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BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UP 187

In the Matter of the Application of PacifiCorp for)
Approval of the Sale and Transfer of Electric) ORDER
Properties and Transfer of Service Territory to the)
City of Hermiston.)

DISPOSITION: APPLICATION GRANTED WITH CONDITIONS

On August 8, 2001, PacifiCorp filed this application pursuant to ORS 757.480, ORS 758.470, and OAR 860-027-0025. PacifiCorp seeks a Commission order approving the sale of its electric distribution system located within the City of Hermiston, Oregon (the Hermiston Properties) to the City of Hermiston (City). The sale will be accomplished pursuant to an Asset Purchase Agreement (the Agreement) between PacifiCorp and the City. PacifiCorp seeks an order transferring to the City that portion of its service territory served by the Hermiston Properties, pursuant to the above statutes. The purchase price to be paid by the City, at closing on or about September 28, 2001, is \$8 million in cash, plus the assumption of certain liabilities as set forth in the Agreement. The purchase price is in excess of two times PacifiCorp's net book value of the assets to be transferred.

The legal descriptions of the properties subject to the sale, both inside the city limits and neighboring and island territories, are attached as Appendix A. Schedule 1.03 of Appendix A sets out the legal descriptions of the boundaries of the City. It is important to note that, while PacifiCorp is transferring to the City the portion of its service territory that lies within these City limits, Umatilla Electric Cooperative also provides service within the City limits. Accordingly, the service territory being transferred is not coextensive with the boundaries of the City. Rather, PacifiCorp is carving out of its allocated service territory the area included within the City boundaries, plus neighboring and island territories identified in the Supplement to Schedule 1.03 in Appendix A.

Staff has reviewed the application and PacifiCorp's statements regarding its efforts in obtaining a substantially higher value for the Hermiston Properties than what the City proposed to the court in the condemnation proceeding and initially offered in the subsequent negotiations to establish a purchase price. PacifiCorp provided a detailed, comparative revenue requirement analysis, before and after the Hermiston Properties sale. This analysis demonstrates to Staff that the company's remaining customers would not be harmed, but in fact, would benefit by the sale of the Hermiston Properties. In

particular, the analysis showed that without Hermiston, two major operating expenses, namely power supply and distribution were materially reduced.

Based on its analysis, Staff recommends that the Commission approve PacifiCorp's application for the Sale of its Electric Properties and the Transfer of its Service Territory at Hermiston, Oregon, with certain conditions. Those conditions require, among other things, that PacifiCorp shall record the after tax net gain on its regulated books of account by allocating 95 percent of this net gain to its customers. The estimated pre-tax gain is about \$4.2 million. Staff explains that this allocation is consistent with Order No. 00-112 regarding PacifiCorp's sale of its interest in the Centralia generating plant. In that order, the Commission recognized that it is appropriate to allocate a share of the gain on a sale of utility property to the utility (its shareholders) when the utility has contributed significantly to the creation of value in the sale. The purpose of such an allocation is "to provide an incentive to the utility to enhance the value of the plant and to use an asset sale process that is most likely to obtain the best price."

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 September 25, 2001, the Commission adopted the Staff's recommendation to approve the sale as proposed. Staff's recommendation, is attached as Appendix B, and is incorporated by reference.

OPINION

Jurisdiction

ORS 757.005 defines a public utility as anyone providing heat, light, water, or power service to the public in Oregon. PacifiCorp is a public utility subject to the Commission's jurisdiction.

Applicable Law

ORS 757.480 provides that, except for water utilities, a public utility doing business in Oregon shall first obtain Commission approval for any transaction to sell, lease, assign or otherwise dispose of property of such public utility necessary or useful in the performance of its duties to the public or any part thereof of a value in excess of \$100,000.

OAR 860-027-0025 specifies the information a public utility must submit when it makes application to sell or lease its property. This application contains the necessary information.

PacifiCorp's sale of the Hermiston Properties is in the public interest as required by ORS 757.480. As described above, PacifiCorp's remaining customers are not harmed by this

transaction, because they are not worse off after the sale. In fact, the remaining customers are benefited by the sale, because their cost of service will be less than it was before the sale.

