

Before the
PUBLIC SERVICE COMMISSION OF UTAH

_____)
In the Matter of the Application of)
PacifiCorp and Scottish Power plc for)
an Order Approving the Issuance of)
PacifiCorp Common Stock)
_____)

Docket No. 98-2035-04

Rebuttal Testimony of

Maurice Brubaker

On Behalf of

Utah Industrial Energy Consumers

July 1999
Project 7094

Brubaker & Associates, Inc.
St. Louis, Missouri 63141-2000

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Rebuttal Testimony of Maurice Brubaker

12 **Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

13 A Maurice Brubaker. My business address is 1215 Fern Ridge Parkway, Suite 208,
14 St. Louis, Missouri 63141-2000.

15 **Q ARE YOU THE SAME MAURICE BRUBAKER WHO HAS PREVIOUSLY SUBMITTED**
16 **DIRECT TESTIMONY IN THIS PROCEEDING?**

17 A Yes, I am.

18 **Q WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

19 A In this testimony I will review the particular merger conditions proposed by the Division
20 of Public Utilities (Division) and compare them to the conditions which I proposed in my
21 direct testimony on behalf of UIEC. In some cases I agree with the conditions proposed
22 by the Division, but in other cases I either disagree with the condition or believe that it
23 does not go far enough. In addition, there are other conditions which I believe are
24 critical, but which have not been addressed by the Division.

1 **Q PLEASE DESCRIBE THE BASIS FOR YOUR COMPARISON.**

2 A Exhibit DPU1.2 attached to the direct testimony of Division witness Lowell Alt, Jr. lists
3 the 46 merger conditions which the Division has developed as a result of its review of
4 the proposed merger. In my direct testimony, beginning on Page 3, I list 11 specific
5 merger conditions. In addition, I also propose a four-step process for merger approval,
6 which immediately follows the recitation of the 11 recommended merger conditions. I
7 will use the numbering system in these two documents for purposes of comparison.

8 **Q ARE THE MERGER CONDITIONS WHICH YOU AND THE DIVISION HAVE SET**
9 **FORTH IN THESE DOCUMENTS THE ONLY CONDITIONS WHICH ARE**
10 **APPROPRIATE?**

11 A No. Both the Division and I expressed our merger conditions as being in addition to, or
12 strengthened versions of, the commitments and conditions already embraced by
13 PacifiCorp/Scottish Power.

14 **Q YOU NOTED THAT IN ADDITION TO THE ELEVEN MERGER CONDITIONS YOU**
15 **ALSO PROPOSED A FOUR-STEP PROCESS FOR MERGER APPROVAL. WHAT IS**
16 **THE NATURE OF THIS FOUR-STEP PROCESS?**

17 A I will discuss this in more detail later, but it is important to state at the outset that the
18 four-step process which I have proposed is for the purpose of defining necessary
19 conditions and actions; and securing the formal support, or at least acquiescence, of the
20 Applicants to these conditions prior to consummation of the merger. The vehicle for
21 this is a transition plan, which I will discuss in more detail later. If the Commission wants
22 to be sure that it can set, and enforce, the conditions that are necessary to make the

1 merger acceptable from the point of view of Utah consumers, then it is essential that all
2 of this occur prior to the time that the Commission "blesses" the merger. Once the
3 Commission approves the merger, its ability to impose and enforce conditions is greatly
4 diminished.

5 **First Category**

6 **Q WHAT IS THE FIRST CATEGORY OF DIVISION CONDITIONS WHICH YOU WILL**
7 **ADDRESS?**

8 A The first category which I will address is those merger conditions which have been
9 proposed by the Division where I have no specific corresponding condition, but where
10 the Division's recommended condition is either consistent with the overall framework of
11 my conditions, or is otherwise acceptable.

12 **Q WHICH OF THE CONDITIONS PROPOSED BY THE DIVISION FALL INTO THIS**
13 **CATEGORY?**

14 A Division Conditions 5, 6, 7, 8, 9, 10, 12, 18, 19, 20, 23, 26, 27, 29, 30, 31, 32, 33, 34, 35,
15 36, 37, 38, 39, 40, 41, 42, 44 and 46 fall into this category. I do not object to any of
16 these Division conditions.

