STATE OF UTAH

BEFORE THE

PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE APPLICATION OF	)	
PACIFICORP AND SCOTTISHPOWER PLC	)	**DOCKET NO. 98-2035-04**
FOR AN ORDER APPROVING THE ISSUANCE	)	
OF PACIFICORP COMMON STOCK	)	

DIRECT TESTIMONY
DR. DENNIS W. GOINS
ON BEHALF OF
NUCOR STEEL

Q. PLEASE STATE YOUR NAME, OCCUPATION, AND BUSINESS ADDRESS.

A. My name is Dennis W. Goins. I operate Potomac Management Group, an economics and management consulting firm. My business address is 5801 Westchester Street, Alexandria, Virginia 22310.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND.

A. I received a Ph.D. degree in economics and a Master of Economics degree from North

Carolina State University. I also earned a B.A. degree with honors in economics from Wake Forest University. From 1974 through 1977 I was employed as a staff economist by the North Carolina Utilities Commission. During my tenure at the Commission, I testified in numerous cases involving electric, gas, and telephone utilities on such issues as cost of service, rate design, intercorporate transactions, and load forecasting. While at the Commission, I also served as a member of the Ratemaking Task Force in the national Electric Utility Rate Design Study sponsored by the Electric Power Research Institute (EPRI) and the National Association of Regulatory Utility Commissioners (NARUC).

Since 1978 I have worked as an economic and management consultant to firms and organizations in the private and public sectors. My assignments focus primarily on market structure, planning, pricing, and policy issues involving firms that operate in regulated markets. For example, I have conducted detailed analyses of cost of service, rate design, and power supply and fuel transaction issues; developed product pricing strategies to respond to market conditions and competitive pressures; evaluated and developed regulatory incentive mechanisms applicable to utility operations; and assisted clients in analyzing and negotiating interchange agreements and power and fuel supply contracts. I have also assisted clients participating in electric utility restructuring proceedings in New Jersey, New York, South Carolina, and Virginia, and have been involved in several cases before the Federal Energy Regulatory Commission involving such issues as utility mergers, market power, and transmission access and pricing.

I have filed testimony and reports in more than 90 proceedings before state and federal agencies as an expert in utility planning and operating practices, competitive market issues, regulatory policy, cost of service, and rate design. These agencies include the Federal Energy Regulatory Commission, the United States Court of Federal Claims, the Circuit Court of Kanawha County, West Virginia, and regulatory agencies in Arkansas, Georgia, Illinois, Louisiana, Maine, Massachusetts, Minnesota, New Jersey, New York, North Carolina, Ohio, Oklahoma, South Carolina, Texas, Utah, Vermont, Virginia, and the District of Columbia. I have previously assisted clients in cases before the Utah Public Service Commission involving Utah Power (Docket Nos. 89-039-10, 85-035-01, 84-035-01) and Mountain Fuel Supply (Docket No. 93-057-01). In addition, I participated in the merger case before FERC involving Pacific Power & Light and Utah Power & Light (Docket No. EC88-2-007).

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. I am appearing on behalf of Nucor Steel, a division of Nucor Corporation. Nucor owns and operates a steel mill in Plymouth, Utah, which is served by PacifiCorp (doing business as Utah Power) under a special contract approved by this Commission.

Q. WHAT ASSIGNMENT WERE YOU GIVEN WHEN YOU WERE RETAINED?

A. I was asked to review and evaluate the proposed merger between PacifiCorp and ScottishPower plc ("Applicants") and determine whether the merger as filed with the Commission meets the "public interest" standard under which the Commission evaluates utility mergers. In conducting my review and evaluation, I relied primarily on documents filed by the Applicants, including their responses to discovery requests in this case and in concurrent merger-related proceedings in other regulatory jurisdictions. In addition, I relied on such merger-related materials as those found on PacifiCorp's Web site.

