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. 98-2035-04**

Direct Testimony of

Maurice Brubaker

On Behalf of

Utah Industrial Energy Consumers

Note: This Version of the Testimony excludes Confidential Information

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Project 7094

Brubaker & Associates, Inc.
St. Louis, Missouri 63141-2000

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<u>Direct Testimony of Maurice Brubaker</u>

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A Maurice Brubaker. My business address is 1215 Fern Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000.

Q WHAT IS YOUR OCCUPATION?

A I am a consultant in the field of public utility regulation and a principal with the firm of Brubaker & Associates, Inc., energy, economic and regulatory consultants.

Q PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A This information is included in Appendix A to my testimony.

Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A I am appearing on behalf of the Utah Industrial Energy Consumers (UIEC). Members of UIEC purchase substantial quantities of electricity from PacifiCorp both under tariff schedules and under separate contracts.

Q HAVE YOU REVIEWED THE JOINT APPLICATION AND TESTIMONY AND EXHIBITS FILED IN THIS PROCEEDING BY PACIFICORP AND SCOTTISH POWER (JOINTLY, APPLICANTS)?

A Yes. I have reviewed the Application, the testimony and exhibits, and responses to numerous data requests by both PacifiCorp and Scottish Power.

Q WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A The purpose of this testimony is to report the results of my analysis and investigation into whether the proposed combination of the two Applicants is likely to be in the public interest, and to express my view with regard to additional conditions that may be required in order to mitigate the exposure of PacifiCorp's customers to the potential for higher energy costs if the combination proposed by Applicants is approved.

Q PLEASE SUMMARIZE THE CONCLUSIONS AND RECOMMENDATIONS FROM YOUR TESTIMONY.

A My fundamental conclusion is that, for a variety of reasons stated herein, the proposed merger is not in the public interest as it will likely cause the customers of PacifiCorp to face higher rates. This risk flows primarily from the following circumstances:

1. Scottish Power is proposing to pay a substantial premium for PacifiCorp, which will result in incurrence of approximately $2 billion of Goodwill. Amortization of this Goodwill has a significant impact on earnings. Simply offsetting the expected premium would require annual expense reductions over 20 years, of $160 million per year, or over $300 million per year if the time value of money is considered.

2. PacifiCorp/Scottish Power have not even attempted a credible demonstration that significant costs could be removed from PacifiCorp's operations.

3. It is admitted by Scottish Power that there is little or no basis for assuming that there will be synergies as a result of this merger.

4. The proposed performance standards are not well supported because even Scottish Power admits that current data is not sufficient to define PacifiCorp's actual performance. Further, no specific plan of action is provided to detail how improvements would be made; and the only evidence submitted with respect to the benefit to consumers is highly speculative.

5. A merger with a global company that is on the acquisition trail, like Scottish Power, can dilute management and capital resources and interfere with PacifiCorp's attempts to "refocus" on its "core electricity business in the western United States."

6. A merger with an entity such as Scottish Power may well foreclose the opportunity for PacifiCorp to merge with another western utility, where the combination of geographically proximate territories could well result in the achievement of significant cost reductions and synergies that more typically justify electric utility mergers.

Following the analysis which leads to this conclusion, I continue to review the proposed transaction and to develop conditions that, if properly applied, may be sufficient to allow the proposed transaction to go forward on a basis which will sufficiently mitigate the exposure of PacifiCorp's customers to higher prices.

The following conditions should be required, and should be addressed in the transition plan which is described following Condition No. 11. These are in addition to, or modifications of, those conditions already proposed or accepted by the Applicants:

1. Scottish Power should make an explicit commitment to achieve an actual capital structure for PacifiCorp that is equivalent to that of comparable A-rated electric utilities in the U.S., and to maintain a common equity ratio of not less than 47%. It should commit to reducing dividend payouts and/or contributing equity capital as necessary to achieve this result. In this regard there should be appropriate limits placed on the amount of outstanding short-term debt that can be excluded from the calculation of the capital structure, and the common equity balance included in the capital structure calculation must be free of any "enhancement" as a result of any acquisition premium.

2. PacifiCorp and Scottish Power should formally commit not to request the inclusion of transaction costs, transition costs or acquisition premium in any revenue requirement filing, or to contend that a higher rate of return or some form of earnings sharing mechanism would be appropriate to allow for the opportunity to recover either these costs or the acquisition premium.

3. Some of the conditions imposed in connection with mergers in the U.K. (including on Scottish Power) should be imposed here as well. They include:

   a. Prohibit cross default provisions in the borrowing agreements among the various companies which constitute the overall enterprise.

   b. Make dividend payments conditional on the directors of PacifiCorp and Scottish Power being convinced and formally certifying to the Commission that PacifiCorp has adequate capital to meet all of its commitments and to carry out its public service obligations.

   c. Maintain investment grade ratings for PacifiCorp's outstanding debt.

   d. In conjunction with the declaration of any dividend, PacifiCorp not only comply with U.C.A. 54-4-27, but also certify to the Commission that the declaration of such dividend will not violate its capital structure commitment.

   e. PacifiCorp not assume any obligation or liability as guarantor, endorser, surety or otherwise for any parent, affiliate, or other entity without the express prior approval of the Commission. This should include an agreement that Scottish Power will not pledge any of PacifiCorp's assets as backing for any securities which Scottish Power or affiliated entities may issue. (The Commission already has the authority–with certain limited exceptions–under U.C.A. 54-4-31 to require pre-approval of any security issued directly by PacifiCorp.)

   f. Provide management and financial resources adequate to enable PacifiCorp to meet its commitments, carry out its authorized activities and to comply with all of its public service obligations.

   g. Separate PacifiCorp's transmission assets from its generation assets and subject them to independent operation.

4. Provide a specific written plan and detailed proposal for the allocation of corporate overheads and other costs among affiliated entities.

5. Require that Scottish Power/PacifiCorp strengthen their commitment concerning access to books, records and other documents to include making available the

records of Scottish Power and any affiliates which pertain to any transactions between PacifiCorp and the affiliated entities, or any allocation of costs from these entities to PacifiCorp by making all such documents available to the Commission at a United States location.

6. Strengthen the commitment by Scottish Power/PacifiCorp concerning compliance with Commission regulations regarding affiliated interest transactions to clearly encompass not only existing rules and requirements, but also any changes which may be made to those statutes and regulations in the future.
7. Scottish Power/PacifiCorp have committed not to assert in any Commission proceeding that the provisions of the Public Utility Holding Company Act of 1935 preempts the Commission's jurisdiction over affiliated interest transactions. Require this commitment to be broadened to include an agreement not to assert lack of jurisdiction by the Commission with respect to regulation or jurisdiction by the Securities and Exchange Commission, whether or not the Public Utility Company Holding Act remains as is, is amended, or is repealed; and also not to assert lack of Commission jurisdiction in any court proceeding.

8. Require that Scottish Power/PacifiCorp agree that if there is a failure to uphold any of the guarantees, conditions or commitments, that the Commission may make adjustments to rates in order to achieve for customers the benefits which they would have received had the commitments, conditions, etc. been fulfilled.

9. Within 24 months following merger approval, separate the transmission portion of PacifiCorp's operations from the remainder and commit to place the transmission function in an RTO that meets Federal Energy Regulatory Commission (FERC) criteria; or if such an RTO does not exist, file within 18 months following merger approval, a plan detailing how PacifiCorp will arrange with other entities to conduct an independent operation of these transmission facilities.

10. Require that Scottish Power/PacifiCorp agree not to make any claim for "stranded cost" in connection with the movement to retail competition.

11. Require that Scottish Power/PacifiCorp agree to cap rates at current levels for a five-year period. Further, special contract customers should be permitted, at their option, to renew existing contracts on terms no less favorable to the customer than the terms of the current special contracts, or (if an RTO with non-pancaked rates is in place) be allowed to seek alternative supplies if Pacifi-Corp/Scottish Power is not willing to agree to renewal and extension on such terms.

Further, I recommend that the Commission require Applicants to file a formal transition plan which will contain the necessary draft agreements and

other forms of implementation and which will express the required commitments and guarantees. This transition plan should also indicate, in detail, how Scottish Power plans to reduce costs and increase efficiencies throughout the existing PacifiCorp organization. The transition plan should be filed for Commission review, and acceptance by the Commission, after hearings, of a satisfactory transition plan should be a prerequisite of merger consummation. In other words, the merger approval process should be a multi-step process. The first step would be issuance of an order by this Commission specifying required conditions and directing PacifiCorp/Scottish Power to file a transition plan. The second step is the filing of and hearings on the transition plan that conforms with the conditions in the Commission's initial order. The third step would be permission to consummate the merger based on a Commission order finding that the transition plan adequately addresses the required conditions and contains enforceable commitments. The final step would be the completion of the merger.

Standard for Merger Approval

Q WHAT STANDARD SHOULD BE APPLIED TO DETERMINE WHETHER THE PROPOSED MERGER IS IN THE PUBLIC INTEREST?

A The standard should be a requirement that the Applicants clearly demonstrate a high probability that consumers will achieve net positive benefits as the result of the combination. The net positive benefits concept has been generally applied by this Commission, including in the 1989 merger of Pacific Power & Light Company and Utah

Power & Light Company to form PacifiCorp. (See Orders dated November 20, 1987 and September 28, 1988 in PSCU Docket No. 87-035-27.) The Commission's guidance memo of March 31, 1999 in this case specifically indicated that this would be the standard used for evaluating the merger.

Q ARE THERE ANY OTHER APPLICABLE STANDARDS OR GUIDELINES WHICH LEND SUPPORT TO OR PROVIDE GUIDANCE WITH RESPECT TO THIS DETERMINATION?

