

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)
_____)

**RESPOSE TESTIMONY OF THE
CITIZENS' UTILITY BOARD OF OREGON**

March 5, 2015



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1 Our names are Bob Jenks and Jaime McGovern, and our qualifications are listed in
2 CUB Exhibit 101.

3 **I. Introduction.**

4 PacifiCorp is asking the Commission for approval related to several aspects of the
5 Deer Creek Mine Transaction, including:

- 6 *Deer Creek mine closure
- 7 *Withdrawal from the UMWA Pension Trust
- 8 *Sale of mining asset to Bowie
- 9 *New Coal Contract for Huntington
- 10 *Settlement of retiree medical obligation

11 The primary benefits of the Deer Creek Mine Transaction are obtained through
12 the withdrawal from the United Mine Workers of America (UMWA) 1974 Pension Trust
13 (Pension Trust) and the settlement of the retiree medical obligation for Energy West
14 union participants. In order to withdraw from the pension trust, PacifiCorp claims that it

1 needs to end its relationship with the UMWA, which requires closing the mine.¹ If
2 PacifiCorp chooses not to close the mine, it would not be able to create the benefits from
3 withdrawal from the multi-employer Pension Trust.

4 So, while most of the benefits of this transaction are not achieved directly by
5 closing the mine, the Company argues that the strategy that it pursued, which included
6 closing the mine was necessary to generate the benefits of this transaction. Therefore,
7 CUB begins its analysis by looking at the mine closure decision. Oregon has a statute that
8 allows a utility to recover its investment in property that is retired before the end of its
9 expected useful life, if that retirement is determined to be in the public interest.²
10 However, legal interpretations of that statute do not allow the utility to recover “profits”
11 on the retired plant, but do allow an adjustment for the time value of money.

12 After examining the mine closure decision, CUB then looks at the issues relating
13 to the new coal contract to determine whether that contract is prudent. Finally, after
14 discussing whether the closure is in the public interest and whether the new contract is
15 prudent, CUB discusses the ratemaking implications of PacifiCorp’s request.

16 Our testimony is organized as follows:

- 17 1. Retired Plant: CUB finds that the Public Interest Standard allows for return of
18 investment.
- 19 2. Retired Plant: Return on Investment is prohibited, but time value of money is not.
- 20 3. The prudence of the new Coal Supply Agreement (CSA) largely rests on the
21 interpretation of the environmental clause.

¹ UM 1712/PAC/100/Crane/19-20.

² ORS 757.140(2)(b).

1 4. The ratemaking treatment in the context of the prohibition on single-issue
2 ratemaking and the Company's agreement to "stay-out" in its last general rate
3 case.

4 5. Other Issues Related to PacifiCorp's Transaction.

5 **II. Retired Plant: CUB Finds That the Public Interest Standard Allows**
6 **for Return of Investment.**

7 Utilities are generally only allowed to charge customers for property that is used
8 and useful for the current provision of utility service.³ An exception to this allows the
9 PUC to grant recovery of retired plant when the PUC finds that the retirement is in the
10 public interest.⁴

11 When considering whether to close the Deer Creek Mine, PacifiCorp examined
12 three options:⁵

- 13 1. *Keeping the mine open and continuing operation (keep case).*
- 14 2. *Closing the mine and signing the new coal contract for Huntington (transaction*
15 *case).*
- 16 3. *Closing the mine and purchasing coal from the market (market case).*

17 PacifiCorp analyzed the present value revenue requirement (PVRR) for each of
18 the three options.⁶ CUB has reviewed the Company's analysis and believes that it
19 supports a finding that closing the mine is in the public interest. Under the Company
20 analysis, both options that involve closing the mine are cost-effective when compared
21 with the option of keeping the mine open.⁷

³ ORS 757.355(1).

⁴ ORS 757.140

⁵ UM 1712/PAC/100/Crane/26.

⁶ UM 1712/PAC/Crane26

⁷ UM 1712/PAC/106/Crane/1.

1 Based on CUB’s review of PacifiCorp’s analysis, CUB believes that the early
2 retirement of the mine is in the public interest and the Company is eligible to earn a
3 return of its investment in capital costs for the Deer Creek Mine.

4 **III. Retired Plant: What is the Appropriate Adjustment for the Time** 5 **Value of Money?**

6 **A. Utilities are Not Allowed to Earn Profits on Retired Property**

7 Under the Oregon courts’ interpretations of the retired property statute and the
8 Commission remand of the Trojan rate case, utilities are prohibited from earning a profit
9 on their retired property but are able to recover their unrecovered capital investment,
10 which can be adjusted for the time value of money.⁸

11 While utilities have complained about this construct, CUB thinks it has produced
12 a pretty good policy balance. Utility regulation rewards utilities for capital investments
13 that are found to be prudent. Utilities are able to recover their investments and earn a rate
14 of return, which includes a return on equity, to reward shareholders and encourage equity
15 investments. However, a reward to shareholders represents profits. Under this Oregon
16 view of retired property, utility shareholders lose their ability to make a profit on an
17 investment when that investment is no longer used and useful in the provision of utility
18 service. But because the utility is allowed to recover its capital investment adjusted for
19 the time value of money, it is not harmed—it just doesn’t get to make a profit.