CONCLUSIONS

Q. WHAT HAVE YOU CONCLUDED ABOUT THE PROPOSED MERGER?

A. On the basis of my review and evaluation, I have concluded that:

1. The merger should be approved only if it is in the public interest, defined as producing "positive benefits" in which ratepayers share.
2. Quantifiable merger savings are relatively meager—about $10 million annually in reduced corporate costs. Although ScottishPower has identified other potential cost-saving areas, it cannot quantify such savings in a meaningful way

that would ensure benefit to ratepayers.

3. ScottishPower has identified several post-merger service quality improvements it hopes to effect, and proposed service quality standards that will result in penalty payments if the standards are not met. These identified service quality improvements and standards could be adopted and implemented by the Commission and PacifiCorp absent the merger. That is, the service quality improvements and standards are not a benefit unique to the merger. Moreover, the proposed penalty payments to commercial and industrial customers are insignificant—far less than estimated outage costs for these customers.
4. ScottishPower has made no guarantee that it will not attempt to recover from ratepayers the large acquisition premium (up to $1.6 billion) that it is paying for PacifiCorp.
5. The acquisition premium's magnitude may put significant pressure on ScottishPower to raise rates or sell existing valuable generation and transmission assets.
6. ScottishPower has not proposed specific methods for sharing with ratepayers the merger's alleged benefits—for example, a rate reduction corresponding to a reasonable sharing of potential savings.
7. ScottishPower's proposal to develop an additional 50 MW of renewable resources is inconsistent with PacifiCorp's integrated resource plan and is not beneficial to ratepayers.

RECOMMENDATIONS

Q. WHAT ARE YOUR RECOMMENDATIONS REGARDING THE PROPOSED MERGER?

A. I recommend that the Commission reject the proposed merger as filed since it does not meet the public interest standard. However, if it approves the merger, the Commission should impose conditions that will ensure ratepayers receive significant merger-related benefits. Specifically, the Commission should:

1. Prohibit recovery of the merger acquisition premium in base rates unless ScottishPower demonstrates with reasonable certainty that quantified merger-related benefits equal or exceed the acquisition premium it is paying for PacifiCorp.
2. Impose an immediate across-the-board base rate reduction applicable to non-special contract customers and a post-reduction 5-year rate freeze applicable to all customers. The magnitude of the rate reduction should reflect a reasonable sharing of merger-related cost savings between ratepayers and ScottishPower. Existing contracts with industrial customers should be extended (at the customer's option) to coincide with the 5-year rate freeze to ensure that all PacifiCorp customers receive the rate freeze's protection and benefit. If the Commission elects not to freeze special contract customers' rates for 5 years, then they should be allowed to choose their electricity supplier when their contracts expire subject to rules and guidelines set by the Commission.
3. Require ScottishPower to forego any generation- and transmission-related stranded cost recovery on existing domestic plant and equipment.
4. Require ScottishPower to file a plan for immediate retail access in Utah if it initiates sales of existing PacifiCorp domestic generation and/or transmission assets (excluding assets currently planned for divestiture) to a third party.
5. Increase the proposed reliability penalty payments to commercial and industrial customers to enhance ScottishPower's incentive to achieve the proposed reliability improvements.
6. Require ScottishPower to absorb any costs associated with developing resources that do not meet standards established in PacifiCorp's existing resource planning process.

PUBLIC INTEREST STANDARD

Q. PLEASE DESCRIBE THE PUBLIC INTEREST STANDARD AGAINST WHICH THE MERGER SHOULD BE EVALUATED.

A. The Utah Code states that "[n]o utility shall combine, merge nor consolidate with another public utility engaged in the same general line of business in this state, without the consent and approval of the Public Utilities Commission, which shall be granted only after investigation and hearing and finding that such proposed merger, consolidation or combination is in the public interest."[1] In a 1987 order addressing the standard for approving proposed electric utility mergers, the Commission adopted the "positive benefits" standard for determining whether a merger is in the public interest. Under this standard, the applicants have the burden to demonstrate that "on balance the merger as proposed will result in benefits not otherwise enjoyed," [2] implying that a merger must result in tangible benefits that could not be realized absent the merger.

