April 21, 2015

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Public Utility Commission
Attn: Filing Center
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Re: Docket No. UM 1712: Sierra Club's Initial Brief

Please find enclosed Sierra Club's Initial Brief in the above-referenced docket.

The redacted version of this filing has been e-filed with the Commission and served upon parties via email. The confidential version of this filing is being filed with the Commission and served pursuant to Protective Order No. 14-431 upon all eligible party representatives via FedEx.

Please let me know if you have any questions. Thank you.

Respectfully submitted,

/s/ Derek Nelson

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REDACTED VERSION

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	SIERRA CLUB'S INITIAL BRIEF

In accordance with OAR 860-001-0650 and the procedural schedule issued on April 16, 2015 by Administrative Law Judge ("ALJ") Allan Arlow in the above-captioned docket, Sierra Club hereby submits its initial brief addressing PacifiCorp's request for approval of the Deer Creek Mine Transaction.

I. SUMMARY OF SIERRA CLUB'S POSITION

It is not prudent to bind ratepayers to a 15-year long-term coal contract. The current regulatory and economic climate facing coal plants is unfavorable, and the risk that a plant will close within the term of a long-term coal contract is high. This risk is particularly true for a plant such as Huntington that is facing pending regulatory action that could impose substantial investment costs. Long-term contract liabilities arising from existing coal contracts may impede PacifiCorp's ability to act in the best economic interests of its customers when faced with a decision on whether or not to close a coal plant. The termination provisions contained in the proposed Huntington coal contract are not sufficient to fully protect customers from this risk.

Sierra Club therefore opposes the Stipulation's assertion that the new long-term coal supply agreement ("CSA") for the Huntington coal plant is prudent.[1]

II. STATEMENT OF FACTS

Through its application, the Company seeks approval and ratemaking treatment of the various aspects of its proposed "Transaction" related to Deer Creek. The requested approvals go beyond approval of the decision to close the Deer Creek mine. The Transaction consists of four components: "(1) the Company will permanently close the Deer Creek Mine and incur direct closure costs; (2) Energy West will withdraw from the United Mine Workers of America (UMWA) 1974 Pension Trust (1974 Pension Trust), incurring a withdrawal liability; (3) the Company will sell certain mining assets (Mining Assets); and (4) the Company will execute a replacement coal supply agreement (CSA) for the Huntington generating plant and an amended CSA for the Hunter generating plant."[2]

PacifiCorp included an analysis in its direct testimony purporting to show the benefits of its proposed Transaction (Transaction case) compared to (1) keeping the Deer Creek mine open (keep case), and (2) relying on market purchases as opposed to the CSA to replace Huntington's fuel supply (market case).[3] Sierra Club did not challenge the Company's analysis with regard to the benefits of closing the Deer Creek mine (keep case), and Sierra Club does not oppose PacifiCorp's decision to close the Deer Creek mine.[4] However, once the mine is closed, the Company severely overstated the benefits of obtaining coal through the Huntington CSA compared to the market. In both the market case and the Transaction case scenarios, PacifiCorp

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[1] Stipulation, ¶9; Joint Brief in Support of Stipulation, pp.1-2.
[2] PAC/400, Dalley/2, n.1.
[3] PAC/106, Crane/1.
[4] Sierra Club takes no position on the proper regulatory treatment of costs related to the closure of the Deer Creek mine, the withdrawal from the UMWA 1974 Pension Trust, or the sale of the Mining Assets.

included an assumption that the Deer Creek mine would close. With that assumption, the comparison of the market case and the Transaction case should have presented an analysis of the difference in costs to customers from committing to the long-term coal contract with Bowie versus the expected cost of relying on the market. However, the Company distorted the analysis by assuming that certain "benefits" related to closing the Deer Creek mine, such as discharging the Retiree Medical Obligation, would not accrue to the market case.[5] In fact, the benefits of closing the Deer Creek mine would accrue – and have accrued – to the Company in the market case.

