BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UM 1712

In the Matter of PACIFICORP, dba PACIFIC POWER, Application for Approval of Deer Creek Mine Transaction	STAFF'S OPENING BRIEF

I. Introduction

On December 12, 2014, PacifiCorp d/b/a Pacific Power (PacifiCorp) filed an application for approval of the Deer Creek Mine transaction (PacifiCorp Application). PacifiCorp's Application consists of four major components: closure of the Deer Creek mine; the sale of certain mining assets at a loss, execution of a new long-term coal supply agreement (CSA) for the Huntington power plant and a revised CSA for the Hunter power plant; and Energy West, a wholly owned subsidiary of PacifiCorp, will withdraw from the United Mine Workers of America 1974 Pension Trust, which will result in a withdrawal liability. In addition and even though not directly part of the overall transaction, Energy West settled its retiree medical obligations related to Energy West union participants and incurred a settlement loss.[1]

PacifiCorp has requested expedited review and approval of the transaction because the "sales of the Mining Assets and CSAs are contingent upon regulatory approval and transaction closure by May 31, 2015."[2] Specifically, PacifiCorp seeks a Commission determination that the closing of the Deer Creek mine is in the public interest and provides net benefits to customers and that the sale of mining assets for a loss is in the public interest and does not harm customers.[3]

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[1] *See* Staff/100; Wittekind/2.
[2] *See* PacifiCorp's Application at 1-2.
[3] *See* Joint Brief in Support of Stipulation at 5-6.

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However, PacifiCorp also requests a Commission determination that its actions are prudent as well as approval for cost recovery outside of a general rate proceeding.

The Public Utility Commission of Oregon Staff (Staff) filed opening and cross-answering testimony that concludes that PacifiCorp's Application for closure of the Deer Creek mine and sale of mining assets for a loss are in the public interest contingent upon including an appropriate condition that eliminates or further mitigates the risk of harm from the new long-term Huntington CSA. However, in the context of an expedited review of isolated issues outside of a general rate case, Staff proposed that the prudence of costs and rate recovery treatment be reserved for the next general rate proceeding. In the event that the Commission is inclined to consider the prudency of costs and rate recovery in this proceeding, Staff offered recommendations for appropriate regulatory and rate treatment.

On March 25, 2015, PacifiCorp and the Citizens' Utility Board (CUB) (hereafter, Stipulating Parties) filed a partial party stipulation resolving all issues between them (PAC/CUB Stipulation). Staff maintains two main objections to the PAC/CUB Stipulation. First, it does not protect customers from the risks of the new long-term CSA. Second, it does not resolve Staff's regulatory and ratemaking concerns. As a result, Staff filed responsive testimony objecting to the PAC/CUB Stipulation.[4] Staff's objections recommend a condition to protect customers from risks of the new long-term CSA, which allows Staff to recommend that closure of the Deer Creek mine and sale of the mining assets at a loss are in the public interest. Consistent with its opening and cross-answering testimony, Staff continues to offer recommendations on the appropriate regulatory and ratemaking treatment of the transactions costs in the event the Commission is inclined to consider them in this proceeding instead of the next general rate proceeding.

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[4] *See generally* Staff/700; Staff/800.

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II. DISCUSSION

1. PacifiCorp, under an expedited schedule and outside of a general rate review, is requesting more Commission determinations than are necessary to close the proposed transaction.

The only Oregon regulatory approvals that PacifiCorp requires are a Commission determination that the closure of the Deer Creek mine and recovery of the undepreciated plant is in the public interest and offers net benefits to customers and that the sale of the mining assets at a loss is in the public interest and does not harm customers.[5] The Stipulating Parties concede that "the Commission does not generally provide prudence determinations before a utility enters into a particular transaction," but requests that the Commission use its discretion to do so here.[6] PacifiCorp must receive all necessary regulatory approvals, but does not need to receive all desired or wished for regulatory approvals.[7]

In the event that the Commission is inclined to predetermine prudence under the circumstances of this proceeding, Staff does offer recommendations on the appropriate regulatory treatment and rate recovery. Staff, however, is concerned that prudence determinations in situations such as this will result in future utility requests outside of general rate cases for a determination of prudence on isolated issues under a limited review schedule. Staff's primary recommendation remains that, assuming the risks of the new long-term CSA can be eliminated or further mitigated, the proposed transaction is in the public interest.[8]

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

The PAC/CUB Stipulation does not mention the risks of the new long-term CSA, but the Joint Brief in Support of Stipulation (Joint Brief) argues that PacifiCorp has "substantially mitigated" the risks of the new long-term Huntington CSA by "negotiating a provision that

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[5] *See* Staff/100; Wittekind/5, lines 1-7.
[6] *See* Joint Brief in Support of Stipulation at 19.
[7] *See* Staff/100; Wittekind/3, lines 4-11; Exhibit PAC/101; Crane/19. To the extent necessary to implement a decision that early retirement and the sale of mining assets is in the public interest, the Commission could employ deferred accounting to account for the removal of the "return on" the 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.
[8] *See* Staff/700; Wittekind/2, lines 9-15.

