ORDER NO. 00-112

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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UP 168

In the Matter of the Application of PacifiCorp for an Order Approving the Sale of its Interest in the Centralia Steam Electric Generating Plant and Related Other Assets.	)))))	ORDER

DISPOSITION: APPLICATION APPROVED

On August 6, 1999, PacifiCorp (Company) filed an application with the Public Utility Commission of Oregon, pursuant to ORS 757.480, for approval to sell its 47.5 percent interest in the Centralia Steam Generating Plant (Plant) and the ratebased portion of the Centralia Coal Mine (Mine) to TECWA Power and TECWA Fuel, two wholly-owned affiliates of TransAlta Corporation. The application also sought approval of PacifiCorp's proposal to split the gain from the sale of the Plant and Mine between its Oregon customers and its shareholders according to a "depreciation reserve method." That method would result in approximately 64 percent of the Oregon allocated portion of the gain going to customers and 36 percent to shareholders. The Company further proposed that the share of the gain allocated to customers be used to write off generation-related regulatory assets, thereby reducing the Company's rate base.

Petitions to intervene by the Citizens' Utility Board (CUB), Industrial Customers of Northwest Utilities (ICNU), Renewable Northwest Project (RNP), and Northwest Energy Coalition (NWEC) were granted. A schedule was established for the proceeding. Following the submission of testimony, the parties agreed that an evidentiary hearing was not necessary. Opening briefs were filed on December 22, 1999, and closing briefs on January 13, 2000.

Background

The Plant is a 1,340 MW coal-fired power plant owned by seven Northwest utilities and operated by PacifiCorp. It consists of two steam units that consume between 5.0 and 6.0 million tons of coal annually. The Plant owners (Owners Group) and their ownership shares are as follows:[1]

PacifiCorp	47.5%
Avista	17.5%
City of Seattle	8.0%
City of Tacoma	8.0%
PUD No. 1 of Snohomish County	8.0%
Puget Sound Energy, Inc.	7.0%
PUD No. 1 of Grays Harbor County	4.0%

The Plant's primary source of coal is the Mine, which is located adjacent to the Plant. The Mine is owned by PacifiCorp and operated by its wholly-owned subsidiary, the Centralia Mining Company (CMC). Over the past ten years, 75 to 100 percent of the coal burned at the Plant has come from the Mine, with the remainder imported by rail from the Powder River Basin in Montana and Wyoming.

The Plant is operated under two agreements among the members of the Owners Group. These agreements appoint PacifiCorp as the operator of the Plant and set out specifications about coal ordering and storage, generation ordering, and approval of budgets. They provide for an Owners Committee which reviews Plant operation. The Mine operates under a contract between CMC (PacifiCorp's subsidiary) and the other members of the Owners Group.

As operator of the Plant, PacifiCorp prepares budgets for the approval of the Owners Group. Capital budgets, including capital expenditures required to meet environmental requirements, require unanimous approval of the Owners Group. Thus, if even one owner does not approve an environmental expenditure, the expenditure is not made.

Reasons for the Sale

PacifiCorp's decision to sell the Mine and its share of the Plant was based primarily on its concern that new air emissions rules will require substantial capital expenditures at the facilities. The environmental requirements of the State of

[1] This table incorporates the sale by PGE of its 2.5 percent interest to Avista, approved in Order No. 99-730 in Dockets 165/170.

Washington obligate the owners to apply Reasonably Available Control Technology (RACT) to limit the emission of air contaminants. PacifiCorp believes it unlikely that the Owners Group would reach unanimity regarding the capital investment required to meet the RACT requirement. That failure might lead to a temporary Plant shutdown or a permanent Plant closure. In addition, PacifiCorp believes electric utility industry deregulation may threaten the recovery of utility plant-in-service investments. For these reasons, PacifiCorp concluded that it would be preferable for an unregulated generator to undertake the large capital investment required at the Plant.[2]

Potential mine reclamation costs also played a role in PacifiCorp's decision to sell the Mine and Plant. PacifiCorp concluded that the Mine would require substantial expenditures both for ongoing reclamation while the mine is still in operation and for final reclamation when the area is fully mined. Studies commissioned by the Owners Group indicated that the potential costs of reclamation would vary widely depending on the reclamation method used. The studies also indicated that, in present value terms, the sooner the mine is shut down and final reclamation occurs, the more expensive it would be. If the sale of the Mine becomes final, the reclamation liability and accrued reclamation balances will transfer to the new owner.

