BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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IN THE MATTER OF THE APPLICATION OF UTAH POWER & LIGHT COMPANY AND PC/UP&L MERGING CORP. (TO BE RENAMED PACIFICORP) FOR AN ORDER AUTHORIZING THE MERGER OF UTAH POWER & LIGHT COMPANY AND PACIFICORP INTO PC/UP&L MERGING CORP. AUTHORIZING THE ISSUANCE OF SECURITIES, ADOPTION OF TARIFFS AND TRANSFER OF CERTIFICATES OF PUBLIC CONVENIENCE AND NECESSITY AND AUTHORITIES IN CONNECTION THEREWITH	)	CASE NO. 87-035-27 POST-HEARING BRIEF OF NUCOR STEEL, A DIVISION OF NUCOR CORPORATION

PETER J.P. BRICKFIELD
KENNETH G. HURWITZ
RITTS, BRICKFIELD & KAUFMAN
Suite 915
Watergate Six Hundred Building
Washington, D.C. 20037-2474
(202) 342-0800

ANDREW W. BUFFMIRE
WILLIAM P. SCHWARTZ
HANSEN & ANDERSON
Sixth Floor, Valley Tower Building
50 West Broadway
Salt Lake City, Utah 84101-2018
(801) 532-7520

ATTORNEYS FOR NUCOR STEEL, A DIVISION OF NUCOR CORPORATION

DATED: June 3, 1988

INTRODUCTION

This Post-Hearing Brief is filed on behalf of Nucor Steel, a Division of Nucor Corporation ("Nucor"). Nucor is one of the largest customers on the Utah Power & Light system.

Nucor is vitally concerned that this Commission lacks sufficient information about the critical issue of inter-company cost allocations to make a fully-informed decision regarding the impact of the proposed merger on the State of Utah. Unless appropriate conditions are adopted, Utah ratepayers could actually be made worse off as a result of the merger. Moreover, we are equally concerned that this Commission will find itself saddled with an unmanageable regulatory burden. To avoid these problems, Nucor recommends that the Commission expressly condition the merger on the Applicants' filing a definitive cost allocation plan prior to merger approval. In the alternative, Nucor recommends that *all* UP&L rates be deemed interim until equitable cost allocation principles are formulated to the satisfaction of the Commission.

In this regard, we emphasize that it was the Applicants who decided to structure their proposal so as to retain separate divisions for purposes of setting rates. Similarly, it was the Applicants who decided *not* to present this Commission with a definitive cost allocation methodology. Accordingly, the Applicants must bear the consequences of conditions that are fashioned to remedy defects in their presentation.

Nucor believes that the proposed merger could result in a deterioration of service to industrial customers. Furthermore, Nucor is concerned that the interests of retail industrial customers will be relegated to secondary status as a result of the Applicants' stated policy to bolster the merged company's role as a participant in the wholesale bulk power markets. Accordingly, Nucor recommends that the following additional conditions be adopted:

> UP&L should be required to offer contract demand customers power for loads in excess of current load levels at the same prices and under similar conditions as it offers power for sales for resale.

> UP&L should be required to implement a set of procedures to ensure that the merger does not have the effect of lowering service quality to interruptible customers.
>
> UP&L should be required to provide wheeling to industrial customers under certain circumstances.

In this Brief, Nucor will address the following issues as enumerated in the Commission's Post-hearing Procedural Order: IV. Allocations/Regulatory Burden Associated with the Merger; VI. Effect of Merger on Retail Prices; VII. Effect of Merger on Major Industrial Customers. Nucor defers to other parties with respect to the remaining issues.

IV. ALLOCATIONS AND REGULATORY BURDEN

A. THE COMMISSION WILL BE SEVERELY HANDICAPPED IN APPLYING THE "NET BENEFIT" STANDARD EMBODIED IN ITS NOVEMBER 20TH ORDER UNLESS THE APPLICANTS ARE REQUIRED TO FILE A DEFINITIVE COST ALLOCATION PLAN.

In this proceeding, as in other jurisdictions, the Applicants have failed to propose a method for allocating costs between the UP&L and PP&L divisions. Nucor contends that the Commission should order the Applicants to file a definitive cost allocation proposal before rendering its decision on the merger. In the alternative, if the merger is approved without consideration of such an allocation plan, Nucor contends that all UP&L division rates should be deemed interim and subject to refund until the Commission approves an equitable allocation methodology.

The Commission will simply be unable to perform the necessary inquiry under the public interest standard unless it obtains in this proceeding a satisfactory understanding as to how costs will be allocated between the two divisions. The Commission will otherwise be unable to determine whether the merger could actually make Utah ratepayers worse off, even if the merger brings net positive benefits to other ratepayers in other states.

That an allocation methodology should have been presented in this case is clear from the Commission's November 20 Order. There, the Commission stated that the "necessary predicate for a determination that the proposed merger is 'in the public interest' is some net positive benefit *to the public in this State*." This standard focuses on the impact of the proposed merger upon Utah ratepayers and Utah interests as distinguished from national, regional or other states' concerns. The Order also explicitly recognizes that the Commission must consider positive benefits and negative impacts, "giv[ing] each its proper weight, and determine whether on balance the merger is beneficial or detrimental to the public." [Order, at 2.]

Even if the merger yields benefits, as the Applicants claim, its impact on Utah cannot be determined unless Utah's share of the benefits and costs can be ascertained. Moreover, it will be impossible to weigh this impact against the merger's attendant harms, such as the loss of local control, the increased regulatory burden upon this Commission and the loss of UP&L's strategically located transmission system.

