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BEFORE THE IDAHO PUBLIC UTILITIES COMMISSION

IN THE MATTER OF THE APPLICATION OF ROCKY MOUNTAIN POWER FOR APPROVAL OF A TRANSACTION TO CLOSE DEER CREEK MINE AND FOR A DEFERRED ACCOUNTING ORDER.	**CASE NO. PAC-E-14-10** **COMMENTS OF THE COMMISSION STAFF**

COMES NOW the Staff of the Idaho Public Utilities Commission, by and through its attorney of record, Neil Price, Deputy Attorney General, and in response to the Notice of Modified Procedure and Notice of Scheduling issued in Order No. 33221 on February 6, 2014, in Case No. PAC-E-14-10, submits the following comments.

BACKGROUND

On December 15, 2014, PacifiCorp dba Rocky Mountain Power ("Rocky Mountain" or "Company") filed an Application with the Idaho Public Utilities Commission ("Commission"), pursuant to *Idaho Code* § 61-328, for approval of a transaction to close the Deer Creek Mine located near Huntington, Utah, and for a deferred Accounting Order. The Company attached the direct testimony of several witnesses, Cindy A. Crane, Seth Schwartz, and Douglas K. Stuver, to its Application.

The mine is currently operated by Energy West Mining Company ("Energy West"), a wholly owned subsidiary consolidated with PacifiCorp for regulatory purposes. This Application is filed by PacifiCorp, on its own and on behalf of Energy West.

STAFF REVIEW

Staff has reviewed the Company's Application and testimonies of the Company's witnesses, including the accompanying exhibits. Additionally, Staff evaluated the impacts the proposed transactions would have on customers. Staff's review focused on the escalating labor costs of the Deer Creek Mine, the labor negotiations with the United Mine Workers of America (UMWA) union, the closure of the Deer Creek Mine, and the sale of mining assets to Bowie. Each element of Staff's review is discussed in greater detail later in these comments.

The Company has been negotiating with the United Mine Workers of America (UMWA) since 2012. Previously, Energy West had serious problems with cost containment, including pension costs, medical costs, and the ability to use contractors as needed. This round of negotiations was very contentious with the union beginning to advertise in the local community to gain support. The Company and the UMWA reached a partial labor settlement on October 31, 2014, but that settlement did little to limit the escalating cost of the Deer Creek Mine.

Due to the rising costs of running the Deer Creek Mine, the Company solicited ideas to remove itself from mining operations. In 2013, the Company received three offers. The first was from Westmoreland to purchase both the Deer Creek Mine as well as the Bridger Coal Mine. This would have resulted in a loss in both the sale of the assets as well as a loss in the purchase of coal. This deal also did not limit the liability due to the collapsing pension plan.

The second offer was from Monarch. This deal was also for both the Deer Creek Mine and the Bridger Coal Mine. While this deal limited the liability from the collapsing pension plan and had less of a loss for the purchase of coal going forward, the loss on the assets was greater.

The third offer was from Murray. This deal was also for both the Deer Creek Mine and the Bridger Coal Mine. This deal also limited the liability due the collapsing pension plan. The offer for the Bridger Coal mine was a significant loss, but the loss for the Deer Creek Mine was limited and the Company did consider a counter offer for just the Deer Creek Mine portion.

Staff concurs with the Company that all three previous offers had fewer benefits to customers than the deal ultimately struck with Bowie Resource Partners (Bowie).

Standards of Review and Executive Summary

The applicable standards of review when property is sold are set forth in *Idaho Code* § 61-328. *Idaho Code* § 61-328 provides that "No electric public utility...shall merge, sell, lease, assign or transfer, directly or indirectly, in any manner whatsoever, any such property or interest therein...except when authorized to do so by order of the public utilities commission." More specifically, this statute requires that the Commission make three specific findings:

a) That the transaction is consistent with the public interest;
b) That the cost of and rates for supplying service will not be increased by reason of such transaction; and
c) That the applicant for such acquisition or transfer has the bona fide intent and financial ability to operate and maintain said property in the public service.

