Applicants' Ex. TJF-1.0

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

WPS Resources Corporation, Peoples Energy Corporation, The Peoples Gas Light and Coke Company, and North Shore Gas Company Application pursuant to Section 7-204 of the Public Utilities Act for authority to engage in a Reorganization, to enter into an agreement with affiliated interests pursuant to Section 7-101, And for such other approvals as may be required under the Public Utilities Act to effectuate the Reorganization.	)))))))))))	Docket No. 06-_______

Direct Testimony Of

THOMAS J. FLAHERTY

Senior Vice President

BOOZ ALLEN HAMILTON INC.

On Behalf of the Applicants

TESTIMONY OF THOMAS J. FLAHERTY
SENIOR VICE PRESIDENT
BOOZ ALLEN HAMILTON

T A B L E O F C O N T E N T S

TESTIMONY OF THOMAS J. FLAHERTY
SENIOR VICE PRESIDENT
BOOZ ALLEN HAMILTON

I. INTRODUCTION AND QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BY WHOM YOU ARE EMPLOYED.

A. My name is Thomas J. Flaherty, and I am a Senior Vice President in the Energy and Utilities practice of Booz Allen Hamilton. My business address is 901 Main St., Suite 6500, Dallas, Texas 75202.

Q. WOULD YOU BRIEFLY SUMMARIZE YOUR ACADEMIC AND PROFESSIONAL BACKGROUND?

A. I graduated from the University of Oklahoma with a B.B.A. degree in Accounting and immediately joined Touche Ross & Co., where I began my career as a management consultant. Subsequently, I worked for Deloitte & Touche (formed by the merger of Touche Ross and Deloitte, Haskins & Sells in 1989) for more than 30 years until joining Booz Allen Hamilton ("Booz Allen") as a Senior Vice President. Over the course of my consulting career, I have specialized in the public utility industry and have performed a variety of assignments.

I have assisted managements from a number of electric and/or gas utilities in the identification, evaluation and integration of acquisitions, including: screening analysis; review of corporate restructuring alternatives; assessment of merger-related cost reduction opportunities; development of regulatory strategies; planning and execution of merger integration; and, assignment and allocation of costs and benefits related to mergers and acquisitions. In addition to my involvement in merger and acquisition consulting, I have participated in numerous other utility consulting engagements in the areas of corporate growth, diversification, restructuring, organizational analysis, business process reengineering, benchmarking, strategic planning, strategic marketing, litigation assistance, economic feasibility studies, regulatory planning and analysis, and financial analysis.

I also have conducted or directed similar assignments for a variety of industries, including construction, retailing, publishing, health care, real estate and manufacturing, in addition to utilities. Applicants' Ex. TJF-1.1 details my previous experience with regulated utilities.

Q. PLEASE SUMMARIZE YOUR EXPERIENCE IN UTILITY MERGERS AND ACQUISITIONS.

A. I have evaluated more than 300 actual, proposed or potential transactions involving electric, electric and gas combination, gas, or water utilities. I have experience working for both buyers and sellers and have assisted client managements in their assessment of a broad range of transactional issues, including the following:

- Target analysis
- Asset quality analysis
- Customer analysis
- Competitor analysis
- Synergy assessment
- Financial analysis
- Transaction structuring
- Regulatory strategy
- Testimony
- Integration planning

The publicly announced transactions in which I have been significantly involved, other than the one that is the subject of this proceeding are: Kansas Power & Light and Kansas Gas and Electric, IPALCO Enterprises and PSI Resources, Entergy and Gulf

States Utilities, Southern Union and Western Resources (Missouri properties), Washington Water Power and Sierra Pacific Resources, Midwest Resources and Iowa-Illinois Gas & Electric, Union Electric and CIPSCO, Northern States Power Company and Wisconsin Energy Corporation, PECO Energy Company and PPL Resources, Public Service Company of Colorado and Southwestern Public Service Company, Baltimore Gas & Electric and Potomac Electric Power Company, Delmarva Power and Atlantic Energy, WPL Holdings, IES Industries and Interstate Power, Puget Sound Power & Light and Washington Energy, TU Electric and ENSERCH, Western Resources and Kansas City Power & Light, Western Resources and ONEOK, Inc. (Kansas, Oklahoma gas properties), Houston Industries and NORAM Energy, Ohio Edison and Centerior, ENOVA and Pacific Enterprises, Brooklyn Union Gas and Long Island Lighting, Allegheny Energy and DQE, Inc., LG&E Energy and KU Energy, NIPSCO Industries and Bay State Gas, American Electric Power and CSW, BEC Energy and COM Energy, Northern States Power and New Century Energies, Dynegy and Illinova, DTE Energy and MCN Energy, ConEdison and Northeast Utilities, PECO Energy and Unicom, AGL Resources and Virginia Natural Gas, Energy East and RGE Energy, FPL Group and Entergy, PNM Resources and TNM Enterprises, Exelon and PSEG Enterprises, Duke Energy and Cinergy, and Constellation Energy Group and FPL Group.

Q. DO YOU HOLD ANY PROFESSIONAL CERTIFICATIONS?

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

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I have been asked to appear for WPS Resources Corporation and Peoples Energy Corporation (collectively, "the Companies") to sponsor the benefits and costs analysis identifying the merger-related synergies from the announced combination of the Companies. Booz Allen assisted the managements of both Companies in the identification and quantification of potential cost savings resulting from the proposed merger of the companies.

In this testimony I: (1) describe the categories of merger-related cost savings that are believed available from the merger of the Companies; (2) provide the basis for quantification of estimated merger-related cost savings; (3) explain the basis for and importance of costs-to-achieve on the identified savings; (4) describe the process by which such identified cost savings categories and estimated merger-related cost savings were derived by the Companies; (5) compare the level of merger-related cost savings identified in this merger with other transactions with which I am familiar, and; (6) describe the approach to allocating the savings and related costs-to-achieve to the jurisdictional level.

Q. HAVE YOU INCLUDED ANY EXHIBITS TO YOUR TESTIMONY?

A. Yes. Applicants' Ex. TJF-1.1 is a summary of my experience with regulated utilities, while Applicants' Ex. TJF-1.2 provides a five-year summary of potential merger cost savings, Applicants' Ex. TJF-1.3 provides a detailed breakout of costs that may be incurred to achieve the identified merger, and Applicants' Exs. TJF-1.4, TJF-1.5 and TJF-

1.6 provide a summary of the results of the allocation of costs savings and costs-to-achieve to the respective jurisdictions within the combined utility, specifically Illinois operations.

III. SUMMARY OF TESTIMONY

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. The combination of the Companies should enable the realization of substantial benefits in the form of economies, efficiencies and operating effectiveness across the corporate, shared services, regulated and, certain non-regulated operating areas. These synergies relate to a variety of operational functions and should result in benefits that will accrue to customers now, and in the future. These savings are directly attributable to the merger and would not occur in its absence.

