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Witness: Thomas J. Flaherty
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Case No.:

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. EM-96-149

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MISSOURI
PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY
OF
THOMAS J. FLAHERTY

Dallas, Texas
November 2, 1995

MISSOURI PUBLIC SERVICE COMMISSION

STATE OF MISSOURI

In the matter of the Application of Union Electric)
Company for an order authorizing: (1) certain)
merger transactions involving Union Electric)
Company; (2) the transfer of certain Assets, Real) Case No. _____
Estate, Leased Property, Easements and Contractual)
Agreements to Central Illinois Public Service)
Company; and (3) in connection therewith, certain)
other related transactions.)

AFFIDAVIT OF THOMAS J. FLAHERTY

STATE OF MISSOURI)
) SS.
CITY OF ST. LOUIS)

Thomas J. Flaherty, being first duly sworn on his oath, states:

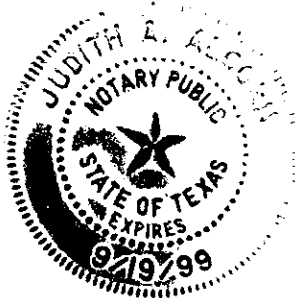
1. My name is Thomas J. Flaherty. I work in the City of Dallas, Texas, and I am the National Partner for Utilities Consulting and a partner in the management consulting function of Deloitte & Touche, LLP.

2. Attached hereto and made a part hereof for all purposes is my Direct Testimony consisting of pages 1 through 49, inclusive, all of which testimony has been prepared in written form for introduction into evidence in the above-referenced matter.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.

Thomas J. Flaherty
Thomas J. Flaherty

Subscribed and sworn to before me this 1st day of November, 1995.



Judith A. Alcorn
Notary Public

1 **DIRECT TESTIMONY**

2 **OF**

3 **THOMAS J. FLAHERTY**

4

5 **I. QUALIFICATIONS**

6 **Q. Would you please state your name and by whom you are employed?**

7 **A. My name is Thomas J. Flaherty, and I am the National Partner for**
8 **Utilities Consulting and a partner in the Deloitte & Touche Consulting Group, a**
9 **division of Deloitte & Touche LLP. My business address is 2200 Ross Avenue, Suite**
10 **1600, Dallas, Texas 75201.**

11 **Q. Mr. Flaherty, would you briefly summarize your academic and**
12 **professional background?**

13 **A. I graduated from the University of Oklahoma with a B.B.A. degree in**
14 **Accounting and immediately joined Touche Ross, where I have been continuously em-**
15 **ployed since 1973. In December 1989, Touche Ross and Deloitte, Haskins & Sells**
16 **consummated a merger and now conduct business under the firm name of Deloitte &**
17 **Touche LLP. Since joining Touche Ross, I have specialized in the public utility**
18 **industry and have performed a variety of assignments. I have performed organization,**
19 **construction and operations reviews on behalf of utilities or regulatory bodies. I also**
20 **have participated in numerous regulatory consulting engagements for gas, electric,**
21 **water and telephone utilities encompassing regulatory policy, rate base, operating**
22 **income, capital structure, rate of return, revenue requirements and jurisdictional**
23 **separations.**

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1 I have assisted a number of electric and/or gas utilities in the
2 identification, evaluation and integration of acquisitions, including: financial
3 modeling; review of corporate organization alternatives; assessment of merger related
4 cost reduction opportunities; establishment of competitive strategies; and assignment
5 and allocation of costs related to mergers and acquisitions. In addition to my in-
6 volvement in merger and acquisition consulting for Deloitte & Touche, I have
7 participated in numerous other utility consulting engagements in the areas of corpo-
8 rate growth, diversification, operations improvement, business process reengineering,
9 benchmarking, strategic planning, marketing and competition, litigation assistance,
10 economic feasibility studies, organizational analysis and financial analysis. I also have
11 conducted or directed similar assignments for a variety of industries, including
12 construction, retailing, publishing, health care, real estate and manufacturing, in
13 addition to utilities. Schedule 1 to this testimony details my experience with regulated
14 utilities.

15 **Q. Please summarize your experience in utility mergers and acquisitions.**

16 **A.** I have been involved in more than 50 actual, proposed or potential
17 transactions involving electric, electric and gas combination, or gas utilities. I have
18 experience working for both buyers and sellers and have assisted with a broad range
19 of transactional issues, including the following:

- | | | |
|----|--------------------------|---------------------------|
| 20 | - Target analysis | - Valuation |
| 21 | - Asset quality analysis | - Transaction structuring |

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- 1 - Customer analysis - Regulatory strategy
- 2 - Competitor analysis - Testimony
- 3 - Synergy assessment - Integration planning
- 4 - Financial modeling

5 The publicly announced transactions in which I have been significantly
6 involved, other than the one that is the subject of this proceeding, are Kansas
7 Power & Light and Kansas Gas and Electric, IPALCO Enterprises and PSI Resources,
8 Entergy and Gulf States Utilities, Southern Union and Western Resources (Missouri
9 properties), Washington Water Power and Sierra Pacific Resources, Midwest Re-
10 sources and Iowa-Illinois Gas & Electric, Northern States Power Company and
11 Wisconsin Energy Corporation, PECO Energy Company and PPL Resources, Public
12 Service Company of Colorado and Southwestern Public Service Company, Puget
13 Sound Power & Light and Washington Energy, and Baltimore Gas & Electric and
14 Potomac Electric Power Company.

15 **Q. Do you hold any professional certifications?**

16 **A.** Yes. I am a Certified Management Consultant and a member of the
17 Institute of Management Consultants.

18 **II. PURPOSE OF TESTIMONY**

19 **Q. Mr. Flaherty, what is the purpose of your testimony?**

20 **A.** I am testifying on behalf of Union Electric ("UE") and Central Illinois
21 Public Service Company ("CIPS") (collectively, the "Joint Applicants").

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1 I have been requested to: (1) provide a comprehensive description of
2 the nature of synergies created from the combination of UE and CIPS; (2) describe
3 the categories of cost savings that will result from the combination of UE and CIPS;
4 (3) provide the basis for quantification of these estimated cost savings; and
5 (4) describe the process by which such identified cost savings categories and estimated
6 cost savings were derived, reviewed with and agreed upon by both UE and CIPS.

7 While my testimony will focus primarily on the nonproduction and
8 nonfuel merger savings, I also will generally discuss the basis of electric production
9 and gas supply related cost savings. More specific discussion of the electric
10 production area and related savings is contained in the testimony of Ms. Borkowski.

11 **Q. Have you prepared any exhibits in support of your testimony?**

12 **A. Yes. Exhibits 1 and 2 were prepared by me or under my supervision.**

13 **III. SUMMARY OF TESTIMONY**

14 **Q. Mr. Flaherty, please summarize your testimony related to merger cost**
15 **savings.**

16 **A. The merger of UE and CIPSCO Incorporated (CIPSCO), the parent**
17 **company of CIPS creates substantial cost savings that should permit rates in the future**
18 **to be below the level that would have otherwise been necessary on a stand-alone**
19 **basis for either UE or CIPS. The approximately \$590.0 million of estimated cost sav-**
20 **ings (before approximately \$19.1 million of out-of-pocket costs and \$21.8 million in**
21 **transaction costs to achieve these savings), provides a unique opportunity to benefit**

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1 both customers and shareholders through the combination, and will result in a
2 stronger, more competitive company.

3 These savings, by area, are identified further below:

4	Total Savings	
5	1997 - 2006	
6	<u>Savings Category</u>	<u>(\$ Millions)</u>
7		
8	Corporate and Operations Labor	\$ 195.8
9	Corporate and Administrative Programs	204.1
10	Purchasing Economies (Nonfuel)	68.8
11	Electric Production	84.1
12	Gas Supply	<u>37.1</u>
13	Total Savings	589.9
14	Less: Costs to Achieve	19.1
15	Transaction Costs	<u>22.0</u>
16	Net Savings	<u>\$ 548.8</u>

17 The estimated cost savings referenced above reflect only those savings
18 created by or attributable to the merger. They reflect the consensus of both UE and
19 CIPS and were jointly developed by the working groups of each company and Deloitte
20 & Touche. This joint development of merger-related cost savings provides a sound
21 basis for identification and quantification and results in well-documented, thoughtfully
22 considered savings components.