Auction process

The Owners Group decided to sell the Plant and Mine through a two-phase auction process overseen by New Harbor, Inc. (NHI), an investment banker. NHI developed a list of prospective bidders and contacted each. Those interested were given a copy of an Offering Memorandum. Each interested party then presented its Initial Indication of Interest. PacifiCorp and NHI reviewed the Indications of Interest in relation to the criteria set out in the Auction Protocols and developed a short-list of bidders.

Once the short-list was developed, the due diligence phase of the process occurred. It included distribution of more information about the Plant and Mine, site visits, data requests, and provision of drafts of the Sale Agreements. Final bids were submitted by those on the short-list on April 19, 1999. TransAlta Energy Corporation made the winning bid of approximately $554 million for the Plant and the Mine.

TransAlta is a Canadian energy company which also operates in the United States and other countries. It is the leading producer of independent power in Canada, where it owns three coal-fired generating plants and has a 50 percent ownership interest in a fourth coal-fired plant. It also owns 13 hydroelectric plants and 2 coal mines. It generates about 4,500 MW of electricity annually, with approximately 95 percent coming from coal generation and the remainder from hydroelectric generation.

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[2] In UM 955, a companion docket to the present docket, the Commission gave its consent to the buyer of PacifiCorp's share of the Plant being considered eligible for determination of exempt wholesale generator (EWG) status. An EWG is exempt from the provisions of the Public Utilities Holding Company Act of 1935.

The Sales Agreement

The members of the Owners Group entered into an agreement under which the proceeds of the sale are to be divided as follows: PacifiCorp will receive its book breakeven value for the Mine (approximately $107 million to be trued up and audited at closing). The remainder of the total proceeds of the sale will be split among the owners based upon their share of Plant ownership. PacifiCorp will receive approximately $215 million as its share of the proceeds from the Plant.

Replacement Power

The Plant is expected to produce about 4 million-megawatt hours annually for PacifiCorp. PacifiCorp will balance its loads and resources with market purchases.

Treatment of the Gain

PacifiCorp will have no gain on the sale of the Mine. It will realize an estimated system-wide gain on the Plant of approximately $83 million to be allocated among the states in which the Company is regulated.[3] The portion allocated to Oregon will be approximately $46.2 million.

PacifiCorp proposes to dispose of the $46.2 million Oregon portion of the gain according to a technique called “depreciation reserve.” This method is based on the relationship between net plant and gross plant. It establishes the percentage of the capital costs of the Plant which has been recovered over time through rates and the percentage of these costs that remains on the Company’s books. These percentages are then multiplied by the overall gain to establish the “sharing ratio.” Using this methodology, PacifiCorp calculates that customers in Oregon should receive 64 percent of the Oregon-allocated portion of the gain and shareholders 36 percent. That split would result in Oregon customers receiving approximately $29.6 million of the Oregon-allocated $46.2 million. The remaining $16.6 million would go to shareholders.

Ratemaking Treatment

PacifiCorp proposes to use the customer portion of the net proceeds from the sale to write off, in the year the transaction closes, generation-related regulatory assets, specifically the “Yampa facilities.” This write-off would reduce the Company’s rate base. PacifiCorp has indicated its willingness to accept a condition on the write-off that if the Company later sells its interest in the Yampa facilities, the Company would owe to customers the full amount of the customer portion of the gain attributable to the prior Centralia sale.

[3] The actual dollar value of the net gain will be determined when the transaction is closed.

DISCUSSION

The Standard for Review of the Application

ORS 757.480 requires that a utility obtain Commission approval for sales of property of a value in excess of $100,000. OAR 860-027-0025(1)(L) requires that the utility show that the sale is "consistent with the public interest."

