BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY
OF
CHARLES J. CICCHETTI, Ph.D.

PACIFIC ECONOMICS GROUP

DOCKET NO.

ON BEHALF OF

FLORIDA POWER CORPORATION

SECTION I: INTRODUCTION

Q. PLEASE STATE YOUR NAME, BUSINESS AND ADDRESS.

A. My name is Charles J. Cicchetti. My address is Pacific Economics Group, L.L.C. (PEG) 201 South Lake Street, Suite 400, Pasadena, California 91101.

Q. WHAT IS YOUR POSITION WITH PACIFIC ECONOMICS GROUP?

A. I am a Co-Founding Member of PEG.

Q. WHAT ARE YOUR DUTIES AS A MEMBER OF PEG?

A. I actively consult with clients on price, costs, environmental, natural gas and electricity market issues and antitrust policies, particularly as those policies relate to regulated industries.

Q. DO YOU HOLD ANY OTHER POSITIONS?

A. I hold the Jeffrey J. Miller Chair in Government, Business and the Economy at the University of Southern California.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I attended the United States Air Force Academy and I received a B.A. degree in Economics from Colorado College in 1965 and a Ph.D. degree in Economics from Rutgers University in 1969. From 1969 to 1972, I engaged in post-doctoral research on energy and environmental matters at Resources for the Future.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL EXPERIENCE.

A. I served as chief economist for the Environmental Defense Fund from 1972 to 1975, and was a faculty member at the University of Wisconsin from 1972 to 1985, ultimately earning the title of Professor of Economics and

Environmental Studies. From 1975 through 1976, I served as the Director of the Wisconsin Energy Office and as Special Energy Counselor for the Governor. In 1977, I was appointed by the Governor as Chairman of the Public Service Commission of Wisconsin and held that position until 1979, and served as a Commissioner until 1980. In 1980, I co-founded the Madison Consulting Group, which was sold to Marsh & McLennan Companies in 1984. In 1984, I was named Senior Vice President of National Economic Research Associates and held that position until 1987. From 1987 until 1990, I served as Deputy Director of the Energy and Environmental Policy Center at the John F. Kennedy School of Government at Harvard University, and from 1988 to 1992, I was a Managing Director and ultimately Co-Chairman of the economic and management consulting firm, Putnam, Hayes & Bartlett, Inc. In 1992, I formed Arthur Andersen Economic Consulting, a division of Arthur Andersen, LLP. In late 1996, I left Arthur Andersen to co-found Pacific Economics Group.

Q. HAVE YOU PUBLISHED ANY PAPERS OR ARTICLES?

A. Yes. I have published a number of articles on energy and environmental issues, public utility regulation, competition and antitrust. A complete listing of my publications is included in Exhibit (CJC-1).

Q. HAVE YOU EVER GIVEN EXPERT TESTIMONY IN A COURT OR ADMINISTRATIVE PROCEEDING?

A. Yes. A list of the proceedings in which I have provided expert testimony since 1980 is also included in Exhibit (CJC –1).

Q. HAVE YOU BEEN INVOLVED IN UTILITY MERGERS BEFORE?

A. Yes. I have been involved with electric utility mergers beginning at the time I was at Putnam, Hayes & Bartlett, as well as with Arthur Andersen and continuing at PEG. My involvement has included most financial and economic aspects of utility mergers, including providing financial and economic analysis and advice to Boards of Directors for investor-owned utilities, cooperatives, and municipally owned utilities with respect to various mergers and acquisitions that they were considering. I have helped negotiate and structure the terms of the deal in several transactions. I have also, on occasion, provided a fairness opinion on the transaction, assuming a role typically played by investment bankers.

I have often been called upon to provide a neutral second opinion for Boards of Directors and to consider other options, including stand alone options, when various utilities considered investment banker's recommendations. In so doing, I have considered and evaluated projected acquisition prices and developed independent synergy savings analyses.

In several cases, I presented regulatory testimony on these merger matters. I have also developed and proposed several regulatory plans designed to fairly share net synergy savings between customers and shareholders. I will describe these more fully in the next section.

Q. DO YOU HAVE ANY EXPERIENCE IN UTILITY RATE CASES?

A. Yes. I have substantial experience on most rate case matters from various sides of the issue. As I mentioned earlier, I was the Chairman of the

Wisconsin Public Service Commission from 1977 until 1979 and served as a commissioner through 1980. In that role, I chaired numerous rate cases filed by the various utilities operating in Wisconsin. Prior to serving on the Wisconsin Public Service Commission, I had testified in utility rate cases and rate design proceedings in nearly all the lower 48 states and several countries. I also testified before the Federal Power Commission and the Federal Communication Commission.

Since leaving the Commission and working as an independent consultant, I have testified numerous times in rate cases throughout the U.S. and Canada. I have testified on capital structure, cost-of-capital issues, electricity pricing and regulatory earnings sharing proposals in many states and other countries.

Q. WHO RETAINED YOU FOR THIS TESTIMONY?

A. Florida Power Corporation (FPC) retained me.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I am appearing at the request of FPC to address several matters related to FPC's recent acquisition by Progress Energy.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. In Section II, I present a regulatory sharing plan that I propose for FPC. There are three cornerstones to this plan. They are: (1) guaranteed rate relief and no downside risk to retail customers in Florida; (2) modifying the regulatory band for Return on Equity (ROE) to stimulate greater FPC and Progress Energy efforts at cost reduction and (3) progressive incentive-

based ratemaking to provide upside gains for retail customers for greater cost cutting and synergy improvements. I propose an earnings sharing mechanism (ESM) where the authorized ROE is set at 13.20%. This ROE is based on the analysis of Professor Vander Weide. A 100 basis point dead band will be established around either side of this ROE for general rate case purposes. FPC's allocated portion of the costs to achieve the merger will be recovered over 15 years from the gross synergy savings achieved by reflecting an after-tax amount for ratemaking and surveillance purposes. Customers will receive a guaranteed $75 million rate credit over this same time period. Additionally, under the ESM, customers will receive a portion of any earnings over the 14.20% dead band. Between 14.21% and 14.70%, customers will receive 80% of any excess earnings; between 14.71% and 15.20%, customers will receive 50% of any excess earnings; and customers will receive 20% of any excess earnings over 15.20%.

In Section III, I discuss the two primary stakeholders in this merger: the customers and shareholders. Here, I discuss why it is important for the FPSC to adopt a regulatory plan that strikes a fair balance between customer and shareholder interests. I explain that a fair, just and reasonable regulatory plan is necessary to avoid harming stakeholders. I explain how the plan FPC proposes strikes a reasonable balance between allowing shareholders a reasonable opportunity to recover the transaction costs associated with this merger if synergy savings can be achieved, while

guaranteeing customers an immediate rate credit, regardless of whether any synergy savings are achieved.

In Section IV, I analyze the gross synergy savings estimated for the Progress Energy transaction and demonstrate that they are statistically equal to the synergy estimates for thirty-eight other electric utility industry mergers. I show this through two separate analyses: through benchmarking with industry data, and using statistical estimation. Thus, I conclude that the projected synergy savings estimated by Progress Energy are reasonable.

In Section V, I discuss a statistical analysis of the price paid to acquire Florida Progress. I demonstrate that the predicted "price paid" is effectively statistically equal to the amount paid in the utility transactions contained in my database of energy utility company mergers. Thus, I conclude that the price paid to acquire Florida Progress was reasonable.

In Section VI, I present my overall conclusions and regulatory policy recommendations.

SECTION II: REGULATORY SHARING PLAN

Q. WHAT EXPERIENCE DO YOU HAVE IN DESIGNING AND PROPOSING SYNERGY SAVINGS PLANS FOR UTILITIES?

A. In various consulting assignments, I have been asked either to develop or to evaluate regulatory plans designed to share between shareholders and customers the savings related to utility mergers, industry restructuring, and innovative utility cost cutting programs.

Q. PLEASE DESCRIBE SOME EXAMPLES OF YOUR WORK ON SUCH REGULATORY PLANS FOR UTILITIES THAT MERGE.

A. I helped to develop and propose merger savings/sharing plans for the Western Resources/Kansas City Power & Light merger. I also helped develop and proposed the merger plan for the Western Resources/Public Service Company of New Mexico merger. I also analyzed and advised utilities on merger related synergy savings plans in Illinois, Iowa, Wisconsin, Michigan, Ohio and Pennsylvania. Finally, I advised several customer-owned and municipally-owned utility companies in Texas, Minnesota, Iowa and Georgia about merger synergies and savings plans.

Along with my colleagues at PEG, I have also developed a synergy database for merging utilities, which I will describe in detail later in this Testimony. This database has been used to benchmark and to estimate synergy savings in all of the above-mentioned states, as well as Indiana and Colorado.

Q. PLEASE DESCRIBE YOUR SYNERGY SAVINGS REGULATORY EXPERIENCE IN STATES UNDERGOING EITHER RESTRUCTURING OR SIGNIFICANT INNOVATIVE COST CUTTING.

A. I have been very much involved in developing and proposing regulatory sharing programs for Georgia Power Company's innovative approach to potential restructuring and cost cutting. In addition, I developed similar plans for Unicom and I have made similar proposals to other regulated businesses.

Q. ARE THERE SOME OVER-RIDING PRINCIPLES THAT HELP TO FOCUS THESE VARIOUS REGULATORY SHARING PROPOSALS?

A. Yes. My basic approach relies on three principles. The first principle is that the consumer benefits related to these various extraordinary utility efforts need to be identified and articulated. Some benefits can and should be quantified. For example, labor savings, and fuel and purchase power cost reductions are examples of these types of savings. Other benefits are not so readily quantified. These savings include achieving sufficient scale and scope economies that will enable the utility to meet increasing consumer needs and to survive as a viable entity in an increasingly more consolidated industry. Regardless, it is very important that the utility's goals, strategies and vision are clearly articulated to consumers and regulators.

The second principle is that few things, in economic terms, are "free." In fact, it is necessary to quantify any and all incremental transaction costs and transition costs. In effect, these represent the premium paid to achieve the gross benefits and savings related to this merger. This is an essential regulatory principle requiring that the costs of achieving or producing change be subtracted from, or netted against, the gross benefits. The net savings, or net synergy benefits, should be used as the basis for establishing a merger or restructuring related regulatory plan.

The third regulatory principle is that utilities should be provided with reasonable incentives to outperform or exceed their projections, plans and

regulatory expectations. Such incentive-based regulatory plans would and should yield additional net benefits for both consumers and shareholders.

These three principles have been central to the regulatory policies and programs that I have developed in various utility proceedings. In addition, I have also been very cognizant of "timing" and have used this particular factor to design regulatory sharing mechanisms. When I use the word "timing", I mean that sometimes it is advantageous for utilities to be granted significant "front end" shares of the savings so as to reduce future regulated prices. While I do not consider "timing", *per se,* to be a fourth regulatory principle, I recommend using approaches that front-load the savings and related cost recovery for shareholders because this can often cause concomitant greater retail consumer gains on the back end.

Q. HAVE YOU DEVELOPED A REGULATORY PLAN FOR FPC THAT REFLECTS THESE PRINCIPLES AND THEIR APPLICATION TO FLORIDA PROGRESS' RECENT ACQUISITION BY PROGRESS ENERGY?

A. Yes.

Q. WHAT DO YOU PROPOSE?

A. I begin with an attribute that is fundamental to the plan I propose. FPC is not asking that any transaction costs be put into rate base.[1] Rather, FPC is simply asking the FPSC to recognize that there are indeed costs associated with this merger, and that without those costs, the customer benefits that will materialize as a result of the merger would never have been available. Thus,

[1] I define transaction costs as the difference between Florida Progress' pre-merger price per share and the price paid by Progress Energy.

FPC is asking that the Commission net the costs to achieve the synergy savings against the gross synergy savings, and then allocate the net synergy savings between customers and shareholders. In fact, FPC is guaranteeing that customers will be better off than had the merger not taken place because, as I explain below, customers will receive an immediate rate credit under FPC's proposed plan. And in the longer term, customers will have the opportunity for additional savings once transaction costs have been recovered from the synergy savings.[2]

The critical point to remember is that this regulatory plan presents a way to split the net synergy savings between customers and shareholders in a manner that increases the incentives for FPC to achieve more potential savings for both customers and shareholders, a classic win-win situation. This regulatory plan has an additional benefit to the FPSC in that it does not require tracking merger savings, a task other jurisdictions find to be difficult, at best. Instead, FPC has made its best estimate of the net synergies to be gained and has guaranteed, through a rate credit, that customers will enjoy 50 percent of these net savings. The regulatory plan requires no further tracking of net synergy savings, which are treated just like any other earnings under the regulatory plan. I explain this in greater detail below.

[2] Thus, this plan conforms to the representations the companies made to FERC that customers would be held harmless from any negative effects should synergy savings not materialize as planned. To the contrary, FPC is guaranteeing that customers will be <u>better</u> off under the merger because it is offering customers rate credits regardless of its success in achieving synergy savings. This also satisfies the FERC criteria as set out in FERC's New Policy Statement (Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act; Policy Statement, 61 FR 58595 (12/30/96)).