The combination of the Companies is expected to provide the potential for approximately $401 million in total gross cost savings to be realized across the corporate, shared services, regulated and, non-regulated businesses over the first five years following the close of the merger. This total includes approximately $29 million in gross cost savings that are directly attributable to the non-regulated business segment, specifically the energy services business.

In addition, approximately $197 million in total corporate, shared services, regulated and, non-regulated costs-to-achieve and other offsets to the identified savings have been estimated associated with the closing of the transaction or the realization of the savings, of which approximately $8 million directly relates to the non-regulated segment. These non-regulated cost savings and costs-to-achieve are excluded from further discussion in my testimony as they do not relate to any aspect of the regulated business. The total level of identified cost savings and costs-to-achieve are illustrated in Table 1.

With respect to the corporate and regulated business segments, the managements of the Companies have identified approximately $373 million of corporate, shared services and utility operating support-related gross cost savings over the first five years following the close of the transaction. In addition, approximately $178 million of out-of-pocket costs-to-achieve these savings and $11 million of cost cutting measures planned or initiated by the Companies prior to the merger (pre-merger initiatives) have also been identified. The above corporate and regulated amounts are before any overall allocations between the regulated and non-regulated business segments and net to approximately $184 million which is expected to benefit all stakeholders, including customers and shareholders, and result in a stronger, more competitive company. These savings will also be achieved without any adverse impacts to service quality, reliability or safety as the areas identified do not relate to direct operating areas. The net $184 million in corporate and regulated cost savings is also shown in Applicants' Ex. TJF-1.2.

TABLE 1: Total Merger Cost Savings and Costs-to-Achieve

($ in thousands)

Potential Areas ($ in 000s)	Year 1 2007	Year 2 2006	Year 3 2009	Year 4 2010	Year 5 2011	5-Year Total
Regulated and Corporate						
Staffing						
Corporate	$ 20,053	$ 29,733	$ 31,369	$ 33,080	$ 34,869	$ 149,105
Utility	1,749	4,088	4,624	5,184	5,769	21,414
Total	$ 21,802	**$ 33,821**	**$ 35,993**	**$ 38,264**	**$ 40,638**	**$ 170,519**
Corporate & Administrative Programs						
Administrative & General Overhead	$ 1,422	$ 2,171	$ 2,231	$ 2,291	$ 2,354	$ 10,469
Benefits	0	1,240	1,318	1,400	1,488	5,446
Credit Facilities	329	338	347	357	366	1,737
Directors' Fees	938	963	989	1,016	1,043	4,950
Facilities	1,678	2,663	2,736	2,811	2,888	12,776
Insurance	1,996	2,051	2,108	2,166	2,226	10,548
Inventory	0	0	0	0	0	0
Professional Services	5,818	5,979	6,144	6,313	6,487	30,740
Regulatory Affairs	0	0	0	0	0	0
Shareholder Services	753	774	796	818	841	3,983
Transportation	0	0	0	0	0	0
Total	**$ 12,935**	**$ 16,179**	**$ 16,668**	**$ 17,173**	**$ 17,694**	**$ 80,648**
Information Technology						
Information Technology (Capital)	$ 1,056	$ 2,821	$ 5,428	$ 8,100	$ 10,840	$ 28,244
Information Technology (O&M)	5,788	8,812	12,204	12,510	12,822	52,127
Total	**$ 6,834**	**$ 11,633**	**$ 17,632**	**$ 20,610**	**$ 23,662**	**$ 80,371**
Supple Chain						
Contract Services	$ 2,883	$ 3,054	$ 3,229	$ 3,409	$ 3,593	$ 16,167
M&S Purchases	1,415	1,729	2,052	2,384	*2,726*	10,306
Total	**$ 4,298**	**$ 4,783**	**$ 5,281**	**$ 5,793**	**$ 6,319**	**$ 26,473**
Fuel						
Gas Supply	$ 3,000	$ 3,000	$ 3,000	$ 3,000	$ 3,000	$ 15,000
Total	**$ 3,000**	**$ 3,000**	**$ 3,000**	**$ 3,000**	**$ 3,000**	**$ 15,000**
Gross Corporate and Regulated Savings	**$ 48,869**	**$ 69,416**	**$ 78,574**	**$ 84,839**	**$ 91,314**	**$ 373,011**
Total Costs-to-Achieve	**($ 108,787)**	**($ 29,893)**	**($ 10,325)**	**($ 28,947)**	**($ 61)**	**($ 178,012)**
Pre-Merger Initiatives	**($ 717)**	**($ 1,453)**	**($ 2,206)**	**($ 2,979)**	**($ 3,770)**	**($ 11,125)**
Net Corporate and Regulated Savings	**($ 60,635)**	**$ 38,070**	**$ 66,043**	**$ 52,913**	**$ 87,483**	**$ 183,874**
Gross Total Non-Regulated Savings	**$4,814**	**$5,335**	**$5,921**	**$6,167**	**$6,424**	**$28,661**
Costs-to-Achieve	**($2,334)**	**($3,097)**	**($749)**	**($2,113)**	**($1)**	**($8,297)**
Total Non-Regulated Savings	**$2,480**	**$2,237**	**$5,178**	**$4,054**	**$6,423**	**$20,364**
Net Regulated, Corporate and Non-Regulated Savings	**($58,156)**	**$40,307**	**$71,214**	**$56,967**	**$93,906**	**$204,238**

From a customer perspective in particular, the cost savings identified above from the merger of the Companies, once appropriately allocated to the regulated business, are anticipated to permit lower rates than otherwise would have resulted on a stand-alone basis for either of the two Companies regulated subsidiaries.

The estimated cost savings referenced above reflect direct merger-related corporate and regulated business support synergies. They reflect the consensus of both Companies and were jointly developed by management of the Companies, with the assistance of Booz Allen. This joint development of merger-related cost savings provided a sound basis for identification and quantification and results in fully-documented and agreed-upon savings. As a result, the process utilized by the Companies was comprehensive and captures all significant sources of merger-related cost savings typically available.

The estimated cost savings reflect the potential creation of cost reduction or cost avoidance opportunities through the ability to consolidate separate, stand-alone operations into a single entity. This consolidation and integration thus may enable duplicative functions and positions to be eliminated; similar activities to be combined, avoided or reduced in scope; external purchases of commodities and services to be standardized, rationalized and aggregated; and certain capital expenditures to be avoided.

