

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

JOINT APPLICATION OF PECO
ENERGY COMPANY AND PUBLIC
SERVICE ELECTRIC AND GAS
COMPANY FOR APPROVAL OF THE
MERGER OF PUBLIC SERVICE
ENTERPRISE GROUP
INCORPORATED WITH AND INTO
EXELON CORPORATION

DOCKET NO. A- 110550 F0160

JK
9-22-05

DIRECT TESTIMONY

OF

DENIS P. O'BRIEN

Describing The Merger And Its Effects
On Customers, Employees
And Local Communities

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PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Date: February 4, 2005

1 PECO's electric and gas operations and overall performance associated with
2 service reliability, customer satisfaction, and regulatory and external affairs.
3 I hold a Bachelor of Science degree in Industrial Engineering from Rutgers
4 University and a Master of Business Administration degree in Finance from
5 Drexel University. I serve on numerous civic and industry boards, including the
6 Energy Association of Pennsylvania, the American Gas Association, the
7 Pennsylvania Economy League, Greater Philadelphia Chamber of Commerce,
8 Select Greater Philadelphia, The Franklin Institute Science Museum, the Greater
9 Philadelphia YMCA, Drexel University and the WHY Y board of trustees.

10 **Q. What is the purpose of your testimony in this proceeding?**

11 A. The purpose of my testimony is to (i) provide an overview of the proposed merger
12 (Merger) of Public Service Enterprise Group Incorporated (PSEG) with and into
13 Exelon Corporation (Exelon), PECO's ultimate corporate parent, (ii) describe the
14 benefits the Merger is expected to create, and (iii) describe generally the effects
15 the Merger will have on customers, employees and local communities in PECO's
16 service territory.

17 II. THE PROPOSED MERGER

18 **Q. Please describe briefly the proposed Merger.**

19 A. In December 2004, the Boards of Directors of Exelon and PSEG unanimously
20 approved an Agreement and Plan of Merger, a copy of which is provided as the
21 separately bound Exhibit "C" to the Joint Application in this matter, pursuant to
22 which PSEG will be merged with and into Exelon, subject to various shareholder
23 and regulatory approvals. The Merger would create the premier electric and gas

1 utility in the United States. Under the agreed upon post-Merger corporate
2 structure, PSEG's subsidiary, Public Service Electric and Gas Company
3 (PSE&G), which provides regulated electric and natural gas service in New Jersey
4 and which holds a limited certificate of public convenience and necessity issued
5 by this Commission, will become a subsidiary of Exelon Energy Delivery
6 Company, LLC (Exelon Energy Delivery). Exelon Energy Delivery is a first tier
7 subsidiary of Exelon and the immediate parent of PECO and PECO's Illinois-
8 based affiliated utility, Commonwealth Edison Company (ComEd).

9 **Q. What will happen at the shareholder level to effect the Merger?**

10 A. Each holder of PSEG common stock will receive 1.225 shares of Exelon common
11 stock upon consummation of the merger, with cash being paid in lieu of fractional
12 shares. The shareholders of PSEG must approve the Merger, and the shareholders
13 of Exelon must approve the issuance of additional shares necessary to effect the
14 Merger. Shareholder meetings for both Exelon and PSEG will be scheduled in
15 mid-2005 to vote on the transaction. In addition, various regulatory approvals are
16 needed in order to complete the Merger, and we currently anticipate that it will
17 take 12-15 months to obtain all of those approvals. Upon completion of the
18 Merger, Exelon will be renamed Exelon Electric & Gas Corporation (EEG).

19 **Q. Please describe briefly the combined post-Merger company.**

20 A. The combined company will have three transmission and distribution utilities
21 operating in three states (PECO in Pennsylvania, PSE&G in New Jersey and
22 ComEd in Illinois) that, in total, will provide service to over 7 million retail
23 electric customers and 2 million retail gas customers. Each of EEG's utility

1 subsidiaries will remain separate corporations with separate headquarters located
2 in their respective service areas: PECO in Philadelphia, Pennsylvania, PSE&G in
3 Newark, New Jersey, and ComEd in Chicago, Illinois.

4 Before planned divestitures, EEG will also have over 50,000 Megawatts
5 (MW) of generation located principally within the centrally dispatched control
6 area of the PJM Interconnection, L.L.C. (PJM), which is the Regional
7 Transmission Organization (RTO) approved by the Federal Energy Regulatory
8 Commission (FERC) for transmission systems covering all or parts of 12 states
9 and the District of Columbia. The headquarters of Exelon Generation Company,
10 LLC (Exelon Generation) will move from Pennsylvania to Newark, New Jersey,
11 and the headquarters of EEG's nuclear operation will move from the Chicago area
12 to southeastern Pennsylvania. The headquarters of the combined energy trading
13 organization will be located in southeastern Pennsylvania as well. Pre-and post-
14 Merger corporate organization charts are attached as Exhibits "A" and "D" to the
15 Joint Application

16 **Q. Who will hold the positions of Chairman, Chief Executive Officer and**
17 **President of EEG after the Merger?**

18 A. When the Merger is consummated, John W. Rowe, the current Chairman,
19 President and Chief Executive Officer of Exelon, will be President and Chief
20 Executive Officer of EEG and a member of the Board of Directors, and E. James
21 Ferland, who currently serves as Chairman, President and Chief Executive Officer
22 of PSEG, will be non-executive Chairman of the Board and a director. Upon Mr.

1 Ferland's retirement, anticipated to occur in March 2007, Mr. Rowe will become
2 Chairman of the Board and remain Chief Executive Officer of EEG.

3 **Q. Will there be any change in the senior management of PECO?**

4 A. Following the Merger, I will remain President of PECO and will continue to be
5 responsible for PECO's day-to-day operations. As is the case today, PECO's
6 paramount goal post-Merger will be the consistent delivery of safe, adequate and
7 reliable retail electric and natural gas service at reasonable rates.

8 III. REQUESTED REGULATORY APPROVALS

9 **Q. What regulatory approvals do the Joint Applicants request of the
10 Commission?**

11 A. The Joint Applicants request that the Commission find that a ruling is not required
12 or, in the alternative, approve a "change in control" of PECO and PSE&G under
13 Section 1102(a)(3) of the Public Utility Code. If the Commission decides to
14 assert jurisdiction over the Merger, the Joint Applicants request that the
15 Commission make the necessary findings under Sections 2210 and 2811 of the
16 Code, namely that the Merger will not lead to the unlawful exercise of market
17 power nor otherwise prevent customers from obtaining the benefits of properly
18 functioning and workable competitive retail natural gas and electricity markets.

19 **Q. On what basis could the Commission conclude that its approval of the
20 merger is not required?**

21 A. I am advised by counsel that the Merger will not result in a "change in control" of
22 either PECO, its immediate parent (Exelon Energy Delivery) or its ultimate parent

1 (Exelon), as that term is defined by the Commission's Merger Policy Statement.
2 In contrast, there will be a "change in control" of PSE&G, as it becomes a first-
3 tier subsidiary of Exelon Energy Delivery and a second-tier subsidiary of Exelon.
4 However, PSE&G's status as a "public utility" for Pennsylvania regulatory
5 purposes is attributable entirely to its fractional ownership interest in an electric
6 transmission line that runs from the Conemaugh Generating Station to the
7 Maryland border. PSE&G does not serve any retail customers in Pennsylvania,
8 nor is it authorized to, and, in fact, the certificate issued by the Commission in
9 1968 at Application Docket No. 94234 specifically provides that PSE&G "shall
10 confine and restrict its operations to the construction, maintenance, repair,
11 replacement, and removal of the proposed electric transmission line."

12 13 **IV. BENEFITS OF THE MERGER**

14 **Q. Please explain generally the benefits the Merger is expected to produce.**

15 **A. We expect the Merger to produce substantial benefits in several important ways.**

16 **Increased Scale, Scope and Operational Diversity.** The Merger of
17 Exelon and PSEG will increase the scale and scope of the combined entity's
18 energy delivery and generation businesses. For retail utility operations, this
19 means a larger geographic "footprint" and, as a result, a more diverse customer
20 base. For the generation business, it means the combined company's larger
21 portfolio of generation assets will enable it to capture economies of scale and will
22 provide more balance and diversification in terms of geographic location, fuel
23 mix, dispatch and load-serving capacity. In addition, EEG's overall operations

1 will be more balanced, with approximately half its earnings and cash flow coming
2 from its three regulated utilities and approximately half from the generation
3 business. The greater scale, scope and diversification of the combined company's
4 operations should provide more stable cash flows and greater earnings
5 predictability, which, in turn, should allow EEG to maintain a strong balance
6 sheet and continued access to capital at favorable rates.

7 **Financial Strength and Flexibility.** The Merger will provide continued
8 financial strength and flexibility associated with a company with a strong balance
9 sheet. Following the Merger, EEG will have approximately \$70 billion in assets,
10 a market capitalization of approximately \$40 billion, annual revenues of
11 approximately \$26 billion and annual net income of approximately \$2.6 billion.
12 The PECO Energy balance sheet will not change as a result of the Merger.

13 **Commitment to High-Quality Service; Sharing of Best Practices.**
14 Exelon is committed to maintaining and, where possible, enhancing the high-
15 quality service it provides. As a result of the merger, PECO will benefit from
16 the opportunity to share best practices with PSE&G, which has an outstanding
17 record of reliability and customer service in terms of both its electric and natural
18 gas delivery functions.

19 **Synergies.** The Merger will create the opportunity to achieve meaningful
20 cost savings not only through the sharing of best practices, as mentioned above,
21 but also through the elimination of duplicative functions, improved operating
22 efficiencies in nuclear and other generation operations and supply-chain benefits
23 from improved sourcing. William Arndt, Exelon's Senior Vice President,

1 Financial Operations, in his testimony, describes both the anticipated synergies
2 and the costs that will have to be incurred to achieve those synergies.

3 **Commitment to Competition.** Exelon and PSEG have been strong
4 advocates of competition in retail and wholesale markets for both electricity and
5 natural gas. This shared vision will allow EEG to be even more active in
6 promoting competitive markets and developing energy-related services. In
7 addition, we anticipate that the knowledge and experience of each company will
8 enhance EEG's ability to manage the transition to competition, which will provide
9 benefits for customers and shareholders. We also recognize that combining the
10 generation assets of the two companies raises certain market concentration
11 concerns. To address those concerns, as part of our Application to the Federal
12 Energy Regulatory Commission (FERC) for approval of the Merger, we are
13 proposing a mitigation plan that entails divesting certain generating assets and
14 selling entitlements to nuclear generation. Dr. William H. Hieronymus, PECO's
15 witness on competitive markets, analyzes the market concentration issues and
16 describes the proposed generation mitigation plan in his testimony.

17 In addition to the benefits I have described above, we believe the Merger
18 will provide greater opportunities for our employees and benefit the communities
19 we serve, as I explain below.

20 **V. EFFECTS OF THE MERGER ON SERVICE,**
21 **RATES, JOBS AND LOCAL COMMUNITIES**

22 **Q. Mr. O'Brien, how will the merger affect PECO's day-to-day operations?**

1 A. It will not have a significant impact on PECO's day-to-day operations. As
2 previously mentioned, I will continue to serve as President of PECO. In addition,
3 PECO's headquarters will remain in Philadelphia in accordance with
4 commitments that we have made in the past. In effect, PECO is going to be the
5 same company that it is today, with the same employees in the field and with the
6 same strong commitment to our customers and the communities in which they
7 reside.

8 Over the past several years, PECO has consistently met or exceeded its
9 commitments in terms of reliability, safety, and customer service. There will be
10 no relaxation in our performance going forward. To the contrary, I believe that
11 the Merger will provide PECO opportunities to perform at an even higher level.
12 I say this because the combined entity, by virtue of its greater resources and
13 sharing of "best practices," will be better positioned to meet future customer
14 demands. Similarly, the Merger, by opening up new and broader career
15 opportunities for employees, will enhance PECO's ability to attract, train and
16 retain an exceptionally skilled workforce.

17
18 **Q. Please provide more details around PECO's performance in the areas of**
19 **safety, reliability and customer service.**

20 A. PECO has met or exceeded all prior merger commitments in the Customer
21 Service area. Additionally, PECO continues to show improvement in its customer
22 service performance. PECO also continues to have any excellent safety record,
23 consistently performing in the top deciles in key safety areas. In regards to

1 reliability, PECO has exceeded all PUC benchmark and standards for reliability
2 and has shown an improving trend, since restructuring in 1998, in the areas of
3 Customer Average Interruption Duration Index (CAIDI) and System Average
4 Interruption Frequency Index (SAIFI). These improvements have occurred within
5 the backdrop of the 2000 PECO/Unicom merger and PECO will have further
6 opportunities to continue to benefit from sharing best practices with PSE&G.

7 **Q. What effect will the Merger have on PECO's rates?**

8 A. None in the short-term. As the Commission is aware, PECO's electric
9 transmission and distribution rates are capped through the end of 2006 and its
10 generation rates are capped through the end of 2010. These commitments, to
11 which PECO agreed to as part of the 2000 PECO/Unicom Merger and the 1998
12 Electric Restructuring Case, will not be affected by the Merger. Nor will there be
13 any change, as a result of the Merger, to any of PECO's rules, regulations, terms
14 and conditions of service, or existing customer assistance programs. At the same
15 time, and as Mr. Arndt explains in his testimony, the Merger will generate
16 economies, some of which will accrue to PECO's Pennsylvania jurisdictional
17 regulated businesses. Those economies will help offset future increases in the
18 cost of providing reliable regulated electric and gas distribution service and, thus,
19 may give rise, over time, to lower rates than would otherwise be the case.

20 **Q. What measures are in effect to assure that PECO's customers are not**
21 **exposed to the risks attendant to EEG's non-jurisdictional operations?**

22 A. In the 2000 PECO/Unicom merger proceeding to which I earlier referred, PECO
23 agreed that the cost of capital used in establishing PECO's retail electric and

1 natural gas rates would “not reflect any risk adjustment associated with its
2 corporate parent Exelon, or any affiliate not regulated by the
3 Commission....PECO’s cost of capital shall include its cost rate for debt,
4 preferred stock, and common equity....” PECO further agreed that, absent the
5 Commission’s authorization, it would not (i) guarantee the debt or credit
6 instruments of Exelon or any affiliate not regulated by the Commission, (ii)
7 mortgage utility assets on behalf of Exelon or such affiliates, or (iii) loan money
8 or otherwise extend credit to Exelon or such affiliates for a term of one year or
9 more. Finally, we agreed to maintain reasonable accounting controls and pricing
10 protocols to govern transactions with affiliates, and to provide the Commission,
11 the OTS, the OCA and the OSBA reasonable access to the books, records and
12 personnel of PECO’s affiliates where necessary for the Commission to adequately
13 review PECO’s purchases of goods or services from those affiliates. We make
14 the same pledges in this case.

15 **Q. In the Unicom merger proceeding, PECO also made various concessions that**
16 **were intended to ensure that Pennsylvania retail customers would not be**
17 **charged certain costs, including nuclear decommissioning expense, associated**
18 **with the ownership and operations of any nuclear generating plants (or**
19 **fractional ownership interests in such plants) that it did not hold on**
20 **December 31, 1999. Does PECO make the same commitment in this case as**
21 **it relates to PSEG’s ownership interests in the Hope Creek, Salem, and Peach**
22 **Bottom plants?**

23 **A. Yes, it does.**

1 **Q. How will the Merger affect the further development of competitive retail**
2 **electric and natural gas markets in Pennsylvania?**

3 A. I am not an expert on competition, and on this subject I will defer to the testimony
4 of Dr. Hieronymus. I understand that Dr. Hieronymus feels certain that if, as is
5 anticipated, the combined entity is successful in increasing the capacity factors of
6 the Salem and Hope Creek plants, the availability of more low-cost nuclear
7 generation should, all other factors being equal, put downward pressure on
8 wholesale power prices in the PJM region. As Dr. Hieronymus explains in his
9 testimony, lower wholesale prices, in turn, should inure to the benefit of retail
10 customers. In addition, PSEG brings a wealth of experience in acquiring energy
11 and capacity through the competitive procurement process employed by its utility
12 subsidiary, PSE&G, as a participant over the past several years in New Jersey's
13 Basic Generation Service (BGS) auction. That experience will be of significant
14 value to PECO and the Commission in developing and implementing the systems
15 required for PECO to satisfy its default/provider of last resort obligations at the
16 end of its generation rate cap period. Regarding the gas market, Dr. Hieronymus
17 in his testimony, after considering the ability of the merging companies to control
18 the price of gas and/or the retail market concluded that the merger will have no
19 impact on the competitive retail gas market.

20 **Q. Will the Merger result in any reductions in force?**

21 A. Yes, but only to a modest degree. Certain positions, primarily in the managerial
22 and administrative ranks, will no longer be necessary as duplicative functions are
23 consolidated. However, we believe that many of the reductions in force will be

1 achieved, to the extent practical, through attrition and/or the normal retirement
2 process. Severance programs may also be utilized. Perhaps more importantly,
3 there are no plans to reduce field forces in either our electric or natural gas
4 delivery functions.

5 **Q. Specifically, how will PECO's union employees be affected by this**
6 **transaction?**

7 A. With respect to PECO's union positions, as with all positions, employees will be
8 treated fairly and equitably. PECO believes the Merger will not affect its
9 relationship with its unionized workforce. Any changes to the terms and
10 conditions of employment for unionized employees will occur as a result of the
11 collective bargaining process. We will accomplish any job reductions in
12 accordance with our collective bargaining obligations and, as much as possible,
13 through attrition. At this time, we do not anticipate that any reductions will be
14 made to field level employees.

15 **Q. Will the Merger affect PECO's support of regional institutions, charitable**
16 **organizations and economic development initiatives?**

17 A. Absolutely not. PECO is a significant contributor to many important nonprofit
18 and civic initiatives in our service territory. Exelon and PSEG share this
19 commitment to community leadership. We will continue to support the
20 educational, environmental, arts and culture and community development
21 programs that improve the quality of life in our region. These include the PECO
22 Primate Reserve at the Zoo, the Philadelphia Academies career education
23 programs, Open Space environmental grants in our five counties, and major

1 support to help build the Kimmel Center, and relight Boathouse Row. We also
2 commit our employee volunteer resources as coaches, mentors and fundraisers
3 and through participation as board members and service on township
4 commissions, school boards and borough councils. Since the merger of PECO
5 and Unicom in 2000, PECO Energy has continued to be a recognized leader in
6 economic development activities within the southeastern Pennsylvania region.
7 PECO has provided direct support to local efforts that led to the attraction and / or
8 retention of over 70 companies to expand or locate in the region, creating more
9 than 8,000 jobs and 98 megawatts of additional electric load. PECO has also
10 actively participated in efforts to revitalize brownfields in order to create jobs and
11 foster economic development in urban areas.

12 **Q. Will the Merger affect PECO's involvement in the customer assistance**
13 **programs?**

14 **A.** No, PECO will continue its strong support for its numerous Universal Service
15 Programs including CAP, LIHEAP, LIURP and CARES. Further, all settlement
16 commitments associated with the 2000 PECO/Unicom Merger and 1997 Electric
17 Restructuring Case will continue to be honored.

18 VI. CONCLUSION

19 **Q. Does this conclude your testimony?**

20 **A.** Yes, it does.

(REVISED)

jk
9-22-05
Phila

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

JOINT APPLICATION OF PECO :
ENERGY COMPANY AND PUBLIC :
SERVICE ELECTRIC AND GAS :
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THE MERGER OF PUBLIC :
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Docket No. A-110550F0160

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REBUTTAL TESTIMONY
OF
DENIS P. O'BRIEN

Providing an Overview of the Joint Applicants' Rebuttal Case and Responding To
Miscellaneous Opposing Party Proposals

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Date: July 29, 2005

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1 allow PECO to continue to sustain this focus after the PSEG merger (Section VI).

2 Finally, I comment upon the opposing parties' synergy-savings and rate-stay out
3 proposals and the corresponding risks to which PECO would be exposed if they were
4 adopted (Section VII).

5 **II. GENERAL COMMENTS ON THE OPPOSING PARTIES'**
6 **PRESENTATIONS**

7 **Q. A number of the parties have raised concerns over the impact of the merger upon**
8 **PECO's local operations and its management. Should they be concerned?**

9 A. No. I have really struggled to understand the concern. There is simply no reason to
10 believe that PECO's operations will be negatively affected by the transaction. On the
11 contrary, in PSE&G, Exelon brings a talented, valuable and accomplished partner to the
12 table that can only enhance performance. On a practical level, this transaction will mean
13 that a larger stable of qualified human talent, materials and resources will be available to
14 PECO. Moreover, as I explain in Section VI below, Exelon will continue to use the
15 management structures and incentive-compensation tools that made the integration
16 process following the last merger so successful. Finally, from a corporate-structure
17 perspective, this transaction has no impact on PECO. Exelon Energy Delivery and, in
18 turn, Exelon Corporation are PECO's parent and grandparent today and will be after the
19 merger is completed. PSE&G's regulated operations in New Jersey will become part of
20 Exelon's family of energy delivery companies. Indeed, as explained in the Joint
21 Application, Commission approval is not required for this transaction because no change
22 of control is involved.

1 **Q. The opposing parties generally contend that the Joint Applicants have not**
2 **demonstrated that the proposed merger will produce “affirmative public benefits . .**
3 **. in some substantial way”. Please comment.**

4 A. I am not a lawyer and will leave it to others to argue over the correct interpretation of
5 these words. However, as the person who is directly responsible for PECO’s day-to-day
6 operations, I believe that the question the Commission should ask itself is whether the
7 public including principally our customers and our shareholders will be better off with
8 the merger than without it, and not, as the opposing parties appear to suggest, whether
9 this proceeding can be leveraged in such a way to satisfy each intervening stakeholder’s
10 “wish list.”

11 **Q. Why do you believe that the public will be better off if the proposed merger is**
12 **approved?**

13 A. In their Joint Application and the testimony submitted with it, PECO and PSE&G
14 described various benefits of the proposed merger that will affirmatively promote the
15 public interest in a number of substantial ways. Those benefits include additional scale
16 and scope in energy delivery; increased financial strength and flexibility; and an
17 opportunity to achieve meaningful cost savings. In short, I expect the merger to enhance
18 overall operations and strengthen PECO’s ability to provide cost-effective, safe and
19 reliable service. It will do so by unlocking synergies; facilitating the sharing of best
20 practices; promoting the further development of competitive wholesale and retail energy
21 markets; providing employees with more opportunities; and enabling PECO to continue
22 to play a leadership role in terms of contributing time, money and other resources to
23 charitable and civic institutions throughout its service territory.

1 **Q. It is evident that the opposing parties do not agree with your assessment. Are there**
2 **any common themes that emerge from the opposing parties' presentations that you**
3 **would care to address?**

4 A. Yes, I believe that there are at least four that deserve mention. First, several parties imply
5 that the sharing of best practices is a nebulous concept entitled to little consideration.
6 Second, the magnitude of the commitments requested strongly suggests that the opposing
7 parties fail to appreciate that this is not a transformational corporate transaction for
8 PECO. Third, and related to the immediately preceding theme, certain parties clearly
9 seek to use this proceeding to extract concessions that go far beyond the proper scope of
10 this case. Fourth, several parties seek to justify the relief they seek on the ground that
11 PECO has somehow failed to live up to the commitments it made five years ago as part
12 of the settlement agreement that ultimately resolved the PECO/Unicom merger
13 proceeding. I address each of these points below.

14 **A. Best Practices**

15 **Q. Mr. O'Brien, the Joint Applicants have been criticized for not identifying and**
16 **quantifying the benefits that may be derived through the sharing of best practices.**
17 **Please comment.**

18 A. I believe that criticism reflects a fundamental misunderstanding as to the nature of best
19 practices and how they are identified and implemented. Plainly, finding ways to do our
20 business better is at the core of what we do. Sometimes that can be achieved through
21 industry-wide training opportunities like seminars and classes. More often, however, the
22 most effective way to incorporate best practices is to bring the people with the knowledge
23 into your business. I am confident that PECO will benefit from the sharing of best

1 practices with the addition of PSE&G's knowledgeable and experienced personnel.
2 PSE&G's history of strong reliability, customer service, and safety performance will
3 result in an even stronger energy delivery record for PECO and Exelon as a whole. I
4 firmly believe that the two-way in-depth exchange undertaken in a systematic way
5 between PSE&G and Exelon will serve to improve the performance of the entire Exelon
6 energy delivery business, including PECO's.

7 **Q. Before we discuss those benefits, please provide a definition of best practices.**

8 A. Certainly. Best practices generally refer to a technique or methodology that, through
9 experience and research, has proven to be the best path to achieve a desired result, such
10 as superior performance against key organizational benchmarks. Best practices may
11 include specific guidelines, tactics, and procedures for accomplishing the work
12 effectively and efficiently. In the context of electric distribution and customer service,
13 best practices can refer to business processes or deployment of technology that enable the
14 service provider to achieve higher levels of service reliability, call-center performance, or
15 safety performance, to name a few. However, to take advantage of the benefits that best
16 practices can provide, an organization must be committed to examine itself critically, to
17 perform the research necessary to identify such practices, to develop the processes for
18 implementing them and to expend the necessary resources to produce results.