The Applicants have made three unconvincing arguments as to why the presentation of an allocation methodology is unnecessary in this proceeding. First, they would have this Commission believe that their failure involves only the omission of "detailed" or "precise" allocation principles. [*E.g.*, Reed, Tr. 555.] Even a cursory reading of the record belies that mischaracterization; the record is replete with repeated instances when the Applicants disavowed even the most general proposals as to how major categories of costs would be allocated. [*E.g.*, Reed, Tr. 604, 606, 676, 678; Steinberg, Tr. 1027.] Second, the Applicants have argued that it is only the shareholder who stands to lose from costs that "fall between the cracks." But the evidence clearly indicates that shareholders stand to reap substantial benefits from the merger. [Colby, Exh. 8.4, line 11.] Third, the Applicants have contended that it simply doesn't matter what allocation method is adopted because the merger will yield benefits and Utah will have its share. [Reed, at Tr. 555.] But as demonstrated below, the choice of allocation method could have a profoundly negative impact upon Utah ratepayers.

1. Certain Allocation Methodologies Could Make Utah Ratepayers Worse Off Even If the Merger Yields Net Positive Benefits For the Merged Company as a Whole.

The choice of allocation methodology could make Utah ratepayers worse off even if the merger yields overall savings. Dr. Spann provided two examples of how this phenomenon could occur in the crucial area of net power supply costs, which Mr. Reed characterized as the "major single focal point" among allocation issues posed by the merger. [Reed, Tr. 673.] Under a "split-the-savings" allocation rule, Utah ratepayers could be worse off under the following scenario:

> Assume . . . the PP&L division can generate power for 10 mills per kwh and that the UP&L division would incur costs of 30 mills if it generated additional kwh to meet its native load. In this case the transfer price is 20 mills and there appears to be a "benefit" from the merger. However, suppose that a third utility offered for delivery at its interconnections with the UP&L division power at a price of 15 mills. In this case ratepayers in the UP&L division would be better off if the merger had not occurred and UP&L bought the power from a third utility at 15 mills instead of a shared savings price of 20 mills, even though from the combined standpoint of both utilities, and both sets of ratepayers, it is better to run a 10 mill PP&L generator than purchase power from a third utility at 15 mills.

[Spann, Direct, Nucor 1.0, at 10.]

Utah ratepayers could also be worse off under certain allocation rules governing revenues from off-system sales. As illustrated in Dr. Spann's direct testimony, if the merged company had an opportunity to sell power to the Pacific Southwest at a price of 30 mills per kwh by increasing the output of a PP&L division generator with an incremental cost of 20 mills per kwh, there would be a net "benefit" of 10 mills, 5 of which would be allocated to UP&L under a fifty-fifty allocation rule. But if, absent the merger, UP&L could have made the 30 mill sale by increasing the output of a 24 mill generator, Utah ratepayers would have received a 6 mill benefit. Again, under the assumed allocation rule, Utah ratepayers would be better off without the merger. [Spann, Direct, Nucor 1.0, at 12.] Mr. Steinberg conceded that these hypotheticals were neither "incorrect" nor "impossible." [Tr. 1038.]

Mr. Steinberg contended that the above detriments to Utah ratepayers would be accounted for in his net power supply allocation method. In particular, he argued that the above transactions would be implicitly reflected in the UP&L stand-alone model. [Tr. 1074.] But this contention is based on an inordinate faith in the reliability and veracity of computer modeling and other estimation techniques.

If UP&L had engaged in the above transactions absent a merger, both the 15 mill purchase from the "third utility" and the 30 mill sale from the 24 mill generator's output would have been recorded and reflected in the EBA as actual costs and revenues from actual transactions. [*See* Colby, Tr. 385.] The only way that these transactions could be "accounted for" under the Applicants' method, on the other hand, is by computer simulation or judgment calls on the assumption that the merger never occurred. While Mr. Steinberg stated that stand-alone transactions can be estimated "by knowing what sales [by the merged company] did take place and the prices that were received for that" [Tr. 1039], in reality such estimates would have to be made on the basis of short-term power supply markets that do not exist, negotiations that never took place and offers and transactions that never happened. [*See* Steinberg, Tr. 952.]

As to whether UP&L's total revenues from off-system surplus sales would improve or deteriorate, Mr. Steinberg could not venture an estimate:

> Q. Did you expect the Utah Division, as a division, to make more total revenues on surplus sales than they would have on a stand-alone basis?
>
> A. I don't know. I've never looked at it that way. I just looked at it from the merged company's perspective and the merged company as a total, as a whole, makes more sales than the sum of the stand-alone. I haven't looked at to -- to which division might that be due to because in a merged system simulation, it doesn't make any difference; that is there is no [sic] two systems, it's one system, and that's why the benefits accrue because you did operate it as one division.

[Tr. 955.] While the Applicants' allocation method might *theoretically* account for the foregone opportunities depicted in Dr. Spann's examples, it might thus turn out that, based on the above testimony, that UP&L would be worse off on a stand-alone basis and the allocation of total company benefits would be insufficient to offset the detriment to UP&L ratepayers. This is the precise point of Dr. Spann's examples.