Based on my experience in other mergers and on my direct involvement with the identification, evaluation, and quantification efforts related to estimated cost savings in this and other transactions, the process utilized for estimating potential merger-related cost savings was consistent with the process utilized by other companies in previous merger transactions. As a result, I believe the level of merger savings identified by the Companies is reasonably attainable provided that management executes its integration plans in a manner consistent with its intent and how other utilities have pursued similar opportunities.

The identified merger cost savings are also within the broad range of those developed by other companies in other similar situations recognizing the unique characteristics of both companies. The estimated levels are well within the range of other transactions for staffing reductions and for non-fuel operations and maintenance expense.

Utility mergers and acquisitions in other states have produced substantial benefits to customers in the form of operational synergies and cost savings that reduce rates or slow the rate of growth in rates. Benefits to customers, however, will not materialize without costs being incurred and risks being assumed. In particular, out-of-pocket costs are incurred in the ordinary course of business to execute a transaction, comply with the various requirements of third-party agencies, successfully integrate the businesses and, close a transaction. In a number of cases, expenditures are incurred solely for the purposes of fulfilling fiduciary responsibilities, satisfying public agency filing requirements or demonstrating the benefits that are conveyed in the transaction. These costs require up-front expenditure of these out-of-pocket amounts without assurance that a transaction will, in fact, be closed. Other expenditures are incurred to assure that employees are treated equitably and that the business is ready for transparent operations on day-one after the close.

In any merger transaction, shareholders assume the risk that the merged entity will achieve the strategic, financial, and operational benefits set forth as the rationale for the proposed combination. To the extent these objectives are not attained (e.g., failing to realize cost savings), shareholders suffer from eroded equity value and / or lower returns. It is my opinion and an established regulatory principle that, to compensate for these risks and to reflect the shareholders' willingness to fund the costs necessary to realize potential cost savings, the utility should be provided the opportunity to recover the costs-to-achieve these savings and that the resulting net cost savings should be equitably shared between customers and shareholders. This principle is borne out in a number of prior transactions where regulatory decisions have provided for equitable savings sharing after the consideration of related costs-to-achieve.

The cost savings and costs-to-achieve from this transaction will flow both to the non-regulated business and to the customers within the specific regulated jurisdictions of the Companies. The approach adopted to allocate these merger savings and costs to the non-regulated businesses and to the relevant jurisdictions resulted in the development of specific allocation factors for each savings and cost-to-achieve category. These specific allocation factors were utilized to establish as direct an allocation basis as possible, given the nature of the savings and costs and the factors most closely related to incurrence of these elements.

In developing this approach the current allocation bases and existing affiliate interest agreements for the Companies were considered as a starting point. However, differences in underlying approach between the Companies necessitated the utilization of an alternative method that would provide a fair basis for allocation of savings and costs in this proceeding, while preserving flexibility regarding a more permanent, cost-of-service based approach at a later time. The existing allocation methods were first aligned, where possible, to the identified savings and costs-to-achieve category. Additional allocation factors that linked more directly to cost causation for the specific categories were then used to supplement the existing allocation approaches. The resulting assignment of savings and costs-to-achieve to specific jurisdictions, thus takes into account the existing methods employed by the Companies and incorporates specific allocation factors to reflect cost incurrence relationships The results of this allocation approach are presented in Applicants' Exs. TJF-1.4, TJF-1.5 and TJF-1.6.

It is critical to the ability of companies to pursue and complete business combinations of the nature proposed with this transaction, for an equitable outcome to be achieved with respect to the sharing of identified allocable regulated merger synergies between customers and shareholders. This equitable outcome can be accomplished through numerous means, but in the end, should result in distribution of identified allocable regulated merger synergies that provides direct benefits to customers, while fairly compensating shareholders for the cost and risks they have assumed. Additionally, the agreed upon equitable sharing mechanism should continue beyond the regular ratemaking cycle to recognize the need for achieving an equitable overall result over time. This approach thus provides the opportunity for both customers and shareholders to be fairly compensated for the risks and expenses associated with completing the merger.

IV. SYNERGIES IDENTIFICATION

Q. IN GENERAL, HOW ARE SAVINGS CREATED FROM THE COMBINATION OF TWO UTILITY HOLDING COMPANIES?

A. The combination of two utility holding companies enables the succeeding company to realize substantial benefits in the form of economies, efficiencies and operating effectiveness that would not otherwise be available to either company on a stand-alone basis. These synergies relate to a variety of operational functions and potentially will result in benefits that will directly accrue to customers. These potential savings areas are viewed as directly attributable to the merger and would not be attainable in the absence of the merger.

Q. ARE THERE DIFFERENT TYPES OF COST SAVINGS THAT CAN RESULT FROM THE COMBINATION OF TWO UTILITY HOLDING COMPANIES?

A. Yes. In identifying potential cost savings, only those opportunities that are directly related to the merger were quantified. The distinction between merger and non-merger related savings is highlighted below:

- Created savings - These are savings that are directly related to the completion of a merger and could not be obtained absent the merger. For example, the reduction of total cost through the avoidance of duplication or overlap and the ability to extend resources over a broader base of operating activities would naturally occur through the consolidation of similar functions. Without the combination, both companies would continue to expend amounts on related activities, and as a result, would incur stand-alone cost levels higher than after consolidation.
- Enabled savings - These savings result from the acceleration or “unlocking” of certain events that could give rise to savings and therefore are considered merger savings.

For example, technology differences that exist between companies may provide an opportunity to share technology and achieve productivity improvements more rapidly and more cheaply than would have occurred on a stand-alone basis. For example, one company that has adopted an enterprise resource planning information management approach will likely enjoy more seamless operation and management, lower costs and higher productivity than a company that has individual, customized packaged applications requiring unique support. While the company without the integrated technology environment can obtain such benefits from independent investment, the merger enables an existing technology environment to be more rapidly deployed and costly stand-alone investment and concept feasibility analysis to be avoided.

- Developed savings - Reductions in cost due to management decisions that could have been made on a stand-alone basis are unrelated to the merger. A decision to restructure or reorganize an organization will result in reduced costs but likely would have been achieved without the merger. None of the cost savings described in my testimony are in this category.

Q. WHAT TYPES OF SAVINGS HAVE BEEN QUANTIFIED WITH RESPECT TO THE WPS RESOURCES AND PEOPLES ENERGY MERGER?

A. The quantification effort focused on merger-related savings only, i.e., those savings that would not be attainable but for the combination of the two companies. The savings described in my testimony fall under the "created savings" category described above. Potential areas of benefit, and subsequently the resulting cost savings, are determined to be merger-related if they are not attainable by any action that management of either company could practically initiate on an independent basis. For example, management of either company could reduce labor costs by eliminating positions as part of undertaking a comprehensive performance improvement program. These reductions, however, would relate solely to that entity's independent operations and would not be related to any merger effects.

