

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)

SCOTTISH POWER

REBUTTAL TESTIMONY OF ANDREW MACRITCHIE

JULY 16, 1999

INTRODUCTION

- Q. Please state your name.
- A. My name is Andrew MacRitchie. I previously submitted direct testimony in this docket.
- Q. What is the purpose of your rebuttal testimony in this proceeding?
- A. My testimony is submitted in response to the testimony submitted by Bruce E. Biewald and Paul Chernick on behalf of the Committee of Consumer Services (CCS), Dr. Richard M. Anderson on behalf of the Large Customer Group (LCG), and Maurice Brubaker on behalf of the Utah Industrial Energy Consumers (UIEC).
- Q. Please summarize your testimony.
- A. Based upon our review of the referenced testimony, I will clarify and expand some points regarding the ScottishPower/PacifiCorp proposals contained within our direct testimony. In addressing these points, my testimony will:
- Introduce our commitment to provide our transition plan for transforming PacifiCorp. This transition plan will be supplied to the Commission within six months of closure of the merger, consistent with the recommendation of the Division of Public Utilities in its proposed condition 15. We believe that this commitment responds to CCS's, LCG's, and UIEC's concerns regarding the lack of specificity associated with the proposed cost savings likely to be realized in the future as a result of a transformed PacifiCorp.
- Address CCS's and UIEC's critique of the yardstick benchmark analysis.
- Respond to criticisms leveled by CCS, LCG, and UIEC concerning the relevance of our Manweb experience to this transaction.

TRANSITION PLAN AND FUTURE COST SAVINGS

Q. The testimonies of Mr. Biewald, Dr. Anderson, and Mr. Brubaker criticize the fact that ScottishPower cannot be more definite as to the magnitude and nature of the cost savings that will be forthcoming over time. Is this criticism valid?

A. No, I do not believe so. These testimonies seem to misunderstand the process by which ScottishPower successfully transforms utility businesses. As described in my direct testimony, ScottishPower starts with the development of a detailed transition plan. At both Manweb and Southern Water, the transition plan was formulated following consummation of the transaction by gaining in-depth knowledge of each company's practices.

Q. Can a transition plan be developed before the merger is completed?

A. No, it cannot. Production of a transition plan would involve significant "intervention" in PacifiCorp. This level of intervention would be inappropriate before consummation of the merger because it involves a significant amount of time and resources. It may therefore be counter-productive to ongoing operational performance. Furthermore, our experience shows that such a process works best once all players have the incentive to deliver on a common goal of improved operation and performance. This can only take place once all of the key players are part of the same organization, in other words, subsequent to the closure of the transaction.

Q. Would ScottishPower be willing to provide the Commission or other parties with this transition plan as a way of satisfying regulatory concerns regarding the lack of specificity with respect to future cost savings potential?

A. Yes, we would. No later than six months after the closing date of the merger, ScottishPower and PacifiCorp will file the merger transition plan with the Commission. This plan will include the anticipated time lines, actions anticipated necessary to

implement the merger and realize the proposed benefits (including expected cost savings), and the estimated associated capital and expense expenditures and anticipated workforce changes. This commitment is identical to the DPU's proposed condition 15.

Q. How will the Commission be able to identify cost savings that result from the merger?

A. PacifiCorp will continue to make its regular, semi-annual earnings reports to the Commission that will reflect savings in both corporate costs and operating costs. In this way, the cost savings attributable to ScottishPower's transformation of PacifiCorp will be identified for this Commission and reflected in the results of PacifiCorp's operation. For this reason, and for the additional reasons discussed in the rebuttal testimony of Alan Richardson, condition 14 proposed by the DPU is not necessary.

Q. Mr. Brubaker testifies that the Commission should hold hearings on the transition plan, and that final merger approval should follow Commission approval of the plan. (Brubaker, p. 52.) Please respond.