In its final order approving the Utah Power & Light/PacifiCorp merger, the Commission applied the positive benefits test to a number of issues. [3] The Commission found that the merger applicants had not adequately quantified benefits in selected areas.[4] Moreover, because of the lack of benefit quantification in certain areas and concerns regarding such issues as local control, the Commission imposed a number of conditions on the merger. The Commission concluded that the merger, subject to the stated conditions, was "in the public interest because the expected benefits of the merger to the Utah jurisdiction outweigh[ed] the costs and detriments associated with it."[5]

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[1] Utah Code § 54-4-28.
[2] 90 PUR 4th at 555 (Utah P.S.C. 1987).
[3] 97 PUR 4th at 79, 98-116 (Utah P.S.C. 1988).
[4] 97 PUR 4th at 101.
[5] 97 PUR 4th at 125.

Q. DOES THE PUBLIC INTEREST STANDARD REQUIRE APPLICANTS TO DEMONSTRATE BENEFITS THAT COULD NOT BE ACHIEVED ABSENT THE MERGER?

A. Yes. As I stated earlier, merger applicants must demonstrate that "on balance the merger as proposed will result in benefits not otherwise enjoyed."

Q. DOES THE PUBLIC INTEREST STANDARD REQUIRE THAT MERGER-RELATED COSTS AND BENEFITS BE QUANTIFIED?

A. Yes. On the basis of my interpretation of the Commission's prior orders discussed earlier, I believe that reasonable estimates of a merger's costs and benefits must be used to determine whether a merger is in the public interest. Pre-approval quantification of merger benefits provides assurance that a merger is in the public interest, establishes the post-merger framework for determining whether benefits are being achieved, and eliminates reliance on promises and unsupported claims.

ALLEGED MERGER BENEFITS

Q. HAVE THE APPLICANTS ASSERTED THAT BENEFITS WILL RESULT FROM THE MERGER?

A. Yes. ScottishPower has identified numerous qualitative and quantitative benefits allegedly attributable to the merger.[6] These alleged benefits include:

- Net $10 million annual reduction in corporate costs achieved by the end of the third year following completion of the merger.
- Network performance improvements measured by benchmark standards accompanied by failure-to-achieve penalties. Specifically, over the next five years ScottishPower plans to improve system availability (measured by SAIDI[7]) and system reliability (measured by SAIFI [8]) by 10 percent, and to reduce

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[6] Alan V. Richardson, supplemental testimony, Ex. SP_(AVR-1).
[7] System Average Interruption Duration Index.
[8] System Average Interruption Frequency Index.

momentary interruptions (measured by MAIFI[9]) by 5 percent.

- Customer service performance improvements measured by benchmark standards accompanied by failure-to-achieve penalties.
- Pledge to develop an additional 50 MW of renewable resources costing approximately $60 million.

Q. HAS SCOTTISHPOWER QUANTIFIED THE MERGER'S ANNUAL COST SAVINGS?

A. No. With the exception of the $10 million net annual reduction in corporate cost, ScottishPower has not quantified annual cost savings from the various initiatives it proposes to undertake when the merger is completed. ScottishPower has provided information concerning the value of reliability measured by customers' outage costs, and also claims that its proposed network system improvements measured by SAIDI and MAIFI create about $60 million in annual benefits to ratepayers.[10]

Q. DO YOU AGREE WITH THE APPLICANTS' ESTIMATED MERGER BENEFITS?

A. No. I am not at this time taking a position regarding the estimated $10 million net annual reduction in corporate costs, although at least part of these benefits would likely occur absent the merger under PacifiCorp's new focused effort to reduce operating costs and overhead.

