

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: April 10, 2018

REGULAR _____ CONSENT X EFFECTIVE DATE _____ N/A _____

DATE: April 5, 2018

TO: Public Utility Commission

FROM: Scott Gibbens *SG*

THROUGH: *JTB & JE* Jason Eisdorfer and John Crider *J*

SUBJECT: PACIFIC POWER: (Docket No. UI 393) Requests Approval of an Affiliated Transaction with BNSF Railway Company

STAFF RECOMMENDATION:

The Commission should approve PacifiCorp's (PacifiCorp or Company) application concerning transportation agreements with Burlington Northern Santa Fe Railway Company (BNSF), subject to the following conditions:

1. The Company shall provide the Commission access to all books of account, as well as all documents, data, and records that pertain to any transactions with BNSF.
2. The Commission reserves the right to review, for reasonableness, all financial aspects of this transaction in any rate proceeding or alternative form of regulation.
3. PacifiCorp shall notify the Commission in advance of any substantive changes to the contract, including any material change in price. Any such change shall be submitted in an application for a supplemental order (or other appropriate format) in this docket.

DISCUSSION:

Issue

Whether the Commission should approve PacifiCorp's request to enter into an affiliate interest agreement with BNSF in order to provide coal transportation to its Cholla power plant.

Applicable Rule

"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 at least five percent of the voting securities of a public utility or by any person or corporation in any chain of successive ownership of at least five percent of voting securities of the utility. ORS 757.495 requires a public utility to seek approval of contracts with affiliated interests within 90 days after execution of the contract. The required process for submitting an agreement for review by the Commission is set forth in OAR 860-027-0040.

ORS 757.495(3) provides that the Commission may approve an affiliated interest agreement if the agreement is fair and reasonable and not contrary to the public interest. Under OAR 860-027-0048(4)(g), for cost allocation purposes, "when services or supplies are sold to an energy utility by an affiliate under contract, the transfer price shall be based upon the tariff or terms of the contract approved by the Commission Order under ORS 757.495. If services or supplies (except for generation) are not sold pursuant to an approved rate, sales shall be recorded in the energy utility's accounts at the affiliate's cost or the market rate, whichever is lower." The Commission need not determine the reasonableness of all financial aspects of the contract for ratemaking purposes, but, rather, may reserve that issue for subsequent proceedings. See Commission Order No. 11-071.

Analysis

PacifiCorp is an indirect, wholly-owned subsidiary of Berkshire Hathaway Energy Company (BHE). BHE is a subsidiary of Berkshire Hathaway, Inc. (Berkshire). BNSF is also a subsidiary of Berkshire Hathaway.

Berkshire's ownership interest in BNSF creates an affiliated interest for PacifiCorp through Berkshire's ownership interest in BHE and BHE's ownership interest in PacifiCorp.

PacifiCorp requests approval for Rail Transportation Agreements (Agreements) entered into between PacifiCorp and BNSF to provide transportation services from mines in New Mexico to the Cholla Generating Station (Cholla) near Joseph City, Arizona. The previous coal transportation contract for Cholla which was approved by the OPUC in Commission Order No. 07-323, expired on December 31, 2017. The new agreement is a two-year agreement for 2018 and 2019 with an option for an additional year if

triggered by PacifiCorp or its operating partner in the Cholla plant, Arizona Public Service Company (APS).

In addition to reviewing the Company's Application, Staff utilized PacifiCorp's responses to six Staff information requests. Staff investigated the following issues in considering whether the agreement is fair, reasonable, and not contrary to the public interest:

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

Terms and Conditions of the Agreement

Staff reviewed the Rail Agreement between PacifiCorp and BNSF and had no issues or concerns with the terms and conditions of the Agreement. Staff found the terms to be common and commensurate with other coal transportation agreements.

Transfer Pricing and Historical Trends

All six of Staff's information requests were to determine the reasonableness of the pricing for the contract. Staff reviews the pricing in order to verify the "lower of cost or market" standard as set forth in OAR 860-027-0048(4)(e). In this circumstance both a determination of market price and of cost based pricing is difficult.

PacifiCorp notes in response to an information request that the Cholla Plant is captive to the BNSF rail line. Transport by other means are not economically viable, due to geographic considerations and lack of necessary facilities. As defined in OAR 860-027-0048(1)(i), Market rate is the "lowest price that is available from nonaffiliated suppliers for comparable services or supplies." Given that BNSF is the only viable option for the service necessary for utility operations, a comparable market price is lacking.

PacifiCorp was unable to provide BNSF's cost when asked in an information request.

Given this dilemma, Staff reviewed the basis by which the Commission approved UI 269, the previous BNSF agreement for Cholla. In that filing, Staff noted that the Surface Transportation Board (STB) regulated the pricing for the contract, and because of this, Staff found the pricing to be reasonable because it was set by an economic regulatory agency. PacifiCorp stated that the new contract is subject to rates in a private pricing authority, and thus not specifically approved by the STB. Staff compared the pricing of the two rail agreements in order to estimate the relative difference. Staff found the relative change in pricing to be reasonable when accounting for the following differences between the two contracts:

- Term: The previous contract lasted 11 years, while the current contract lasts only two. Shorter terms mean less risk for the purchaser and less certainty for the supplier, raising the price.
- Minimum Annual Volumes: The previous agreement had a higher minimum annual volume than the new agreement. This also lowers risk for the purchaser and lowers economies of scale, which raises the price.
- Liquidated Damages: The contract terms stipulating liquidated damages for the failure to ship minimum annual volumes were favorably reduced in the current agreement from the previous agreement.

The final consideration for Staff was that APS led the negotiations which resulted in the new agreement. Given that APS is not an affiliated interest and receives the same pricing and terms as PacifiCorp, it has an incentive to negotiate the most favorable contract terms.

Due to the aforementioned reasons, Staff finds the pricing to be fair and reasonable.

Public Interest Compliance

PacifiCorp owns and operates many generation facilities, some of them fueled by coal. Coal-fired generation may be located near mine heads or may be located far away from a coal source. According to PacifiCorp, in situations where coal must travel a great distance to reach the generation plant, railroad transportation service is less expensive than other potential transportation sources such as semi-truck hauling.

Additionally, rail service providers are somewhat analogous to public utilities in that they usually serve exclusive service territories with rates governed by the STB. BNSF is the only rail service company that can provide transportation services to Cholla from the New Mexico mine.

These Agreements, which were originally negotiated as third-party agreements, serve the public interest by ensuring PacifiCorp obtains supplies for its coal-fired base load generation plants.

Records Availability, Audit Provisions and Reporting Requirements

Order Condition Number 1, listed above in the Staff recommendation, affords the necessary Commission examination of PacifiCorp's records concerning this Application.

Conclusion

Based on the review of the Application, Staff concludes:

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

PROPOSED COMMISSION MOTION:

Approve PacifiCorp's Application for Approval of an Affiliated Interest Agreement with BNSF, subject to the conditions recommended by Staff.

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