LAW OFFICES
WATKISS & CAMPBELL
A PROFESSIONAL CORPORATION
TWELFTH FLOOR
310 SOUTH MAIN STREET
SALT LAKE CITY, UTAH 84101-2171

DAVID K. WATKISS
ROBERT S. CAMPBELL, JR.
JAMES P. COWLEY
HERSCHEL J. SAPERSTEIN
H. WAYNE WADSWORTH
WILLIAM VOGEL
PHILIP C. PUGSLEY
GLEN E. DAVIES
ROBERT D. MAACK
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MARY T. NOONAN
C. SCOTT BROWN
LESLIE J. RANDOLPH
BRETT F. WOOD
MICHAEL C. VAN

OF COUNSEL
ZAR E. HAYES
RICHARD B. FERRARI
FRANKLIN N. SMITH, JR.

TELEPHONE
(801) 363-3300

TELECOPIER
(801) 350-3892

WRITER'S DIRECT NUMBER:

RECEIVED
'88 JUL 18 P2:09
UTAH PUBLIC
SERVICE COMMISSION

July 18, 1988

HAND DELIVERED

Public Service Commission of Utah
Heber M. Wells Building
160 East 300 South
Salt Lake City, Utah 84111

ATTN: Honorable Brian T. Stewart, Chairman
Honorable Brent H. Cameron
Honorable James M. Byrne

Re: Utah Power/Pacific Corp. Merger Application
PSC Docket 87-035-27

Dear Mr. Chairman and Commissioners:

Pursuant to my letter and enclosures to the Commission of July 15, 1988, in the above-referenced matter, I have now received and there is herewith enclosed a copy of the Order handed down on July 15, 1988, by the Oregon Public Utility Commission in the companion case in Oregon.

The Order of the Oregon Commission approves the merger and to that end, the Stipulation entered into between Pacific Corp. and the Oregon Commission staff. However, as will be noted from the Order, the Commission subjects the merger application to independent analysis and focuses, from the Oregon perspective, on many of the issues of fact and law that are pending before this Commission.

A copy of this letter and accompanying Order is being served upon all counsel of record in this proceeding.

Respectfully submitted,

ROBERT S. CAMPBELL, JR.
Legal Counsel for Pacific Corp.

RSC:ecd
cc. All Counsel of Record

RECEIVED
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UTAH PUBLIC
SERVICE COMMISSION

ORDER NO. 88-767

ENTERED JULY 15 1988

BEFORE THE PUBLIC UTILITY COMMISSION

OF OREGON

UF 4000

In the Matter of the Application of PACIFICORP and PC/UP&L MERGING CORP. for an Order Authorizing the Merger of PACIFICORP and UTAH POWER & LIGHT COMPANY into PC/UP&L MERGING CORP. (to be Renamed PACIFICORP upon Completion of the Merger), and Authorizing the Issuance of Securities, Assumption of Obligations, Adoption of Tariffs, and Transfer of Certificates of Public Convenience and Necessity, Allocated Territory, and Authorizations in Connection Therewith.	)	ORDER

On September 17, 1987, PacifiCorp, a Maine Corporation (PacifiCorp Maine), and PC/UP&L Merging Corp., an Oregon Corporation (PacifiCorp Oregon), filed an application with the Commission requesting approval of the following transactions:

1. The merger of PacifiCorp Maine and Utah Power and Light Company (Utah Power), with and into PacifiCorp Oregon, with PacifiCorp Oregon to be the surviving corporation, in accordance with an Agreement and Plan of Reorganization and Merger among PacifiCorp Maine, Utah Power and PacifiCorp Oregon, dated August 12, 1987 (Merger Agreement), pursuant to ORS 757.480;

2. The issuance by PacifiCorp Oregon of shares of its common and preferred stocks upon conversion of the outstanding shares of common and preferred stock of PacifiCorp Maine and Utah Power in accordance with the terms of the Merger Agreement, pursuant to ORS 757.410;

3. The assumption by PacifiCorp Oregon of all outstanding debt obligations of PacifiCorp Maine and Utah Power, pursuant to ORS 757.440, and the continuation or creation of liens in connection therewith, pursuant to ORS 757.480;

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4. The transfer to PacifiCorp Oregon of all certificates of public convenience and necessity of PacifiCorp Maine, pursuant to ORS 758.015;

5. The transfer to PacifiCorp Oregon of all rights to allocated territory granted to PacifiCorp Maine, pursuant to ORS 758.460;

6. The adoption by PacifiCorp Oregon of all tariff schedules and service contracts of PacifiCorp Maine on file with the Commission and in effect at the time of the merger, pursuant to ORS 757.205;

7. The transfer to PacifiCorp Oregon of all Commission authorizations and approvals granted to PacifiCorp Maine for transactions with controlled corporations or affiliated interests, pursuant to ORS 757.490 and 757.495, and;

8. The transfer to PacifiCorp Oregon of all Commission authorizations and approvals for the issuance of securities by PacifiCorp Maine which have not been fully utilized, pursuant to ORS 757.410.

A prehearing conference was held in this matter on October 7, 1987 to identify parties and establish a procedural schedule. A settlement conference was convened February 13, 1988.

A public hearing was held on April 13-14, 1988, in Salem, Oregon, before Commissioners Ron Eachus, Myron Katz, and Nancy Ryles, and Hearings Officer Samuel Petrillo. Post hearing briefs were filed on May 17, and May 27, 1988.

Parties

The Applicants in this proceeding are PacifiCorp (PacifiCorp Maine or Pacific) and PC/UP&L Merging Corp. (PacifiCorp Oregon) (jointly, Applicants). In addition to the Applicants, the parties to this proceeding are the Public Power Council (PPC), the Bonneville Power Administration (BPA), the Citizens Utility Board (CUB), the Utility Reform Project (URP), Austin Collins, the Pacific Northwest Generating Company (PNGC), and the Commission Staff (Staff). Testimony was presented at the hearing by the Applicants, PPC, BPA, and Staff. URP, PNGC, and Austin Collins did not participate in the hearing or briefing of this case.

