

STATE OF INDIANA
INDIANA UTILITIES AND REGULATORY COMMISSION

VERIFIED PETITION OF PSI ENERGY,)
INC. CONCERNING: (1) CERTAIN)
AFFILIATE TRANSACTIONS, INCLUDING)
SERVICE AGREEMENTS, (2) THE)
SHARING OF MERGER-RELATED)
BENEFITS WITH CUSTOMERS, (3))
DEFERRED ACCOUNTING OF CERTAIN)
MERGER-RELATED COSTS, (4))
AUTHORITY TO CONTINUE)
MAINTAINING CERTAIN BOOKS AND)
RECORDS OUTSIDE THE STATE OF)
INDIANA, AND (5) ANY AND ALL OTHER)
ISSUES RELATING TO THE MERGER OF)
CINERGY CORP., THE PARENT COMPANY)
OF PSI ENERGY, INC., AND DUKE)
ENERGY CORPORATION INTO A NEW)
PUBLIC UTILITY HOLDING COMPANY)

CAUSE NO. 42873

TESTIMONY

OF

ROBERT M. FAGAN

ON BEHALF OF THE

CITIZENS ACTION COALITION OF INDIANA

NOVEMBER 8, 2005

**TESTIMONY OF
ROBERT M. FAGAN**

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CAUSE NO. 42873
BEFORE THE INDIANA UTILITY REGULATORY COMMISSION
TESTIMONY OF ROBERT M. FAGAN
ON BEHALF OF CITIZENS ACTION COALITION OF INDIANA

I. INTRODUCTION

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

A. My name is Robert M. Fagan. I am a Senior Associate at Synapse Energy Economics, Inc., 22 Pearl Street, Cambridge, Massachusetts, 02139.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGROUND.

A. I am an energy economics analyst and mechanical engineer with 20 years of experience in the energy industry. My work has focused primarily on electric power industry issues, especially economic and technical analysis of competitive electricity markets development, electric power transmission pricing structures, and assessment and implementation of demand-side resource alternatives. I hold an M.A. from Boston University in Energy and Environmental Studies and a B.S. from Clarkson University in Mechanical Engineering. Details of my experience are provided in Exhibit RMF-1.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of the Citizens Action Coalition of Indiana (“CAC”).

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

1 A. The purpose of my testimony is to assess certain aspects of the proposed merger
2 between Cinergy and Duke, with particular attention focused on issues that impact
3 PSI's Indiana consumers. I examined the following aspects of the proposed
4 merger: 1) cost and savings allocation, 2) the global protections for ratepayers in
5 place with the proposed merger commitments, in comparison to protections
6 guaranteed in the 1994 PSI/CG&E merger, including energy efficiency
7 commitments by PSI, 3) reliability and customer service, and 4) affiliate
8 transactions for energy and capacity.

9 **Q. ARE YOU TESTIFYING IN THIS CAUSE TO AN OPINION**
10 **REGARDING WHETHER THE DUKE-CINERGY MERGER IS IN THE**
11 **PUBLIC INTEREST AND SHOULD BE APPROVED BY THE**
12 **COMMISSION?**

13
14 A. No, I am not. I have been advised by counsel that the Indiana Supreme Court
15 ruled in *Indiana Bell Tel. Co. v. Indiana Util. Reg. Comm'n*, 715 N.E.2d 351 (Ind.
16 1999), that Commission approval is not required for a transfer of control of a
17 utility operating company from one utility holding company to another if the
18 assets of the operating company remain in the operating company and the only
19 things transferred between the holding companies are the outstanding shares of
20 the operating company. I understand that is the case here. Moreover, in its
21 Petition, PSI has not sought Commission approval of the merger of its parent
22 Cinergy with Duke, but only of certain ratemaking procedures, accounting

1 treatments and practices, and affiliate contracts and guidelines which would
2 become effective for PSI only after consummation of the Duke-Cinergy merger.

3 **II. SUMMARY OF TESTIMONY**

4 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

5 A. The proposed net merger savings mechanism and resulting rate impacts proposed
6 by PSI are not in the public interest because the merger savings sharing
7 mechanism will allocate only 30% of the first five year's net retail savings to PSI
8 ratepayers, even though they shoulder 100% of the costs to obtain the merger.
9 PSI has not provided any supporting documentation that indicates a 30%
10 allocation is either reasonable or in line with other regulatory commission
11 decisions in the recent past.

12 The global protections provided to PSI's retail customers as a result of the
13 commitments obtained at the time of the 1994 PSI/CG&E merger are in jeopardy,
14 as the form and substance of the merger commitments offered by PSI for this
15 merger do not include with adequate specificity equivalent protections. I
16 recommend that the IURC ensure that the substance of prior commitments,
17 especially those provided under the 1994 Joint Stipulation and Agreement, the
18 1994 Indiana Settlement Agreement, the 1994 Service Agreement, and the 1994
19 PSI Retail Affiliate Guidelines be retained prior to granting approval for any
20 merger-related agreements.

21 PSI's Case-in Chief contains non-specific references to ensuring reliability
22 and customer service. I suggest that the Commission charge PSI with ensuring
23 reliability and good customer service by instituting a performance mechanism (or

1 at least a threshold goal for maximum levels of service interruption) tied to
2 achieving at least historical levels of interruption minimization, rather than
3 relying solely on non-specific assurances.

4 As part of the 1994 protections afforded customers, PSI committed to
5 aggressive levels of energy efficiency. Those initial efforts faded quickly; I
6 suggest that PSI renew its commitment made in the original merger by setting
7 new goals for energy efficiency implementation throughout its service territory as
8 part of any renewed commitment to integrated resource planning. These new
9 goals should reflect the spirit and aggressiveness of the original commitments.
10 PSI should increase its current commitments and implement cost effective energy
11 efficiency with a goal of reducing forecast retail sales by 1%.

12 PSI short-term energy transactions should be limited to sales and
13 purchases to/from the MISO spot markets. Energy transactions between affiliate
14 companies should be prohibited to prevent potential affiliate abuse. The structure
15 of forward sales and purchases by PSI once the JGDA (“Joint Generation and
16 Dispatch Agreement”) is terminated should be resolved through the current
17 proceedings in Cause No. 41954. All PSI capacity and ancillary service
18 transactions should be overseen by the IURC, since there is yet to be established a
19 working wholesale market for these products.

20 **III. MERGER SAVINGS, COSTS AND ALLOCATION TO PSI RATEPAYERS**

21
22 **Q. HAVE YOU REVIEWED THE MERGER COST AND SAVINGS**
23 **INFORMATION CONTAINED IN THE APPLICANT’S FILING?**

1 A. Yes. In particular, I reviewed the testimony of Mr. Flaherty, Mr. Steffen, Mr.
 2 Blackwell, Mr. Fetter, Ms. Pashos and Mr. Procario. I also reviewed the
 3 workpapers of Mr. Flaherty and the regulatory commission cases referenced by
 4 Mr. Fetter. Mr. Flaherty’s testimony focuses on the proposed merger’s costs-to-
 5 achieve and savings. Mr. Steffen describes the company’s proposal for sharing
 6 the proposed merger’s net savings with PSI ratepayers. Mr. Blackwell’s
 7 testimony includes a description of how the proposed merger’s costs and savings
 8 are allocated to PSI. Mr. Fetter’s testimony includes an opinion on the proposed
 9 net savings allocation. Ms. Pashos’ testimony and response to discovery offers an
 10 explanation for the proposed net savings allocation, and addresses at a high level
 11 reliability and customer service aspects of the proposed merger, along with issues
 12 related to global protections for PSI ratepayers. Mr. Procario addresses reliability
 13 and customer service impacts of the merger.

