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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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In the Matter of the Application of PACIFICORP and SCOTTISH POWER PLC for an Order Approving the Issuance of PACIFICORP Common Stock	)	**DOCKET NO. 98-2035-04** **UIEC'S POST HEARING BRIEF**

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The Utah Industrial Energy Consumers ("UIEC") hereby submit this post-hearing brief to summarize the evidence and assist the Public Service Commission ("Commission") in deciding the issues discussed herein.

I. INTRODUCTION

A. <u>Standard For Approval.</u>

Utah law provides:

> No public utility shall combine, merge nor consolidate with another public utility engaged in the same general line of business in this state, without the consent and approval of the Public Utilities Commission, which shall be granted only after investigation and hearing and finding that such proposed merger, consolidation or combination is in the public interest.

Utah Code Ann. § 54-4-28. The statute requires that the Commission find the merger is in the public interest before it grants permission to ScottishPower and PacifiCorp to consummate the merger. The Commission has correctly stated:

> [A]pplicants have the burden to show that the merger is in the public interest, meaning, given the approval standard, that it will produce net positive benefits. This means that <u>the record must show both the costs and the benefits</u> of the merger so we could determine whether, on balance, netting costs and benefits, the merger is or is not in the public interest.

Memorandum, March 31, 1999 at ¶ 4 (emphasis added). The UIEC contend that the benefits and costs have not been sufficiently identified to allow the Commission to find that the merger is in the public interest. The Commission should not approve the merger without clarifying the conditions in the proposed Stipulation and requiring additional conditions. Although the Stipulation reached with the Division of Public Utilities ("DPU") and the Committee of Consumer Services ("CCS"), Stipulation Exh. 1 ("Stipulation") is intended to mitigate the risks of the merger, the record demonstrates that a number of those mitigation measures may be difficult to construe and equally difficult to enforce. Unless certain protections contained in the Stipulation are strengthened, and unless a number of new conditions are imposed, the risk of harm as a result of the merger will outweigh the few tangible benefits. Conditions capturing the tax benefits, capping rates and extending special contracts are necessary for the transaction to be found in the public interest. The Commission also has the opportunity in this case to resolve two critically important issues related to restructuring. It should take advantage of that opportunity.

B. The Need for Structure.

The statutes and regulations under which the Commission operates do not expressly provide all of the tools that it needs to regulate in an evolving market or to deal with the issues raised by the unique nature of this proposed transaction. There is no provision in Utah, for example, that addresses the Commission's ability to regulate and obtain information from intermediate holding companies of utilities operating in this state. There is no provision that specifically allows the Commission to capture the tax benefit that a foreign corporation might realize from a domestic enterprise. To fill the apparent void, the Commission must invoke its authority to approve or disapprove mergers. Mr. Richardson testified that in the UK merger of ScottishPower, the regulatory body imposed conditions directly on the license of ScottishPower in order to steer the utility and to define is obligations.[1] Under Section 54-4-2 which authorizes the Commission to investigate the proposed merger, to hold hearings and to determine whether the merger is in the public interest, the Commission may impose conditions on the proposed merger of ScottishPower and PacifiCorp. Utah Code Ann. § 54-4-28; Report and Order, Docket No. 87-035-27 at 41, 103, 108. Like the UK

[1] Compare, for example, the requirement that UK regulator has imposed on ScottishPower to produce information, Cross Exh. 1 at 16, with paragraphs 11 and 12 of the Stipulation. See also Morris, Tr. 881-887(comparing the Stipulation with the clarity of the UK Regulator in prescribing prohibitions on the company's behavior). The UK conditions are much clearer and provide much more definite enforcement procedures. The UK Regulator also required that the conditions be accepted in writing, thus creating private law as a structure for enforcement on a going forward basis.

regulator, the Commission may use this proceeding to create a structure under which Utah's new electric utility must operate.

The Stipulation provides part of that structure. The Commission can provide the remainder by imposing additional, and in some cases different conditions on the merger as a means of more clearly defining utility rights and obligations. ScottishPower should be required to enter into a written agreement accepting those conditions before the Commission approve the merger. Thus, instead of having to resort to subsequent proceedings as a means of enforcing the general promises the companies are now making in the Stipulation, the Commission will have a clear and enforceable agreement that serves as the law of the case in future proceedings. The Division agrees that it is better to create structures now rather than try to control the utility through future enforcement proceedings. Alt, Tr. 99. The Commission should require ScottishPower to accept the conditions in writing to establish the law that is to govern the merged company going forward.

During the hearings, there was a great deal of debate about whether the Commission would have an opportunity to address the treatment of tax savings that are expected to result from the merger. The confusion surrounding that debate illustrates the reason that the Commission should impose conditions now. After it was discovered that tax savings exist, ScottishPower and PacifiCorp were quick to promise that the question of whether Utah customers would realize the benefit of the tax savings would be preserved for another case. Cross Exh 2; Larson, Wright, Tr. 93. Yet, ScottishPower's meaning of "preserved" was apparently different from everyone else's. ScottishPower was finally forced to admit that, although the tax issue would be preserved, the Company would assert every defense available to it in that future proceeding. It will contend the Commission does not have jurisdiction to decide the issue and challenge the Commission's ability to capture the value of those savings. Tr. 979. It will likely argue the Commission is acting arbitrarily, outside its authority, and in violation of its rights. It will appeal. It will be to ScottishPower's advantage to voraciously litigate every conceivable point to avoid crediting any tax benefit to Utah customers. Clear promises regarding the treatment of tax savings have not been made on the record in the case or in any other jurisdiction that has considered the ScottishPower/PacifiCorp merger. The UIEC agree that the amount of tax savings can await a future determination. The fact that such savings will be passed on to customers, however, should be decided in this case. To approach the issue in a future case may not only be inefficient but it may be futile if ScottishPower challenges the Commission's jurisdiction. Moreover, the rate payers will be left with the cost and risk of the litigation. The Commission can avoid all of that if it will create the law of this case through a contract with the merged company requiring it to account for upstream tax savings as a merger benefit.