I have serious concerns regarding ScottishPower's $60-million estimate of annual benefits from network system improvements. Some monetary benefit to customers will occur if reliability increases. However, the key issue is whether the cost of reliability improvements exceeds the value that customers place on such incremental improvements. ScottishPower has neither quantified the cost of meeting

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[9] Momentary Average Interruption Frequency Index.

[10] Alan V. Richardson, supplemental testimony, page 19 and Ex. SP_(AVR-2).

the incremental reliability improvements, nor demonstrated that customer benefits outweigh such cost. For example, ScottishPower's estimation technique is similar to asking a customer to pay $150 for a computer power supply backup system and still incur four momentary interruptions each year. The customer would not accept such a deal, and neither should Utah ratepayers unless and until ScottishPower provides a benefit-cost analysis of its proposed network system improvements.

Q. ARE SIGNIFICANT MERGER-RELATED COST SAVINGS ACHIEVABLE IN THE NEAR-TERM?

A. No. Witness Robert D. Green addressed this issue succinctly.

> This transaction presents *very limited opportunities for achieving immediate cost savings*. Unlike most other U.S. utility mergers, there are *no significant, redundant corporate operations* to be eliminated, *nor are there synergies* to be obtained in combining operating systems. Over time, however, the improvement in operating performance achieved by ScottishPower will lead to cost savings resulting in rates lower than they would have been without the transaction.[11] (emphasis added)

Q. ARE THE UNQUANTIFIED MERGER BENEFITS SUFFICIENT FOR THE MERGER TO MEET THE PUBLIC INTEREST STANDARD?

A. No. ScottishPower is unable to quantify the vast majority of alleged merger benefits. While I do not doubt ScottishPower's sincerity in believing the merger will produce the alleged benefits, the Commission and Utah's ratepayers should rely on more than mere statements and promises that the benefits will be achieved. More importantly, if the Commission determines that PacifiCorp's customer service is currently inadequate, the Commission can impose additional customer-service standards backed up by its ratemaking and regulatory authority regardless whether the merger occurs. In my opinion, the Commission should consider the unquantified merger benefits in its public interest deliberations only if it:

- Accepts that ScottishPower's claimed corporate turnaround capabilities can

[11] Robert D. Green, direct testimony, page 4.

effectively and efficiently be transferred to PacifiCorp

- Determines that PacifiCorp's current management is incapable of remedying any identified service quality deficiencies in the near future.

MERGER-RELATED COSTS AND RISKS

Q. DOES THE MERGER IMPOSE ANY COSTS AND RISKS FOR PACIFICORP'S CUSTOMERS?

A. Yes. Certain aspects of the proposed merger may pressure ScottishPower to seek rate increases in PacifiCorp's regulatory jurisdictions and/or impose cost reductions leading to deterioration in service quality and reliability. Whether the risk of price increases and/or lower service quality and reliability is offset by merger benefits is unknown since ScottishPower has not quantified merger-related benefits. Moreover, Utah customers face these merger-related risks without a guaranteed share of any achieved merger-related cost savings. Finally, the merger precludes PacifiCorp's merger with a domestic utility with which it may have more obvious corporate synergies.

<u>Rate Increase Pressure</u>

Q. WILL THE MERGER INCREASE PRESSURE TO RAISE PRICES?

A. Yes. Two merger-related factors—speculative cost savings and the large acquisition premium—may ultimately force ScottishPower to seek base rate increases in PacifiCorp's regulatory jurisdictions.[12] One of ScottishPower's objectives appears to be pushing PacifiCorp's earned return up to the regulatory ceiling, in large part by capturing merger-related cost savings for shareholders. If the claimed cost savings do not materialize, then ScottishPower's most readily available options to meet this

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[12] These two factors ignore others—for example, cost of investments to improve service, transaction costs, promised dividends, and transition costs—that may pressure ScottishPower to seek rate increases.

objective are base rate increases from PacifiCorp's customers and/or cost reductions that may lead to deterioration in service quality and reliability.[13]

Q. WHAT IS THE SIZE OF THE ACQUISITION PREMIUM?

A. According to information presented in the Utah and Oregon merger-related cases, the acquisition premium ranges from $1.3 billion [14] to $1.6 billion.[15] (The estimated premium depends on the stock prices used.) Regardless of the precise acquisition premium value, we can conclude that ScottishPower paid a significant premium for PacifiCorp.

