ORDER NO. 03-726

ENTERED DEC 12 2003

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UI 221

In the Matter of	)	
	)	ORDER
PACIFICORP	)	
	)	
Application for Approval of a Cross Charge Contract with SCOTTISHPOWER UK PLC Governing Affiliated Interest Cost Allocation.	)	

DISPOSITION: APPLICATION APPROVED WITH CONDITIONS

On October 1, 2003, PacifiCorp filed an application with the Public Utility Commission of Oregon (Commission) pursuant to ORS 757.490, ORS 757.495 and OAR 860-027-0040, requesting approval to enter into a service contract (Agreement) with ScottishPower UK plc (SPUK), an affiliated interest. As part of the Agreement, SPUK would provide necessary corporate services to PacifiCorp, including legal, government and corporate affairs, tax, financial, risk management, human resources, and environmental. Estimated annual payment by PacifiCorp to SPUK for these services is approximately $24,000,000. The Agreement is in effect for one year and automatically extends for successive periods of one year. A description of the filing and its procedural history is contained in the Staff Report, attached as Appendix A, and incorporated by reference.

Based on a review of the application and the Commission’s records, the Commission finds that the application satisfies applicable statutes and administrative rules. At its Public Meeting on December 4, 2003, the Commission adopted Staff’s recommendation. This written order memorializes the Commission's formal decision made at the December 4 Public Meeting.

OPINION

Jurisdiction

ORS 757.005 defines a "public utility" and the Company is a public utility subject to the Commission's jurisdiction.

Affiliation

An affiliated interest relationship exists under ORS 757.015.

Applicable Law

ORS 757.495 requires public utilities to seek approval of contracts with affiliated interests within 90 days after execution of the contract.

ORS 757.495(3) requires the Commission to approve the contract if the Commission finds that the contract is fair and reasonable and not contrary to the public interest. However, the Commission need not determine the reasonableness of all the financial aspects of the contract for ratemaking purposes. The Commission may reserve that issue for a subsequent proceeding.

CONCLUSIONS

1. The Company is a public utility subject to the jurisdiction of the Commission.

2. An affiliated interest relationship exists.

3. The agreement is fair, reasonable, and not contrary to the public interest.

4. The application should be approved, with certain conditions.

ORDER

IT IS ORDERED that the application of PacifiCorp to enter into an affiliated interest transaction with ScottishPower UK plc, is approved, subject to certain conditions, as further stated in Appendix A.

Made, entered, and effective ________________________.

BY THE COMMISSION:

____

Becky L. Beier
Commission Secretary

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A party may appeal this order to a court pursuant to ORS 756.580.

ITEM NO. CA1

PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: December 4, 2003

REGULAR _____ **CONSENT** __X__ **EFFECTIVE DATE** ____________________________

DATE: November 18, 2003

TO: Lee Sparling through Marc Hellman and Rebecca Hathhorn

FROM: Michael Dougherty

SUBJECT: PACIFIC POWER & LIGHT: (Docket No. UI 221) Application for Approval of a Cross Charge Contract with ScottishPower UK plc Governing Affiliated Interest Cost Allocations.

STAFF RECOMMENDATION:

The Commission should approve Pacific Power & Light's (PacifiCorp) application to enter into a cross charge contact governing affiliated interest cost allocations with ScottishPower UK plc (SPUK), an affiliated interest, subject to the following conditions:

1. PacifiCorp shall provide the Commission access to all books of account, as well as documents, data, and records of PacifiCorp and SPUK's affiliated interests that pertain to this transaction.

2. PacifiCorp shall maintain a detail line item listing of all charges that are included in the allocated costs and be able to provide supporting documentation including, but not limited to, invoices, payroll records and journal record entries when requested by Staff.

3. PacifiCorp shall continue to comply with merger Condition No. 12(f) of Commission Order No. 99-616 (UM 918), dated October 6, 1999, which states, "Through December 31, 2004, ScottishPower/PacifiCorp agree that corporate costs allocated to PacifiCorp (in U.S. dollars) will not be greater than 1999 costs for comparable PacifiCorp functions escalated for inflation using the GDP-PI."

