

**BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH**

In The Matter Of The Application of )

PacifiCorp and Scottish Power plc )  
for an Order Approving the Issuance )  
of PacifiCorp Common Stock )

Docket No. 98-2035-004

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**SCOTTISH POWER**

**DIRECT TESTIMONY OF ANDREW MacRITCHIE**

**FEBRUARY 26, 1999**

## **INTRODUCTION**

Q. Please state your name and business address.

A. My name is Andrew MacRitchie, and my business address is 500 N.E. Multnomah St., Portland, Oregon, 97232.

Q. By whom are you employed and in what capacity?

A. I am employed by Scottish Power plc ("ScottishPower" or the "Company"), a Glasgow-based company in the United Kingdom ("U.K."), in the role of Business & Organization Development Manager.

Q. What are your responsibilities in your current position?

A. My current responsibilities are to manage the ScottishPower teams based in the U.S. working on the merger of ScottishPower and PacifiCorp. I report to Alan Richardson.

Q. Please summarize your education and previous business experience.

A. My first degree was undertaken at Glasgow University in Electrical and Electronic Engineering. After working as Operations Manager for a large transport company, I joined ScottishPower in 1986, initially as a Project Team Leader on engineering IT project work, before moving into an internal consultancy role in the Productivity Services section. Since then I have either led, or took a leading part in, many of the significant change programs within the Company. These included development and implementation of the benchmarking framework for the Distribution and Customer Service parts of the business, project management of the Manweb transition following its acquisition, and production of a strategic development plan for integrating the water business with the electric wires business. In between these project roles I was responsible for regulation, strategic planning, IT and change management for the Power Systems (transmission and distribution) business of ScottishPower. I obtained my MBA from Strathclyde Graduate Business School in 1992 and undertook an Executive Development Program at Wharton Business School in 1996.

Q. What position will you hold with PacifiCorp after this transaction is closed?

A. After the transaction is completed, I will be responsible to the PacifiCorp CEO for the development and implementation of transition plans, the development of business plans and strategic guidance to the business.

## **SUMMARY OF TESTIMONY**

Q. What is the purpose of your direct testimony in this proceeding?

A. The purpose of my testimony is to demonstrate that ScottishPower has proven capabilities with regard to transforming and delivering step change improvements in regulated utility businesses. When applied to PacifiCorp, these capabilities will lead to improvements in performance and efficiency at a pace and scale greater than PacifiCorp could manage on its own. In so doing, service levels will be raised for all customers and costs reduced over time. These cost reductions will mitigate the traditional upward pressure on prices.

Q. Please summarize your testimony in this proceeding.

A. As part of its assessment of PacifiCorp, ScottishPower developed high-level preliminary estimates of the potential for operating cost savings. The estimates were developed through benchmarking the vast majority of PacifiCorp's non-generation operating costs against those for other U.S. electric utilities as provided through FERC Form 1 submissions. The benchmarking exercise

showed that PacifiCorp's operating costs per customer were higher than those experienced by many other utilities both in the Pacific Northwest and across the rest of the U.S. As such, we believe there is potential for reducing operating costs in PacifiCorp. However, benchmarking is merely the first step in ScottishPower's methodology for transforming utility businesses. This methodology has been developed and honed through its application in the Scottish core businesses since 1991 and in Manweb and Southern Water following their acquisitions. The key success factors within this methodology are:

- the use of benchmarking to identify best practices within and outside of the organization;
  - a specific management approach for delivering complex organizational change;
- and
- a structured approach to defining and implementing investments in people and systems to enable change.

These aspects of our methodology are encompassed within an overall style of management which ensures clear accountability and sustained management focus, backed by a commitment at all levels in the organization to deliver against aggressive goals.

Our capability in transforming regulated utility businesses is unique, in that it is a complex mix of skills, experiences, knowledge, processes, systems and people that deliver the results. This capability has not been developed to the same extent within PacifiCorp. As such, the combination of ScottishPower's transformation capabilities and the experience and operational management of PacifiCorp will be able to deliver improvements in performance and efficiency faster, more economically, to a greater extent and with more certainty than PacifiCorp could achieve on a stand-alone basis.

While our proven capability in change management and our ability to deliver step changes in performance and efficiency are a matter of record, it should be noted that we have only begun the process to quantify the potential efficiencies which exist. A significant amount of work still needs to be undertaken with PacifiCorp before we can assess the potential for efficiencies with any degree of certainty. Furthermore, cost savings will only be achieved on an incremental basis over time. Our current estimate is that it will take up to five years to undertake the transformation both in terms of cost and performance improvement. We therefore submit that any attempt to infer an impact on rates as a result of our preliminary yardstick comparisons is inappropriate, as discussed in Robert Green's testimony. Rather, we recommend that the Commission utilize the traditional ratemaking process to effect any required changes in rates.