A Yes. The 1992 (as amended in 1997) U. S. Department of Justice/Federal Trade Commission (DOJ/FTC) horizontal merger guidelines are also instructive. In viewing proposed mergers to determine whether there are benefits which offset potential increases in market power, the DOJ/FTC guidelines look to three basic factors. First, the guidelines look to efficiencies that are generated as a result of the proposed merger, and which are unlikely to be accomplished absent the merger. Second, the guidelines also indicate that efficiency claims will not be considered if they are vague or speculative or otherwise cannot be verified by reasonable means. Third, DOJ/FTC look both to the expected benefits as well as the cost to achieve those benefits–in other words, the expected net savings or net benefits.

Although the proposed PacifiCorp/ Scottish Power merger does not increase horizontal market power, the basic guidelines published by DOJ/FTC are much broader in application than just to the inquiry concerning additional horizontal market concentration. After all, the overall purpose of the guidelines is to determine whether the benefits outweigh the detriments–and what we face with the PacifiCorp/Scottish

Power merger is a similar cost-benefit analysis. Thus, the particular factors and considerations contained in the DOJ/FTC guidelines should be applied to the asserted benefits of this proposed merger in determining if the potential benefits outweigh the detriments.

Q WHAT IS THE SIGNIFICANCE OF THE CONCEPT OF "NET" BENEFITS?

A In a merger, it is possible that some costs will increase, or that there will be some costs incurred as a result of the merger that would not have been incurred absent the merger. The concept of "net" benefits allows for a finding of positive benefits, and a public interest determination, even though some costs may increase–PROVIDED that other costs decrease by an amount more than sufficient to offset these increases. More simply, it means that the pluses and minuses must be tallied to determine if the pluses are larger.

Q HOW LARGE OF A MARGIN SHOULD THERE BE BETWEEN EXPECTED COST INCREASES AND EXPECTED COST DECREASES?

A Recognizing that there are no perfect projections, and that there is some risk of error, I believe it is important that the reasonably expected decreases should offset the reasonably expected increases by a large enough margin that the Commission can have a high degree of confidence that the net effect will be positive benefits, i.e., a net reduction in costs. If there is not a large margin, then consumers clearly run the risk that the net result will be higher prices than they would have experienced absent the merger.

For example, if it were projected that the merger would bring benefits of $50 million, but additional costs of $40 million, the anticipated net benefit would only be $10 million. This would be a relatively small amount of expected benefit in light of the overall cost structure of PacifiCorp, and would not provide a high degree of assurance of realizing net positive benefits. On the other hand, if expected benefits were $250 million, while expected costs were $50 million, then a substantial margin would exist and the Commission could be much more confident about the outcome. It is not possible to specify a mathematical relationship which defines the necessary margin between expected benefits and expected costs. This is the situation because we cannot quantify the projection errors. Therefore, the net benefit must be large enough that the Commission can be confident of the result.

Q HOW CAN THE COMMISSION MAKE AN ACCURATE ASSESSMENT OF THE LIKELIHOOD THAT THERE WILL BE NET BENEFITS?

A Because so much is at risk, I believe it is essential that the Applicants in a merger proceeding provide comprehensive, detailed evaluations which support their assertions that there are positive benefits to be had for consumers. Absent such a showing by Applicants, claims of merger savings are just that–claims, which cannot be relied upon.

Applicants might be able to show, for example, that there are significant expected cost savings in a particular area by detailing the practices or procedures that are currently undertaken and describing what changes could be made, how they could be made, what the cost would be, and what benefits would be expected. A specific analysis of this type can be evaluated, the assumptions tested and an appraisal made of the validity of the contentions. Vague references to the ability to transfer management skills or to reproduce savings that were created in different environments under different circumstances simply do not pass muster.

Cost Savings Potential

Q IS IT LIKELY THAT THE PROPOSED MERGER WILL PRODUCE SIGNIFICANT SYNERGIES OR THE OPPORTUNITIES FOR IMPROVED EFFICIENCIES?

A No, it is not. To state the obvious, Scottish Power's operations are located in Europe, while PacifiCorp's are located in North America and in Australia. Given the physical separation of the properties, it is unlikely that any significant amount of cost reductions can be achieved by the merger that could not be achieved without the merger. In fact, this is rather explicitly acknowledged by PacifiCorp witness Richard T. O'Brien at Page 10 of his direct testimony, where he states:

> "The present transaction does not involve consolidation of two operating companies and is not principally motivated by potential operating improvements and savings."

Scottish Power witness Robert D. Green makes a similar statement at Page 4 of his direct testimony, noting:

> "The benefits to customers from this transaction takes the form of improvements in the quality of service and increased efficiency in operations, not rate adjustments. This transaction presents very limited opportunities for achieving immediate cost savings. Unlike most other US utility mergers, there are no significant, redundant corporate operations to be eliminated, nor are there synergies to be obtained in combining operating systems."

Q HAVEN'T APPLICANTS COMMITTED TO A $10 MILLION ANNUAL NET REDUCTION IN CORPORATE COSTS ALLOCATED TO PACIFICORP?

A Yes. Keep in mind, however, that no plan has been put forward to show how the $10 million savings will be achieved. Only broad generalities support this claim of cost reduction. Further, Applicants have not come forward with any specific plan of allocation of corporate costs that would allow parties to test the validity of these assertions. Applicants simply want the Commission and the parties to accept that this will be the result without detailing how it will be accomplished and without demonstrating that other costs will not increase.

Q HAVE APPLICANTS PUT FORWARD ANY PROJECTIONS OR ESTIMATES OF WHAT THE CORPORATE COSTS WOULD BE ABSENT THE MERGER?

A No, they have not. Without some kind of base line or starting point which indicates what the cost levels would be without the merger, it would be completely impossible to determine, in some future period of time, whether a $10 million "lower than before" cost item was the result of a combination of corporate functions and the introduction of efficiencies that resulted from the merger, or whether the $10 million reduction was the result of cost reductions that would have or could have occurred in the absence of the merger. Applicants have not shown that this asserted $10 million reduction is merger-related.

Q IF APPLICANTS CLEARLY DEMONSTRATED A $10 MILLION COST REDUCTION IN CORPORATE OVERHEADS, WOULD THAT BE SUFFICIENT, IN YOUR VIEW, TO DEMONSTRATE NET POSITIVE BENEFITS?

A No. $10 million is such a small percentage (0.2%) of PacifiCorp's total operating revenues as to be virtually meaningless in the overall context of PacifiCorp's operations. Moreover, the margin of error is too large to conclude that a $10 million reduction is merger-specific.

Q APPLICANTS HAVE PROPOSED TO IMPLEMENT CERTAIN PERFORMANCE STANDARDS AND CUSTOMER GUARANTEES. ARE THERE COSTS ASSOCIATED WITH THESE ACTIVITIES?

A Yes. At Page 15 of his direct testimony, Scottish Power witness Bob Moir describes a $55 million expenditure (<u>exclusive</u> of additional increases associated with potential investments in new information technology systems and also exclusive of costs of needed customer education and communication activities). Of this amount, approximately $30 million is described as capital investment for new infrastructure (mainly investments in the distribution network), and the remaining $25 million is characterized as additional maintenance, payments for failures to meet guarantees, employee costs and training. These are all in the nature of recurring expenses.

Q ARE THESE COSTS OVER AND ABOVE CURRENT BUDGETED EXPENDITURES FOR PACIFICORP?

A It depends on whose testimony you read. For example, in his direct testimony Mr. Moir (Page 15), in addressing the $55 million outlay, clearly states that they are:

> "These expenditures are in addition to the funding for which PacifiCorp had already planned without the transaction."

On the other hand, in his supplemental direct testimony, Scottish Power witness

Alan V. Richardson (at Page 7 of his supplemental testimony), in addressing the same $55 million outlay, just as clearly states that they are not:

> "PacifiCorp's overall capital and revenue budgets will not increase as a result of these expenditures, however."

Q HOW DOES MR. RICHARDSON SUPPORT THIS CONTENTION?

A Mr. Richardson does not directly confront the conflict between his testimony and Mr. Moir's. However, in rationalizing his statement, he asserts that Scottish Power will seek to make offsetting performance-improving investments which also will lead to operational efficiencies and that it will simultaneously be seeking other efficiencies. Not only does he fail to quantify these offsetting benefits, but he does not even describe what they might be. These vague and unsupported claims do not support the ability to achieve these reductions.

His second rationalization is that a portion of the committed expenditures will be the result of modifying or accelerating projects which are already contained in PacifiCorp's budget. In particular, he mentions capital projects to improve the "worst performing circuits." If, in fact, these amounts are already budgeted by PacifiCorp, it is difficult to see how Applicants can claim merger-related benefits from these expenditures. To the extent that these actions were already planned by PacifiCorp, they are simply costs that would have been incurred in the ordinary course of business and the resulting benefits are not merger benefits at all.

Q DO YOU HAVE ANY COMMENTS ON THE PROPOSED PERFORMANCE

MEASURES AND CUSTOMER GUARANTEES?

A I have concerns with respect to the base line or starting point, the proposed improvements and the attempted quantification of the value to the consumers of these changes.

Q WHAT IS YOUR CONCERN WITH RESPECT TO THE STARTING POINT OR BASE LINE?

A The main problem here is that PacifiCorp/Scottish Power do not know what the starting point or base line is. They have repeatedly stated a belief that the existing reporting systems are inaccurate, and that outages are under-reported. (See Testimony of Mr. Moir.) Furthermore, Applicants are unable to state how their performance under the specific criteria compare to performance of other electric utilities in the United States. (See PacifiCorp's Response to UIEC Request 6.19.) If they don't know where they are, and they don't know how they compare with their peers, it is difficult to understand how the existing performance can be determined to be in need of improvement, or by how much.

