BEFORE THE WYOMING PUBLIC SERVICE COMMISSION

IN THE MATTER OF THE)
APPLICATION AND PETITION OF)
PACIFICORP AND SCOTTISHPOWER (plc)) Docket No. 20000-EA-98-141
FOR AUTHORITY TO REORGANIZE)
PACIFICORP AS A WHOLLY OWNED)
SUBSIDIARY OF SCOTTISH POWER (plc))

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Application of)
PacifiCorp and Scottish Power plc) Docket No. 98-2035-04
for an Order Approving the Issuance)
of PacifiCorp Common Stock)
)

DIRECT TESTIMONY AND EXHIBITS OF DR. RICHARD M. ANDERSON

On behalf of
WYOMING INDUSTRIAL ENERGY CONSUMERSON BEHALF OF LARGE
CUSTOMER GROUP

MAY 25,JUNE 18, 1999

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Richard M. Anderson, 39 W. Market Street, Suite 200, Salt Lake City, Utah 84101.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Energy Strategies, Inc. as a Senior Associate.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I have a Bachelor of Business Administration degree from the University of Texas-Austin and a Ph.D. in Economics from the University of Utah.

Q. PLEASE DESCRIBE YOUR WORK EXPERIENCE.

A. I have approximately 16 years of work experience relating to the energy industry, with particular emphasis in the electricity industry.on electricity. Prior to my current employment I spent nine years as Director of the State of UtahÆs Energy Division. In my current position I am directly involved with thein issues ofrelating to electric market restructuring, competitive procurement, market and strategic options analysis, and regulatory policy on behalf on a variety of clients in various western and southwestern states.

I participated in the 1996 PacifiCorp rate case (Docket No. 20000-ER-95-99) before this Commission filing testimony on behalf of the Wyoming Industrial Energy Consumers. I have participated in various proceedings before the Utah, Wyoming and Idahoand Utah Commissions and I currently representingrepresent a number of industrial entities in bothall three of those states in connection with the proposed PacifiCorp/ScottishPowerproposed merger.

Q. ON WHOSE BEHALF ARE YOU FILING TESTIMONY IN THIS PROCEEDING?

A. I am filing testimony on behalf of the Wyoming Industrial Energy Consumers (WIEC). The entities participating in WIEC include; BP Amoco, the Chevron Companies, Church and Dwight, Conoco Pipeline, Exxon Corporation, FMC Corporation, General Chemical Partners, Marathon Oil Company, SF Phosphates Inc., Solutia Inc., Solvay Minerals Large Customer Group (ôLCGö).
Inc., and Texaco.

I. INTRODUCTION

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The primary purpose of my testimony is to discuss the benefits and associated risks to PacifiCorp ratepayerscustomers of the proposed acquisition of PacifiCorp by ScottishPower. The extent to which the benefits and risks associated with this acquisition can be valued and the likelihood of their occurrencesthat they will occur are of critical importance in determining whether the proposed merger is in the ôpublic interestö. I will address whether the Applicants (ScottishPower and PacifiCorp) have demonstrated that the proposed merger is in the ôpublic interestö and the extent to which that showing is supported by a reasonable assessment of benefits and costs.

Q. PLEASE DESCRIBE THE STANDARD BY WHICH THE WYOMING COMMISSION MUST REVIEW THIS APPLICATION?YOU UNDERSTAND THE UTAH COMMISSION WILL REVIEW THIS APPLICATION.

A. According to Wyoming Code Section 37-1-104, the Commission is to review any proposed reorganization of a public utility within the state of Wyoming as to whether it ôadversely affects the utilityÆs ability to serve the public.ö The proposed merger between PacifiCorp and ScottishPower must be viewed within the context of a utility reorganization. Under Utah Code Ann. ºº 54-4-28 û 31, a utility must obtain Commission approval to sell its stock or utility assets or merge, combine or consolidate with another utility. The merger or acquisition contemplated by the Applicants can only be approved if the Applicants have made an adequate showing that the proposed transaction is consistent with the ôpublic interest.ö In connection with the PacifiCorp/Utah Power merger, this Commission explained that ôthe necessary predicate for a determination that the proposed merger is æin the public interestÆ is some net positive benefit to the public in this State.ö The Commission further explained that this determination should be made after giving consideration to ôallö positive benefits and negative impacts of the merger, after ôgiving each its proper weightö so as to ôdetermine whether on balance the merger is beneficial or detrimental to the public.ö (Order Re Standard of Approval for Merger, Case No. 87-035-27, issued November 20, 1987, at 2). As I interpret this ôpublic interestö standard, the merger should be approved only upon a substantial showing that the quantifiable benefits of the merger clearly outweigh the potential detriments, costs and risks of the merger.

Q. PLEASE PROVIDE A SUMMARY OF YOUR TESTIMONY.

A. Based on my review and analysis of the ApplicantsÆ filing, their responses to various data requests, and other public information available, it is my opinion that the Applicants have not demonstrated that the merger, as currently proposed, is in the public interest. The ApplicantsÆ filing fails to showdoes not guarantee that PacifiCorp ratepayers will garner economiccustomers will receive any benefits resulting fromsignificant benefits from the merger or the proposed actions of ScottishPower. The transaction as proposed could produce adverse impacts on Utah customers through increased economic risks. Moreover, post-merger pressures to recover costs and produce profits may put Utah consumers at risk of degradations in reliability.

To the contrary, the proposed action will likely have an adverse impact on the economic well being of ratepayers by increasing economic risk without providing concomitant benefits of equal or greater value. The proposed merger is ôconditionedö on the acceptance of ratepayersThe merger, as proposed by the Applicants, is essentially ôconditionedö on customers underwriting in excess of $121 million in transition program investments. There has beenAt this point, no determination ofhas been made as to the need or cost effectiveness of such investments. Also absent is determination regarding ratepayersÆMoreover, the customersÆ ôwillingness to payö for such investments has not been shown. investments. TheWhile the ApplicantsÆ contentioncontend that the transition program investments will be funded out of current budget projections and cost savings and will not result in upward pressure on rates, that contention is based upon unsubstantiatedunproven and non-guaranteed beliefs or expectations thatof the Applicants that they will improve operational efficiencies at PacifiCorp to a level sufficient to offset the investment expense. Their argument issolely predicated on theirScottishPowerÆs claimed experiences in the United Kingdom (UK). The extent to which the results oftheir UK experience are transferable and likely to create similar savings at PacifiCorp isthe UK experiences are accurately stated or transferable to PacifiCorp remains highly uncertain.

As proposed, I believe that the merger presentshas a skewed benefit/cost impact on ratepayers.customers. The costs are substantial, and have not been demonstrated as cost effective, or eveneffective or necessary. The benefits, for the most part, remain unquantified and spurious. The result placesunguaranteed. As a result, unjustified economic risks may be placed on customers, creating a real potential for adverse on ratepayers resulting in an adverse impactimpacts on the public interest. The merger proposal as currently presented should thus be denied. Accordingly, the merger application should be either denied or conditioned to eliminate the substantial economic risks being placed on ratepayers.Before the proposal could be considered to be in the public interest, it would need to be changed or conditioned significantly in order to shift the risks of the merger from customers to shareholders.

Q. CAN YOU ELABORATE ON WHY YOU REACHED THIS CONCLUSION?

A. A number of issues that are critical to ensure that the ApplicantsÆ ôpromisesö A.There are a number of issues thatwill be fulfilled have not been adequately addressed that are critical forthe ApplicantsÆ ôpromisesö to be fulfilled and for the acquisition to be in the ôpublic interestö.

addressed.

First, ScottishPowerÆs contention that its experiences in the UK are fully transferable to PacifiCorp and will produce significant cost savings is questionable. The efficiencies that ScottishPower claims to have implemented at Manweb appear to be substantially overstated in that they include the results of reforms initiated by Manweb prior to the acquisition. assertion that its experience in the UK is transferable to PacifiCorp, producing similar cost savings as have been claimed at Manweb and Southern Water, is questionable. Since PacifiCorpÆs current ôcorporate healthö is much more robust thanIn any event, it appears highly unlikely that PacifiCorp suffers from the same degree of inefficiency as either Manweb or Southern Water when ScottishPower acquired them, thebefore they were acquired by ScottishPower. The potential for cost reductions at PacifiCorp is likely tomay thus be of a much smaller magnitude. The burden of demonstrating that the Applicants can produce theamount of savings necessary to support a favorable public interest finding by the Commission using the Manweb and Southern Water acquisitions as ômodelsö has not been met.

Second, the risk of cost exposure to PacifiCorpÆs ratepayerscustomers resulting from the proposed acquisition is substantial and is larger than any quantifiable potential benefits. Approximately ninety percent of the $135 million investment the Applicants are proposing to undertake in implementing their transition programs are ôabove the lineö costs, that is, costs that will be passed on to ratepayers. All in all, thesethe Applicants will propose to pass on to customers. These non-requested programs will cost ratepayersmay cost customers $121.6 million for implementation and operation, with ScottishPower stockholders contributingexpected to contribute only $13.6 million. Under this proposal, ScottishPower stockholders arewould be exposed to only ten percent of the total cost of program implementation. This asymmetry of the economic risks, coupled with the unsubstantiated flow of benefits placesbenefits, could leave PacifiCorpÆs ratepayerscustomers with a potentially significant economic burden.

Third, although the Applicants promise reliability improvements, the merger will also create tremendous cost-cutting pressures in order for ScottishPower to earn its desired return of and on the substantial investments associated with the merger. These significant cost-cutting pressures could result in reduced quality of service and reliability over time, despite ScottishPowerÆs intentions and pledges to the contrary. The standards and guarantees offered by Applicants, while perhaps a reasonable starting point, do not adequately address the risks. Moreover, the promised guarantee payments and other proposed consequences of failures to achieve the reliability commitments are insignificant when compared to the economic risks that could be borne by PacifiCorp customers, particularly the larger customers, if reliability ultimately suffers. Once again, the risks that customers are asked to bear are not commensurate with any guaranteed level of benefits.

Fourth, the proposed transaction creates a potential for the merger to inject additional risks relating toalso injects risks stemming from international operations and multi-utility practices, to the potential economic detriment of PacifiCorp core retail electric customers. PacifiCorpÆs recent history has been characterized by a long and continuing string of unwise acquisitions and attempted acquisitions. Among other things, the lack of focus on the ôcore businessö resulted in severe financial losses to the company. The result was a management overhaul in 1998 and a new corporate ôrefocusö. Such focus on itsThat refocus on the core domestic retail electric business should be continued by PacifiCorpcontinued, rather than subjecting it and its ratepayersPacifiCorp and its customers to yet another round of aggressive international and multi-utility expansion.

Fourth, the proposal will eliminate the long term potential for ratepayer benefits that would result from efficiencies created by diversifying generation, transmission and distribution through merging with another operating utility in the U.S. In similar mergers in progressùNorthern States Power and New Century Energies, American Electric Power and utility expansion.

Central and Southwest Corporation, Western Resources and Kansas City Power and Light, for exampleùserviceFifth, the proposal may impede potential customer benefits that might result from real diversification efficiencies available from a merger with another utility. In many other mergers and proposed mergers, service territories are being consolidated in an attempt to achieveorder to produce real production, transmission, distribution and customer service synergies in addition to the stand-alone benchmarking efficiencies being proposed by ScottishPower. ScottishPowerÆs acquisition will not add significant value to the PacifiCorp business and may only add complexityrather add complexities to the pledge of focusingto re-focus on its ôcoreö business.

Q. IN YOUR OPINION HAS THERE BEEN AN AFFIRMATIVE CASE MADE BY THE APPLICANTS WHICH DEMONSTRATES THAT THIS MERGER APPLICATION MEETS THE STANDARD TO BE APPLIED BY THIS COMMISSION?PUBLIC INTEREST?

A. No. The ApplicantsÆ filing fails to provideApplicants have failed to make an affirmative showing that the merger meets the standard to be applied by this Commission.satisfies the public interest standard. The PacifiCorp ratepayer iscustomers are exposed to significant economic risks as a result of the investments ScottishPower has deemed necessary. The resulting benefits from these investmentsrate and reliability risks, and the promised benefits are highly uncertain. The ratepayer is simplycustomers are being asked to underwritea major economic investments without any concomitant assurances of economic or other benefits.

II. APPLICANTSÆ ôPROMISESö

Q. WHAT ARE THE APPLICANTSÆ PRINCIPAL GOALS OF THISSTATED GOALS IN CONNECTION WITH THE PROPOSED MERGER?

A. The Applicants have announced numerous goals, such as providing ôworld class serviceö, ôworld class performanceö service that reflects the ôbest practices in the worldö, becomingmaking PacifiCorp ôbest in its classö and bringing PacifiCorpit into the ôtop 10ö best performing electric utilities in the United States. Unfortunately, these stated goals are very general and have little meaning whenyou look at each of them moreexamined closely. Let me give you an example.

InFor example, in Witness OÆBrienÆs direct testimony, page 6, lines 2 through 4, he states that ôScottishPower is fully committed to our goal for providing world class serviceö. Yet, when Mr. OÆBrien was asked to define the term and the detailto provide the details of how PacifiCorp has or has not met ôworld class standardsö, his responseto discovery was noncommittal. (ApplicantsÆ Response to WIEC, 1.4 a, b and c).

Q. WAS ANY EVIDENCE PRESENTED BY APPLICANTS AS TO WHAT CONSTITUTES ôWORLDÆS BEST PRACTICESö?

A. No. Witness OÆBrien, in his direct testimony at page 5, lines 11 through 14 discusses the quest of the company to engage in ôworldÆs best practicesö by stating:

> ôDespite our decision to focus on our core electricity business, we remained convinced that our customers would be

best served by a large, stable enterprise able to offer the most competitive prices while providing customer service and reliability that reflect the worldÆs best practicesö.

However, when asked to define öworldÆs best practicesö in a discovery request, Mr. OÆBrien was unable to respond in any meaningful way:

> ô...the term æworldÆs best practicesÆ is used in Mr. OÆBrienÆs testimony in a general sense. As the term is used in only a general sense, PacifiCorp has no documents that specifically define or address the topic of the æworldÆs best practicesÆ...PacifiCorp has no specific documents evaluating its performance as measured by æworldÆs best practicesÆ...since the term is used in only a general sense in Mr. OÆBrienÆs testimony and by itself does not provide a reasonable basis to evaluate utility performance.ö (WIEC discovery request 1.5, (numbers a, b and c)).

Q. WHAT IS YOUR CONCLUSION?

A. The Applicants have failed to present an affirmative case as to what goals they expect to achieve and the method by which they expect to achieve them. Indeed, it seems to be a moving target. While the overall objective of achieving ôworld class practicesö at PacifiCorp is clearly meritorious, the definition ofno means for defining or measuring such practices are remains unclear.provided. Thus, instead of providing a detailed map as to how suchnew standards orand objectives are to be obtained, we are given only general statements from the Applicants regarding what constitutes key success factors.promises.

III. BENEFITS OF THE MERGER

A. III. POTENTIALCLAIMED BENEFITS

Q. DO THE APPLICANTS CONTEND THAT PACIFICORP RATEPAYERS WILL STAND TOCUSTOMERS WILL BENEFIT FROM THE PROPOSED

MERGER?

A. Yes. The Applicants argue that PacifiCorpÆs current ratepayerscustomers will realize substantial benefits from the proposed merger. The ApplicantsÆ presentation of thepromised benefits is divided into three main components:

1) $10 million in annual cost savings (beginning in 2003) resulting from reductions ofin duplicative costs at the corporate level;
2) $60 million ofin claimed annual economic benefits resulting from the promised service reliability enhancements (Richardson Utah Supplemental Exhibit AVR-2); and
3) Other benefits that by their ownthe ApplicantsÆ admission cannot be quantified but will arguably materialize with the introduction of the transition programs envisionedquantified, but which they believe will materialize as a result of unspecified programs to be implemented by Scottish Power.

Q. WHAT REASONS DOARE GIVEN BY THE APPLICANTSGIVE AS TO WHY ECONOMIC BENEFITS WILL ULTIMATELY MATERIALIZE?

A. The basis ofprimary bases for the ApplicantsÆ contention lies in twocontentions lie in two primary sources. The first is theira ôhigh-levelö benchmarking exercise. The second is ScottishPowerÆs experience in the UK, particularly with the 1995 acquisition of the Manweb electric distribution company acquired in 1995.

1) $10 MILLION BENEFITS FROMIN CORPORATE COST REDUCTIONS

Q. DO THE APPLICANTS PROVIDE A DETAILED EXPLANATION OF HOW THEY WILL REDUCE CORPORATE OVERHEAD COSTS?

A. No. The ApplicantsÆ Direct Testimony explains only that the $10 million of annual savings will be generated through reductions in corporate overhead costs--basically through reductions in corporate staff employee levels. They have stated:

> ôBy the end of the third year following the closing of the transaction, ScottishPower expects to achieve approximately $15 million of annual cost savings in corporate costs which, when offset by $5 million of cost increases, will produce a net reduction of $10

> million annually in corporate costs. ScottishPower will commit to reflecting this reduction in PacifiCorpÆs results of operations.ö (Direct Testimony of Robert D. Green, page 9, lines 20-24).

