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**BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH**

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| In the Matter of the Application of PacifiCorp<br>and ScottishPower plc for an Order Approving<br>the Issuance of PacifiCorp Common Stock | )<br>)<br>) | Docket No. 98-2035-04 |

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# PACIFICORP

# REBUTTAL TESTIMONY OF RICHARD T. O'BRIEN

## JULY 13, 1999

## INTRODUCTION

Q. Please state your name.

A. My name is Richard T. O'Brien.

Q. Are you the same Richard T. O'Brien who submitted direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. I provide testimony regarding the overall conclusions reached by the Division of Public Utilities (DPU). I address several issues raised by Large Customer Group (LCG) witness Richard M. Anderson and Utah Industrial Energy Consumers' (UIEC) witness Brubaker. These issues relate to ScottishPower's suitability as a merger partner for PacifiCorp and PacifiCorp's ability to achieve efficiencies and improvements on its own compared to its ability to achieve those efficiencies and improvements in combination with ScottishPower. My testimony also responds to a number of other issues raised by the UIEC, the Committee of Consumer Services (CCS), Deseret Generation & Transmission (DG&T) and the Utah League of Cities and Towns (ULCT).

## BENEFITS OF THE TRANSACTION

Q. What is Pacificorp's response to the overall conclusions articulated by the DPU?

A. We are very pleased that the DPU has recommended that the Commission approve the transaction. With respect to the concerns raised by the DPU in its direct testimony, PacifiCorp and ScottishPower have worked with the DPU to address and resolve these concerns and are committed to continue to do so throughout this process.

Q. LCG witness Anderson suggests that ScottishPower is not a "very good merger candidate" (LCG/Anderson, page 48) due to a lack of quantifiable synergies between ScottishPower and PacifiCorp. UIEC witness Brubaker also seems to suggest that

PacifiCorp, on its own, could achieve the same degree of improvement in performance without the transaction (UIEC/Brubaker, page 14). Please respond.

A. I strongly disagree. ScottishPower is an excellent merger candidate for PacifiCorp. ScottishPower and PacifiCorp have complementary assets, views and objectives. As I noted in my direct testimony, ScottishPower's demonstrated commitment to its regulated utility business was one of the reasons we decided it was the right partner for us. The ScottishPower commitments to improve service will bring significant benefits to Utah customers. These are not commitments that PacifiCorp could, or was intending to make absent this merger. ScottishPower has a proven track record for improving customer service and reliability while achieving efficiencies in operations. ScottishPower will bring to PacifiCorp a unique set of experiences, skills and business practices—such as benchmarking, best practice transfer, transition planning, and program management—which could not easily be replicated. I do not believe PacifiCorp alone could achieve similar improvements as quickly, as fully or with the same high probability of success.

Q. LCG seems to suggest that the Commission should review this transaction in comparison with other recent merger proposals. Do you agree that this would be an appropriate approach?

A. No. The Commission's task is to evaluate this transaction and determine whether it is in the public interest. The Commission should compare the benefits offered by combining the skills and effort of ScottishPower and PacifiCorp only to those that would be offered by PacifiCorp standing alone. It should not compare this transaction to some hypothetical deal or one involving different utilities. Moreover, the transactions mentioned by LCG may present risks not associated with this transaction, such as the potential for concentration of market power and a reduction in competition. It would be speculative and futile to attempt to compare the identifiable characteristics of this transaction with the unknown characteristics of a hypothetical transaction.

Q. LCG witness Anderson contends that in identifying merger savings, ScottishPower has failed to consider the cost cutting and performance enhancements that PacifiCorp has undertaken in its 1998 "Refocus" program and other re-engineering efforts. (LCG/Anderson, pages 34-37). Is this a valid criticism?

A. No. It has always been our intention that merger-related savings will be incremental to those that have been realized through PacifiCorp's "Refocus" program and other re-engineering efforts. As stated in Mr. MacRitchie's rebuttal testimony, ScottishPower's transition plan filing will take into consideration any PacifiCorp-initiated cost savings to ensure that no double-counting takes place. For example, in the third quarter of 1998, PacifiCorp announced a cost reduction program to achieve $30 million of savings to 1999 budgets. This initiative is described in Chairman Keith McKennon's March 31, 1999 press release included in the LCG testimony as RMA ____ Exhibit 7. These cost-saving measures are reflected in PacifiCorp's 1999 budget and will be reflected in 1999 results of operations before ScottishPower's post-merger initiatives are identified. PacifiCorp has no specific plans for achieving cost savings in addition to the $30 million reduction to 1999 budgets.