19 **Q. How are best practices identified and implemented?**

20 A. Best practices are identified generally as a result of research, investigation and testing.
21 Under Exelon's management model, Exelon and its energy delivery business is
22 committed to identifying and implementing best practices through benchmarking other
23 companies in the industry and internal development. Through this research and

1 development, we are able to identify practices, procedures and methods that are
2 performed elsewhere inside and outside the organization that may be applied to improve
3 performance and Exelon. Implementation of those practices typically begins with the
4 development of a policy, procedure or method and then proceeds through the training of
5 employees who then apply the practice in their work environment. Through this process,
6 Exelon has been able to improve its performance and, as a result, provide benefits to
7 PECO's customers in the form of improved reliability, customer service, safety, fiscal
8 management and corporate governance.

9 **Q. Are there examples of best practices that have been identified and implemented**
10 **since PECO's merger with Unicom in the year 2000?**

11 A. Yes. Consistent with its vision of becoming a world-class company, Exelon has
12 developed literally hundreds of new practices, procedures, and methods over the past few
13 years that have led to improved efficiency and effectiveness in areas of our business
14 including electric distribution operations, gas distribution operations, financial controls,
15 human resources, etc. A partial listing includes a standard related to correcting substation
16 problems (ST-EMS-111), a storm lockout response procedure (OP-ED-4003), a
17 procedure related to reporting and tracking defective transmission equipment (OP-ED-
18 993), a self-guide for investigating circuit-line trippings (OP-PE-040013), and a ready to
19 start checklist for newly installed or reconfigured equipment (OP-ED-020013), to name
20 just a few.

21 **Q. Did these practices result from choosing a particular practice that had previously**
22 **been used by PECO or Unicom prior to the merger?**

1 A. Not entirely. Rather, they evolved from a number of sources. Simply choosing a practice
2 that had been in use at PECO or Unicom's ComEd subsidiary prior to the merger was not
3 our goal. At the time of the merger, both PECO and ComEd desired to improve
4 reliability, customer service and safety and both recognized that, to make those
5 improvements, we had to do more than simply choose one practice or the other.
6 Importantly, combining the companies gave the merged entity the unique opportunity to
7 create practices for corporate governance, financial management and reporting, and
8 operations that truly reflected improved means of doing business. Imposition of the
9 Sarbanes-Oxley requirements also mandated that Exelon adopt practices that enabled it to
10 comply efficiently and effectively with the complexities of that legislation.

11 **Q. Does the merger with PSE&G present opportunities for the identification and**
12 **implementation of additional best practices?**

13 A. Yes, we believe it does. PSE&G has strong performance in many areas, including
14 service reliability, safety and customer service. It also has a very talented and well-
15 educated workforce that is experienced in dealing with the same or similar work
16 situations that PECO and ComEd must deal with every day. In the reliability arena,
17 PSE&G's performance surpasses PECO's in certain measures of performance. After the
18 merger, and with the assistance of those very talented employees, we intend to
19 benchmark PSE&G methods and practices and to determine which can be applied or
20 remodeled to improve the overall Exelon reliability performance. Consistent with
21 Exelon's desire to be a world-class company, similar efforts will be engineered to
22 determine areas of improvement that can be achieved in every aspect of the business.

1 **Q. Earlier you expressed disagreement with the notion that the benefits of best**
2 **practices resulting from the merger with PSE&G are illusory because no examples**
3 **of these benefits have been identified to date. What is the basis of your**
4 **disagreement?**

5 A. As I have stated, the implementation of best practices first requires identification through
6 research and benchmarking, then processes must be developed and tested. The
7 implementation phase requires employee training and outreach communications. To
8 expect Exelon to complete the identification phase before the Companies actually merge
9 would be unreasonable. Yet, while we cannot say what specific practices will be
10 identified and implemented after the merger is consummated, there is strong evidence
11 that PECO and the rest of Exelon will benefit in the energy delivery function. This
12 evidence comes in the form of PSE&G's strong safety, customer service and reliability
13 record.

14 **B. Magnitude Of The Concessions Sought**

15 **Q. Have you had an opportunity to quantify the magnitude of the concessions sought**
16 **by the opposing parties?**

17 A. Yes, for the most part. As other witnesses will describe in greater detail, we have
18 conservatively estimated the value of the various concessions sought to exceed \$900
19 million (including PennFuture witness Plunkett's proposed \$204 million capital
20 investment in energy efficiency). (Exhibit DPO – 1.) These requests include, amongst
21 others, recommended rate discounts ranging from \$134 million (OTS) to \$347 million
22 (OSBA); additional low-income customer assistance of \$96.0 million to \$103.0 million;
23 the funding of environmental and energy-efficiency programs of approximately \$473

1 million; and additional expense associated with proposed staffing and charitable-
2 contribution commitments. The cost to PECO of these requests, and the implications
3 they would have in terms of our ability to continue to provide safe and reliable service,
4 are staggering. Moreover, the cost of the many social and environmental programs
5 eventually would be borne by our customers. As the OCA's expert, Ms. Barbara
6 Alexander, testified in her deposition, the social program costs "should be paid for by
7 other customers" in any future base rate case. (Exhibit DPO-2 at 109.) Thus, in the long
8 run, the hundreds of millions of dollars in costs for these social and environmental
9 programs will likely drive up rates, not reduce them.

10 **Q. Why, in your judgment, have the opposing parties come up with such unrealistic**
11 **demands?**

12 A. I'm not quite sure. What is apparent, however, is that the parties have failed to recognize
13 that, unlike certain other deals in which they may have been involved, this transaction is
14 not transformational in terms of its impact on PECO. When PECO merged with Unicom
15 in 2000, numerous corporate and administrative functions were consolidated and, indeed,
16 PECO's operations were significantly restructured. As a result, the opportunities to
17 achieve cost savings in regulated operations were far greater. PECO was therefore able
18 to offer and deliver substantial rate reductions. Yet, even there, the relief that we were
19 able to provide in the form of stipulated concessions was but a fraction of what the
20 opposing parties now seek in this case. Moreover, in the years following the
21 PECO/Unicom merger, we were able to extract further economies through the "Exelon
22 Way" program, which helped to pay for some of the concessions to which we had agreed.
23 That is not to say that the current merger will not unlock more savings. To the contrary,

1 Mr. Arndt has demonstrated in his study that additional synergies are available.

2 Nonetheless, any attempt to compare the two mergers would be a serious mistake.

3 **Q. How do you respond to the opposing parties' contention that the savings calculated**
4 **by Mr. Arndt are illusory because PECO has not proposed specific rate reductions?**

5 A. I believe that criticism is unwarranted. As we pointed out in the Joint Application, the
6 synergies that will accrue to PECO's regulated operations over time will, at least in part,
7 offset the increasing cost of providing regulated retail utility service and will thereby
8 reduce the size of future rate increases. Nonetheless, and as I discuss later in my rebuttal
9 testimony, if the Commission concluded that it would be beneficial, PECO would be
10 willing to consider a modest extension of the current distribution and transmission rate
11 cap coupled with an appropriate sharing of future regulated merger savings.

12 **C. Requests That Exceed The Proper Scope Of This Proceeding**

13 **Q. Apart from their dollar impact, are there other reasons why certain of the opposing**
14 **parties' requested concessions should be rejected?**

15 A. Yes. In my opinion, many of the requested concessions represent attempts to either (1)
16 extract commitments that have little or nothing to do with this case and the company, (2)
17 circumvent other ongoing Commission proceedings, or (3) relitigate positions that the
18 opposing parties have already lost elsewhere.

19 **Q. What are some examples of attempts to extract commitments that you believe have**
20 **nothing to do with this case?**

21 A. One obvious example is the request by DEP that PECO provide funding for the DEP's
22 "nuclear safety, emergency preparedness and environmental surveillance activities." As

1 became apparent in Mr. Allard's response to discovery (see answer attached as (Exhibit
2 DPO-6), the purported rationale for this request is the claim that the current fee assessed
3 the operators of Pennsylvania nuclear generating plants is insufficient to cover the DEP's
4 "salaries, benefits and other program costs." If that, in fact, is the case, the answer lies in
5 the legislative budgeting process or in an increase in the annual fee for all jurisdictional
6 nuclear plant operators (i.e., FirstEnergy, PPL and Exelon). There is certainly no basis
7 for singling out PECO or this merger proceeding in that regard. Indeed, Mr. Allard's
8 proposal is apparently directed at Exelon Generation Company, not PECO. Similarly,
9 and as I discuss later, Mr. Kuders' deposition reveals that the Labor Parties'
10 recommendation that merger approval be denied is tied to labor issues that should not be
11 addressed in these proceedings.

12 **Q. How have the opposing parties sought to circumvent other ongoing Commission**
13 **proceedings?**

14 A. Several parties, including the DEP, PennFuture and The Reinvestment Fund, would
15 condition merger approval on PECO's agreement to fund, in substantial amounts totaling
16 hundreds of millions of dollars, renewable resources and energy-efficiency initiatives.
17 Yet, as Mr. Crowe points out in his rebuttal testimony (PECO Statement No. 7-R), issues
18 concerning the development of renewable energy sources, net metering and
19 interconnection rules, and demand-side response and energy-efficiency programs are all
20 being addressed by the Commission at Docket No. M-00051865 as part of its
21 implementation of the Alternative Energy Portfolio Standards Act of 2004. Likewise,
22 Mr. Geller, on behalf of Action Alliance et al., would have PECO take certain undefined
23 steps to mitigate the effect of Act 201 on service terminations and would thereby

1 prejudice the outcome of another Commission proceeding dealing with the
2 implementation of that legislation. OSBA witness Kalcic, on the other hand, would deny
3 PECO recovery of any “premium” to which PECO might be entitled under the
4 Commission’s default service (POLR) regulations if it were shown that Exelon had
5 “abused market power,” even though the regulations in question have not even been
6 finalized.

7 **Q. Lastly, Mr. O’Brien, you previously stated that certain parties seek to relitigate**
8 **issues that they may have lost in other proceedings. Please explain.**

9 A. While there are several instances where I find this to be the case (e.g., the “ring-fencing”
10 measures proposed by OTS witness Deardorff and OCA witness La Capra, the market-
11 power concerns expressed by witnesses for FirstEnergy, the OCA, PPL and the
12 Philadelphia Gas Works), perhaps the clearest example concerns OCA witness
13 Alexander’s recommended Service Quality Improvement Plan, which includes automatic
14 penalty provisions called “compensation dollars.” As Mr. Patterer discusses in his
15 rebuttal testimony (PECO Statement No. 8-R), the Commission recently concluded a
16 year-long rulemaking proceeding in which it thoroughly evaluated its existing service
17 reliability rules and adopted new regulations that became effective in September 2004.
18 The OCA and many other parties participated in that proceeding. In total, tens of
19 thousands of pages of data and policy statements were submitted to the Commission as
20 part of the rulemaking initiative. The resulting rules balanced the parties’ many
21 competing interests and positions by adopting standards that reflect the complexity of the
22 reliability issues and, in particular, variables such as storm frequency and severity. The
23 comprehensive rules go far beyond a set of metrics and standards and deal with the

1 interplay of reporting requirements with the standards themselves. Amongst its other
2 findings, the Commission rejected the penalty provisions, i.e., compensation dollars,
3 advocated by the OCA in that proceeding and concluded that penalties are not
4 appropriate. Indeed, Ms. Alexander testified at her deposition that the Commission twice
5 has rejected the same penalty provisions which the OCA has recommended in this matter,
6 namely, in the: (1) 2004 rulemaking; and (2) the FirstEnergy/GPU merger proceeding
7 (Exhibit DPO-2 at 90, 92.) Nonetheless, Ms. Alexander believes “that the Commission
8 ought to re-think that position”, (Id.) and that the Commission should “reconsider their
9 prior decisions on that matter” (Id.). As a matter of policy, we respectfully suggest that
10 the Commission should not revisit comprehensive proceedings in this merger case simply
11 because a party wants another bite at the apple to reargue positions that already were
12 rejected.

13 **D. Living Up To Prior Commitments**

14 **Q. Several witnesses, including those appearing on behalf of Action Alliance et al., the**
15 **City and the Labor Parties contend that PECO has failed to live up to commitments**
16 **made as part of the Unicom Merger Settlement in 2000. Do you agree?**

17 **A.** I certainly do not and, quite frankly, I find the allegation that we have not kept our
18 promises to be completely unfair. I also find the timing of these claims highly suspect. If
19 these parties truly believed that PECO was not in compliance with the Unicom Merger
20 Settlement, I must question why they waited until this merger proceeding before bringing
21 their concerns to PECO’s and the Commission’s attention. In any event, specific
22 arguments regarding staffing levels at our Main Office Building and workplace safety are
23 addressed later in this testimony. In addition, Ms. Crutchfield (PECO Statement No. 4-

1 R) responds to the assertion that PECO has failed to honor its commitments in the area of
2 low-income customer assistance. For present purposes, I would simply state that these
3 accusations are unfounded and should be disregarded.

4 **Q. Do you have any concluding remarks regarding this portion of your rebuttal**
5 **testimony?**

6 A. For many years, PECO has provided safe and reliable service to the residents of
7 southeastern Pennsylvania. It presently enjoys a well-deserved reputation for furnishing
8 safe and reliable service; is an environmental leader; provides far more financial
9 assistance to low-income customers than any other utility in the Commonwealth; is a
10 major contributor to charitable and community-based organizations through the donation
11 of funds and the active involvement of its employees; and plays a major role in the
12 ongoing economic revitalization of the Delaware Valley. Approval of the proposed
13 merger, without significant or unreasonable conditions being attached, will enable PECO
14 to continue on this course.

15 **III. OVERVIEW OF THE JOINT APPLICANTS' REBUTTAL CASE**

16 **Q. Please identify the specific subject areas that the Joint Applicants' witnesses cover**
17 **in their rebuttal testimony.**

18 A. PECO's rebuttal witnesses address the following major subject areas:

- 19 • Market Concentration And Mitigation
- 20 • Rate Reductions And Corporate Ring-Fencing
- 21 • Customer Service And Low Income Assistance
- 22 • Environmental And Energy Efficiency Initiatives
- 23 • Economic Impact On Community

1 The nature of the testimony with respect to each of the foregoing areas is summarized
2 below.

3 **A. Market Concentration And Mitigation**

4 Several parties, including FirstEnergy, the OCA, PGW and PPL, contend that the merger
5 will provide Exelon both horizontal and vertical market power and that the Joint
6 Applicants' mitigation plan is insufficient to curb potential exercises of such power.
7 Recommended remedies include the sale of additional generating units, actual rather than
8 "virtual" divestiture of nuclear power, and the spin-off to an independent third party of
9 the combined natural gas operations of PECO and PSE&G.

10 As explained by Drs. Hieronymus (PECO Statement No. 3-R) and Morris (PECO
11 Statement No. 11-R), nearly all of the analyses and arguments presented by the opposing
12 parties were carefully reviewed and rejected by the Federal Energy Regulatory
13 Commission ("FERC") in its July 1, 2005 Order approving the merger and proposed
14 mitigation plan. Indeed, in at least one instance (FirstEnergy), an opposing party has
15 simply submitted the same statements it earlier filed at the FERC. Moreover, and as
16 noted by Mr. Crowley (PECO Statement No. 9-R), the PJM's Market Monitoring Unit is
17 fully equipped to police any potential exercise of market power.

18 PGW's recommended spin-off of gas operations is similarly without merit. According to
19 PECO's experts, PGW witness Carpenter's market concentration calculations are flawed
20 in a number of critical respects. In addition, and as pointed out by Mr. Arndt (PECO
21 Statement No. 2-R), the corporate separation of gas operations would sacrifice many of
22 the substantial economies of scale and scope presently enjoyed by PECO and PSE&G
23 and would increase, not decrease, the costs borne by customers.

1 **B. Rate Reductions And Corporate Ring-Fencing**

2 The OTS, OCA and OSBA request massive rate reductions which they purport to justify,
3 either explicitly or impliedly, by flowing through to retail customers a significant portion
4 of the savings that Exelon hopes to achieve by combining its non-jurisdictional
5 generation and wholesale power marketing lines of business with PSE&G. OTS witness
6 Gruber would further compound this inequity by requiring that the proceeds from the sale
7 of any generating units divested in accordance with the Joint Applicants' mitigation plan
8 also be used to reduce retail rates.

9 Mr. Sidak explains in his rebuttal testimony (PECO Statement No. 12-R) that the
10 proposed sharing of non-regulated savings and flow through of divestiture proceeds
11 represents a transparent and improper attempt to rewrite PECO's 1998 Restructuring
12 Settlement and 2000 Unicom Merger Settlement, and to radically redefine the careful
13 balancing of stakeholder interests embodied therein. The net effect of these
14 recommendations would be an after-the-fact disallowance of previously approved
15 stranded cost recovery, which, I am advised by counsel, would be contrary to the Electric
16 Competition Act and prior decisions of this Commission.

17 Notwithstanding their insistence that the Commission fund rate reductions with Exelon's
18 non-regulated savings, the OTS and OCA would also impose certain corporate "ring-
19 fencing" restrictions, the principal purpose of which is to insulate retail customers from
20 the risks attendant to Exelon's non-regulated operations. The patent inconsistency of
21 these positions is readily apparent. In any event, and as discussed by Mr. Mitchell
22 (PECO Statement 6-R), the rate, security issuance and affiliated interest provisions of the
23 Public Utility Code render such additional measures unnecessary.

1 **C. Customer Service And Low Income Assistance**

2 OCA witness Alexander would impose on PECO a 14-point Service Quality
3 Improvement Plan and would subject PECO to penalties ranging up to \$14 million per
4 year if one or more of her suggested reliability and customer service standards were not
5 met. She contends that such a program is needed - - even though PECO has met or
6 exceeded all reliability and customer service commitments - - because the merger could
7 lead to a “deterioration” of PECO’s performance.

8 Ms. Reidy (PECO Statement No. 5-R) and Mr. Patterer (PECO Statement No. 8-R)
9 respond to Ms. Alexander’s proposal. Ms. Reidy explains why there is no reason to be
10 concerned that the consolidation of functions and/or the implementation of a new
11 customer information software system will adversely affect customer service. Mr.
12 Patterer, in turn, critiques the specific components of Ms. Alexander’s recommended
13 Service Quality Improvement Plan, noting that Ms. Alexander has misconstrued and
14 misapplied certain historic data and that many elements of her Plan, including the
15 automatic penalty provisions, were rejected by the Commission in its recently concluded
16 service reliability rulemaking proceeding. Moreover, I am told that Ms. Alexander
17 admitted at deposition that the tables outlining her proposal are in error. I am further
18 advised that the full scope of these errors could not be determined at her deposition
19 because Ms. Alexander refused to answer further questions about her tables or the errors
20 in her testimony. (Exhibit DPO-2 at 61 – 72.)

21 Action Alliance et al. and the OCA urge significant modifications to PECO’s current low
22 income customer assistance programs, including an expansion of the usage levels eligible
23 for rate discounts, mandatory increases in program enrollment, arrearage forgiveness,

1 substantial donations to PECO's hardship funds, and the recruitment of seven additional
2 CARES workers. Ms. Crutchfield evaluates each of these recommendations in her
3 rebuttal testimony (PECO Statement No. 4-R) and determines that the opposing parties'
4 criticisms are unwarranted. Ms. Crutchfield acknowledges that PECO's existing low-
5 income assistance offerings are not perfect, and she pledges to make certain
6 programmatic changes to enhance their effectiveness. However, she rejects the
7 suggestion that wholesale revisions in funding levels or eligibility criteria are required at
8 this time.

9 **D. Environmental And Energy Efficiency Initiatives**

10 Three parties - - the DEP, PennFuture and The Reinvestment Fund - - would have PECO
11 spend the truly astounding sum of \$473.5 million on various environmental and energy
12 efficiency causes, ranging from the funding of wind power and other renewable resources
13 to payments to cover the costs incurred by the DEP in carrying out its statutory
14 responsibilities. As previously explained, and as Mr. Crowe (PECO Statement No. 7-R)
15 and Mr. Benjamin (PECO Statement No. 10-R) properly note, there is no reasonable
16 nexus between these proposals and this merger proceeding. I am advised that, largely for
17 this reason, similar requests were denied in the FirstEnergy/GPU merger case.

18 **E. Economic Impact On Community**

19 The City, the Labor Parties and Senator Williams express concern over workforce
20 reductions, both in aggregate and at PECO's corporate headquarters at 2301 Market
21 Street. I respond to these concerns in the next section of this rebuttal statement. In
22 addition, Mr. Kuders, on behalf of the Labor Parties, contends that the adverse economic
23 impact of purported "job losses" will far outweigh any savings that the merger may yield.

1 Mr. Arndt (PECO Statement No. 2-R) demonstrated that Mr. Kuders' analysis does not
2 withstand scrutiny.

3 The City, the OCA and Senator Williams also seek assurances that PECO will not reduce
4 its historic levels of charitable giving following the merger. I made that commitment at
5 the outset of this case and reaffirm it later in this testimony. [REDACTED]

6 [REDACTED]

7 [REDACTED]

8 [REDACTED]

9 [REDACTED]

10 IV. RESPONSE TO THE LABOR PARTIES' CLAIMS

11 **Q. Let's start with your overall view of the Labor Parties' testimony and, in particular,**
12 **Mr. Kuders' opposition to the merger.**

13 **A.** As I will explain, Mr. Kuders' analyses are flawed, his testimony is factually inaccurate,
14 and his economic public benefit theories and conclusions are wrong. However, before I
15 discuss these issues, I want to express PECO's concern that the Labor Parties, like others,
16 are using this proceeding as a vehicle to address issues that are truly outside the scope of
17 this proceeding. Mr. Kuders' testimony does not suggest any set of conditions that
18 would make the merger acceptable. In this sense, the Labor Parties stand alone. While I
19 certainly do not wish to invite conditions, it appears to me that the reason that the Labor
20 Parties do not offer specific conditions is because many of their real interests lie outside
21 the proper scope of this proceeding. Some of these interests are revealed in Mr. Kuders'
22 testimony and yet others are suggested in his deposition testimony. For example, Mr.
23 Kuders complains that Exelon Generation has not guaranteed employment for all

1 employees at plants that Exelon Generation divests as part of the FERC mitigation. In
2 effect, the Labor Parties want Exelon Generation or PECO to give jobs to anyone
3 affected by a future job reduction at a divested plant after new owners take-over. Yet, at
4 his deposition, Mr. Kuders conceded that Exelon Generation's employment decisions
5 "are not regulated by the Commission" and, indeed, that Exelon Generation can reduce
6 jobs at any time without the Commission's approval. (Exhibit DPO-3 at 27, 28.) We
7 agree with Mr. Kuders that Exelon Generation's labor practices are not regulated by the
8 Commission and respectfully suggest that these issues should not be before the
9 Commission now under the guise of a merger objection. At deposition, Mr. Kuders also
10 suggested that the ongoing collective bargaining negotiations between IBEW Local 614
11 and PECO create reliability issues that may be relevant to this merger. (Exhibit DPO-3 at
12 84.) I disagree. The 614 contract status has no impact on reliability. However, even
13 assuming, for the sake of argument, that the current collective bargaining negotiations
14 had something to do with reliability, that situation exists irrespective of, and has no
15 connection to, this merger.

16 **A. Economic Impact Analysis**

17 **Q. Mr. Kuders asserts that the merger is not in the public interest because the**
18 **anticipated workforce reductions are bad for labor and will result in a net loss to the**
19 **Philadelphia area economy of \$20 million per year. Mr. LaCapra also references**
20 **labor reductions as a basis for opposing the merger. Please comment.**

21 **A.** Mr. Kuders' economic theory and his analysis are both flawed. Exelon, PECO, and
22 PSE&G employ thousands of people in high paying jobs in Pennsylvania, New Jersey,
23 and Illinois. After the merger, the combined company will employ over 28,000 people in

1 these states. Of this total, only 250 positions in Pennsylvania, and only about 100 at
2 PECO, will be affected by the merger. Following the merger, thousands of men and
3 women will remain employed at high wages with good benefits. In fact, the average
4 PECO electrical mechanic now makes in excess of \$30 per-hour (not including benefits)
5 – among the highest wages for comparable positions in the country. In addition, Exelon
6 and PECO provide tuition reimbursement, formal training, and other career development
7 opportunities to ensure that our people are among the best trained in the country.

8 **Q. How is that relevant to the public benefit standard and management's view that the**
9 **merger will strengthen Exelon and PECO?**

10 A. It is relevant because any company's ability to pay high salaries and provide great
11 benefits is contingent upon its continued financial health. We understand and appreciate
12 the Labor Parties' desire that Exelon and PECO maintain the largest workforce possible.
13 As Mr. Kuders states at page 5 of his testimony, labor leaders and unions always want
14 companies to hire and retain the most employees. However, the practical reality is that
15 no company can remain competitive and continue to pay high wages to its employees if it
16 is not allowed to properly size its workforce and implement new technologies and
17 practices to more efficiently deliver goods and services. Labor may benefit in the short
18 run by forcing companies to maintain unnecessary positions. However, restricting the
19 company's ability to compete and operate efficiently will cause the company and labor to
20 suffer in the long run. In my view, it always is in the public's interest for a company, like
21 PECO, to constantly challenge itself to perform its mission in a manner that is smarter,
22 more efficient and less expensive. Our hope is that labor could be a constructive force in

1 this process by supporting strategic partnerships and mergers that promise to make
2 Exelon and PECO more efficient.

3 **Q. Please explain how customers benefit from PECO's drive for efficiency.**

4 A. PECO's drive for efficiency has allowed it to deliver hundreds of millions in rate relief
5 since 1998 and invest many more millions in environmental and low-income programs,
6 while, at the same time, improving its safety, reliability and customer service. In fact,
7 PECO customers pay about the same rates for transmission and distribution service today
8 than they paid over eight years ago. PECO has been able to provide this level of rate
9 stability by implementing new technologies and best practices that increase efficiency.

