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August 9, 2010

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Public Utility Commission of Oregon
550 Capitol St NE – Suite 215
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Re: UE 219 – Staff Opening Brief on Surcharge Issues

Enclosed is Staff's Opening Brief on Surcharge Issues. The document contains confidential Non-Public Information that should only be disclosed and distributed in accordance with Special Protective Order (Order No. 10-148). I am submitting this confidential Non-Public Information in the manner specified by the Special Protective Order (i.e. on yellow paper that is placed within a sealed, marked, envelope) and delivering a copy to the qualified parties on the service list.

Sincerely,

David B. Hatton

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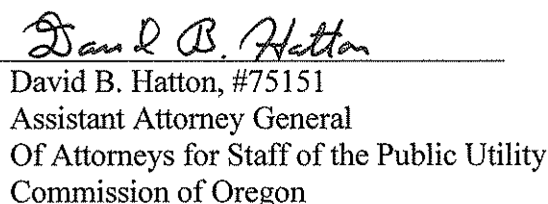

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Of Attorneys for Staff of the Public Utility Commission of Oregon

1 **BEFORE THE PUBLIC UTILITY COMMISSION**

2 **OF OREGON**

3 UE 219

4 In the Matter of 5 PACIFICORP, dba PACIFIC POWER 6 7 Application to Implement the Provisions of Senate Bill 76 8	STAFF'S OPENING BRIEF ON SURCHARGE ISSUES

9 Oregon Senate Bill 76 ("SB 76") allows PacifiCorp to collect two surcharges from its
10 customers for the purpose of funding the costs of removal for the four Klamath River
11 Hydroelectric Project dams ("Project").[1] *See* ORS 757.736(2). This is a proceeding under ORS
12 757.210 to determine whether the surcharges that PacifiCorp is collecting result in rates that are
13 fair, just and reasonable. *See* ORS 757.736(4). Staff of the Public Utility Commission of
14 Oregon ("Staff") has the following comments on surcharge issues:

15 **I. Relicensing v. Decommissioning: whether the surcharges are fair, just, and**
16 **reasonable**

17 Staff reviewed PacifiCorp's assessment of relicensing costs and studies related to the
18 costs and risks of potential relicensing and dam removal outcomes. The most significant
19 relicensing costs are the costs associated with the mitigation measures that PacifiCorp might
20 incur in obtaining the license for the Project. When looking at decommissioning, excluding the
21 cost of dam removal, the cost of replacement power it the most significant cost. PacifiCorp's
22 current estimate for relicensing mitigation costs is ______ on a 44-year present value of revenue
23 requirement basis.[2]

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25

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[1] The four dams are the J. C Boyle Dam, Copco 1 Dam, Copco 2 Dam, and Iron Gate Dam.

[2] *See* Confidential Exhibit PPL/202,Kelly/1.

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1 Federal Energy Regulatory Commission ("FERC") staff issued a Final Environmental
2 Impact Statement ("FEIS") regarding relicensing measures for the Klamath River dams on
3 November 16, 2007.[3] The FEIS is FERC staff's final assessment of the positive and negative
4 environmental impacts of relicensing and proposed mitigation measures or alternative actions in
5 order to address these impacts. Using the Project FEIS, Appendix A, table A-1, staff alternative
6 plus mandatory conditions, FERC staff estimated relicensing mitigation costs at approximately
7 $219 million (in 2006 dollars). PacifiCorp's current assessed costs for these mitigation measures
8 are significantly higher than what was originally included in the FEIS.
9 The California Energy Commission ("CEC"), in cooperation with the U.S. Department of
10 the Interior, also commissioned a study regarding "Economic Modeling of Relicensing and
11 Decommissioning Options for the Klamath Basin Hydroelectric Project." This study was
12 prepared by M.Cubed and the U.S. Bureau of Reclamation Technical Services Center in
13 November 2006.[4] The CEC study concluded mitigation costs on a net present value basis ranged
14 from $100 million to $192 million (in 2006 dollars). Altogether, the study found that the
15 relicensing option could cost between $230 and $470 million in 2006 dollars over a 30 year
16 period. This estimate includes costs associated with on-going capital costs, continued operation
17 and maintenance, and restricted power output due to relicensing measures.
18 In response to a PacifiCorp filing in March 2007 that disputed many of the CEC's cost
19 estimates and claiming significant modeling errors, the CEC filed an Addendum to its initial
20 report in April 2007. The Addendum recognized many of PacifiCorp's corrections and posted a
21 revised total relicensing cost estimate on a net present value basis of $223 million to $415
22 million.
23 / / /
24

25 [3] For a copy of the FEIS use the following URL address: http://www.ferc.gov/industries/hydropower/enviro/eis/2007/11-16-07.asp.

