I. INTRODUCTION

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

A. My name is David E. Peterson. I am currently employed as a public utility rate consultant by Chesapeake Regulatory Consultants, Inc. ("CRC"). Our business address is 6837 Guilford Road, Clarksville, Maryland 21029-1632. I maintain an office in Dunkirk, Maryland.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE IN THE PUBLIC UTILITY FIELD?

A. I graduated with a Bachelor of Science degree in Economics from South Dakota State University in May of 1977. In 1983, I received a Master's degree in Business Administration from the University of South Dakota. My graduate program included accounting and public utility courses at the University of Maryland.

In September 1977, I joined the Staff of the Fixed Utilities Division of the South Dakota Public Utilities Commission as a rate analyst. My responsibilities at the South Dakota Commission included analyzing and testifying on ratemaking matters arising in rate proceedings involving electric, gas and telephone utilities.

Since leaving the South Dakota Commission in 1980, I have continued performing cost of service and revenue requirement analyses as a consultant. In December 1980, I joined the public utility consulting firm of Hess & Lim, Inc. I remained with that firm until August 1991, when I joined CRC. Over the years, I have analyzed filings by electric, natural gas, propane, telephone, water, wastewater, and steam utilities in connection with utility rate and certificate proceedings before federal and state regulatory commissions.

Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY IN PUBLIC UTILITY PROCEEDINGS?

A. Yes. I have presented testimony in 75 proceedings before state regulatory commissions in Alabama, Arkansas, Colorado, Connecticut, Indiana, Kansas, Maine, Maryland, Montana, Nevada, New Jersey, New Mexico, New York, Pennsylvania, South Dakota, and West Virginia, and before the Federal Energy Regulatory Commission.

Collectively, my testimony has addressed the following topics: the appropriate test year, rate base, revenues, expenses, depreciation, taxes, capital structure, capital costs, rate of return, cost allocation, rate design, life-cycle analyses, affiliate transactions, mergers, acquisitions, and cost-tracking procedures.

Q. HAVE YOU PREVIOUSLY PRESENTED TESTIMONY IN UTILITY MERGER/ACQUISITION PROCEEDINGS?

A. Yes, I have. In April 1996, I presented testimony to the Colorado Public Utilities Commission in Docket No. 95A-531EG on behalf of the Colorado Office of Consumer Counsel relating to the merger application of Public Service Company of Colorado and Southwestern Public Service Company. In August 1997, I presented testimony to the New Jersey Board of Public Utilities ("Board") in BPU Docket No. EM97020103 on behalf of the Division of the Ratepayer Advocate ("Ratepayer Advocate") relating to the acquisition of Atlantic Energy, Inc. and Atlantic City Electric Company by Delmarva Power and Light Company. More recently, on April

16, 2001, I presented testimony to the Board in BPU Docket No. EM00110870 on behalf of the Ratepayer Advocate relating to the acquisition of GPU, Inc. by FirstEnergy Corp. of Akron, Ohio.

II. PROPOSED TRANSACTION

Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A. I am appearing in this proceeding on behalf of the Ratepayer Advocate.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. CRC was asked by the Ratepayer Advocate to review the Petition, testimonies and exhibits filed by Atlantic City Electric Company ("ACE"), Conectiv Communications, Inc., and New RC, Inc. and to present testimony on the proposed acquisition of Conectiv, Inc., including ACE, by Pepco and New RC, Inc.[1] The purposes of my testimony are to describe the Ratepayer Advocate's examination and to explain the analyses supporting my findings and recommendations. The Ratepayer Advocate is also sponsoring testimony from other technical witnesses; Barbara Alexander, James Rothschild, Bruce Biewald and David Schlissel.

Q. WHAT DID YOU REVIEW IN PREPARATION FOR YOUR TESTIMONY?

A. I reviewed the May 11, 2001 Petition, the Agreement and Plan of Merger ("Merger Agreement") dated February 9, 2001, and the testimonies and exhibits of the Joint Petitioners' four witnesses which were filed along with the Petition. In addition, I

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[1] "New RC, Inc. is a temporary name that has been given to the new holding company that is to be created in the merger. A new, permanent name will be chosen at sometime in the future. Throughout this testimony ACE, Conectiv Communications, Inc., and New RC, Inc. will be referred to collectively as the "Joint Petitioners."

have reviewed New RC's Securities and Exchange Commission ("SEC") Form S-4 Registration Statement under the Securities Act of 1933, which included a Joint Proxy Statement/Prospectus, New RC's July 20, 2001 SEC U-1 Application/Declaration under the Public Utility Holding Company Act of 1935 ("PUHCA") certain Pepco and Conectiv financial and operating reports, and the Joint Petitioners' responses to requests for additional information submitted by the Ratepayer Advocate, the Board Staff and by other intervenors in the case.

Q. PLEASE BRIEFLY DESCRIBE ACE, CONECTIV AND PEPCO.

A. ACE is a public utility providing service to 497,000 electric customers in New Jersey under rates regulated by the Board. ACE's common stock is wholly-owned by Conectiv, Inc. of Wilmington, Delaware. Conectiv, an SEC registered holding company under PUHCA, was formed by the 1998 acquisition of ACE by Delmarva Power & Light Company. Today, both ACE and Delmarva are first-tier subsidiaries of Conectiv. In addition to providing wholesale and retail electric and natural gas service, Conectiv's present business strategy also centers on building and operating "mid-merit" power plants that can respond quickly to changes in the demand for power within PJM.

Pepco is an electric utility company with headquarters in Washington, DC. Presently, Pepco is not an SEC registered holding company. Pepco provides electric service to approximately 480,000 customers in Maryland and 220,000 customers in the District of Columbia. In addition to wholesale and retail electric distribution services, Pepco provides a wide range of telecommunications services including local and long-distance telephone, high-speed Internet and cable television. Pepco also provides energy products and services in competitive retail markets. Like the Conectiv companies, Pepco is also a member of PJM.

The following table compares the relative size of Conectiv and Pepco for the year 2000.

($Millions)

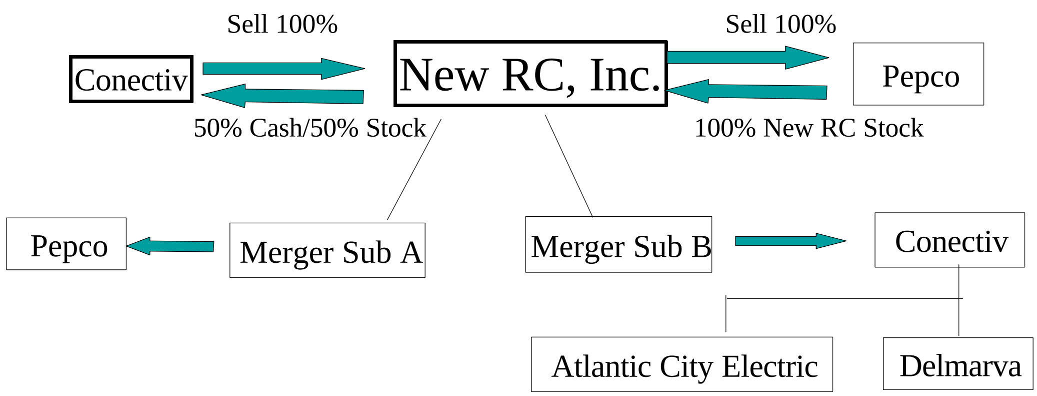
	Conectiv		
	ACE	Delmarva	Pepco
Customers	497,000	471,000	711,000
Revenue	$ 956	$ 1,560	$ 2,201
Assets	$ 2,573	$ 2,428	$ 6,585
Long-term debt	$ 1,075	$ 1,092	$ 2,103

The Joint Petitioners claim the proposed business combination will create the largest electric delivery company in the mid-Atlantic region (i.e., wholly within PJM) both in terms of load (i.e., KW) and sales (i.e., KWH), serving 1.8 million customers.

