BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UE 170

In the Matter of PACIFIC POWER & LIGHT COMPANY (dba PacifiCorp) Request for a General Rate Increase in the Company's Oregon Annual Revenues Klamath River Basin Irrigation Rates	STAFF'S OPENING BRIEF

INTRODUCTION

In previous phases of this proceeding, the Commission has concluded that it has the authority and duty to review the Klamath River Basin irrigator rates and that the appropriate standard of review is the "just and reasonable" standard. *See* Orders Nos. 05-1202 and 05-726, respectively. In this phase of the proceeding, the issue is the appropriate rates that PacifiCorp should charge Klamath irrigators for electric service, including how new rates should be implemented. *See* ALJ Memorandum, dated February 22, 2006.

In this phase of the proceeding, there has been voluminous testimony as well as extensive cross examination of testifying witnesses. The vast majority of this testimony and cross examination deals with water flows in the Klamath River Basin. Clearly, this evidence and cross examination is aimed at the concurring opinion of Commissioner Baum and the dissenting in part, concurring in part opinion of Chairman Beyer in the Order establishing the "just and reasonable" standard that will apply to the retail rates of the Klamath River Basin irrigators. *See* Order No. 05-1202 at 10-11. Specifically, it seems clear that the Klamath irrigators' testimony is intended to demonstrate that the Klamath project provides a benefit of return water flows that should be considered unique circumstances of this case that support the continuation of a subsidy for the Klamath irrigators.

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While the testimony and cross examination on water usage and return flows is voluminous and complex, return flows are not benefits or unique circumstances that have been, or should be, considered in the context of setting Oregon retail rates. As will be discussed below, the Commission should not consider return flows in setting retail rates; return flows are not considered in setting retail rates for other Oregon regulated electric utilities; and the Federal Energy Regulatory Commission's ("FERC") proposal to decouple the Government dam use charges from PacifiCorp's retail rates all demonstrate that the Commission has not, and should not, consider return flows as an appropriate factor to consider when setting Oregon retail rates. Arguments regarding return flows are not a substantial and reasonable basis for establishing a separate and distinct customer classification under ORS 757.230.

As a result, the current Schedule 33 customers should be moved, beginning on April 17, 2006, onto Schedule 41.[1] This transition should be accomplished consistent with SB 81's rate mitigation requirements and the intent of the Oregon Legislature to move the Klamath irrigators retail rates to cost of service rates within seven years.

Consistent with the issues list and the ALJ Memorandum dated February 22, 2006, Staff will organize its opening brief around the issues applicable to this portion of the proceeding, which are[2]:

1. What are the appropriate rates PacifiCorp should charge the Klamath Basin irrigators for electricity service?
2. If any rate change affecting these customers is implemented, how and when should these customers be transitioned from the rates established in the historic contracts?

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[1] Staff notes that there may be one customer that is moved to Schedule 48, rather than Schedule 41.

[2] The two issues applicable to this portion of the proceeding also contain sub-issues. However, Staff's discussion of the two issues will demonstrate its answers to the sub-issues, either explicitly or implicitly.

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DISCUSSION

1. <u>The Klamath Basin irrigators should be moved to, and charged, Schedule 41 rates beginning April 17, 2006.</u>[3]

The characteristics of current Schedule 33 customers are similar to the current Schedule 41 customers in that the distributions are similar, including small to high usage customers, both schedules contain usage that is seasonal, and the aggregate load factors are similar. *See* Staff/1502, McNamee/8, lines 1-12 *discussing* PPL/1214, Griffith/6-7 and PPL/1700, Anderberg/5. The characteristics and usage of Schedule 33 and Schedule 41 customers are substantially similar and do not merit a separate customer classification. *See* Staff/1502, McNamee/9, line 18 through McNamee/10, line 3; *see also* Transcript[4] at 377 at lines 17-23. (Dr. McNamee stating that he agrees with the summaries on McNamee/8).

While the Schedule 33 and Schedule 41 customers have substantially similar characteristics, it is true that the average usage of Schedule 33 customers is larger than that of Schedule 41 customers. *See* Staff/1502, McNamee/8, lines 13-14 *citing* PPL/1214, Griffith/7. Although the usage characteristics are still substantially similar enough to support Schedule 33 customers moving to Schedule 41, price elasticity provides additional support that Schedule 33 customers should be moved to Schedule 41.

Because the Klamath Basin irrigators have been receiving highly subsidized rates under Schedule 33, there is a huge price difference between the electric rates paid by the Klamath Basin irrigators and PacifiCorp's other irrigation customers with similar usage characteristics. *See* Staff/1502, McNamee/8, lines 14-16. Thus, it is easy to understand that Schedule 33 customers, who pay a highly subsidized low rate for electricity, use more electricity than Schedule 41 customers, who pay a higher cost of service rate. However, when the impact of a price change - in this case moving the subsidized Schedule 33 customers from their low,

[3]Although the Klamath Basin irrigators should be moved to, and charged, Schedule 41 rates beginning on April 17, 2006, Staff notes that, as discussed in more detail under Issue 2, the Klamath Basin irrigators will receive a rate mitigation credit consistent with SB 81.