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1 The projected cost savings reflect the creation of cost reduction or cost
2 avoidance opportunities through the ability to consolidate separate, stand-alone
3 operations into a single entity. This consolidation and integration will thus enable
4 duplicative functions and positions to be eliminated; similar corporate activities to be
5 combined, avoided or reduced in scope; external purchases of commodities and
6 services to be aggregated; capital expenditures to be avoided; and generation
7 resources to be more effectively coordinated and dispatched.

8 Based on my experience in other mergers and on my direct
9 involvement with the identification, evaluation and quantification efforts related to
10 these estimated cost savings, I believe that the level of merger savings presented are
11 reasonably attainable. The level of expected savings will change somewhat as
12 decisions are made regarding post-merger operations, but the projections that have
13 been developed should not deviate significantly from the savings actually achieved.

14 **IV. SCOPE OF ANALYSIS**

15 **Q. Mr. Flaherty, what has been the scope of your involvement in the**
16 **proposed merger between UE and CIPSCO?**

17 **A. UE and CIPSCO first retained Deloitte & Touche in mid-July 1995 to**
18 **assist their internal working groups in the assessment of the opportunities created by a**
19 **potential combination. We also were asked to help identify potential synergies**
20 **between UE and CIPS and to quantify associated cost savings that could be derived**
21 **from the combination of the two companies. This assistance was provided to facilitate**

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1 management's consideration of the strategic and economic benefits and merits of
2 merging UE and CIPSCO. Upon approval of the merger by the respective Boards of
3 Directors, we also were subsequently retained to present our analysis in various
4 regulatory proceedings involving the merger, including this one.

5 **Q. Have the savings estimates presented in this testimony been used by**
6 **the Joint Applicants for any other purpose?**

7 **A. UE and CIPS have utilized the analysis presented here to assess**
8 **various approaches to operating on a joint basis. They also are using this cost savings**
9 **analysis in their transition planning.**

10 **Q. Please describe the role that you performed in connection with the**
11 **development of the merger savings estimates.**

12 **A. Deloitte & Touche worked directly with members of the UE and CIPS**
13 **working groups to develop the merger cost savings and interacted on a day-to-day**
14 **basis with its members. This approach combined the knowledge and experience of**
15 **the working groups, who are intimately familiar with the operations of each of the**
16 **companies, with the prior transaction experience of the Deloitte & Touche project**
17 **team.**

18 **UE and CIPS collectively were involved in all aspects of the merger**
19 **savings analysis and provided unique and individual insights into cost savings**
20 **identification and quantification. In the electric production area, working group**
21 **personnel from UE principally executed the overall analysis effort due to the in-house**

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1 modeling activities already underway. This close working relationship provided
2 further opportunity to develop a collaborative and consensus-based work effort and
3 product.

4 **Q. How were identified cost savings quantified?**

5 A. The cost savings estimates developed were quantified based on the
6 individual facts regarding existing and projected costs for each company, the current
7 mode of operation of each company, analysis of the synergies which could be achieved
8 by modifications to the organizational and operational framework, the timing of
9 achievement of the savings, and the interrelationship of these factors and the cost and
10 complexity of savings attainment. Estimates of cost savings were developed on a
11 nominal cost basis for the ten-year period from 1997 to 2006 to provide a long-term
12 view of attainable savings. This ten-year period is the same time period in which
13 merger related savings are ordinarily evaluated by various Commissions that I have
14 testified before in other proposed utility merger transactions.

15 **Q. What methods did you use to quantify the individual cost savings**
16 **components?**

17 A. Cost savings were developed using three principal methods of
18 quantification:

19 Direct analysis - Use of actual costs and changes to these costs based on
20 planned consolidation activities, e.g., position reductions were estimated
21 based on detailed analyses of fully aligned individual functions and positions

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1 Estimation - Determination based upon more limited analysis of actual data
2 with joint working group assessment of potential cost reduction using
3 expected changes to markets and operations, e.g., reduction in gas supply
4 commodity costs from decreased reserve margins and procurement benefits
5 realized from additional buying power and lower pipeline demand charges
6 Comparison to other transactions - Utilization of expectations in other
7 proposed utility mergers as a proxy for the UE and CIPS impacts, e.g.,
8 average insurance premium reductions based on expected or realized
9 reductions achieved by other companies

10 These methods of quantification are consistent with those utilized in
11 other analyses and reflect the collective best judgment of the working group. For
12 example, it is well recognized that insurance premiums will likely be reduced from a
13 merger, however, the actual amount of the reduction will not be known until
14 negotiations with insurers are finalized. Using other expected or realized reduction
15 amounts is a reasonable method for quantification pending such negotiation.

16 **Q. Are the cost savings that you have quantified attainable only during**
17 **the 1997 to 2006 period?**

18 A. No, the majority of the identified savings components generate
19 benefits that will continue beyond this period. For example, positions that are
20 reduced from the merger will be permanently eliminated since they relate to
21 duplicative functions. Likewise, procurement benefits that are realized will continue

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1 indefinitely as the costs of materials and supplies acquisition is reduced per unit. The
2 estimated cost savings for this period are demonstrative of an ongoing level of benefits
3 that will continue to inure to the benefit of customers.

4 **Q. Has your analysis of savings resulting from the integration of UE and**
5 **CIPS been predicated upon any particular organizational structure?**

6 **A.** The cost savings related to the integration of common functions are
7 predicated upon centralization of these functions, where appropriate and practical.
8 Such centralization could occur in several ways: within an expanded headquarters
9 organization; within a corporate services entity; or by a combination of centralization
10 of corporate and administrative type services and decentralization of common
11 technical support services into operating units.

12 Our approach to quantification of cost savings was to assume the maxi-
13 mum extent of centralization practical without creating an ineffective, bureaucratic
14 and costly organization. Our analysis assumes common corporate and administrative
15 functions would generally be centralized, with common technical support functions
16 either similarly centralized or located as required within the various operating units.

17 **V. BENEFITS CREATED FROM UTILITY MERGERS**

18 **Q. In general, how are savings created from the combination of two**
19 **utilities?**

20 **A.** The combination of two utilities enables the succeeding company to
21 streamline operations and integrate critical functions, such as resource planning, to

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1 minimize total costs expended or incurred. Typically, the total costs of the combined
2 company are less than the sum of both stand-alone companies.

3 **Q. Are there different types of cost savings that can result from the**
4 **combination of two utilities?**

5 **A. Yes. Several types of cost savings can result from a merger as**
6 **described below:**

7 Created savings - These are savings that are directly related to the
8 completion of a merger and could not be obtained absent the merger. For
9 example, the reduction of total cost through the avoidance of duplication or
10 overlap and the ability to extend resources over a broader base of activity
11 would naturally occur through the consolidation of similar functions.

12 Without the combination, both companies would continue to expend
13 amounts on related activities, and as a result would incur stand-alone cost
14 levels higher than otherwise accomplishable through consolidation.

15 Enabled savings - These savings result from the acceleration or "unlocking"
16 of certain events that could give rise to savings. For example, technology
17 differences that exist between companies may provide an opportunity to
18 share technology and achieve productivity improvements more rapidly and
19 more cheaply than would have occurred on a stand-alone basis. For
20 example, one company that uses automatic dialing equipment for credit and
21 collections follow-up will enjoy a productivity benefit over another that does

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1 not. While the company without the technology can obtain such
2 productivity benefit from investment, the merger enables existing technology
3 to be deployed and stand-alone investment to be avoided.

4 Developed savings - Reductions in cost due to management decisions that
5 could have been made on a stand-alone basis are unrelated to the merger.
6 A decision to reengineer an organization will result in reduced costs but
7 likely would have been achieved without the merger.

8 **Q. What types of savings have you quantified with respect to the UE and**
9 **CIPSCO merger?**

10 A. We have focused on merger-related savings only, i.e., those savings
11 that would not be attainable but for the combination of the two companies. The
12 savings presented in my testimony all fall under the "created savings" category
13 described above.

14 **Q. How do "created savings" result from the typical combination of two**
15 **utilities?**

16 A. Typically, the quantifiable created savings resulting from a utility
17 merger occur in three ways:

18 Cost reduction - The total cost of service is reduced as a result of the
19 merger by avoiding duplication of the cost input required to achieve the
20 same level of output. For example, similar operating functions, such as

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1 corporate planning, could now be integrated and would require less input to
2 achieve results on a combined basis.

