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ATTORNEYS FOR NUCOR STEEL, A DIVISION OF NUCOR CORPORATION

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 INITIAL BRIEF OF NUCOR STEEL, A DIVISION OF NUCOR CORPORATION

Pursuant to Utah Code Ann. § 63-46b-8 (1992) and the Commission's order from the bench in this proceeding, [1] Nucor Steel, a Division of Nucor Corporation ("Nucor"), hereby submits its Initial Brief in the above-referenced proceeding before the Public Service Commission of Utah.

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[1] Tr. 1536 at 3-9. This reference style, which Nucor will use throughout this Initial Brief, signifies page 1536 of the transcript, at lines 3 through 9.

I. INTRODUCTION AND BACKGROUND

In December 1998, PacifiCorp and ScottishPower PLC (collectively the "Applicants") filed an application with this Commission seeking an order approving the issuance of common stock by PacifiCorp. This stock issuance was designed to facilitate a transaction making PacifiCorp a wholly-owned subsidiary of a U.S. holding company, and a sister company of ScottishPower. The agreement between the Applicants is contained in an "Amended and Restated Agreement and Plan of Merger," dated as of December 6, 1998, and amended as of January 29, 1999 and February 9, 1999. (This transaction will be referred to herein as the "merger.") The Applicants and numerous intervenors filed testimony in this proceeding. Nucor filed the direct and rebuttal testimony of Dr. Dennis W. Goins in support of its positions. The Applicants, the Utah Division of Public Utilities (the "Division" or the "DPU"), and the Committee of Consumer Services (the "Committee" or the "CCS") agreed upon and filed a Stipulation (Ex. Stipulation-1) prior to the commencement of the hearing in this docket, which began on August 2, 1999.

Taken as a whole, the testimony, the evidence introduced at hearing, and the responses to cross-examination lead to the inescapable conclusion that the proposed merger, even as modified by the terms of the Stipulation and additional promises made by the Applicants during the hearing, provides scant quantifiable benefits for ratepayers[2] – benefits that in sum are insufficient to outweigh the very significant uncertainties and risks the merger imposes on ratepayers. This is particularly true for PacifiCorp's current special contract customers, who see largely speculative benefits yet bear real merger-related risks.

Additional conditions are required to ensure that the merger protects not only special contract customers, but all Utah ratepayers. Nucor urges the Commission to impose sufficient conditions to guarantee that the merger is in the public interest, and Nucor suggests that, in addition to those protections already promised in the Stipulation and during the hearing, merger approval should be conditioned on the acceptance by Applicants of the following additional conditions:

(1) Rates of all Utah tariff customers should be capped and all provisions of the Stipulation should be adopted as conditions of merger approval;

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[2] *See* Tr. 17 at 12-14 (Alt).

(2) Current Utah special contract customers should have the option of having their contracts extended through the transition period on current terms and conditions, subject to Commission approval;

(3) The Applicants should be required to acknowledge that if the Commission determines that tax savings result from the merger, then those tax savings will go to benefit customers, through rate reductions. Whether tax savings are created and the amount of any savings should be left for a future proceeding; and

(4) The Applicants should be required to waive any and all future claims to stranded costs relating to existing generation- and transmission-related assets, as well as claims relating to the merger premium and/or merger transaction costs, in any proceeding.

Without conditions sufficient to ameliorate the uncertainties and risks remaining after the adoption of the Stipulation, as well as ensure that no single group of customers is singled out for disparate treatment, the proposed merger will not be in the public interest.

II. THIS MERGER, AS PROPOSED AND AS MODIFIED BY THE STIPULATION, DOES NOT SATISFY THE STANDARD FOR APPROVAL

To satisfy the "public interest" standard, the merger must produce quantifiable net benefits that are shown to result from the merger. As currently constructed and conditioned, however, this merger produces much uncertainty, little benefit, and retains, despite the Stipulation, significant risks for customers, and particularly for special contract customers.

A. The Applicants Must Demonstrate Net Positive Benefits That Result From the Merger

Utah Code sections 54-4-28 to 31 require that public utilities seeking to combine, merge, consolidate, acquire voting securities of another utility, acquire the property of another utility, or issue securities, obtain the consent and approval of the Public Utilities Commission, which is only to be granted upon a showing that the proposed transaction is in the "public interest." UTAH CODE §§ 54-4-28 to 31. The Commission has adopted a "positive benefits" standard for determining whether a merger is in the public interest. *Re Utah Power and Light Company*, 90 PUR 4th 555 (Utah P.S.C. 1987) ("*UP&L I*").

As the Commission has formulated this standard, a merger is in the public interest if "the expected benefits of the merger to the Utah jurisdiction outweigh the costs and potential detriments associated with it." *Re Utah Power and Light Company,* 97 PUR 4th 79, 125 (Utah P.S.C. 1988) ("*UP&L II*"). Merely showing the absence of negative impacts from the merger is inadequate under

this standard. *UP&L I*, 90 PUR 4th at 555. The positive benefits standard places the burden on the applicants to show that the merger will result in benefits that could not be achieved without the merger. *Id*. Finally, in *UP&L II,* the Commission made it clear that the burden is on the applicants to *quantify* the savings resulting from the merger. *UP&L II*, 97 PUR 4th at 101.

[3]

With the exception of the four-year, $12 million per year merger credit provided in the Stipulation (which eliminates the guarantee of a $10 million reduction in annual corporate costs[4]), the Applicants have not quantified annual cost savings created as a result of the merger,[5] nor has any plan been put forward to show how savings will be achieved – only broad generalities support the claim of $10 million in cost reductions.[6]

B. The Merger Creates Significant Risks that Were Recognized by All Parties

Virtually every witness that examined the proposed merger (other than those from the Applicants) identified significant potential risks to customers. Division, Committee, Nucor, Utah Industrial Energy Consumers ("UIEC"), Large Customer Group ("LCG"), Utah League of Cities and Towns, and Deseret Generation and Transmission Co-operative, Inc. witnesses all identified specific risks, concerns, and/or detriments related to the proposed transaction. For example, the Division of Public Utilities acknowledged that large risks and great uncertainty will come with the proposed merger:

> "This proposed merger . . . is expected to bring very small assured benefits and large uncertainties and risk."[7]
> "[T]he foremost concerns are that service quality and reliability may get worse and rates may go up as a result of the proposed merger."[8]

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3 Committee witness Gimble concluded that "the Applicants shoulder a heavy burden to demonstrate that the positive net benefits are both *significant* and *sustainable* over time." Direct Testimony of Daniel E. Gimble, Ex. CCS-1 ("Gimble Direct"), p. 7 at 22-23 (emphasis in original).

4 Tr. 982 at 8-10 (MacRitchie).

5 *See* Supplemental Testimony of Alan V. Richardson, Ex. SP-1S ("Richardson Supplemental"), p. 3 at 4-7.

6 *See* Direct Testimony of Maurice Brubaker, Ex. UIEC-1 ("Brubaker Direct"), p. 10 at 20-22.

7 Direct Testimony of Lowell B. Alt, Jr., Ex. DPU-1 ("Alt Direct"), p. 9 at 14-16; *see also* Tr. 17 at 10-14 (Alt).

8 *See* Alt Direct, p. 5 at 5-12, *see also* Direct Testimony of Dr. Dennis W. Goins, Ex. Nucor-1 ("Goins Direct"), p. 10 at 6-10.

"[T]he degree of unsubstantiated claims is enough to stagger all but the most sanguine supporter."[9]

The Committee shared these concerns:

> In my opinion, a ScottishPower acquisition would bring financial costs, risks and uncertainties to PacifiCorp and its customers that are not offset by a possible improvement in PacifiCorp's operating efficiency.[10]

Large Customer Group witness Anderson identified in direct testimony some of the risks posed by the merger:

> Efforts to recover acquisition premiums, transition costs and transaction costs, to shore up uncertain U.K. returns and to fund significant shareholder dividends will create tremendous pressure to slash personnel, maintenance and operating budgets and other costs, resulting in significant risks of reduced quality of service and reliability degradations over time, with the potential for staggering economic damages to PacifiCorp customers.[11]

The testimony, as well as evidence adduced at hearing, serves to elaborate on the concerns identified at the outset of the case.

