

PUBLIC UTILITY COMMISSION OF OREGON  
STAFF REPORT  
PUBLIC MEETING DATE: July 21, 2015

REGULAR \_\_\_\_\_ CONSENT X EFFECTIVE DATE \_\_\_\_\_ N/A \_\_\_\_\_

DATE: July 7, 2015

TO: Public Utility Commission

FROM: Brian Bahr <sup>3B</sup>

THROUGH: Jason Eisdorfer and Marc Hellman <sup>*JE*</sup> <sup>*RA for MH*</sup>

SUBJECT: PACIFICORP: (Docket Nos. UP 328 and UI 357) Requests approval to sell certain mining equipment to Bridger Coal Company, an affiliated interest.

**STAFF RECOMMENDATION:**

The Public Utility Commission of Oregon (Commission) should grant a waiver of OAR 860-027-0048(4) and approve the application by PacifiCorp dba Pacific Power (PacifiCorp or Company) to sell certain mining equipment to Bridger Coal Company (BCC), an affiliated interest, subject to the following conditions:

1. Company shall notify the Commission in advance of any substantive changes to the transfer of properties, including any material changes in price. Any changes to the agreement terms that alter the intent and extent of activities under the agreement from those approved herein shall be submitted for approval in an application for a supplemental order (or other appropriate form) in this docket.
2. The final journal entry recording the transaction shall be submitted to the Commission within 60 days after the transaction closes.

**ISSUE**

With this application, the Company requests Commission approval to sell certain mining equipment to BCC.

## **BACKGROUND**

PacifiCorp is the majority owner of BCC, which provides coal to the Jim Bridger Plant. BCC currently uses DBT America, Inc. longwall equipment (DBT) for coal extraction. However, the conditions of the mine have differed from those initially expected, and consequently the DBT equipment is not well-suited for the effective mining of certain veins of coal. The result is higher costs of coal production.

In Docket No. UM 1712, the Commission approved the closing of the Deer Creek Mine. Coincidentally, the Joy longwall equipment previously used at the Deer Creek Mine is more ideal for effectively mining at Bridger than the DBT longwall equipment. PacifiCorp is proposing to sell the Joy longwall equipment, in conjunction with support equipment and a backup generator, to BCC.

In addition to its application in Oregon, the Company is requesting approval from the California Public Utilities Commission, and also must file notices to the Idaho Public Utilities Commission, Utah Public Service Commission, Washington Utilities and Transportation Commission, and Wyoming Public Service Commission.

The application was filed by the Company on June 19, 2015, concurrent with a separate application filed by Idaho Power Company (IPC), which owns one third of BCC, for the purchase of the mining equipment (Docket No. UP 327). The Company has requested approval of this application by August 3, 2015.

## **APPLICABLE LAWS AND STANDARD OF REVIEW**

ORS 757.480 and 757.495, and OAR 860-027-0025 and OAR 860-027-0040, are the laws governing the sale or lease of utility property and affiliated interests.

ORS 757.480 provides, in relevant part, that a utility doing business in Oregon shall obtain the Commission's approval prior to selling property used to provide utility service. In support of a request for approval of a property sale, the utility must provide the information and documentation listed in OAR 860-027-0025. OAR 860-027-0025(1)(l) requires the applicant to show that the property sale will be consistent with the public interest. The Commission has interpreted the phrase "consistent with the public interest" to require a showing of "no harm to the public" in asset sale dockets. See, e.g. *In the Matter of the Application of PacifiCorp*, Order No. 00-112 at 6 (2000); *In the Matter of the Application of Portland General Electric*, Order No. 99-730 at 7 (1999).

The Commission has reserved the right to review any or all financial aspects of a transaction in a general rate case or other proceeding, and may condition approval of a sale on receiving notice in advance of any substantive changes to the sale and transfer of the property including any material change in price. See Docket No. UP 235, Order No. 06-651; Docket No. UP 57, Order No. 90-433.