Q WHAT CONCERN DO YOU HAVE WITH RESPECT TO THE PROMISED DEGREE OF IMPROVEMENT?

A Similar to the above concerns, the specific 10% or 5% improvements that are described generally are without regard to a knowledge of the level of current performance and how that compares with the performance of peers. The 10% and 5% improvements appear to be just arbitrary, and are obviously not based on any studied consideration of the current level of performance or what level of performance is either desirable, acceptable or cost-effective. Furthermore, there is no demonstration that this degree of improvement could not be accomplished through a more concentrated effort by PacifiCorp, without the merger. Even setting aside the other concerns, which I just expressed, there is no showing that these benefits could not be achieved absent the proposed merger. Thus, they are not entitled to consideration as merger benefits.

Q WHAT IS YOUR CONCERN WITH RESPECT TO THE EFFORT TO QUANTIFY THE POTENTIAL BENEFITS TO CONSUMERS AS A RESULT OF IMPROVED PERFORMANCE?

A The quantification effort is based on extrapolating data from a 10-year old study of outage costs performed by the Bonneville Power Administration (BPA). The determination of outage costs is really an attempt to determine what benefits are foregone by, or what detriments are incurred by, consumers as a result of power outages of various durations. These types of studies tend to be very subjective and there has been little or no agreement in the industry as to what constitutes a valid measure or a valid quantification.

Furthermore, the asserted benefits do not show up in the form of reductions to utility rates, but are effects that would be experienced by consumers outside of the utility rates. It seems clear from PacifiCorp's testimony that rates will go up because of the carrying charges on additional investments and because of additional operating expenses. Other than vague assertions about the possibility of increased efficiencies, there is not even an attempted quantification of offsetting reductions in costs that might justify these additional expenditures.

Q **WHEN WOULD APPLICANTS MAKE A DETERMINATION ABOUT WHETHER THEY HAVE MET THE IMPROVED PERFORMANCE LEVELS?**

A I understand that this would not occur until the end of the fifth year following implementation. Since implementation could not occur at the time the merger would be approved, but only after further analysis has been conducted to accurately determine what the current level of performance is, this could be six or seven years after merger approval. This is a considerable amount of time for consumers to wait for a determination on whether performance is improved.

Q **WHAT WOULD BE THE PENALTY TO APPLICANTS IF THEY FAIL TO ACHIEVE THE PROMISED IMPROVEMENTS?**

A The promise is to pay each customer $1 for each standard that is not met. There are five such standards, and PacifiCorp has approximately 1.4 million electric utility customers, system-wide. Accordingly, failure to meet each and every one of these standards would result in a maximum penalty payment of only $7 million. This is an extremely small amount of money, even smaller than the promised benefits of reduced corporate cost allocation. Furthermore, more than $7 million might be saved by not implementing changes. Thus, there is no real incentive for performance improvement.

Q **ARE THERE ANY ALTERNATIVE WAYS THAT PACIFICORP/SCOTTISH POWER COULD DEMONSTRATE ITS COMMITMENT TO QUALITY SERVICE?**

A Yes. One way to do this would be to waive any tariff and other provisions that limit their liability to customers for failure to provide continuous and adequate service. The current tariffs provide certain liability limitations that shield the utility from damage claims by its customers. If these liability limits were removed then customers would have a direct avenue to enforce the supply of quality service because PacifiCorp would not be shielded from lawsuits and damage claims in the event of their failure to provide continuous and adequate service. I understand this is similar to the condition that Scottish Power faces in the U.K. (See Scottish Power's Response to UIEC Request 15.6.)

Q HAVE APPLICANTS UNDERTAKEN ANY SPECIFIC STUDY OF HOW PACIFICORP'S COSTS MIGHT CHANGE AS A RESULT OF THE PROPOSED MERGER?

A No. The response given by Scottish Power to Committee of Consumer Services Data Request S3.12 is both typical and instructive.

> "Based on the information provided in 3.11, please quantify the impact of merger-related changes on PacifiCorp's annual, total budget for domestic (regulated) electric operations. Please provide all supporting documents, workpapers, etc. [S&P]
>
> Response:
>
> ScottishPower has not yet had the opportunity to review PacifiCorp's domestic electrical operations business in detail, or indeed any other component of PacifiCorp's business. Such a review will only be completed once the transaction has closed and ScottishPower has free and unfettered access to the PacifiCorp business. At this time, ScottishPower, in conjunction with PacifiCorp staff, will develop a Transition Plan that will detail the precise impacts on all parts of PacifiCorp's business.
>
> It is therefore not possible to quantify the impact of merger-related changes on PacifiCorp. An account of the work that has been carried out to date, as well as details of the approach that ScottishPower will adopt to improve the efficiency of PacifiCorp's business in future,

> is contained within the direct testimony of Andrew MacRitchie that was filed with the Commission on February 26, 1999."

This is typical of the responses given by Applicants to all of the questions that have been asked seeking to determine more precisely how Scottish Power would propose to achieve cost reductions on the PacifiCorp system.

In a similar vein, the response of Scottish Power to the Committee of Consumer Services Data Request S9.77 is also illuminating.

> When Scottish Power suggests that prices for PacifiCorp's customers will be lower than they otherwise would have been without the transaction, what specific projections of PacifiCorp's prices are they using in each state? Who prepared these projections? [S]
>
> Response:
>
> The statement that prices will be lower than they otherwise would have been is not based on any specific projection of PacifiCorp's prices. Instead, it is based on the expected results of joint activities and initiatives, which will take place after completion of the transaction. The rate setting process provides the framework for the treatment of cost efficiencies, which might result following the completion of the transaction. So long as the regulated utility is earning its fair rate of return, efficiencies (i.e., cost reductions) would produce earnings in excess of this return level, which could lead to a reduction in rates. To the extent that the regulated utility is not earning its fair rate of return, those cost reductions would allow utilities some room to avoid or mitigate price increases.
>
> Once the transaction is completed, ScottishPower and PacifiCorp plan to undertake joint activities and initiatives that would improve PacifiCorp's operating performance and customer service. Based upon its prior experience, ScottishPower is confident that these sorts of initiatives will be successful and alleviate the pressure for price increases. These initiatives will ultimately keep PacifiCorp's cost of service from rising as rapidly as it otherwise could."

Q HAVE APPLICANTS PROMISED THAT RATES WILL NOT BE INCREASED IF THE MERGER IS PERMITTED TO OCCUR?

A No, they have not. In fact, at Page 9 of his direct testimony Mr. O'Brien explicitly rejects the notion that guaranteed price reductions should be a part of the merger conditions. Further, in response to UIEC Data Request No. 11.10, Scottish Power states as follows in response to a question concerning its expected return on investment:

> "ScottishPower as does PacifiCorp, seeks to earn its permitted return on equity. Cost reductions will be used to improve the rate of return. Returns in excess of the permitted level are subject to a rate review at the request of the Commission. Equally, ScottishPower reserves the right to seek justified rate increases if cost reductions are inadequate to generate required returns."

Q IS SCOTTISH POWER COMFORTABLE IN ITS CLAIMED ABILITY TO REDUCE COSTS FOR PACIFICORP'S CUSTOMERS?

A Scottish Power has more than one answer to this question. When it is attempting to convince the Commission and the parties that it is capable of removing significant costs from PacifiCorp's operations, it expresses the utmost confidence. When it is challenged as to whether it is willing to offer guarantees, its level of confidence is much lower.

Q WHAT LEVEL OF COST REDUCTION HAS SCOTTISH POWER INDICATED IT COULD ACHIEVE AT PACIFICORP?

A Scottish Power has indicated that it believes it could achieve savings of as much as $200 million per year. The basis for this was disclosed in response to Committee of Consumer Services Data Request S9.19.

> "ScottishPower has been reported as saying that PacifiCorp's annual costs could be reduced by as much as $200 million. Please provide the basis for this or any other estimates–however preliminary they may be–of PacifiCorp cost savings that ScottishPower believes might be achievable with better management. [S&P]
> Response:
> The yardstick comparison outlined within Mr. MacRitchie's testimony suggests that PacifiCorp's non-production costs would need to be reduced by around $140m from their current levels to move it to a top ten position. It is not therefore unreasonable for Scottish-Power to speculate that if it was to look across the whole company, to also include all the previously excluded costs, then there could indeed be the potential to save up to $200m. However, until detailed planning is undertaken with PacifiCorp, ScottishPower cannot quantify what level of savings will actually be available from these indicative target ranges."

Q OBVIOUSLY, IN THIS RESPONSE, SCOTTISH POWER EXHIBITS GREAT CONFIDENCE IN ITS ABILITIES. WHERE HAS IT EXPRESSED A LOWER DEGREE OF CONFIDENCE?

A Among other places, in response to UIEC Data Request No. 6.159 to Scottish Power/ PacifiCorp. In answering a question requesting the preliminary estimates of potential cost savings, Mr. MacRitchie stated with respect to the yardstick analysis that was attached to his testimony that:

> "The yardstick analysis is shown in exhibit AM1 to the testimony of Andy MacRitchie. This indicates that a substantial amount of cost reduction would have to occur for PacifiCorp to be ranked as one of the top ten utilities within the US. ScottishPower believes that it can assist PacifiCorp in its drive to reach such a position. No detailed plans have been developed. It is important to understand that ScottishPower has found that the yardstick comparison, while directionally correct, can be

> 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 has 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.
>
> For these reasons, it is inappropriate to conclude actual values of cost savings using this approach."