In further elaboration of the proposed reduction,discovery, the Applicants without clarity responded through discovery:elaborated, without clarifying:

> ...No decision has been made as to where these savings will be made across the combined group. Similarly the $5 million estimate of cost increases reflects the recognition that there will be some increased costs to the remaining function after duplication has been eliminated.ö (ApplicantsÆ Response to Utah Division of Public Utilities Eighth Merger Data Request S8.9, Docket No. 98-2035-04).

Even accepting ApplicantsÆ calculation of this $10 million ôsavingsö, such a ôsavingsö will not be fully realized bysavings, they will not all benefit PacifiCorpÆs customers since the purported ôcost savingsö would occur to both PacifiCorp and ScottishPower. A $10 million ôsavingsö for companies the size of PacifiCorp and ScottishPower, however, will be insignificant in terms of thecost savings will presumably occur, and need to be shared, by both PacifiCorp and ScottishPower customers.

Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE COMPONENTS OF THE $10 MILLION ôSAVINGSö.

A. Applicants claim that $10 million in corporate cost savings will be achieved by consolidating a number of PacifiCorp corporate functions with ScottishPower. The specific functions that the Applicants propose to consolidate are identified in ApplicantsÆ Confidential Response to DPU S8.9.

Q. IS THE APPLICANTSÆ $10 MILLION ôSAVINGSö ESTIMATE OVERSTATED?

A. Yes. The Applicants have erroneously assumed that the $10 million ôsavingsö (even after considering the $15 million of ôsavingsö netted against $5 million of costs) would be achieved without significant costs that generally accompany merging departments and reducing manpower. ApplicantsÆ $10 million ôsavingsö assumption is clearly overstated, as demonstrated by recent manpower reduction experiences at PacifiCorp.

It is expensive to consolidate operations and reduce manpower in light of the one-time costs of early retirement packages, transfers, termination benefits and employee separation packages. For example, in PacifiCorpÆs January 1998 personnel downsizings, 759 people were terminated. As a result of that downsizing, PacifiCorp took a $123.4 million pre-tax charge in 1998. (PacifiCorpÆs SEC Form 10-K, 1998, page 31). Corporate downsizings are definitely not ôcostlessö as assumed in the ApplicantsÆ $10 million ôsavingsö contention. Rather, a downsizing would produce significant early-year cost impacts that do not appear to have been recognized in ApplicantsÆ calculations.

Q. IS IT VALID FOR THE APPLICANTS TO ASSUME THAT ALL OF THE CORPORATE COST ôSAVINGSö WOULD BE ATTRIBUTABLE TO RETAIL ELECTRIC CUSTOMERS?

A. No. The cost savings may or may not occur in areas of ôallowable expensesö in a rate case. The Applicants mistakenly assume that cost-reductions in all of these corporate functions would benefit retail electric customers. Some of the proposed consolidations, including the one with the greatest purported ôconfidentialö savings, may not involve recoverable expenses in revenue requirements determinations by PacifiCorpÆs various state regulators.

Q. AFTER THE APPLICANTSÆ DIRECT TESTIMONY AND DATA RESPONSES WERE FILED, DID THEIR CONCEPT OF THE $10 MILLION ôSAVINGSö CHANGE?

A. Yes, it apparently did. In ApplicantsÆ Oregon rebuttal testimony, they appear to have moved from basing the $10 million on actual cost savings from consolidating functions between PacifiCorp and ScottishPower to more of a ôsurrogateö savings ôguaranteeö of $10 million. As described by Mr. Green:

> ô...the promised $10 million net reduction is permanent and guaranteed

whether or not we actually achieve it, and I am providing a methodology whereby this net reduction can be tracked and verified.ö (Green Oregon Rebuttal, page 4, lines 11-13)

ôIn any event, our commitment is to reflect a $10 million reduction in PacifiCorpÆs cost of service for ratemaking purposes. Cost areas that are disallowed are not part of that calculation and do not diminish the $10 million reduction.ö (Green Oregon Rebuttal, page 5, lines 13-16)

Q. HOW DO THE APPLICANTS PROPOSE TO GUARANTEE THIS $10 MILLION IN ôSAVINGSö?

A. Mr. Green promised to provide to the Oregon Commission a corporate cost allocation proposal by June 18, 1999 to be used to ôverifyö the $10 million corporate cost reduction:

ôWe will use PacifiCorpÆs 1999 budgeted corporate costs as a baseline and use that figure, after adjusting for inflation (using the GDP Price Index), as a benchmark. At the end of three years following completion of the transaction, the amount of PacifiCorpÆs corporate costs will in no event be greater than this benchmark less $10 million. If we achieve corporate cost savings greater than $10 million, this additional reduction in corporate cost savings will be captured for customers. In other words, we will reflect in PacifiCorpÆs cost of service for ratemaking purposes the lower of (1) the benchmark less $10 million, or (2) the actual corporate costs. We will track the corporate cost savings in this manner for the next five years, although the savings will continue in perpetuity. Moreover, the $10 million in annual savings to which we are committed will not be affected by currency exchange risk.ö (Green Oregon Rebuttal, page 4, lines 16-26)

After I have had a chance to further analyze this proposal (assuming it is also presented in Utah), I may have further comments on this issue.

Q. WHEN ALL IS SAID AND DONE, IS THIS $10 MILLION OF ôSAVINGSö SIGNIFICANT?

A. Not really. The $10 million in projected annual savings for companies of the combined size of PacifiCorp and ScottishPower is relatively small. With combined ScottishPower and PacifiCorp annual revenues of $5.2 billion, $10 million in promised annual savings becomes almost inconsequential. In my view, this diminutive level of promised savings is insufficient to satisfy the ôpublic interestö standard, particularly in light of potential ratepayer risks.

Q. MR. RICHARDSON HAS TESTIFIED THAT THIS $10 MILLION CORPORATE ôSAVINGSö WOULD BE ôWORTH ABOUT $100 MILLION ON A NET PRESENT VALUE BASISö. (SUPPLEMENTAL PAGE 1, LINE 15). HOW WAS THIS FIGURE DETERMINED?

A. In responding to LCG Request 1.5, Applicants provided the derivation of the $100 million net present value (ôNPVö) calculation:

> ôThese figures are approximate and are based on achievement of the $10 million cash savings in year three. The $10 million is then assumed to flow in perpetuity. A conservative discount rate of 9% has been used to allow the NPV calculation to be undertaken.ö

Q. DO YOU AGREE WITH THE APPLICANTSÆ $100 MILLION NPV CALCULATION?

A. No. The ApplicantsÆ determination of the $100 million net present value, results in a significant overstatement of the purported ôsavingsö, even assuming that $10 million in annual savings could be realized at all.

The ApplicantsÆ $100 million net present value ôsavingsö calculation assumes a continuing stream of benefits in perpetuity. The ApplicantsÆ claimed ôsavingsö would not be fully achieved until after more than 200 years. Such an extended time period cannot reasonably be used in estimating ôbenefitsö to customers.

2) $60 MILLION IN RELIABILITY BENEFITS

ScottishPower Witness Alan Richardson, in his Supplemental Testimony filed in Utah and Wyoming, presented limited arguments on quantification ofTestimony, argues that he can quantify customer benefits stemming from promised system reliability benefits: enhancements:

> ô...inô[I]n the case of our promised improvement in system availability and momentary interruptions, there are techniques available which attempt to put dollar figures on the value to customers of not having their power interrupted. I have included as Exhibit SP__(AVR-2) one such study which attributes dollar values on these measures of improved service quality. That estimate, using a 1990 survey performed by the Bonneville Power Administration and the Electric Power Research Institute, suggests that the improvements in SAIDI and MAIFI to which we are committed produce approximately $60 million annually in value to our customers...ö (Utah Supplemental Testimony of Alan V. Richardson, April 16, 1999, page 4, line 22 to page 5, line 4)

Mr. Richardson goes on to argueargues (Richardson Supplemental, p. 5, lines 4-5) that thethis $60 million in annual value derivedstemming from improvements in network performance standardsallegedly represents $600 million dollars to ratepayersin value to customers on a net present value basis. Given the source of Mr. RichardsonÆs contentions, the values he purports as ratepayer benefits areThese claimed benefits are wholly unsubstantiated and illusory. Indeed, Mr. Richardson essentially unsubstantiated. Even Mr. Richardson seems to suspect such criticism when he states at page 5, lines 5 through 7 (Richardson Supplemental), ôWhile parties mayacknowledges the weakness of his claims by admitting that parties ômay debate the analytical techniques used in deriving these figuresà.ö (Richardson Supplemental, page 5, lines 5 through 7).

figuresàö As is well known, theThe proper interpretation and application of survey techniques is very complicated and highly sensitive to thetype/form of technique employed, its timing, the audience to whom its is administered, andtypes and forms of techniques employed, timing, the audience, the interpretation of the results.results, etc. To assume adefinitive value of $60 million based onsuch a survey conducted almost a decade ago for a different utility serving different customers under very different market conditions is indefensible. I may have further comments on the ApplicantsÆ $60 million ôsavingsö and $600 million netNo weight should be given to this weak attempt to quantify claimed benefits. Moreover, customers will largely be expected to pay for all of the system reliability enhancements. ScottishPower can hardly claim merger benefits stemming from system improvements funded by the customers. If these types of investments and present value contention after I receive and review the workpapers supporting Mr. RichardsonÆs calculations in Supplemental Exhibit__(AVR-7).enhancements are needed--which is certainly possible, although no showing to that effect has been made-- they should be done by PacifiCorp regardless of the proposed merger.

Q. HAVE YOU REVIEWED THE WORKPAPERS SUPPORTING THE $60 MILLION CLAIM MADE IN MR. RICHARDSONÆS SUPPLEMENTAL EXHIBITù(AVR-2)?

A. Yes, the figure is derived from two studies conducted in 1990 and 1995 by the Bonneville Power Administration and the Electric Power Research Institute. In both cases, a survey technique was employed to estimate the value of outage or interruptions on the system.

Q. HAVE YOU REVIEWED THE WORKPAPERS SUPPORTING THE $600 MILLION NET PRESENT VALUE CLAIM MADE IN MR. RICHARDSONÆS SUPPLEMENTAL EXHIBITù(AVR-2)?

A. Yes, I have. In responding to LCG Request 1.5, Applicants provided the derivation of the $600 million net present value ôsavingsö calculation:

> ôThese figures are approximate and are based on a gradual æramp upÆ of the cash savings for the first five years. The $60 million is then assumed to flow in perpetuity. A conservative discount rate of 9% has been used to allow the NPV calculation to be undertaken.ö

Q. DO YOU AGREE WITH APPLICANTSÆ CALCULATION OF THE $600 MILLION NET PRESENT VALUE?

A. No. Similar to the ApplicantsÆ $100 million net present value savings claim, it would take more than 200 years to achieve a $600 million net present value. It is inappropriate for the Applicants to place a definitive value of $60 million on a survey conducted almost a decade ago under different market conditions and a different survey population; it is even less appropriate for the Applicants to assume that the claimed ôbenefitsö would continue unabated for the next 200 years.

There are a number of errors involved in ApplicantsÆ determination of the $600 million net present value, resulting in a significant overstatement of the value, even assuming a $60 million annual value can be realized at all.

First, the applicants have assumed that the initial $60 million ôsavingsö would be achieved on a costless basis despite the fact that they have recognized elsewhere in this proceeding that the proposed performance standards would initially cost customers $41.5 million for network investment, implementation and operation (Exhibit__ (RMA-1)). ApplicantsÆ have neglected to include up-front capital costs of $31.1 million and annual operating costs of $10.4 million in their net present value calculation.

Secondly, In the ApplicantsÆ $600 million calculation, ôthe $60 million annual ôsavingsö is assumed to flow in perpetuityö, eventually resulting in a $600 million net present value ôsavingsö after 200 years. Such an extended time period should not be used in estimating ôbenefitsö to customers.

Finally, the ApplicantsÆ assumed $60 million in annual savings is based on a particular assumed customer mix and electricity consumption characteristics. It would be incorrect to assume that the customer characteristics and mix upon which the survey was conducted would remain stable for the next 200 years.

3) OTHER UNQUANTIFIABLE BENEFITS

Mr. Richardson states that a portion of the benefits ratepayers arethat customers are expected to experience are at this time unquantifiable:

> ôOther benefits flowing to customers from the transaction, while capable of being quantified, do not lend themselves easily to being measured in dollar savings. However, these benefits are substantial and must be taken into account in any aggregation of customer benefits from the transaction.ö (Wyoming(Richardson Supplemental Testimony of Alan V. Richardson, April 16, 1999, page 3, lines 4-7).

Remarkably, after acknowledging that these ôsavingsö are not quantifiable,cannot be measured in dollars, Mr. Richardsonthen proceeds to state as a known fact that the benefits are a ôsubstantialö portion of the benefit package ratepayers willcustomers will supposedly receive from the merger. The conclusion to be drawn is that ratepayers areCustomers are thus left to ponder theactual value of a substantial portion of their benefits,promised benefits--benefits benefits that, by ScottishPowerÆs own admission, cannot be assigned a value and are thus likely to be ephemeral.

Q. ARE THE BENEFITS CREATED BY THE PROPOSED ACTIONS OF THE APPLICANTS UNCERTAIN?

A. Yes. Beyond the $10 million corporate savings claim made by the Applicants, thereThere exists little certainty as to the source, value or actuality of additional merger savings. A case in point isany merger savings resulting from the merger. As acknowledged in the direct testimony of ScottishPower Witness Robert Green:

> ôScottishPower has, to date conducted

only preliminary studies of potential areas for cost reduction and because those studies are preliminary they are insufficient to base any opinion or commitment to specific cost savings that would be forthcoming immediately from this mergerö. (at page 5, lines 18-21).

Similar statements of the ApplicantsÆ inability to quantify cost reductions or, what is their equivalent,or equivalent benefits to ratepayers beyond the $10 million corporate overhead reduction,customers are found in the direct testimony of a number of witnesses, including Witnesses Richardson, (Richardson Supplemental, p 5, lines 13-16). Richardson (Supplemental, p 5, lines 13-16), OÆBrien (Direct, p 8, line 6), and MacRitchie (Direct, p 13, lines 1-7). The uncertainty ofthe future benefits arising from the proposed merger stems from at least two separate areas.

Q. WHAT ARE THE TWO AREAS OF UNCERTAINTY?
A. The first area of uncertainty centers on properlystems from the difficulty in identifying the source of benefits ratepayers may realizecost savings that may occur in future years. Identifying thecost reductions or benefits attributable to actionson the part of ScottishPower as compared to thosecost reductions or benefitsbeing created through PacifiCorpÆs 1998 ôRefocus Programö and other PacifiCorp process re-engineering programs in progress before the merger agreement announcement will be very difficultwas announced will prove very difficult, if not impossible.

Q. WHAT IS THE SECOND AREA OF UNCERTAINTY?
A. The second area of uncertainty lies in the general inability of ScottishPower to identify specific actions they will undertake as part of their efficiency improvement program, coupled with theirits inability to quantify the value of any such actions. Witness MacRitchie statesadmits in his direct testimony (Direct, page 13, lines 1-3) that, because of the high level benchmarking used in identifying PacifiCorp as a utility in which substantial cost savings were likely, the specifics of how such cost savings are tocan be

developed have yet to be addressed.

B. ESTIMATION OF BENEFITS

4)1) MANWEB COST REDUCTION ôMODELö

Q. WITH REGARD TO MANWEB, WHAT EVIDENCE DO THE APPLICANTS PRESENT THAT DEMONSTRATES THEIR ABILITY TO ENACT THE TYPE OF COST REDUCTIONS AND PERFORMANCE STANDARDS THEY SEEKHOPE TO INTRODUCE AT PACIFICORP?

A. Witness Richardson, in his direct testimony at page 5, lines 2-5, discusses specific key improvements at Manweb since the time of the acquisition.he claims occurred at Manweb after its acquisition by ScottishPower. In addition, Witness Richardson in hisRichardsonÆs supplemental testimony, pages 9 through 16, provides considerable discussion ofdiscusses the ScottishPower experience in the transformation of Manweb that took place transforming Manweb. Richardson concludes that
after the acquisition:

> ôTheôThe Manweb experience provides a proven track record that substantiates our commitment here to produce cost savings.ö (Page 9, lines 10-11)

At page 10, lines 20-22, Mr. Richardson quantifiesattempts to quantify the cost savings shownreflected in his Figure 1 that ôScottishPower was able to achieve in its transformation of Manwebö:

> ôSince 1993/94, the year before we acquired Manweb, its business operating costs have been reduced by over 55%, from ú176 million to ú78 million in 1997/98...ö (May 10, 1999 Wyoming Supplemental Testimony of Alan Richardson, page 10, lines 20-22)

In a similar manner, Mr. RichardsonÆs Figure 3 at page 13 compares Manweb manpower levels using a comparison of ô1993/94ö pre-merger levels with manpower data after the merger.

