

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: August 6, 2013**

REGULAR _____ CONSENT X EFFECTIVE DATE _____ N/A _____

DATE: July 23, 2013

TO: Public Utility Commission

FROM: Brian Bahr *BB*

THROUGH: Jason Eisdorfer *E*, Maury Galbraith *MG*, and Marc Hellman *A*

SUBJECT: PACIFICORP: (Docket No. UI 337) Requests Approval of Affiliated Interest Agreement with International Business Machines Corporation.

STAFF RECOMMENDATION:

The Public Utility Commission of Oregon (Commission) should approve PacifiCorp's (PacifiCorp or Company) application for approval of an agreement (Agreement) with Sirius Computer Solutions, Inc. (Sirius) for, among other things, purchase of mainframe equipment from International Business Machines Corporation (IBM), an affiliated interest, subject to the following conditions:

1. PacifiCorp shall notify the Commission of any substantive changes to the Agreement, including any material changes in price or other parameters specified in the Agreement. Any such changes shall be submitted in an application for a supplemental order (or other appropriate format) in this docket.
2. PacifiCorp shall report to the Commission, as part of its annual affiliated interest report, all transactions entered into under the Agreement that involve IBM or any of its subsidiaries.

DISCUSSION:

Background

PacifiCorp filed this application with the Commission on May 28, 2013, pursuant to ORS 757.495(1) and OAR 860-027-0040, and requests approval of the Company's agreement with Sirius for, among other things, purchase of equipment from IBM.

"Affiliated interest," as defined in ORS 757.015(3), includes "[e]very corporation five percent or more of whose voting securities are owned by any person or corporation owning five percent or more of the voting securities of such public utility or by any person or corporation in any chain of successive ownership of five percent or more of voting securities of such public utility."

PacifiCorp is an indirect, wholly-owned subsidiary of MidAmerican Energy Holdings Company (MEHC). MEHC is a subsidiary of Berkshire Hathaway, Inc. (BRK). BRK holds over five percent of IBM common stock. BRK's ownership interest in PacifiCorp and IBM constitutes an affiliated interest.¹

BRK does not hold any ownership interest in Sirius. ORS 757.495, however, requires Commission approval of contracts under which indirect payments will be made to affiliate interests. PacifiCorp is purchasing IBM mainframe equipment from Sirius, which qualifies as an indirect payment.

The contract between PacifiCorp and Sirius was executed on October 31, 2012. ORS 757.495(2) requires applications for approval of contracts with affiliated interests to be filed within 90 days of execution. The Company, in the process of preparing its annual affiliated interest report for 2012, discovered a filing for approval had not been made for this transaction and subsequently filed on May 28, 2013, which is past the 90 day requirement. The Company states that the late filing was an inadvertent oversight, and its internal processes have been strengthened to prevent late filings in the future.

Staff's analysis of this application included review of the Company's current application, prior applications from the Company, and responses to ten data requests.

Issues

Staff investigated the following issues:

1. Terms and Conditions of the Agreement;
2. Transfer Pricing;
3. Public Interest; and
4. Records Availability, Audit Provisions, and Reporting Requirements.

Terms and Conditions of the Agreement

Staff reviewed the Agreement between the Company and Sirius and did not observe any unusual terms or conditions. The Agreement consists of the purchase of IBM hardware equipment and associated installation services, as well as a three-year maintenance contract.

Transfer Pricing

According to OAR 860-027-0043, the Commission may, for good cause, waive the affiliated interest transaction requirements of OAR 860-027-0040. The rule provides:

¹ Staff accessed the Yahoo finance website on June 12, 2013 at <http://finance.yahoo.com/q/mh?s=IBM%2C+&q=1>. This resource reports that as of March 31, 2013, BRK owned over 68 million shares, or 6.14 percent of the outstanding common stock of IBM.