Different allocation rules for non-power supply costs could also have negative impacts on Utah ratepayers. Consider the following example: The UP&L division hires an additional attorney at a salary of $100,000 thereby saving PP&L $500,000 in outside legal fees. Under an allocation rule assigning costs directly to the situs division, UP&L ratepayers would see a cost increase. Alternatively, the increased salary expense could be allocated to the respective divisions on the basis of some allocation factor, such as investment and operating expenses. [Reed, Tr. 587.] Whether a particular expense should be directly assigned to the incurring division under a situs allocation rule or allocated between divisions under some other allocation scheme could obviously fundamentally alter the impact of the merger upon UP&L ratepayers. Moreover, tracing every expense to determine whether it was incurred strictly to meet the needs of one division as opposed to the needs of the merged company is an impossible exercise. Untraceable cost and benefit transfers will abound because the two separate divisions will be managed by "common corporate management [which will be] responsible to a single group of shareholders." [*See* Reed, Tr. 558.]

2. The Allocation Principles Suggested by the Applicants Inherently Deprive Utah Ratepayers of the Benefits of UP&L's Strategically Located Transmission System Without Compensating Benefits: "What's Mine Is Mine and What's Yours We Will Talk About How We Are Going to Share. . . ."

Mr. Bolender stated that transmission access is one of the major benefits that PP&L will acquire from UP&L as a result of the merger. [Tr. 222.] The cost allocation principles suggested by the Applicants, while ill-defined, will deprive Utah ratepayers of the benefits of the strategically-located UP&L transmission system without compensating benefits. Moreover, the Applicants have specifically rejected proposed conditions that would provide such compensation. [Bolender, Tr. 251.]

The Applicants do not intend to "roll-in" the embedded generation and transmission plant of each of the divisions. [Reed, Tr. 579-80.] Consequently, Utah ratepayers, who in the past have paid for the capital recovery and carrying costs of the UP&L transmission system, will continue to do so without contribution from PP&L division ratepayers. According to the Applicants, the cost of betterments to the UP&L transmission system should also be allocated to UP&L ratepayers. [Reed, Tr. 580.]

While the costs of the UP&L transmission system would be borne by UP&L ratepayers, the benefits from the transmission system would be apportioned *between* UP&L Division and PP&L Division ratepayers unless hypothetical stand-alone off-system sales could be properly attributed to UP&L. Despite Applicants' repeated assurances that such stand-alone sales could be captured and assigned to the appropriate division, Mr. Steinberg could not provide a definitive answer as to how this determination would be made:

> Q. Now. let's assume that [the Nevada Power] sale were made post-merger and we can assume, if you like, that the sale was made to Nevada Power on identical terms. . . . On what basis would it be possible to conclude that that sale could not have been made by UP&L on a stand-alone basis?
>
> A. I'm not sure. It would be up to us to demonstrate why it should be included or why it shouldn't be included, but my judgment is that the type of sales that the merged system will actually do will be distinguishable between sales that either one of us could have done.
>
> Q. But you are not certain on what basis you would make that distinction; is that what you are saying?
>
> A. Well, it would be looking at the capabilities of each of the stand-alones.
>
> Q. And how would you measure the capabilities of each of the stand-alones?
>
> A. I don't have a cookbook formula at this moment in time to do that.
>
> Q. So that would have to be worked out later on; is that what you are saying?
>
> A. Yes, sir.

[Tr. 1041.]

Such determinations will inevitably be biased in favor of concluding that major off-system sales could only have been made by the merged company. Indeed, only those sales reflecting combined company capabilities, on terms and conditions negotiated by the combined company will *actually* take place. Stand-alone sales would "occur" only in the *hypothetical* non-merger world. Under these circumstances, proving unreal stand-alone transactions will be a profoundly difficult burden, a burden that will fall squarely on the

Utah Commission and Utah ratepayer representatives. If the burden cannot be met, the benefits of off-system sales attributable to the UP&L transmission system will be lost to Utah ratepayers.

Just as the Applicants' allocation method would deprive Utah ratepayers of the full benefits of the UP&L transmission system, it would also unfairly retain the benefits of PP&L's inexpensive power production costs for PP&L. Mr. Bolender admitted that, as a result of the merger,

> . . . the benefits from the existing PP&L hydro system are going to predominantly continue to flow to the customers of the Pacific Power Division.

[Tr. 204.] The Applicants have categorically asserted that they are unwilling to consider rolling in the energy costs of the two divisions for at least ten years. [Bolender, Tr. 204; Colby, Tr. 241; Steinberg, Tr. 1029.] Doing this, according to Messrs. Bolender and Colby, would constitute "cross-subsidization." Mr. Bolender further asserted that

> . . . certainly our Commissions in the states where we presently serve, Pacific Power presently serves, are going to try to make sure that there is no cross-subsidization of customers in this merger; . . .

[Tr. 204.]

Why does sharing the benefits of PP&L's cheap energy costs constitute "cross-subsidization" but sharing the benefits of UP&L's strategic transmission system does not? Applicants have no answer to that question. Commissioner Byrne captured the essence of this paradox as follows:

> What's mine is mine and what's yours we will talk about how we are going to share. . . .

[Tr. 602.] Nucor contends that a definitive allocation plan must be considered *now*, before the disposition of the merger, to ensure that Utah ratepayers receive a fair share of benefits from the UP&L transmission system.

B. The Applicants' Proposal To Make Pervasive Use Of "Stand-Alone" Modeling Poses New And Intractable Regulatory Problems For This Commission. The Net Result Is That Rates Would Be Set On A Highly Speculative And Unreliable Basis.

The Applicants propose to make pervasive use of stand-alone modeling for purposes of setting rates. The use of this highly speculative estimation technique will introduce new and uncertain elements into the rate setting process. The net result is that rates would be set on the basis of intuition, not the cost of serving UP&L ratepayers.