Q. PLEASE SUMMARIZE THE PROPOSED TRANSACTION.

A. On February 9, 2001, the Joint Petitioners executed the Merger Agreement. To accomplish the merger, New RC, Inc. and two other subsidiaries were formed, “Merger Sub A” and “Merger Sub B”. Forming these two subsidiaries were necessary to place Pepco and Conectiv as first tier subsidiaries of the holding company, New RC, following the merger. If the necessary approvals are granted, Merger Sub A will be merged into and with Pepco, and Pepco will be the surviving entity. At the same time, Merger Sub B will be merged into and with Conectiv, with Conectiv surviving. ACE and Delmarva will remain subsidiaries of Conectiv. New RC has applied with the SEC to register as a holding company under the Public Utility

Holding Company Act of 1935. The following chart illustrates the proposed combination:



Pepco will purchase Conectiv for $2.2 billion in cash and stock. Upon merger closing, all of the outstanding shares of Pepco common stock will be converted to an equal number of New RC shares. Conectiv shareholders will elect to either receive cash for their outstanding shares of stock ($25 per share for common stock and $21.69 for Class A common stock), New RC stock, the number of shares to be determined by an agreed upon exchange ratio formula, or a combination of both cash and New RC stock. Conectiv shareholders as a group will receive 50 percent cash and 50 percent New RC stock as compensation for their shares of common stock. It is anticipated that Pepco shareholders will own approximately 67 percent of New RC shares, while the remaining 33 percent will be owned by Conectiv shareholders. Pepco is expected to pay the roughly $1.1 billion cash consideration using $400 million of proceeds from the recent sales of its generating assets. The rest of the cash will need to be raised from external sources. New RC will also assume $3.2 billion of Conectiv's outstanding debt and preferred stock.

New RC's corporate offices will be located in Washington, DC. New RC intends to continue its utility operations on a stand-alone basis following the merger. Therefore, Pepco will continue to maintain its corporate offices in Washington, DC, and Conectiv will continue operations from its Wilmington, Delaware corporate offices. New RC's Board of Directors will consist of 12 members. Ten of the members will be nominated exclusively by Pepco. It is anticipated that all ten of Pepco's current directors will be nominated as directors of New RC. The remaining two directors are to be nominated by Conectiv, subject to Pepco approval. Mr. Howard Cosgrove, Conectiv's current Chairman of the Board and Chief Executive Officer, will retire at merger closing. John M. Derrick, Jr., Pepco's present Chairman and Chief Executive Officer, will serve in the same capacities for New RC. Thomas Shaw, Conectiv's President and Chief Operating Officer will serve in the same capacities for New RC.

New RC will account for the transaction under the purchase method of accounting, with Pepco being the acquiring company. Under the purchase accounting method, the estimated fair market value of Conectiv's assets and liabilities will be consolidated with Pepco. The excess of the transaction purchase price, including Pepco's merger-related fees and expenses, over the estimated fair market value of Conectiv's assets will be recorded as "goodwill" on New RC's post-acquisition books. The Joint Petitioners estimate that $543.1 million will be recorded as goodwill.[2] The goodwill created in this transaction will remain on New RC's books, without amortization, until

[2] The gross amount of goodwill to be recorded by New RC in the transaction is $885 million. That amount, however, will be reduced by $341.9 million to eliminate the unamortized goodwill presently on Conectiv's books which arose from the Atlantic Energy/Delmarva merger. See the Joint Petitioners' response to NJRAR-R- 1-32.

it has been determined to be financially impaired, pursuant to newly adopted generally accepted accounting procedures.[3]

Q. WHAT APPROVALS ARE NECESSARY BEFORE THE TRANSACTION CAN BE CONSUMMATED?

A. Both Pepco and Conectiv have received the requisite votes from their respective shareholders approving the merger. The Joint Petitioners must have Board approval before the transaction can close. The companies also must receive approvals from other state regulatory bodies including the Delaware Public Service Commission, the Maryland Public Service Commission, the Pennsylvania Public Utility Commission, the Virginia State Corporation Commission, and the District of Columbia Public Service Commission. In addition to the foregoing state approvals, the companies must receive clearance or approval by the following Federal regulatory agencies: The Federal Trade Commission, the Department of Justice, the Securities Exchange Commission, the Federal Energy Regulatory Commission, the Federal Communications Commission and, possibly, the Nuclear Regulatory Commission. The Joint Petitioners expect to complete the regulatory approval process in time to close the transaction by the first quarter of 2002.

[3]Financial Accounting Standards Board Statement No. 142, “Goodwill and Other Intangible Assets,” issued July 20, 2001.

III. CLAIMED BENEFITS

Q. WHAT IS THE UNDERLYING STRATEGY IN PEPCO ACQUIRING CONECTIV?

A. The Joint Petitioners claim that even though it had acquired ACE in a merger in 1998, by early 2000, Conectiv had already begun to realize it was just too small to compete with its larger rivals in emerging competitive energy markets. Thus, Conectiv essentially offered itself for sale. Ultimately, Conectiv's directors determined that Pepco's offer was the most advantageous of those it had considered. The apparent underlying strategy in Pepco acquiring Conectiv is one of retail expansion of energy delivery services within PJM. Pepco believes a much larger scale of retail service operations will better equip the company to deal with the new challenges brought on by industry restructuring and the introduction of retail customer choice. Pepco will also consider Conectiv's mid-merit generation strategy. It can choose to adopt Conectiv's strategy for itself, it can choose to halt Conectiv's deployment of that strategy, or it can choose to halt deployment and sell off Conectiv's existing mid-merit plants. [**Confidential:**

[End of Confidential].[4] The loss of control over the mid-merit strategy by Conectiv was the very reason that one of Conectiv's directors voted against the merger with Pepco.[5]

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[4]These strategies were discussed in the Merrill Lynch confidential reports to the Pepco Board of Directors, which were reviewed by the Ratepayer Advocate *in camera*.

[5]SEC Form S-4 (Pre-effective Amendment No. 3), filed May 30, 2001, page 85.

Even after the merger is consummated, New RC will not be as large as some of the other utilities created by the recent mega-mergers, e.g., the recent FirstEnergy/GPU merger. Control over New RC that is retained by Pepco, however, will allow New RC the flexibility to seek additional acquisition partners in the future, or to itself be acquired by another utility. Thus, ACE's local interests may be pushed even further down the priority chain than it will find itself if the Pepco/Conectiv merger is approved.

Q. WILL THE COMPANIES' STOCKHOLDERS BENEFIT FROM THE TRANSACTION?

A. Clearly, the majority of stockholders from both companies perceive the proposed acquisition as beneficial. This is evidenced by the fact that the requisite number of shareholders from each company have voted to approve the merger. For Pepco's stockholders, there is an expectation that the combination will increase earnings even within the first year, without considering synergy savings. This is due, in part, to the new accounting requirement that does not require amortizing or writing down goodwill until it has been determined that the recorded goodwill has been financially impaired. Following the initial year post-merger, investment analysts project the transaction will enhance Pepco's growth prospects from 6% - 8%.

For Conectiv's shareholders, Pepco's offer to pay $25 per share for Conectiv's common stock ($21.69 for Conectiv Class A common stock) results in an attractive premium. Based on Conectiv's trading price just prior to the acquisition announcement (i.e., February 7, 2001), the $25 per share offer represents a 30 percent premium to owners of Conectiv common stock ($21.69 represents a 14 percent premium to Class A shareholders).