10 **Q. How do the rate discounts provided by PECO over the past eight years compare to**
11 **changes in the salary and benefits paid to PECO employees over that same period?**

12 A. Salary and benefits paid to PECO employees have increased well over 30% since 1997.
13 While rates for contract labor and materials also have substantially increased in the
14 intervening years, PECO has been able to offset these increases through effective
15 workforce and contractor management and the consolidation of certain business functions
16 in Exelon Business Services Company and Energy Delivery Shared Services. These
17 steps have enabled PECO to mitigate the impact of inflation.

18 **Q. How else does a stronger, more efficient PECO benefit labor and the economy?**

19 A. PECO has been an engine for economic development in southeastern Pennsylvania for
20 many years. In fact, this year JD Power ranked PECO second among 15 Pennsylvania
21 utilities in terms of small business customer satisfaction. (Exhibit DPO-4.) Plainly, what
22 is good for small business is good for labor. In addition, last year the Pennsylvania

1 Economic Development Association bestowed its "Partner of the Year" award on PECO.

2 Each year PECO's economic development department helps dozens of companies to

3 locate facilities in the region, thereby helping to create thousands of new jobs. For

4 *example:*

- 5 • PECO partnered with the commercial real estate firm CB Richard Ellis in
6 its successful effort to attract Shire Pharmaceuticals to an existing 200,000
7 square foot facility in the Chesterbrook Corporate Center in Wayne,
8 Pennsylvania, where some 700 people are now employed.
- 9 • PECO's team contributed to Siemens Medical Solutions' decision to
10 relocate to the Great Valley Corporate Center in Malvern, Pennsylvania,
11 creating 3,000 jobs and \$75 million in capital investments.
- 12 • PECO's economic development team helped the site selection division of
13 *Deloitte & Touche* identify a suitable site for the new 1.4 million square
14 foot Marshalls/TJ Maxx distribution center in Northeast Philadelphia
15 where over 1,000 people are employed.
- 16 • PECO helped GlaxoSmithKline expand its pharmaceutical operations to
17 the Renaissance Corporate Center in Upper Merion Township. The new
18 center houses 800 workers and created capital investments of \$40 million.
- 19 • PECO's team worked with Universal Technical Institute resulting in the
20 construction of a 120,000 square foot facility in the Eagleview Industrial
21 Park in Exton, Pennsylvania.

22 Efforts like these have led to PECO being recognized by Site Selection Magazine as a
23 national leader in the area of regional economic development. In fact, in each of the past
24 five years, Site Selection ranked PECO's economic development efforts No. 1 in
25 Pennsylvania and among the ten best in the entire country. (Exhibit DPO-5.)

26 **Q. How would a merger with PSE&G benefit the regional economy?**

27 A. By combining the two organizations, the opportunities for delivering economic
28 development services will be even greater, covering a combined multi-county area
29 spanning both southeastern Pennsylvania and New Jersey. In today's climate of
30 "regional marketing and corporate attraction," the combination of the two companies and

1 their service areas will allow for the promotion of our region's combined assets,
2 especially for those companies that will have facilities in both states.

3 **Q. As President, does PECO operate best when its leadership has the flexibility to**
4 **change operations and incorporate best practices and technology?**

5 A. Absolutely. PECO must have the ability to manage its operations flexibly by taking
6 advantage of opportunities presented in the marketplace for goods, services and labor.
7 Flexibility allows PECO to control costs while optimizing performance. Here, there is a
8 disconnect between the interveners' "asks" that PECO stabilize rates, provide discounts,
9 and invest hundreds of millions of dollars in environmental and low income customer
10 assistance programs, on the one hand, and Labor's attempts to tie management's hands so
11 that it cannot properly size its workforce on the other.

12 **Q. Putting aside the errors in Mr. Kuders' economic harm theory, has he correctly**
13 **computed the impact of the proposed position eliminations?**

14 A. No. As Mr. Arndt explains in detail in his rebuttal testimony (PECO Statement No. 2-R),
15 Mr. Kuders' calculations and conclusions about the economic effect of the position
16 eliminations are based on assumptions that have no factual support. Moreover, even if
17 the Commission accepted his faulty economic theory, Mr. Kuders mixes and matches
18 data applicable only to PECO with data that applies to all Exelon businesses, thereby
19 distorting the purported impact of the merger on PECO and the Philadelphia area
20 economy.

1 **B. Alleged Effect of The Merger On Reliability And Call Center**
2 **Performance.**

3 **Q. Some of the opposing witness including Mr. Kuders and Ms. Alexander contend**
4 **that PECO's reliability will suffer if the merger is approved. Please comment.**

5 A. These claim are unsupported. PECO's reliability over the past two years is better than it
6 has been in my 23-year career with the company. As Ms. Alexander acknowledges in
7 her testimony, PECO has met or exceeded all of its reliability commitments. While Mr.
8 Kuders disagrees that PECO has performed well, he admitted at deposition that he never
9 has worked in the transmission and distribution side of PECO's business, never read the
10 Merger Settlement setting forth PECO's reliability commitments, has conducted no
11 analysis whatsoever of PECO's reliability, and has no personal knowledge of PECO's
12 reliability status. (Exhibit DPO-3 at 43-47.) Mr. Kuders testified at deposition that his
13 opinions about PECO's reliability are based solely upon "the feedback I get from
14 members", however, he could not remember the names of any of those members.
15 (Exhibit DPO-3 at 46.)

16 **Q. Mr. Kuders states in his testimony that PECO cut over 220 field force jobs between**
17 **1999 and 2005. Were those eliminations a result of the Unicom merger?**

18 A. No. In fact, over half of those reductions (approximately 127) occurred between January
19 1, 1999 and January 1, 2000, before the Unicom merger took place. Most of the rest of
20 the position eliminations (71) took place within the last two years. During the Unicom
21 merger proceeding, PECO pledged that it would not reduce field forces as a result of the
22 merger. PECO carried through on that commitment. In 2000, PECO employed 1,051
23 field employees. That number remained about the same until 2003 and 2004, when

1 Exelon Way initiatives further reduced that number to 957. None of those position
2 eliminations resulted from the merger. Notwithstanding these reductions, PECO
3 improved its reliability performance. In my view, this track record demonstrates that: (1)
4 a properly sized workforce can achieve excellent results; and (2) PECO has properly
5 sized its workforce.

6 **Q. Are additional field force reductions anticipated as part of this merger?**

7 A. No. As I said, we believe that our field forces are properly sized to the job. As Mr.
8 Arndt noted in his direct testimony (PECO Statement No. 2, p. 8), our philosophy from
9 the start of this process was that “front-line field service positions would not be affected”
10 by the merger. Mr. Arndt confirmed this commitment later in his testimony when he
11 stated: “We have made it clear that field service personnel will not be affected” by the
12 merger (p. 27).

13 **Q. What positions does PECO consider to be “field forces”?**

14 A. As explained in the company’s revised response to a merger discovery question (Labor-I-
15 1), PECO’s field forces are those employees in electric distribution, electric transmission,
16 and gas distribution who have direct responsibility for the construction, operation, and
17 maintenance of our facilities. In other words, they are the employees with “hands-on”
18 responsibility in the field for making sure that our service is on and stays on.

19 **Q. On page 11 of his testimony, Mr. Kuders suggests that PECO will make “significant**
20 **cuts” to support functions such as engineering and dispatch, because PECO has**
21 **excluded those functions from the definition of “field forces.” Do you agree with**
22 **that statement?**

1 A. No. First, let's be clear that the positions he's talking about are not "field forces," but
2 rather are office-based support positions. Second, a review of the proposed position
3 elimination figures demonstrates that PECO is not planning "significant cuts" in those
4 positions. As stated before, PECO plans only about 100 position eliminations as a result
5 of the merger. Of those 100 positions, thirty-four (34) positions will be eliminated from
6 the call center and another fifteen (15) will be eliminated from back-office support
7 functions in Customer and Marketing Services, such as billing and payment processing.
8 As Mr. Arndt explains in his testimony, the remaining reductions will center on business
9 unit management, as well as engineering, standards, document services, and other support
10 roles. Notably, these positions will be eliminated to avoid unnecessary duplication and
11 will not reduce the level or quality of the support furnished. In short, PECO will still
12 provide field forces with all of the support that they need to work efficiently, effectively,
13 and safely.

14 **Q. Several parties question whether PECO can meet its customer service obligations**
15 **after the merger. Would you care to respond?**

16 A. Yes. I am confident that PECO not only will meet its customer service obligations after
17 this merger, but will improve upon its historic performance in doing so. As explained by
18 Ms. Reidy (PECO Statement No. 5-R), PECO's customer service has steadily improved
19 since the merger with Unicom and there is no reason to be concerned that this trend will
20 not continue in the future. Once again, while Mr. Kuders states that PECO's customer
21 service operations will be impacted, he freely admitted at deposition that he conducted no
22 analysis to support his statements. (Exhibit DPO-3 at 60-64.) For example, although he
23 discusses call center staffing levels and alleges that the staffing levels will be insufficient,

1 he conducted no analysis to determine the necessary staffing for call center operations
2 (Exhibit DPO-3 at 63-64.) Likewise, other than the 1998 newspaper article on the billing
3 platform that he references in his testimony, Mr. Kuders has no idea how the computer
4 billing platform is functioning today or whether the platform will improve customer
5 service at PECO. (Exhibit DPO-3 at 60-62.) Ms. Alexander likewise criticizes the
6 platform but has done no analysis of it. (Exhibit DPO-2 at 56-57.)

7 **C. Staffing Levels At PECO's Main Office Building**

8 **Q. The Labor Parties assert that PECO cannot be counted on to fulfill staffing**
9 **commitments because it breached its agreement with the City of Philadelphia**
10 **regarding staffing levels at the Main Office Building at 2301 Market Street in**
11 **Philadelphia. Mr. Miller, on behalf of the City of Philadelphia, also raises staffing**
12 **levels as a concern. Has PECO fulfilled its commitment?**

13 A. Yes. Mr. Kuders' testimony mischaracterizes PECO's commitment and the data.
14 Likewise, I believe that Mr. Miller's concern can be easily resolved.

15 **Q. Please describe the commitment.**

16 A. PECO's commitment pertained to overall staffing levels, which included all PECO,
17 Exelon and contract employees assigned to the Main Office Building. Specifically,
18 PECO committed to maintain the following staffing levels:

1,325 through December 31, 2001

1,300 through December 31, 2002

1,275 through January 1, 2004

1,100 through January 1, 2008

1 Q. Do the figures cited by Mr. Kuders encompass all staff positions or just full-time
2 Exelon/PECO employees?

3 A. Mr. Kuders relied on data that was reported in response to a City of Philadelphia
4 interrogatory during the discovery phase of this case. However, the figures cited by Mr.
5 Kuders comprise only a subset of total staffing levels and ignore both contract and part-
6 time employees, as PECO's interrogatory answer made clear. When all categories of
7 employees are properly included, the staffing level totals are those that were reported to
8 the Commission:

<u>Date</u>	<u>Target Staff</u>	<u>Actual Staff</u>
December 31, 2001	1,325	1,412
December 31, 2002	1,300	1,313
December 31, 2003	1,275	1,286
December 31, 2004	1,100	1,155

9 In short, PECO has met its staffing level commitments for the Main Office Building in
10 every year.

11 Q. Has PECO changed its use of contractors since the Unicom merger?

12 A. The answer to that question is yes and no. PECO consistently has employed contractors
13 in all areas of its business, both before and after the Unicom merger. Successful and
14 competitive employers must have the flexibility to determine the appropriate level and
15 composition of its workforce in order to be efficient and meet the changing demands of
16 the industry. Therefore, PECO will continue to employ contractors when it makes good
17 business sense. However, what has changed is the extent to which PECO has relied on
18 contractors as part of its workforce over the past several years. In 2001, the first year of

1 PECO's staffing commitment, PECO's total staffing level at its Main Office Building
2 included over 310 contract employees. By 2004, that figure had dropped to 131, a
3 decrease of almost 60%. In other words, contract labor comprises a much smaller
4 *percentage of Main Office Building staffing levels than it did four years ago.*

5 **Q. You mentioned part-time employees. How many part-time employees are included**
6 **in the current staffing levels at the Main Office Building?**

7 A. Of the 1,155 employees and contract labor as of December 31, 2004, there were
8 approximately 18 part-time employees in the main office building.

9 **Q. Has PECO changed its use of part-time employees?**

10 A. No. PECO always has used a small number of part-time employees.

11 **D. Workplace Safety**

12 **Q. Let's discuss Labor's claim that PECO has not met its workplace safety**
13 **commitment.**

14 A. Labor is the only party that makes this claim and, once again, Mr. Kuders is mixing up
15 PECO commitments and data from other Exelon companies to paint an incorrect picture.
16 In fairness to Mr. Kuders, however, it appears from his deposition that he never truly
17 understood that PECO - - not Exelon, Exelon Power or EED - - made the commitment in
18 the 2000 merger settlement. (Exhibit DPO-3 at 47-51.) As a result, he repeatedly
19 confuses the data for these entities. As set forth in the Restructuring Settlement, PECO
20 committed to "remain in the top 10% of EEI comparable utilities (companies with 1500-
21 4000 employees). The Company will be considered non-compliant for this index if it
22 falls below the top 20% of the EEI comparable utilities." As shown below, PECO has

1 met this commitment and has maintained performance well within the top decile (10%)
2 as measured by Lost Work Day Cases (LWDC's).

	PECO LWDC Rate	EEI Top Decile
3		
4	2001	0.76
5	2002	0.69
6	2003	0.47
7	2004	0.98
		N/A

8 **Q. At page 12 of his testimony, Mr. Kuders tries to support his claim that PECO failed**
9 **to meet its safety commitment by citing to a presentation by Exelon Chairman and**
10 **CEO, John Rowe, in September 2002 to the Merrill Lynch Global Power and Gas**
11 **Leaders Conference. Please describe the data contained in that report.**

12 A. The data contained in that report comprised statistics for Exelon Energy Delivery
13 ("EED"), which is a combination of PECO and ComEd. PECO, not EED or Exelon,
14 made the commitment in the Merger Settlement. As stated above, Mr. Kuders' testimony
15 appears to be based on a misunderstanding of Exelon's structure inasmuch as Mr. Kuders
16 incorrectly believes that EED is comprised only of PECO. (Exhibit DPO-3 at 15.)
17 PECO has met its commitment and, as explained above, PECO achieved EEI top decile
18 safety performance in 2001 as well as in each of the years since then. Although Exelon
19 obviously made no commitment in the Merger Settlement as to ComEd's performance,
20 Exelon aspires to best in class performance and to create a workplace culture where No
21 One Gets Hurt. In 2003, Exelon set a target to achieve first quartile performance (based
22 on EEI data) for the OSHA Recordable Incidence Rates, Days Away, Restricted and
23 Transfer (DART) rates, and Severity Rate. In 2004, Exelon achieved first quartile status

1 for the OSHA Recordable Incidence and DART Rates and achieved second quartile
2 performance for the OSHA Severity Rate. Exelon will continue to strive for an injury
3 free workplace.

4 **Q. You said that PECO made the top 10% in 2001 as measured by EEI and therefore**
5 **met its commitment. How do you reconcile that statement with Mr. Kuders' claim**
6 **that PECO's .76 LWDC rate did not meet the "promise in the settlement agreement**
7 **to achieve top 10% performance in worker safety?"**

8 A. Mr. Kuders is simply wrong. EEI's top 10% performers included companies with
9 LWDC rates of .86 or lower. As such, PECO's LWDC rate of .76 actually put it well
10 into the top 10%. At deposition, Mr. Kuders could not explain where he obtained his
11 numbers. (Exhibit DPO-3 at 52.)

12 **Q. Mr. Kuders next claims that PECO's comparable Lost Workday rate for 2004 of**
13 **1.03 represents "a marked deterioration from its actual level of performance in**
14 **2001." How do you respond?**

15 A. Again, Mr. Kuders is wrong. While this is greater than the rate in 2001, the practical
16 difference is very small. In fact, PECO's rate is so low that a small increase in the
17 number of cases has a significant effect on the rate. For example, 22 cases were brought
18 in 2004 compared to 21 cases in 2001. The EEI benchmark data for 2004 has not been
19 published as of yet, and is expected in late July. We anticipate that PECO again will be
20 in the top decile.

1 Q. Mr. Kuders next contends that a 2004 report confirms that PECO failed to meet its
2 commitments regarding worker safety when measured in terms of OSHA's Severity
3 Incidence Rate (p. 13):

4 The report shows that the first quartile (again, top 25%, not
5 the top 10% which was PECO's goal) is 9.3 lost days per 100
6 employees. In 2002, Exelon's rate was 11.29; in 2003 it
7 ballooned to 15.31 days; and in 2004 it came down slightly to
8 13.68 days – none of which were even in the top 25% of
9 comparable companies. In the report, Exelon describes its
10 2003 performance as follows: "In 2003, Exelon Power
11 experienced an unacceptable increase in safety 12 incidents
12 throughout its fleet." It then describes some of the efforts made
13 in 2004 to improve the safety culture at Exelon, but notes that
14 "Exelon Power did not meet its safety goals in 2004." In other
15 words, PECO has failed to live up to its promise that it would
16 be a top 10% performer in worker safety. In fact, it appears
17 that under the Exelon umbrella, PECO has failed to achieve
18 even top 25% performance in worker safety. And there are no
19 indications that the next merger would make things any better.

20
21 Please comment.

22 A. A careful reading of Mr. Kuders' statement reveals the flaws in his logic and underscores
23 his misunderstanding of the commitment and his confusing mismatch of data relating to
24 other Exelon companies with PECO's performance and PECO's commitment. Mr.
25 Kuders argues that "PECO failed to live up to its promise" because "Exelon Power did
26 not meet its safety goals." PECO, not Exelon Power, made the commitment and PECO
27 lived up to that commitment.

28 Q. Mr. Kuders also refers to Exelon's presentation at an EEI Finance Meeting, held on
29 May 19, 2005, wherein Exelon presented comparable safety numbers for Exelon and
30 PSE&G. Mr. Kuders quotes from the report as follows:

31 Exelon's OSHA Recordables Rate (the number of work-
32 related injuries per 100 employees) was 2.40, while PSE&G's

1 was 2.88. Both of those fell in the second quartile (roughly top
2 50% of comparable companies).
3

4 **Do these data evidence a failure on PECO's part to live up to its commitments?**

5 A. The Exelon presentation made at the EEI Finance Meeting on May 19, 2005 referenced
6 by Mr. Kuders was actually a comparison between Exelon EED (the *combination* of
7 ComEd and PECO) and PSEG's transmission and distribution utility (PSE&G). The
8 OSHA Recordable Incidence Rate reported in this presentation cannot be used to
9 demonstrate that PECO did not meet its safety performance commitment. In fact,
10 PECO's OSHA Recordable Incidence Rate for 2003 was 1.57 and the EEI first decile
11 level for the OSHA Recordable Incidence Rate in 2003 was 2.01. In other words, PECO
12 met its commitment.

13 Although the table on the slide lists safety performance under "Exelon", clearly the
14 context of the slide (as stated in the title) is transmission and distribution. The 2003
15 OSHA Recordable Incidence Rate for Exelon EED was 2.40. Once again, use of these
16 data to support the claim that PECO failed to live up to hits commitment is not valid. As
17 stated earlier, the commitment to first decile performance was made by PECO and not
18 Exelon, or EED.

19 **Q. Mr. Kuders concludes the safety portion of his testimony by stating that there is no**
20 **reason to believe the merger will improve safety because: "In the last merger, we**
21 **saw PECO's promises of improved safety as a result of the merger, but they never**
22 **happened." Do you agree?**

23 A. No. For all the reasons described above, Mr. Kuders is wrong that PECO did not meet its
24 safety commitment. Safety is a personal passion of mine and I have led many of PECO's
25 safety initiatives. Candidly, of all the issues that might arise in this proceeding, it never

1 occurred to me that PECO's safety record would be attacked. I understand that Mr.
2 Kuders confuses the data, but claims of a poor safety culture at PECO cannot truthfully
3 be made. We operate a safe workplace - - period. PECO operates safely because we
4 believe that our greatest obligation is to return our employees to their families, safe and
5 sound, at the end of each day. I do not believe that any PECO employee honestly holds
6 the view that PECO is not safety conscious. I believe that our safety performance is
7 unmatched in Pennsylvania and I am proud that PECO was recognized with the Energy
8 Association of Pennsylvania's Safety Achievement Award in 2001, 2002, 2003, & 2004
9 as the safest utility in the Commonwealth and received the Safety Improvement Award in
10 2002 for the most improved utility. PECO also received the Pennsylvania Governor's
11 Award for Safety Excellence in 2002, recognizing PECO's accident and illness
12 prevention programs as among the best in the state. PECO was the only utility company
13 to receive this honor. Finally, in 2003 PECO received the American Gas Association's
14 (AGA) Safety Achievement Award for having the lowest incident rate of disabling
15 injuries of any of the very large utilities in the United States.

16 **V. CHARITABLE CONTRIBUTIONS** [REDACTED]
17 [REDACTED]

18 **Q. Have you reviewed the interveners' testimony on PECO's charitable contributions?**

19 **A.** Yes. OCA witness Alexander recommends that the Commission "require PECO to
20 maintain its historic level of charitable giving of at least \$8 million per year for a period
21 of at least five years as a condition of the Merger." Mr. Miller, appearing on behalf of
22 the City of Philadelphia, recommends (p. 8) that the Commission "must ensure that the
23 merger does not lead PECO to reduce its charitable giving to the City, or to the other
24 communities it serves, in the short or long term." [REDACTED]

1 [REDACTED]

2 [REDACTED]

3 [REDACTED]

4 Q. Do you have any response to these recommendations?

5 A. Yes. In my direct testimony, I noted that PECO is a significant contributor to non-profit
6 and civic initiatives in our service territory and a strong and respected presence in
7 economic development. I also noted that PECO has continued to demonstrate that
8 commitment in the five years since its merger with Unicom. Finally, I expressed PECO's
9 commitment to continue to support the educational, environmental, arts and culture and
10 community development programs that improve the quality of life in our region. I
11 reaffirm that commitment – although I do find it disconcerting that Ms. Alexander and
12 Mr. Miller apparently believe that PECO cannot be trusted, notwithstanding its long
13 history as a leader in this area. I see nothing in their testimony or in PECO's strong
14 historic commitments that would justify mistrust.

15 I also need to correct Ms. Alexander's figures. PECO spends approximately \$3 - \$3.5
16 million annually on charitable contributions, and between \$3.5 and \$4 million annually
17 on economic development, for a total of \$6.5 to \$7.5 million. Ms. Alexander seems to
18 have included in her charitable giving figure contributions to energy assistance funds,
19 which are not included in the category of giving being discussed here, and individual
20 contribution commitments from the Merger Settlement that have since expired. I note
21 that Ms. Alexander agreed at deposition to recalculate her figures and exclude economic
22 development and energy assistance funds from her calculation for 2003 and 2004.

1 In the PECO/Unicom Merger Settlement, PECO committed to maintaining its
2 contributions for charitable and civic giving and economic and community development
3 for a three-year period. While PECO has continued its charitable and civic giving and its
4 economic and community development commitments beyond that three-year period and
5 will continue its support in those areas in the future, I do not believe that it is appropriate
6 for the Commission to order a utility to make charitable contributions.¹

7 Q. [REDACTED]

[REDACTED]

8 [REDACTED]

9 [REDACTED]

10 [REDACTED]

11 [REDACTED]

12 [REDACTED]

13 [REDACTED]

14 [REDACTED]

15 [REDACTED]

16 [REDACTED]

17 [REDACTED]

18 [REDACTED]

19 [REDACTED]

20 [REDACTED]

¹ Indeed, Ms. Alexander acknowledged at deposition that charitable contribution commitments are different from other items recovered “because there is a certain amount of discretion by any corporation with respect to its giving patterns, to whom it gives and in what categories, and I acknowledge the management discretion that exists with regard to this issue.” (Exhibit DPO-2 at 135.)

1 [REDACTED]

2 [REDACTED]

3 [REDACTED]

4 [REDACTED]

5 [REDACTED]

6 [REDACTED]

7 [REDACTED]

8 [REDACTED]

9 [REDACTED]

10 [REDACTED]

11 [REDACTED]

12 [REDACTED]

13 [REDACTED]

14 [REDACTED]

15 [REDACTED]

16 [REDACTED]

17 [REDACTED]

18 [REDACTED]

19 [REDACTED]

20 [REDACTED]

21 [REDACTED]

22 [REDACTED]

1
2
3
4

[REDACTED]

5 VI. PECO'S MANAGEMENT STRUCTURE AND INCENTIVE PLANS ENSURE
6 THAT PECO WILL MAINTAIN ITS STRONG LOCAL FOCUS

7 Q. Mr. O'Brien, several witnesses have expressed concern that the merger between
8 Exelon and PSE&G will result in a management team that will be less focused on
9 PECO's service reliability and customer service performance. Do you agree?

