

**BEFORE THE PUBLIC UTILITY COMMISSION
OF OREGON**

UE 323

In the Matter of

PACIFICORP, dba PACIFIC POWER,

2018 Transition Adjustment Mechanism

SIERRA CLUB’S RESPONSE BRIEF

Sierra Club hereby submits this Response Brief in accordance with the April 26, 2017 Prehearing Conference Memorandum issued in the above-captioned docket. This brief summarizes the concerns raised by Sierra Club in the pre-filed direct and rebuttal testimony of Dr. Thomas Vitolo, filed on June 9 and August 2, 2017, respectively. Sierra Club also addresses the scope of the workshop proposed by PacifiCorp and filed in this docket on August 29, 2017 as supplemental cross examination exhibit PAC/1112. While Sierra Club continues to have concerns about the dispatch of coal units in PacifiCorp’s fleet, discussed in more detail below, at this time Sierra Club accepts PacifiCorp’s proposal to hold workshops as proposed in PAC/1112 as an appropriate step to begin to address those concerns. Sierra Club does not seek any further relief from the Commission in this docket.

I. INTRODUCTION

This docket UE 323 is the first time that Sierra Club intervened and participated in PacifiCorp’s annual transition adjustment mechanism (“TAM”) proceeding. Sierra Club’s primary concern upon reviewing the filing for PacifiCorp’s annual adjustments related to power costs was – and still remains – the impact that changes to the economic dispatch of PacifiCorp’s

coal fleet has on actual dispatch and planning decisions. In particular, as the marginal cost of operating coal units across the country becomes less and less competitive compared to other alternatives such as wind and solar power, Sierra Club is concerned that certain provisions in coal fuel contracts may result in utilities like PacifiCorp dispatching their coal units in a manner that is not least-cost. In other words, utility practices related to long-term coal contracts may result in customers not receiving the market benefits that are possible from the increasingly high penetration of low or zero marginal cost renewable energy.

To address this concern, Sierra Club provided four recommendations in its direct testimony: (1) a moratorium on entering into new multi-year coal supply and transportation agreements; (2) a reduction of \$2.4 million in net power costs; (3) a requirement that future TAM filings include an affirmative showing that minimum take provisions in coal contracts are prudent; and (4) a requirement that PacifiCorp include all variable costs in future TAM proceedings and other long-term planning dockets.¹

After all pre-filed testimony had been submitted in the proceeding, Sierra Club and PacifiCorp engaged in settlement discussions to address Sierra Club outstanding concerns. While no settlement was reached, Sierra Club and PacifiCorp came to an understanding whereby PacifiCorp agreed to hold workshops related to its coal procurement practices, as proposed in Exhibit PAC/1112. Sierra Club determined that the scope of these workshops should provide additional insight into the process used by PacifiCorp, if any, to evaluate and manage risk in coal fuel contract negotiations and dispatch planning. Given the annual nature of the TAM

¹ Sierra Club/100, Vitolo/18-19. In rebuttal testimony, Sierra Club revised certain aspects of its modeling addressing the uneconomic dispatch of the Naughton coal units. Following that revision, Sierra Club withdrew its recommendation #2 regarding a reduction in net power costs. Sierra Club/200, Vitolo/2.

proceeding, this information is an appropriate first step in addressing Sierra Club concerns. Sierra Club may revisit these issues in a future TAM proceeding or other appropriate docket.

II. SUMMARY OF SIERRA CLUB'S TESTIMONY AND PACIFICORP'S RESPONSE

As noted above, PacifiCorp's proposal to hold a workshop related to its coal fuel procurement practices is a first step to better understanding the issues underlying Sierra Club's concerns with coal contracting and dispatch. However, it does not eliminate those concerns. While Sierra Club does not seek further relief from the Commission in this docket, the issue of uneconomic coal dispatch due to coal fuel contract impediments will continue to be a source of concern that the Commission should monitor.

