

1 **BEFORE THE PUBLIC UTILITY COMMISSION**

2 **OF OREGON**

3 UM 1712

4 In the Matter of

5 PACIFICORP, dba PACIFIC POWER,

6 Application for Approval of Deer Creek Mine
7 Transaction

STAFF'S RESPONSE BRIEF

8 **I. Introduction**

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10 The Public Utility Commission of Oregon Staff (Staff) agrees that the closure of the Deer
11 Creek mine and the sale of the mining assets for a loss are in the public interest contingent upon
12 including an appropriate condition that eliminates or further mitigates the risk of harm from the
13 new long-term Huntington Coal Supply Agreement (CSA). However, Staff proposes that the
14 other aspects of PacifiCorp's d/b/a Pacific Power (PacifiCorp) request be reserved for its next
15 general rate proceeding.¹ If the Commission does consider the other aspects of PacifiCorp's
16 request in this proceeding, Staff offers recommendations for the appropriate regulatory and rate
17 treatment.²

18 On March 25, 2015, PacifiCorp and the Citizens' Utility Board (CUB) (hereafter,
19 Stipulating Parties) filed a partial party stipulation (PAC/CUB Stipulation) resolving all issues
20 between them. In testimony objecting to the PAC/CUB Stipulation, Staff objected to the
21 PAC/CUB Stipulation because it does not protect customers from the risks of the new long-term
22 Huntington CSA and it does not resolve Staff's previously stated regulatory and ratemaking
23 concerns.³

24 ¹ To the extent necessary to implement a decision that early retirement and the sale of mining assets is in the public
25 interest, the Commission could employ deferred accounting to account for the removal of the "return on" the
26 undepreciated investment in plant and a regulatory account for the later consideration of costs in a general rate case.
The loss on the sale of mining assets can be accounted for in Schedule 96, as contemplated in the PAC/CUB
Stipulation.

² See Staff's Opening Brief at 2, lines 3-11.

³ See Id. at lines 12-23.

1 **II. Discussion**

2 1. The Commission is not required to determine prudence in this proceeding.

3 In their Joint Brief in Support of the Stipulation, the Stipulating Parties conceded that
4 “the Commission does not generally provide prudence determinations before a utility enters into
5 a particular transaction.”⁴ While the Joint Parties requested that the Commission use its
6 discretion to consider prudence in this proceeding, PacifiCorp now seems to argue that a
7 prudence determination is necessary and a lack of such a determination in this proceeding would
8 undermine the transaction.⁵ On the other hand, CUB filed a separate opening brief that admitted
9 that the PAC/CUB Stipulation constituted single-issue ratemaking that the Commission generally
10 disfavors, but argued that the unique circumstances of the proposed transaction weighed in favor
11 of setting aside the general policy limitation of single-issue ratemaking.⁶

12 Because this proceeding is not a general rate case where all rates are reviewed holistically
13 under a full schedule, Staff’s primary recommendation is to focus on the regulatory approvals
14 necessary (*i.e.* the public interest determinations), not the additional approvals that PacifiCorp
15 would like outside of normal process and that would constitute single-issue ratemaking (*i.e.*
16 prudence and rate treatment determinations).⁷ The Commission could condone single-issue
17 ratemaking and make a prudence determination in this proceeding, but such approval is not
18 necessary to allow PacifiCorp to move forward with the transaction and Staff remains concerned
19 that prudence determinations in situations such as this will lead to future utility requests outside
20 of a general rate case for prudence determinations on isolated issues under a limited review
21 schedule.⁸

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23 ⁴ See Joint Brief in Support of Stipulation at 19.

24 ⁵ See PacifiCorp Opening Brief at 12 (“Given the significance of the Transaction to PacifiCorp’s customers, the key
25 components of the Transaction require approval of the Company’s regulators, necessitating a prudence
determination from the Commission.”) (“This delay could undermine the Transaction . . .”)

26 ⁶ See Opening Brief of CUB at 2-3.

⁷ See Staff’s Opening Brief at 3, lines 7-11; *see also* Id. at 5-6.

⁸ See Id. at 3, lines 12-16; *see also* Id. at 5, footnote 17 (“In any event, Staff’s argument is not that the Commission
is legally precluded from considering the Deer Creek costs outside of a general rate case. Instead, Staff argues that
the Commission’s long-standing policy is to avoid single-issue ratemaking, except in limited circumstances.”)