### **BENCHMARKING ANALYSIS**

Q. Does ScottishPower intend to take advantage of opportunities to reduce costs in PacifiCorp's regulated utility business?

A. Yes, we do. However, it is important to stress that ScottishPower believes customers should benefit from both a low cost and high quality service. We pursue these twin objectives with equal vigor. ScottishPower has established a corporate objective that PacifiCorp should be within the top ten major U.S. electric utilities with respect to non-generation operating costs as soon as possible. To achieve this objective, we are going to have to look directly at the performance of each area of the business, including the costs of performing each function. Robert Green's testimony discusses the reduction in costs that will be achieved in the corporate area. To achieve our overall objective, the scope of our inquiry must extend beyond corporate costs.

Q. Have you estimated the potential cost savings that could be achieved in PacifiCorp?

A. We conducted a high-level yardstick assessment in the fall of 1998 to determine the

amount of potential cost savings that could be obtained over a period of time subsequent to the transaction. A copy of the results of this assessment are attached

SP \_\_\_\_ (AM-1).

Q. Please describe Exhibit SP \_\_\_\_ (AM-1).

A. Exhibit SP \_\_\_\_ (AM-1) compares the operating costs per customer for PacifiCorp to other U.S. electric utilities. This comparison was based upon 1996 FERC Form 1 data and is limited to transmission, distribution, customer service and informational, marketing, sales, administrative, and general expenses less those expenses under the FERC headings of "customer service and informational" and "uncollectibles".

Q. Why did you exclude production, customer service and informational expenses and uncollectibles from this calculation?

A. These categories were excluded because we found that geography, system resource addition decisions and state policies on demand-side management, advertising and collections policies, rather than performance, were the primary drivers for these categories of costs. Since our objective was to develop a basis for comparing PacifiCorp's historical performance to that of other utilities in those areas under management control, these categories needed to be excluded.

Q. What conclusions do you draw from Exhibit SP \_\_\_\_ (AM-1)?

A. I conclude from Exhibit SP \_\_\_\_ (AM-1) that PacifiCorp has higher operating costs than average. It also suggests that a substantial amount of cost reduction would have to occur in order for the Company to be ranked as one of the top ten electric utilities in the U.S. The results of this yardstick assessment lead us to believe that potential cost savings for PacifiCorp exist.

Why do you categorize the cost savings as "potential"?

A. As I will detail later, ScottishPower has had extensive experience in all parts of its business in identifying and then implementing cost savings in conjunction with delivering improvements in performance. What we have found is that the yardstick assessment that was the start of this process, while directionally correct, can be somewhat misleading for a number of reasons:

- Differences in overall operating environments for individual utilities may require them to invest in and then operate more expensive systems such as underground high-voltage transmission facilities;
- Different cost allocation procedures or accounting conventions regarding the capitalization or expensing of certain items have the potential to distort results; and
- Yardstick comparisons have inherent data problems and can mask best or worst practices in specific areas. Drawing too great a set of inferences about steps that should be taken to better manage the organization without knowing whether best practices are being employed in any or all areas could lead to erroneous recommendations.

## **SCOTTISHPOWER'S METHODOLOGY FOR TRANSFORMING REGULATED UTILITY BUSINESSES**

Q. Please outline ScottishPower's methodology for transforming regulated utility businesses and explain how these will apply to this transaction.

A. ScottishPower has managed many significant business transformations within its Scottish businesses and within Manweb and Southern Water. Each transformation has had a different set of

issues and therefore required a tailored approach. However, there are several common key elements that have been developed as part of each and every significant change program which the Company has undertaken. We have now established these elements as key success factors for every future business transformation. These key success factors are outlined below:

- the use of benchmarking to identify best practices within and outside of the organization;
- a specific management approach for delivering complex organizational change;
- and
- an understanding of the investments that are required in people and systems to enable change to take place.

The success of the ScottishPower approach to business transformation is due to more than just the methodology. The critical element is the overall style of management within which the methodology is encompassed, ensuring clear accountability and sustained management focus, backed by a commitment to deliver against aggressive goals. It is this approach to business transformation which we intend to apply to PacifiCorp.

Q. Could you please explain how you use benchmarking as part of this transformation process?

A. A framework for delivering benchmarking has been developed internally within ScottishPower and refined over time with the benefit of our past experiences. It was initially developed by drawing on the experiences of leading benchmarking practitioners such as Rank Xerox and Royal Mail. Its ultimate objective is to deliver action plans developed by a process relying upon comparisons with companies that exhibit superior performance, including companies outside the utility businesses. A copy of the approach we use in conducting benchmarking is provided, starting on page 5, of Exhibit SP \_\_\_\_ (AM-2).