3 Cost avoidance - The total cost of service is reduced as a result of the
4 merger from the ability to forego certain types of parallel expenditures. For
5 example, expenditures to be made by both entities, such as for information
6 systems, could be avoided by selecting one approach and application and
7 avoiding duplication.

8 Revenue enhancement - The creation of additional revenue streams as a
9 result of the merger through use of existing assets to supplement existing
10 revenue sources can be used to increase benefits for shareholders and
11 customers. These revenue streams would be related directly to the ability
12 to combine and package available resources in a more attractive manner
13 than could be achieved independently.

14 **Q. What categories of quantifiable "created savings" typically result from
15 a utility merger?**

16 **A. Quantifiable created savings resulting from a merger typically can be
17 categorized as follows:**

- 18 ● Corporate and operations labor
- 19 ● Facilities consolidation
- 20 ● Corporate and administrative programs (nonlabor)
- 21 ● Purchasing economies (nonfuel)

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- 1 ● Fuel procurement
- 2 ● Production dispatch
- 3 ● Gas supply
- 4 ● Financing costs

5 In certain situations parallel unique organizations, such as nuclear, also
6 can be integrated and combined to create merger cost savings.

7 **VI. DETAILED COST SAVINGS DESCRIPTION SUMMARY**

8 **Q. Mr. Flaherty, you previously testified that you have quantified**
9 **approximately \$590.0 million in costs savings, prior to considering the costs to**
10 **achieve and merger transaction costs that would result from a merger of UE and**
11 **CIPSCO. Would you identify and define the principal categories of cost savings that**
12 **comprise this \$590.0 million amount?**

13 A. Yes. As Schedule 2 illustrates, there are five primary categories of
14 cost savings that have been quantified. Each of these is described briefly below:

15 Corporate and Operations Labor - Position reductions related to
16 consolidation of corporate, administrative and technical support functions.

17 Corporate and Administrative Programs - Reductions in nonlabor programs
18 and expenses, such as insurance and shareholder services, as a result of
19 consolidation of key activities or cost elements

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1 Purchasing Economies (nonfuel) - Aggregation of materials and supplies
2 volumes and services contracts to increase purchasing power and reduction
3 in standardized inventory to reduce carrying charges

4 Electric Production - Reduction in production cost from optimization of the
5 use of existing generating facilities and aggregation of fuel supply
6 purchasing and delivery

7 Gas Supply - Reductions in reserve margins, additional buying power and
8 lower pipeline demand charges.

9 Each of these individual categories is explained in much greater detail
10 in either my following testimony or that of Ms. Borkowski.

11 **Q. Are there only five categories of cost savings that have been**
12 **quantified?**

13 A. No. These categories represent only the general classification of cost
14 savings. There are multiple, individual cost savings elements that comprise these
15 general categories. In total, there have been 18 different cost savings elements
16 quantified, as listed below and as further illustrated in Schedule 2:

- 17 - Corporate and Operations Labor
- 18 - Corporate and Administrative Programs
 - 19 ● Advertising
 - 20 ● Administrative and General Overhead Expense
 - 21 ● Association Dues and Memberships

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- 1 ● Benefits administration
- 2 ● Gross Receipts Tax
- 3 ● Insurance
- 4 ● Information Services
- 5 ● Professional Services
- 6 ● Other Corporate Expenditures
- 7 ● Shareholder Services
- 8 ● Vehicles
- 9 ● Facilities Consolidation
- 10 - Purchasing Economies (nonfuel)
- 11 ● Procurement
- 12 ● Contract Services
- 13 ● Inventory Reduction
- 14 - Electric Production
- 15 - Gas Supply

16 **Q. What costs would be incurred to achieve the projected savings?**

17 A. There are several categories of costs to achieve the savings that have
18 been identified. These costs to achieve reflect expenditures necessary to effectuate
19 the cost savings identified from the merger through company integration. These costs
20 to achieve include:

- 21 ● Systems integration/Telecommunications

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- 1 ● Employee relocation
- 2 ● Employee retraining
- 3 ● Separation packages
- 4 ● Internal/external communication
- 5 ● Facilities consolidation
- 6 ● Transition costs

7 Costs to achieve total approximately \$19.1 million. In addition,
8 transaction costs of approximately \$22.0 million, which include investment banking,
9 legal and consulting fees, should be subtracted from the savings calculation.

10 **Q. What is your projection of total cost savings after these costs to**
11 **achieve are reflected?**

12 A. The total cost savings identified from the merger over the first ten
13 years after the merger, after being reduced by costs to achieve and transaction costs,
14 are approximately \$549 million.

15 **B. GENERAL ASSUMPTIONS**

16 **1. Escalation Rates**

17 **Q. What assumptions about the escalation of costs were employed in**
18 **calculating cost savings?**

19 A. For the most part, cost savings were calculated based on current cost
20 and expense levels. To account for inflation and other economic factors appropriate-
21 ly, an escalation rate was then applied to year one savings levels to determine the

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1 level of savings in each of the subsequent years. Applying the estimated cost savings
2 over the ten year period to be reviewed (January 1, 1997 to December 31, 2006) with-
3 out escalation would have resulted in the total cost savings over this period being
4 significantly understated.

5 **Q. Was the same escalation rate used for all savings categories?**

6 **A. Yes.** The differential in projected escalation rates for the cost
7 categories contemplated in our analysis was marginal. For this reason, and to simplify
8 the cost savings analysis, a single escalation rate of 3.5% was used for all other cost
9 savings categories. The 3.5% level is consistent with the Joint Applicants' pre-merger,
10 stand-alone assumptions for salary increases. Further, the 3.5% is consistent with and
11 perhaps conservative with respect to long-term forecasts of inflation and forecasted
12 national wage growth, but is a reasonable estimate of overall cost escalation within a
13 utility.

14 **2. Treatment of Capital Savings**

15 **Q. Were there other general assumptions or methodologies employed in**
16 **the cost savings analysis?**

17 **A. Yes.** In treating capital deferrals and avoidance related to the merger,
18 it would be inappropriate to count the entire amount of the capital expenditure
19 deferred or avoided as cost savings. For example, if it were projected that the Joint
20 Applicants could avoid installing a \$10 million computer system in 1998, we did not
21 quantify this as a \$10 million saving in 1998. Including the \$10 million as savings

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1 achieved in 1998 would not represent the revenue requirements associated with that
2 \$10 million capital expenditure from either the company or customer perspective.
3 Additionally, it would result in overstating the cost savings in the early years following
4 the merger by taking credit for the entire avoided investment as cost savings in those
5 years. Instead, it is more appropriate to reflect only the revenue requirements savings
6 associated with capital deferral and avoidance as cost savings. These include, but are
7 not limited to, financing or cost of capital, depreciation, insurance and property tax.
8 This gives a more realistic picture of the savings generated as part of the merger.

9 **Q. What methodology was used to capture these capital deferral and**
10 **avoidance savings?**

11 **A.** A levelized fixed charge rate for each year over the forecasted period
12 (1997-2006) was applied to each year's capital expenditure reductions. The levelized
13 fixed charge rate methodology, which reflects normal declining balance ratemaking
14 treatment and includes cost of capital, depreciation and property taxes, was used to
15 more accurately match annual savings levels with the appropriate levelized charge
16 rate.

17 The levelized charge rate is a composite rate for both companies. The
18 levelized charge rate used for this analysis was provided by each of the companies and
19 then blended for a net amount of 14.23%.

1 C. **COST SAVINGS SUMMARY**

2 1. Corporate And Operations Labor

3 Q. **Please discuss in more detail the nature of the cost savings typically**
4 **created through corporate, administrative and technical support functional integra-**
5 **tion.**

6 A. The combined companies would be able to reduce employment in the
7 corporate, administrative and technical support areas through the elimination of
8 redundant functions within headquarters and field support operations in areas
9 including:

- | | | |
|----|------------------------|-------------------------|
| 10 | ● Finance | ● Materials management |
| 11 | ● Accounting | ● Facilities management |
| 12 | ● Public relations | ● Information services |
| 13 | ● Rates and regulation | ● Marketing |
| 14 | ● Human resources | ● Legal |
| 15 | ● Corporate planning | ● Internal auditing |
| 16 | ● System planning | ● Shareholder relations |
| 17 | ● Engineering | ● Fuel supply |
| 18 | ● Construction | ● Customer service |

19 A merger provides an opportunity to consolidate these functions and
20 eliminate duplicate activities, because the payroll costs of such functions are relatively

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1 fixed and do not vary directly with an increase or decrease in the number of
2 customers served.