Obviously, PacifiCorp/Scottish Power alternately embrace and disavow their own cost reduction claims and analyses depending upon whether they are attempting to persuade the Commission and the parties that they can take significant costs out of PacifiCorp, or whether the are attempting to avoid making corresponding cost reduction or rate reduction commitments.

Q ASSUME, FOR THE MOMENT, THAT SOME SIGNIFICANT LEVEL OF COST REDUCTION AT PACIFICORP WERE POSSIBLE. WOULD THE BENEFIT OF THESE COST REDUCTIONS GO TO CUSTOMERS UNDER THE PROPOSED MERGER PLAN?

A No. Scottish Power/PacifiCorp would need to try to retain the benefit of these cost savings for stockholders in order to fund the large merger premium. This means that customers are unlikely to see any part of these cost reductions, even if they do materialize.

The ability to reduce costs at PacifiCorp and hold the benefit of the cost reductions for shareholders has been mentioned in a number of analysts' reports which have addressed the merger. For example, a December 19, 1998 report by Warburg Dillon Read is clear about this concept. (The Warburg Dillon Read report notes that it has been produced independently of Scottish Power, but that Warburg Dillon Read is advising Scottish Power with respect to the PacifiCorp merger.) At Page 32 of its report, Warburg Dillon Read comments on this issue, stating as follows:

> "Scottish Power plans to increase PacifiCorp's actual regulatory rate of return toward the allowed rate of return via core cost reductions. In theory, Scottish Power has the management experience to achieve this and the <u>full benefit will flow to shareholders</u>. However–in practice–there is a careful balancing act to achieve with the state regulators in order to ensure that an increase in the actual rate of return is not clawed back by the state regulators via a regulatory reset to reduce the allowed rate of return. This will require diplomatic handling of the regulators and skillful management of the cost reduction process." (Emphasis supplied.)

Q ARE THERE ANY OTHER CONSIDERATIONS WITH RESPECT TO COST REDUCTIONS?

A Yes. To the extent that PacifiCorp is operating in ways that are inefficient, or could be improved, customers would be better off if PacifiCorp focused on its "core electricity business in the western United States," and took the steps necessary to effect these efficiency improvements and cost reductions. This way, customers would be able to directly experience the benefits of the cost reductions, and not have to see them extracted in order to pay for a merger premium that itself brings no value to the enterprise.

Q PRIOR TO THE ANNOUNCEMENT OF THE PROPOSED MERGER, DID PACIFICORP ANNOUNCE ANY COST REDUCTION PROGRAMS?

A Yes, it did. In January 1998 PacifiCorp implemented a significant workforce reduction, resulting in an after-tax charge against income of $113 million. This elimination of 700 positions should produce a substantial reduction in annual costs. In October 1998 PacifiCorp reported that it was undertaking steps to achieve further and significant cost reductions. These cost reductions included a number of items and were expected to result in an annual cost reduction of approximately $30 million before taxes.

Q DO YOU BELIEVE THAT A COMBINATION WITH SCOTTISH POWER WOULD HELP PACIFICORP FOCUS ON ITS "CORE ELECTRICITY BUSINESS IN THE WESTERN UNITED STATES"?

A No, I do not. Scottish Power has declared itself to be on a global acquisition path, and obviously has aspirations far beyond PacifiCorp. This will inevitably be a distraction for management, and will dilute other resources as well. In addition, as an entity within the Scottish Power group of companies, PacifiCorp will depend upon Scottish Power for equity capital. If Scottish Power experiences any impairment in its ability to raise equity capital–as a result of poor investment results in other currently operated or acquired properties, this would have a negative impact on PacifiCorp and its customers.

PacifiCorp has been down this route before. In large part the financial disappointments that have occurred recently have been the result of diversification, spreading management attention and resources too thin, and failing to adequately concentrate on the "core electricity business in the western United States." While

Scottish Power may bring valuable management experience, Scottish Power itself is not focused strictly on PacifiCorp's "core electricity business in the western United States," and the tremendous cost pressure created by the acquisition premium associated with this proposed transaction significantly reduces the likelihood that PacifiCorp's electricity customers will see benefits as a result of the application of this management talent.

Q DO YOU FIND ANY SPECIFIC EVIDENCE THAT LEADS TO A CONCERN THAT SCOTTISH POWER MAY BE LOOKING TO PACIFICORP TO FUND OTHER ACQUISITIONS?

A Yes. In the May 6, 1999 document entitled "PacifiCorp Proxy Statement, Scottish Power plc Prospectus for up to 714,560,000 Ordinary Shares, New Scottish Power plc Prospectus for up to 714,560,000 Ordinary Shares" (proxy/prospectus) PacifiCorp revealed (at pages 136-137) a proposal to increase its unsecured debt limit by $5 billion, from approximately $2.2 billion currently, to $7.2 billion. (This is contained in the proxy/prospectus because PacifiCorp's preferred stockholders must approve this increase.)

The asserted reason for the increase in the unsecured debt limit is to achieve objectives of flexibility and favorable cost structure. No specific plan is set forth. This is a very substantial increase in unsecured debt for a company that has approximately $9 billion of permanent capital, and underscores the concern about the plans which Scottish Power may have for using PacifiCorp's borrowing capacity and cash generation to fund the acquisition of other companies or to finance affiliates.

Additional Costs and Earnings Pressure

Q ARE THERE SIGNIFICANT TRANSACTION COSTS INVOLVED IN THE PROPOSED MERGER?

A Yes. The proxy statement/prospectus dated May 6, 1999 reveals that the Applicants anticipate incurring substantial transaction costs in connection with the proposed merger. At Page 97, it is revealed that in connection with the merger the Applicants will incur fees and expenses of approximately £147 million, or approximately $240 million. This is a substantial cost which Applicants undoubtedly plan to recover in one fashion or the other–even if they do not propose explicitly to include it as a line item cost for rate-setting purposes.

Q ARE THERE OTHER IMPACTS ON THE COMBINED FINANCIAL RESULTS OF THE APPLICANTS THAT WOULD BE OF CONCERN?

A Yes. Referring again to the proxy/prospectus, the method of accounting for the transaction requires Scottish Power to establish a new accounting basis, to be based upon the fair market values of PacifiCorp's assets and liabilities and the purchase price for PacifiCorp, including the direct costs of the acquisition. This is discussed at Pages 96-98 of the proxy/prospectus.

For purposes of this presentation to investors, Scottish Power/PacifiCorp value PacifiCorp's regulated utility assets at essentially their historic net book value. The difference between that amount and the purchase price is attributed to "Goodwill" and is to be amortized to income over an expected 20-year useful life. Based on the stated assumptions concerning the relative common stock prices and the exchange ratio, the proxy/prospectus at Page 98 presents a Goodwill calculation amounting to approximately £1.2 billion, or $2 billion.

A 20-year amortization of this amount has an <u>after-tax</u> impact on combined operations of approximately £60 million per year, or almost $100 million per year. Since this is an after-tax amount, the reduction in expenses required to offset this amortization is approximately $160 million per year.

Recall also that the amounts discussed so far are strictly an amortization of the Goodwill premium, without regard to any return being earned on these funds. With a 20-year amortization period and an 8% interest rate, the annual burden essentially doubles from $100 million to $200 million on an after-tax basis, or to approximately $320 million on a before-tax basis. Scottish Power will be under severe pressure to cut costs in order to make this transaction economical for its shareholders.

Q IS ALL OF THE ACQUISITION COST AND ACQUISITION PREMIUM ATTRIBUTABLE TO PACIFICORP'S WESTERN U.S. ELECTRIC OPERATIONS?

A Almost all is. According to the response of Scottish Power to Emery County Data Request No. 2.10, approximately 80% of the overall value of the enterprise is attributed to the western U.S. electric operations. Thus, the annual cost reduction, before taxes, required to offset 80% of the total is approximately $250 million per year. This is a very substantial amount in comparison to PacifiCorp's annual operation and maintenance expense of approximately $1.4 billion (excluding purchased power transactions).

To the extent that it is unable to cut costs, PacifiCorp's electric customers are at substantial risk — facing requests for rate increases. And, as noted earlier, Scottish Power has been clear that it will not hesitate to file for rate increases if

it is failing to achieve its rate of return expectations.

Experience Elsewhere

Q SCOTTISH POWER POINTS TO ITS TRACK RECORD IN REDUCING COSTS IN COMPANIES RECENTLY ACQUIRED IN EUROPE, MAINLY MANWEB AND SOUTHERN WATER. ARE THE CIRCUMSTANCES AT MANWEB AND SOUTHERN WATER SIMILAR TO THOSE AT PACIFICORP?

A No, they are not.

Q PLEASE EXPLAIN HOW CIRCUMSTANCES AT MANWEB AND SOUTHERN WATER ARE DIFFERENT.

A The two primary differences are geography and history. With respect to geography, Manweb is physically proximate to Scottish Power. As Mr. Richardson testified at Page 16 of his Supplemental Testimony, this geographic proximity presented greater opportunities (than here) for cost savings by eliminating duplicative functions and combining electric operations. (This is the typical means by which merging electric utilities drive out costs and improve efficiencies.) The Southern Water acquisition is also similar in that the systems are geographically close.

In terms of historical differences, both Manweb and Southern Water were systems that had previously been government owned, and then been privatized. One of the primary drivers for privatization was the belief that privately operated enterprises subject to the profit motive would deliver better value to customers than did the bureaucratic entities then operating the utility systems. Taking costs out of these types of utilities is a different proposition than taking costs out of a utility that, like PacifiCorp, has a history of private ownership and which has already gone through a significant merger and cost reduction process.

Q BUT, WASN'T SCOTTISH POWER PREVIOUSLY GOVERNMENT OWNED AS WELL?

