BEFORE THE STATE OF NEW JERSEY
OFFICE OF ADMINISTRATIVE LAW
BOARD OF PUBLIC UTILITIES

I/M/O THE JOINT PETITION OF PUBLIC SERVICE ELECTRIC AND GAS COMPANY AND EXELON CORPORATION FOR APPROVAL OF A CHANGE IN CONTROL OF PUBLIC SERVICE ELECTRIC AND GAS COMPANY AND RELATED AUTHORIZATIONS	))))))	**BPU DKT. NO. EM05020106 OAL DKT. NO. PUC-1874-05**

SURREBUTTAL TESTIMONY OF DAVID E. PETERSON ON BEHALF OF THE NEW JERSEY DIVISION OF THE RATEPAYER ADVOCATE

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is David E. Peterson. I am a Senior Consultant employed by Chesapeake Regulatory Consultants, Inc. ("CRC"). Our business address is 1698 Saefern Way, Annapolis, Maryland 21401-6529. I maintain an office in Dunkirk, Maryland.

Q. ARE YOU THE SAME DAVID E. PETERSON THAT PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. Yes, I am. I filed direct testimony on behalf of the New Jersey Division of the Ratepayer Advocate earlier in this proceeding.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of my surrebuttal testimony is to respond to arguments in the rebuttal testimonies of Mr. William D. Arndt and Ms. Ruth Ann Gillis relating to issues that I discussed in my direct testimony.

II. RESPONSE TO WILLIAM D. ARNDT'S REBUTTAL TESTIMONY

Q. BEFORE YOU BEGIN DISCUSSING SPECIFIC ARGUMENTS ADVANCED IN MR ARNDT'S REBUTTAL TESTIMONY, DO YOU HAVE ANY GENERAL COMMENTS ON MR. ARNDT'S REBUTTAL TESTIMONY?

A. Yes, I do. The central theme in Mr. Arndt's Rebuttal Testimony as it relates to criticisms by me and by other witnesses regarding his synergy analysis is captured in the following passage taken from his Rebuttal Testimony:

> "The comprehensive synergy study presented in my direct testimony, supporting schedules and workpapers results from a rigorous and thorough effort of a large number of key managers at PSEG and Exelon. The results of that study have been examined and verified by the PSEG and Exelon merger integration teams that are designing the post-merger organization and have been determined that they are reasonable and attainable."[1]

Mr. Arndt echoes this "*rigorous, thorough, and verified*" theme throughout the remainder of his Rebuttal Testimony, as if repeating the mantra often enough will divine certainty from his synergy estimates, where certainty clearly is unwarranted.

I have no doubt that Mr. Arndt and his "key managers" worked diligently completing the synergy study. That study, however, will never be anything more than an elaborate "what if" analysis unless and until Exelon officially commits to implementing the personnel and operating assumptions that are embodied in the study. To date, however, no such commitment has been provided. The Joint Petitioners' rebuttal testimonies did not change an earlier acknowledgment that,

to-date, no formal workforce requirement studies have been performed for post-merger operations.[2] Nor is Exelon willing to commit to the post-merger workforce assumptions that are reflected in Mr. Arndt's synergy study. [3] Thus, by not committing to the business plan embodied in the synergy study, Exelon retains for itself the freedom to implement whatever business plan it desires post-merger, whether or not it reflects the assumptions contained in Mr. Arndt's synergies study. Therefore, there can be no assurance that Mr. Arndt's study accurately reflects the operating model that will be implemented and the synergy savings that are likely to be achieved following the merger.

As to Mr. Arndt's assertion that his synergies estimates have been verified, again there is no proof that this is the case. As I understand Mr. Arndt's testimony on the subject, without guidance from detailed workforce requirement analyses and without executive commitment to a specific post-merger business plan, managers from both companies projected post-merger operating levels and an assumed workforce. Those projections were then reviewed and "approved" by other members of the merger integration teams. Booz Allen Hamilton consultants also reviewed and "approved" the work of the synergy study teams. This internal review process, however, is not the type of verification that I spoke of in my Direct Testimony when I complained that the synergy study is not verifiable.[4] Webster's New Collegiate Dictionary provides the following definitions for the word "*verify*":

> *Verify:* v 1: To confirm or substantiate in law by oath 2: to establish the truth, accuracy, or reality of

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1 Rebuttal Testimony of William D. Arndt, page 3.
2 Response to RAR-RR-27.
3 Ibid.
4 Peterson Direct Testimony, page 10.