3 For example, the consolidation of two accounting departments would
4 typically create significant savings. Potential redundancy identification within the two
5 departments would begin with the alignment of the functional departments within
6 each company to ensure comparability across different organizational structures. Each
7 individual function within the finance area, including budgets and forecasting, financial
8 reporting, general accounting, tax accounting and accounts payable, among others,
9 contains duplicate personnel performing similar tasks. These overlapping positions
10 could be eliminated to capture economies of scale. Similarly, the costs of legal
11 representation in regulatory proceedings would be lower as fewer filings would be
12 made by a combined entity, thus requiring less representation.

13 The availability of potential cost savings does not extend equally
14 through each organization as some functions, such as sales, are directly customer
15 related in that the total level of work to be performed will not be significantly reduced
16 after a merger. In these cases, the available cost reduction more likely will be limited
17 to the nontransactional or nonactivity-based functions, such as administration and
18 supervision, except where stand-alone resources can be reconfigured to provide better
19 work or customer coverage.

20 **Q. How did you apply this principle to determine the potential labor sav-**
21 **ings that would result from a merger of UE and CIPS?**

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1 A. The first step in determining corporate, administrative and technical
2 support labor savings was to perform a detailed functional analysis of each company.
3 Both UE and CIPS provided organizational and functional breakdowns of their
4 respective companies that identified each position within its respective corporate
5 function. The stand-alone company functional areas were then aligned so that staffing
6 levels for similar functions/activities performed by each company could be compared.
7 The working group was careful to ensure that the intercompany functional alignments
8 were consistent and that the alignments were representative of similar activities
9 required in the daily operation of both companies.

10 Upon completion of the functional alignment, discussions ensued
11 between the working groups to identify the staffing levels necessary to perform the
12 required activities under the merged company scenario for each functional area. In
13 determining the appropriate future staffing levels of the merged companies, the
14 following items were considered:

- 15 ● Duplicative or redundant activities that could be identified and
16 subsequently eliminated;
- 17 ● Ability to consolidate functions in one location and the impact of
18 maintaining the functions at different headquarters locations; and
- 19 ● The specific cost drivers, if any, of the functional areas that would
20 affect appropriate staffing requirements.

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1 Reviews of each functional area were performed to ensure that any
2 potential reductions did not exceed the staffing levels of either company on a stand-
3 alone basis.

4 **Q. How are these corporate, administrative and technical support**
5 **functions assumed to be structured after the merger to enable these labor savings to**
6 **be realized?**

7 A. The achievement of the estimated level of savings assumes that these
8 functions will be centralized to the extent determined most practical, effective and
9 efficient. The labor savings identified above are predicated on the centralization of
10 these functions into either a traditional service company, or otherwise among the
11 operating units. Where appropriate, decentralization into operating units would occur
12 on a "mission critical" basis so as to avoid unnecessary duplication of related functions.

13 **Q. Please describe the results of the analysis discussed above.**

14 A. As of third quarter 1995, UE had 6,318 employees, of which 1,143, or
15 18%, performed corporate and administrative functions. CIPS had 2,584 employees,
16 of which 359, or 14%, performed corporate and administrative functions. The
17 combined corporate and administrative employees of the two companies was thus
18 1,502, or 17% of total combined employees. We identified 148 corporate and
19 administrative personnel reductions that could result from the consolidation of sepa-
20 rately performed functions. This constitutes 10% of the combined corporate and
21 administrative staff, and 2% of the combined companies' total personnel of 8,902.

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1 These reductions represent the collective judgment of Deloitte & Touche and the
2 working groups regarding the opportunity to avoid functional duplication and create
3 an integrated and merged corporate and administrative organization.

4 UE also had 5,175 personnel in field, production and technical support
5 functions while CIPS had 2,225 personnel in these categories. We identified 147
6 reductions in positions performing these functions, which constitutes 2% of personnel
7 in these categories.

8 **Q. What are the estimated total personnel reductions from the combina-**
9 **tion of UE and CIPS?**

10 A. Total personnel reductions are estimated at 295 or approximately 3.4%
11 of total combined company personnel.

12 **Q. When are these personnel reductions assumed to occur?**

13 A. The Joint Applicants intend to achieve all reductions exclusively
14 through attrition and strictly controlled hiring. Approximately twenty percent of the
15 estimated reductions are scheduled to will be achieved in each of the first five years.

16 **Q. Once you identified the potential personnel reductions, how did you**
17 **calculate the labor reduction cost savings?**

18 A. The average salary levels for corporate functions, distribution functions
19 and generation functions were calculated and then applied to the personnel reductions
20 in those respective areas. The summation of the savings for each functional area

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1 resulted in the total corporate and operations cost savings. The average salary of the
2 personnel reductions identified was approximately \$49,502 in 1995 dollars.

3 **Q. Are there other cost savings associated with personnel reductions**
4 **other than salary expense?**

5 A. Yes. Benefit costs should also be considered when determining the
6 cost savings associated with personnel reductions. Benefits include such items as
7 health insurance, life insurance, employee investment plans, pension expense, accruals
8 for retirement health benefits of active employees, incentives and bonuses, payroll
9 taxes and others. In general, benefits can comprise between 30% and 40% of total
10 labor costs and need to be considered when quantifying cost savings resulting from
11 personnel reductions. The benefits loading rate for UE was 42.3% while for CIPS it
12 was 40.5%. The resulting average annual total compensation including benefits
13 loading for the positions to be reduced through the merger was approximately \$69,576
14 in 1995 dollars.

15 **Q. Were any of these corporate and operations labor savings allocated to**
16 **construction?**

17 A. Yes. A certain portion of these expenses are capitalized rather than
18 expensed annually, reflecting their relation to the capital or construction elements of
19 the business. Capitalized amounts thus are recovered over the life of the asset to
20 which these costs are assigned. Capitalization rates of 9%, 31%, and 3% were used
21 for allocating corporate, distribution, and generation labor respectively.

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1 **Q. How were cost savings calculated on the construction portion of**
2 **corporate and operations labor reductions?**

3 A. We used the same method that I described previously for calculating
4 cost savings from the avoidance of capital expenditures. The annual fixed charge rate
5 that I described previously was applied to the portion of labor savings allocated to
6 construction to convert these labor savings to revenue requirements. The reduced
7 revenue requirements were then used as the actual savings that result from the con-
8 solidation of corporate functions as a result of construction-related activities.

9 **Q. What were the total savings projected to result from corporate and**
10 **operations labor consolidation?**

11 A. The total corporate, administrative and technical support labor
12 reductions are 295 positions. The labor reductions are estimated to be achieved
13 essentially through attrition and are phased in by 20% in each of the first five years.
14 The total cost savings corresponding to these reductions are \$3.7 million in 1997, \$7.8
15 million in 1998, \$12.2 million in 1999, \$17.1 million in 2000 and \$22.4 million in 2001.
16 The total cost savings from corporate and operations labor for the ten-year period
17 ending December 31, 2006, are \$195.8 million.

18 **Q. Mr. Flaherty, could these labor related savings have been achieved**
19 **without the merger?**

20 A. No. The position reductions previously described are attributed to the
21 merger. The reduction opportunities arise from overlap and duplication in functional

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1 performance rather than from other stand-alone initiatives unrelated to the merger.
2 Both companies have ongoing continuous improvement programs in place which have
3 previously restrained cost growth or reduced cost levels and which would continue into
4 the future. Attention was given to avoiding double-counting of these initiatives in the
5 merger savings estimates. The savings discussed above are triggered by the
6 opportunity to combine functions, not by the simple reduction of the level of staff.

7 **2. Corporate And Administrative Programs - Non-Labor**

8 **Q. What cost savings can be created through corporate program and**
9 **expenditure consolidation?**

10 A. The integration of corporate and administrative functions reduces
11 certain non-labor costs, primarily through the consolidation of overlapping or
12 duplicative programs and expenses.

13 Two examples, insurance and information systems expenses, will
14 illustrate how these savings are created through a merger:

15 • Insurance - Cost savings typically would be realized in the areas of
16 property insurance and excess general liability insurance, among
17 others. On a stand-alone basis, each company carries insurance (or is
18 self-insured) in these areas independently. A larger combined
19 company has the ability to carry higher deductibles or to self-insure
20 the risks. In addition, asset concentration will be less significant, which
21 should translate into lower premiums for the combined company.