14 1. Merger Savings
 15

16 **Q. DO THE REGULATED-SIDE MERGER SAVINGS ESTIMATED BY MR.**
 17 **FLAHERTY APPEAR REASONABLE?**

18 A. Yes. In fact, if anything the projection of net savings could be considered
 19 conservative, or certainly readily obtainable. Mr. Flaherty states that the savings
 20 are “almost exclusively” “created savings”¹ and that “the vast majority of savings
 21 were quantified using direct analysis”². The other savings quantification methods
 22 listed by Mr. Flaherty include “estimation” and “comparisons to other

¹ Flaherty 12:8-9

² Flaherty 21:5-6.

1 transactions”³. Arguably, the direct analysis method provides a greater level of
2 confidence that the savings will be obtained. Mr. Flaherty states that created
3 savings are those “directly related to the completion of a merger”⁴, and that they
4 are “reasonably attainable”⁵ as long as management executes their intended
5 integration plan.

6 **Q. IS IT POSSIBLE THAT ADDITIONAL MERGER-RELATED SAVINGS**
7 **COULD BE SEEN?**

8 A. Yes. Mr. Flaherty describes three types of savings opportunities, two of which
9 are merger-related, “created savings” and “enabled savings”. The third method he
10 describes is “developed savings”, which are savings that could occur absent the
11 merger. Based on Mr. Flaherty’s categorization of savings, it’s arguable that
12 additional “enabled savings” could possibly accrue as a result of the merger.
13 Enabled savings include savings arising from “for example, technology
14 differences”⁶ that can help increase productivity.

15 **Q. WHY IS IT NOTEWORTHY THAT THE SAVINGS PROJECTION IS**
16 **WELL-FOUNDED?**

17 A. If the savings projection is based on a fundamental assessment of likely “created
18 savings”, it stands to reason that the risk of obtaining these savings is relatively
19 low if the merger is approved, as long as the merger integration is executed in an
20 intentional and disciplined manner.

³ Flaherty 20:15 – 21:12

⁴ Flaherty 11:4-5

⁵ Flaherty 23:7

⁶ Flaherty, 11:14.

1 **Q. WHY DOES IT MATTER IF THE RISK ASSOCIATED WITH**
2 **OBTAINING NET SAVINGS IS RELATIVELY LOW?**

3 A. The allocation of the costs and savings associated with the merger between PSI
4 ratepayers and “New Duke Energy” shareholders should include consideration of
5 the risks involved in obtaining such savings.

6 **Q. HOW LARGE ARE THE NET SAVINGS IN THE FIRST FIVE YEARS**
7 **ON THE REGULATED SIDE OF THE LEDGER?**

8 A. On the regulated side, the net savings in years 1 through 5 total \$807 million.⁷
9 PSI’s share of these savings is approximately \$122 million; excluding fuel
10 savings, PSI’s share is approximately \$116 million.⁸

11 **Q. HOW LARGE ARE THE NET SAVINGS AFTER THE FIRST FIVE**
12 **YEARS?**

13 A. On the regulated side, the net savings in years 6 through 10 total \$1.98 billion, or
14 almost 2.5 times as great as the net savings accruing in years 1 through 5, which
15 total \$807 million. This occurs due to a front-loading of the merger costs-to-
16 achieve, and a continued escalation of the merger benefits beyond year 5. PSI’s
17 share of these net savings (regulated side) is approximately \$299 million.⁹

⁷ Flaherty 6:20, and Table 1, “Net Corporate and Regulated Savings” line item.

⁸ Steffen, Exhibit J-1, line 5, column F lists \$115.7 million for the total company (PSI) estimated net savings. This value excludes PSI’s share of “Fuel Savings” as listed in Mr. Flaherty’s Table 1 of his direct testimony.

⁹ Flaherty, years 6-10 data embedded in Table 1. The \$299 million is based on Mr. Flaherty’s value of 1.98 billion multiplied by the PSI overall allocation factor of 15.085%, as noted in Mr. Blackwell’s Exhibit I-5, (cell V75 on the spreadsheet).

1 **Q. WILL THE MERGER CREATE SIGNIFICANT SAVINGS FOR**
2 **CINERGY AND DUKE SHAREHOLDERS ON THE NON-REGULATED**
3 **SIDE OF THE LEDGER?**

4 A. Yes, absolutely. Mr. Flaherty estimates a five-year savings of \$719 million, net
5 of costs-to-achieve, for the non-regulated side.¹⁰ This level of shareholder
6 savings is of the same order of magnitude as the \$807 million savings net of
7 costs-to-achieve identified for the regulated side of the companies for the first five
8 years. Based on the data in Mr. Flaherty's Table 1, non-regulated net savings are
9 estimated to reach a total of almost \$1.1 billion in years 6 through 10. Thus total
10 10-yr. net merger savings on the non-regulated side appears to be approximately
11 \$1.8 billion¹¹.

12 **Q. ARE PSI RATEPAYERS GUARANTEED A PORTION OF THE NET**
13 **MERGER SAVINGS?**

14 A. Yes, but only those net savings accruing on the regulated side, based on the
15 applicants proposed sharing of such net savings. PSI ratepayers will not share in
16 the \$1.8 billion of net savings projected over 10 years on the non-regulated side.

17 **Q. IS THE SHARING OF REGULATED-SIDE SAVINGS AFFECTED BY**
18 **THE TIMING OF PSI'S NEXT BASE RATE CASE?**

19 A. Yes. If there is no base rate case in years 1 through 10, then PSI ratepayers will
20 continue to receive the merger credit, but only at the level of year 5 savings for
21 years 6 through 10 (equal to \$10.9 million per year), even though net merger

¹⁰ Flaherty 5:14-22, and Table 1, page 7.

¹¹ Flaherty, Table 1, with escalated gross savings using Mr. Flaherty's implied annual average escalation.

1 savings continue to increase after year 5. Exhibits RMF-2 and RMF-3 illustrate
2 the allocative impact across ratepayers and PSI shareholders if there is no base
3 rate case.

4 **Q. PLEASE EXPLAIN EXHIBIT RMF-2.**

5 A. Exhibit RMF-2 illustrates regulated-side net merger savings allocation between
6 PSI ratepayers and “New Duke Energy” shareholders in the absence of a rate
7 case. It uses the data provided by Mr. Flaherty for net merger savings in years 1
8 through 10, along with the net savings allocation information provided by Mr.
9 Steffen in his Exhibit J-1, which is based on the allocation to PSI as provided in
10 Mr. Blackwell’s Exhibit I-5.

11 The PSI savings are approximately 15% of the total net merger savings of
12 \$807 million¹², and as depicted in Mr. Steffen’s Exhibit J-1, 94.29% of those net
13 merger savings are applicable to the retail segment of PSI’s business. Thus
14 Exhibit J-1 shows a PSI “allocation” of \$109.129 million of the net merger
15 savings during years 1-5 (line 6, column F).¹³ This particular line in Exhibit J-1
16 does not represent a true “allocation” of savings to PSI retail customers, but
17 merely illustrates the total assignment of net savings to the PSI retail side of the
18 regulated business; line 9 column F shows the proposed net savings allocation to
19 PSI ratepayers of \$32.7 million over the first five years.

20 Exhibit RMF-2 compiles this information, along with year 6 through 10
21 data from Mr. Flaherty, to show how the net savings are allocated between PSI

¹² Blackwell Exhibit I-4 shows an allocation of 15.085% to PSI.

¹³ The allocation presented by Mr. Steffen excludes PSI’s portion of the “Fuel Savings” listed in Mr. Flaherty’s Table 1; Mr. Flaherty’s \$807 million net savings value includes the fuel savings.

1 ratepayers and “New Duke Energy” shareholders over three different time
2 periods: years 1 through 5, years 6 through 10, and overall across years 1 through
3 10.

