415

Dear Filing Center:

Enclosed please find an original and five (5) copies of the Opening Comments on behalf of the Industrial Customers of Northwest Utilities in the above-referenced docket.

Thank you for your assistance, and please do not hesitate to contact our office if you have any additional questions.

Sincerely yours,

/s/ Sarah A. Kohler
Sarah A. Kohler

Enclosures

cc: Service List

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing Opening Comments on behalf of the Industrial Customers of Northwest Utilities upon the parties, on the service list, by causing the same to be deposited in the U.S. Mail, postage-prepaid, where paper service has not been waived.

Dated at Portland, Oregon, this 8th day of September, 2011.

/s/ Sarah A. Kohler
Sarah A. Kohler

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