



OFFICE OF THE ILLINOIS STATE TREASURER
MICHAEL W. FRERICHS

January 27, 2021

Gregory E. Abel
Director and Vice Chairman
Berkshire Hathaway Inc.
3555 Farnam Street
Omaha, NE 68131

Re: Use of Reverse Auction Bidding at Berkshire Hathaway Energy

Dear Mr. Abel,

I am writing as a long-term investor seeking to discuss Berkshire Hathaway Energy's use of reverse auction/e-auction bidding for the procurement of construction services and learn about board oversight and risk assessment activities related to this practice.

As the Treasurer of the State of Illinois, I am responsible for safeguarding and prudently investing \$35 billion on behalf of taxpayers, retirement and college savers, and units of local government. To effectively execute my fiduciary duties as State Treasurer, my office and our investment service providers actively engage portfolio companies to address material and relevant investment risks and encourage increased transparency and reporting – all of which serves the mutual interests of shareowners and corporate managers.

In this case, we seek your assistance addressing viable questions about the integrity, longevity and safety of the company's energy infrastructure assets, given the company's use of e-auction bidding, and a description of the company's policy on reverse auction bidding with an assessment of the risks/benefits that this policy creates.

We are concerned that the use of reverse auction bidding for energy and pipeline infrastructure projects is inappropriate and presents elevated regulatory and operational risks

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to the company, and as such may increase the likelihood of adverse material impacts to investors.

Reverse auctions, which prioritize price at the expense of other deciding factors and incentivizes race-to-the-bottom bidding, is widely considered unsuitable for the acquisition of design and construction services, with criticism levied by and shared among numerous industry associations, professional trade groups, and government bodies (see attached document for a detailed summary of oppositional stances and government restrictions). Two of the most representative critiques, which echo the findings among stakeholders, are as follows:

- The U.S. Army Corps of Engineers (USACE), the largest and most experienced federal construction agency, found “their use of reverse auctions did not reduce costs in practice and that they are ill-suited to the variability and unpredictability that comes with construction projects.”¹
- The California Public Utilities Commission, which prohibits reverse auctions for utility construction contracting, emphasizes that reverse auctions can have adverse impacts on “worker safety, product safety, product quality and timeliness of project completion,” and that “reverse auctions may... motivate bidders to oversimplify the elements of a complex project and to emphasize price at the expense of other project criteria, such as long-term integrity, safety or quality.”²

Given the drawbacks of reverse auctions, several states have banned the practice for public construction projects, including Illinois, South Dakota, Tennessee, Kentucky, and Mississippi. At the federal level, a bipartisan group of lawmakers are pushing to prohibit the practice across federal construction contracts. The legislation, the Construction Consensus Procurement Improvement Act, passed the U.S. Senate in December 2019., and is likely to be reintroduced again this year.

Focusing further on the specific risks to Berkshire Hathaway Energy and its subsidiaries, the Pipeline Safety Trust, the leading organization promoting pipeline safety best practices in the United States, does not include use of reverse auctions for pipeline infrastructure projects as a best practice. With BHE’s purchase of Dominion Energy’s gas transmission assets, BHE will own 18% of all interstate gas transmission pipelines in the United States. More significantly, BHE’s subsidiary Northern Natural Gas holds more pre-1970 gas transmission lines than any other company in the United States, with more than 85% of its transmission lines installed before 1970.³ As such, Northern Natural Gas and BHE face considerable risks and costs related to asset modernization, pipeline integrity, and compliance.

¹ Country Buble, Government Executive, “Bipartisan Bill Would Ban Reverse Auctions for Federal Construction Contracts.” January 17, 2020, available at <https://www.govexec.com/management/2020/01/bipartisan-bill-would-ban-reverse-auctions-federal-construction-contracts/162528/>.

² State of California Public Utilities Commission, “Order Adopting Rules for Utilities Construction Contracting,” November 2, 2004, available at https://docs.cpuc.ca.gov/word_pdf/COMMENT_DECISION/41885.doc.

³ Tom DiChristopher, S&P Global, “With miles of aging pipe, midstream and utility giants face new compliance costs.” February 6, 2020. Available at <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/with-miles-of-aging-pipe-midstream-and-utility-giants-face-new-compliance-costs-56942555>.

We note that on October 30, 2020, the U.S. Pipeline and Hazardous Materials Safety Administration (PHMSA) sent a violation notice and compliance order to Norther Natural Gas for (1) failure to provide immediate notice of a gas leak in Iowa, (2) failure to perform a risk analysis to determine the effective preventive and mitigative measures, and (3) failure to maintain required construction, repair, and emergency planning procedures. Under 49 U.S.C. § 60122 and 49 CFR § 190.223, violators are subject to a civil penalty up to \$218,647 per violation per day as the violation persists, up to a maximum of \$2,186,465 for a related series of violations.⁴

With its aging pipeline infrastructure, we are concerned about the potential reoccurrence of such incidents (or more costly accidents), and with increased testing and maintenance requirements under the U.S. Pipeline Safety Act, it is vital that the company consider employing best-in-class procurement, construction and maintenance practices to ensure the long-term integrity of its infrastructure, protect the safety of workers, residents, and communities, and mitigate potential adverse material impacts to the company and its investors.

Our hope is that we can work with you to discuss enhanced bidding specifications to ensure that the most highly trained, well-qualified, and capable internal and contracted-out workforce are building and maintaining your energy assets, which offers a significant value-add to the company and long-term investors. We have reviewed what peers typically do in the energy industry and best practices tend to include the use of project labor agreements or best-value contracting metrics to procure construction services.