4 **Q. WHAT IS THE BOTTOM LINE ON ALLOCATION OF REGULATED-**
5 **SIDE NET MERGER SAVINGS TO PSI RATEPAYERS IN THE**
6 **ABSENCE OF A BASE RATE CASE?**

7 A. Net savings benefit from the regulated side is allocated 30% to ratepayers on
8 average over the first five years, using the proposed allocation method shown in
9 Exhibit J-1, which returns \$32.7 million to PSI retail ratepayers (line 9, column
10 F). Since ratepayer savings allocation is held at year 5 levels, and net savings
11 continue to grow in years 6 through 10, ratepayers will receive smaller
12 proportional savings allocations in the absence of a rate case. Exhibit RMF-2
13 shows that the average ratepayer net savings allocation is only 19.8% over years
14 6-10, for a 10-year average allocation of only 22.7% for ratepayers.

15 **Q. WHEN NON-REGULATED NET SAVINGS ARE CONSIDERED, WHAT**
16 **IS THE RESULTING OVERALL ALLOCATION OF NET MERGER**
17 **SAVINGS BETWEEN PSI RATEPAYERS AND NEW DUKE ENERGY**
18 **SHAREHOLDERS?**

19 A. PSI retail ratepayers receive an overall allocation of 15.5% of the 5-year net
20 savings, and only 13.6% of the total 10-year net savings, in the absence of a base
21 rate case. Exhibit RMF-3 illustrates the pattern of net savings allocation over the
22 10 year timeframe. Exhibit RMF-3 uses the 10-yr. data available from Mr.

1 Flaherty’s Table 1 (as embedded in the word document included in the CD which
2 includes Case-in-Chief Testimony and Exhibits).

3 2. Merger Costs

4 **Q. FOR WHAT FRACTION OF THE MERGER COSTS ARE THE**
5 **APPLICANTS SEEKING COST RECOVERY?**

6 A. The applicants are seeking 100% cost recovery for the portion of costs allocated
7 to the regulated functions. PSI’s share of these costs, approximately 14%, is over
8 \$71 million, and the retail jurisdictional portion is over \$67 million.

9 **Q. DOES THIS INCLUDE TRANSACTION COSTS TO MAKE THE**
10 **MERGER HAPPEN, OR JUST THE COSTS TO ACHIEVE THE**
11 **MERGER SAVINGS?**

12 A. It includes all transaction and regulatory process costs. For example, the
13 applicants seek to recover PSI’s share of \$ 41 million paid to three investment
14 banking firms for “assistance with certain aspects of the merger”. These costs are
15 for fees for a “fairness opinion” and assistance in “transaction structuring and
16 negotiation”¹⁴.

17 **Q. IS “NEW DUKE ENERGY” AT RISK FOR ANY OF THE ESTIMATED**
18 **COSTS ON THE REGULATED SIDE?**

19 A. No. PSI ratepayers bear the full costs (amortized over five years) to achieve the
20 merger.

¹⁴ Flaherty 66:9-15. Mr. Flaherty’s workpapers show that this amount was split between UBS (\$13.5 million), Lazard (\$4 million), and Merrill Lynch (\$23.6 million).

1 **Q. IS “NEW DUKE ENERGY” AT RISK FOR ANY OF THE ESTIMATED**
2 **SAVINGS ON THE REGULATED SIDE?**

3 A. Yes. However, as noted, based on Mr. Flaherty’s testimony, it appears that the
4 relative risk of achieving the merger savings is low if the integration is executed
5 as intended.

6 3. Level of Merger Savings Allocation

7 **Q. WHAT DO THE APPLICANTS PROPOSE FOR ALLOCATING THE**
8 **MERGER SAVINGS?**

9 A. As shown in Mr. Steffen’s Exhibit J-1 and my Exhibit RMF-2, on the regulated
10 side of the ledger the applicants propose to allocate 30% of the net merger savings
11 over the first five years to PSI retail ratepayers, absent a base rate case. Over ten
12 years, the total savings allocation to ratepayers falls to just under 23%.

13 On the non-regulated side of the ledger, shareholders receive 100% of the
14 allocation of net benefits. Combining regulated and non-regulated net savings,
15 PSI ratepayers will receive 15.5% of the net benefits over the first five years, and
16 13.6% of the benefits over ten years, assuming no base rate case before year 10.

17 **Q. ON WHAT BASIS DID THE APPLICANTS DETERMINE THE LEVEL**
18 **OF NET MERGER SAVINGS ALLOCATION TO PSI RATEPAYERS?**

19 A. There does not appear to be any particular basis. In a response to a discovery
20 request, Ms. Pashos gives an opinion that the proposal allocation is fair, but that
21 opinion is not supported by any documentation or benchmarks to other merger
22 allocations. Ms. Pashos states that “PSI customers will ultimately receive 100%

1 of actual merger savings allocable to PSI through traditional base ratemaking
2 processes. Consequently, over time, PSI customers will receive the vast majority
3 of merger savings – far more than one-third....Accordingly, it is fair for PSI and
4 its shareholders to have an opportunity to share in merger savings.”¹⁵

5 **Q. DOES MS. PASHOS INDICATE WHY IT MIGHT BE FAIR TO ALLOW**
6 **SHAREHOLDERS TO SEE AN ALLOCATION OF THE REGULATED**
7 **MERGER SAVINGS?**

8 A. Yes. Ms. Pashos states “Notably, while customers will be guaranteed to receive
9 merger benefits under PSI’s proposal, PSI shareholders have an opportunity, but
10 no guarantee”.

11 **Q. DO YOU AGREE SHAREHOLDERS DO NOT HAVE A GUARANTEE OF**
12 **SAVINGS?**

13 A. No, I do not. Based on Mr. Flaherty’s testimony, it appears almost certain that
14 savings will indeed accrue if this merger is consummated and, as would be
15 expected, management executes its integration plan. A “vast majority” of the
16 savings are based on an analysis that looks at the direct savings that will be
17 created from fundamental synergistic mechanisms. While there is less
18 information in the filing about the certainty of savings from the non-regulated side
19 of the business, Mr. Flaherty’s testimony is at odds with Ms. Pashos’
20 characterization that shareholders are at some substantial risk and therefore should

¹⁵ PSI response to OUCC 1.65.

1 be compensated beyond the level that they normally receive through regulated
2 earnings.

3 **Q. DO NEW DUKE ENERGY SHAREHOLDERS HAVE AN OPPORTUNITY**
4 **TO SHARE IN MERGER SAVINGS SEPARATE FROM ANY**
5 **ALLOCATION OF MERGER NET SAVINGS FROM THE REGULATED**
6 **COMPANIES?**

7 A. Yes. Mr. Flaherty states that non-regulated merger savings over the first five
8 years will be approximately \$719 million net of costs to achieve. Years 6 through
9 10 will see an additional \$1.98 billion in non-regulated savings, for a total 10-year
10 net merger savings of \$2.7 billion for shareholders.¹⁶

11 **Q. ARE THERE ANY CONDITIONS THAT WOULD ENSURE THAT PSI**
12 **WOULD BRING A BASE RATE CASE BEFORE THE IURC WITHIN**
13 **THE NEXT TEN YEARS?**

14 A. No. In fact, given the existence of considerable tracking mechanisms in place that
15 automatically adjust certain components of rates to PSI retail customers, arguably
16 there is less pressure on PSI to bring a rate case before the IURC.

17 **Q. DOES YOUR ANALYSIS SUPPORT THE ASSERTION THAT PSI**
18 **CUSTOMERS WILL ULTIMATELY RECEIVE 100% OF ACTUAL**
19 **MERGER SAVINGS ALLOCABLE TO PSI?**

20 A. No. As shown in Exhibit RMF-2, it is possible that ten years after merger
21 consummation, PSI ratepayers will have seen a 23% net savings allocation, or \$87

¹⁶ Flaherty, Table 1 as embedded, including the 10-year projections.

1 million, while New Duke Energy shareholders see a 77% allocation, or \$296
2 million in net benefits, just for the PSI portion of the allocated merger savings on
3 the regulated side. This is in addition to the savings shareholders will see from
4 non-regulated operations, which total \$2.7 billion company-wide over ten years.