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provides the Company with broad termination rights if new environmental laws or regulations, or a settlement agreement, affect the Company's ability to burn coal at Huntington."[9]

The provision that provides PacifiCorp termination rights (Article 8) and "substantially" mitigates risks of the take and pay obligations or damages applies to laws and regulations that are enacted and promulgated, not instances where prudent planning dictates that the most prudent action is closure or conversion of the plant, even though that decision is made based upon potential future actions and not existing regulatory action.[10] There remains risk associated with the take or pay obligations or damages associated with the new long-term CSA.

As an example, Staff offered a hypothetical situation in which the boiler fails at the Huntington plant, requiring a significant investment. The expected remaining life of the plant is relevant in determining whether or not it is economic to repair or replace the boiler. In analyzing the expected future life, a range of scenarios are examined that include the likelihood of future environmental requirements. In these types of scenarios, the prudent decision could be to close the plant because the projected costs of boiler repair and future environmental compliance may make the boiler investment uneconomic. Under circumstances such as this, PacifiCorp's ability to terminate the take and pay obligations of the long-term CSA may be challenged under the language of Article 8.[11] In essence, the proposed CSA does not appear to limit risk in a meaningful way except where new environmental controls have been enacted.

To address the risks of the new long-term CSA, Staff recommends that a Commission decision to find the transaction in the public interest should include a condition that PacifiCorp will hold customers harmless for any take and pay obligations or damages incurred, unless PacifiCorp can demonstrate by clear and convincing evidence that such obligations or damages arose from circumstances that were unforeseeable at the time they entered into the contract.[12]

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[9] *See* Joint Brief at 8.
[10] *See* Staff/700; Wittekind/10, lines 12-21.
[11] *See* Id. at Wittekind/11, lines 1-11.
[12] *See* Id. at 11-17.

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3. The PAC/CUB Stipulation is single-issue ratemaking.

In its opening testimony, Staff raised single-issue ratemaking as a concern in this proceeding.[13] As this Commission has stated:

> [c]oncerns about single-issue ratemaking are grounded in the idea that the ratemaking formula is designed to determine a company's revenue requirement based on the aggregate costs and demands of the utility. Except in limited circumstances, it is improper to consider changes to components of the revenue requirement in isolation . . . a change in one item of the revenue requirement is often offset by a corresponding change in another item. If rates are increased based solely on the fact that one type of expense is higher than expected, without considering changes to other elements of revenue requirement, the company's reasonable revenue requirement could be overstated.[14]

The Stipulating Parties do not deny that the PAC/CUB Stipulation is single-issue ratemaking.[15] Instead, the Stipulating Parties argue that, while the Commission disfavors single-issue ratemaking, it has approved similar tariff filings related to early retirement of utility plant outside of a general rate case.[16]

However, the one similar tariff filing cited in the Joint Brief is Order No. 08-487, which was the Commission decision on remanded orders from DR 10 (declaratory ruling), UE 88 (general rate case), and UM 989 (application for accounting order approving tariff sheets implementing rate reduction). Specifically, the Joint Brief cites page 72 of Order 08-487, which finds that the undepreciated investment in the Trojan plant should be collected over 10 years instead of 17 years. While the Joint Parties may argue that provides that the amortization period for undepreciated investment in utility plant can be shortened, it does not seem to support the position that single-issue ratemaking is appropriate in this proceeding.[17]

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[13] *See* Id. Staff/100; Wittekind/5, lines 10-13.
[14] *See NW Natural Gas Co.*, Docket No. UG 221, Order No. 12-437 at 26.
[15] *See* Joint Brief at 14.
[16] *See* Id. (*citing* Order No. 08-487 at 72).
[17] PacifiCorp's reply testimony did offer additional examples of what it terms similar tariff filings. For example, the costs associated with the early closure of the Boardman plant. However, and as PacifiCorp notes, the separate tariff for Boardman was approved in a general rate case and only the actual rate change was on a stand-alone basis. *See* PAC/400; Dalley/4-5. 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.

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Staff's primary recommendation that a prudency determination and appropriate rate recovery be reserved for the next general rate case is consistent with the long-standing policy limitation on single-issue ratemaking. However, if the Commission is inclined to consider these isolated costs here, Staff still argues that aspects of the PAC/CUB Stipulation should be rejected.