Q. DO YOU BELIEVE THAT MR. RICHARDSONÆS FIGURE 3 PROPERLY REFLECTS THE ACTUAL MANPOWER SAVINGS ATTRIBUTABLE TO

SCOTTISHPOWERÆS MANAGEMENT OF MANWEB?

A. No. Mr. RichardsonÆs Figure 3 comparisons do not correctly characterize the manpower ôsavingsö Manweb actuallysavings achieved byas a result of ScottishPowerÆs acquisition. While Mr. RichardsonÆs approach may appear to be reasonable at first blush, theThe underlying assumptions of the comparison bias the results, resulting in anhis comparison result in distortions, leading to a significant overstatement of the manpower reductions attributable to the ScottishPower merger.

Mr. RichardsonÆs Figure 3 ômerger savingsö compares manpower levels from an incorrect and premature starting point that attributesincludes significant manpower reductions made by Manweb management prior to ScottishPowerÆs acquisition. Mr. Richardson uses a ô1993/94ö base of comparison forcomparison--April 1, 1993 to March 31, 1994--for business operating costs (Figure 1) and manpower (Figure 3)--the12 month period April 1, 1993 to March 31, 3). 1994. ScottishPower did not acquire control of Manweb until October, 1995 and did not complete its transition team planning until the end of 1995. Mr. Richardson is thus using a base for comparison that coversincludes all of ManwebÆs independent activity for 18 months prior to the acquisition. To correctly measure the merger-related related manpower savings at Manweb, manpower levels at the time of acquisition should be used, rather than data from 18 months before ScottishPowerÆs October 1995 acquisition.

Prior to ScottishPowerÆs acquisition,the acquisition by ScottishPower, Manweb management had implemented several programs that reduced manpower levels, from 4,634 positions on 3/31/94March 31, 1994 to 3,353 positions on September 31, 1995, about1995--about one week before ScottishPower took control of Manweb on October 6, 1995. My testimony corrects Mr. RichardsonÆs manpower comparisons using a more reasonable basis of September 31, 1995 employee levels to measure ScottishPowerÆscost savings attributable to reductions in Manweb manpower. manpower after the acquisition.

Q. WHAT IMPACT SHOULD THE RECOGNITION OF SCOTTISHPOWERÆS INCORRECT MANPOWER DATA HAVE ON THE COMMISSIONÆS EVALUATION OF THE PROPOSED PACIFICORP MERGER?

A. Recognizing this overstatement of ManwebÆs merger-related manpower savings is important in that it casts doubt upon the actual savings that ScottishPower was able to achieve through the Manweb acquisition. This has import forthe claimed potential savingsScottishPower believes exist within the PacifiCorp system. Aswill be discussed below, the experienceScottishPowerÆs claimed experiences and cost savings ScottishPower claims forfrom the Manweb merger are the linchpin of theirits contention that similar savings await us atexist in PacifiCorp. My correction of ScottishPowerÆs presentation shows significantly reduced manpower savings from the Manweb merger than purported by ScottishPower. If the savings at Manweb are substantially less than as claimed in the ApplicantsÆ filing, it there iscases doubt regardingon ScottishPowerÆs assertion that the proposed merger will save alead to significant amount of moneysavings at PacifiCorp.

Q. PLEASE EXPLAIN MR. RICHARDSONÆS FIGURE 3.

A. Figure 3 of Mr. RichardsonÆs Supplemental Testimony is a bar chart illustrating ManwebÆs manpower levels from ô1993/94ö to ô1997/98. My annotated version of Figure 3 showing year-to-year manpower reductions appears below:

MANWEB EMPLOYEE REDUCTIONS

Period	Ending	Employees	Reduction
1993/94	3/31/94	4,634	
		)	219
1994/95	3/31/95	4,415	
		)	1,355
1995/96	3/31/96	3,060	
		)	147
1996/97	9/30/96	2,913	

) 156

1997/98 3/31/97 2,757

Total Reduction 93/94 û 97/98 1,877

(RichardsonWyoming Supplemental Figure 3, page 13)

According to Mr. RichardsonÆs Figure 3, Manweb employee levels were reduced by a total of 1,877 employees (4,634 û 2,757) over the 1993/94 û 1997/98 period.

Q. WERE ALL OF THESE 1,877 EMPLOYEES IN MANWEBÆS ELECTRIC DISTRIBUTION BUSINESS?

A. No. ScottishPowerÆs response to data requests adds insight into the typeshows the types of positionsthat were eliminated at Manweb between 1994 and 1997. I have prepared a table using the annual manpower data for Manweb for the terminal years shown in Mr. RichardsonÆs Figure 3:

	1994	1997	Change	% of Total
Distribution	2,513	1,774	(739)	39.4%
Supply	650	498	(152)	8.1%
Corporate Services	396	88	(308)	16.4%
Contracting Services	414	314	(100)	5.3%
Retail-Appliances	661	83	(578)	30.8%
Total	4,634	2,757	(1,877)	100.0%

(Source: ApplicantsÆ Response to Wyoming CAS Eighth Data Request 231b)

Q WOULD IT BE FAIR TO SAY THAT SCOTTISHPOWER REDUCED MANWEB EMPLOYEE LEVELS BY 1,877 BETWEEN 1993/94 AND 1997/98?

A. No. In making such a claim, ScottishPower takes credit for manpower reduction at Manweb prior to ScottishPowerÆs acquisition. A majority of the manpower reductions (and their associated cost savings) appear to have been initiated prior to ScottishPower acquiring Manweb in a hostile takeover on October 6, 1995. A more realistic characterization would be that ScottishPower inherited the benefits of the Manweb cost reduction programs initiated in 1994 and 1995 that had not yet been fully completed at the time of the takeover. According to my calculations, Manweb manpower at the time of ScottishPowerÆsScottishPower assumed control of the company on October 6, 1995 was approximately 3,353 positions segmented as follows, based on data as of September 30, 1995 (WIEC Data Request 2.3(a)):

Distribution	1,984
Supply	499
Corporate Services	283
Contracting Services	368
Retail-Appliances	190
Other	29
Total	3,353

A more accurate characterization of ScottishPowerÆsFigure 3 manpower reductions at Manweb would start with the 3,353 total for September 30, 1995 and compare it with Mr. RichardsonÆs 3/31/97March 31, 1997 staffing valuelevel of 2,757, resulting in total manpower reductions of 596 employees rather than the 1,877 reported in ScottishPowerÆs Figure 3. Even thisthe 596 figure of 596 is inflated because it includes employees not involved in ManwebÆs electric distribution and supply business. Taking those employees into account reduces actual manpower savings in ManwebÆs electric distribution and supply business to 211 employees.

Q. PLEASE EXPLAIN WHY YOU ARE UTILIZING A DIFFERENT TIME PERIOD THAN MR. RICHARDSON TO ASSESS MANPOWER SAVINGS.
A. The ApplicantsÆ filing seeks credit for manpower reduction at Manweb prior to ScottishPowerÆs acquisition.

Q. WHEN DID SCOTTISHPOWER FIRST INITIATE ITS MERGER WITH MANWEB?

A. ScottishPower reports that it initiated a bid for Manweb on July 24, 1995. (ôDelivering Future Valueö, Charles Berry, Bates No. SP0369)

Q. COULD THISIT BE CHARACTERIZED AS A æFRIENDLY MERGERÆ?

A. No. ScottishPower has characterized thisit as a ôhostile bidö with ôno leakage and no prior contactö with Manweb. Mr. Berry characterizes ManwebÆs defense in this hostile takeover as a ôscorched earth defenseö where ô1,000 people left in September 1995ö. (ôDelivering Future Valueö, Charles Berry, Bates No. SP0369) It was reported that Manweb had rejected ScottishPowerÆs bid because it had undervalued Manweb. (EnergyOnLine, September 8, 1995)

Q. WHEN DID SCOTTISHPOWER FINALIZE THE MERGER?

A. The Department of Trade and Industry cleared the merger bid on August 31, 1995. (CCNS Full Text News, August 31, 1995) ScottishPower reports that it took control of the company on October 6, 1995 with transition team conclusions made in December 1995. (ôDelivering Future Valueö, Charles Berry, Bates No. SP0369)

Q. DID SCOTTISHPOWER START COST-CUTTING MEASURES IMMEDIATELY UPON ACQUIRING MANWEB ON OCTOBER 6, 1995?

A. Apparently not. Since Mr. Berryhas indicated that transition team conclusions were not finalized inuntil December 1995, significant manpower adjustments shouldpresumably could not have been prudently considered until early 1996. (ôDelivering Future Valueö, Charles Berry, Bates No. SP0369) For purposes of any comparisons, the use of manpower levels for 12/31/95 may be more appropriate than those levels that existed at the time of the acquisition (October 6, 1995). Use of the December 31, 1995 cutoff date would reduce further the figure of 211further reduce the 211 figure discussed above.

Q. MR. RICHARDSON SET FORTH NINE ôACTIONSö THAT HE CLAIMS SCOTTISHPOWER IMPLEMENTED TO ACHIEVE EFFICIENCIES AND COST SAVINGS AT MANWEB (SUPPLEMENTAL TESTIMONY, PAGE 10, LINES 1-17). HAS SCOTTISHPOWER SHOWN THAT THESE ôACTIONSö ARE TRANSFERABLE TO PACIFICORP?

A. No. PacifiCorp was unable to verify that any of ScottishPowerÆs nine efficiency and cost savings öactionsö at Manweb would even be applicable to PacifiCorp, not to mention whether or not efficiencies would be achieved or costs saved:

> ôPacifiCorp objects to this request on the grounds that it is overly broad and vague. The referenced actions in the Supplemental Testimony are broad categories of management actions that ScottishPower undertook to achieve efficiencies and cost savings at Manweb. As such, a response would require a complete analysis of all performance management efforts undertaken by PacifiCorp over the last several years. Even then, the output would not be a reliable guide to potential transition actions at PacifiCorp as this will be based on the specific conditions encountered at PacifiCorp, not those that were present at Manweb.ö (ApplicantsÆ Response to LCG 1.18)

Q. DO THE MANPOWER REDUCTION OPPORTUNITIES AT MANWEB AT THE TIME OF THE SCOTTISHPOWER ACQUISITION MIRROR THOSE AT PACIFICORP TODAY?

A. No.I do not believe so. The conditions at Manweb, at the time of the acquisition by ScottishPower on October 6, 1995, wereparticularly in the 1993-1994 timeframe used by ScottishPower, appear to be far different than the conditions that exist at PacifiCorp today. At the Utah Public Service CommissionÆs Technical Conference on April 21, 1999 conducted in Salt Lake City, ScottishPower made available Mr. Charles Berry, Chief Executive Officer of Manweb. When asked the question ôwhat condition was Manweb in at the time of the acquisition,öacquisition?ö Mr. Berry referred to Manweb as being high cost with a lack of focus. ôhigh costö with a ôlack of focus.ö

While both Manweb and PacifiCorp appear to have been in the process of reducing personnel and instituting cost reductions programs at the times the ScottishPower acquisitions were launched, the opportunities for

ScottishPower to consolidate operations at PacifiCorp, as was done at Manweb, are admittedly missing.appear very different. As Applicants respondedconceded in response to the Wyoming CAS data request 2.3(a):

> ôThe opportunities for cost reductions are different in PacifiCorp, but definitely real. The Manweb situation involved the combination of two electric utilities operating in nearby geographic areas, and thus presented greater opportunities for cost savings by eliminating duplicative functions and combining electric operations. The PacifiCorp transaction process presents limited opportunity for savings achieved in this manner...ö (ApplicantsÆ Response to Wyoming CAS 231.a)

I do not believeMoreover, it is not clear that PacifiCorp cancould properly be characterized as lacking focus.ôlacking focusö at the time of the acquisition. In announcing its 1998 ôRefocusö effort, PacifiCorphas made well known its intention to go backreturn to its ôcore businessö of serving retail electricity customers in the western states. Manweb had apparently not made any such strides beforeprior to ScottishPowerÆs takeover in 1995. It had clearly not done so in the 1993-1994 timeframe used by ScottishPower.

In submitting its Business Plan to OFFER, the Office of Electricity Regulation in the UK, in December 1998, ScottishPower stated:

> ôWe have worked hard to reduce controllable operating costs whilst improving customer service and system performance...The majority of cost savings have been achieved through reductions in staffing levels (29% on March 1995). There is obviously a limit to which future staffing levels (hence future levels of controllable operating costs) can be further reduced.ö (Reviews of Public Electricity Suppliers 1998-

2000 PES Business Plans Consultation Paper, December 1998, "Manweb-Overviewö).

Althoughit is true that ScottishPower has reduced manpower levels at Manweb since 1995,it is also true that PacifiCorp has also made significant personnel cuts in the last few years. The practical limit to staffing reductions citedthat was acknowledged by ScottishPower is likely tomay well be reached much more quickly at PacifiCorpsince PacifiCorp has already had significant downsizing on two recent occasions.in light of its recent downsizing efforts. In 1998, PacifiCorp had two major early retirement programs, one announced in January 1998 and the other announced in October 1998. Those downsizings eliminated1998, resulting in the elimination of 926 electric operations positions (759 + 167). These cuts were reported in PacifiCorpÆspositions. (PacifiCorpÆs 1998 SEC Form 10-K at page 31.31)

Details of PacifiCorpÆs electric operations manpower levels in each of its service territories was provided by Applicants in response to a data request. request:

ôEmployment by State, PacifiCorp Electric Operationsö

	1994	1995	1996	1997	1998
California	105	102	94	98	74
Idaho	234	222	201	195	180
Montana	84	76	68	60	0
Oregon	2,145	2,155	2,194	2,331	2,215
Utah	3,091	2,899	2,820	2,758	2,373
Washington	519	477	435	416	361
Wyoming	1,427	1,367	1,247	1,223	1,112
Other	1	1	2	5	4
Total	7,606	7,299	7,061		

7,086 6,319

(Source: ApplicantsÆ Response to WIEC Data Request 2.16)

In addition to the significant reductions in electric operations personnel in 1998 shown in the above table, PacifiCorpÆs divestiture of a number of non-core businesses has produced even greater manpower reductions.

Q. DO OTHER OPPORTUNITIES FOR COST REDUCTIONS AT PACIFICORP MIRROR SIMILAR OPPORTUNITIES THAT EXISTED AT MANWEB AT THE TIME OF THE SCOTTISHPOWER ACQUISITION?

A. As explained above, many of the actions undertaken by ScottishPower at Manweb were unrelated to the distribution and supply segments of the business. Also, the opportunities for combining staff positions at Manweb and ScottishPower were much more apparent as compared to similar opportunities at PacifiCorp.

ManwebÆs recently filed Business Plan provides general insight on how ScottishPower reduced ManwebÆs costs since acquiring it in 1995:

> ôManagement Initiatives: The operating costs, excluding Rates, Depreciation and NGC Exit Charges, have reduced in real terms by 24% over the last three years as a result of a focused and coordinated drive to improve efficiency and productivity following the acquisition, while increasing the quality of service provided:

The initiatives following the acquisition were to:

- Merge the management of duplicate support functions.
- Align operating cost base of ScottishPower and Manweb by transfer of best practice and general efficiencies;
- Reorganize Manweb Distribution Operations into three regions with supporting depots for the more rural operations;
- Reduce Corporate Centre in size;

╖ Reduce Customer Service call centres from three down to two.

(Reviews of Public Electricity Suppliers 1998-2000 PES Business Plans Consultation Paper, December 1998, "Manweb-Section 2.1ö).

Recall that the elimination of the æduplicate corporate overheadÆ has already been accounted for in the claimed $10 million guaranteed saving.in annual savings. No additional ôduplicative support functionsö have been claimed to exist. PacifiCorp has already reduced the number of its support centers and has reorganized its customer support services. If ScottishPower is to followfollows the Manweb model, asthey contend in theirit contends in its filing, the areas in which cost savings may be enacted are little to noneappear very limited when compared to those available at Manweb inprior to 1995.

Q. IS THERE COMPARATIVE DATA THAT WOULD INDICATE PACIFICORP IS A HIGH COST UTILITY AND A LIKELY CANDIDATE FOR THE EFFICIENCY ACTIONS PROPOSED BY SCOTTISHPOWER?

A. There are undoubtedly inefficiencies and excess costs in PacifiCorpÆs operations that can and should be eliminated. However, PacifiCorpÆs average retail electricity rates, reflecting its underlying cost of operations, are relatively low when compared to many other U.S. utilities. In fact, the Edison Electric InstituteÆs ranking of 185 investor owned utilities for the 12 months ending June 30, 1998, as shown in Exhibit ___ (RMA-2), listed PacifiCorpÆs rates among the lowest in the country. In that study, a higher numerical ranking indicated a lower comparative average retail rate. PacifiCorpÆs Utah territory ranked 179th,142nd; the Wyoming-West territory ranked 167th,and theUtah territory ranked 142nd.

the Idaho territory ranked 179th and the Wyoming-East territory ranked

A. The180th. This study suggests that PacifiCorpÆs rates are relatively low. Assuming that lower rates reflect low costreasonable costs of operations, PacifiCorp would appear to be a different utility than Manweb was in 1995. This is a critical distinction because it suggests that the base from which Scottish Power will begin its cost cutting and efficiency measures is very different than its starting point with Manweb.