Q. PLEASE DESCRIBE THE OTHER FACTORS THAT YOU CONSIDERED WHEN YOU DESIGNED THIS REGULATORY PROPOSAL. WILL YOU FIRST EXPLAIN HOW YOU DETERMINED FPC'S SHARE OF GROSS SYNERGY SAVINGS?

A. Table 1 summarizes the process by which I ascertained the net synergy savings available to share with customers.

TABLE 1

ANNUAL ADJUSTMENT	MILLIONS
Total Estimated Savings	$175.000
FPC share of savings	$58.700
Less amortized (15 yrs) merger related transition expense	($4.645)
FPC share of savings	$54.055
Less wholesale share (5.55%)	($3.000)
Less taxes at FPC's 38.575% tax rate	($19.694)
Retail After-Tax Synergies	$31.361
Less transaction costs	($25.310)
Net after-tax synergies	**$6.051**
Net pre-tax synergies	**$9.871**

I started with the total gross synergy savings estimated by the companies. The total merger related synergy savings have been estimated to be $175 million. The gross synergy savings associated with FPC are $58.7 million per year. From this amount, the merger-related transition costs of $4.645 million per year need to be deducted, reducing the annual FPC gross synergy savings to $54.055 million.[3] A further allocation is then necessary between retail and wholesale customers in Florida. The FPC retail/wholesale customer split is about 94.45%/5.55%. Applying the retail jurisdictional split

reduces the retail portion for FPC's gross synergy savings from $54.055 million per year to $51.055[4]. These gross retail synergy savings are then taxed at FPC's 38.575% tax rate, reducing the gross after-tax synergies to $31.361 million.

Q. ARE ALL THESE SAVINGS AVAILABLE FOR CUSTOMERS?

A. No. The cost necessary to accomplish these synergy savings first needs to be identified. Then this cost is allocated between CP&L and FPC, and between retail and wholesale customers using the cost allocation factors developed from FPC's pro rata share of synergies[5]. Then, this amount is netted against the gross savings.

Progress Energy paid an incremental amount equal to about $924.038 million[6] to purchase Florida Progress' equity. This is equal to the premium paid for Florida Progress' shares above its then pre-merger market value. Applying the 30.9% allocator I discussed above to these costs results in a transaction cost of $285.528 million being allocated to FPC. Applying the same 94.5%/5.5% split between retail and wholesale customers that I used

[3] $69.676 million ÷ 15 = $4.645 million per year. And, $58.700 million - $4.645 million = $54.055 million.
[4] $54.055 *.9445 = $51.055.
[5] The allocator is derived by dividing FPC's share of the synergy savings by the total estimated synergies. $54.055/$175 = 30.9%.
[6] $9.37 * 98,616,658 shares.

to allocate the savings between retail and wholesale customers, $269.824 needs to be recovered from the gross savings associated with FPC's retail business. I propose to spread this cost over 15 years at an after-tax interest rate of 4.607 percent based on Progress Energy's merger related debt, or a pre-tax 7.5% interest rate. The annual cost to recover $269.824 million over 15 years at 4.607 percent interest is $25.310 million.

Q. WHAT ARE THE ANNUAL "NET" UTILITY SYNERGY SAVINGS AVAILABLE TO BE SHARED BETWEEN FPC'S RETAIL CUSTOMERS AND SHAREHOLDERS?

A. FPC's retail allocated portion of the total pre-tax gross synergy savings estimate is $51.055 million per year. On an after-tax basis, the gross synergy equals $31.361 million. The annual cost to pay for this merger, allocated to FPC's retail customers over 15 years at a 4.607 percent after-tax interest rate is $25.310 million. The net utility synergy savings portion for FPC is the difference, or about $6.051 million after taxes, or $9.871 million in revenue requirements on a pre-tax basis. FPC proposes to grant customers an immediate rate credit equal to 50 percent of the estimated net synergy savings, rounded up to $5 million.

Q. WHAT IS YOUR SPECIFIC INCENTIVE BASED REGULATORY PROPOSAL FOR FPC?

A. I propose an earnings sharing mechanism (ESM) using the steps I outline below. These are:

1. The authorized ROE will be set at 13.20%, based upon the ROE recommended by Professor Vander Weide.

2. A 100 basis point dead band will be established around either side of this authorized ROE for general rate case purposes, which is consistent with the company's current rate order and consistent with what the Commission has done with the other Florida electric utilities.

3. The allocated Florida portion of the merger's transaction costs shall be recovered over 15 years, at an after-tax interest rate of 4.607% interest, and this amount annually will be netted against the "total" estimate of the allocated synergy savings to FPC's retail customers. In that FPC will recover the transaction costs at a set rate over 15 years, the company will bear the risk that the synergy savings will be sufficient to amortize FPC's portion of the transaction cost. The company is authorized to reflect an after-tax amount for ratemaking and regulatory surveillance of $25.310 million from the allocated gross portion of FPC's annual retail utility synergy savings of $31.361 million. This accounting is necessary to ensure that only net synergy savings associated with the merger are subject to the net earnings sharing mechanism described below.

4. In other jurisdictions, shareholders are often given 100 percent of the synergy savings for a set period (ranging from 3-7 years),

before customers share any of the net savings. In contrast, here FPC has proposed that customers be granted an immediate pre-tax rate credit totaling $5 million per year. This, in effect, guarantees that customers receive the first one half of the "net" estimated quantifiable savings associated with this merger each year, regardless of the company's success in achieving these savings. The company will provide this pre-tax rate credit whether or not any synergies are actually achieved, thus guaranteeing that customers receive a monetary benefit from this merger. This amounts to a guaranteed $75 million rate credit over the 15 years of FPC's proposed regulatory plan.

5. After achieving the savings required to pay down the transaction costs and fund the retail rate credit guarantee each year, any additional net savings would not be exempt from the surveillance reporting and would apply to calculating the company's ROE. This means that, because earnings achieved through cost cutting from the merger are treated like any other earnings, it is not necessary for the FPSC to "track" merger savings. After the $5 million guaranteed rate credits for customers, there is no requirement under FPC's proposal to segregate or "color code" synergy savings, a task that other jurisdictions have found next to impossible to accomplish as time goes on. Here, FPC is guaranteeing that customers receive an immediate 50 percent

share of the estimated synergy savings, whether or not FPC actually achieves any synergy savings at all. Any eligible earnings, from whatever source, above the 14.20% upper end of the proposed rate case dead band shall be shared between customers and shareholders in a way that maximizes the utility's incentives to achieve savings. It is fairly evident that the first savings are the easiest to achieve, hence, the advantage for customers of the one time retail customer guarantee. It becomes increasingly more difficult to squeeze more and more savings from cost cutting and efficiency improvements. Therefore, the following sharing mechanism is designed to encourage the company to maximize its cost cutting and other efficiency improvements.

- Between the 12.20% and 14.20% dead band, base rates will be frozen (after the $5 million rate decrease described above) and there will be no sharing of any net savings with customers, but additional savings will work in the consumers' favor by pushing up the ROE for surveillance and sharing purposes.
- Between 14.21% and 14.70%: customers receive 80% of the excess earnings and shareholders receive 20%;
- Between 14.71% and 15.20%: customers receive 50% of the excess earnings and shareholders receive 50%;

- Above 15.20%: customers receive 20% of the excess earnings and shareholders receive 80%.

Q. IS THE PLAN YOU ARE PROPOSING SIMILAR TO OTHER REGULATORY PLANS ADOPTED IN MERGER CASES?

A. It is quite similar to plans that have been adopted and that I have recommended for other utilities.

Q. YOUR REGULATORY PLAN ALLOWS FOR RECOVERY OF THE INCREMENTAL TRANSACTION COSTS OVER 15 YEARS. HOW DOES THIS COMPARE WITH REGULATORY PLANS IN OTHER JURISDICTIONS?

A. As I mentioned briefly above, in other jurisdictions, it is somewhat common to give shareholders 100 percent of the initial synergy savings for a shorter period of time, rather than institute some form of sharing immediately. In these fully front-end loaded regulatory plans, retail prices are often frozen for a set period (typically 3-7 years) during which shareholders capture all the synergy savings. When shorter terms (e.g., 3 years) are initially used, regulators can revisit the issues and extend the plan for a similar three-year time period. This full front-end loading is done to allow the companies an opportunity to recover the transaction costs associated with the merger.[7]

This initial price freeze is often followed by a sharing of the net synergy savings for some extended period of time on something like a 50/50 basis between shareholders and customers. See Exhibit CJC-2 for a

summary of recent merger orders that tend to follow this basic full front-end loading design. In this way, Commissions are recognizing that the costs to achieve the merger must be netted against the synergy benefits. Merging companies are effectively permitted to recover their transaction costs to encourage such beneficial mergers to continue occurring. In other words, the benefits and costs are netted. Commissions are sometimes explicit in so stating. More often, this intent to net gross benefits and costs is implicit in these orders.

There are some regulatory plans where transaction costs are spread out over as long a period as 40 years. Such a plan was approved by the Kansas Corporation Commission in the KPL/KGE merger.[8] In that case, an acquisition premium was actually put into rate base. However, this is not what FPC proposes here and such extended forty-year recovery periods are an exception.

In the plan I propose here, I have incorporated the best portions of various regulatory plans from around the country. Thus, the FPC plan guarantees immediate customer rate credits, offers incentives that encourage the company to achieve savings that would allow additional rate credits, and allows a reasonable period for the company to recover its transaction costs from synergy savings while not putting customers at risk. Customers will not be charged any merger related costs in excess of merger related synergies. Additionally, in the longer term, customers would enjoy

[7] The 15-year term of FPC's regulatory plan is also consistent with the 1993 revisions in the Federal Tax Act for amortizing, over fifteen years, the premium paid over book to acquire assets.

the opportunity to obtain substantial rate credits when the transaction costs have been fully recovered.

Q. HOW HAS THE FPSC TREATED MERGERS?

A. I have reviewed about 20 FPSC orders on mergers. The FPSC actively encourages mergers that benefit consumers. To that end, the FPSC has even allowed adjustments to rate base where it finds that "extraordinary circumstances exist.[9] Similarly, the FPSC has generally refused to reduce rate base when a troubled utility is acquired for less than book value. The rationale for these actions is similar: to encourage mergers that provide net benefits for consumers. This has long been the overarching goal behind the FPSC's actions.

The FPSC understands that to encourage mergers that offer net consumer benefits, a utility must have some incentive to take the time, incur the expense, and assume the risks inherent in putting together a merger or acquisition. That is why the FPSC has permitted rate base to be adjusted in extraordinary circumstances.

It is against this backdrop that the FPSC will undertake this rate case. Although the merger is a done deal, the FPSC must take care to fashion a

[8] 127 P.U.R. 4th 201 (1/15/91).

[9] For example, when FPC acquired Sebring Utilities (Sebring) at a cost above Sebring's book value the FPSC allowed a 15-year rider to Sebring's customers' rates to recover these above book costs. The FPSC noted this situation presented extraordinary circumstances and was not to be cited as precedent. However, my point is that the FPSC recognizes that it is important to encourage mergers that benefit consumers.

just and reasonable order in this rate case to fairly share net synergies between shareholders and customers. To do otherwise would harm shareholders immediately, and customers in the long run. In addition, such an outcome would have a chilling effect on future mergers. This would deny Florida consumers any potential benefits associated with such future mergers. Thus, although this merger has been completed, the rationale behind encouraging future mergers that will provide benefits to consumers requires just and reasonable regulatory treatment for netting transaction costs against merger savings. This is an extraordinary merger because customers benefit from the operational and financial benefits discussed later in my testimony and discussed in greater detail in Mr. Myers' testimony.

Q. HOW DOES THE FPSC TRADITIONALLY TREAT ACQUISITION ADJUSTMENTS?

A. The FPSC traditionally defines an acquisition adjustment as the difference in the price paid to acquire a company and the net book value of the company based on the original investment cost less depreciation.[10] This definition is more akin to what others often define as goodwill. Adding to the confusion, others often define an acquisition premium as the difference between the pre-merger price per share and price per share paid in the merger for the acquired utility. This is what I define as the transaction cost in this testimony to avoid confusion. In this case, transaction costs are the difference

[10] See, for example, South Waterfront Park Homeowners Assn., Docket No. 850460-WU; Order No. 15925, April 2, 1986.

between $54 per share and $44.67 per share, or $9.37 per share, plus incremental transition costs.

FPC is not seeking to recover "goodwill" through the net utility synergy savings. The "goodwill" is recorded, as required, on the parent's books, not at the subsidiary level. The amount of goodwill is far greater than the acquisition premium or transaction cost because goodwill includes the difference between FPC's pre-merger market value in excess of its book value, plus the transaction costs.