1 2. The PAC/CUB Stipulation does not address the risks of the new long-term Huntington CSA.

2 The provision that gives PacifiCorp termination rights and mitigates the risks of the take
3 or pay obligations or damages applies to laws and regulations that are enacted and promulgated,
4 not instances where prudent planning dictates that the most prudent action is closure or
5 conversion of the plant, even though that decision is based upon potential future actions and not
6 existing regulatory action.⁹ Staff offered a hypothetical example where a boiler fails at the
7 Huntington plant and the prudent decision could be to close the plant because the projected costs
8 of the boiler repair and future environmental compliance may make the boiler investment
9 uneconomic. Under a scenario such as this, PacifiCorp's termination rights may be challenged
10 and customers remain at risk.¹⁰ To address the risks of the new long-term Huntington CSA, Staff
11 recommended that a Commission decision to find the transaction in the public interest should
12 include a condition that PacifiCorp will hold customers harmless for any take and pay
13 obligations or damages incurred, unless PacifiCorp can demonstrate by clear and convincing
14 evidence that such obligations or damages arise from circumstances that were unforeseeable at
15 the time they entered into the contract.¹¹

16 The Stipulating Parties argue that Staff's hold harmless condition is unreasonable
17 because no party has challenged PacifiCorp's evidence that take or pay provisions are generally
18 required to obtain a long-term CSA and a long-term CSA is the least-cost, least-risk option for
19 fueling the Huntington plant.¹² The Stipulating Parties also argue that Staff's hold harmless
20 condition is unnecessary because they agree that the Commission may include the following
21 condition in its approval order:

22 If the Company is unable to successfully exercise its termination rights and is
23 required to pay costs or damages related to the Huntington CSA for coal that it is
24 unable to use at Huntington or another facility, then the prudence of any costs or
25 damages will be subject to future Commission review, taking into account the

25 ⁹ See Staff's Opening Brief at 4, lines 3-8 citing Staff/700; Wittekind/10, lines 12-21.

26 ¹⁰ See Id. at lines 9-18 citing Staff/700; Wittekind/11, lines 1-11.

¹¹ See Id. at lines 19-23 citing Staff/700; Wittekind/11, lines 11-17.

¹² See Joint Opening Brief at 14-15.

1 overall benefits to customers. Parties are free to take any position they choose in
2 a future review.

3 The Stipulating Parties' arguments regarding the hold harmless condition for the new
4 long-term Huntington CSA ignore the fact that Staff has argued that the closure of the Deer
5 Creek mine is in the public interest and provides net benefits to customers only if the risk of
6 being contractually obligated to the long-term CSA can be eliminated or substantially
7 mitigated.¹³ For example, PacifiCorp did not provide evidence that supplying the Hunter and
8 Huntington plants with a new long-term CSA is a least cost, least risk solution compared to
9 either shutting down the plants or converting them to natural gas.¹⁴

10 Because Staff argues that the closure of the Deer Creek mine is in the public interest only
11 if the risks of the new long-term Huntington CSA are eliminated or further mitigated, the
12 proffered condition that reserves the parties' ability to argue in a future Commission review who
13 should pay for the take or pay obligations or damages does not resolve Staff's concern. In
14 addition, under the Stipulating Parties' proffered condition a future Commission review of the
15 prudence of any costs or damages should not be limited by "taking into account the overall
16 benefits to customers," which is an unnecessary and new limitation on the prudence standard.¹⁵

17 3. If regulatory assets are created, they should begin amortization at the time the asset is created
18 on PacifiCorp's books.

19 The Stipulating Parties argue that Staff's recommendation that amortization begins when
20 the regulatory asset is created on PacifiCorp's books, *i.e.* at its inception, but the fact that Staff
21 does not support immediate amortization in rates means that by the time the rates reflect the
22 regulatory asset's amortization, the asset's value will have already decreased.¹⁶ The Stipulating
23 Parties claim that this will result in a disallowance of the Company's prudently incurred
24 investments, that it is at odds with the express language of the stay-out provision which allows

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¹³ See Staff/100; Wittekind/15, lines 1-4;

26 ¹⁴ See Staff/300; Crider/6, lines 9-13.