<u>That the transaction is consistent with the public interest</u>

Staff agrees with the Company that the proposed sale transaction is the best way to limit the increasing costs of the Deer Creek Mine, due to both the increased costs from the pension plan and the decrease in coal quality from the mine. In addition, the Deer Creek Mine coal supplies are expected to be depleted in 2019. The new coal supply contract would extend for fifteen years and provide a reliable supply with steady coal prices. The contract is effective for an additional ten years beyond the expected depletion of the reserves at the Deer Creek Mine. Staff believes these benefits and therefore the sale transaction are in the public interest.

<u>That the cost of and rates for supplying service will not be increased by reason of such transaction</u>

The costs of coal for the Huntington plant were increasing regardless of the actions taken by the Company. The pension contribution increase alone would raise the cost of coal from the Deer Creek Mine. However, if the same base and monthly costs in the 2014 ECAM period (December 2013 to November 2014) were used, the costs of purchasing coal from Bowie would have been approximately $254,000 less on a Company-wide basis than mining coal from the Deer Creek Mine. Part of this is because the Company will no longer be responsible for the preparation plant and blending coal. The proposed transaction should not be a driver for increasing costs and therefore would not increase rates to customers above what they would have been otherwise.

That the applicant for such acquisition or transfer has the bona fide intent and financial ability to operate and maintain said property in the public service

Staff interprets this requirement as it applies to this transaction to mean that the new owner, Bowie Resource Partners, has the ability to provide the coal needed for operation of the Huntington power plant.

Bowie Resource Partners is the largest western coal provider, with four mines producing about 13 million tons of coal annually. Three of those mines are in Utah: Dugout, Skyline, and Sufco. In addition to these mines, as part of the transaction, Bowie Resource Partners has gained access to another mine, Fossil Rock. Staff agrees that Bowie has sufficient capacity to fulfill the contract for the entire term.

Summary

Staff agrees with the Company's proposal to close the Deer Creek Mine and sell the Mining Assets to Bowie because it results in a lower cost option than continuing to invest in and operate the Deer Creek Mine through 2019. Staff recommends that the Commission find the Company's decision to consummate the sale to be prudent and in the public interest.

The transaction for which approval is requested in this case consists of several sections:

1. The closing of the Deer Creek Mine
2. The execution of an additional coal contract with Bowie
3. The sale of assets to Bowie
4. The settlement of the Retiree Medical Obligation
5. The withdrawal from the UMWA 1974 Pension Trust
6. Ratemaking treatment

Closing of Deer Creek Mine

The only way for the Company to withdraw from the UMWA 1974 pension is to stop mining operations at the Deer Creek Mine. This will leave stranded assets of **[This section of Staff's comments contains confidential information]** and incur closure costs of [redacted]. *See* Confidential Attachment A.

Coal Contract with Bowie Resource Partners

With the closure of the Deer Creek Mine, the Company must find a different source of coal for the Huntington and Hunter power plants. Bowie bought Canyon Fuel Company from Arch Coal in 2013. Since then Bowie has been providing the coal previously provided by Canyon Fuels for the Hunter power plant. The Company has entered into an additional 15-year Coal Supply Agreement with Bowie to replace the coal provided by the Deer Creek Mine.

Sale of Assets to Bowie Resource Partners

The Company has agreed to sell the preparation plant as well as the central warehouse property to Bowie. This will allow the Company to avoid the costs of blending coal for the Hunter power plant, reduce the inventory being held, and eliminate the liabilities for the reclamation and other retirement obligations of those assets. *See* Confidential Attachment A.

The Company is also transferring other assets to Bowie. The Company will transfer the Trail Mountain Mine, and Bowie will assume all reclamation and other retirement obligations. The Company will also transfer the Fossil Rock Mine to Bowie. This mine has never been included in Idaho rates and therefore its transfer has no impact on Idaho rates.