A. This is neither a necessary nor appropriate course of action. It is not necessary because ScottishPower's commitment to file its transition plan and regularly report its earnings, combined with the Commission's authority to set cost-based rates, provides assurance that the cost savings ScottishPower achieves can be reflected in rates. It is also not possible because the plan practically cannot be developed until after the transaction closes, for the reasons discussed above. Moreover, the transition plan is essentially a business decision, which is not appropriate to subject to the Commission approval process. The plan relates to how the business will be run, and ScottishPower and PacifiCorp have the experience to make these decisions. The Commission also needs to recognize that the transition plan could change as the company begins to implement it.

For all of these reasons, the Commission should not accept Mr. Brubaker's suggestion.

Having said that, it is of course in ScottishPower's interest to discuss the content of the transition plan with the Commission in order to gain support for its recommendations.

Q. Mr. MacRitchie, can you provide the Commission with an example of the process of developing a transition plan and the elements that are included in one?

A. Yes, I can. I have attached to this testimony as Exhibit SP __ (AM-1) a copy of a timeline for developing a transition plan. Included in this timeline are the major tasks that are undertaken to develop the transition plan and the activities that are necessary to begin to implement the plan.

Q. Please describe Exhibit SP __ (AM-1).

A. Exhibit SP __ (AM-1) shows the activities undertaken in developing a transition plan. The activities are segregated between those necessary to be undertaken at a high level to initiate plan development (Phase I) and those necessary to develop the detailed implementation plan (Phase II).

Q. Please describe the activities undertaken in Phase I.

A. The Phase I Activities are as follows:

1. Benchmarking

Once ScottishPower has full access to PacifiCorp information, one of the key initial activities will be to validate the benchmark information and put in place a benchmark framework that will evaluate, at a high level, the potential levels of performance improvement available within PacifiCorp. Key activities within this process will include: Production of a PacifiCorp benchmarking framework; Verification of PacifiCorp's current operational performance levels; Standardization of process and functional costs between PacifiCorp and ScottishPower

where appropriate; and

Establishment and quantification of internal and external benchmarks for PacifiCorp.

2. Transition Planning

The transition team planning will be the precursor to the implementation planning.

Building on the directional outputs of the PacifiCorp benchmarking exercises and ScottishPower's experience of transition planning from Manweb and Southern Water, this exercise will put in place a framework that will support the delivery of detailed implementation plans. This planning framework will include:

Agreement on combined PacifiCorp/ScottishPower transition teams and senior

management sponsors;

Timescales and accountabilities for final delivery;

Identification of key performance indicators, high level targets and format for

implementation plans; and

Identification of key high level enablers.

3. Organizational Review

This is primarily concerned with ensuring that there is an interim organizational structure in place that will ensure current PacifiCorp operations are maintained while the transition plans are developed. The tasks in this section are:

Undertake a strategic review of all PacifiCorp regulated and non-regulated operations;

Establish a post-merger interim management structure;

Define interim accountabilities for PacifiCorp operations; and

Develop an interim management control framework.

4. Communications Planning

A comprehensive communications plan will be developed that will manage the

communication to all relevant parties following the outcome of the high level organizational review and during the detailed implementation planning stage. The main audiences will consist of both internal and external parties including employees, unions, customers, shareholders, elected officials and regulators. Key communication areas will include:

The business rationale for change;
Interim management structure;
Overall transition and implementation plan timetables; and
Staffing changes.

Q. Please describe the activities undertaken in Phase II.

A. The activities in this Phase emphasize the development of detailed integration plans and associated enabling strategies.

Project teams consisting of individuals from both ScottishPower and PacifiCorp will be responsible for developing detailed functional and process plans that will deliver performance improvements and ensure delivery of the testimony commitments. Spanning across all activities will be a set of "enablers" that will need to be integrated into plans. These will include human resources, communications, technology, information systems and finance. The output of this process will be a consolidated implementation plan with efficiency targets, accountabilities and delivery dates.