20 This makes a lot of sense. Once the Deer Creek Mine is closed and the fuel from
21 the plant comes from a long-term contract or the market, the Company no longer has a
22 capital investment that is tied to the fuel supply for the coal plants. Market purchases and

⁸ OPUC Order No. 08-487, pages 69-70.

1 fuel contracts do not earn a return; instead, a utility gets to expense its fuel costs. Once
2 the mine has ceased producing coal, there is no basis for PacifiCorp to earn a return on its
3 investment because there is no investment that is fueling the plant.

4 **B. Ratemaking Treatment after the Trojan Remand Decision**

5 The Trojan remand order provided ratemaking principles that apply to retired
6 property. Let's review those principles and then apply them to this Transaction. In the
7 Trojan remand, the Commission first found that it could not allow a *profit* on the
8 undepreciated investment:

9 The Court of Appeals apparently accepted URP's and CUB's arguments
10 that rate of return was something other than "interest." The Court of
11 Appeals repeatedly referred to the return on PGE's remaining Trojan
12 investment as "profit" and was careful to specify that ORS 757.355 does
13 not allow utilities to "obtain a *profit* from ratepayers on their investments
14 in facilities that are not used to serve ratepayers." The court appropriately
15 looked at rate of return for what it is in utility regulation—the utility's
16 opportunity to earn a profit. In fact, the court specifically rejected PGE's
17 attempt to justify the *return on* by calling it "interest."

18 We interpret the Court of Appeals' decision in *Trojan I* to mean what it
19 says, and nothing more. It is clear from the decision that the Commission
20 cannot include PGE's undepreciated investment in rate base with the
21 opportunity to earn a return (or profit). But the Court of Appeals' decision
22 is silent on the question of whether the Commission may require recovery
23 of PGE's remaining investment over time with interest to compensate for
24 the time value of money. We believe the parties' view to the contrary is
25 inconsistent with the plain language of the decision.⁹

26 Second, the Commission found that neither allowing the return of the investment
27 over a single year nor allowing the return over a long period of time with no adjustment
28 for time value of money would result in just and reasonable rates:

29 We also believe that the parties' interpretation of *Trojan I* would require
30 this Commission to disregard its statutory duty to balance the interests of
31 customers and the utility. Under the parties' interpretation of *Trojan I*, the
32 Commission would be required to choose between burdening customers

⁹ OPUC Order No. 08-487, page 69 (internal citations omitted).

1 with a drastic rate increase for one year in order to allow PGE full
2 recovery of its remaining Trojan investment or effectively disallowing a
3 significant amount of a prudently-incurred investment in utility plant by
4 requiring recovery over time without interest. This interpretation would
5 make it exceedingly difficult, if not impossible, for the Commission to
6 appropriately balance the interests of the utility and its customers.¹⁰

7 Finally, the Commission decided to allow the utility to collect its remaining investment
8 over 10 years with an adjustment for the time value of money:

9 Our decision to allow PGE to recover its remaining investment over 10
10 years with interest presents a question that was not addressed by the
11 parties: What interest rate appropriately reflects the time value of money?
12 The Commission often, but not always, uses a utility's authorized rate of
13 return as the applicable interest rate when an amount is amortized over
14 time, even when that amount is not included in rate base. The theory
15 behind using a utility's authorized rate of return as the applicable interest
16 rate is that it best represents a utility's lost earning opportunity because, if
17 the utility recovered the money immediately, it could invest it in a rate
18 base asset that would earn a return. To provide symmetrical treatment of a
19 utility and its customers, the Commission has also used the utility's
20 authorized rate of return as the interest rate applicable to customer credits
21 that are refunded over time. Given the Court of Appeals' specific
22 prohibition on allowing a utility to earn a return on a utility's remaining
23 investment in retired assets, however, we obviously cannot use PGE's rate
24 of return as the applicable interest rate in this case.

25 Another option is to use the cost of debt adopted for PGE in UE 88. As
26 discussed above, a utility's rate of return is calculated by identifying the
27 costs and components of the utility's capital structure. The cost of each
28 capital component—typically debt, preferred stock, and equity—is
29 estimated using financial models and weighted according to its percentage
30 of total capitalization. These weighted costs of capital are then combined
31 to calculate the utility's overall cost of capital, which becomes the allowed
32 rate of return on rate base. The cost of debt represents the amount a utility
33 must pay for borrowed funds, which we believe is a reasonable estimate of
34 a utility's time value of money. PGE's cost of debt for 1995 was set at
35 7.71 percent in UE 88.

36 A final option would be to use an interest rate that is unrelated to utilities
37 or utility operations. The Commission has previously used U.S. Treasury
38 bond rates to determine a reasonable interest rate. For example, the
39 Commission recently decided to use a blended Treasury bond rate, plus a
40 100 basis point adjustment, as the interest rate applicable to deferred

¹⁰ OPUC Order No. 08-487, page 70.