17 **Second Category**

18 **Q WHAT IS THE SECOND CATEGORY OF DIVISION CONDITIONS?**

19 A The second category of Division conditions consists of those conditions where I do not
20 have a corresponding recommendation, but where I believe the Division condition to be
21 unnecessary or addressing the wrong problem. These are Division Condition Nos. 3 and

1 14. Both of these focus on achievement of the \$10 million system-wide savings in
2 corporate overheads promised by PacifiCorp/Scottish Power. Division Condition No. 3
3 proposes that the \$10 million savings be guaranteed and measured from PacifiCorp's
4 1999 actual corporate costs, normalized and adjusted to reflect only costs that would be
5 included in rates. I disagree with this condition because I do not believe that the savings
6 can accurately be measured by starting with actual 1999 expenses, normalized and
7 adjusted. This approach does not take into account the potential cost reductions that
8 PacifiCorp could achieve on its own, absent the merger.

9 Division Condition No. 14 is intended to eliminate the risk that this \$10 million in
10 merger savings will not be realized in rates. It is an elaborate requirement for a year
11 2001 information filing on merger savings, and for a guarantee that such total savings
12 will not be less than \$10 million. In addition to the concerns I expressed in discussing
13 Division Merger Condition No. 3, I do not see the value of an informational filing of this
14 nature.

15 **Third Category**

16 **Q WHAT IS THE THIRD CATEGORY OF CONDITIONS WHICH YOU WILL DISCUSS?**

17 A The third category of Division conditions which I will discuss consists of those proposed
18 conditions where I have made a similar recommendation, but where the specific
19 recommendation differs to some important degree. Division conditions falling in this
20 category are Condition Nos. 2, 4, 11, 13, 15, 16, 17, 21, 22, 24, 25, 28, 43 and 45. I will
21 discuss each of these, in turn.

1 **Q PLEASE BEGIN BY ADDRESSING DIVISION CONDITION NO. 2.**

2 A Division Condition No. 2 would require PacifiCorp/Scottish Power to make a filing of its
3 proposed cost allocation methodology for approval by the Commission, 30 days after the
4 completion of the merger. The Division sets forth certain principles which must be
5 followed, and would require that PacifiCorp/Scottish Power assume the risk that the Utah
6 Commission may adopt an allocation method which differs from those adopted in other
7 U.S. or U.K. jurisdictions. While I do not disagree with the principles expressed as a part
8 of these conditions, I disagree with the timing.

9 UIEC Condition No. 4 contains a similar requirement to file a specific written plan
10 and detailed proposal for the allocation of corporate overheads and other costs among
11 affiliated entities. However, UIEC's transition proposal would require that this plan be
12 filed for review and approval by the Commission prior to the Applicants being allowed
13 to consummate the merger.

14 As I indicated above, it is absolutely essential that matters of this nature be
15 defined, and that commitments be secured in advance.

16 **Q HAVE APPLICANTS PROVIDED TESTIMONY EXPLAINING HOW THEY WOULD**
17 **PROPOSE TO PERFORM THESE ALLOCATIONS?**

18 A Yes. On June 17, 1999 Scottish Power filed with the Utah Public Service Commission
19 a document entitled "Proposed Post-Merger Treatment of Affiliate Transactions,
20 Corporate Cost Allocation and Location of Scottish Power Corporate Costs."

1 **Q DOES THIS DOCUMENT PROVIDE THE KIND OF DETAIL THAT IS NECESSARY?**

2 A No, it does not. This document expresses allocation intentions only in the broadest of
3 generalities. It spends much more time describing the corporate structure and where
4 costs will be located than it does in explaining what factors will be used to allocate costs.
5 While useful as an initial explanation, it falls far short of providing the detailed analysis
6 of corporate costs and allocation methods that are necessary to understand the process.
7 In addition, it contains no specific numerical data to illustrate how the methodology would
8 be applied, or what the results would be.

9 **Q IS DIVISION CONDITION NO. 22 SIMILAR TO DIVISION CONDITION NO. 2?**

10 A Yes, in some respects. It would require a filing, 30 days after the approval of the
11 merger, of a detailed report indicating PacifiCorp's proportionate share of the holding
12 company's total assets, operating revenues, expenses and number of employees.
13 Subsequent updates would be made with each semi-annual filing. I believe that the
14 initial filing of this information should be in the transition plan that is to be filed prior to
15 Commission final approval of the merger. I have no disagreement with the contents
16 specified by the Division.