The verification that Mr. Arndt speaks of in his Rebuttal Testimony does not establish the truth, accuracy or reality of the estimates contained in his synergy study. For as much experience as Exelon's managers and Booz Allen Hamilton consultants have gained in other mergers, none of these people can be certain how Exelon will operate post-merger and what level of synergies can be achieved in this merger because Exelon has been unwilling to make an official commitment in that regard, except as it concerns PSEG's union workers. Thus, neither the merger integration team nor Booz Allen Hamilton consultants are in a position to verify the truth, accuracy, and reality of the synergies analysis as an accurate and reliable representation of Exelon's post-merger operations. This type of verification can only be obtained after Exelon has committed to a specific business plan post-merger. Even then, it seems unlikely that the synergies estimates will ever truly be verified because Exelon has no intention of tracking actual merger savings once the transaction has closed.[5]

Q. BEGINNING AT PAGE 14 OF HIS REBUTTAL TESTIMONY, MR. ARNDT CRITICIZES YOU AND MR. EFFRON FOR RECOMMENDING A TEN-YEAR SYNERGIES ANALYSIS RATHER THAN THE FOUR-YEAR ANALYSIS THAT HE SPONSORED. DO YOU AGREE WITH MR. ARNDT'S CRITICISMS?

A. No, I do not. Mr. Arndt acknowledges that mergers benefits will continue into perpetuity, while costs-to-achieve are one-time events. He also claims that there are no new, incremental synergies following Year Four post-merger. Thus, Mr. Arndt argues that extending the analysis beyond the initial four years "is an attempt to portray a larger synergy estimate to use for alternatives purposes."

[5] Rebuttal Testimony of William D. Arndt, page 10.

Further, he argues that using a four-year analysis is appropriate because of the likelihood of a base rate case within the four-year time frame.

Neither of Mr. Arndt's reasons for objecting to a 10-year analysis is persuasive or even relevant. Moreover, it wrong for Mr. Arndt to claim that my motivation for using a ten-year analysis is an attempt to portray a larger synergy estimate to use for "alternatives purposes." Rather than advancing hidden ulterior motives, as Mr. Arndt suggests, my reasons for recommending a ten-year synergies analysis were clearly stated in my Direct Testimony.[6] Those reasons are: 1) because the Board had required and relied on ten-year studies in previous New Jersey merger proceedings and 2) because I am recommending that costs-to-achieve be amortized over ten years to better match expected savings with costs-to-achieve. Because merger-related savings are to continue indefinitely, I am recommending that costs-to-achieve be spread out and amortized over a number of years (i.e., ten years) to better match expected savings with the underlying costs that were incurred to achieve those savings. The matching principle, which supports this treatment for costs-to-achieve, is a fundamental and pervasive accounting and ratemaking principle. That PSE&G may file a base rate case within the ten-year period post-merger is irrelevant to the determination of whether to use a four-year or a ten-year synergy study. The fact is I am not advocating that any expected net savings beyond Year Three post-merger be reflected in rates at this time. The ten-year synergies study simply provides a better illustration and representation of expected annual net savings when an appropriate attribution period is assigned to the costs-to-achieve.

[6] Direct Testimony of David E. Peterson, pages 8-9.

Q. MR. ARNDT DISAGREES WITH YOU AND MR. EFFRON THAT TRANSACTION COSTS SHOULD BE EXCLUDED FROM RECOVERABLE COSTS-TO-ACHIEVE. ARE MR. ARNDT'S ARGUMENTS PURSUASIVE?

A. No, they are not. Mr. Arndt argues that it is necessary for the merging companies to incur certain transaction costs and that those transaction costs help unlock merger benefits that will be enjoyed by both utility customers and shareholders. Thus, Mr. Arndt concludes that transaction costs should be included in recoverable costs-to-achieve. I disagree.

The transactions costs in question were incurred to secure approvals for the merger from the boards of directors and the stockholders of the two companies. Transaction-related activities included independent valuations, market analyses, and fairness opinions. Together, these activities were undertaken to protect shareholder interests. They were not incurred to insure that New Jersey ratepayers received their fair share of anticipated merger savings. That responsibility is left to Your Honor and the New Jersey Board of Public Utilities ("Board"). Mr. Arndt seems to have no trouble allocating costs-to-achieve in his synergies analysis among Exelon's and PSEG's affiliates and business groups. Yet, he is unwilling to consider that it is also necessary and appropriate to allocate and to assign certain costs-to-achieve among shareholders and ratepayers. The division of utility-incurred costs between shareholders and ratepayers is common in New Jersey ratemaking and elsewhere and is no less appropriate in merger proceedings. Because transaction costs are incurred to protect shareholder interests, those costs should be assigned to shareholders and excluded from recoverable costs-to-achieve.