[4] Hereafter, the Transcript will be referred to with the abbreviation "Tr."

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subsidized rates to a higher, cost of service Schedule 41 rate – is considered it demonstrates that demand for consumption will generally decrease as price increases. *See* Staff/1502, McNamee/8, lines 14 through McNamee/9, line 17. The consideration of the price elasticity of demand as it relates to moving from subsidized Schedule 33 rates to higher, cost of service Schedule 41 rates provides additional support for the conclusion that Schedule 33 customers should be moved to Schedule 41, beginning April 17, 2006. *See* Id.

A. Arguments regarding return water flows from irrigation in the Klamath Basin are not a benefit that constitutes unique circumstances or a substantial and reasonable basis for establishing a separate and distinct class of irrigation customers.

As discussed at the hearing, arguments regarding return water flows are not an appropriate consideration in establishing Oregon retail rates for electricity services. Staff's witness, Dr. McNamee, was asked on redirect to assume, hypothetically, that return flows were greater than withdrawals.[5] *See* Tr. at 375 lines 5-9. Dr. McNamee was then asked whether he believed that, if this was in fact true, could return flows be a benefit that the Commission should recognize in this type of proceeding, to which he testified:

> A: No.
>
> Q: Will you please explain why?
>
> A: They're diverting water for their agricultural production, and then what is coming back is either from that process or from lands that they are draining in order to have those lands be capable of agricultural production.
>
> And the water that's being returned is - - basically from their operational purposes, there's no intent to benefit PacifiCorp. And once it returns to what is a public waterway, I'm not sure there's any value in that as far as - - or in terms of ratemaking, that's not the way we set rates.
>
> If there is value in that, it would have to be - - and it is thought there is some sort of compensation - - that, that would be entitled to the irrigators, that would have to be handled in a different manner than in ratemaking.

See Tr. 375, line 10 through 376, line 1.

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[5] As will be mentioned below, Dr. McNamee was asked to assume hypothetically that return flows were greater than withdrawals because his testimony concludes, using the irrigators own testimony, that withdrawals are greater than return flows. *See* Staff/1502, McNamee/10-13.

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Therefore, Dr. McNamee's testimony demonstrates that irrigation is a consumptive process as related to water and that the evidence shows that withdrawals from the watershed exceed return flows. *See* Staff/1502, McNamee/10, line 4 through McNamee/13, line 4. Furthermore, Dr. McNamee's testimony demonstrates that, even if return flow was grater than withdrawals, return flows are not a benefit that should be considered in retail ratemaking.

Staff's position that return flows are not a benefit that should be considered a substantial and reasonable basis for establishing a separate and distinct class of irrigation customers is further supported by the fact that other regulated Oregon electric utilities do not compensate irrigators that are located upstream of an existing utility hydro project for instream waters flows that may derive from upstream irrigation or drainage operations. *See* Staff/1502, McNamee/11, lines 3-9; *see also* Tr. at 376, lines 2-5. For example, Idaho Power and Portland General Electric do not reduce rates to irrigators for potential return flows to the Snake River and Deschutes or Crooked Rivers, respectively. *See* Id. at 9-13.

B. <u>The FERC's proposal to decouple the Government dam use charges from PacifiCorp's retail rates is additional evidence and support for Staff's position that this Commission need not determine a value for any surplus water flowing from the Link River Dam.</u>

As discussed above, return flows are not a benefit that should be considered a substantial and reasonable basis for establishing a separate and distinct class of irrigation customers. On January 20, 2006, FERC issued an Order Denying Petition for Declaratory Order and Issuing Notice of Proposed Readjustment of Annual Charges for the Use of A Government Dam ("FERC Order"). *See* 114 FERC ¶ 61,051. The FERC Order states:

> 29. We conclude that the most prudent and practical course at this time is to exercise our reserved authority to readjust PacifiCorp's charges for the use of surplus water from Link River Dam. Specifically, we proposed to decouple these charges from PacifiCorp's retail rates. We do so for several reasons. First, this Commission clearly has no jurisdiction over PacifiCorp's retail rates. Second, continuing to tie Government dam use charges to PacifiCorp's retail rates creates the potential for conflict between the annual charges we set and those retail rates. Third, there is an established alternative means of setting annual charges in our regulations. Fourth, nothing in the 1954, 1956,

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> or 1957 Orders indicates that the FPC intended to tie the Government dam use charges to the licensee's retail rates beyond the expiration date of the original license. Finally, this issue is readily severable from the relicense proceeding, which will not be resolved for at least another year.
>
> 30. To this end, we are issuing notice of our intent to set the annual Government dam use charges for Klamath Project No. 2082 at the graduated fixed rates set forth at 18 C.F.R. § 11.3(b), effective [April 17, 2006].