PacifiCorp

PacifiCorp Maine is a diversified corporation whose operations include electric utility service, telecommunications, mining, leasing of capital and business equipment,

lending against receivables and inventories, and providing equity investments in leveraged lease transactions.

PacifiCorp conducts its electric utility business under the assumed business name "Pacific Power & Light Company" (Pacific, or PP&L). It provides electric service to more than 670,000 retail customers in California, Idaho, Montana, Oregon, Washington, and Wyoming. PP&L serves approximately 396,400 retail customers in Oregon. Its Oregon retail electric operating revenues for the 12 months ending December 31, 1986, were $526,838,000.

Pacific's electric generating resources consist primarily of coal-fired generation and, to a lesser extent, hydroelectric facilities and power supplies purchased from other utilities. Its total resource capability of 5,859 megawatts (mw) includes 3,073 mw from coal-fired resources, 868 mw of system hydro, 1,027 mw of BPA peaking capability, 583 mw of purchased hydro resources, and 308 mw of other resources. During 1986, Pacific met 59.2 percent of its total energy requirements from its thermal resources, 15.3 percent from firm purchases, 14.5 percent from hydro resources, and 11 percent from other resources.

Utah Power

Utah Power provides retail electric service to approximately 510,000 customers in Idaho, Utah, and Wyoming. It does not provide electric service in Oregon.

Utah Power's total resource capacity is 2,946 mw. Approximately 91.5 percent of that capacity is from coal-fired generation, with the remainder from system hydro and other resources. In 1986, Utah Power derived 72.1 percent of its total energy requirements from its thermal facilities, 5.2 percent from its hydro facilities, 0.2 percent from firm purchases, and 22.5 percent from other resources.

Merger Agreement

On August 12, 1987, PacifiCorp Maine, Utah Power, and PC/UP&L Merging Corp. (PacifiCorp Oregon) entered into an Agreement and Plan of Reorganization and Merger (Merger Agreement). The Merger Agreement calls for Utah Power and PacifiCorp Maine to merge with and into PacifiCorp Oregon, a new Oregon corporation which will be named PacifiCorp contemporaneously with the merger. Under the terms of the Merger Agreement, Utah Power and PacifiCorp Maine will cease to exist on the effective date of the merger, and PacifiCorp

Oregon will succeed to all rights and properties and all debts, liabilities, and obligations of PacifiCorp Maine and Utah Power.

The outstanding shares of common and preferred stock of PacifiCorp Maine will be converted into shares of the new corporation on a one-for-one basis. The common stock of Utah Power will be converted into shares of the new corporation based on a formula derived from the PacifiCorp Maine closing price during a 10-day computation period following final regulatory approval. Except for shares owned by dissenters, outstanding Utah Power preferred stock will be converted to preferred stock of the new corporation. The Applicants contemplate that the transaction will qualify as a tax-free reorganization under the Internal Revenue Code.

If the merger is approved, PacifiCorp Oregon will operate two electrical divisions--one doing business as Pacific Power & Light Company (Pacific Power division) and the other as Utah Power & Light Company (Utah Power division). Pacific Power will continue to serve customers within its existing territory, as will the Utah division. Each division will operate as a separate "profit center" and will have a separate board of directors. The organization and function of each board will be similar to PP&L's existing board of directors.

Although the two divisions will maintain their separate retail identities, the power supply and transmission systems of the Utah Power and Pacific Power divisions will be planned and operated on a single-utility basis. A plan has been developed to further integrate the transmission facilities linking the Pacific Power and Utah Power divisions. Likewise, arrangements will be established to coordinate the dispatch of power to ensure that the merged systems operate efficiently. The specific merger benefits anticipated by the Applicants are discussed below.

Stipulation

On March 3, 1988, the Staff and Applicants entered into a stipulation recommending approval of the application subject to a number of conditions regarding reporting requirements, allocation of merger costs and benefits, future rate cases, and specific approval requests.

a) Reporting Requirements

The reporting requirements of the stipulation require that Pacific shall file semiannual reports demonstrating the effects of the merger, including:

1. Consolidated operating merger benefits achieved;

2. Oregon allocated merger operating benefits achieved;

3. Current bond ratings and an explanation of any change;

4. Description of Pacific's preferred stock and debt series before and after the merger; and

5. Descriptions of all major post-merger additions to generation and system transmission plant and related system facilities, including costs.

The semiannual reports required by the stipulation must be supported by detailed workpapers and shall be submitted in conjunction with the semiannual regulatory results of operations currently received by the Commission. In addition, Pacific must also file monthly and quarterly operating results, construction budgets, and operating budgets used to monitor operating results and plans, irrespective of the stipulation requirements.

The stipulation further provides that Pacific shall also submit reports demonstrating the effects of the merger in all general rate applications and show cause actions initiated by the Commission.

b) Allocation guidelines

The stipulation provides that, within six weeks after the merger has been approved by all authorities, the merged company will initiate a meeting of an allocation committee consisting of representatives from all appropriate regulatory jurisdictions. The function of the committee will be to develop methods for allocating joint costs and benefits of the merger between the Pacific Power and Utah Power divisions. Allocations within each division will be governed by that division's existing jurisdictional allocation methods.

Until final methods for the allocation of merger costs and benefits are developed and adopted, the stipulation provides that certain general guidelines will apply with respect to Pacific's Oregon customers. These guidelines are:

1. Pre-merger generation and transmission facilities of Pacific and Utah Power will remain the responsibilities of the Pacific and Utah Power divisions, respectively.

2. Post-merger additions to generation and system transmission plant and related system facilities due to the merger will be allocated on an equitable basis that is based on sound economic principles and is mutually agreeable to Staff and Pacific.