Quantified merger-related savings result only from action taken by management in association with the combination of the Companies. For example, the fact that both companies maintain separate investor relations activities provides an opportunity to consolidate these functions and avoid replication. This integration of similar functions and activities would not be possible without the merger of WPS Resources and Peoples Energy. Thus, the benefits identified are only those believed to be directly attributable to the merger.

Additionally, cost savings or cost avoidances that result from the new size and economic scope of the combined entity are merger-related. For example, routine activities that could not be economically outsourced by either company individually may now be candidates for outsourcing, given the new combined entity's greater volumes. Similarly, other activities that either of the companies now outsource might be performed more cost-effectively internally by the combined entity where volumes now justify specialized resources. The greater size of the combined entity should also enable it to be a more cost-effective purchaser of various products and services. Further, to the extent that the combination of two companies enables the companies to reduce costs by transferring technology or competencies to each other, these benefits are also merger-related if such actions could not have been effectively implemented by the companies independently, or if such transfers enable operating costs to be reduced more rapidly or to a lower level than otherwise would have been the case.

Each of the examples described above, as well as other cost savings or cost avoidances that are directly attributable to the merger, are considered merger-related synergies. Conversely, cost savings or avoidances that would have occurred even in the absence of the merger are not merger-related and should not be included in a calculation of the savings attributable to the merger.

Q. WHAT TYPES OF QUANTIFIED BENEFITS TYPICALLY RESULT FROM THE COMBINATION OF TWO UTILITY HOLDING COMPANIES?

A. Savings estimates reflect those areas where the total level of costs can be affected by actions of management that are the direct result of the combination of WPS Resources and Peoples Energy. These savings areas are derived from the operational synergies that are created upon integration of two previously independent operations. These savings areas would typically impact operations in the following ways:

- Cost reduction - The total cost of service is reduced as a result of the merger by avoiding duplication of the cost input required to achieve the same level of output. For example, similar operating functions, such as corporate planning, could now be integrated and would require less input to achieve results on a combined basis.
- Cost avoidance - The total cost of service is reduced due to the ability to forego certain types of parallel expenditures. For example, redundant expenditures required by both entities (e.g., information systems) could be avoided by selecting one set of development efforts to forgo duplication.
- Revenue enhancement - The creation of additional revenue streams by using existing regulated assets to supplement revenue sources could also be a means to increase benefits for shareholders and customers. These revenue streams would be related directly to utilizing available resources, such as storage assets, in a more attractive

manner, *i.e.*, to produce or increase commodity sales, than could be achieved independently.

Q. WHAT SPECIFIC CATEGORIES OF QUANTIFIABLE SAVINGS CAN BE EXPECTED TO RESULT FROM A UTILITY HOLDING COMPANY MERGER?

A. Quantifiable savings resulting from a merger typically can be categorized as follows:

- Corporate and Headquarters Staffing
- Utility Back-Office Staffing
- Corporate and Administrative Programs
- Information Technology
- Supply Chain
- Gas Supply

Each of these categories have been identified in this merger and will be described later in my testimony. These savings areas relate to common functions and costs within the business and do not directly relate to service performance and areas that may affect service quality, reliability or safety.

Q. WERE COSTS-TO-ACHIEVE ALSO IDENTIFIED IN THE MERGER COST SAVINGS ANALYSIS?

A. Yes. Certain costs must be incurred to facilitate the realization of the identified cost savings. Costs-to-achieve are an inherent component of any merger transaction and are necessary to successfully complete a transaction and/or produce the level of intended benefits. These costs-to-achieve are expenses that are directly related to pursuing or executing the transaction and have the effect of offsetting the level of distributable benefits. Were the total cost savings to be distributed without recognition of these costs to achieve, the utilities would, in effect, be distributing a greater level of savings than in fact exist.

In addition, if these out-of-pocket costs were not recognized as a related element of producing cost savings, the Companies would effectively be required to support such expenditures without reimbursement. Thus, to be equitable to all parties, it is only the net level of savings that is available for sharing with customers. In the vast preponderance of utility merger transactions with which I am familiar, costs-to-achieve have been considered and recognized in determining the net level of benefits available to customers and shareholders. In other words, costs to achieve have been recognized and netted against gross merger synergies in determining distributable savings to customers and shareholders.

Q. WHAT PROCESS WAS UTILIZED BY THE COMPANIES IN DEVELOPING THE ESTIMATED COST SAVINGS ASSOCIATED WITH THE PROPOSED MERGER?

A. The process began by examining underlying data related to the organization of each of the Companies from both publicly available and internally provided sources. This information encompassed geographical, organizational and operational data and included: total numbers of positions, positions distributed by various departments, position location, and related salaries and benefits.

Next, information related to specific cost categories, including recent actual and expected future expenses for these categories, was identified and obtained. Information obtained through this process included external spending, and various forecasts and budgets, as well as, internal operating plans.

General organizational and operational philosophies for each Company were also identified. As part of this process, potential organizational and operational approaches were discussed and areas for potential savings were identified. This process resulted in the development of a set of overall operating assumptions.

Finally, from all of the information and analyses identified above, savings estimates were developed, reviewed, analyzed, and revised by the management working groups, with the assistance of Booz Allen, to produce the level of estimated savings reflected in the initial merger announcement. This level of savings was subsequently refined with minor adjustments made to reflect revised baseline data and timing assumptions.

Q. **WHAT WAS THE SCOPE OF THE ASSISTANCE PROVIDED BY BOOZ ALLEN RELATED TO THE POTENTIAL COST SAVINGS ASSOCIATED WITH THIS PROPOSED MERGER?**

A. Booz Allen was asked to assist the managements of the Companies in the identification and quantification of both potential savings and additional costs necessary to realize those savings associated with the merger. This assistance was provided based upon our previous experience and included assistance in the identification of necessary data elements and potential cost savings areas, discussion of potential organizational and operational philosophies, discussion of potential assumptions to be utilized by

Companies, assistance in the identification and quantification of estimated savings and costs-to-achieve and comparison of results to other previous transactions.

Q. WERE PERSONNEL FROM THE COMPANIES INVOLVED IN THIS PROCESS?

A. Yes, a number of senior executives from both Companies were involved in the cost savings identification and quantification process described above. Initially, a small working group was involved in providing data to Booz Allen, confirming assumptions around the operating model and evaluating the identified savings opportunities, i.e., the timing and amounts of savings. After announcement, a broader senior executive and middle management team was involved, representing the corporate and utility operating support areas of the Companies. These executives evaluated potential savings opportunities and provided guidance regarding the timing of savings realization, and in some cases, provided additional data to Booz Allen for purposes of developing savings estimates.