Q. DO THE JOINT APPLICANTS CLAIM OTHER BENEFITS CAN BE ACHIEVED THROUGH THE MERGER?

A. Yes. The Joint Petitioners allude to benefits that should be attainable without ever critically examining tangible savings that may result. For example, in their joint testimonies, Messrs. Derrick and Shaw state that the combined companies can command greater purchasing power and can achieve lower costs.[6] The Joint Petitioners' expert witness, Joe D. Pace, identifies other potential benefits arising from the merger, including:

1. Creating opportunities for savings or strengthened management by consolidating corporate functions at a measured rate;

2. Providing potential savings and/or service improvements through sharing "best practices" between the two companies;

3. Allowing for better responses to system emergencies and improving customer service by taking advantage of geographic diversity; and

4. Reducing the cost of goods and services procured by making larger-volume purchases.[7]

Yet, in contrast to the customary practice in these types of regulatory petitions, the Joint Petitioners in this proceeding have not prepared a comprehensive study of savings opportunities and related costs created by the proposed merger.[8]

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[6]Joint Testimony of John M. Derrick, Jr. and Thomas S. Shaw, page 5.

[7]Testimony of Joe D. Pace, page 9.

[8]See response to NJRAR-R 1-27 and NJRAR-R- 1-27(Supplemental).

Q. HAVE THE JOINT PETITIONERS COMMITTED TO ANY TANGIBLE BENEFITS TO ACE'S CUSTOMERS THAT ARE TO RESULT FROM THE MERGER?

A. No. Through the testimony of Mr. Hasbrouck, the Joint Petitioners have committed to a package of service guarantees. Certainly, maintaining adequate and reliable service is an extremely important consideration in a merger proceeding such as this. But, as Ms. Alexander explains in her testimony, the service quality package that has been offered is far weaker and provides fewer benefits to ratepayers than similar Service Quality Guarantee programs adopted in other jurisdictions as part of merger proposals or conditions. Moreover, this service guarantee could have been offered without the merger proposal. That is, the ability of ACE to offer the service guarantees is not dependent on Conectiv merging with Pepco. The Joint Petitioners have made no commitment to any customer benefits that are to directly result from the merger.

Q. DOES PEPCO HAVE MERGER EXPERIENCE?

A. Yes, it does. In 1995, Pepco signed a merger agreement with Baltimore Gas and Electric Company ("BGE") to form a $15 billion electric and gas company called Constellation Energy. The merging companies in that proceeding estimated merger-related savings over the first ten years post-merger of $1.35 billion, net of costs to achieve those savings. Pepco and BGE successfully secured the regulatory approvals that were needed to merge. Yet, the merging companies were dissatisfied with the financial conditions imposed on the merger by the Maryland and District of Columbia Public Service Commissions who required the utilities to share a substantial portion of the projected merger-related savings with ratepayers.[9] Thus, after spending approximately $100 million on the merger, Pepco and BGE decided in December 1997 to terminate the merger.

IV. STANDARD OF REVIEW

Q. WHAT SPECIFIC AUTHORIZATIONS DO THE JOINT PETITIONERS SEEK FROM THE BOARD IN THIS PROCEEDING.

A. The Joint Petitioners seek Board approval of the merger pursuant to N.J.S.A. 48:3-10 and 48:2-51.1. In addition, ACE seeks Board approval to establish an accounting mechanism to track merger related costs for later consideration. ACE, however, has not stated if or how it intends to recover its share of merger related costs from New Jersey ratepayers.

Q. WHAT DO THESE NEW JERSEY STATUTES REQUIRE?

A. I have been advised by counsel that N.J.S.A. 48:3-10 prohibits New Jersey public utilities from selling or transferring capital stock to any other public utility and from selling majority interest in capital stock to any corporation without Board authorization. In considering requests under this statute, I am advised that the Board must determine, *inter alia*, if the utility is able to meet pension benefit commitments previously made to employees.

N.J.S.A. 48:2-51.1 imposes additional requirements on the Joint Petitioners. I am advised that written Board approval is required before any person can acquire control

[9] Both the Maryland and the District of Columbia Public Service Commissions ordered Pepco and BGE to share 75 percent of the projected first year net savings with ratepayers. Maryland PSC Case No. 8725, Order No. 73405, issued April 16, 1997. District of Columbia PSC Formal Case No. 951, Order No. 11075, October 20, 1977.

of a New Jersey public utility. Under the statute, the Board is required to evaluate four specific areas in making a public interest finding. The statute states in relevant part:

> ". . . In considering a request for approval of an acquisition of control, the board shall evaluate the impact of the acquisition on competition, on the rates of ratepayers affected by the acquisition of control, on the employees of the affected public utility or utilities, and on the provision of safe and adequate utility service at just and reasonable rates . . ."

The Board will make specific findings on each aspect of the public interest standard outlined in the merger statutes. Ultimately, the Board must determine whether the transaction will result in an adverse impact on competition, on rates, on New Jersey employees, and on the provision of safe and adequate utility service at just and reasonable rates. More generally, I am advised by counsel that after the merger, ACE must still meet the basic requirements specified under N.J.S.A. 48:2-23 by furnishing "safe, adequate and proper service, including furnishing and performance of service in a manner that tends to conserve and preserve the quality of the environment and prevent pollution of the waters, land and air of this State, and including furnishing and performance of service in a manner which preserves and protects the water quality of a public water supply, and to maintain its property and equipment in such condition as to enable it to do so."

Q. HAS THE BOARD INTERPRETED THESE REQUIREMENTS IN OTHER MERGER PROCEEDINGS?

A. Yes. I have been advised by counsel that in prior merger proceedings the Board has alternately used a "positive benefits" standard and a "no harm" standard to evaluate applications for changes in control. Under the positive benefits standard merger applicants must prove a merger will result in positive benefits relative to the statutory review requirements. A no harm standard requires merger applicants to merely demonstrate a merger will not produce an adverse result relative to the four areas specified in the statute.

The Ratepayer Advocate contends that the Board should use the positive benefits standard to evaluate Pepco's take-over of Conectiv. That is, the Joint Petitioners should convincingly demonstrate that New Jersey ratepayers will receive positive net benefits resulting from the merger that could not have been achieved without the merger. This is, in essence, what the Board required in the prior merger involving ACE and Delmarva. Therein, while stating that ACE had met the no harm standard as "sufficient to ensure the continuation of safe, adequate and proper service at reasonable rates and adherence to the other requirements of N.J.S.A. 4:2-51.1"[10], the Board nevertheless required the utility to share 75 percent of the anticipated net savings with New Jersey ratepayers in the form of immediate rate reductions and required proportionate job reductions between the merging companies. Sharing 75 percent of expected merger savings with ratepayers was the same condition that the Maryland and the District of Columbia Public Service Commissions imposed on Pepco's previous merger attempt. Thus, in these respects, the Board relied on the positive benefits standard when it imposed conditions on ACE's merger to form Conectiv. The same positive benefits standard should be applied to ACE and Pepco in this proceeding.

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[10] I/M/O Petition of Atlantic City Electric and Conectiv, Inc. for Approval of a Change in Ownership and Control, ("*1998 Conectiv Merger*")January 7, 1998, Docket No. EM97020103, page 6.

