STATE OF UTAH
BEFORE THE
PUBLIC SERVICE COMMISSION

DOCKET NO. 98-2035-04

APPLICATION OF
PACIFICORP AND SCOTTISHPOWER PLC
FOR AN ORDER APPROVING THE ISSUANCE OF
PACIFICORP COMMON STOCK

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

JULY 16, 1999

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REBUTTAL TESTIMONY
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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. DID YOU FILE DIRECT TESTIMONY IN THIS CASE?

A. Yes.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. I am appearing on behalf of Nucor Steel.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose is to respond to testimony filed by the Division of Public Utilities (DPU). In particular, I address the direct testimony filed by DPU witnesses Lowell E. Alt, Jr., and Kenneth B. Powell.

CONCLUSIONS

Q. WHAT HAVE YOU CONCLUDED ABOUT THE DPU TESTIMONY?

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

1. Conducted a wide-ranging and methodical review of the proposed PacifiCorp/ScottishPower merger.
2. Apparently adopted a "net positive benefit" standard for judging whether the merger is in the public interest and should be approved by the Commission.
3. Concluded that quantifiable merger savings are relatively meager—about $10 million annually in reduced corporate costs.
4. Identified numerous financial and operating risks associated with the merger.
5. Recommended that the Commission approve the merger subject to 46 conditions even though the DPU never concluded that the conditioned merger meets the "net positive benefit" standard.
6. Failed to provide special contract customers the same protection from merger risks that it recommended for non-special contract customers.

RECOMMENDATIONS

Q. WHAT ARE YOUR RECOMMENDATIONS REGARDING THE DPU TESTIMONY?

A. I recommend that the Commission reject the merger since neither the DPU nor any other party has been able to demonstrate that the merger yields a net positive benefit. However, if the Commission approves the merger, it should impose rate protection conditions that are significantly stronger than those recommended by the DPU.[1] Specifically, the Commission should:

1. Reject the DPU's proposed merger condition No. 43 regarding rate increases, and instead 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.
2. Reject the DPU's conclusion that merger conditions are unnecessary to protect special contract customers from merger risks.[2] Instead, the Commission should require that ScottishPower extend existing contracts with industrial customers (at the customer's option) to coincide with the post-reduction 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.

DPU MERGER EVALUATION

Q. PLEASE DESCRIBE THE STANDARD THE DPU USED TO EVALUATE THE PROPOSED MERGER.

A. The DPU does not clearly enunciate the standard it used to evaluate the merger, although it appears to have used the net positive benefit standard. The DPU recognizes that the Commission:

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[1] The Commission should impose the conditions detailed in my direct testimony at pages 4-6. Some of these conditions are covered by the DPU's non-rate protection conditions.

[2] Kenneth Powell, direct testimony, page 9, lines 1-6.

> …ordered that the appropriate standard to be used in evaluating the merger application is a net positive benefit to the public interest in the State of Utah. We understand this to mean that when all known costs and benefits related to the merger have been evaluated and netted that if there is a net positive benefit then the merger should be approved. The PSC, however, did not set the amount of the net positive benefit required for merger approval nor did they specifically define the public interest. The public interest normally considered by the Division involves those areas within the PSC's jurisdiction such as rates charged to utility customers. This case demands a broader perspective…. Consideration should be given to the impact on ratepayers, shareholders, employees, the State of Utah, its citizens and its general economy.[3]

Instead of clearly explaining how it applied the net positive benefit evaluation standard, the DPU identified numerous merger-related risks, and then proposed conditions to mitigate such risks. For example, the DPU says:

> …[W]e soon realized that the ScottishPower merger posed new risks and that the conditions offered by ScottishPower and PacifiCorp in their direct testimony would be insufficient to remedy possible adverse outcomes. This merger is quite different from the previous merger in that benefits appear to be much smaller and harder to quantify.…With smaller and less certain merger benefits, mitigating the risks becomes more important if the net positive benefit standard is to be met.
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> If possible adverse outcomes materialize, they could easily offset the small assured savings and result in a net harm to the public interest.…The Division has developed a list of conditions that attempt to mitigate the risks related to specific areas of the merger.[4]

Q. DOES THE DPU'S TESTIMONY EXPRESS DOUBTS THAT THE MERGER YIELDS A NET POSITIVE BENEFIT?

A. Yes. For example, consider not only the statements quoted above, but also the following statements from the DPU's direct testimony.

- "This proposed merger…is expected to bring very small assured benefits and large uncertainties and risk."[5]
- "Only $10 million in merger savings have been specifically identified from PacifiCorp and none from ScottishPower.…This merger is not as clearly a 'good

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[3] Lowell B. Alt, Jr., direct testimony, page 4, line 14, to page 5, line 3.

[4] Lowell B. Alt, Jr., direct testimony, page 7, line 4, to page 8, line 5.