Commission approval of the accounting treatment for this transaction does not constitute approval for ratemaking purposes. There is no indication that the proposed sale will impair the Company's ability to provide public utility service in Oregon.

CONCLUSIONS

1. The Company is a public utility subject to the jurisdiction of the Public Utility Commission of Oregon.
2. The Company's proposed transaction meets the requirements of ORS 757.480.
3. The application should be granted.

ORDER

IT IS ORDERED that the application of PacifiCorp, for approval of the Sale and Transfer of Electric Properties and Transfer of Service Territory to the City of Hermiston, is granted, with the conditions as further described in Appendix B.

Made, entered and effective _____.

BY THE COMMISSION:

Vikie Bailey-Goggins
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.

**PUBLIC UTILITY COMMISSION OF OREGON
STAFF REPORT
PUBLIC MEETING DATE: SEPTEMBER 25, 2001**

REGULAR X **CONSENT** _____ **EFFECTIVE DATE** _____

DATE: September 18, 2001

TO: Phil Nyegaard through Marc Hellman and Mike Myers

FROM: Tom Riordan

SUBJECT: UP 187 – PacifiCorp Application for approval of the Sale of Electric Properties and Transfer of Service Territory at Hermiston, Oregon

SUMMARY RECOMMENDATION:

I recommend approval of the requested properties sale and transfer of service territory with the conditions noted in the detailed recommendation.

DISCUSSION:

Background:

PacifiCorp filed this application on August 8, 2001, pursuant to ORS 757.480, ORS 758.470 and OAR 860-027-0025. The company seeks a Commission order approving the sale of its electric distribution system located within the City of Hermiston, Oregon (the Hermiston Properties) to the City of Hermiston (City). The sale will be accomplished pursuant to an Asset Purchase Agreement (the Agreement) between PacifiCorp and the City, dated July 13, 2001. Finally, PacifiCorp seeks an order transferring to the City that portion of its service territory served by the Hermiston Properties, pursuant to the above statutes.

The purchase price to be paid by the City, at closing on or about September 28, 2001, is \$8 million in cash, plus the assumption of certain liabilities as set forth in the Agreement.

The purchase price is in excess of two times PacifiCorp's net book value of the assets to be transferred.

On September 15, 1998, the citizens of Hermiston voted their support for a proposal that the City take local ownership of PacifiCorp's electrical facilities that provide service within the city limits. Thereafter, the City filed a Complaint against PacifiCorp seeking to acquire the company's assets by condemnation. In its Complaint, the City alleged the value of the Hermiston Properties (including severance damage to PacifiCorp) totaled \$3,266,900. The Umatilla County Circuit Court (the Court) entered an order on November 21, 2000 affirming the City's right to condemn PacifiCorp's property and rejected the company's affirmative defenses. The court set a trial date of October 15, 2001 for valuation of the property. The parties then entered into negotiations to settle the valuation issue and subsequently settled their differences by executing the Agreement in this application.

In connection with this docket, a pre-hearing conference was held on September 4, 2001. The participating parties were the Citizens' Utility Board, Industrial Customers of Northwest Utilities, City of Hermiston, PacifiCorp, and Staff. The parties discussed and preliminarily resolved the docket's key issue, namely the appropriate treatment of the gain on the sale of the Hermiston Properties. The parties unanimously agreed that the final disposition for accounting purposes would be, as reflected in Staff's proposed condition No. 4, that 95 percent of the gain would be recorded by PacifiCorp in an account designated for consumers.

Issues

I have investigated the following issues:

1. Scope and Terms of Agreement
2. Allocation of Gain
3. Public Interest Compliance
4. Transfer of Service Territory
5. Records Availability, Audit Provisions, and Reporting Requirements

Scope and Terms of Agreement – Based upon my analysis of the Agreement, there appear to be no unusual or restrictive terms that would harm customers.