1. The Merger Will Create Upward Pressure on Rates

Notwithstanding the promises made in the Stipulation, the large acquisition premium paid by ScottishPower, the speculative nature of the merger's cost savings, the cost of investment to improve service, and the potential transition costs and/or transaction costs all could exert pressure on ScottishPower to seek base rate increases in PacifiCorp's regulatory jurisdictions.[12] In order to justify the purchase price,[13] dividend policy, and promised expenditures, it appears that ScottishPower will seek to push PacifiCorp's earned return up to the regulatory ceiling, primarily by capturing merger-related cost savings for shareholders.[14] Committee witness Talbot recognized this risk:

> No doubt, ScottishPower will attempt to improve PacifiCorp's operating efficiency,

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9 Direct Testimony of Dr. William A. Powell, Ex. DPU-4 ("W. Powell Direct"), p. 2 at 6.

10 Direct Testimony of Neil H. Talbot, Ex. CCS-4 ("Talbot Direct"), p. 4 at 28-30.

11 Direct Testimony of Richard M. Anderson, Ex. LCG-1 ("Anderson Direct"), p. 63 at 30-34.

12 *See* Goins Direct, p. 10 at 19-21.

13 The acquisition premium "puts extra pressure on ScottishPower to make a success of the acquisition." Talbot Direct, p. 25 at 4-5; *see also* Brubaker Direct, p. 24 at 13 to p. 26 at 2.

14 Goins Direct, p. 10 at 21-23; *see also* Brubaker Direct, p. 21 at 3-21; Anderson Direct, p. 39 at 32-35.

> but it has refused to provide customers or regulators with any rate guarantees. PacifiCorp itself has already embarked on a program of efficiency improvements and it is not clear that ScottishPower will significantly improve the efficiency outlook. By refusing to provide any rate guarantees, ScottishPower appears to be attempting to retain prospective cost savings in order to maintain its high dividend growth. The operation of "regulatory lag" can allow a utility to delay the re-setting of rates to reflect efficiency gains for a period of approximately three years.

[15]

If these speculative cost savings do not materialize, ScottishPower will face significant pressure to seek base rate increases from PacifiCorp's customers in order to fulfill shareholder expectations. Given the inherent difficulty, particularly several years into the future, of identifying and protecting ratepayers against "merger-related" costs, it will be nearly impossible to protect against rate increases driven by a desire to indirectly recover merger-related costs.

2. The Merger Will Create Pressure to Cut Costs Below Levels Necessary to Operate Safely and Reliably

The combined company will be under significant pressure to cut costs in order to enhance shareholder value.[16] Applicants' proposal creates the real threat that necessary capital investment and equipment maintenance expenditures will be sacrificed to meet the combined company's dividend objective.[17] A stated goal of ScottishPower's is to reduce non-production costs from $350 per customer to $210 per customer.[18] Achieving this goal requires savings approaching $200 million.[19] Intervenors in this case have expressed concern that the merger will adversely affect service quality and reliability.[20] While the Stipulation certainly takes some steps towards mitigating service quality risk, the admitted difficulty in identifying merger-related costs in the "out-years," coupled with the considerable dollars at stake, create uncertainty (and therefore risk) as to the ability

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[15] Talbot Direct, p. 4 at 31 to p. 5 at 9. ScottishPower's history is to attempt to retain cost savings for investors:

> In the case of ScottishPower, it appears that *if* the company did indeed achieve greater efficiency gains than its peers, the gains were reflected in higher profits for investors, not lower rates for customers, during the past five or ten years.
> Talbot Direct, p. 12 at 31 to p. 13 at 3 (emphasis in original).

[16] *See* Tr. 1227 at 2-24 (Anderson).

[17] Anderson Direct, p. 40 at 5-7.

[18] Tr. 923 at 13 to 924 at 6 (MacRitchie).

[19] Tr. 925 at 18-23 (MacRitchie); *see also* Tr. 1152 at 12-15 (Anderson).

[20] *See* Tr. 16 at 19-21 (Alt); *see also* Goins Direct, p. 10 at 6-10.

and willingness of ScottishPower to maintain safety and reliability in the long run.

3. The Merger May Create Pressure to Sell Major Assets

Pressure on ScottishPower to increase earnings as a result of the large acquisition premium and uncertain cost savings could also force ScottishPower to sell major generation and/or transmission assets.[21] In response to Commissioner White's inquiry about the possibility of ScottishPower selling off generation, Mr. Alt testified that we will "have to take them at face value" that it is not in their strategy.[22] Even with a provision in the Stipulation that purports to provide protection (paragraph 9), upon further questioning, Mr. Alt suggested that the Commission could *probably* address this issue in the future.[23] It is precisely this type of uncertainty that should give the Commission pause, and that creates continuing risk associated with this merger.

4. The Merger Will Once Again Make PacifiCorp a Diversified International Company – This Strategy Already Failed

The Applicants' merger proposal contravenes PacifiCorp's recent move to refocus on its core electricity business in the western United States. ScottishPower is in an aggressive acquisition phase that will likely continue after this merger.

[24] Many of PacifiCorp's recent financial disappointments resulted from an aggressive expansion strategy very similar to that now being pursued by ScottishPower.[25] This global expansion will dilute many resources and certainly occupy the time and attention of management. Poor investment results under this aggressive strategy could impair ScottishPower's ability to raise equity capital, thereby making it more difficult for PacifiCorp to raise capital as well.[26]

C. The Benefits Attributed to the Merger Are Slight, Speculative and Not Caused by the Merger

In spite of a merger standard that focuses on a required showing of net quantifiable benefits,

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21 *See* Goins Direct, p. 18 at 12-15.
22 *See* Tr. 1228 at 19 (Alt).
23 *See* Tr. 1228 at 4-15 (Alt).
24 *See* Brubaker Direct, p. 22 at 11-15.
25 *See* Brubaker Direct, p. 22 at 21 to p. 23 at 2; *see also* Anderson Direct, p. 48 at 15 to 49 at 2.
26 *See* Brubaker Direct, p. 22 at 17-20.

the only quantifiable benefits the Applicants, Division, and Committee would attach to this merger (the merger credit) are minimal in light of the scale of the merger and its concomitant risks. The other claimed benefits are entirely speculative and unquantifiable, and in many cases not even clearly attributable to the merger. Committee witness Biewald recognized the nature of the Applicants' claims:

> As for any additional cost savings [beyond the $10 million], ScottishPower makes positive but unsubstantiated and noncommittal claims. I recommend that the Utah Public Service Commission (Commission) take a skeptical view toward cost savings that are not backed up by enforceable guarantees and specific mechanisms. . . . I also recommend that the Commission not approve the merger on the basis of ScottishPower's unsubstantiated and noncommittal claims.

[27]

1. Quantified Benefits to Ratepayers Are Slight (Especially When Compared to Benefits Received by Shareholders and Management)

Numerous witnesses in this proceeding noted the disparity between the merger benefits being received by shareholders and senior PacifiCorp management, and those being provided to customers.[28] Committee witness Gimble described this disparity:

> A stark asymmetry presently exists between what ScottishPower is offering PacifiCorp's shareholders (a premium in excess of $750 million) and executive management (prospective "golden handshakes" totaling $7 million for PacifiCorp's top executives), and what ScottishPower is offering PacifiCorp's ratepayers ($10 million in corporate overhead and "soft promises" in other areas).