The Board explicitly relied on the positive benefits standard in 1984 when reviewing a merger between NUI Corporation and Elizabethtown Gas Company.[11] In ruling on that merger, the Board set forth a 12-part test to determine whether that merger provided positive benefits to the public interest and not merely caused no harm.[12]

V. SUMMARY OF FINDINGS

Q. PLEASE DESCRIBE THE RATEPAYER ADVOCATE'S EXAMINATION IN THIS PROCEEDING.

A. Pursuant to N.J.S.A. 48:2-51.1, Your Honor and the Board must consider the effect of the acquisition on (1) competition, (2) ACE's regulated service rates in New Jersey, (3) ACE's employees, and (4) the provision of safe and adequate service at just and reasonable rates. The Ratepayer Advocate designed its examination and analyses with these requirements in mind. Collectively, the witnesses for the Ratepayer Advocate have considered and will offer testimony on each of these four areas. I was assigned to address issues of general regulatory policy raised by the Petition, and more specifically, issues concerning the impacts of the merger on rates and on ACE's employees and the accounting order that ACE seeks from the Board concerning tracking merger related costs. To aid in my evaluation of these areas, I identified four questions to determine if Pepco's proposed acquisition of Conectiv and ACE is in the public interest. The four questions relating to rates and employee impacts resulting from the merger are as follows:

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[11] I/M/O Petition of New Jersey Resources Corporation and New Jersey Natural Gas Company v. NUI Corporation and Elizabethtown Gas Company, ("*NUI Merger Order*") BPU Docket No. 8312-1093, January 1, 1984.

[12] *NUI Merger Order*, pp. 7-8.

1. Will the merger result in tangible and determinable net benefits that could not be achieved without the merger?

2. Will New Jersey ratepayers realize tangible merger benefits contemporaneous with the merger?

3. Does the Merger Agreement contain adequate protection for ACE's current employees against any unreasonable treatments that may result from the merger?

4. Will regulatory oversight be unduly complicated by the merger in ways that effective regulation by the Board will be impeded?

My testimony addresses each of these questions. The final section of my testimony addresses ACE's request concerning tracking merger-related costs. The Ratepayer Advocate's other witnesses address competition, service reliability, and other relevant issues.

Q. PLEASE SUMMARIZE YOUR FINDINGS.

A. The Petition fails to meet the positive benefits standard. The Joint Petitioners have not demonstrated that New Jersey ratepayers will receive net positive benefits arising from the merger. Moreover, the Joint Petitioners fail to make a minimum showing the proposed transaction will result in no harm. Specifically relating to my areas of inquiry, i.e., rates and employees, the Joint Petitioners have not sufficiently demonstrated its plan will not result in harm to ratepayers. Following is a brief summary of my findings on each of the four questions that formed the basis for my examination.

Finding 1: Whether the merger produces tangible positive benefits depends on a comprehensive analysis of merger-related costs and benefits. Benefits realized as a direct result of the merger should exceed costs incurred to accomplish the merger. The meager analysis offered by Joint Petitioners has not shown this to be the case. In short, the Joint Petitioners fail to sufficiently quantify both short-term and longer-term merger-related costs and anticipated benefits. They also fail to demonstrate that the costs that are being incurred are necessary, prudent, and reasonable. Moreover, other than the cursory estimates of non-operating savings over the next five year that were provided late in the discovery process, the Joint Petitioners fail to quantify specific benefits to be achieved in the merger in a comprehensive manner. Nor do they state their plan for achieving the benefits described in Dr. Pace's testimony. The merging companies have not proven there will be positive benefits to New Jersey ratepayers resulting from the merger. Nor have they proven that the less restrictive no harm standard has been satisfied. In fact, the benefits that have been quantified thus far by the Joint Applicants are less than the merger-related costs that have been estimated, suggesting the merger will result in a net harm.

Finding 2: Assuming, *arguendo*, that net merger benefits can be achieved, which has not been shown to date, the Joint Petitioners have no plan for sharing those benefits with ratepayers, other than stating that the normal rate setting process will capture those benefits for ratepayers in the future. ACE will remain a public utility subject to the Board's rate regulation following the merger. The Joint Petitioners simply dismiss any rate impact implication of the merger because ACE's rates have been capped until July 31, 2003 and because Pepco plans to integrate the two utilities at a "measured pace" following the merger. The merger plan is permanent, however. Its affects on ACE's costs and rates will extend beyond the year 2003. Yet, the Joint Petitioners have not quantified the expected impact of the merger on its regulated rates. Nor have they stated a plan for integrating merger benefits into ACE's rate structure either now or in the future.

Finding 3: Concerning employees, the Joint Petitioners steadfastly claim that ACE's New Jersey employees will largely be unaffected by the merger, at least for the period of time immediately following the merger. No commitments with respect to employees is made over the longer term following the merger, however, as Pepco integrates the two companies at the measured pace to which it refers. In the matter of corporate governance, the Merger Agreement does not adequately consider the proportionate contribution of resources to be made by ACE and Conectiv. The Joint Petitioners' promise to keep a corporate presence in New Jersey is not sufficient because it lacks specific details of that commitment. Thus, the Joint Petitioners have not satisfied the positive benefits standard with respect to the impact on employees. Nor has it even met the less restrictive no harm standard.

Finding 4: Moving corporate headquarters and possibly the service company operations to Washington, DC, can complicate the regulatory process in New Jersey and will likely increase the cost of retail rate regulation.

These findings highlight areas in the Merger Plan that I have examined and found contrary to the public interest. The Joint Petitioners have not demonstrated that the merger, as proposed, will result in a net positive benefit to New Jersey ratepayers. Furthermore, the Joint Petitioners have not demonstrated that the merger will not harm New Jersey ratepayers and employees. Therefore, the Joint Petition should not be approved in its present form and, in fact, should be dismissed and re-filed. At the end of my testimony, I identify specific conditions relating to ACE's rates, employees, and post-merger operations upon which approval of the merger should be conditioned. Other Ratepayer Advocate witnesses will recommend other conditions to be placed on the merger as well.

VI. NET POSITIVE BENEFITS

Q. IS IT YOUR POSITION THAT THE JOINT PETITIONERS SHOULD SHOW NET POSITIVE BENEFITS RESULTING FROM THE MERGER AS A CONDITION TO GAINING BOARD APPROVAL?

A. Yes, it is. Aside from supporting case law in prior New Jersey merger proceedings, the positive benefits standard makes good common sense. Before utilities undertake to spend billions of dollars on an investment there should be threshold showing of positive benefits. Utilities routinely make this calculation when evaluating virtually every construction, research and development, and investment decision, unless the project is required by law or for safety or reliability reasons. The Board should review this $2.2 billion merger, which involves the sale and acquisition of all of the ratepayer-funded assets of ACE, with no less scrutiny.

Q. HAVE THE MERGING COMPANIES PREPARED A NET POSITIVE BENEFITS CALCULATION TO SUPPORT THE PETITION?

A. No, they have not. The calculation of net positive benefits (or no harm) requires a detailed assessment of the (1) potential for synergy savings, (2) costs necessary to close the transaction, i.e., the so-called transaction costs; and (3) costs necessary to integrate the separate technologies, operations and functions of the separate companies, i.e., the so-called transition costs. Of these three, the Joint Petitioners were required in their SEC filing to provide estimates of certain transaction costs only. With respect to expected savings, the companies have not undertaken a comprehensive synergy study to quantify merger-related savings. Nor has a comprehensive estimate of transition costs been provided.

While the Joint Petitioners testify that substantial savings in utility operating areas are expected, there was no attempt to quantify either the savings or the costs necessary to achieve those savings. What the Joint Petitioners did provide late in the discovery phase of this proceeding was a sketchy estimate of some savings opportunities in non-operating areas (i.e., corporate governance, supply chain and information technology areas) over the first five years post-merger.

Q. LOOKING FIRST AT THE COSTS IN THE POSITIVE BENEFITS CALCULATION, WHAT COSTS SHOULD BE CONSIDERED?

A. Generally any cost incurred to accomplish the merger, i.e., transaction costs, or any costs incurred to integrate the separate technologies, operations and functions of the newly combined entity, i.e., transition costs, should be identified and quantified by Joint Petitioners. Of course, merely quantifying such costs does not necessarily mean that they are reasonable or necessary, or should offset any merger-related savings.