As an example of issues related to single-issue ratemaking, Staff notes that where it recommends that PacifiCorp account for changes in the Embedded Cost Differential (ECD) for the effects of this transaction and changes in costs, PacifiCorp claims that changing the ECD in isolation is inappropriate outside of a general rate case, discussed further in section 7, below.

4. The PAC/CUB Stipulation avoids the applicable stay-out provision.

In its last rate case, PacifiCorp agreed to and the Commission approved a stay-out provision that provided the "earliest proposed rate effective date for the Company's next general rate case filing will be January 1, 2016."[18] In testimony, PacifiCorp argues that it is inappropriate for them to have to absorb costs that are the result of a prudent transaction that benefits customers.[19] However, if prudently incurred costs are an exception to the application of the stay-out provision and a utility can only collect prudently incurred costs, it is difficult to view the stay-out provision as having value. The PAC/CUB Stipulation avoids application of the stay-out provision as follows:

- The Stipulating Parties agree to a two-year amortization period for a closure tariff, beginning January 1, 2016, with interest accruing at 3.31 percent, effective June 1, 2015, and continuing through amortization. The Stipulating Parties agree that PacifiCorp can establish a regulatory asset for amounts included in the tariff and that regulatory asset will be amortized as amounts are collected through the tariff.
- The closure tariff will include the unrecovered investment in the Deer Creek mine and actual closure costs through November 30, 2015.
- The Stipulating Parties agree that PacifiCorp may establish a regulatory asset, with interest accruing beginning June 1, 2015, at PacifiCorp's authorized weighted average cost of debt.
- The regulatory asset will include the following components for consideration in the next general rate case: one-time retiree medical settlement loss, actual closure

[18] *See* Order No. 13-474, Appendix A, ¶ 15 at 5-6.
[19] *See* PAC/400; Dalley/3-4; Id at 14.

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costs incurred after November 30, 2015, any difference between estimates included in the closure tariff and actual amounts, and a credit for the difference between fuel costs from June 1, 2015, through December 31, 2015, included in rates through the 2015 TAM for the Huntington and Hunter plants and replacement fuel costs, including the CSAs.

- The regulatory asset will be offset by a credit beginning June 1, 2015, for the "return on" the undepreciated Deer Creek assets currently included in rates.

For the undepreciated investment in the Deer Creek plant and current and future closure costs through November 30, 2015, PacifiCorp will collect 100 percent of those costs, over a two-year amortization period beginning the day the stay-out provision expires. Although the amortization period does not begin until January 1, 2016, interest begins to accrue at 3.31 percent on June 1, 2015. For the costs outlined in the last two bulleted items, PacifiCorp may establish a regulatory asset that will accrue interest at PacifiCorp's authorized weighted cost of debt, for consideration in its next general rate case.

The result of the PAC/CUB Stipulation is that the stay-out provision is avoided because amortization of the closure tariff does not begin until January 1, 2016, even though some of the costs occur in 2015. Furthermore, customers will pay interest on this balance beginning June 1, 2015; however, amortization does not begin until January 1, 2016. These are not consistent or equitable. In relation to the costs included in the regulatory asset for consideration in the next general rate case and as stated in its objections to the PAC/CUB Stipulation, Staff does not object to the proposed regulatory asset, with the exception of the one-time retiree medical loss,[20] being considered in the next rate case so long as amortization on the regulatory asset begins at the time the asset is created on PacifiCorp's books.

In summary, Staff opposes the PAC/CUB Stipulation to the extent it delays amortization of costs incurred during the term of the stay-out provision so that PacifiCorp does not have to absorb them. In addition, the PAC/CUB Stipulation, which delays amortization, nevertheless

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[20] *See* Staff/800; Bahr/3, lines 10-20 (the one-time loss is severable from the transaction). However, if the Commission is inclined to consider it here, Staff does support a regulatory asset so long as it begins to amortize at the time it is recorded on the books. *See* Id. at Bahr/4, lines 1-17.

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allows interest on those closure costs to accrue beginning on June 1, 2015, which is more interest than would otherwise accrue if actual amortization began on June 1, 2015.