Stand-alone modeling would be assigned many demanding roles in the post-merger world. First, as stated above, stand-alone modeling would be utilized to perform inter-divisional allocations of net power supply costs for at least ten years. [Reed, Tr. 581.] Second, the UP&L EBA would be established on the basis of an estimate of UP&L's stand-alone energy costs. Third, the Applicants have made a formal commitment that costs will not go up as a result of the merger, a commitment which they intend to verify by means of stand-alone projections of total cost levels (including both power supply and all non-power supply costs) for each division every time a rate case is filed. [Reed, Tr. 610.]

Many of the public witnesses in this proceeding expressed serious reservations about the reliability and veracity of stand-alone modeling of net power supply costs. While these witnesses recognized that, in the near term, stand-alone costs and revenues can be compared with actual pre-merger UP&L and PP&L data, in the long run, such benchmarks are unavailable. It is here that the process of setting rates would be completely shaken from its traditional cost of service foundations.

Recognizing this very severe difficulty, Dr. Weaver stated that

> there is no question that the further we get into the future, the fuzzier those are, the more difficult they are to define with any degree of reliability or with an adequate degree of reliability.

[Tr. 2087.] Mr. Burrup agreed that the difficulty of estimating net power supply costs "increases as time passes." [Tr. 2057-58.] And Mr. Huntsman summed it up this way:

> . . . I think for the first years that may not be too hard but as we get further away from debarkation of approval of the merger, that may become speculative and more subject to disagreement

> between the parties on what the stand-alone animal would look like.

[Tr. 1426.]

Even apart from the speculative character of stand-alone net power supply costs is the impossibility of verifying the results of the Applicants' method. Consider that, of the three variables that would play a role in formulating allocations under the stand-alone method, only one -- the net power supply costs of the combined system -- can actually be observed in the form of actual accounting data. [Spann, Direct, Nucor 1.0, at 6.] The other two variables, the stand-alone costs of the PP&L and UP&L divisions, can *never* be verified. While the *sum* of the rates of the PP&L and UP&L Divisions might be "just and reasonable," the rates of the two divisions, taken separately, would lack any reasonable cost foundation. In this respect, the Applicants' allocation methodology would represent a radical departure from traditional methods.

The DPU and other participants in UP&L rate cases will find that their normal rate case duties will become frighteningly complicated by virtue of the Applicants' proposal. Because energy costs constitute a major portion of UP&L operating costs, the UP&L Division could be entitled to a rate increase under any of the following scenarios: (1) UP&L stand-alone costs increase; (2) PP&L stand-alone costs increase; or (3) merged company costs increase. [*See* Steinberg, Tr. 1042-43.] Given these possibilities, the DPU and other rate case participants would not only need to develop an understanding of the stand-alone operation and capabilities of the UP&L Division, but they would also need to understand the stand-alone operation and capabilities of the PP&L Division. Moreover, DPU will have to develop an understanding of the PP&L system sufficient for it to estimate what the following variables *would have been* in the absence of the merger: fuel costs, purchased power costs, wheeling costs and revenues from firm and non-firm transactions. Such an understanding will be immediately required in order to evaluate the cost of service filing contemplated by the UP&L Division in the first quarter of 1989.

Acquiring the necessary expertise is not simply a matter of expanding the DPU's expertise to include another power production system similar to UP&L's. Rather, as Mr. Steinberg testified, systems such as PP&L, which have a great deal of hydroelectric capability, are characterized by the interaction of many complex factors:

> The character of hydroelectric capability is more than just water running through a dam. It's multi-faceted resources that has storage capabilities . . . [and] we can move power from Utah's system off-peak, store it in our reservoirs and use it on-peak where it has more benefit. . . . Therefore, when you speak about the hydro system in general, its character is rather complex . . . .

[Tr. 920.] Referring to the ability of regulators to verify the validity of stand-alone models and, in particular, estimates of off-system sales, the "only assurance" the Applicants can offer is a belief that regulators "can determine whether they're being told a reasonable story or not." [Comish, Tr. 1393.] These assurances are plainly inadequate. Even if regulators can recognize "a reasonable story" as readily as the merged company can tell one, the demands of the Applicants' method are so great that the merged company would enjoy an undue advantage over regulators and private party intervenors.

The role of stand-alone modeling contemplated for non-power supply costs would involve an even greater degree of speculation and uncertainty. Mr. Reed testified that the merged company would have the burden in every rate case of establishing that the costs of the UP&L Division did not go up as a result of the merger. [Reed, Tr. 704; *See* Colby, Tr. 362.] The difficulty of performing such an exercise is staggering. The Applicants would have to estimate, in addition to a projected test year, a *non-merger test year* showing what each and every cost element of the UP&L revenue requirement would have been in the absence of a merger. In other words, if the Applicants had created a combined insurance department, an estimate would have to be performed as to what insurance costs *might* have been for each company standing alone. The exercise would have to be repeated for wage levels, depreciation, taxes, materials and supplies, production plant, transmission plant, *ad infinitum*.

If merger savings were large in magnitude, this exercise would be inconsequential. But if merger savings did not materialize, as claimed, or if exogenous costs, such as income taxes, increased, then the Applicants' commitment to "cap" rates based on the hypothetical non-merger case would come into play. The above stand-alone exercise would actually be utilized to establish rate levels. Plainly, the resultant rates would be indefensible and the entire ratesetting process would be reduced to arbitrary guesswork.

