DIRECT TESTIMONY

OF

THOMAS E. SCHOOLEY

DOCKET NO. UE-981627

Q: Please state your name and business address.

A: My name is Thomas E. Schooley. My business address is 1300 South Evergreen Park Drive Southwest, P. O. Box 47250, Olympia, Washington 98504-7250.

Q: By whom are you employed and in what capacity?

A: I am employed by the Washington Utilities and Transportation Commission as a Revenue Requirements Specialist in the electric section of the Regulatory Services division.

Q: How long have you been employed by the Commission?

A: Since September 1991.

Q: Would you briefly state your educational background?

A: I attended Central Washington University achieving a Bachelor of Science degree in 1986. I completed the requirements for a double major in Accounting and Business Administration-Finance. In addition I have a Bachelor of Science degree from the University of Michigan majoring in Geology. I passed the Certified Public Accountant Exam in May 1989.

Q: What is your experience as a Revenue Requirements Specialist?

A: Since joining the Staff of this Commission I participated in the Puget Power general rate case (Docket UE-921262) presenting testimony on several topics. I also presented the Staff recommendation on environmental remediation (Docket No. UE-911476), and testified in the merger of Puget Power and Washington Energy (Docket UE-960195). I am on the committee maintaining oversight of the PacifiCorp inter-jurisdictional allocations. I also occasionally present Staff recommendations on various other tariff filings at Commission open public meetings.

Q: What topics does your testimony cover in this proceeding?

A: My testimony covers the following points from the Commission's Third Supplemental Order:

A. Scottish Power's qualifications to take over a jurisdictional public utility in Washington in terms of its financial and managerial fitness;

B. The costs of system improvements and who bears the costs;

C. The impact of the merger on rates, now or in the future;

D. Assurance that the Commission will have access to books and records in order to accomplish its regulatory oversight; and

E. Required filings yet to be made by the Applicant.

I also address the following items in the Stipulation: 14, 15, 18, 19, 20, 22, 23, and 25.

Q. What did you consider in evaluating ScottishPower's financial and managerial fitness to take over PacifiCorp?

A. My review covered several publicly available documents. I considered the bond ratings for PacifiCorp and Scottish Power debt and reports from third party analysts. I also compared recent financial results of the two companies.

Q. What factors did you consider in evaluating managerial fitness?

A. One is looking at the type of businesses in which ScottishPower engages. ScottishPower provides electricity, water, wastewater, and telephone service to about five million urban and rural customers in Great Britain. ScottishPower derives 95% of its revenues from regulated utility operations. As with PacifiCorp, the roots of ScottishPower go back to the beginning of the electricity business.

Another factor is the opinion of the bond rating agencies. Standard & Poors rates PacifiCorp bonds as single A and ScottishPower bonds as single A+. Both are on S&P's credit watch list; PacifiCorp with positive implications and ScottishPower with negative implications.

Q. How do PacifiCorp and ScottishPower compare financially?

A. Two difficulties exist in comparing a company in the United States with one in the United Kingdom (UK). One is the need to convert dollars to pound sterling, or vice versa. And the other is that accounting standards differ in the two countries. PacifiCorp's proxy statement to its shareholders makes these conversions presenting both companies in pounds (£) and by UK generally accepted accounting practices. Exhibit ____ (TES-1) presents unaudited pro forma financial information from the proxy statement. Taking a macro-look at the operations of both companies, we see both are of comparable size with assets in the mid single digit billions and revenues in the low billions, as measured in pound sterling.

Q. Based on your reviews what is your opinion of ScottishPower's financial and managerial fitness?

A. I conclude that the two companies are similar in nature and size. ScottishPower is apparently run with competence and I see no reason to doubt ScottishPower's fitness to manage and operate a utility in Washington.

Q. ScottishPower intends to make many improvements in PacifiCorp's system. What is your understanding of how ScottishPower intends to finance these improvements?

A. As I understand ScottishPower's intent, it will turn PacifiCorp's primary attention to customer satisfaction while streamlining the operations. First and foremost, ScottishPower plans to increase returns through more efficient operations. Mr. Moir's direct testimony claims $55 million will be spent over the next five years in PacifiCorp's territories, about $11 million per year. He further explains the funds for these projects will come from modifying existing capital budgets, operational efficiencies, and capital budgeting efficiencies. Basically this means that internal sources are being used for service and network improvements.