"Affiliated interest," as defined in ORS 757.015(3), includes every corporation five percent or more of whose voting securities are owned by any corporation or person owning five percent of the voting securities of a public utility or in any successive chain of ownership of a public utility. The Commission reviews affiliated interest transactions to ensure they are fair and reasonable and not contrary to the public interest. ORS 757.495(3). For transactions between affiliated interests, applications are subject to the requirements of OAR 860-027-0040 and 860-027-0041. In addition, OAR 860-027-0048(4) requires utilities to record the approved affiliated transaction at the lower of cost or market.

OAR 860-027-0043 allows the Commission to waive OAR 860-027-0040 or OAR 860-027-0041, except "for any transactions exceeding 0.1 percent of the previous calendar year's Oregon utility operating revenues unless the transaction or transactions can be demonstrated in advance to be fair and reasonable and not contrary to the public interest." Under OAR 860-027-0000(2), the Commission may waive any of the other Division 27 rules for good cause shown.

## **DISCUSSION:**

Staff investigated the following issues:

1. Scope and Terms of the Sale and Purchase Agreement
2. Transfer Pricing and Allocation of Gain
3. Public Interest Compliance
4. Records Availability, Audit Provisions, and Reporting Requirements

Staff's review of these issues included examination of the Company's application, applicable laws, and the Company's responses to 12 data requests from Staff, discussions with Company representatives via phone and email, and a meeting in person on July 1, 2015. The Company promptly responded to Staff's requests for information.

Scope and Terms of the Sale and Purchase Agreement

The Sale and Purchase Agreement (Agreement) between the Company and BCC, included in the Company's application as Attachment A, does not appear to contain any unusual terms or conditions. The Agreement specifies that transportation costs are included in the purchase price, delivery of the property is the responsibility of the seller, and other standard sale and purchase agreement conditions. Also, Exhibit A of the Agreement details the specific longwall equipment and support equipment included in the transaction. Exhibit B is the bill of sale, including the transportation costs.

A certificate of liability insurance is included as Exhibit C. The Company has described to Staff the potential risk inherent in the transportation of the equipment and the need for liability insurance. The amount of insurance purchased was determined based on the inherent risks and equipment replacement cost, and the cost of liability insurance is included in the purchase price to be paid by BCC.

Transfer Pricing and Allocation of Gain

The total purchase price for BCC, consisting of the market value of the assets, the cost of refurbishment and transportation, and sales tax payable to the state of Wyoming, is \$20.3 million. The purchase price of the equipment is broken down in the table below.

Table 1. Elements of Purchase/Sale

Cost Element	NBV (000)	Market Value (000)
Joy longwall equipment	\$22,160	\$13,344
Sales tax on Joy longwall equipment		\$801
Transportation of Joy longwall equipment		\$513
Refurbishment of Joy longwall equipment		\$4,038
Sales tax on refurbishment		\$240
Support equipment	\$1,267	\$1,190
Sales tax on support equipment		\$71
Transportation of support transportation		\$40
Generator		\$22
Sales tax on generator		\$1
Transportation of generator		\$2
	<b>TOTAL PURCHASE PRICE</b>	<b>\$22,259</b>

As shown in the table above, the net book value of the Joy longwall equipment is a little over \$22 million and of the support equipment is a little over \$1 million. The generator being sold was part of the unrecovered investment associated with closure of the Trail Mountain Mine in 2001 and included in a regulatory asset which has been fully

amortized. In total, the net book value of the assets included in the transaction is approximately \$23.5 million.

The Company determined market value of the assets by averaging independent appraisals. The Joy longwall equipment was appraised by three independent appraisers who, in aggregate, charged total appraisal fees of slightly less than \$30 thousand, which was borne by PacifiCorp. There was no appraisal fee charged by the five independent appraisers who provided appraisals for various pieces of the support equipment, nor by the two appraisers of the generator.

Liability insurance for the transportation of the equipment was purchased and has a \$10 thousand deductible and a \$2 million limit, as the replacement value of any single load to be transported does not exceed that amount. The cost of liability insurance is included in the transportation costs, which are to be reimbursed by BCC as part of the purchase price.