Q. IS THIS PROCESS TYPICAL OF OTHER COST SAVING ESTIMATION PROCESSES IN WHICH YOU HAVE BEEN ENGAGED ?

A. Yes. The overall process undertaken by the two Companies to identify merger cost savings was typical of other engagements in which I have been involved. Senior executives from each company were identified to create a joint synergies team, of which Booz Allen was a part. These executives had broad visibility across the organization and within their respective areas of responsibility and were able to provide insights into how the business operated and to how particular impacts may occur given anticipated changes to the operating model.

In addition, a broader working group was in place to support this identification and quantification process comprised of several members of middle management which further increased the knowledge base available for the synergies analysis. The involvement of these personnel in the pre-announcement analysis provided the requisite operating insights into operations of the Companies and enabled the management groups to understand and assess the identified savings prior to announcement.

In addition, a post-announcement refinement process was undertaken to further review the initially identified synergies and to obtain additional source data given the tight confidentiality limitations that existed prior to announcement of the merger. This process enabled all assumptions to be validated and extended the number of involved management personnel from the Companies. In addition, it allowed for deeper analysis and review of the synergies areas to increase the confidence in attainment of these expected amounts.

The combination of these involved management group members in the pre-announcement process and the expansion of the management group participation post-announcement, provided a sound basis for the identification and quantification of the estimated merger synergies.

Q. HOW WERE THE COST SAVINGS QUANTIFIED IN THIS PROCESS?

A. Estimates of cost savings were developed on a nominal cost basis over a five-year period, with the first beginning post-close (2007) and extending through the end of year five

(2011), thus providing a multi-year view of attainable savings. Since the level of savings once integration is completed grows with escalation, a five-year period has been adopted for presentation of the cost savings information. This five-year period is representative of the level of ongoing savings and can be used as a reasonable determination of both annual and cumulative savings.

Q. ARE THE IDENTIFIED COST SAVINGS ONLY ATTAINABLE DURING THIS DEFINED PERIOD?

A. No. The majority of the identified savings components will generate benefits that will continue indefinitely into the future. For example, potential staffing reductions associated with the merger will generally continue into the future since they relate to redundant functions with no need to replace these displaced positions, although future business changes may require other resource additions to occur. Likewise, potential supply chain benefits will continue indefinitely as the cost of materials and supplies acquisition is reduced.

Although the cost savings estimated over the period generally will continue into perpetuity, only a five-year period has been used to present these savings as this period fully illustrates the ramp-up in savings realization. The estimates of cost savings are presented in nominal dollars over the relevant period of the merger to recognize that these savings increase annually from the ramp-up and that they will flow to customers and shareholders on that basis at some future point in time.

Q. WHAT METHODS WERE USED TO QUANTIFY THE INDIVIDUAL COST SAVINGS COMPONENTS?

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

- Direct analysis - Use of actual costs and changes to these costs based on planned consolidation activities (e.g., position reductions were estimated based on detailed analyses of fully aligned individual functions and positions).
- Estimation - Determination, based upon more limited analysis of actual data, of potential merger-related cost reductions considering anticipated changes to operations (e.g., reduction in materials and supplies costs from enhanced strategic sourcing and additional volume buying).
- Comparison to other transactions - Utilization of expectations in other proposed utility mergers as a proxy for the Companies' impacts (e.g., average insurance premium reductions based on expected or realized reductions achieved by other companies).

Of the three methods, the vast majority of the savings were quantified by using direct analysis. These several methods of quantification are consistent with those utilized by other utility companies in prior mergers, particularly where subsequent negotiations will ensue. For example, it is well recognized that insurance premiums will be reduced from a merger; however, the actual amount of the reduction will not be known until negotiations with an insurance broker are finalized. Using other expected or realized reduction amounts is an appropriate method for quantification pending such negotiation.

Q. ARE THERE ALTERNATIVE ORGANIZATIONAL MODELS AVAILABLE TO THE COMPANIES TO ACHIEVE THE IDENTIFIED COST SAVINGS?

A. Yes. The Companies will have a great deal of flexibility in determining how to organize the business to provide for effective performance and to maximize the level of savings attained.

The cost savings related to identical or similar functions within the Companies are, however, predicated upon achieving a level of integration that enables a common model for execution between the Companies. This integration could occur in several ways: within a corporate headquarters organization; an enterprise level shared services entity; within an operating level shared services entity; through a functional or process model across the companies; or, by a combination of integration of corporate and headquarters function at the corporate level and integration of common technical support services into the operating units, such as the utilities. Any of these approaches would provide the Companies an opportunity to realize merger cost savings in those affected areas.

In quantifying cost savings, it was assumed that a fully aligned and integrated organizational model would be implemented, i.e., related functions would be performed across the operating utilities on a common basis, regardless of where the responsible resource was actually located. This approach assumes that common corporate and headquarters transactional functions or activities would generally be performed in a shared services entity, with common technical support functions either similarly centralized, or located as required within the various operating units. While I will further discuss the underlying organizational concept used in the analysis later in my testimony, the Companies maintain a broad degree of discretion on how to align (i.e., centralize or decentralize) the processes, activities and resources within the headquarters, support and operating organizations.

Q. CAN THE LEVEL OF SAVINGS ESTIMATED BY THE COMPANIES AND REFLECTED IN YOUR TESTIMONY BE ACHIEVED?

A. Yes. The process utilized by the Companies for estimating potential merger cost savings was consistent with that utilized by other companies in previous merger transactions. As a result, the savings levels are reasonably attainable provided that management of the combined Company executes its integration plans in a manner consistent with its intent and how other utilities have pursued similar opportunities.

V. DETAILED COST SAVINGS DESCRIPTION

A. Summary

Q. YOU PREVIOUSLY TESTIFIED THAT APPROXIMATELY $184 MILLION IN NET MERGER SAVINGS HAVE BEEN QUANTIFIED BY THE COMPANIES OVER THE FIRST FIVE YEARS POST-CLOSE. WOULD YOU IDENTIFY AND DEFINE THE PRINCIPAL CATEGORIES OF COST SAVINGS THAT COMPRISE THIS AMOUNT?

A. Yes. As Applicants' Ex. TJF-1.2 illustrates, there are six primary categories of cost savings that have been quantified. Each of these is described briefly below:

- Corporate and Headquarters Staffing - Position reductions related to redundancies in staffing levels associated with corporate and administrative functions, such as finance and accounting, human resources, information technology and supply chain, among others.
- Utility Back-Office Staffing – Position reductions in operating support areas, such as asset management, operations planning, customer billing and processing and other business unit support related to redundancies in back-office staffing levels.