A Yes. And, its demonstrated successes would clearly indicate that it was more aggressive and better managed than either Manweb or Southern Water. The fact that circumstances are different in Utah does not at all diminish Scottish Power's accomplishments or capabilities. However, the geographic and historical differences between the proposed PacifiCorp/Scottish Power merger and the Scottish Power/Manweb and Southern Water merger cannot be overlooked. Despite the track record of Scottish Power, and its assurances that it can achieve improved quality of service while reducing costs, no specific showing has been made as to what will be done, or how it will be done.

Public Interest Conclusion

Q BASED ON YOUR ANALYSIS, DO YOU BELIEVE THAT THE PROPOSED MERGER IS IN THE PUBLIC INTEREST?

A I believe that it is not. As is clear from the above, Scottish Power must effect significant economies at PacifiCorp in order to make this transition economic for its shareholders. There is little evidence presented by Scottish Power as to how it would accomplish this result. And, there are no promises for rate reductions, or even rate caps which would provide some measure of protection to consumers.

Further, the potential exposure of PacifiCorp customers to the use of PacifiCorp's credit strength for additional financing and for acquisitions, as well as the management distraction that would be caused by the acquisition raise additional problems with respect to the proposed merger. Furthermore, there has not been a demonstration that there will be benefits in terms of cost reductions or increased efficiencies that will flow to customers; or if they do, that such benefits and increased efficiencies could not have been achieved absent the merger.

Given the substantial exposure to higher costs, and the limited amount of potential benefit indicated for customers, I believe that the proposed transaction is not in the public interest and that the Utah Public Service Commission should reject it.

Mitigation Conditions

Q IS IT POSSIBLE THAT THE PROPOSED MERGER COULD PRODUCE BENEFITS TO CONSUMERS, AND BE IN THE PUBLIC INTEREST?

A It is possible that, with enough conditions to mitigate risk and protect consumers from higher prices and impaired service, that the merger could be found to be in the public interest. These conditions should be designed to protect consumers from the possibility that net benefits are not produced by the transaction, and from increased risk resulting from the activities of the new global-minded parent corporation. To be effective, the conditions must address the particular risks to which customers are exposed, must mitigate those risks, and also be capable of implementation and enforcement by the Utah PSC.

This approach is consistent with that which was recently adopted by the FERC. In Docket No. RM-96-6; "Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement," Order 592, issued December 18, 1996, the FERC indicated as follows at Page 38:

> "Rather than requiring estimates of somewhat amorphous net merger benefits and addressing whether the applicant has adequately substantiated those benefits, we will focus on ratepayer protection. Merger applicants should propose ratepayer protection mechanisms to assure that customers are protected if the expected benefits do not materialize. The applicant bears the burden of proof to demonstrate that the customer will be protected. This puts the risk that the benefits will not materialize where it belongs–on the applicants."

Q HAVE SCOTTISH POWER/PACIFICORP OFFERED ANY ASSURANCES OR MITIGATION MEASURES IN THIS REGARD?

A Some limited commitments have been proposed. They are summarized at Pages 6 and 7 of Exhibit AVR-1 which is attached to the supplemental testimony of Scottish Power witness Richardson.

Q THE FIRST SET OF COMMITMENTS IS DESCRIBED AS "ACCESS TO BOOKS AND RECORDS." PLEASE COMMENT ON THE ADEQUACY OF THIS COMMITMENT.

A This condition appears to be adequate as it pertains to the books and records of PacifiCorp. Essentially, there is an agreement for PacifiCorp to maintain its own accounting system, separate from Scottish Power's accounting system, and for all PacifiCorp financial books and records to be kept in Portland, Oregon, and to continue to be available to the Commission upon request at PacifiCorp's offices in Portland, Salt Lake City and elsewhere ". . . in accordance with current practice." As it pertains to PacifiCorp's specific books and records, this appears to be adequate. However, I would defer to the opinion of the Division with respect to the specific expression of this commitment and its adequacy.

Q THE SECOND COMMITMENT IS IN THE AREA OF "COST ALLOCATION, AFFILIATED INTEREST TRANSACTION." ARE THESE COMMITMENTS ADEQUATE?

A No. In this area, the first commitment is to a $10 million net reduction in PacifiCorp's corporate costs, by the end of the third year after the completion of the transaction. In connection with this, and the second commitment in this area, Scottish Power proposes to provide an analysis of the proposed allocation of corporate costs within 90 days after completion of the merger transaction. I find this to be inadequate.

As I testified previously, it is important that the Applicants come forward with a specific and detailed plan for allocation of costs <u>before</u> this Commission rules on the merger request. Leaving such important matters to be decided after the merger creates the opportunity for disagreement and possible litigation. The Commission should not condone this approach. Prior to merger approval the Commission should require the Applicants to file, as a part of its proposed transition plan, a specific, detailed and enforceable allocation plan. Accompanying this plan should be an illustration of the allocation of costs among the various corporate entities using actual data from a recent 12-month period.

The third and fourth commitments in this area pertain to the auditing of Scottish

Power costs that are assigned to or allocated to PacifiCorp, and a commitment to make available the records of Scottish Power and any affiliates which pertain to any transactions between PacifiCorp and the affiliated interests. These commitments should be strengthened by requiring that all such books, records, documents and data be made available to the Commission at a United States location.

The fifth commitment in this area is an agreement for Scottish Power and PacifiCorp to comply with all existing Commission statutes and regulations regarding affiliated interest transactions. It should be clearly understood that "existing" means not only what is in place today, but also covers any changes which may be made to those statutes and regulations that pertain to affiliated interest transactions.

The sixth commitment is for Scottish Power not to subsidize its activities by allocating to or directly charging PacifiCorp expenses not authorized by the Commission to be so allocated or directly charged. This is consistent with the other provisions.

Finally, the seventh commitment in this area is that neither Scottish Power nor PacifiCorp will assert in any future Commission proceeding that the provisions of the Public Utility Holding Company Act of 1935 preempt the Commission's jurisdiction over affiliated interest transactions. This is fine as far as it goes, but it does not go far enough. It should be broadened to include regulation or jurisdiction by the Securities and Exchange Commission, whether or not the Public Utility Holding Company Act of 1935 remains as is, is repealed, or is amended. This provision should also be broadened to include agreement by Scottish Power and PacifiCorp that they also will not claim in any court proceeding that the Commission lacked jurisdiction over these transactions.

These broadened conditions are important because there can arise issues about whether this Commission has jurisdiction over particular agreements or contracts that may be filed with or approved by other agencies. The end result should be to ensure that this Commission has full authority to review, test the reasonableness of, and make decisions about the level of costs appropriate to be charged to Utah customers irrespective of the basic jurisdiction of the SEC. Furthermore, the agreement as proposed simply addresses assertions in Commission proceedings, and does not extend to court proceedings that might be triggered by appeals of the Commission's decisions. Inclusion of the same conditions–i.e., not to assert that the Commission's jurisdiction is preempted–at the court level is also required for this provision to be effective.

Q THE NEXT SET OF COMMITMENTS IS IN THE AREA OF "TRANSACTION COSTS." IS THIS AN ADEQUATE COMMITMENT?

A In this section Scottish Power and PacifiCorp simply state that they will exclude all costs of the transaction from PacifiCorp's utility accounts. They should also expressly commit not to request to include these costs in any revenue requirement filing, or to contend that a higher rate of return or some form of earnings sharing mechanism would be appropriate to allow for the opportunity to recover these costs.

In addition to the agreement not to include transaction costs, PacifiCorp and Scottish Power should explicitly agree not to include any transition costs or any part of the merger premium as an expense, or to contend that a higher rate of return or some form of earnings sharing mechanism should be implemented to allow for the opportunity to recover the acquisition costs. As previously discussed, the acquisition premium is substantially higher than transaction costs, and for the same reasons that it would be inappropriate to allow a recovery of transaction costs, recovery of the acquisition premium from Utah customers should similarly be prohibited.

Q THE NEXT SET OF COMMITMENTS IS IN THE AREA OF "FINANCIAL ISSUES." WHAT ARE THESE COMMITMENTS AND ARE THEY ADEQUATE?

A The first sub-point is a statement that Scottish Power "intends" to achieve an actual capital structure equivalent to that of comparable A-rated electric utilities in the U.S., with a common equity ratio for PacifiCorp of not less than 47%. I would describe this as an "intention" rather than a "commitment."

It would have much more value if Scottish Power would commit to "achieve and maintain an actual capital structure equivalent to that of comparable A-rated electric utilities in the U.S., with a common equity ratio for PacifiCorp of not less than 47%, unless a different common equity ratio is approved by the PSC after hearings. Scottish Power will adjust dividend payouts and/or contribute equity capital as necessary to achieve and maintain this result."

In addition, the commitments as now expressed do not define how capital structure will be calculated. For example, the treatment of short-term debt is not addressed, nor is the issue of merger premium–should part or all of the merger premium ultimately be recorded on the books of PacifiCorp.

Q WHAT IS THE CONCERN WITH RESPECT TO SHORT-TERM DEBT?

A As previously noted, PacifiCorp is requesting its preferred stockholders to approve a significant increase in the amount of unsecured debt, increasing the limit by $5 billion. Should Scottish Power/PacifiCorp determine to substitute a significant amount of short-term debt for long-term debt and common equity capital, the result would not show up in the capital structure if all short-term debt were excluded when the capital structure ratios were calculated.

To address this problem, I would recommend that the capital structure calculation made to determine whether the 47% equity ratio has been met include all short-term debt except that which is associated with the financing of construction work in progress (CWIP). Financing CWIP is a traditional use of short-term debt, but short-term debt in excess of that amount should be included as it is likely being used to support PacifiCorp's rate base.