This docket presents an opportunity for the Commission to guide the policies and activities of this new utility by requiring it to enter into a legally binding agreement to accept the Commission's conditions. In some instances, it may be the only method the Commission has to retain jurisdiction over issues that are important to the future of the electric industry in Utah.

II. NEITHER THE EVIDENCE NOR THE STIPULATION ESTABLISHES THAT THE MERGER IS IN THE PUBLIC INTEREST

A. <u>ScottishPower's Claims of Benefits Due to the Merger.</u>

The positive benefits that are outlined in the testimony in this case are that (1) there will be a 1.7% credit against future rates; (2) there will be new management; and (3) there will be some undetermined value in improving quality of service. See Wright, Tr. 39-51.[2] To be "merger-

[2] Mr. MacRitchie similarly described the benefits of the merger as: "Customer service improvements and guarantees, system performance improvements, environment and community commitments and training, greater Utah executive presence, financial stability brought about as being part of a larger group, and the $48 million merger credit." Tr. 919.

related," those purported benefits must be both due to the merger and incremental to the benefits that PacifiCorp could have achieved on its own. Any such merger-related benefit also must be measured against the risks that are likely to accompany the transaction.

Rate Credit. Scottish Power's claim of a net benefit due to the merger primarily relies on projections of expected costs of operating the company between the years 1999 and 2003. The magnitude of those estimated savings is unknown.[3] As a result of discussions with the Division and Committee, ScottishPower has offered a 1.7% rate credit it claims will tip the balance of the transaction to a net benefit. That rate credit is largely illusory. While the credit amounts to $12 million annually for four years, PacifiCorp has also promised it will soon seek a rate increase of $100 million. Larsen, Tr. 430. The UIEC do not see an $88 million net rate increase as a positive benefit. In addition, although the amount increased to $12 million annually, that amount is no longer a "guaranteed" credit. Stipulation, ¶ 43. In ScottishPower's mind, the $12 million dollar credit is not only subject to offset by a rate increase, but, after the second year, it is offset by the Company's level of savings. Tr. at 980-82. After the merger credit runs out, there is no commitment to cost savings whatsoever. Id. Tr. 982, L. 8-10.

In addition to the uncertainty about the amount of the benefit, there is serious question as to whether the cost savings promised by ScottishPower would exceed those that PacifiCorp could have achieved on its own through proper management. At hearing, evidence was presented comparing PacifiCorp's projected costs absent the merger with ScottishPower's projected costs after the merger. Tr. 1268-71; Cross Exam. Proprietary Exh. 23. When the total projected costs of one company was compared with total project costs of the other, it appeared that ScottishPower's costs

[3] ScottishPower initially estimated the savings at $10 million annually. Wright, Tr. 40.

exceeded PacifiCorp's costs in both the conservative and optimistic cases for every year between 1999 and 2003. Tr. 1270-71. Although ScottishPower witnesses criticized the nature of the comparison, their criticism in that regard purports to rely solely on data that, according to ScottishPower, had been destroyed, were not compiled or were unduly burdensome to retrieve. Tr. 1476-77; 1480. In view of the PacifiCorp projections, it does not clearly appear from the record that ScottishPower will be able to achieve any greater cost savings than PacifiCorp could have.

ScottishPower claims its "transition plan" will consist of a great number of individual initiatives, which on the whole will give a net benefit." Wright, Tr. at 118, L. 14-17.[4] Unfortunately, the Commission has not received the transition plan. ScottishPower says it does not even have a draft of the plan and that the Commission will not see one for six months. Wright, Tr. 287, L. 10-18.[5] This is surprising in view of ScottishPower's testimony that the transition plan for Manweb was completed in three months.[6] Worse still, ScottishPower maintains that when it finally files the transition plan, the Commission will have not authority to approve or disapprove of it. Stipulation, ¶ 13; Wright, Tr. 193-194. Under the circumstances, the Commission would be prudent to delay final approval of the merger until the transition plan is filed and approved. Alternatively, if it chooses to allow ScottishPower to take control of Utah's electric utility now, the Commission should require approval of the transition plan, clarify the Stipulation accordingly, and impose strict conditions that will ensure the rate payers receive the promised benefits and suffer no harm.

New Management. ScottishPower claims that one of the benefits of merger is its

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[4] ScottishPower is inconsistent in its testimony about whether the transition plan is necessary to achieve a "net benefit." Mr. Wright apparently contended that it was, Tr. at 118, Mr. MacRitchie contended that it was not. See MacRitchie, Tr. at 919. (transition plan is "icing on the cake.").

[5] It is hard to imagine how ScottishPower can be so confident that the transition plan will yield the benefits claimed, since Mr. Wright testified that the plan is still in "very preliminary stages." Tr. 384, line 22.