- Corporate and Administrative Programs - Reductions in non-labor programs and expenses, such as insurance and shareholder services, resulting from economies of scale and cost avoidance.
- Information Technology – Consolidation of operating environments including data centers, network servers, workstations and applications, among other areas, from selection of a single operating platform.
- Supply Chain – Improved strategic sourcing of materials and contract services from specification standardization, vendor consolidation, rationalization of requirements and, aggregation of spend for purchasing.
- Gas Supply – Integration of portfolio supply management allows for improved commodity costs.

A. These savings categories provide for approximately $373 million in gross cost savings, before allocation between the regulated and non-regulated segments, over the five-year period and continue thereafter.

Q. ARE THERE ANY ITEMS THAT OFFSET MERGER SAVINGS?

A. Yes. Cost savings initiatives which were already planned prior to the merger were offset against the gross savings estimates because there is likely to be some overlap between these initiatives and identified cost savings resulting from the merger. These ongoing or future initiatives will contribute to lower total costs to customers and are estimated at $11 million over the five-year period. The merger thus allows the Companies to achieve additional cost savings opportunities beyond those previously identified. These stand-alone savings reduce the gross merger savings because they are not merger-related initiatives.

Additionally, the costs to achieve the merger are offset against gross savings as discussed below.

Q. WHAT ARE THE CATEGORIES OF AND APPROXIMATE COSTS NECESSARY TO ACHIEVE THE SAVINGS?

A. There are several categories of costs that must be incurred to achieve the identified savings that are expected by the Companies. These costs reflect expenditures necessary to effectuate the cost savings identified from the merger through company integration. These categories of costs-to-achieve, as listed below, are further illustrated in Applicants' Ex. TJF-1.3:

- Separation
- Change-in-control
- Retention
- Relocation
- System Integration
- Directors' and Officers Coverage
- Regulatory Process and Compliance
- Facilities Integration
- Internal / External Communications
- Integration Costs
- Transaction Costs

Estimated costs-to-achieve total approximately $178 million, which will principally be incurred in 2007 through 2010, but will extend over a multi-year period to reflect certain ongoing costs.

Q. WHAT IS THE ANTICIPATED LEVEL OF TOTAL COST SAVINGS AFTER PRE-MERGER INITIATIVES SAVINGS AND COSTS TO ACHIEVE ARE REFLECTED?

A. The total estimated cost savings identified from the merger over the first five years after the merger, after being adjusted for costs to achieve and pre-merger initiatives, are approximately $184 million. The annual level of steady-state savings at the end of this five-year period will continue into perpetuity as related reduction decisions have been fully implemented.

B. General Assumptions

1. Escalation Rates

Q. WHAT ASSUMPTIONS ABOUT THE ESCALATION OF COSTS WERE UTILIZED BY THE COMPANIES IN ESTIMATING COST SAVINGS?

A. For the most part, cost savings were estimated based on 2006 budgeted expense levels. In certain cases, such as supply chain, 2005 data was used because a greater level of accuracy could be achieved by using actual, as opposed to budgeted, data. To account for inflation appropriately, specific escalation rates were then applied, by category, to initial year savings levels to determine the level of savings in each of the subsequent years. These escalation rates reflected the current financial planning assumptions adopted by the Companies' management and are generally consistent with those I have observed in use at other similar companies. Development of the estimated cost savings over the five-year period without application of an escalation factor would result in understatement of the total cost savings available over this period due to the year-to-year change in baseline cost levels.

Q. WAS THE SAME ESCALATION RATE USED FOR ALL SAVINGS CATEGORIES?

A. No. A differential existed in the anticipated escalation rates for the cost categories included in the analysis (*e.g.*, differences between salaries and other cost categories). For this reason, a single escalation rate could not be used for all cost savings categories. Although approximately 2.75% was used for general inflation, a higher blended rate (approximately 4.5%) was used for salaries and benefits to reflect market requirements and existing contractual arrangements. This 4.5% level is consistent with the Companies' pre-merger, stand-alone assumptions for salary and benefit increases. This blended rate reflects an escalation rate of approximately 3.5% for wages and salaries and approximately 6.3% for benefits due to the continuing high rate of inflation for medical costs that American industry has experienced. These escalation rates are comparable to those used by other companies with which I am familiar and to other longer-term estimates for general inflation.

2. <u>Treatment of Capital Savings</u>

Q. WERE THERE OTHER GENERAL ASSUMPTIONS OR METHODOLOGIES EMPLOYED IN THE COST SAVINGS ANALYSIS?

A. Yes. In treating capital deferrals and avoidance related to the merger, such as in information technology investment, it would be inappropriate to count the entire cash amount of the capital expenditure deferred or avoided as cost savings. For example, if it were anticipated that the Companies could avoid incurring a $10 million system upgrade in 2007, this reduction in expenditures was not used for the actual savings. Including the $10 million as savings achieved in 2007 would not represent the avoided revenue requirements associated with that capital expenditure from either the company or customers' perspectives. Additionally, such a methodology would result in overstating the cost savings in the early years following the merger by taking credit for the entire avoided investment as cost savings in those years. Instead, it is more appropriate to reflect only the revenue requirements savings associated with capital deferral / avoidance as cost savings. The components of revenue requirements include financing, depreciation, insurance and property tax. A levelized revenue requirements approach, rather than a cash flow approach, provides a more appropriate determination of the savings estimated to be generated due to the merger.

Q. WHAT METHODOLOGY WAS USED TO CAPTURE THESE CAPITAL DEFERRAL/AVOIDANCE SAVINGS?

A. A levelized fixed charge rate for each year following completion of the merger was applied to each year's capital expenditure reductions. The fixed charge rate methodology, which reflects normal declining balance ratemaking treatment, was used to estimate annual savings levels. Fixed charge rates were determined for each entity and then were blended to determine both general rates for long term assets and specific rates for information technology-related expenditures. The levelized fixed charge rate for capital items other than information technology was 15.0% while for information technology items it was 32.1%, reflecting the more rapid (five year) depreciation period. These estimates were based upon the amortization period of the various asset classes (long term at 40 years and short term at 5 years) as well as the estimated weighted average cost of capital adjusted for tax. Capital costs were based on each company's debt levels of approximately 45% for Peoples Energy and approximately 33% (excluding preferred stock) for WPS Resources. Debt costs were approximately 7.7% for Peoples Energy companies and 5.6% for WPS Resources entities. Currently authorized costs of common equity of between 11.1% and 11.3% for the Peoples Energy regulated entities and 11.0% for Wisconsin Public Service Company were adopted for this analysis and then grossed-up for income taxes. Each company's calculation was weighted by their spend to arrive at a combined average fixed charge rate.

C. Cost Savings Summary

1. Corporate and Headquarters Staffing

Q. PLEASE DISCUSS IN MORE DETAIL THE NATURE OF THE COST SAVINGS CREATED THROUGH THE INTEGRATION OF THE CORPORATE AND HEADQUARTERS STAFFING FUNCTIONS.