PacifiCorp's two thirds ownership interest in BCC qualifies as an affiliated interest. Because BCC is an affiliated interest of PacifiCorp, this transaction entails PacifiCorp, a regulated utility, selling property to an affiliated buyer. As such, the standard rules of affiliated interest transactions require the sale to be recorded at the higher of cost or market. However, the Company has requested a waiver of this affiliated interest pricing requirement, contained in OAR 860-027-0048(4).

As set forth above, the Commission may grant a waiver of any OAR Division 27 rule for good cause (OAR 860-027-0000(2)). The intent of the affiliated interest pricing rules is to ensure that transactions between the utility and its affiliates are fair and reasonable, not harmful to customers, and do not take advantage of the utility's position as a regulated entity to earn rate recovery on costs not directly necessary in providing for safe and reliable energy to customers.

Staff supports waiver of OAR 860-027-0048(4) in this case due to a fairly straight forward basis. The sale of the equipment is to BCC. For revenue requirement purposes, BCC costs are rolled into revenue requirement for PacifiCorp as if BCC were part of PacifiCorp. Because of this rate treatment, a waiver is reasonable to include the costs at market. This is a benefit to PacifiCorp customers because market is less than book. If the plant were sold at book, rate base and rates would be higher.

It should be noted that in Docket No. UM 1712, the plant being sold was estimated to be of lower value. Based on that lower value estimate, the remaining net plant was placed in an interest bearing account to be amortized over a four-year period. However, because the market value of the equipment is greater than was anticipated in Docket

No. UM 1712, the Company proposes to credit customers through the property sales balancing account for the difference between the estimated salvage value used in that docket (\$6 million) and the actual market value of the equipment being sold (\$14.5 million). Oregon's share of that \$8.5 million difference would be approximately \$2 million, based on the same allocation factor of 24.484 percent, which is the same as used in Docket No. UM 1712.

Even though the property sales balancing account is handled in such a way to clear on an annual basis, PacifiCorp has increased the gain on the sale to reflect what would have been four-years of interest on the gain had the plant gain been also amortized over a four-year period. In this manner, PacifiCorp is essentially creating the value or cost PacifiCorp customers would have experienced had parties known in UM 1712 the true "salvage value" of the equipment. PacifiCorp has taken an innovative path in their filing to capture a just and reasonable result.

As the majority owner of BCC, the purchaser of the equipment, PacifiCorp may seek to include the asset in rates at the time of its next general rate case. Staff believes the purchase price of the equipment is reasonable, as the market price is below the net book value and was determined by averaging independent appraisals. Staff reviewed the appraisals and did not find any unusual or unexpected amounts. The purchase will ultimately result in lower fuel prices for customers. This is discussed further in the Public Interest Compliance section of this memo.

#### Public Interest Compliance

As stated, the Commission customarily applies a "no harm" standard with regard to the public interest compliance of property sales and affiliated interest transactions. As the equipment is not currently in use, the delivery of safe and reliable energy to customers is not affected by its sale.

For the purpose of determining to engage in this transaction, PacifiCorp did an analysis that took into account fueling the Jim Bridger Plant under two different scenarios, one using DBT and one using Joy. Staff reviewed the analysis and concluded that the significant savings in fuel costs generated by purchase and use of the Joy system demonstrate the prudence of the decision to enter into this transaction. Fuel costs are updated annually through the Company's fuel cost adjustment mechanism; therefore, lower fuel costs for the Company result in lower costs to customers, regardless of the timing of general rate cases.

#### Records Availability, Audit Provisions, and Reporting Requirements

Staff notes that the Commission retains the ability to review all property sales of the Companies through general rate case filings. Staff's recommended conditions provide

for documentation of this property sale. The Company has reviewed this memo and has no objections or concerns. Staff is also not aware of objections from any other parties.

Conclusion

Based on the review of this application, Staff concludes:

1. The Agreement did not contain any unusual or restrictive terms or conditions;
2. The transfer pricing and allocation of gain is fair and reasonable;
3. The transaction is in the public interest; and
4. Necessary records are available.

**PROPOSED COMMISSION MOTION:**

PacifiCorp's application for approval to sell certain mining equipment to BCC be approved with a waiver of OAR 860-027-0048(4) and subject to Staff's recommended conditions.