Q. HAVE ALL OF THE TRANSACTION FEES ASSOCIATED WITH THE MERGER BEEN QUANTIFIED AT THIS TIME?

A. No.[13] However, New RC's July 20,2001 SEC Form U-1 Application provides an estimate of certain transaction costs associated with the merger, as follows:

[13]Petition, paragraph 34, page 15. "With respect to N.J.A.C. 14.1-5.14(a)(14), the total amount of fees and expenses to be incurred in connection with the Merger are not quantifiable at the present time."

1.	SEC registration	$ 959,650
2.	Financial advisor fees (New RC)	$ 9,100,000
3.	Financial advisor fees (Conectiv)	$19,800,000
4.	Accountant fees	$ 600,000
5.	Legal fees	$ 7,000,000
6.	Stockholder communications	$ 4,336,919
7.	Miscellaneous	$ 4,000,000
8.	Total	$45,796,569[14]

In addition to the fees and costs identified above, both Pepco and Conectiv have change of control employment severance contracts with several of its officers and managers, which, if exercised, could add millions of dollars to the transaction costs. In total, Pepco estimates that it will capitalize $16 million in direct acquisition costs.[15] What is missing from the record in this proceeding are estimates of Pepco's and Conectiv's transaction costs that will be expensed. Moreover, because the Joint Petitioners do not provide detailed estimates of their costs, and supporting documentation, we cannot determine whether the costs themselves are legitimate, prudently incurred, and reasonable. Thus, despite the fact that ACE is requesting Board authorization to establish a mechanism to track merger-related costs for later disposition, there has been no indication as to the level and the specific nature of costs that will be charged to ACE.

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[14]New RC's July 20, 2001 SEC Form U-1 Application/Declaration, page 33.

[15]New RC's May 30, 2001 SEC Form S-4 (Pre-effective Amendment No. 3), page 104.

Q. HAVE THE JOINT PETITIONERS INDICATED THE LEVEL OF TRANSITION COSTS THEY EXPECT TO INCUR?

A. No.[16] The Joint Petitioners state in testimony that the merged entity will continue to function as two separate stand-alone companies, that employment levels will remain substantially as they are today, and that there will be no wide spread consolidation of operations following the merger.[17] This mantra is repeated in virtually all of the companies' responses to interrogatory requests that seek more information concerning the companies' estimates of savings and costs.[18] Yet, the Joint Petitioners also point to the ability to gain purchasing power and lower costs to their customers through the merger.[19] Such benefits, if they are to be realized, will require careful planning and will involve costs. The Joint Petitioners have not revealed their plans for achieving these lower costs. Nor have they provided estimate of costs that are likely to be incurred to achieve the expected benefits. We cannot determine now whether the transition costs incurred by the Joint Petitioners are legitimate, prudently incurred, and reasonable. There should be no rate recovery for transaction costs, either now or in the future. In addition, no rate recovery of any transition costs should be authorized until there has been a showing of positive net benefits and that the costs incurred were necessary, prudent, and reasonable.

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[16]Petition, paragraph 17, page 7. "The costs to achieve the Merger have not been quantified at this time."

[17]Joint Testimony of John M. Derrick, Jr. and Thomas S. Shaw, pages 4 and 11.

[18]For example, see Joint Petitioners' responses to NJRAR-R 1-22, 1-27, 1-39, 1-40, 1-42, 1-43, 1-48, 2-68, 2-77.

[19]Joint Testimony of John M. Derrick, Jr. and Thomas S. Shaw, page 5.

Q. IS THERE ANY INDICATION THAT ACE AND NEW RC INTEND TO SEEK RECOVERY OF MERGER RELATED COSTS FROM NEW JERSEY RATEPAYERS?

A. Yes, there is. Paragraph 23(B) of the Petition contains the following statement: "The achieved efficiencies and cost savings, ***net of Merger-related costs,*** will be reflected in the electric cost of service studies prepared in connection with future rate proceedings."(emphasis supplied) The notion of netting benefits with unspecified costs should not be accepted by Your Honor and the Board. As an initial matter, the Board and ratepayers are entitled a comprehensive evaluation of both expected benefits and costs. This information is necessary for Your Honor and the Board to complete its jurisdictional review of the proposed merger. There is no good reason for the Joint Petitioners to withhold transaction/transition cost information from either the Board or the Ratepayer Advocate. Moreover, any cost incurred by a utility that it may seek to include in rates should be subject to the normal regulatory review requirement that costs must be reasonable, necessary and prudently incurred. Benefits resulting from a merger should not be diminished because the utility has incurred unreasonable and unnecessary costs in the process.

The Joint Petitioners have not quantified any merger-related benefits or costs to either ACE or its ratepayers. The Joint Petitioners have not explained their plan to track either merger-related costs or merger-related savings. Nor have they stated a plan for integrating either in ACE's rates. Without identification and tracking procedures in place, we cannot determine if costs that are reflected in rates are offset by merger savings. There is no accountability in the Joint Petitioners' plan to net merger costs against merger savings. Nor is there any opportunity in this proceeding to determine if the costs being incurred by ACE are legitimate for future rate recovery. Nor is there any concrete indication that there will be a net positive benefit to New Jersey ratepayers as a result of this merger.

Q. ARE THERE MERGER-RELATED COSTS THAT SHOULD NOT BE CHARGED TO RATEPAYERS?

A. Yes. Because the Joint Petitioners have not identified all of their merger related costs, I cannot provide a definitive list of such costs at this time. But, because there has been no comprehensive examination of merger benefits and costs, the only clear beneficiaries of the merger will be those officers and managers that have golden parachute employment severance contracts and the stockholders of both Conectiv and Pepco. Earlier I outlined the premium that Conectiv's shareholders will receive for their stock ownership. I also mentioned the positive impact the merger is expected to have on Pepco's post-merger earnings. These are the only clear benefits that have been identified in the merger. In this case, New RC's shareholders should bear all of the transaction costs.

Aside from my general recommendation that stockholders bear all transaction costs, there are specific costs that should not be recoverable from ratepayers in any instance. For example, there should be no rate recovery for the golden parachute costs.

Q. WHY SHOULDN'T GOLDEN PARACHUTE COSTS BE CHARGED TO RATEPAYERS?

A. Golden parachutes refer to severance payments made to executives who will lose their current positions as a result of the merger. Severance compensation packages offered to key officers generally exceed the level of compensation that may be offered to the rank and file employees that also may be displaced because of the merger. Since it is the executives who are largely the driving force in this merger and who will define post-merger resource requirements, those executives should not be allowed to promote their self interests at the expense of ratepayers. Golden parachute costs should not be deemed a recoverable merger expense. This is consistent with the Board's treatment of golden parachute costs in the *1998 Conectiv Merger*.[20]

Q. IS THERE ANY INDICATION HOW SIGNIFICANT GOLDEN PARACHUTE COSTS WILL BE?

A. No. Thus far, apparently only Mr. Derrick and Mr. Shaw have been appointed to positions with New RC. The Joint Applicants have not disclosed which of Conectiv's and Pepco's current officers and managers having golden parachute contracts will remain following the merger.

Q. IN THE 1998 MERGER THAT FORMED CONECTIV, THE JOINT APPLICANTS IN THAT PROCEEDING REQUESTED THE BOARD TO NET EXPECTED MERGER SAVINGS WITH AN AMORTIZATION ALLOWANCE FOR THE GOODWILL PREMIUM THAT AROSE IN THE TRANSACTION. IS THAT A CONSIDERATION IN THIS PROCEEDING?