See FERC Order at 11-12. (footnotes omitted).

The import of FERC's statement of intent to decouple the Government dam use charges from PacifiCorp's retail rates could not be clearer or more consistent with Staff's position on the alleged benefits of return flows. FERC, through dam use charges (as opposed to retail rates), will determine the value of any surplus water flowing from the Link River Dam. That dam use charge fee would then likely be passed through in rates as a hydro expense. The FERC Order adds additional support to Staff's conclusion that return flows are not an appropriate benefit to measure in setting retail rates. If there is a benefit of surplus water, the extent of that benefit will be calculated and collected under Government dam charges and is outside the scope of setting Oregon retail rates. The FERC Order is consistent with and adds additional support to Staff's position that return flows are not a benefit that should be considered in setting retail rates.

2. <u>If any rate change affecting these customers is implemented, how and when should these customers be transitioned from the rates established in the historic contracts?</u>

As discussed above, the current Schedule 33 customers should be transitioned to Schedule 41 beginning on April 17, 2006. This transition should be done consistent with the Oregon Legislature's decision to give the Klamath Basin irrigators up to a seven year mitigation period to get to the full cost of service Schedule 41 rates. *See* Oregon Laws 2005, Chapter 594 ("SB 81"). The legislature intended to give the Klamath irrigators up to a seven year glide or ramp to get to full cost of service rates contained in Schedule 41. The statements contained in the legislative history make it clear that the legislature intended SB 81 to operate in a way that provided some rate mitigation while also getting the Klamath irrigators to cost of service rates within seven years. For example, consider the following statements:

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> The House added an amendment to this bill which provides for a * * * rate credit for farmers in the Klamath Basin. This would allow them to, over a seven year period, a glide slope from what has been historically an extremely low energy cost that has been borne by other ratepayers, but that is now coming to an end. And rather than see their rates go up precipitously as a result of this change, <u>would allow a seven year glide slope to adjust those rates back to market levels.</u>

Senate Floor Speech of Senator Rick Metsger, July 11, 2005, http://www.leg.state.or.us/listn/ (Legislative Audio, Real Player between 8:05 and 9:57) (emphasis added).

> This measure requires the Oregon PUC to increase the rate no more than 50% per year for seven years. At that rate of increase, <u>the rate will be at full market tariff on the seventh year.</u>

Senate Floor Speech of Senator Doug Whitsett, July 11, 2005, http://www.leg.state.or.us/listn/ (Legislative Audio, Real Player between 10:10 and 11:25) (emphasis added).

As a result, the current Schedule 33 customers should be moved to Schedule 41 beginning on April 17, 2006. Once the current Schedule 33 customers are moved to Schedule 41, they should receive a rate credit according to the provisions of SB 81. The following formula should be used to calculate the rate credit:

Rate credit = ((S+A) – ((Xi)(1.50)))

In this rate credit formula, the variables are as follows:

> S = Currently effective standard irrigation rate (e.g. Schedule 41)
> A = Current schedule 90 adjustments for Schedule 41
> Xi = Schedule 33 – applicable contract rate (with i = 1 to 7, representing the 7 year adjustment period).

See KOPWA/604, page 3; Staff/1502, McNamee/16-17.

This rate credit formula is consistent with SB 81 and accomplishes the legislative intent of that bill by providing a seven year glide or ramp to get Klamath irrigator rates up to cost of service rates. The formula also allows for future changes in the rate schedules. Furthermore, this formula takes into account all special charges and credits (including the BPA credit) as required by the bill, which is represented by the variable "A" in the formula.

The Klamath irrigators' attempt to circumvent the legislative intent by subtracting the BPA credit from the contract rate on the right side of the formula, which in turn lowers the

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number that is multiplied by 50 percent. In essence, it appears that the Klamath irrigators are attempting to mathematically manipulate the calculation in such a way as to circumvent the intent of the legislation. For example, under the Klamath irrigators proposed calculation, the Klamath irrigation rates would not be anywhere close to the Schedule 41 cost of service rates. Rather, the Klamath On-project irrigator rates would be about 40 percent of the Schedule 41 rates and the Klamath Off-Project irrigator rates would be approximately 70 percent of the Schedule 41 rates after seven years. *See* Staff/1500, McNamee/17, lines 13-17. Such a result would circumvent the intent of the legislation, which is to bring the Klamath irrigators to market rates in seven years. Therefore, Staff's rate credit calculation should be adopted as it calculates the rate credit based upon a class of customers as required by SB 81, includes all special charges and credits, and accomplishes the legislative intent of SB 81.

DATED this 6th day of March 2006.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I certify that on March 6, 2006, I served the foregoing upon the parties hereto by electronic mail and/or by mailing a true, exact and full copy by regular mail, postage prepaid, or by hand-delivery/shuttle mail.

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