Allocation of Gain – PacifiCorp believes the circumstances of the City's condemnation action and the resultant sale warrant an allocation to the company of a share of the net gain. The company states that it aggressively defended its service territory for the purposes of maximizing the proceeds from the condemnation action and discouraging

condemnation actions that would shift costs onto remaining customers. As a result, PacifiCorp points out that it will receive a value in excess of two times the net book value, which is within the higher range of likely condemnation outcomes. All this effort has required significant management time and attention over the lengthy condemnation process. Furthermore, the company states that it pursued innovative income valuation and severance damage approaches and worked extensively with a number of appraisers to support its valuations and refute the City's attempts to value the Hermiston Properties at net book or salvage value.

Lastly, PacifiCorp cites the Commission's Order No. 00-112 regarding PacifiCorp's sale of its interest in the Centralia generating plant. In that order, the Commission recognized that it is appropriate to allocate a share of the gain on a sale of utility property to the utility (its shareholders) when the utility has contributed significantly to the creation of value in the sale. The purpose of such an allocation is "to provide an incentive to the utility to enhance the value of the plant and to use an asset sale process that is most likely to obtain the best price."

Staff has reviewed the application and PacifiCorp's statements regarding its efforts in obtaining a substantially higher value for the Hermiston Properties than what the City proposed to the court in the condemnation proceeding and initially offered in the subsequent negotiations to establish a purchase price. Specifically, in response to Staff Data Request No. 3, PacifiCorp provided a detailed, comparative revenue requirement analysis, before and after the Hermiston Properties sale. This analysis demonstrated to Staff that the company's remaining customers would not be worse off (harmed), but in fact, would be better off (benefited) by the sale of the Hermiston Properties. In particular, the analysis showed that without Hermiston, two major operating expenses, namely power supply and distribution were materially reduced.

Staff, on the other hand, was troubled by the content of PacifiCorp's response to Staff Data Request No. 4. In that response, the company admitted it did not track its internal costs of labor and other relevant internal expenses until 2001, even though the project began in 1997 and continued in earnest from 1998 through at least mid July 2001. This laxity in regulated record keeping results in a poor audit trail for the Commission.

Transfer of Service Territory – PacifiCorp is proposing to transfer essentially its service territory that has provided electricity to the City of Hermiston. There are, however, some properties, although a very small portion of the total number of properties in the sale, that are legally outside the City that will also be transferred, as these customers can then be more efficiently served by the City rather than by the company upon completion of the sale. The proposed transfer of service territory is consistent with ORS 758.470.

Public Interest Compliance – PacifiCorp's sale of the Hermiston Properties is in the public interest (customarily a no harm standard applied by the Commission) as required pursuant to ORS 757.480. In particular, the City's alleged value of \$3,266,900, had it been upheld by the Court, would have been less than half of the subsequently negotiated sale price of \$8,000,000. As a result, and as described above, PacifiCorp's remaining customers are not harmed by this transaction, because they are not worse off after the sale. In fact, the remaining customers are benefited by the sale, because their cost of service will be less than it was before the sale.

Records Availability, Audit Provisions, and Reporting Requirements – Proposed ordering condition No. 1 provides the necessary records access to PacifiCorp's relevant books and records.

CONCLUSIONS:

Based on an investigation and review of the application, I conclude the following:

1. PacifiCorp is a regulated electric company, subject to the jurisdiction of the Public Utility Commission of Oregon.
2. The electric properties sale and transfer of PacifiCorp electric service territory at Hermiston, Oregon is not contrary to the public interest.

DETAILED RECOMMENDATION:

I recommend that the Commission approve PacifiCorp's application for the Sale of its Electric Properties and the Transfer of its Service Territory at Hermiston, Oregon and include the following Commission conditions in this matter:

1. PacifiCorp shall provide the Commission access to all its books of account, as well as all its documents, data, and records that pertain to the property sale to the City of Hermiston. Additionally, PacifiCorp shall provide copies of all journal entries and final documents regarding the property sale to the City of Hermiston.
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 Agreement, including any material changes in any revenue or cost. Any

changes to the terms which alter the intent and extent of activities under the Agreement from those approved herein shall be submitted in an application for a supplemental order (or other appropriate format) in this docket.

4. For accounting purposes, PacifiCorp shall record the after tax net gain on its regulated books of account by allocating 95 percent of this net gain to its customers. The estimated pre-tax gain is about \$4.2 million.