A. No, it is not. The goodwill premium arose in the prior Conectiv merger because the price that Delmarva paid for Atlantic Energy stock, plus estimated transaction costs, exceeded the fair market value of Atlantic Energy's stock. The same will be true in this merger, i.e., Pepco's $25 per share offer price significantly exceeds Conectiv's current fair value. However, generally accepted accounting procedures ("GAAP") for goodwill have changed since the Board considered the issue in the ACE/Delmarva merger. In the past, GAAP required companies to amortize goodwill assets over

[20] *1998 Conectiv Merger,* Initial Decision, p. 10.

forty-years. GAAP now requires goodwill assets to remain on the books until such time as it is determined that the asset has been impaired. Once financially impaired, the previously recorded goodwill would then be written down to its unimpaired value. Therefore, the $543.1 million of goodwill created in this merger will not be subject to amortization. There is no basis for reducing merger savings by consideration of goodwill.

Q. HAVING DISCUSSED MERGER-RELATED COSTS, LET US NOW TURN OUR ATTENTION TO MERGER-RELATED SAVINGS. EARLIER IN YOUR TESTIMONY YOU REFERRED TO THE PREVIOUS MERGER EXPERIENCE OF CONECTIV AND PEPCO. IN THOSE EARLIER MERGER PROCEEDINGS DID CONECTIV AND PEPCO PRESENT COMPREHENSIVE SYNERGY SAVINGS STUDIES?

A. Yes, they did. All of the companies in the ACE/Delmarva and the Pepco/BGE mergers retained Deloitte & Touche Consulting Group from Texas to prepare and present comprehensive synergy savings analyses of each merger. The format of the synergy savings studies in the two mergers were quite similar. Each projected merger-related operating and non-operating savings and costs during the first ten years post-merger. The same witness, Mr. Thomas J. Flaherty of Deloitte & Touche, was retained by both sets of merging companies as their expert witness on net merger savings. In connection with the ACE/Delmarva merger, Mr. Flaherty's study showed $509 million of net merger savings during the first ten years post-merger. In the Pepco/BGE merger, Mr. Flaherty's study showed $1.35 billion of merger savings, net of costs, over the first ten years post-merger. Regulators unquestionably found the studies to be an invaluable tool in evaluating the proposed mergers.

Q. HAVE THE JOINT PETITIONERS PRESENTED A COMPREHENSIVE SYNERGY SAVINGS STUDY FOR THIS PROCEEDING?

A. No, they have not.

Q. WHAT REASON WAS GIVEN FOR NOT CONDUCTING A COMPREHENSIVE SYNERGY SAVINGS STUDY?

A. Even though the Joint Applicants anticipate long-term cost reducing benefits of the merger, they claim the merger is not driven by synergies resulting from wide spread consolidation and immediate cost reductions. Apparently, their position is that the "measured pace" at which savings are to be achieved justifies not preparing a comprehensive savings analysis.

Q. DO YOU AGREE WITH THIS POSITION?

A. No, I do not. Before Your Honor and the Board can make well-reasoned decisions regarding the merger, there must be awareness of the companies' plans and expectations. The Joint Petitioners have testified that there will not be wide spread layoffs or cost-cutting measures immediately following the merger. On the other hand, there is also no reason to doubt Pepco's ability to implement strategies following the merger to achieve substantial savings and cost reductions in the longer term. This, essentially, is how the companies and Dr. Pace have testified in this proceeding. This view is also shared by a Merrill Lynch equity analyst who has reviewed the merger plan. Steven I. Fleishman, a Merrill Lynch equity analyst, states in his February 13, 2001 report on the merger: "While the companies are reluctant to quantify merger synergies, we believe that neighboring service regions provide a decent opportunity for cost savings and merger synergies."[21]

In Pepco's and Conectiv's prior merger proceedings, longer term cost savings were an integral element in Mr. Flaherty's saving analyses. A similarly structured savings analysis for this merger may not show savings of the same order of magnitude for near term savings as was shown in the previous mergers, but longer term merger savings expectations should be documented nevertheless. This analysis is critical to determining whether the merger satisfies the no harm and the positive benefit standards. It is imperative that the Joint Petitioners conclusively demonstrate that expected merger savings will exceed merger-related costs. That showing has not been made in this proceeding.

There may be another motive underlying Pepco's reluctance to document substantial merger savings prior to receiving regulatory approvals. In the Pepco/BGE merger, Mr. Flaherty's synergy savings study showed net merger savings of $1.3 billion over the first ten years post-merger. Pepco and BGE sought regulatory approval of that merger based in large measure on Mr. Flaherty's savings estimates. While the Maryland and the District of Columbia Public Service Commissions granted approval of the merger, both required that 75 percent of the identified net merger savings be shared with ratepayers. Pepco and BGE found this condition unacceptable, wanting to retain a larger share of the expected savings for their shareholders. Ultimately, Pepco and BGE terminated their merger plans when it appeared unlikely the commission decisions would be reversed any time soon. Pepco is certainly aware of

[21]Fleishman, Steven I., Merrill Lynch Research Bulletin, Reference Number 10141004, February 13, 2001, page 3. Provided in response to NJRAR-R 1-58.

the Board's 1997 Order in the Conectiv case wherein ACE also was required to return 75 percent of the projected first-year savings to ratepayers in the form of a rate reduction. A requirement to share a large portion of expected merger savings with ratepayers provides Pepco strong incentive to conservatively estimate merger savings. My suspicions appear to be shared by at least one equity analyst. The February 13, 2001, report by equity analyst David M. Schanzer of Janney Montgomery Scott LLC includes the following passage:

> "Given the problems Potomac experienced when trying to merge with what was Baltimore Gas & Electric Co. several years ago, both Potomac and Conectiv are not discussing the size of the savings expected from the merger. This is unlikely to fool regulators (nor do we think anyone has deliberately tried to hide these so-called synergies) and we note that this may be unique in that savings are not being discussed at all."[22]

Q. WHAT MERGER SAVINGS, IF ANY, HAVE THE JOINT PETITIONERS QUANTIFIED THUS FAR?

A. No net merger savings have been quantified as yet. Very late in the discovery phase of this proceeding, however, the Joint Petitioners provided a preliminary estimate of merger savings over the first five years post-merger. The Joint Petitioners were quick to caution that their estimates do not constitute a comprehensive synergies study such as those that had been presented in both the ACE/Delmarva and Pepco/BGE mergers. In fact, the estimates provided by the Joint Petitioners relate only to certain categories of savings in non-operating areas such as corporate governance, supply chain and information technology. No savings estimates were provided in the companies' operating areas where additional savings opportunities have been acknowledged.

[22]The Janney Montgomery Scott LLC report was provided in response to NJRAR-R 1-58.

[**CONFIDENTIAL]**

[**END OF CONFIDENTIAL]** In all, the savings that are identified in the study are less than the $45.8 million of transaction costs that have been identified in the Joint Petitioners' SEC Form U-1 Declaration. Keep in mind that the transaction cost estimates shown in the SEC filing do not include certain categories of transaction costs such as golden parachute costs. Nor do they include any transition costs that will be necessary to achieve the gross savings that are quantified. Clearly, merger related costs will exceed the savings that are quantified in the Joint Petitioners' analysis by a wide margin. The Joint Petitioners' preliminary savings analysis does not show the merger providing net benefits or causes no harm.

Q. WHAT DO YOU RECOMMEND REGARDING THE JOINT PETITIONERS SAVINGS ESTIMATE?

A. There is no evidence in this proceeding detailing either the costs or the expected benefits of this merger to ACE and to New Jersey ratepayers. The scant evidence presented by the Joint Petitioners concerning system-wide merger-related savings and costs do not form an adequate basis upon which Your Honor and the Board can determine that the net benefits standard in New Jersey has been met. I recommend that Your Honor and the Board direct the Joint Petitioners to submit a comprehensive study of anticipated merger- related costs and savings and their impacts on ACE and its New Jersey ratepayers. Only after reviewing and analyzing such a study can Your Honor and the Board reasonably determine if the proposed merger is in the public interest for New Jersey.