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1 ● Information systems expense - Organizations must facilitate systems
2 development and support the information processing needs of each
3 company. Companies typically have independent plans to develop a
4 variety of systems in the future, including most likely some parallel
5 systems development efforts. A combination would enable the
6 companies to avoid incurring these duplicate capital expenditures.
7 Additional information systems savings could result from deferred
8 capital projects, such as mainframe upgrades or personal computer
9 purchases. Additionally, savings could be realized from the
10 elimination of other duplicate costs, including disaster recovery costs,
11 systems software support costs, various software and hardware costs,
12 including license fees, and computer maintenance costs.

13 **Q. In which specific areas have you quantified savings that would result**
14 **from the consolidation of UE and CIPS corporate and administrative programs?**

15 **A. We have identified and quantified savings in the following areas:**

- | | |
|--|--------------------------------|
| 16 ● Information Services | ● Benefits Administration |
| 17 ● Professional Services | ● Insurance |
| 18 ● Vehicles | ● Other Corporate Expenditures |
| 19 ● Administrative and
20 General Overhead | ● Advertising |
| 21 | |
| 22 ● Association Dues and
23 Memberships | ● Shareholder Services |

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1 ● Gross Receipts Tax ● Facilities

2
3 Each of these categories is described below.

4
5 Information Services ("IS")

6
7 **Q. Please briefly describe the management information systems**
8 **departments of UE and CIPS.**

9 A. UE operates its own information system department with average
10 annual operating costs of \$30.1 million and a complement of 222 personnel to support
11 these requirements. System development efforts currently are underway in several
12 areas including customer information. CIPS operates the majority of its own informa-
13 tion systems department with average annual operating costs of \$17.1 million and a
14 complement of 105 personnel to support these requirements.

15 **Q. How were savings in the IS area determined, and what is their**
16 **magnitude?**

17 A. Savings were projected to be generated from the reduction in
18 duplicative system development, combined expenditures for computer leases, equip-
19 ment maintenance, disaster recovery and various software/hardware packages, as
20 these items become duplicative and redundant. PC workstation and server
21 expenditures also will decline in connection with merger-related personnel reductions.

22 Avoidance of duplicative system development will result in the
23 avoidance of certain capital expenditures in several areas, principally in customer
24 information systems expense. These savings are based on a detailed review of the

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1 planned capital outlays for each company and the avoidance of these expenditures
2 where parallel systems development exists and unwarranted or recent system
3 completion obviates similar expenditure.

4 As stated, CIPS currently has stand-alone plans to develop a customer
5 information system (CIS) which may be avoided by adoption of UE's system which has
6 recently been modified and updated. Adoption of the UE system would create
7 opportunities for capital and operating and maintenance savings as a result of having
8 a single CIS which serves both operating companies. In addition, capital savings will
9 result from reduced PC and workstation expenditures, and reduced software/hardware
10 packages. The savings generated from the avoidance of IS capital costs equate to \$7.4
11 million in 1997 and total \$69.2 million over the ten year period.

12 The O&M savings are comprised of avoided computer lease costs and
13 consolidation of maintenance agreements. These O&M savings are \$1.3 million in
14 1997 and total \$14.8 million over the ten year period. These two components
15 combine to produce total IS savings of \$8.7 million in 1997 and \$84.0 million over the
16 ten year period.

17 **Q. Could these savings be achieved absent a merger?**

18 **A.** No. The elimination of duplicative system development costs can only
19 be achieved by consolidating the two IS departments into one. As a practical matter,
20 it would be unlikely that two independent utilities would want to share such services,
21 hardware and software.

1 Professional Services

2 Q. What gives rise to savings in the area of professional services?

3 A. Professional services functions include such areas as audit, taxation,
4 legal, and general consulting. In many cases, these functions are duplicated at both
5 companies. An explicit example of this would be in the case of external audits, which
6 would be integrated over both companies at a lower total cost on a combined basis.

7 Q. How were savings in the area of professional services quantified, and
8 what was their magnitude?

9 A. The savings calculated were generated from the reduction of the
10 combined audit fees, legal fees and general consulting services. The audit savings
11 were based on reducing the total stand-alone costs of UE and CIPS to a level
12 reflecting a combined, consolidated structure. UE and CIPS legal fees and general
13 consulting services fees also were reduced from current levels to reflect the ability to
14 combine internal and external resources more efficiently and effectively. The total
15 savings resulting from these reductions is \$4.3 million in 1997 and \$51.0 million for
16 the ten year period under consideration.

17 Q. Could the savings in the professional services area that you have
18 calculated be achieved absent a merger?

19 A. No. They can only be achieved by consolidating the use of
20 professional services. Otherwise, there will continue to be two sets of independent

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1 auditors, two sets of external legal counsel for issues such as FERC proceedings and
2 overlapping sets of general consultants.

3 **Vehicles**

4 **Q. How are vehicle reductions derived from utility combinations?**

5 A. Typically, these reductions result from the reduced level of total
6 administrative and general or field operations employees. They are directly related to
7 the number of these employees and as the number of employees can be reduced the
8 relative number of vehicles available to and used by these employees is reduced.

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

10 A. The number of vehicles available for administrative and general
11 employee use was identified along with the associated costs. The reduced
12 headquarters employees (148) would result in approximately 26 fewer vehicles that
13 would be required by the combined UE and CIPS. At an approximate annual cost of
14 \$5,500 per vehicle the savings would amount to \$.150 million in 1997 and \$1.8 million
15 for the full ten year period.

16 **Q. Could these savings be captured outside the merger?**

17 A. No, they are directly merger related in that they are derived from the
18 merger related position reductions and therefore could not be achieved without the
19 merger.

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Miscellaneous Overhead Expense

Q. What types of expenses are included in miscellaneous overhead expense and how are they affected by the merger?

A. Miscellaneous overhead expense includes, but is not limited to, periodicals, postage, stationery, telecommunications, transportation and office supply expenses. These costs are variable with the total number of personnel and change as the number of personnel increases or decreases. As personnel reductions are achieved through the merger, miscellaneous overhead expenses also are reduced.

Q. How were cost savings for this area quantified?

A. Miscellaneous overhead expenses were identified and separated between fixed and variable components and divided by the total personnel for which they were applicable. The variable administrative and general costs for UE and CIPSCO are incurred primarily by administrative and general ("A&G") personnel and therefore were reduced by A&G personnel impacts only. The combined average miscellaneous overhead expense per A&G employee was then multiplied by total merger-related A&G corporate employee reductions to arrive at a merger savings level for this area. The merger savings identified were \$.8 million in 1997, with a ten year total of \$9.0 million.

Q. Could the miscellaneous overhead expense savings that you have quantified be achieved absent a merger?

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1 A. No. These savings are directly related to the personnel reductions that
2 would result from the merger.

3 **Benefits Administration**

4 **Q. What levels of costs for administration or benefits programs do UE**
5 **and CIPS expect to incur?**

6 A. Estimates of total annual benefits costs for UE and CIPS are \$117.3
7 million and \$62.4 million, respectively. These costs include medical, life insurance and
8 pension benefit costs and the administrative costs associated with those benefits pro-
9 grams. Annual benefits administrative costs for of UE and CIPS are \$1.9 million and
10 \$1.6 million, respectively.

11 **Q. How can cost savings be achieved in the area of benefits**
12 **administration, and what level of savings should be expected?**

13 A. Benefits administration savings will be realized as a result of greater
14 purchasing power for the combined entity when negotiating administration fees with
15 third-party administrators. Additionally, purchasing power can be exercised in
16 negotiating the dollar cost of benefits provided without reducing the level of benefits
17 provided. The savings generated from the combination of UE and CIPS were based
18 on reducing benefit administration fees and benefit costs to reflect this purchasing
19 power. Savings estimates reflect prior transaction experience and equate to \$1.1
20 million in 1997 with total savings of \$14.4 million through the ten year period ending
21 December 31, 2006.

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1 reduced for the combined companies, reflecting broader coverage opportunity.
2 Finally, excess casualty insurance liability coverage of the smaller of the two
3 companies was reduced to reflect an improved ability to negotiate a better
4 arrangement. These reductions were derived from my experience in estimating
5 savings in these areas in other merger analyses, as well as from results of other
6 utilities regarding actual savings negotiated with insurance brokers in other mergers.
7 The total 1997 savings for insurance was \$1.7 million with a total ten year savings of
8 \$20.3 million.