Because this is a complex issue, PacifiCorp should be given the opportunity to demonstrate to the Commission, in an evidentiary hearing, if it so chooses, that this additional short-term debt is not being used to support rate base, and that its financial policy is in the best interests of its customers.

Q WHAT IS THE ISSUE WITH RESPECT TO THE ACQUISITION PREMIUM?

A The proxy/prospectus indicates in the pro forma financial statements that the effect of the merger premium would be to create an "intangible asset" on the asset side of the balance sheet, and an addition to the common equity balance on the liabilities side of the balance sheet. If all of the merger premium is recorded on the books of Scottish Power, this is likely not to be an issue. However, if any part of the merger premium ultimately is recorded on the books of PacifiCorp, the common equity balance would be inflated by this intangible investment, and could be an indirect way of recovering part or all of the acquisition adjustment. Since the acquisition adjustment is not to be recovered from customers, it is appropriate to require PacifiCorp/Scottish Power to commit not to include the effects of any merger premium in the common equity balance of PacifiCorp for its regulated operations.

Q WHAT IS THE NEXT SUB-POINT?

A The second sub-point is a commitment to maintain separate debt and preferred stock ratings. I would presume that so long as there is debt and/or preferred stock outstanding for PacifiCorp that they will be rated separately.

The third sub-point is that Scottish Power and PacifiCorp will provide the Commission with unrestricted access to all written information provided to common stock, bond or bond-rating analysts, which directly or indirectly pertains to PacifiCorp. I would assume this would also include transcripts of all telephone conferences, presentations and other briefings or interviews.

Q ARE THERE OTHER KINDS OF COMMITMENTS OR CONDITIONS THAT WOULD BE APPROPRIATE?

A Yes, there are. In determining what kinds of conditions or requirements would be appropriate, it is instructive to review how the U.K. has reacted to on-shore and off-shore acquisitions of its utilities, and how it has responded in light of the proposed acquisition of PacifiCorp by Scottish Power and the proposed acquisition of the New England Electric System by the National Grid Group plc.

Q PLEASE EXPLAIN HOW THE U.K. HAS APPROACHED THESE ISSUES.

A Relevant history begins with a February 24, 1998 publication of a "consultation paper" by the Office of Electricity Regulation (OFFER) concerning possible modifications to be made to the Public Electricity Supply Licenses (PES) of licensees that have been taken over by other owners. OFFER's stated intent was to strengthen the so-called "ring fence conditions" which had previously been established.

After taking comments, OFFER published its proposed further modifications on February 11, 1999. (This was provided in response to UIEC Data Request No. 12.3 to Scottish Power/PacifiCorp.) The adopted conditions include the separation of the generation business from the delivery service business, the requirement to maintain investment grade credit ratings, the prohibition of cross-default provisions in borrowing agreements, and limitations on dividend payments.

All of these conditions were intended to separate the business operations, to improve the assurance of availability of adequate capital and management resources, and the delivery of quality service. The document which memorializes these findings is fairly lengthy, but the press release which accompanied the publication is fairly succinct in its summary of the main points. They are as follows:

> "OFFER today published its response to a consultation on further modifications to the licences of public electricity suppliers (PESs) which have been subject to takeovers. The main points are:
>
> where a PES has been taken over by another company having interests in generating plant, such that its own-generation limit would be breached, the generation business should be held by an affiliate which is not a subsidiary. In such cases, the generation business should be place outside the PES's financial ring-fence;
>
> the present provision allowing PESs to carry on certain

> activities, provided they do not exceed 5 per cent of aggregate turnover, should be restricted further by introducing an additional test based on cumulative investment;
> PESs should be required to seek and maintain investment grade credit ratings;
> cross default provisions should be prohibited in any borrowing agreement; and
> dividend payments should be conditional on the PES's directors being satisfied that the PES had complied with the ring-fencing conditions in its licence."

Q PLEASE CONTINUE WITH YOUR DISCUSSION OF THE ACTIONS TAKEN IN THE U.K. IN RESPONSE TO MERGERS.

A On February 4, 1999, just prior to the release of the general conditions noted above, OFFER released a consultation paper specifically directed toward the proposed acquisition of PacifiCorp by Scottish Power and the proposed acquisition of New England Electric System by the National Grid Group plc. In this release, OFFER succinctly expressed some of its concerns surrounding these transactions:

> "The proposed acquisition raises some of the same concerns as were raised in those cases where PES licensees were taken over by US utility groups. OFFER will need to be satisfied that the interests of customers of ScottishPower's public electricity supply businesses in England, Scotland and Wales, and its transmission business in Scotland, will continue to be properly protected and competition facilitated, in particular, that these businesses will continue to have available to them adequate management and financial resources to carry on their authorized activities and to comply with their obligations under their respective licences and the Electricity Act, and that adequate safeguards are in place to prevent such resources being diverted elsewhere.
>
> OFFER has made a number of modifications to the PES licences of licensees that have been taken over to provide continued protection of customers and to maintain regulatory effectiveness following take-over. These provisions have come to be referred to collectively as the

> "ring-fence". These modifications were made to Manweb's PES licence following its acquisition by ScottishPower. Similarly, the Director General of Water Services has introduced analogous protections in respect of Southern Water. However, no comparable modifications have yet been made to ScottishPower's licence to ensure protection of its Scottish distribution, PES supply and transmission businesses."

Obviously, OFFER was quite concerned about the ability of its domestic entities to stay focused on and provide adequate supplies in light of the distractions and obligations imposed by the foreign acquisitions.

Subsequently, after having received assurances from Scottish Power, the Department of Trade and Industry (DTI) approved the proposed merger of Scottish Power and PacifiCorp without referring it to the Competition Commission. According to the April 13, 1999 press release, the recommendation was made in accordance with the advice of the Director General of Fair Trading (DGFT) and with the views of the Director General of Electricity Supply (DGES).

Accompanying this release was an April 1, 1999 letter from Scottish Power to the Secretary of State for Trade and Industry, which contains Scottish Power's commitments. Notable among Scottish Power's commitments made in this letter are the following:

> "1) ensure that sufficient financial and management resources and other facilities are available to enable subsidiaries licensed under the 1989 Electricity Act to carry out their statutory and licence obligations;
>
> 2) ensure that the DGES is provided with such information from any company in the holding company group as he requires in relation to the exercise of his regulatory functions;

> 3) co-operate with the DGES in ensuring appropriate financial separation and financial independence for subsidiaries licensed under the 1989 Electricity Act;
>
> . . . .
>
> 6) restructure its business in Great Britain as soon as reasonably practicable and in any event within three years so as to place generation, and any non-electricity activities, in one or more separate group companies which would be affiliates but not subsidiaries or parent companies of the remaining electricity activities. In the meantime, it will ensure that any new investment in additional generation capacity or other significant diversification by group companies licensed under the 1989 Electricity Act will be undertaken by a separate group company or companies, and not by any company or by any subsidiary of any company holding any existing licences granted under the 1989 Electricity Act; and dealings between the holders of such licences and any such separate group company will be at arm's length and on normal commercial terms;
>
> 7) following restructuring, to accept a financial ring-fence around the public electricity supply and transmission businesses presently carried on by Scottish Power plc on similar terms to the standard ring-fence terms;"

Q DO YOU BELIEVE THAT PARALLEL ASSURANCES TO THE UTAH PSC AND TO THE CUSTOMERS OF PACIFICORP WOULD BE APPROPRIATE?

A Yes, I do. The financial conditions, the capital and managerial resource commitments and the separation of business activities all provide important assurances to consumers.

Q DO YOU HAVE SPECIFIC SUGGESTIONS WITH RESPECT TO THESE ADDITIONAL COMMITMENTS?

A Yes. I would suggest that Scottish Power/PacifiCorp be required to conform to the following:

1. Maintain investment grade ratings for PacifiCorp's outstanding debt.

2. In conjunction with the declaration of any dividend, PacifiCorp not only comply with U.C.A. 54-4-27, but also certify to the Commission that the declaration of such dividend will not violate its capital structure commitment.

3. PacifiCorp not assume any obligation or liability as guarantor, endorser, surety or otherwise for any parent, affiliate, or other entity without the express prior approval of the Commission. This should include a pledge that Scottish Power will not pledge any of PacifiCorp's assets as backing for any securities which it or its affiliates may issue. (The Commission already has the authority under U.C.A. 54-4-31 to approve the issuance of any security–with certain limitations–issued by PacifiCorp.)

4. Provide management and financial resources adequate to enable PacifiCorp to carry out its authorized activities and to comply with all of its public service obligations.
5. Separate PacifiCorp's transmission assets from its generation assets and subject them to independent operation, and agree to fund all (or its proportionate share) of necessary expansions.

<u>Separation of Transmission Function</u>

Q WHY DO YOUR RECOMMENDATIONS EXTEND TO THE SEPARATION OF THE TRANSMISSION ASSETS FROM THE GENERATION ASSETS?

A This is a very important consideration.

It is clear that the U.S. electric utility industry is moving to a competitive market both at the wholesale level and the retail level. A vibrant competitive market for generation depends heavily upon the ability of generation owners to have nondiscriminatory access to the transmission networks at fair and reasonable prices.

The FERC continues to underscore the importance of this concept. It was most recently addressed in the May 13, 1999 Notice of Proposed Rulemaking (NOPR), Docket RM99-2, on "Regional Transmission Organizations." In this NOPR, the Commission proposes to establish fundamental characteristics and functions for appropriate retail transmission organizations. In Section I the Commission provides a brief recitation of the recent history of promoting open access transmission systems, and at Pages 6 and 7 states as follows:

> "As a result, the traditional means of grid management is showing signs of strain and may be inadequate to support the efficient and reliable operation that is needed for the continued development of competitive electricity markets. In addition, there are indications that continued discrimination in the provision of transmission services by vertically integrated utilities may also be impeding fully competitive electricity markets. These problems may be depriving the Nation of the benefits of lower prices, more reliance on market solutions, and lighter-handed regulation that competitive markets can bring."