VII. RATE IMPACTS

Q. HAVE THE JOINT APPLICANTS PROPOSED A PLAN TO SHARE MERGER BENEFITS WITH ACE'S CUSTOMERS?

A. No, they have not. The Joint Petitioners do not intend to modify ACE's rates as a result of the merger. Dr. Pace's testimony at page 8 seems to suggest that because ACE's rates have been capped until July 1, 2003, there can be no adverse rate impact resulting from the merger. Thus, the Joint Petitioners dismiss any notion of sharing any merger benefits with ratepayers.

Q. DO YOU AGREE WITH THIS POSITION?

A. No, I do not. First of all, I disagree with Dr. Pace's characterization that ACE's rates are "frozen" until July 1, 2003. The rates have been capped, not frozen. That is, the rates cannot increase, but there is no good reason for them not to decrease if ACE's underlying cost of service has been reduced by the merger.

By referring to the rate cap, the Joint Petitioners would have Your Honor and the Board believe that because rates cannot be increased as a result of the merger, no harm can result. This clearly is backwards logic. The underlying strategy of this merger is to enable the combined company to better meet competition for retail load by increasing efficiencies and lowering costs. Because ACE's cost of service following the merger should fall, rather than increase, the fact that there is a rate cap is irrelevant.

ACE's energy delivery services in New Jersey will remain subject the Board's regulatory powers in the restructured industry environment. Distribution rates will continue to be set by the Board based on ACE's cost of service. To the extent that ACE's rates deviate unreasonably from its underlying cost of service, those rates are not just and reasonable. Therefore, if the merger reduces ACE's cost of service in a measurable way, and if those savings are not correspondingly reflected in ACE's rates, an adverse rate impact will result. ACE's rates, under those circumstances, would not reflect its underlying cost of service. Such rates cannot be considered just and reasonable.

Q. DOES THE PETITION PROVIDE SUFFICIENT INFORMATION TO QUANTIFY THE IMPACT OF THE MERGER ON ACE'S RATES?

A. No, it does not.

Q. WHAT DO YOU RECOMMEND?

A. While I am certain that Pepco is mindful of what the Maryland and District of Columbia Public Service Commission required in Pepco's merger attempt with BGE, the Joint Petitioners in this proceeding have presented no rationale for withholding from ratepayers the merger-related savings it anticipates, for the exclusive benefit of its stockholders. As I discussed above, Your Honor and the Board must direct the Joint Petitioners to submit a comprehensive study of anticipated merger-related costs and savings. If, after the Board and all parties to this case have the opportunity to review (and respond to) this additional analysis, the Board determines that Joint Petitioners have demonstrated that the merger would result in net positive benefits to New Jersey ratepayers, Your Honor and the Board should then condition merger approval on the pass through of 100 percent of the annualized savings as a reduction to ACE's Distribution rates contemporaneously with the closing of the merger transaction. To do otherwise and ignore the rate impact of savings creates a windfall to New RC's stockholders and a net detriment to ACE's ratepayers. This recommendation is consistent with the Board's decisions in the Atlantic Electric and Rockland Electric merger cases.[23]

VIII. EMPLOYEE IMPACTS

Q. DID THE JOINT PETITIONERS QUANTIFY THE ECONOMIC IMPACT OF THE MERGER ON THE STATE OF NEW JERSEY?

A. No.

Q. DID THE JOINT PETITIONERS QUANTIFY THE IMPACT OF THE MERGER ON ACE'S CURRENT OFFICERS AND EMPLOYEES?

A. No, not specifically. Regarding local New Jersey workers, the Joint Petitioners have consistently maintained throughout this proceeding that ACE and Conectiv will continue operations with "substantially the same employees" as there are today and

[23] In two recent electric utility merger cases, the Board required 75% of the merger-related savings to be flowed through to customers as a rate reduction, effective with the merger's closing date. *See 1998 Conectiv Merger*, Order, pp. 7, 22; I/M/O Joint Petition of Orange and Rockland Utilities, Inc., for Approval of the Agreement and Plan of Merger and Transfer of Control, April 1, 1999, BPU Docket No. EM98070433, Order, pp. 17-18.

that the merger "will require few, if any involuntary terminations."[24] Regarding corporate officers, other than for Messrs. Derrick, Shaw, and Cosgrove there has been no indication who will fill the remaining officer and manager positions. All that we know thus far is that a small hand full of corporate positions have been targeted for elimination due to redundancies.[25]

Q. IS NEW RC COMMITTED TO HONOR ACE'S AND CONECTIV'S COLLECTIVE BARGAINING AGREEMENTS?

A. Yes. The Joint Petitioners' SEC Form S-4 Registration filing includes the following commitment:

> "Following the effective time of the transaction, and subject to the other terms of the merger agreement, New RC will, or will cause the appropriate subsidiary to assume and honor all employment-related obligations, agreements and benefits plans covering current and former employees, directors and consultants of Conectiv or any of its subsidiaries; ..."[26]

In short, New RC is obligated to honor commitments made to present ACE and Conectiv employees and retirees pursuant to collective bargaining agreements. The merger cannot alter those obligations.

Q. WILL CONECTIV HAVE PROPORTIONATE REPRESENTATION ON NEW RC'S BOARD OF DIRECTORS?

A. No. As I understand the negotiations, Conectiv insisted on proportionate representation on New RC's Board early on. Apparently, that condition was dropped

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[24] See the Joint Testimonies of John M. Derrick, Jr. and Thomas S. Shaw, pages 4 and 12. See also, for example, the Joint Petitioners' response to NJRAR-R 2-68.

[25] See Pace Testimony pp. 9-10.

[26] SEC Form S-4 (Pre-effective Amendment No. 3), filed May 30, 2001, page 85.

somewhere in the negotiation process. As the Merger Agreement now stands, New RC's Board of Directors will consist of ten directors to be nominated solely by Pepco. Conectiv, with concurrence from Pepco, is permitted to nominate at least two directors. The 10-Pepco/2-Conectiv mix results in disproportionate representation on the board when one considers that Conectiv's shareholders will contribute approximately 33 percent to the initial ownership of New RC. Conectiv and ACE bring considerable assets and value to this transaction, if the Joint Petitioners' claims are to be believed. Yet, New Jersey's interests, as well as the interests of Conectiv throughout its service territory, may suffer because of the disproportionate representation of Conectiv on New RC's Board. In fact, it was for this very reason that one of Conectiv's present board members, Mr. Cyrus Holley, voted against the merger.[27]

Q. WHAT ARE YOUR RECOMMENDATION CONCERNING THE IMPACT OF THE MERGER ON EMPLOYEES?

A. Your Honor and the Board have been asked to approve the merger based on the Joint Petitioners' representations that ACE and Conectiv will have "substantially the same employees" as they have today and that "the merger will require few, if any, involuntary terminations." Your Honor and the Board will consider the impact of the merger on New Jersey employees. Therefore, Your Honor and the Board should strictly enforce the Joint Petitioners' stated commitments with respect to employees and employment levels. That is, the merger should be conditioned on no significant changes in New Jersey employees and employment levels following the merger. Because of the way the Joint Petitioners have presented its case, we must rely on the

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[27] Ibid., page 45.

commitment by New RC to cause no significant reductions in ACE's New Jersey employment base. New RC must be held accountable for its representations.

I am also concerned that the structure of the new company fails to give Conectiv and ACE, a strong enough voice in the management and operations of the post-merger company. If this results, the interests of New Jersey ratepayers may be adversely affected. Therefore, I recommend that Your Honor and the Board condition approval of the merger on Conectiv being given proportionate representation on New RC's Board of Directors. This would increase Conectiv's representation on the board from two persons to four persons (4/12 equals 33 percent). These steps would help avoid adverse impacts on ACE's employees following the merger.

