

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of PacifiCorp and ScottishPower plc for an Order Approving the Issuance of PacifiCorp Common Stock	DOCKET NO. 98-2035-04
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**COMMENTS OF INDUSTRIAL CUSTOMERS ON THE PROPOSED SETTLEMENT
STIPULATION AMONG SCOTTISHPOWER PLC, PACIFICORP, THE DIVISION OF
PUBLIC UTILITIES
AND THE COMMITTEE OF CONSUMER SERVICES**

The Utah Industrial Energy Consumers, the Large Customer Group and Nucor Steel (collectively “Industrial Customers”), consisting of a number of large PacifiCorp customers who have intervened and participated in this case and filed extensive testimony, submit these initial comments and concerns regarding the Stipulation recently submitted in this matter by the Applicants, the Division of Public Utilities and the Committee of Consumer Services. The Industrial Customers do not believe that the Stipulation goes far enough in protecting the public interest.

General Statement. Representatives of the Industrial Customers received a copy of the proposed Stipulation late in the afternoon on Wednesday, July 28, 1999. While the Industrial Customers were invited to provide comments on an earlier draft of the Stipulation, the Stipulation as signed was not accepted or negotiated by the Industrial Customers and did not incorporate many of their suggestions. Among the principal concerns of the Industrial Customers are that the Stipulation does not adequately ensure that potential benefits of the merger will flow to PacifiCorp customers, that PacifiCorp will remain solvent and able to provide needed system improvements, or that special contract customers will participate in any of the assured benefits of the merger.

The proposed merger is designed to create tremendous benefits for the shareholders and

management of both PacifiCorp and ScottishPower – benefits far greater than those promised to customers. The Stipulation fails to ensure proper controls in connection with certain financial and accounting issues, making it less likely that Utah consumers will fully share in potential cost savings resulting from the merger, and leaving the possibility of a weakened local utility. Moreover, the proposed transfer of control of Utah’s primary electric utility to a location across the Atlantic will make it much more difficult for Utah consumers to resolve customer concerns or negotiate contracts. The Industrial Customers urge the Commission to carefully consider the following issues:

1. Taxes. The structure of ScottishPower’s acquisition of PacifiCorp, involving two subsidiaries, a holding company and a Nevada partnership, creates the opportunity for significant income tax savings. ScottishPower has forecasted, in documents it has classified as confidential, that the amount of the potential tax savings is enormous. The proposed Stipulation does not ensure that the income tax savings resulting from the ownership and operation of PacifiCorp will flow through to PacifiCorp customers. The Stipulation states at paragraph 25 that any reductions in the cost of capital resulting from the merger and the companies’ corporate structure will benefit customers. The Industrial Customers suggested that the huge potential tax savings be similarly treated. Unfortunately, their suggestion was not incorporated into the Stipulation, leaving the potential that all of the significant tax benefits may be realized by the consolidated company in a manner that may escape commission consideration in any future case. The Industrial Customers submit that tax savings resulting from the merger should flow to the benefit of PacifiCorp customers. We recommend that paragraph 25 be amended to include taxes.

2. Cash. PacifiCorp has a significant amount of cash on hand that was once intended to be used to repurchase an estimated \$750 million in PacifiCorp stock. The Stipulation permits

PacifiCorp to become a creditor of the new holding company, allowing cash to flow upstream to ScottishPower and leaving PacifiCorp as the holder of notes from its new parent. The Stipulation permits ScottishPower to participate as an affiliate in making and receiving loans and contemplates that the Commission will not review intercompany loans. The Commission should adopt conditions that would preclude the upstream movement of cash until service quality in the State of Utah has been found to be adequate. Only after service quality has been adequately improved--including distribution and transmission systems--should cash be allowed to flow upstream.

3. Access to Employees and Records. Access to employees and records should be the same for customer representatives who have intervened in proceedings or are negotiating or enforcing contracts as for representatives of the Division of Public Utilities or Committee of Consumer Services.