10 A. As I explained earlier in my testimony, I most certainly do not. Through the experience
11 of the first merger, Exelon and its operating energy delivery companies PECO and
12 ComEd have reaffirmed these core values and instituted programs that have led to
13 improved workplace safety and the major performance standards for the service
14 reliability and customer service areas. This performance is acknowledged in Ms.
15 Alexander's testimony but it is reaffirmed in more detail in Mr. Patterer's and Ms.
16 Reidy's rebuttal testimony. This record speaks for itself. We will remain committed to
17 service reliability, employee safety, and customer service, not only because we are
18 required to provide safe and reliable service under the Public Utility Code and the
19 Commission's regulations, but also because of our adherence to these core values. There
20 is no basis whatsoever to suggest that PECO will not be focused on these tasks.

21 Q. Please provide examples of how the core values of customer service, service
22 reliability and workplace safety are reflected in Exelon's performance culture.

23 A. These values are directly incorporated in a variety of ways through the Exelon Energy

1 Delivery (EED) Management Model. As an example, Exelon directly ties its
2 performance in these areas to executive, key manager and employee compensation
3 through its Annual Incentive Compensation Plan. We believe that the Company's overall
4 focused attention on customer service and service reliability are otherwise proven by our
5 track record in these areas.

6 **Q. How does the EED management structure work to ensure that PECO meets its**
7 **commitments?**

8 A. EED represents a consolidated management structure that allows Exelon to tightly
9 oversee the financial and operational performance of its energy delivery businesses at
10 ComEd and PECO. Through EED's structure, certain functions such as Customer and
11 Marketing Services, Construction and Maintenance, and Distribution Services
12 Operations, Technical Services, Quality Services, and other functions have been
13 consolidated in order to achieve cost and operational efficiencies in the business
14 operations but also to ensure that Exelon's senior management is aware of the
15 performance of the various distribution business units. Local management benefits from
16 these efficiencies and utilizes services that are provided by EED to achieve their
17 individual, EED, and Exelon goals financial and operational performance goals.
18 Under this structure as President of PECO, I am responsible for ensuring that PECO
19 achieves its customer service, workplace safety and service reliability goals by ensuring
20 that adequate resources are being brought to bear. In my view, this consolidation has
21 achieved a variety of efficiencies that have led to improved performance at PECO.

1 **Q. Please explain how the Company's Annual Incentive Compensation Plan gives**
2 **employees the incentive to work in the interest of customer service, reliability and**
3 **worker safety.**

4 A. A substantial portion of an employee's annual incentive compensation is directly tied to
5 the performance of the Company in these areas. Depending on the employee's position
6 grade, operational key performance indicators (KPIs) comprise 25 to 50 percent of the
7 weighting of the reward payout. If these key performance indicators are not met, then the
8 portion of the employee's target annual incentive compensation will not be paid.

9 **Q. What are the EED Operational KPIs?**

10 A. Operational KPIs vary based on the employee's grade level and work group. For EED's
11 senior managers, the operational KPIs include service reliability measures (SAIDI and
12 CAIDI), as well as a measure tied to the Company's performance under the American
13 Customer Satisfaction Index, a survey conducted by an independent research group.
14 These factors amount to 25 percent of the employee's annual incentive compensation.
15 Likewise, key managers below the senior level also have the same reliability and
16 customer satisfaction KPIs. For positions below key management positions, there are a
17 variety of operational KPIs that apply depending on the department in which the
18 employee is located. For those employees, 50 percent of their incentive compensation is
19 tied to performance under 3-5 operational KPIs.

20 **Q. What are some examples of the operational KPIs for non-management employees?**

21 A. Among others, these factors include satisfying defined performance objectives in the
22 areas of gas leak backlog, field productivity, system design readiness, SAIDI and CAIDI
23 targets, meter reading, call answering, first call resolution, reducing uncollectible

1 accounts expense, corrective and preventative maintenance, work schedule management,
2 gas odor response, OSHA incidence rates, callout response, field crew productivity,
3 vegetation management, and human performance events.

4 **Q. Do you have any other comments concerning the Company's Annual Incentive**
5 **Compensation Program?**

6 A. Just one. Our annual incentive compensation plan has evolved over time to one that has
7 become increasingly targeted on an employee's performance at the department or
8 business unit level rather than just Exelon's performance as a whole. This means, for
9 example, that the operational KPIs for employees responsible for PECO's Customer and
10 Marketing Services functions focus on goals related to providing quality customer service
11 at PECO – percent of meters read, percent of calls answered timely, and percent of first
12 call resolution. Another example would be in the area of Distribution System Operations
13 whereby employees responsible for PECO's distribution system operations must satisfy
14 operational KPIs related to callout percentage, gas odor response rates, crew productivity,
15 and adherence to work management schedule.
16 Compliance with these operational KPIs feeds into the ability of the managers and
17 executives above these employees to satisfy their more general KPIs related to SAIFI,
18 CAIDI, and the ACSI customer satisfaction criteria. Having operational performance of
19 their employees dictating how a portion of their compensation is determined provides
20 Exelon's upper management the incentive to focus on the local operational performance
21 of the business units.

22

1 **Q. Will the recent announcement that PSE&G's President Ralph Izzo will become the**
2 **President of EED affect the focus of EED on service quality and reliability?**

3 **A.** Yes, I believe it will have a very positive affect because of Mr. Izzo's proven track record
4 at PSE&G. Mr. Izzo has a broad based energy background, including several years as a
5 research scientist, and has held several management positions since joining PSE&G in
6 1992. Under his leadership, I believe that the appropriate focus on service quality and
7 reliability will be provided and result in the exchange of ideas within EED that is needed
8 for PECO and the rest of EED to improve even more in those operational areas.

9 **VII. THE SHARING OF MERGER SAVINGS AND CORRESPONDING RISKS**

10 **Q. Mr. O'Brien, earlier in your testimony you noted that the opposing parties were**
11 **seeking rate reductions ranging from \$134 million to \$347 million. Am I correct**
12 **that certain of those parties are also requesting an extension of PECO's**
13 **transmission and distribution rate cap for an additional four years, or through**
14 **December 31, 2010?**

15 **A.** Yes. The OCA proposed an extension of the electric transmission and distribution rate
16 cap for an additional four years, through December 31, 2010. In addition, the OTS has
17 proposed extending the electric transmission and distribution rate cap to January 1, 2009
18 and imposing a cap on gas distribution rates to that same date. Other parties have
19 proposed gas and electric rate stayouts and reductions.

20 **Q. Would the coupling of rate reductions and rate cap extensions expose PECO to any**
21 **financial and/or operating risks?**

1 A. Yes, it clearly would. In fact, we are really talking about several interrelated risks. One
2 is the cost of the rate decreases themselves. This risk is relatively straightforward and
3 boils down to whether we can continue to run the business with less revenue given what
4 we project our costs to be during the years in question. Of course, this involves a second
5 risk, namely: do we have a concrete idea of what our costs will be? Based upon our
6 experience, that is the greater risk. There are many unforeseeable market and regulatory
7 variables that drive our costs. These variables include rising labor rates and benefits (i.e.,
8 how will the union negotiations that I referred to earlier be resolved), weather, normal
9 increases in materials costs, inflationary pressures that drive credit and cost of capital,
10 and the ongoing potential for costly changes to the federal and state regulatory
11 environment. To illustrate, the following are just a few examples of the increased costs
12 that PECO has experienced since the 1998 Restructuring Order:

- 13 • Skyrocketing employee and pension benefit costs (medical, dental,
14 disability, tuition reimbursement etc.). Medical benefits alone for
15 employees and retirees increased about 200% during this period.
- 16 • Critical materials cost increases of over 20% between 1998 and today.
- 17 • Employee salary increases (without benefits) of over 28%.
- 18 • A four-fold increase in the cost of facility relocations in public right of
19 way.

20
21 In addition, PECO has had to absorb the increased cost of doing business in an ever-
22 changing regulatory and legal landscape. Since 1997, the Commission alone has
23 implemented many new rules creating enhanced service requirements on a full gamut of
24 reliability and customer service issues. The EPA, DEP and other regulatory agencies
25 similarly have created more stringent requirements impacting our operations. New
26 federal laws and regulations like the SEC's Sarbanes-Oxley and the FERC's Standards of

1 Conduct regulations have triggered millions of dollars in compliance expenses, including
2 increased professional service costs for outside accountants, consultants, engineers and
3 lawyers.

4 Let me be clear, PECO does not disagree with any of these legal or regulatory changes.
5 But, the fact is that these changes, in the aggregate, have created millions of dollars of
6 additional and unanticipated business costs. Although we do not know what changes will
7 occur next, it is clear that the legal and regulatory world will continue to evolve. Further,
8 if the past is any barometer, it is unlikely that changes will make it less expensive to
9 operate.

10 **Q. Do the parties that seek rate reductions and stayouts appear to contemplate the**
11 **risks that you just described?**

12 A. No. While the parties fairly acknowledge that there is risk associated with successfully
13 implementing synergy savings in the face of costs to achieve, they ignore the enormous
14 market and regulatory risks associated with a guaranteed rate reduction package coupled
15 with a rate stay-out period beyond December 31, 2006. The interveners' demands for
16 immediate rate reductions also do not recognize that the costs to achieve are heavily
17 front-loaded into the first few years after the merger.

18 **Q. Does the fact that these risks exist mean that PECO cannot enter into any**
19 **agreement to guarantee regulated synergy savings and provide rate certainty?**

20 A. No. Although substantial risks exist, PECO always has recognized that its regulated
21 synergy savings should be shared with customers. While PECO anticipated that these
22 savings would be used to alleviate the level of future rate increases, PECO recognizes

1 certain parties' desire for rate discounts and rate stability. Further, PECO understands
2 that the Commission has provided public benefits through these mechanisms in other
3 recent mergers.

4 **Q. How do rate discounts and a stay-out period mesh with the parties' many other**
5 **demands for substantial changes to low income, environmental, charitable giving,**
6 **and regional economic development programs?**

7 A. These demands do not presently mesh at all. Each party demands everything on their
8 wish list. However, the reality is that the programmatic changes must compete with any
9 rate relief/rate stay-out package for the same pool of regulated synergy savings. PECO
10 is not indifferent to the use of the regulated synergy savings calculated by Mr. Arndt and
11 strongly prefers using available monies for the direct benefit of its customers. Moreover,
12 as I stated at the beginning of my testimony, we are concerned that the costs of the low
13 income, economic development, and environmental programs ultimately will be borne by
14 our customers after some future rate proceeding. In my view, the challenge remains the
15 same, namely, crafting a package that addresses the competing interests of the various
16 parties within PECO's regulated synergy savings. The \$900+ million in aggregate
17 intervener demands is more than ten times PECO's estimated regulated synergy savings
18 over the 2006 – 2010 period and illustrates that the opposing parties are not of like mind
19 as to how the available savings should be used.

20 **Q. Is PECO willing to entertain changes to its low income, environmental and**
21 **economic development programs?**

22 A. Certainly. We believe that our low-income, environmental and economic development
23 programs are second to none. However, the scrutiny applied to PECO in proceedings

1 such as this one sometimes triggers good suggestions. I believe that this process is
2 healthy and ultimately good for PECO. Accordingly, PECO welcomes constructive
3 criticism of its programs, and, indeed, we hope that the parties will not wait for the
4 happenstance of a merger to address issues with PECO.

5 **Q. In your view, are additional reliability, safety or customer service commitments**
6 **necessary for the public to benefit from this merger?**

7 A. No. We are committed to addressing through this merger legitimate and fair criticisms of
8 our performance. As I said, it is healthy for us to hear and address these comments.
9 However, most of the arguments presented by the opposing parties are designed not to
10 inform, but instead to extract concessions under the pretext that this transaction is
11 harmful for Pennsylvania. I do not believe that is the purpose or a proper use of this
12 proceeding.

13 **Q. Does that conclude your rebuttal testimony?**

14 A. Yes, it does.

AK
9-22-05
Phila

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

**JOINT APPLICATION OF PECO :
ENERGY COMPANY AND PUBLIC :
SERVICE ELECTRIC AND GAS :
COMPANY FOR APPROVAL OF :
THE MERGER OF PUBLIC :
SERVICE ENTERPRISE GROUP :
INCORPORATED WITH AND :
INTO EXELON CORPORATION :**

Docket No. A-110550F0160

DOCKETED
NOV 10 2005

**FURTHER SUPPLEMENTAL TESTIMONY
OF
DENIS P. O'BRIEN**

**In Support Of
The Joint Petition For Settlement**

**DOCUMENT
FOLDER**

RECEIVED

SEP 26 2005

PA PUBLIC UTILITY COMMISSION
SECRETARY'S BUREAU

Date: September 14, 2005

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1 dated March 30, 2005, p. 9), settlement conferences were convened in Philadelphia and
2 Harrisburg in May and June. Those initial meetings produced an open and frank
3 exchange on a wide range of issues, including the likely impact of the Merger on rates,
4 service, reliability, competitive market conditions, local communities and the
5 environment, as well as a variety of other matters.

6 **Q. Did all protestants and intervenors have an opportunity to fully participate in those**
7 **discussions?**

8 A. Yes, they did and, in fact, all major stakeholder groups were represented.

9 **Q. Were the parties able to resolve their differences at those initial meetings?**

10 A. No, they were not. However, substantial progress was made and, most importantly, a
11 dialogue was established. Over the next several months, the parties continued to meet,
12 both in person and telephonically, and to exchange ideas and information. That process
13 culminated in the execution and filing of the September 12, 2005 Joint Petition.

14 **Q. Does the Joint Petition enjoy broad-based support?**

15 A. Yes, it does. The Joint Petition represents the product of numerous compromises on a
16 host of issues by and among parties that represent virtually all potentially affected
17 constituencies - - residential, commercial and industrial customers; advocates for low
18 income consumers, the environment and economic development; and state government.
19 In addition, it is my understanding that organized labor, while not a signatory to the
20 agreement, has indicated that it will not oppose approval of the Joint Petition.

21 **Q. Is the Joint Petition responsive to the Directed Questions posed by Vice Chairman**
22 **Cawley and Commissioner Shane?**

1 A. Yes, it is. The Joint Petition provides for the payment, over the 2007-2010 period, of
2 \$8.0 million to the Pennsylvania Energy Development Authority (“PEDA”) to spur
3 energy related economic development projects and initiatives of benefit to PECO’s
4 service territory. The Joint Petition also facilitates the initiation of a separate fact-finding
5 investigation to examine issues related to a potential consolidation of the natural gas
6 operations of Exelon and the Philadelphia Gas Works in a shareholder-owned utility.

7 **Q. Why does PECO believe that the proposed Settlement embodied in the Joint**
8 **Petition is in the public interest?**

9 A. The specific reasons are set forth in the Joint Petition and may be summarized as follows:
10 (1) rates will be reduced; (2) transmission and distribution charges will be capped
11 through December 31, 2010; (3) post-cap distribution rate increases will be mitigated; (4)
12 system reliability and customer service will be enhanced; (5) universal service coverage
13 and outreach will be expanded; (6) the environment will benefit; (7) customers will be
14 protected against affiliate risk and cross-subsidization; (8) PECO will maintain a strong
15 corporate presence in southeastern Pennsylvania; (9) economic development will be
16 promoted; (10) wholesale market conditions will be closely monitored; and (11)
17 substantial litigation and associated costs will be avoided. Finally, the Joint Petition
18 includes staffing commitments minimizing labor impacts.

19 In my view, the enthusiastic support of the Joint Petition by those parties that will be
20 most affected by the Merger provides compelling evidence that the proposed Settlement
21 is in the public interest.

22

1 Q. Does that conclude your further supplemental testimony?

2 A. Yes, it does.

**BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION**

Joint Application of PECO Energy Company and :
Public Service Electric And Gas Company for :
Approval of the Merger of Public Service Enterprise : **Docket No. A-110550F0160**
Group Incorporated with and into Exelon Corporation :

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a true copy of Further Supplemental Testimony of Denis P. O'Brien In Support Of The Joint Petition For Settlement via first class mail and e-mail to the following:

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1 **I. INTRODUCTION AND QUALIFICATIONS**

2 **Q. Please state your name and by whom you are employed.**

3 **A.** My name is William D. Arndt and I am the Senior Vice President, Financial
4 Operations for Exelon Corporation. My business address is 10 S. Dearborn, 38th
5 Floor, Chicago, Illinois 60603.

6 **Q. Would you briefly summarize your academic and professional background?**

7 **A.** I graduated from the U.S. Merchant Marine Academy with a Bachelor of
8 Science degree in Marine Engineering in 1980. After working for two years as a
9 licensed engineer aboard U.S merchant vessels, I began my professional career at
10 General Electric Company (GE) where I remained until joining Exelon in 2001.
11 During my tenure at GE, I held a number of operating, commercial and management
12 positions within GE's nuclear energy business. My early responsibilities included
13 field service engineering, project management, marketing and various customer
14 relations and account leadership roles. My last five years at GE were at the executive
15 level where I held global business leadership roles for two different divisions of GE
16 Nuclear Energy in which my responsibilities included integration and leadership roles
17 for two global joint ventures within GE's nuclear fuel business.

18 **Q. Please describe your current and previous roles within Exelon.**

19 **A.** As Senior Vice President, Financial Operations, I am currently responsible for
20 leading the Business Unit financial organizations for Exelon Generation, Exelon
21 Energy Delivery, Exelon Enterprises, and Exelon Business Services. My
22 responsibilities include strategic long-range planning, profit and loss forecasting and

1 reporting, budgeting, financial variance analysis, cost management, business
2 performance reporting and decision support, as well as leveraging economic
3 synergies across these Business Units. I have also been responsible for managing our
4 internal transformation program - The Exelon Way – from February 2003 through the
5 present.

6 Prior to my current role, I was Senior Vice President, Business Operations for
7 Exelon Generation, Enterprises and Services. My initial role at Exelon was Vice
8 President, Business Operations for Exelon Nuclear with responsibility for the
9 business planning, finance, supply chain and information technology functions across
10 our nuclear business.

11 II. PURPOSE OF TESTIMONY

12 **Q. What is the purpose of your testimony?**

13 **A.** I am providing testimony on behalf of Exelon Corporation and Public Service
14 Enterprise Group, Incorporated (the Companies) and their respective regulated utility
15 operating companies, Public Service Electric & Gas Company (PSE&G); PECO
16 Energy Company (PECO); and Commonwealth Edison Company (ComEd), to
17 sponsor the identified merger-related synergies from the announced combination of
18 the Companies. My testimony addresses the regulated cost savings from the merger
19 and the costs-to-achieve those savings.

20 In this testimony I: (1) describe the process for identifying synergies from the
21 merger of the Companies; (2) describe the synergies categories quantified by this
22 process; (3) identify the specific areas where synergies are expected from the

1 combination; (4) present the overall gross and net synergies to the regulated business
2 over the relevant four-year time period; (5) describe the allocation process used to
3 develop related savings distribution to the regulated business, the respective utility
4 operating companies, and the business segments, i.e., electric and gas, transmission
5 and distribution; and (6) affirm the reasonableness of the synergies presented.

6 **Q. How is the remainder of your testimony organized?**

7 **A.** My testimony is organized into the following sections:

- 8 - Summary of Testimony
- 9 - Approach to Synergies Identification
- 10 - Synergies Description and Quantification
- 11 - Costs-to-Achieve
- 12 - Pre-merger Initiatives
- 13 - Allocation of Savings

14 **Q. Have you included any exhibits to your testimony?**

15 **A.** Yes. EXHIBIT WDA-1 is a summary of my Exelon and prior work
16 experience, EXHIBIT WDA-2 provides a four-year summary of the total net
17 regulated business cost savings, EXHIBIT WDA-3 summarizes the total regulated
18 business costs-to-achieve, EXHIBIT WDA-4 provides a before and after view of
19 corporate and shared services savings allocations to the regulated business, EXHIBIT
20 WDA-5 summarizes a similar before and after view of costs-to-achieve allocations to
21 the regulated business, and EXHIBIT WDA-6 provides an overall allocation of total
22 regulated business cost savings and costs-to-achieve between the respective utility
23 operating companies and business segments.

1 **III. SUMMARY OF TESTIMONY**

2 **Q. Please summarize your testimony.**

3 **A.** As I will discuss in the balance of my testimony, the merger is anticipated to
4 result in costs below the levels that otherwise would have been achievable on a stand-
5 alone basis for any of the utility operating companies. These savings in costs also will
6 be realized without creating reliability risks or adverse impacts to the effective and
7 safe delivery of service to customers.

8 The Companies have identified approximately \$155 million of estimated net
9 O&M and capital carrying cost savings within or allocated to the regulated business
10 over the four-year period 2006-2009. This net amount also reflects approximately
11 \$358 million of out-of-pocket costs-to-achieve these savings, and approximately \$22
12 million of planned cost constraint or reduction initiatives by the utility operating
13 companies prior to the merger (pre-merger initiatives).

14 On an annual basis, net regulated business savings are expected to grow from
15 a negative \$70 million in 2006 due to the high initial costs-to-achieve, to a positive
16 savings level in excess of \$107 million by 2009 after the majority of costs-to-achieve
17 have been incurred. This savings level will generally continue on an ongoing basis.
18 These identified savings, however, do not reflect other ongoing cost increases
19 occurring within the overall business. Thus, the merger cost savings do not fully
20 offset recurring cost escalation.

21 These identified total corporate and shared services savings before and after
22 allocation to the regulated business are summarized on the following table.

1 **NET REGULATED SAVINGS**

2 (\$ in Millions)

I. Gross Regulated Savings	2006	2007	2008	2009	Total
A. Allocated Corporate					
Corporate and Shared Services Staffing	\$29	\$37	\$44	\$47	\$157
Corporate and Administrative Programs	14	16	17	18	64
Information Technology	<u>14</u>	<u>17</u>	<u>23</u>	<u>24</u>	<u>78</u>
Sub-Total Allocated Corporate	\$56	\$70	\$84	\$89	\$299
B. Utility					
Support Staffing	\$14	\$37	\$40	\$44	\$135
Non-Labor	<u>16</u>	<u>25</u>	<u>28</u>	<u>32</u>	<u>101</u>
Sub-Total Utility	\$30	\$62	\$69	\$76	\$236
Total Gross Regulated Savings	\$86	\$132	\$152	\$165	\$535
II. Regulated Cost-to-Achieve	\$(152)	\$(91)	\$(65)	\$(49)	\$(358)
III. Regulated Pre-Merger Initiatives	\$(3)	\$(5)	\$(6)	\$(8)	\$(22)
Net Regulated Savings	\$(70)	\$35	\$81	\$108	\$155

3
4 The total identified corporate and shared services savings before allocation
5 that were used to develop the above table are illustrated in EXHIBIT WDA-4.
6 Through the remainder of my testimony, I will discuss the regulated business savings
7 levels, by category.

8 The identified synergies above reflect the net regulated business savings
9 expected to result from the merger and were jointly developed by the Companies.

10 The cost savings that have been identified reflect my view of where and how
11 operating synergies can be achieved for the regulated business. A structured process
12 including officers and employees from each Company was utilized for synergies
13 identification and quantification to guide management's evaluation and provide a
14 basis for determining the potential benefits from the merger. I believe that this

1 process effectively quantified a reasonable estimate of the savings that will be
2 realized by the Companies.

3 The identified cost savings relate to the reduction or avoidance of costs from
4 the consolidation of the separate corporate, shared services and utility operations
5 support into single operating entities. The direct field service functions of the utility
6 operating companies are not affected by the merger and no savings have been
7 quantified in these areas.

8 Through consolidation, duplicative functions and positions can be eliminated
9 and certain corporate costs, both O&M and capital, can similarly be reduced or
10 avoided. In addition, expenditures for materials and third-party services can be
11 reduced from more effective sourcing from suppliers and vendors, thus capturing
12 economies of scale.

13 Related out-of-pocket costs-to-achieve these savings have also been identified
14 and reflect the expenses that will be incurred in integrating the Companies to realize
15 the savings and in processing the merger applications through the various Federal and
16 state regulatory agencies, among other required expenditure areas. These costs-to-
17 achieve are necessary expenses incurred to attain the identified benefits from the
18 merger.

19 The regulated business synergies estimate that has been prepared reflects only
20 those savings that arise directly from the merger. The process we employed focused
21 on savings that would not otherwise be attainable from management actions that
22 either Company could have initiated on its own. In addition, we took deliberate
23 efforts to avoid double-counting any potential savings that could relate to initiatives

1 already underway or planned at either Company. Through this process we determined
2 the level of cost initiatives already incorporated within those projections.

3 The identified regulated business savings reflect an allocation, where
4 necessary, between regulated and non-regulated operations, and subsequently to the
5 respective utility operating companies and the business segments. The total savings
6 from corporate and shared services were split between the regulated and non-
7 regulated businesses as they support both of these operational segments.

8 IV. APPROACH TO SYNERGIES IDENTIFICATION

9
10 **Q. Please describe in more detail the process that the Companies utilized for**
11 **developing the overall synergies analysis.**

12 **A.** The Companies used a two-step process for synergies quantification. Prior to
13 the announcement of the transaction, the Companies assembled a working group to
14 focus on the identification and quantification of potential cost savings and costs-to-
15 achieve. I was responsible for the overall Exelon synergies team with the President of
16 PSEG's Shared Services organization as my counterpart.

17 Post-announcement, I again led, with support from my PSEG counterpart, a
18 focused effort to validate and refine the pre-announcement synergies and costs-to-
19 achieve. This effort included a broader group than the original teams to identify any
20 other factors that could affect synergies and that may not have been identified earlier.
21 From this post-announcement effort, a refined synergies estimate was prepared which
22 is the focus of my direct testimony.

