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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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In the Matter of the Application of)	DOCKET NO. 98-2035-04
PACIFICORP and SCOTTISHPOWER)	
PLC for an Order Approving the Issuance of)	REPLY OF THE UTAH INDUSTRIAL
PACIFICORP Common Stock)	ENERGY CONSUMERS TO
)	APPLICANTS' ISSUES
)	MEMORANDUM

* * * * *

Pursuant to the Supplemental Scheduling Order of the Public Service Commission of Utah ("Commission"), the Utah Industrial Energy Consumers ("UIEC") hereby respond to Applicants' Issues Memorandum dated April 12, 1999.

INTRODUCTION

ScottishPower and PacifiCorp (the "Applicants") cannot complete their proposed merger (the "Transaction") without the approval of the Commission. Utah Code Ann. §§ 54-4-28. The Commission can only approve the Transaction if it finds that it is in the interest of Utah ratepayers. Id. In undertaking the required analysis of the Transaction, the UIEC believes that

no issues or remedies related to the public interest should be excluded from the proceedings. In this submission, the UIEC addresses the critical issue of restructuring in the context of the Transaction, identifies the remedies available in the restructuring context (i.e., regional transmission organization and the separation of functions), and suggests that the Commission consider retaining the ability to use restructuring-type remedies to mitigate the risks in this Transaction.

INDUSTRY RESTRUCTURING
SHOULD BE CONSIDERED IN ANALYZING
THE PROPOSED TRANSACTION

Remedies for the risks created by the Transaction must play an important role in the Commission’s consideration of the Transaction. There are several important reasons why the Commission should not take restructuring-type remedies off the table in advance. Instead, the Commission should reject Applicants’ request for a blanket bar on any remedy in advance of understanding the issues that the Transaction could raise for Utah ratepayers.

Restructuring covers a wide set of specific remedies for electric utility industry problems and it is not prudent for the Commission to decide at present that any particular remedy is not an efficient or effective means of protecting Utah ratepayers. While the UIEC recognizes that the acquisition of PacifiCorp by ScottishPower involves entities with no overlapping service areas, and while restructuring in some fashion is the usual remedy for increased concentration, it does not follow from this fact that similar remedies are irrelevant as Applicants contend. In several merger cases involving non-overlapping service areas, regulatory agencies have conditioned

¹ The contours of what is included under the umbrella of “restructuring” is not well defined. If the Commission accepts the Applicants’ argument, it is likely any future conditions that it may order will be labeled by Applicants as “restructuring.”

merger approval on some type of restructuring-type remedy. For example, the recent merger of Sierra Pacific Power Company and Nevada Power Company was conditioned on an agreement to divest production assets and to join a regional ISO within three years, even though the companies were not interconnected and operated in different geographic markets. See Order Approving Merger and Conditionally Accepting For Filing Proposed Joint Open Access Transmission Tariff 87 FERC ¶ 61,077 (1999) (“our approval of the merger is premised in part on the Applicants’ representation that divestiture of their generating assets will take place”) Attachment A. Indeed, in this very case, the UK Competition Commission has ordered several restructuring-type remedies as a condition for regulatory approval of this transaction. See Department of Trade and Industry Press Notice dated April 13, 1999 (“ScottishPower have assured the Secretary of State that, following restructuring, a financial ring-fence will be placed around the electricity supply and transmission business currently carried on by ScottishPower . . . and restructuring its business in Great Britain as soon as possible and in any event within years by separating generation from transmission”). See Attachment B. ScottishPower has acquiesced to the UK Competition Commission requirements. That acquiescence is attached as Attachment C. There is no a priori reason why their remedy should not be carefully considered in this proceeding.

Applicants inappropriately allude to early termination in the Hart-Scott-Rodino process as a reason for muting any discussion of restructuring. The Commission cannot defer its authority to order restructuring to either the Federal Trade Commission or to the FERC. Both of these agencies currently analyze mergers under a competitive standard that does not take account of the impact of a transaction on either (1) the ability of the state commission to effectively regulate

the new entity, or (2) the possibility of the impairment of the specific interests of Utah ratepayers. See Department of Justice and Federal Trade Commission 1992 Horizontal Merger Guidelines, FERC Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act 61 FR 68595 (1996). Even if the Transaction is found to not significantly increase market power in the United States, the behavior of the utility and its pre-existing dominance in a market may compel restructuring-type remedies to facilitate effective regulation by Utah regulators and to avoid any negative impact of the Transaction on Utah ratepayers. The Commission may only have the opportunity to remedy such problems in merger cases.