A. The combined Companies expect to fully integrate existing corporate and headquarters areas, such as strategic planning, treasury and compensation, among others. Such integration would generate savings through the elimination of redundant positions within these functions as the scope of related activities are generally identical within each Company.

A merger between the Companies provides an opportunity to consolidate these functions and eliminate redundant activities. For example, the consolidation of two information technology functions would typically create significant savings. Potential redundancy within the two departments is identified through an alignment of sub-functions between the Companies to ensure comparability across different organizational structures. Each individual sub-function within the information technology area contains positions performing duplicate tasks. Overlapping positions for non-variable work activity can be consolidated and subsequently eliminated without an impact on remaining workload volumes.

Q. HOW WAS THIS PRINCIPLE APPLIED TO DETERMINE THE POTENTIAL POSITION SAVINGS THAT WOULD RESULT FROM A MERGER OF THE COMPANIES?

A. The first step in determining corporate and headquarters staffing savings was to develop a detailed functional alignment of each Company. Each Company provided functional and sub-functional breakdowns that identified each position within its respective organization. The stand-alone company functional areas then were aligned, by sub-function, so that position levels for similar activities performed by the respective companies could be compared. The analysis maintained consistency between the inter-company functional categories and aligned representative activities between the Companies.

Upon completion of the functional and sub-functional alignment, the positions necessary to perform the required activities on a merged company basis were identified. In determining the appropriate going-forward future position levels of the merged company, the following items were considered:

- The relevant operating model to be employed within the particular area
    - **i. The relative scale and resource concentration between the two companies**
    - **ii. The type of activity and potential for redundancy**
- The fixed or variable nature of the activity

Consideration of these factors provided the means by which going-forward staffing levels could then be defined and resulting reductions determined.

Q. WHAT OPERATIONAL MODEL WAS ASSUMED FOR DETERMINATION OF STAFFING REDUCTIONS IN THE CORPORATE AND HEADQUARTERS FUNCTIONS?

A. Although no specific organizational structure was assumed to be in place post-closing of the transaction, there was a guiding presumption that the Companies would establish an operating model that would allow them to generally simplify and optimize operations, thus creating an opportunity to capture available savings from alignment, standardization and integration of common functions. This meant that similar functions would be fully integrated, where practical, and that resources would be aligned in the most effective manner to execute corporate objectives. It was intended that full organizational design flexibility would be maintained by the Companies to develop an operating structure that reflected the prerogatives of management and the requirements of managing and executing the business.

At the corporate level, it was assumed that those functions that relate to managing the business on an enterprise basis, e.g., strategic planning, finance and accounting, external relations, etc., would be fully integrated to reflect the overlap and duplication in these areas. With respect to these functions, consolidation would occur in those areas that were not geographically dependent, such as investor relations, or were related to business policy, such as compensation and benefits.

The identified staffing reductions in the corporate and headquarters areas also assumed that a shared service-type entity, similar to what Peoples Energy currently has in place, could also be in place after the close of the transaction. This type of entity typically aligns the common and transactional elements of the various functions, such as human resources, information technology, supply chain, etc., that are performed for all aspects of the business to capture economies of scale. Without defining whether the scope of this shared services entity could increase to incorporate other transactional activities, it was assumed that this type of organization would remain in place and serve as a means to achieve standardization and lower unit costs for similar activities.

Q. PLEASE DESCRIBE THE RESULTS OF THE CORPORATE AND HEADQUARTERS STAFFING ANALYSIS DISCUSSED ABOVE.

A. As of June 2006, WPS Resources had a total of 778 positions in the corporate and shared services areas, while Peoples Energy had a total of 490 positions at this same date for these functions. Approximately 230 corporate and headquarters position reductions were identified by the Companies that could result from the consolidation, which constitutes 18.1 % of the combined corporate and headquarters position baseline. These reductions represent the anticipated level of functional duplication that would exist between the Companies and could be avoided through the creation of an integrated corporate and headquarters organization. The savings associated with this area are $20.0 million in the first year and grow to $31.4 million by the third year when all information technology conversion is completed and steady-state operations are achieved.

2. <u>Utility Back-Office Staffing</u>

Q. WHAT OPERATING MODEL WAS ASSUMED FOR THE ANALYSIS OF THE UTILITY BACK-OFFICE AREAS?

A. In addition to the corporate related organization impacts, additional opportunities for consolidation will be available in the back-office areas of the utilities, i.e., the non-field or service delivery areas that support operations, such as system planning, asset management and customer billing, among other areas.

Given that utility operating companies exist in multiple state jurisdictions and the different approaches to organization within these companies, a common model needed to be defined for consideration with respect to operations and organization. A model was adopted where similar and commonly performed functions were assumed to be aligned, harmonized and integrated, regardless of where they were located. This meant that work could be electronically shared across the utility operating companies, where practical, so that local resources could support company-wide operations efforts and reduce the total level of staffing required. Thus, the total back-office staff work requirements could be distributed across engineering or asset management staff located in any one of the states where the new company will operate and joint standards would be in place to guide the work performed. Similarly, common back-office support in areas such as operations planning, budgeting and project management could also be consolidated and executed from any location in support of overall utility operations.

Specifically in the gas distribution business, the vast majority of resources are totally unaffected by the merger as the field work volumes are not reduced. Thus, there is no impact to service reliability, quality or safety from the merger as no reductions in staffing are expected in the field execution areas. However, for those functions that relate to areas such as business unit management, engineering, gas supply planning, maintenance standards and other common functions in place to support each Company's network, it was assumed that these resources could be shared across the operating companies and would be aligned to allow for a fully integrated operating model to be employed. The adoption of this type of model does not require relocation of personnel between the Companies rather, it simply enables available resources to be jointly leveraged and scheduled to meet the total work requirements of the business. Under this operating model there is no reduction in the level of dedicated resources of either Company's field force, thus service reliability is not affected.

With respect to the customer service area, the Companies will evaluate whether to move to a single billing platform which would enable a variety of customer care functions like customer accounting, remittance processing and credit and collections to be fully integrated. The consolidation of these functions would enable back-office resources to also be reduced over time. The common billing platform will enable customer calls to be routed among the Companies' call centers and be handled in a standard, systematic manner. This will improve overall productivity and allow for the total customer representative staffing base to be sized to meet the combined needs of the Companies, rather than simply the sum of the two stand-alone companies.

In each of the operating models described above, the operations of the Companies, i.e., the field crews, are unaffected with no impacts to service reliability, quality or safety. In addition, there is no movement of assets or resources away from their jurisdictional control and, therefore, no impact to the ability of local regulators to continue to monitor operating company performance or to maintain access to responsible operating company management.