There are only two ways to cure these severe regulatory problems. The first would be to require Applicants to roll-in net power supply costs on a merged company basis. As Mr. Helsby testified, the Applicants' proposal to keep the two divisions totally separate for ratemaking purposes, but to operate on a single utility basis with respect to certain functions, is the root of the above-described cost allocation problems. [Helsby, Tr. 2118.] The Applicants are, of course, unwilling to do this. The second would be to require the Applicants to file a definitive cost allocation plan subject to Commission approval or, alternatively, to deem all rates interim until reasonable allocation methods can be worked out, as recommended in Dr. Spann's testimony.

VI. EFFECT ON RETAIL PRICES

A. THE EFFECT OF THE MERGER ON RETAIL PRICES IS UNKNOWN EXCEPT DURING THE FOUR-YEAR PERIOD IMMEDIATELY FOLLOWING THE MERGER.

The Applicants have made various rate reduction commitments which would become effective during the first four years after the proposed merger. In particular, the Applicants have stated that they would reduce the rates of most retail ratepayers (except special contract industrial customers) by two percent within sixty days of the proposed merger and by an additional three percent within four years. [Applicants' Opening Statement, Tr. 22; Davis, Tr. 111-112.] As Mr. Davis acknowledged, the second half of that commitment is illusory, for the second-tier three-percent decrease could be implemented on the last day of the four-year period, followed by the filing for a rate increase on the next day. [Davis, Tr. 116.] Beyond the four-year period, the only commitment the Applicants have made is that rates would never rise above stand-alone levels for each division. [Davis, Tr. 73.]

Given the absence of definitive information about inter-divisional cost allocation methodology on this record, the Commission cannot venture a guess as to the impact of the merger on UP&L's projected cost levels and retail rates beyond the initial four-year period. The Applicants have failed to produce critical cost allocation information, even though it was clearly their burden to do so. [*See* November 20 Order, at p. 2]. The Commission must therefore take steps on its own to obtain this vital information. The Commission should require the Applicants to produce a cost allocation plan subject to Commission approval or should deem all rates interim. If the Commission does not take these steps, it should deny the merger.

B. THE TREATMENT PROPOSED BY THE APPLICANTS FOR REDUCTIONS OF INDUSTRIAL CUSTOMER RATES IS HOPELESSLY SELF-CONTRADICTORY AND DISCRIMINATORY.

The treatment proposed by the Applicants for industrial customer rates is hopelessly self-contradictory and discriminatory. The Applicants propose to apply the initial two percent rate reduction to all classes of retail ratepayer *except* special contract industrial customers whose rates are not tied to Rate Schedule 30.

The Applicants recognize that the merger is a singular development transcending ordinary rate spread and rate design considerations:

> With respect to how an interruptible customer is priced or whether or not residential gets a different decrease than does industrial is a whole other set of issues and those issues are there regardless of whether or not the merger is consummated and I don't see the two as necessarily needing to be tied together.

[Faigle, Tr. 1116.] The Applicants would nonetheless deny certain special contract industrial customers the initial two percent decrease on the grounds that the rates of these customers are below full tariff rates. But if, as Ms. Faigle testified, rate spread and merger-related issues need not be tied together, and recognizing that the merger is a once-in-alifetime event, the two percent reductions should be applied to all retail customers, including industrial customers.

If the rate reduction commitments are to be tied to rate spread and rate design considerations, then the Commission should await the outcome of the pending rate spread proceeding as well as a full hearing on the recommendations of the task force on incentive rates. Only then will the Commission be in a position to make a determination based on a full evidentiary record. The Commission should reject the Applicants' *ad hoc* rate design proposal. [*See* Confidential Exhibit 16.3 (Faigle).] The initial two percent rate reduction should be applied across-the-board.

VII. THE EFFECT ON MAJOR INDUSTRIAL CUSTOMERS

A. NUCOR'S RECOMMENDED CONDITION THAT THE MERGED COMPANY BE REQUIRED TO OFFER CONTRACT DEMAND CUSTOMERS POWER FOR INCREMENTAL LOADS IS INEXTRICABLY INTERTWINED WITH THE MERGER.

Nucor contends that the merged company should be required to offer contract demand customers power for incremental loads at the same price and under similar conditions as it offers power for sale for resale. Simply stated, the above condition must be considered in this proceeding because it is a necessary adjunct to the declared policy of the merged company to maximize off-system sales. The proposed condition would preserve the beneficial aspects of the Applicants' policy but would also have an additional benefit: fostering economic development in Utah.

The Applicants in large measure stake their claim for merger benefits on their purported ability to make dramatically increased levels of wholesale firm and non-firm power sales. [Boucher, Substituted Direct, App. 18, at 17.] Indeed, one of the fundamental strategic objectives of the merged company will be to aggressively pursue opportunities to enhance off-system sales. [Topham, Tr. 1195; Reed, Direct, App-9, at 3.] In this connection, Mr. Boucher testified as follows:

> I believe that the combined system is well situated to provide the broad spectrum of energy supply services demanded in the wholesale marketplace. [*Id.*, at 19.]

> These melded attributes should allow the merged systems to respond to ever-increasing competition in wholesale power markets. [*Id.*]
>
> The merger will permit us to remain competitive in wholesale power markets. [*Id.*, at 23.]

Based on these assertions, the Applicants claim that the merged company will be capable of making 3,294,770 MWh of special sales for resale over and above the projected level for the sum of the two companies standing alone from 1988 to 1992. [*See* Steinberg, Exh. 8.5, at 10.]