Sierra Club adjusted the analysis of the market case to reflect those changes. When taken together, these adjustments reduce the overall present value revenue requirement differential ("PVRR(d)") to only [REDACTED]. In other words, when comparing the Huntington CSA to a plan to obtain coal on the market – based on PacifiCorp's own projections of what that market coal would cost – there is only a [REDACTED] benefit over the 15-year term of the contract. Sierra Club acknowledges that this price differential still creates an expected benefit to customers; however, the Commission must weigh that benefit against the risk that PacifiCorp could incur take-or-pay penalties that could reach or exceed [REDACTED] if the plant closes and the Company is unable to terminate the Huntington CSA before the end of the contract term.[6] In light of the economic challenges facing the coal industry nationwide, including coal in Utah, the risk that Huntington may face closure before 2029 is too high, and the Commission cannot determine at this time that customers would be protected from such risk. Therefore, based on the facts in the record at this time, the Commission cannot determine that the Huntington CSA is prudent.

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[5] Sierra Club/109, Fisher/1.
[6] Sierra Club/100, Fisher/14.

Sierra Club recommended and Staff supported four conditions that the Commission could adopt to protect customers. (1) the Company must continue to model the operation of Huntington with the assumption that no penalties are incurred for early termination of the CSA; (2) the Company commits to hold ratepayers harmless for any and all penalties resulting from an early exit from the CSA; (3) the Company commits to operational modeling of the Huntington plant using only the variable cost of fuel as represented in the Huntington CSA; and (4) the Company commits to assess the forward-looking economics of the Huntington units when capital expenditures in excess of $25 million are planned.[7] With these protections in place, Sierra Club would support a determination that the Huntington CSA and the Transaction as a whole is prudent. However, without those protections, a determination that the Huntington CSA is prudent or in the public interest is improper and would put customers at substantial risk.

On March 31, 2015, PacifiCorp and the Citizens Utility Board ("CUB") filed a joint stipulation ("Stipulation"). Paragraph 9 of the stipulation states: "The Settling Parties agree that the decision to enter into the Transaction including the decisions to … enter into the new and amended CSAs for the Huntington and Hunter plants (respectively)-was prudent." If approved without condition, the Stipulation would establish a presumption that the Huntington CSA, including the risk of take-or-pay costs, is prudent. Sierra Club therefore objected to the Stipulation because PacifiCorp and CUB have not demonstrated that the Huntington CSA is prudent.[8]

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[7] Sierra Club/100, Fisher/30-31; Staff/600, Crider/8.

[8] Sierra Club Objections, p.1.

III. THE COMMISSION CANNOT DETERMINE BASED ON THE FACTS IN THE RECORD THAT THE HUNTINGTON CSA IS PRUDENT OR IN THE PUBLIC INTEREST

PacifiCorp has not demonstrated on the record that the terms of the Huntington CSA are prudent. In particular, Sierra Club calculated that the take-or-pay provisions in the 15-year contract could impose contract liabilities that could reach or exceed [REDACTED] if the Huntington plant retires and the Company is unable to put to use the minimum amount of coal required by the agreement.[9] This downside risk substantially outweighs the [REDACTED] estimated present value benefit of securing somewhat lower coal pricing in the 15-year take-or-pay contract compared to flexibly buying coal on the open market.[10]

PacifiCorp and CUB acknowledge that the Commission "does not generally provide prudence determinations before a utility enters into a particular transaction…"[11] Nevertheless, the Company and CUB seek such pre-determination in this instance, which would extend to the Huntington CSA. In making this request, the Company brushes aside the risk highlighted by Sierra Club and other parties that customers could be exposed to hundreds of millions of dollars in contract liabilities if the Huntington plant becomes uneconomical. It is not appropriate for the Commission to grant a request for a pre-determination of prudence in circumstances where the ultimate costs to ratepayers are not yet known.[12] The Commission should therefore reject PacifiCorp's request to determine that the Huntington CSA is prudent and in the public interest

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[9] Sierra Club/100, Fisher/14. Sierra Club calculated liabilities based on a scenario where Huntington 1 and 2 shutdown in 2022 and Hunter is unable to take any coal from the contract. The calculation therefore reflects paying the full value for the minimum take amount from 2022 through 2029.

[10] *Id.* at 8, Table 1.

[11] Joint Brief in Support of Stipulation, p.19.

[12] *See, e.g.,* Docket UM 1374, Order 08-376, In the Matter of Pacificorp, DBA Pac. Power, 08-376, 2008 WL 2810189 (July 17, 2008)(holding that where PacifiCorp may later be found to have been fundamentally wrong in its assessment of future costs, subsequent prudence review of whether an agreement appropriately protected customers is appropriate).

unless it first imposes the requirements recommended by Sierra Club and supported by Staff to protect customers.