23 **Q. How was the analysis conducted for the purpose of estimating available cost**

1 **savings from the merger?**

2 **A.** Business unit focused teams were established by each Company to assess
3 potential savings from the combination. The teams developed baseline data to
4 compare starting cost and staffing levels. Assumptions were also developed about
5 how the combined organizations would operate once the transaction was closed and
6 the Companies could be aligned and integrated to produce savings from consolidation
7 and / or the capture of economies of scale. With this data, the teams determined the
8 level of going-forward staffing necessary to continue to provide high-quality service
9 to either internal or external customers.

10 An underlying philosophy of this effort was that front-line field service
11 positions would not be affected since the day-to-day work itself was not going to be
12 impacted by the combination.

13 The teams also evaluated non-labor cost levels to identify elements that could
14 be reduced from consolidation, wholly or partially avoided, absorbed through the
15 larger entity, or reduced at the unit cost level from economies of scale.

16 **Q. What period was used for the quantification of cost savings?**

17 **A.** The savings were quantified for the regulated business over a four-year period
18 from 2006-2009. This four-year period was utilized because it reflected the period
19 during which a steady state of operations would be achieved, after which the savings
20 will generally continue. For example, reductions in staffing will be sustained into
21 future years since they relate to functions that are duplicative and related positions
22 will be permanently eliminated.

1 Benefits from improved sourcing of materials will also continue into the
2 future as increased volumes on a combined basis create opportunity to permanently
3 reduce the unit and total costs of materials and services procured. Certain savings that
4 relate to avoided technology projects in particular years are generally more event-
5 driven, but will typically be replaced by other project expenditures from period-to-
6 period.

7 **Q. What assumptions were made about the organizational model to be in place for**
8 **the combined Company?**

9 **A.** The teams assumed that the current business unit based structure of Exelon
10 would provide the future model for the combined organization. Essentially, separate
11 business units would exist for generation operations, transmission and distribution
12 (T&D) operations (both electric and gas), shared services and the corporate functions.

13 Within the T&D business unit, which also includes the customer care
14 functions, the individual utility operating companies were assumed to remain in place
15 essentially as-is and to continue to focus on local service delivery. The T&D business
16 unit management and operations support functions, e.g., technical services, however,
17 were assumed to be consolidated across the three utility operating companies to
18 leverage economies of scale without affecting local operations capability or focus.

19 The shared corporate and services functions were assessed together regardless
20 of where the function actually resided.

21 **Q. Could the savings that have been quantified been achieved without the**
22 **combination of the Companies?**

1 A. No. The teams identified and quantified cost savings that would only arise
2 from the direct combination of the Companies and would not reflect reductions that
3 could have been achieved on a stand-alone basis. For example, the consolidation of
4 specific corporate functions, such as information technology, would not occur without
5 the merger. Similarly, the ability to capture economies of scale would not be possible
6 without the combination serving as the basis for joint planning, design and
7 procurement.

8 Even though both Companies have been continuously focused on constraining
9 or reducing costs, the cost savings that I am sponsoring do not duplicate these stand-
10 alone initiatives. In fact, I offset these savings to recognize the value of initiatives that
11 are already contained within the high level, near term financial forecast of each of the
12 Companies.

13 **Q. Were the costs-to-achieve the identified cost savings also identified during the**
14 **analysis?**

15 A. Yes. As I will describe in more detail later in my testimony, out-of-pocket
16 costs will be incurred to complete the merger, as well as integrate the Companies to
17 support realization of the savings. These costs-to-achieve also only arise because of
18 the merger and would not otherwise be incurred. Thus, internal costs associated with
19 completing the merger would not be reflected in these amounts and are considered
20 sunk-costs.

1 **V. SYNERGIES DESCRIPTION AND QUANTIFICATION**

2 **A. Summary**

3 **Q. What are the principal categories of cost savings that you have quantified?**

4 **A.** EXHIBIT WDA-2 indicates five primary categories of cost savings as
5 described below, with the corporate and shared services staffing, corporate and
6 administrative programs, and information technology areas assessed on an enterprise-
7 wide basis and requiring allocation of total identified savings between the regulated
8 and non-regulated businesses.

- 9 • Corporate and Shared Services Staffing – Position reductions related to
10 redundancies associated with corporate management and business support
11 functions that support the regulated and non-regulated businesses.
- 12 • Corporate and Administrative Programs – Reductions in non-labor programs and
13 expenses, such as insurance and shareholder services, resulting from economies of
14 scale and cost avoidance that support the regulated and non-regulated businesses.
- 15 • Information Technology – Reductions in hardware, software, projects, and
16 operating costs associated with support of the regulated and non-regulated
17 businesses, from consolidation of redundant technology and system platforms.
- 18 • Utility Support Staffing – Position reductions in utility business management and
19 related support organizations from alignment and integration of functions.
- 20 • Utility Non-Labor – Aggregation and rationalization of materials and supplies
21 volumes and services contracts to achieve greater sourcing economies plus
22 improvements in bad debt expense from a combined billing platform.

1 Q. What level of gross and net regulated cost savings have been identified over the
2 first four years after the merger?

3 A. Based on the overall operating philosophy and the approach to cost analysis I
4 described earlier, approximately \$535 million of gross cost savings were quantified
5 for the regulated business over the four-year period 2006-2009. The total amount of
6 out-of-pocket costs-to-achieve related to these regulated business cost savings are
7 estimated at \$358 million over the first four years. Similarly, regulated business
8 related pre-merger initiatives are estimated at approximately \$22 million.

9 The total estimated net regulated cost savings identified over the first four
10 years after the merger, after being adjusted for costs-to-achieve and pre-merger
11 initiatives, are approximately \$155 million.

12 **B. General Assumptions**

13 Q. What general financial assumptions were utilized to support the quantification?

14 A. Given the multi-year period used in the quantification of merger cost savings,
15 several underlying assumptions were required for the determination of annual and
16 recurring synergies, related to both O&M and capital. For the most part, the cost
17 savings were estimated based on analysis of the budgeted 2005 expense levels. To
18 reflect the continuing nature of the cost savings, specific escalation rates were then
19 applied, by category, to determine the level of savings in subsequent years.

20 Other financial assumptions were utilized for fixed charge rates and for
21 capitalization of costs. The fixed charge rate recognizes that a number of the cost
22 savings areas include reduced or avoided capital related costs, which would then

1 reduce the capital carrying costs of the utility operating companies. The fixed charge
2 rate is used to quantify those impacts.

3 Certain expenditures in each of the business units are typically capitalized,
4 rather than expensed, based on the type of cost incurred and the policies of the
5 business unit. Specific capitalization rates were reviewed and applied for each of the
6 business units in the areas, where relevant, to recognize this accounting treatment.

7 **Q. Was a common escalation rate used for all savings categories?**

8 **A.** No, a single escalation rate could not be used for all cost savings categories,
9 because certain cost components, e.g., salaries, escalate at different rates than others,
10 e.g., benefits. An approximate 2.3% rate was used for general inflation. However, a
11 higher rate of 3.8% was used for salaries to reflect existing contract arrangements and
12 market requirements. This rate was then adjusted to reflect loadings for benefits and
13 applicable taxes, which resulted in a blended salaries and benefits escalation rate of
14 5.1%. The rates used reflect those developed for normal internal financial forecasting
15 purposes.

16 **Q. How were fixed charge rates developed for the capital related savings**
17 **components?**

18 **A.** A fixed charge rate was used in each year and applied to the capital-related
19 expenditure reductions identified. The fixed charge rate, which covers depreciation
20 and the pre-tax cost of capital, was determined for each of the utility operating
21 companies. The fixed charge rates of each utility operating company were then
22 blended to determine an overall rate for long-lived assets, such as plant-in-service,
23 and for more rapidly recovered assets, such as information technology-related

1 expenditures. The fixed charge rate for capital items other than information
2 technology was approximately 14.4%, while for information technology items it was
3 approximately 32.1%, reflecting the more rapid (five year) depreciation period.

4 **C. Cost Savings Summary**

5 **1. Corporate & Shared Services Staffing**

6 **Q. What is the nature of the cost savings identified in the corporate staffing**
7 **category?**

8 **A.** The Companies expect to consolidate the respective corporate management
9 and related functions performed within each stand-alone company. This consolidation
10 would allow for the execution of these corporate and administrative functions by a
11 single entity and create cost savings from reduced staffing levels associated with
12 these functions. This area captures the typical management functions of executive,
13 external relations, human resources, finance and accounting, information technology,
14 communications, supply chain, and various other administrative support functions.

15 These savings reflect those costs that can now either be achieved due to the
16 avoidance of the need for certain positions which perform similar tasks or from the
17 leveraging of existing positions to handle the workloads within the combined
18 Company due to economies of scale.

19 **Q. How were the identified staffing reductions developed?**

20 **A.** After a comparative baseline was constructed, the current number of positions
21 was reviewed to determine the level of necessary future positions to perform the
22 required activities as a combined Company. Generally, it was assumed that there

1 would be full consolidation of these corporate and administrative functions and that
2 duplication of functions and activities would be avoided.

3 The analysis assumed that the Companies would move to a common view of
4 which functions would be performed within either the corporate management
5 functions or the shared services business unit. For our purposes, it was assumed that
6 significant consolidation would occur and that specific organization structures were
7 not necessary for this analysis. In conducting the analysis, however, the nature of the
8 activities performed; the requirement for proximate performance of related functions;
9 the relative scale of the respective companies; and the relative stand-alone business
10 models, were all considered.

11 **Q. What did you determine to be the level of comparable positions for the corporate
12 management and shared services functions?**

13 **A.** For Exelon, approximately 1,626 positions were identified for the corporate
14 and shared services areas, and 1,222 similar positions were identified for PSEG.
15 These position totals capture currently filled and open positions, as both categories
16 are affected by the merger.

17 A total of 528 corporate management and shared services position reductions
18 were identified from the merger and the adoption of a consolidated operating model.
19 These reductions represent the identified level of functional overlap and duplication
20 that could be avoided through the creation of tightly integrated corporate management
21 and shared services organizations.

22 **Q. When are these position reductions assumed to occur?**

1 A. These position reductions are assumed to occur over several years as the
2 related work can be consolidated and integrated. We have assumed that 313 positions
3 can be reduced within the first year after close. Other reductions have been linked to
4 anticipated system integration completion dates to reflect the timing of specific
5 system cutovers. Of the total 528 position reductions in these corporate management
6 and shared services areas, 119 would occur in the second year after the merger,
7 another 71 in the third year, and 25 in the fourth year. All of the staffing reductions
8 will occur within the four-year time period I have presented for savings
9 quantification.

10 **Q. How were the actual position reduction cost savings calculated?**

11 A. Average salary levels were calculated by function and level and then applied
12 to the identified position reductions in those respective areas. Benefit costs were also
13 included in quantifying the cost savings associated with the identified position
14 reductions. These benefits typically include health insurance, life insurance,
15 employee investment plans, pension expense, accruals for retirement health benefits,
16 incentives and bonuses, payroll taxes and others. A blended benefits loading rate
17 of 37.5% was used to estimate average aggregate benefits cost.

18 **Q. Do any of the savings relate to costs that are capitalized?**

19 A. Yes. A certain portion of these savings reduce costs that are capitalized rather
20 than expensed in the year incurred, reflecting the normal business practice of the
21 Companies. Capitalized amounts are recovered over the life of the asset to which
22 these costs are assigned. A blended capitalization rate of approximately 1% was used

1 for the corporate management and shared services areas, based on historical
2 experience.

3 **Q. How were savings calculated related to these capitalized amounts?**

4 **A.** The fixed charge rates that I previously described were applied to the portion
5 of savings allocated to capital to convert these savings to capital carrying costs that
6 would be reduced.

7 **Q. What were the total regulated business savings estimated to result from
8 corporate and shared services staffing consolidation?**

9 **A.** Cost savings for the corporate and shared services staffing reductions
10 allocated to the regulated business are \$28.5 million in the first year, growing to
11 \$47.5 million in the fourth year, resulting in average annual savings of \$39.2 million.

12 **2. Corporate and Administrative Programs**

13 **Q. What is the nature of corporate and administrative program cost savings?**

14 **A.** The merger allows for the reduction of non-labor costs that relate to these
15 same corporate management or shared services functions that I described earlier.
16 These costs can either be reduced or avoided as economies of scale can be leveraged,
17 redundant costs will simply not be expended or lower amounts may be expended for
18 similar activities from consolidation of stand-alone needs.

19 **Q. What specific areas were quantified in the corporate and administrative
20 programs area?**

1 A. Savings were identified, quantified, and allocated to the regulated businesses
2 over the four-year period. The following table shows the allocated cost savings to the
3 regulated business, by category.

4 **CORPORATE AND ADMINISTRATIVE PROGRAMS**

5 (\$ in Millions)	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>	<u>Total</u>
6 Administrative and General Overhead	2.1	3.0	3.5	3.8	12.4
7 Advertising	0.9	0.9	0.9	0.9	3.6
8 Association Dues	0.1	0.1	0.1	0.1	0.5
9 Benefits Administration	1.4	1.5	1.6	1.8	6.3
10 Directors' Fees	0.2	0.2	0.2	0.2	0.8
11 Facilities	1.7	2.3	2.6	2.8	9.4
12 Insurance	2.1	2.1	2.2	2.2	8.5
13 Professional Services	4.2	4.4	4.7	4.9	18.3
14 Shareholder Services	1.1	1.1	1.1	1.2	4.5
15 Total Corporate and Admin. Programs	13.7	15.7	17.0	17.9	64.3

16 Each of the aforementioned categories is described below.

17 **a. Administrative and General Overhead**

18 **Q. How are administrative and general expenses affected by this merger?**

19 **A.** A variety of administrative expenses exist to support the day-to-day execution
20 of work responsibilities by employees. These miscellaneous types of expense are
21 generally characterized as overhead expenses and include training, postage,
22 stationery, employee travel, transportation, and office supply expenses, among others.
23 These costs are generally variable with the total number of positions and change as
24 the number of positions increase or decrease. As position reductions are achieved
25 through the merger, these miscellaneous overhead expenses also are reduced.

1 Q. How were estimated cost savings for this area quantified?

2 A. Miscellaneous overhead expenses were identified in the synergies
3 quantification process I described earlier, by category, by Company. The variable
4 administrative and general costs for the Companies are incurred primarily by, or on
5 behalf of, all employees. A \$16,363 loader was developed for application to each of
6 the reduced positions to reflect these incidental support expenses that will no longer
7 be incurred after the merger is completed. The estimated merger savings identified
8 and allocated to the regulated business are \$2.1 million in the first year growing to
9 \$3.8 million in the fourth year, resulting in an average annual savings of \$3.1 million.

10 b. Advertising

11 Q. How are the advertising expenditures of the Companies affected by the merger?

12 A. Both Companies maintain separate programs for advertising at the corporate
13 level. After the merger is complete, the manner in which the Companies administer
14 these programs will change with Exelon administering this program across the family
15 of companies. Consolidation of each Company's agency spending and elimination of
16 stand-alone advertising will enable cost savings to be achieved.

17 Q. How were savings with respect to advertising expenditures quantified?

18 A. The advertising and related expenditures of each Company were reviewed to
19 identify categories of expenditures that could be avoided. As stated above, agency
20 fees, campaign costs and general program consolidation will provide the opportunity
21 for cost savings to be realized immediately. In this case, it is likely that corporate
22 level PSEG expenditures will simply no longer be incurred, as all programs will be

1 integrated at the Exelon enterprise level. The estimated cost savings for the regulated
2 business in the advertising category are \$0.9 million in the each year, resulting in an
3 average annual savings of \$0.9 million.

4 **c. Association Dues**

5 **Q. How are the regulated business association dues of the Companies affected by**
6 **the merger?**

7 **A.** Both Companies incur dues for trade groups, such as the Edison Electric
8 Institute (EEI) and the American Gas Association (AGA), which are calculated based
9 on proscribed formulas. As a combined entity, these dues will be reduced after
10 applying the formula to the combined two companies. The estimated cost savings for
11 the regulated business in this category are \$0.1 million annually over the four years.

12 **d. Benefits Administration**

13 **Q. How can cost savings be achieved in the area of benefits administration in this**
14 **merger?**

15 **A.** Benefits administration savings typically arise from the consolidation of the
16 benefits plan administrators, trustees, and related costs. This can occur even without
17 the consolidation of the benefits plans themselves as these vendors are skilled at
18 handling multiple plans and most companies today have more than a single plan
19 across the business. These cost savings relate to the reduction in total administrative
20 fees as a result of sourcing this support from fewer vendors.

21 **Q. What is the level of estimated regulated business benefits administration cost**
22 **savings?**

1 A. The respective administrative fees paid by Exelon and PSEG to current
2 vendors were reviewed to determine the baseline expenditures and the opportunity for
3 plan management consolidation. The level of savings from improved sourcing of
4 benefits administration allocated to the regulated business is estimated at \$1.4 million
5 in the first year growing to \$1.8 million in the fourth year, resulting in an average
6 annual savings of \$1.6 million.

7 **e. Directors' Fees**

8 **Q. How are savings in directors' fees derived from this specific combination?**

9 A. These reductions result from the reduced number of total directors in the
10 combined Company compared to that of the separate Companies. The new board of
11 the combined Company will be smaller than the total size of the two separate boards.
12 The source of the savings is the reduced meeting and committee fees paid to directors
13 as a result of these directors leaving the board, as well as the reduction in travel
14 related costs from the fewer directors on the new board.

15 **Q. How were cost savings estimates in this category developed?**

16 A. In this case, four directors will be reduced from the Companies as a result of
17 the merger. Based on the average fees and expenses for directors at each Company,
18 the total regulated business savings would amount to \$0.2 million in the first through
19 fourth years, resulting in average annual savings of \$0.2 million.

20 **f. Facilities**

21 **Q. How are regulated business facilities cost savings created through the merger?**

1 A. Cost savings arise from the number and geographic location of the various
2 corporate and headquarters locations. Cost savings are possible from the lower
3 square footage needed to be maintained after position reductions are worked through
4 the existing space configuration.

5 **Q. What level of facilities savings was calculated from the merger?**

6 A. An average amount of square footage per employee was developed based on
7 the actual configurations. We also assumed that the amount of freed-up space could
8 be sub-let at the prevailing market rate to determine a blended sub-lease rate. Based
9 on this approach, regulated business facilities savings were estimated at \$1.7 million
10 in the first year growing to \$2.8 million in the fourth year resulting in average annual
11 savings of \$2.4 million.

12 **g. Insurance**

13 **Q. Please describe how cost savings can be achieved from the merger in the area of**
14 **insurance.**

15 A. A variety of insurance programs and coverages are established for the
16 property, director and officer liability and excess casualty areas, among others, by the
17 Companies. Each Company has independently defined its own risk philosophy,
18 established its coverage levels, determined related deductibles and negotiated other
19 terms and conditions of its insurance program. The combined Company will
20 undertake these same activities across a broader asset base and a different loss profile.
21 This view will result in lower insurance costs from a mix of program consolidation
22 and redesign for the combined Company.

1 **Q. How were the savings in the area of insurance quantified in this merger?**

2 **A.** Savings on insurance premiums were determined across the various insurance
3 program types through consultation with risk managers within each Company. The
4 ability to combine the insurance programs is estimated to result in approximately a
5 10% to 20% reduction in premium levels, by type of insurance. We have estimated
6 regulated business savings of \$2.1 million in the first year growing to \$2.2 million in
7 the fourth year, resulting in average annual savings of \$2.1 million.

8 **h. Professional Services**

9 **Q. Please describe the nature of savings possible from the professional services**
10 **area.**

11 **A.** The Companies utilize a variety of third-party advisors for skills and expertise
12 beyond that available within either Company or to meet market or statutory
13 requirements. These professional services functions include such areas as audit, tax,
14 legal, and general management consulting and address similar areas within each
15 Company.

16 **Q. How were savings in the area of professional services quantified?**

17 **A.** Savings were calculated by identifying and reviewing the expenditures for
18 third-party vendors at each Company. Audit savings were based on reducing the total
19 stand-alone costs of the Companies to a level reflecting the consolidated needs of the
20 business. Legal and general consulting services were reduced from current levels to
21 reflect the ability to combine internal and external resources more efficiently and
22 effectively. The total savings resulting from these reductions for the regulated

1 business is \$4.2 million in the first year growing to \$4.9 million in the fourth year,
2 resulting in an average annual savings of \$4.6 million.

3 **i. Shareholder Services**

4 **Q. How will the merger of the Companies impact the expenses incurred for**
5 **shareholder services?**

6 **A.** In addition to the labor savings identified, cost savings are anticipated to result
7 through the combination of transfer agents, the elimination of duplicative investor
8 relations and a reduction in the total cost of processing transactions. Moreover,
9 reductions are expected in combined non-labor shareholder services costs in common
10 activities, such as proxy filings and registration costs, and from elimination of
11 duplicate costs associated with annual meetings and annual reports.

12 **Q. What is the level of savings estimated and how was it calculated?**

13 **A.** The total estimated regulated business savings in the area of shareholder
14 services based on the 2004 expenditures of each of the Companies is approximately
15 \$1.1 million in the first year growing to \$1.2 million in the fourth year, resulting in an
16 average annual savings of \$1.1 million.

17 **3. Information Technology (IT)**

18 **Q. Would you please describe how information technology savings are available to**
19 **the Companies?**

20 **A.** The merger will result in a single IT organization, allowing stand-alone
21 operations of both Companies to be fully integrated and the related operating and
22 capital costs to be reduced. The opportunity to achieve these savings results from the

1 rationalization and consolidation of underlying applications and standardization of
2 infrastructure including: data centers, servers, networks, telecommunications and
3 workstations and elimination of duplicate projects. In essence, the merger will create
4 a fully aligned and integrated IT organization that operates across the enterprise using
5 consistent systems, networks, tools and methodologies.

6 **Q. How were the estimated savings in information technology developed?**

7 **A.** A specific team was chartered with members from each Company to focus on
8 the IT area. This was done due to the complexity of the underlying decisions to be
9 made and the potential level of IT savings. This team compiled stand-alone baselines
10 to understand the current operating environments within each Company and the near-
11 and long-term plans for the respective IT organizations. This team reviewed the
12 stand-alone budgets of the Companies and inventoried the various applications in use.
13 With this information, the team developed a preliminary view of how the respective
14 IT organizations could be integrated in the future. Since the IT function serves the
15 entire enterprise, it was analyzed as a total function with potential savings either
16 directly assigned or allocated to the regulated business.

17 **Q. Are there particular information technology areas that are likely to provide**
18 **significant savings contribution?**

19 **A.** Yes. PSEG and Exelon utilize different applications in many areas,
20 particularly in the backbone applications areas for the finance, human resources and
21 work management areas. For example, PSEG utilizes SAP for its backbone
22 applications while Exelon uses a PeopleSoft platform. Only one of these platforms in

1 each area makes sense to carry forward as a combined Company. Consolidation into
2 one system will avoid significant maintenance and upgrade expenditures.

3 Additionally, the customer billing platforms of each Company are different,
4 with significant benefits available once a single system is selected for use across all of
5 the utility operating companies. Aligning the billing systems of the Companies will
6 not just benefit the IT organizations; the customer care function will also benefit as
7 resources can be more effectively and productively employed across the enterprise.

8 Beyond these two specific applications, almost all other applications will be
9 integrated to provide similar benefits. Similarly, almost all of the operating
10 architecture can be standardized and consolidated to leverage the common system
11 environment.

12 **Q. What are the components of the savings in the information technology area?**

13 **A.** Total IT function projected capital expenditures savings associated with the
14 development of duplicative systems and future application development have been
15 estimated at an average annual amount of \$18 million over the four-year period. The
16 avoided annual cash flows have been converted to capital carrying costs using the
17 fixed charge rate described earlier and assuming a five-year depreciable life, which
18 reflects the planned amortization period for these investments. The level of savings in
19 carrying costs related to IT capital expenditure avoidance for the regulated business is
20 estimated at \$3.2 million in the first year growing to \$9.3 million in the fourth year,
21 resulting in annual average carrying costs savings of \$6.4 million. These carrying
22 costs savings recognize that as future IT expenditures are avoided, future rates to
23 customers to recover these costs would be lower.

1 business unit and functional leadership that would exist in parallel between Exelon
2 and PSEG.

3 Similar impacts would also occur in the back-office support areas of
4 transmission and distribution (T&D) operations. These areas would include functions,
5 such as standards, engineering, and customer care activities related to customer
6 accounting and billing system support. The integration of a common customer billing
7 system will also enable the call centers to be aligned and staffing levels managed
8 across time zones to levelize peak load requirements, resulting in resources being
9 capable of handling overflow calls from any location.

10 The supply chain and bad debt savings areas related to utility operations are
11 described more fully in the next section of my testimony. The supply chain savings
12 deal with the opportunities that are available for improved sourcing from the
13 consolidation of procurement programs across the three utilities. The bad debt savings
14 relate to improved collecting processes and reduction of write-offs enabled by
15 implementing a common billing system platform across the utility operating
16 companies.

17 **Q. How were the impacts to the utility business unit determined?**

18 **A.** A team was chartered to focus on the opportunities to the T&D business
19 through the merger. This group developed an initial staffing and cost baseline,
20 determined the operating philosophy, constructed assumptions regarding how
21 baseline staffing and cost baselines would be affected, and quantified the potential
22 impacts.

1 chain.

2 A. Our regulated utilities incur significant investment requirements associated
3 with corrective and preventative system maintenance, new business connections,
4 capacity expansion, facility relocation, and system performance upgrades. Costs
5 associated with fulfilling these requirements are typically reflected in the areas of
6 materials and supplies and contract services expenditures.