Upon petition by a utility and approval by the Commission for good cause, the requirements of OARs 860-027-0040 and 860-027-0041 may be waived for individual transactions or classes of transactions. As a general guideline, in the absence of showing that the transaction is fair and reasonable and not contrary to the public interest, transactions exceeding 0.1 percent of the previous calendar year's Oregon utility operating revenues will not qualify for waiver.

As part of MEHC's acquisition of PacifiCorp, however, the Company agreed to file affiliated interest applications for all transactions between MEHC affiliates, regardless of the monetary amount involved. The indirect payment of \$574,043 to IBM under this contract would normally qualify for a waiver of OAR 860-027-0040 as the expense is less than 0.1 percent of PacifiCorp's annual Oregon operating revenue in 2012 of approximately \$1.3 billion. However, the aggregate of PacifiCorp's contracts with IBM is greater than the \$1.3 million threshold.²

The Company invited seven companies to the bid event for the replacement of the IBM equipment. No other companies besides Sirius responded to the request for bids. The Company still evaluated the bid using a selection matrix weighted 35 percent technical and operational and 65 percent commercial. Despite being the only bidder, Sirius scored highly on the evaluation matrix. Before selecting Sirius, the Company reviewed and scored the proposed contract terms and the proposed pricing.³

The cost of the equipment to PacifiCorp is \$418,128. This amount will be capitalized and amortized over the life of estimated useful life of the product, which is five years. The contract also includes a three-year maintenance agreement in the amount of \$155,914 to be amortized over three years.⁴

Because the price of the equipment and maintenance contract were determined through an independent bidding process that included evaluation and review of the winning bid, Staff finds the pricing to be fair and reasonable.

Public Interest Compliance

The Company uses the IBM equipment for the purpose of creating, maintaining, and processing critical business records. The Company's Customer Service System is written to specifications proprietary to IBM equipment and will not run operate on other

² See Orders No. 12-227, No. 12-228, and No. 12-385 for approvals of other affiliated interest contracts between PacifiCorp and IBM.

³ See Company's responses to Staff Data Requests No. 6 and No. 7.

⁴ See Company's response to Staff Data Request No 8.

equipment, necessitating the replacement of the IBM equipment with new IBM equipment.

The previous equipment was purchased by the Company in 2007 for \$439,500. However, the hardware is no longer able to accommodate the Company's needs, specifically the growing customer base and the expansion of the Company's customer self-service internet application. Neither the equipment nor additions such as extra memory or processors are currently offered for sale.⁵

Staff reviewed an analysis performed by PacifiCorp indicating that, due mainly to lower monthly maintenance fees and software costs, purchase of the new equipment is more cost effective over the initial three years by approximately \$0.3 million.⁶ The cost effectiveness of purchasing the new equipment relative to continuing use of the old would only increase past this timeframe.

The Commission customarily applies a "no harm" standard when reviewing affiliated interest contracts. Because purchasing the equipment increases the Company's ability to serve customers and will cost less than maintaining the outdated hardware, Staff finds the transaction to be in the public interest.

Records Availability, Audit Provisions, and Reporting Requirements

Two of the specific issues analyzed by Staff were the timeliness of the Company's filing of the application and the aggregate effect of the Company's multiple affiliated interest contracts with IBM.

Timely Filing Compliance

As part of a previous affiliated interest application filed after the 90 day deadline by PacifiCorp, Staff reviewed the Company's processes that ensure compliance with regulatory requirements regarding affiliated interests. The Company stated that its policy is to avoid transactions with affiliated interests unless the affiliate is clearly the best or only option. Affiliated Interests are tracked in a database, which is periodically reviewed. This database is used to flag transactions with affiliated interests, and transactions with affiliated interests must be reviewed and acknowledged by the Company's Legal and Regulation departments. The application was approved, based on Staff's recommendation.⁷

In its current application, the Company states that the delayed filing was an inadvertent oversight and that internal processes have since been strengthened. Staff reviewed the

⁵ See Company's response to Staff Data Requests No. 2 and No. 3.