The first question before the Commission is to determine what the "public interest" standard means in this instance. Staff and PacifiCorp argue that the statute and administrative rule should be interpreted to require that a utility show that a sale results in "no harm" to its ratepayers. The Commission has recently explicitly applied that standard in an asset sale case.[4] ICNU acknowledges that the Commission has used that standard in several cases. It argues, however, that the Commission should resolve asset sale applications on a case-by-case basis suited to the specific transaction. In this case, ICNU asserts, the standard for approval should be a "net benefits" test rather than the "no harm" test.

In support of its argument, ICNU asserts that federal law requires that the Commission make an explicit finding that customers will benefit from the removal of the Centralia facilities (Plant and Mine) from PacifiCorp's rate base. It cites the Energy Policy Act of 1992, 15 U.S.C. 79-5a in support. Those provisions relate to the process for designating generating assets as EWGs. ICNU cites specifically 15 U.S.C. 79z-5a(c), which states as follows:

> [I]n order for the facility to be considered an eligible facility, every State commission having jurisdiction over any such rate or charge must make a specific determination that allowing such facility to be an eligible facility (1) will benefit consumers, (2) is in the public interest, and (3) does not violate State law . . .

ICNU claims that the plain meaning of this provision is that the Commission must make a specific determination that attainment of EWG status, and the resulting removal of the asset from rate base, will benefit consumers. This, ICNU argues, "implies that a 'net benefits' standard should be applied in this case."

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[4] *In the Matter of the Application of Portland General Electric*, UP 165/UP 170, Order No. 99-730 at 7. This case involves the sale by PGE of its interest in the Centralia Plant.

Disposition

The Commission rejects ICNU's argument that federal law binds us to a net benefits test. The Energy Policy Act's provisions are directed at the designation of facilities as EWGs. As ICNU notes, Congress was concerned that utilities would use EWG status to avoid state jurisdiction and it thus created the test set out above. It follows, we believe, that since Congress was attempting to protect the interest of the states, it could not have intended that the Act limit states' jurisdiction over asset sales or impinge on their discretion to develop and apply a standard for those transactions based on their own interests and concerns. In other words, it is not credible that the Act was intended to preempt state authority in the matter before us, which is not an application for EWG status but an application for approval of the sale of an asset.

We believe the "no harm" test is appropriate in this case. It provides protection to ratepayers while allowing utilities a reasonable opportunity to exercise their judgment regarding the sale of their assets. A "net benefits" test, on the other hand, could prohibit sales that are in the interests of the utility, as it perceives those interests, even though the utility's customers are not harmed by that transaction. We see no benefit to the public interest in applying that standard in this case. We note, however, that, as ICNU asserts, the public interest may require a different standard in another case.

Approval of the Sale

ICNU points out correctly that the question of whether the sale meets the no harm standard is inextricably tied to the issue of the disposition of the gain. PacifiCorp claims that the sale meets the no harm test if its proposed 64/36 split is accepted. Staff, based on an economic analysis of the impact of the sale, asserted that that standard would be met if at least $17.8 million of the Oregon allocated portion of the gain goes to customers.[5] Staff's analysis calculates the costs and benefits (net present value) of the sale over the expected remaining life of the plant. It concludes that on a system-wide basis, treating $29.5 million as a rate base reduction would result in the "expectation that customers would not face rates higher than the 'keep' Centralia scenario." Staff then multiplied the total $29.5 million figure by the allocation percentage PacifiCorp calculated for determining the Oregon share, 55.8 percent, and arrived at the $17.8 million figure. This figure is a firm threshold in Staff's view for meeting the no harm standard; it is not dependant on the total amount of gain, which may change from the amounts set out in the record, depending on when the sale actually closes. Staff therefore asks that the Commission establish the $17.8 million figure as the minimum amount that must be allocated to customers to satisfy the standard.[6]

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[5] Staff expressed some reservations about the auction process but did not assert that it resulted in a price that was not a fair market price.

[6] We note that Staff's argument relating to the $17.8 million is not intended to establish its position on the disposition of the proceeds or the ratemaking treatment of the gain.