[5] Lowell B. Alt, Jr., direct testimony, page 9, lines 14-16.

deal' like the 1989 merger."[6]

- "…[T]he degree of unsubstantiated claims is enough to stagger all but the most sanguine supporter."[7]

Q. WHAT TYPES OF RISKS DID THE DPU IDENTIFY?

A. The DPU identified numerous merger-related financial and operating risks. More specifically, the DPU said:

> …[W]e believe that the foremost concerns are that service quality and reliability may get worse and rates may go up as result of the proposed merger. These concerns are followed by the concern that the Utah PSC's ability to regulate the merged company may be adversely impacted. The possibility of adverse impact on the State, communities and employees through the loss of jobs, loss of local company presence and reduced support for community and economic development was also raised. Other parties have raised concerns about the environment, energy conservation, municipalization, retail competition and utility facilities.[8]

Q. HOW DOES THE DPU PROPOSE TO MITIGATE SUCH RISKS?

A. The DPU recommends a set of 46 conditions, including a proposed 3-year rate cap.

Q. WILL THE MERGER YIELD A NET POSITIVE BENEFIT WITH THE DPU'S RECOMMENDED CONDITIONS?

A. No. The DPU says the following regarding the need for its proposed rate cap:

> …[W]e are concerned that not all merger related costs including transition costs are or would be tracked. We are not sure that our proposed conditions on asset valuations and the related impact on property taxes will provide complete protection. We are concerned about the possible adverse and difficult to predict impact on the economy from the potential loss of Utah jobs. We are concerned that our proposed conditions may not completely mitigate all possible risks of adverse outcomes. The penalties available if service quality and reliability deteriorate may not be adequate to assure a net positive benefit.[9]

In my opinion, the DPU's proposed rate cap does not mitigate the risks that it identified.

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[6] Ronald L. Burrups, direct testimony, page 3, lines 15-19.
[7] William A. Powell, direct testimony, page 2, line 6.
[8] Lowell B. Alt, Jr., direct testimony, page 5, lines 5-12.
[9] Lowell B. Alt, Jr., direct testimony, page 10, lines 4-11.

Q. PLEASE DESCRIBE THE DPU'S PROPOSED RATE CAP.

A. The DPU's proposed 3-year rate cap would take one of two forms. Under the first option, rate increases during the 3 years following the merger's approval would be limited to current levels adjusted by an external inflation index. Under the second option, rate increases would be limited such that PacifiCorp's earned rate of return on equity in Utah did not exceed PacifiCorp's allowed rate of return on equity in another state.[10]

Q. WHY IS THE DPU'S PROPOSED RATE CAP INADEQUATE?

A. The 3-year rate cap provides no assurance that ratepayers will share in any meaningful merger-related savings. In fact, under the inflation indexed option, a mere 2.5-percent annual inflation rate could generate nearly an 8-percent cumulative rate increase over 3 years. A mechanism that permits such increases provides no assurance of a net positive benefit to ratepayers.

Q. IS ANOTHER OPTION AVAILABLE TO PROTECT RATEPAYERS BETTER THAN THE DPU'S RATE CAP?

A. Yes. In my direct testimony I recommended that if it approves the merger, the Commission should 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. Post-merger regulatory protection cannot undo a merger and its ill effects. As a result, my recommended rate reduction and post-merger rate freeze (along with other conditions detailed in my direct testimony) are necessary 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.

A rate reduction is necessary to protect non-special contract customers from merger-

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[10] Lowell B. Alt, Jr., direct testimony, page 9, lines 4-11.

related risks, and to put meaning behind ScottishPower's numerous, and generally unsupported claims of merger benefits. 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, combined with my other recommended merger conditions, would significantly increase the likelihood that customers receive some tangible, net positive benefit from the merger.[11]

Q. WOULD THE DPU'S RATE CAP APPLY TO ALL CUSTOMERS?

A. No. As I noted earlier, the DPU has apparently concluded that merger conditions are unnecessary to protect special contract customers from merger risks.[12] Special contract customers deserve the same protection as other customers from merger risks. To exclude special contract customers from such protection is unjust, unreasonable, and discriminatory. While special contract customers should not participate in my recommended rate reduction, they should have the opportunity to extend their existing contracts to coincide with my recommended 5-year rate freeze. This condition would 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 those customers should be allowed to choose their electricity supplier when their contracts expire subject to rules and guidelines set by the Commission.

Q. DOES THIS COMPLETE YOUR REBUTTAL TESTIMONY?

A. Yes.

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[11] The Staff of the Oregon Public Utility Commission has recommended a 6-year, 2.5-percent annual rate credit to mitigate the proposed merger's risks and provide ratepayers with tangible merger benefits. "Staff cannot conceive of all risks potentially presented by the merger or all conditions that would be necessary to protect PacifiCorp ratepayers against such risks. A financial benefit [rate credit] is required to offset known and unknown risks of the merger and to provide some expected net benefit to PacifiCorp's customers." *See* John S. Thornton, Jr., and Thomas P. Riordan, Surrebuttal Testimony, Docket No. UM-918, July 14, 1999, page 30, lines 13-17.

[12] Kenneth Powell, direct testimony, page 9, lines 1-6.

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