Retiree Medical Obligation

As part of the settlement with the UMWA, the Company transferred its Retiree Medical Obligation to the UMWA. This required the Company to transfer $150 million from its trust to the UMWA's trust in exchange for UMWA assuming the Retiree Medical Obligation. This was a savings from the expected liability amounts in the future. Settlement accounting under GAAP requires that the Company accelerate recognition of a portion of the remaining unrecognized actuarial losses. The resulting estimated settlement loss of [redacted] represents recognized accelerated actuarial losses that would have otherwise been amortized as Financial Accounting Standards (FAS) 106 expenses. For this reason, Staff believes it is appropriate to defer the settlement loss for future recovery.

UMWA 1974 Pension Trust

Energy West is obligated to make contributions to the 1974 Pension Trust, a multi-employer pension plan in which assets are pooled so that contributions by one employer are used to provide benefits to employees of other participating employers. If an employer ceases participation in the plan, the employer is obligated to pay a withdrawal liability based on the participants' unfunded vested benefits in the plan. Currently, Energy West contributes $5.50 per hour worked for all UMWA employees employed prior to January 1, 2012. The standard wage rate for the highest-paid UMWA employee as of July 1, 2011 was $25.42 per hour, so the current contribution is greater than 20% of the regular payroll rate.

The financial condition of the 1974 Pension Trust has deteriorated dramatically over the last several years. As of the last valuation on June 30, 2013 (the latest information available at the time the Company filed its Application), the trust was underfunded by $5.5 billion. After filing its Application, the union's actuaries completed a new valuation of the Pension Trust, and the financial condition of the trust improved slightly, though continues to remain critically underfunded by $4.4 billion. The underfunding is the deficit between the market value of the assets and the present value of the vested benefits. Because of the financial status of the pension trust, all participating employers will be required to increase their contribution rates to the plan in 2017. The current contribution rate of $5.50 per hour worked will more than double to a new contribution rate of $13.20 per hour worked in 2017, and continually increase to a rate of $26.00 per hour worked by 2022. At such a high contribution rate, the pension costs alone would add $7.00 per ton to the price of coal at the average UMWA mine, causing most UMWA mines to be uneconomical and be forced to close.

If a mass withdrawal of participating employers occurs, the unfunded obligations of the plan will be borne by the remaining participating employers, including any employers that have withdrawn within the previous three years. Furthermore, to the extent that a participating employer defaults on its obligation to the plan, the remaining employers may be allocated a share of the defaulting employer's obligation for the unfunded vested benefits. The only way to limit future financial obligations to the 1974 Pension Trust is to withdraw from the plan. The only options for a withdrawal are bankruptcy or cessation of contributions to the plan, which would occur upon the last hour being worked by the Company's UMWA workforce, which can be only accomplished by either sale or closure of the mine. At that time, Energy West will be obligated to pay a withdrawal liability equal to its proportionate share of the unfunded vested benefits as of the last valuation date. At the time the Company filed its Application, the projected withdrawal liability was approximately $126 million. Improved market conditions over the last year have decreased the withdrawal liability to approximately $97 million, however, the exact amount of the withdrawal liability will not be known until the mine is officially sold and the last UMWA hour has been worked.

The Company's current contributions, in aggregate, total approximately $3 million per year. These contributions are included in Energy West's operating costs, which are charged to the Company's fuel expense and are included in the Company's base Net Power Supply Costs. If Energy West were unable to sell or otherwise close the mine, customers would pay for the increased costs through the Company's annual Energy Cost Adjustment Mechanism (ECAM).

The Company is proposing to continue to recover the ongoing $3 million annual payment already included in rates. The Company would defer the estimated [redacted][1] accounting loss associated with the withdrawal liability. Because the $3 million would only cover the interest on the withdrawal liability, neither the regulatory asset nor the withdrawal liability would be reduced over time at current rates. At some future date, when the plan terminates or the accrual of future benefits is frozen, this liability and associated asset would be quantified and amortized. Alternatively, if the Company is successful in negotiating a one-time pre-payment of the annual installments that is more economical to customers, the Company proposes that the amount of the pre-payment be deferred until the next rate case, at which point the Company can request recovery of that deferred amount.