ICNU and CUB argue that the sale cannot meet the no harm test if 36 percent of the gain goes to PacifiCorp's shareholders, as PacifiCorp proposes. CUB asserts, moreover, that acceptance of Staff's $17.8 million threshold would subject customers to enormous amounts of risk “even as the utility is made whole and receives a windfall.” Both parties thus argue that the no harm test will be met only if all the gain goes to customers.

Disposition

The Commission concludes that the sale, under the conditions we set out in this order relating to the disposition of the proceeds, meets the no harm standard. As we noted above, the parties focused most of their attention on the division of the gain between shareholders and customers. No party challenged the fairness of the price or questioned the computation of the gain. No other source of potential “harm” to customers was suggested by any party. We have considered the evidence and argument on this issue. We consider Staff's threshold figure of $17.8 million to be a persuasive estimation of the amount necessary to prevent any harm to customers. The decision we make below regarding the sharing of the gain by customers and PacifiCorp on a 95 percent/5 percent basis would provide more money to customers than Staff's threshold and it will thus protect customers against any harm from the sale. We also note that Senate Bill1149, the electric restructuring bill passed by the Oregon Legislature in 1999, encourages divestiture of utility generation resources, where appropriate, as a way of introducing competition into the generation of electricity.[7] Under the circumstances set out above in this order, we conclude that the sale should be approved.

Disposition of the Proceeds

Staff suggests that we defer the question of the allocation of that portion of the gain which exceeds $17.8 million until PacifiCorp's next rate case. ICNU asks that we defer consideration of the allocation of the entire gain until then. PacifiCorp objects to deferral of the question because it desires to know the allocation before the sale is approved.

The Commission concludes that we should indicate our current thinking on the allocation of the gain now, so that PacifiCorp will have that information before the sale is final. Of course, the allocation set out herein is for accounting purposes only. A final decision on allocation will be made in PacifiCorp’s pending rate case docketed as UE 111.

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[7] *See* Order No. 00-111 in UP 158, issued concurrently with this order. In that order, we concluded that the facts did not warrant approval of the application.

Disposition

The Commission does not find PacifiCorp's position on the allocation of the gain persuasive. We see no nexus between the proportion of the book value that has been depreciated and the proportion of the gain that should go to customers. As several parties point out, PacifiCorp will ultimately be paid all of the book value of the Plant. No one contests PacifiCorp's right to return of that investment in total. In the final analysis, then, the Company will have been "paid back" 100 percent of the book value. Thus, the proportion of the book value that has been paid back up to the time of the sale is of no apparent significance. PacifiCorp has not established any such significance. The few cases cited by PacifiCorp in which we used the depreciation reserve do not persuade us that that method is appropriate for this case.[8]

The analysis we have used most often in the past in deciding who gets the gain is to assign it to the party who has borne the risk. We believe this is the appropriate method to use in this case. It comports with important existing legal authority, such as *Democratic Central Committee v. Washington Metropolitan Area Transit Commission.*[9] The court in that case held that neither ratepayers nor shareholders are necessarily entitled to gains in the value of assets. Increases are to be allocated under a two-step analysis. The first step is to determine which party bears the risk of loss, with higher risks warranting larger returns. Only if the relative risks cannot be determined does the second step come into play, namely that the party which "bears the financial burden of particular utility activity should also reap the benefits resulting therefrom."[10]

The "reward follows risk" test is also persuasive from a policy standpoint. It is clear that a utility's customers do bear the risk related to the book value of a plant such as the Centralia facility. They pay the utility back through rates during the life of the plant. When it goes out of service, they, in most cases, will continue to pay back to the utility any portion of the book value still remaining unpaid.[11] The principle that the right to gains falls to the party who has borne the risk of loss is an equitable way of recompensing customers for the risk they have shouldered.

[8] *Portland General Electric*, UP 36, Order No. 86-845 and *CP National Corporation*, UP 57, Order No. 90-433. These cases merely conclude that the depreciation reserve method provides a reasonable division of the gain. We have no reason to doubt that those decisions were appropriate for the facts involved; however, they do not analyze the issue to any extent and provide no basis for our use of the depreciation reserve method in the present case.

[9] 485 F2d 786 (DC Cir 1973), *reh den*, *cert den*, 415 US 935 (1973).