Thereafter, FERC finds (Pages 7 and 8) that appropriately structured regional transmission institutions can: (1) improve efficiencies in transmission grid management through improved pricing, congestion management, better estimates of available transmission capacity, improved parallel path flow management, more efficient planning and increased coordination between regulatory agencies; (2) improve grid reliability; (3) remove remaining opportunities for discriminatory transmission practices; (4) improve market performance; and (5) facilitate lighter-handed regulation.

The Commission goes on to discuss these issues and expresses the following conclusion at Page 8.

> "Thus, we believe that appropriate regional transmission institutions could successfully address the existing impediments to efficient grid operation and competition and could consequently benefit consumers through lower electricity rates resulting from a wider choice of services

> and service providers. There are likely to be substantial cost savings brought about by regional transmission institutions."

Nondiscriminatory access to the transmission network at reasonable prices is no less important to retail customers in a competitive environment than to wholesale customers in a competitive environment. Simply stated, unless there is an independent, effective organization to plan, maintain and operate the transmission system, competition will be an illusion rather than a reality.

In addition, a regional organization which brings together the transmission assets of a large number of utilities enhances competition by making available use of the entire transmission network of the combined group at a single transmission price. For example, if there are currently four separate transmission systems, each system might have a transmission rate of, for instance, $1 per kilowatt-month. To move power across all four entities, under today's pancaked rate arrangement, would cost a transmitter $4 per kW-month. If these transmission assets were folded into a single ISO or RTO structure with the typical postage stamp type of rate structure, then a transmitter could utilize all four systems by paying a single price of $1 per kW-month. This is a significant benefit of an ISO or RTO because it greatly enhances the number of generation resources that can be competitive for any given load. Developing region-wide transmission rates such as these is essential to the development of a robust competitive market.

Q WHAT IS THE ATTITUDE OF SCOTTISH POWER TOWARD THE SEPARATION OF TRANSMISSION ASSETS?

C o n f i d e n t i a l A

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Given this expressed attitude by Scottish Power, the Utah Public Service Commission should do as OFFER did and take this opportunity to extract from Scottish Power/PacifiCorp a definitive restructuring commitment. The commitment should be to place PacifiCorp's transmission assets into an RTO that meets FERC's criteria (as stated in RM 99-2) within 24 months after the approval of the merger, or to file within

18 months after the approval of the merger a definitive plan outlining how PacifiCorp would place its transmission assets in the hands of an independent and capable third-party administrator.

If the Commission fails to extract this commitment as a condition of merger approval, it may have a difficult, if not impossible, time in requiring this action to be taken after the merger has been approved.

Q WHY WOULD FAILURE TO EXTRACT THIS COMMITMENT AS A MERGER CONDITION MAKE IT DIFFICULT, IF NOT IMPOSSIBLE, FOR THE COMMISSION TO REQUIRE THIS ACTION TO BE TAKEN AFTER THE MERGER HAS BEEN APPROVED?

A It is my understanding that this Commission may not have the authority to directly order a utility to create or join an ISO or RTO. However, this Commission could achieve the same results by imposing this as a condition of merger approval and requiring Scottish Power/PacifiCorp to accept this condition in return for merger approval. This approach has been applied in numerous instances by the FERC and by other regulatory commissions. (For example, see FERC Opinion No. 318, issued October 26, 1988, in Docket No. EC88-2-000. This was the FERC Opinion which conditionally approved the merger of Utah Power & Light Company and Pacific Power & Light Company. In it, the FERC expressly conditioned its willingness to approve the merger on the Applicants' undertaking an absolute obligation for the merged company to provide firm wholesale transmission service at cost-based rates to any utility requesting such service.This was the beginning of a series of actions which culminated in the Energy Policy Act of 1992 which opened transmission systems in general.)

<u>Other Opportunities</u>

Q ARE THERE ANY OTHER FACTORS ARISING FROM THE MERGER THAT SHOULD BE CONSIDERED BY THE COMMISSION IN DETERMINING WHETHER TO CONDITION MERGER APPROVAL ON THE SEPARATION OF TRANSMISSION ASSETS?

A Yes. Absent the merger with Scottish Power, PacifiCorp could merge with, acquire, or be acquired by another geographically proximate electric utility. This would result in a consolidation of transmission assets across the entire service territories of the combined utilities and would, at a minimum, result in the availability of transmission service across the entire region at a single, un-pancaked, rate. I also consider it likely that as a condition of the merger regulators would require the transmission assets to be placed into some form of ISO or RTO.

If the merger with Scottish Power is approved, PacifiCorp will no longer be a separate entity, but will be a part of Scottish Power. Therefore, in order to achieve a consolidation of transmission assets, it would be necessary for a geographically proximate utility to acquire Scottish Power in its entirety or for Scottish Power to acquire the other utility. Acquisition of post-merger Scottish Power in its entirety, given its capitalization and multiple holdings, is a far different proposition than acquiring Pacifi-Corp.

Even if a geographically proximate utility were interested in acquiring the entirety of Scottish Power, there is an impediment in the form of the "Special share" of Scottish

Power held by the Scottish Government. The purpose and function of the special share are described in more detail at Pages 109-110 and 122 of the proxy/prospectus. Essentially, no one may own or control 15% or more of the voting rights of Scottish Power without the explicit consent of the holder of the "Special share"–the U.K. Government. If anyone acquires 15% or more of the stock, the Directors of Scottish Power are entitled to give notice to such holder, and to require it to reduce its holdings to less than 15% within 21 days. Failure to comply with such notice will result in the Directors of Scottish Power disposing of the excess shares on terms that the Directors believe reasonable.

This "Special share" clearly gives the U.K. Government veto power over the acquisition of Scottish Power, and hence PacifiCorp and its electric operations and the transmission assets. This is an impediment that would not be faced but for the merger of PacifiCorp into Scottish Power, and is another factor that the Commission should consider in determining to require a separation and independent operation of PacifiCorp's transmission assets as a condition for the merger.

Stranded Costs

Q ARE THERE ANY OTHER CONDITIONS OR COMMITMENTS THAT THE COMMISSION SHOULD REQUIRE?

A Yes. As discussed previously, Scottish Power is proposing to pay a substantial premium for PacifiCorp's assets. This is purely a voluntary transaction on the part of Scottish Power. The willingness to pay this substantial premium clearly suggests that the market value of PacifiCorp's generation assets at least equal, and probably exceed, their book value. Otherwise, what would be the basis for paying a substantial premium to book value? Scottish Power operates in a competitive environment in the U.K. and is certainly well aware of the trends toward competition in the United States' retail markets.

Existing PacifiCorp stockholders, under the proposed transaction, would receive a substantial premium, not only to book value (basis for regulatory earnings), but also to the market price of the stock, which itself was in excess of book value. PacifiCorp's stockholders will receive shares in Scottish Power, which they may retain or are free to sell and convert into cash or invest in other enterprises.

Stranded cost claims are typically based on the argument that investors acted in "good faith" and committed their capital to a regulatory scheme where they would expect to receive fair compensation. Regulation, however, typically sets prices based on the actual book value of the prudently incurred costs for assets that are used and useful. The significant amount being paid for PacifiCorp's stock should certainly extinguish any claim that shareholders may have had to any additional compensation for stranded cost. And, the acquiring company, Scottish Power, certainly cannot be said to be naive or unaware of the potential for either no stranded cost recovery or less than full stranded cost recovery in a retail market that is made competitive.

Thus, an additional condition which should be placed on the merger is that when retail customers are allowed to purchase electricity competitively, Scottish Power/ PacifiCorp agree <u>not</u> to make any claim for stranded cost recovery. If the Commission does not impose this condition now, then Scottish Power could subsequently be requesting compensation for stranded costs, while at the same time arguing that it should be allowed to keep the benefit of cost reductions because they are necessary to compensate it for the merger premium, which it voluntarily paid for these "inflated" assets.

Rate Levels

Q HAVE PACIFICORP OR SCOTTISH POWER MADE ANY COMMITMENTS WITH RESPECT TO RATE LEVELS?

A No. In fact, as discussed previously in this testimony, they specifically have refused to make any commitments either to hold rates constant or to decrease rates.

Q DOES THIS CREATE A SIGNIFICANT EXPOSURE FOR CUSTOMERS?

A Yes, it does. As noted above, a substantial premium over book value is being paid for PacifiCorp, and the annual amortization of the merger premium created in this process has a significant impact on earnings.

Q WHAT RATE-RELATED COMMITMENT WOULD BE REQUIRED IN ORDER FOR THE PROPOSED TRANSACTION TO BE CONSIDERED IN THE PUBLIC INTEREST?

A In order to protect customers, it is necessary to shield them from exposure to the possibility that cost increases offset cost decreases. This is best done by transferring the risk for failure to achieve these cost reduction and efficiency goals to utility management and shareholders–who are making the promises and who have control over the Company. At a minimum, I believe that a five-year rate cap should be instituted. A rate cap means that rates cannot be increased above where they are currently, but they could be decreased. Also, a rate cap would not prohibit PacifiCorp from filing new or innovative rates or contracts, and tariff rates and contract rates could be reduced below their current levels.

Q PLEASE ELABORATE ON THIS FIVE-YEAR RATE CAP.

A First, a reasonable period of time is required in order to allow Scottish Power to effect the changes that it asserts it can implement. For example, it claims to need more than five years to benchmark and to achieve the improvements in system performance. It would presumably also take some period of time for Scottish Power to "get the PacifiCorp house in order" and effect the other reductions which it claims are possible.