[29]

The Applicants' promise of a $48 million merger credit (a net present value of approximately $37.5 million[30]) to be shared amongst all its tariff ratepayers over a four year period[31] is inadequate, and the credit is relatively small.[32] To put this promise in perspective, it is notable that: (1) PacifiCorp and ScottishPower paid $61 million in advisory fees, excluding lawyers fees,[33] and (2)

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[27] Direct Testimony of Bruce E. Biewald, Ex. CCS-2 ("Biewald Direct"), p. 5 at 6-14.
[28] *See, e.g.*, Tr. 17 at 19 (Alt); Tr. 27 at 6 (Gimble); Tr. 1143 at 17 (Anderson).
[29] Gimble Direct, p. 30 at 16-20 (footnote omitted).
[30] Tr. 1146 at 3-15 (Anderson).
[31] *See* Tr. 700 at 13-23 (O'Brien).
[32] *See* Tr. 1194 at 14-25 (Anderson) (the rate credit is insufficient to "get us over the bar.")
[33] Tr. 699 at 12-13 (O'Brien).

the premium shareholders would receive, if the share price were the same as on the date the merger was announced, would be $1.8-1.9 billion.[34] Given these facts, the $48 million merger credit is relatively insignificant.[35] As Nucor witness Goins put it, "two of [my] more important concerns . . . are not addressed by the stipulation, . . . one . . . is the sharing of merger related savings on an equitable basis. And in particular, between the various stakeholders."[36] Committee witness Gimble concluded that, "[W]hile shareholder benefits are large ($750 million-plus), immediate and known, ratepayer benefits appear to be small ($10 million), distant and unverifiable."[37] The only real cost benefit created by the Stipulation is that the small amount of benefits are fixed and provided sooner.

2. Certain Claimed Benefits Represent Nothing But Speculation on the Part of the Applicants

The performance standard enhancements and customer guarantees serve as a linchpin to the benefits ScottishPower claims to bring to PacifiCorp. However, on closer inspection, ScottishPower's claims as to the "benefits" provided by improved performance standards and customer guarantees turn out to be the most glaring example of the speculative nature of the claimed merger-related benefits:

> Q: Do ScottishPower's proposed performance standards and customer guarantees represent a powerful argument for approving the merger?
> A: No. As described in my testimony below, ScottishPower's proposals appear to be well-intentioned, and should move PacifiCorp in appropriate directions. However, there is no clear connection between improving PacifiCorp performance and the merger. In fact,
> - PacifiCorp's performance in most areas is not particularly problematic.
> - PacifiCorp should be able to obtain the skills necessary to improve performance in many ways, with or without the aid of ScottishPower.
> - The proposed improvements are generally vague and minor.
> - Some of the improvement targets cannot be set meaningfully until PacifiCorp has improved its data-collection system and determined the baseline from which improvements will be made.
> - ScottishPower has not clearly defined portions of its proposal.
> - ScottishPower does not appear to have thought through the cost-effectiveness

[34] Tr. 138 at 11-13 (Larson); Tr. 892 at 24 to 893 at 1 (Morris); Tr. 695 at 3-19 (O'Brien).

[35] Dr. Anderson testified that he does not think this credit, taken with all the other facts relating to the merger, is sufficient to render the merger in the public interest. (Tr. 1147 at 13-15.)

[36] Tr. 1018 at 18 to 1019 at 2 (Goins).

[37] Gimble Direct, p. 16 at 16-18.

of alternative levels of reliability at PacifiCorp, and may have made uneconomic investments for reliability in its UK service territories.

In summary, ScottishPower's service proposals, while superficially attractive, are not well thought through. ScottishPower has promised improvements without knowing the baseline performance level from which the improvement will be measured, and without being clear about what it is promising.

[38]

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 (system average interruption duration index) and MAIFI (momentary average interruption frequency index) create about $60 million in annual benefits to ratepayers.

[39] The proposed improvements are minimal, however, and are approximately the same as the normal levels of annual SAIDI, SAIFI, and MAIFI variance.[40] Moreover, ScottishPower has neither quantified the cost of meeting the incremental reliability improvements, nor demonstrated that customer benefits outweigh the cost.[41] The $60 million in annual value stemming from improvements in network performance standards are unsubstantiated and illusory. By the Applicants' own admission, the $60 million estimate is based on a survey performed by the Bonneville Power Administration and the Electric Power Research Institute in 1990. This survey was performed for a different utility serving different customers in different conditions and was performed almost a decade ago. Committee witness Chernick describes the problem:

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[38] Direct Testimony of Paul Chernick, Ex. CCS-3 ("Chernick Direct"), p. 4 at 19 to p. 5 at 21.

[39] *See* Goins Direct, p. 8 at 11-14. Committee witness Chernick noted that a portion of the benefits claimed for SAIDI are actually attributable to SAIFI (system average interruption frequency index). Chernick Direct, p. 33 at 16 to p. 34 at 12.

[40] *See* Chernick Direct, p. 23 at 8 to p. 24 at 2.

[41] *See* Goins Direct, p. 9 at 1-3.

> ScottishPower's use of data from the Bonneville Power 1990 survey (cited extensively by Richardson at AVR-2) makes an inherently uncertain exercise particularly unreliable.

[42]

Division witness Alt testified that the Division "didn't really count on [the $60 million benefit] because, to me, we saw a probability that it could go the other way."

[43] As Dr. Richard Anderson testified "[n]o weight should be given to this weak attempt to quantify claimed benefits."[44]

Likewise, the possibility of additional rate reductions are purely speculative, as PacifiCorp's witness O'Brien expressly admitted under cross-examination. ("I think they are speculative, yes."[45]). Applicants vacillate between steadfastly supporting their potential cost savings when arguing the benefits of the merger and exhorting the complexities inherent in cost cutting strategies when asked to commit to reductions.[46] Other statements by Mr. O'Brien implicitly acknowledge the speculative nature of price reduction "benefits":

> [ScottishPower] can assist us in realizing our cost reduction programs. They have a proven track record of using a different set of tools, tools that PacifiCorp doesn't have or has not employed. We *think* that that *should* lead to prices that are lower than they otherwise would have been.[47]

Vague claims as to the potential for cost reductions and lower prices cannot be included in any reasonable summary of merger benefits.

3. Numerous Claimed Benefits Are Not Caused by the Merger

Applicants failed to show that many of the claimed benefits that allegedly arise from the

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[42] Chernick Direct, p. 34 at 13-15.

[43] Tr. 472 at 16-18 (Alt).

[44] Anderson Direct, p. 13 at 36-37; *see also* Goins Direct, p. 8 at 21 to p. 9 at 3; Brubaker Direct, p. 14 at 5-14. Moreover, Dr. Anderson notes that customers will largely be expected to pay for all of the system reliability enhancements. ScottishPower can hardly claim merger benefits stemming from system improvements funded by the customers. Anderson Direct, pp. 13-14

[45] Tr. 764 at 24-25 (O'Brien).

[46] *See* Brubaker Direct, p. 19 at 3 to p. 20 at 30.