FPC is seeking to recover only the transaction costs incurred to pay for the future gross synergy benefits. These transaction costs equal the difference between the price paid for Florida Progress stock and the market price for that stock plus incremental transition costs. FPC proposes to recover these costs netted against the gross synergy savings. Accordingly, FPC proposes to give "net" utility synergy savings to retail customers in two forms: (1) An immediate retail rate credit; (2) Use additional savings for ratemaking and surveillance regulatory purposes through an ESM. In addition, after 15 years, the use of all savings would be reevaluated along with other factors to enable lower retail prices. Importantly, FPC is not proposing an acquisition adjustment be included in rate base, even though this merger falls under the parameters of the FPSC's definition of extraordinary circumstances.

Q. PLEASE REVIEW WHAT FPC IS PROPOSING TO DO WITH THIS TRANSACTION USING THESE VARIOUS REFERENCE TERMS.

A. FPC first proposes to allocate a portion of the total estimate of gross synergy savings ($175 million per year) to the retail portion of its utility business. As I showed in Table 1 above, this amounts to $51.005 million of gross utility pre-tax synergy savings per year after subtracting labor-related transition costs.

FPC recognizes that the base pre-merger market value portion of the transaction to acquire Florida Progress is equal to about $44.63 per share, or Florida Progress' pre-merger announcement fair market value (one day prior to the merger announcement). The difference between Florida Progress' book value (about $19 per share) and the pre-merger market price $44.63 per share, or some $25.63 per share times about 98,616,658 Florida Progress shares would make up a disproportionate share of what is generally called "goodwill" and what the FPSC traditionally defines as an acquisition adjustment. It is very important to understand that none of this difference between the pre-merger market value and Florida Progress' book value, or some $2.53 billion of the price paid to acquire Florida Progress is considered in FPC's regulatory plan or in its retail rates now or in the future.

Instead, the $9.37 per share difference between the pre-merger market value of $44.63 per share and the $54 per share times 98,616,658 shares paid to acquire the entire business is treated as the principal component ($924.038 million) of the merger's transaction costs. FPC seeks to recover its share of those transaction costs from its share of the gross utility synergy savings. This is not an acquisition adjustment as the FPSC has used that term. Instead, this is a principal component of a transaction

cost that it is necessary to pay to achieve the gross synergy savings benefits shared by the two utility companies. Importantly, FPC does not seek to change its rate base.

Q. WHAT CONSTITUTES EXTRAORDINARY CIRCUMSTANCES SUCH THAT THE FPSC WOULD INCLUDE THE ACQUISITION ADJUSTMENT IN RATE BASE?

A. The FPSC has allowed acquisition adjustments to be put in rate base in "extraordinary" circumstances. This actually increases rate base by the amount of the adjustment and raises the rates paid by customer. Again, this is not what FPC is proposing here. Rather, the transaction costs will not go into rate base and as I explained, retail rates will actually be credited immediately by $5 million per year even if FPC fails to achieve its synergy target. However, it is illustrative to examine FPSC precedent with respect to "extraordinary circumstances."

Often, but not always, these circumstances occur where a larger utility is taking over a financially troubled or inept utility. The FPSC has cited as evidence of extraordinary circumstances increased service quality, lowered operating costs, increased ability to attract capital for needed improvements, lower overall cost of capital, and more professional and experienced managerial, financial, technical and operational resources.[11]

In the past, when the FPSC has permitted what it called an acquisition adjustment, it rejected calls to reduce prices when the rate base of the utility

[11] See, for example, In Re Application of People's Gas System Inc. for a Rate increase, Docket No. 891353-GU; Order No. 23858, December 11, 1990.

exceeded the purchase price paid for a troubled utility. Here, the acquisition price was greater than FPC's rate base, and FPC is requesting only that the FPSC recognize the amount that was paid to secure gross synergies and to base its cost of service treatment on net utility synergy savings. To deny this amount of recovery would harm the parent company that took these beneficial steps. Furthermore, any regulatory consideration of more than the net savings would signal investors that Florida's utility companies should effectively be taken out of play. This result could increase the prices paid by customers of Florida's utilities and adversely affect service for Florida's retail customers for the reasons explained above in greater detail.

Q. ARE YOU SUGGESTING THAT THIS MERGER IS EXTRAORDINARY UNDER THE GUIDELINES SET FORTH BY THE FPSC?

A. Yes, I am. As is further discussed in Mr. Mark Myers' testimony, the Progress Energy merger offers extraordinary benefits and opportunities for both shareholders and customers. In addition to the estimated synergy savings, there are other benefits associated with the merger. The merger takes two strong medium-sized companies and combines them into a larger regional utility. The combined company will have an increased ability to offer a wider variety of energy related services to a broader customer base than was possible prior to the merger. This enhanced capability should improve investor confidence in the combined company. In turn, the combined company should be better able to attract and retain capital than was possible with the two smaller companies that existed prior to the merger. This should

enhance the company's long-term financing capabilities and support the growth objectives of Progress Energy.

Additionally, the combined company has a more balanced and diverse generation portfolio and customer mix. This will enable it to more readily manage and absorb the risk and volatility inherent in the increasingly competitive energy markets.

These non-monetized synergies benefit customers by improving the company's access to capital and could lead to lower overall financing costs, which could eventually lead to reduced revenue requirements and lower prices for customers. The generation diversity also reduces the company's (and customers') exposure to fuel price fluctuations and availability. Regardless, FPC is not requesting the same favorable treatment that the FPSC has given in other such extraordinary transactions (i.e., including goodwill or acquisition premium in rate base). All it asks for is a just and reasonable regulatory treatment of net synergy savings (i.e., a regulatory recognition of both benefits and costs).

Q. THE FPSC HAS STATED THAT ACQUISITION ADJUSTMENTS SHOULD NOT BE CONSIDERED IN STOCK TRANSFER CASES. DOES THIS HAVE ANY EFFECT ON YOUR PROPOSED REGULATORY PLAN?

A. No. The FPSC has indicated its position that acquisition adjustments are not appropriate in stock transfer cases because stock has no regulatory relationship to the established rate base.[12] Here, FPC is asking the FPSC

[12] See, for example, In Re Application of Rainbow Springs Utility, Docket No. 971195-WS; Order No. PSC-98-0593-FOF-WS; April 27, 1998.

to recognize that there are costs associated with achieving this merger and its concomitant benefits for customers. FPC seeks to have the FPSC net these transaction costs against the gross synergy savings before it allocates net benefits between shareholders and customers. FPC is also not asking for any increase in rate base. Therefore, my proposed rate plan is not inconsistent with FPSC precedent.

Q. AS A CONCEPTUAL MATTER, WHY DO YOU PROPOSE INCENTIVE REGULATION?

A. Incentive regulation is designed to emulate the behavior of competitive markets in which success has some upside and failure reduces income. This is sometimes called the “competitive market paradigm” for incentive plan design. Many regulators now seem to share this view.

Q. WHAT IS AN EARNINGS SHARING MECHANISM APPROACH TO INCENTIVE REGULATION?

A. Incentive regulatory plans can take many different forms. Earnings sharing mechanisms (ESMs) are one of the performance-based approaches used in the United States. Another common incentive method is price cap or rate freeze regulation. This approach is popular in the telephone industry and outside the United States.

Q. WHAT CAN BE SAID ABOUT EARNINGS SHARING MECHANISMS AS A FORM OF INCENTIVE REGULATION?

A. ESMs can strengthen performance incentives since shareholders may enjoy higher upside returns under this approach than under traditional regulation.

This focuses management's attention on cost cutting, efficiency, and other goals set by regulators to benefit consumers in both the short and longer run. ESMs also allow customers to share the benefits from this improved performance. By aligning the customers' interests with shareholders' interests, ESMs can contribute to regulatory stability and lengthen the time between traditional rate cases. Longer regulatory lags, in turn, improve incentives for superior performance.

It is useful to distinguish between ESMs and normal regulatory lag. The reason for this is that under cost of service regulation, prices are typically fixed between rate cases. Shareholders therefore retain all the benefits from improved cost cutting or revenue enhancement performance until the next rate case. This is commonly known as regulatory lag. Under earnings sharing, shareholders receive a proportion of these benefits and consumers also benefit. Typically, ESMs are established for a fixed time period, while regulatory lag is often uncertain. Therefore, the sharing concept is balanced against the fixed duration of the ESM.

Reasonable care must be taken in designing ESMs in order to balance the utility's incentives and customer benefits. The plan that I presented above has been crafted to fairly share savings between customers and shareholders, while retaining the incentive necessary for the company to maximize its savings. This plan is added to the rate case regulatory approach that FPC is proposing to continue.

Q. PLEASE SUMMARIZE THE CONCEPTS YOU USED TO DESIGN THE INCENTIVE BASED REGULATORY PLAN YOU PROPOSE.

A. I proposed a plan designed to closely mimic the incentives of a competitive market. FPC proposes to assume the risk associated with recovering the transaction costs associated with the merger at the parent level. At the same time, as I describe below, FPC is proposing an immediate rate credit of $5 million per year for retail consumers regardless of whether or not FPC achieves any of its projected net utility synergy savings. This, in effect, guarantees that customers receive the first, and easiest to achieve net utility synergy savings from this merger. Further, I propose a progressive incentive plan that will provide FPC with the incentive to aggressively pursue cost cutting measures by allowing them to keep a higher percentage of the earnings that result from these efforts. This will further benefit customers by making future rate cuts larger than they would likely have been, while increasing the likelihood of greater short-term rate relief.

Q. HOW DOES FPC'S PROPOSAL COMPARE TO OTHER ESMS CURRENTLY IN PLACE IN OTHER JURISDICTIONS?

A. FPC is proposing an ROE of 13.20 percent in its rate case and an ESM band of plus or minus 100 basis points (*i.e.*, 12.20 percent to 14.20 percent). This approach is sometimes described as a neutral zone of 200 basis points, which is well within the range of other similar ESM bands around the nation. For example, Georgia Power's recent ESM uses a 250 basis point neutral zone. Pacificorp's PBR plan in Oregon includes a 250 basis point dead band

above its benchmark ROE and a 500 basis point neutral zone *in toto*. Some neutral zones are substantially higher. For example, the ESM in Central Maine Power's plan has a 700 basis point neutral zone. The ESM for Boston Gas includes an 800 basis point neutral zone.

I have previously prepared a summary of recently approved ESMs for energy utilities. This survey is attached as Exhibit CJC–3, which shows that among active PBR plans featuring ESMs with bounded neutral zones on both sides of benchmark ROE, the average neutral zone was 379 basis points at the time I prepared my summary.

Q. HAS THE FPSC PREVIOUSLY AUTHORIZED REGULATORY PLANS CONTAINING ESMs AND REVENUE SHARING PLANS?

A. Yes. Southern Bell has an ESM. Southern Bell's neutral band is 80 basis points above and 70 basis points below its target ROE. Earnings that push its ROE between 80 basis points and 350 basis points above its target ROE are shared 60/40 between customers and shareholders. Earnings that push the ROE beyond 350 basis points over authorized ROE goes to customers.

Gulf Power has what is known as a revenue sharing plan. It has an authorized ROE of 11.5 percent with a 100 basis point neutral band above and below this authorized ROE (i.e., 10.5 percent – 12.5 percent). Revenue that results in an ROE between 12.5 percent and 14 percent is allocated between three "pots." One-third goes to customers, one-third goes to shareholders, and one-third goes to increase Gulf Power's insurance

reserve. The Commission has reserved jurisdiction to allocate revenue that pushes the ROE beyond 14 percent.

Florida Power & Light (FP&L) also has a revenue sharing plan. Under that plan, FP&L has an authorized ROE of 11 percent with a 100 basis point neutral band above and below that point (i.e., 10 percent – 12 percent). The order also establishes the sharing between customers and shareholders for revenues above 12 percent. Any revenue that falls within the first established tier will be shared one-third to shareholders and two-thirds to customers. Any revenue that falls above this tier is refunded to customers.[13]

Q. IN ADDITION TO BEING CONSISTENT WITH PRECEDENT, ARE THERE OTHER REASONS TO FAVOR AN ESM APPROACH.

A. The 200 basis point dead band that FPC proposes creates strong incentives to push earnings into ranges where shareholders and consumers will both benefit from greater cost cutting and other operating efficiencies. I propose an additional incentive plan as an addendum to the ESM dead band that would cause FPC to perform at a heightened performance level. Weaker

[13] The order states "For the first 12 months beginning with the Implementation Date, FPL's retail base rate revenues in excess of $3.400 billion up to $3.556 billion will be shared between FPL and its customers on a one-third/two-thirds basis, one third to be retained by FPL and two-thirds to be refunded to its customers. Retail base rate revenues above $3.556 billion for the first 12-month period will be refunded to FPL's customers." The second and third periods of the rate order follow the same formula, changing only the amounts of the retail base rate revenues.

incentives could discourage FPC from undertaking actions that increase earnings and benefit consumers now and in the future.

It takes great effort for well-managed utilities such as FPC and CP&L to achieve additional cost cutting savings. A progressive regulatory plan that rewards the company with a higher percentage of the hardest to achieve savings would accomplish this additional incentive. I recommend such an approach here because: (1) it encourages the utility to make the extra effort necessary to achieve these savings and perhaps, to exceed its projections; and, (2) it insures that customers enjoy a larger portion of the most easily attained savings now and, to the extent the company can exceed projections, allows consumers to enjoy additional current and higher future retail rate reductions than they would otherwise.