In addition, PacifiCorp and Scottish Power will be incurring transaction costs and transition costs for an extended period of time. Since these costs are not to be included in developing rates charged to customers, imposing a rate cap for a reasonable period of time maximizes the incentive for PacifiCorp/Scottish Power to minimize these costs and avoids the need for the Division and other parties to rate proceedings to spend the resources required to ensure that all of these costs are extracted from any revenue requirement claim.

Third, to the extent that Scottish Power's earnings come under pressure because of the amortization of the merger acquisition premium, the mechanism of a five-year rate cap eliminates the temptation to use rate increases from PacifiCorp to cover these additional costs.

It is also instructive to note that in the proxy/prospectus, at Page 40 and at Page

51, it is reported that the investment bankers for both PacifiCorp and Scottish Power analyzed and adjusted projections of the earnings potential for PacifiCorp under various conditions. The advisors to PacifiCorp (Salomon Smith Barney) evaluated PacifiCorp based on the base or "plan case," as well as under an "improvement case" forecast. The advisors to Scottish Power (Morgan Stanley) performed a parallel analysis, in which the base case was referred to as the "conservative case" and the alternative case was referred to as the "optimistic case." Both advisors produced substantially higher estimates of value for PacifiCorp using the more aggressive assumptions than under the base case assumptions. The Salomon Smith Barney analysis was based on a particular forecast that extended through 2003, while the Morgan Stanley analysis was based on a forecast that extended through the year 2007. These analyses not only indicate the potential for cost reductions, but also support the idea that several years will be required to achieve these potential savings, to the extent that they are present.

Q SHOULD THIS RATE PROTECTION EXTEND TO SPECIAL CONTRACT CUSTOMERS AS WELL AS TO TARIFF CUSTOMERS?

A Yes. PacifiCorp/Scottish Power have been less than definitive in stating their intentions with respect to renewal of special contracts. At Page 17 of his supplemental testimony, Scottish Power witness Richardson addresses the issue of special contracts, but states only that PacifiCorp will continue to honor existing contracts through the expiration of their current terms. Beyond that, he defers to the results of the Commission task force on special contracts established in the March 4, 1999 Order in Docket No. 97-035-01.

This provides little or no assurances to current special contract customers. After existing special contracts expire, contract customers are exposed–to an even larger degree than are the tariff customers–to potential cost increase because they would face increases not only to the same extent as tariff customers, but also to the extent of the difference between the rates under the existing special contracts and the tariff rates.

Q WHAT DO YOU RECOMMEND WITH RESPECT TO SPECIAL CONTRACT CUSTOMERS?

A To afford these customers a measure of protection similar to that which would be afforded to tariff customers, I recommend that PacifiCorp be required to renew any existing special contracts that expire during the five-year rate cap period, at the option of the customer, on terms no less favorable to the customer than the terms of the current special contracts.

Alternatively, if PacifiCorp is resistant to renewing existing special contracts on these terms, then PacifiCorp should be required to release these customers from any commitment to purchase electricity from PacifiCorp and allow them, instead, to purchase electricity competitively on the open market and to deliver the power to their locations on the PacifiCorp system using the FERC-approved OATTs. PacifiCorp/ Scottish Power should not be allowed to refuse renewal of contracts unless customers have a viable transmission option in the form of an RTO or an ISO so that the pancaking problem is avoided.

Transition Plan

Q IF THE COMMISSION SHOULD DECIDE TO APPROVE THE MERGER, BUT WITH CERTAIN CONDITIONS, HOW SHOULD IT PROCEED?

A If the Commission decides to approve the merger, with conditions, then it should explicitly state in its order the conditions which it will require to be fulfilled along with any other specific requirements. PacifiCorp/Scottish Power should then be required to file with the Commission a transition plan which would contain the specific details of how the merger would be implemented along with copies of any documents such as allocation agreements and explicit acceptance of the required merger conditions by the management of Scottish Power and PacifiCorp.

In this transition plan, Applicants should be required to specify the exact form of corporate structure that will be used, including all subsidiary and affiliate relationships.

The transition plan should also contain Applicant's preliminary plans for achieving cost reductions and efficiencies in each major functional area of operations. This is necessary in order to provide some level of assurance that there are significant and reasonably verifiable benefits which will result from the merger.

As a part of the transition plan, and ultimately as a part of merger approval, Applicants should be required to certify their commitments to these conditions.

Q HOW WOULD THE TRANSITION PLAN RELATE TO FINAL MERGER APPROVAL?

A The Commission should make it clear in its initial order that filing an acceptable transition plan is a <u>precondition</u> to the merger. The Commission should not leave major conditions or details about post-merger organization or operations vague and unspecified. If the transition plan is not satisfactory, then the Commission should reject the merger proposal. If the Commission determines, after hearings, that the transition plan is acceptable, then the merger transaction can go forward.

Q PLEASE SUMMARIZE THE STEPS TO MERGER APPROVAL.

A The first step would be issuance of an order by this Commission, after hearings, stating the conditions that PacifiCorp/Scottish Power will be required to agree to in order to achieve merger approval, and requiring that a transition plan be filed to address these conditions.

The second step is for PacifiCorp/Scottish Power to file a transition plan that contains all of the necessary conditions, formal commitments and certifications, plans, programs and documentation which the Commission requires as merge conditions.

The third step would be to hold hearings on the transition plan. If the Commission finds that the transition plan is acceptable, then, as the final step, the merger can go forward.

Q HAVE YOU REVIEWED THE REBUTTAL TESTIMONY OF SCOTTISH POWER/ PACIFICORP IN THE OREGON MERGER PROCEEDING, DOCKET UM 918?

A Yes, I have.

Q MR. MACRITCHIE STATES AT PAGE 3 OF HIS OREGON REBUTTAL TESTIMONY THAT SCOTTISH POWER WOULD BE WILLING TO PROVIDE A TRANSITION PLAN ADDRESSING HOW COST SAVINGS WOULD BE ACHIEVED. WOULD

SCOTTISH POWER'S PROPOSAL OFFERED IN ITS OREGON REBUTTAL TESTIMONY BE SATISFACTORY?

A It would not be satisfactory, but it is a step in the right direction. While acknowledging the need to come forward with more explicit plans concerning implementation of actions that will result in cost reductions and efficiencies, the transition plan is apparently limited to just these matters. Furthermore, the Company proposes that this transition plan would be offered six months after the closing date of the merger. This is totally unacceptable. By then the merger will be a done deal, and the Commission will not have an opportunity to unravel it. As I indicated earlier, the transition plan must be filed with the Commission prior to approval, and the preparation of an acceptable transition plan must be a precondition to the merger.

Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A Yes.

Appendix A

Qualifications of Maurice Brubaker

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A Maurice Brubaker. My business mailing address is P. O. Box 412000, 1215 Fern Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000.

Q PLEASE STATE YOUR OCCUPATION.

A I am a consultant in the field of public utility regulation and President of the firm of Brubaker & Associates, Inc., energy, economic and regulatory consultants.

Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A I was graduated from the University of Missouri in 1965, with a Bachelor's Degree in Electrical Engineering. Subsequent to graduation I was employed by the Utilities Section of the Engineering and Technology Division of Esso Research and Engineering Corporation of Morristown, New Jersey, a subsidiary of Standard Oil of New Jersey.

In the Fall of 1965, I enrolled in the Graduate School of Business at Washington University in St. Louis, Missouri. I was graduated in June of 1967 with the Degree of Master of Business Administration. My major field was finance.

From March of 1966 until March of 1970, I was employed by Emerson Electric Company in St. Louis. During this time I pursued the Degree of Master of Science in Engineering at Washington University, which I received in June, 1970.

In March of 1970, I joined the firm of Drazen Associates, Inc., of St. Louis, Missouri. Since that time I have been engaged in the preparation of numerous studies relating to electric, gas, telephone and water utilities. These studies have included analyses of the cost to serve various types of customers, the design of rates for utility services, cost forecasts, cogeneration rates and determinations of rate base and operating income.

I have testified before the Federal Energy Regulatory Commission (FERC), various courts and legislatures, and the state regulatory commissions of Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Guam, Hawaii, Illinois, Indiana, Iowa, Kentucky, Louisiana, Michigan, Missouri, New Jersey, New Mexico, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, South Dakota, Texas, Utah, Virginia, West Virginia, Wisconsin and Wyoming.

The firm of Drazen-Brubaker & Associates, Inc. was incorporated in 1972 and assumed the utility rate and economic consulting activities of Drazen Associates, Inc., founded in 1937. In April, 1995 the firm of Brubaker & Associates, Inc. was formed. It includes most of the former DBA principals and staff. Our staff includes consultants with backgrounds in accounting, engineering, economics, mathematics, computer science and business.

We have prepared many studies relating to electric, steam, gas and water properties, including cost of service studies in connection with rate cases and negotiation of contracts for substantial quantities of gas and electricity for industrial use. In these cases, it was necessary to analyze property records, depreciation accrual rates and reserves, rate base determinations, operating revenues, operating expenses, cost of capital and all other elements relating to cost of service.

During the past five years, Brubaker & Associates, Inc. and its predecessor firm has participated in over 500 major utility rate cases and statewide generic investigations before utility regulatory commissions in 40 states, involving electric, gas, water and steam rates. Rate cases in which the firm has been involved have included more than 80 of the 100 largest electric utilities and over 30 gas distribution companies and pipelines.

In addition to our main office in St. Louis, the firm also has branch offices in Kerrville, Texas; Plano, Texas; Denver, Colorado; Chicago, Illinois; and Washington, DC.