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Department of Commerce

Division of Public Utilities

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TO: Public Service Commission

FROM: Division of Public Utilities
Chris Parker, Director
Artie Powell, Energy Manager
Thomas Brill, Technical Consultant
Carolyn Roll, Utility Analyst

DATE: August 4, 2011

RE: PacifiCorp Notice of Subsidiary Formation and Affiliate Transaction, Docket Nos. 05-035-54 and 11-999-01.

I. RECOMMENDATION (No Action)

In a letter dated June 21, 2011, PacifiCorp dba Rocky Mountain Power (Company) filed its Notice of Subsidiary Formation and Affiliate Transaction (Notice) pursuant to Commitment U3(1) and U3(2) in Docket No. 05-035-54 of the Company's intent to form a regulated affiliate, Fossil Rock Fuels (Fossil Rock). Based upon the following review, the Division of Public Utilities (Division) believes that PacifiCorp is generally in compliance with its Acquisition Commitment U3(1) and U3(2). At this time, the Division does not recommend any action.

II. ISSUE

The Company is forming Fossil Rock as a regulated subsidiary solely for the purpose of administering the Cottonwood mine leases, with Fossil Rock's business activities consolidated into the Company's results of operations for reporting purposes. The acquisition of the Cottonwood mine leases is in the public interest, since it ensures the Company has access to quality coal supplies necessary for continued operation of its coal-fired generation plants. The creation of a regulated subsidiary to administer these contracts is also in the public interest, and

both the Company and its customers benefit with the coal mine located adjacent to the Company's existing Trail Mountain mine. It is been a fairly common business practice on the part of PacifiCorp to have its coal-mining operations in a subsidiary rather than folded into its electric generation operations. This practice creates and allows for some distance between the Company's coal-mining operations and the Company's generation plant, transmission lines, and distribution facilities. For example, one reason for creating this "distance" may be for legal liability and related issues. PacifiCorp intends to form the Fossil Rock affiliate for the purpose of transacting business with the Company's regulated operation; its Notice serves to document an affiliate transaction with an Operating Agreement to be entered into by and between the Company and Fossil Rock. This Memorandum provides comments by the Division on the status of its review of the Company's supporting documents for this Notice. Commitment U3 maintains that PacifiCorp will notify the Commission in writing prior to implementation of a Company plan: 1) to form an affiliate for the purpose of transacting business with the Company's regulated operations; 2) to commence new business transactions between an existing affiliate and the Company; or 3) to dissolve an affiliate that has transacted substantial business with the Company. The Company has filed previous affiliate notice letters with the Commission in the past.

III. DISCUSSION

The Division meets with the Company on a regular basis for a briefing on the coal supply situation. In particular, declining coal quality has been an issue of concern. Utah coal mines face steady reserve depletion and difficult mining conditions. The Division notes that the Company has made a good faith effort to keep it apprised of the Company's coal supply plans and activities. The Company intends to make a capital contribution of \$20,020,000 to Fossil Rock, which will use the contribution to acquire two leases related to the Cottonwood coal mine. As part of a settlement of litigation the Company brought against Arch Coal Sales Company (Arch Coal), the Company received the right to mine coal minerals in the Cottonwood coal mine. These coal reserves are intended to be used to supply coal to the Company's generation plants. Fossil Rock is scheduled to accept transfer of the coal leases for the purchase price payment of

\$20,020,000 as well as the assumption of the remaining lease payment of \$5,000,000. The purchase price of \$20,020,000 plus the remaining lease payment of \$5,000,000 is equivalent to Arch Coal's original bid and obligations for these coal leases when Arch Coal acquired them from the Utah State Institutional Trust Lands Administration (SITLA).

The Division met with the Company in order to review documents associated with the Arch Coal Settlement Agreement. The Arch Coal Settlement Agreement included several exhibits. These exhibits covered an addendum to the coal supply agreement; Arch Coal "work products" associated with the Cottonwood mine lease (such as survey information); a list of permitting actions; two approvals of assignments of the Cottonwood leases from Arch Coal to Fossil Rock; a notice of dismissal without prejudice; and the two original leases dated January 18, 2008.¹ When the Division met with the Company in February 2011 to review coal issues for the current rate case (Docket No. 10-035-124), the Company explained that it was currently negotiating with Arch Coal to extend the current coal supply agreement that had expired on December 31, 2010. At that time the Company could not discuss any of the specific information included in the coal supply agreement.

IV. CONCLUSION

Based upon the review of the Notice of Subsidiary Formation and Affiliate Transaction and the Operating Agreement of Fossil Rock Fuels, LLC, as well as the review of supporting documents, the Division believes that PacifiCorp is substantially in compliance with its Acquisition Commitment U3(1) and U3(2). The Division also notes that the Company has made a good faith effort to keep it apprised of the Company's coal supply plans and activities.

cc Dave Taylor, Rocky Mountain Power
Michele Beck, Office of Consumer Services

¹ A subsidiary of Arch Coal known as Ark Land was the actual entity that held the Cottonwood leases.