17 **Q PLEASE COMMENT ON DIVISION CONDITION NO. 4.**

18 A Division Condition No. 4 is a requirement that all merger-related costs incurred by
19 PacifiCorp and Scottish Power be recorded below the line. While I certainly agree with
20 the intent of this requirement, it is too general.

21 UIEC Condition No. 2, on the other hand, goes further. It is a requirement for a
22 formal commitment by Applicants not to request the inclusion of transaction costs or
23 transition costs in any revenue requirement filing, and not to contend that a higher rate

1 of return or some form of earnings sharing mechanism would be appropriate to allow for
2 the opportunity to recover from customers either these costs or the acquisition premium.

3 Accordingly, UIEC Condition No. 2 is more comprehensive and more specific and
4 should be adopted instead of Division Condition No. 4, because UIEC Condition No. 2
5 not only requires a formal commitment, but also covers more (hopefully all) of the ways
6 in which merger-related costs could be inappropriately charged to Utah consumers.

7 **Q IS DIVISION CONDITION NO. 28 SIMILAR?**

8 A Yes. Division Condition No. 28 is a requirement that rates be set based upon original
9 cost, and not revalued cost, and that any premium paid by Scottish Power for
10 PacifiCorp's stock will be disregarded for ratemaking purposes. I believe UIEC
11 Condition No. 2 encompasses Division Condition Nos. 4 and 28.

12 **Q PLEASE DESCRIBE DIVISION CONDITION NOS. 11 AND 13.**

13 A Division Condition Nos. 11 and 13 address access to books and records and the ability
14 of the Commission to effectively regulate PacifiCorp. The corresponding UIEC condition
15 is No. 5. I believe that both sets of proposed conditions are similar, and I defer to the
16 Division with respect to its specific language and requirements.

17 **Q PLEASE ADDRESS DIVISION CONDITION NO. 15.**

18 A Division Condition No. 15 would require the filing of a transition plan with the
19 Commission within six months after the closing date of the merger. While I have also
20 recommended that a merger transition plan be filed with the Commission, the point of
21 departure that I have with the Division is one of timing. I believe it is imperative that the
22 transition plan be filed prior to the final approval of the merger. Filing the transition plan

1 after the merger has been consummated materially compromises the ability of the
2 Commission to set the conditions under which the business will be conducted.

3 While the Commission may be able to effect some minor changes by disallowing
4 certain costs or requiring certain procedures to be followed, the Commission's ability to
5 make major changes is clearly reduced once it has approved the merger. Rather than
6 the approach taken by the Division, which permits the plan to be filed after the merger
7 has been approved, I believe it is essential to have a formal transition plan filed prior to
8 merger consummation. Because of the importance of this concept, I will repeat here,
9 verbatim, the recommendation contained at Pages 5 and 6 of my direct testimony:

10 **"Further, I recommend that the Commission require**
11 **Applicants to file a formal transition plan which will**
12 **contain the necessary draft agreements and other**
13 **forms of implementation and which will express the**
14 **required commitments and guarantees. This tran-**
15 **sition plan should also indicate, in detail, how**
16 **Scottish Power plans to reduce costs and increase**
17 **efficiencies throughout the existing PacifiCorp**
18 **organization. The transition plan should be filed for**
19 **Commission review, and acceptance by the Commis-**
20 **sion, after hearings, of a satisfactory transition plan**
21 **should be a prerequisite of merger consummation. In**
22 **other words, the merger approval process should be**
23 **a multi-step process. The first step would be**
24 **issuance of an order by this Commission specifying**
25 **required conditions and directing PacifiCorp/Scottish**
26 **Power to file a transition plan. The second step is the**
27 **filing of and hearings on the transition plan that**
28 **conforms with the conditions in the Commission's**
29 **initial order. The third step would be permission to**
30 **consummate the merger based on a Commission**
31 **order finding that the transition plan adequately**
32 **addresses the required conditions and contains**
33 **enforceable commitments. The final step would be**
34 **the completion of the merger."** (Direct Testimony of
35 Maurice Brubaker, Page 5, Line 29 through Page 6, Line
36 8, June 1999.)