1 accounts after amortization is authorized. The interest rate applicable to a
2 Treasury bond depends upon the bond's maturity (for example, there are
3 different interest rates applicable to 3-year bonds and 5-year bonds). In
4 this case, we would use the annual rate for 1994 (the closest full year to
5 the April 1, 1995 effective date of the UE 88 order) applicable to the bond
6 maturity that most closely reflects the length of amortization of PGE's
7 remaining Trojan investment—10 years. The annual Treasury rate for 10-
8 year bonds in 1994 was 7.09 percent.

9 We believe that, under the circumstances of this case, it is most
10 appropriate to choose an interest rate that is unrelated to utilities. This
11 helps ensure the rate reflects solely the time value of money and is not in
12 any way reflective of PGE's opportunity to earn a profit on its rate base. In
13 addition, the lower Treasury bond rate better balances the interests of the
14 utility and the customer because it allows PGE to recover the full
15 authorized amount of its remaining Trojan investment at the least cost to
16 customers. We therefore conclude that 7.09 percent is the appropriate
17 interest rate to use to reflect PGE's time value of money in this case.¹¹

18 **C. Applying the Trojan Remand Ratemaking Principles to this Transaction**

19 PacifiCorp proposed collecting the full amount of its remaining investment
20 beginning in mid 2015 and ending in early 2016.¹² CUB understands that the Company
21 is not seeking a return on its investment during this period. Based on the Trojan remand,
22 this is unnecessary. If the Commission finds that the Deer Creek Mine Closure is in the
23 public interest, then the Commission can decide to provide assurance to the Company of
24 recovery of the unrecovered asset.¹³ The Commission can allow the recovery to stretch
25 over multiple years and protect the Company by allowing an interest rate that
26 compensates the Company for the time value of money.

27 In the Trojan remand, the Commission considered both the Company's cost of
28 debt (7.71 percent) and the annual Treasury for a 10-year bond (7.09 percent) – a ten year
29 bond was used because the recovery period was 10 years. The Commission chose the 10-

¹¹ *Ibid.* at 72-73

¹² UM 1712 - PAC/200/Stuver/3

¹³ If, however, the Commission finds that the Mine closure is not in the public interest, then the discussion of return is moot, and the Company should not be allowed a return of or return on the unrecovered asset.

1 year Treasury because that was unrelated to the utility and allowed recovery at a lower
2 cost to customers.

3 ***i. CUB's Recommendation Based on Trojan Remand***

4 Because of the dollar amount at issue here, CUB does not believe that a 10-year
5 recovery is necessary. CUB would recommend a recovery period that is no longer than 5
6 years.¹⁴ According to Bloomberg, the Treasury bond rates on March 4, 2015 for a two-
7 year Treasury is 0.63, and for a 5-year Treasury the interest rate is 1.51.¹⁵ Based on the
8 Trojan remand, CUB recommends that the methodology used match the interest rate to
9 the recovery period.

10 It is hard to review the Trojan remand and its applicability here without being
11 struck by the different circumstances regarding Treasury bonds. When PGE retired
12 Trojan, PGE's cost of debt was 7.71 percent and 10-year Treasury bonds had an interest
13 rate of 7.09 percent. Today, PacifiCorp's cost of debt is 5.25 percent, while the 5-year
14 Treasury is at 1.51 percent.¹⁶ So, during the Trojan remand, the difference between the
15 utility's cost of debt and the applicable Treasury bond was less than 100 basis points;
16 today it is more than 350 basis points.

17 The situation is not so dire, however. There are additional factors that lead to a
18 lower appropriate interest rate for the current case.

19 In 1994, the year of the Trojan retirement, inflation was 2.6 percent.¹⁷ Today the
20 inflation rate is close to zero:

¹⁴ The mine is currently being amortized through 2019. UM 1712/PAC/200/Stuver/5

¹⁵ <http://www.bloomberg.com/markets/rates-bonds/government-bonds/us/>

¹⁶ *Ibid.*

¹⁷ <http://www.inflation.eu/inflation-rates/united-states/historic-inflation/cpi-inflation-united-states-1994.aspx>

1 The latest inflation rate for the United States is -0.1% through the 12
2 months ended January 2015 as published by the US government on
3 February 26, 2015.¹⁸

4 The additional drop to 1.51 percent for a 5-year bond and 0.63 percent for a 2-
5 year treasury bond are testament to the principle that a longer term bond commands a
6 higher yield, and that short term payback is less risky. The same was true at the time that
7 Trojan was retired. The PUC chose a 10-year bond because 10 years was selected as the
8 recovery period for the remaining Trojan investment. If the recovery period had been
9 shorter, as CUB recommends here, it would have had a lower interest rate. A 5-year bond
10 in 1994 would have had an interest rate of 5.09 percent.¹⁹

11 Comparing the real interest rate (the interest rate minus the rate of inflation) for
12 comparable 5 year bonds, shows that CUB's proposal is within 100 basis points of the
13 Trojan methodology.