Q. HOW WILL THE ACQUISITION PREMIUM BE TREATED FOR RATEMAKING PURPOSES?

A. ScottishPower apparently plans to reflect the acquisition premium in PacifiCorp's future base rates. That is, we can reasonably assume that ScottishPower will try to earn a return on and return of the acquisition premium through rates. For example, ScottishPower says::

> …Scottish Power does not separate the premium [from the purchase price], and will seek a return on its total investment. ScottishPower intends to earn a return on the transaction price by ensuring that PacifiCorp consistently earns its permitted rate of return.[16]

If projected costs savings are not realized or realized much slower than expected, ScottishPower will be pressured to try and recover the acquisition premium through a base rate increase. Alternatively, ScottishPower may elect to reduce expenditures on system performance improvements and cut back on basic maintenance expenses,

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[13] Another option is asset divestiture—particularly valuable generation and transmission assets. The only currently planned divestitures are those previously announced by PacifiCorp.

[14] Oregon Public Service Commission, Docket No. 98-2035-04, ScottishPower's response to UIEC Merger Data Request No. 11.7.

[15] Oregon Public Utility Commission, Docket No. UM 918, John S. Thornton, Jr., direct testimony, page 4.

[16] Oregon Public Service Commission, Docket No. 98-2035-04, ScottishPower's response to UIEC Merger Data Request No. 14.3.

resulting in poorer quality and less reliable service.

Q. IS IT REALISTIC TO BELIEVE THAT SCOTTISHPOWER WOULD REDUCE SERVICE QUALITY AND RELIABILITY SIMPLY TO RECOVER THE ACQUISITION PREMIUM?

A. Yes. ScottishPower's primary objective is (and should be) to protect and enhance the value of its shareholders' investment. If it becomes necessary to cut budgets below levels necessary to make PacifiCorp a "top-10 utility" to meet ScottishPower's earning goals and to recoup the acquisition premium, then we should reasonably expect that ScottishPower will make such cuts.[17]

Uncertain Benefits

Q. ARE UTAH RATEPAYERS GUARANTEED A SHARE OF THE MERGER'S BENEFITS?

A. No. ScottishPower indicates that merger-related cost savings will mitigate pressure for rate increases. However, in addition to being unable to quantify most of the merger's alleged benefits, ScottishPower makes no affirmative proposal to share realized merger benefits immediately or in the near-term with Utah ratepayers via a base rate reduction. For example, witness Robert D. Green says that "[w]ithout any firm assurances that such cost savings are available, it would be premature to reflect these hoped-for cost reductions in rates."[18]

Q. ARE UTAH RATEPAYERS PROTECTED IF THE APPLICANTS FAIL TO ACHIEVE THE ALLEGED MERGER BENEFITS?

A. No. Post-merger regulatory protection cannot undo a merger and its ill effects. Moreover, as I discussed earlier, the merger puts significant pressure on ScottishPower to raise rates and/or cut operating and maintenance budgets below acceptable levels if

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[17] A recent coach trip on most major airlines should sufficiently demonstrate that companies can and will reduce service quality if necessary to enhance shareholder returns.

[18] Robert D. Green, direct testimony, page 5.

its management and operating initiatives do not reduce costs and increase earnings as planned. Although ScottishPower has agreed to some modest penalties if it fails to achieve the promised network and customer service performance improvements, the proposed penalties are not adequate compensation for merger-related risks imposed on ratepayers.