1 I believe the above is essential, and is the approach that should be taken by the
2 Commission. The optimum (and perhaps only) time to extract meaningful commitments
3 from Applicants is before the Commission give Applicants what they want. If Applicants
4 are required to formally accept specific, comprehensive, written conditions before they
5 are given authority to proceed, there is a much greater likelihood that the conditions
6 necessary to protect Utah ratepayers can be secured, implemented and subsequently
7 enforced. If the Commission, instead, expresses only general conditions, or even waits
8 until after it has given merger approval to review and comment on cost allocation plans
9 and other key aspects of the merger, the chances of securing a favorable outcome for
10 Utah consumers are much diminished. Waiting until after the merger has been
11 approved to review the transition plan is like closing the barn door after the horse is
12 already out. It doesn't work on the farm, and it doesn't work in mergers.

13 **Q PLEASE ADDRESS DIVISION CONDITION NO. 16.**

14 A Division Condition No. 16 is intended to address the risk that intra-company loans may
15 disadvantage electric customers. In particular, it would require PacifiCorp and Scottish
16 Power to apply to the Commission for approval of intra-company loan agreements. This
17 has the same general intent as UIEC Condition Nos. 3(a) and 3(e). However, Division
18 Condition No. 16 is extremely vague—stating only that PacifiCorp and Scottish Power
19 should apply to the Commission for approval of intra-company loan agreements.

20 In contrast, UIEC Condition Nos. 3(a) and 3(e) go much further and explicitly
21 require certain actions and prohibit others. For example, UIEC Condition 3(a) explicitly
22 prohibits the inclusion of cross-default provisions in any borrowing agreements by the
23 various companies which constitute the overall enterprise. UIEC Condition 3(e) also is
24 comprehensive in that it explicitly prohibits PacifiCorp from assuming any obligation or

1 liability as guarantor, endorser, surety or otherwise for any parent, affiliate, or other entity
2 without the express prior approval of the Commission.

3 In my opinion, UIEC Condition Nos. 3(a) and 3(e) are superior to Division
4 Condition No. 16 because they are much more definitive and do more to protect the
5 interests of Utah consumers.

6 **Q DOES THE DIVISION HAVE ANOTHER CONDITION THAT IS SIMILAR TO NO. 16?**

7 A Yes. Division Condition No. 24 would require PacifiCorp to apply to the Commission for
8 approval of debt issuances.

9 **Q ARE DIVISION CONDITION NOS. 16 AND 24 EQUIVALENT TO UIEC CONDITIONS**
10 **NOS. 3(a) AND 3(e)?**

11 A I believe that they are similar as to intent, but as noted above, UIEC Conditions 3(a) and
12 3(e) are more comprehensive and specific, and should be adopted instead of the
13 corresponding Division conditions.

14 **Q PLEASE COMMENT ON DIVISION CONDITION NO. 17.**

15 A The issue addressed here is whether dividend payments by PacifiCorp will interfere with
16 construction obligations. Division Condition No. 17 would require PacifiCorp to file, for
17 two years following the merger, a cash flow summary (or other evidence) with its periodic
18 dividend reports, showing that service will not be impaired by payment of the dividend.

19 The corresponding UIEC condition is No. 3(b). The UIEC condition is much more
20 explicit and concrete. It would make dividend payments conditional on the Directors of
21 PacifiCorp and Scottish Power formally certifying to the Commission that PacifiCorp has
22 adequate capital to meet all of its commitments and to carry out its public service

1 obligations. A formal certification by the Utility is much stronger than the requirement
2 simply to file a cash flow summary. The formal certification is in the nature of an "official
3 promise," whereas the filing of a cash flow summary could simply be construed as an
4 informational item, over which there could be interpretation disputes. For these reasons,
5 I believe that UIEC Condition No. 3(b) is superior to Division Condition No. 17.

6 **Q WHAT IS CONTAINED IN DIVISION CONDITION NO. 21?**

7 A Division Condition No. 21 would permit the use of a hypothetical capital structure for
8 ratemaking purposes. The hypothetical capital structure would be constructed using a
9 group of A-rated electric utilities comparable to PacifiCorp.