The Applicants' declared policy favoring the maximization of off-system sales must be measured against the Commission's public interest standard which requires as a prerequisite to merger approval net benefits to the State of Utah. Nucor contends that the proposed condition is not only "merger-related," but that it is inextricably intertwined with the merger because it is designed to counterbalance the Applicants' policy to maximize off-system sales with policies that would maximize the welfare of the State of Utah. As such, it is vital that the Commission fully consider the proposed condition in this proceeding and not relegate the issue to later proceedings relating to individual industrial customer contracts.

In circumstances where capacity is short, off-system sales in effect compete for system resources that could otherwise be used to provide industrial customers additional energy to expand output in Utah. Under UP&L's current surplus capacity situation, the proposed condition would increase the total magnitude of surplus sales, not substitute an industrial sale for a surplus sale to another utility. [Spann, Surrebuttal, Nucor 1.11, at 7.] Given these phenomena, and given that the Applicants expect to greatly enhance their efforts in wholesale markets, it is imperative that industrial customers be afforded some assurance that surplus energy will be available to serve their competing needs.

Offering surplus energy to serve incremental industrial loads would yield substantial benefits to Utah customers. Assuming an off-system sale were made at some price above incremental variable cost, the margins would be flowed through the EBA, effectively reducing the fixed cost burden that would otherwise be borne by retail customers. [Spann, Direct, Nucor 1.0, at 14.] Similarly, if an industrial customer were willing to increase its usage of electricity by adding a shift, expanding plant or increasing the utilization of existing production facilities because surplus power could be obtained at or near incremental cost, the margins could also be flowed back to firm ratepayers, yielding the identical benefit. There is one important difference, however, between the impact of the off-system sale and sale made to the Utah industrial customer: While the benefits of the off-system sale will be split between the selling and the purchasing utility [Topham, Tr. 1197], in the case of the retail industrial sale, there is the additional benefit of stimulating economic development in Utah. As Dr. Spann testified,

> It makes much more sense to use Utah natural resources to promote economic growth in Utah than to export those resources to promote economic growth in other states.

[Spann, Direct, Nucor 1.0, at 14.]

Despite its obvious appeal, Mr. Topham initially raised objections to this condition on practical grounds. First, Mr. Topham questioned whether industrial customers would be willing to accept an arrangement under which payment for surplus energy would be required whether or not it was used. [Topham, Rebuttal, App. 17, at 14.] Notwithstanding his initial objection, Mr. Topham admitted that such an arrangement "might be acceptable to a particular customer." [Topham, Tr. 1194.] Second, Mr. Topham contended that "it is highly unlikely that any industrial customer" would be capable of expanding industrial production on short notice. He conceded, however, that if an industrial customer knew sufficiently in advance that it could purchase off-system energy for incremental loads, it could adapt its production process to make use of such energy, very much like industrial customers taking service under time-of-day rates. [Topham, Tr. 1200.] Finally, Mr. Topham made the specious objection that offering surplus energy to industrial customers would displace energy sold at contract rates, thus depriving firm customers of higher margins. [Topham, Rebuttal, App. 17, at 15.] But Dr. Spann's condition is explicitly limited to incremental industrial loads which would not otherwise be taken at current retail rates. [Spann, Direct, Nucor 1.0, at 14; Surrebuttal, Nucor 1.11, at 4.]

Finally, Mr. Topham stated that the Applicants would certainly be willing to consider the recommended condition for customers who could make use of surplus power. [Topham, Tr. 1207.] In light of the Applicants' willingness, Nucor contends that the Commission should expressly condition its Order in this proceeding on a requirement that the Applicants immediately convene meetings with interested industrial customers to formulate procedures, and to discuss terms and conditions for the delivery and receipt of surplus power. Notwithstanding the smoke screen of arguments raised by the Applicants, this Commission, its Staff, and the merging entities certainly have the ability to structure an appropriate mechanism for such sales.

B. THE COMMISSION SHOULD ADOPT A CONDITION THAT ENSURES THAT ECONOMIC INTERRUPTIONS NOT INCREASE AS A RESULT OF THE MERGER.

Nucor's third condition is designed to ensure that economic interruptions not increase, and the quality of service to industrial customers not deteriorate, as a result of the merger. Unless this condition is adopted, the potential decline in the quality of service to industrial customers must be weighed heavily against the asserted benefits of the merger. Certainly, this Commission should not approve the merger if it will harm any significant group of customers.

The Applicants' plans to dramatically increase the level of off-system sales after the merger substantially heightens the risk of economic-based interruptions. [Spann, Tr. 1966.] Interruptible customers are interrupted when UP&L's incremental variable costs exceed specified levels. Higher incremental costs, in turn, will come about as a result of increases in total system loads attributable to increased off-system sales. [*Id.*]

To counteract this phenomenon, Dr. Spann originally recommended that incremental cost calculations for the purpose of economic interruptions should be performed prior to any off-system sales in excess of current load levels. [Direct, Nucor 1.0, at 18.] This procedure would effectively hold interruptible customers harmless against the increased risk of economic interruptions due specifically to the merger. [*Id.*] As such, it is an appropriate merger-related condition. Mr. Powell's contention that interruptible customers must assume the risk of increased interruptions is a draconian and inappropriate interpretation of these customers' rights and the merged company's service obligation to them. Obviously, Nucor and other industrial customers could not have foreseen the fundamental operational changes that will accompany the proposed merger. Mr. Powell's contention that the proposed condition, which was narrowly drawn to address these changes, would raise interruptible customers to "artificial firm status" is plainly wrong. [*See* Powell, First Rebuttal, DPU 7.0, at 5-6.]