Q. What role does Program Management play in the development of the transition plan?

A. Program Management is part of each phase of the planning process. It will involve a small team to facilitate and project manage the transition and integration planning process. Key activities will include:

Specification of the main tasks to deliver the transition plan;

Identification of key enablers and dependencies;

Identification of key milestones and accountabilities for delivery of the transition plan;

and

Tracking of progress against plan for management reporting purposes.

RESPONSE TO THE CRITIQUE OF THE SCOTTISHPOWER BENCHMARKING ANALYSIS

- Q. Mr. Biewald, Dr. Anderson, and Mr. Brubaker testify that ScottishPower's benchmarking study has "very limited" value in predicting the potential for cost savings in PacifiCorp's operations. (Biewald, p. 9; see also Anderson, p. 34; Brubaker, p. 20.) Please comment.
- A. As stated in my direct testimony, the benchmarking study was used as a directional tool by ScottishPower senior management to confirm at a high level that cost savings opportunities are available at PacifiCorp. These witnesses presume incorrectly that ScottishPower will continue to rely solely upon the benchmarking study to identify cost savings within PacifiCorp. Preliminary discussions that ScottishPower is currently undertaking with PacifiCorp indicate that real opportunities for cost savings exist, and these will be confirmed and developed as part of the transition planning process that will take place following closure.
- Q. In their testimony, Mr. Biewald and Dr. Anderson refer to reports purporting to show that PacifiCorp is one of the most efficient and lowest cost U.S. electric utility operators. (Biewald, pp. 10-11; Anderson, p. 33.). Please comment.
- A. These benchmark comparisons are fundamentally different from the yardstick analysis undertaken by ScottishPower. The studies mentioned above combine *all* of PacifiCorp's

costs, including production, on a per kWh or per MWh basis. Within any electric utility, production constitutes the largest cost element. ScottishPower would expect PacifiCorp to appear in a favorable position based on such comparisons, since PacifiCorp has low generation and purchase power costs and supplies or trades high volumes of electricity. Accordingly, ScottishPower deliberately focused on PacifiCorp's non-production costs. Moreover, ScottishPower's analysis of non-production costs confirmed that PacifiCorp is out of step with leading U.S. utilities in this area. ScottishPower's yardstick comparison of these costs is based on its experience in the U.K., as adopted by the U.K. regulator, that the closest correlation for unit cost comparison purposes is between customer numbers and operating costs.

- Q. CCS claims that ScottishPower has not fully accounted for efficiency programs PacifiCorp may undertake on its own. (Biewald, pp. 11-12.) How do you respond?
- A. ScottishPower has never stated that PacifiCorp is not capable of achieving savings on its own. What ScottishPower has stated is that it believes that PacifiCorp can achieve savings of a greater magnitude, faster, and with more certainty as a result of the combination with ScottishPower. Moreover, Mr. O'Brien has testified that PacifiCorp has no current plans for additional cost-savings initiatives.
- Q. LCG also claims that ScottishPower's benchmarking study does not count for the future effect of PacifiCorp's cost-reduction initiatives. (Anderson, pp. 34-35). What is your reaction to this assertion?
- A. Mr. Anderson refers to PacifiCorp's Refocus Program that is designed to save PacifiCorp \$30 million in costs annually. With regard to the \$30 million Refocus Program, ScottishPower is aware of these savings which we understand will be substantially delivered by the end of 1999. We therefore believe that the potential for double-counting

of the savings in the Refocus Program within the transition plan does not exist and, in any event, will be specifically excluded.