The absence of a restructuring risk is at the center of ScottishPower's rationale for investment in PacifiCorp. The Transaction will create strong incentives to at least slow down Utah's ability to restructure or to adjust rates. One of ScottishPower's reasons for investing, as reported by its investment advisors, is to increase efficiencies that will raise the new entity's rate of return, but only so long as no restructuring occurs, and rates are not "reset" to channel any accrued benefits to Utah ratepayers. According to the Warburg Dillon Read report commissioned by ScottishPower, the primary risk to investors is a regulatory reset which reduces the allowed return or the initiation of competition. Bates SP5993. The document states that "in most of the states in which PacifiCorp operates we believe there is little risk of any imminent rate review initiated by the state regulators." Id. The report predicts that in states in which PacifiCorp operates "deregulation may not occur for four-to-five years." Bates SP5994. The report characterizes Utah as in "the slow lane moving toward the Federal goal of liberalization." Bates SP6001. In sum, ScottishPower believes that the Transaction is a good investment because of the combination of efficiencies gained through competitive practices combined with an absence

of restructuring: “There is, therefore, an opportunity to reduce costs in order to increase the achieved return and ensure that the benefits flow to shareholders” (Emphasis added) Bates SP6003. See Attachment D.

While ScottishPower is investing with the expectation that restructuring is off the table, thereby ensuring that any efficiency benefits flow to shareholders, witnesses in this proceeding have testified differently before this Commission. At the February 2, 1999 hearing before the Commission, ScottishPower PLC and PacifiCorp testified as follows:

Q. How will the benefits that you expect be reflected in PacifiCorp’s prices?

A. ... Following the initial period of service quality and customer service improvements, cost savings will begin to occur and will reduce the need for pure increases. These benefits will result in prices lower than they would be without the transaction (Emphasis added.)

Direct Testimony of Richard T. O’Brien at 9. In other words, Scottish Power is investing because the risk of rate resetting or restructuring is low, and because profits will rise as costs decline. Yet, they have told the Commission that costs will not decline but only fail to rise sufficiently to require rate increases. Accordingly, some restructuring-type remedies may be required to assure that ratepayers benefit from the efficiency that competitive practices might bring. This is especially true given the unwillingness of Scottish Power to make any commitment regarding rate levels and renewal or continuation of special contracts.

Other State Commissions or the FERC may place conditions on the Transaction before approval. Those conditions could involve restructuring-type remedies. If this happens, the Commission’s ability to regulate and enforce its own Transaction conditions could be adversely affected. The State Commissions in Washington, Oregon, Idaho and Wyoming, and the FERC,

must approve the Transaction, and any restructuring in those states could have unintended effects on Utah ratepayers who may be left without a remedy unless Utah also implements restructuring. See e.g., The Unintended Impacts of Restructuring, National Counsel on Competition and the Electric Industry IX (1996) (“neighboring states may need to take defensive regulatory or legislative actions to address harmful impacts” from restructuring in other states). Equally at play is the risk of federal legislation and the FERC RTO rulemaking. The recently filed Administration Bill may breathe new life into the legislation, and FERC releases give the impression that a proposed rulemaking on regional transmission is only weeks away. The enforceability of any merger condition, whether restructuring-type remedies or otherwise, requires that it be crafted to be enforceable in a restructured environment. Only by examining restructuring and restructuring-type remedies can the Commission begin to understand what remedies to fashion and enforce in order to protect Utah ratepayers.

Finally, Applicants’ suggestion that any industry restructuring must be delayed because of legislative action is misguided. The fact that the Utah legislature is considering future deregulation does not in any way preclude the Commission from ordering relief in the interest of Utah ratepayers. Restructuring-type remedies must often be imposed when the need and opportunity arises and often do not await legislative action. Moreover, the public interest is clearly at issue if the proposed Transaction adversely impacts the future ability of the legislature to craft deregulatory legislation. The Commission has a responsibility to insure that the Transaction does not harm the public interest by undermining any future legislation. Taking restructuring off the table will clearly not advance this goal.

For the foregoing reasons the Commission should reject Applicants' request to exclude consideration of industry restructuring for these proceedings.

DATED this 29th day of April, 1999.

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CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of April, 1999, I caused to be mailed, first class, postage prepaid, a true and correct copy of the foregoing UIEC ISSUES STATEMENT to:

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