Q. WOULD YOU CONCLUDE THAT THE MANWEB EXPERIENCE EXPERIENCE IS APPLICABLE TODEMONSTRATES AVAILABLE COST REDUCTIONS AND IMPROVED SERVICE ATFOR PACIFICORP?

A. No. The basis from which ScottishPower will attempt to achieve the goals it has generally described for PacifiCorp is very different than it was for Manweb. It would be unrepresentative to use Manweb as a case example of what can be achieved at PacifiCorp.

Q. WOULD YOU CONCLUDE THAT SCOTTISHPOWERÆS EXPERIENCE WITH SOUTHERN WATER IS APPLICABLE TO COST REDUCTIONS AND IMPROVED SERVICE AT PACIFICORP?

A. No. Southern Water, like Manweb, was apparently an unfocused, over-manned government water utility that also had ôdiversifiedö into a number of non-core businesses:

> ôSouthern Water, at the time of acquisition in August 1996, had accumulated a portfolio of 20 enterprise businesses. The total fiscal 1996 turnover for these businesses was ú134 million. Of this ú73 million was internal and ú61 million was external representing 14% of the Southern WaterÆs total sales. There was little evidence of strategic direction other than an overall encouragement to grow external business. There had been almost no attempt to rationalize the portfolio into larger groupings, little in the way of business planning and no attempt to formulate an overall market or industry strategy. As a result, the inherited enterprise business portfolio lacked

focus, had high overheads and gave rise to complex interfaces and a significant burden of internal transaction costs...ö (ScottishPower 1997 SEC Form 20-F, page 24).

Unlike the Southern Water acquisition, where ScottishPower divested 13 subsidiaries of Southern Water, totalingWater for a total of ú 90 million (Financial Times, November 5, 1997), there appears to be relatively little for ScottishPower to clean up at PacifiCorp after the large number of major divestitures during the last year stemming from the 1998 PacifiCorp ôRefocusö:

ôThe Company sold its wholly owned telecommunications subsidiary, Pacific Telecom, Inc. (ôPTIö), on December 1, 1997...The Company sold Pacific Generation Company (ôPGCö) on November 5, 1997, and the natural gas gathering and processing assets of TPC on December 1, 1997. During May 1998, a majority of the real estate assets held by PFS were sold.ö (PacifiCorpÆs SEC Form 10-Q for the quarterly period ended September 30, 1998).

ôPacifiCorp expects, over the next 12 months, to divest all of its businesses other than its western U.S. electric business and Powercor, its Australian electricity distribution business, assuming reasonable values can be achieved. The most significant businesses include:

- TPC Corporation, the companyÆs U.S. natural gas storage and marketing business;
- The eastern U.S. electricity trading business of PacifiCorp Power Marketing;
- EnergyWorks, the companyÆs joint venture with Bechtel Enterprises;
- The companyÆs energy development activities in Turkey and the Philippines; and
- The companyÆs investment in the Hazelwood power station in Australia.

The company has recorded charges totaling $230 million pre-tax in its third quarter financial results for expected losses associated with its planned business divestitures.ö (October 23, 1998 press release, ôPacifiCorp Reports Third Quarter 1998 Financial Resultsö)

Q. PLEASE COMMENT ON SCOTTISHPOWERÆS CLAIMED MANPOWER REDUCTIONS AT SOUTHERN WATER.

A. ScottishPower contends that it has made significant employee reductions at Southern Water since its takeover on August 6, 1996. For example, see ScottishPowerÆs presentation to financial analysts dated June 1998 (Exhibit ___ (RMA-3)).

While the ômanpower reductionsö illustrated in ScottishPowerÆs analystsÆ presentation may be accurate for Southern Water in total, they are also misleading. A recent ScottishPower data response shows that ScottishPowerÆs manpower ôreductionsö claimed at Southern Water were almost entirely derived from the divestiture of 13 subsidiaries (ôEnterprise Businessesö) by ScottishPower after the merger. In fact, during the 1996-1998 period, employment at Southern Water Services actually increased by 202 employees:

	1996	1997	1998	Change 96-98
Southern Water Services	2,003	1,782	2,205	+202
Enterprise Businesses	1,859	1,650	52	-1,807
Headquarters	144	94	107	-37
Agency	350	300	145	+205
Total	4,356	3,826	2,509	-1,847

Source: ApplicantsÆ Response to LCG 1.17, Appendix F

Q. HAVE SOUTHERN WATERÆS ôTYPICAL HOUSEHOLD BILLSö DECREASED SINCE SCOTTISHPOWERÆS ACQUISITION IN 1996?

A. No. According to the Applicants, the typical water and wastewater combined bill increased from ú218.71 in 1996/97 to ú266.06 in 1998/99 (ApplicantsÆ Response to LCG 1.17, Appendex G)

Q. HAS SCOTTISHPOWER INSTITUTED ITS ôMULTI-UTILITYö PLAN AT SOUTHERN WATER?

A. Yes. ScottishPower instituted a natural gas sales program in February 1997 (ScottishPower Presentation to U.S. Analysts, July 1997, page SP0662), within six months of its acquisition and just shortly after the implementation of a detailed transition plan:

> ôThe take-over of Southern Water was completed at the beginning of August 1996. A detailed transition plan for reconstructing the Company was prepared, with implementation commencing in January 1997.ö (ApplicantsÆ Response to Utah LCG 17)

ScottishPowerÆs SEC Form 20-F for the fiscal year ended March 31, 1997 stated:

> ôIn addition, the first stage of opening the gas supply market to full competition (i.e., to premises with consumption under 2,500 therms per annum) has been completed by the introduction of 2 million gas customers to competition in the gas trial in the south of England. The group was able to take advantage of the fact that many of these customers reside in the area served by Southern Water and has rapidly established itself as one of the leading challengers to British Gas (Centrica) in this market, acquiring over 70,000 customers, approximately 8%, of the market in the Kent and Sussex areas. In addition, the gas trial provided the

group with valuable experience in all aspects of operating in a competitive energy market.ö (page 19)

ôBusiness Objectives:...In addition, further growth will come from exploiting multi-utility sales opportunities in the area as evidenced by ScottishPowerÆs participation in the gas trials in Kent and Sussex, a large part of Southern Water territory, where ScottishPower gained 8% of the gas market.ö (page 23)

Q. WHAT IS YOUR CONCLUSION REGARDING THE TRANSFER OF THE UK EXPERIENCE?APPLICABILITY OF SCOTTISHPOWERÆS UK EXPERIENCES?

A. It really is notThose experiences do not appear to be transferable to PacifiCorp to any significant extent. The efficiency opportunities present in the UK acquisitions are simply not replicated in the PacifiCorp operations.

Q. HAVE YOU ANALYZED FIGURE 1 BUSINESSTHE OTHER OPERATING COSTS IN A MANNER SIMILAR TO YOUR ANALYSIS OF MANPOWER?

A. No, I have not. I willmay have further comments on two other figures referenced in Mr. RichardsonÆs supplemental testimony (Figure 1-Business Operating Costs and Figure 2- Net Capital Expenditures) after I have reviewedhad a chance to more fully review the supporting workpapers.

5)2) BENCHMARKING

Q. HAVE THE APPLICANTS PRESENTED A DETAILED ASSESSMENT OF HOW THEY DETERMINED PACIFICORP TO BE A CANDIDATE FOR THEIR PROPOSED COST REDUCTION EFFORTS?

A. The Applicants state that their assessment of the potential for cost reductions at PacifiCorp iswas primarily based on ôa high level preliminary benchmark studyö (MacRitchie Direct, at page 2, lines 16-17). Witness MacRitchie states (at page 3, lines 19-22) that ôthe process to identify the potential efficiencies that can be undertaken at PacifiCorp has actually only begunö. In fact he goes on to statebegun.ö In fact, he states (at page 3, line 20-21) that ôa significant amount of work still needs to be undertaken with PacifiCorp before we can assess the potential for efficiencies with any degree of certainty.ö In fact, Mr. MacRitchie (at page 12-13, lines 24-25 on page 12 and lines 1-3 on page 13) statesalso stated (at page 12, lines 24-25 and page 13, lines 1-3) that ôScottishPower intends to set up a full integration team and conduct an exhaustive survey of PacifiCorp operations but that has not been undertaken to dateàö Additionally,date.àö He also acknowledges (at page 13, lines 9-10)he contends that ôa significant amount of work and further investment still needs to be undertaken in conjunction with PacifiCorp before the positive affects of this effort will materialized.ö

Q. FROM THE ARGUMENTSBASED UPON THE INFORMATION PRESENTED BY THE APPLICANTS, IS IT ACCURATE TO STATE THAT THE POTENTIAL FOR COST REDUCTIONS AT PACIFICORP IS HIGHLY UNCERTAIN?

A. Yes. Beyond theParticularly beyond the projected $10 million in annual corporate overhead reductions promised by 2003, the potential for cost reductions at PacifiCorp remains highly uncertain and speculative. Indeed, ScottishPower hadessentially indicated as much in its own testimony by failingtestimony, in that it failed to identify or present a detailed action plan that would delineatethe specific objectives and their expected value to ratepayers.values to customers.

Q. DIDNÆT SCOTTISHPOWER IDENTIFY THE POTENTIAL FOR COST REDUCTIONS AT PACIFICORP THROUGH BENCHMARKING PACIFICORP AGAINST OTHER UTILITIES?

A. Not really. As discussed above, ScottishPower conducted a ôhigh levelö benchmarking assessment of PacifiCorp, comparing it to other utilities it considered to be similar in operating and geographic conditions. Witness MacRitchie in his exhibit (Ex.SP_AM-1) provides a comparison of non-production cost per customer for several utilities in 1996. In that exhibit, Mr. MacRitchie highlights Puget Sound Energy, New Century Energies, Sierra Pacific Power Company, PacifiCorp and Idaho Power Company as utilities with similar characteristics and operating conditions.

Q. WHAT DOES MR. MACRITCHIE CONTEND HIS EXHIBIT DEMONSTRATES?

A. Mr. MacRitchieÆs conclusion is that PacifiCorp has a higher non-production cost per customer than Puget Sound Energy, New Century Energies and Sierra Pacific Power Company. On the other hand, PacifiCorp has a lower non-production cost per customer than does Idaho Power.

Q. DO YOU BELIEVE MR. MACRITCHIEÆS EXHIBIT AM-1 PROVIDES A REASONABLE BASIS TO CONCLUDE PACIFICORP HAS RELATIVELY HIGH COSTS?

A. No. The comparison between PacifiCorp and those highlighted in Mr. MacRitchieÆs Exhibit AM-1 is not a comparison of utilities with similar characteristics.

Comparisons with the ôtop ten utilitiesö listed in Mr. MacRitchieÆs exhibit produce some very curious comparisons. For example:

- Utility number four, Citizens Electric had 6,211 customers in Lewisburg, Pennsylvania, and 16 employees in 1997.
- Utility number six, Northwestern Wisconsin Electric, had 10,796 customers, 57 full time employees and slightly more than $50,000 of annual transmission operation and maintenance expenses in 1996.
- Utility number ten, Superior Water Light and Power had slightly less than 14,000 customers and 54 employees in 1996, and was owned and operated by the Minnesota Power & Light Company. Minnesota Power & Light is not included in the study.

The stark differences among those three utilities alone create real questions about the meaningfulness of the ôtop tenö comparison soughtmade by ScottishPower.

Additionally, the top two utilities noted in the exhibit, Florida Power and Light and Florida Power Corporation, as well as the number five utility, San Diego Gas and Electric, and the number four utility, ConsumerÆs Energy, are large urban utilities that have very little in common with PacifiCorpÆs operating conditions.

conditions.

Moreover, ScottishPower admits that it has yet to gauge PacifiCorpÆs performance against other IOUsö:utilities:

"ScottishPower has not yet developed the portfolio of measures it will use to gauge PacifiCorp's performance against other IOUs...ö (ApplicantsÆ Response to WIEC First Data Request 1.52(a)).

It would appear that theThe use of the general benchmarking technique as applied to Mr. MacRitchieÆs exhibit and the quest to position PacifiCorp as a ætop ten utilityÆ is illusory.

Q. DOES THE BENCHMARKING TECHNIQUE USED BY SCOTTISHPOWER DIFFERENTIATE BETWEEN REGULATED AND NON-REGULATED COSTS?

A. No. Mr. MacRitchieÆs testimony fails to inform the reader that the non-production costs he has highlighted include both wholesale and retail as well as regulated and non-regulated costs, including instances of one-time charges for significant corporate write-offs. In addition, this ôbenchmarkingö does not recognize the ôused and usefulö or ôtest yearö conventions utilized in revenue requirements proceedings at the state regulatory level. Benchmarking analysis, thus,The benchmarking analysis thus has little value in determining similarly situated utilities that could be used as a basis for reducing costs topredicting cost reduction potential for PacifiCorpÆs retail electric ratepayers.customers. The ôcostsö benchmarked may not even be the relevant costs to be studied as far as ôbenefitsö accruing to those customers.

Q. DID THE BENCHMARKING TECHNIQUE USED BY APPLICANTS IN COMPARING PACIFICORP TO OTHER UTILITIES RECOGNIZE THE SIGNIFICANT INVESTMENTS IN NEW EFFICIENCY PROGRAMS UNDERTAKEN BY PACIFICORP OVER THE LAST FEW YEARS?

A. To an extent, yes. The significant investments made by PacifiCorp in customer information systems, customer call centers and the Business Systems Integration Projectmade by PacifiCorp over the last several years would presumably be included in this cost comparison. Mr. MacRitchieÆs benchmarking testimony, however, does not recognize the cost of any process re-engineering engineering that occurred in the benchmarking yearstudied nor any anticipated benefits of these long-term cost reduction efforts. Also, to the extent that the costs reflected in his exhibit are from 1996, they would not include the $30 million cost reduction activities highlighted in the ôRefocus Programö. Therefore, the costs stated in MacRitchieÆs testimony are suspect.

Q. DOES THE HIGH LEVEL PRELIMINARY BENCHMARKING TECHNIQUE FURTHER INCREASE THE UNCERTAINTY OF THE PERCEIVED MERGER BENEFITS TO PACIFICORPÆS RATEPAYERSCUSTOMERS ?

A. Yes. The MacRitchie exhibit does not provide any kind of meaningful basis to gauge PacifiCorpÆs operating costs or realistic cost-cutting opportunities.

In addition, the ApplicantsÆ benchmarking analysis, which is calculated using the number of customers served, would be inherently biased against companies such as PacifiCorp that have extensive transmission investments and operating costs in serving wholesale loads. While Mr. MacRitchieÆs benchmarking treats transmission as ônon-production costö expense, in reality, much of the transmission costs for PacifiCorp are production-related. Moreover, using the number of customers to determine benchmarking costs instead of another unit of consumption, such as kilowatt-hours, distorts the comparisons as shown in RMA__Exhibit 2.comparisons. This exhibit ranks the per megawatt-hour unit operating costsofAs reflected in my Exhibit ___ (RMA-4), by ranking ApplicantsÆ ôtop 10 utilitiesörather than by customers. This highlights the significantly different results in rankings when unit costs are based on consumption rather than on a customer basis.

by per-megawatt-hour unit operating costs rather than by customers, significant differences appear in the rankings.

Q. DO YOU BELIEVE THAT THE CONCLUSIONS DRAWN BY MR. MACRITCHIE ARE UNCERTAIN, IF NOT INACCURATE?

A. OtherYes. This is also supported by other studies by industry researchers have reachedthat reach completely different conclusions about PacifiCorpÆs efficiency ranking compared to other utilities. For example, in a September 1, 1998 article in Public Utilities Fortnightly, (Exhibit ___ , R(RMA-5)) entitled the ôFortnightly 100ö, PacifiCorpÆs 1996 ôefficiency scoreö tied for the number 8 position nationwide. A similar ranking in Public Utilities Fortnightly, (Exhibit ___ , R(RMA-6)) June 15, 1997, ranked PacifiCorp number 5 out of 94 electric utilities investigated.

Q. DOES THE APPLICANTSÆ GENERAL BENCHMARKING APPROACH INTRODUCE UNCERTAINTY AS TO THE PUBLIC INTEREST IMPACT OF THIS MERGER?