The significance of these "Refocus" cost savings measures should not be understated. I am convinced, however, that ScottishPower's proven capability for transforming utility businesses in the U.K. will allow PacifiCorp to achieve further efficiencies while at the same time improving customer service and system reliability.

Q. CCS witness Talbot asserts that PacifiCorp is in a strong financial position and that the proposed transaction would not enhance PacifiCorp's financial strength. Please comment.

A. While I would agree with Mr. Talbot that PacifiCorp's return to its core business is likely to improve PacifiCorp's financial strength over time, I do not agree that it is appropriate to conclude that PacifiCorp is in a strong financial position that would be worsened through the proposed transaction with ScottishPower. For example, one measure of financial strength is the amount of earnings that are used to meet dividend payments to shareholders. On average, U.S. electric utilities have a dividend payout ratio - - the ratio of dividends to earnings on a per share of common stock basis - - of between 60% to 70%. In 1998, PacifiCorp's earnings were insufficient to cover dividends to shareholders; the payout ratio exceeded 100%. For 1999, the expectation on Wall Street is that this payout ratio will continue to be over 100%, significantly exceeding the industry average. By contrast, we expect that post-transaction, the combined company's payout ratio will be lower than the industry average. PacifiCorp's ability to attract capital will not be diminished. Indeed, PacifiCorp was placed on "credit watch positive"after the transaction was announced. Overall, I believe that the proposed transaction will result in a financially stronger company than PacifiCorp on a stand-alone basis.

Q. CCS witness Chernick suggests that, as a result of the annual Oregon performance review and the Utah Commission reliability docket, PacifiCorp's service quality will improve over the next few years without this transaction. Please respond.

A. This is possible, although not assured. The Oregon performance standards are designed to prevent a deterioration of service, and the outcome of the Utah docket is not yet known. I recognize that the Commission has broad authority over its jurisdictional utilities, but this should not detract from the significance of what ScottishPower is proposing. I believe a voluntary and well-communicated commitment to customers backed by proven experience will deliver results to customers that PacifiCorp and the Commission could not achieve otherwise.

## RESTRUCTURING CONDITIONS

Q. UIEC witness Brubaker argues that the Commission should take the opportunity to extract from ScottishPower/PacifiCorp definitive restructuring commitments (UIEC/Brubaker, pages 42-47). Would you please respond?

A. Mr. Brubaker suggests two restructuring commitments. The first is that PacifiCorp should be required to place its transmission assets into a Regional Transmission Organization ("RTO") that meets criteria to be established by the Federal Energy Regulatory Commission ("FERC"). The second is that ScottishPower/PacifiCorp should be required to "agree not to make any claim for stranded cost recovery." These proposals are not appropriate for this docket. RTO's, stranded costs and other restructuring issues involve policy and factual considerations that go beyond the scope of a merger proceeding. The Utah legislature has already established a Task Force to examine restructuring issues for the state of Utah. Similarly, FERC has already opened a docket to look at RTO issues. Restructuring issues should be addressed and resolved in those forums. In addition, even if restructuring were an appropriate issue for this case, the Commission would require an adequate record, especially in the absence of any direction from the legislature, to impose restructuring requirements on PacifiCorp. That record certainly doesn't exist in this case.

## SPECIAL CONTRACT CONDITIONS

Q. UIEC witness Brubaker makes several recommendations with regard to special contract customers. Would you please address these recommendations?

A. Mr. Brubaker suggests that PacifiCorp be required to renew existing special contracts, or allow special contract customers "to purchase electricity competitively on the open market."

In Docket No. 87-035-27 (the Utah Power/PacifiCorp merger proceeding) special contract customers sought a number of merger conditions, including contract amendments and retail wheeling. The Commission rejected those proposed conditions, stating:

> "The Commission will not alter the contracts for interruptible customers as a condition of the merger by providing a higher priority than was originally negotiated, signed by the parties, and approved by the Commission. We will provide the opportunity for this issue to be addressed in future proceedings, including any proceeding resulting from the cost-of-service filing in this case. We note, as a general observation, that in this era of increased competition and low energy prices the industrial customers have other options for power supply such as co- and self-generation which they have been able to use to some advantage in negotiating power contracts with the Company. It is therefore unlikely that these customers will be left "holding the bag" after the merger is consummated. In addition, the Commission has another proceeding in which a task force has been looking at the general issue of incentive rates. Whether or not the merger is consummated, the Commission intends to press forward with this proceeding and the interruptible industrial customers will be given full opportunity to present their case as to the value of incentive rates to Utah and Utah customers. The Commission further acknowledges the responsibility to determine just, reasonable, fair and equitable rates for and among the industrial and all customers. One customer should not get preferential treatment over others."