Also, as a larger, financially stronger global corporation, ScottishPower should be able to lower its borrowing costs, thereby reducing the cost of money for PacifiCorp.

Q. Is there an immediate concern of PacifiCorp earning more than a reasonable return on rate base in Washington?

A. No, not in the near future. The authorized return on rate base for PacifiCorp has not been reviewed by this Commission since 1986, but PacifiCorp's return on rate base in

Washington for 1998 was about six percent.

Q. Could PacifiCorp proceed with a similar plan?

A. Yes. PacifiCorp could embark on a plan of reducing expenses and increasing customer service if it wishes. Staff would be concerned if a plan involved increasing rates while reducing service by letting the infrastructure deteriorate. Staff discussed that potential with ScottishPower and understands that ScottishPower does not view efficient operations and high quality service as mutually exclusive.

Q. How will the merger impact rates?

A. ScottishPower's stated intent is to revise the corporate structure and management techniques prior to seeking any tariff changes. If so, it may take a couple years to achieve significant progress. Mr. Green's direct testimony outlines the company's principles on future rate filings. Staff understands his testimony to mean that ScottishPower will seek to improve returns first through its efficiency efforts. At some point in the future, ScottishPower may determine that its returns are insufficient and will file for new rates. Its efficiency efforts should mitigate the magnitude of rate increases at that time. The Commission retains its authority to review any such filing, and its ability to assess the prudence and reasonableness of management's actions.

Q. How else may the merger impact rates?

A. Allocations of corporate overhead are an area of concern. PacifiCorp/ScottishPower propose to file a methodology to allocate corporate and affiliate investments, expenses, and overheads by June 18 of this year. This draft will serve as a discussion document for state commissions and staff. These concerns are addressed by Stipulation items 14 and 15.

Q. What is the issue addressed in Stipulation item 18?

A. Item 18 derives from a stipulation between PacifiCorp/ScottishPower and the Wyoming Consumer Advocate Staff. The Wyoming staff wished to reserve the right to request an audit of the cost allocations and affiliated transactions of ScottishPower. If this audit occurs, ScottishPower/PacifiCorp will provide the Commission a copy of the audit results.

Q. Will the Commission have adequate access to the documents necessary to conduct a meaningful review of PacifiCorp's operations?

A. Two concerns arise from this query. First, will the commission have the same access to books and records as it has always had? Second, will the affiliated company status of PacifiCorp to ScottishPower under the Public Utility Holding Company Act change the ability of the Commission to review the records of the parent company, or other affiliated companies? Stipulation points 19, 20, 22, and 23 address these concerns.

On the first count, ScottishPower makes every assurance that the books and records of the corporation will be available for review. Stipulation items 19, 20, and 22 memorialize these commitments.

As to the second concern, Chapter 80.16 RCW applies. Per this law, the Commission "...shall disallow the payment or compensation, in whole or in part, in the absence of satisfactory proof that it is reasonable in amount." Satisfactory proof is "the original (or verified copies) of the relevant cost records and other relevant accounts of the affiliated interest, ..., as the commission may deem adequate." (RCW 80.16.030-040) Staff will apply these protections when auditing the records of ScottishPower. Stipulation item 23 addresses this concern.

With respect to affiliated transactions, ScottishPower also agrees that the Commission may invoke the lower of company cost, or market price, if a market exists for a given service or product.

Q. Why is Stipulation item 25 concerning confidentiality included?

A. PacifiCorp/ScottishPower requested this clause and we do not object to it.

Q. Does PacifiCorp plan to issue common shares incidental to the proposed transaction?

A. Yes. According to the Joint Application PacifiCorp will issue to an entity, indirectly and wholly owned by Scottish Power, an equal number of shares with the same rights, powers and privileges as the canceled Merger Sub common stock (Page 12 - Joint Application).

Q. Will this issuance of common stock by PacifiCorp require an additional filing with the Commission?

A. Yes. RCW 80.08.040 requires any public service company that undertakes to issue stock to file a statement with the Commission including the information set forth in WAC 480-146-290. PacifiCorp/ScottishPower agrees to file this document, which should occur after PacifiCorp's shareholders vote on the acquisition.

Q: Does this conclude your testimony?

A: Yes.