7 The combination of the Companies enables a more effective and efficient
8 sourcing of these materials and services needs. With respect to the purchase of
9 materials and supplies, savings can be realized in the procurement of commodity
10 items, consumable materials (e.g., conductors, wire, cable), and other equipment. In
11 addition, standardization of system components such as meters, transformers, and
12 poles can be achieved.

13 With respect to the procurement of services, particularly contract services
14 such construction assistance, expenditures can be consolidated and contracted from
15 fewer sources. Cost savings are created by achieving a lower per unit cost for the
16 service provided due to a broader contracting capability or the repackaging of work
17 into more attractive options to the contractor. In addition, internal and external force
18 utilization mix can be improved which can provide both unit cost and total cost
19 benefits.

20 Within the utility back-office support areas, the Companies will be able to
21 improve efficiencies in functions such as customer billing. Moving to a common
22 billing system platform, for example, will enable more effective management of
23 collections which will reduce bad debt expense.

1 **a. Materials and Supplies**

2 **Q. What level of merger cost savings was determined available from supply chain**
3 **integration for materials and supplies?**

4 **A.** Annual T&D purchases for 2004 for Exelon were approximately \$329
5 million, while for PSEG they were approximately \$129 million. These expenditure
6 levels capture a mix of consumables, stock items and engineered items. The
7 Companies will be able to improve how they source these items and the unit cost
8 paid. They will also be able to reduce the overall level of total expenditures based on
9 the standardization of specifications and the rationalization of maintenance
10 philosophies and programs.

11 Based on the review of the detailed composition of the materials and supplies
12 expenditures, the team estimated between 0.5% to 7.5% improvements to total
13 expenditure levels, by category, from improved sourcing. Total savings from pro-
14 curement of materials and supplies were estimated at \$ 6.3 million in the first year
15 growing to \$11.5 million in the fourth year, resulting in an average annual savings of
16 \$8.9 million.

17 **Q. Should any of the materials and supplies savings be treated as capital savings?**

18 **A.** Yes. Approximately 69% of the materials and supplies savings has been
19 assumed to be capital in nature based on the estimated capitalization rate for all
20 materials and supplies. The fixed charge rate previously described was applied to
21 convert the capital cost reductions into capital carrying cost savings.

1 **b. Contract Services**

2 **Q. What is the nature of savings from contract services as a result of the merger**
3 **and how were they quantified?**

4 **A.** Just as in consolidating materials and supplies volumes and rationalizing
5 overall expenditure levels, the Companies will be able to gain economies of scale
6 from the aggregation of related contract service providers such as general
7 construction contractors.

8 Exelon's total T&D contract services for 2004 were \$ 497 million, while they
9 were \$ 154 million for PSE&G. On a combined basis, the Companies should be able
10 to achieve additional economies of scale and execute a revised sourcing strategy with
11 contractors. Based on a detailed review of the contract services expenditures of both
12 companies, the team estimated a 1% to 4% improvement in unit costs, by category,
13 from improved sourcing.

14 Some of the contract services savings should be considered as capital savings.
15 A capitalization rate of 53%, based on the estimated blended rate for the Companies,
16 was used to reflect the amount of contract services expenditures that are charged to
17 capital. These savings amounts were then converted to capital carrying cost savings
18 using the fixed charge rate. The total estimated savings from contract services was
19 \$9.9 million in the first year growing to \$15.0 million in the fourth year, resulting in
20 an annual average savings of \$12.4 million.

21 **c. Bad Debt Expense**

22 **Q. What is the nature of savings in bad debt expense as a result of the merger and**
23 **what level was quantified?**

1 A. As described previously, the Companies' intend to align and integrate their
2 stand-alone billing systems to realize efficiencies and capture economies from a
3 single billing platform. These efficiencies include an improvement in the Companies'
4 overall bad debt expense as the single platform will provide improved information on
5 delinquent customer accounts and automate the collection process. Total savings are
6 estimated at \$5.2 million in year two growing to \$5.5 million in year four resulting in
7 an annual average savings of \$4.0 million over the four-year period.

8 VI. COSTS-TO-ACHIEVE

9 Q. What are costs-to-achieve and why are they incurred in this merger?

10 A. Costs-to-achieve are typically incurred in all mergers and relate to completing
11 the transaction and combining the two entities to capture the identified cost savings.
12 These costs-to-achieve include all of the costs associated with planning, prosecuting,
13 integrating and closing a transaction and generally reflect contracted costs with third
14 parties, commitments to employees and other incremental expenditures for effecting
15 merger integration.

16 Costs-to-achieve reflect out-of-pocket cash payments and usually are one-time
17 payouts incurred as a result of the merger. These expenditures generally are front-
18 loaded and capture costs incurred leading up to an announcement, during the
19 regulatory approval process and through the integration process. In some cases, these
20 costs can be ongoing and relate to incremental, fixed expenditures, e.g., information
21 technology seat licenses or capacity upgrades.

22 Q. Why is it appropriate to recognize each of these types of costs-to-achieve?

1 A. The completion of the merger is dependent upon three primary conditions: the
2 ability to demonstrate to the respective Boards of Directors, shareholders and the
3 financial community the merits of the proposed combination; the ability to
4 demonstrate the benefits of the combination to all Federal and state regulatory
5 agencies; and the ability to successfully integrate the Companies. The costs incurred
6 are not avoidable, and are required to ensure that the merger receives approval by the
7 Board of Directors of each company and by Federal and State regulatory agencies;
8 employees leaving the Company are fairly treated; systems and infrastructure are
9 converted and integrated to support operations; internal and external stakeholders
10 receive adequate communications; and integration activities are thoroughly planned
11 and conducted.

12 **Q. Was the process used for estimating costs-to-achieve consistent with that**
13 **followed for cost savings?**

14 A. Yes. Where relevant, each team identified those types of out-of-pocket cost
15 areas or levels that were anticipated to be required to integrate the respective business
16 units.

17 **Q. What necessary level of out-of-pocket expenses has been estimated to merge the**
18 **Companies?**

19 A. The regulated business costs-to-achieve are estimated at \$358 million over the
20 four-year period 2006-2009. The expenses to be incurred over the first two years -
21 2006 and 2007 - reflect approximately 68% of the total costs-to-achieve. The high
22 proportion of costs in these years reflects the incurrence of costs related to merger
23 approval, support for information technology readiness and the reduction in positions

1 that occurs once the merger is closed and the Companies begin to operate on a
2 combined basis.

3 The primary estimated regulated business costs-to-achieve relate to: severance
4 (\$77 million), relocation (\$3 million), retention (\$4 million), systems integration
5 (\$212 million), facilities integration (\$4 million), customer / supplier / employee
6 education communication (\$6 million), regulatory and compliance processes (\$20
7 million), transition (\$8 million), Directors' and Officers' liability coverage (\$4
8 million), and transaction costs (\$21 million). The regulated business costs-to-achieve
9 are summarized by year on EXHIBIT WDA-3.

10 **Q. Would you please describe the nature of the severance and other employee**
11 **related costs?**

12 **A.** Once the merger is approved, the organizations of the Companies will be able
13 to be integrated and fewer positions will be required. Although the Companies intend
14 to utilize attrition, controlled hiring, open positions, and other mechanisms to reduce
15 total positions, more formal severance programs will also need to be utilized to
16 achieve targeted staffing levels.

17 The costs-to-achieve for severance and employee related expenses actually
18 capture several individual components: employee and executive severance costs,
19 retention costs, and relocation costs. The severance costs are estimated based on the
20 number of severance packages that would be needed to meet the expected workforce
21 reductions. Additional severance related costs for payments to be made to employees

1 in lieu of transfer, i.e., where employees elect to separate rather than move to a new
2 job location, have also been estimated.

3 The estimated number of employees to whom severance payments will be
4 made is 861 with separations occurring over the period from 2006 to 2009. This
5 number is less than the total number of reduced positions as normal attrition and the
6 open positions will be used to reduce the need for equivalent severance packages,
7 where possible, within the Companies. Executive severance costs are also included in
8 these amounts and reflect the required payments to departing officers and executives
9 based on existing employment contracts in PSEG and estimated severances within
10 Exelon. The total regulated business cost for the severance programs for employees in
11 both Companies is estimated at \$77 million dollars and is primarily incurred in 2006
12 and 2007.

13 For those employees that elect to move to a new location, relocation cost
14 allowances will be extended to defray expenses associated with such moves.
15 Employee retention payments, i.e., "stay payments", are also anticipated to be
16 required to maintain needed employees and related skills in critical functions, e.g.,
17 information technology and finance, through and beyond merger close. These
18 payments reflect the extension of final separation dates where skills for critical
19 activity completion is required or where the success of the merger and ability to
20 produce the type and level of indicated benefits to customers could be threatened. The
21 total retention and relocation payment amounts are estimated at \$7 million for the
22 regulated business.

23 **Q. Please explain how the information technology costs-to-achieve was determined.**

Page

37

Missing

1 The incurrence of these costs will provide the basis for realizing much of the cost
2 savings potential that I have previously described. Without the integration of the
3 information technology platforms of the two Companies, the ability to consolidate the
4 Companies and operate in a seamless manner will not be achieved. The expenses
5 associated with systems and communications integration are principally expected to
6 be incurred in 2006 through 2008 but will carry through the full period to reflect
7 additional hardware lease costs.

8 **Q. Can you describe the regulatory and compliance process costs-to-achieve related**
9 **to the merger?**

10 **A.** Certain costs for assistance from professional service firms will be incurred
11 for preparation and pursuit of necessary regulatory filings and related compliance
12 requirements, such as those related to SEC, FERC, NRC and DOJ filings, as well as
13 the merger approval cases filed before the state regulatory jurisdictions in New Jersey
14 and Pennsylvania. These costs include professional services for legal, tax, accounting
15 and consulting assistance associated with these filings related to market analyses,
16 synergies and corporate restructuring, among other areas. These costs are necessary
17 for the receipt of required regulatory approvals and the successful completion of the
18 merger. Regulatory process and compliance costs are estimated at \$20 million with
19 respect to the regulated business.

20 **Q. Would you describe the estimated customer, supplier, and employee education**
21 **communication costs-to-achieve?**

1 A. Communication expenses will be incurred as the Companies provide
2 information about the merger to the various stakeholders that deal with the
3 Companies. Mailings and informational brochures will be sent to customers,
4 employees, retirees, suppliers, shareholders, rating agencies, and regulatory agencies
5 to explain the specifics of the merger. Communications costs-to-achieve also include
6 costs associated with implementing the new Company name and logo, e.g., signage
7 across the business entities. These expenditures are estimated at \$6 million for the
8 regulated business.

9 **Q. Please explain the transaction cost component.**

10 A. Transaction costs are necessary to secure the required internal approvals from
11 the Boards of Directors and external approvals from the shareholders to pursue
12 proposed transactions. These costs relate to fees for transaction structuring and
13 valuation assistance, financial market analysis and fairness opinions. Transaction
14 costs are not avoidable and typically are expended prior to the announcement of a
15 merger. Transaction costs of \$21 million are allocated to the regulated business.

16 **Q. Are there additional costs-to-achieve beyond those you have described?**

17 A. Yes. Other costs that were attributed to the regulated business from the merger
18 are transition costs (\$8 million); facilities integration (\$4 million); and D&O tail
19 coverage (\$4 million). Transition costs include consulting fees for assistance with the
20 integration of the Companies and expenses, such as travel for the transition teams.
21 These costs will be incurred through and beyond closing of the merger. Additional
22 facilities-related expenses are also necessary for addressing the space requirements of
23 the Companies, e.g., restacking, refurbishment and leasehold improvements, and

1 lease adjustment or cancellation. D&O tail liability coverage applies to directors and
2 officers that will be leaving the Companies as a result of the merger.

3 VII. PRE-MERGER INITIATIVES

4 **Q. What are pre-merger initiatives and how were they determined?**

5 **A.** Each Company is separately planning on mitigating future cost increases on a
6 stand-alone basis. To avoid double counting the quantified cost savings, I have
7 determined the level and timing of any initiatives that had been planned prior to the
8 announcement of the merger.

9 **Q. Once the baseline effect of these planned initiatives was established, what was
10 the next step in your analysis?**

11 **A.** The merger savings were then specifically mapped to each of the business
12 units to measure the relative impact of these savings. The merger savings related to
13 the corporate management and shared services areas have a much greater impact on
14 baseline costs in those areas because of the extent of duplication that typically exists
15 in those areas between the two Companies. The level of combined merger savings is
16 only a small percentage of total O&M (approximately 6% in year four) for the
17 combined Company because most of the costs associated with utility operations, i.e.,
18 field service costs, are simply not affected. However, when the savings are mapped
19 to business units, the corporate management and shared services merger savings have
20 a higher than 6% impact on relevant baseline O&M costs, and consequently would
21 have the potential for greater overlap with the separately identified merger cost
22 savings in that area.

1 Q. How were these observed ratios then used in the analysis of pre-merger
2 initiatives?

3 A. The calculated ratios were then applied against the estimated decline by each
4 individual business unit. As an example, the calculated merger savings impact on
5 corporate O&M was applied to the decline estimated for corporate O&M. This
6 essentially suggests that any stand-alone cost reduction initiatives planned against
7 corporate O&M would overlap in roughly the same percentage as the merger savings
8 affecting the baseline level of costs. Stated another way, on a stand-alone basis, each
9 of the Companies would mitigate future increases in costs that will occur in areas
10 both affected and unaffected by the merger. Consequently, there is only a partial
11 overlap between the merger cost savings and the stand-alone initiatives.

12 Q. What impact did this analysis have on the level of regulated business merger cost
13 savings?

14 A. Based on this approach, I reduced the identified regulated business cost
15 savings downward by \$3.3 million in the first year growing to a reduction of \$7.6
16 million in the fourth year, resulting in an annual average reduction of \$5.6 million to
17 reflect the potential overlap between the savings realized directly from the merger and
18 the indicated forecast levels of O&M cost change.

19 **VIII. ALLOCATION PROCESS**

20 Q. What is the purpose of this section of your testimony?

21 A. Here, I describe how the total cost savings and costs-to-achieve have been
22 allocated between the regulated and non-regulated businesses, respective utility

1 operating companies and business segments. Since a large portion of the savings arise
2 from the corporate and shared services businesses and relate to both regulated and
3 non-regulated operations, they need to be allocated between these businesses to
4 define the flow of benefits.

5 **Q. Please describe the approach used to allocate the corporate and shared services**
6 **merger savings to the regulated and non-regulated businesses.**

7 **A.** The Companies used the corporate and shared services cost savings and
8 related cost-to-achieve categories identified in EXHIBIT WDA-4 and EXHIBIT
9 WDA-5 to this testimony as the basis from which to begin the allocation analysis.

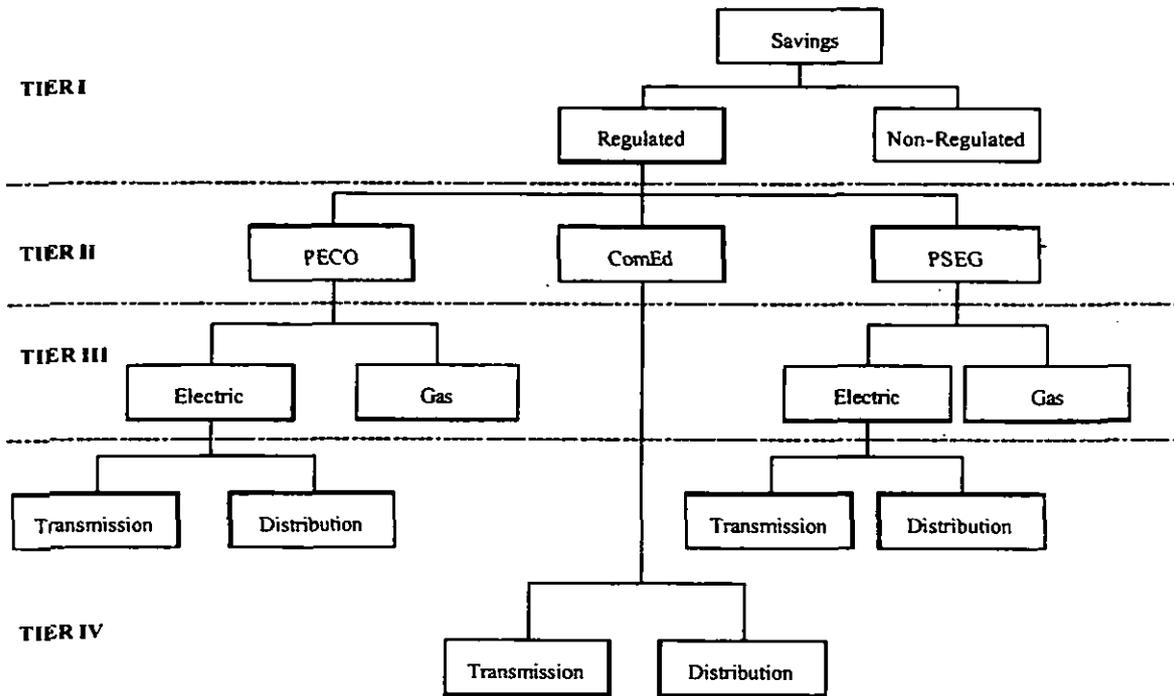
10 **Q. Please elaborate on the allocation methodology that has been utilized.**

11 **A.** The allocation methodology used to allocate the merger savings employed a
12 three-basis, four-tier allocation process that approximates the anticipated future cost
13 structure of the combined Company. The three allocation bases used to assign
14 savings, in order of precedence, are direct assignment, generally allocated or
15 historically allocated. The first basis, direct assignment, represents savings that relate
16 to operations that do not flow from corporate or shared service allocations; i.e., they
17 were either savings from costs that are directly incurred in the utility operating
18 companies, or savings from costs that are charged to utility operating companies on a
19 direct assignment basis. The assignment of savings for this category was determined
20 primarily through detailed analysis of the underlying costs charged for each type of
21 savings. For example, reductions in direct business unit expenditures or business unit
22 labor costs would be allocated directly to that business unit.

1 The second and third bases, generally allocated or historically allocated
2 savings, represented all other savings. These savings resulted from costs almost
3 exclusively incurred at the corporate level or in the service companies that could not
4 be directly assigned. Generally allocated savings, utilized for tiers I and II discussed
5 below, were assigned to each entity based upon that entity's anticipated non-fuel
6 O&M costs as a percentage of the total merged Company's anticipated non-fuel O&M
7 costs. This approach aligns estimated cost savings with the anticipated cost pools that
8 are affected by the merger, thereby matching savings with costs. For example, the
9 savings resulting from a reduction in the costs of systems that support all elements of
10 the Company, e.g., financial applications were allocated to the utility operating
11 companies based upon their O&M weighting.

12 Historically allocated savings, utilized for tiers III and IV discussed below,
13 were assigned to each entity based upon that entity's historical cost experience. For
14 example, when looking at the composition of PECO's regulated O&M it has
15 historically been comprised of approximately 83% electric and 17% gas respectively.
16 This historical "split" was applied to the Pennsylvania Regulated savings in tier III to
17 disaggregate it into their electric and gas components. Likewise, PECO's electric
18 O&M has historically been comprised of approximately 7% transmission and 93%
19 distribution respectively. This historical split was utilized in tier IV to disaggregate
20 PECO's electric savings into their transmission and distribution components. A
21 visual representation of the allocation methodology is shown below:

SAVINGS ALLOCATION OVERVIEW



1

2 **Q. Were most savings directly assigned or allocated using allocation factors?**

3 **A.** Approximately sixty percent of the savings were directly assigned to either the
 4 "Regulated" or "Non-Regulated" categories of tier I, described below, with the
 5 remainder of the savings utilizing the weighted O&M or historical allocations. As the
 6 "Regulated" savings were further disaggregated through tiers II, III, and IV, the same
 7 allocation approach and methodology was employed, but a greater percentage of
 8 savings were allocated using the weighted O&M or historical allocations rather than
 9 direct allocation.

10 **Q. Please describe the first tier employed in the allocation of merger savings.**

1 A. The first tier separated the net cost savings into two categories. The first
2 category, "Non-Regulated", represented all savings from costs incurred in the non-
3 regulated utility operating companies, as well as those costs incurred in the corporate
4 and shared services areas that were allocated to the non-regulated companies. The
5 second category, "Regulated", included all savings from costs incurred in the
6 regulated utility operating companies, as well as those costs incurred in the corporate
7 and shared services areas that were allocated to the regulated companies. "Non-
8 Regulated" and "Regulated" savings represent all savings resulting from the merger.
9 In summary, the purpose of this first tier allocation was to segregate the identifiable
10 non-regulated savings from the total savings before further disaggregating the
11 regulated savings by jurisdiction and line of business.

12 **Q. Please describe the second tier of the allocation process.**

13 A. The "Regulated" savings category identified in the first tier was then further
14 separated into the three jurisdictions where the combined Company will operate. The
15 first jurisdiction, "Illinois", contained those savings related to costs directly incurred
16 by, or allocated to, ComEd. The second jurisdiction, "New Jersey", contained those
17 savings related to costs directly incurred by, or allocated to, PSE&G. The third
18 jurisdiction, "Pennsylvania", contained those savings related to costs directly incurred
19 by, or allocated to, PECO. The sum of the three jurisdictions represents all
20 "Regulated" savings and aligns the cost savings with all three utilities involved in the
21 merger and the jurisdictional entities.

22 **Q. Please describe the third tier of allocation process?**

1 **A.** The third tier of the allocation process further disaggregated the jurisdictional
2 savings from the "Pennsylvania" and "New Jersey" categories from tier two into their
3 electric and gas line of business components using the previously discussed O&M
4 weighting allocation. As the "Illinois" category is electric only, it was not further
5 disaggregated at tier three. The sum of the Pennsylvania and New Jersey gas and
6 Illinois, Pennsylvania and New Jersey electric components reflects all regulated
7 savings.

8 **Q.** **Please describe the fourth tier of the allocation process?**

9 **A.** The fourth tier of the allocation focused on disaggregating the electric
10 components identified in tier three, along with the "Illinois" component from tier two,
11 into their transmission and distribution components using the same O&M weighting
12 basis for development. The fourth tier represented the final level of savings
13 disaggregation.

14 **Q.** **Were all types of savings treated similarly in the allocation process you have**
15 **described?**

16 **A.** Yes. Each type of savings was analyzed to determine the appropriate
17 allocation factor to use through an analysis of the underlying costs and the
18 Companies' anticipated post-merger cost structure. This approach was used
19 consistently across all four tiers of the analysis. For the elements in the savings
20 analysis making up the difference between gross savings and net savings, namely the
21 costs-to-achieve, the allocations were calculated to have the costs follow the savings
22 wherever possible. In other words, costs-to-achieve that could not be directly
23 assigned were allocated on an O&M weighting or historical basis so that they

1 followed allocated gross savings. For example, if 10% of the gross savings were
2 allocated to the "Regulated-Illinois" category, then approximately 10% of the costs-
3 to-achieve those savings were also allocated to the "Regulated-Illinois" category. This
4 ensured that the savings and the costs necessary to create the savings were aligned.

5 **Q. Based on the allocation process you have described, what was the resulting**
6 **breakdown of gross regulated business savings into the identified categories?**

7 **A.** The results of the allocation process, by tier, are shown on the following table
8 for the four-year total gross regulated business savings.

SUMMARY OF ALLOCATIONS

FOUR-YEAR TOTAL GROSS REGULATED SAVINGS

(\$ millions)

Tier I	Percentage of Total Non-Fuel O&M	Total Four-Year Allocable Savings	Total Four-Year Direct Savings	Total Four-Year Savings
Total Regulated	100%	\$299	\$236	\$535
Tier II				
Illinois	37%	\$110	\$74	\$184
New Jersey	39%	\$116	\$97	\$213
Pennsylvania	24%	\$73	\$65	\$138
Total	100%	\$299	\$236	\$535
Tier III				
Illinois Electric	37%	\$110	\$74	\$184
New Jersey Gas	15%	\$44	\$30	\$74
New Jersey Electric	24%	\$72	\$67	\$139
Pennsylvania Gas	4%	\$12	\$10	\$22
Pennsylvania Electric	20%	\$61	\$55	\$116
Total	100%	\$299	\$236	\$535
Tier IV				
Illinois Transmission	3%	\$10	\$10	\$20
Illinois Distribution	34%	\$100	\$64	\$164
New Jersey Gas	15%	\$44	\$30	\$74
New Jersey Transmission	3%	\$9	\$13	\$22
New Jersey Distribution	21%	\$63	\$54	\$117
Pennsylvania Gas	4%	\$12	\$10	\$22
Pennsylvania Transmission	2%	\$4	\$5	\$9
Pennsylvania Distribution	18%	\$57	\$50	\$107
Total	100%	\$299	\$236	\$535

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2 **Q. Have you also calculated these regulated business savings on any additional**
3 **bases?**

4 **A.** Yes. The following table starts with gross regulated business savings. It then
5 shows these savings on a net regulated business basis, i.e., after cost-to-achieve and
6 pre-merger initiatives, for both the total four-year period and as an average annual
7 amount over the four-year period.