4. Utah Presence. The Stipulation in the Utah Power/PacifiCorp merger required the merged utility to continue to have its Utah operations headquarters in Utah and to maintain in Utah officers and employees responsible for customer service. Unfortunately, the company has not faithfully abided by that condition. Utah customers need and deserve local access to those responsible for customer service decisions concerning Utah operations. Since the merger with PacifiCorp, customer service issues, service quality issues, and contract issues have frequently required the attention of personnel from Portland. As a condition of this merger, the Commission should require that ScottishPower/PacifiCorp provide agents in Utah capable of binding the Company and making decisions regarding Utah operations. Utah customers should not be required to deal with people seven time zones away regarding the terms and conditions of their financial relationships with the Utah monopoly provider of their electrical services.

5. Existing Evidence. Significant amounts of confidential information relevant to this merger are currently stored in the offices of counsel for PacifiCorp and ScottishPower. The parties have not been permitted to make copies or verbatim notes of these documents. The confidential information includes inputs and outputs to valuations performed by Solomon Smith Barney and Morgan Stanley as referred to in the Prospectus, including several PacifiCorp projections for future PacifiCorp operations on a stand-alone basis. It also explains the planned merger behavior of ScottishPower. Such evidence will be relevant in future determinations of merger savings. Only if the results of operation of the merged company exceed the results that PacifiCorp management projected would have been obtained by PacifiCorp on its own can we be assured that the merger has provided benefits in future years. Evidence relevant to such determinations must be preserved for consideration in future rate cases. As a condition of the merger, the Commission should enter an order requiring that copies of all such confidential evidence, including documents relating to projected tax savings and PacifiCorp stand-alone projections, be delivered to the Commission in a confidential format to be preserved under seal by the Commission for use by the parties in subsequent rate cases.

6. Stranded Costs. The Stipulation states that no merger transaction costs will be allowed in rates but provides no assurance that ScottishPower will not attempt to claim as stranded costs the huge premium it is paying for PacifiCorp stock (not only above book value but also above market value). As the electric service market moves inexorably toward customer choice, Utah will face the issue of stranded costs/stranded benefits. In light of premium payments representing 1.8 times book value, there can be no doubt that PacifiCorp shareholders have received full value for any assets that might otherwise be claimed as “stranded” as a result of industry restructuring. Having received such a premium, the shareholders should never be allowed to assert a claim for stranded

costs. Moreover, because ScottishPower is making this acquisition with full awareness of the market value of PacifiCorp's assets and industry restructuring, it has no legitimate claim to stranded costs. The Commission should, therefore, require as a condition of the merger that PacifiCorp and ScottishPower renounce any future claim to any stranded costs relating to PacifiCorp.

7. Regional Transmission Organization ("RTO"). It is clear that the U.S. electric utility industry is moving to a competitive market both at the wholesale level and the retail level. A vibrant competitive market for generation depends heavily upon the ability of generation owners to have nondiscriminatory access to the transmission networks at fair and reasonable prices.

The FERC continues to underscore the importance of this concept. It was most recently addressed in the May 13, 1999 Notice of Proposed Rulemaking (NOPR), Docket RM99-2, on "Regional Transmission Organizations." In this NOPR, the Commission proposes to establish fundamental characteristics and functions for appropriate regional transmission organizations. Nondiscriminatory access to the transmission network at reasonable prices is no less important to retail customers in a competitive environment than to wholesale customers in a competitive environment. Simply stated, unless there is an independent, effective organization to plan, maintain and operate the transmission system, competition will be an illusion rather than a reality.

The Commission should exercise its authority in connection with this merger to assure that ScottishPower does not attempt to balkanize the West by isolating its transmission network. ScottishPower has been ordered by UK regulators to separate its transmission facilities and ScottishPower acquiesced in that requirement. Absent a specific Commission requirement, however, there is no assurance that ScottishPower's approach to the PacifiCorp system will result in the same outcome. If an RTO is not expected to be available within 24 months after the approval of the merger, it should file within 18 months after the approval of the merger a definitive plan outlining

how it would place its transmission assets in the hands of an independent and capable third-party administrator. If the Commission fails to extract this commitment as a condition of merger approval, it may have a difficult, if not impossible, time in requiring this action to be taken after the merger has been approved. The Commission should impose a condition that ScottishPower actively participate in the formation of an RTO under Commission-approved conditions. The Commission should become a participant in the RTO process like other commissions. It should not allow itself to remain a bystander.