26 [4] For copies of the CEC Original study, Addendum A and PacifiCorp's responses please see www.ferc.gov in the elibrary under Docket P-2082 using the provided dates.

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1 PacifiCorp continued to dispute the CEC study, including the Addendum. Using its own
2 mitigation cost assumptions PacifiCorp claimed that, due to errors in the model and differences
3 of opinion with regard to the appropriateness of specific mitigation costs, its midline estimate
4 was approximately $249 million on a net present value basis (in 2006 dollars).

5 PacifiCorp witness Corey Scott estimates mitigation costs to be in excess of $400 million
6 in capital costs over a 40-year license term (in 2009 dollars).[5] PacifiCorp's estimates are now
7 comparable to the CEC study that estimated that relicensing mitigation costs would be
8 approximately $397 million (in 2009 dollars). The FEIS estimated relicensing costs at
9 approximately $232 million (in 2009 dollars).[6]

10 Staff believes that the Company's cost estimate is reasonable, particularly when taking
11 into consideration the potential risk of costs being much higher. For example, if PacifiCorp
12 pursues relicensing it may not meet Section 401 water quality standards that are required
13 certifications from California and Oregon.[7] A Section 401 water quality certification requires
14 any applicant of a federal license to obtain certification from the applicable state that it will
15 comply with the water quality parameters of the federal Clean Water Act.[8] FERC may not grant
16 a federal license if a Section 401 water quality certification has been denied.[9] PacifiCorp notes
17 that "FERC would be unable to issue a new license, yet maintains that it has the authority to
18 require the owner to decommission and remove the project facilities at the owner's expense."[10]
19

20 [5] PPL/300,Scott/6.

21 [6] The CEC estimate of $397 million in 2009 dollars was calculated using a rate of inflation of 1.9 percent from the current 2006 estimate of approximately $375 million. The FEIS estimate of $232 million in 2009 dollars was
22 calculated using a rate of inflation of 1.9 percent from the current 2006 estimate of approximately $219 million

23 [7] The Section 401 water quality certification applications are currently being held in abeyance as a condition of the Klamath Hydroelectric Settlement Agreement.

24 [8] Complaints regarding the Klamath River include excessive foaming, water discoloration, overabundance of algae, high water temperature, unsightliness, fish kills, and damaged ecosystems. The issues of greatest concern are the
25 Klamath Project's impact on water quality issues affecting fisheries.

26 [9] PPL/300,Scott/10,lines 11-15.

[10] PPL/300,Scott/10,lines 13-15.

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1 PacifiCorp also has exposure for additional costs if the initial measures prescribed by the
2 FERC license are unsuccessful. If those measures fail, the Company is not only financially
3 responsible for those failed attempts, but is also responsible for any new and more costly efforts
4 that may be required. In addition, there are potential legal liabilities associated with the
5 economic fallout of failure of the initial measures, *e.g.* salmon fishery closures and health
6 problems with water quality issues. The responsibility for future problems and cost escalations
7 is borne solely by the Company and its customers.

8 PacifiCorp has shown that customer costs under the Klamath Hydroelectric Settlement
9 Agreement ("KHSA") are below the costs of relicensing the four Klamath dams. This analysis
10 does not taking into consideration the significant risk of relicensing cost escalations. In contrast,
11 the KHSA caps and mitigates the risks associated with decommissioning and removal of the
12 facilities for PacifiCorp and its customers. Therefore, the KHSA, or decommissioning of the
13 dams, is a less risky option for customers than relicensing. Accordingly, Staff recommends that
14 the Commission determine that the surcharges are fair, just and reasonable.