4. The Commission reserves the right to review, for reasonableness, all financial aspects of this transaction in any rate proceeding or alternative form of regulation.

5. 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:

PacifiCorp filed this application on October 1, 2003, pursuant to ORS 757.490, ORS 757.495 and OAR 860-027-0040. PacifiCorp requests authorization from the Commission to enter into a cross charge contract (Agreement) that relates to affiliated interest cost allocations between PacifiCorp and SPUK.

As part of the Agreement, SPUK would provide necessary corporate services including legal, government and corporate affairs, tax, financial, risk management, human resources, environmental, and other services to PacifiCorp. Estimated annual payment by PacifiCorp to SPUK for these services is approximately $24 million for PacifiCorp's 2004 fiscal year. The Agreement is in effect for one year and automatically extends for successive periods of one year.

PacifiCorp and SPUK are both wholly owned subsidiaries of ScottishPower plc and therefore, are affiliated interests as defined in ORS 757.015.

Issues

Staff investigated the following issues:

1. Scope and Terms of the Agreement
2. Public Interest Compliance
3. Records Availability, Audit Provisions and Reporting Requirements

Scope and Terms of the Agreement – The Agreement describes the various corporate services that SPUK will provide to PacifiCorp, and establishes a process for direct charging of external costs, directly allocating costs and apportioning costs to PacifiCorp and other SPUK affiliates.

A competitive procurement process was not utilized for the Agreement, as SPUK has been providing, although not charging[1], PacifiCorp for these services since the PacifiCorp / ScottishPower merger in 1999. Additionally, PacifiCorp stated, and Staff agrees, that an outside entity should not be entrusted with executive management and oversight responsibilities. PacifiCorp estimates that it will pay SPUK approximately $24 million in fiscal year 2004.

[1] PacifiCorp represented that for the last four years, the UK Divisions of ScottishPower have borne the full cost of SPUK Group Corporate functions and PacifiCorp has received services from SPUK without any cost allocations.

Per the Agreement, direct charging for services will take place whenever possible. When direct charging is not appropriate, costs would be examined for direct allocation. When costs are not subject to either direct charging or direct allocation, costs will be apportioned using a four-factor formula. The four-factor formula is developed using equally weighted percentages of (1) gross retail sales, (2) operating profit, (3) net assets and (4) number of employees.

The cost categories subject to allocation are limited to common corporate functions such as executive management and corporate oversight including corporate secretarial, corporate communications, group strategy, group legal, group human resources, and group finance.

As part of the Agreement, PacifiCorp would also provide services to SPUK including human resource management, communications, information technology support services, and energy risk management. The estimated annual cross charges to SPUK by PacifiCorp are estimated to be under $2 million annually. Based upon my analysis of the Agreement, there appears to be no unusual or restrictive terms that will harm customers.

Public Interest Compliance – Based on the four-factor allocation, PacifiCorp will pay SPUK approximately 49.8 percent of the Group Corporate Costs that are not directly assigned. As a result, PacifiCorp will pay approximately 30 percent of the total group Corporate Costs ($82 million). Staff compared the four-factor formula that is approved by ScottishPower's United Kingdom (UK) Regulator with the three-factor formula that is standard in the United States (US). The US standard does not use the profitability metric. As a result, PacifiCorp, depending on profitability, could pay more or less in allocation charges in any given year, than if a three-factor formula was utilized. However, since the four-factor allocation is being used for all UK and US operations under the Agreement, Staff recommends that the four-factor formula be allowed.

To ensure that adoption of the four-factor formula does not result in harm to customers, PacifiCorp will continue to comply with merger Condition No. 12(f) of Commission Order No. 99-616 (UM 918), dated October 6, 1999, which states, "Through December 31, 2004, ScottishPower/PacifiCorp agree that corporate costs allocated to PacifiCorp (in U.S. dollars) will not be greater than 1999 costs for comparable PacifiCorp functions escalated for inflation using the GDP-PI."