Ratemaking Treatment

Net Power Costs

The Company currently recovers the cost of coal from the Deer Creek Mine to fuel the Hunter and Huntington plants through net power costs (NPC) embedded in base rates. The amount recovered is adjusted annually through the ECAM so that customers pay no more or no less than the actual cost subject to a symmetrical 90/10 percent sharing band.

Included in the NPC embedded in base rates for Deer Creek coal are unrecovered investments associated with the mine and other mining assets in addition to operationally-related mining and processing costs. The Company is proposing to defer the difference between these

[1] [redacted]

costs and the costs of continued amortization of the unrecovered investment plus the cost of new coal supply agreements (CSA) without application of the 90/10 percent sharing through the ECAM. In addition, the Company is proposing to receive the authorized rate of return on the unamortized amount (Crane, Di, p. 25).

Staff agrees that the Company is currently authorized to recover 100 percent of depreciation expense in base rates related to Deer Creek and the Mining Assets outlined in the Company's Application (Application at 16). Staff also agrees that applying the sharing band to Deer Creek depreciation expenses would not allow the Company to fully recover an expense it is authorized to recover and therefore it is not equitable.

However, Staff believes the extraordinary variable operation and purchase fuel cost associated with the Deer Creek mine closure should be subjected to sharing in the ECAM as are all other variable NPC expenses not currently recovered in the base rates. Idaho utilities commonly shift fuel supply from internal to external sources (or vice versa) and negotiate new fuel supply contracts on an ongoing basis while remaining subject to sharing through cost adjustment mechanisms in between rate cases.

Staff proposes to separate the unamortized investment in the mine and related assets from all other Deer Creek NPC-related expenses. This allows the regulatory treatment to be determined in a future general rate case for the unamortized amount recorded in a separate deferral. The specific accounting treatment of this amount is outlined later.

For the remaining Deer Creek NPC-related expenses, Staff proposes they be treated as part of the next ECAM deferral in the same manner as all other NPC-related expenses, including the 90/10 percent customer sharing. As proposed by the Company, the Deer Creek NPC base-to-actual amount would need to be separated from other Hunter and Huntington NPC deferral expenses and calculated on a dollar per million British Thermal Unit (MMBtu) basis instead of a dollar per Megawatt-hour (MWh) basis.

The calculation the Company has proposed multiplies "the total MMBtu consumed for the two plants included in base net power costs times the difference between the weighted average cost per MMBtu (consumed) included in the base net power costs for the Huntington and Hunter power plants and the actual weighted-average cost per MMBtu (consumed) during the deferral period." (*See* Crane, Di, 25). Although the Company maintains that its calculation "isolates the impact of the Transaction on fuel costs in the Energy Cost Adjustment Mechanism (ECAM)," in response to Staff Data Request No. 6, Staff believes this methodology fails to account for changing load since base rates were last established. Instead, Staff proposes that the difference in the unit price of coal be multiplied by the actual amount of coal consumed by the two plants during the deferral period. This approach is consistent with Commission authorized ECAM methodology and accurately represents the portion of the Deer Creek deferral costs subject to 90/10 sharing.

Staff recommends that the resulting ECAM deferral amount (minus unamortized asset depreciation amounts) be subject to 90/10 percent sharing. Although difficult to accurately determine, Staff estimates that ECAM sharing could reduce customer costs by as much as $150,000 annually until Bowie CSA's are included in base rates.