Further, the incentive plan I propose is more likely to replicate the disciplines and outcomes of competitive markets. Good service and improved efficiency are central to best business practices. The plan I propose for FPC is progressive (i.e., shareholders retain a higher percentage of the harder to achieve cost savings and customers retain a larger percentage of the easier to attain cost savings), so it is more consistent with efficient and sound incentive regulation principles.

SECTION III: THE STAKEHOLDERS

Q. WHO ARE THE STAKEHOLDERS IN THIS MERGER?

A. There are two primary stakeholders: customers and shareholders. This merger needs to be beneficial to both. This is a matter of both fairness and reasonableness.

Fairness and reasonableness mean that regulators should seek to capture some acceptable amount of net merger benefits for consumers, while providing an opportunity, although not necessarily a guarantee, to shareholders that they will be able to recover their incremental costs without suffering undue dilution in market value.

Q. HOW ARE RETAIL CUSTOMERS PROTECTED UNDER YOUR PROPOSED REGULATORY PLAN?

A. Under its proposed plan, FPC is not requesting that any of the debt incurred to acquire Florida Progress stock and for other transaction costs associated with the merger be included in retail rate base. Under the regulatory plan FPC proposes, this parent-held debt does not appear in the utility's capital structure. Instead, FPC asks only that its share of the costs incurred to complete the merger be netted against gross synergy savings. Further, with the guaranteed $75 million rate credit over fifteen years, customers will be better off than had FPC remained a stand-alone utility. Only the savings and synergies that FPC and other affiliates are able to squeeze from their operations as a result of the merger will be used to pay down this holding company debt. The costs associated with the merger will be paid off only to the extent that synergies are realized. Then, after costs have been netted against the synergies, synergy savings will be shared between shareholders

and customers. And, recall that FPC is committing to provide a $5 million pre-tax rate credit immediately, in effect guaranteeing that customers receive benefits from the merger. In fact, the proposed plan is one in which customers will enjoy an immediate rate credit and will have a very real opportunity to enjoy further rate credits under a progressive earnings sharing mechanism.

Q. IS IT IMPORTANT FOR FPC'S FINANCIAL WELL-BEING AND SHAREHOLDER HEALTH TO HAVE THE FPSC APPROVE A REGULATORY PLAN THAT BALANCES CUSTOMER AND SHAREHOLDER INTERESTS AS YOU HAVE?

A. Yes. Financial analysts will be watching closely the regulatory treatment that FPC receives in this rate case. Typically, merging companies are required to obtain state regulatory commission approval of the merger prior to consummating the deal. In those situations, regulatory sharing mechanisms are proposed and negotiated as part of the merger approval process. If a state commission wants concessions that the companies think are too expensive and will be dilutive to shareholders, they can back out of the deal. Such events are not unheard of.[14] In Florida, the FPSC has participated in discussions with FPC, but has not yet had the opportunity to review fully the merger, which has been consummated. Nevertheless, the company is not in a position to undo the deal if it does not get reasonable regulatory treatment

[14] For example, consider the recent proposed merger of PEPCO and BCE, where the Maryland Public Service Commission approved the merger but imposed conditions that were too onerous for the companies to live with and the deal died, despite having received regulatory approvals at the federal and several other state levels.

from the FPSC. Consequently, financial analysts will be watching this proceeding very closely and the FPSC, by following some "just and reasonable" principles, can craft a regulatory arrangement that is fair to all stakeholders and provides incentives to beat, not just achieve, expectations.

SECTION IV: SYNERGY SAVINGS

Q. WILL YOU REPEAT BRIEFLY WHY REGULATORS NEED TO DETERMINE THE REASONABLENESS OF PROJECTED SYNERGY SAVINGS?

A. Yes. Synergy savings are simply gross merger benefit estimates. Regulators need to establish that both the benefits and costs of a merger are reasonable in order to determine that any proposed "net sharing of synergy" is just and reasonable for rate making purposes.

Q. HAVE YOU MADE ANY NATIONAL COMPARISONS WITH THE $175 MILLION GROSS SYNERGY SAVINGS ESTIMATES MADE BY THE COMPANIES?

A. Yes. I have assembled a database for synergy savings and mergers. In assessing whether synergy savings estimates are reasonable, I generally rely on two methods. I typically use both a ratio method and a regression method to predict synergy savings based on the characteristics of the merging utilities. In the past, I have used this ratio method and regression analyses to serve as a check on or benchmark for the more complex and accurate synergy savings analyses, similar to the one performed by the companies here, and that I have completed in other merger proceedings.

Q. PLEASE DESCRIBE THE RATIO METHOD USED TO BENCHMARK SYNERGY ESTIMATES IN UTILITY MERGERS.

A. I first gather the synergy savings claimed in 38 previously announced electric and combination electric and natural gas mergers. I then analyze these claimed savings as percentages of various operating categories (kWh sales, operating expenses, revenues, customers, market capitalization, book capitalization and assets). For example, I calculate average annual claimed savings on a per 1000 kWh sold, per customer basis, and as a percent of total annual operating expenses and revenue. I also measure total claimed savings over a ten-year period as a percent of the total assets of the combined companies, and as a percent of total market and book capitalization.

Q. WHAT DO YOU DO WITH THESE RATIOS?

A. I calculate the high, low and mean gross synergy estimates for the 38 mergers. Attached, as Exhibit CJC-4 is a table that shows the various ratios I attained for benchmarking by applying various operational characteristics to the claimed synergy savings. I utilize the key ratios to calculate the savings the merged companies would need to attain to achieve the national mean. Here, the ratio analysis shows that, to achieve the mean, merger savings based on the previous mergers around the nation, the synergy savings would need to total about $1.682 billion over ten years, or about $168 million per year. It is very significant that the predicted savings levels for Progress Energy in all seven categories are close to the mean of the 38 mergers

considered. Exhibit CJC-5 shows the results of the ratio analysis when applied to the synergy savings estimated by the companies for this merger. Exhibit CJC-5 also shows the savings predicted for this merger by the ratio method. As can be readily seen by comparing Exhibits 4 and 5, the ratios for this merger do not vary significantly from the mean of the previous 38 recently announced mergers.

Q. PLEASE DESCRIBE THE SECOND BENCHMARKING METHOD -- YOUR REGRESSION ANALYSIS.

A. The regression analysis is a statistical analysis that is driven by key factors similar to the ones utilized in the ratio analysis. I prefer to think of this analysis as another approach to the same data. This means that it is not a second test. Instead, it is another methodology used to estimate synergy savings. Utilizing the same database from 38 previous mergers, the regression analysis predicts, using key explanatory variables for each of the merger candidates, what the merger savings would be in each case. The regression used has a high R-squared, suggesting that it is generally a strong predictive tool. I used this model to “predict” the savings claimed in recent mergers to demonstrate its accuracy. I have attached a table as Exhibit CJC-6 to demonstrate the regression model’s high success level. This schedule depicts how accurately the model predicts announced synergy savings levels.

Q. WHAT AMOUNT DOES THIS REGRESSION MODEL PREDICT FOR THE MERGER SAVINGS IN THIS CASE?

A. The predicted savings for this merger, using the regression analysis, are $1.54 billion over ten years, or $154 million per year.

Q. AFTER COMPLETING THESE ANALYSES, HAVE YOU REACHED ANY CONCLUSIONS REGARDING THE SYNERGY SAVINGS PREDICTED BY THE COMPANIES?

A. Yes. Both analyses show that, based on similar utility merger transactions across the nation, the companies' estimated synergy savings estimate is relatively close to the synergy savings predicted by both the ratio and regression methods. This should provide the FPSC with comfort that the projected synergy savings projections are reasonable when compared with synergy projections in other electric utility mergers.

SECTION V: REGULATORY ANALYSIS OF THE PRICE PAID TO ACQUIRE FLORIDA PROGRESS

Q. AGAIN, FOR COMPLETENESS OF THE RECORD, WILL YOU EXPLAIN THE REGULATORY RELEVANCE OF THE PRICE PAID TO ACQUIRE FPC?

A. Yes. Sharing "net" synergy savings is about subtracting the cost, or price, from the benefit. If too much is paid, the "net" value would decline. Therefore, regulators often review the price paid to ascertain that the "net" synergy sharing is just and reasonable for ratemaking purposes.

Q. ARE YOU FAMILIAR WITH THE TERMS OF THE MERGER THAT CREATED PROGRESS ENERGY?

A. Progress Energy acquired all the outstanding shares of Florida Progress common stock for a purchase price of approximately $5.3 billion. Pursuant to the Agreement and Plan of Exchange dated August 22, 1999 and revised and amended on March 6, 2000 (the Revised And Amended Exchange Agreement), Progress Energy acquired all of the issued and outstanding common stock of Florida Progress for a combination of cash and shares of Progress Energy common stock. Florida Progress shareholders could elect to receive $54 in cash for each outstanding share of Florida Progress common stock or a number of shares of Progress Energy common stock equal to the exchange ratio. This was subject to pro-ration in the event that Florida Progress shareholders elected to receive more than 65% of the total consideration for the exchange in cash or more than 35% of Progress Energy in stock.[15]

After completing the transaction described above, Progress Energy directly owned all the common stock of Florida Progress. FPC is a wholly owned subsidiary of Florida Progress.

Q. HAVE YOU ANALYZED THE AMOUNT PAID BY PROGRESS ENERGY TO ACQUIRE FLORIDA PROGRESS?

A. Yes. I find that the total transaction costs paid by Progress Energy for Florida Progress are reasonable. Here, the transaction costs include all the costs required to complete the merger, including the price paid to acquire

[15] Florida Progress shareholders also received one contingent value obligation (CVO) for each share of Florida Progress common stock they owned, representing the right to receive contingent payment based upon the net after-tax cash flow to Progress Energy generated by four synthetic fuel plants purchased by Florida Progress in October 1999.

Florida Progress stock. Unless these costs were incurred, the merger would not have been consummated, and the synergy savings and other benefits would not be realized. Merger analyses often begin by quantifying synergy or cost reductions. These savings are used to determine how much an acquirer could pay to merge without experiencing dilution in its respective market value. In addition to such cost-based synergies, there are other factors that I discussed above, not easily converted to monetary value, that would encourage firms to merge and could affect the acquisition premium the acquiring firm pays to the target firm's shareholders.

Q. WHAT ARE THE OTHER NON-MONETIZED FACTORS THAT GENERALLY COULD AFFECT UTILITY MERGERS?

A. These other factors include financial, corporate, and environmental matters. The financial reasons include several subcategories, such as the potential for different earnings growth potential, different dividend yields, and different risk profiles (Beta). The corporate reasons include factors such as gaining control of an entire company, not just existing shares representing partial ownership, repairing a troubled company, and preventing a hostile takeover. Environmental reasons include regulatory factors, strategic value, and defensive rationales. These factors are especially important in today's changing regulatory environment where states are moving towards a more competitive market place and the industry is rapidly consolidating and regulators, as well as management, seek to insure a viable utility service provider. I discussed these matters above.

Q. WHAT DATA DO YOU HAVE REGARDING THE PRICE PAID IN VARIOUS RECENTLY ANNOUNCED MERGERS IN THE ELECTRIC INDUSTRY?

A. Distinct from my synergy savings database, I have compiled a database for fifty recently announced mergers of energy utilities in the United States, where I compiled data from these mergers on the change in price of the target utility's stock before the merger and after it had been converted into stock of the acquiring utility. This change is the difference in the market price of the acquired utility prior to the date the merger is announced and made public and the price actually paid by the acquiring utility. These announced mergers are shown in Exhibit CJC-7.

Q. WHAT ADDITIONAL DATA DID YOU COLLECT REGARDING THESE MERGERS?

A. To test the significance on the prices paid to complete utility mergers, I also compiled data on the various synergy and non-synergy reasons to support a merger. These constitute 83 separate variables. These variables are shown in Exhibit CJC-8. In my experience, I find that it is important both to normalize transactions for size and other differences and to account for the various factors that determine and affect economic value.

Q. PLEASE EXPLAIN YOUR ANALYSES.

A. I performed numerous econometric tests to determine the statistically significant factors that explain variation in the price paid above the pre-merger market price to acquire energy utility companies. In addition, I was also interested in establishing econometric equations with relatively high

predictive power.

I often rely on day-ahead regression analyses to define the premium paid in the merger over the target company's pre-merger market value one-day prior. In this particular merger, a twenty-day average pre-merger market value was used to determine Florida Progress' exchange value. However, not all mergers use exactly the same terms. Therefore, I use a consistent one-day difference in per share prices across all mergers in my regression analysis. When I apply these regressions to Florida Progress and Progress Energy, I find that the actual price paid for Florida Progress is essentially statistically equal to the values that I would have forecasted from my regression analyses.