8. Special Contracts. The Stipulation includes four years of rate protection in the form of \$48 million in merger credits for Utah tariff customers. During that four-year rate protection period, the terms of most of the existing Utah special contracts will expire. In the past, PacifiCorp has entered into good faith negotiations for the renewal or extension of such contracts several years before their expiration. Special contract customers require several years lead-time in case they ultimately must pursue alternative energy sources. Since the announcement of the merger, PacifiCorp and ScottishPower have been unwilling to enter into good faith negotiations to extend the expiring contracts, despite the approaching end of existing contract terms.

Nearly every witness in this case has confirmed the existence of significant risks that will be faced by Utah consumers as a result of the merger. Indeed, those risks caused the Division and the Committee to reject the merger absent significant concessions—including the four-year merger credit. The special contract customers face essentially all of the same risks that will be faced by other Utah consumers as well as risks unique to special contracts customers. The Stipulation provides them with no assurance of participation in any guaranteed merger benefits. The guaranteed merger credit benefits were apparently sufficient in the judgment of the Division and Committee to outweigh the merger risks facing tariff customers. There is nothing in the Stipulation to mitigate the

risks faced by special contracts customers. Special contract customers should be provided protection during the period of the merger credit to avoid discriminatory treatment.

The special contract customers do not seek a portion of the guaranteed rate credits, but rather another form of risk mitigation through the four-year merger credit period. Special contracts should be extended to the end of the four-year rate credit period, so long as the rates cover the cost of providing the services. Otherwise, these Utah companies--including some of Utah's largest employers, many of whom are already experiencing very difficult financial circumstances—may incur significant unnecessary and uneconomic expenses or be left to the whims of a new utility with whom they have no history or experience. The Industrial Customers submit that, in order to ensure that PacifiCorp's special contract customers in Utah receive benefits of the merger and protections against risks of the merger commensurate with PacifiCorp's other retail customers, the following conditions should be adopted:

In order to ensure that PacifiCorp's special contract customers in Utah receive benefits of the merger and protections against risks of the merger commensurate with PacifiCorp's other retail customers, it is agreed as follows:

(1) PacifiCorp will honor all of its obligations under existing special contracts and will not seek or support any effort to increase the rates provided in existing special contracts during their remaining terms.

(2) PacifiCorp will negotiate contract extensions in good faith with each existing special contract customer.

(3) Each special contract that expires during the merger credit period will be extended through December 31, 2003, if desired by the customer, provided that:

a. In order to ensure that PacifiCorp's other Utah customers are no worse off as a result of the extension, projected revenues throughout the extended contract period must be sufficient to cover the projected costs of providing service (determined in a manner similar to when the existing contract was approved).

b. In order to ensure that PacifiCorp's shareholders are no worse off as a result of the extension, if the Commission adopts material changes in the historical treatment of special contract costs and revenues so as to place significantly greater economic risks on PacifiCorp's shareholders as a result of special contract extensions, PacifiCorp will not be required to extend special contracts thereafter.

c. Either party may terminate a special contract extension, upon twelve months' advance notice to the other party, if special contract customers have reasonable access to competitively priced market power as a result of changes in federal or state laws or regulations and the electric power market is workably competitive.

d. If it is determined under the principles stated herein that a special contract cannot be extended on rates and terms substantially similar to those in the existing contract, then PacifiCorp will not oppose efforts by that special contract customer to obtain service from alternative sources available or potentially available under existing laws.

(4) If the parties do not reach agreement on rates or terms for a contract extension no later than eighteen months prior to the end of the current term, the customer may ask the Commission to mediate or appoint a mediator or, failing agreement in mediation, to act as or appoint an arbitrator to establish appropriate rates and terms for the contract extension under the principles provided herein.

Conclusion. The Industrial Customers have grave concerns about the proposed merger.

PacifiCorp customers face significant risks as a result of this merger, yet most of the claimed benefits are extremely speculative and uncertain. The Stipulation provides an excellent beginning point for mitigating against many of the most obvious risks. Unfortunately, it does not go far enough. The Industrial Customers respectfully submit that the merger application should not be approved without the additional conditions outlined in this memorandum. The Industrial Customers intend to provide testimony at the hearing in support of these requested conditions.

Respectfully submitted, the 2nd day of August, 1999.

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CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 1999, I caused to be mailed, first class, postage prepaid, a true and correct copy of the foregoing to:

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