Regulatory Assets

Regulatory assets can be established for expenses that are currently not included in rates, yet are significant enough to warrant deferring until the next general rate case for a determination on the amount to be included in rates at that time. Were a company to propose, in a general rate case, that certain expenses from past years be included in the current rates, it would generally not be allowed because those costs should have been expensed in the year they occurred. In order to be considered in the general rate case, the utility usually must have an Accounting Order from the Commission allowing it to defer the costs for possible future recovery. PacifiCorp's filing appropriately requests an Accounting Order from the Commission allowing deferral of Deer Creek expenses for future recovery.

In its request for an Accounting Order, the Company proposes to earn its authorized rate of return during the deferral period. Staff does not support either accrual of return nor any other interest on the deferrals. Staff believes that because Deer Creek assets are no longer "used and useful," the Company is no longer eligible to earn a return on any remaining unamortized Deer Creek amounts. Staff believes that allowing the Company to defer the expenses for future recovery when they would likely otherwise be unrecoverable is sufficient relief to the Company. Staff believes the Commission has discretionary authority in determining whether to approve a carrying charge on a deferral account. Reference Idaho Power Company v. Idaho State Tax Commission, 141 Idaho 323 and Order No. 30235, page 3 in Case No. IPC-E-06-06. *See* also Order No. 30638, page 4 in Case No. AVU-E-08-03.

The Commission may evaluate the appropriateness of a carrying charge when a utility requests an Order authorizing deferred accounting treatment in advance of the expenditure, or the deferral account is related to implementation of a program the Commission has ordered. In those circumstances, the Commission has an opportunity to evaluate the necessity and anticipated benefit for customers before the Company incurs the expense.

When the Commission has ordered a carrying charge for a deferred expense, the carrying charge typically has been at the customer deposit rate. The customer deposit rate for 2015 is 1%. Reference Order No. 33187 in Case No. GNR-U-14-02.

Normal Accounting Treatment

PacifiCorp's request to defer mine closure costs and unrecovered investment in the Deer Creek Mine and Mining Assets is a deviation from normal accounting procedures. PacifiCorp witness Crane identifies on page 27, line 9, that the closure of the mine will result in undepreciated assets. If normal accounting procedures are followed, the costs of the unrecovered investment and mine closure will be credited to the electric plant in which it is included. As a depreciable class of property, the book cost of the retired unit is credited to electric plant and also charged to the accumulated provision for depreciation applicable to the property. The cost of removal and the salvage would also be charged or credited, as appropriate, to the applicable depreciation accounts. The investment that has not been recovered would normally be recovered through depreciation. Depreciation is the recognition that physical assets are consumed in the process of providing a service or a product. Generally accepted accounting principles (GAAP) require the recording of depreciation to be rational and systematic.

The Company proposes to establish several regulatory assets and to transfer the unrecovered investment (Deer Creek Mine and Mining Assets) from the relevant subaccounts of Plant in Service.

Regulatory Asset Breakdown

Currently there is $102 million in plant-in-service. Of this amount $21 million will be sold to Bowie Resource Partners in return for a [redacted]. Staff recommends that the loss of [redacted] and the remaining assets of [redacted] for a total of [redacted] be recorded as a regulatory asset and be subject to the Staff proposed treatment for regulatory assets and amortization. Some assets may have salvage value, and Staff recommends that any salvage value recognized be used as an offset to the regulatory asset. Staff also recommends all interest earned from the note be reflected for ratemaking purposes as a reduction to the regulatory asset with the amortization period shortened as appropriate.

In addition to the actual plant-in-service that is part of the transaction, the Company has $5 million in Construction Work In Progress (CWIP). Staff examined the entries in CWIP, and found all entries into CWIP were normal and related to the operations of the mine. Staff recommends that this $5 million currently in CWIP also be placed in a regulatory asset and be subject to the Staff proposed treatment for regulatory assets and amortization.