3. Net power cost changes due to the merger will be allocated on the basis described in paragraph 2 above and shall embody the principle of Pacific's existing allocation Notes 1 and 1A. Net power cost changes will be determined based on the results of three power cost studies: one showing net power costs for Pacific Power separately as if the merger had not occurred; a second showing net power cost for Utah Power separately as if the merger had not occurred; and a third showing net power costs of the merged company.

4. Other cost changes due to the merger will be allocated using equitable allocation methods that (i) embody the principle that incurred costs and benefits follow the cause of such costs and benefits and (ii) are mutually agreeable to Staff and Pacific. In general, costs that can be directly assigned to an operating division will be so assigned.

If Staff and Pacific are unable to reach agreement on an allocation issue, the method of allocation will be determined by the Commission based on the guidelines in the stipulation. Pacific agrees, however, that its shareholders will assume all risks that may result from less than full system cost recovery if interdivisional allocation methods differ among the merged company's jurisdictions.

e) <u>Future Rate Cases</u>

With regard to future rate cases, the stipulation provides that: (i) pre-merger Utah Power rate base assets will be excluded from Pacific's Oregon rate base; (ii) the Staff may propose adjustments to Pacific's embedded debt and preferred stock costs; and (iii) the calculation of post-merger common equity costs will be determined under a method that relies upon the use of comparable companies.

Pacific further agrees that, by the end of the second quarter of calendar year 1989, it will file a general rate case incorporating the estimated merger benefits shown on Exhibit 1 of the stipulation. The filing will include Oregon's allocated share of estimated system merger benefits totaling $59 million. Assuming that final allocation methods attribute approximately 58 percent of system merger benefits to the Pacific division, and 50 percent of the Pacific division merger benefits to Oregon, the general rate filing will include $17 million in cost savings due to the merger.

In addition, the stipulation provides that Pacific shall not "effect any overall increase in electric rates in Oregon prior to the end of calendar year 1992." While Pacific may propose rate spread/rate design changes during that time frame, such proposals would first have to approved by this Commission.

Lastly, Pacific has agreed to hold Oregon customers harmless if the merger results in greater net costs to serve Oregon customers than if the merger had not occurred. Pacific witness Reed testified that this commitment is not limited in duration and shall apply both before and after application of the residential exchange credit from BPA.

d) Specific Approvals

With respect to the specific approvals requested by Pacific in its application, the stipulation provides:

(1) Pacific will demonstrate, when necessary, the need for any existing certificates of public convenience and necessity;

(2) Tariffs will not be changed between the time of Commission approval and closing of the merger except as specifically approved by the Commission;

(3) The terms and conditions of affiliated interest and controlled corporation contract approvals will be unchanged in all material respects at the time of the merger, except as specifically approved by the Commission;

(4) Information regarding the shares of PacifiCorp Oregon common stock to be issued upon consummation of the merger will be unchanged in all material respects at the time of the merger, and if the issuance of additional shares is required, the Applicants will promptly amend their application;

(5) Pacific will file with this Commission the Forms 10-K, 10-Q, and 8-K submitted to the Securities and Exchange Commission for Pacific and Utah Power prior to the date an order is issued in this application. Thereafter, Pacific will report any material changes in merger-related contingent liabilities to the Commission;

(6) The Applicants accept all terms and conditions attached to existing authorizations for the issuance of securities.

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e) Term and Modification of Stipulation

The stipulation will be effective for a period of five calendar years commencing the first day of the year after the merger is consummated. Thus, if the merger is consummated during 1988, the terms of the stipulation will be effective from the date of closing through December 31, 1993. Both Pacific and Staff recognize that the five-year term of the stipulation does not prohibit the Commission from determining at some future time that the terms and conditions of the stipulation should be extended.

Standard of Review

In its post-hearing brief, BPA argues that approval of the proposed merger is governed by ORS 756.040 rather than the "consistent with the public interest" standard. BPA contends that the two standards are different, and suggests that, whereas the public interest standard only requires no public detriment, ORS 756.040 imposes an affirmative obligation that that the public be made better off as a result of the proposed transaction.

The Commission disagrees with this interpretation. The standard of review contemplated by applicable statutes and administrative rules is that the Commission must find that a proposed merger is not contrary to the public interest before it may be approved. ORS 757.480. OAR 860-27-025.[1] See also Re Pacific Power and Light Company, 39 PUR3d 142 (OR PUC 1961), and Pacific Power and Light Company v. Federal Power Commission, 111 F2d 1014 (9th Cir 1940). The same standard applies to the remaining transactions proposed by the Applicants in this case. ORS 757.415, 757.440, and 757.495.

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[1]BPA claims that OAR 860-27-025 deals only with filing requirements and does not prescribe a standard for judging transactions made pursuant to ORS 757.480. It further maintains that section (1)(1) of the rule addressing the public interest standard specifically omits mergers, and is therefore inapplicable in this case. Neither argument has merit.

Section (1)(1) of OAR 860-27-025 requires that applications made pursuant to ORS 757.480 and 757.485 must include facts showing that the proposed transaction is consistent with the public interest. Obviously, the requirement would not have been made part of the rule if another standard had been intended to apply. Also, the first paragraph of OAR 860-27-025 clearly states that its requirements apply to every application within the purview of ORS 757.480, including mergers. When the rule is read in context, it is apparent that the omission of the word "merger" from section (1)(1) is a typographical error.

The public interest standard is consistent with the Commission's general duty under ORS 756.040 to use its jurisdiction and powers to protect utility customers and the public generally from "unjust and unreasonable exactions and practices and to obtain for them adequate service at fair and reasonable rates." A finding that a proposed transaction is consistent with the public interest necessarily encompasses a determination that the public will be protected from unjust and unreasonable exactions and will receive adequate service at fair and reasonable rates. Contrary to BPA's contention, ORS 756.040 does not require that every transaction authorized by the Commission must improve the position of utility customers and the public.