SUMMARY OF ALLOCATIONS

FOUR-YEAR NET AND AVERAGE REGULATED SAVINGS

(\$ millions)

Tier I	Total Four-Year Savings	Total Costs-to-Achieve/Pre-Merger	Total Net Four-Year Savings	Average Net Four-Year Savings
Total Regulated	\$535	\$380	\$155	\$39
Tier II				
Illinois	\$184	\$141	\$43	\$11
New Jersey	\$213	\$147	\$66	\$16
Pennsylvania	\$138	\$92	\$46	\$12
Total	\$535	\$380	\$155	\$39
Tier III				
Illinois	\$184	\$141	\$43	\$11
New Jersey Gas	\$74	\$55	\$19	\$4
New Jersey Electric	\$139	\$92	\$47	\$12
Pennsylvania Gas	\$22	\$16	\$7	\$2
Pennsylvania Electric	\$116	\$76	\$39	\$10
Total	\$535	\$380	\$155	\$39
Tier IV				
Illinois Transmission	\$20	\$13	\$7	\$2
Illinois Distribution	\$164	\$128	\$36	\$9
New Jersey Gas	\$74	\$55	\$19	\$4
New Jersey Transmission	\$22	\$12	\$10	\$3
New Jersey Distribution	\$117	\$80	\$37	\$9
Pennsylvania Gas	\$22	\$16	\$7	\$2
Pennsylvania Transmission	\$9	\$5	\$4	\$1
Pennsylvania Distribution	\$107	\$71	\$35	\$9
Total	\$535	\$380	\$155	\$39

1

2

IX. CONCLUSION

3 **Q. Does this conclude your testimony?**

4 **A. Yes, it does.**

William D. Arndt, Senior Vice President, Financial Operations, Exelon Corporation

Exelon Corporation

4/01-Present

Senior Vice President, Financial Operations, Exelon Corporation, 6/04-Present, Chicago, Illinois – Responsible for leading the Business Unit financial organizations for Exelon Generation, Exelon Energy Delivery, Exelon Enterprises, and Exelon Business Services. Responsibilities include strategic long-range planning, profit and loss forecasting and reporting, budgeting, financial variance analysis, cost management, business performance reporting and decision support, and leveraging economic synergies across these business units.

Senior Vice President, Business Operations, Exelon Corporation, 2/03-5/04, Chicago, Illinois – Led The Exelon Way, a restructuring of the corporation and transformation of how Exelon conducts business. Program's goal is to achieve sustainable business improvement while increasing cash flow from O&M and capital expense reduction by \$300M in 2004.

Senior Vice President, Business Operations, Exelon Generation, Enterprises & Services, 5/02-3/03, Chicago, Illinois – Selected by President to provide oversight for business management processes and strategic planning across Exelon's three unregulated Business Units, with focus on strengthening the depth and quality of financial talent and accomplishing organizational realignment to leverage economic synergies.

Vice President, Business Operations, Exelon Nuclear, 4/01-5/02, Warrenville, Illinois – Recruited to lead finance, business planning and performance monitoring / reporting organizations for largest nuclear operating company in the U.S, and AmerGen, an Exelon Nuclear joint venture with British Energy. Budget performance accountability for \$2 billion in operating costs and \$1 billion in capital expenditures, including fuel, across 17 operating plants and two corporate headquarters locations. Nuclear Supply Chain and Information Technology organizations added to scope 11/01.

Global Nuclear Fuel, LLC (Joint Venture of GE, Hitachi & Toshiba) / GE Power Systems

4/98-4/01

Manager, Product Management, Wilmington, North Carolina – Leader of \$300M global nuclear fuel manufacturing and engineering business responsible for all commercial activities and overall customer relations for Asia, Europe and the Americas. Accountable for orders, sales, project and contract management, marketing, pricing, the engineering and administration functional cost budget and strategic planning for the business. Sales and Marketing integration leader for the formation of Global Nuclear Fuel (GNF) on 1/1/00, a \$500M+ annual sales joint venture of GE, Hitachi and Toshiba. Chairman and President of GENUUSA from 2/99 through 4/01, a GE joint venture with ENUSA (Spain) for nuclear fuel marketing and manufacturing operations in Europe.

General Electric Company, GE Power Systems

2/82-4/98

Manager, Reactor Modifications, 1/96-4/98, San Jose, California – Promoted to GE executive with profit and loss responsibility as leader of a global services business segment focused on developing and delivering major plant repair and replacement services for customers in Japan, Taiwan, Europe and the U.S.

Account Manager, 1/90-12/95, Chattanooga, Tennessee; Baton Rouge, Louisiana; Oak Brook, Illinois – Held account leadership roles of progressively increasing scope and size with responsibility for all commercial activities and overall customer relations between the business and assigned customers.

Program Manager, Services Marketing, 2/89-2/90, San Jose, California – Provided marketing support to analyze and segment the \$300M Plant Services business and develop a fix / sell / close strategy for its product lines. Performed market studies to evaluate key competitors and assess the viability of proposed development programs, commercial alliances and joint ventures.

Commercial Programs, 1/87-2/90, Oak Brook, Illinois – Developed account sales / marketing plans and prepared engineering / service proposals for Central Region's Account Managers.

Project Manager & Field Service Engineer, 2/82-1/87, Darien, Illinois – Project Manager and Lead Engineer with budget, schedule and quality accountability in support of maintenance outages, plant modifications and construction activities at U.S. power plants.

Lykes Brothers Steamship Company / Keystone Tankships

7/80-1/82

Third Assistant Engineer, Marine Engineers Beneficial Association, District I – Licensed operations and maintenance engineer aboard U.S. merchant vessels.

Professional Education - General Electric: Six Sigma Certified Green Belt; Global Business Manager's Course

Education - United States Merchant Marine Academy, Kings Point, New York, 1980, BS in Marine Engineering

Military - Lieutenant, U.S. Naval Reserve (Retired)

**Four Year Net Regulated Savings
(\$ in 000s)**

EXHIBIT WDA - 2

	2006	2007	2008	2009	Total
Allocated Corporate and Shared Service Savings					
Corporate and Shared Services Staffing	\$28,526	\$37,294	\$43,561	\$47,467	\$156,848
Corporate & Administrative Programs:					
Administrative & General Overhead	\$2,107	\$2,973	\$3,540	\$3,799	\$12,419
Advertising	868	888	908	928	3,591
Association Dues	129	132	135	138	535
Benefits Administration	1,387	1,507	1,836	1,777	6,307
Directors' Fees	183	187	192	196	758
Facilities	1,682	2,311	2,639	2,798	9,430
Insurance	2,057	2,103	2,150	2,199	8,509
Professional Services	4,228	4,445	4,874	4,914	18,260
Shareholder Services	1,086	1,110	1,135	1,161	4,493
Total Corporate and Administrative Programs	\$13,728	\$15,656	\$17,009	\$17,909	\$64,302
Information Technology					
Information Technology (Capital Carrying Cost)	\$3,173	\$5,956	\$7,310	\$9,295	\$25,735
Information Technology (O&M)	10,385	11,363	15,877	14,449	51,874
Total Information Technology	\$13,559	\$17,319	\$22,987	\$23,744	\$77,609
Total Allocated Corporate and Shared Services Savings	\$55,812	\$70,289	\$83,557	\$89,121	\$298,759
Utility					
Support Staffing	\$13,721	\$37,122	\$40,301	\$43,844	\$134,789
Non-Labor					
Materials and Supplies	\$6,306	\$8,003	\$9,739	\$11,513	\$35,561
Contract Services	9,902	11,505	13,191	14,983	49,561
Bad debt expense	0	5,227	5,344	5,485	16,038
Total Non-Labor	\$16,208	\$24,735	\$28,274	\$31,941	\$101,158
Total Utility Savings	\$29,929	\$61,857	\$68,575	\$75,585	235,947
Total Gross Regulated Savings	\$85,741	\$132,127	\$152,132	\$164,706	\$534,706
Regulated Costs-to-Achieve	\$152,115	\$91,366	\$65,061	\$49,207	\$357,748
Regulated Pre-Merger Initiatives	\$3,278	\$5,459	\$6,010	\$7,603	\$22,349
Net Regulated Savings	(\$69,651)	\$35,302	\$81,062	\$107,897	\$154,809

**Four Year Regulated Costs-to-Achieve
(\$ in 000s)**

EXHIBIT WDA - 3

	2006	2007	2008	2009	Total
Allocated Costs-to-Achieve					
Severance and Employee Related					
Severance	\$56,268	\$17,574	\$2,247	\$837	\$76,926
Relocation	1,802	1,020	0	0	2,822
Retention	3,855	0	0	0	3,855
Subtotal Severance and Employee Related	<u>\$61,925</u>	<u>\$18,595</u>	<u>\$2,247</u>	<u>\$837</u>	<u>\$83,603</u>
Information Technology	\$29,828	\$70,714	\$62,814	\$48,369	\$211,726
Facilities	\$2,012	\$2,057	\$0	\$0	\$4,068
Customer / Supplier / Employee Education Communication	\$5,624	\$0	\$0	\$0	\$5,624
Regulatory and Compliance	\$19,532	\$0	\$0	\$0	\$19,532
Transition	\$8,203	\$0	\$0	\$0	\$8,203
D&O Tail Coverage	\$3,822	\$0	\$0	\$0	\$3,822
Transaction	\$21,170	\$0	\$0	\$0	\$21,170
Total Regulated Costs-to-Achieve	<u>\$152,115</u>	<u>\$91,366</u>	<u>\$65,061</u>	<u>\$49,207</u>	<u>\$357,748</u>

**Four Year Corporate and Shared Services Savings
Before and After Allocation
(\$ in 000s)**

EXHIBIT WDA - 4

	2006	2007	2008	2009	Total
Total Corporate and Shared Services Savings Before Allocation					
Corporate and Shared Services Staffing	\$70,903	\$92,897	\$108,273	\$117,882	\$389,855
Corporate & Administrative Programs:					
Administrative & General Overhead	\$5,237	\$7,390	\$9,788	\$9,442	\$30,857
Advertising	2,158	2,208	2,258	2,307	8,927
Association Dues	174	178	182	186	722
Benefits Administration	3,448	3,746	4,067	4,417	15,678
Directors' Fees	456	486	478	487	1,884
Facilities	4,180	5,743	6,580	6,955	23,439
Insurance	6,135	6,273	6,413	6,557	25,378
Professional Services	10,509	11,049	11,618	12,213	45,387
Shareholder Services	2,899	2,760	2,822	2,885	11,166
Total Corporate and Administrative Programs	\$34,996	\$39,810	\$43,181	\$45,450	\$163,448
Information Technology					
Information Technology (Capital Carrying Cost)	\$7,888	\$14,803	\$18,170	\$23,104	\$63,965
Information Technology (O&M)	25,813	28,243	38,987	35,914	128,937
Total Information Technology	\$33,701	\$43,047	\$57,136	\$59,018	\$192,902
Total Corporate and Shared Services Savings Before Allocation	\$139,599	\$175,554	\$208,601	\$222,451	\$746,205
Allocated Corporate and Shared Services Savings					
Corporate and Shared Services Staffing	\$28,526	\$37,294	\$43,561	\$47,467	\$156,848
Corporate & Administrative Programs:					
Administrative & General Overhead	\$2,107	\$2,973	\$3,540	\$3,799	\$12,419
Advertising	868	888	908	928	3,591
Association Dues	129	132	135	138	535
Benefits Administration	1,387	1,507	1,838	1,777	6,307
Credit Facilities	0	0	0	0	0
Directors' Fees	183	187	192	198	758
Facilities	1,682	2,311	2,639	2,798	9,430
Insurance	2,057	2,103	2,150	2,199	8,509
Professional Services	4,228	4,445	4,674	4,914	18,280
Shareholder Services	1,086	1,110	1,135	1,181	4,493
Total Corporate and Administrative Programs	\$13,728	\$16,858	\$17,009	\$17,909	\$64,302
Information Technology					
Information Technology (Capital Carrying Cost)	\$3,173	\$5,958	\$7,310	\$9,295	\$25,735
Information Technology (O&M)	10,385	11,383	15,877	14,449	51,874
Total Information Technology	\$13,559	\$17,319	\$22,987	\$23,744	\$77,809
Total Allocated Corporate and Shared Services Savings	\$55,812	\$70,269	\$83,557	\$89,121	\$298,759

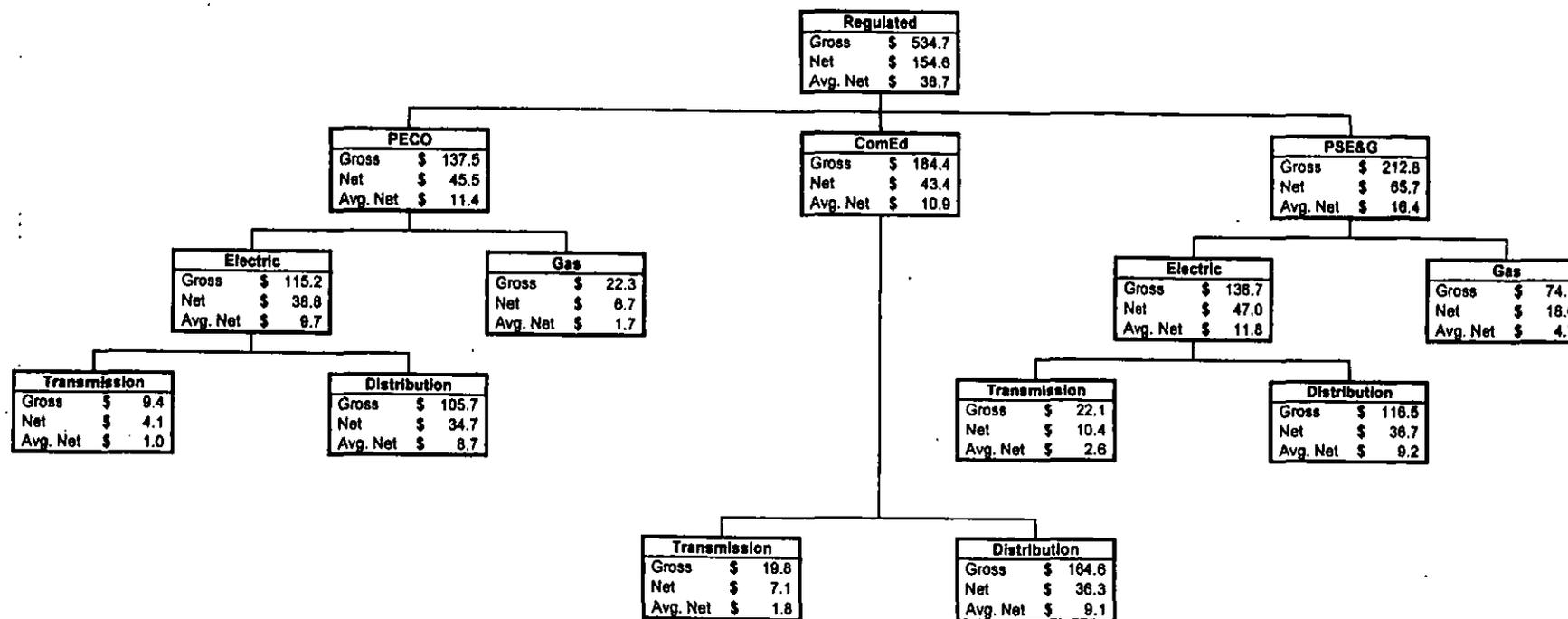
**Four Year Costs-to-Achieve
Before and After Allocation
(\$ In 000s)**

EXHIBIT WDA - 5

	2006	2007	2008	2009	Total
Costs-to-Achieve Before Allocation					
Severance and Employee Related					
Severance	\$110,874	\$27,933	\$6,709	\$2,500	\$148,016
Relocation	3,900	2,208	0	0	6,108
Retention	9,582	0	0	0	9,582
Subtotal Severance and Employee Related	<u>\$124,356</u>	<u>\$30,141</u>	<u>\$6,709</u>	<u>\$2,500</u>	<u>\$163,706</u>
Information Technology	\$43,874	\$104,012	\$92,392	\$71,145	\$311,423
Facilities	\$5,000	\$5,112	\$0	\$0	\$10,112
Customer / Supplier / Employee Education Communication	\$13,978	\$0	\$0	\$0	\$13,978
Regulatory and Compliance	\$24,778	\$0	\$0	\$0	\$24,778
Transition	\$20,000	\$0	\$0	\$0	\$20,000
D&O Tail Coverage	\$9,500	\$0	\$0	\$0	\$9,500
Transaction	\$52,820	\$0	\$0	\$0	\$52,820
Total Costs-to-Achieve Before Allocation	<u>\$294,105</u>	<u>\$139,266</u>	<u>\$99,100</u>	<u>\$73,645</u>	<u>\$606,116</u>
Allocated Costs-to-Achieve					
Severance and Employee Related					
Severance	\$56,268	\$17,574	\$2,247	\$837	\$76,926
Relocation	1,802	1,020	0	0	2,822
Retention	3,855	0	0	0	3,855
Subtotal Severance and Employee Related	<u>\$61,925</u>	<u>\$18,595</u>	<u>\$2,247</u>	<u>\$837</u>	<u>\$83,603</u>
Information Technology	\$29,828	\$70,714	\$62,814	\$48,369	\$211,726
Facilities	\$2,012	\$2,057	\$0	\$0	\$4,068
Customer / Supplier / Employee Education Communication	\$5,624	\$0	\$0	\$0	\$5,624
Regulatory and Compliance	\$19,532	\$0	\$0	\$0	\$19,532
Transition	\$8,203	\$0	\$0	\$0	\$8,203
D&O Tail Coverage	\$3,822	\$0	\$0	\$0	\$3,822
Transaction	\$21,170	\$0	\$0	\$0	\$21,170
Total Allocated Costs-to-Achieve	<u>\$152,115</u>	<u>\$91,366</u>	<u>\$65,061</u>	<u>\$49,207</u>	<u>\$357,748</u>

Four Year Savings Allocation Detail
 (\$ in millions)

WDA Exhibit 6



*JK 9-22-05
Phila*

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

JOINT APPLICATION OF PECO :
ENERGY COMPANY AND PUBLIC :
SERVICE ELECTRIC AND GAS :
COMPANY FOR APPROVAL OF : Docket No. A-110550F0160
THE MERGER OF PUBLIC :
SERVICE ENTERPRISE GROUP :
INCORPORATED WITH AND :
INTO EXELON CORPORATION :

DOCKETED
NOV 10 2005

REBUTTAL TESTIMONY

OF

WILLIAM D. ARNDT

Responding To Opposing Party Testimony
With Respect to Synergies And The
Costs To Achieve Those Synergies And
The Proposal That Joint Applicants'
Gas Operations Be Divested

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Date: July 29, 2005

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SECRETARY'S BUREAU

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**REBUTTAL TESTIMONY OF
WILLIAM D. ARNDT**

I. INTRODUCTION

Q. Please state your name, title and business address.

A. My name is William D. Arndt, and I am the Senior Vice President, Financial Operations for Exelon Corporation. My business address is 10 South Dearborn, 38th Floor, Chicago, Illinois 60603.

Q. Have you previously participated in this proceeding?

A. Yes. I submitted direct testimony (PECO St. No. 2) and accompanying exhibits (Exhibits WDA-1 through WDA-6) with the Joint Application filed on February 4, 2005. A statement of my qualifications is contained in my direct testimony.

Q. What is the purpose of your rebuttal testimony?

A. I will address issues raised by the Labor Parties, the Office of Trial Staff (OTS), the Office of Consumer Advocate (OCA) and the Office of Small Business Advocate (OSBA) concerning merger synergies and the costs to achieve those synergies as follows:

Frank Kuders (Labor Parties) – Job losses in Pennsylvania and their economic impact; reduction in call center staffing; effect on field forces.

David Keim (OTS) – Tracking and reporting of actual merger savings and cost reductions.

Richard La Capra (OCA) – Proportionality of regulated synergies and costs-to-achieve.

1 **Brian Kalcic** (OSBA) – Non-regulated synergies and costs-to-achieve and allocation
2 between jurisdictions.

3 In addition, I will address the proposals of Messrs. Keim, La Capra and Kalcic to use a
4 portion of the merger synergies attributable to non-regulated operations to reduce
5 PECO's regulated rates.

6 Lastly, I will address the recommendation of the Philadelphia Gas Works' witness, Paul
7 Carpenter, that the Joint Applicants divest their respective gas operations.

8 **II. SUMMARY OF CONCLUSIONS**

9 **Q. Please summarize your conclusions.**

10 **A.** The positions articulated by the opposing party witnesses are based on a
11 misunderstanding or misapplication of the operative facts or reflect policy judgments that
12 are inconsistent with prior practice. They should be rejected for multiple reasons, as
13 explained below:

14 **Labor Parties.** Mr. Kuders' assertion that the adverse economic impact of workforce
15 reductions in Pennsylvania outweighs the cost savings to be achieved by the merger is
16 wrong in several fundamental ways:

- 17 • The estimated reduction of 250 positions includes all Exelon business
18 units in Pennsylvania. Only approximately 100 of those position
19 reductions will occur within PECO and, as to these, Mr. Kuders overstates
20 the employee compensation level.
- 21 • Position reductions do not necessarily translate into net job losses.
22 Moreover, PECO will strive to implement any position reductions that
23 may be required through attrition, retirements and the elimination of open
24 positions to the maximum possible extent.

- 1 • Mr. Kuders erroneously compares the alleged annual economic impact of
2 workforce reductions in regulated and unregulated operations (\$32
3 million) to the average annual net regulated synergies projected for the
4 2006-2009 period (\$12 million). He also ignores the fact that net
5 regulated synergies are projected to equal or exceed his overstated \$32
6 million figure in subsequent years.
- 7 • Mr. Kuders ignores the robust package of severance payments and other
8 benefits that will be provided to employees in positions that are
9 eliminated.

10 Mr. Kuders' contention that PECO understated the level of call center staffing reductions
11 that will actually occur is wrong because he misinterpreted the data and used the data
12 erroneously. The reductions estimated by PECO are achievable with the conversion to a
13 common billing system and will not result in any impairment in customer service.
14 Similarly, Mr. Kuders' claim that "field forces" will be adversely affected by a reduction
15 in support personnel is wrong. The reduction in support personnel will be minimal and
16 limited to efficiency gains from standardizing processes and eliminating duplication and
17 overlap.

18 **OTS.** Mr. Keim's proposal that actual merger savings be tracked for the years 2006-
19 2009 is impractical. After a merger is completed, a company is focused on achieving
20 overall efficiencies from whatever sources they may be derived, and it is extremely
21 difficult – and not always possible – to identify and quantify savings attributable to the
22 merger. Furthermore, unforeseen changes in the business and market environments will
23 naturally occur during the years after the merger, which will affect how savings are
24 achieved. For these reasons, the tracking of actual merger savings has rarely, if ever,
25 been required to the best of my knowledge.

1 OCA. Contrary to Mr. La Capra's contentions, the regulated utilities' costs-to-achieve
2 are not disproportionate to their merger savings. Mr. La Capra erroneously assumes that
3 merger savings and costs-to-achieve were developed on an overall basis and then
4 arbitrarily "allocated" between regulated and non-regulated operations - that was not the
5 case. Merger savings generated within the regulated utilities were identified and directly
6 assigned to those entities. Similarly, the costs to achieve those savings were directly
7 assigned. Moreover, the same kind of direct assignment was performed for merger
8 savings and the costs to achieve those savings generated within non-regulated entities. In
9 fact, an allocation was used only for savings and costs-to-achieve generated within the
10 merger partners' respective business service companies, which could not be directly
11 assigned. Mr. La Capra's simplistic attempt to compare the regulated utilities' share of
12 total merger savings to their share of total merger-related costs-to-achieve completely
13 ignores the effect of directly assigned savings and costs. Mr. La Capra also disregards
14 the fact that the regulated utilities have greater costs-to-achieve primarily because of the
15 need to implement a common customer billing platform in order to capture merger
16 savings - a cost that the non-regulated entities do not incur. In addition, Mr. La Capra
17 ignores the fact that, in order to assure the continued corporate presence of the regulated
18 utilities, each will remain a separate corporate entity with separate headquarters and local
19 administrative and management personnel. For non-regulated business units, a greater
20 degree of integration and, therefore, a higher level of synergies is possible.

21 **Brian Kalcic.** Mr. Kalcic proposes to allocate a portion of non-regulated synergies to
22 regulated utility operations. Mr. Kalcic contends, however, that he was unable to obtain
23 information about the costs to achieve non-regulated synergies and pre-merger initiatives

1 and, therefore, he did not reduce gross non-regulated savings to account for those
2 elements. Contrary to Mr. Kalcic's contention, that information was readily available,
3 having been presented in response to discovery. Indeed, OTS witness Keim used that
4 information to quantify his position, as shown in OTS Exhibit No. 1, Schedule 4.
5 Similarly, Mr. Kalcic's allocation of one-third of such savings to Pennsylvania is wrong
6 and excessive. State allocation determinants were provided, and were also used by Mr.
7 Keim.

8 **Proposals To Allocate A Portion Of Non-Regulated Synergies To PECO.** Messrs.
9 Keim, La Capra and Kalcic propose that a portion of the merger synergies generated by
10 non-regulated businesses should be allocated to PECO's customers through a reduction
11 of distribution and transmission rates. The fundamental errors in these proposals will be
12 addressed by Mr. Sidak. Although my focus on the merger-related synergies of regulated
13 entities has been criticized by opposing party witnesses, my approach is the same one
14 used in the synergy study presented in the PECO-Unicom merger proceeding. It is also
15 consistent with other merger transactions of which I am aware that involved companies
16 with both regulated utilities and non-regulated operations.