[10] *Id.* at 808.

[11] The potential exception for instances in which the expense for the plant is determined to have been imprudently incurred presents a different issue, one not applicable to this case.

As Staff notes, the Commission has in the past "held that gains or losses from the sale of rate-based depreciable property go to customers because they were held in rate base."[12] (Opening brief at 6.) Staff thus argues persuasively that the two cases in which the Commission used the depreciation reserve method are aberrant. It also notes that those cases provide no explanation for the Commission's departure from its established practice. The Commission agrees with Staff's analysis and concludes that our treatment of this issue in this order is consistent with our better prior practice. We thus conclude that because PacifiCorp's customers bore the risk, they are entitled to the gain from the sale of the Plant.

PacifiCorp argues that, even under the "reward follows risk" method of allocating gain, its shareholders should get the 34 percent share it proposes. It asserts that neither the shareholders nor the customers have borne all the risk. It argues, for example, that the Company bore the risks during the construction phase and also the risks associated with capital additions before they were placed in rates. It also claims that it bears or has borne the risks associated with the vagaries of regulation, such as a utility's decision to forego price increases because of customer impact, unexpected expenses or revenue decreases, changes in regulatory policy, and regulatory lag. It also claims that it will bear certain future risks associated with the Plant and Mine, such as the costs of environmental mitigation and Mine reclamation. Moreover, it notes that it will also face the risks associated with replacement power costs after the sale. Finally, it also remarks that it has no guarantee that TransAlta will honor its contract or will even remain in business.

PacifiCorp's argument is not persuasive. The catalog of "risks" it cites has little to do with the issues in this case. The risks borne by customers for which they are to be compensated are matters over which they have little, or no, control. Many of the "risks" PacifiCorp claims for itself were voluntarily undertaken by the company in pursuing this sale, such as the possibility that the purchaser of the Plant and Mine will default or go out of business. We see no reason to take money from customers to reimburse shareholders for risks they have undertaken to further the transaction at hand, especially as that transaction has not been shown to confer any benefit on customers. Moreover, those risks are business risks PacifiCorp could protect itself from by negotiating guarantees or other assurances. Nor are the general risks associated with regulation something we need to consider here. The Company has little to fear in that regard unless its decisions to build or add to a facility are imprudent.[13] The risks associated with the environmental mitigation and mine reclamation are supposedly the risks PacifiCorp is trying to avoid by the sale. The risks associated with replacement

[12] Citing *Portland General Electric*, UP 62, Order No. 90-2438; *Portland General Electric*, UP 48, Order No. 89-404; and *Portland General Electric*, UP 68, Order No. 91-1658.

[13] As Staff notes, utilities in Oregon were allowed to place construction work in progress into rate base at the time the Centralia Plant was placed in rate base. PacifiCorp did not attempt to show how the Commission actually treated those costs, or other costs related to the Plant.

power are also risks PacifiCorp is voluntarily opting for by pursuing this sale. In any event, those costs are recoverable in rates. We conclude that PacifiCorp has not demonstrated that it should share in the gain, except to the extent we set out in this order.

Staff argues that it is appropriate to give PacifiCorp a small portion of the gain in this case, specifically the larger of five percent of the gain or the value of any extraordinary action taken by the Company to increase the sale price. Staff believes that PacifiCorp's creation of a limited liability company to minimize taxes related to the sale "was creative and resourceful and increased the Oregon-allocated net gain by $2.2 million." CUB disagrees, arguing that the record is not sufficient to support the grant of a portion of the gain to PacifiCorp.

We agree with Staff, both as to the policy issue and as to the specific application of that policy to this case. The five-percent maximum suggested by Staff is in a general sense consistent with our treatment of so-called transition costs/benefits in the recent PGE restructuring case.[14] The gain in the present case is not a transition benefit, but the purpose behind giving the Company a share is the same as it was in UE 102: to provide an incentive to the utility both to enhance the value of the plant and to use an asset sale process that is most likely to obtain the best price.[15] The amount of the benefit as calculated by Staff, $2.2 million, is smaller than five percent of the probable gain, $2.3 million.[16] We conclude that the Company should receive the greater of five percent of the final gain or the $2.2 million.