As it turns out, the issue raised by BPA is academic. As explained below, the record in this case demonstrates that the proposed merger and related transactions will yield significant net benefits to Pacific's Oregon ratepayers and the public generally.

Burden of Proof

The application in this proceeding requests authority for the merged company to adopt all tariff schedules and service contracts of Pacific on file with the Commission and in effect at the time of the merger, pursuant to ORS 757.205. That statute requires a public utility to file with the Commission schedules "showing all rates, tolls and charges which it has established and which are in force at the time for any service performed by it within the state," together with all rules and regulations that affect rates.

BPA argues that ORS 757.205 and 757.210 require the Commission to determine that the existing rate schedules are just and reasonable for the merged company before the merger may be approved.

The law does not require a general rate inquiry prior to the approval of a proposed merger. As emphasized above, the Commission rule implementing ORS 757.480, requires only that the merger be consistent with the public interest. It does not require as a precondition to approval that the Applicants refile tariff schedules or demonstrate that existing rate schedules will be just and reasonable for the merged company. Indeed, the appropriate time to conduct a rate inquiry is after the merger has been consummated. The

stipulation executed by Staff and Applicants provides that such an inquiry will occur during 1989.[8]

BPA has also misinterpreted ORS 757.210(1). That statute states that whenever a public utility files a rate schedule "stating or establishing a new rate or schedule of rates, the commission may, either upon written complaint or upon the commission's own initiative, after reasonable notice, conduct a hearing to determine the propriety and reasonableness of such rate or schedule." The application filed in this matter does not request authority to establish new rates or to increase rates. Applicants are seeking only to adopt existing rate schedules that were found to be just and reasonable by the Commission in February 1988.[9]

Issues Presented

The principal issues presented by this application are as follows:

1. Is there a reasonable likelihood that the proposed merger, if approved, would result in net benefits to Pacific's Oregon ratepayers that otherwise would not be achievable if the company were to continue operating under its current form of organization?

2. Are mechanisms available to protect Oregon ratepayers from potential adverse effects of the merger, to insure that Oregon ratepayers receive an equitable allocation of any net benefits arising from the merger, and to prevent Oregon ratepayers from subsidizing benefits for another jurisdiction's ratepayers?

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[8]The issue of the need to review the rates of a merged company was addressed in California v. Federal Power Commission, 296 F2d 348 (DC Cir 1961), rev. on other grounds, 369 US 482 (1962). The court in that case held that an applicant seeking approval of a merger did not have the burden of presenting evidence justifying rates where no change in existing rates was requested.

[9]Even if ORS 757.210 were applicable, the statutory requirements have not been met. The notice of hearing issued by the Commission in this matter did not state that the hearing would be held to determine the propriety and reasonableness of the Applicant's rates. Nor was any complaint filed within 60 days of the application.

Benefits of the Merger

The Applicants presented evidence at the hearing which demonstrates that the proposed merger will provide significant benefits to Pacific's Oregon customers. The benefits associated with the merger include:

a) The merger will facilitate the profitable disposition of available power supplies through increased sales margins and enhanced firm and nonfirm power sales. With respect to increased margins, Pacific anticipates that the costs associated with delivery of power to wholesale customers will be lower due to the diversity in energy production costs and other operating efficiencies. In addition, sales margins are expected to improve due to the combined systems' ability to offer a wider variety of energy services to existing and potential purchasers, thereby commanding better prices. Specifically, the merged company will be in a better position to "package" power sales to offer contract elements such as flexible delivery arrangements, system backup, long-term price stability, and other services that are important in maximizing wholesale power prices.

The merged company's extensive and complimentary access to California and southwest energy markets, should also improve both firm and nonfirm power marketing opportunities. The expectation of increased power sales is also based on the ability to maximize use of the merged systems' available market through joint energy supply control (unit commitment dispatch and maintenance scheduling), through being more price competitive as a result of operating efficiencies, and through greater overall supply reliability.

b) The merger will improve Pacific's ability to take greater advantage of low cost power opportunities which are available in the short term but which are unlikely to be available in the long term. The additional interconnections will increase the transfer capability between Utah Power and Pacific Power from 200-300 megawatts to approximately 900 megawatts.

Expanded interconnections between the Pacific and Utah power systems will permit greater utilization of surplus capacity available from third parties and will enable the merged company to reach wholesale power markets it has heretofore been unable to reach. The proposed transmission interconnections will also reduce capacity resource needs by allowing greater reserve sharing between the two systems.

c) The merged company will benefit from system load diversity. Pacific's peak loads have historically occurred during the winter months of November through February, while Utah's power peaks have occurred during the summer months. Viewed on an integrated basis, the combined system will peak during the winter. The coincidental peak of the merged system is substantially lower than the sum of the two system's non-coincidental annual peak loads. The difference, or annual peak load diversity, is 436 megawatts.

Pacific projects that the peak load diversity of the combined system together with seasonal differences in resource availability will lower the combined systems' future capacity requirements by over 350 megawatts. This, in turn, will postpone peak capacity purchases that are now expected to be needed as early as 1990.

d) The merger will reduce system operating costs through the integrated economic dispatch of generation. Specifically, the adoption of both joint unit commitment (deciding which generating facilities to make available for use) and dispatch (deciding the extent to which available resources are actually utilized) will allow the merged system to take advantage of fuel-cost diversities and improve overall generating unit operating efficiencies, resulting in fuel-cost savings.

The merger will also result in the acquisition of additional load-following capability, i.e., the ability of the generation system to instantaneously respond to changing resource requirements caused by system load fluctuations, generation or transmission failures, etc. According to Pacific witness Boucher, Pacific's existing thermal resources are not designed or equipped to respond to the large and rapid load changes encountered during actual system operation. This fact, together with scheduling limitations associated with the purchased resources, has required Pacific to use its Mid-Columbia Hydro resources to provide primary system load-following services. As a result, Mid-Columbia resources are not normally operated at their maximum capability.