The $24 million cost to the contract is in addition to the approximately $17 million in annual payments that PacifiCorp pays to support the costs of International Assignees working in the US for PacifiCorp. Staff examined these costs for International Assignees during PacifiCorp's latest rate case, UE 147.

Specific controls are in place to ensure the Agreement is not contrary to the public interest. These controls include:

1. *Condition No. 12 of Commission Order No. 99-616 (UM 918)*
   This merger condition limits allocations to common corporate functions and requires ScottishPower to demonstrate a basis for recovery of costs; requires an audit trail to ensure all costs subject to allocation can be specifically identified and adequately supported by appropriate documentation; and requires that corporate costs allocated to PacifiCorp, through December 31, 2004, will not be greater than 1999 costs for comparable PacifiCorp functions escalated for inflation using the GDP-PI.

2. *Auditing and Internal Controls*
   Both SPUK and PacifiCorp have implemented specified internal controls to ensure compliance with the corporate cross charge policy including validation of cross charges before payment is made, quarterly audits of financial records by an external auditor and periodic reviews by PacifiCorp's internal audit department.

3. *Specific PacifiCorp Regulatory Requirements*
   The Agreement specifically addresses regulatory requirements concerning affiliated interest transactions and recognizes that although charges will be at cost, PacifiCorp will have to demonstrate and reconcile the lower of cost or market for charges from SPUK. SPUK will also provide PacifiCorp with a detail line item listing of all charges that are included in the costs that are allocated.

   Per the Agreement, full supporting documentation will be on file at SPUK and will be available upon request. This supporting documentation includes invoices, payroll records and journal record entries. As part of the review, PacifiCorp agreed that they should not be cross-charged for the HR Stewardship program[2].

   PacifiCorp will also ensure that the cost of time, travel and other group corporate responsibilities performed by PacifiCorp personnel for SPUK are recorded in a non-utility account.

There is no profit element incorporated into the cross charge policy. Because there is no profit element, PacifiCorp represents that corporate costs, directly assigned or allocated to PacifiCorp

[2] The HR Stewardship program is an ongoing development program for UK personnel.

are below market costs. PacifiCorp is required to comply with the Commission's Transfer Pricing Policy stated in Oregon Administrative Rule (OAR) 860-027-0048, *Cost Allocations by an Energy Utility*, and only pay SPUK, the lower of cost or market for services provided. As a result, there would not be any cross-subsidization of SPUK operations by PacifiCorp's regulated operations.

PacifiCorp also provided Staff with a list showing transition plan savings relative to specific corporate initiatives that resulted from the merger. These savings represent both PacifiCorp productivity benefits and economies of scope that resulted from the movement of corporate services to SPUK.

<u>Records Availability, Audit Provisions and Reporting Requirements</u> - The proposed ordering conditions Nos. 1 and 2 provide the necessary records access to PacifiCorp's relevant books and records.

Based on review of the application, Staff concludes the following:

1. Customers are not harmed by this transaction because PacifiCorp has met the requirements of the Commission's transfer pricing policy for affiliate transactions and is required to comply with the merger condition that prevents corporate costs from exceeding 1999 costs adjusted for the GDP-PI;
2. The Commission will have the necessary records access to PacifiCorp's books and records; and
3. The application involves an affiliated interest transaction that is fair and reasonable and not contrary to the public interest, with the inclusion of the proposed ordering conditions.

Both PacifiCorp and the Industrial Consumers of Northwest Utilities have reviewed and agree with Staff's recommended conditions.

PROPOSED COMMISSION MOTION:

PacifiCorp's UI 221 application to enter into an affiliated transaction with Scottish Power UK plc be approved, subject to the five recommended conditions.

UI 221 PMM - PacifiCorp Cross Charge Contract with SPUK