15 **II. Surcharge Calculation**

16 The KHSA sets the initial targeted surcharge collection at $172 million. The analysis
17 relied upon by the Company assumes an annual rate of return of 3.5 percent interest on balances
18 in the trust account established by the Commission for collection and disbursement of
19 surcharges. As surcharge balances will be invested in a manner that will not put principal at risk,
20 this assumption of 3.5 percent annual interest earnings is an estimate and the actual earnings
21 could differ considerably, on both average and cumulative bases, over the timeframe of the
22 trust's existence.

23 Staff has proposed periodic adjustment to the surcharge rate, taking into consideration
24 actual interest earned and changes in load that may affect the rate of surcharge collection and the
25 likelihood of obtaining a total of surcharge collected plus interest earned of approximately $172
26 million by December 31, 2019. More specifically, Staff recommends that the Company file

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1 updated surcharge rates, using its most recent forecast of future loads, the history of interest
2 earned, and other transactions impacting actual and projected trust account balances, concurrent
3 with its annual Transition Adjustment Mechanism ("TAM"). No less than thirty days prior to the
4 annual TAM filing, PacifiCorp, Staff and other interested parties will meet to review the actual
5 interest earned, the surcharge balance, and the forecast of future loads to determine whether it is
6 necessary to file a revised surcharge tariff. If there is over- or under-collection of the surcharge
7 relative to obtaining a total of surcharge collected plus interest earned of approximately $172
8 million by December 31, 2019, Staff would recommend PacifiCorp file modified Schedule 199
9 tariff within 60 days following the TAM filing, with the revised tariff to be effective thirty days
10 from the revised tariff filing.

11 **III. Disclaimer of jurisdiction under ORS 757.480**

12 Staff opposes PacifiCorp's request for disclaimer of jurisdiction under ORS 757.480, the
13 Commission's property transfer statute. PacifiCorp argues that SB 76 preempts ORS 757.480.
14 PacifiCorp cites to no provision in SB 76 that preempts the Commission's property transfer law
15 and Staff finds no language indicating that the legislature intended such a result.

16 PacifiCorp argues in the alternative that the Commission should approve the transfer
17 under ORS 757.480 contingent upon satisfaction of the conditions precedent for the transfer
18 under of the KHSA.[11] Staff questioned the timing of PacifiCorp's request given the uncertainly
19 of dam removal and recommended that the Commission not consider the request until PacifiCorp
20 actually decides on dam removal.[12] In its reply testimony the Company stated that it has already
21 made its decision to pursue dam removal under the terms of the KHSA.[13] Staff continues to
22 question the timing of PacifiCorp's request given the numerous contingencies that must occur
23 under KHSA before the Company may remove the dams.

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25 [11] PPL/203,Kelly/2.

26 [12] Staff/100,Brown/3.

[13] PPL/203,Kelly/2.

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1 **IV. Schedule 199 Refund Provision**

2 PacifiCorp revised Schedule 199 to remove the refund condition and requests that the
3 Commission allow Schedule 199 to go into effect without the refund condition upon a final
4 determination under ORS 757.736(4) that the dam removal surcharges result in rates that are fair,
5 just and reasonable.[14] Staff believes that the Commission should retain refund language in
6 Schedule 199. If the Commission finds that the surcharges are not fair, just and reasonable, then
7 the tariff will have refund language to address that situation. Staff recommends that the
8 Commission include the following refund language in Schedule 199: "If the rates resulting from
9 these surcharges are determined not be fair, just and reasonable the surcharges shall be
10 refunded."[15]

11 **V. Rate spread**

12 PacifiCorp proposes, as a first step, that the PacifiCorp-Oregon ratepayers' portion of the
13 annual dam removal costs be allocated among customer classes based on each class's share of
14 *generation* revenues. That preliminary allocation was then mitigated as follows: Each customer
15 class's share of the dam removal costs should be at least 1.5 percent of its own *overall* revenue
16 requirement (*i.e.*, not just the generation portion), and should be not more than 2 percent of its
17 own *overall* revenue requirement. The Company's proposal follows a functional approach by
18 basing the surcharge amounts on generation revenues inasmuch as the associated dam removal
19 costs are generation-related.[16]

20 ICNU urges the Commission to allocate the dam removal costs on the same basis as the
21 rate spread proposed by PacifiCorp in its most recently filed general rate case, UE 217.[17]
22 According to that proposal, the dam removal costs would be spread on an equal percentage of
23

24 [14] PPL/203,Kelly/4.