Nucor believes that an acceptable alternative to Dr. Spann's original condition would be one which embodies three features: (1) that the marginal cost for purposes of economic interruptions would be calculated before any non-firm off-system sales but after firm off-system sales; (2) that UP&L would not interrupt interruptible customers for capacity reasons except under short-term emergency system conditions; and (3) that UP&L will not make an economic interruption when it can sell non-firm energy at a higher rate off-system. It is Nucor's understanding from Ms. Faigle's and Mr. Boucher's testimony [*see* Tr. 1137 and Tr. 1307-09, respectively], and from a Technical Conference held on May 17, that these conditions are acceptable to the Applicants.

C. THE COMMISSION SHOULD MANDATE RETAIL WHEELING IF THE ABOVE REGULATORY CONDITIONS ARE NOT IMPOSED AS CONDITIONS OF MERGER APPROVAL.

Nucor has proposed two distinct conditions requiring retail wheeling. Nucor strongly believes that these conditions are appropriate in light of increased competition in the utility business. One of the central purposes of the merger is to enhance the merged company's ability to compete in wholesale and retail markets. [Bolender, Direct, App. 30, at 7.] Customers must also be allowed to respond to these changes through access to alternative suppliers.

The first wheeling condition would explicitly state that nothing in the Commission's Order precludes retail customers connected at the transmission or subtransmission level from seeking wheeling of power from other suppliers under the same general terms and conditions as any wheeling for wholesale customers required by the FERC. [Spann, Direct, Nucor 1.0, at 3.] The purpose of this condition is simply to complement merger-related conditions that might be ordered in the FERC proceeding. [*Id.*, at 20.] If the FERC orders wholesale wheeling to remedy anticompetitive impacts of the merger, this Commission should not foreclose Nucor and other industrial customers from seeking similar relief.

Nucor's second wheeling condition would *affirmatively require* UP&L to offer contract demand customers wheeling of power from other suppliers under the same general terms and conditions as any wheeling for wholesale customer required by the FERC. [Spann, Direct, Nucor 1.0, at 3.] Nucor strongly believes that this condition is warranted if the Commission does not adopt the above regulatory conditions, all of which are designed to ensure that industrial customers are not harmed as a direct result of the merger. [*Id.*, at 20.] Simply stated, industrial customers must have the protections of a competitive market if regulation cannot offer appropriate safeguards to the merger which, after all, is plainly a voluntary transaction.

CONCLUSION

For the foregoing reasons, the proposed merger should be approved only if the conditions proposed by Nucor are adopted.

Respectfully submitted,

RITTS, BRICKFIELD & KAUFMAN

Kenneth G. Hurwitz

Peter J.P. Brickfield, Esq.
Kenneth G. Hurwitz, Esq.

Watergate 600 Building
Suite 915
Washington, D.C. 20037-2474
(202) 342-0800

HANSEN & ANDERSON

Andrew W. Buffmire

Andrew W. Buffmire, Esq.
William P. Schwartz, Esq.
Valley Tower Building
Suite 600
50 West Broadway
Salt Lake City, Utah 84101
(801) 532-7520

COUNSEL FOR NUCOR STEEL, A DIVISION OF NUCOR CORPORATION

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UTAH PUBLIC
SERVICE COMMISSION

Andrew W. Buffmire, Esq.
William P. Schwartz, Esq.
HANSEN & ANDERSON
Valley Tower Building, Suite 600
50 West Broadway
Salt Lake City, Utah 84101
Telephone: (801) 532-7520

Peter J.P. Brickfield, Esq.
Kenneth G. Hurwitz, Esq.
RITTS, BRICKFIELD & KAUFMAN
Watergate 600 Building, Suite 915
600 New Hampshire Avenue, N.W.
Washington, D.C. 20037
Telephone: (202) 342-0800

Attorneys for Nucor Steel

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of UTAH POWER & LIGHT COMPANY and PC/UP&L MERGING CORP. (to be renamed PACIFICORP) for an Order Authorizing the Merger of UTAH POWER & LIGHT COMPANY and PACIFICORP into PC/UP&L MERGING CORP. Authorizing the Issuance of Securities, Adoption of Tariffs and Transfer of Certificates of Public Convenience and Necessity and Authorities in Connection Therewith.	Case No. 87-035-27 **CERTIFICATE OF SERVICE**

On this 3rd day of June, 1988, I hereby certify that I caused to be mailed, via United States first class mail, postage prepaid, a true and accurate copy of the POST-HEARING BRIEF OF NUCOR STEEL, A DIVISION OF NUCOR CORPORATION, to the parties listed below:

Raymond W. Gee, Esq.
KIRTON, McCONKIE & BUSHNELL
330 South 300 East
Salt Lake City, Utah 84111

Donald B. Holbrook, Esq.
Calvin L. Rampton, Esq.
Ronald J. Ockey, Esq.
L.R. Curtis, Esq.
JONES, WALDO, HOLBROOK & McDONOUGH
1500 First Interstate Building
170 South Main Street
Salt Lake City, Utah 84101

F. Robert Reeder, Esq.
Val R. Antczak, Esq.
PARSONS, BEHLE & LATIMER
185 South State Street, Suite 700
Post Office Box 11898
Salt Lake City, Utah 84147-0898

Ms. Myrna J. Walters
Idaho Public Utilities Commission
Statehouse Mail
Boise, Idaho 83720