These regressions are shown in computer printout form in Exhibit CJC-9, along with the percent of prices paid over pre-merger per share values for the one-day models. The four regressions I used are presented in a more simplified form, with an explanation of the variables, in Exhibit CJC-10.

Q. HOW ACCURATE ARE THESE REGRESSIONS?

A. In past assignments, I have found that these regressions are very accurate. I have prepared four charts that show statistical plots of the actual premium offered or paid for the merger targets used to estimate the four regression models along with corresponding predictions from Equations 1 to 4, as shown in Exhibit CJC-10 for the one day ahead model. These charts are attached collectively as Exhibit CJC-11(a-d). I have found that these

regressions predict accurately the relative purchase prices paid in these mergers.

Q. DID YOU USE THESE REGRESSION EQUATIONS TO ESTIMATE THE PURCHASE PRICE THAT WOULD BE LIKELY TO BE PAID FOR FLORIDA PROGRESS?

A. Yes. I used the four regression equations to estimate Florida Progress' likely purchase price when Progress Energy was the acquiring company. These predictions are shown in exhibit CJC-9, page 1. Using Florida Progress' one day pre-merger per share market value of $44.63 as a starting point, the premium paid equals 20.99 percent. These four regressions predict a premium of 20.7. I conclude that the predicted price paid by Progress Energy, using other regulated utility mergers as a guide, is statistically indistinguishable from the price actually paid by Progress Energy for Florida Progress. No one who relies on market outcomes to produce competitive results when a well-informed seller confronts a well-informed buyer should be surprised by this outcome. In a competitive market, an acquirer or an individual shareholder will pay more than the market price per share for all the shares of virtually any investor-owned utility or any other company he/she buys in its entirety.

Q. WHAT DO THESE RESULTS DEMONSTRATE FOR REGULATORS?

A. Florida Progress received a fair price based upon other utility mergers. The price paid is used to determine transaction costs, which are subtracted from gross synergy savings to determine the "net" savings available for retail rate

credits. The FPSC can reasonably conclude that both the gross synergy and purchase prices have been established consistently with all other utility mergers in the nation.

SECTION VI: CONCLUSIONS

Q. PLEASE SUMMARIZE YOUR PRINCIPAL CONCLUSIONS.

A. First, I strongly recommend a specific regulatory plan that reflects the net benefits of the acquisition of Florida Progress by Progress Energy. Specifically, I recommend a plan that does two things:

(1) Provides an immediate retail customer credit worth $5 million per year, for a total guaranteed customer benefit totaling about $75 million over the life of the regulatory plan; and

(2) Modifies FPC's proposed regulatory band above the authorized ROE for additional sharing and incentives that would benefit retail customers in Florida.

Second, net benefits are the basis for regulatory sharing plans in utility mergers. In addition, there are non-monetized values in this merger, such as being able to improve retail customer service, terms of service, diversity of supply and demand, and attracting capital.

Third, the gross synergy savings projected from this merger are statistically similar to synergy estimates in thirty-eight other electric utility mergers.

Fourth, the price paid to acquire Florida Progress is essentially equal to statistically forecasted prices based upon the prices paid for other energy utilities in the United States.

Q. WHAT DO YOU RECOMMEND?

A. This is a good merger. It is important for the FPSC to adopt a regulatory plan that strikes a fair balance between customer and shareholder interests. The plan proposed by FPC does just this, striking a reasonable balance between allowing shareholders a reasonable opportunity to recover the transaction costs associated with this merger if synergy savings can be achieved, while guaranteeing customers an immediate rate credit, regardless of whether any synergy savings are achieved. I urge the FPSC to recognize that costs were required to bring about these benefits, and to net these costs against the estimated gross synergies. Accordingly, I recommend that the FPSC approve FPC's regulatory plan.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

Exhibit CJC-1

September 2001

CHARLES J. CICCHETTI

PROFESSIONAL EXPERIENCE

1998-present	Jeffrey J. Miller Professor in Government, Business, and the Economy, University of Southern California;
1996-present	Co-Founder, Pacific Economics Group;
1990-1997	Adjunct Professor of Economics, University of Southern California;
1992-1996	Managing Director, Arthur Andersen Economic Consulting;
1991-1992	Co-Chairman, Putnam, Hayes & Bartlett, Inc.;
1988-1991	Managing Director, Putnam, Hayes & Bartlett, Inc.;
1987-1990	Deputy Director, Energy and Environmental Policy Center, John F. Kennedy School of Government, Harvard University;
1984-1987	Senior Vice President, National Economic Research Associates;
1980-1984	Co-Founder and Partner, Madison Consulting Group;
1979-1986	Professor of Economics and Environmental Studies, University of Wisconsin-Madison;
1977-1979	Chairman, Public Service Commission of Wisconsin, Appointed by Governor Patrick J. Lucey (member until 1980);
1975-1976	Director, Wisconsin Energy Office and Special Energy Counselor for Governor Patrick J. Lucey, State of Wisconsin;
1974-1979	Associate Professor, Economics and Environmental Studies, University of Wisconsin-Madison;
1972-1974	Visiting Associate Professor, Economics and Environmental Studies, University of Wisconsin-Madison;
1972	Associate Lecturer, School of Natural Resources of the University of Michigan;
1969-1972	Resources for the Future, Washington, D.C.;
1969	Ph.D., Economics, Rutgers University;
1968-1969	Instructor, Rutgers University;
1965	B.A., Economics, Colorado College;
1961-1964	Attended United States Air Force Academy.

EDITORIAL BOARDS

Journal of Environmental Economics and Management;
Energy Systems and Policy, Former Member;
Land Economics, Former Editor.

ADVISORY BOARDS

Alliance for Energy Security;
Association of Environmental and Resource Economics, Executive Committee, Former Member;
Association of Environmental and Resource Economics, Contributing Members Program Committee;
California ISO MAG, Appointed by Governor Gray Davis;
Center for Public Policy Advisory Committee, Former Member;
Department of Energy, Fuel Oil Marketing Advisory Committee, Former Member;
Graduate School of Public Policy at the University of California, Berkeley;
Institute for the Study of Regulation;
National Association of Regulatory Utility Commissioners, Executive Committee and Chairman of the Ad Hoc Committee on the National Energy Act, Former Member;
New Century Land Renewals;
Public Interest Economics Center, Board of Directors, Former Member;
Rutgers University, Energy Research Advisory Board;
U.S. Chamber of Commerce Energy and Natural Resources Committee.

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Exhibit CJC-1

September 2001

CHARLES J. CICCHETTI

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"Transmission Products and Pricing: Hidden Agendas in the ISO/Transco Debate," with Colin M. Long, Public Utilities Fortnightly, Vol. 137, No. 12. June 15, 1999

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September 2001

CHARLES J. CICCHETTI

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Examples of Regulatory Plans

Jurisdiction	*Rate Freeze/Cap*	*Sharing of Net Savings Shareholder/Customer*	*Costs*	*Merging Companies*
Arkansas	5 years	New rate case in Year 6	50% of non-recovered A.P. included in rate base over 35 years	Utilicorp Empire
California	5 years	N/A	Amortized over 5 years	Sierra Pacific Washington Water
Colorado	30 month	Rate case after 2 years extend ESM to 2006	---	PS Colorado NSP
Connecticut	3 years	50/50 on earnings exceeding authorized ROE	---	Consolidated Edison Northeast Utilities
D.C.	4 years	25/75	---	Baltimore Gas & Electric Potomac Energy
Idaho	5 years	50/50 over authorized ROE	$47 million amortized over 5 years	Washington Water Sierra Pacific
Indiana	Base rates set for 8 years based on estimated synergies	45/55 of estimated synergies	Amortized over 8 years	AEP CSW
Kansas	4 years	---	$179.5 million straight line over 35 years	Western Resources KCP&L
Kentucky	New rate case in 5 years	50/50	$77 million amortized over 5 years	LGE KU

Jurisdiction	*Rate Freeze/Cap*	*Sharing of Net Savings Shareholder/Customer*	*Costs*	*Merging Companies*
Louisiana	5 years	60/40 on O&M savings		Entergy Gulf States
Michigan	4 years (after initial 2% rate reduction)	Company keeps all	---	Wisconsin Electric NSP
Nevada	3 years	New rate case after 3 years	Can recoup over 3 year rate freeze	Nevada Power Sierra Pacific
New Hampshire	33 month followed by $75 million rate decrease over 7 years	25/75	Subject to prudence review	PSNH ConEd
New Mexico	54 months	50/50	N/A	NCE NSP
North Carolina	5 years	$2 million rate reduction over 2 years	$495 million out of utility accounts	SCANA Public Service Company of North Carolina
Pennsylvania	6-1/2 years (3 year extension of current rate freeze)	N/A	$1 billion amortized over 6-1/2 years	GPU First Energy
Pennsylvania	Cap extended for total of 7-1/2 years	50/50 over authorized ROE	$160 million amortized over 7-1/2 years	Allegheny Duquesne
Washington	Gas rates frozen for 5 years, electric rates increased 4-6% over 4 years after 5.7% initial decrease	---	---	Puget Sound Washington Natural Gas

Exhibit CJC-3

Summary of Earnings Sharing Mechanisms in Approved PBR Plans

Jurisdiction	Company	Neutral Band			Customer Share up to Basis Points Above Target ROE [2]															
		Above Target	Below Target	Spread	25	50	75	100	125	150	175	200	225	250	275	300	350	400	450	500	500+
Plans with ESMs																				
Energy																				
CA	San Diego Gas & Electric	100	150	250	0%	0%	0%	0%	75%	75%	75%	50%	50%	50%	50%	50%	50%	50%	50%	50%
CA	Southern California Edison	50	50	100	0%	0%	*75%*	*75%*	*75%*	*50%*	*50%*	*25%*	*25%*	*25%*	*25%*	*0%*	0%	0%	0%	0%
CO	Public Service of Colorado	0	infinite	infinite	65%	65%	65%	65%	50%	50%	50%	50%	50%	50%	50%	50%	35%	35%	35%	100%	100%
CT	United Illuminating[1]	0	150	infinite	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%	33%
FL	Tampa Electric	25	infinite	infinite	0%	60%	60%	60%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
GA	Georgia Power	125	125	250	0%	0%	0%	0%	0%	66%	66%	66%	66%	66%	66%	66%	66%	66%	66%	66%	66%
ME	Central Maine Power	350	350	700	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	50%	50%	50%	50%
MO	Union Electric[3]	130	130	260	0%	0%	0%	0%	0%	50%	50%	50%	50%	50%	10%	10%	10%	10%	10%	100%	100%
OR	Pacificorp	250	250	500	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	25%	25%	25%	50%	50%	50%	50%
VA	Appalachian Power	0	infinite	infinite	66%	66%	66%	66%	66%	66%	66%	66%	66%	66%	66%	66%	66%	66%	66%	66%	66%
VA	Virginia Electric & Power[1]	0	infinite	infinite	66%	66%	66%	66%	66%	66%	66%	66%	66%	66%	100%	100%	100%	100%	100%	100%	100%
CA	Southern California Gas	25	175	infinite	0%	75%	65%	55%	45%	35%	25%	25%	15%	15%	5%	5%	0%	0%	0%	0%	0%
MA	Boston Gas	400	400	800	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	75%	75%
LA	Central Louisiana Electric	0	infinite	infinite	50%	50%	50%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
MI	SEMPCO Energy Gas	200	infinite	infinite	0%	0%	0%	0%	0%	0%	0%	0%	50%	50%	50%	50%	50%	50%	50%	50%	50%
MI	Michigan Consolidated Gas	200	infinite	infinite	0%	0%	0%	0%	0%	0%	0%	0%	50%	50%	50%	50%	50%	50%	50%	50%	50%
ME	Bangor Gas Company	335	infinite	infinite	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	0%	50%	50%	50%	50%	50%
LA	Entex	42	42	84	0%	50%	50%	50%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%
Telecommunications																				
KY	Cincinnati Bell	50	infinite	infinite	0%	0%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%
FL	Southern Bell	80	70	150	0%	0%	0%	60%	60%	60%	60%	60%	60%	60%	60%	60%	100%	100%	100%	100%	100%
NJ	Bell Atlantic	100	100	200	0%	0%	0%	0%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%
	Average of Active Plans with Known or Estimatable Target ROE	**117**	**na**	**na**	**13%**	**22%**	**28%**	**32%**	**41%**	**45%**	**45%**	**42%**	**47%**	**47%**	**47%**	**46%**	**49%**	**53%**	**53%**	**64%**	**64%**
	Average of 5 Active Plans with Bounded Neutral Zone	**163**	**167**	**329**	na	na	na	na	na	na	na	na	na	na	na	na	na	na	na	na	na
Kansas Proposals																				
Commission Staff		75	75	150	0%	0%	0%	40%	40%	40%	40%	60%	60%	60%	60%	60%	80%	80%	80%	80%	80%
Joint Applicants - Grid 1		125	125	250	0%	0%	0%	0%	0%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%	50%
Joint Applicants - Grid 2		125	125	250	0%	0%	0%	0%	0%	50%	50%	40%	40%	40%	40%	40%	40%	40%	40%	40%	40%
Joint Applicants - Grid 3		125	125	250	0%	0%	0%	0%	0%	50%	50%	40%	40%	30%	30%	30%	30%	30%	30%	30%	30%
Joint Applicants - Grid 4		125	125	250	0%	0%	0%	0%	0%	50%	50%	40%	40%	30%	30%	20%	20%	20%	20%	20%	20%

[1] Each of these plans has some amount of extra earnings going toward a writedown of regulatory assets or stranded cost.