Utah Power's thermal generating units are designed and equipped with automatic generation control (AGC) devices and serve the same purpose as Mid-Columbia and other hydro generation on Pacific's system. The diversity of the combined system and its larger load base are expected to reduce the burden on Pacific's Mid-Columbia resources, as well as Utah Power's AGC thermal resources. This should result in improved operating efficiencies and lower system operating costs, prolonged facility life, and elimination of the need to retrofit Pacific's generating units with AGC equipment.

Operating savings are also expected to occur as a result of consolidation of inventories, increased flexibility in scheduling maintenance of generation plants, and shared power operations services between the operating divisions.

e) The merger is expected to result in reduced construction requirements. For example, planned construction at the Jim Bridger and Centralia thermal facilities will be postponed or avoided as a result of the merger. Total benefits resulting from reduced construction are estimated to amount to $11 million by 1992.

f) In addition to the foregoing benefits, Pacific also asserts that substantial benefits will be achieved in the areas of economic development, administrative combinations, and manpower efficiencies.

Summary of Projected Merger Benefits

Pacific has projected that savings in net power costs, including additional revenue from wholesale sales as well as savings in power system operating costs, will yield $16.7 million per year in 1988, increasing to $44.2 million per year in 1992. The estimated net present value of other power supply benefits due to the postponement of new capacity and energy resource acquisitions is expected to be $99 million over 10 years and $358 million over 20 years.

Total benefits accruing from power supply, reduced construction, economic development, administrative combinations, and manpower efficiencies are projected to be $48 million in the first calendar year following the merger and increase to $158 million in the fifth year following the merger.

Objections to the Merger

Power Supply Benefits. PPC argues that the power supply benefits projected by Pacific are overstated and will come at a cost to others. It maintains that:

a) Power supply savings depend on the completion of transmission additions and are, therefore, uncertain;

b) Reduced secondary purchases by the merged company will be at the expense of existing suppliers, such as Portland General Electric Company (PGE) and Idaho Power Company (IPC);

c) Increased secondary sales by the merged company will displace sales that would otherwise have been made by BPA and PPC members and will impair access to the merged companies' transmission facilities;

d) Power supply savings can be achieved through other means such as contractual arrangements.

These arguments are not persuasive. While PPC is correct that a portion of the power supply savings estimated by Pacific is dependent on improved transfer capability resulting from expanded interconnections between the Pacific and Utah Power systems, the proposed transmission additions are relatively modest and do not involve the uncertainties associated with construction of major transmission facilities.

Likewise, PPC's claim that reduced secondary purchases by the merged company will adversely affect PGE and IPC has not been substantiated. PPC witness William Drummond concluded that approximately $9.5 million in sales-for-resale made by PGE and IPC could be jeopardized by the merger. However, Mr. Drummond's analysis has several flaws:

a) Mr. Drummond's calculations reflect gross revenues only. No effort was made to quantify offsetting savings in power production costs resulting from reduced secondary purchases by the merged company;

b) Mr. Drummond's analysis assumes that if IPC and PGE are unable to make sales to the merged company at historical levels, the power cannot be sold to another utility or to the merged company at any price;

c) The $9.2 million figure used as a measure of lost IPC sales is misleading since less than 10 percent of IPC's retail load is in the State of Oregon. At most, Oregon's retail share of the lost revenues computed by Mr. Drummond would be no more than $1 million.

While it is certainly possible that IPC and PGE may experience some lost revenue as a result of the greater competition from the merged system, it has not been demonstrated that either utility will be adversely affected. Indeed, the absence of IPC and PGE from these proceedings suggests that those utilities do not perceive a significant loss of revenues as a result of the merger.

PPC's third argument is that increased secondary sales by the merged company will displace sales that would otherwise be made by BPA, thereby causing Oregon's preference

utilities to incur a total of $3.6 million per year in additional purchase power costs as a result of increases in BPA's priority firm (PF) rate. The potential rate impact on preference customers associated with this "worst case" scenario is an increase of 0.2-0.5 mills/kilowatt hour in the PF rate by 1991. Mr. Drummond further observes that an increase in the PF rate would reduce exchange benefits to those Oregon preference utilities that generate electricity and participate in BPA's residential exchange program.

PPC's analysis of the impact on BPA's sales suffers from the same defects noted above; i.e., it considers only the effect on gross revenues without recognizing BPA's cost of generation and transmission; it assumes that all of the merged companies' increased surplus sales would come at BPA's expense; and it assumes BPA would have no other market for its surplus power at any price. In fact, as BPA witness Roberts testified, the increased sales projected by the Applicant could result in substantial reductions in BPA's residential exchange payments and a potential reduction in the PF rate by 0.2-0.3 mills/kilowatt hour. A 0.2 mill/kilowatt hour reduction would lower the annual purchase power cost of preference customers by $4.4 million region-wide and $1.3 million in Oregon.

PPC also alleges that increased secondary sales by the merged company will impair transmission access for PPC members participating in bulk power markets. The record shows that the potential harm alleged by PPC is both remote and speculative. The only Oregon PPC member participating in wholesale sales markets is the Eugene Water and Electric Board (EWEB), and that utility has participated only in nonfirm transactions on a very limited basis. While the record indicates that there are a few PPC members contemplating participation in bulk power markets, these utilities have either never made any wholesale power sales, or do not own the generation from which they could make such sales.

Finally, PPC argues that the projected power supply savings resulting from the merger could be achieved through other means, such as contractual arrangements. With respect to this issue, the Commission agrees that while significant benefits might be achieved through contracts, greater benefits are likely to result from the merger. It is unrealistic to assume that competing companies would share marketing strategies and information in a manner that would achieve the level of coordination that will result from the merger.

<u>Non-Power Supply Benefits</u>. PPC and CUB argue that the merger benefits expected from administrative combinations, economic development, manpower efficiencies, and reduced construction have not been substantiated and, in some instances, could be achieved without the merger.