Q. CAN THE MERGER BE UNDONE IF THE CLAIMED MERGER BENEFITS ARE NOT ACHIEVED?

A. I do not know the legal answer. However, from a practical standpoint, the answer is no. Once the merger is completed, an intense regulatory game of "estimate the benefits" will ensue, even though reasonable techniques to quantify the merger's benefits may never be found. At the end of the transition for system improvements and thereafter, we may find that customers are no better off (and possibly worse off) than they would have been if PacifiCorp had remained an independent company. The risk of not achieving the alleged merger benefits is simply unacceptable.

Q. ARE THE APPLICANTS' CLAIMS REGARDING THE CORPORATE TURNAROUND AND RELATED COST SAVINGS AT MANWEB DIRECTLY APPLICABLE TO PACIFICORP?

A. No. ScottishPower does not identify similar cost and operating conditions at Manweb that are directly applicable to PacifiCorp. We are simply asked to believe that ScottishPower can replicate at PacifiCorp its alleged management turnaround at Manweb.

Q. SHOULD WE RELY ON THE APPLICANTS' COST-SAVING CLAIMS AS AN OFFSET TO THE MERGER'S RISKS?

A. No. ScottishPower used a benchmarking to estimate potential cost savings arising from making PacifiCorp a "top-10 utility." Specifically, ScottishPower estimated that PacifiCorp's average non-production cost per customer is about $100 higher than the "top 10" domestic utilities.[19] Reducing PacifiCorp's non-production cost per customer by $100 implies around $130 million annual savings (assuming PacifiCorp serves 1.3 million customers). If ScottishPower believes it can achieve such significant reductions in PacifiCorp's non-production operating costs, then it should commit to sharing these savings with Utah ratepayers. Because ScottishPower has made no such commitment, the Commission should assume that ScottishPower's faith in the savings estimate is not as strong as its public statements. A famous president said that we should "trust, but verify." This statement is particularly applicable to ScottishPower's claims regarding cost savings.

RENEWABLE RESOURCE PROPOSAL

Q. DO THE APPLICANTS CLAIM THAT THE MERGER PRODUCES SIGNIFICANT ENVIRONMENTAL BENEFITS?

A. Yes. One of the major claimed benefits is a commitment to spend up to $60 million to develop 50 MW of additional renewable resources.

Q. SHOULD THIS COMMITMENT BE CONSIDERED A MERGER BENEFIT?

A. No. First, if investment in additional renewable resources is needed, PacifiCorp can undertake such investment absent the merger—that is, ScottishPower is not needed to ensure that such resources are developed. Second, 50 MW of additional renewable resources may be unneeded. PacifiCorp's recent Resource and Market Planning Program analysis (RAMPP-5, December 1997) indicates that gas-fired resources—not renewable resources—are its least-cost supply-side option, and that no new resources are needed for several years.

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[19] Andrew MacRitchie, direct testimony, Ex. SP_(AM-1).

RATEPAYER SAFEGUARDS

Q. SHOULD THE COMMISSION APPROVE THE MERGER AS FILED?

A. No. The merger as filed is plainly not in the public interest. The merger creates no significant, quantitative benefits. Moreover, even alleged qualitative benefits (that cannot be measured) are uncertain, and could possibly be achieved absent the merger. In addition, the merger imposes risks of future rate increases and/or deterioration in service quality and reliability.

Q. IF THE COMMISSION APPROVES THE MERGER, SHOULD IT IMPOSE CONDITIONS TO PROTECT RATEPAYERS?

A. Yes. The Commission should impose conditions to:

- Provide assurance that the merger's alleged benefits are achieved
- Ensure that ratepayers share in achieved merger benefits
- Insulate ratepayers from potential merger-related risks.