25 [15] Staff/100,Brown/13.

26 [16] PPL/200,Kelly/9.

[17] ICNU/100, Falkenberg/8.

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each major class's overall revenue requirement—*i.e.*, where distribution, transmission, and customer costs are combined with generation costs. This ICNU argument for consistency has been nullified by all the parties in UE 217 having since stipulated to an *unequal* percentage rate spread increase in that proceeding.[18]

A more substantive argument against the ICNU proposal goes to its not matching the dam removal costs recovery with the utility function, generation, with which the dams have always been associated. In *Re Methods for Estimating Marginal Costs of Service for Electric Utilities*, Docket UM 827, Order No. 98-374 (September 11, 1998), the Commission endorsed a functional approach to ratemaking when it adopted a stipulation that provided that marginal costs and revenue requirements should be reconciled on a functional basis – *i.e.,* separated according to the functions of generation, transmission, distribution, and customer prior to being allocated to customer classes. Those allocations are then summed (*i.e.,* across the functions) to determine each class's overall revenue requirement. In adopting the stipulation in UM 827, the Commission explained:

> "This new approach will improve our historical efforts to **allocate cost** responsibility to customer **classes** in ways that lead to more efficient price signals for **customers** and efficient use of electrical service. It will also improve fairness in our rates by ensuring that the **costs** of another function (*e.g.*, distribution) do not affect the **allocation** of the **costs** of another function (*e.g.* generation)." *Id.* at 3. (Emphasis in original).

See also the UE 216 Transition Adjustment Mechanism update, which allocates net power costs based on each class's share of generation revenues rather than their shares of the overall revenue requirement.

The Company's proposed rate spread follows the functional approach endorsed by the Commission in UM 827 by basing the surcharges on generation revenues since the associated costs are generation-related; *i.e.*, reflecting the cost of removal of a generation resource, the dams. Contrarily, ICNU's allocation proposal would incorporate distribution- and transmission-

[18] *See* Stipulation Exhibit C at 1.

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1 related costs and therefore does not appropriately apportion the generation-identified cost of dam
2 removal. The inclusion of distribution costs[19] is of particular concern because they are relatively
3 large (*i.e.,* second in magnitude to generation costs) and are heavily attributed and allocated to
4 the residential class. Under ICNU's proposal residential customers would be allocated a larger
5 share of the dam removal surcharges due to those customers' relatively larger share of
6 distribution costs—even though the cost of dam removal is clearly generation-related and not
7 distribution-related. ICNU's rate spread proposal is flawed and should be rejected.
8 Staff also supports the 1.5 percent floor and the 2.0 percent ceiling on the surcharge for any
9 customer class as a reasonable means to mitigate the impact on any customer class.[20] Recall that
10 the floor and ceiling percentages refer to the classes' overall revenue requirement amounts—*i.e.,*
11 not just to the generation portions of those requirements. The ceiling protects ICNU-represented
12 customers because the ceiling allows them to receive an increase as a percentage of generation
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25 [19] Distribution costs include poles, conductors, line transformers, service drops and meters.

26 [20] The Company has estimated the surcharge results in an overall average increase to Oregon rates of approximately 1.6 percent. *See* PPL/200 Kelly/7 lines 4 – 5.

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1 revenues that is below the overall generation percentage average. To compensate, the
2 residential, small commercial/industrial, and all the lighting schedules receive percentage
3 increases that are above the overall average when measured as a percentage of generation
4 revenues.[21]
5
6 DATED this 9th day of August 2010.
7
Respectfully submitted,
8
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Of Attorneys for Staff of the Public Utility
13 Commission of Oregon
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25 [21] Column 15 of Exhibit PPL/201 Kelly/4 reveals the customer schedules whose surcharges are based on percentage shares of generation revenues that are above the average (*i.e.*, those whose allocations are elevated up to the 1.5%
26 floor) and those whose surcharges are based on percentage shares of generation revenues that are below the average (*i.e.*, those whose allocations are brought down to the 2% ceiling).

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