14	1994 5-year bond	5.09 percent
15	<u>Minus inflation</u>	<u>2.61 percent</u>
16	Equals real interest rate	2.48 percent
17		
18		
19	2015 5-year bond	1.51 percent
20	<u>Minus inflation</u>	<u>- .1 percent²⁰</u>
21	<u>Equals real interest rate</u>	<u>1.61 percent</u>
22		

23 *ii. An Alternative Interest Rate that CUB believes is Reasonable Under Current*

24 *Circumstances*

25 Today's low interest rates are caused by our current economic situation, with the
26 Federal Reserve maintaining low interest rates as a mechanism to stimulate the economy
27 after the Great Recession. In recognition of this unusual circumstance and in an attempt

¹⁸ <http://www.usinflationcalculator.com/inflation/current-inflation-rates/>

¹⁹ <http://www.multip.com/5-year-treasury-rate/table>

²⁰ Inflation is negative, so in subtracting we are subtracting a negative number.

1 to maintain the fair balance that the Commission achieved in the Trojan remand, CUB
2 offers the following alternative as a mechanism to determine the interest rate.

3 CUB believes that it is not necessary to have to choose between the cost of debt
4 and the cost of Treasury bonds as the Commission did in the Trojan remand. Instead, we
5 can account for them both. PacifiCorp financed Deer Creek Mine with a mixture of debt
6 and equity. Today, PacifiCorp's cost of debt is 5.25 and it represents 48% of their capital
7 structure.²¹ The remaining 52% is Return on Equity. As stated previously, under the
8 Trojan remand, the Company's return on equity represents the earned profits that the
9 Court of Appeals found to be prohibited. Therefore, CUB proposes an alternative in
10 which the interest rate would be based on applying the Company's cost of debt to 48% of
11 the return and applying the appropriate Treasury to the remaining 52%. Using the 2 and
12 5 year Treasury bonds, this gives us an interest rate between 2.85 and 3.31.

13 **IV. The Prudence of the New Coal Contract Largely Rests on the** 14 **Interpretation of the Environmental Clause.**

15 Long-term coal contracts typically contain "take or pay" provisions which require
16 the coal buyer to pay for a minimum amount of coal, regardless of whether the coal is
17 used or not. The contract at issue here contains such a clause which could make the
18 contract case more risky than the market case. Recent PacifiCorp IRPs show that the
19 Company's coal consumption can change significantly depending on environmental
20 regulations. PacifiCorp argues that the coal supply contract contains an environmental
21 provision that reduces or eliminates that risk.

²¹ UE 263 Stipulation, page 4.

1 CUB is concerned, however, because on its face the clause seem open to
2 interpretation. CUB was not party to the negotiations, so it does not know what was
3 intended by the clause. PacifiCorp has not been helpful by stating that the contract
4 speaks for itself.

5 PacifiCorp's Application for Approval states that:

6 "[t]he Huntington CSA provides the Company with broad termination
7 rights if new environmental laws or regulations, or a settlement agreement,
8 adversely affect the Company's ability to consume coal at the Huntington
9 power plant."²²

10 But one could interpret this provision in a way that offers good, solid protection
11 or in a way that offers less protection. It all hinges on a simple issue. Do environmental
12 regulations, including settlements, shut down coal plants, or do the economics of
13 complying with environmental regulations shut down a coal plant? Take two PacifiCorp
14 examples. The Carbon plant is being shut down this year because the EPA's Mercury and
15 Air Toxics Rule requires an environmental upgrade that includes a baghouse, but because
16 of the location of the plant, it is not feasible to add a baghouse. There is little doubt that
17 the environmental regulations themselves were the driver in the Company's decision to
18 close the plant.

19 On the other hand, consider Naughton 3. Regional Haze Rules require the
20 Company to install a SCR. The Company's analysis showed that, while it is feasible to
21 install and run the plant with a SCR, it would be less expensive to repower the plant and
22 run it with natural gas. There was no technical reason the plant could not put on an SCR
23 and keep operating as a coal plant. In this case, the economics of environmental
24 regulations drove PacifiCorp's decision to cease burning coal at the plant.

²² UM 1712 – PacifiCorp's Application for Approval at 9-10.

1 The risk of environmental regulations affecting coal plant operations is huge.
2 CUB is concerned about the possible sequence of events that could occur at Huntington,
3 and who would be held responsible for the costs of the take or pay provision should
4 environmental legislation or regulation restrict operations of the plant directly (like with
5 Carbon) or indirectly (like with Naughton 3). Sierra Club in a data request²³ asked the
6 Company to interpret and illuminate how it interpreted this section of the contract,
7 specifically posing the question of what would the Company's options be if (1) regulation
8 caused the Huntington Coal Plant operation to be uneconomical on a forward looking
9 basis, or (2) the Coal plant suffered a break down. The same data request also looked for
10 guidance by seeking examples of other similar contracts. Sierra Club's search for clarity,
11 however, was in vain. The Company refused to provide further understanding or to
12 explicitly shoulder responsibility should some 'adverse' regulatory event occur. The
13 Company merely responded that the "contract speaks for itself."²⁴