Sierra Club's witness Dr. Thomas Vitolo noted that PacifiCorp obtains nearly 60 percent of its coal fuel either through long-term contracts or self-owned mines.² This means that PacifiCorp primarily obtains its coal through illiquid markets. As a result, it frequently includes minimum take provisions that require it to accept a certain amount of coal or face penalties.³ While this practice provides a greater level of certainty as to the price and availability of coal fuel to meet maximum demands from its coal plants,⁴ it limits PacifiCorp's ability to reduce its consumption of coal if market conditions are more favorable for other resources like wind, solar and natural gas.

This level of inflexibility to reduce coal dispatch is a growing concern as more and more low or even negative marginal cost renewables come online in the region. PacifiCorp itself acknowledges that at certain times it is making fundamental changes to the operation of its coal

² Sierra Club/100, Vitolo/4.

³ Sierra Club/100, Vitolo/5.

⁴ See, PAC/700, Schwartz/8.

units in response to increased renewables. PacifiCorp's witness Kelsey Brown described some of these changes to the dispatch of its coal fleet in response to the energy imbalance market (EIM):

However, PacifiCorp also made a multitude of operational changes at its coal facilities at the end of 2016 that increased the flexibility of its resources relative to the prior year. For example, PacifiCorp removed the configurations and transition times at many of its coal facilities and lowered its minimum operating parameters to take greater advantage of lower priced renewable energy available in the market.⁵

This decision by PacifiCorp to increase the operational flexibility of its coal plants in a manner that reduces coal dispatch is a good thing. It results in less coal burned, which in turn means cleaner air and water in addition to lower prices for customers. This effect is precisely the goal that Sierra Club and other clean energy advocates have been pushing for years as cleaner and cheaper energy develops throughout the region.

Sierra Club is concerned, however, that this operational flexibility in the coal fleet is at risk or could be undermined by long-term coal fuel contracts that contain minimum take provisions. While PacifiCorp may be changing operational methods that allow for lower minimum operating parameters at its coal fleet, those gains could be mitigated or erased if the utility chooses to burn more coal at another date to "catch up" to its minimum take requirements.

Dr. Vitolo looked specifically at one example to determine if this effect of burning extra coal to meet minimum take provisions was occurring. He concluded that Naughton was indeed dispatched at sub-optimal level in 2015 and 2016 due to the minimum take requirement in the coal fuel contract.⁶ To support this conclusion, Dr. Vitolo ran three dispatch scenarios: (1) actual,

⁵ PAC/500, Brown/6.

⁶ Sierra Club/100, Vitolo/16

(2) minimum take, and (3) optimal.⁷ He then compared the revenue minus cost for each scenario and explicitly excluded any contract damages that would have been triggered by PacifiCorp dropping below the minimum take provisions.

Dr. Vitolo's modeling showed exactly what Sierra Club had feared: the Naughton plant's "optimal" dispatch level was below the minimum take requirement. That result meant that PacifiCorp's actual operations of Naughton were higher than what they could have achieved if there had not been a minimum take provision in the coal fuel supply agreement.⁸ In other words, the coal fuel contract restrictions created an impediment to the flexibility of the Naughton plant that resulted in a greater level of coal dispatch.

PacifiCorp's witness, Dana Ralston, responded to Sierra Club's "optimal" dispatch scenario as follows (confidential figures indicated by "X" not necessary to repeat here):

Sierra Club fails to include in its ["Optimal"] scenario the minimum take-or-pay contractual obligation of [\$X] which would have been triggered by reducing the coal purchases to [X] tons. After taking into account the additional [\$X] in damages stipulated per the Naughton CSA, Sierra Club's calculation of [\$X] "Revenue Minus Coal Cost" would have been [\$X], a very unfavorable result for customers.⁹

PacifiCorp's criticism of Sierra Club's modeling missed the point of the argument. Sierra Club did not "fail" to include the damages associated with the minimum take provisions; the entire purpose of the exercise was to exclude those damages to consider what the optimal dispatch costs would have been if that contract provision had not been in place. In both Mr.

⁷ See Table 1, Sierra Club/100, Vitolo/16.