[6] The Manweb transaction was a hostile takeover and ScottishPower did not have access to books and records of the operating company like it does in the transaction with PacifiCorp. MacRitchie, Tr. 928-930.

management expertise. It can offer no evidence to support this contention, only that it claims that it's management has been effective in achieving cost savings for utilities in the United Kingdom. E.g., Wright, Tr. 287. To this point, ScottishPower has been unable to provide any detailed description of how financial operations might be revised to achieve any savings. ScottishPower is simply asking the Commission to put its faith in ScottishPower's new management to provide a net benefit. At the same time, it is unwilling to concede that if new management causes costs to increase, those costs would be as a result of the merger. Wright, Tr. 493-496. There is insufficient evidence on the record for the Commission to decide that the benefit of new management outweighs the risks. Moreover, the programs that new management may bring should be weighed against the burdens on regulation that are suggested by new management's attitudes about restructuring and information management. Finally, assuming new management could be effective in reducing costs or providing other benefits, there is no indication that it will create any benefit that PacifiCorp could not have created on its own.

Quality of Service. ScottishPower has claimed that it will improve the service quality of the company and has proposed a number of service quality standards. No one seems to disagree that better customer service would be a boon to rate payers and that standards may be of assistance in assuring quality. There is no reason, however, that PacifiCorp could not be held to the same service quality standards. The Commission has the authority to require public utilities to construct and maintain adequate facilities and the authority to promulgate rules establishing standards for quality of service. Utah Code Ann. § 54-4-8; 54-4-1. It is difficult to see how the rate payers obtain any net benefit through ScottishPower's offer to attain certain service quality standards when either PacifiCorp or ScottishPower could be compelled by law to meet the same standards.

The testimony shows that the significant deterioration of the quality of customer service available from PacifiCorp has been due, at least in part, to its absentee ownership. Gardner, Tr. 1121-22. The testimony on public witness day was that when PacifiCorp's center of management moved to Portland, service declined. Id. While ScottishPower would like Utahns to believe that management from Scotland is going to be better than management from Portland, it seems intuitively wrong to conclude that absentee management gets better when it gets farther away.

ScottishPower has been quick to make broad promises about better customer service. Yet, it has been unwilling to say that any customer would see a reduction in the number or duration of outages due to its alleged service quality improvements. MacLaren, Tr. 826-27. It has also been unwilling to back up any of its service quality promises with its balance sheet as it does in the UK.[7] Instead, ScottishPower will hide behind the tariff's limitations on liability when it fails to meet service standards. Stipulation, ¶ 27; Alt, Tr. 301-03. The Commission should discount ScottishPower's promises of improved quality of service in weighing the benefits and risks of this merger.

Benefits to Shareholders and Management. This proposed merger is a very rich transaction. The shareholders of PacifiCorp will get approximately $1.6 billion over market value.[8] Richardson, Tr. 608. Twenty-seven PacifiCorp managers are eligible for $20 million in severance benefits. The lawyers and the consultants were paid $250 million as "transaction costs," including $36 million to Morgan Stanley and $25 million to Salomon Smith Barney. Richardson, Tr. 618-19; O'Brien, Tr. 697-99. ScottishPower proposes to give the rate payers only a $12 million credit per year for four years with the last two years subject to offset. Without additional conditions, that credit

[7] Mr. Wright testified that there are no limits on the Company's liability for an outage in the UK when caused by the Company's negligence. Tr. 302, L. 5-6. Mr. MacLaren testified that there is a $1 million pound liability limit for negligence. Tr. 303, L. 12-19.

[8] While that amount may fluctuate with stock prices, the estimated value of this transaction is $1.6 billion over market. Tr. 609, l. 5-11.

will quickly evaporate if the company is able to win the rate increase it has promised to seek. The net benefit of this transaction goes to the shareholders, management and consultants, not to the rate payers.

B. <u>Any Potential Benefit of The Merger Must Be Weighed Against the Burden That It Will Place on the Regulatory Process.</u>

The benefits that can be identified as a result of the merger must be weighed against the risks of potential harm from the merger. The merger will exert pressure to cut costs creating a risk of deterioration of service quality. Anderson, Tr. 1227; Alt, Tr. 16. If the alleged cost savings do not materialize, the merger will put upward pressure on rates. There is a real risk that ScottishPower will not be able to achieve the cost savings that it hopes to achieve. The Commission should also recognize the substantial risk that change of control from PacifiCorp to ScottishPower will impose on regulators due to the attitudes of new management. Neither the Division, the Committee or the Commission has any experience dealing with ScottishPower management prior to this case. If this proceeding is any indication of the manner in which ScottishPower approaches the regulatory process, there is cause for concern.

Never in all the years that the UIEC have participated in proceedings before the Commission has there been such an abundance of information classified as confidential. The hearings were a discouraging preview of ScottishPower's information management policy. Its attitude about restricting the availability of information created a problem for the parties and an inconvenience for regulators. The Division did not have ready access to certain important documents. Alt, Tr. 83-84. Consequently, it became aware of the potential tax savings and the magnitude of the tax savings just days before hearings began. Alt, Tr. 282. The Division did not have adequate time to analyze the effect of the tax savings or whether it should be considered a "merger benefit". Id. Alt, Tr. 370.

For the same reason, the Division did not make the comparison between PacifiCorp's projected costs and ScottishPower's projected costs. The necessary information could only have been discovered by personally visiting the offices of counsel for both ScottishPower and PacifiCorp. Parties were not allowed to make copies of the documents. Incredibly, neither ScottishPower nor PacifiCorp could have made the comparison because neither had access to the confidential documents of the other.