Since the merger has not yet been consummated, it is necessarily difficult to quantify the magnitude of these benefits with precision. Moreover, it is possible that some of these non-power supply benefits might be realized without the merger. Despite these facts, the Commission finds that ratepayers will obtain net benefits in these areas as a result of the elimination of duplicative functions, the creation of economies of scale and increased competitiveness.

<u>Rate Stability Benefits</u>. PPC, BPA, and CUB maintain that the rate stability benefits expected by Pacific are illusory because: 1) Pacific has already committed itself to not raising rates for the remainder of the decade, and 2) Pacific has retained the option of requesting rate spread/rate design changes. These arguments are without merit.

Pacific witness Reed testified that Pacific had made a prior commitment not to increase overall rates (<u>i.e.</u>, seek a change in its revenue requirement) through the balance of the decade. The merger has enabled the Applicants both to strengthen and extend this commitment. As noted above, Pacific will file a general rate case by the second quarter of 1989 incorporating Oregon's share of estimated merger benefits equaling approximately $17 million. Second, Pacific has extended its commitment not to raise overall rates for an additional three years, or through December 31, 1992.

The promise of rate stability is not negated by the provision in this stipulation permitting Pacific to propose changes in rate spread and rate design. As Pacific emphasizes, any such proposals must first be presented to the Commission for approval. In fact, the Commission would have difficulty with the stipulation if it were to recommend that no rate spread/rate design changes were to be made over the five-year term. In our opinion, it is important to continually monitor the rate spread/rate designs of regulated utilities to ensure that equitable and economically efficient allocations of revenue responsibility are maintained and fostered. Given this fact, there is no basis for suggesting that the rate stability guarantees of the stipulation will be jeopardized by Pacific's ability to submit rate spread or rate design proposals.

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<u>BPA Exchange Credits</u>. In addition to the argument concerning the effect on the PF rate, PPC and BPA suggest that the merger could also have other potentially negative impacts on BPA exchange credits. The concerns relate to the possibility that non-regional resources may be included in exchange costs and the fear that the merged company will form a generation and transmission subsidiary which will abuse BPA's exchange program.

These concerns are unfounded. In the first place, it is unlikely that non-regional resources will be included in average system cost ASC calculations for the Pacific division. The stipulation provides for a segregation of the Utah division rate base from the Pacific division rate base for rate-making purposes. In the event power costs do not converge by the end of the five-year term of the stipulation, the Commission may continue to require such a separation.

By approving the merger, the Commission is not relinquishing any of its authority to ensure compliance with the Residential Exchange Program. Likewise, BPA regularly analyzes the ASC filings made by Pacific. If BPA finds that certain costs should be excluded from ASC calculations, presumably it will make the appropriate adjustment.

Lastly, PPC's concern regarding the formation of a generation and transmission subsidiary is unwarranted. Pacific has stated for the record that it has no intention of forming such a subsidiary. Even if the company were to change its plans, no such reorganization could take place without specific approval of this Commission.

<u>Transmission Issues</u>. PPC argued that the proposed merger will lessen competition in bulk power markets because the merged company would gain control over transmission facilities from the Pacific Northwest into Southern California and Southwest markets. Our consideration of this issue is necessarily limited by the fact that jurisdiction over interstate transmission matters is vested exclusively in Congress and the Federal Energy Regulatory Commission.

To the extent that the Commission may consider these issues in its assessment of the public interest, there is insufficient evidence to demonstrate that the proposed merger will lessen competition in bulk power markets. In particular, we note the following:

a) PPC's contention that Pacific exercises control over the Pacific intertie is overstated. Out of the 5,156 megawatts of intertie capacity, Pacific has the right to use 300 megawatts as compared with PGE's right to use 800 megawatts and BPA's right to use 4,056 megawatts. Clearly, transmission access from the Pacific Northwest to California is dominated much more by BPA and PGE than by Pacific.

b) PPC's claim that Utah Power controls an important transmission path from the Northwest to the Southwest does not consider that a utility cannot access the Utah Power system without utilizing transmission systems controlled by BPA or other utilities. Even if one assumes that Utah Power does control the transmission corridor in question, the merger will not increase this control, but rather will provide Pacific increased access to markets from which it might have otherwise been excluded. In this sense, Pacific's ratepayers may be significantly advantaged by the merger.

c) The analysis prepared by PPC appears to be incomplete in that it does not consider all relevant bulk power suppliers and overlooks potential transmission paths.

Environmental Concerns. CUB alleges that the application is deficient because it does not address environmental concerns. The applicable statutes and administrative rules do not require an applicant to demonstrate that a proposed merger will not adversely impact the environment. Pacific did not have an opportunity to address this issue on rebuttal because it was not raised in the issue statement filed by CUB prior to the hearing.

To the extent this Commission has authority to consider such issues, there is no evidence to suggest that the merger will have adverse environmental impacts. Indeed, as Pacific points out, it is reasonable to conclude that the merger will have a favorable impact on the environment since it will defer the need for additional generating resources. If CUB believes otherwise, it should have presented evidence in support of its contention.

Reporting Requirements/Term of the Stipulation. PPC and BPA maintain that the semiannual reporting requirements set forth in the stipulation are inadequate. They contend that regulatory lag will prevent ratepayers from obtaining all of the merger benefits to which they are entitled. It is recommended that no limitation be placed on the duration of the reporting requirements.

The Commission does not believe that regulatory lag will be a substantial impediment to prompt ratepayer receipt of merger benefits. The normalized semiannual report that Pacific will file under the stipulation is similar to a rate case filing and will identify and allocate merger benefits. If a rate reduction is in order, a rate proceeding can be instituted quickly. Moreover, regulatory lag will be mitigated by the fact that rate filings are based upon forecasted test periods which are adjusted to reflect revenues and costs in effect during the period the new rates will be in effect. For example, Pacific's rate filing in the second quarter of 1989 will employ estimated merger benefits for the period July 1, 1989, through June 30, 1990. In that case, Pacific's shareholders will bear the risk if the estimated merger benefits imputed in the filing are not realized.