Given these matters of mutual interest, we would greatly appreciate your response and, as noted above, a description of the company's policy on reverse auctions/e-auctions with an assessment of the risks/benefits that this policy presents. We would also welcome the opportunity to meet with you and other company representatives via phone or videoconference. To that end, please direct correspondence to Max Dulberger, Director of Corporate Governance & Sustainable Investment, at mdulberger@illinoistreasurer.gov or (217) 843-0132.

Thank you for your time and attention.

Sincerely,



Michael W. Frerichs
Illinois State Treasurer

cc: William J. Fehrman, President & CEO, Berkshire Hathaway Energy
Cathy S. Woollums, Senior Vice President & Chief Sustainability Officer, Berkshire Hathaway Energy
Jeffery B. Erb, Corporate Secretary and Chief Corporate Counsel

⁴ Mary Louis McDaniel, Director, Southwest Region, U.S. Pipeline and Hazardous Materials Safety Administration, "Notice of Probable Violation and Proposed Compliance Order," October 30, 2020.

POSITIONS ON REVERSE AUCTIONS AMONG INDUSTRY ASSOCIATIONS, PROFESSIONAL TRADE GROUPS, AND GOVERNMENT BODIES

- The U.S. Army Corps of Engineers (USACE), the largest and most experienced federal construction agency, emphasizes that reverse auctions, while useful for commodities purchases, are inappropriate for construction services acquisitions. USACE reports that the use of reverse auctions “for the purchase of construction services where the dynamics and variables are just too diverse and should be the very rare exception and not the rule – if used at all.”¹
- The Association of General Contractors (AGC), which represents over 25,000 construction contractors, suppliers and service providers across the nation, has consistently advocated for legislation to prohibit the use of reverse auctions for construction projects, emphasizing that “vendors that promote reverse auctions for construction services misuse a procurement process originally designed for commodities. It ignores the unique nature of construction.”²
- The Construction Industry Procurement Coalition, made up of several leading industry associations, advocate for legislation prohibiting federal agency use of reverse auctions for design and construction services. Members of the coalition include:
 - American Council on Engineering Companies
 - American Institute of Architects
 - American Society of Civil Engineers
 - American Subcontractors Association, Inc.
 - Association of General Contractors
 - Construction Management Association of America
 - Council on Federal Procurement of Architectural and Engineering Services
 - Design Build Institute of America
 - Independent Electrical Contractors
 - National Association of Surety Bond Producers
 - National Electrical Contractors Association
 - National Society of Professional Surveyors
 - Management Association for Private Photogrammetric Surveyors
 - Surety & Fidelity Association of America³
- The Pipeline Safety Trust, one of the leading organizations promoting pipeline safety best practices nationally, expresses opposition to the use of reverse auction bidding for pipeline infrastructure projects.

¹ <https://www.gao.gov/assets/660/659530.pdf>

² <https://archives-veterans.house.gov/witness-testimony/mr-nigel-cary>

³ <https://cofpaes.org/wp-content/uploads/2017/10/COFPAES-Cosigns-Coalition-Letter-on-NDAA-11-18-2014.pdf>

and

https://cdn.ymaws.com/www.nspis.us.com/resource/resmgr/govt_affairs/2017_March_NSPS_JGAC_Governm.pdf

In addition to scrutiny among industry and trade groups, federal and state lawmakers have taken action prohibit the practice for design and construction projects. On the federal level, the Construction Consensus Procurement Improvement Act bans the use of reverse auctions for federal construction projects (Senate Bill 1434 sponsored by Sen. Portman, Rob [R-OH] & Sen. Hirono, Mazie K. [D-HI]⁴ and House Bill 5644 sponsored by Rep. Meadows, Mark [R-NC-11] & Rep. Khanna, Ro [D-CA-17]).⁵ The U.S. Senate passed this legislation on December 19, 2019,⁶ though it was not taken up by the House (but will certainly be reintroduced).

In its analysis of the legislation, the U.S. Congressional Budget Office found that “reverse auctions have not been suitable for complex contracts like design and construction services because they do not consistently result in procurement costs that are lower than what would result from other contracting methods such as sealed bids or negotiated procurements.”⁷

Beyond ongoing federal efforts to restrict the practice, numerous states have acted:

- Illinois statutes permitting reverse auctions in procurement explicitly exclude contracts for construction projects. (30 ILCS 500/20-10)
- The California Public Utilities Commission prohibits reverse auctions, noting that reverse auctions had adverse impacts on “worker safety, product safety, product quality and timeliness of project completion.” The Commission ruled that “reverse auctions may...motivate bidders to oversimplify the elements of a complex project and to emphasize price at the expense of other project criteria, such as long-term integrity, safety or quality.”
- Tennessee excludes construction from reverse auctions. (Tenn. Code Ann. § 12-3-513)
- Kentucky excludes construction from reverse auctions. (§§ 45A.005 — 45A.990)
- Mississippi excludes design or construction of public infrastructure from reverse auctions. (Miss. Code Ann. § 31-7-13)
- South Dakota bans reverse auctions for infrastructure improvements.⁸

⁴ <https://www.congress.gov/bill/116th-congress/senate-bill/1434/all-info?r=1&s=4>

⁵ <https://www.congress.gov/bill/116th-congress/house-bill/5644/text?q=%7B%22search%22%3A%5B%22%5C%22reverse+auction%5C%22%2C+construction%2C+procurement%22%5D%7D&r=2&s=1>

⁶ <https://www.congress.gov/bill/116th-congress/senate-bill/1434/all-info?r=1&s=4#cosponsors-content>

⁷ <https://www.congress.gov/116/crpt/srpt100/CRPT-116srpt100.pdf>

⁸ https://sdlegislature.gov/Statutes/Codified_Laws/DisplayStatute.aspx?Type=Statute&Statute=5-18A-39