Q. WHAT CONDITIONS SHOULD THE COMMISSION IMPOSE ON THE PROPOSED MERGER?

A. The Commission should:

1. Prohibit recovery of the merger acquisition premium in base rates unless ScottishPower demonstrates with reasonable certainty that quantified merger-related benefits equal or exceed the acquisition premium it is paying for PacifiCorp.
2. Impose an immediate across-the-board base rate reduction applicable to non-special contract customers and a post-reduction 5-year rate freeze applicable to all customers.
3. Require ScottishPower to forego any generation- and transmission-related stranded cost recovery on existing domestic plant and equipment.
4. Require ScottishPower to file a plan for immediate retail access in Utah if it

initiates sales of PacifiCorp's existing domestic generation and/or transmission assets (excluding assets currently planned for divestiture) to a third party.

5. Increase the proposed reliability penalty payments to commercial and industrial customers to enhance ScottishPower's incentive to achieve the proposed reliability improvements.

6. Require ScottishPower to absorb any costs associated with developing resources that do not meet standards established in PacifiCorp's existing resource planning process.

Acquisition Premium Recovery

Q. WHY SHOULD THE COMMISSION PROHIBIT RECOVERY OF THE ACQUISITION PREMIUM IN BASE RATES?

A. As I noted earlier, ScottishPower's takeover precludes PacifiCorp's merger with a domestic utility with which it may have more obvious corporate synergies that create significant—and measurable—benefits. Because of uncertainty about the proposed merger's benefits, ratepayers should be protected from paying a premium for a company that already serves them.

Rate Reduction

Q. WHY IS AN IMMEDIATE BASE RATE REDUCTION NECESSARY IF THE COMMISSION APPROVES THE MERGER?

A. A rate reduction is necessary to protect non-special contract customers from merger-related risks, and to put meaning behind ScottishPower's numerous, and generally unsupported claims of merger benefits. If ScottishPower has faith in its estimates of merger-related cost savings, then it should back up that faith by sharing some of the cost savings with ratepayers now. In addition, the 5-year rate freeze for all customers is necessary to protect ratepayers from a post-reduction (or post-contract) series of rate increases. A base rate reduction and 5-year rate freeze would ensure that customers receive some tangible, positive benefit from the merger.

Q. WHAT PERCENTAGE RATE REDUCTION SHOULD BE IMPLEMENTED IF THE COMMISSION APPROVES THE MERGER?

A. I am not recommending a specific percentage reduction at this time. The magnitude of the rate reduction should reflect a reasonable sharing of merger-related cost savings between ratepayers and ScottishPower. If the parties cannot agree on a settlement rate cut, then the Commission should reduce rates enough to mitigate merger-related risks, but not enough to impair PacifiCorp's financial viability.

Q. SHOULD THE RATE REDUCTION APPLY TO ALL CUSTOMERS?

A. No. The rate reduction should apply only to non-special contract customers, although all customers—including special contract customers—should be covered by the 5-year rate freeze.

Q. HOW SHOULD SPECIAL CONTRACT CUSTOMERS BE TREATED UNDER THE 5-YEAR RATE FREEZE?

A. Existing contracts with industrial customers should be extended (at the customer's option) to coincide with the 5-year rate freeze to ensure that they—like tariff customers—receive some tangible, positive benefit from the merger. If the Commission elects not to freeze special contract customers' rates for 5 years, then they should be allowed to choose their electricity supplier when their contracts expire subject to rules and guidelines set by the Commission.

Stranded Cost Recovery and Asset Divestiture

Q. WHAT IS THE BASIS FOR YOUR RECOMMENDATION REGARDING STRANDED COST RECOVERY?

A. Stranded cost typically reflects the difference between the market value and embedded cost of a utility asset.[20] In making its bid for PacifiCorp, ScottishPower has explicitly valued PacifiCorp's assets and compensated investors responsible for creating those assets. I view ScottishPower's bid for PacifiCorp much as a third-party's bid for divested utility assets occurring today in states with retail access. The basic rule for such purchases is *caveat emptor*—let the buyer beware. ScottishPower is well aware of the movement in this country toward generation deregulation and retail access. The only question facing ScottishPower is when—not if—retail access will happen in PacifiCorp's service areas. This awareness implies that ScottishPower's bid price for PacifiCorp reflects the risk of less-than-total stranded cost recovery.