A. Yes. Even the Applicants acknowledge that this generalized benchmarking approach has significant analytical problems:

> ôIt is important to point out that benchmarking efforts alone do not precisely specify likely cost savings, as explained in Mr. MacRitchieÆs testimony. ScottishPower has found that the variances identified in benchmarking comparisons while directionally correct, can be inaccurate for a number of reasons:
>
> - Differences in overall operating environments for individual utilities may require investment in, and operation of, different systems such as underground high-voltage transmission facilities.
> - Differences in cost allocation procedures or accounting conventions regarding the capitalization or expensing of certain items has the potential to distort results; and
> - Yardstick comparisons, by their nature, are imprecise and can mask best or worst practices in specific areas. Drawing too great an inference 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 from a yardstick comparison where potential savings exist. Therefore, ScottishPower would not advocate the use of such a yardstick comparison to project savings over a ten-year period.ö (ApplicantsÆ Response to WIEC 1.118(b) (Emphasis Added).

Q. APPLICANTS HAVE RECENTLY PROPOSED IN OTHER

STATES TO FILE A DETAILED ôTRANSITION PLANö WITHIN SIX MONTHS OF COMPLETING THE MERGER. WILL THIS REDUCE THE RISK TO PACIFICORPÆS CUSTOMERS?

A. No. Mr. Richardson mistakenly believes that an after-the-fact quantification of merger costs and benefits will show that the merger is in the public interest:

> ôSeveral parties desire greater specificity with regard to the mechanism and timing under which cost savings will be achieved and reflected in rates. We believe that the normal ratemaking process will allow this to happen; however, we now understand that the parties want a more specific commitment with respect to the timing and process...we will agree to develop and share our transition plan within six months after closing the merger, identifying the specific areas in which ScottishPower expects to achieve cost savings, the plan for achieving them, and the expected cost and benefits of such initiatives.ö (Richardson Oregon Rebuttal, page 4, lines 5-13)

Unfortunately, the Applicants have yet to commit to a mechanism that will recognize promised merger cost savings in present customer rates.

Q. WHAT IS YOUR CONCLUSION REGARDING THE BENCHMARKING EXERCISE USED BY SCOTTISHPOWER?

A. The exercise produced spurious results that haveproduces no meaningful results. Rather, it produces misleading implications regarding PacifiCorpÆs relative cost level. It is mistakenly used by the Applicants as a ôsignalö that costs are relatively high. In fact, the results are meaningless.that conclusion has not been supported.

6)3) PACIFICORPÆS 1998 ôREFOCUS PROGRAMö

Q. TO WHAT EXTENT HAVE THE APPLICANTS ADDRESSED HOW THEIR ôMERGER SAVINGSö CLAIMS ARE RELATED TO PACIFICORPÆS 1998 ôREFOCUS PROGRAMö?

A. The Applicants failed to consider the effects of cost cutting and performance enhancements that PacifiCorp has undertaken in its 1998 ôRefocus Programö. According to a March 31, 1999 statement by Mr. Keith McKennon, (Chairman and CEO of PacifiCorp) the ôRefocus Programö was successful in improving PacifiCorpÆs financial performance, reorienting its corporate focus and implementing a cost reduction program with changes designed to improve customer service.

In that March 31, 1999 press release, (Exhibit ___ (RMA-__Exhibit7)), Chairman McKennon stated that the ôRefocus Programö had implemented an overhead cost reduction program designed to save the company $30 million annually in pre-tax operating costs. It stated that PacifiCorp had also restructured its customer service and other operation functions to better address ôcustomer needö as well as having divested a number of non-core businesses. Chairman McKennon stated that he was ôencouraged by the early results of the renewed focus on the western U.S. business and that the results mean even better service to our customerö.

In addition to the cost savings derived from the ôRefocus Programö, on May 11, 1999 PacifiCorp and its partners agreed to sell the 1,340 MW Centralia Washington power plant and its affiliated coalmine to TransAlta for $554 million. PacifiCorp had been the operator and 47.5% owner of the plant and 100% owner of the Centralia coal mine.

Q. HAVE THE APPLICANTS ADDRESSED ANY OF THE SPECIFICS OF THE ôREFOCUS PROGRAMö AND THE SUCCESSES OUTLINED BY CHAIRMAN McKENNON?

A. The ApplicantsÆ filing does not address any of the specific actions undertaken by PacifiCorp under the auspices of the ôRefocus Programö. More importantly, it does not separate out the expected $30 million of overhead cost reductions or the significant divestiture of non-core businesses.

Q. DOES THIS ADD UNCERTAINTY TO THE MEASUREMENT OF ANY BENEFITS OF THE MERGER?

A. Yes. The results of the ôRefocus Programö are just now beginning to materialize and should continue to unfold over a number of years. Attributing benefits to the merger as opposed to the ôRefocus Programö will be difficult. RatepayersCustomers will risk having to underwriteunderwriting ScottishPowerÆs transition programs when, in the absence of such actions, they wouldmight reap benefits from the ôRefocus Programö at no incremental cost.

4) PACIFICORPÆS OTHER PRE-MERGER RE-ENGINEERING

Q. ARE THERE ANY OTHER NEW PACIFICORP PROGRAMSOTHER THAN ôREFOCUSö THAT MAY IMPACT EFFICIENCY IN THE NEW FUTURE?

A. Yes there are. Although I do not have specific costs and benefits of these programs, I am aware that PacifiCorp has been developing a number of new programs aimed at improving efficiencies. Several of them--a new distribution service monitoring system, an SAP system that replaces most finance, work management, materials management and human relations computer systems as well as major consolidations of distribution dispatch and accounting--have been featured in PacifiCorpÆs corporate newsletter NetworkôNetwork,ö including distribution automation, system mapping a new SAP system and themapping, a new SAP system, consolidation of accounting functions as well asand distribution dispatch:

> ôInternet-based system helps pinpoint outages:...Last month, PacifiCorp went æliveÆ with a new Internet-based operation visualization system (OVS). It delivers to the computer screens of field managers, dispatchers and employees an advanced data display capability to show where service interruptions have occurred right down to individual customers...The OVS can take advantage of the nearly $10 million investment we have made to transforming all our paper distribution maps to digital versions...ö(May 4, 1998).

ôD2000+ removes mystery from outages:...D2000+ is up and running in Portland. It combines the best of available automation and computer technology into one complete system significantly improving response to customer outages and use of existing physical assets-power lines, transformers and substations. D-2000E is what we believe an electric utility would look like if it were built from scratch...Other utilities have implemented pieces of this technology, but weÆve tied them all together into one integrated system...ö (September 7, 1998).

ôAccounting consolidates/moves to Portland: All accounting functions throughout the company have been consolidated into the controllerÆs department. In addition...most employees in the accounting functions in Salt Lake City will be asked to relocate to Portland as part of a geographic consolidation. In æbenchmarkingÆ with other companies, it became clear that the most effective and efficient way to provide accounting services is through geographic and functional centralization. We will eliminate duplications that were occurring, reduce overall costs and improve business unit support.ö (February 16, 1998).

ôDistribution dispatch begins move to SCC: The consolidation of region and system dispatching into the Salt Lake Control Center (SCC) took a major step June 10, as distribution dispatchers moved from the Salt Lake Service Center to the SCC...ItÆs the first phase of a plan to combine three dispatch centers into one...The benefits of this consolidation include savings in operation and maintenance by combining three different computer systems into two located in SCC. Eventually, all the dispatching functions will be further consolidated to one computer system.ö (June 29, 1998).

ôBSIP software demo gets good reviews: Employees in Portland and Salt Lake City recently got a sneak preview of the horsepower of SAP, the software which the business systems integration project (BSIP) will install throughout the company beginning Sept. 1...SAP R/3 software will replace most finance, work management, materials management and human relations computer systems. Implementation will be completed company-wide by the end of 1999, and training begins in some areas this summer.ö (May 25, 1998).

Further elaboration on these programs maycan be found in Exhibit ___ (RMA-8__Exhibit 6).

Based on this sampling of PacifiCorp re-engineering programs, ScottishPower has failed to show that PacifiCorp is unable to provide efficiency improvements acting alone, in the absence of a merger.

IV. IV. RISK INCURRED BY RATEPAYERSCUSTOMER RISKS RESULTING FROM THE PROPOSED MERGER

A. 1) TRANSACTIONIDENTIFIED COSTS

Q. WHAT COSTS HAVE THE APPLICANTS IDENTIFIED AS NECESSARY TO COMPLETEIN CONNECTION WITH THE MERGER?

A. Two types of cost have been identified in the ApplicantsÆ filing. First are the transaction costs--costs incurred by the merging utilities in conducting studies and transactions necessary to complete the merger application. The second area of costs are transition costs--costs to ScottishPower of implementing the programs and guarantees they have promised.

1) TRANSACTION COSTS

Q. WHAT IS THE APPLICANTSÆ ESTIMATION OF TRANSACTION COSTS?

A. ScottishPower has indicated that the transaction costs for this merger could be as high as $250 million (ScottishPowerÆs response to Wyoming CAS Second Request Number 1). It acknowledged that ôFinalô[f]inal costs of the transaction are unknown at this stageö.

Q. HAS PACIFICORP INCURRED ANY TRANSACTION COSTS?

A. As of December 31, 1998, PacifiCorp had recorded $13 million in transaction costs, as identified in a response to an Oregon data request. (ApplicantsÆ Response to ICNU Data Request Number P1.38). It is not clear how much in additional transaction costs have been incurred by PacifiCorp in 1999. ScottishPowerÆs ôCircular to Shareholdersö for its June 15, 1999 shareholder meeting provides additional information on acquisition costs:

> ôIn connection with the Merger, the Combined Group will incur fees and expenses of approximately ú132 million (including stamp duty reserve tax) and the cost of redeeming PacifiCorp Preferred Stock of approximately ú15 million. Share issue costs of approximately ú65 million and the costs of redemption of PacifiCorp Preferred Stock of approximately ú15 million will be incurred by PacifiCorp. Other costs, totaling approximately ú68 million, relate principally to investment banking fees as well as legal, accounting and regulatory filing fees. These other costs have been taken into account in calculating goodwill in the Unaudited Pro Forma Statement of Net Assets. In total, these costs have been treated as resulting in additional debt of ú147 million.ö (page 62)

Q. HOW HAVE THESE COSTS BEEN RECORDED TO DATE?

A. ScottishPower and PacifiCorp transaction costs have been charged to account 426. (ApplicantsÆ Response to UDPU Data Request Number P4.2).

Q. HAVE THE APPLICANTS PROPOSED THAT THESE COSTS BE ABSORBED BY RATEPAYERS?CUSTOMERS?

A. No. The Applicants have indicatedA. Not yet. The Applicants have stated that account 426, is ôa below the line accountö.

Q. WILL RATEPAYERS BE SUBJECT TO ANYDOES THAT MEAN CUSTOMERS HAVE NO RISKS RELATING TO TRANSACTION COSTS?

A. No. The Applicants have A. That is not certain. The Applicants have indicatedwarned that they may attempt to recover transaction costs from ratepayerscustomers under certain circumstances:

> ôIn the interest and expectation of a relatively simple and expeditious approval process, PacifiCorp intended not to seek recovery of its transaction costs from customers. However to the extent parties seek to cause the proposed transaction to be viewed in the same manner as a more typical utility merger, PacifiCorp reserves the right to urge a different approach to transaction cost recovery.ö (ApplicantsÆ Response to UDPU Data Request Number P1.4).

Apparently the Applicants are holding in reserve the option of attempting to shift transaction cost recovery to ratepayerscustomers if intervenors or Commission staff attempt to add conditions to the merger approval.

Q. DO THESE LARGE TRANSACTION COSTS PLACE ADDITIONAL PRESSURE ON THE APPLICANTS TO PRODUCE COST SAVINGS?

A. Yes.

Q. ARE THERE OTHER SOURCES OF PRESSURE TO REDUCE COSTS THAT WILL RESULT FROM THE TRANSACTION?

A. Yes. It appears that a significant premium, of approximateestimated at times by some to be as high as $1.6 billion, could be paid by ScottishPower for the acquisition of PacifiCorp. This premium will exert additional pressure for significant cost reductions.The Commission should require Applicants to affirm that any acquisitions will be recovered ôbelow-the-lineö by stockholders and no attempts will bemade in the future to assess any of these costs to ratepayers.

Q. THE APPLICANTSÆ ACTION PLAN INCLUDES SIGNIFICANT COST REDUCTIONS, GREATER INVESTMENT IN FACILITIES AND A SUBSTANTIAL DIVIDEND RETURN TO COMPANY STOCKHOLDERS. TO WHAT EXTENT DOES THIS THREE PART ACTION PLAN PRESENT RISK TOCREATE RISK FOR PACIFICORPÆS RATEPAYERS?CUSTOMERS?

A. In order to meet all of the above goals, the Applicants must ensure that cost reductions are large enough to sustain both planned investments and stockholder dividend returns. To the extent the cost reductions fail to provide such substantial savings, the company may not be able to meet itsdual objectives.

Q. IF THE EFFICIENCY GAINS DO NOT PRODUCE THE KIND OF COST REDUCTIONS THAT SCOTTISHPOWER ANTICIPATES, WILL THAT IN TURN RESULT IN AN INCREASE IN RISK TO RATEPAYERS?INCREASED RISK TO CUSTOMERS?

A. Yes, particularly to the extent the dual objectives ofan aggressiveposture toward both investments and dividends are in conflict with each other. If the objectives remain in conflict, thereThere is a risk that necessary capital investments, maintenance and system improvements may not be undertaken, in order thatto meet the dividendobjective is met.

objective. If aggressive cost reduction programs place greater operational risks on the system, the ratepayerscustomers will be at risk of decreased reliability and higher long-term costs.

The Applicants have promised significant improvements in reliability. However, they will also face tremendous pressures to slash costs in dramatic ways. These pressures may well be inconsistent with the promised reliability enhancements. The result could be reduced reliability over time, despite ScottishPowerÆs intentions to the contrary. The applicants have pledged to meet certain performance standards. While these standards contain some basic commitments that may be a worthwhile first step, they do not go nearly far enough in protecting customers from reliability risks. Moreover, the ôguaranteeö payments to be paid to customers and the charitable contributions proposed for failure to meet certain commitments are wholly inadequate to protect Utah customers from the reliability risks. For example, the promised $100 ôguaranteeö payment to a commercial or industrial customer if power is not restored within 24 hours is hardly a guarantee and is wholly inadequate, particularly in light of the tremendous economic penalties that will be borne by the ApplicantsÆ customers if reliability in fact suffers over time. These consequences, along with potential after-the-fact consequences that might be imposed by the Commission if PacifiCorp allows unacceptable degradations in service or reliability, are hardly of comfort to customers whose businesses may have suffered significant economic losses.

In light of the tremendous cost-cutting pressures and other economic risks associated with the merger, the ApplicantsÆ customers are again being asked to bear the risks of the ApplicantsÆ promises. The risks to customers are simply not commensurate with any guaranteed benefits to customers.

2) TRANSITION COSTS

Q. WHAT LEVEL OF TRANSITION COSTS WILL BE NECESSARYDO THE APPLICANTS PROPOSE TO IMPLEMENT THEAPPLICANTSÆ PROPOSED MERGER?

A. The Applicants have indicatedidentified a number of programs or actions they intend to undertake once the merger is completed. The transition programs involve system performance standards, customer guarantees, environmental resources, community programs and educational commitment. The projected cost of the transition programs is $135 million.

Q. TO WHAT EXTENT ARE RATEPAYERSCUSTOMERS EXPOSED TO HIGHER RATES RESULTING FROMIF THE APPLICANTSÆ PROPOSED TRANSITION PROGRAMS FAILING TO CREATE SUBSTANTIAL COST SAVINGS?

ApplicantsÆ $135 million transition cost proposal is summarized in the previously referenced Exhibit ___ R(RMA__Exhibit-1). This isThat exhibit provides a categorical breakoutbreakdown of the costs that Applicants propose to include as ôabove the lineö, items that will be ratepayerlineö items--costs that they believe should be the responsibility of customers--as well as ôbelow the lineö at shareholder expense.costs that they offer at the shareholdersÆ expense.

Q. WITH REFERENCE TO EXHIBIT ___ (RMA-__EXHIBIT 1), WHAT IS THE BREAKOUT BETWEEN CAPITALIZED AND EXPENSED ITEMS, AS PRESENTEDITEMS PROPOSED BY SCOTTISHPOWER?

A. Exhibit ___ R(RMA-__Exhibit 1) illustrates that of the $135 million in proposed transition costs, $92 million will be in the form ofare proposed as capitalized expenses, with $43.2 million in the form of expensed items. The Applicants suggest that the ôbelow the lineö commitment of stockholders should be roughly $13.6 millionùabout 10% of the total merger transition cost. The Applicants suggest that $121.6 million--90% of the costs becosts--be absorbed by ratepayers.customers. The Applicants are thus basically ôbuyingöproposing to ôbuyö the purported benefits of the merger with ratepayercustomer money in an effort to make the transaction appear to be in the public interest.