A. Long-Term Coal Contract Liabilities Could Impede a Future Decision to Close Coal Units

Sierra Club's concern that long-term coal contract liabilities could impede PacifiCorp's ability to make appropriate economic choices on behalf of its customers is not new. In a recent Wyoming rate case, Sierra Club and other parties considered the Company's request to recover costs related to the installation of selective catalytic reduction ("SCR") controls on the Hayden coal plant in Colorado. Through discovery in the present docket, PacifiCorp admitted that the existence of a long term take-or-pay coal contract significantly impacted an economic analysis of the SCR capital expense compared to a retirement of the unit. "If take-or-pay provisions were applicable under an early retirement scenario, the present value revenue requirement differential (PVRR(d)) comparing selective catalytic reduction (SCR) versus early retirement [of Hayden] was reduced by approximately [CONFIDENTIAL BEGINS] [REDACTED] [CONFIDENTIAL ENDS] with the reduction being less favorable to the SCR alternative."[13] This liability would, presumably, be applied in proportion to PacifiCorp's share of Hayden unit 1 (24.5%) and unit 2 (12.5%). That type of liability could be expected to increase for a larger facility, such as Huntington, that is 100% owned by the Company. Sierra Club's concern in this docket is that the type of long-term coal contract liability the Company faced with respect to Hayden will be similarly applicable at Huntington in a future review. The magnitude of long-term coal contract liabilities could easily reach a magnitude sufficient to wipe out the current estimated benefit of the Huntington CSA compared to flexible market purchases.

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[13] Sierra Club/200, Confidential 1st Revised Response to Sierra Club Data Request 1.31. PacifiCorp further asserted that the economic analysis did not influence the Company's decision making with respect to SCR at Hayden.

In addition to creating real financial impacts for customers if Huntington shuts down before the expiration of the long-term coal contract, the risk of incurring penalties or other liability costs under the long-term take-or-pay contract for Huntington may distort PacifiCorp's decision making. If PacifiCorp includes take-or-pay contract liabilities in its forward looking analyses as a cost that would be incurred following a unit retirement, as it did in its economic analysis of Hayden, then the results of those analyses will be biased toward keeping a coal unit open. CUB acknowledged that its support for the Stipulation was conditioned on its understanding that PacifiCorp would conduct its future planning based on the assumption that take-or-pay costs related to the Huntington CSA would be avoidable. CUB stated:

> If, however, the Company did model the take-or-pay costs as fixed in a resource planning docket, CUB would likely ask the Commission not to acknowledge the modeling results. If, in a future rate case, the Company sought recovery of costs for environmental controls based on analysis that included take-or-pay costs as fixed costs, CUB would likely argue that the Company's actions based on this analysis were not prudent.[14]

Sierra Club appreciates CUB's position on this issue; however, the operative language of the Stipulation is silent as to the obligations PacifiCorp would have to model future forward looking cost analyses. Sierra Club therefore recommends that if the Transaction is approved, the Commission direct PacifiCorp to conduct its forward looking planning under the assumption that it will not incur take-or-pay costs related to the Huntington CSA if a unit or units at Huntington close prior to 2029. This condition is appropriate and necessary considering that PacifiCorp's 2015 IRP includes multiple scenarios where one or two Huntington units shut down in the early 2020's.[15]

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[14] ICNU/301, Mullins/9, CUB's Response to Sierra Club Data Request 1-1.
[15] Sierra Club/103, Fisher/2.

B. The Huntington CSA's Environmental Termination Provision is Not Sufficient for the Commission to Determine that it will Protect Ratepayers

PacifiCorp asserts that the long-term Huntington CSA will protect ratepayers because the Company can exercise a termination provision in the contract if environmental regulations render the plant uneconomic.[16] Sierra Club acknowledges that the Company's reply testimony addressed in greater detail the environmental termination provisions of the Huntington CSA. PacifiCorp witness Cindy Crane testified as follows:

> Q. Would Article 8 allow the Company to terminate the CSA if an environmental requirement made continued operation of Huntington uneconomic?
> A. Yes. The Company intended Article 8 to address a scenario where an environmental requirement made the continued operation of the plant as a coal-fired facility uneconomic, and the Company made this intent clear during its negotiations with Bowie.[17]

The Company further stated its intention to model the forward-looking economics of Huntington based on the assumption that it will be able to terminate the Huntington CSA if the Huntington coal plant becomes uneconomic:

> Because the Company can exercise its termination rights if it becomes uneconomic to burn coal at Huntington, there is no incentive to continue burning coal when it is uneconomic to do so and the Company's options are not limited. Furthermore, the Company will conduct its future planning based on its understanding of Article 8.[18]

If the contract operates as Ms. Crane stated is intended, then it should protect customers, in some circumstances related to environmental requirements,[19] from long-term contract costs in the event it becomes preferable to retire Huntington early. However, PacifiCorp in the proposed

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[16] PAC/400, Dalley/3; PAC/500, Crane/6-7.
[17] PAC/500, Crane/6.
[18] *Id.* at 7.
[19] In its Objection and Responsive Testimony, Staff identifies an additional scenario where an equipment failure and repair may render the Huntington plant uneconomical in a manner that may not trigger the environmental termination provisions of the contract. Staff/700, Wittekind/11.

Stipulation is asking for a blanket determination that the Huntington CSA is prudent. Such a determination could expose customers to substantial risk if the contract does not in fact operate as Ms. Crane suggests it is intended.

Sierra Club is concerned that the Stipulation, if approved without condition, could be interpreted at a later date to insulate PacifiCorp from any future review of costs related to the take-or-pay requirements in the Huntington CSA if the plant does in fact close before 2029. For example, Bowie may disagree with PacifiCorp's interpretation of the contract and could sue for damages if Huntington closes before 2029. If Bowie is successful in such a claim, ratepayers should not be on the hook for the long-term contract damages agreed to by the Company in 2014.

With regard to a determination of prudence, this Commission has held, "the company's conduct should be judged by asking whether the conduct was reasonable at the time, under all circumstances, considering that the company had to solve its problems prospectively rather than in reliance on hindsight."[20] In the present docket, the Company is making a prospective decision that relies heavily on its assertions that the scenario of incurring take-or-pay penalties under the Huntington CSA is unlikely to occur. The Company repeatedly made this assertion in the face of concerns raised by Sierra Club and other parties that the Huntington CSA was not sufficient to protect customers. The Company should therefore assume the risk that the "unlikely scenario" of take-or-pay penalties may occur. The Company should not be allowed at a later date to avail itself of the principle that a future disallowance may constitute hindsight. Sierra Club and other parties have made PacifiCorp fully aware that incurring the risk of future take-or-pay liabilities is not prudent. If the Company chooses to proceed with this or any other long-term coal contract in

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[20] Docket UE-246, In the Matter of Pacificorp, DBA Pac. Power Request for A Gen. Rate Revision, 12 493, 2012 WL 6644237 (Dec. 20, 2012)

spite of its awareness of this risk, then it is appropriate to require the Company's shareholders to assume that risk.

Sierra Club therefore recommends that the Commission condition any approval of the Stipulation on a clear directive that ratepayers will not assume the risk of penalties or damages from the take-or-pay requirements of the Huntington CSA. Given the confidence with which PacifiCorp asserted in reply testimony that it can exercise its termination rights if it becomes uneconomic to burn coal at Huntington, such conditions should be neither objectionable nor burdensome to the Company.

IV. CONCLUSION

For the foregoing reasons, Sierra Club respectfully recommends that the Commission withhold a determination that the Huntington CSA is prudent or in the public interest unless the Commission includes conditions to protect ratepayers. Sierra Club recommends the following conditions:

> (1) the Company must continue to model the operation of Huntington with the assumption that no penalties will be incurred for early termination of the CSA;
>
> (2) the Company will hold ratepayers harmless for any and all penalties resulting from an early exit from the CSA;
>
> (3) the Company will model the Huntington plant using only the variable cost of fuel as represented in the Huntington CSA; and
>
> (4) the Company will assess the forward-looking economics of the Huntington units when capital expenditures in excess of $25 million are planned.

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With these protections in place, Sierra Club would support a determination from the Commission that the Huntington CSA, and the Transaction as a whole, is prudent.

Dated: April 21, 2015

Respectfully submitted,

/s/ Travis Ritchie

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CERTIFICATE OF SERVICE

I hereby certify that on this 21st day of April, 2015, I caused to be served the foregoing SIERRA CLUB'S INITIAL BRIEF upon all party representatives on the official service list for this proceeding via electronic mail. The confidential version of this filing is being served pursuant to Protective Order No. 14-431 upon all eligible party representatives via FedEx.

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Dated this 21st day of April, 2015 at San Francisco, CA.

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