⁶ See Confidential Attachment provided in response to Staff Data Request No. 3.

⁷ See Commission Order No. 12-143.

Company's responses to data requests in this previous docket as well as a data request in this docket to determine if the Company's affiliated interest transaction monitoring is accurate and complete.

As included in Appendix A of Order No. 12-143, the Company represents that:

When a request for proposals is created, the procurement buyer is required to check the listing of affiliated vendors to determine if the proposal is from an affiliate. Bidders are required to state if they are affiliated interests. If an affiliate is awarded a contract, it is flagged and required to be acknowledged by the Regulation department. The procurement buyer is also notified with a pop-up message in the purchasing program when a purchase order is created for an affiliate. A form is prepared for review and acknowledgement by the Legal and Regulation departments, which would then prepare any necessary regulatory filings.

With regard to how the Company has improved its monitoring, PacifiCorp stated:

The Company strengthened its internal processes by creating an affiliate interest transaction tracker to be used by the legal and regulation departments to monitor affiliate interest transactions that may require regulatory filings. Additionally, key members of the legal and regulation departments meet on a monthly basis to discuss affiliate transactions and timelines for making any necessary regulatory filings.⁸

Based on Staffs review of the Company's processes for monitoring affiliated interest transactions, Staff believes no Commission action is necessary regarding the violation of ORS 757.495.

Aggregate Transactions with IBM

Staff notes that in a previous affiliated interest application filing, Docket No. UI 327, the Commission approved PacifiCorp's request for approval of certain master agreements with IBM, which consolidated various prior agreements, and under which PacifiCorp purchases renewal of IBM software and support services. However, the Agreement with Sirius for purchase of the equipment and maintenance contract is not directly between PacifiCorp and IBM, and indirect transactions are not discussed in the master agreements. Therefore, this transaction does not fall under the umbrella of software and services already addressed in Docket No. UI 327.

⁸ See Company's response to Staff Data Request No. 1.

Dockets No. UI 321 and UI 322 also addressed applications for approval of transactions between the Company and IBM. Condition 3 in each of the orders in these dockets, Orders No. 12-227 and No. 12-228, requires:

PacifiCorp shall notify the Commission in advance of any substantive changes to this agreement, or any other Company contract with IBM, that would result in an aggregate annual billing to the Company by IBM, across all contracts between IBM and PacifiCorp, of an amount greater than 0.1 percent of PacifiCorp's Oregon annual revenues.

As noted above in the Transfer Pricing section of this memo, 0.1 percent of the Company's Oregon annual revenue is approximately \$1.3 million. The Company estimates that it annually purchases from IBM approximately \$2.5 to \$3 million in software and support services.⁹ The following table exhibits the Company's total annual direct and indirect payments to IBM from 2010 through the present.¹⁰

Year	Amount
2010	\$1,744,899
2011	\$2,647,041
2012	\$2,674,496
2013	\$349,081

Staff notes that the Commission retains the ability to review all affiliated transactions of the Company through both its annual affiliated interest report and in general rate case filings. Staff's recommended Conditions 1 and 2 provide for all necessary Commission examination of PacifiCorp's records concerning the Agreement with Sirius.

PacifiCorp has reviewed this memo and has not communicated any objections or concerns.

Based on the review of this application, Staff concludes:

1. The application regards an affiliated interest agreement that is fair and reasonable and not contrary to the public interest with inclusion of the proposed ordering conditions; and
2. Necessary records are available.

⁹ See pg. 3 of Appendix A of Order No. 12-385.

¹⁰ For details of the annual amounts, see Company's confidential response to Staff Data Request No. 10.

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PROPOSED COMMISSION MOTION:

PacifiCorp's application for approval of an agreement with Sirius for, among other things, purchase of mainframe equipment from IBM, an affiliated interest, be approved subject to Staff's recommended conditions.

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