9 **Q. Could the savings that you have quantified in the insurance area be**
10 **achieved absent a merger?**

11 A. No. These savings are predicated directly on the assumption that the
12 combined companies integrate this function so as to utilize the total purchasing power
13 of the combined entity to achieve lower premium costs due to a different risk profile.

14 **Advertising**

15 **Q. Please describe how advertising expenditures could be affected by the**
16 **combination of UE and CIPS.**

17 A. The combination gives rise to cost savings resulting from the elimi-
18 nation of duplicate fixed production, e.g., studio, and distribution costs related to
19 external agency fees.

20 **Q. What is the level of savings that can be achieved and how were they**
21 **calculated?**

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1 A. The total savings in the area of advertising for 1997 is \$0.06 million
2 with a ten year total of \$0.7 million. The savings reflect a reduction in the combined
3 expenditures of UE and CIPS resulting primarily from the elimination of duplicative
4 fixed production costs.

5 **Q. Could the savings that you have quantified in the advertising area be
6 achieved absent a merger?**

7 A. No. These savings are predicated directly on the assumption that
8 there is a single, combined company jointly developing and producing its needed
9 media messages.

10 Shareholder Services

11 **Q. How will the merger of UE and CIPSCO impact the expenses incurred
12 by the corporate secretary and shareholder services departments?**

13 A. In addition to the labor savings identified, cost savings will result
14 through the combination of transfer agents, the elimination of duplicative investor
15 relations activities and a reduction in the total cost of processing transactions.

16 **Q. What is the level of savings that can be achieved, and how were they
17 calculated?**

18 A. The total savings in the area of corporate secretary/shareholder
19 services for 1997 is approximately \$0.5 million, with a total ten year savings of \$5.3
20 million. The savings were based on a reduction in the combined nonlabor
21 shareholder services costs in duplicate activities to the lower cost per shareholder of

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1 the individual companies. Since these costs are not linear and could expect to be
2 lower given the increased number of shareholders, the estimate is conservative. A
3 reduction in total annual meeting costs was based on the smaller company's expense
4 which will be largely avoided.

5 **Q. Could the savings that you have quantified in the shareholder services**
6 **area be achieved absent a merger?**

7 **A.** No. These savings are predicated directly on the assumption of lower
8 total costs driven by the larger size of the new company.

9 **Facilities**

10 **Q. Please elaborate on the typical savings created through consolidation**
11 **of facilities.**

12 **A.** This area of cost savings is made possible by the nature and
13 geographic location of the various field functions and facilities. Cost savings can be
14 created through the consolidation of proximate business offices, service centers,
15 warehouses or staging areas. The streamlining of the work force to which I previously
16 testified also permits a reduction of total facilities. For example, support facilities,
17 such as service centers, business offices, test sites, machine shops, warehouses, garages,
18 etc. can be combined to avoid duplication or to provide for reconfiguration to
19 optimize service territory coverage. In addition, other back-up facilities can be further
20 consolidated across the combined company.

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1 **Q. Were there any facilities consolidation savings as a result of the UE**
2 **and CIPS combination?**

3 **A. Yes. It is anticipated that approximately 50 of CIPSCO's Illinois**
4 **headquarters personnel will be relocated to UE's St. Louis headquarters. The**
5 **resulting space made available in the CIPSCO headquarters can then be leased at**
6 **current market rates. Total savings in this category amount to approximately \$.06**
7 **million in 1997 and total approximately \$.7 million through 2006.**

8 **Q. Could these savings be achieved absent a merger?**

9 **A. No. The facilities consolidation is possible only as the result of the**
10 **consolidation of UE and CIPSCO and of the personnel reductions described above. If**
11 **UE and CIPSCO were to remain as separate corporate entities or if there was no**
12 **merger to generate the personnel reductions, then these savings could not occur.**

13 **3. Purchasing Economies (Nonfuel)**

14 **Q. Mr. Flaherty, please discuss the cost savings that can be created**
15 **through purchasing economies.**

16 **A. Combining companies can achieve savings through the centralization**
17 **of purchasing and inventory functions related to the construction, operation and**
18 **maintenance of generating plants, service centers, warehouses and headquarters. The**
19 **greater purchasing power and the relative quantity of both goods and services that can**
20 **be obtained as a result of the combination of companies provide additional cost sav-**
21 **ings.**

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1 supplies for the 1994-1995 period for UE were approximately \$151 million while for
2 CIPSCO they were approximately \$58 million. Savings again were estimated based on
3 previous transactions and represent an estimated 5% reduction of the costs of the
4 smaller company for materials as a result of extending the purchasing power of the
5 larger company across the broad range of commodity categories. This purchasing
6 power enhancement reflects permanent economies of scale through lower unit costs.

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

9 **A. Yes. We allocated 30% of the materials and supplies savings to**
10 **capital accounts based on the combined company's capitalization rate for all materials**
11 **and supplies. A yearly fixed charge rate again was applied to convert the capital cost**
12 **reductions into revenue requirement savings. The total savings from procurement for**
13 **1997 were \$2.4 million, with a ten year total savings of \$34.7 million.**

14 **Inventory**

15 **Q. How are inventory savings resulting from the combination of UE and**
16 **CIPS merger obtainable and calculated?**

17 **A. Similarity in the systems - electrical distribution and generation - will**
18 **offer the potential for inventory reduction from standardization and limited sharing of**
19 **parts and components. For example, each company maintains certain spare parts for**
20 **their fossil generating and distribution facilities that can be shared. The combination**
21 **will allow for the rationalization of existing inventory levels to maintain the**

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1 appropriate level of spare parts that eliminates redundancy and duplication. The
2 average year-end inventory levels for nonfuel, nonnuclear material and supplies were
3 identified at \$54 million for UE and \$35 million for CIPS. These levels were
4 estimated to be reduced by 10% in 1997, based on previous experience, for a one-time
5 benefit. The annual fixed charge rate described above was then applied to this one-
6 time permanent inventory reduction to calculate the total savings from inventory
7 reductions. The total inventory savings for 1997 was \$0.8 million, with a ten year total
8 savings of \$7.6 million. UE's nuclear inventory was excluded from this analysis.

9 Since the final determination of the individual materials and supplies
10 components to be shared will not occur until the transition planning process, the
11 reduction rate was based on previous transaction experience.

12 The level of the one-time reduction reflects my experience in similar
13 undertakings and, more importantly, the experience of other companies in realizing
14 similar reductions. Unique plant items, such as certain engineered equipment will be
15 less standardized and shareable. However, normal commodities and consumables,
16 such as cable, and other engineered items such as valves are more standardized and
17 common to both systems. The sharing of these items will effectively reduce the need
18 for inventory replenishment and extend the reorder cycle.

19 Contract Services

20 **Q. What is the nature of savings from contract services as a result of the**
21 **combination and how are they quantified?**

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1 A. Similar to consolidating materials and supplies purchasing volumes, the
2 combined companies will be able to gain economies of scale from the aggregation of
3 related work activities and increased purchasing power with service providers.
4 Examples of these services include outage work, tree trimming, construction,
5 inspection, etc.

6 The savings estimate also is dependent upon future negotiations with
7 contractors and based on previous transaction experience and represents purchasing
8 power savings across the broad range of these services. UE's total contract services
9 for 1994 were \$59 million while for CIPSCO they were \$34 million. The combined
10 company thus should be able to achieve additional economies of scale and scope by
11 negotiating with competing vendors.

12 Some contract services savings should be considered capital savings.
13 We used a capitalization rate of 50% to allocate contract services expenditures to
14 capital accounts. We then converted these savings amounts to revenue requirements
15 savings using the applicable fixed charge rate for each year. The total savings from
16 contract services for 1997 were \$1.5 million with a ten years total savings of \$26.5
17 million.

18 **Q. Please compare the methodology that you used to quantify the various**
19 **categories of procurement and inventory savings with the methodology that you used**
20 **to quantify other projected savings.**

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1 A. Procurement and inventory savings, which for the most part require a
2 prediction of how well the combined company will be able to use its increased size to
3 negotiate better unit prices, are more difficult to quantify precisely than savings
4 associated with the elimination of redundant expenses. It is possible today to analyze
5 and determine which costs would be redundant in a consolidated organization.
6 Predictions of future behavior cannot be determined so precisely.