Q. CAN YOU PROVIDE A MORE DETAILED BREAKDOWN OF THESE TRANSITION COSTS AND WHO WILL PAY FOR THEM?

A. Customer Guarantees:

Ratepayers:Customers: $14.1 million

Stockholders: $ 1.0 million

ScottishPower represents that the anticipated $1.0 million of non-performance penalties of its proposed Customer Guarantee program will be funded by stockholders ôbelow the lineö:

ôThe cost of payments to customers as a result of failure to meet customer guarantees will be borne by the companyÆs shareholders, not its customers, i.e. they will be recorded æbelow the lineÆ.ö (ApplicantsÆ Response to Utah DPU 8th Request S8.4).

The ApplicantsÆ proposal, however, is that ratepayerscustomers will pay more than $14 million to implement and operate it.the program. Exhibit ___ (RMA__Exhibit-1).

Performance Standards: Ratepayers:Customers: $41.5 million
Stockholders: $ 0

Exhibit ___ (
RMA-__Exhibit 1) also shows that ScottishPowerÆs proposed performance standards will cost ratepayerscustomers $41.5 million for additional network investment, implementation and operation. Under the ScottishPower proposal, there would be no ôbelow the lineö participation by stockholders in funding such programs. The proposal exposes ratepayerscustomers to a $41.5 million economic risk without any demonstration that such an expenditure will be cost effective.

TheAgain, the Applicants suggest spending millions of dollars of ratepayersÆcustomersÆ money gearing-up for programs that have not been shown to be necessary. Moreover, the proposed ôimprovementsö have not been requested by PacifiCorp ratepayers.customers.

Training: Ratepayers: $6.0 million
Stockholders: $ 0Customers: $6.0 million
Stockholders: $ 0

The Applicants suggest that training and open learning programs will cost ratepayerscustomers approximately $6 million, with no contributions made by stockholders.

Renewable Resources:
Ratepayers:Customers: $60.0 million
Stockholders: $ 0.1 million

The pledge that ScottishPower has made to develop 50 MW of renewable generation would cost the ratepayerscustomers $60 million with a $100,000 stockholder donation to the Bonneville Foundation. The ApplicantsÆ proposed 50 MW commitment to renewable generation is far beyond the resource needs as identified in PacifiCorpÆs RAMPP 5 report. The cost effectiveness of the proposal is thus unsubstantiated. In addition, the 50 MW ôcommitmentö had three ôstringsö attached to it in Oregon that Applicants failed to disclose in its WyomingUtah testimony (Richardson Oregon Direct, page 14, lines 14-16): As testified by Mr. Richardson in Oregon:

> ôPacifiCorp will develop an additional 50 MW of renewable resources...at an anticipated cost of approximately $60 million within five years after the approval of the transaction, on the following bases:
>
> - Extension of the system benefit charge and renewables incentive portion of the AFOR;
> - Increase in the Oregon AFOR cap on eligible renewable resources; and
> - Resources must pass the AFOR renewable resource cost-effectiveness standard.ö(Prefiled Oregon Direct Testimony of Alan Richardson, page 14, lines 14-21)

In the event the Oregon Public Utility Commission does not accept these additional constraints, the value of this renewable ôcommitmentö to the other states would be in doubt.

Q. PLEASE SUMMARIZE THE APPLICANTSÆ TRANSITION COST PROPOSAL.

A. Applicants propose a $135 million package of transition costs, where 90% of those costs will be charged to PacifiCorp ratepayers;customers:

Total $135 Package:

Ratepayers:Total $135 Package:

Customers: $121.6 million

Stockholders: $ 13.6 million

In addition, Applicants have publicly stated that they will file for a rate increase in Wyoming before the end of 1999.

Q. WILL RATEPAYERSCUSTOMERS BENEFIT FROM THIS $135 MILLION PACKAGE?

A. A. TheThat is not possible to predict at this point. The net benefits of the $135 million arepackage will only be as real as the cost saving/efficiency gainssavings, efficiency gains and needed reliability enhancements that ScottishPower is capable of creating.can create as a result. If the merged company has less of an efficiency window than ScottishPower officials currently believe, their ability to create cost savings of significant sizesufficient to offset the proposed $121 million rate commitment will be lessened. Under such a scenario, rates will be increasedscenario customers may suffer rate increases to pay for programs that were not necessary or of value to them. In any event, the promised ôbenefitsö would not be a ôresultö of the merger. Rather, customers are asked to buy the potential have not been subjected to a æneedsÆ test or, for that matter, have not even been found to be of value by customers. Ultimately, ratepayers will become inured to a program package they never stated as desirable.benefits with customer money and at customer risk.

Q. THE APPLICANTS CLAIM THAT THEIR CUSTOMER GUARANTEE AND SERVICE STANDARD PACKAGES REPRESENT A $55 MILLION PACKAGE OF BENEFITS TO THE CUSTOMERS. HOW WILL THE COST OF THESE PACKAGES BE PAID?

A. ScottishPower argues that the $55 million should not be viewed as incremental costs, but ôwill be achieved through efficiencies within the existing spending plans of PacifiCorp.ö (Utah Supplemental Testimony of Alan Richardson 4/16/99 at page 1, lines 18-21) The source and payment of these ôcostsö thus remain a mystery. If ScottishPower is Again ratepayers are requiredsimply reorganizing capital spending priorities or cutting capital budgets, such actions, if prudent, should be demanded of PacifiCorp in any event and they cannot be considered ôbenefitsö of the merger. Once again, customers are asked to ôpurchaseö theirbenefits through investments in efficiency programs. Moreover, ratepayerspurported benefits. Moreover, customers must rely upon only a promise that higher rates will not result from the investments. To the extent that the projected efficiency savings do not materialize, ratepayerscustomers are at risk.

Mr. Richardson has recently attempted to ôfinesseö the propriety of the $55 million package cost by claiming that it will not affect customers:

> ô...I must clarify that the estimated $55 million will not cause PacifiCorpÆs overall capital and revenue budgets to increase, as discussed in my Supplemental Testimony at 7-8. Rather, ScottishPower will seek other efficiencies in capital and operating expenditures, make investments which lead to operational efficiencies, and modify capital projects in PacifiCorpÆs existing budget. This refocusing of investment will not have an impact on the rates of Oregon customers.ö (Richardson Oregon Rebuttal, page 10, lines 18-23)

This reasoning, however, is not valid. Assuming that ScottishPower were to make the stated modifications to reduce expenditures, but did not spend the $55 million for service improvements, PacifiCorpÆs customers would enjoy the benefits of a rate decrease, other things being equal. No matter how the ApplicantsÆ spin the characterization of the $55 million service improvements budget, in reality those costs are incremental.

Q. HOW WOULD YOU SUMMARIZE THE OVERALL APPROACH OF APPLICANTS AS TO TRANSITION COSTS?

A. What has been placed on the table is $135 million in planned investments for transition related costs associated with this merger. Of the $135 million, almost 90% would be borne by ratepayers. There is no guaranteePacifiCorp proposes that 90% be borne by customers. There is no guarantee, and it has certainly not been demonstrated, that the investment can be repaid out of savings generated through efficiency measures. It is unlikely that such a magnitude of efficiency gains can be squeezed from the PacifiCorp system. If not, ratepayersCustomers will be asked to pay for the so-called benefits they are supposed to receive. Virtually all of the economic risk has thus been shifted to the ratepayer.customer. The only conclusion to be drawn is that there is a significant asymmetry in the allocation of risks and benefits of the proposed merger.

B. OTHER POTENTIAL RISKS

3) EXECUTIVE1) EXECUTIVE SEVERANCE PLAN

Q. PLEASE SUMMARIZE YOUR UNDERSTANDING OF THE PROXY STATEMENTÆS $7.0 MILLION ôPACIFICORP EXECUTIVE SEVERANCE PLANö AND INDICATE WHETHER THOSE COSTS ARE INCLUDED IN THE $135 MILLION OF TRANSITION COSTS THAT YOU HAVE BEEN DISCUSSING?

A. The May 6, 1999 PacifiCorp Proxy Statement describes the proposed ôExecutive Severance Planö as follows:

> ôThe PacifiCorp Executive Severance Plan (ôExecutive Planö) provides severance benefits to terminated executives, including enhanced change-in-control benefits in the event of certain terminations during the 24- month period following a qualifying transaction, including the consummation of the merger. Twenty-six PacifiCorp executives are entitled to severance pay under the Executive Plan...ö (PacifiCorp Proxy Statement, page 55).

To my knowledge, the Applicants have not designated those costs inidentified these costs as part of the $135 million transition program in any testimony, exhibits or data responses that I am aware. On the other hand, they have not indicated whether those costs wouldin transition costs and have not explained if they expect these costs to be ôabove-the-lineö costs charged to ratepayerscustomers or ôbelow-the-lineö costs absorbed by the stockholders. The release of the proxy statement followed the ApplicantsÆ direct and supplemental filings. We now have anAn additional $7 million of uncertainty in the proposed merger cost.is thus added to the potential merger costs.

2) BONUS AND RETENTION PLANS

Q. IN A SIMILAR VEIN, THE PROXY STATEMENT (PAGE 57) SETS FORTHALSO IDENTIFIES PAYMENTS TO PACIFICORPÆS DIRECTORS ANDA RETENTION AND BONUS INCENTIVES. PLEASE SUMMARIZE THESE PROGRAMS AND INDICATE WHETHER THESE COSTS ARE INCLUDED IN THE $135 MILLION.

A. The payments to PacifiCorpÆs directors are based on the following:

> ôNon-employee directors of PacifiCorp have been granted restricted stock under a non-employee directorsÆ stock compensation plan. Stock granted under this plan vests over the five-year plan following the grant or shorter period to retirement, and unvested shares are forfeited if the recipient ceases to be a director. PacifiCorp has agreed to pay each non-employee director $50,000 promptly following the date the directorÆs unvested shares are forfeited following the completion of the merger.ö (Proxy Statement, page 57).

The PacifiCorp ôRetention and Bonus Incentivesö are described in the Proxy Statement as follows:

> ôPacifiCorp has provided retention incentives to retain employees in key positions through completion of the mergeràTherefore, some executive officers of PacifiCorp may receive bonuses or retention incentive awards. (Proxy Statement, page 57).

To my knowledge, the Applicants have not quantified these costs nor have theycosts, have not designated them as components of the $135 million in any testimony, exhibits or data responses that I am aware. Theytransition costs and have not indicated whether these costs willthey should be ôabove-the-lineö costs charged to ratepayerscustomers or ôbelow-the-lineö costs absorbed by the stockholders. Again, the sudden appearance This, too, creates additional uncertainty and risk.

of these costs adds to the uncertainty of ratepayer risk.

Q. DO YOU HAVE ANY OTHER CONCERNS ABOUT THESE SEVERANCE, BONUS AND RETENTION PAYMENTS?

A. It appears that payments to some PacifiCorp officers could be substantial. The potential for these kinds of payments can create and distort incentives in a manner that is inconsistent with the best interests of customers--or even shareholders. The extent and magnitude of payments that may be made to various individuals if the merger is successful should be considered in evaluating the incentives and credibility of those individuals.

4)C. CONCLUSIONS REGARDING THE TRANSITION PROGRAMS

Q. THE APPLICANTS ARGUE THAT THEIR INABILITY TO QUANTIFY BENEFITS DOES NOT MEAN THAT THE RATEPAYERSCUSTOMERS WILL NOT BENEFIT AND THAT SAVINGS CAN BE CAPTURED IN TRADITIONAL RATEMAKING PROCEDURES. DO YOU AGREE WITH THIS CONTENTION?

A. Not necessarily. Under the traditional ratemaking process, regulatory lag is a reality. If one adds to theWhen the uncertain and illusive benefits that will purportedly result from the merger are added to normal complications of regulatory lag,the uncertain flow of the benefits purported to result from the merger, traditional rate proceedings will be cumbersome and inefficient.an inefficient means of capturing benefits.

Q. DO YOU BELIEVE THAT CUSTOMERS SHOULD RECEIVE SOME KIND OF GUARANTEE THAT THE BENEFITS OF THE PROPOSED EFFICIENCY MEASURES SHOULD BE LINKED TO A RATE REDUCTION OR RATE CAP?WILL MATERIALIZE?

A. Yes. If the merged company is confident enough to spend $135 million in transition investments, it is confident that it will realizeThe Applicants are asking the customers to bear significant risks associated with the merger based on their confidence that savings will ultimately result. The ApplicantsÆ actual level of confidence in the availability of substantial efficiency gains sufficient for it to commit to rate reductions or a rate cap.can be tested through specific rate reduction or rate cap commitments. An out of handreduction or rate capout-of-hand rejection of any rate guarantees suggests that the contemplated efficiencies areuncertain and unreliable and should notnot nearly as certain as the Applicants suggest. As such, they cannot be relied upon in gauging purported benefits of the merger. The Applicants have presented a case where thein which the claimed benefitsof the merger are highly uncertain and largely unprovable, either before or after the merger, and the economic the economic risk of ratepayers substantial. A rate cap or rate reduction guarantee provides the onlyrisks to customers are substantial. Rate guarantees could provide a means for equalizing risks and benefits of the merger.

V. OPPORTUNITY COST OF THE PROPOSED MERGER

Q. DOESWILL THIS MERGER PRODUCE THE TYPE OF BENEFITS RESULTING FROM SYNERGIES TYPICALLY PRESENT IN MOST MERGERS WOULD?TYPES OF SYNERGISTIC BENEFITS TYPICALLY ASSOCIATED WITH MERGERS?

A. No. ScottishPower admits that, because of the distance between the utilities and the lack of overlap in operating systems, there are few synergies between the two companies. Most mergers produce quantifiable economic benefits and significant synergistic effects to ratepayers.for the benefit of customers. The proposed merger with ScottishPower not only does not produce these kinds of synergistic benefits, it may very well preclude a future merger with anotherdomestic utility whichthat could produce these morekinds of traditional benefits.

ScottishPower goes toargues at considerable lengthto argue thatthere are no significant synergies so that it cannot guaranteewill result from the merger and that significant cost reductions beyond $10 million. The irony lies in this statement which suggeststhus cannot be guaranteed. Ironically, these arguments prove that ScottishPower is not a very good merger candidate.The fact that realReal synergies can produce quantifiable benefits isto customers, as demonstrated clearly byby several recent merger proposals betweeninvolving other utilities, such as Portland General Electric and Enron, Sierra Pacific Resources and Nevada Power, Western Resources and Kansas/Enron, Sierra Pacific

Resources/Nevada Power, Western Resources/Kansas City Power and Light, American Electric Power and CentralPower/Central SouthwestCorporation and Northern States Power andPower/ New Century Energies.

A. OTHER AREAS OF RISK

Q. ARE THERECOULD OTHER ASPECTS OF THIS MERGER BESIDES THE LACK OF SYNERGIESTHAT COULD RESULT IN FUTURE PROBLEMS FOR RATEPAYERSCUSTOMERS OF PACIFICORP?

A. Yes. ScottishPower has presented a corporate strategy to become an international multi-utility corporation. It has circulated among parties in this case a four-quadrant table (Exhibit ___ (RMA-__Exhibit 9)) demonstrating its transformation from a UK electric company to a multi-utility entity in the UK, its intention to move into an international position in the electricity industry, and its plan from there to become anventure into the international multi-utility industry. PacifiCorp will thus serve as a base or a platform from which ScottishPower can enactpursue its strategic goal of becoming a multi-utility provider in an international setting.

Observers of PacifiCorp have already witnessed the risks of attempting to become an international multi-utility. PacifiCorpÆs failed international efforts left it financially weakened, leading to a significant change of management and the need for the ôRefocus Programö to return it to its core business of serving theits existing customer base in the western states. Having spent less than a year refocusing on theits core business, this merger would send PacifiCorp back in the opposite direction by serving as the platform for multi-utility acquisitions. Whether PacifiCorp ratepayers shouldcustomers should again be subjected to risks inherent in these expansive strategic goals is highly questionable. PacifiCorp is once again at risk of losing its focus on its core electric utility operations to the detriment of ratepayers.customers.

1)In addition, the proposed merger will apparently be structured such that a holding company owned by ScottishPower will own all of the stock of PacifiCorp. As I understand it, in the future the holding company could be sold to another entity and could buy and sell other utilities without approval from this Commission. Moreover, it is far from clear to what extent this Commission may lose its current jurisdiction or control over intra-company transactions and cost allocations as a result of a holding company structure. The result may well be that this Commission could lose significant control that it can currently exercise over the dominant electric utility in this state and its parent.

B. INDUSTRY RESTRUCTURING

Q. ARE THERE OTHER ISSUES WITH THIS MERGER THAT HAVE LONG TERM IMPLICATIONS FOR RATEPAYERS THAT HAVE NOT BEEN BROUGHT OUTDO OTHER ISSUES ASSOCIATED WITH THIS MERGER HAVE POTENTIAL LONG-TERM IMPLICATIONS FOR CUSTOMERS THAT HAVE NOT BEEN ADEQUATELY EXPLAINED IN THE TESTIMONY OF THE APPLICANTS?