[47] Tr. 666 at 7-12 (O'Brien) (emphasis added).

merger, are in fact a *sine qua non* of the merger. On the contrary, the evidence shows that PacifiCorp could have obtained or was in the process of obtaining benefits that are allegedly merger-related. With regard to the performance standard enhancements, several witnesses noted the lack of nexus between the claimed benefits and the merger:

> Furthermore, there is no demonstration that this degree of improvement could not be accomplished through a more concentrated effort by PacifiCorp, without the merger. Even setting aside the other concerns, which I just expressed, there is no showing that these benefits could not be achieved absent the proposed merger. Thus, they are not entitled to consideration as merger benefits.[48]

Committee witness Chernick came to the same conclusion:

> My most important recommendation with regard to the application in this proceeding is that nothing that ScottishPower has offered with respect to the performance standards and customer guarantees demonstrates any significant benefit from the merger.[49]

As to cost savings, PacifiCorp witness Richard T. O'Brien testified that the management of PacifiCorp was already taking steps to achieve cost cutting goals:

> In October of last year, as you've heard, PacifiCorp announced a strategy to return to its roots. In short, PacifiCorp identified that it must focus on its core business, the domestic western electric utility business; shut down all other endeavors with the exception of Powercor; embark on a cost reduction program, commit [PacifiCorp] and its staff to higher levels of customer service; and in addition, we simultaneously announced a share repurchase program designed to support

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[48] Brubaker Direct, p. 14 at 10-14. Indeed, PacifiCorp has undertaken a number of programs since 1996 designed to improve customer service and reliability. *See* Ex. LCG-1.8

[49] Chernick Direct, p. 42 at 17-20. Mr. Chernick elaborated on this position as follows:

> Q: Has ScottishPower demonstrated that the merger would provide service- or reliability-related resources to PacifiCorp that PacifiCorp could not obtain elsewhere?
>
> A: No. In some cases, the resource that ScottishPower would bring to the merger seems to be little more than familiarity with available commercial products, such as improved databases for collecting and processing reliability data. In other cases, ScottishPower is offering little more than a can-do attitude and a determination to improve the operation of systems (such as distribution line maintenance) that PacifiCorp already understands well.
>
> PacifiCorp may need to bring in some new, customer-oriented (or results-oriented) managers from other companies or other industries, to shake up aspects of the corporate culture. If so, some of the ScottishPower managers who are prepared to relocate to PacifiCorp's service territory may be good candidates for those jobs. But it is far from clear that PacifiCorp lacks much of the technical and managerial resources needed to achieve the goals ScottishPower has proposed, and in much the same time frame.
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> Chernick Direct, p. 37 at 17 to p. 38 at 11 (footnote omitted).

> PacifiCorp's share price and return capital to our then dissatisfied investors.[50] . . .
>
> [PacifiCorp's] general plan … was to use a combination of cost reductions and price increases to get nearer to our authorized returns and provide earnings growth to [PacifiCorp's] shareholders.[51]

As far as the impact of those measures is concerned, PacifiCorp witness O'Brien acknowledged under cross-examination that the pre-merger PacifiCorp savings programs were having "[a] good effect."[52] Evidence was introduced at hearing demonstrating that PacifiCorp did intend to pursue future cost-cutting strategies, as well as its estimates as to the effectiveness of those strategies.[53] Other witnesses concurred:

> The results of the "Refocus Program" are just now beginning to materialize and should continue to unfold over a number of years. Attributing benefits to the merger as opposed to the "Refocus Program" will be difficult. Customers will risk underwriting ScottishPower's transition programs when, in the absence of such actions, they might reap benefits from the "Refocus Program" at no incremental cost.

[54]

Moreover, given the utter lack of a point of reference for alleged savings, there is a serious question as to whether *any* of the cost savings that the Applicants claim will arise from the merger will in fact be a result of the merger. Mr. O'Brien testified that:

> I think it's very difficult to compare forecasts from merged entities to standalone entities. And while we have a standalone plan . . . we were not in a position to have spent enough time to know where each and every individual cost cut or each and every individual rate case was going to go and what it was going to result in. . . . I think it's very, very difficult to be able to make those sorts of comparisons in any meaningful way.[55]

Mr. O'Brien likewise conceded that it is difficult to enforce a commitment that rates will not increase in the out years as a result of the merger.[56] In response to a question from Chairman Mecham, Mr.

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50 Tr. 664 at 20 to 665 at 6 (O'Brien).

51 Tr. 719 at 4-8 (O'Brien).

52 Tr. 682 at 5-7 (O'Brien). Indeed, Mr. O'Brien stated that if the merger is not approved, PacifiCorp would be "in a better position than it has been to effectively deliver service to customers at a reasonable price." Tr. 791 at 12-14 (O'Brien).

53 *See* Cross-Examination Exhibit 23 (Highly Confidential). Nucor directs the Commission's attention to the base or conservative case performance expected by each applicant.

54 Anderson Direct, p. 35 at 23-27.

55 Tr. 767 at 22 to 768 at 19 (O'Brien).

56 Tr. 770 at 11-16 (O'Brien).

O'Brien testified that PacifiCorp's standalone plan did not contain sufficient specificity to act as a point of comparison. [57]

Nucor shares the Chairman's apparent concern with the difficulty in precisely ascertaining merger savings without some form of comparison. Committee witness Biewald recognized this as well, noting that, "[a] true analysis of the 'benefits of the merger' would compare scenarios with and without the proposed merger."

[58] On additional questioning from Chairman Mecham as to how benefits that "result from the merger" will be measured, Applicants' witness Mr. Wright said:

> The yardstick, the comparison tool, I think – well, I think it will become clear when we file the transition plan, because that will incorporate the initiatives that we believe are directly as a result of ScottishPower bringing its skills and experience to PacifiCorp and pursuing a number of initiatives to make the business more efficient.[59]

Thus, there will be no stand-alone PacifiCorp point of comparison – only the Transition Plan.

Without some kind of base line or starting point which indicates what the cost levels would be without the merger, it will be impossible to determine, in some future period of time, whether a "lower than before" cost item was the result of a combination of corporate functions and the introduction of efficiencies that resulted from the merger, or whether the reduction was the result of cost reductions that would have or could have occurred in the absence of the merger.

D. The Stipulation Does Not Bring the Risks and Benefits Into Balance

The Utah public interest standard requires a showing of quantifiable net benefits caused by the merger. Given the slight benefits and the substantial risks identified above, the Stipulation must act as an effective tool to remedy those risks for the merger to be in the public interest. However, due to a variety of limitations, the Stipulation will not act to fully mitigate the risks and uncertainties

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[57] Tr. 793 at 11-22 (O'Brien).
[58] Biewald Direct, p. 12 at 3-5.
[59] Tr. 210 at 3-10 (Wright).

facing Utah customers.

1. The Stipulation Does Not Cover All Risks Imposed by the Merger

As was acknowledged on cross-examination by DPU witness Alt, the Stipulation does not perfectly protect against the merger-related risks identified by Division and Committee witnesses:

> Q: Okay. And as I understand the rationale, it's because the risks couldn't be perfectly mitigated, you want to have some guarantee of benefits that essentially put this over the top in terms of meeting the net benefit standard?
>
> A: That's right.

[60]

Likewise, CCS witness Gimble and ScottishPower witness Wright concurred with Mr. Alt's opinion.[61] It was because of this lack of complete protection that the Stipulation included a "merger credit."[62]

2. To the Extent the Stipulation Protects Against Cost Increases or Permits Pass-Throughs of Savings, The Difficulty in Identifying Merger-Related Savings and Costs Diminishes the Stipulation's Usefulness

One of the recurring themes of the hearing was the difficulty the Commission is likely to face in attempting to "track merger related costs [and] merger related savings."[63] Given this difficulty, it is impossible to conceive how, in future years, the Stipulation can be an effective remedy to the myriad identified risks. Division witness Alt explained the meaning of one Stipulation provision this way:

> Q If, as a result of a change in management, a change of philosophy arises having to do with rate cases, would that change in management and change of philosophy be an event that this paragraph [44] would preclude as a cause for rate increases?

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[60] Tr. 361 at 25 to 362 at 6 (Alt).

[61] Tr. 362 at 16-22 (Gimble); Tr. 175 at 20-22 (Wright).

[62] Tr. 361 at 25 to 362 at 6 (Alt); Tr. 362 at 16-22 (Gimble); Tr. 175 at 20-22 (Wright).

[63] *See, e.g.,* Tr. 1195 at 9-10 (Anderson); *see also* Tr. 1201 at 15-24 (Anderson).

> A Well, my opinion would be that possibly. I think that it's a very simple general statement and I think that each party in a future rate case should have the right to interpret it as they see fit and make a presentation and argue for whatever treatment that their interpretation would support, and so I wouldn't preclude any party's position at this point. I think it's – you know, can be interpreted in a lot of different ways today.