Q. MR. ARNDT ALSO OBJECTS TO YOUR RECOMMENDATION TO EXCLUDE GOLDEN PARACHUTE PAYMENTS, RELOCATION AND RETENTION PAYMENTS, AND SIGNAGE COSTS FROM RECOVERABLE COSTS-TO-ACHIEVE. PLEASE COMMENT.

A. As for golden parachute payments, the reason for their exclusion from recoverable costs-to-achieve is self-evident. In a word, golden parachutes granted to senior executives who are leaving the companies as a result of the merger are repugnant to ratepayers. Nearly three dozen senior executives are expected to leave following the merger and will receive millions of dollars for doing so. As I stated in my direct testimony, the average severance payment that was assumed in Mr. Arndt's synergies study for senior executives leaving the companies is approximately $2.02 million. Yet, Mr. Arndt assumed that the average severance payment for non-executives who will lose their jobs as a result of the merger would be approximately $74,000. It is not reasonable to require ratepayers to pay for a situation created by senior executives to agree to a merger and then be extraordinarily rewarded at ratepayers' expense for leaving the company once the merger is finalized.

Much the same reasoning applies to retention and relocation payments. The companies have created a situation where it is more advantageous for certain employees to leave the companies rather than remaining with the company or relocating following the merger. Ratepayers should not be responsible for reimbursing Exelon for retention and relocation payments because the merger has made it more attractive for certain employees to leave the companies.

Finally, Mr. Arndt's reasoning on signage change costs is incomprehensible. Mr. Arndt acknowledges that PSE&G's image will remain on all signs, stationery, and

communications. Yet, he claims that some signage changes will be required to "eliminate any confusion for New Jersey customers."[7] This is absurd. Any confusion for New Jersey customers that exists will result from, and will not be alleviated by, signage changes. PSE&G's current and long-standing corporate relationship with PSEG is well known by New Jersey customers throughout the state. Including Exelon's corporate logo on PSE&G's communications will likely cause confusion rather than eliminate it.

Q. ON PAGE 29 OF HIS REBUTTAL TESTIMONY, MR. ARNDT ARGUES THAT COSTS-TO-ACHIEVE SHOULD BE RECOVERED AS INCURRED RATHER THAN BE AMORTIZED THROUGH RATES OVER TEN YEARS AS YOU RECOMMEND. DO YOU AGREE?

A. No. Mr. Arndt ignores the fundamental ratemaking principle that extraordinary one-time costs are generally not included in rates as incurred. Rather, such costs are either excluded from rate recovery entirely because they are non-recurring or they are amortized over several years. In this instance, it is appropriate to amortize merger-related costs-to-achieve over a relatively long period of time because merger-related benefits will continue in perpetuity. Matching costs with benefits, which is also a fundamental ratemaking principle, requires a relatively long amortization for costs-to-achieve.

Q. ALSO ON PAGE 29 OF HIS REBUTTAL TESTIMONY, MR. ARNDT CLAIMS THAT USING A TEN-YEAR SYNERGY ANALYSIS IS INCONSISTENT WITH YOUR RECOMMENDATION TO IMPLEMENT A RATE REDUCTION FOR THREE YEARS. IS HE CORRECT?

[7] Rebuttal Testimony of William D. Arndt, page 28.

A. No, he is not. Apparently, Mr. Arndt does not understand my recommendation. I did not use the ten-year analysis merely to "attempt to extract a larger rate reduction." In fact, I have not included any net merger savings from Years Four through Ten in the rate reduction that I recommend at this time. As stated previously in my direct and surrebuttal testimonies, a ten-year net savings presentation is necessary to properly attribute merger costs-to-achieve to expected merger-related savings. My recommendation to reduce rates by expected net savings, however, considers only net savings during the first three years post-merger. I calculated the $43 million rate reduction amount by averaging expected net savings in Years One, Two and Three, from the ten-year synergies study. I did not, however, include any anticipated savings following Year Three, nor did I "annualize ten year's worth of savings" as Mr. Arndt claims.