¹⁵ See *In re Portland Gen. Elec. Co.* Docket No. UE 196, Order No. 10-051 at 6.

¹⁶ See Joint Opening Brief at 25.26.

1 parties to seek deferrals before January 1, 2016, that Staff never testified that the UE 263
2 settlement required immediate amortization of the deferral, and that the parties to the settlement
3 never understood the stay-out provision to require immediate amortization of the regulatory
4 assets created during the stay-out period.¹⁷

5 Staff does support immediate amortization in rates, which in conjunction with the
6 application of the stay-out provision requires PacifiCorp to absorb costs.¹⁸ The Stipulating
7 Parties argue that it is inappropriate for them to have to absorb costs for prudently incurred
8 investments.¹⁹ Staff argued that the stay-out provision does prohibit the collection in rates of
9 prudently incurred costs and opposed the PAC/CUB Stipulation because it avoids the stay-out
10 provision by creating regulatory assets that start to accrue interest on June 1, 2015, and collecting
11 in rates the entire regulatory asset plus accrued interest beginning January 1, 2016.²⁰

12 Staff agrees with the Joint Parties that the express language of the stay-out provision
13 allows parties to seek deferrals before January 1, 2016.²¹ Staff also agrees that the stay-out
14 provision does not state that deferrals must begin amortization immediately.²² However, Staff
15 has not argued that a deferral must begin immediately, but that the PAC/CUB Stipulation avoids
16 the application of the stay-out provision by its use of regulatory assets that do not amortize,
17 whereas use of a deferral could be consistent with the requirements of the stay-out provision.²³
18 The stay-out provision allows for deferrals that meet the guidelines of Docket No. UM 1147, but
19 deferrals are also subject an earnings review and could be amortized before the next general rate
20 case, lowering the amount of accrued interest. The PAC/CUB Stipulation does not purport to

21 ¹⁷ See Id. at 26-27.

22 ¹⁸ See Staff/100; Wittekind/11, line 8 through Wittekind/13, line 15.

23 ¹⁹ See Joint Opening Brief at 26; see also PAC/400; Dalley/3-4; Id. at 14.

24 ²⁰ See Staff's Opening Brief at 6, line 9 through page 7, line 20.

25 ²¹ See Joint Opening Brief at 26.

26 ²² See Id.

²³ The stay-out provision provides: General Rate Case Stay-Out. The Company agrees to forego a general rate filing in Oregon in 2014. Following the implementation of rates on January 1, 2014, in this case and the implementation of Lake Side 2 tariff rider on approximately June 1, 2104, the earliest proposed rate effective date for the Company's next general rate case filing will be January 1, 2016. The Stipulating Parties may file for deferrals during the general rate case stay-out period, but such filings will be subject to the Commission's guidelines for deferrals set forth in Docket UM 1147, unless otherwise authorized by the Commission. The Stipulating Parties agree that their goal is to minimize rate changes during the general rate case stay-out period. See Order No. 13-474, Appendix A, ¶ 15 at 5-6.

1 create a deferral consistent with the guidelines of UM 1147 and subject to an earnings test.
2 Instead, it creates regulatory assets that accrue interest beginning June 1, 2015, but do not
3 amortize until they are included in rates.

4 Likewise, Staff never testified that the stay-out provision required immediate
5 amortization of a deferral because PacifiCorp was not proposing recovery through a deferral. As
6 stated above, Staff testified that amortization of the closure tariff should begin immediately,
7 which would cause PacifiCorp to absorb some costs consistent with the stay-out provision.

8 Staff has not changed in position.²⁴ In order to avoid immediate amortization of the
9 closure tariff and absorption of costs as Staff recommended, the PAC/CUB Stipulation proposes
10 to create regulatory assets that do not begin amortization upon inception or when entered upon
11 PacifiCorp's books, but only upon collection in rates after the stay-out period. Notwithstanding
12 the Stipulating Parties' inappropriate attempt to use the subjective intentions of the parties,²⁵ as
13 subjectively interpreted by them, on the stay-out provision,²⁶ the text of the stay-out provision is
14 silent regarding regulatory assets and only explicitly contemplates the use of deferrals.