A. Yes. For example, ScottishPower and PacifiCorp have steadfastly refused to discuss issues relating to electric restructuring in this docket, but thatdocket. That silence is very troubling. Whatever oneÆs views of electric restructuring, it is indisputably an issue of major import to all ratepayers.Utah customers. While we do not know when or how the various State Legislatures or the U.S. Congress will enact laws to introducefacilitate industry restructuring, the fact that ScottishPower remains silent on the issue gives ratepayerscustomers absolutely no information as to whether ScottishPower wouldon ScottishPowerÆs intentions or positions. For example, we do not know whether it will support or oppose reasonable restructuring efforts, its views on how or when restructuring should take place, its position on stranded costs or its view on other vital issues. RatepayersCustomers are being asked to take on a new partner with whom we are to march forward into the future with almost no information about what this partner thinks regarding what is arguably the most important issue confronting the industry and ratepayerscustomers today.

VI. SCOTTISHPOWERÆS ACQUISITIONC. ACQUISITION STRATEGY

Q. DO OTHER ISSUES RELATING TO THE FILING REMAIN UNCLEAR

OR WITHOUT DISCUSSION ATINADEQUATELY DISCUSSED AT THIS TIME?

A. Yes. A May 1, 1998 research report on ScottishPower by HSBC Securities reviewed ScottishPowerÆs previous attempt at merging with Florida Progress, the holding company for Florida Power. In spite of the fact thatAlthough the merger was not consummated, the analysts reported that the strategy of ScottishPower in that acquisition would likely serve as a model for future attempted acquisitions of U.S. utilities. The strategy centered on the following three components: increase debt on the combined balance sheet of the two companies; issuance ofissuance of new equity; and divesting ofing of non-network assets (such as generation assets). The relevant section of that report has been attached at Exhibit ___ (RMA-__Exhibit 10).

Q. WHAT IS YOUR CONCLUSION REGARDING THE SCOTTISHPOWER ACQUISITION STRATEGY?

A. It is unclear at this time what that strategy entails. If the strategy is a replication of the one utilized in the attempt to acquire Florida Progress, the Applicants have not been forthright in their discussions of the issue.

1) FURTHER DIVESTITURES

Q. TO WHAT EXTENT IS THIS DIVESTITURETHE ôDIVESTITUREö STRATEGY LIKELY TO BE USED IN THE PACIFICORP MERGER?

A. It is unclear at this time. To the extent that ScottishPower hopes to offset the costs of the merger by divestingthe generation assets, or to the extent that ScottishPower wants to focus on the wires end of the business, divestiture may make sense.

Q. WOULD YOU OPPOSE SUCH DIVESTITURE?

A. Not necessarily. It might be a positive step for addressing market power issues. My concern, once again, is that we have inadequate information about the future intentions of ScottishPower. ScottishPowerÆs failure to provide sufficient information to understand and reconcile this very criticalthis important issue should concern both ratepayerscustomers and regulators alike.

2) UNSECURED DEBT INCREASE TO $5 BILLION

Q. HAS SCOTTISHPOWER ATTEMPTED TO INCREASE PACIFICORP DEBT, AS SUGGESTED BY THE ANALYSTÆS REPORT?

A. Yes. PacifiCorpÆs May 16, 1999 Proxy Statement requestsasks its preferred stockholders to authorize increasing the unsecured debt limit from $2.15 billion to $7.15 billion:

> ôReasons for the Unsecured Debt Consent. PacifiCorp is seeking the consent of the holders of the PacifiCorp preferred stock to issue up to $5 billion of unsecured indebtedness in addition to the amount permitted to be issued under the present unsecured debt limit. As of March 31, 1999, PacifiCorp had approximately $4.1 billion of indebtedness outstanding, of which approximately $1.2 billion was unsecured.
>
> As competition intensifies in the electric utility industry, as a result of regulatory, legislative and market developments, flexibility and cost structure will be even more crucial to success in the future... PacifiCorp believes that the unsecured debt consent is key to meeting the objectives of flexibility and favorable cost structure...ö (Proxy Statement, page 136).

Q. WAS THIS PROPOSAL INCLUDED IN APPLICANTSÆ FILING WITH THIS COMMISSION?

A. No, it was not. Mr. GreenÆs Exhibit__(RDG-2), the draft proxy statement, does not contain this proposal.

Q. IF APPROVED, WILLCOULD THIS SIGNIFICANT INCREASE IN UNSECURED DEBT SUBJECT PACIFICORPÆS RATEPAYERSCUSTOMERS TO ADDITIONAL RISK?

A. Yes, it would.Potentially. According to the Proxy Statement (page 136), at this time, PacifiCorp has total outstanding debt of $4.1 billion, of which, $1.2

billion is unsecured debt. ApplicantsÆ request to the Preferred Stockholders would provide a more than five-fold increase toin unsecured debt. I may have further comments on ApplicantsÆ proposal after I have reviewed this in more detail.

Q. IS IT TRUE THATHAS PACIFICORP WILLOFFERED TO PAY ITS PREFERRED STOCKHOLDERS TO VOTE TO INCREASE THEIN FAVOR OF THE INCREASED UNSECURED DEBT LIMIT BY $5.0 BILLION IN ADDITION TO APPROVING THE PROPOSEDAND APPROVAL OF THE MERGER?

A. Yes, it is a true statement.has. As provided in the Proxy Statement:

> ôSpecial Cash Payments: If, but only if, the merger is approved at the PacifiCorp annual meeting and all regulatory approvals for the merger required under the merger agreement have been obtained, PacifiCorp will make a special cash payment in the amount of $1.00 per share...to each holder of record of PacifiCorp preferred stock on the PacifiCorp record date that voted FOR the merger...
>
> In addition, if, but only if, the unsecured debt consent is approved, PacifiCorp will make a special cash payment in the amount of $1.00 per share...to each holder of PacifiCorp preferred stock on the PacifiCorp record date that voted FOR the unsecured debt consent.ö (Proxy Statement, pages 138-139).

Q. WILL SUCH PAYMENTS ADD TO THE COST OF THE MERGER?

A. Yes, they will.

3. FUTURE PACIFICORP LOANS TO SCOTTISHPOWER BUSINESSES3) INTRACOMPANY LOANS

Q. DOES THE APPLICANTSÆ AMENDED AGREEMENT AND PLAN OF

MERGER CONTEMPLATE ôINTRA-SCOTTISHPOWERö LOANS AMONG AND BETWEEN SCOTTISHPOWER BUSINESSES?

A. The filed amended agreement does not indicate any plannedwhether any loans are planned between PacifiCorp and ScottishPower.

Q. ARE YOU AWARE OF ANY EXISTING LOANS BETWEEN SCOTTISHPOWER BUSINESSES?

A. Yes, I am. Based upon Manweb plc.ManwebÆs monthly financial reports made available to me, I am awareshow that Manweb has consistently made ôloansö within the ScottishPower family with an average outstanding monthly balance of ú215.2 million for the April 1996 to March 1998 period (ApplicantsÆ Response to WIEC 2.3(a)). I do not have access to the necessary documents to ascertain the donors or benefactors of these intra-company loans.

Q. SHOULD PACIFICORP RATEPAYERSCUSTOMERS BE LOANING FUNDS TO OTHER SCOTTISHPOWER COMPANIES?

A. No. If it is ScottishPowerÆs intention to use PacifiCorp cash flow as a partial funding mechanism for activities undertaken elsewhere in the ScottishPower family of businesses, PacifiCorp ratepayers should be ôheld harmlessö forcustomers should be held harmless from any risks associated with such activities, including any foreign exchange risks. ScottishPower has made its intention to become an international multi-utility well known. To the extent that PacifiCorp ratepayers are beingcustomers are used as a funding mechanism for such actions, the economic risks to PacifiCorp ratepayerscustomers inherent in this proposed merger simply becomes greater.increases.

4) THE SCOTTISHPOWER æSPECIAL SHAREö

Q. MR. RICHARDSON REFERS TO THE SCOTTISHPOWER ôSPECIAL SHAREö HELD BY THE UK GOVERNMENT (UTAH SUPPLEMENTAL TESTIMONY, PAGE 18). WHAT IS YOUR UNDERSTANDING ABOUT THE SPECIAL SHARE?

A. The ôSpecial Shareö apparently acts as a kind of UK ôsafety netö to ensure that no company can acquire a controlling interest in ScottishPower without consent of the UK government. Moreover, it is not clear what standard the U.K. Government would apply in exercising its rights under the Special Share. The Special Share was described in the Proxy Statement as follows:

> The ScottishPower Special Share The U.K. Government (through the Secretary of State for Scotland) holds a special rights non-voting redeemable preference share, which is redeemable at par (ú1) only at the option of the Secretary of State for Scotland. The special share, which may only be held by the U.K. government, does not carry any rights to vote at general meetings, but does entitle the holder to receive notice of, attend and speak at general meetings. The articles specify matters, in particular the alteration of specified provisions of the articles including the provision relating to limitations which prevent a person from owning or having an interest in 15% or more of ScottishPower voting shares require the written consent of the holder of the special share. The U.K. government, as holder of the special share, does not have a right to appoint or nominate directors to the ScottishPower Board of Directors.
>
> If the holding company structure is adopted, the special share in ScottishPower will be cancelled and replaced by an equivalent special share in New ScottishPower, which will be issued to the Secretary of State for Scotland. The New ScottishPower special share will have the same rights as the special share in ScottishPower, together with additional consent rights specified in the articles, the

purpose of which will be to ensure that no persons other than New ScottishPower will be able to own or have an interest in more than 15% in aggregate of the ScottishPower voting shares without the Secretary of StateÆs consent.ö (PacifiCorp Proxy Statement, May 6, 1999, page 122)

Q. HOW MIGHT THE SPECIAL SHARE AFFECT FUTURE COST REDUCTION OPTIONS FOR PACIFICORP CUSTOMERS?

A. The ôSpecial Shareö could possibly prevent a future takeover of ScottishPower by a utility that could produce significant cost reductions.

V. CURRENT RISKS SURROUNDING SCOTTISHPOWERÆS OPERATIONS AND GLOBAL STRATEGY

Q. SCOTTISHPOWER HAS EMERGED IN THE UK AS AN AGGRESSIVE MULTI-UTILITYWHOSE INTENT IS TO MOVEON MOVING INTO THE GLOBAL MARKET. ARE THERE RISKS ASSOCIATED WITH SCOTTISHPOWERÆS STRATEGY?

A. There is aA multitude of risksthat have begun to be recognized by regulators and the financial community surrounding the actions and strategystrategies ScottishPower seems to be employing. Such risks can be categorized by the following breakdown;include the following:

- Risks associated with current UK operations
- Earnings risks of:
  - Manweb
  - Southern Water
  - ScottishPower Transmission
- Capital expenditure program risks
- UK industry restructuring
- US expansion plan risks

A review of UK regulatory information indicates that ScottishPowerÆs financial strength could well be on the downturn. The critical factor is that volatilityVolatility in ScottishPowerÆs UK earnings base could influence corporate decisions regarding PacifiCorp operations. Such a down swingA down-swing in the financial status of the UK operations, in light of ScottishPowerÆs focus on meeting stockholdersÆ dividend expectations, is likely to place additional pressure for cost reductions in the PacifiCorp system.

Q. YOU INDICATED THAT SCOTTISHPOWER IS LIKELY TO FACE NEW RISK TORISKS IN CONNECTION WITH ITS CURRENT EARNINGS. COULD YOU PLEASE EXPLAIN?

A. ScottishPowerÆs earnings could decline over the foreseeable future due to increased UK regulation mandating revenue reductions in a number of ScottishPowerÆs holdings.

In a Wyoming data response ScottishPower commented on this increased regulation in the UK:these UK regulatory changes:

> ô...priceô... [P]rice controls have become tighter at each review since privatization. In the case of generation, the allowed revenue from generation purchases for ScottishPowerÆs domestic and small business customers reduced by 24% in real terms from an indexed price established at privatization in 1990 to a market based price in 1997/98. All this is clear evidence of tighter regulation.ö (ScottishPowerÆs Response to WIEC 1.12(a)).

A May 21, 1999 news article characterized UK utilities at a ôstrategic crossroadsö:

> ôStrategy and regulation issues will be to the fore when British power and water companies kick off their year to March industry reporting season next week. The sector is racing to secure new income streams, as tightening regulation restricts core business growth. Analysts expect some casualties along the way...ö (ôUK Utilities at a Strategic Crossroadsö, Reuters, May 21, 1999)

ScottishPower recognizes the tightening of regulation, but believes the effects on earnings and consequent risk to stockholders and ratepayerscustomers may be ôminimizedö by operating more efficiently:

> ôSince privatization of the UK electricity industry in 1990-91, the group has experienced tightening regulation. Revised price controls governing the groupÆs electricity supply activities took effect from April 1, 1998 with a potential further review from April 1, 2000. Reviews of the price controls governing the groupÆs transmission activities, distribution activities and water business are underway and new price controls take effect from April 1, 2000. In addition, wide-ranging changes to the framework of regulatory and industry structure is under discussion as a result of HM GovernmentÆs Green Paper issued in 1998 and proposals by OFFER. Management believes that by operating efficient customer focused businesses regulatory risks are minimized.ö (ScottishPowerÆs 1998 SEC Form 20-F, page 6).

ScottishPower, however, has not explained or quantified these more efficient operations or how they will ôminimizeö increased regulatory risks. Whether ScottishPower can provide sustained earnings growth under a long-term scenario of tighter UK regulation is being carefully monitored by investors:

> ôScottishPower Under Pressure: ScottishPower finance director Ian Russell will be fending off questions about the effect of ever-tightening regulation on the utility giantÆs income as he unveils its preliminary annual results next Thursday...analysts will be looking for reassurance that ScottishPower can protect its revenues in the face of efforts by water, gas and electricity regulators to reduce prices for consumers...ö (Accountancy Age, April 29, 1999).

Q. ARE SIMILAR RISKS APPARENT IN SCOTTISHPOWERÆS OTHER OPERATING COMPANIES?

A. Yes. On November 3, 1998, one month prior to the announcement of the PacifiCorp acquisition, MoodyÆs Investor Service placed certain ScottishPower senior debt on review for possible downgrade because of the potential for a 20% rate reduction mandated by the UK water regulator (ôOFWATö) for ScottishPowerÆs Southern Water Company:

> ôMoodyÆs Investors Service Tuesday has placed the long-term senior debt ratings of Scottish Power plc (ôScottish Powerö rates Aa2) and its wholly-owned subsidiary Southern Water Services Limited (ôSouthern Waterö rated A1) on review for possible downgrade. The review is prompted by the prospect of significant reductions in regulated earnings, particularly at Southern Water, at a time when Scottish Power is considering international expansionà(ScottishPower PLC Put On Downgrade Review By MoodyÆs, Dow Jones Newswires, November 3, 1998).

ScottishPower has criticized and resisted OFWATÆS proposed price decrease. Recent media reports indicate that Southern Water and OFWAT are not close to resolving their differences:

> ôWater Groups Defy Price Cut Demand: Three of the UKÆs biggest water companies yesterday threw down the gauntlet in their battle with the water regulator, Ofwat, over the amount they can charge customers for the next five years. Only one, Thames Water, is proposing a cut in bills...
>
> ScottishPower, owner of Southern Water, brushed aside demands for a cut, proposing to raise bills 3.5 percent next year and 3 percent above inflation until 2005...The proposals are in stark contrast to demands for hefty price cuts from Ian Byatt, director-general of Ofwat, last October. In SouthernÆs case, he wanted a 17.5 percent price cut next

year.

Nigel Hawkins, utilities analyst at Williams de Broe, said: æThereÆs a gap between the proposals of Ofwat and Thames Water, but with ScottishPower itÆs more like a chasm.Æ (The Independent, April 10, 1999)

As reported in The Scotsman on April 10, 1999:

ôScottishPower was yesterday heading for a clash with the water regulator, Ian Byatt, countering his proposals for hefty price cuts at its Southern Water subsidiary with plans for a rise instead.

...Southern Water, bought by ScottishPower in 1996, has above average bills at an expected 273 in 1999-2000, against 245 across the UK, and was facing a 17.5 percent initial price cut.

But ScottishPower argued yesterday that Government plans announced last month to force the water industry to spend an extra 8 billion overall for 2000-2005 on environmental improvements would now land Southern Water with a bill for an extra 500 million on top of the 1 billion it had already earmarked.

...However, more heated negotiations between ScottishPower, the other water companies and the regulators are expected in the next few months. Mr. Byatt is due to publish revised proposals in July, with a final decision in November.ö (The Scotsman, April 10, 1999).

Q. ARE THEREDO SIMILAR REVENUE RISKS FACINGFACE MANWEB?

A. Yes. The Manweb operations are also confronting the prospect of new price controls which will restrict current revenue.revenue:

> ôManweb, Scottish PowerÆs Regional Electricity Co., also faces the possibility of significant tariff reductions. While the debt profile of the group-in the absence of any U.S. activity-is not expected to rise significantly, the pricing reviews will weaken cash flow from 2000 and impair debt protection measurements and financial flexibility.ö (ScottishPower PLC Put On Downgrade Review by MoodyÆs, Dow Jones Newswires, November 3, 1998).