The objections to the five-year term of the stipulation center around two issues: first, the concern that Applicant's hold-harmless commitment will expire at the end of the five-year term; and second, the concern that the Commission will be unable to regulate the merged company effectively after the stipulation terminates.

These concerns lack substance. As noted above, Pacific's commitment to hold customers harmless against any overall increase caused by the merger is not limited in duration. Further, if it is determined that additional reporting requirements are necessary, either before or after the five-year term of the stipulation, the Commission has authority to extend the requirements.

We also agree with Pacific and Staff that the reporting requirements will have accomplished most or all of their objectives within a five-year period. By that time, methods should be established for identifying and allocating merger costs and benefits, and for establishing the capital structure and cost of capital for rate case purposes.

<u>Allocation Guidelines</u>. PPC contends that numerous difficulties will be encountered resolving interjurisdictional allocation matters and recommends that a decision on the merger be withheld until such problems have been resolved. PPC further recommends that the Commission modify the composition of the allocation committee described in this stipulation.

In addition, BPA recommends an extension of the reporting requirements for Allocation Guidelines 1 (pre-merger generation and transmission facilities) and 3 (net power cost analyses). BPA also requests clarification of Allocation Guideline 5 (resolution of disputes).

The recommendations made by PPC and BPA are not adopted. The Commission does not believe that significant problems will be encountered in resolving interjurisdictional allocation matters. Pacific currently operates within a six-state service territory and has not experienced difficulty establishing allocation methods consistent with sound regulatory principles. More importantly, Pacific has agreed that its shareholders will assume all risks that may result from less than full system cost recovery if interdivisional allocation methods differ among the jurisdictions served by the merged company. Thus, Pacific's ratepayers are insulated from any harm.

With respect to the other concerns mentioned, the Commission finds that the allocation provisions set forth in this stipulation are reasonable and should not be modified.

Interdivisional Transfers. In its post-hearing brief, BPA proposed that additional conditions be attached to this stipulation relating to treatment of interdivisional power cost transfers. The proposal reflects BPA's concern that Pacific will attempt to increase net power costs, and therefore average system cost, by manipulating interdivisional purchase power prices and sale for resale revenues.

The conditions proposed by BPA are unnecessary. The three net power cost studies required by the stipulation provide a reasonable means of determining the net impact of the merger on power costs. Moreover, the opportunity costs associated with power sales and purchased power transactions are regularly audited by Staff in conjunction with utility rate filings. The Commission contemplates that the opportunity costs associated with interdivisional power transfers made by the merged company will be fully explored in any future rate filings made by Pacific.

Guarantee of Merger Benefits. In its post-hearing brief, BPA recommends that upon consummation of the merger, the Commission order Pacific to immediately reduce rates in an amount equal to Oregon's allocated share of the first year estimated merger benefits. Pacific would be required to make similar filings each year for a total of five years. Any additional merger benefits realized in excess of those estimated would be passed on to customers retroactively.

While BPA's proposal has a certain amount of surface appeal, it violates due process by requiring immediate merger-related rate reductions without consideration of Pacific's overall results of operations. Assuming the merger results in the net benefits projected, Pacific still must be afforded an opportunity to include any offsetting non-merger related costs in its rate filings.

BPA's concern is based on the assumption that "extra caution" is required to shield Pacific's customers from unreasonable risks. The Commission does not share this view. As noted above, Pacific has already agreed to impute approximately $17 million in net merger benefits in its next rate filing. In our opinion, substantial additional net benefits will continue to accrue in the future. However, even if they do not, Pacific's customers are protected from any harm by the stipulation and various commitments made by the Applicants. If merger benefits prove to be greater than projected, the Commission can initiate a rate proceeding at any time pursuant to ORS 756.500 and 756.515.

Subsidization of Utah division. CUB alleges that despite the guarantee of short-run revenue stability, the merger will result in upward pressure on Oregon rates in the long term. It maintains that Oregon customers will end up subsidizing Utah division customers because of the substantial disparity between the average cost of the Pacific and Utah divisions.[4]

CUB's opposition to the merger also appears to be related to the fact that the Applicants have pledged to decrease rates for Utah Power division customers by two percent within 60 days after the merger is approved. The Applicants anticipate, but do not guarantee, total rate decreases of 5-10 percent for Utah Power division customers during the first few years following the merger. Currently, retail rates paid by Utah Power customers are significantly greater than those paid by Pacific's customers.

CUB's concerns are misplaced. In the first place, costs incurred during the period the stipulation is in effect cannot be recovered in subsequent rate proceedings unless the Commission authorized the deferral of such costs pursuant to ORS 757.259. No such request has even been made in this case.

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[4]CUB alleged that staff failed to investigate thoroughly the proposed merger and that it acted improperly by entering into a stipulation. These allegations are completely unfounded. The stipulation executed by Staff contains detailed measures to ensure that ratepayers are protected from adverse effects and will receive an equitable allocation of merger benefits. CUB's position regarding the propriety of executing stipulations reflects a overall misunderstanding of legal and administrative processes.

Second, the stipulation provides that pre-merger generation and transmission facilities of Pacific and Utah Power shall remain the responsibility of the Pacific and Utah divisions, respectively. This will ensure that the higher cost facilities located in Utah will not have a negative impact on Oregon ratepayers. If necessary, the Commission has the authority to require the continued segregation of the Utah Power rate base from the Pacific Power rate base beyond the term of the stipulation. Likewise, the determination of variable power costs by use of stand-alone and merged-operation simulations and the allocation of net merger benefits could be continued beyond the five-year period.

Third, Applicants have committed indefinitely that Pacific's customers will not be harmed by the merger and will not subsidize benefits to Utah Power customers. Applicants recognize that if the merger results in higher costs, those costs will be borne by the merged company's shareholders. Applicants further agree that shareholders will assume all risks that may result from less than full system cost recovery if interdivisional allocation methods differ among the various jurisdictions.