The Company will also be incurring significant closure costs in for the Deer Creek Mine. This includes [redacted] in materials and supplies, [redacted] in taxes, [redacted] in retirement obligations, [redacted] in severance and unemployment costs, [redacted] in royalties, and [redacted] in other costs associated with closing the mine. Staff recommends this total [redacted] be recorded as a regulatory asset and be subject to the Staff proposed treatment for regulatory assets and amortization. Because some of these expenses are estimates, Staff recommends that they be trued up to actual costs when they are incurred.

Finally, the Company will be assuming a [redacted] liability due to the settlement of the retiree medical benefits. Staff recommends that amount be recorded as a regulatory asset and be subject to the Staff proposed treatment for regulatory assets and amortization.

<u>Amortization</u>

The Company proposes to amortize the remaining unrecovered investments in the Deer Creek Mine and the Mining Assets on a basis consistent with the current rate of depreciation reflected in base rates. The Company further proposes that at the time rates are next reset, the remaining unrecovered investments in the Deer Creek Mine and the Mining Assets be amortized and recovered over a period of three years (Application, page 15). The Company has included construction work in progress and preliminary survey and investigation costs in its Deer Creek Mine unrecovered investment numbers on page 15 of its Application. Staff recommends that the Commission approve a minimum five-year amortization period beginning with the next rate case to recognize the longer-term nature of these obligations. This five-year amortization period matches that approved in Case No. PAC-E-01-02, Order No. 28700 when PacifiCorp applied for an Accounting Order to defer costs associated with its Trail Mountain Mine.

The Company proposes to defer the mine closure-related costs as a regulatory asset until later incorporated in base rates and recovered over an amortization period of five years. The Company indicates that a significant portion of these costs will be recognized for accounting purposes in 2014 while certain of these costs will be incurred in 2015 and 2016. Staff recommends that the Commission approve a five-year amortization period beginning with the next general rate case.

The Company also requests a three-year amortization period of its Retiree Medical Obligation beginning with the next general rate case (Application, page 18, item 4). Staff recommends that the Commission approve a minimum five-year amortization period beginning with the next rate case to recognize the longer-term nature of these obligations.

Reporting

Once the transactions are finalized, Staff recommends PacifiCorp file all closing documents, journal entries and the true up of the estimated costs to actual costs including the workpapers associated with those journal entries within 45 days.

STAFF RECOMMENDATIONS

Staff recommends the following:

- The Company separate the unamortized investment in the mine and related assets from all other NPC-related expenses. This separate deferral, without carrying charge, should allow recovery without sharing and without additional return on investment in a future general rate case.
- Deer Creek NPC minus depreciation of unamortized amounts and Bowie CSA's should be treated as part of the ECAM deferral in the same manner as all other NPC related expense, including 90/10 sharing and over/under recovery of actual cost due to change in load.
- Record any loss on the sale of assets as a regulatory asset without carrying charge (Expected to be [redacted]).

- Any interest earned on notes from the transaction be used as a reduction to the regulatory asset with the amortization recovery period shortened as appropriate.
- Construction work in process be recorded as a regulatory asset without carrying charge ($5 million).
- All closure costs of the Deer Creek Mine be recorded as a regulatory asset without carrying charge (Expected to be $74 million). This amount will be trued up as costs are actually incurred.
- The retiree medical obligation settlement be recorded as a regulatory asset without carrying charge ($4 million).
- All amortization periods be over a 5-year period beginning with the next rate case.

Respectfully submitted this 24th day of April 2015.

Neil Price
Deputy Attorney General

Technical Staff: Mike Louis
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Donn English

i:umisc:comments/pace14.10npmlphjtde comments

ATTACHMENT A IS CONFIDENTIAL AND PROTECTED UNDER THE PROTECTIVE AGREEMENT

CERTIFICATE OF SERVICE

I HEREBY CERTIFY THAT I HAVE THIS 24th DAY OF APRIL 2015, SERVED THE FOREGOING **COMMENTS OF THE COMMISSION STAFF,** IN CASE NO. PAC-E-14-10, BY E-MAILING A COPY THEREOF, POSTAGE PREPAID, TO THE FOLLOWING:

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