17 **PGW.** Dr. Carpenter contends that the combination of the gas operations of PECO and
18 PSE&G will create "market power" that should be remedied by the mandatory divestiture
19 of both companies' gas divisions. Drs. Hieronymus and Morris explain why Dr.
20 Carpenter's market concentration analysis is flawed and why his conclusion that the
21 merger will create market power is wrong. In addition, Dr. Carpenter ignores the
22 substantial diseconomies that would be created by divestiture, which would ultimately
23 increase the costs borne by retail customers.

1 III. FRANK KUDERS (LABOR PARTIES)

2 Q. Mr. Kuders contends that the merger will not produce an affirmative benefit
3 because the net merger savings PECO will realize will be outweighed by the
4 economic impact of "250 job losses in Pennsylvania." Please address this
5 contention.

6 A. Mr. Kuders' analysis is flawed in several important respects, including the use of
7 erroneous data, an incorrect "apples to oranges" comparison of costs and benefits, and the
8 failure to consider several significant factors that undercut his assessment of economic
9 impact. Properly analyzed, the efficiency gains from the merger and their resulting
10 benefits will be substantial and should have a positive economic effect.

11 Q. What are the errors in Mr. Kuders' testimony?

12 A. Mr. Kuders presents a calculation that purports to show a negative impact on the state
13 economy from merger-related workforce reductions in Pennsylvania of \$32 million per
14 year. He then compares that figure to the four-year average of net merger savings within
15 PECO of \$12 million per year and concludes that the proposed merger will result in "net
16 harm" to Pennsylvania of \$20 million per year (Labor St. 1, page 6). There are several
17 significant errors in Mr. Kuders' calculation.

18 First, the figure of \$32 million is Mr. Kuders' calculation of the lost wages and benefits
19 from all of the estimated 250 positions to be eliminated in Pennsylvania across all of
20 Exelon's business units, including non-regulated businesses. However, only
21 approximately 100 position reductions are projected to occur at PECO. Obviously,

1 comparing state-wide position reductions to PECO-only merger savings is inaccurate and
2 unreasonable.

3 Second, Mr. Kuders attempts to quantify the economic effect of "job losses" using the
4 figure of \$128,000 per position. Mr. Kuders derived that figure from a workpaper
5 (Loaded Salary Calculation Worksheet (L13)) to my synergy study, which Mr. Kuders
6 attached to his testimony as Schedule FK-2. As shown on that workpaper, the fully-
7 loaded salary figure of \$128,000 is for "utility support" which, in turn, was based upon
8 "overall utility average salaries," as explained in Note 2 of the workpaper. However, of
9 the approximately 100 positions being eliminated at PECO, most are in Customer
10 Marketing Services. For example, 34 position reductions – approximately one-third – are
11 projected to be at the call center. As shown on Schedule FK-2, the fully-loaded salary for
12 Customer Marketing Services employees is \$90,000 per year. In short, Mr. Kuders
13 substantially overstated the average compensation for the positions that will be reduced at
14 PECO.

15 Third, as previously noted, Mr. Kuders quantifies PECO merger savings using a four-
16 year (2006-2009) average of net savings, which he rounds to \$12 million per year.
17 However, in years four and five, synergy savings exceed the costs-to-achieve by \$29
18 million and \$32 million, respectively, as shown in Exhibit WDA-7, and increase each
19 year thereafter. An accurate depiction of merger savings and position reductions shows
20 that the benefits of the merger substantially outweigh the adverse economic impact
21 alleged by Mr. Kuders.

22 Q. **What factors did Mr. Kuders fail to consider?**

1 A. There are several significant factors that Mr. Kuders left out of his calculations. First,
2 position reductions do not translate into "job losses" on a one-for-one basis. Some
3 positions being eliminated may be vacant. Alternatively, some employees in eliminated
4 positions could transfer to continuing but unfilled positions. Therefore, "job losses" as
5 such will likely be less than 100.

6 Second, position reductions will be implemented to the maximum extent possible through
7 attrition so that economic impacts will be mitigated. Attrition includes employees who
8 choose to retire. As to retiring employees, the reductions will not withdraw all wages and
9 benefits from the economy, as Mr. Kuders erroneously assumed, because the former
10 employee continues to receive income and benefits from PECO, which remain part of the
11 local economy.

12 Third, PECO employees who are separated as a result of the merger will receive
13 severance payments and benefits as they transition to retirement or other employment.
14 Represented employees at PECO who are impacted by the merger will receive benefits
15 under the current Exelon Corporation Severance Benefit Plan, unless Local 614
16 negotiates a different arrangement for them. Non-represented employees will receive
17 severance payments in the amount of two weeks of base pay compensation for each year
18 of service with a minimum of 12 weeks and a maximum of 52 weeks of severance pay.
19 Severance payments will be made in the form of salary continuation for the severance
20 period. Displaced employees also will receive a prorated portion of their target incentive
21 awards. In addition, displaced employees will receive extended subsidized medical and
22 life insurance and tuition reimbursement benefits, as well as outplacement services to
23 assist them in finding new employment. Further, employees who are at least 50 years old

1 with 10 or more years of service are eligible to receive early retiree healthcare benefits.
2 These severance payments and services will mitigate the impact on both the affected
3 employees and the economy overall.

4 Fourth, most workforce reductions are designed to eliminate overlapping and duplicative
5 positions. Contrary to assumptions implied in Mr. Kuders' testimony, no sustainable
6 economic benefit results from maintaining unnecessary or non-productive positions.

7 Fifth and finally, Mr. Kuders does not consider the benefits to other stakeholders from
8 efficiency gains created by the merger. PECO's capacity to continue to employ people in
9 well-compensated positions, to meet its public service obligations, to continue to promote
10 economic development and to support local organizations, while maintaining customer
11 rates within the existing rate caps, directly depends on its ability to increase productivity
12 and efficiency.

13 **Q. Mr. Kuders contends that PECO's call center staffing will be reduced by 26% as a**
14 **consequence of moving to a common billing system, rather than 12% as suggested in**
15 **a prior interrogatory response (Labor Parties St. 1, p. 8). Is he correct?**

16 **A.** No. Mr. Kuders' calculation is erroneous, and he has misinterpreted my workpapers and
17 interrogatory responses. He has confused the call center function with the overall
18 customer service function, of which the call center is only a part. The projected
19 reductions in the PECO call center are 34, not 49 as Mr. Kuders states. The 34 position
20 reductions represent approximately 18% of the total call center staff of 190, and a
21 reduction of this magnitude would be generally consistent with the 12% impact across all
22 customer care personnel after considering that there are many functions within the

1 customer service area (e.g., meter reading, market research, meter maintenance) that are
2 not affected by the billing consolidation. Also, I must reiterate what I stated earlier,
3 namely that the 34 position reductions do not necessarily equate to job losses.

4 **Q. How then did Mr. Kuders calculate a 26% impact at PECO?**

5 A. The 49 position reductions at PECO referenced by Mr. Kuders relate to all customer care
6 functions affected by the billing platform consolidation (call center, billing and payment
7 processing, credit and collections). These reductions will occur over a baseline of 264
8 positions, resulting in an approximate 19% reduction, not 26% as Mr. Kuders calculated.

9 **Q. Mr. Kuders states that he does not accept the accuracy of the 12% reduction
10 because PECO did not provide a "study" to support it. Please address that
11 contention.**

12 A. The Joint Applicants provided a detailed synergy study, which I sponsored, along with
13 hundreds of pages of detailed supporting workpapers, which were provided in response to
14 a discovery request. As explained in my direct testimony, the analysis undertaken by
15 Exelon and PSEG was performed under my supervision by management personnel from
16 both companies with the required functional knowledge in each synergy category. These
17 individual teams first collected and compared the baseline staffing and cost levels to
18 understand the relative resources committed to the functional areas. From this
19 information, the teams then determined the number of positions that could be eliminated
20 by combining the billing platform and having standardized, integrated processes that a
21 common system would enable.

1 Mr. Kuders does not offer an alternative savings estimate or approach to quantify these
2 benefits. The study I have sponsored estimates the merger savings and costs that arise
3 from this combination using the knowledge and experience of those personnel who
4 manage these functions.

5 **Q. Mr. Kuders has also questioned an interrogatory response that corrected the**
6 **definition of “field forces.” Specifically, Mr. Kuders contends that “many of the**
7 **people who are needed for field workers to do their jobs – engineers, dispatchers,**
8 **and many others – are no longer covered by PECO’s unsupported promise of no**
9 **merger impact” (Labor Parties St. 1, p. 11). Please address these claims.**

10 **A.** First, PECO revised the initial answer to provide accurate information in response to the
11 Labor Parties’ Interrogatory (Set I) No. 1 and not to broaden the number of employees
12 likely to be affected by the merger. As I stated in my direct testimony, field forces will
13 not be affected by the combination, and no position reductions are projected in those
14 functions.

15 Second, the estimated reduction in electric field operations (back office functions that
16 support work in the field, but are not “field forces”) is minimal and is focused on areas of
17 overlap and duplication created by common processes and standardization in certain
18 support functions such as engineering, environmental compliance, testing laboratories
19 and research and development.

20 **Q. Can positions be reduced in certain utility support functions while maintaining high**
21 **quality service to customers?**

1 A. Certainly. As is the case with corporate and administrative functions, both companies
2 employ managers to oversee and lead certain support functions. Through the merger, the
3 management of these functions can be consolidated, and duplicative positions eliminated.
4 For example, both companies have distribution design engineering departments where
5 engineers are responsible for designing the technical specifications for the construction of
6 substations, transformers, etc. The consolidation of these departments will make certain
7 management positions redundant. Similarly, by standardizing the design specifications
8 for certain common projects (substations, transformers, etc.) across both companies, the
9 resources required to perform this task are fewer than if each company maintained
10 separate and distinct design standards. This philosophy was followed by the synergies
11 working group when identifying the benefits from consolidating the utility support
12 functions. Therefore, it is incorrect to suggest, as Mr. Kuders does, that streamlining
13 certain utility support functions will detract from the field forces' ability to perform high
14 quality work. Mr. Kuders ignores the benefits of standardizing processes and overlooks
15 the fact that reductions estimated in this area are the result of the efficiencies made
16 available by eliminating duplication and overlap.

17 **IV. DAVID KEIM (OTS)**

18 **Q. Mr. Keim proposes that "within 45 days of the end of calendar years 2006-2009,**
19 **PECO shall file detailed annual reports regarding actual savings and cost**
20 **reductions which result from the merger" (OTS St. 1, p. 16). Please address this**
21 **proposal.**

22 A. It is very difficult to measure the actual savings and cost reductions related to a specific
23 initiative or event, largely because of changing market and business environment

1 conditions. For example, once the Exelon merger was completed in October 2000, the
2 business environment for the energy industry changed dramatically (e.g., the California
3 energy crisis, Enron's collapse, the general economic slowdown, changing emphasis on
4 deregulated markets and increasing generation reserves), which required Exelon to
5 reassess its strategies to respond to these changed conditions. Certain businesses were
6 de-emphasized (e.g., Exelon Enterprises) and new and different internal cost management
7 and restructuring programs were initiated to comprehensively reassess resources required
8 to most efficiently and effectively operate our core businesses. This reassessment
9 produced changes in organizational business models and cost structure to respond to
10 changing business conditions. Therefore, the distinction was blurred between the
11 synergies made possible by the merger and the benefits of restructuring and cost
12 containment initiated after the merger due to changes in the economic market and
13 business environment.

14 Following the merger of Exelon and PSEG, one of Exelon's objectives will be to achieve
15 overall efficiencies and earnings growth, of which the attainment of synergies from the
16 Exelon-PSEG merger will be just one component. The merged company will strive for
17 overall operating and management efficiencies while continuing to provide high quality,
18 reliable service to its customers. A requirement to specifically identify the savings and
19 costs directly attributable to the merger would be an artificial and onerous condition and
20 one whose benefit is unclear due to the questionable results it would produce. Notably, a
21 reporting requirement such as Mr. Keim proposes was not adopted in the PECO-Unicom
22 merger or in any other major utility merger in Pennsylvania of which I am aware.

1 Q. Can the Commission rely upon this estimate of merger synergies without imposing a
2 post-merger tracking and reporting requirement such as Mr. Keim proposes?

3 A. Yes, it can, for several reasons. First, the approach to the identification and
4 quantification of merger synergies and costs-to-achieve employed in this case is generally
5 consistent with the one presented in support of the PECO-Unicom merger. Exelon has
6 used this method before, and the Commission is familiar with the method and its results.
7
8 Second, a broad group of management personnel from Exelon and PSEG participated in
9 this analysis. The experience and knowledge of these individuals in each of the major
10 business units and functional areas was relied upon to develop both the savings and cost
11 estimates.

12
13 Third, Exelon and PSEG were assisted by a third-party consultant, Booz Allen Hamilton,
14 that facilitated the data analysis and developed an integrated model of the merger savings
15 and costs. The senior members of the Booz Allen Hamilton team have performed similar
16 studies in many other utility mergers, including assisting PECO and Unicom in the
17 Exelon merger. The approach and framework, level of analysis, and general assumptions
18 used here are consistent with other transactions in which Booz Allen Hamilton has
19 provided assistance.

20
21 Finally, as I stated earlier, the tracking of savings related to this specific event is difficult
22 because of changing market and business environment conditions.

V. RICHARD LA CAPRA (OCA)

21 Q. Mr. La Capra states that “the Applicants appear to have allocated a
22 disproportionate share of the costs to achieve to ‘regulated entities,’ that is, to

1 **ratepayers, even though the major beneficiaries of the merger will be shareholders**
2 **and the ‘unregulated’ entities” (OCA St. 1, p. 15). Is his assessment correct?**

3 A. No, it is not. The regulated entities have not been allocated a “disproportionate” share of
4 the costs-to-achieve. It appears that Mr. La Capra assumed that merger savings and
5 costs-to-achieve were determined on an overall basis and then arbitrarily “allocated”
6 between regulated and non-regulated operations (OCA St. 1, page 20, lines 24-31 and
7 page 21, lines 1-2). That is not correct. The regulated utilities were specifically analyzed
8 to identify the savings the merger would generate within the regulated operations, and
9 those savings were directly assigned to the regulated operations. For example, the
10 benefits from supply chain integration in the three utilities were directly assigned to the
11 utility business and not allocated between the regulated and non-regulated businesses.
12 Similarly, the costs-to-achieve the regulated utilities’ savings were also specifically
13 identified and directly assigned as appropriate. This approach was followed for merger
14 savings and costs-to-achieve in the non-regulated businesses as well. Only those savings
15 and costs that could not be directly assigned, namely the savings and costs associated
16 with corporate and shared services functions, were allocated between the regulated and
17 non-regulated businesses, as I will explain further below.

18 The regulated utilities have unique, directly-assigned costs-to-achieve associated with the
19 implementation of a common customer billing platform to capture certain merger savings
20 in the customer service function. Therefore, when comparing the total costs-to-achieve
21 of the regulated and non-regulated businesses, it is inappropriate to assume that the costs-
22 to-achieve will be proportionate to the regulated and non-regulated merger savings.

1 Q. Explain further the allocation between regulated and non-regulated operations that
2 was used for certain costs.

3 A. As I previously explained, such an allocation process was used for savings and costs-to-
4 achieve in the corporate and shared services functions, which could not be directly
5 assigned. These savings and costs-to-achieve were allocated using allocation factors that
6 are based on the relative net future costs in the regulated and non-regulated businesses.
7 The allocation factors were developed after reviewing the planned operating and
8 maintenance costs and direct merger savings levels in each of these businesses.
9 Consequently, the merger savings and costs-to-achieve for the regulated utilities consist
10 of a combination of directly assigned and allocated amounts. The costs-to-achieve that
11 could not be assigned to the regulated or non-regulated businesses were allocated using
12 the same allocation factors (40% to regulated and 60% to non-regulated) that were used
13 to allocate the merger savings that could not be directly assigned. In short, costs that
14 could not be directly assigned were allocated between regulated and non-regulated
15 operations in the same proportion as the merger savings that could not be directly
16 assigned.

17 Q. Are there any other flaws in Mr. La Capra's analysis?

18 A. Yes. The regulated utilities (PECO, ComEd, and PSE&G) all will remain separate
19 corporate entities with separate headquarters and local administrative and management
20 personnel. In addition, the field forces at each utility will be unaffected by the merger.
21 By contrast, the non-regulated businesses have much more significant integration
22 potential because the managements of the generation fleet can be combined and the
23 trading and marketing businesses can be consolidated. This degree of integration leads to

1 relatively higher synergies when compared to the regulated businesses. For example,
2 Exhibit WDA-2 accompanying my direct testimony shows that in 2007 (or year 2 after
3 the merger) directly-assigned utility savings are approximately \$62 million. Workpaper
4 ii2 supporting my direct testimony shows that the O&M-only portion of these year 2
5 savings is \$54 million. As part of the response to OSBA (Set 1) Interrogatory No. 2
6 shows, the merger savings directly assigned to the non-regulated businesses are
7 approximately \$250 million in that same year. The O&M-related portion is
8 approximately \$175 million after reducing these savings for non-cost-related nuclear
9 improvement synergies. Therefore, directly assigned non-regulated O&M savings are
10 approximately 76% of the total direct O&M savings ($\$175/(\$175+\$54)$).

11 **Q. Why is this significant?**

12 **A.** Because a greater degree of integration is possible in the non-regulated businesses, their
13 proportionate use (and, therefore, their proportionate share of the costs) of the corporate
14 and shared services functions will be relatively less after the merger than before.
15 Correspondingly, the regulated businesses' proportionate use (and proportionate cost
16 share) of the corporate and shared services functions will be relatively greater after the
17 merger than before. The allocation factors used to allocate merger savings and costs-to-
18 achieve generated in the corporate and shared services functions reflect the relative
19 changes in the costs of those functions that the regulated and nonregulated businesses
20 will bear after the merger. Accordingly, corporate and shared services savings and costs
21 were allocated 40% to the regulated business and 60% to the non-regulated business.

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VI. BRIAN KALCIC (OSBA)

Q. Mr. Kalcic would allocate 50% of gross non-regulated synergies to regulated operations by way of a rate reduction. Have you reviewed that calculation?

A. Yes, I have. As I previously stated, I disagree fundamentally with using any estimated non-regulated synergies to reduce regulated rates. However, this aspect of Mr. Kalcic's proposal will be addressed primarily by Mr. Sidak. I will comment on the mechanics of Mr. Kalcic's calculation and, specifically, his claim that the use of gross figures is justified because PECO did not provide information about the costs to achieve non-regulated savings or pre-merger initiatives. In fact, the costs to achieve non-regulated synergies and the savings associated with non-regulated pre-merger cost-reduction initiatives were provided in response to the OCA's Interrogatory (Set XI) No. 1. That information was used by Mr. Keim to compute his proposed rate reduction, as shown on OTS Exhibit No. 1, Schedule 4.

Q. Mr. Kalcic allocated one-third of non-regulated merger savings to each of Pennsylvania (PECO), New Jersey (PSE&G) and Illinois (ComEd) because, he asserts, the Joint Applicants did not provide an analysis of any alternative allocation. Please address that contention.

A. The attempt to allocate non-regulated merger savings to each of three regulatory jurisdictions simply underscores the fundamental error in Mr. Kalcic's approach. The merger savings he is trying to capture are not generated by, and do not relate to, any regulated operations. Therefore, there is no basis to allocate those savings to any

1 regulatory jurisdiction. That having been said, there is certainly no basis to allocate to
2 PECO a share of non-regulated savings that exceeds its share of regulated merger
3 savings, which is what Mr. Kalcic has done. The method and determinants for allocating
4 regulated merger savings by regulatory jurisdiction are set forth in my direct testimony
5 and Exhibit WDA-6. That allocation method was used by Mr. Keim to compute his
6 proposed rate reduction, which allocates less than one-third of net savings to
7 Pennsylvania. While I also disagree with Mr. Keim's position, he at least did not use an
8 arbitrary jurisdictional allocation.

9 **VII. PROPOSALS TO ALLOCATE A PORTION OF NON-REGULATED**
10 **SYNERGIES TO PECO**

11 **Q. Messrs. Keim, La Capra and Kalcic propose using a portion of the estimated non-**
12 **regulated merger synergies to reduce regulated rates. Please comment.**

13 **A. Mr. Sidak will address why this is not appropriate. Additionally, as I have described**
14 **previously, the synergy analysis that I presented in this case is consistent with the one**
15 **performed for the PECO-Unicom merger. In that analysis, an appropriate portion of**
16 **corporate and administrative savings and costs was allocated to the non-regulated**
17 **businesses. The non-regulated businesses of PECO-Unicom also had direct savings and**
18 **costs derived from the combination of those businesses. Neither the directly assigned**
19 **non-regulated savings and costs, nor the corporate and administrative costs allocated to**
20 **the non-regulated businesses, were reflected in the merger filing made with the**
21 **Commission. The approach followed in this filing is the same.**

22 Further, in the regulatory filings of other transactions that I have reviewed, the non-
23 regulated savings were not included as part of the regulatory filing nor, to my knowledge,

1 used to assess whether the merger met the applicable state standard for approval. These
2 two factors and Mr. Sidak's arguments lead to the conclusion that the non-regulated
3 savings and costs were appropriately excluded from the synergy analysis presented as
4 part of the merger filing.

5 VIII. PAUL CARPENTER (PGW)

6 **Q. Dr. Carpenter has proposed that PECO and PSE&G be required to divest their gas**
7 **operations in order to remedy "market power" concerns that he claims the merger**
8 **will create. Please address this proposal.**

9 A. Drs. Hieronymus and Morris explain why Dr. Carpenter's market concentration and
10 market power analyses are wrong and why his proposed remedy is, therefore,
11 unwarranted. Additionally, Dr. Carpenter has failed to consider the substantial
12 diseconomies that would be created by his proposed divestiture. For example,
13 incrementally greater costs would be incurred in customer and field operations because
14 an entirely separate organization would have to be created for the meter reading, billing,
15 customer accounting and call center functions. Similarly, a new organization would have
16 to be created to perform the corporate and shared services functions that Exelon and
17 PSEG already perform for the gas operations of PECO and PSE&G, for example,
18 accounting, regulatory compliance, human resources, risk management, financial
19 services, legal services, and administration and management. Incremental costs would be
20 incurred in a number of other areas as well, such as facilities and information technology.
21 In addition, the corporate separation of the gas operations would lose many of the
22 economies currently realized by being part of much larger companies, such as supply
23 chain efficiencies and lower acquisition costs from greater bargaining power in dealing

1 with vendors of goods and services. The loss of those economies of scale and scope
2 would materially increase the costs of both companies' gas divisions and, ultimately,
3 increase the costs borne by customers through retail rates.

4 **Q. Can you provide a sense of the potential magnitude of the lost economies from such**
5 **a divestiture?**

6 A. The Company has recently completed an analysis of the potential lost economies from a
7 divestiture of the PECO and PSE&G gas businesses to accompany a filing with the
8 Securities and Exchange Commission. In this analysis, the impact of such a divestiture
9 has been estimated to create an additional annual revenue requirement of approximately
10 \$250 million, or more than a 23% impact to customer's non-fuel rates.

11 **IX. CONCLUSION**

12 **Q. Does this conclude your rebuttal testimony?**

13 A. Yes, it does.

**Five Year Net Regulated Savings
(\$ in 000s)**

EXHIBIT WDA - 7

PECO

	2006	2007	2008	2009	2010
Allocated Corporate and Shared Service Savings					
Corporate and Shared Services Staffing	\$6,930	\$9,060	\$10,582	\$11,531	\$12,140
Corporate & Administrative Programs:					
Administrative & General Overhead	\$512	\$722	\$860	\$923	\$944
Advertising	\$211	\$216	\$220	\$225	\$230
Association Dues	\$36	\$37	\$38	\$39	\$40
Benefits	\$337	\$366	\$398	\$432	\$469
Directors' Fees	\$45	\$46	\$47	\$48	\$49
Facilities	\$409	\$561	\$641	\$680	\$695
Insurance	500	511	522	534	546
Professional Services	1,027	1,080	1,135	1,194	1,255
Shareholder Services	264	270	276	282	288
Total	\$3,340	\$3,808	\$4,137	\$4,356	\$4,516
Information Technology					
Information Technology (Revenue Requirements)	\$771	\$1,447	\$1,776	\$2,258	\$2,751
Information Technology (O&M)	2,523	2,760	3,808	3,510	3,590
Total	\$3,294	\$4,207	\$5,584	\$5,768	\$6,341
Total Allocated Corporate and Shared Services Savings	\$13,563	\$17,075	\$20,304	\$21,655	\$22,997
Utility					
Support Staffing	\$3,275	\$9,423	\$10,230	\$11,079	\$11,971
Non-Labor					
Materials and Supplies	\$1,576	\$2,001	\$2,435	\$2,878	\$3,332
Contract Services	2,475	2,876	3,298	3,741	4,207
Bad debt expense	0	3,136	3,207	3,279	3,352
Total Non-Labor	\$4,052	\$8,013	\$8,939	\$9,898	\$10,891
Total Utility Savings	\$7,327	\$17,437	\$19,169	\$20,977	\$22,862
Total Gross Regulated Savings	\$20,891	\$34,512	\$39,473	\$42,632	\$45,859
Regulated Costs-to-Achieve	\$36,605	\$22,222	\$15,809	\$11,955	\$11,750
Regulated Pre-Merger Initiatives	\$796	\$1,326	\$1,460	\$1,847	\$1,900
Net Regulated Savings	(\$16,510)	\$10,964	\$22,204	\$28,830	\$32,208

**Five Year Net Regulated Savings
(\$ in 000s)**

EXHIBIT WDA - 7

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