Paul T. Morris, Esq.
West Valley City Attorney
Mr. I. Robert Wall
UTAH PUBLIC POWER CO-OP
2470 South Redwood Road
West Valley City, Utah 84119

James A. Holtkamp, Esq.
VAN COTT BAGLEY CORNWALL & McCARTHY
50 South Main Street, Suite 1600
Post Office Box 45340
Salt Lake City, Utah 84145

Richard W. Giauque, Esq.
Gregory P. Williams, Esq.
Gary F. Bendinger, Esq.
GIAUQUE, WILLIAMS, WILCOX & BENDINGER
500 Kearns Building
136 South Main Street
Salt Lake City, Utah 84101

Michael Ginsberg, Esq.
Assistant Attorney General
State Capitol Building
Salt Lake City, Utah 84114

Sandy Mooy, Esq.
Assistant Attorney General
State Capitol Building
Salt Lake City, Utah 84114

A. Wally Sandack, Esq.
SANDACK & SANDACK
370 East 500 South
Salt Lake City, Utah 84111

Ms. Alice Ritter Burns
Cedar City Attorney
110 North Main Street
Post Office Box 249
Cedar City, Utah 84720

Michael S. Gilmore, Esq.
Ms. Lori Mann
Deputy Attorneys General
Idaho Public Utilities Commission
Statehouse Mail
Boise, Idaho 83720

Chris L. Engstrom, Esq.
Washington City Attorney
SNOW, NUFFER, ENGSTROM & DRAKE
90 East 200 North
St. George, Utah 84770

Stephen R. Randle, Esq.
UNGRICHT, RANDLE & DEAMER
520 Boston Building
9 Exchange Place
Salt Lake City, Utah 84111

Dale A. Kimball, Esq.
Gary A. Dodge, Esq.
KIMBALL, PARR, CROCKETT & WADDOUPS
185 South State Street, Suite 1300
Post Office Box 11019
Salt Lake City, Utah 84147

Lynn W. Mitton, Esq.
F. Elgin Ward, Esq.
DESERET GENERATION & TRANSMISSION
8722 South 300 West
Sandy, Utah 84070

Ronald R. Allen, Esq.
John P. Williams, Esq.
DUNCAN, ALLEN & MITCHELL
1575 Eye Street, N.W.
Washington, D.C. 20005

Roger Cutler, Esq.
Salt Lake City Attorney
324 South State Street
Salt Lake City, Utah 84111

George M. Galloway, Esq.
James Fell, Esq.
STOEL, RIVES, BOLEY, JONES & GREY
900 S.W. Fifth Avenue
Portland, Oregon 97204

Mr. Sidney G. Baucom
Mr. Thomas W. Forsgren
Mr. Edward A. Hunter Jr.
UTAH POWER & LIGHT COMPANY
1407 West North Temple Street
Post Office Box 899
Salt Lake City, Utah 84110

Charles F. McDevitt, Esq.
Suite 200, Park Place
277 North 6th Street
Boise, Idaho 83702

John R. Morris, Esq.
LeBOEUF, LAMB, LEIBY & MacRAE
1000 Kearns Building
136 South Main Street
Salt Lake City, Utah 84101

Ms. Salli Barash
WILLKIE, FARR & GALLAGHER
1 Citi Corp Center
153 East 53rd Street
New York, New York 10022

David S. Christensen, Esq.
Assistant Attorney General
236 State Capitol Building
Salt Lake City, Utah 84114

Charles M. Darling IV, Esq.
J. Patrick Berry, Esq.
Ms. Sheryl S. Hendrickson
BAKER & BOTTS
555 West 13th Street, N.W.
Suite 500 East
Washington, D.C. 20004-1104

Mr. Fredric D. Reed
Senior Vice President
PACIFIC POWER & LIGHT COMPANY
902 S.W. Sixth Avenue
Portland, Oregon 97204

Robert S. Campbell, Esq.
Gregory S. Monson, Esq.
WATKISS & CAMPBELL
310 South Main Street, 12th Floor
Salt Lake City, Utah 84101

Peter J.P. Brickfield, Esq.
Kenneth G. Hurwitz, Esq.
RITTS, BRICKFIELD & KAUFMAN
Watergate Six Hundred Bldg., Suite 915
600 New Hampshire, N.W.
Washington, D.C. 20037

Wesley F. Merrill, Esq.
109 North Arthur Spaulding Building
Pocatello, Idaho 83204

Mr. L. Christian Hauck
COLORADO UTE ELECTRIC ASSOCIATION
Post Office Box 1149
Montrose, Colorado 81402

Glen J. Ellis, Esq.
Dean B. Ellis, Esq.
60 East 100 South, Suite 102
Post Office Box 1097
Provo, Utah 84603

James S. Jardine, Esq.
RAY, QUINNEY & NEBEKER
400 Deseret Building
79 South Main Street
Post Office Box 45385
Salt Lake City, Utah 84145-0385

Mr. Robert J. Grow
Basic Manufacturing and Technologies
of Utah dba Geneva Steel
Post Office Box 2500
Provo, Utah 84603

Mr. Edwin E. Blaney
Salt Lake County Council of Governments
420 West 1500 South, Suite 100
Bountiful, Utah 84010

Ms. Kathryn T. Whalen
BENNETT, HARTMAN, TAUMAN & REYNOLDS
One S.W. Columbia, Suite 1450
Portland, Oregon 97258

DATED this 3rd day of June, 1988.

HANSEN & ANDERSON

By Andrew W. Buffmire

Andrew W. Buffmire
William P. Schwartz
Attorneys for Nucor Steel