7 **Q. Does that mean that your projected inventory and procurement**
8 **savings are less likely to occur?**

9 A. Not at all. Experience with prior transactions shows that the expected
10 purchasing power does emerge and that these savings can be achieved. I believe that
11 the projections that we have used are conservative, based on my experience in this
12 area. I am every bit as confident that the projected level of nonfuel purchasing
13 economies can be achieved as I am in the other projected savings.

14 **Q. Could the savings that you have quantified in the purchasing**
15 **economies area be achieved absent a merger?**

16 A. No. These savings are predicated directly on the assumption that
17 there is a combination of the companies with the resulting combination having greater
18 purchasing power.

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1 4. Electric Production and Gas Supply Savings

2 Q. Have the Joint Applicants calculated savings that will result in the
3 fuel procurement, production dispatch, and gas supply areas?

4 A. Yes. These savings have been developed by other witnesses, but
5 appear on my summary in this testimony and on Schedule 2. Ms. Borkowski testifies
6 as to production savings and as to gas supply savings.

7 VII. COSTS TO ACHIEVE

8 Q. Please describe your approach to estimating the costs that will be
9 incurred with the integration of the two companies.

10 A. Costs are incurred in all merger transactions from the process of
11 combining the two entities and attaining the identified cost savings. These costs
12 reflect out-of-pocket cash payments and usually are one-time payouts incurred as a
13 result of the merger.

14 Q. Please explain the process by which the costs to achieve were
15 estimated.

16 A. Deloitte & Touche discussed with the working groups on several
17 occasions the consolidation requirements and the estimated integration costs
18 associated with the merger. The functional analysis described above that was used to
19 determine duplicative functional areas where employee reductions would likely occur
20 also was used to estimate the number of positions that would need to be relocated to
21 achieve the merger cost savings. The costs that will be incurred in systems

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1 integration, telecommunications network requirements, nuclear, internal and external
2 communications and other miscellaneous expenses also were identified.

3 **Q. What expenses are estimated to be incurred to combine UE and**
4 **CIPS?**

5 **A.** Costs to achieve are estimated at \$19.1 million over ten years, with the
6 majority of the costs to be incurred over two years beginning in 1997. The expenses
7 that will be incurred subsequent to 1997 are associated with personnel reduction
8 phase-in and other miscellaneous systems conversions.

9 **Q. What are the primary components of your calculation of the costs to**
10 **achieve the projected savings?**

11 **A.** The primary components used to estimate costs to achieve are
12 employee separation costs (estimated to cost \$1.1 million), employee relocation costs
13 (\$2.0 million), systems integration/telecommunications networking (\$12 million), inter-
14 nal/external communications costs (\$1 million), employee retraining (\$1 million),
15 facilities consolidation (\$1 million), and transition costs (\$1 million).

16 **Q. Explain the rationale for the development of an employee reduction**
17 **plan.**

18 **A.** A major component of the merger cost savings is the reduction in
19 work force which is primarily due to the elimination of duplicative functions and tasks.
20 These reductions are primarily expected to be achieved through attrition and strictly
21 controlled hiring.

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1 **Q. How did you calculate the level of cost to achieve work force**
2 **reductions through a separation package?**

3 A. Workforce reductions will occur by attrition and controlled hiring for
4 the first five years. It is anticipated that only a limited number of executives will be
5 offered severance packages outside of the attrition process. The estimates used for
6 the severance package calculation was 100% of base salary for one year, plus
7 extended medical benefits for 18 months from the date of separation.

8 **Q. When is it assumed that employees would leave under the severance**
9 **package?**

10 A. These executives are assumed to take the severance packages on
11 1/1/97.

12 **Q. Explain how relocation costs were calculated.**

13 A. To provide for efficient consolidation, certain functional areas will be
14 centralized and thus require employee relocation to a new site. Based on the
15 functional analysis, it was determined that 50 positions possibly would need to be
16 relocated. Relocation expenses were estimated to cost \$40,000 per employee, for a
17 total of \$2 million. The cost of the actual package to be offered to eligible UE and
18 CIPS employees has not yet been determined. The components of a relocation
19 program could include moving expenses, househunting costs, cost of living
20 differentials, and closing costs. The \$40,000 estimate is a composite cost based on a
21 national study of relocation programs.

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1 **Q. Explain how systems integration and telecommunications networking**
2 **costs were calculated.**

3 A. Significant effort will be expended in integrating the information
4 technology and services functions of UE and CIPS. These efforts will relate to
5 reducing redundancy, integrating systems, and linking data bases. Further, voice, data
6 and video networks will need to be integrated through expanded telecommunications
7 capabilities. Integration costs for these areas were estimated at \$12 million. Cost
8 estimates are consistent with prior transaction experience and reflect adjustments for
9 scale, complexity, and platform differences. These expenses associated with systems
10 and communications integration will carry through 1998 and will reflect the potential
11 retention of contract programmers to supplement existing personnel.

12 **Q. Please describe the estimated internal and external communications**
13 **costs to achieve.**

14 A. Communication expenses will arise from the need to disseminate
15 merger information to the various stockholders of the individual organizations and
16 combined company. Informational brochures will be sent to employees, shareholders,
17 rating agencies, and state and federal commissions to explain the specifics of the
18 merger. These expenditures are estimated to cost \$1 million, which is consistent with
19 prior transaction experience after adjusting for differences in scale and scope.

20 **Q. Are there additional costs to achieve that will be incurred related to**
21 **savings attainment?**

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1 A. Other costs that were estimated to be attributed to the merger are
2 employee retraining (\$1 million), facilities consolidation (\$1 million), and transition
3 costs (\$1 million). Retraining costs will be incurred to help offset the work force
4 downsizing. Facilities consolidation costs would include remodeling and retrofitting of
5 the combined companies' remaining facilities, moving costs, and exit costs from
6 vacated facilities. Other transition costs would include the use of outside professional
7 firms to assist in the integration of the combined companies' and outside expenses
8 incurred during the regulatory approval process. Cost estimates are consistent with
9 prior transaction experience and have been adjusted to reflect differences in scale and
10 scope.

11 **Q. Does this conclude your direct testimony?**

12 A. Yes, it does.

SUMMARY OF REGULATORY ENGAGEMENTS

Alaska Public Utilities Commission

- Anchorage Sewer Utility

Arizona Corporation Commission

- U S WEST Communications - Docket No. E-1051-88-146

Beaumont, Texas

- Entex, Inc.
- Gulf States Utilities Company

California Public Utilities Commission

- The Washington Water Power Company and Sierra Pacific Power Company - Application No. 94-08-043

Clark County

- Washington Public Power Supply

Federal Energy Regulatory Commission

- Trans-Alaska Pipeline System - Docket No. OR78-1
- Middle South Energy, Inc. - Docket No. ER-82-483-000
- Middle South Energy, Inc. - Docket No. ER-82-616-000
- Kansas Power and Light Company and Kansas Gas and Electric Company - Docket No. EC91-2-00
- The Washington Water Power Company and Sierra Pacific Power Company - Docket No. EC94-23-000

Federal Power Commission

- Organization and Operations Review

Garland, Texas

- General Telephone Company of the Southwest
- Lone Star Gas Company

Georgia Public Service Commission

- Georgia Power Company - Docket No. 3673-U

Houston, Texas

- Houston Lighting & Power Company

Idaho Public Utilities Commission

- The Washington Water Power Company and Sierra Pacific Power Company - Case Nos. WWP-E-94-7 and WWP-G-94-4

Illinois Commerce Commission

- Illinois Power - Docket No. 84-0055

Iowa Electric Light and Power

- Organization and Operations Review

Kansas Corporation Commission

- Southwestern Bell Telephone Company - Docket Nos. 117,220-U and 123,773-U
- Kansas Gas & Electric - Docket No. 120,924-U
- Kansas Power and Light Company and Kansas Gas and Electric Company - Docket No. 174,155-U
- Western Resources - Docket No. 190,362-U

Kentucky Public Service Commission

- Louisville Gas & Electric Company - Case Nos. 5982, 6220, 7799, 8284, 8616 and 8924
- South Central Bell Telephone Company - Case Nos. 6848, 7774 and 8150
- Kentucky-American Water Company - Case No. 8571

Michigan Public Service Commission

- Wisconsin Electric Power Company and Northern States Power Company - Case No. U-10913

Minnesota Public Service Commission

- Continental Telephone Company - Docket No. PR-121-1
- Northern States Power Company - Docket No. E002/GR-89-865
- Northern States Power Company and Wisconsin Energy Corporation - Docket No. E,G002/PA-95-500