Ratemaking Treatment

PacifiCorp claims that its proposal to use the customer portion of the net proceeds from the sale to write off generation-related regulatory assets will benefit customers by "immediately reducing the Company's rate base and, by extension, the Company's revenue requirement." The reduction to revenue requirement will be reflected, according to the Company, in results of operations and thus in rates. This method of disposing of the customers' portion of the gain is "both prudent and sensible," according to the Company, because it best matches, from a timing standpoint, "the flow of benefits associated with the sale with the potentially-higher replacement power costs that may be incurred by the Company over the long-term." PacifiCorp agrees to a condition that if it sells its interest in the facilities, it would owe to the customers the full amount of the customer portion of the gain attributable to the prior Centralia sale.

[14] *Portland General Electric*, UE 102, Order No. 99-033, at 39-40.
[15] The fact that the sale here occurred before our decision to grant the Company a share of the gain does not (as some parties argue) destroy the reasoning behind granting a share to PacifiCorp, since the Company presumably knew during the entire process that it would seek a share of the gain.
[16] The exact price will be determined only at closing.

PacifiCorp asserts that its proposed treatment would have "the same present-value revenue requirement effect as the method proposed by Staff." Staff's proposal is to create a balancing account and separate tariff to amortize the grossed-up gain to customers over five years. This method, according to Staff, will provide a more certain and less complicated benefit to customers than the rate reduction proposed by PacifiCorp.

Disposition

The Commission concludes that Staff's proposal is sound. It is a simple and direct way of passing the benefit to customers. PacifiCorp's plan is somewhat more complex than Staff's proposal. We do not see how it would provide greater benefit to customers and we thus choose the less complicated method.

Replacement Power

RNP argues that ORS 757.480 and ORS 757.020 give the Commission the authority to determine whether the facilities PacifiCorp will use to replace the lost power are safe and can provide adequate service. Under Oregon air quality and energy policies, RNP asserts, the grant of authority to make the sale should be conditioned to require PacifiCorp to issue an RFP for replacement power with low carbon dioxide emissions. That condition should also be used as a means to implement the agreement that Scottish Power made in its acquisition of PacifiCorp to develop and acquire an additional 50 MW of system-wide renewable resources. A portion of the gain from the sale should be used to acquire the additional 50 MW of system-wide renewable resources and to acquire low CO_2 replacement energy. Both ratepayers and the Company would benefit from this use of the money, according to RNP.

CUB generally echoes RNP's view that PacifiCorp should purchase cleaner replacement power or other environmental remediation. It suggests that it "would be a nice gesture on the part of PacifiCorp to reinvest some of that investment capital in renewable and environmentally friendly resources."

PacifiCorp did not respond to the proposals by RNP and CUB. No other party commented on them.

Disposition

The Commission credits RNP and CUB with thoughtful ideas on these matters. We will not, however, direct PacifiCorp to undertake these specific steps. Aside from legal questions about the extent of our authority to make such directives, we do not think the record in this case is sufficient to allow us to do so. We will thus not impose these specific conditions.

ORDER

IT IS ORDERED that:

1. The sale proposed by PacifiCorp in its application is approved as described in this order provided that no less than $17.8 million of the gain goes to customers.

2. For accounting purposes, the gain from the sale shall be divided up as follows: The Company shall receive the greater of five percent of the final gain or $2.2 million; customers shall receive the remainder.

3. For accounting purposes, the customers' portion of the gain shall be placed in a balancing account and separate tariff to amortize the grossed-up gain to customers over five years.

Made, entered, and effective ______________________________.

______________________________	______________________________
Ron Eachus Chairman	**Roger Hamilton** Commissioner
	______________________________
	Joan H. Smith Commissioner

A party may request rehearing or reconsideration of this order pursuant to ORS 756.561. A request for rehearing or reconsideration must be filed with the Commission within 60 days of the date of service of this order. The request must comply with the requirements of OAR 860-014-0095. A copy of any such request must also be served on each party to the proceeding as provided by OAR 860-013-0070. A party may appeal this order to a court pursuant to ORS 756.580.

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