



State of Utah

DEPARTMENT OF COMMERCE
Division of Public Utilities

APPROVED BY COMMISSIONERS

BRIAN T. STEWART *BTS 1/16/91*
JAMES M. DYRNE *JMD 12/20/91*
STEPHEN C. HEWLETT *SH 12/20/91*

Norman H. Bangert
Governor

David L. Buhler
Executive Director

Frank Johnson
Division Director

Heber M. Wells Building
160 East 300 South/P.O. Box 45802
Salt Lake City, Utah 84145-0802
(801) 530-6651

M E M O R A N D U M

Date: December 9, 1991

To: Utah Public Service Commission

From: Frank Johnson, Division Director *FJ*
Wesley Huntsman, Manager, Management Analysis *Wesley*
Ken Powell, Manager, Electric Utility Section *KP*
Division Of Public Utilities (DPU)

Copies: Steven L. Walton, Director Economic Regulation
Utah Power & Light (UP&L)

Subject: UP&L Transfer Pricing Policy pursuant to Docket No.
87-035-27 order.

Introduction

On October 24, 1991, the Division of Public Utilities (DPU) received a copy of the Company's proposed Transfer Pricing Policy and a cover memo to the Commission dated October 18, 1991 (See attachment # 1). The Transfer Pricing Policy had also been the subject of several data requests and discussions in the UP&L Rate Case No. 90-035-06.

Recommendation

The Commission should approve the proposed Transfer Pricing Policy, but in so doing, it should specifically state that it is not preapproving costs incurred by Utah Power & Light through transactions with affiliates under the Policy.

Additionally, the Commission should require documentation and justification whenever qualitative factors are utilized to assert that affiliate transactions are in compliance with the Transfer Pricing Policy.

The policy should be used as a general statement of intent against which specific future transactions will be measured to determine whether affiliate transactions are in the public interest and result in reasonable costs and revenues.

Details

During the PacifiCorp & UP&L merger case (Case No. 87-035-27), the Division expressed concerns about the pricing of goods and services provided by an affiliate to the merged company utility operations (See filed testimony of W. Huntsman, attachment # 2). During the merger proceedings, the Company indicated its intent to assure that affiliated transactions resulted in fair transactions and did not subsidize unregulated affiliates.

The Commission concurred with the Division's recommendations in the merger case and among the conditions stated for its merger approval was a requirement (No. 17) that: "The Merged Company shall adopt a transfer pricing policy regarding the pricing of goods and services and the transfer of assets and submit an application for the Commission's review and approval of such pricing policy."

Specifically regarding provisions of the proposed Transfer Pricing Policy, the Division is concerned that the wording to recognize the importance of qualitative factors in paragraph A of the Exchange of Goods and Services section does not specify the necessity for documenting and justifying the use of qualitative factors in relation to the specific quantitative pricing elements. In addition, The Division assumes that the rate of return included under the policy for goods and services provided by Electric Operations to affiliated Companies will be no lower than the Commission authorized rate of return, otherwise a subsidy would occur.

At the time the Division filed testimony in the rate case (Case No. 90-035-06) the Company's proposed Transfer Pricing Policy had not been finalized. Therefore, the Division testimony by witness W. Huntsman contained a general discussion regarding transfer pricing (See attachment # 3). In response to Division data request No. AI-10, the Company stated that: "The Company intends to engage in transactions which are mutually beneficial to electric customers and shareholders. In order to fully develop advantageous affiliate relationships, it is important to have the flexibility to develop prices which recognize the unique features of each transaction." (See attachment # 4)

Despite the apparent common interpretation of the general intent for affiliate transactions to avoid subsidization of unregulated affiliate operations and reasonable utility costs; the Company and the Division had different perspectives regarding specific charges for services provided by an affiliate in the rate case. Even though the revenue phase of the case has resulted in a stipulated settlement, it is clear that the parties did not agree on the appropriate costs which ratepayers should bear for Utility personnel usage of the Corporate aircraft operated by an unregulated affiliate. Therefore, it appears that specific case by case consideration of the reasonableness of affiliate charges under the Transfer Pricing Policy will be necessary.