III. RESPONSE TO RUTH ANN M. GILLIS'S REBUTTAL TESTIMONY

Q. ON PAGE 9 OF HER REBUTTAL TESTIMONY, MS. GILLIS CONTESTS YOUR CLAIM THAT THE JOINT PETITIONERS HAVE NOT PROPOSED A GENERAL SERVICES AGREEMENT ("GSA") TO GOVERN TRANSACTIONS BETWEEN PSE&G AND EXELON BSC FOLLOWING THE MERGER. HAS MS. GILLIS'S REBUTTAL TESTIMONY CAUSED YOU TO CHANGE YOUR POSITION ON THIS ISSUE?

A. No, it has not. Nothing in Ms. Gillis's Rebuttal Testimony has caused me to change my position that the Joint Petitioners have thus far not provided a GSA that will govern transactions between PSE&G and Exelon BSC following the merger. Even though Ms. Gillis claims in her Rebuttal Testimony that "Exelon

BSC currently does not expect to make any changes to the GSA,"[8] in my Direct Testimony I pointed out where the Joint Petitioners' discovery responses stated they have not yet determined the future services to be provided by Exelon BSC post-merger and it has not yet been determined what allocations methods will be used to allocate Exelon BSC's costs among participating affiliates post-merger.[9] Ms. Gillis never reconciles these two apparent inconsistent positions. Her Rebuttal Testimony does not change the essential facts regarding the ambiguity of Exelon BSC's post-merger business plan. In fact, Ms. Gillis reinforced those ambiguities by stating that "the integration process has not yet reached the point where the exact nature of the future products and services of the combined service company are known."[10] Thus, there is no certainty or assurance that Exelon BSC's current GSA, for which the Joint Petitioners seek Board approval, will be reflective of its post-merger business plan.

Q. ON PAGE 11 OF HER REBUTTAL TESTIMONY, MS. GILLIS RESPONDS TO YOUR CLAIM THAT A SIGNIFICANT PROBLEM WITH THE GSA IS THAT IT COMPLIES WITH SEC RULES AND REGULATIONS AND NOT NEW JERSEY REQUIREMENTS. WOULD YOU LIKE TO ADD ANYTHING FURTHER TO THAT DISCUSSION?

A. Yes, I would. Ms. Gillis responds to my argument not by demonstrating that the GSA is compatible with what the Board has required of other New Jersey service company agreements, but rather by stating the GSA has been approved by the SEC and by the Illinois and Pennsylvania state regulatory commissions. Moreover, Ms. Gillis states that any changes in the GSA that the Board would require would have to be approved by the SEC and the state regulatory

[8] Rebuttal Testimony of Ruth Ann M. Gillis, page 10.
[9] Direct Testimony of David E. Peterson, page 27.
[10] Rebuttal Testimony of Ruth Ann Gillis, page 2.

commissions in Illinois and Pennsylvania. Ms. Gillis then states it would be a costly and time-consuming process to change the GSA's form. This is exactly the type of high-handed tactics by Exelon that the Ratepayer Advocate cautioned Your Honor and the Board about in its Direct Testimony. Here Exelon BSC has presented a GSA to PSE&G and to the Board as a *fait accompli* leaving the Board no room to incorporate its own unique regulatory requirements in the GSA. The statutory authority under which the Joint Petitioners seek Board approval of the GSA, N.J.S.A. 48:3-1.1, however, does not appear to require the Board to approve the GSA merely because it has been approved by the SEC and by other state regulatory commissions, nor does it appear to require that such approval be granted if changes to the GSA would be costly and time-consuming. New Jersey law grants the Board authority to review the GSA independently of the SEC and other state regulatory commissions.

Ms. Gillis claims that an Exelon discovery response provided a list of Exelon BSC service providers along with specific allocation methods being used by each one. Such information, while informative, is insufficient for approving the GSA. It clarifies how Exelon BSC has provided services and allocated costs in the past. It does not represent how Exelon BSC intends to operate post-merger. Moreover, even though specific allocation methods were identified in the matrix provided in the discovery response, the GSA permits discretion in the choice of allocation methods because it includes the terms "expected allocation ratios." If Exelon BSC intends to apply the specific allocation methodologies to the specific service provider groups as reflected in S-ENE-SA-22, it should incorporate this level of detail as an appendix to the GSA.

To summarize my position, Your Honor and the Board cannot reasonably approve a GSA until it has been determined what services will be provided post-merger by Exelon BSC and how Exelon BSC will allocate common and jointly-incurred costs among participants to the GSA. To date, this essential information has not been provided.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.