Further evidence of the information deficit created by ScottishPower is its refusal to produce even a preliminary transition plan until six months after the merger is consummated. Wright, Tr. 384-89. It is hard to imagine any company paying $3.6 billion for an asset without having even as much as a preliminary plan on how to operate the acquisition. Nevertheless, ScottishPower has chosen to keep the Commission and the parties in the dark. As a result, we do not have the information to determine whether ScottishPower "as utility managers [have] the competence to take the business forward." Wright, Tr. 388, L. 13-16.

The burden on regulators and intervenors due to ScottishPower's information management policy was evident in the difficulties with which this proceeding was conducted and from the fact the Division did not find the tax issue and cost comparison until the last minute.[9] There is no reason to think that, if the merger is approved, ScottishPower will ever be forthcoming with adequate information for intervenors to study or for regulators to perform their duty.

In this climate of information deficit, ScottishPower was able to reach a Stipulation that put the Division and Committee in the position of defending at hearing an agreement that

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[9] See also, Tr. at 968-970, and again at 1475-1481 suggesting ScottishPower failed to produce certain information in response to UIEC data request.

ultimately appears to be of questionable value in protecting some important rate-payers interests. Two of the great evils of regulation in the minds of most classical economists are that the regulators get imperfect information and, that regulators may be "captured" or co-opted by those they regulate. Regulation becomes ineffective if either situation is present. See, e.g., BONBRIGHT, JAMES C., *Principles of Public Utility Rates*, 1988 ed. at pp. 560-61. In this case, the merger proceedings suffered from both evils.

The UIEC urge the Commission to consider the burden that is likely to fall upon regulators if this merger is approved. It should weigh heavily against any purported benefit. If the Commission approves the merger, it should be clear about imposing conditions that will ensure the cooperation of ScottishPower and obviate information deficiencies in future proceedings.

III. THE STIPULATION DOES NOT PROVIDE ADEQUATE ASSURANCES THAT THE MERGER WILL BE IN THE PUBLIC INTEREST.

The UIEC support most of the conditions in the Stipulation reached between the Division, the Committee, ScottishPower and PacifiCorp. The UIEC commend the parties for disposing of a number of issues in a fair and reasonable way. Nevertheless, although it may increase the likelihood, the Stipulation does not ensure that the merger will be in the public interest. The Commission should require a more definite statement of certain conditions that are now in the Stipulation, and it should require additional conditions to ensure that the public interest has been met.

A. PSC Not Bound to Accept the Stipulation

ScottishPower and PacifiCorp mistakenly assume that a showing of a net benefit, however small, wins them the right to merge. There is no such right to merge. The Commission must decide not only whether the merger offers a net benefit now, but also whether the transfer of control of Utah's largest electric utility to the new entity will be in the public interest in the years to come. Utah Code Ann. § 54-4-28; 54-3-1 (the Commission has continuing duty to see that rates, charges and services are just and reasonable). The Commission must take the long view to ensure that when we turn the keys of the car over to the teenage driver, we know where he's going and when he'll be back.

The Commission is not bound by the stipulations of some of the parties in this case. It may accept or reject those stipulations as it deems appropriate, consistent with its statutory duty. As discussed above, if the Commission approves the merger on the basis of the agreements concerning future behavior, the merged company will be bound by the conditions contained in them. If the Commission determines that the merger will only be in the public interest if conditions are imposed in addition to the conditions in the stipulations, ScottishPower and PacifiCorp will have to accept those additional conditions before they receive approval to merge. [10] If they accept the conditions and consummate the merger, the contract is made, the behavior is directed, and future litigation may be avoided.

Some of the provisions in the Stipulation, lack the clarity necessary to provide the structure for future enforcement. In addition, there are certain essential conditions that have not been included in the Stipulation. As discussed above, at the time the Stipulation was signed, neither the Division nor the Committee had information about the tax savings taxes or the comparison between ScottishPower and PacifiCorp's forecasted savings. While the UIEC recognize that those parties are bound by good faith to support the Stipulation, and that appears to be the reason why the Division and Committee witnesses both stated they would support it, nonetheless the Division and Committee

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[10] See Report and Order, Docket No. 87-035-27 at 41, 103, 108 (approval of UP&L/PacifiCorp merger upon stipulated conditions, other conditions imposed by the Commission, and voluntary acceptance of such conditions by applicants).

appear to have no objection to additional conditions. Tr. 96-98.

B. The Stipulation Contains Ambiguities Left to be Resolved in Future Cases and Thus Increases the Regulatory Burden.

The merger should not be approved on the basis of the Stipulation alone. As discussed above, it fails to consider the tax savings and the uncertainty of future cost trends under new management. Under the Stipulation, ScottishPower will not pass on the tax benefits, and may significantly over earn without action by the Commission. Moreover, ScottishPower may seek higher rates while earning excessive return at the parent level unless the tax savings are not captured for rate payers.

In addition to the obvious omissions, the Commission may find it very difficult to implement the Stipulation. ScottishPower and PacifiCorp and the Division and Committee could not agree on the meaning of a number of its provisions. They could not agree, for example, whether, under paragraph 9 of the Stipulation, Commission notification and approval would be required if the Company placed transmission, distribution, generation or its coal mining operations into a separate subsidiary (see discussion at Tr. 171-179.) Likewise, paragraphs 10 and 11 of the Stipulation create the potential for an on-going battle over the obligation of the merged company to provide information to regulators, inviting ScottishPower to challenge any such request and failing to provide penalties when it withholds information or fails to timely produce it. Stipulation, ¶¶ 10-11; Tr. 190-91. It was also unclear, for example, whether the parties to the Stipulation intended paragraph 14 to preclude loans from PacifiCorp upstream to ScottishPower. Tr. 224. Paragraph 13 requiring the filing of the transition plan will be an endless service of controversy. There is disagreement as to whether the Commission must approve the plan, whether the Commission will have any input on the benchmark that ScottishPower declares as the baseline for determining savings as a result of the merger, or whether the Division has a right to audit the amount of merger savings claimed. Tr. 194-202; 209-12.