14 CUB believes that there are two significant risks associated with the interpretation
15 of the contract.

16 **A. The Take or Pay Provision Could Prevent an Otherwise Economic Shutdown**

17 When the Company is subject to environmental regulations relating to burning coal,
18 it analyzes whether complying with the regulation will be lower cost than closing the coal
19 plant or converting it to natural gas. Because take or pay provisions require the Company
20 to pay for coal even if it will not use it, the Company's analysis will not show these costs
21 go away if it shuts the plant or converts it. From the Company's view, this makes sense
22 because shutting the plant will not save on coal costs. CUB is concerned that there may

²³ UM 1712 / CUB/102/Jenks-McGovern/1.

²⁴ *Ibid.*

1 be a scenario where a plant might retire, but the addition of the unavoidable take or pay
2 costs prevent that retirement.

3 **B. The “Take or Pay” Provision if a Plant is Closed Due to the Economic Effect of**
4 **Environmental Regulation**

5 The other scenario is where the plant is closed due to economic reasons resulting
6 from environmental regulation. If the environmental clause is interpreted to mean that
7 that the take or pay provisions do not apply when environmental regulations make a plant
8 uneconomic, then customers could be on the hook for the take or pay charges, even
9 though those charges represent coal purchases that are not used and useful.

10 **C. Prudence of the Coal Contract**

11 CUB believes the prudence of the coal contract rests on what level of protection
12 does this environmental clause provide to customers. If customers are (1) protected from
13 the take or pay provisions being seen as a fixed, unavoidable cost when analyzing
14 environmental regulations, and (2) protected from paying for take or pay charges if the
15 plant is shut down or converted to gas for economic reasons that are caused by
16 environmental regulations, then CUB believes the contract is prudent. If customers are
17 not being provided this protection, then the contract is not prudent.

1 **V. The Ratemaking Treatment in the Context of the Prohibition on**
2 **Single-Issue Ratemaking and the Company's Rate Case Stay Out.**

3 PacifiCorp is asking for a rate adjustment to collect the costs associated with the
4 retired plant in an accelerated time period beginning in May 2015 and finishing in early
5 2016.²⁵ This aligns with the plant's closure activities.

6 CUB does not think that closure activities have a lot to do with determining
7 whether a plant is used and useful for purposes of recovering investments (and return on
8 investment). Decommissioning activities continue on at Trojan. If that counted as still
9 being used and useful, there would be no basis for the Trojan litigation of the last 20
10 years.

11 PacifiCorp is asking the Commission to determine that the closure of the mine is
12 in the public interest under ORS 757.140(2)(b) and that the decision to enter into the
13 transaction is prudent. CUB supports finding the closure is in the public interest. CUB
14 supports finding the transaction is prudent, if the environmental clause is interpreted to
15 clearly protect customers from costs associated with the "take or pay" provision if the
16 plant is shut down for economic reasons related to environmental regulation.

17 Finding the closure is in the public interest and finding that the transaction is
18 prudent set the stage for rate recovery. Unfortunately, CUB cannot support the
19 Company's proposed rate recovery. The Company is seeking:

20 [U]nder ORS 757.210, approval of the Company's proposed Deer Creek
21 Mine Closure tariff for rate recovery of direct mine closure costs effective
22 June 1, 2015.²⁶

23 ORS 757.210 is the general ratemaking statute:

²⁵ UM 1712/PAC/200/Stuver/3 and 7.

²⁶ UM 1712, PacifiCorp's Application for Approval of the Deer Creek Mine Transaction, page 2.

1 Whenever any public utility files with the Public Utility Commission any
2 rate or schedule of rates stating or establishing a new rate or schedule of
3 rates or increasing an existing rate or schedule of rates, the commission
4 may, either upon written complaint or upon the commissions own
5 initiative, after reasonable notice, conduct a hearing to determine whether
6 the rate or schedule is fair, just and reasonable. The commission shall
7 conduct the hearing upon written complaint filed by the utility, its
8 customer or customers, or any other proper party within 60 days of the
9 utility's filing; provided that no hearing need be held if the particular rate
10 change is the result of an automatic adjustment clause. At the hearing the
11 utility shall bear the burden of showing that the rate or schedule of rates
12 proposed to be established or increased or changed is fair, just and
13 reasonable. The commission may not authorize a rate or schedule of rates
14 that is not fair, just and reasonable.²⁷

15 While the Company has offered evidence that the closure is in the public interest
16 and the transaction is prudent, it has not demonstrated that the proposed price change is
17 "fair, just and reasonable."

18 **A. Single-Issue Ratemaking**

19 CUB will discuss this issue more in briefing, but generally states that there is a
20 general prohibition on single-issue ratemaking. The reason is pretty simple. Knowing
21 that a particular issue has a revenue requirement of \$X, does not tell us whether rates
22 need to be changed in order to allow the utility to recovery \$X.