[2] Italics indicates that the endpoints of the sharing region were known but the intermediate points were imputed.

[3] The target ROE was assumed to be at the middle of the sharing region

Exhibit CJC-4

Merger Benefits Analysis
Comparison of Claimed or Estimated Savings to Combined Operating Statistics

Merger	Average Annual Savings (Thousands)	Per 1000kWh Sold	Annual Savings as Percent of: Annual Operating Expenses	Annual Revenue	Per Customer	Ten Year Savings as Percent of: Total Assets	Market Capitalization	Book Capitalization
Cleveland Illuminating Toledo Edison	$79,100	$2.19	2.8%	2.4%	$46.53	8.7%	21.7%	46.5%
Southern Savannah	$75,000	$0.60	1.2%	1.0%	$24.19	3.6%	11.9%	10.6%
PacifiCorp Utah P&L	$101,000	$2.35	2.3%	3.4%	$74.14	11.2%	31.6%	33.7%
SDG&E SCE	$170,000	$1.58	2.7%	2.3%	$30.91	9.1%	19.8%	22.7%
KGE KCP&L	$17,000	$0.89	1.9%	1.4%	$26.15	3.3%	11.4%	11.7%
Iowa RES Midwest	$50,000	$4.76	6.3%	5.0%	$66.67	21.7%	55.6%	76.9%
NEU PSNH	$90,000	$3.13	6.7%	5.0%	$90.00	11.5%	38.3%	32.1%
KP&L KG&E	$28,000	$1.56	2.0%	1.8%	$18.06	6.4%	17.5%	20.0%
Iowa Southern Iowa Electric	$16,000	$2.13	3.2%	3.3%	$29.09	12.3%	25.0%	33.7%
Gulf States Entergy	$169,500	$1.84	3.9%	3.0%	$70.63	8.1%	24.6%	24.2%
CG&E PSI	$150,000	$3.13	6.8%	5.8%	$93.75	22.4%	48.4%	68.2%
PSI IPALCO	$150,000	$3.85	1.1%	0.8%	$150.00	37.5%	55.6%	107.1%
Central Southwest El Paso Electric	$38,500	$0.64	1.2%	1.0%	$21.39	3.4%	6.2%	14.3%
Washington Water Sierra Pacific	$45,000	$2.81	5.0%	4.1%	$56.25	13.20%	34.6%	40.9%
Iowa Illinois G&E Midwest Resources	$16,000	$2.13	3.2%	3.3%	$29.09	12.30%	25.0%	33.7%

Exhibit CJC-4

Merger	Average Annual Savings (Thousands)	Per 1000kWh Sold	Annual Savings as Percent of: Annual Operating Expenses	Annual Revenue	Per Customer	Ten Year Savings as Percent of: Total Assets	Market Capitalization	Book Capitalization
Union Electric CIPSCO	$57,000	$1.43	2.5%	2.0%	$35.63	6.8%	12.4%	19.7%
WPL IES Interstate	$75,000	$2.78	4.4%	4.0%	$62.50	17.9%	41.7%	53.6%
Northern States Power Wisconsin Energy	$200,000	$3.45	5.4%	4.8%	$64.51	20.0%	33.3%	55.6%
Baltimore Gas Potomac Electric	$130,000	$2.20	3.4%	2.8%	$54.17	8.6%	20.0%	29.6%
PECO PPL	$200,000	$2.33	4.0%	2.9%	$64.52	8.3%	22.0%	29.4%
SPS PSCo	$77,000	$1.75	3.1%	2.8%	$32.08	12.8%	24.1%	40.5%
KCP&L Utilicorp	$63,600	$2.36	0.7%	0.7%	$37.41	7.6%	20.5%	30.3%
Western Resources KCP&L	$95,000	$2.38	3.7%	3.3%	$95.00	8.7%	21.6%	33.9%
Centerior Ohio Edison	$100,000	$1.54	2.6%	2.0%	$47.62	5.3%	22.7%	22.2%
Atlantic Energy Delmarva	$50,000	$2.36	2.9%	2.4%	$50.00	8.8%	22.7%	28.9%
DQE Allegheny	$100,000	$1.32	3.3%	2.9%	$50.00	9.0%	17.2%	27.8%
LG&E KU	$76,000	$2.33	1.9%	1.8%	$71.02	16.2%	27.1%	52.2%
AEP CSW	$200,000	$0.98	2.2%	1.8%	$43.48	6.9%	13.3%	24.4%
Boston Edison Commonwealth Energy	$50,000	$2.06	2.2%	1.8%	$39.78	9.8%	27.7%	35.3%
Nevada Power Sierra Pacific	$50,000	$2.34	4.2%	3.3%	$55.56	11.9%	22.7%	33.3%
ConEd Orange & Rockland	$46,800	$0.87	0.7%	0.6%	$10.64	3.0%	3.9%	7.3%

Exhibit CJC-4

Merger		Average Annual Savings (Thousands)	Per 1000kWh Sold	Annual Savings as Percent of: Annual Operating Expenses	Annual Revenue	Per Customer	Ten Year Savings as Percent of: Total Assets	Market Capitalization	Book Capitalization
ConEd NEU		$150,000	$1.64	1.6%	1.3%	$26.32	6.1%	11.5%	18.8%
Sierra Pacific Portland Gen		$42,000	$1.56	3.0%	2.4%	$38.18	7.8%	18.3%	26.3%
PECO Unicom		$111,000	$0.64	1.0%	0.9%	$20.56	2.9%	7.6%	13.9%
NCE NSP		$110,000	$1.17	2.0%	1.7%	$23.91	7.3%	11.3%	21.6%
FPL Entergy		$150,000	$0.78	1.1%	1.0%	$23.81	4.1%	9.4%	12.5%
First Energy GPU		$150,000	$1.25	1.7%	1.4%	$37.50	3.8%	13.6%	16.7%
RGS Energy East		$50,000	$1.52	1.7%	1.4%	$42.55	7.9%	13.9%	25.0%
	High	$200,000	$4.76	6.8%	5.8%	$150.00	37.5%	55.6%	107.1%
	Low	$16,000	$0.60	0.7%	0.6%	$10.64	2.9%	3.9%	7.3%
	Mean	$92,855	$1.96	2.9%	2.5%	$48.78	10.2%	22.8%	32.5%

CPL / FLA Progress

	kWh	Operating Expenses	Revenue	Customers
CPL	55,000,000	2,500,000,000	3,100,000,000	1,200,000
FLA Progress	37,000,000	3,100,000,000	3,600,000,000	1,300,000
Total	92,000,000	5,600,000,000	6,700,000,000	2,500,000

	Assets	Market Capitalization	Book Capitalization
CPL	8,300,000,000	6,700,000,000	2,900,000,000
FLA Progress	6,100,000,000	4,100,000,000	1,900,000,000
Total	14,400,000,000	10,800,000,000	4,800,000,000

1) kWh:	175,000,000	/	92,000,000	=	$ 1.90
2) Exp:	175,000,000	/	5,600,000,000	=	3.13%
3) Rev:	175,000,000	/	6,700,000,000	=	2.61%
4) Cust:	175,000,000	/	2,500,000	=	$ 70.00
5) Assets:	1,750,000,000	/	14,400,000,000	=	12.15%
6) Mkt:	1,750,000,000	/	10,800,000,000	=	16.20%
7) Book:	1,750,000,000	/	4,800,000,000	=	36.46%
1) kWh:	180,320,000	/	92,000,000	=	$ 1.96
2) Exp:	162,400,000	/	5,600,000,000	=	2.90%
3) Rev:	167,500,000	/	6,700,000,000	=	2.50%
4) Cust:	121,950,000	/	2,500,000	=	$ 48.78
5) Assets:	142,800,000	/	14,000,000,000	=	10.20%
6) Mkt:	246,240,000	/	10,800,000,000	=	22.80%
7) Book:	156,000,000	/	4,800,000,000	=	32.50%

Average Annual: $ 168,172,857
Total Ten Years: $ 1,681,728,571

Exhibit CJC-6

	MERGER	KWH	ANNEXP	TSVNGS	YEAR	Forecasted Savings Over 10 Years
1	TOLEDO/CLEVE	24800000	1350000000	900000000	85	$837,986,903.00
2	SOUTHERN/SAV	125000000	6100000000	750000000	87	$2,459,969,280.00
3	UTAH/PACIFCORP	43000000	2400000000	1010000000	87	$1,080,693,650.00
4	SDGE/SCE	78000000	6100000000	1700000000	88	$1,571,329,110.00
5	KGE/KCP&L	19200000	900000000	170000000	90	$610,675,962.00
6	IOWA/MIDWEST	10500000	800000000	500000000	90	$454,660,645.00
7	NEU/PSNH	36000000	2800000000	791000000	90	$855,485,000.00
8	KP&L/KGE	18000000	1400000000	280000000	90	$572,161,000.00
9	IOWA SOUTH/IOWA ELECT	6900000	540000000	160000000	91	$369,405,571.00
10	GULF STATES/ENTERGY	91400000	4400000000	1695000000	92	$1,761,242,434.00
11	PSI/CGE	48000000	2300000000	1500000000	92	$1,035,923,070.00
12	PSI/IPALCO	38000000	1400000000	1500000000	93	$854,635,100.00
13	CSW/ELPASO	60000000	3200000000	385000000	93	$1,197,979,660.00
14	SIERRA PAC/WASH WATER	16000000	900000000	450000000	94	$440,359,530.00
15	IOWA ILL/MIDWEST RES	18700000	1500000000	500000000	94	$469,957,437.00
16	CIPSCO/UNION ELECTRIC	40000000	2300000000	570000000	95	$805,632,890.00
17	WPL/IES/INTERSTATE	26400000	1700000000	750000000	95	$576,423,174.00
18	NSP/WEC	67000000	3700000000	2000000000	95	$1,253,773,980.00
19	BALT GAS/POTOMAC	59000000	3800000000	1300000000	95	$1,103,962,030.00
20	PECO/PPL	86000000	5000000000	2000000000	95	$1,558,718,860.00
21	SPS/PSCO	44000000	2500000000	770000000	95	$872,269,190.00
22	KCPL/UTILICORP	27000000	3300000000	636000000	96	$506,556,360.00
23	WESTERN/KCPL	40000000	2600000000	950000000	96	$767,780,580.00
24	CENTERIOR/OHIO ED	62000000	3800000000	1000000000	96	$1,130,972,360.00
25	ATLANTIC/DELMARVA	20400000	1600000000	500000000	96	$441,924,284.00
26	DQE/ALLEGHENY	75700000	3000000000	1000000000	97	$1,380,394,857.00
27	LGE/KU	32600000	4000000000	760000000	97	$558,025,426.00
28	AEP/CSW	195000000	9200000000	2000000000	97	$3,360,049,010.00
29	BOSTON ED/COMMONWEAL	26000000	2500000000	500000000	98	$458,848,910.00
30	NEV PWR/SIERRA PAC	22300000	1200000000	500000000	98	$434,093,083.00
31	CON ED/ORANGE & ROCK	54000000	6600000000	468000000	98	$835,990,520.00
32	CON ED/NEU	91000000	9500000000	1500000000	98	$1,417,643,660.00
33	SIERRA PAC/PORTLAND	27000000	1400000000	420000000	99	$485,619,790.00
34	PECO/UNICOM	173000000	10300000000	1110000000	99	$2,864,918,820.00
35	NCE/NSP	94000000	5500000000	1100000000	99	$1,576,968,790.00
36	FPL/ENTERGY	193000000	14000000000	1500000000	99	$3,108,787,830.00
37	FIRST ENERGY/GPU	120000000	9000000000	1500000000	0	$1,909,402,900.00
38	ENERGY EAST/RGS	33000000	3000000000	500000000	1	$486,714,530.00
A	CPL/FLORIDA PROG	92000000	5600000000	1000000000	99	$1,537,034,900.00

Model Specification: $TSVNGS = \beta_0 + \beta_1 KWH + \beta_2 ANNEXP + \beta_3 YEAR$ (model excludes KWH outliers)