Even when conditions in the Stipulation are apparently simple and clear, they might not supply an adequate structure for future decisions. The Stipulation states that there will be "no rate increases as a result of the merger." Stipulation Exh. 1, ¶ 44. While it sounds simple, the Commission will have to hear evidence and argument about every cost or action claimed to result in an increase or savings and decide whether it was "a result of the merger."[11] It will be a bone of contention, for example, whether the refocus plan projecting a $30 million cost reduction and its related program of seeking rate increases in each of the regulated jurisdictions, occurred as a result of the merger.[12]

The Commission should not let itself be thrown into the dilemma of forever having to wonder about whether future costs or savings are a result of the merger. The Stipulation bequeaths a regulatory nightmare by leaving essential details to be litigated ad infinitum in the midst of a serious information deficit. The Commission will have the enormous task of discerning and implementing the intention of the Stipulation by taking evidence and making decisions about every

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[11] ScottishPower witnesses state that ScottishPower intends to set the "benchmark" for merger costs and savings in its Transition Plan that will not be subject to review. **].** Thus, it apparently expects regulators to take its word for what is a merger cost or saving and what is not.

[12] PacifiCorp contends savings from the refocus plan and the accompanying petitions to raise rates will not be "as a result of the merger." Larsen, Tr. 53, 203. PacifiCorp is likely to argue in a future rate case that it was just coincidental that it was developing its western strategy plan to increase rates and seek a higher rate of return in the respective jurisdictions at the same time it was having discussions with Scottish Power. On the other hand, it would appear that these things might have been done to make PacifiCorp a more attractive candidate for ScottishPower's overtures. PacifiCorp divested its international business so it would not have conflicts with Scottish Power's international business. It filed applications or threatened to file applications to drive its revenue to rate of return so it could enhance its stock price. These actions demonstrate the same pattern of behavior that any rational company would have followed if it were contemplating a transaction exactly like the proposed merger. There are a number of paragraphs in the proxy statement where it is described, day-by-day, these activities of PacifiCorp and the simultaneous negotiations with ScottishPower. <u>See</u> Cross-Exh. 4 at 31-32 (describing that on October 23, 1998, PacifiCorp completed its strategic review and was refocusing its electricity business in the U.S. while, on the same day, ScottishPower reported to its board on the status of ongoing discussions with PacifiCorp).

point that is not specifically addressed. The Commission can avoid the future regulatory burden by using this opportunity to create the rules for going forward.

IV. THE COMMISSION SHOULD APPROVE THE MERGER ONLY IF SCOTTISHPOWER AGREES TO CERTAIN ADDITIONAL CONDITIONS.

The Commission should not accept the Stipulation and allow the merger to be consummated unless it imposes additional conditions that clarify the obligations of ScottishPower, captures the benefits of the merger for rate payers, and further protects customers against the risks of this transaction. The UIEC propose six additional conditions: (1) rate payers should be entitled to the tax benefits to be realized; (2) rates should be capped at a reasonable level through the transition period; (3) special contracts should be extended through the transition period; (4) intervenors, customers and regulators must have access to essential information in the possession of ScottishPower or its affiliates; (5) the merged company should waive any future claim for stranded costs; and (6) ScottishPower should present a plan to the Commission for formation of a regional transmission group within a time certain, and should acknowledge the Commission's authority to compel it to join such an organization. These additional conditions will greatly relieve the regulatory burden and will protect rate payers from bearing the risks of the merger.

A. <u>ScottishPower Should Agree that Any Tax Savings Due to the Merger Inure to the Benefit of the Rate Payers</u>

ScottishPower will realize a huge windfall from tax savings as a result of the structure of the acquisition. The structure of this transaction, involving two subsidiaries, a holding company and a Nevada partnership, creates the opportunity for significant federal and state income tax cost reductions, ultimately attributable to the difference in U.S. and Scottish tax laws. According to Mr. Talbot's calculation, there may be as much as a $109 million per year in tax savings to the owner of PacifiCorp. Talbot, Tr. 87-88. Although confidential documents suggest Mr. Talbot's estimate is too high, ScottishPower's estimates show that it is a very substantial amount. See Morris, Confidential Tr. 269. The issue before the Commission is whether the UK entity should be allowed to keep all of the cost savings, or whether it should pass the savings on to rate payers.

Both the Division and the Committee assumed, perhaps wrongly, that the tax savings could be captured in a later proceeding. Alt, Tr. 83, 86, 92, 93, 370; Gimble, Tr. 86-87, 95. ScottishPower repeatedly assured the Commission that the issue would be preserved for a future docket. See Cross Exhibit 2.[13] When pressed for a commitment, however, ScottishPower was careful to preserve the right to argue in a future case any defense it might have against an attempt to capture tax savings, including the right to argue that the Commission has no jurisdiction to address the issue or to compel the upstream entities to pass along tax savings to Utah rate payers. Fell, Tr. 979; see also Larsen, Tr. 93; Wright, Tr. 106 (refusing to acknowledge PSC jurisdiction to decide issue in future case). The proposed concession in Cross Exhibit 2 is nothing more than PacifiCorp and ScottishPower's attempt at damage control now that the magnitude of tax savings is known. Cross Exhibit 2 must be rejected.