23 PacifiCorp's last rate case was in 2013 and set rates for 2014 based on a forecast
24 of costs expected in 2014.²⁸ While CUB agrees that there are costs associated with this
25 transaction that were not forecast into that 2014 test year, there may also be costs that
26 were forecast into that 2014 that are no longer occurring today. Costs change between
27 rate cases. Some costs go up and some costs go down. Loads and revenues also change.
28 The reason we use a forecasted test year for determining ratemaking is that it is necessary
29 to account for all costs and revenues in setting fair, just and reasonable rates.

²⁷ ORS 757.210(1)(a).

²⁸ UE 263

1 In addition to changes that happen between rate cases, it should be recognized that
2 our ability to accurately forecast all costs for a test year is limited because there are
3 simply too many variables to get it accurate. Quite simply, it does not matter how good
4 we are at forecasting—our forecasts are always wrong. If we over-forecasted costs in
5 PacifiCorp’s last rate case, then rates today might be sufficient to cover the costs
6 associated with the prudent actions the utility took in this docket. But because we are just
7 two months out from the end of 2014, the Company has not yet filed its Results of
8 Operations Report which will show us what actual costs and revenues were in 2014.

9 Providing PacifiCorp the ratemaking treatment it seeks violates the prohibition on
10 single-issue ratemaking. In addition, there is no evidence on the record in this case to
11 support a finding that rates need to be raised in order to allow PacifiCorp to recover its
12 costs.

13 **B. PacifiCorp Stay Out**

14 In addition to the prohibition on single-issue ratemaking, PacifiCorp’s proposed
15 ratemaking treatment conveniently ignores the fact that PacifiCorp agreed that it would
16 forego general rate changes until January 1, 2016. From the stipulation that settled the
17 case:

1 General Rate Case Stay-Out. The Company agrees to forego a general rate
2 case filing in Oregon in 2014. Following the implementation of rates on
3 January 1, 2014, in this case and the implementation of the Lake Side 2
4 tariff rider on approximately June 1, 2014, the earliest proposed rate
5 effective date for the Company's next general rate case filing will be
6 January 1, 2016. The Stipulating Parties may file for deferrals during the
7 general rate case stay-out period, but such filings will be subject to the
8 Commission's guidelines for deferrals set forth in Docket UM 1147, unless
9 otherwise authorized by the Commission. The Stipulating Parties agree
10 that their goal is to minimize rate changes during the general rate case
11 stay-out period.²⁹

12 While PacifiCorp might argue that this is not a general rate case because it is
13 really a single-issue rate case, it has not explained why a single-issue rate case is
14 appropriate. But it was filed under the general ratemaking statute. To interpret this stay
15 out provision in manner that allows this filing would suggest that the Company can come
16 in a seek immediate recovery of new costs, and that the primary result of this clause in
17 the settlement is to prohibit other parties from looking to see if some costs have gone
18 down and offset those new costs.

19 Such an interpretation would also conflict with the references to deferrals in the
20 settlement clause. Deferrals are the exception to the prohibition on single-issue
21 ratemaking. If this clause allowed single-issue ratemaking through immediate rate
22 adjustments, there would be no reason to reference deferrals. But deferrals are allowed
23 under the terms of the settlement. The parties to the stipulation knew that discreet issues
24 that were not accounted for in the general rate case might come up and agreed that the
25 proper way to handle these was through a deferral subject to the guidelines set forth in
26 UM 1147.

²⁹ UE 263 Stipulation, pages 5-6.

1 **C. CUB's Proposed Ratemaking Treatment**

2 The Company filed a deferral request with this filing. Specifically, the Company
3 requested:

4 An order authorizing the Company to defer costs associated with the
5 Transaction to the extent necessary to effectuate the regulatory treatment
6 otherwise requested in this application.³⁰

7 CUB thinks that the request for a deferral was a smart move by PacifiCorp in light
8 of the prohibition on single-issue ratemaking and the rate case stay-out provision in its
9 last general rate case settlement. Its filing largely ignores it, as the Company seeks
10 recovery of costs without utilizing the deferral.

11 CUB believes that the Company's actions here are in the public interest, and
12 depending on the interpretation of the environmental clause in the CSA, they are prudent.
13 CUB therefore supports deferring the costs at issue here for later recovery.

14 The Company did not propose how to apply a deferral to these costs. CUB
15 encourages the Company to discuss that issue in its next round of testimony. This
16 transaction is a complicated mixture of asset sales, asset retirements, elimination of some
17 historic costs, and the incurring of new costs. PacifiCorp proposed a ratemaking
18 treatment that was comprehensive. A deferral does not need to be as comprehensive,
19 since many of the ratemaking decisions will be determined in the amortization phase. But
20 the deferral has to account for all the costs and revenues that are not currently accounted
21 for in rates. But that is not the same as the costs and revenues that are included in
22 PacifiCorp's proposed tariff.

23 CUB does not believe that accelerated depreciation, for example, should go into a
24 deferral. Deer Creek mine is currently in rates at its historic depreciation schedule.