Mississippi Public Service Commission

- Mississippi Power & Light Company - Docket No. U-4285

Missouri Public Service Commission

- Union Electric Company - Case Nos. ER-84-168 and EO-85-17
- Kansas City Power & Light Company - Case Nos. ER-85-128 and EO-85-185
- Kansas Power and Light Company and Kansas Gas and Electric Company - Case No. EM-91-213
- Southwestern Bell Telephone - Case No. TC-93-224

Nevada Public Service Commission

- Bell Telephone Company of Nevada - Docket No. 425
- Central Telephone Company - Docket No. 91-7026
- The Washington Water Power Company and Sierra Pacific Power Company - Docket No. 94-8024

New Mexico Public Service Commission

- Public Service Company of New Mexico

New Mexico State Corporation Commission

- Continental Telephone of the West - Docket No. 942
- General Telephone Company of the Southwest - Docket Nos. 937 and 990
- Mountain States Telephone and Telegraph Company - Docket Nos. 943, 1052 and 1142
- U S WEST Communications - Docket No. 92-227-TC

New Orleans, Louisiana

- New Orleans Public Service Company

Ohio Public Utilities Commission

- Ohio Bell Telephone Company - Case No. 79-1184-TP-AIR
- Cleveland Electric Illuminating Company

Oklahoma Corporation Commission

- Organization and Operations Review
- Southwestern Bell Telephone Company - Cause No. 26755
- Public Service Company of Oklahoma - Cause Nos. 27068 and 27639
- Southwestern Bell Telephone Company - Cause No. 000662

Oregon, Public Utility Commission of

- Pacific Power and Light Company - Revenue Requirements Study
- Portland General Electric Company - Revenue Requirements Study
- The Washington Water Power Company and Sierra Pacific Power Company - Docket No. UM-696

Riverside, City of

- San Onofre Nuclear Generating Station

Sherman, Texas

- General Telephone Company of the Southwest

Tennessee Public Service Commission

- United Inter-Mountain Telephone Company - Docket Nos. U-6640, U-6988 and U-7117

Texas Attorney General

- Southwestern Bell Telephone Company

Texas, Public Utility Commission of

- Texas Power and Light Company - Docket Nos. 178 and 3006
- Southwestern Bell Telephone Company - Docket Nos. 2672, 3340, 4545 and 8585
- Houston Lighting & Power Company - Docket Nos. 2448, 5779 and 6668
- Lower Colorado River Authority - Docket No. 2503
- Gulf States Utilities Company - Docket No. 2677
- General Telephone Company of the Southwest - Docket Nos. 3094, 3690 and 5610
- Central Telephone Company - Docket No. 9981

Utah Public Service Commission

- Utah Power and Light Company - Docket No. 76-035-06

Vermont Public Service Board

- New England Telephone and Telegraph Company - Docket Nos. 3806 and 4546

Waco, Texas

- Texas Power & Light Company

Washington Utilities and Transportation Commission

- The Washington Water Power Company and Sierra Pacific Power Company - Docket No. UE-94-1053 and UE-94-1054

Washington Metropolitan Area Transit Authority

- D.C. Transit

Wyoming Public Service Commission

- Mountain States Telephone and Telegraph Company - Docket No. 9343, Subs. 5 and 9
- Organization and Operations Review
- Pacific Power and Light Company - Docket No. 9454, Sub. 11

MERGER SAVINGS SUMMARY

<i>Areas (\$ in 000s)</i>	<i>1997</i>	<i>1998</i>	<i>1999</i>	<i>2000</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>	<i>2004</i>	<i>2005</i>	<i>2006</i>	<i>Total</i>	<i>% of Total</i>
Labor	\$3,703	\$7,768	\$12,216	\$17,070	\$22,351	\$23,684	\$25,063	\$26,491	\$27,970	\$29,500	\$195,816	33.2%
Corporate & Admin Programs	19,070	17,800	19,185	20,618	22,103	19,705	20,361	21,040	21,744	22,472	204,098	34.6%
Purchasing Economies (Nonfuel)	4,619	5,077	5,551	6,041	6,548	7,073	7,617	8,179	8,762	9,364	68,832	11.7%
Electric Production	7,752	6,412	6,419	5,652	5,756	6,441	6,348	10,446	13,346	15,567	84,139	14.3%
Gas Production	3,091	3,216	3,343	3,477	3,616	3,761	3,911	4,068	4,230	4,399	37,111	6.3%
Total Savings	\$38,235	\$40,273	\$46,714	\$52,858	\$60,374	\$60,664	\$63,300	\$70,224	\$76,052	\$81,302	\$589,996	100.0%
Costs to Achieve	\$15,043	\$4,093	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$19,136	
Transaction Costs	\$22,000	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$22,000	
Net Savings	\$1,192	\$36,180	\$46,714	\$52,858	\$60,374	\$60,664	\$63,300	\$70,224	\$76,052	\$81,302	\$548,860	

**MERGER SAVINGS SUMMARY
(Detail)**

Areas (\$ in 000s)	Reductions	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
Labor												
Corporate & Administrative	148	\$2,112	\$4,402	\$6,880	\$9,558	\$12,443	\$13,042	\$13,660	\$14,300	\$14,963	\$15,649	\$107,009
Production and Technical Support	147	1,591	3,366	5,336	7,512	9,908	10,642	11,403	12,191	13,007	13,851	88,807
Total	295	\$3,703	\$7,768	\$12,216	\$17,070	\$22,351	\$23,684	\$25,063	\$26,491	\$27,970	\$29,500	\$195,816
Corporate & Admin Programs												
Advertising		\$63	\$65	\$67	\$69	\$72	\$74	\$77	\$80	\$82	\$85	\$734
Administrative & General Overhead		771	798	826	855	885	916	948	981	1,016	1,051	9,047
Association Dues & Memberships		114	118	122	127	131	136	140	145	150	156	1,339
Benefits		1,138	1,199	1,263	1,328	1,395	1,465	1,538	1,613	1,690	1,770	14,399
Gross Receipts Tax		1,414	1,414	1,414	1,414	1,414	1,414	1,414	1,414	1,414	1,414	14,140
Insurance		1,729	1,790	1,853	1,917	1,985	2,054	2,126	2,200	2,277	2,357	20,288
Information Services		8,718	7,114	8,153	9,228	10,342	7,561	7,820	8,089	8,368	8,656	84,049
Professional Services		4,345	4,497	4,655	4,818	4,986	5,161	5,342	5,529	5,722	5,922	50,977
Other Corporate Expenditures		120	124	128	133	137	142	147	152	158	163	1,404
Shareholder Services		453	469	485	502	520	538	557	577	597	618	5,316
Vehicles		150	155	160	166	172	178	184	190	197	204	1,756
Facilities		55	57	59	61	64	66	68	70	73	76	649
Total		\$19,070	\$17,800	\$19,185	\$20,618	\$22,103	\$19,705	\$20,361	\$21,040	\$21,744	\$22,472	\$204,098
Purchasing Economies (Nonfuel):												
Procurement		\$2,382	\$2,602	\$2,831	\$3,066	\$3,310	\$3,562	\$3,824	\$4,094	\$4,374	\$4,664	\$34,709
Contract Services		1,477	1,715	1,960	2,215	2,478	2,751	3,033	3,325	3,628	3,941	26,523
Inventory Reduction		760	760	760	760	760	760	760	760	760	760	7,600
Total		\$4,619	\$5,077	\$5,551	\$6,041	\$6,548	\$7,073	\$7,617	\$8,179	\$8,762	\$9,365	\$68,832
Electric Production		\$7,752	\$6,412	\$6,419	\$5,652	\$5,756	\$6,441	\$6,348	\$10,446	\$13,346	\$15,567	\$84,139
Gas Production		\$3,091	\$3,216	\$3,343	\$3,477	\$3,616	\$3,761	\$3,911	\$4,068	\$4,230	\$4,399	\$37,111
Total Savings		\$38,235	\$40,273	\$46,714	\$52,858	\$60,374	\$60,664	\$63,300	\$70,224	\$76,052	\$81,302	\$589,996
Costs to Achieve		\$15,043	\$4,093	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$19,136
Transaction Costs		\$22,000	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$22,000
Premerger Initiatives		\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Net Savings		\$1,192	\$36,180	\$46,714	\$52,858	\$60,374	\$60,664	\$63,300	\$70,224	\$76,052	\$81,302	\$548,860