Utah is a rate-of-return regulated state. Except as specifically provided by law, a public utility is not allowed to collect taxes from rate payers when it does intend to pay them to state or federal taxing authorities. When taxes are collected and never paid, the company realizes a return in excess of its authorized rate of return and in violation of the prohibition against unjust and

[13] The proposed additional condition set out in Cross Exhibit 2 states:

> The parties to this Docket preserve their right to raise the issue of treatment of upstream tax savings and costs in future rate cases. All parties preserve their positions and have not waived their rights on this issue. ScottishPower commits to retain records regarding upstream tax savings and costs relating to the merger and make these records available to the DPU, CCS and other parties in accordance with Stipulation Ex. 1 and the discovery rules of the Commission.

unreasonable rates. There is absolutely nothing in the law that would allow ScottishPower to charge phantom taxes and keep them as an enhancement to its rate of return. The Commission should not allow ScottishPower to retain tax savings generated as a result of the merger.

This is a case of first impression. The UIEC are not aware of any other state public service commission that has had to consider how to treat tax savings arising from the structure and foreign ownership of a public utility. The question has never been subject to any administrative or judicial review as far as we can tell. The UIEC agree that the amount of tax savings should be dealt with in a future rate case. The issue of whether or not the tax benefit belongs to rate payers, however, must be decided now so that the Commission can preserve its authority to address the treatment of the tax benefit later. ScottishPower should promise as a condition of the merger to provide and to cause its affiliates to provide whatever documentation is necessary to ascertain the amount of upstream tax savings. ScottishPower should also acknowledge that the Utah Public Service Commission has jurisdiction and authority to order that the tax savings be credited to Utah rate payers. The only open question should be the amount of tax savings to be credited.

B. ScottishPower Should Agree to Cap Rates For the Duration of the Transition Period.

The UIEC advocate a rate cap as the only method of ensuring that rates will not increase because of the merger. ScottishPower has consistently testified not only that rates would not increase but also that ScottishPower's efficiencies could achieve savings that PacifiCorp could not. Yet, at the same time ScottishPower is promising cost savings, it has been unable to produce a transition plan so that the Commission will know how ScottishPower intends to operate this public utility. Given that inability and the uncertainty it has caused, the risk of ScottishPower successfully achieving its objectives should be on ScottishPower, not the rate payers. A rate cap provides proper incentive to ScottishPower to make beneficial changes in the operation of PacifiCorp in a way that will reduce its costs. If rates are capped, it becomes far less important that the Commission approve the transition plan before allowing the merger. Brubaker, Tr. at 1259.[14]

A rate cap also has the advantage of making unnecessary any attempt to determine what costs are merger-related transition costs and what cost savings could have been achieved absent the merger. As discussed above, Mr. Brubaker testified that when he compared ScottishPower's confidential projection of costs with PacifiCorp's confidential projection of costs it appeared PacifiCorp projected lower costs. While ScottishPower protested the nature of the comparison, the PacifiCorp projections raise serious questions about whether ScottishPower can achieve lower costs than PacifiCorp. The existence of those projections also raise the question why, if the information was available, ScottishPower did not perform the comparison itself. Because ScottishPower made obtaining the information so difficult, the parties were disadvantaged in performing a thorough analysis. As it stands, there is a legitimate argument on this record about which company will produce lower costs over the next five years. A rate cap would protect customers in the event ScottishPower is not as successful as PacifiCorp would have been in reducing costs.

ScottishPower will not be harmed by a rate cap if it can deliver on its promise to reduce costs In addition, the likelihood that ScottishPower will suffer any harm would be reduced if the Commission were to determine that the tax savings would accrue to the benefit of rate payers. The cost reduction represented by those tax savings would provide a very substantial protection to ScottishPower from any adverse impact of unforeseen costs.

ScottishPower was willing to agree to a rate cap in Wyoming, even though PacifiCorp has

[14] UIEC do not necessarily contend that rates should be kept at current levels. There may be occasional costs in a 1998 test year that are fairly attributable to the pre-merger activities of PacifiCorp that were disallowed in the 1997 year. In that case, it would be reasonable to have another very limited rate case before imposing a cap.

been severely under-earning in Wyoming. The Division initially proposed a rate cap in the present case similar to the Wyoming mechanism. DPU 1, Alt Direct at 9-10. ScottishPower has refused Utah rate payers the same protection as Wyoming customers. If ScottishPower is correct in its claimed ability to reduce costs, it will not be harmed by a rate cap in Utah. The Commission should conclude that the most practical and efficient way of ensuring that the merger provides a net benefit is to cap rates and require ScottishPower to deliver on its promises.

C. ScottishPower Should Agree to Extend Special Contracts Through the Transition Period.

For many special contract customers, contracts will expire midway through the transition period, in 2001 or 2002. Negotiations on extending (or reforming) those contracts should have already begun. Special contract customers need time to implement alternatives if they cannot negotiate an acceptable contract. When the application for approval of this merger was filed, special contract negotiations were stopped dead in their tracks. ScottishPower refused to negotiate. Brown, Tr. 1233-34. PacifiCorp contended they could not negotiate while the merger application was pending. It is clear that new management has brought a new attitude toward special contracts.

Now, after the hearings are concluded, in an obvious attempt at damage containment, they have invited some industrial customers to discuss special contracts. (See redacted letter from R. O'Brien and A. Richardson to industrial customers, August 17, 1999, attached as Appendix 1 to this Memorandum). Yet, as a result of their delay in negotiating, special contract customers are facing a most inhospitable negotiating environment. Special contract customers are going to be negotiating during the transition period, with new management, at a time when future costs are more uncertain than ususal, and before a transition plan is submitted. The Stipulation makes no provision for the protection of special contract customers.