10 The corresponding UIEC condition is Condition No. 1. It goes beyond the
11 authority to use a hypothetical capital structure and imposes a requirement that
12 PacifiCorp/Scottish Power take action to specifically achieve a common equity ratio
13 comparable to A-rated electric utilities, and not less than 47%. It enforces this by
14 requiring a commitment to reduce dividend payouts and/or contribute equity capital as
15 necessary to maintain this ratio. Further, in light of concerns about the potential use of
16 short-term debt, UIEC Condition No. 1 places limits on the amount of outstanding short-
17 term debt that could be excluded from the calculation of the capital structure.

18 Also, UIEC Condition No. 1 prohibits the inclusion of any "acquisition premium"
19 in the equity balance used in the capital structure. This can be very important if the
20 accounting requirements change or if Scottish Power's present intentions on how to treat
21 the acquisition premium on its books either changes or is changed by its auditors.

22 In addition, the requirement to actually have a capital structure with a specific
23 equity ratio actually produces the benefits of that equity ratio in terms of credit strength
24 for the utility. Having a different capital structure, but pretending that the equity

1 component of the capital structure is larger when it comes to set rates is not the same
2 thing because the benefits are only provided hypothetically, and not actually. For
3 example, assume that PacifiCorp actually had a common equity ratio of 35%. Even
4 though the target was 47%, the actual credit rating of the Company may not be based
5 on the hypothetical capital structure, but most likely on its actual results of operations.

6 In addition, setting rates on the basis of a hypothetical capital structure with an
7 equity component that exceeds the actual equity component in the capital structure can
8 provide the utility with income to which it should not be entitled, because the rate of
9 return calculated from the hypothetical capital structure may be higher than the rate of
10 return based on the actual, and lower, equity ratio. For these reasons, I believe that
11 UIEC Condition No. 1 is superior to Division Condition No. 21.

12 **Q PLEASE ADDRESS DIVISION CONDITION NO. 25.**

13 A Division Condition No. 25 relates to PUHCA issues. It would require PacifiCorp/ Scottish
14 Power to agree not to assert in a future Utah proceeding that the provisions of PUHCA
15 or the related Ohio Power v FERC case would preempt the Commission's jurisdiction
16 over affiliated interest transactions, and would require an explicit waiver of any such
17 defense in those Utah proceedings.

18 The corresponding UIEC condition is Condition No. 7. UIEC Condition No. 7 is
19 broader in application, and more specific in terms of detail. It would require PacifiCorp/
20 Scottish Power also to agree not to assert lack of Commission jurisdiction in any court
21 proceeding, in addition to any Commission proceeding. Also, it would make the
22 agreement not to claim lack of jurisdiction applicable even if the Public Utility Company
23 Holding Act is amended or repealed.

1 UIEC Condition No. 7 does not explicitly reference the Ohio Power v FERC case.
2 I would recommend adopting UIEC Condition No. 7, broadened to include specific
3 reference to the Ohio Power v FERC case.

4 **Q PLEASE ADDRESS DIVISION CONDITION NOS. 43 AND 45.**

5 A These conditions are intended to assure a net positive benefit for consumers. Condition
6 No. 43 would limit rate increases for a maximum of three years to either inflationary
7 increases or to increases such that the Utah return on equity would not exceed that
8 resulting from proceedings in any other state. Condition No. 45 simply states that rates
9 in Utah shall not increase as a result of the merger.

10 The corresponding UIEC condition is No. 11. In UIEC No. 11, I have proposed
11 that Scottish Power/PacifiCorp agree to cap rates at current levels for a five-year period.
12 Thus, the protection which I propose extends for two years beyond what the Division
13 proposes. Further, my recommendation is to cap the rates at their current levels, as
14 opposed to the Division position which would allow increases to occur under certain
15 circumstances. I think the rate cap in UIEC Condition No. 11 is a far more effective
16 means of controlling the actions of PacifiCorp/Scottish Power and ensuring that Utah
17 customers do not experience rate increases. Further, this requirement makes Scottish
18 Power accountable for its claims that it can significantly reduce PacifiCorp's costs.

19 In addition, it is my recommendation that the rate cap be applicable to contract
20 customers as well as to tariff customers, a point which I will discuss in more detail later
21 when I respond to the testimony of Division witness Kenneth Powell.