Q. WOULD PROHIBITING STRANDED COST RECOVERY BE UNFAIR TO CURRENT PACIFICORP INVESTORS?

A. No. PacifiCorp's current investors have been compensated for their previous investments by ScottishPower's above-market bid price.

Q. WHY ARE YOU RECOMMENDING IMMEDIATE RETAIL ACCESS IF SCOTTISHPOWER SELLS GENERATION OR TRANSMISSION ASSETS?

A. I noted earlier that the merger's large acquisition premium and uncertain cost savings could pressure ScottishPower to take steps to increase earnings. Such steps—including selling generation and/or transmission assets—could lead to reductions in service quality and reliability. To ensure that ScottishPower does not succumb to this pressure by selling strategic and high-value generation and/or transmission assets, the Commission should impose the retail access condition on the merger.

Q. WHY SHOULD THE COMMISSION ADDRESS THESE ISSUES NOW?

A. Because ScottishPower's bid price compensates current PacifiCorp investors and

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[20] My recommendation addresses only stranded costs associated with generation and transmission assets. I am making no recommendation in this case regarding potential stranded costs associated with distribution and general plant assets, regulatory assets, or above-market contracts with nonutility generators (NUGs).

reflects the risk of less-than-total stranded cost recovery, the Commission's future review of potential stranded costs associated with existing generation and transmission assets is unnecessary. Moreover, the Commission needs assurance that ScottishPower's current plan not to divest assets does not change shortly after the merger is approved. Finally, customers need tangible, pre-merger protection against ScottishPower's potential earnings-related divestiture of generation and/or transmission assets.

Commercial and Industrial Penalty Payments

Q. PLEASE DESCRIBE THE PROPOSED COMMERCIAL AND INDUSTRIAL RELIABILITY PENALTY PAYMENTS.

A. ScottishPower proposes paying commercial and industrial customers $100 for each of the following reliability events:

- Power is not restored within 24 hours following a service interruption
- PacifiCorp fails to notify the customer at least 2 days in advance of a planned service interruption.

Q. SHOULD THE PROPOSED RELIABILITY PENALTIES BE INCREASED FOR COMMERCIAL AND INDUSTRIAL CUSTOMERS?

A. Yes. ScottishPower's proposed package of service enhancements—including reliability improvements—is the key component of the merger's alleged benefits. Yet ScottishPower is unable to quantify these benefits, and fails to bear significant risk if the merger fails to produce them.[21] The proposed commercial and industrial penalty-payment scheme is simply one example of how ScottishPower's claims of huge merger benefits are not matched by its willingness to bear the risk that the benefits either will not materialize, or will be significantly less than expected. The proposed $100 penalty payment is meaningless, particularly with respect to payments for failing to restore

[21] ScottishPower also has failed to demonstrate that these alleged benefits could not be achieved absent the merger.

service within 24 hours. ScottishPower estimates that the cost of an 8-hour outage to commercial and industrial customers is about $4,000 and $21,000, respectively.[22] That is, the proposed penalties are not even remotely close to costs that customers may incur with outages that last longer than a day. A reasonable step would be to make penalties for not restoring service within 24 hours meaningful by increasing them to $2,000 for commercial customers and $5,000 for industrial customers.

Renewable Resources

Q. SHOULD THE APPLICANTS ASSUME COST-RECOVERY RISKS FOR RESOURCES THAT DO NOT MEET COST AND EFFICIENCY STANDARDS REFLECTED IN EXISTING RESOURCE PLANS?

A. Yes. In particular, ratepayers should not bear cost responsibility for ScottishPower's proposed 50-MW increment in renewable resources unless such resources meet these standards.

Q. DOES THIS COMPLETE YOUR DIRECT TESTIMONY?

A. Yes.

[22] Alan V. Richardson, supplemental testimony, Ex. SP_(AVR-2), page 4, Table 1 (1999).