³⁰ UM 1712 - PacifiCorp's Application for Approval, page 4.

1 Unless a party is disputing the level of unrecovered investment, CUB does not believe
2 any change in amortization needs to be made in this docket. However, because current
3 rates include both return of and return on the investment in Deer Creek, CUB believes
4 that such a deferral should include a credit representing the difference between the
5 Company's authorized rate of return and the time value of money. Because the
6 amortization period for the deferral has not been chosen, CUB believes the interest rate in
7 this calculation should be no more than 3.31.

8 CUB is not proposing 3.31 percent as the interest rate applied to the deferral, but
9 that the deferral include an adjustment to remove the profit on the Deer Creek Mine
10 investment that is currently in rates.

11 Beyond accelerated depreciation, CUB believes that most or all of these costs and
12 revenues should fit within a traditional deferral.

13 **VI. Other Issues.**

14 The Company requests that the Commission find that the mine closure be in the
15 public interest and that the transaction is prudent. CUB agrees with this, subject to our
16 concerns about the environmental clause in the Huntington CSA. CUB urges the
17 Commission to reject the Company's ratemaking treatment and instead handle these costs
18 through a deferral, as appropriate, for ratemaking treatment in a later proceeding.

19 The Company also asks the Commission for several other items which we discuss
20 below.

21 **A. An Accounting Order Related to Accelerated Depreciation**

22 The Company requests:

1 an accounting order authorizing the Company to transfer the remaining
2 plant balance for the Deer Creek Mine from electric plant in service,
3 establish a regulatory asset, and accelerate recovery of the asset.³¹

4 CUB believes that the ratemaking treatment associated with accelerated
5 depreciation is best handled in a general rate case. Transferring the remaining plant
6 balance to a regulatory asset seems reasonable.

7 **B. An Accounting Order Related to Withdrawing from the Pension Trust**

8 PacifiCorp requests an accounting order to establish a regulatory asset for the
9 1974 Pension trust withdrawal liability.³² CUB believes such an accounting order is
10 reasonable.

11 **C. An Accounting Order for the Loss Associated with the Settlement of the Energy
12 West's Retiree Medical Obligation**

13 PacifiCorp requests an accounting order for the loss associated with the settlement
14 of Energy West's Retiree Medical Obligation.³³ Because CUB is recommending that this
15 loss be included in a deferral, we are unsure why an accounting order would also be
16 necessary. But CUB has no objections if one is still necessary. The Company also
17 requests a determination that its decisions to withdraw from the Pension Trust and to
18 settle the Retiree Medical Obligation are prudent.³⁴ CUB does not understand why the
19 Company is asking for this in addition to asking that the entire deal be found to be
20 prudent. However, CUB does agree that the decision to withdraw from the Pension Trust
21 and to settle the Retiree Medical Obligation were prudent actions.

³¹ UM 1712 - PacifiCorp's Application for Approval, page 3.

³² *Ibid.*

³³ *Ibid.*

³⁴ *Ibid.*

1 **D. Approval of the Sale of the Mining Assets**

2 PacifiCorp seeks:

3 approval of the sale of the Mining Assets, adding the loss on the sale to
4 the Deer Creek Mine Closure tariff for immediate amortization, with an
5 offset for costs now in rates.³⁵

6 CUB supports approval of the sale of the Mining Assets, but CUB believes that
7 the loss should be added to the deferral with an offset for costs that are currently in rates.

8 **E. Approval of an Accounting Order Reflecting the Costs of the Coal Supply**
9 **Agreements (CSAs)**

10 PacifiCorp seeks approval of an accounting order reflecting costs associated with
11 the CSAs in 2015 in the regulatory asset for unrecovered investment. With the deferral,
12 CUB is not sure that an accounting order is necessary, but CUB does believe that the
13 Coal Supply Agreements are prudent depending on the interpretation of the
14 environmental clause.

15 **VII. Conclusion.**

16 CUB appreciates the work that the Company has placed into this transaction. It is a
17 complicated deal, with a lot of pieces, but includes significant customer benefits related
18 to withdrawing from a multi-employer pension plan and settling the retiree medical
19 liability.

20 Withdrawing from the pension plan is dependent on closing the mine. CUB
21 recommends that the Commission find that the early closure of the mine is in the public
22 interest.

³⁵ UM 1712 - PacifiCorp's Application for Approval, page 4.

1 CUB believes that this finding will allow the Company to recover its remaining
2 investment in the plant. However, Oregon does not allow the Company to earn a profit
3 on its remaining investment. CUB recommends that an interest rate of up to 1.51 percent
4 be used to compensate the Company for the time value of money based on the Trojan
5 methodology. CUB can also support an alternative methodology that produces an
6 interest rate of between 2.85 percent and 3.31 percent.

7 With regards to the prudence of the overall transaction, CUB's recommendation is
8 dependent on the interpretation of the environmental provision of the coal supply
9 contract. If it protects customers from take or pay costs when environmental regulations
10 make a plant uneconomic, then CUB believes the transaction is prudent.