[64]

In other words, the Stipulation is nothing more than an invitation to argue later, with guidelines as to some of the parameters.

[65] As to identifying merger-related costs and savings, the Stipulation offers few assurances to ratepayers. Mr. Alt reiterates this difficulty:

> Q: Mr. Alt, what kind of an investigation are we going to have to conduct to present evidence to this Commission to help it sort out what is as a result of this merger in light of at least a coincidence of the two events occurring simultaneously?
>
> A: I think that's a very difficult question to answer. I think each party is going to submit whatever they think will carry their burden in making the demonstration.

[66]

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[64] Tr. 1362 at 19 to 1363 at 7 (Alt).

[65] Certain Stipulation provisions, such as paragraph 9, are so vague as to depend almost entirely on future argument before the Commission. *See* Tr. 163 at 14 to 164 at 7 (Alt); Tr. 165 at 21 to 166 at 3 (Alt).

[66] Tr. 1365 at 8-17 (Alt).

Mr. MacRitchie claims that these issues only arise in the short term.[67]

Nucor, on the contrary, believes that we should expect battles for years to come as to what costs and savings are merger-related. To maximize shareholder values, the Applicants will have a great incentive to hide merger-related savings (so as to keep the savings) and characterize cost increases as non-merger related (so as to avoid the Stipulation's prohibitions on merger-related cost increases). One potential example of this incentive was noted by Dr. Anderson. While the Applicants have the ability to offset the $12 million in merger credits for the last two years of the credit, if the Applicants actually include $12 million in savings in rates, those savings will be provided to customers in perpetuity. The incentive is thus to pay the credit, and retain the savings for shareholders.[68]

Only when we see the transition plan will we begin to have an inkling as to the costs and savings associated with this merger. Even with the transition plan, however, the Commission and interested parties will find themselves limited. There will be no input to the transition plan from interested parties, nor will the transition plan be subjected to Commission review.[69]

Mr. Wright was straightforward in describing these limitations facing the Commission in determining merger savings:

> Q: What if hypothetically the merger plan filed six months after the merger is approved – or the transition plan shows $5 million a year can be captured in efficiencies and that's all? Is it your view that the Commission is basically stuck with that determination, that it can't say, No, no. Merger savings are more than that?
>
> A: Well, it would be difficult, I think, for the Commission to determine that the savings there were more than that. . . .[70]

3. The Portions of the Stipulation That Merely Restate Current Obligations Do Not Provide Significant Benefits

Certain provisions in the Stipulation simply reiterate current obligations of PacifiCorp, even

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67 Tr. 1494 at 22 to 1495 at 17 (MacRitchie).
68 Tr. 1160 at 2-10 (Anderson).
69 Tr. 194 at 11-16 (Wright).
70 Tr. 195 at 19 to 196 at 3 (Wright).

though the merger will not affect these obligations. All or part of Stipulation paragraphs 2(b), 2(c), 2(f), 5, 8, 19, 37, 39, and 46 set forth existing obligations of PacifiCorp. For example:

> Well, what we were trying to do in a lot of these conditions, even if some people may feel the Commission had the authority, we wanted to make it clear that there was no doubt about it, and this [Stipulation paragraph 2(f)] is one of those cases.
>
> [71]
>
> [W]e felt, by putting this in [Stipulation paragraph 8], we're putting the Company, ScottishPower and PacifiCorp on notice, there is a rule that deals with this risk and you have to follow it.[72]
>
> And I guess I would say that this [Stipulation paragraph 19] is just one of many of the conditions here that memorializes what is currently the practice with PacifiCorp and really not anything different than ScottishPower.[73]
>
> [T]his is simply pointing out there's a code section that basically gives the Commission authority to take action. . . .[74]

Getting a commitment from the Applicants to continue to do things they will be obligated to do anyway is certainly no "benefit" of the merger or the Stipulation, and these provisions will do little to further the balance of merger-related risks and benefits.

III. THE IMBALANCE OF RISKS AND BENEFITS PARTICULARLY IMPACTS SPECIAL CONTRACT CUSTOMERS

Not only does the application propose an inequitable sharing of merger benefits – heavily favoring shareholders and strongly disfavoring customers – but it also discriminates against special contract customers. This discrimination takes the form of denying special contract customers protection from the risks of the merger (including risks unique to them) while offering non-special contract customers a merger credit to mitigate those risks. As Nucor witness Goins put it, "when the conditions that may be necessary to protect ratepayers from . . . merger related risks [are] put into effect, one group is left out."[75] The Commission should reject this unfair, unreasonable and

[71] Tr. 81 at 3-7 (Alt).
[72] Tr. 160 at 18-22 (Alt).
[73] Tr. 236 at 7-11 (Larson).
[74] Tr. 327 at 18-20 (Alt).
[75] Tr. 1043 at 15-18 (Goins).

discriminatory approach.

A. Special Contract Customers are Subject to Risks in Addition to those Facing All Ratepayers

Many of the risks identified by various witnesses to this proceeding (such as risks related to prices, service, reliability, affiliate transactions, etc.) are risks that face all customers, whether they take service from a generally available tariff or pursuant to a contract.[76] While much is made of the protection afforded by a contract, this protection is not complete, nor does it extend beyond the expiration date of the contract.[77] All of the special contracts expire in 2001 or 2002, well over a year prior to the end of the transition period.[78] In addition to exposure to the generally applicable merger-related risks, "[t]he largest customers . . . are exposed to risks that no other ratepayer under the stipulation is exposed to."[79] Although the Stipulation provides *non*-special contract customers with an assurance that they will share in guaranteed merger benefits through the merger credit, the Stipulation does not provide special contract customers with similar assurances of a benefit. There is absolutely nothing in the Stipulation to offset the risks faced by special contract customers in a manner similar to the merger credit. In plain language, the Stipulation discriminates against special contract customers.

In particular, it is the change of control that subjects special contract customers to unique risks. Division witness Alt agreed that this risk is clearly a possibility.[80] Mr. Alt also agreed that part of the risk arising from a change in control is a new attitude about how to price services.[81] Even ScottishPower witness MacRitchie, attempting to discount industrial customer concerns, admitted that the ultimate decision-makers will change as a result of the merger.[82]

Committee witness Chernick recognized the risk that can accompany a change in control:

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[76] Tr. 1052 at 9-17 (Goins); Tr. 367 at 21-25 (Alt).
[77] Tr. 365 at 23-24 (Alt); Brubaker Direct, p. 20 at 18-23.
[78] Tr. 1385 at 2-4 (K. Powell); *see also* Tr. 1149 at 3-5 (Anderson).
[79] Tr. 1020 at 7-10 (Goins).
[80] *See* Tr. 456 at 6-10 (Alt).
[81] *See* Tr. 456 at 11-18 (Alt).
[82] Tr. 1489 at 6-9 (MacRitchie).

> If certain of the risks identified in the testimony of other CCS witnesses come to pass, ScottishPower may be in a worse situation to make good on its promises than a free-standing PacifiCorp would be. ScottishPower's analyses, promises, and thinking about regulatory goals and regulatory accountability in this docket have been vague. ScottishPower appears to be honestly confused about the nature and benefits of what it is offering. This confusion courts future disputes, if parties interpret the commitments differently, and as parties seek to clarify the nature and extent of the commitments, in the future. Despite the best of intentions, ScottishPower may not be as well prepared as it thinks for dealing with US utility regulation, or for solving PacifiCorp's problems. If ScottishPower has made a mistake, and the merger goes through, future disputes over unclear promises, and conflicting expectations, may result in high costs for both ScottishPower and PacifiCorp customers. If ScottishPower finds that it cannot do what it promised customers and regulators, as well as shareholders, unforeseen consequences could result.

[83]

Due to the cost adjustment clauses in many of the special contracts, those customers are directly exposed to cost changes, from whatever source they occur. Depending on the particular contract, cost exposure can arise from a variety of sources.