Q. IS A NEW SHAREHOLDER VOTE REQUIRED TO INCREASE CONECTIV'S REPRESENTATION ON NEW RC'S BOARD OF DIRECTORS?

A. No, apparently not. In response to a Ratepayer Advocate interrogatory concerning the composition of New RC's Board of Directors, the Joint Petitioners stated:

> "There is no condition of the merger that limits the number of Conectiv seats on the New RC Board of Directors. The Merger Agreement provides that there will be at least "two" Board Members from Conectiv. The composition of the Board of Directors of New RC was just one component of the Merger Agreement negotiations and, is therefore, part of a comprehensive package of terms that were negotiated and was not determined in isolation. In addition, the term specifies "at least two" of New RC's Board members will be from Conectiv's Board, so this simply represents a minimum threshold."[28]

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[28]See Joint Petitioners' response to NJRAR-R 1-41.

Thus, shareholder approval is not required for the Board to condition the merger on increasing Conectiv's representation on New RC's Board of Directors. The interests of ACE, Conectiv, and New Jersey ratepayers will be better served by increased representation on New RC's Board of Directors.

IX. REGULATORY OVERSIGHT

Q. WHERE WILL NEW RC'S CORPORATE HEADQUARTERS BE LOCATED FOLLOWING THE MERGER?

A. The holding company's corporate headquarters will be located in Washington, DC.

Q. DOES HAVING CORPORATE HEADQUARTERS IN WASHINGTON CREATE ANY PROBLEMS IN NEW JERSEY?

A. Yes, quite possibly. New RC intends to use a service company structure following the merger to staff corporate governance and centralized service functions. Presently, Conectiv has a subsidiary, Conectiv Resource Partners ("CRP"), that provides centralized services to the Conectiv affiliates, pursuant to a contract filed with the SEC and the Board. As I understand New RC's plan, CRP will continue its service company functions immediately following the merger. However, no firm decision has been made for CRP to continue operations thereafter. New RC has formed a new service company that temporarily has been named "New Service Co." New RC is considering transferring the service company functions from CRP to New Service Co. New RC has not stated where New Service Co. will be located, but one must consider the possibility that it may be located in Washington, DC. If that happens, the effectiveness of the Board's regulatory oversight may be diminished because of the merger. New Jersey regulators, the Ratepayer Advocate, legislators, and the public at large may have to look to a company that is even further away than Delaware

(Conectiv's headquarters) to address issues formerly addressed on a local and more personal level. Routine service company functions, which previously were performed in New Jersey and Delaware, could also be transferred further away from New Jersey to Washington, DC. The greater distance involved will create increased audit burdens and costs for the Board Staff and for the Ratepayer Advocate. The transfer of corporate offices and the service company to Washington could complicate the Board's regulation of ACE and will likely increase both the cost and the frustration of regulation for all parties concerned.

Q. WHAT ARE YOUR RECOMMENDATIONS CONCERNING SERVICE COMPANY AND AFFILIATE TRANSACTION ISSUES?

A. As one of the conditions of merger approval, Your Honor and the Board should require the Joint Petitioners to: (1) file for Board approval of the structure and creation of the new, post-merger service company; (2) subject themselves to Board jurisdiction for filing, review, and approval of any cost allocation manual or formulas that the new service company will use, in addition to any other regulatory approvals that may be required; (3) staff an office in New Jersey with high level decision makers knowledgeable in New Jersey local affairs. These requirements will help mitigate the merger's impact on the Board's ability to regulate ACE post-merger, including the potential for improper cost allocation to and cross-subsidization by New Jersey customers. The Board ordered Conectiv to comply with similar requirements in its order in the Atlantic Electric merger case.[29]

X. MERGER COST TRACKING REQUEST

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[29] *See 1998 Conectiv Merger,* Order, pp. 16-17.

Q. PARAGRAPH 34 OF THE PETITION INCLUDES ACE'S REQUEST FOR "ANY NECESSARY APPROVALS FROM THE BOARD TO TRACK [MERGER-RELATED] COSTS FOR LATER CONSIDERATION". DO YOU HAVE ANY COMMENTS?

A. Yes, I do. As an initial matter, it is not clear exactly what approval ACE is seeking in this regard. I can find no other statements in the Joint Petitioners' filing explaining precisely what ACE seeks from the Board. Apparently, ACE would like some sort of an accounting order that would allow it to carry on its books the merger-related costs that it incurs or that are allocated to it by Conectiv and Pepco until there is a later determination of the treatment, and presumably, recovery of those costs.

Q. IF YOUR UNDERSTANDING IS CORRECT, DOES ACE'S REQUEST SEEM PROPER TO YOU?

A. No, it does not. FAS 71 permits utilities to defer costs and recognize regulatory assets only if it is "probable" the regulatory commission will permit the deferred cost to be recovered in future rates.[30] Earlier in my testimony, I addressed why it is not appropriate for the Joint Petitioners to recover its transaction costs from ratepayers in this proceeding. As for transition costs that may be incurred in the future, the Joint Petitioners have provided no evidence as to the nature of those costs or their magnitude. Moreover, there is no evidence that any of the costs that have been incurred or that will be incurred in connection with the merger are necessary, reasonable and prudent. ACE's merger cost tracking petition should be denied.

XI. CONCLUSION

[30] Statement of Financial Accounting Standards No. 71, "Accounting for the Effects of Certain Types of Regulation," issued December 1982.

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS AND RECOMMENDATIONS.

A. The Joint Petitioners claim the proposed merger represents an opportunity for both companies to significantly increase their combined competitive positions in a restructured industry offering customer choice. This is to be accomplished by increasing operating efficiencies and by eliminating redundant functions and lowering costs. Yet, the Joint Petitioners fails to provide a sufficient road map explaining how these goals will be met. In effect, the Joint Petitioners are asking the Board to approve the merger without first telling Your Honor and the Board (1) how much savings can to be expected, (2) how much it will cost to close the merger, (3) how much it will cost to achieve the anticipated savings, (4) how ratepayers will participate in and benefit from these savings, (5) what voice ACE will have in the newly established holding company, and (6) that offices in New Jersey will be staffed with high level decision makers knowledgeable in local affairs. Joint Petitioners have not provided the basic facts for Your Honor and the Board to make an informed decision in this matter. Clearly, the Joint Petitioners have not met either the net positive benefits standard or the even less restrictive no harm standard. Therefore, before Your Honor and the Board acts on the Joint Petition, I recommend that it direct the Joint Petitioners to re-file their Petition and:

A. Prepare comprehensive estimates of transaction and transition costs, including supporting documentation; and

B. Prepare comprehensive estimates of merger savings, including supporting documentation;

All parties to this case must then have the opportunity to review and respond to this additional documentary data in an evidentiary hearing process. Thereafter, if the Board determines that there is quantification of net positive benefits from the merger, it should order ACE to reduce its Distribution rates by an allocable share of 100 percent of the annualized net savings, effective with the closing date of the merger. Your Honor and the Board should also condition its approval on the following items:

1. Conectiv be granted proportionate representation on New RC's Board of Directors (i.e., at least 4 representatives to be nominated by Conectiv);
2. The same number of customer service centers remain in New Jersey following the merger and a corporate office in New Jersey be maintained and staffed with high level decision makers knowledgeable in New Jersey affairs;
3. That ACE maintain employment levels substantially as they are today and that there be few, if any, involuntary terminations. To the extent that there is any deviation from this commitment post-merger, New RC must first obtain Board approval;
4. Transaction costs will not be included in the rates for ACE's customers;
5. The Joint Petitioners shall submit a service company agreement and cost allocation manual to the Board for review and approval, and abide by the Board's decisions thereto for purposes of utility rates and services; and
6. ACE's request to track merger related costs for later disposition should be denied.

The Ratepayer Advocate's other witnesses recommend additional conditions that the Board should impose on the Joint Petitioners as well.

Q. DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A. Yes it does.