Q. What benchmarking exercises has ScottishPower undertaken and what has been the outcome?

A. ScottishPower has undertaken numerous benchmarking exercises to facilitate the successful transformation of all of its businesses. The most significant ones we have conducted in the areas of distribution and

customer service are described below:

### **Benchmark I (1992)**

ScottishPower's earliest introduction to benchmarking was a quantitative study undertaken by McKinsey consultancy called Benchmark I. This sought to identify the performance gap between the Company and leading class utilities. For Distribution & Supply, Duke Power was identified as the benchmark, and an efficiency target of \$30.4 million was set and achieved over four years.

### **Activity Costing (1993)**

A large activity costing project was initiated to identify internal benchmarks between ScottishPower's nine operating districts. This allowed ScottishPower to identify best practices between similar operating units within the Company. The process proved extremely successful with internal budgets being set for the first time by internal comparison. A value of approximately \$4.8 million was identified and delivered over two years.

## **Benchmark II (1994)**

External benchmarking, both qualitative and quantitative, was undertaken with various U.S. utilities as well as companies from outside the industry. A detailed understanding of the characteristics of leading class companies in terms of performance and quality was gained and change plans were developed to incorporate these. These set a target of \$32 million which was delivered over three years. It also led to a major re-organization of activities and business accountabilities, coupled with the development of a five-year information systems development plan to establish the systems infrastructure to support improved efficiency and performance.

## **Regulatory Positioning (1994/95)**

During 1994/95, OFFER undertook regulatory price reviews with all the regional electricity companies. One of the methods it used for measuring relative efficiency levels between companies was yardstick comparisons. Detailed regression analysis had, for example, demonstrated that there was a close comparison between operating costs and numbers of customers. The study demonstrated that ScottishPower was the lowest-cost distributor and positioned extremely favorably in terms of customer service performance compared with its competitors. ScottishPower believed that its strategy of "sticking to the knitting" was critical to this outcome.

## **Acquisition and Integration of Manweb (1995/96)**

In 1995, ScottishPower launched a successful bid for Manweb. During the following transition and integration phases of merging the two organizations, the ScottishPower benchmarking approach was used to identify synergies and the opportunity for the sharing of best practices. Total cost savings of \$102 million were identified during this exercise.

## **Benchmark III (1996/97)**

With the integration of Manweb complete, further external benchmarking of both a strategic and generic nature was undertaken. The primary focus of these studies was the area of best practices in procurement. This led to a plan which subsequently delivered savings of over \$12.8 million of annual cost. This involved extensive studies with companies such as Nissan, BP and Compaq.

## **Benchmark IV (1997/98)**

Benchmark IV utilizes new, improved work and asset management systems to establish a more accurate set of internal benchmarks between similar operating units within the organization. These newly developed benchmarks, coupled with further external benchmarks, have established a target of \$12.8 million annual cost savings being delivered.

As can be seen from the examples above, benchmarking has been a major driver of ScottishPower business performance since privatization. More important, ScottishPower has successfully achieved the targets set through the benchmarking exercises. Outlined below is a summary of these initiatives:

<b>Benchmarking Initiative</b>	<b>Year</b>	<b>Total Annual Saving No</b>	<b>Total Annual Cash Saving Nominal (\$million)</b>
Benchmark I Quantitative Yardstick Comparison	1992	30.4	30.4
Benchmark II Qualitative and Quantitative Study	1993	32.0	32.0

Acquisition and Integration of Manweb	1995	102.0	
Benchmark III Generic Benchmarking	1996	12.812.8	
Benchmark IV Internal Benchmarking	1997	12.812.8	

Q. What is the management approach which ScottishPower uses to deliver complex organizational change?

A. The success of any business change initiative, whether it relates to improving performance, systems or processes can be judged only by the ability of an organization to implement it. Many companies have had their "fingers burned" through failing to manage effectively the implementation of change. ScottishPower's approach has two key management methodologies that support the successful delivery of change within the organization:

- Program Management; and
- Performance Framework.

Q. Please describe the program management methodology.

A. ScottishPower has developed in-house a methodology for delivering complex change within the company called program management. This methodology ensures the coordination of many discrete projects which are linked by a common goal. Each project has a senior operational manager as a sponsor who ensures that the project remains business-led. The overall program is managed through a program office which reports to a senior management steering group. As projects near the implementation stage, a standard approach has been developed to formalize the transfer from project to line management as well as to enable full training for all users.