[84] Division witness Alt admitted that for those special contracts with automatic adjustment clauses, those customers also face cost risk resulting from the merger:

> Mr. Dodge: . . . I'm saying, if costs go up as a result of the merger, which your conditions are designed to prevent, but if they do and if there's an adjustment clause, then special contract customers face some risk of cost adjustment from that; is that not a fair statement?
>
> Mr. Alt: I would agree with that.

[85]

An automatic adjustment clause does not require a rate case to take effect – it's impact will occur according to the terms of the clause. There is nothing in the Stipulation that protects special contract customers from any cost increase risk added as a result of the merger, save for the open-ended promise that "[r]ates in Utah shall not increase as a result of the merger."

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[83] Chernick Direct, p. 43, n. 36.

[84] Nucor is concerned that due to the confidential nature of the contracts the record may not fully reflect the types of cost adjustment mechanisms contained in the contracts. Nucor therefore suggests that if the Commission wishes to delve into the specifics of the cost-adjustment provisions, it review the contracts contained in the Commission's records – the contracts themselves provide a better source for details than any witness.

[85] Tr. 440 at 20-25 (Alt).

[86] While it is far from clear to Nucor whether this provision is even intended to be applied to special contracts, this provision is virtually unenforceable as it might be applied in this situation. Given the difficulty in tracing the effects of the merger on costs and savings,[87] this provision provides little solace. Moreover, Mr. Alt recognized that some of the existing contracts have clauses that "at least some people interpret to mean at any time they could be re-opened and the rates adjusted to meet then current cost considerations. . . ."[88]

Despite their contracts, special contract customers face risks as a result of this merger – risks that should not and cannot be ignored in evaluating whether this merger generates net benefits.

B. The Principal Benefit of the Stipulation Specifically Designed to Outweigh Remaining Risk (the Merger Credit) Does Not Apply to Special Contract Customers

Paragraph 43 of the Stipulation, which sets forth the merger credit, does not apply to special contract customers.

[89] Nucor agrees that, because of the unique nature of each special contract, it would be inappropriate for special contract customers to receive this merger credit.[90] However, because the stated reason for putting a merger credit in place was to assure that there was some guaranteed benefit from the merger sufficient to outweigh the risks of the merger,[91] excluding special contract customers from the credit, while not providing some alternative benefit, assures that for those customers (representing over 10% of Utah revenues)[92] the merger-related risks continue to outweigh the

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86 Ex. Stipulation-1 ¶ 44. Even this promise is subjected to varying interpretations:

> Condition 44 ensures that rates, or more specifically the revenue requirement, will not go up by reason of the merger.

Tr. 1490 at 1-3 (MacRitchie). Mr. MacRitchie apparently seems to believe that this provision only applies to revenue requirement increases, even though the words "revenue requirement" are not mentioned in Stipulation paragraph 44.

87 Tr. 1195 at 9-10 (Anderson).

88 Tr. 441 at 2-5 (Alt).

89 Tr. 363 at 6 (Alt).

90 *See* Tr. 1044 at 14-16; Goins Direct, p. 15 at 16-17.

91 Tr. 361 at 25 to 362 at 6 (Alt); Tr. 362 at 16-22 (Gimble). Of course, as discussed herein, Nucor does not believe that the merger credit is sufficient to overcome the substantial risks imposed by this merger and create a net positive benefit sufficient to satisfy the Commission's standard.

92 Tr. 1436 at 15-17 (K. Powell).

benefits.

C. Promises Made at Hearing with Respect to Special Contract Customers Offer Insufficient Protection

At the close of the hearing, ScottishPower witness MacRitchie attempted to assuage special contract customer concerns by offering a series of promises:

(1) ScottishPower will honor existing contracts;

(2) PacifiCorp will allow ScottishPower representatives to join in negotiations prior to the completion of this transaction;

(3) ScottishPower and PacifiCorp will negotiate in good faith;

(4) ScottishPower and PacifiCorp will commence negotiations as "early as practical" and will complete negotiations "promptly";

(5) ScottishPower and PacifiCorp will negotiate recognizing the contribution special contract customers make to the Utah economy; and

(6) ScottishPower and PacifiCorp will negotiate in accordance with Commission rules.

[93]

These promises are insufficient to mitigate the merger-related risks facing special contract customers identified above, and do not provide benefits to these customers sufficient to outweigh the risks. These promises are completely unenforceable or already required, and offer special contract customers no actual assurance that they will be protected from harm or share in merger benefits. Reduced to the basics, the promises set forth above evidence nothing other than a willingness on the part of the new owner to talk to its largest customers – hardly comforting, and hardly a benefit.

IV. FOR THIS MERGER TO BE IN THE PUBLIC INTEREST, ADDITIONAL CONDITIONS ARE NECESSARY

The merger as originally proposed subjected ratepayers to significant risks and uncertainties and promised only the barest of benefits. All parties other than the Applicants thus asserted that

[93] Tr. 1487 at 16 to 1488 at 14 (MacRitchie).

additional conditions on the merger were necessary before the merger would satisfy the Commission's public interest standard. While the Stipulation submitted by the Applicants, Division and Committee provides some ratepayer protection and guarantees that some small amount of benefit will be passed through to the ratepayers taking service under generally available tariffs, the Stipulation does not go nearly far enough. Indeed, the Stipulation leaves one group of ratepayers, special contract customers, exposed to significant risks while receiving little, if any benefit from the merger.

The Commission must provide additional protections for all ratepayers to resolve uncertainty and risk where possible and, thereby, ensure that net benefits are achieved. These protections should take the form of a rate cap for tariff customers, contract extensions for special contract customers, measures that ensure that any tax benefits realized from the transaction go to the benefit of ratepayers, and a waiver of future stranded cost claims.

A. A Rate Cap is Necessary to Equitably Balance the Risks and Benefits to Customers

One of the most significant remaining risks of this transaction is the difficulty, if not impossibility the Commission will have identifying "merger-related" costs and benefits in future years. A rate cap would remove the uncertainty inherent in tracking merger savings, it would provide an economic incentive to the company to achieve savings and deliver benefits to customers, and it would mitigate the merger-related risk facing customers.[94] The Applicants are advocating approval of their proposed merger, and, in the process, they claim that there are significant benefits to be derived from this merger.[95] The Commission should require that the Applicants show their good faith, and faith in their own assertions, by implementing a rate cap.

Rather than ask for the ratepayers' blind trust in their claims, the Applicants should show that they truly trust those claims themselves. As Nucor witness Goins testified:

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94 Tr. 1223 at 25 to 1224 at 6 (Anderson).

95 "The company has made pledges and statements asserting major, major cost savings." Tr. 1050 at 12-13 (Goins). As discussed above, the majority of these claims are non-quantified and speculative.

> If ScottishPower believes it can achieve . . . significant reductions in PacifiCorp's non-production operating costs [as it claims], 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.[96]

Likewise, LCG witness Anderson testified that the "Applicants' actual level of confidence in the availability of substantial efficiency gains can be tested through specific rate reduction or rate cap commitments."

[97] The risk of the merged entity failing to perform should be borne by the entity itself – management and shareholders – not customers.

A rate cap is the appropriate means of shifting merger-related risk away from the customers. UIEC witness Brubaker succinctly described the need for a rate cap as follows:

> A rate cap does several things. First of all, it gives a proper incentive to ScottishPower to make beneficial changes in the operations of PacifiCorp that will reduce its cost.
>
> Second, it limits the extent of the debate that you'd have to have in reviewing subsequent test years about what is and is not a merger cost and a transition cost and what costs could or could not have been achieved absent the merger.
>
> And third, it protects the customers from additional rate increases in the event ScottishPower is not as successful as it wants to be in reducing PacifiCorp's costs.[98]

LCG witness Anderson testified that "[t]he quickest way to remove that uncertainty [that underlies this merger application] would be simply to have [the] transition plan put forward."[99] However, the Applicants will not provide the transition plan until six months after the merger is completed.[100] Accordingly, the Commission should remove some of the uncertainty through "some form of rate concession that is beyond what has been put forth in the merger credit."[101]

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96 Goins Direct, p. 14 at 1-5.