Order	Target / Acquirer	Announcement Date
1	Toledo Edison / Cleveland Electric	6/25/1985
2	Savannah / Southern	11/2/1987
3	Utah Power and Light / Pacificorp	8/13/1987
4	San Diego Gas & Electric / Southern California Edison	7/26/1988
5	Iowa Resources / Midwest Energy	3/16/1990
6	Kansas Gas & Electric / Kansas City Power and Light	7/23/1990
7	Kansas Gas & Electric / Kansas Power & Light	10/29/1990
8	Iowa Southern / IE Industries	2/28/1991
9	Gulf States / Entergy	6/8/1992
10	PSI / Cincinnati Gas & Electric	12/14/1992
11	El Paso Electric / Central Southwest	5/5/1993
12	PSI / IPALCO	3/15/1993
13	Iowa-Illinois Gas & Electric / Midwest Resources	7/27/1994
14	Sierra Pacific / Washington Water Power	6/29/1994
15	CIPSCO / Union Electric	8/14/1995
16	IES / WPL	1/1/1995
17	Interstate / WPL	1/1/1995
18	Northern States Power / Wisconsin Energy	5/1/1995
19	Potomac / Baltimore Gas & Electric	9/25/1995
20	PP&L Resources / PECO	8/14/1995
21	Southwestern Pubic Service / PS of Colorado	8/23/1995
22	Washington Energy / Puget Sound Power & Light	10/18/1995
23	Centerior Energy / Ohio Edison	5/31/1996
24	Enserch / Texas Utilities	4/15/1996
25	Kansas City Power and Light / Utilicorp	1/22/1996
26	Pacific Enterprises / Enova	10/15/1996
27	Sierra Pacific / Nevada Power Co.	4/30/1998
28	Commonwealth Energy / Boston Edison	12/7/1998
29	DQE / Allegheny	4/7/1997
30	KU / LG&E	5/21/1997
31	Central Southwest / American Electric Power	12/22/1997
32	Atlantic Energy / Delmarva Power & Light	8/12/1996
33	Consolidated Natural Gas / Dominion Resources	2/22/1999
34	ESELCO / WEC	3/25/1997
35	Upper Peninsula Power Co.(UPPCO) / WPS	7/7/1997
36	Kansas City Power and Light / Western Resources	4/13/1996
37	Orange & Rockland / Consolidated Edison	5/11/1998
38	Northern States Power / New Century Energies	3/25/1999
39	Columbia Energy Group / Nisource	6/7/1999
40	Indiana Energy / SIGCORP	6/14/1999
41	Illinova / Dynegy*	6/14/1999
42	Yankee Energy System / Northeast Utilities	6/15/1999
43	WICOR / Wisconsin Energy Corp	6/28/1999
44	Florida Progress Corp / Carolina P&L	8/23/1999
45	PECO / Unicom	9/23/1999
46	MCN Energy Grp / DTE Energy Co	10/5/1999
47	Northeast Utilities / Consolidated Edison	10/13/1999
48	Entergy / FPL	7/31/2000
49	GPU / First Energy	8/8/2000
50	RGS Energy Grp / Energy East	2/20/2001

** Not used in the regression analysis.*

List of Variables

Variable Symbol	Variable Definition
AASSCUST	Acquiror Assets per Customer
AASSETS	Acquiror Assets
ABETA	Acquiror Beta Statistic
ABOOK	Acquiror Book Value
ACQ_PREM	Acquisition Premium, Day Ahead
ACQPREMM	Acquisition Premium, Thirty Days Ahead
ACUST	Acquiror Number of Customers
ADIVPO	Acquiror Dividend Payout Ratio for the
ADIVYLD	Acquiror Dividend Yield
AEPS	Acquiror Earnings per Share
AEPSGR	Acquiror EPS Growth (1+%)
AEPSP	Acquiror Earnings per Share - Prev. yr
AEXP	Acquiror Total Operating Expenses
AEXPKWH	Acquiror Expenses per kWh
AKCOST	Acquiror Cost of Capital
AKWH	Acquiror kWh Sales
AMARBK	Acquiror Market to Book Ratio
AMARKET	Acquiror Market Value
APE	Acquiror PE Ratio
APR	Acquiror Stock Price
AREV	Acquiror Revenue
AREVKWH	Acquiror Revenue per kWh
CASSETS	Combined Company Assets
CBOOK	Combined Company Book Value
CCOST	Total Cost of the Merger
CCUST	Combined Number of Customers
CEXP	Combined Total Operating Expenses
CKWH	Combined kWh Sales
CMARKBK	Combined Market to Book Ratio
CMARKET	Combined Market Value
CONTROL	Control Premium Paid to Target
CREV	Combined Revenue
CSAVING	Predicted Savings for the Merger
DIVRATIO	Ratio of Targ Div Yield to Acq Div Yld
DJIA	Dow Jones Industrial Average
DJUI	Dow Jones Utilities Index
EPS_EXCH	Ratio of T & A EPS*EPS Growth
FIN_EXCH	EPS_EXCH over Stock Price Ratio
GAS	Target is a Gas Company
HOSTILE	Merger is a Hostile Takeover
NOTRBLE	0=Troubled, 1=Not Troubled
NOTRBLE2	1=Troubled, 2=Not Troubled
ORDER	Observation Number
RATES	Ratio of Targ Rev/kWh to Acq Rev/kWh
RSKFREE	Risk Free Rate - 30 Year Government Bond
RSKMKT	Market Risk - NYSE Composite Index
SAVASS	Ratio of Combined Sav to Comb. Assets
SAVBOOK	Ratio of Comb. Sav to Comb. Book Val
SAVCUST	Annual Savings over Comb. Customers
SAVEXP	Annual Savings over Comb. Expenses

List of Variables (cont...)

SAVKWH	Annual Savings over Comb. kWh
SAVMKT	Ratio of Comb. Sav to Comb. Mkt Val
SAVREV	Annual Savings over Comb. Revenue
SIZASSET	Ratio of Targ Assets to Acq Assets
SIZECUST	Ratio of Target Cust to Acquiror Cust
SIZEKWH	Ratio of Target kWh to Acquiror kWh
SIZEREV	Ratio of Target Rev to Acquiror Rev
TASSCUST	Target Assets per Customer
TASSETS	Target Company Assets
TBETA	Target Beta Statistic
TBOOK	Target Book Value
TCUST	Target Number of Customers
TDIVPO	Target Dividend Payout Ratio
TDIVYLD	Target Dividend Yield
TEPS	Target Earnings per Share
TEPSGR	Target EPS Growth (1+%)
TEPSP	Target Earnings per Share -Prev. yr.
TEXP	Target Total Operating Expenses
TEXPKWH	Target Expenses per kWh
TKCOST	Target Cost of Capital
TKWH	Target kWh Sales
TMARKBK	Target Market to Book Ratio
TMARKET	Target Market Value
TPE	Target PE Ratio
TPR	Target Stock Price
TREV	Target Revenue
TREVKWH	Target Revenue per kWh
TROUBLE	0=Not Troubled Merger, 1=Trouble
TROUBLE2	1=Not Troubled Merger, 2=Trouble
TSMRBK	Comb. Mkt/Book*NOTRBLE2
VAL_EXCH	Exchange Ratio from EPS, EPSgr, Kcost
YEAR	Year
YEARSAV	Combined Savings Divided by 10
YEARTEST	YEAR-85

Summary Sheet

One Day Ahead

Percent Per Share Premium Over Pre Merger Market Value	
Model 1	20.9%
Model 2	20.8%
Model 3	20.5%
Model 4	20.7%
Average	20.7%

REGRESSION #1

	Estimated Coefficients	Merger Data
Intercept	0.30628	1.000
DIVRATIO	-0.18946	1.136
(VALEXCHS/(TPR/APR))	7.36041E-003	1.135
SAVMKT	0.09105	0.098
HOSTILE	5.78267E-002	0.000
(TROUBLE*SIZEKWH)	0.18829	0.000
(CONTROL*DIVRATIO)	0.10894	1.136
(CONTROL*SAVMKT)	-0.23751	0.098
ACQ_PREM		20.9%

REGRESSION #2

	Estimated Coefficients	Merger Data
Intercept	0.30178	1.000
DIVRATIO	-0.17767	1.136
VALEXCHS	2.53151E-003	1.299
SAVMKT	0.08272	0.098
HOSTILE	5.93313E-002	0.000
(TROUBLE*SIZEKWH)	0.18499	0.000
(CONTROL*DIVRATIO)	0.10139	1.136
(CONTROL*SAVMKT)	-0.18871	0.098
ACQ_PREM		20.8%

REGRESSION #3

	Estimated Coefficients	Merger Data
Intercept	0.17085	1.000
DIVRATIO	-0.20076	1.136
FIN_EXCH	2.72970E-002	0.957
(TBETA/ABETA)	0.09018	0.750
SAVMKT	0.15661	0.098
HOSTILE	1.87043E-002	0.000
RATES	6.05023E-005	1.237
(TROUBLE*SIZEKWH)	0.20576	0.000
(CONTROL*DIVRATIO)	0.16430	1.136
(CONTROL*SAVMKT)	-0.33871	0.098
ACQ_PREM		20.5%

REGRESSION #4

	Estimated Coefficients	Merger Data
Intercept	0.18824	1.000
DIVRATIO	-0.17432	1.136
EPS_EXCH	7.94969E-003	1.095
(TBETA/ABETA)	0.06472	0.750
SAVMKT	0.15157	0.098
HOSTILE	3.11429E-002	0.000
RATES	6.52033E-005	1.237
(TROUBLE*SIZEKWH)	0.19289	0.000
(CONTROL*DIVRATIO)	0.14408	1.136
(CONTROL*SAVMKT)	-0.19163	0.098
ACQ_PREM		20.7%

Variable Inputs for Forecasting		Data for 8/20/99
	Florida Progress	CPL
DIVRATIO		1.136
Div Yield	5	4.4
VAL_EXCH/(TPR/APR)		1.135
VAL_EXCH		1.299
EPS	2.9	2.75
EPS Growth	0.09	0.05
BETA	0.45	0.6
30 yr bond	0.0599	0.0599
S&P 500	0.2283	0.2283
FIN_EXCH		0.957
EPS	2.9	2.75
EPS Growth	0.09	0.05
Prices	44.63	39
EPS_EXCH		1.095
EPS	2.9	2.75
EPS Growth	0.09	0.05
TBETA/ABETA		0.750
BETA	0.45	0.6
SAVMKT		0.0976
SAVINGS	-	1,000,000,000
Market Value	4,344,142,544	5,902,162,617
Shares	97,336,826	151,337,503
Book Value/Share	$ 19.13	$ 19.49
RATES		1.237
Electric Revenue	2,648,200,000	3,130,045,000
KWh	37,251,100,000	54,476,000,000
Dummies		
TROUBLE	0	
CONTROL	1	
HOSTILE	0	
GAS	0	
SizeKWh	0.683807548	
(TROUBLE*SIZEKWH)	0	
(CONTROL*DIVRATIO)	1.136363636	
(CONTROL*SAVMKT)	0.10	

The Four Least Square Regressions

Equation 1

Acquisition Premium depends upon:

$$(1)\ \frac{\text{Target Dividend Yield}}{\text{Acquirer Dividend Yield}}$$

This variable has a negative sign, which means that when the target has a lower dividend yield relative to the acquirer, the purchase price is relatively higher, and vice versa.

$$(2)\ \frac{\dfrac{\text{Earnings Per Share of Target (1 + Growth Target)}}{\dfrac{\text{Price per Share}}{\text{Return on Equity of Target}}}}{\dfrac{\text{Earnings Per Share of Acquirer (1 + Growth Acquirer)}}{\dfrac{\text{Price Per Share}}{\text{Return on Equity of Acquirer}}}}$$

This variable has a positive sign, which means that when the target's growth in earnings per share, adjusted by share price and return on equity, is stronger than the acquirer's, the relative purchase prices and exchange value are higher.

$$(3)\ \frac{\text{Merger Synergy Savings}}{\text{Combined Market Value}}$$

This sign is positive, which means that higher synergy savings relative to the market value of the combined equity causes higher purchase prices.

(4) Hostile Bid

This sign is positive, which means that mergers that represent special opportunities for the acquirer (*e.g.*, to prevent some third utility from

gaining control) equate to higher acquisition premium. (This variable is probably a good indicator of strategic value.)

$$(5)\ \text{Trouble times } \frac{\text{Size of Target (kWh)}}{\text{Size of Acquirer(kWh)}}$$

This sign is positive, which means that turning around a troubled utility of some reasonable size relative to the acquirer would increase the acquisition premium.

$$(6)\ \text{Control times } \frac{\text{Target's Dividend Yield}}{\text{Acquirer's Dividend Yield}}$$

This sign is positive, which means that the acquiring utility pays a higher price for utilities with high dividend yield.

$$(7)\ \text{Control times } \frac{\text{Merger Synergy Savings}}{\text{Combined Market Value}}$$

This sign is negative, which means that when an acquirer will control a target, synergy savings are less important.

Equation 2

This equation is identical to Equation 1 with one exception. The sole exception is Variable (2), which is:

$$(2)\ \frac{\dfrac{\text{Earnings Per Share of Target (1 + Growth Target)}}{\text{Return on Equity of Target}}}{\dfrac{\text{Earnings per Share of Acquirer (1 + Growth Acquirer)}}{\text{Return on Equity of Acquirer}}}$$

This sign is again positive, suggesting higher stock purchase price and greater exchange values when the target is financially relatively healthy.