22 **Q IS THERE ANY RATIONALE FOR THE DIVISION'S RECOMMENDATION TO ALLOW**
23 **INCREASES BUT LIMIT THEM TO INFLATION AS MEASURED BY THE GDP?**

1 A No. If the expectation (or at least the representation by Scottish Power) is that
2 substantial costs can be removed from PacifiCorp's operations, I see no basis for
3 including a condition which would allow rates to increase at the rate of inflation. Further,
4 I see no basis for setting the return on equity to equal that resulting from proceedings
5 in other states. These conditions are simply invitations to file rate cases in the event that
6 Scottish Power is unable to extract costs from PacifiCorp's operations to the extent they
7 claim to be able to do.

8 **Q ARE THERE INDICATIONS THAT PACIFICORP'S COSTS WILL BE DECREASING?**

9 A Yes. As discussed in more detail in my direct testimony (Pages 24 and 25), PacifiCorp
10 undertook several restructuring measures in 1998. These measures are expected to
11 result in significant cost reductions. The January 19, 1998 work force reductions
12 entailed the elimination of 700 positions. I would expect these reductions to produce
13 annual savings approaching, and perhaps exceeding, \$50 million. Furthermore, in
14 October 1998 PacifiCorp reported that it was undertaking still additional steps to achieve
15 further and significant cost reductions, which have been reported as producing annual
16 savings of approximately \$30 million. In addition, Scottish Power frequently talks about
17 increased tax efficiency, which I assume means reduced taxes.

18 Rather than put ratepayers at risk for either a potential inability to reduce costs,
19 or to expose ratepayers to efforts to avoid passing cost savings through, the rate freeze
20 which I recommend makes Scottish Power/PacifiCorp explicitly accountable for their
21 claims, and gives them the opportunity to achieve the rewards from cost reduction
22 efforts, but also requires them to assume the risk that they might not be successful. The
23 Division conditions that allow increases based on inflation or return on equity decisions
24 in other jurisdictions simply do not address this situation and do not protect consumers.

1 **Fourth Category**

2 **Q WHAT IS THE FOURTH CATEGORY THAT YOU WILL DISCUSS?**

3 A The fourth category consists of those merger conditions which are a part of the UIEC
4 proposal, where the Division does not have a corresponding condition.

5 **Q PLEASE CONTINUE.**

6 A There are several UIEC conditions relating to financial areas that do not appear to have
7 an analog in the Division conditions. These are UIEC Condition Nos. 3(c), 3(d) and 3(f).

8 UIEC Condition 3(c) is a requirement to maintain investment grade bond ratings
9 for PacifiCorp's outstanding debt. This is related to the maintenance of an adequate
10 equity ratio in the capital structure, adequate cash flow, and the other factors that the
11 rating agencies consider in rating bonds. I believe it is an important complement to the
12 other financial conditions.

13 UIEC Condition 3(d) would require PacifiCorp, in declaring dividends, to certify
14 to the Commission that it complies with U.C.A. 54-4-27, and also to certify that the
15 declaration of such dividend will not violate its capital structure commitment.

16 UIEC Condition 3(f) is a requirement to provide management and financial
17 resources adequate to enable PacifiCorp to meet its commitments, carry out its
18 authorized activities and to comply with all of its public service obligations.

19 I believe these all are important additions to the conditions proposed by the
20 Division. In fact, these are conditions that were imposed on Scottish Power and other
21 utilities in the U.K. If they were necessary and/or acceptable in the U.K., they should
22 certainly be acceptable in the U.S.

23 **Q DOES THE DIVISION HAVE AN ANALOG TO UIEC CONDITION NO. 6?**

1 A No. UIEC Condition No. 6 strengthens a commitment made by PacifiCorp/Scottish
2 Power concerning compliance with Commission regulations regarding affiliated interest
3 transactions. While PacifiCorp/Scottish Power have committed to comply with current
4 regulations, UIEC Condition No. 6 would extend that commitment to include compliance
5 with any changes which may be made to those statutes and regulations in the future.