5 **Q. IF THERE IS A BASE RATE CASE BEFORE 10 YEARS AFTER**
6 **MERGER APPROVAL, WHAT SHARE OF REGULATED-SIDE NET**
7 **MERGER SAVINGS WOULD BE ALLOCATED TO RATEPAYERS?**

8 A. As noted by Ms. Pashos in a discovery response to a question concerning the
9 fairness of the proposed allocation, traditional ratemaking processes would allow
10 for customers to receive 100% of the actual merger savings¹⁷, once the directives
11 of the rate case order are implemented.

12 **Q. DID THE APPLICANTS PROVIDE ANY ADDITIONAL INFORMATION**
13 **ON PRECEDENT FOR THE PROPOSED ALLOCATION OF MERGER**
14 **SAVINGS?**

15 A. Yes. Mr. Fetter testified that “the Merger savings sharing mechanism proposed
16 by PSI is generally in line with current regulatory practice across the United
17 States and, indeed, is more favorable to customers than the way savings/benefits
18 from several recent transactions have been shared.”¹⁸

19 **Q. DID MR. FETTER DOCUMENT WHICH OF “SEVERAL RECENT**
20 **TRANSACTIONS” HE WAS REFERENCING?**

¹⁷ Response to OUCC discovery request number 1.65, “Second, PSI customers will ultimately receive 100% of actual merger savings allocable to PSI through traditional ratemaking processes”.

¹⁸ Fetter 15:5-8.

1 A. No. Mr. Fetter did provide a set of State Regulatory Commission orders that he
2 stated he used for reference.¹⁹

3 **Q. HAVE YOU REVIEWED THE ALLOCATION OF NET MERGER**
4 **SAVINGS IN RECENT MERGERS ACROSS THE COUNTRY?**

5 A. Yes. I reviewed the nine Regulatory Commission orders included in Mr. Fetter's
6 documents.²⁰ Exhibit RMF-4 is a summary of the mergers and the allocation of
7 savings resulting from those regulatory rulings.

8 **Q. PLEASE SUMMARIZE EXHIBIT RMF-4.**

9 A. RMF-4 illustrates that in general, merger net savings allocations to ratepayers
10 were considerably greater than 30% over five years and generally were not in line
11 with the applicant's proposal, contrary to Mr. Fetter's contention.

12 The first case, the Indiana-Michigan (AEP) merger with CSW (before the
13 IURC) resulted in an average 55% allocation of net merger savings over 8 years,
14 with the savings percentages front-loaded, for example year 1 allocated 59% of
15 savings to ratepayers. This was a similar outcome as reported in the Michigan
16 PSC ruling on the same case.

17 The next case, the Indiana Gas Company and the Southern Indiana
18 Electric and Gas Company merger before the IURC, resulted in an 18-month rate
19 moratorium and exclusion of all merger costs from ratepayer cost recovery.

20 The ConEd-ORU merger and the First Energy/GPU-JCPL merger led to a
21 75% allocation of net savings to customers.

¹⁹ Response to discovery request CAC 1.1.

²⁰ Discovery response CAC 1.1, A.1.1.-CAC.Q.1.1.-Attachment-CAC1.1-F.pt.1 through pt.13.

1 The acquisition of Illinois Power by Ameren presented a more complex
2 picture of savings allocation; the outcome of that case resulted in limited cost
3 recovery and linking the merger savings allocation to the next general rate case.

4 In the Florida Progress – Carolina Power and Light merger, the North
5 Carolina utilities commission ordered immediate rate reductions and all costs of
6 the merger were excluded from base rates.

7 Finally, in the Louisville Gas and Electric – Kentucky Utilities merger, the
8 Kentucky PSC implemented a 50/50 sharing of net savings for the first five years,
9 with no ramping, and a likely continuation of this sharing upon a re-visitation 5
10 years down the road.

11 **Q. WHAT DOES THIS SUMMARY ILLUSTRATE?**

12 A. What this summary illustrates is 1) Mr. Fetter’s statement that the sharing
13 mechanism proposed by the applicants is “generally in line with current
14 regulatory practice” is incorrect; and 2) ratepayers in the jurisdictions involved in
15 the noted merger cases usually received considerably more than 30% of the net
16 savings over the first five years.

17 **Q. DO YOU HAVE AN OPINION AS TO WHETHER THE MERGER**
18 **SAVINGS SHARING MECHANISM AND RESULTING RATE IMPACTS**
19 **PROPOSED BY PSI ARE IN THE PUBLIC INTEREST?**

20 A. Yes. In my opinion, the merger savings mechanism and resulting rate impacts
21 proposed by PSI are not in the public interest because (1) the merger savings
22 sharing mechanism will allocate only 30% of the net retail savings (approximately

1 57% of the gross savings²¹) while allocating 100% of the gross retail costs to
2 retail customers during the first five years following the merger, (2) if continued,
3 the merger savings sharing mechanism will allocate on the order of only 50% of
4 the gross retail savings during the second five years of the merger, while having
5 already allocated 100% of the gross retail costs to retail customers during the first
6 five years of the merger, and (3) the merger sharing savings mechanism will
7 continue beyond five years absent a base rate case, for the occurrence of which
8 PSI provides no assurance.

9 **Q. WHAT DO YOU RECOMMEND FOR ALLOCATION OF REGULATED-**
10 **SIDE NET MERGER SAVINGS?**

11 A. I recommend that 100% of the regulated-side net merger savings be credited to
12 PSI ratepayers for years 1 through 5. I also recommend that if no base rate case is
13 brought before the IURC by year 6, then a re-visitation of the merger
14 costs/savings occurs at year 6, and 100% of re-computed net merger savings for
15 years 6 through 10 be credited to ratepayers.

16 4. Comparison to 1994 Merger Net Savings Allocation

17 **Q. HOW DOES THE NET SAVINGS ALLOCATION BETWEEN**
18 **SHAREHOLDERS AND RATEPAYERS COMPARE TO THE ULTIMATE**
19 **ALLOCATION FROM THE 1994 MERGER?**

20 A. In testimony in the 1994 merger, Mr. Rogers stated “We believe that we have
21 created an opportunity for the vast majority of these savings to be achieved and to

²¹ Calculated from the data provided by Mr. Steffen’s Exhibit J-1.

1 flow through to utility customers in all three states that the CINergy companies
 2 will serve”²² (emphasis added). Unlike that case, that vast majority of the merger
 3 savings in this case are slated for shareholders. In 1994, the savings allocation
 4 was settled in a rate case (Cause No. 39584 and 39584-S2, Decision rendered on
 5 February 17, 1995) and it appears that a large majority of non-production and
 6 non-avoided capacity savings were returned to ratepayers through rate credits
 7 over 1995-1997, and a new rate case (Cause No. 40003) that was resolved in
 8 1996.²³ It is my understanding that most if not all of the production savings –
 9 energy and avoided capacity costs – were effectively credited to ratepayers. Thus,
 10 the net merger savings returned to ratepayers was certainly more than the 30%
 11 proposed in this merger, and likely was greater than 75%.

12

13 **IV. GLOBAL PROTECTIONS FOR PSI RETAIL RATEPAYERS**

14

15 **Q. WHAT DO YOU MEAN BY “GLOBAL PROTECTIONS” FOR PSI’S**
 16 **RETAIL CUSTOMERS?**

17 **A.** Global protections are provisions or merger commitments that seek to ensure PSI
 18 ratepayers are not harmed, intentionally or unintentionally, by the effect of PSI’s
 19 becoming part of an even larger holding company than Cinergy. In particular, I
 20 am concerned that the substance of the some of the key protections obtained for
 21 PSI consumers in 1994 may not remain in force if/when this merger is approved.

²² Rogers 9:4-7, direct testimony in Cause No. 39897 before the IURC, March 1994.

²³ Based on the decision rendered in Cause No. 39584 and 39584-S2.