Equation 3

This equation is also similar to Equation 1. However, there are three differences. First, Variable (2) is different. The replacement variable is:

$$(2)\ \frac{\dfrac{\text{Earnings per Share of Targets (1 + Growth Target)}}{\text{Price per Share of Target}}}{\dfrac{\text{Earnings per Share of Acquirer (1 + Growth Acquirer)}}{\text{Price per Share of Acquirer}}}$$

This sign is positive and works just like the alternative specifications in Equations (1) and (2) for this variable. Specifically, when the target is relatively financially strong, the acquisition premium is higher.

There are two additional explanatory variables in Equation 3 that are not statistically significant or present in Equations (1) and (2). These are:

$$(8)\ \frac{\text{Target's Beta Statistic}}{\text{Acquirer's Beta Statistic}}$$

This sign is positive, which suggests that when the Beta estimated in a CAPM is higher for the Target than the Acquirer, the expected return on equity for the target is higher and the price paid to the target is also higher.

$$(9)\ \frac{\text{Target's Average kWh Price}}{\text{Acquirer's Average kWh Price}}$$

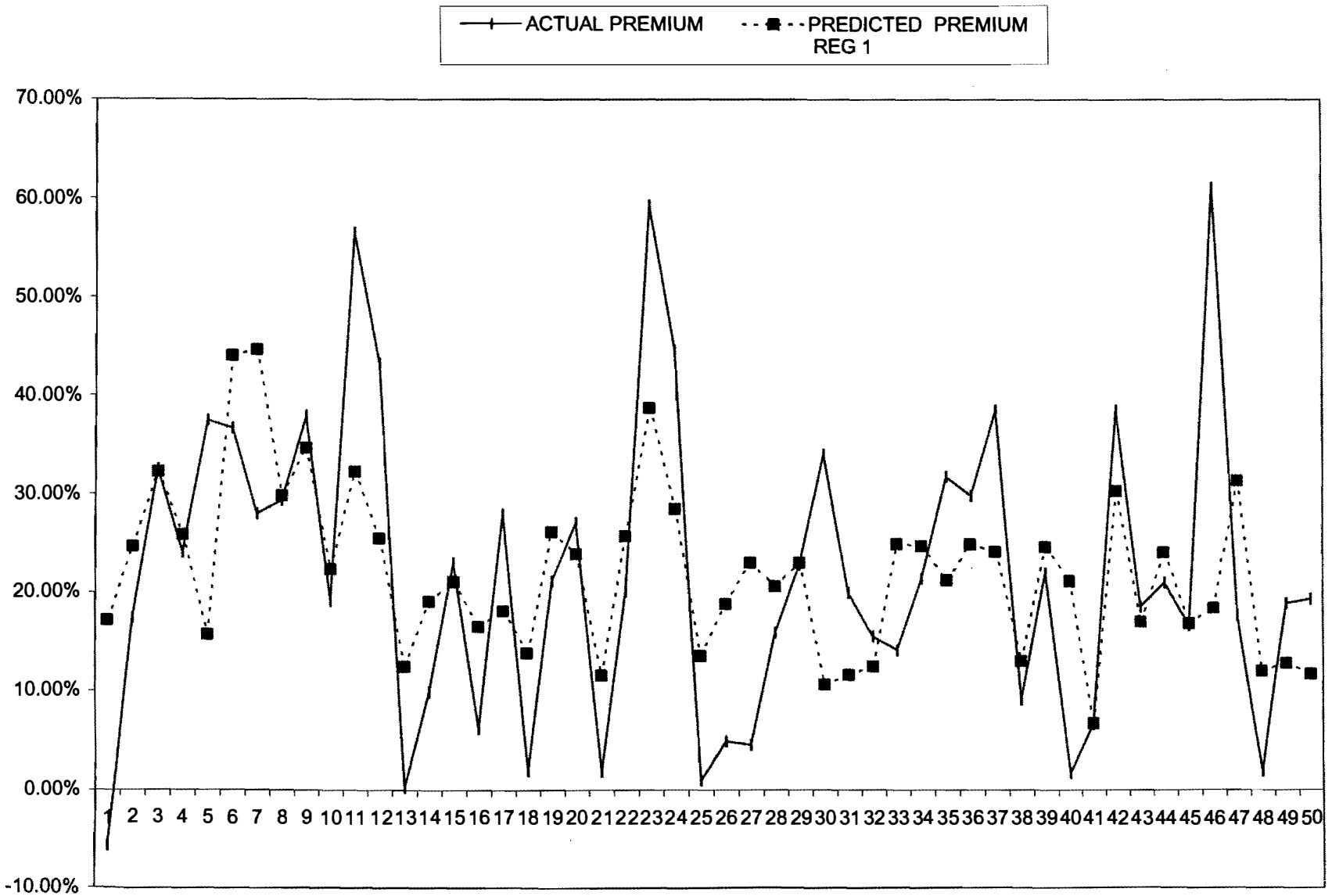
The sign is positive, which means that very efficient target utilities with relatively low prices will generally receive low acquisition premiums. This result is somewhat counter intuitive unless we relate the purchase price to the acquiring utility's prospects for cutting the target's costs and prices.

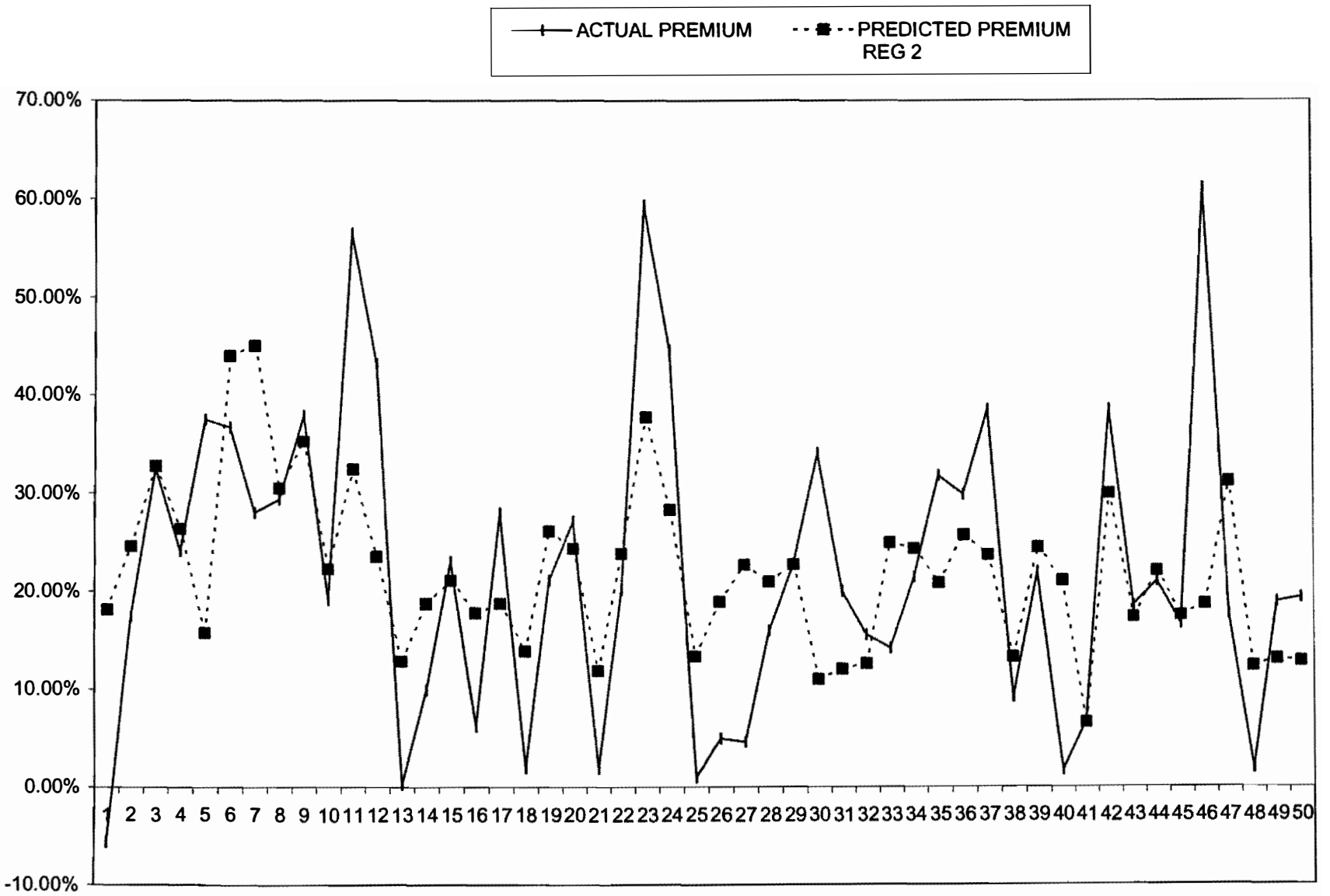
Equation 4

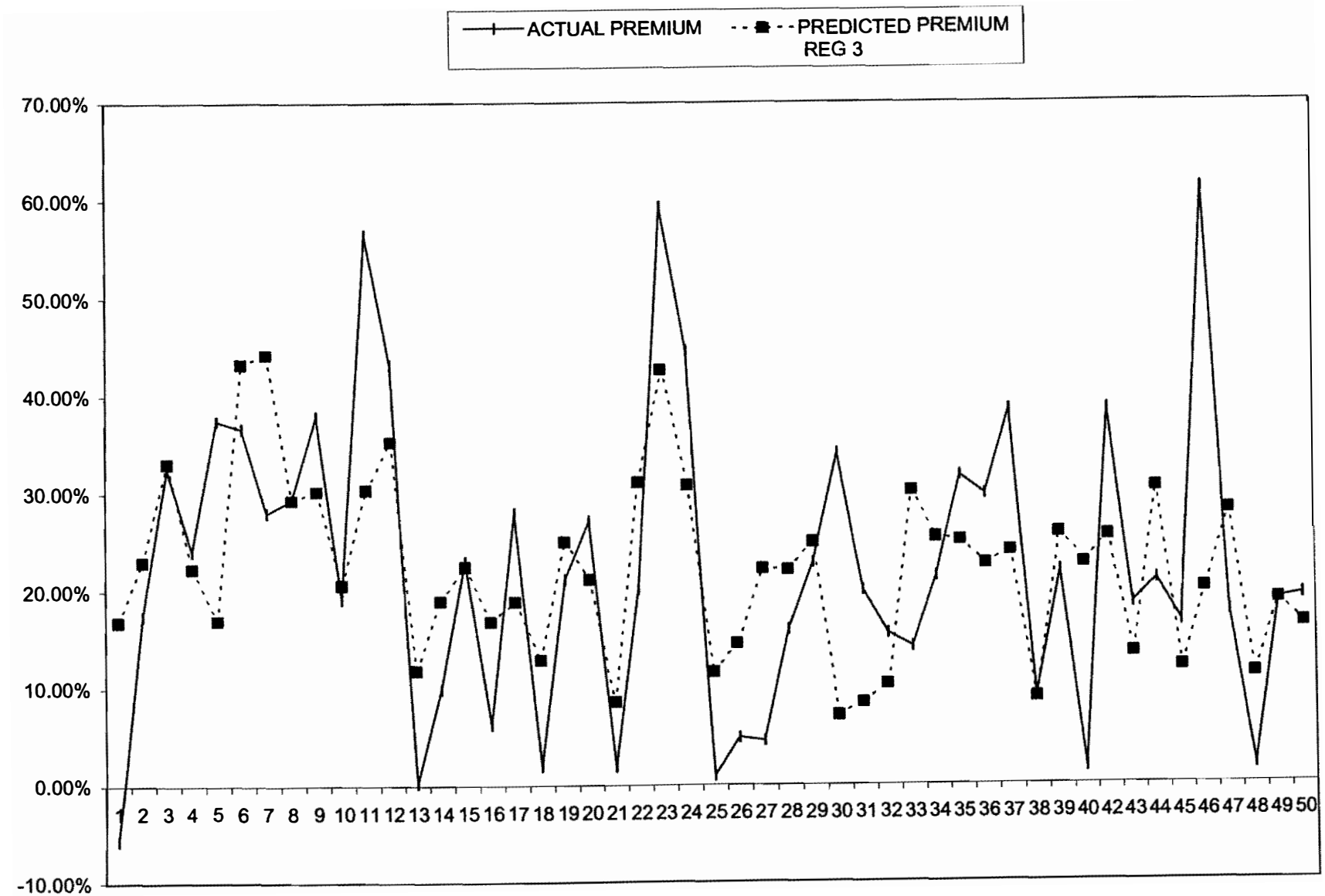
This equation is identical to Equation 3, with a sole exception, which is:

$$(2)\quad \frac{\text{Earnings per Share of Target (1 + Growth Target)}}{\text{Earnings per Share of Acquirer (1 + Growth Acquirer)}}$$

This sign is positive, indicating, just as in the other three specifications, a financially strong target would command a higher acquisition premium.







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