6 **Q DOES THE DIVISION HAVE AN ANALOG TO UIEC CONDITION NO. 8?**

7 A No. UIEC Condition No. 8 would require PacifiCorp/Scottish Power to agree that if there
8 is a failure to uphold any of the guarantees, conditions or commitments, that the
9 Commission may make adjustments to rates in order to achieve for customers the
10 benefits which they would have received had the commitments, conditions, etc., been
11 fulfilled as intended. I believe this is a valuable condition, because it helps the
12 Commission to enforce the merger conditions and deliver the expected benefits to
13 customers.

14 **Q PLEASE ADDRESS UIEC CONDITION NO. 9.**

15 A UIEC Condition No. 9 is a requirement that within 24 months following merger approval,
16 the transmission portion of PacifiCorp's operations will be separated from the remainder
17 and placed in a retail transmission organization (RTO) that meets FERC criteria; or if
18 such RTO does not exist, to file within 18 months after merger approval a plan detailing
19 how PacifiCorp will arrange with other entities to conduct an independent operation of
20 these transmission facilities. (UIEC Condition No. 3(g) is related to this condition.)

21 **Q PLEASE EXPLAIN THE IMPORTANCE OF SEPARATING THE TRANSMISSION**
22 **ASSETS AND ENSURING THEIR INDEPENDENT OPERATION.**

1 A As explained at Pages 40-44 of my direct testimony, separating the assets and ensuring
2 their independent operation is necessary to achieving the nondiscriminatory access to
3 the transmission network that is a prerequisite to a properly functioning competitive
4 market. Unless there is an independent, effective organization to plan, maintain and
5 operate the transmission system, competition will be an illusion rather than a reality. In
6 addition to planning and operation and ensuring nondiscriminatory access, the question
7 of rate level and structure is important. A regional organization would typically have an
8 area-wide rate, which would permit the movement of power throughout the region for a
9 single transmission charge, rather than the payment of multiple or pancaked
10 transmission rates as is the case without a region-wide organization.

11 It is important to require this commitment today, as one of the merger conditions,
12 because this Commission may not have the requisite authority to directly order
13 PacifiCorp to create or join an ISO or RTO. This requirement, however, can be achieved
14 by making it a condition to merger approval. Furthermore, the requirement to separate
15 the transmission assets is the same as imposed on Scottish Power in the U.K.

16 **Q DOES THE DIVISION HAVE AN ANALOG TO UIEC CONDITION NO. 10?**

17 A No, it does not. UIEC Condition No. 10 would require that Scottish Power/PacifiCorp
18 disavow any claim for "stranded cost" in connection with movement to retail competition.
19 While Division witness William Powell alludes to this stranded cost issue, and points out
20 the inconsistency between the large merger premium and any expectation of stranded
21 costs, the Division does not make any specific recommendations in this regard.

1 **Q PLEASE EXPLAIN WHY IT IS IMPORTANT TO HAVE THIS COMMITMENT?**

2 A As I explained at Pages 45-47 of my direct testimony, the willingness to pay substantially
3 above book value is a clear indication of an expectation that the market value of
4 PacifiCorp's generation assets exceeds their book value. Scottish Power is not naive,
5 and is well aware of the trend toward competition in the U.S. retail electric markets. If
6 the Commission does not require PacifiCorp/Scottish Power to relinquish any claim for
7 stranded cost recovery, then it could subsequently request compensation for stranded
8 costs, while at the same time argue that it should be allowed to keep part or all of the
9 benefit of cost reductions because they are necessary to compensate it for the merger
10 premium, which it voluntarily paid for these "inflated" assets.

11 **Q DOES THE DIVISION ADDRESS THE ISSUE OF THE RATES FOR CONTRACT**
12 **CUSTOMERS?**

13 A Only to a limited degree. Division witness Kenneth Powell addresses this at Pages 7-9
14 of his testimony. Mr. Powell essentially defers to the PSC task force on special
15 contracts, which he chairs, as setting the rules for special contracts, and states that no
16 specific merger condition is appropriate. According to his testimony, the task force is to
17 determine the criteria for evaluating contracts and the ratemaking treatment of those
18 contracts. In terms of how contract customers are to be treated in a rate cap
19 environment, the particular ratemaking treatment is not relevant. Furthermore, to the
20 extent that the task force addresses the criteria for evaluating contracts, the task force
21 activities also would not seem to be particularly relevant to the question at hand.