Exhibit SP \_\_\_ (AM-3) provides a more in-depth description of the methodology.

Q. Please describe the performance framework methodology.

A. The performance framework methodology is designed to track and report the results of business change. As discussed earlier, a key element of the successful implementation of change is the rigor with which ScottishPower's change initiatives are tracked through delivery with senior management accountability assigned. Exhibit SP \_\_\_ (AM-4) provides an example of the standard monthly reporting which is used within the Power Systems business to ensure top management visibility of change.

Q. What is ScottishPower's approach with employees in implementing change?

A. ScottishPower works hard to nurture an organizational culture where change is viewed positively. This has not occurred overnight and still continues to be developed within the organization. Some of the activities associated with facilitating the attitudinal changes are outlined below:

- External and internal benchmarking has been instrumental in changing attitudes and working practices. External benchmarking has helped to eliminate parochial attitudes that have historically slowed change. Benchmarking assists in developing a learning culture that seeks the betterment of processes, always believing that there is a smarter way to operate;
- Strengthening and adding more depth to general management capabilities through an extensive range of tailored courses such as Business Leadership Programs and MBA courses;
- Introduction of schemes such as "Managing in the Millennium," which is designed for employees with limited formal qualifications who show the potential to move into management or supervisory roles;

- The provision of an extensive network of 51 Open Learning centers has provided staff with the opportunity to learn new skills. As well as benefiting the employees personally, it also provides renewed confidence through the achievement of additional knowledge and new skills; and
- Constant communication of the rationale for change and the plans that are in place to deliver it. In many projects, employees are now actively involved in driving change from the "bottom up" through local initiatives and projects generated by courses such as "Managing in the Millennium." Underpinning the development of agility within the organization is the Values program to which the company is totally committed. ScottishPower recognizes that as the business changes and grows, it is important that this is underpinned by a commonly held set of values. To support acceptance of these values by staff, a Values Based Leadership development process has helped employees understand how the values fit into day-to-day operations. This scheme has been in place since 1996 and has helped shape the identity and culture of the Company.

Q. What role does investment in information systems play in implementing change?

A. With respect to investment in information systems, a significant amount of the change within ScottishPower has been facilitated by the introduction of new technology. ScottishPower has successfully managed a broad range of projects which are primarily business change projects with a significant IT component. The fact that the design of customer facing systems dovetails so closely with the business strategy is no coincidence. ScottishPower has undertaken fundamental reviews of its IS strategy with respect to the customer and asset management systems under a project known as the System Framework Study. This is attached as Exhibit SP \_\_\_ (AM-5). The Study provided the blueprint for an integrated systems infrastructure which underpinned the business transformation in the core ScottishPower businesses.

Q. Have the efficiency improvements made by ScottishPower in its various businesses been at the expense of customer service?

A. No, on the contrary. ScottishPower has always pursued its efficiency goals alongside a parallel objective of raising customer service and system performance standards. Indeed, our external benchmarking exercises have often been as much about identifying service excellence as they have about replicating low-cost operations. Our track record in this area speaks for itself, and the testimonies of Alan Richardson and Bob Moir describe some of the very real service improvements we have made as part of the transformation of Manweb and Southern Water.



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Q. When will ScottishPower begin the process of examining the potential for cost reductions for PacifiCorp?

A. Shortly before completion of the transaction, ScottishPower intends to set up a full integration team and conduct an exhaustive survey into the operations of PacifiCorp based on our

benchmarking methodology. This process has to be accomplished jointly with PacifiCorp to ensure ownership of the plans which will subsequently need to be delivered by PacifiCorp with minimal

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management input from ScottishPower. The output of this process will be an integrated business plan for PacifiCorp with detailed initiative plans to support the performance goals.

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Q. How long will it take for the cost savings from this process to be realized?

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A. A significant amount of work and further investment still needs to be undertaken in conjunction with PacifiCorp before the positive effects of this effort will materialize. Therefore, the cost

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savings will be realized only incrementally and over a period of time. Our current estimate is that it will



take up to five years to undertake the transformation both in terms of cost and performance improvement.

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Q. What does this mean with respect to the opportunity to require price reductions in connection with approval of this transaction?

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A. Based upon the lack of any definitive estimates of potential cost savings available at present, any attempt to set lower rates today to take advantage of yet-to-be realized cost savings is

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premature. As discussed in Robert Green's testimony, once the cost savings have been achieved, this Commission will be able to gauge the effect of these steps in our operating results. To the extent that a

rate review is justified, ScottishPower would expect to have its rates re-examined and any justifiable changes could be made at the relevant time.

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Q. Does this conclude your testimony?  
A. Yes, it does.

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