1 Those protections were documented in a series of agreements which I include as
2 exhibits to this testimony, and which I describe below. They include:

- 3 • The Indiana Joint Stipulation and Agreement (Exhibit RMF-5);
- 4 • The Indiana Settlement Agreement (Exhibit RMF-6);
- 5 • The 1994 Service Company Agreement (Exhibit RMF-7); and
- 6 • The Energy Efficiency Agreement (Exhibit RMF-8).

7

8 1. Indiana Joint Stipulation and Agreement

9 **Q. WHAT IS THE “INDIANA JOINT STIPULATION AND AGREEMENT”?**

10 A. The Indiana Joint Stipulation and Agreement was filed as an offer of settlement
11 with the FERC on March 4, 1994 in the FERC Docket No. EC93-6, the
12 PSI/CG&E reorganization or merger case. The Agreement contains a series of
13 PSI ratepayer protections that remain in force today, and that merit consideration
14 by the IURC in the current proceeding as a template for ongoing protection if the
15 Duke-Cinergy merger is approved. I attach a copy of the Indiana Joint Stipulation
16 and Agreement as Exhibit RMF-5.

17 **Q. WHAT ARE THE KEY PSI RATEPAYER PROTECTIONS ARISING**
18 **FROM THE INDIANA JOINT STIPULATION AND AGREEMENT?**

19 A. Article III of the Agreement, in particular, contains provisions that:
20 • Ensure PSI’s commitment to seek and obtain IURC approval concerning
21 construction, purchase or leasing of electricity generation facilities for serving

1 PSI retail customers, pursuant to Indiana law (Article III, Section A.1.a through
2 A.1.d);

3 • Ensure PSI’s commitment to seek and obtain IURC approval concerning the use
4 of clean coal technology at new or existing generating facilities used to serve
5 PSI’s retail customers, pursuant to Indiana law (Article III, Section A.2.a
6 through A.2.d);

7 • Ensure PSI’s commitment to seek IURC approval concerning participation in
8 implementation of any plan to comply with Federal Clean Air Act Amendments
9 at generating facilities used to serve PSI’s retail customers, pursuant to Indiana
10 law (Article III, Section A.3.a through A.3.c); and

11 • Ensure PSI’s commitment “to submit to the IURC specified affiliate contracts
12 prior to any necessary review by [FERC] and/or by the SEC.” This provision
13 was intended to address “questions [...] regarding the effectiveness and
14 coordination of regulation under a registered holding company structure”
15 (Article III, Section B).

16 It is my understanding that once approved by the IURC and the FERC, these
17 commitments became binding legal obligations.

18 **Q. ARE THESE PROTECTIONS AFFORDED PSI RATEPAYERS IN 1994**
19 **CONTINUED UNDER THE AGREEMENTS PROPOSED IN THE**
20 **CURRENT MERGER?**

21 A. No, at least not in the same form or to the same extent. Ms. Pashos makes
22 general, passing reference in her testimony to certain commitments and includes a
23 list of proposed commitments in her Exhibit D-3. But, her testimony and exhibit

1 certainly do not address all of the key commitments made in 1994, either in
2 substance or in form. For example, the four commitments referenced in my
3 previous answer are not addressed at all.

4 **Q. WHAT DO YOU RECOMMEND THE IURC CONSIDER IN REGARDS**
5 **TO THE PROTECTIONS CURRENTLY AFFORDED PSI RATEPAYERS**
6 **UNDER THE TERMS OF THE INDIANA JOINT STIPULATION AND**
7 **AGREEMENT?**

8 A. I recommend that the IURC ensure that the substance of these commitments,
9 especially the four provisions noted above, be retained in the set of agreements
10 and/or provisions that will define PSI ratepayer protections in the future. It is
11 critical that PSI ratepayers continue to have the benefits of access to an Indiana
12 forum and oversight by Indiana regulators to address any issues with PSI affecting
13 retail rates, retail service, and relationships with affiliates.²⁴

14 2. Indiana Settlement Agreement

15 **Q. WHAT IS THE 1994 “INDIANA SETTLEMENT AGREEMENT”?**

16 A. As part of the 1994 PSI/CG&E merger, the negotiated “Indiana Settlement
17 Agreement”²⁵ was entered into by many parties and PSI to protect PSI’s utility
18 customers in a number of ways from risks associated with becoming part of the
19 Cinergy registered holding company structure. I have attached the Indiana

²⁴ This concern was noted by the IURC in its filing to the FERC in Docket No. EC05-103-000, the Duke Cinergy merger case. The IURC noted that its key concern [in respect of 1990s mergers] “was the preservation of the IURC’s ability as a state commission to maintain proper regulatory oversight regarding the components of the charges to be passed through to Indiana ratepayers, who then as now secure their service through a traditional cost-of-service regulatory system”. Pages 5-6.

²⁵ “Indiana Settlement Agreement”, as noted by Ms. Pashos, 19:19-20.

1 Settlement Agreement as Exhibit RMF-6. The protections included policies and
2 procedures whose effects would:

- 3 • Ensure that PSI ratepayers don't subsidize affiliate activities;
- 4 • Ensure that PSI's costs which are recovered in regulated rates reflect only
5 the costs to serve PSI's customers;
- 6 • Ensure that Cinergy factored into its integrated resource planning process
7 the risks resulting from future enactment of environmental statutes and
8 regulations;
- 9 • Ensure that PSI's customers received an appropriate share of the benefits
10 of the merger; and
- 11 • Ensure that the IURC has access to PSI's books and records.

12 Such assurances²⁶ were guaranteed by the umbrella "Affiliate Guidelines
13 Negotiation Agreement" and documented in part in the "Affiliate Guidelines"
14 included as part of the Settlement Agreement²⁷. I understand that the provisions
15 of the Settlement Agreement were designed in large part to assure that PSI's
16 ratepayers continued to have the substantive protections and local forum provided
17 by Indiana law to address particular risks and costs associated with receiving
18 utility service from PSI in the same manner *after* the Cinergy merger as they did
19 *before* the merger.

²⁶ Indiana Settlement Agreement, P. 15, pages 5-6.

²⁷ See Schedule A ("PSI Energy Inc. Affiliate Guidelines, March 1994") to Exhibit C of the "Indiana Settlement Agreement", part of "Documents, Volume II" as filed before the FERC in Docket No. EC93-6, March 4, 1994; this is contained as part of Exhibit RMF-6.

1 **Q. ARE THE PROTECTIONS AFFORDED PSI’S CUSTOMERS THROUGH**
2 **THE 1994 INDIANA SETTLEMENT AGREEMENT RETAINED IN THE**
3 **PROPOSED MERGER COMMITMENTS IN THIS CASE?**

4 A. Not completely. While some of the substance contained in the Indiana Settlement
5 Agreement is retained in PSI’s current merger filing (such as the statement that
6 the IURC will continue to have authority over PSI’s capital structure for the
7 purposes of ratemaking²⁸), these commitments are not as comprehensive, precise
8 and formal as those made in 1994.

9 For example, PSI proposes a sub-docket be opened “to deal with the review
10 and any revisions to PSI’s affiliate guidelines”²⁹, rather than directly incorporate
11 an updated version of the current affiliate guidelines. Also, requirements to
12 provide annual information filings are not included in PSI’s proposed merger
13 commitments, as they were in the 1994 merger case. .

14 PSI intends that all merger commitments coming out of the 1994 PSI/CG&E
15 merger will be superseded by commitments made in this proceeding³⁰. Thus, to
16 ensure consumer protection, it is critical that the protections documented in the
17 1994 Indiana Settlement Agreement do not expire without at least equivalent
18 protections.

19 **Q. WHAT DO THE AFFILIATE GUIDELINES CONTAIN?**

20 A. The affiliate guidelines contain four specific sections setting out 1) cross-
21 subsidization principles, 2) affiliate transactions procedures, 3) annual

²⁸ Pashos 19: 17 – 20:20.
²⁹ Pashos 29: 9-10.
³⁰ Pashos, 31: 6-8.