The DPU and CCS are concerned that if special contracts are extended now, as a result of this proceeding, some of those contracts might not meet costs at some point during the period of time in which they are in effect. They would like to have, as we all would, a better idea of what costs might be in 2002 or 2003 before they recommend extending those contracts. Unfortunately, one possible forecast of those costs is unavailable because ScottishPower has refused to file a transition plan. The UIEC share the DPU's concern about future costs and they do not expect to receive special contracts that will impose a burden on other rate payers. Nevertheless, despite the uncertainty about future costs, these expiring special contracts must be renegotiated within the next six months to one year. Because we are not likely to know any more about costs in 2002 or 2003 six months from now than we know today, uncertainty about future costs is not a reason for the DPU to recommend against extending special contracts.

There is no present indication that current contracts will not be compensatory through the transition period. Indeed, Scottish Power states that it intends to reduce costs in the future through more efficient operation of the company. If the tax savings were captured for rate payers, costs would be further reduced. Assuming new management accomplishes the efficiencies it claims it can achieve and the tax savings are captured, there will be very little risk of harm either to the company or to its tariffed customers in extending special contracts through the transition period. If rates are capped, there will be no harm.[15]

The DPU's traditional analysis of special contracts is not helpful because it deals only with firm contracts. The contracts at issue in this docket are not firm. In addition, the RAMMP studies on which Mr. Powell relies are of questionable applicability in a rapidly changing industry.

[15] Even if rates are adjusted before they are capped, special contract rates should be extended. Special contract customers enjoyed no rate reduction in the past cases. Any rate increase now would not change the relative position of the classes.

Even assuming a conventional model can yield a result that is relevant, there is no reliable information on future costs that can help us predict whether special contracts will remain above cost. These difficulties in analyzing special contracts are obviated if rates are capped. In that case, tariffed rate payers cannot be harmed by extending special contracts because the company is prevented from raising rates to subsidize them.

Special contract customers are the only group of customers who will receive no merger credit and no protection under the Stipulation. It is patently discriminatory for all other customers to receive an explicit benefit of the merger and to exclude special contract customers from any comparable benefit. The Commission should require that as a condition of the merger, special contracts must be extended through the transition period.

D. The Commission Should Require that Scottish Power Implement Reasonable Information Management Practices.

The Commission, the Division, Committee and intervenors must have access to information promptly, and in a place that is convenient. As discussed above, claims of confidentiality obstructed the discovery of the facts in this case. ScottishPower informed the UIEC that it had destroyed certain work papers and then its witnesses referenced the data in those work papers in their testimony from the stand at hearing. Tr. 1475-81. The hearings were impeded by special procedures taken not to disclose pink documents to the public. The parties, consultants and lawyers were prevented from understanding important aspects of this merger because they were not entitled to see certain documents. And, for all of the confidentiality, it was unclear why the same kind of information printed on yellow sheets in every other PacifiCorp proceeding, was printed on pink sheets for the ScottishPower merger proceeding.

ScottishPower's information management practices will lay a tremendous burden on regulation in the future unless the Commission expressly requires that information be made available timely to all parties. The Commission should secure the agreement of ScottishPower itself and on behalf of its immediate affiliates—the two subsidiaries that own the partnership, the partnership and the holding company—to preserve information and make it reasonably available to regulators and parties. It should also require ScottishPower to acknowledge that the Commission may impose penalties for withholding information or obstructing access to it.

E. Scottish Power Should Be Required to Waive All Future Claims for Stranded Costs.

The Commission should require as part of the merger that ScottishPower waive any claim to stranded costs in future proceedings. Stranded costs occur when the assets of a utility that are capable of providing potentially competitive services are exposed to competition. The theory is that the costs of those assets cannot be fully recovered because the assets are not worth as much in a competitive market as in a regulated market. By definition, when a utility asset brings more on the open market than its book value, there can be no stranded costs. Brubaker, Tr. 1261. According to the proxy prospectus, the value that ScottishPower proposes to pay for PacifiCorp's stock exceeds the book value for the generation assets by a factor of between 1.4 to 1.8. That substantial premium should foreclose any claim for stranded costs in a future case because PacifiCorp's stockholders have already been compensated above market value for the assets. Id. at 1262.

ScottishPower is a sophisticated company. It operates in the United Kingdom in a competitive environment. It is seeking to expand its investment into the western United States at a time when it knows that the assets of PacifiCorp will be exposed to competition. It understands the value of PacifiCorp's assets and it understands the effect of competition on those assets. Nevertheless, ScottishPower is paying a price not only substantially above book value, but substantially above market value. Although this is a stock transaction, the form of the transaction cannot conceal the fact that ScottishPower believes the assets have value above book and market value.

Scottish Power apparently concedes that it can have no claim for the premium over book value as an item of stranded cost. See Tr. 136-146. It also apparently agrees that there can be no claim for the transaction costs as stranded costs. Id. It may argue, however, that it should still be entitled to the claim that would have been PacifiCorp's claim for stranded costs if any exist. PacifiCorp's argument would be that in order to be entitled to stranded costs and thus to waive any claim, the assets must be exposed to competition: it is premature to even address the issue now. That argument is nothing more than a complaint that PacifiCorp received payment before it suffered the loss. Unlike every other utility in America who had to wait until the instant it faced the pain of competition, PacifiCorp's shareholders are receiving payment without yet facing competition.