97 Anderson Direct, p. 47 at 16-18.

98 Tr. 1258 at 13-25 (Brubaker); *see also* Rebuttal Testimony of Maurice Brubaker, Ex. UIEC-1R ("Brubaker Rebuttal"), p. 14 at 6-8.

99 Tr. 1150 at 25 to 1151 at 2 (Anderson).

100 Tr. 117 at 25 to 118 at 2 (Wright); Tr. 1151 at 3-10 (Anderson).

101 Tr. 1151 at 17-18 (Anderson).

Nucor proposes that the merger credit continue to be applied (as well as the other components of the Stipulation) in addition to a rate cap.[102] These two measures would act independently to mitigate the risks inherent in approving the merger. The merger credit would provide an immediate bill credit (albeit only 69 cents per month to the average customer[103]) and the rate cap would lock in merger-related savings, reduce uncertainty, and give the new entity an incentive to achieve the merger-related savings they claim will arise.[104] Nucor is, however, not asking that the merger credit apply to special contract customers – only that the rate cap (in the form of a contract extension) apply to special contract customers.[105]

Nucor believes the approach recommended by UIEC witness Brubaker is a reasonable modification to Nucor's rate cap recommendation:

> My recommendation is this: That I think it's reasonable to conduct a rate review based on a '98 test year, which I understand the company is preparing. And hopefully that would be as limited as possible to deal with items that were put forward from the last case. But the objectives would be to get a clean starting point for pre-merger PacifiCorp that would set a platform for comparisons on a going forward basis.
>
> After that, it's my recommendation that the rates be capped through 2003 and that the merger credits of $12 million a year, per the stipulation, also be applied during that period of time.

[106]

Only with a rate cap and merger credit will customers receive protection from the uncertainties and risks created by the merger sufficient to satisfy the public interest standard.

B. The "Rate Cap" for Special Contract Customers Should Take the Form of a Contract Extension at the Customer's Option

The disparity in merger-related benefits being provided special contract customers versus those provided to other customers, as well as the unique and significant merger-related risks those

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102 Tr. 1021 at 2-17 (Goins).

103 Tr. 23 at 19-20 (Alt).

104 *See* Tr. 1021 at 2-11 (Goins).

105 *See* Tr. 1044 at 12-16 (Goins).

106 Tr. 1257 at 21 to 1258 at 8 (Brubaker).

customers face, cannot be ignored. These customers account for over ten-percent of PacifiCorp's electric revenues.[107] By virtue of the expiration of the special contracts during the four year period following consummation of the merger, these customers are at significant risk as a result of the merger. These customers can be protected by requiring, as a condition of approval, that the special contracts be extended, at the customer's option, through the end of the four-year merger credit period (referred to by Dr. Goins as the "transition" period[108]).

The application to special contract customers of a rate cap "would essentially mean that [the special contracts] would be extended for the transition period under their current terms and conditions."[109] Extending the terms of the special contracts would effectively convey upon special contract customers protection from the risks of the merger similar to the protection afforded to other customers. Thus, while the Applicants' proposal discriminates against special contract customers in that it fails to offer them protection against merger risks, Nucor's proposal

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107 *See* Tr. 1436 at 14-17 (K. Powell).
108 *See* Tr. 1055 at 12-23 (Goins).
109 Tr. 1021 lines 12-17 (Goins).

erases that discrimination.[110] Moreover, as stated by Nucor's witness Dr. Goins, Nucor is "not asking that any component in terms of pricing, conditions of service, or anything else in those contracts be changed."[111] Prior Commission approval of these extensions, as suggested by UIEC witness Brubaker,[112] would be appropriate.

The rationale for leaving special contract customers out of the "public interest" equation is founded upon the existence of the contracts. Absent the contracts, these customers have none of the alleged price protections alluded to by the Division.

[113] But the Division readily admitted that any protection will die with the contract:

> Q: And assuming there are protections, how long would those protections last for contract customers? Would it be just to the end of their contract?
> A: To the end of their contract.
> Q: And once the contract has expired, obviously the cost to the Company would influence what happens in the future upon expiration?
> A: That's right.

[114]

110 *See* Tr. 1028 lines 4-12 (Goins) ("I'm recommending the special contracts customers be given the same protection as non-special contracts customers covered by the stipulation. That's all. I'm not asking for any special treatment, any more favorable treatment than another customer. I'm simply saying, let those customers have the same protections from merger related risk as non-special contracts customers are given under the stipulation. That's all").

111 Tr. 1043 at 1-6 (Goins).

112 Tr. 1265 at 25 to 1266 at 12 (Brubaker).

113 *See, e.g.*, Tr. 364 at 2 to 365 at 11 (Alt).

114 Tr. 365 at 19 to 366 at 4 (Alt).

In addition, those who support the Stipulation but who maintain that special contracts should not be extended contemplate an unlikely scenario -- that the stipulation is adequate to get the merger over the public interest bar even though it does nothing to protect PacifiCorp's largest customers. The merger should not be approved without at least affording special contract customers protection and benefits commensurate to those afforded other customers.

In the alternative, if contracts are not extended through the transition period, the Commission should require, as a condition of approving this merger, that the Applicants agree to permit special contract customers, at the customers' option, to acquire power supplies from providers other than the Applicants, and further require the Applicants to transmit such power to the special contract customers. This alternative was suggested by both Nucor witness Goins[115] and UIEC witness Brubaker.[116] This very limited remedy, applicable to only the existing special contract customers in Utah, is well within the Commission's conditioning authority and would act largely to eliminate the merger risk facing special contract customers.

C. The Tax Savings Generated by the Merger Should be Reserved for the Benefit of Ratepayers

Due to the lack of a transition plan and the difficulty of tracking future merger-related costs and benefits, the Commission should use this opportunity to secure for ratepayers a right to a share of all merger-related benefits that can be reasonably identified. One such merger-related benefit is the tax-related benefit first suggested in the testimony of Committee witness Talbot:

> [ScottishPower] has not raised the possibility of flowing through to ratepayers any tax or cost-of-capital savings related to the new corporate structure. In answers to a number of data responses, it appears to be defining rather narrowly the areas of ScottishPower's business that it regards as appropriate for scrutiny by U.S. state regulators.[117]

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115 Goins Direct, p. 17 at 10-15.

116 Brubaker Direct, p. 50 at 5-17. Mr. Brubaker argued that if there is no extension of the special contracts, PacifiCorp should be required to allow special contract customers "to purchase electricity competitively on the open market and to deliver the power to their locations on the PacifiCorp system using the FERC-approved OATTs." *Id.*, p. 50 at 12-14.

117 Talbot Direct, p. 48 at 23-27.

Mr. Talbot estimated the amount of the tax benefit resulting from a double-leveraged capital structure and difference in domestic and foreign income tax rates at $109.2 million per year.[118] The testimony introduced at the hearing demonstrated not only the existence of these benefits, which had not previously been disclosed by Applicants, but also the very significant dollar amounts involved.[119]

There is no question that these tax savings are merger-related. As Nucor witness Goins acknowledged, tax related savings are "potentially a major merger related savings."[120] However, as Dr. Goins also noted, tax savings are "not addressed by [the] stipulation."[121] Thus, savings derived in one area that truly offers the potential for significant merger-related savings – income taxes – are reserved for the benefit of shareholders and management. This is entirely inequitable and unreasonable. Shareholders had the benefit of voting on the merger, approved it, and are receiving a premium for their shares. Customers, on the other hand, will be subjected to risk if the merger proceeds, will not receive a share premium, had no opportunity to vote on the merger but would be deprived by the Applicants of a significant portion of the identified merger benefits. Rather, the potential tax savings should be treated in the same way that the Stipulation proposes to treat reductions in the cost of capital (Stipulation, paragraph 25), such that any reductions in income taxes resulting from the merger will go to benefit customers through rate reductions.