1 information filing requirements, and 4) a description of the companies' process
2 for making books and records available to the IURC, the OUCC, and other
3 requesting parties.

4 **Q. IS PSI'S CURRENT PROPOSAL TO ADDRESS AFFILIATE GUIDELINE**
5 **UPDATING IN A SUBSEQUENT SUBDOCKET SUFFICIENT?**

6 A. No. The affiliate guidelines are a core protection for PSI ratepayers. The IURC
7 should not approve merger-related agreements sought by PSI prior to obtaining
8 certainty on the form and substance of any updated affiliate guidelines.

9 **Q. DOES PSI PROPOSE TO MAKE ANNUAL INFORMATIONAL FILINGS**
10 **TO THE IURC?**

11 A. No. PSI does not include any such commitment in its list of merger
12 commitments.³¹

13 **Q. WHAT DO YOU RECOMMEND THE IURC CONSIDER IN REGARDS**
14 **TO THE PROTECTIONS CURRENTLY AFFORDED PSI RATEPAYERS**
15 **UNDER THE TERMS OF THE INDIANA SETTLEMENT AGREEMENT?**

16 A. I recommend that the IURC ensure that the substance of these commitments,
17 especially those provided by the affiliate guidelines and fundamental
18 requirements for annual filings be retained prior to granting approval for any
19 merger-related agreements.

³¹ Pashos, Petitioner Exhibit D-3, Cinergy Corp. / Duke Energy Corporation Merger Commitments.

1 **Q. ARE THERE ADDITIONAL CONSIDERATIONS THAT MERIT**
2 **REVIEW BY THE IURC?**

3 A. Yes. There are two considerations I want to address in particular.

4 First, as part of the Indiana Settlement Agreement, Cinergy agreed to
5 factor into its integrated resource planning process the risks resulting from future
6 enactment of environmental statutes and regulations believed to represent
7 significant “Environmental Risks”³². Cinergy agreed to use “sensitivity analyses
8 or other accepted techniques which Cinergy deems appropriate to its integrated
9 resource planning process”³³. Given the changing circumstances on the
10 acceptance of carbon as a pollutant, I recommend that a more explicit recognition
11 of the “cost of carbon” be factored into Cinergy’s planning processes, instead of
12 just including “sensitivity analysis” as a means of recognizing such
13 “environmental risks”.

14 Specifically, Cinergy should be required to incorporate its best forecast of
15 carbon dioxide emissions credit prices into its base case or reference case
16 planning assumptions. While there is considerable uncertainty about the specifics
17 of future regulation of carbon dioxide emissions, that uncertainty can be
18 addressed by sensitivity analysis using low and high case assumptions.

19 Cinergy’s current practice of using zero as the assumed price of CO2
20 emissions credits for the bulk of its planning analyses, and then considering
21 carbon emissions regulations as a mere sensitivity is, simply stated, imprudent
22 and unacceptable for its customers and its shareholders, given the Company’s

³² Indiana Settlement Agreement, Article XII, 12.2, pages 37-38.

³³ *Ibid.*

1 planning environment in 2005, even though it was considered appropriate given
2 its planning environment in 1994.

3 Even Cinergy’s merger partner, Duke, acknowledges the likelihood of a
4 non-zero carbon price. In fact, in the testimony of Duke’s Group Vice President
5 for Public and Regulatory Policy, Richard Osborne, he states “We endorse a
6 transition to a lower-carbon-intensive economy, promoting a federal economy-
7 wide approach – such as through a carbon tax – and are taking a leadership role to
8 engage stakeholders and craft a national policy consistent with our principles”³⁴.

9 Second, the merger agreement between Duke and Cinergy provides for
10 certain Midwest-region Duke Energy North America non-regulated generation
11 assets becoming part of the CG&E generation asset base, given their location in
12 the Cinergy region and their unregulated status. Cinergy should provide specific,
13 express assurances that any consideration of PSI purchase of any part of these
14 assets, or the power produced by these assets, will first allow both for an in-depth
15 review before the IURC and competitive bidding.

16 3. 1994 Service Company Agreement

17 **Q. WHAT IS THE 1994 SERVICE COMPANY AGREEMENT?**

18 A. The 1994 Service Company Agreement described the way in which the Cinergy
19 Service Company would provide, and be compensated for, services to PSI. I have
20 included this agreement as Exhibit RMF-7. In this current application, PSI has
21 submitted a revised, proposed “Service Company Agreement” similar in form to
22 the 1994 agreement.

³⁴ Petitioner’s Exhibit B, Testimony of Richard Osborne, 26: 14-17.

1 **Q. DOES PSI EXPLAIN THE DIFFERENCES BETWEEN THE CURRENT**
2 **SERVICE COMPANY AGREEMENT AND THE PROPOSED NEW**
3 **SERVICE COMPANY AGREEMENT?**

4 A. Yes; however, the description focuses on the allocation method and does not
5 address more fundamental aspects of the differences between the agreements.

6 **Q. HOW ARE CERTAIN FUNDAMENTAL ASPECTS OF THE PROPOSED**
7 **SERVICE COMPANY AGREEMENT DIFFERENT FROM THE**
8 **FUNDAMENTAL ASPECTS OF THE SERVICE COMPANY**
9 **AGREEMENT IN PLACE AS A RESULT OF THE PSI/CG&E MERGER?**

10 A. The proposed agreement contains many similarities, and similarity of structure, to
11 the 1994 agreement; however, there are key PSI ratepayer protection provisions
12 present in the 1994 agreement that are not present in the proposed agreement.

13 Those protections include:

- 14 1. The ability for the IURC to oversee and control costs associated with the
15 service agreement;
- 16 2. The ability for the IURC and the Indiana Utility Consumer Counselor to
17 review proposed amendments and ensure their reasonability before they
18 are approved, and to negotiate changes to proposed amendments;
- 19 3. A requirement that new domestic utility companies becoming part of the
20 holding company enter into the service agreement, thus helping to
21 maintain cost efficiencies.

1 There are also other differences arising as a result of the recent repeal of PUHCA.
2 In particular, costs in the proposed agreement include “costs of capital” without
3 reference to the provisions of the old PUHCA.

4 Lastly, the new service agreement specifically references the fact that it
5 would supersede the existing Cinergy service company agreement³⁵, and thus any
6 PSI ratepayer protections present in the existing agreement that are not reflected
7 in the new agreement would be lost.

8 **Q. HOW CAN THE POTENTIAL LOSS OF THESE PROTECTIONS**
9 **IMPACT PSI RATEPAYERS?**

10 A. PSI ratepayers must rely on proceedings before the IURC to ensure that they are
11 receiving the least cost utility service allowed under Indiana’s laws and
12 regulations. The loss of the first protection cited above means that additional
13 costs might be imposed on PSI through the new service agreement that under the
14 existing framework would not be allowed to be passed on to ratepayers.
15 Currently, there is a forum for ratepayers or the Indiana Office of Consumer
16 Counsel or CAC, or other intervenors to address potential allocation of costs to
17 ratepayers that may not be reasonable. The new service company agreement
18 conditions, as proposed, threaten that protection.

19 **Q. WHAT DO YOU RECOMMEND THE COMMISSION CONSIDER WITH**
20 **RESPECT TO THE PROPOSED SERVICE COMPANY AGREEMENT?**

³⁵ Petitioner’s Exhibit I-1, Section 5.2, page 6.

1 A. The IURC could consider incorporating the relevant protections included in the
 2 current service company agreement. In particular, there are whole sections of the
 3 current agreement that were deleted from the form of the proposed agreement that
 4 address fundamental state-level protections for PSI ratepayers. This includes
 5 Section 4.5, which preserves the IURC's ability to disallow, for example,
 6 recovery of costs from PSI ratepayers as a result of costs accruing to PSI from, for
 7 example, the proposed service company agreement. Also deleted in the proposed
 8 new service company agreement are Sections 5.1 through 5.7 of the existing
 9 service company agreement (in regards to Amendments to the agreement), which
 10 preserve the IURC's ability to find a proposed amendment unreasonable.