The Commission should require ScottishPower to waive any claim for stranded costs in the future based on the substantial premium that shareholders will receive if this merger is approved. Alternatively, the Commission should enter findings that will allow the Legislature to conclude that a claim for stranded costs has been satisfied as a result of this transaction. The Commission should find that ScottishPower is a sophisticated buyer, that an independent appraisal has been done as to the value of the assets, that ScottishPower is paying 1.4 to 1.8 times the value of PacifiCorp's stock, that such payment reflects the value of generation assets, and that PacifiCorp shareholders have received such a premium over book value in this transaction.

F. The Commission Should Require ScottishPower to Participate in the Planning, Development and Operation of a Regional Transmission Organization.

The UIEC believe that the Commission should require, as a condition of the merger, that ScottishPower make a commitment about planning and participating in a regional transmission organization ("RTO").

It appears in view of the FERC's Notice of Proposed Rulemaking in Docket RM99-2, that the electric utility industry in the United States is moving toward nondiscriminatory access to transmission networks. Prior to the proposed merger, PacifiCorp was apparently willing to explore and develop a variety of approaches to regional transmission. ScottishPower has a different attitude. In the U.K., ScottishPower did not willingly separate generation from transmission until it was ordered by U.K. regulators to divest. In this proceeding, ScottishPower has stated it has no corporate policy about the development of transmission access. Richardson, Tr. 612. This changed attitude and the potential loss of jurisdiction cry out for Commission action.

ScottishPower's position on regional transmission is complicated by Scottish Government's "Special Share." The Special Share is a nominal value share reserved for the Scottish Government. Cross Exh. 4 at 122. This Special Share allows the government to prevent any person or group of persons from owning or controlling more than 15% of the voting rights of ScottishPower without the UK government's consent. Richardson Supp. Test. April 16, 1999. In effect, the UK government can block some processes in the development of a regional transmission organization. The Commission should act now to prevent potential interference by the UK government in the restructuring of the western power markets.

The UIEC urge the Commission to require ScottishPower to submit a plan for an RTO (or other model for regional transmission access) within a certain period of time. If the Commission fails to extract this commitment as a condition of merger approval, it may lose any opportunity to do so because statutory or regulatory action may be preempted. Legislation cannot restore the lost opportunity. The only mechanism available to ensure the Commission's participation is to impose a condition upon the merger. If ScottishPower accepts the condition and consummates the merger, the Commission will retain some control over regional transmission.

CONCLUSION

ScottishPower has failed to meet its burden of showing that the proposed merger creates a net benefit for the customers of PacifiCorp. The Stipulation while mitigating to some extent the risks of the merger, fails to provide sufficient clarity to avoid litigation about magnitude of savings attributable to the merger, the authority of the Commission to approve the transition plan, and a number of other ambiguities that invite future litigation. To the extent possible, the Commission should clarify the Stipulation, especially those provisions affecting the Commission's authority to address unresolved issues.

In addition, the merger can only be found to be in the public interest if additional conditions are imposed on and accepted in writing by ScottishPower. It should be established in this proceeding that any tax savings occurring as a result of the merger, either at the level of the operating company or its affiliates, belongs to the rate payers. Although the amount of the benefit can be the subject of a future case, the Commission must determine in this proceeding that the benefits should be allocated to rate payers or it may forever lose that opportunity.

The Commission should also impose as a condition of the merger a cap on rates through the year 2003. A rate cap acts as a guarantee of ScottishPower's promise that rates will not go up as a result of the merger. A rate cap also obviates the need for rate cases during the transition period, remedies the vacuum of information created by ScottishPower's failure to file the transition plan, provides an incentive to ScottishPower to achieve its expected savings, and ensures a net benefit to all customers at least for the next four years.

No transaction can be found to be in the public interest when it unfairly discriminates against one class of customers. Special contracts customers have been offered literally no benefit from this merger. The Commission should require ScottishPower to extend special contracts through the transition period to afford special contract customers some measure of the benefits that have been offered to other customers. A rate cap would ensure that no customers would be harmed by extending special contracts. In any event, the Commission should take ScottishPower at its word and assume that it can achieve cost savings that would prevent cross subsidization of special contracts by tariffed customers.

This merger will not be in the public interest if regulators and intervenors cannot obtain more cooperation and better access to information than they had in this case. ScottishPower, on behalf of itself and its affiliated companies, must agree to preserve, disclose and provide access to information in a convenient and timely manner.

The Commission has an opportunity in this proceeding to set the stage for restructuring. Given the premium paid for PacifiCorp, the Commission may conclude that its shareholders have been compensated for any stranded costs that could conceivably arise in any future restructuring proceeding. Alternatively, the Commission should enter clear findings and conclusions that would allow the Legislature to conclude that all claims for stranded costs have been satisfied as a result of this transaction.

Finally, the Commission should not ignore the opportunity to retain some degree of control over the development of regional transmission groups in the western United States. Unless ScottishPower enters into an enforceable agreement to plan and participate in developing a regional transmission organization, the Commission may be forever preempted by federal authorities from directing the future of power markets in the West.

WHEREFORE, the Commission should clarify the Stipulation, impose the conditions suggested herein, and any other conditions or modifications it deems are just, reasonable or necessary to ensure that the proposed merger is in the public interest.

DATED this ____ day of September, 1999.

PARSONS BEHLE & LATIMER

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CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of September, 1999, I caused to be mailed, first class, postage prepaid, a true and correct copy of the foregoing **UIEC'S POST HEARING BRIEF**, to:

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