OFFERÆs intends to publish its final price control proposals on November 1999.

Q. WHAT ABOUT THE CURRENT RATES SET ONFOR SCOTTISHPOWER TRANSMISSION?

A. A similar situation exists with the rate structure currently in place at ScottishPower transmission.Once again UK regulators are reviewing the current rate structure and will soon decide on new rates for the years 2000-2004. The decision by OFFER is expected in November of 1999.

Q. HAVE THESE INCREASES ININCREASED REVENUE RISKS RESULTED IN SCOTTISHPOWER REDUCING ITS CAPITAL INVESTMENT IN THE UK?

A. No. In fact, the opposite seems to be the case. ScottishPower has already obligated itself to fund significant UK capital improvements well into thefuture:

future. OFFERÆs February 1999 Business Plan Review indicates that ScottishPower is anticipating significant increases in capital spending in the future:

> ô...The companiesÆ projected, real increases in the average annual level of gross capital expenditures for the five years from April 2000 to the average during the six years preceding April 2000 are 19 percent for Scottish Hydro-

> Electric and 67 percent for ScottishPower.ö (ôReviews of Public Electricity Suppliers 1998-2000: Business Plans for Transmission Businesses in ScotlandùConsultation Paperö, February 1999, Section 1.20).

Q. HAS THIS INCREASING RISK TO REVENUE HAD ANY IMPACT ON SCOTTISHPOWERÆS GLOBAL STRATEGY?

A. Apparently so. MoodyÆs Investors Service has raised a concern that ScottishPowerÆs international expansion plans were primarily being used as an effort to prop-up its languishing earnings in the UK with the corresponding increase in financial risk:

> ôIn order to counter declining regulated earnings, the group has indicated it will pursue further business opportunities in the UK, as well as the possibility of a significant U.S. acquisition. MoodyÆs review will focus on the groupÆs appetite for increased financial risk in order to meet shareholder demands,ö the rating agency said.ö (ScottishPower PLC Put On Downgrade Review By MoodyÆs, Dow Jones Newswires, November 3, 1998).

UK investors have expressed similar concerns aboutthe amount of expansion in America and the ensuing risk:

> ôInvestors Fear Trend to Buy US Utilities: UK institutional investors have voiced concerns about a move by British utilities to buy their counterparts in the US. Complaints about the trend came a month after ScottishPower became the first non-US company to enter the...US electricity market with its...bid for PacifiCorp...ö (Financial Times, January 13, 1999).

Q. IT APPEARS THAT SCOTTISHPOWER HAS INCREASING RISKS OF REVENUE DECLINE IN ITS UK OPERATIONS, HAS SIMULTANEOUSLY COMMITTED TO MAJOR CAPITAL EXPENDITURES IN THE UK, AND NOW IS PURSUINGA GLOBAL EXPANSION THAT ENTAILS PAYINGINCLUDES PAYMENT OF A SUBSTANTIAL PREMIUM

FOR PACIFICORP? HOW IS THIS LIKELY TO AFFECT RATEPAYERSPACIFICORP. HOW COULD THIS AFFECT CUSTOMERS IN THE PACIFICORP SYSTEM?

A. The increasing risks to revenue that ScottishPower is fighting in its UK operations will result in additional pressure forthere to be major cost reductions and revenue increases throughout the PacifiCorp system. Only through such reductions will revenue flow inDramatic cost reductions could permit revenue to flow from the U.S. operations to help offset these growing financial risks. As discussed above, it is Whetherunclear whether such cost reductions are feasible is, as without declines in quality of service and reliability.

A. argued above, unlikely.

Q. YOU MENTIONED ABOVE THERE ARE PROPOSED POLICY CHANGES REGARDING INDUSTRY RESTRUCTING IN THE UK. HOW WILL THIS AFFECT SCOTTISHPOWER?

A. In 1998, HM Government issued a far-ranging ôGreen Paperö on electric utility industry restructuring, the effects of which are yet to be evaluated for ScottishPower. ôIt is not clear how these changes will impact ScottishPower.ö (ApplicantsÆ Response to WIEC Data Request 1.12(e)). However, the extent to which industry restructuring results in additional downward pressure on prices will require that ScottishPower adjust its operations to offset any potential loss in current revenue.

VII. ADDRESSING MERGER RELATED RISKS IN OTHER RECENT U.S. MERGERS

Q. THERE HAVE BEEN NUMEROUS PROPOSED AND ENACTEDSEVERAL ELECTRIC MERGERS IN THE U.S. DURING THE LAST FEW YEARS. HOW WERE THEHAVE MERGER-RELATED RISKS ADDRESSED IN THOSEBEEN ADDRESSED IN OTHER PROCEEDINGS?

A. There have been several mergers that have been conducted or that are currently proposed affectingA. Several mergers have been concluded or are currently being pursued among a number of U.S. electric companies. In every case, the merger hasmost cases, merger approvals have been conditioned ona set of commitments and conditions designed to protect ratepayer economic exposure. The following is a

highlight of thecustomers from exposure to risks. Following is a brief discussion of summary of several recent mergers and certain accompanying conditions.
conditions.

Sierra Pacific- Nevada Power (December 1998) û The Nevada Commission (Docket No. 98-7023) approved the merger but only after shifting the majority of economic risk to stockholders. The following language was adopted byincluded in the Commission order:

> ôThe Commission finds that the merger savings are estimates. Furthermore, when analyzed on a net present value basis, the Commission agrees with the UCA in that the benefit to cost ratios become uncomfortably low. à. Therefore, the Commission finds that the risk of actually realizing merger savings should be placed squarely on the Joint Applicants. (IIIA2).
>
> Given the uncertain benefits associated with this merger, the Commission finds that it is not appropriate to place on ratepayerscustomers the risk that they will have to pay for merger costs without receiving merger benefits. Utility management designed the transaction, arranged the terms and incurred the costs.ö(IIIB2).

American Electric Power û Central and South West Corporationû In the eleven statethis eleven-state merger, the companies have proposed a rate freeze until the year 2005.2005:

> ôThe merger will form the largest electric utility holding company in the United States, serving 4.6 million customers in the United States (11 states) and more than 4 million customers in the United Kingdom.ö (CSW Merger Update, parenthetical added).

As a result of the settlement negotiations, AEP has pledged to establish performance standards to maintain or improve customer service and system reliability, to apply to join a federally-approved regional transmission grid organization, and to keep its base rates unchanged until 2005.ö (Dow Jones Newswires, April 26, 1999).

ôThe Oklahoma Corporation Commission...signed a final order confirming its May 11 decision to approve the proposed merger...The final order also provides a partial settlement... Among the terms of the Oklahoma settlement, AEP and CSW have agreed to share net merger savings with customers of CSWÆs subsidiary Public Service Company of Oklahoma (PSO), as well as shareholders, effective with the merger closing; to not increase PSOÆs base rates above their current levels prior to Jan 1, 2003; to file to join a regional transmission organization by Dec. 31, 2001; and to implement additional quality-of-service standards for PSO.ö (PR Newswire, May 17, 1999)

Northern States Power û New Century Energies û Asimilar rate freeze is anticipated in Colorado.Colorado:

ôIf the deal is completed, the combined company would have 4.5 million electric and natural-gas customers in 12 states stretching from the Canadian to Mexican borders and revenue totaling $6.4 billion a year...ö (ôNorthern States Power, New Century Agree to Merge in $4 Billion Stock Dealö, The Wall Street Journal, March 26, 1999).

Colorado regulators say a similar rate cut could emerge from this deal. æWe will review this merger to make sure the ratepayerscustomers are not disadvantaged,Æ said Terry Bote, spokesman for the Colorado Public Utilities Commission. (ôMerger Energizes Utilityö, Rocky Mountain News, March 26, 1999).

Western Resources û Kansas City Power & Light û In its direct case, the Missouri Commission staff opposed the proposed merger. A four year rate moratorium was recently stipulated by the parties:

ôMissouri Public Service Commission staff have recommended against approval of a proposed merger involving Western Resources Inc. and Kansas City Power and Light Co. The Commission said in a statement issued Tuesday that staff had concluded in testimony that the merger in its present form is detrimental to the public interest and should be denied unless various conditions are accepted by the companies.

æThe CompaniesÆ proposed regulatory plan for rate treatment of merger costs and savings, if adopted, will lead to Missouri customers receiving very little or no rate benefitÆ, said staff account Mark Oligschlaeger in filed testimony.ö (ôMissouri PSC Staff Oppose W. Resources/KCPL Mergerö, Reuters, April 27, 1999).

A stipulation was recently announced between Western Resources and the Kansas Corporation Commission Staff. One of the proposed recommendations for settlement was:

ôThere will be an electric rate moratorium of four years beginning on the date the transaction closes.ö (Western Resources Press Release, May 6, 1999).

Q. IT WOULD APPEAR THAT EACHTHE MERGER APPROVAL ORDERS DISCUSSED ABOVE INVOLVES SOME FORM OF CONDITIONINGIMPOSED CONDITIONS AS A MEANS TO PROTECT RATEPAYERS INTEREST.CUSTOMERSÆ INTERESTS. DO YOU BELIEVE THAT SIMILAR CONDITIONINGCONDITIONS SHOULD BE APPLIEDORDERED IN THIS MERGER APPLICATION?

A. As detailed above, I do not believe that the transaction as currently proposed by the Applicants is in the public interest. The benefits are speculative and uncertain and the risks are substantial. At a minimum, I believe that a number ofIn my view, the proposed transaction cannot be considered in the public interest unless it is changed significantly, through mandatory or voluntary conditions would be necessary before a public interest finding could be made. A list of appropriateconditions, so as to effectively conditionsplace all of the risks of the merger on the ApplicantsÆ shareholders.

VIII. MERGER CONDITIONINGCONDITIONS

Q. WHAT TYPE OR FORM OF CONDITIONINGTYPES OR FORMS OF CONDITIONS WOULD YOU SUGGEST THIS COMMISSION CONSIDER FOR THISIF IT APPROVES THE MERGER?

A. I have not yet been able to develop, nor have I seen, a complete set of merger conditions that I believe would be adequate to minimize risks to PacifiCorpÆs customers. It is possible that an adequate set of conditions could be developed, but it would be complicated. If the Commission wishes to develop a set of conditions, a good starting point would be conditions imposed by UK regulators in connection with this and previous acquisitions by ScottishPower, conditions agreed to by or imposed on the Applicants in other states in connection with this proposed merger, and conditions utilized in connection with other recent mergers. Among the areas that should be covered by conditions are the following:

1. ScottishPower should be directed to convert any claimed ôefficienciesöforced to convert its claimed efficiencies and cost reductions into price stability or price reduction guarantees. A five yearfive-year period of such rate conditioningguarantees should be applied. This would berequired, consistent with the five-year benefit flow that the Applicants have suggestedassured us will result from

their actions.

2. ScottishPower should be required to adopt adequate "safety net" conditions to insulate the acquired companies from the parent. SimilarPacifiCorp from acts and risks of its parent and affiliates, including the requirementswere imposed in connection with the Southern Water acquisition.

1. 3. ScottishPower should be required to separate financings in order to ensure that investments are properly made for each of the acquired companies. Incompanies, including those required in ScottishPower's acquisitions such conditions were imposed.UK acquisitions.
2. 4. ScottishPower should be required to follow strict "arms-length transactions" criteria between the group companies. This is commonly referred to as ring fencing and is a requirement ofor among related companies, including "ring fence" conditions like those required by OFFER. ScottishPower should also be required to consent to continued jurisdiction and control by this Commission over affiliate transactions and cost allocations.
5. ScottishPower should be required to meet strict conditions before distributing dividends from PacifiCorp. The UK regulators have imposed such conditions:PacifiCorp dividends, including requirements imposed by UK regulators:

> "OFFER has proposed that, before recommending or declaring any dividend or other distribution, the directors of a PES should certify to the DGES that the licensee is in compliance with the ring-fencing conditions of its PES license and that payment of the dividend or making the distribution would not result, either alone or when taken together with any other reasonably foreseeable circumstance, in a breach of such conditions." (February 11, 1999, OFFER, "Modifications to Public Electricity Supply Licenses Following Takeover; Response to Consultation by the Office of Electricity Regulation", page 8).

X. CONCLUSIONS

Q. WHAT ARE YOUR CONCLUSIONS REGARDING THE APPLICATION FOR MERGER?

A. The ApplicantsÆ filing fails to show an affirmative case that the benefits of the proposed merger equal or exceed the economic cost to be incurred by ratepayers. The proposed transition program plan, a necessary and critical part of the ApplicantsÆ strategy, contains a $121.6 million commitment on behalf of ratepayers to underwrite approximately 90% of the program package costs. If such an investment is to be rate neutral, this $121.6 million dollar expense must be offset with an equal or greater value in operational savings. The extent to which this amount of efficiency gains can be realized in the PacifiCorp system is highly uncertain. The Applicants have based their argument that such costs savings do exist primarily on two observations; first, their experience in transforming Manweb and secondly, the ôhigh levelö benchmarking they employed to identify PacifiCorp as a merger candidate. The benchmarking exercise, I believe, produced results that are at best spurious if not misleading. By their own admission, the Applicants acknowledge that the benchmarking exercise cannot be used as a basis from which to design specific cost reduction efforts. Equally unfounded is the use of Manweb as their ômodelö for successful cost reductions to be undertaken at PacifiCorp. The starting point from which they will begin to seek efficiency gains at PacifiCorp is far different than the starting point they confronted at Manweb. As highlighted in my testimony, manpower reductions are limited at PacifiCorp compared to Manweb, reduction of duplicative services is also limited, and the redesign of customer service support facilities has already been undertaken through the ôRefocus Programö.

In essence, what the Applicants have placed on the table is a promise; a promise that they will seek to reduce cost at PacifiCorp if ratepayers are willing to invest $121 million. Beyond the promise there exists no plan of action and no affirmative showing that ratepayers have asked for such investments or are willing to pay for the investments. Instead, we are left with an asymmetrical benefit/cost equation, where the benefits to ratepayers remain uncertain and are incapable of being quantified while the costs imposed presents a well-defined economic risk.

In order that ratepayers are not unjustly exposed to the significant amount of economic risk this merger entails, the application should be denied. If the Commission should choose to approve the merger application, the approval should be conditioned according to those specific conditions outlined above. A key component of this conditioning should be a rate commitment on the part of the Applicants to provide either a rate cap or rate reduction effective at the time of the merger and to be in effective for five years. The Applicants have expressed the utmost confidence that they can deliver sizable cost savings over the next five years. Their commitment to such an objective should be matched by an equal commitment to ôhold harmlessö the ratepayers who will underwrite this adventure. 6. Stringent reliability conditions should be developed and imposed to ensure that PacifiCorp customers do not suffer degradations in quality of service or reliability as a result of the merger. Among other things, the consequences for failure to meet reliability requirements or guarantees should be commensurate with the potential economic harm to customers.

IX. CONCLUSION

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS ABOUT THE MERGER APPLICATION.

A. The ApplicantsÆ filing fails to establish an affirmative case of demonstrable benefits of the proposed merger that equal or exceed economic risks or costs to PacifiCorp customers.

Efforts to recover acquisition premiums, transition costs and transaction costs, to shore up uncertain U.K. returns and to fund significant shareholder dividends will create tremendous pressure to slash personnel, maintenance and operating budgets and other costs, resulting in significant risks of reduced quality of service and reliability degradations over time, with the potential for staggering economic damages to PacifiCorp customers.

Expenses necessary to implement the ApplicantsÆ proposed transition program include $121.6 million in customer commitments to underwrite approximately 90% of the program package costs. In order to be rate neutral, the $121.6 million in expenses must ultimately be offset by equal or greater operational savings. The extent to which this degree of efficiency gains are available in the PacifiCorp system is uncertain and unsubstantiated. Neither the ApplicantsÆ claimed experiences with Manweb nor their ôhigh levelö benchmarking analysis produces meaningful or quantifiable results that can be used to support a finding of merger benefits. In essence, the Applicants propose to try to reduce PacifiCorpÆs costs by investing $121 million in customer funds. Beyond that, there are no guarantees, commitments, plans of action or affirmative showings that the proposed investments are needed or desirable or will produce the anticipated savings.

The merger proposal produces an unfair and asymmetrical benefit/cost equation. Benefits to customers are highly uncertain, speculative and incapable of quantification. Customer risks are apparent. To avoid customer exposure to these risks, the application should be denied or significantly altered through voluntary or mandatory conditions designed to insulate customers from both rate and reliability risks. If the ApplicantsÆ shareholders desire to proceed with this merger despite the absence of demonstrable benefits to PacifiCorp customers, they and they alone should bear all significant risks of the merger. Customers should be held harmless. Meaningful rate/cost-reduction guarantees, financial assurances, reliability conditions and other meaningful protections should be required

Q. DOES THIS CONCLUDE YOUR TESTIMONY?
A. Yes.