15 The PAC/CUB Stipulation circumvents the stay-out provision as well as the limitations
16 of deferred accounting by using regulatory assets and providing rate treatment for regulatory
17 assets that is equivalent to deferred accounting, but without its limitations. It is inappropriate to
18 use regulatory assets in this manner. Furthermore, it is generally understood that some costs will
19 increase and other decrease during a stay-out period. The fact that utility actions are prudent
20 should not render a stay-out provision meaningless and the Commission should expect a utility to
21 act prudently during a stay-out period. The amortization of regulatory assets when they are

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²⁴ See Joint Opening Brief at 26.

24 ²⁵ See *Sollars v. City of Milwaukie*, 222 Or App 384, 193 P3d 75 (2008), *rev den* 346 Or 184, 206 P3d 1058 ("The
25 existence of a contract does not depend on the parties' uncommunicated subjective understanding but on their
26 objective manifestations of intent to agree to the same express terms.") *see also Bessett v Hunson*, 179 Or App 69,
39 P3d 220 (2002) ("Oregon law enforces contracts based on an objective theory, and not a subjective, unexpressed
understanding of one party to the contract.")

²⁶ See *Id.* at 27 ("Moreover, the fact that Staff is the only party that has interpreted the UE 263 settlement in such an
extreme way indicates that the parties to the settlement never understood the stay-out provision to require immediate
amortization of regulatory assets created during the stay-out period.")

1 created honors the stay-out provision and prevents regulatory accounts being inappropriately
2 used in place of deferred accounts.

3 4. The costs of this transaction should be included in calculating the Embedded Cost Differential
4 in the costs of other resources.

5 Staff argues that the costs associated with this transaction should be included in
6 calculating the Embedded Cost Differential (ECD) component of costs of other resources.²⁷ The
7 Stipulating Parties argue that the ECD is only updated in the context of a general rate case,²⁸ but
8 that in order to address Staff's concerns, PacifiCorp expressly agrees that it will update the ECD
9 in its next general rate case to account for the impact of this transaction.²⁹

10 PacifiCorp's agreement to update the ECD in its next general rate case to account for the
11 impact of this transaction does address one of Staff's concerns,³⁰ but it does not address Staff's
12 primary concern. Staff argues that consideration of these isolated transaction costs constitute
13 disfavored single-issue ratemaking, but that if these costs are going to be considered in this
14 proceeding it is equitable to include the ECD as it would be if these costs were appropriately
15 considered in a general rate case.³¹

16 While Staff appreciates PacifiCorp's agreement to account for the impact of this
17 transaction when it updates its ECD in the next general rate case, the Stipulating Parties also
18 propose a two-year closure tariff beginning on January 1, 2016. The costs of the transaction will
19 be captured in the ECD if they are included in costs of other resources for purposes of
20 calculating the ECD, but to the extent that the costs are amortized before the next general rate
21 case, customer costs in Oregon are not reduced by the ECD and hence customers will not get the
22 full benefit of the protection from those costs related to the ECD, meaning that customers will
23 not receive the full value of the ECD, *i.e.* hydro endowment. In order to be consistent and give

24 ²⁷ See Staff's Opening Brief at 9, lines 15-17 *citing* Staff/100; Wittekind/10, lines 5-8; Staff/400; Wittekind/9, lines
25 13-18.

²⁸ See Joint Opening Brief at 30.

²⁹ See *Id.*

³⁰ See Staff's Opening Brief at 10, lines 5-7.

³¹ See *Id.* at 9, line 21 through page 10, line 5 *citing* Staff/700; Wittekind/8, lines 2-7.

1 customers the value of the ECD in this proceeding, PacifiCorp should maintain its current ECD
2 assumptions, except it should also include the effects of this transaction by including the costs of
3 the transaction when calculating the component of the costs of other resources.

4 5. The undepreciated investment in the Deer Creek mine plant should be amortized over a four-
5 year period, beginning on January 1, 2016.