RELEVANCE OF THE MANWEB EXPERIENCE

- Q. Mr. Biewald, Dr. Anderson, and Mr. Brubaker all assert that ScottishPower's experience in transforming Manweb is of limited value in determining the level of cost savings that ScottishPower can be expected to achieve at PacifiCorp. (Biewald, pp. 14-16; Anderson, pp. 17-25; Brubaker, pp. 26-27.) Please comment.
- A. We have always been very clear that we will *not* use Manweb as a template for identifying potential savings that might be available in PacifiCorp. There are differences in operating conditions and historical factors, unique to both companies, that make accurate comparisons regarding either the amount or type of cost savings inappropriate. The point of my direct testimony, and that of Alan Richardson's Supplemental Testimony, is to demonstrate that our experience at Manweb confirms a proven track record of business transformation that delivers sustainable customer benefits. What we *will* draw from the Manweb model is the experience gained in how to manage and deliver successful change within a complex utility organization.
- Q. CCS suggests that PacifiCorp could hire some ScottishPower managers in lieu of completing the merger to obtain the same experience. (Chernick, p. 39). Does ScottishPower's ability to transfer its Manweb experience to PacifiCorp depend on utilizing the individuals who were involved in that transition?
- A. Not entirely. While ScottishPower does intend to draw upon the experience of several people, such as myself, who were involved in planning and executing the Manweb and Southern Water transformations, the relevance of ScottishPower's experience in transforming three U.K. companies goes much deeper. ScottishPower as a business has a

culture and philosophy that embodies the principles, values, and skills that are essential to effectively transforming a utility business. We intend to transfer this culture and philosophy to PacifiCorp to enable the management and workforce here to implement the successful practices about which I have testified. That is how PacifiCorp will be able to achieve both improvements in customer service and lower costs more quickly and with greater certainty as a result of the merger than it would as a standalone company.

- Q. These witnesses also attempt to draw some distinctions between the situation at Manweb in 1995 and that at PacifiCorp today. (Biewald, pp. 14-15; Anderson, pp. 22-26; Brubaker, pp. 26-27.) Are these distinctions valid?
- A. Although, naturally, Manweb in 1995 and PacifiCorp today do not present entirely identical circumstances, they are not as dissimilar as he testifies, for the reasons discussed below.
- Q. Mr. Biewald states that in 1995 the "distribution companies in the U.K. had been government organizations with well known inefficiencies, and were in the process of being privatized." (Biewald p. 14; see also Brubaker, pp. 26-27.) Is this statement accurate?
- A. No, it is not. Manweb was actually privatized in 1990. By the time ScottishPower acquired Manweb in 1995, Manweb had had the opportunity to reduce its costs, and indeed it had done so quite aggressively during the five-year period, within the context of the incentive-based U.K. regulatory framework. This framework is designed to reward efficiency so Manweb had every incentive to reduce its cost base during this time.

Q. Mr. Biewald also attempts to contrast geographic differences between the service territories of Manweb and PacifiCorp, stating "Manweb serves a fairly small and densely populated area in England while PacifiCorp serves a sprawling area . . ." (Biewald p.

14.) Are these distinctions accurate?

A. No, they are not. Manweb serves both densely populated urban areas, such as the City of Liverpool, and much more remote rural areas, such as parts of north Wales. Likewise, PacifiCorp's service territory includes both types of areas.

Q. Mr. Biewald testifies that ScottishPower's achievements at Manweb and ScottishPower in terms of price reductions are not superior to the results of other U.K. electric companies. (Biewald, pp. 15-17.) Please comment.

A. During the period in question, electricity rates in the U.K. were set under the price control mechanism dictated by the U.K. regulator. Manweb customers experienced similar reductions to the England and Wales average. We believe that, currently, our prices to consumers are extremely competitive. This is supported by the fact that ScottishPower and Manweb were two of the first four companies in the U.K. to open up their franchise markets to competition. Since the market opening in September 1998, we have lost just 5 percent of our franchise customers, all of whom have the opportunity to choose an alternative supplier if they are not content with either the price or the level of service offered by ScottishPower. In turn, these losses have been more than offset by the gain in customers ScottishPower has achieved in other parts of the U.K.

Q. Does this conclude your rebuttal testimony, Mr. MacRitchie?

A. Yes, it does.