1 **Q PLEASE EXPLAIN THE SITUATION WITH RESPECT TO CONTRACT CUSTOMERS**
2 **AND WHY THEY SHOULD BE PROTECTED BY THE SAME OR SIMILAR FACTORS**
3 **THAT WOULD APPLY TO REGULAR TARIFF CUSTOMERS.**

4 A For special contract customers, the special contract serves the same function that the
5 standard tariff rate schedule does for non-contract customers. Both the standard tariffs
6 and the special contracts are subject to Commission review and approval. To the extent
7 that a rate freeze or a rate cap is appropriate as a merger condition, there is absolutely
8 no reason why this protection should not be extended to special contract customers.
9 The special contracts address individual circumstances, and are essentially equivalent
10 to tariffs that are applicable to a single customer.

11 An important difference, from the perspective of the customer and the protection
12 that the customer has, is that while the regular tariffs are set by the Commission after
13 hearings, the special contracts are the result of negotiations between the customer and
14 the utility. After the customer and the utility reach agreement, these contracts then are
15 presented to the Commission for review and approval. Thus, the initiating factor for
16 development of the rates, terms and conditions is negotiations between the customer
17 and the utility. While there is a track record of negotiations with PacifiCorp (and Utah
18 & Power Light Company) there is absolutely no track record with Scottish Power. To the
19 extent that any special contracts reach the end of their term during a rate cap or rate
20 freeze period, special contract customers are exposed to significant uncertainty by virtue
21 of having to negotiate new or extended contracts with an entirely unknown entity which
22 is used to dealing in an atmosphere where customers have choice, rather than in an
23 atmosphere where customers do not have a choice of alternate supplier.

24 As expressed in my direct testimony (Pages 49-50) fair treatment of these
25 customers could be assured by requiring PacifiCorp/Scottish Power to renew any

1 contract expiring during the rate cap period, on terms and conditions the same as exist
2 in the current contract. The renewal would be to the end of the rate cap period. If
3 PacifiCorp/Scottish Power are unwilling to do this, the customer should be allowed to go
4 off-system to an alternate supplier of their choice. To make this latter option a viable
5 one for customers, however, there must be some form of RTO with an area-wide
6 transmission rate in place. If there is not, then it would be appropriate to require renewal
7 or extension of the contract at existing rates and on existing terms and conditions.

8 **Q MR. POWELL MAKES A POINT CONCERNING THE CHANGE IN THE RESERVE**
9 **MARGIN SITUATION BETWEEN THE TIME THAT CURRENT SPECIAL CONTRACTS**
10 **WERE APPROVED AND WHEN THEY WILL BE UP FOR RENEWAL. DOES THIS**
11 **INFLUENCE THE POSITION THAT SHOULD BE TAKEN WITH RESPECT TO**
12 **SPECIAL CONTRACTS?**

13 A No. First, Mr. Powell's testimony seems to assume that some situation of excess
14 capacity was the reason for approving each existing contract. That may or may not have
15 been the case. Even if it were the case, and even if owned capacity is no longer surplus
16 to the same extent as previously was the case, this change in circumstance does not
17 address the economics of the contract. It may be that power purchased on the market
18 is an adequate substitute. In other words, to the extent that there is any reason not to
19 renew the special contracts, through the end of the rate cap period, on their current
20 terms as I have suggested, it must flow from a consideration of a significant change in
21 economics—and not merely some perceived change in the amount of "surplus" power.

22 It also should be noted that other consumers are not harmed by the renewal,
23 because their rates are capped during this five-year period. At the end of this period

1 tariff rates would be up for review, as would any special contracts that had been
2 renewed during the rate cap period.

3 **Q PLEASE SUMMARIZE YOUR POSITION WITH RESPECT TO SPECIAL CONTRACTS.**

4 A I recommend that special contract customers be accorded the same degree of
5 protection as tariff customers. Any special contracts that reach the end of their term
6 during this period would be renewed on terms and conditions no less favorable to the
7 customer than the current contract. This renewal would extend the contract to the end
8 of the rate cap period. If an adequate RTO with non-pancaked rates was operational,
9 however, the utility would be allowed to propose to change the prices, terms and
10 conditions of the contract; but the customer would be given the opportunity to utilize
11 PacifiCorp's transmission system to purchase from other suppliers.

12 **Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

13 A Yes.