11 **Q. IS THERE AN ADDITIONAL CONSIDERATION FOR THE IURC TO**
 12 **REVIEW?**

13 A. Yes. The Commission could also consider formalizing, via some form of cost
 14 cap, PSI's witness Blackwell's claim that there will not be a material shift of
 15 administrative, management and support costs as a result of the proposed service
 16 company agreement implementation.³⁶ If this is true, PSI should not object to a
 17 structure that formally ensures PSI ratepayers, through maximum cost guarantees
 18 or equivalent forms of protection, will not be exposed to any material shift in
 19 costs.

20 4. Energy Efficiency Agreement

21 **Q. WHAT IS THE ENERGY EFFICIENCY AGREEMENT?**

³⁶ Blackwell, 11: 7-14.

1 A. PSI, Cinergy and CAC entered into an agreement in 1994 as part of the
2 PSI/CG&E merger whereby Cinergy affirmed its continued commitment to
3 energy efficiency in the PSI region. The Energy Efficiency Agreement³⁷ is
4 another of the agreements that afford protections to PSI ratepayers, in the form of
5 complementary mechanisms for meeting ratepayers needs for the services that
6 electricity provides: i.e., providing light, heat, air conditioning, refrigeration,
7 motor drive and other services with fewer kW and kWh than might otherwise be
8 required. Thus, energy efficiency services provide ratepayers with an additional
9 hedge against increasing electricity prices by helping them to reduce the quantity
10 of energy they consume. I attach the 1994 Energy Efficiency Agreement as
11 Exhibit RMF-8.

12 **Q. WHAT ENERGY EFFICIENCY PROVISIONS WERE INCLUDED AS**
13 **PART OF THE 1994 MERGER BETWEEN PSI AND CG&E?**

14 A. The Energy Efficiency Agreement provided for a set of aggressive energy
15 efficiency targets over a five-year timeframe (1995-1999), and an agreement to
16 negotiate comparable energy efficiency goals over the 2000 – 2004 timeframe.
17 The goal for the first five years was to achieve a cumulative reduction in peak
18 demand of 560 MW and a cumulative reduction in annual energy use of 2.445
19 million MWh by 1999 through implementation of cost-effective energy efficiency
20 programs. This goal was also stated as an intention “to achieve at least a 1%
21 annual reduction in the level of forecasted retail energy sales and peak demand”³⁸.

³⁷ Filing to FERC, Docket # EC93-6, Documents, Volume II, Exhibit C, Schedule B, “Energy Efficiency Agreement”.

³⁸ Energy Efficiency Agreement, p. 3.

1 **Q. WERE THOSE GOALS MET?**

2 A. It does not appear so. Exhibit RMF-9 illustrates the pattern of PSI's energy
3 efficiency expenditures and savings between 1992 and 2003 (the last year for
4 which EIA Form 861 data is available). Through 1999, the cumulative reduction
5 in annual energy use was .67 million MWh , according to EIA Form 861 data,
6 only about one-quarter of the goal of 2.445 million MWh (which would have been
7 1% of the forecasted sales). While the share of energy savings reached almost 1%
8 in 1995, it has declined rather precipitously since that time, and in 2002 and 2003
9 the level was approximately .03%, more than thirty-fold short of the target. The
10 most recent summary information, provided in Cinergy updates to the IURC,
11 illustrate that "over 160 MW" of annual peak demand reduction has occurred
12 since 1991, and the current annual energy reduction is .661 million MWh. The
13 data from the Cinergy update and the EIA data illustrate that the lion's share of
14 PSI's energy efficiency efforts occurred in the distant past, with minimal efforts
15 over the last seven years: spending has been less than \$4 million per year since
16 1998.

17 **Q. WHAT IS THE PATTERN OF ENERGY EFFICIENCY SPENDING BY**
18 **PSI OVER THE PAST 10 YEARS?**

19 A. PSI's spending peaked in the mid-1990's, hitting almost \$40 million in 1994, but
20 dropped to less than \$2 million in 1998, remaining in the low single digits through
21 2002 and 2003, when spending averaged about \$3.5 million per year.

1 **Q. BUT HASN'T DSM SPENDING DECREASED THROUGHOUT THE**
2 **COUNTRY SINCE THE MID-1990s?**

3 A. Yes, it has; but in a state with fully-regulated retail sales and integrated resource
4 planning, the reasons for considering utility-sponsored DSM at levels similar to
5 the aggressive implementation levels demonstrated by PSI in the mid-1990s have
6 not changed. Marketplace imperfections continue to lead to “underinvestment” in
7 energy efficiency by individual consumers, especially by less sophisticated
8 residential and small commercial electricity customers; thus utility-sponsored
9 energy efficiency programs remain the primary vehicle to capture cost-effective
10 savings. Cost-effective DSM through utility-sponsored energy efficiency
11 programs is still critical to achieving least-cost utility service. This is especially
12 true in the current era, as increasing coal and natural gas price trends make energy
13 efficiency investments even more attractive.

14 **Q. WHY IS THIS RELEVANT TO THE CURRENT MERGER CASE?**

15 A. The failure of PSI to meet the challenge of the prior merger agreement on energy
16 efficiency indicates that stakeholders should carefully regard any promises made
17 in the case of this merger.

18 Also, the merger will produce significant benefits for utility shareholders,
19 but the level of benefits to PSI ratepayers remains uncertain. Consideration of
20 renewing aggressive energy efficiency programs will help provide additional
21 benefits to PSI ratepayers in the form of both direct bill reductions from
22 participating customers, and reduced costs for all customers in the form of
23 avoidance of longer-term capital costs for new supply. Energy efficiency efforts

1 provide customers with the ability to offset higher energy bills; without more
2 aggressive energy efficiency, increasing fuel costs alone could offset the projected
3 merger credit, and other “tracked” cost items could reduce the net effect of the
4 merger credit.

5 **Q. WHAT REMEDIES DO YOU SUGGEST?**

6 A. I suggest that PSI renew its commitment made in the original merger by setting
7 new goals for energy efficiency implementation throughout its service territory as
8 part of any renewed commitment to integrated resource planning. These new
9 goals should reflect the spirit and aggressiveness of the original commitments.
10 PSI should increase its current commitments and implement cost effective energy
11 efficiency with a goal of reducing forecast retail sales by 1%.

12 **Q. WHO SHOULD PAY FOR THE COST OF ENERGY EFFICIENCY**
13 **EFFORTS?**

14 A. The costs of well-run, cost-effective energy efficiency programs can be recovered
15 from customers, in the same way that prudent, necessary expenditures on supply-
16 side alternatives are recovered from ratepayers. All energy efficiency programs
17 should contain mechanisms to ensure efficient administration and measured
18 success prior to allowance of cost recovery.

19 **Q. ARE YOU SUGGESTING A SPECIFIC SUITE OF ENERGY**
20 **EFFICIENCY PROGRAMS?**

21 A. Not at this time. At a minimum, small commercial and residential customers who
22 might not otherwise invest in cost-effective energy efficiency, or may be

1 precluded from investing due to well-understand imperfections in the market for
2 energy efficiency³⁹, benefit greatly from utility-sponsored energy efficiency
3 programs. And while larger, more sophisticated customers with a greater level of
4 understanding of energy efficiency economics can often access some level of
5 energy efficiency “from the market”, from a utility’s perspective there remains
6 value in offering energy efficiency programs, especially those that reduce peak
7 load, to industrial customers.