6 The Stipulating Parties state that Staff's proposed four-year amortization period is more
7 reasonable than the Industrial Customers' of the Northwest Utilities (ICNU) proposed nine-year
8 amortization period, but that it fails to reasonably accelerate recovery of the undepreciated
9 investment and is contrary to the Commission's approach in the Trojan case.³² ICNU testifies
10 that the cumulative benefits received by ratepayers are expected to be equal to the undepreciated
11 investment in costs near the end of 2024.³³ Staff would normally want to match the benefits and
12 burdens over this same period of time, but because, absent a sale or closure, the existing plant
13 would be fully depreciated in 2019, Staff recommends a four-year amortization period.³⁴ Staff's
14 four-year amortization period is more reasonable than a two-year, or nine-year, amortization
15 period and reasonably matches the benefits and the burdens under the circumstances. ORS
16 757.140 does not require an accelerated recovery of the undepreciated investment in plant, but
17 the amortization period selected will affect the appropriate interest rate to be applied to the
18 undepreciated investment.

19 6. The PAC/CUB Stipulation's proposed interest rate of 3.31 percent is only reasonable if the
20 amortization period is four-years.

21 Staff recommended use of the effective blended treasury rate to reflect the proper
22 discount rate.³⁵ However, in response to the PAC/CUB Stipulation, Staff concluded that it could
23 support an interest rate of 3.31 percent if the amortization period was four years.³⁶ If the
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25 ³² See Joint Opening Brief at 21.

26 ³³ See Staff's Opening Brief at 8, lines 15-17 citing ICNU/300; Mullins/11.

³⁴ See Id. at lines 17-20.

³⁵ See Id. at 9, lines 5-7 citing Staff/100; Wittekind/13, lines 19-22; Staff/400; Wittekind/17, lines 14-15.

³⁶ See Id. at lines 7-9 citing Staff/700; Wittekind/7, lines 7-10.

1 Commission were to choose a two-year amortization period, Staff continues to recommend the
2 use of the effective blended treasury rate.³⁷

3 In response to Staff's recommendation to use the effective blended treasury rate if the
4 amortization period is two-years, the Stipulating Parties assert that there is nothing indicating
5 that PacifiCorp could finance an investment of this magnitude using short-term debt.³⁸ However,
6 the standard is not what interest rate would be necessary to finance an investment of this
7 magnitude, but rather what is the time value of money. The time value of money is less over two
8 years in today's market than it is over four years; therefore, a lower interest rate is more
9 appropriate over a two-year amortization period and a higher interest rate is more appropriate
10 over a four-year amortization period.

11 III. Conclusion

12 Staff's primary recommendation is that the Commission determine that the closure of the
13 Deer Creek mine and recovery of the undepreciated plant is in the public interest and offers net
14 benefits to customers and that the sale of the mining assets at a loss is in the public interest and
15 does not harm customers, provided that PacifiCorp is required to hold customers harmless for
16 any take and pay obligations or damages incurred related to the new long-term Huntington CSA,
17 unless PacifiCorp can demonstrate by clear and convincing evidence that such obligations or
18 damages arose from circumstances that were unforeseeable at the time they entered into the
19 contract.

20 If the Commission is inclined to consider regulatory and ratemaking treatment in the
21 PAC/CUB Stipulation, it should order that amortization of the assets begins at the time of
22 inception or when entered onto the books, extend the amortization of the closure tariff from two
23 to four years, only approve the 3.31 percent interest rate if the amortization period is four years,

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26 ³⁷ See Id. at lines 13-14.

³⁸ See Joint Opening Brief at 25.

1 and order PacifiCorp to include the costs associated with this transaction in calculating the ECD
2 component of other resources.

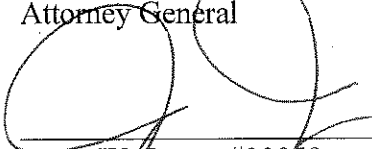
3 The Commission should not adopt the PAC/CUB Stipulation's proposed treatment of
4 regulatory assets as it circumvents the stay-out provision and the requirements of deferred
5 accounting. Instead, if the Commission is inclined to consider aspects of the PAC/CUB
6 Stipulation, it should order that amortization begin with the creation of the regulatory asset.

7 For the foregoing reasons, Staff respectfully requests that the Commission issue an order
8 consistent with its primary or secondary recommendations.

9 DATED this 28th day of April 2015.

10 Respectfully submitted,

11 ELLEN F. ROSENBLUM
12 Attorney General

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16 Assistant Attorney General
17 Of Attorneys for Staff of the Public Utility
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