11 CUB cannot, however, support the Company's proposed ratemaking treatment for
12 this transaction. The Company is seeking a rate change in May for this transaction. CUB
13 believes that such a rate change violates the prohibition on single-issue ratemaking and
14 the stay-out provision of the stipulation that settled PacifiCorp's last rate case. However,
15 the Company filed a deferral with this docket and CUB supports using the deferral to
16 allow the Company to recover the prudently incurred costs associated with this
17 transaction.

WITNESS QUALIFICATION STATEMENT

NAME: Bob Jenks

EMPLOYER: Citizens' Utility Board of Oregon

TITLE: Executive Director

ADDRESS: 610 SW Broadway, Suite 400
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EDUCATION: Bachelor of Science, Economics
Willamette University, Salem, OR

EXPERIENCE: Provided testimony or comments in a variety of OPUC dockets, including UE 88, UE 92, UM 903, UM 918, UE 102, UP 168, UT 125, UT 141, UE 115, UE 116, UE 137, UE 139, UE 161, UE 165, UE 167, UE 170, UE 172, UE 173, UE 207, UE 208, UE 210, UG 152, UM 995, UM 1050, UM 1071, UM 1147, UM 1121, UM 1206, UM 1209, UM 1355, UM 1635, UE 233, UE 246, UE 283, UM 1633, and UM 1654. Participated in the development of a variety of Least Cost Plans and PUC Settlement Conferences. Provided testimony to Oregon Legislative Committees on consumer issues relating to energy and telecommunications. Lobbied the Oregon Congressional delegation on behalf of CUB and the National Association of State Utility Consumer Advocates.

Between 1982 and 1991, worked for the Oregon State Public Interest Research Group, the Massachusetts Public Interest Research Group, and the Fund for Public Interest Research on a variety of public policy issues.

MEMBERSHIP: National Association of State Utility Consumer Advocates
Board of Directors, OSPIRG Citizen Lobby
Telecommunications Policy Committee, Consumer Federation of America
Electricity Policy Committee, Consumer Federation of America
Board of Directors (Public Interest Representative), NEEA

WITNESS QUALIFICATION STATEMENT

NAME: Jaime McGovern

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EDUCATION: PhD, Economics
W.P. Carey School of Business
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Masters of Science, Economics
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Bachelors of Arts, Economics and Mathematics
Arizona State University

EXPERIENCE: Provided testimony or comments in a number of OPUC dockets, including UE 262, UE 283, UM 1633, and UM 1654. Worked as Utility Analyst at the Oregon Public Utility Commission from 2006-2008, providing advice on rate cases, analysis in meetings with the Bonneville Power Administration and performing benchmarking studies regarding telecom and electric competition in the state of Oregon.

Economics professor at Mesa Community College and the State University of New York from 2004–2010.

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Reference the Direct Testimony of Cindy Crane, page 13, lines 6-10. "The Huntington CSA contains a broad termination right in favor of the Company in the event existing or new environmental obligations adversely affect the Company's ability to burn coal at the Huntington power plant."

- a. Please explain PacifiCorp's understanding of the scope of an environmental obligation that would "adversely affect the Company's ability to burn coal."
- b. If an environmental regulation requires large capital improvements that would negatively impact the forward-looking economics of the Huntington plant, can PacifiCorp exercise its right to terminate the Huntington CSA? What penalties or damages would apply?
- c. If PacifiCorp is required to install selective catalytic reduction pollution controls at Huntington pursuant to the Regional Haze Rule, under what circumstances could PacifiCorp exercise its right to terminate the Huntington CSA? What penalties or damages would apply?
- d. If the Huntington Plant suffered a major breakdown, such as a boiler malfunction, under what circumstances could PacifiCorp exercise its right to terminate the Huntington CSA? What penalties or damages would apply?
- e. Has the Company ever included in any other coal supply contract language similar to the environmental regulations provisions in the Huntington CSA that allow a broad termination right in favor of the Company in the event existing or new environmental obligations adversely affect the Company's ability to burn coal? If yes, please identify all currently operative coal supply contracts and provide those contracts.
- f. To the extent the Company cannot or will not produce any contracts identified in part (e) above, please provide an excerpt or transcript of the specific operative language that would allow termination rights in the event of existing or new environmental obligations adversely affecting the Company's ability to burn coal.

Response to Sierra Club Data Request 1.25

- a. The Company objects to this data request as speculative and as requiring a legal conclusion or the disclosure of information protected by the attorney-client privilege or attorney work product doctrine. Without waiving these objections, the Company responds as follows;

The contract speaks for itself.

- b. See response to subsection (a) above.
- c. See response to subsection (a) above.
- d. See response to subsection (a) above.
- e. The Company objects to this data request on the basis that it is overly broad, unduly burdensome, vague and not reasonably calculated to lead to the discovery

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of admissible evidence. Without waiving these objections, the Company responds as follows:

To the best of the Company's knowledge, no.

- f. See the response to request 1.25(e).