At hearing it was apparent that while Applicants are willing to commit to having these tax savings reviewed in future cases, they are unwilling to commit to the Commission's jurisdiction and ability to order a sharing of the tax savings, much less commit to actually share the tax savings with ratepayers:

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118 Talbot Direct, p. 48 at 20-21; *see also* Tr. 87 at 20 to 88 at 5 (Gimble).

119 For details as to the Applicants' tax savings estimates, *see* Cross-Examination Ex. 3 (Highly Confidential). *See also* Tr. 265 at 13-18 (Morris) (Highly Confidential); Tr. 278 at 12 to 279 at 11 (Morris) (Highly Confidential).

120 Tr. 1034 at 16-17 (Goins). Division witness Alt agreed these benefits are directly related to the merger. Tr. 370 at 3-5 (Alt).

121 Tr. 1034 at 17 (Goins).

> They [(industrial customers)] raised the consolidated tax issue, which we have argued is very much a matter for rate cases. And we have not waived any of the rights of ourselves or other parties at this time to argue that at a future time.

122

Similarly, Cross-Examination Exhibit 2 is simply an agreement by Applicants to retain and make available tax records in accordance with the Stipulation provisions and the discovery rules of the Commission. It does not acknowledge the Commission's jurisdiction to utilize tax benefits (benefits created by the merger) for the benefit of ratepayers. Applicant's attorney was clear that Cross-Examination Exhibit 2 "reserves our right to argue that because those [tax savings] are not cost of service related tax issues, that they are outside of what the Commission has authority to reflect in rates in a rate case."

123

Because these savings are indisputably merger-related, because of the very significant level of the savings, because of the potential difficulty in identifying the future savings, and because of the Applicants' unwillingness to commit to share the savings with ratepayers, the Commission should take steps necessary at this time to ensure that the potential tax savings described in Cross-Examination Exhibit 23 (Highly Confidential) are shared with PacifiCorp ratepayers. The amount of tax savings and how to treat the tax savings can be decided in a rate case; it is critical at this time, however, for the Commission to take steps to preserve the benefits for customers. To clarify any future legal dispute that might arise, the Commission should, at a minimum, amend Stipulation paragraph 25 to include consideration of tax effects of the merger.[124] Specifically, Stipulation paragraph 25 should be amended to read:

> If ScottishPower is able to lower the costs of capital *and/or taxes*, then those savings shall be reflected in rates in accordance with regulatory practices in the State of Utah. If, however, the cost of capital of electric operations of PacifiCorp *and/or taxes* increase as a direct result of the merger, ScottishPower's shareholders will bear the

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122 Tr. 1486 at 16-20 (MacRitchie).
123 Tr. 979 at 7-15.
124 *See, e.g.*, Tr. 1260 at 21-24 (Brubaker).

cost.

[125]

Given numerous instances where conditions were added to the Stipulation simply to restate existing obligations of PacifiCorp, Nucor believes it is prudent to add, as a condition to the merger, a finding that any tax benefits arising from the merger should go to benefit customers, in addition to the requirement that the Applicants provide the Commission with sufficient information to determine the level of those benefits.

D. The Applicants Should be Required to Forego Future Stranded Cost Claims

In light of the significant benefit obtained by PacifiCorp's existing shareholders, the meager merger credit being provided to ratepayers, and the difficulty of ensuring that other future savings be shared with ratepayers, the Commission should further mitigate the merger-related risk to ratepayers by requiring as a condition of finding the merger in the public interest that the Applicants forego any future claims to stranded cost recovery.

[126] With the uncertainty involved in attempting to identify merger-related risks in the future, any significant risks that can be identified now should be dealt with.

The Division and Committee apparently believe that the Applicants have already waived any rights to recover the merger premium through a stranded cost charge as a result of Stipulation paragraph 26.[127] Likewise, the Applicants, Division and Committee confirmed that the Applicants cannot seek to recover merger-related transaction costs through a stranded cost charge.[128] If this is the intent of the Stipulation, it should say so clearly. The Stipulation is already being used to simply restate current obligations. It is appropriate and efficient to clarify issues now, rather than wait for

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[125] Ex. Stipulation-1 ¶ 25 (proposed changes in italics).

[126] *See* Tr. 1262 at 6-10 (Brubaker) ("In my view, given all the facts and circumstances surrounding this transaction, I think the issue should be settled and there should not be any claim for stranded cost given the compensation to stockholders that's taken place").

[127] Tr. 248 at 11-15 (Alt); Tr. 144 at 20 to 145 at 4 (Gimble).

[128] Tr. 137 at 14-25.

future disputes, when addressing obligations derived from the Stipulation itself.

Moreover, Nucor urges this Commission to go beyond this limited waiver of stranded costs, and require as a condition of the merger that the Applicants forego all future claims to generation- and transmission-related stranded costs based on existing domestic plant and equipment.[129] UIEC witness Brubaker explained the rationale for this condition:

> If the Commission does not require PacifiCorp/ScottishPower to relinquish any claim for stranded cost recovery, then it could subsequently request compensation for stranded costs, while at the same time argue that it should be allowed to keep part or all of the benefit of cost reductions because they are necessary to compensate it for the merger premium, which it voluntarily paid for these "inflated" assets.

[130]

In essence, this should be treated as a merger-related benefit, to which the customers are entitled. By paying a massive premium for PacifiCorp shares, ScottishPower has removed all doubt as to the existence of stranded costs related to PacifiCorp's existing assets. Given Applicants' admitted ability and willingness to waive stranded cost claims related to the premium and the transaction costs, it is no stretch to extend this waiver to other stranded costs. This positive benefit of the merger should be recognized as such by the Commission in the form of a merger condition.

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[129] Goins Direct, p. 5 at 16-17.

[130] Brubaker Rebuttal, p. 19 at 6-10.

V. CONCLUSION

The common themes in this case, from the initial rounds of testimony through the hearing, have been the slim benefits for customers, the significant risks brought by the merger, and the likely difficulty the Commission will have in determining, in the future, the savings and/or costs that resulted from the merger. Due to this uncertainty as to the ability to identify merger-related savings and costs in the future, for the merger to satisfy the public interest standard, the Commission must take steps now to ensure that merger-related risk is placed appropriately on the Applicants and to preserve identified merger-related benefits.

While the Stipulation protects against some of the identified risks, it suffers from significant flaws. The principal flaw is that no protection comparable to the merger credit (which is designed to put the net benefit test "over the top") is provided to special contract customers, who comprise a significant portion of the Utah customer base, and this shortcoming cannot be ignored. It is not sufficient for a monopoly service provider to simply tell these customers to leave the system if they suffer ill effects from the merger. All customers are entitled to protection and to consideration as part of the "net benefits" standard.

For these reasons, the Commission should condition approval of the proposed merger on the acceptance by Applicants of the following:

(1) Rates of all Utah tariff customers should be capped and all provisions of the Stipulation should be adopted as conditions of merger approval;

(2) Current Utah special contract customers should have the option of having their contracts extended through the transition period on current terms and conditions, subject to Commission approval;

(3) The Applicants should be required to acknowledge that if the Commission determines that tax savings result from the merger, then those tax savings will go to benefit customers, through rate reductions. Whether tax savings are created and the amount of any savings should be left for a future proceeding; and

(4) The Applicants should be required to waive any and all future claims to stranded costs relating to existing generation- and transmission-related assets, as well as claims relating to the merger premium and/or merger transaction

costs, in any proceeding.

WHEREFORE, for the reasons set forth above, the Commission should adopt the additional conditions suggested herein, impose such additional conditions as it deems appropriate, and make such modifications to the Stipulation as it believes are necessary to clarify the protections meant to be provided therein.

DATED this 3rd day of September 1999.

Respectfully submitted,

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