8 **Q. ARE THERE OTHER REASONS FOR PSI TO CONSIDER**
9 **ESTABLISHING A RENEWED COMMITMENT TO ENERGY**
10 **EFFICIENCY AT THE TIME OF THIS PROPOSED MERGER?**

11 A. Yes. As fuel prices increase and consideration of carbon emission costs becomes
12 a mainstream electricity public policy issue, any means to limit fuel consumption,
13 especially of carbon-intensive coal-fired electricity production, should be
14 carefully considered or reconsidered.

15

16 **V. RELIABILITY AND CUSTOMER SERVICE ISSUES**

17 **Q. WHAT CLAIM DOES PSI MAKE IN REGARDS TO CUSTOMER**
18 **SERVICE AND RELIABILITY ISSUES?**

19 A. PSI claims that “there will not be any adverse impacts on PSI’s reliability as a
20 result of the Merger”⁴⁰. Mr. Procario also states “the only impacts on reliability

³⁹ For example, renters do not have the incentive to invest in rental properties, while landlords do not have to pay tenant electricity bills. Also, residential sector consumers in aggregate usually will use implicitly high discount rates when considering investments in energy efficiency.

⁴⁰ Procario 12:10-11.

1 arising from this Merger will be positive”⁴¹. Ms Pashos states “PSI is and will
2 remain committed to providing reliable electric service”⁴².

3 **Q. ARE THESE CLAIMS SUPPORTED WITH ANY DETAILED**
4 **COMMITMENTS ENSURING A CERTAIN LEVEL OF RELIABILITY**
5 **OR CUSTOMER SERVICE?**

6 A. No, even though an obvious assurance mechanism exists. Mr. Procario reports on
7 three different reliability / customer service indices. These indices are the
8 Customer Average Interruption Duration Index (“CAIDI”), the System Average
9 Interruption Duration Index (“SAIDI”), and the System Average Interruption
10 Frequency Index (“SAIFI”). He provides, in Exhibits E-1 and E-2, a ten-year
11 history (by month) of the level of these indices, with (E-1) and without (E-2) the
12 effect of major storms. However, the applicants do not propose to ensure
13 reliability by setting as a goal a targeted level of interruptions as measured by
14 these indices.

15 **Q. WHAT REMEDY DO YOU SUGGEST?**

16 A. I suggest that the Commission charge PSI with ensuring reliability and good
17 customer service by instituting a performance mechanism (or at least a threshold
18 goal for maximum levels of service interruption) tied to achieving at least
19 historical levels of interruption minimization.

20 **Q. WHAT ARE RECENT INTERRUPTION LEVELS?**

⁴¹ Id. 12:19

⁴² Pashos 8:16.

1 A. Exhibits E-1 (with severe storms excluded from the data) shows that during most
2 of 2003 and 2004 the SAIFI has been approximately 1.2, CAIDI has been about
3 100, and SAIDI has been about 125. These benchmarks appear to be reasonable
4 targets to ensure a minimum level of reliability/customer service as measured by
5 customer interruption metrics.

6 **Q. WHAT IF PSI IS NOT ABLE TO MEET THESE METRICS?**

7 A. PSI should increase expenditures to ensure such reliability; and the source of
8 increased expenditures should be from both ratepayers and shareholders. One
9 possible allocation of costs would be in the same proportion as the ultimate
10 allocation of net merger savings.

11

12 **VI. AFFILIATE ENERGY AND CAPACITY TRANSFER ISSUES**

13 **Q. WHAT DO THE APPLICANTS PROPOSE FOR AFFILIATE ENERGY**
14 **TRANSFER PRICING?**

15 A. It is my understanding that the applicants propose that all affiliate energy
16 transactions be conducted at the MISO RTO spot LMP prices. It is also my
17 understanding that pricing for energy transactions at wholesale between affiliate
18 companies is a FERC-jurisdictional issue, not a state-jurisdictional issue, and that
19 Cinergy's current market-based rates filing before FERC addresses this issue.

20 **Q. ARE WHOLESALE ENERGY TRANSACTIONS BETWEEN**
21 **AFFILIATES OF CONCERN TO PSI'S RETAIL RATEPAYERS?**

1 A. Yes. The major concern is that any sales or purchases between PSI and any of its
2 affiliates be priced fairly, and that PSI's ratepayers see the benefits of any surplus
3 energy sales made from jurisdictional generating plants whose costs are part of
4 PSI's base rates. In short, PSI's ratepayers bear the cost or share the benefit of
5 wholesale purchases and sales.

6 These issues are also currently being addressed in the ongoing "Joint
7 Generation and Dispatch Agreement" ("JGDA") Cause No. 41954, and to date
8 there has been no full resolution on prescribing a structure around which PSI can
9 make forward sales and purchases. Such a structure is required, given the
10 impending termination of the JGDA.

11 **Q. IS THERE A WAY TO GUARANTEE SUCH FAIR PRICING?**

12 A. Yes. The proposal to price all transactions at the MISO LMP spot price is a good
13 start. However, the MISO spot markets serve as an alternative to short-term sales
14 or purchases between affiliates. For any short-term sales, PSI can use the MISO
15 market and not enter into affiliate energy transactions.

16 **Q. ARE THERE OTHER ENERGY TRANSACTIONS PSI MAY CONSIDER**
17 **BESIDES SHORTER-TERM MISO SPOT MARKET SALES AND**
18 **PURCHASES?**

19 A. Yes. Bilateral sales and purchases at horizons greater than the MISO day-ahead
20 and real-time spot markets present a reasonable opportunity for PSI to sell surplus
21 or purchase required energy at prices that could be better (lower, for purchases;
22 higher, for sales) than those they would see in the MISO spot markets. For this

1 reason, it is important to carefully consider the rules that PSI will operate under
2 for such sales and purchases.

3 **Q. ARE THERE ANY REASONS FOR THERE TO BE AFFILIATE ENERGY**
4 **TRANSACTIONS OF A SHORT DURATION?**

5 A. No. PSI can buy and sell to and from the MISO spot markets, and the revenues
6 received or paid would be the same as if they sold to their affiliate (or any other
7 market participant) at prices indexed on the MISO spot markets.

8 **Q. SHOULD AFFILIATE TRANSACTIONS OF A LONGER DURATION**
9 **THAN DAY AHEAD BE ALLOWED?**

10 A. Possibly, to allow for the chance that PSI ratepayers could be made better off if
11 PSI was allowed to sell and buy forward of the MISO markets. There could be
12 times when PSI's affiliate might be a logical trading partner for such a
13 transaction, especially given the proximity of CG&E's (and DENA's) generation
14 facilities.

15 However, the potential for undetectable affiliate abuse exists since there is
16 a limited ability to ascertain if pricing terms are truly "market-based", unlike the
17 pricing of short-term (day-ahead or real time) energy which can be based on sales
18 and purchases into/from the MISO spot market. For this reason, longer-term
19 bilateral sales or purchases are more "safely" made only with non-affiliated
20 companies. Such a consideration is likely to preserve for PSI the opportunity to
21 sell and buy longer-term (and allow some of those benefits to flow to ratepayers)
22 while preventing even any perception of affiliate abuse.

1 **Q. ARE WHOLESALE CAPACITY OR ANCILLARY SERVICE**
2 **TRANSACTIONS BETWEEN AFFILIATES OF CONCERN TO PSI'S**
3 **RETAIL RATEPAYERS?**

4 A. Yes. Similar to concerns with energy sales and purchases, capacity or ancillary
5 service transactions also must be priced fairly. PSI's ratepayers should see the
6 benefits of any surplus capacity sales made from jurisdictional generating plants
7 whose costs are part of PSI's base rates. However, there is no "spot" market for
8 capacity or ancillary service transactions as there is for energy. Until such
9 independent markets are created, all contracts for sale or purchase of capacity or
10 ancillary service should remain under the IURC's jurisdiction and be cost-based.

11 **Q. DOES THIS COMPLETE YOUR TESTIMONY?**

12 A. Yes.
13
14