⁸ As noted above, Sierra Club revised the modeling somewhat in rebuttal testimony. That revision reduced the difference between the "actual" and the "minimum take" scenarios. However, even under the revised modeling, the "optimal" scenario that assumed no minimum take provision was still the best outcome. Sierra Club/200, Vitolo/5.

⁹ PAC/1000, Ralston/12-13.

Ralston's Reply and Surrebuttal testimony, he attempted to refute Dr. Vitolo's analysis by simply re-introducing contract damages into the equation.¹⁰

Sierra Club understands that in actual practice, had PacifiCorp reduced its coal take at Naughton below the minimum take provisions in the coal contract, it would have incurred penalties. Sierra Club therefore did not recommend a disallowance based on the hypothetical difference in net power costs between the "actual" and "optimal" scenarios. Rather, the example highlights the problem that PacifiCorp's coal contract negotiations have resulted in restrictions that are preventing the optimal dispatch of its coal units. Furthermore, there is little to no evidence that PacifiCorp takes any steps to analyze the trade-offs in price and flexibility that necessarily flow from these contracting decisions.¹¹ During hearings, Mr. Ralston confirmed that the Company does not have specific policies on evaluating parameters such as the length of the contract, liquidated damages or other risk mitigation policies.¹²

Sierra Club accepts that there are trade-offs between the inclusion of minimum take provisions in long-term coal contracts and the price or availability of coal from certain suppliers. However, PacifiCorp must analyze those trade-offs and provide sufficient evidence to this Commission that it is prudently managing those trade-offs.

PacifiCorp's witness Seth Schwartz explained the purpose of minimum take contracts in his testimony.¹³ He concluded that minimum take contracts are frequently required by coal suppliers because those suppliers need a minimum assurance that some level of revenue will be

¹⁰ See, Table 2, Row labeled "Take-or-Pay Coal Cost", PAC/600, Ralston/12; *see, also*, PAC/1000, Ralston/13.

¹¹ Sierra Club/100, Vitolo/7 (noting that PacifiCorp provided a minimal response when asked what its practices were to consider factors related to minimum take provisions in coal contracts).

¹² Tr. 166.

¹³ PAC/700 at p.8-9.

generated in order to be in a position to appropriately invest in and staff the mines to provide the maximum level of coal the buyer may want to purchase. “No coal producer could afford to agree to such a contract [without a minimum take provision] as it would require a large investment of capital in reserves, development, and equipment to be available to supply coal with no assurance that any coal would be purchased.”¹⁴

Sierra Club does not dispute that minimum take provisions are a common occurrence in the industry. Sierra Club also acknowledges that negotiating a lower minimum take level for any given contract could result in either (1) a lower maximum available tonnage, or (2) a higher dollar per ton contract price, or both. However, the fact that those trade-offs exist does not mean that they should be avoided at all costs. As Dr. Vitolo’s example showed with regard to the Naughton plant, PacifiCorp’s customers would have been better off if Naughton had been able to reduce its minimum take below the contracted level. It is unclear from the record what the negotiated trade-off is for plants like Naughton that are forced to consume more coal than is optimal due to contract restrictions. Without an analysis by PacifiCorp showing that it prudently considered what those trade-offs are, and that the negotiated minimum take provisions and variable dollar-per-ton costs justify the ultimate contract that was negotiated, then Sierra Club and other stakeholders have no way of knowing if PacifiCorp’s management is acting prudently. This lack of transparency into coal procurement practices is particularly troubling given the increasing shift toward lower marginal cost resources like wind and solar.

¹⁴ Id.

III. CONCLUSION

Sierra Club appreciates PacifiCorp's willingness to at least attempt to address some of Sierra Club's concerns in a workshop on its coal procurement policies. At this time, that proposal appears to be an appropriate first step in addressing the impediments that long-term coal contracts and minimum take provisions are creating for the reduced dispatch of PacifiCorp's coal fleet. Sierra Club therefore does not request any further relief from the Commission in this docket. However, Sierra Club may raise these issues in future TAM proceedings or other appropriate dockets.

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Respectfully submitted,

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