The Commission's reasoning in our prior merger case is equally applicable to the special contract customer demands in this case. The Commission has established a task force to review and make recommendations regarding the appropriate criteria for evaluating special incentive contracts. The task force report should be available by the end of the year and presumably Commission action on the report will not occur until next year. As DPU witness Ken Powell notes in his testimony, the existing contracts need no special protection and it would not be "prudent to require future special incentive contracts unless they pass whatever screens the task force recommends and are approved by the PSC."

## DG&T CONDITIONS

Q. DG&T witnesses Albrecht, Bowler and Stover allege that PacifiCorp's service to its wholesale and wheeling customers has deteriorated. (DG&T/Albrecht, pages 2-3; DG&T/Bowler, pages 2-3; DG&T/Stover pages 8-11) Would you please respond?

A. As Mr. Stover notes in his testimony, those allegations have already been raised in Docket No. 99-2035-01. That docket was opened by the Commission to investigate quality of service and reliability issues and that is also the docket in which PacifiCorp will have an opportunity to address the merits of the DG&T allegations in detail. However, I would like to make several general points. The first is that PacifiCorp takes its responsibilities to its FERC jurisdiction customers seriously and it has not and will not compromise its service to those customers through staff reductions, office closings or otherwise. For example, the staff reductions and office closings cited by Mr. Albrecht as a cause of Dixie's service problems involved the consolidation of business offices. PacifiCorp's operation centers, which are responsible for the actual maintenance and operation of the system, were not part of that consolidation. Another important point to consider is that DG&T, its members and PacifiCorp are all utilities which share, in varying degrees, responsibility for the safe and reliable operation of their interconnected systems, including the responsibility to pay their share of the costs of system improvements. As a result, system planning decisions, including those involving the

"Middleton delivery point", are more complicated than DG&T suggests.

Q. DG&T witness Stover has suggested five conditions for approval of this transaction. Mr. Stovers' condition number 3 would require PacifiCorp to make specified system changes to "improve service reliability at the Middleton delivery point." (DG&T/Stover, Exhibit ___ (CNS-4)). Do you agree with this condition?

A. No. My engineering staff has informed me that the DG&T proposal is not the best approach for all the affected utilities and their customers, specifically including PacifiCorp's retail customers. To the extent that the Commission wants to explore the merits of various solutions to system problems, it should require DG&T to provide, in an appropriate proceeding, the detailed engineering and cost support documentation which could provide a basis for a decision. This is not the appropriate proceeding for that engineering analysis and DG&T has not provided the information required to make any decisions regarding the problem, much less the solution.

Q. Mr. Stover's condition number 4 would require PacifiCorp to enter into discussions with DG&T regarding the transfer of service territories from PacifiCorp to DG&T. Is this an appropriate condition for this transaction?

A. It is not. Several months ago DG&T suggested that, if PacifiCorp were willing to transfer service territory to DG&T's members, DG&T would support the transaction. PacifiCorp/ Scottish Power rejected DG&T's proposal and we continue to believe that service territory transfers are simply irrelevant to the Commission's analysis of this transaction. If DG&T believes that particular service territory transfers could provide benefits to customers, it already has the option, outside of this proceeding, to bring its proposals to PacifiCorp and the Commission for review.

Q. Mr. Stover's condition number 5 would "establish a fixed A&G allocation factor applicable to the Hunter II ownership and management agreement." (DG&T/Stover,

Exhibit ____ (CNS-4)) Would you please address that condition.

A. As I noted earlier, the Commission has previously rejected suggestions to provide similar relief to retail customers as a condition of merger approval. It should also reject this attempt by DG&T to unilaterally amend an agreement that was the product of lengthy negotiations between the two utilities as a condition of approval for an unrelated transaction.

## ULCT CONDITION

Q. ULCT witness Dolan suggests that the Commission condition the approval of the transaction on the reopening of PacifiCorp's current franchise agreements. Please respond to that proposed condition.

A. The abrogation of existing agreements, including agreements between PacifiCorp and the municipalities in which it serves, is not an appropriate condition of this transaction.

Q. Does this conclude your rebuttal testimony?

A. Yes.