5. The two-year amortization period in the PAC/CUB Stipulation does not equitably allocate the benefits and burdens.

The PAC/CUB Stipulation proposes a two-year amortization period. The Stipulating Parties argue that a two-year amortization period is reasonable because the Commission found - in Trojan - that it was reasonable to allow recovery of an undepreciated investment in plant over a shorter period of time than the original depreciable life of the plant.[21] However, neither ORS 757.140(2) nor Order No. 08-487 requires recovery of an undepreciated investment in plant over a shorter period than the original depreciable life of the plant. Rather, Order No. 08-473 found that in that case a shorter recovery period (10 years instead of 17 years) "would equitably allocate the benefits and burdens while allowing quicker recovery to offset any increase in PGE's risk profile."[22]

Absent sale or closure, the Deer Creek undepreciated plant would be collected in rates at PacifiCorp's rate of return through 2019.[23] In its supplemental responsive testimony, ICNU argues that the cumulative benefits received by ratepayers are expected to be equal to the undepreciated investment in costs near the end of 2024.[24] As stated in is responsive testimony, Staff would normally desire to match the benefits and burdens over the same period of time.[25] However, Staff understands that the existing plant would be fully depreciated in 2019; therefore, Staff recommends an amortization period of four years.[26]

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[21] *See* Joint Brief at 12.
[22] *See* Order No. 08-473 at 72.
[23] *See* Staff/700; Wittekind/6, lines 5-7 *citing* PAC/200; Stuver/5.
[24] *See* ICNU/300; Mullins/11.
[25] *See* Staff/700; Wittekind/6, lines 8-9.
[26] *See* Id. at lines 9-14.

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

The Stipulating Parties agreed to an interest rate of 3.31 percent for the closure tariff, beginning June 1, 2015, and continuing through a two-year amortization period, which begins on January 1, 2016.[27] In opening and cross-answering testimony, for a two-year amortization period, Staff recommended use of the effective blended treasury rate to reflect the proper discount rate.[28] In its responsive testimony to the PAC/CUB Stipulation, Staff concluded that it could support an interest rate of 3.31 percent if the amortization period was four years.[29] Staff rationalized that a longer amortization period would make the higher interest rate reasonable as interest rates are projected to increase over time.[30] While the applicable blended effective treasury rate would change each year over the course of the amortization period, and the treasury rate is expected to increase as well, fixing the interest rate at 3.31 percent is reasonable in the context of a four-year amortization period.[31] If the Commission is inclined to choose a two-year amortization period, Staff's recommendation is to use the then effective blended treasury rate.

7. The PAC/CUB Stipulation and Joint Brief fails to address the Embedded Cost Differential.

In opening and cross-answering testimony, Staff argued that the costs associated with this transaction should be included in calculating the ECD component of costs of other resources.[32] Although both the PAC/CUB Stipulation and Joint Brief fail to address the ECD, PacifiCorp argued that the ECD is only set in a general rate revision so it would be inappropriate to update it in this proceeding.[33]

As discussed above under section 3, consideration of isolated costs in this proceeding is single-issue ratemaking for which Staff argues against. However, if these isolated costs are going to be considered in this proceeding it seems only fair that the ECD should be included in

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[27] *See* Staff/700; Wittekind/6, lines 15-19 *citing* PAC/CUB Stipulation at 4, lines 6-7.
[28] Staff/100; Wittekind/13, lines 19-22; Staff/400; Wittekind/17, lines 14-15.
[29] *See* Staff/700; Wittekind/7, lines 7-10.
[30] *See* Id. at lines 10-13.
[31] *See* Id. at lines 13-15.
[32] *See* Staff/100; Wittekind/10, lines 5-8; Staff/400; Wittekind/9, lines 13-18.
[33] *See* Staff/700; Wittekind/7, line 22 through Wittekind/8, line 1.

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calculating the ECD component of costs in other resources as it would be if these costs were appropriately considered in a general rate case.[34] Under PacifiCorp's proposal, it would receive both the benefit of single-issue ratemaking and also avoid including the costs of this transaction in the ECD component of costs of other resources as it would be required to do in a general rate case.[35] In addition, PacifiCorp may be able to argue in a subsequent general rate case that the costs of this transaction should not be incorporated in the ECD by reason of the PAC/CUB Stipulation, which would harm customers.[36] The purpose of the ECD is to ensure Oregon receives the benefits of the specified hydroelectric resources. By not updating the ECD for the costs of this transaction, Oregon will not be receiving the benefits of the assigned low-cost hydroelectric resources.

III. Conclusion

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

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

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[34] *See* Staff/700; Wittekind/8, lines 2-7.
[35] *See* Id. at lines 8-14.
[36] *See* Id. at lines 15-21.

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

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

DATED this 21st day of April 2015.

Respectfully submitted,

ELLEN F. ROSENBLUM
Attorney General

Jason W. Jones, #00059
Assistant Attorney General
Of Attorneys for Staff of the Public Utility Commission of Oregon

Department of Justice
1162 Court Street NE
Salem, OR 97301-4096
(503) 947-4520 / Fax: (503) 378-3784