Fourth, Applicants have agreed to file quarterly reports on the activity in the residential exchange balancing account. This will allow verification that Pacific is not using the balancing account to defer residential exchange related costs incurred during the four-year revenue stability period set forth in the stipulation.

Lastly, the two percent decrease guaranteed to Utah Power customers does not negate the significant benefits that will be realized by Pacific's existing customers from the merger. As staff points out, the $17 million in merger benefits to be imputed in Pacific's 1989 rate filing translates into a rate reduction of nearly 2.8 percent for Oregon ratepayers, all other things being equal. It should also be re-emphasized that Applicants have agreed that the shareholders of the merged company will assume all risk in the event the rate decrease to Utah Power customers exceeds the proper allocation of merger benefits to the Utah division.

In summary, there is no basis for CUB's contention that a merger will result in higher rates or lead to subsidization of the Utah Power division by Oregon ratepayers.

Request for Interlocutory Order. PPC urges the Commission to withhold a final decision in this matter pending a decision by the Federal Energy Regulatory Commission on the proposed merger. We find that the public interest will be best served by prompt approval of the application. The request is therefore denied.

Summary

The Commission finds that the proposed merger and related transactions are consistent with the public interest. The record shows that the merger will defer the need for new generating resources, reduce system operating costs, reduce system reserve requirements, improve system reliability, and permit the expansion of transmission interconnections which will allow the merged company to take greater advantage of lower cost power supplies now available. In addition, a merger is likely to result in significant non-power cost benefits resulting from elimination of duplicative activities and improved efficiency.

The proposed merger and related transactions will not have an adverse impact upon Pacific's ratepayers or the public generally. The provisions of the stipulation, together with the various commitments made by the Applicants and the regulatory powers available to the Commission, ensure that Pacific division customers will not absorb any merger-related costs or subsidize the Utah Power division. In fact, Oregon ratepayers will realize substantial net benefits as a result of the guaranteed imputation of estimated benefits in Pacific's 1989 rate filing.

Finally, the record does not disclose that BPA or PPC members will experience any significant adverse impact as a result of the merger. On the contrary, the evidence suggests that benefits will accrue as a result of reductions in the merged company's average system cost.

CONCLUSIONS OF LAW

1. The Public Utility Commission of Oregon has jurisdiction over the application in this matter, pursuant to Oregon Revised Statutes, Title 57, Chapters 756 and 757.

2. The proposed merger and related transactions are consistent with the public interest.

3. The stipulation executed by Applicant and the Commission Staff is reasonable and should be approved.

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ORDER

IT IS ORDERED that PacifiCorp, a Maine Corporation, dba Pacific Power and Light Company, and PC/UP&L Merging Corp., an Oregon Corporation (to be renamed PacifiCorp upon completion of the merger), are hereby authorized to complete the following transactions:

1. The merger of PacifiCorp Maine and Utah Power and Light Company, a Utah Corporation (Utah Power) with and into PacifiCorp Oregon, with PacifiCorp Oregon to be the surviving corporation, in accordance with an Agreement and Plan of Reorganization and Merger among PacifiCorp Maine, Utah Power, and PC/UP&L Merging Corp., dated August 12, 1987 (merger agreement), pursuant to ORS 757.480;

2. The issuance by PacifiCorp Oregon of shares of its common and preferred stocks upon conversion of the outstanding shares of common and preferred stock of PacifiCorp Maine and Utah Power in accordance with the terms of the merger agreement, pursuant to ORS 757.410;

3. The assumption by PacifiCorp Oregon of all outstanding debt obligations of PacifiCorp Maine and Utah Power, pursuant to ORS 757.440 and the continuation or creation of liens in conjunction therewith, pursuant to ORS 757.480;

4. The transfer to PacifiCorp Oregon of all certificates of public convenience and necessity of PacifiCorp Maine, pursuant to ORS 758.015;

5. The transfer to PacifiCorp Oregon of all rights to allocated territory granted to PacifiCorp Maine, pursuant to ORS 758.460;

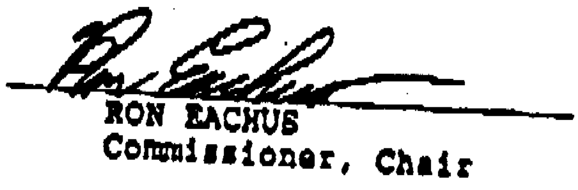
6. The adoption by PacifiCorp Oregon of all tariff schedules and service contracts of PacifiCorp Maine on file with the Commission and in effect at the time of the merger, pursuant to ORS 757.205;

7. The transfer to PacifiCorp Oregon of all Commission authorizations and approvals granted to PacifiCorp Maine for transactions with controlled corporations or affiliated interests, pursuant to ORS 757.490 and 757.495; and

8. The transfer to PacifiCorp Oregon of all Commission authorizations and approvals for the issuance of securities by PacifiCorp Maine which have not been fully utilized, pursuant to ORS 757.410.

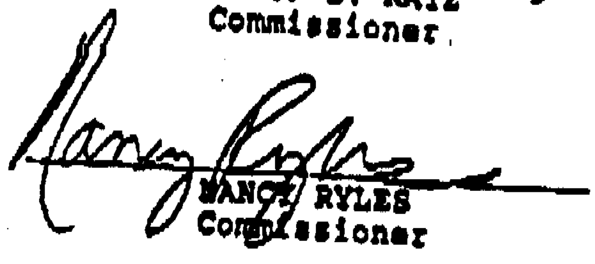
IT IS FURTHER ORDERED that the approvals and authorizations previously listed shall be subject to the conditions set forth in the stipulation executed between the Applicants and the Commission Staff, dated March 3, 1988.

Made, entered, and effective JULY 18 1988.



RON EACHUS
Commissioner, Chair

MYRON B. KATZ
Commissioner



NANCY RYLES
Commissioner

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