Q. WHAT LEVEL OF SAVINGS WAS QUANTIFIED WITH RESPECT TO UTILITY BACK-OFFICE STAFFING?

A. The baseline level of utility staffing for the WPS Resources operating utilities was 2,115 and for the Peoples Energy operating utilities was 1,566. The identified staffing reductions in the utilities were 65 positions, which represents only 1.8% of the overall staffing baseline in the utility support area. These amounts reflect reductions that arise directly from adoption of the "virtual" operating model where functions are consolidated and managed and executed across the operating utilities in the field support back-office functions. The total level of labor savings in the utility support area was quantified at $1.7 million in the first year growing to $4.6 million by the third year when steady-state operations are achieved.

Q. WHAT ARE THE ESTIMATED TOTAL POSITION REDUCTIONS FROM THE COMBINATION OF THE OPERATING UTILITIES?

A. Total position reductions are estimated at 295 or approximately 6.0% of total current combined company corporate, shared services and regulated utility positions. These reductions reflect the operating models discussed above and result from the ability to reduce overlapping responsibilities, align related functions and activities and leverage a consolidated resource base.

Q. WHEN ARE THESE POSITION REDUCTIONS ASSUMED TO OCCUR?

A. The Companies intend to achieve a number of these reductions, 177, by the beginning of the first year following completion of the merger. Due to the need for extensive integration of information systems applications that will be required in association with consolidating operations of the Companies, approximately 118 reductions will not be fully realized until the second year following completion of the merger. These reductions have been synchronized with anticipated system completion dates to reflect the timing of system cut-overs, work practice standardization and process harmonization.

Q. ONCE THE POTENTIAL POSITION REDUCTIONS WERE IDENTIFIED, HOW WERE THE POSITION REDUCTION COST SAVINGS CALCULATED?

A. Average salary levels were calculated by function and then applied to the identified position reductions in those respective areas. The average blended salary for the position reductions identified (excluding executives) is estimated to be approximately $77,000 in 2007 dollars based on the expected salary levels for the Companies, weighted by the number of functional resources in each entity, and then escalated one year.

Q. ARE THERE COST SAVINGS ASSOCIATED WITH POSITION REDUCTIONS OTHER THAN SALARY EXPENSE?

A. Yes. Benefit costs are also considered when determining the cost savings associated with position reductions. Benefits include such items as health insurance, life insurance, employee investment plans, pension expense, accruals for retirement health benefits of active positions, incentives and bonuses, payroll taxes and others. A blended benefits loading rate of 33.7% was used to estimate average aggregate benefits cost. This loading rate reflects all the elements, including health and medical benefits and other insurance

(13.6%), FICA taxes (8.6%) and, pension loadings (11.5%). These rates were developed using benefits costs provided by each company and weighting the average based on benefits spend. The resulting total compensation (excluding executives), including benefits, averaged approximately $99,000 in 2007 dollars.

Q. WAS ANY PORTION OF THESE CORPORATE, HEADQUARTERS AND UTILITY BACK-OFFICE STAFFING SAVINGS CAPITALIZED?

A. Yes. A certain portion of these expenses are capitalized rather than expensed annually, reflecting their relation to the capital or construction elements of the business. Capitalized amounts thus are recovered over the life of the asset to which these costs are assigned. A blended capitalization rate (i.e., the percentage of the total cost reduction that would have been capitalized rather than expensed) of approximately 3.2% was used based on the stand-alone expectations of each company weighted by relative size.

Q. WHAT TOTAL SAVINGS LEVEL WAS ESTIMATED FROM CORPORATE, HEADQUARTERS AND UTILITY BACK-OFFICE STAFFING CONSOLIDATION?

A. Cost savings from corporate, headquarters and utility back-office staffing consolidation were estimated at $21.8 million the first year, $33.8 million in the second year, and $36.0 million in year three, when steady-state operations is achieved. Total savings for the five–year period were estimated to be approximately $171 million.

Q. COULD THESE POSITION SAVINGS HAVE BEEN ACHIEVED WITHOUT THE MERGER?

A. No. The position reductions described are solely attributed to the merger. The reduction opportunities arise from overlap and duplication in functional performance, rather than from stand-alone initiatives unrelated to the merger. The savings discussed above are triggered by the opportunity to combine functions and eliminate redundancy, not by assumed improvements in operating efficiencies. Although continuous improvement programs are regularly pursued, the savings identified above are not related to these stand-alone initiatives. Where cost reductions planned post-2006 were identified, these impacts were subsequently identified, quantified and offset against potential savings to avoid double-counting potential non-merger impacts. The subject of pre-merger initiatives is discussed further elsewhere in this testimony.

3. <u>Corporate And Administrative Programs</u>

Q. WHAT COST SAVINGS CAN BE CREATED THROUGH CORPORATE PROGRAM AND EXPENDITURE CONSOLIDATION?

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

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

- Insurance - Cost savings typically would be realized in the areas of property insurance and excess general liability insurance, among others. On a stand-alone basis, each company carries insurance (or is self-insured) in these areas independently. A larger combined company will have a reduced risk profile because of its broader asset base. In addition, asset concentration will be less significant due to the broader geography and more diversified balance sheet, which should translate into lower rates for the combined company.

- Information systems - Organizations must facilitate systems development and support the information processing needs of each company. Companies typically have independent plans to develop a variety of systems in the future, including parallel systems development efforts. A combination would enable the Companies to avoid incurring these duplicate capital expenditures. Additional information systems savings could result from deferred capital projects, such as server upgrades or workstation purchases. Additionally, savings could be realized from the elimination of other duplicate costs, including disaster recovery, software support, miscellaneous software and hardware, license fees, and computer maintenance.

Q. WHAT ARE THE AMOUNTS, BY SPECIFIC AREA, OF THE CORPORATE AND ADMINISTRATIVE PROGRAM SAVINGS?

A. Savings were identified and quantified over the five-year period in the following areas:

	Five-Year Total ($Millions)
Administrative & General Overhead	$ 10.5
Benefits	5.4
Credit Facilities	1.7
Directors' Fees	5.0
Facilities	12.8
Insurance	10.5
Professional Services	30.7
Shareholder Services	4.0
Total Corporate & Administrative Programs	$80.6

Each of the aforementioned categories is described below.

a. Administrative and General Overhead

Q. WHAT TYPES OF EXPENSES ARE INCLUDED IN ADMINISTRATIVE AND GENERAL OVERHEAD EXPENSE AND HOW ARE THEY AFFECTED BY THE MERGER?

A. Administrative and general overhead expense includes, but is not limited to, postage (other than customer billing), employee travel and education, periodicals, and office supply expenses related to employee support. These costs vary with the total number of positions and change as the level of employee staffing increases or decreases. As position reductions are realized, the related administrative and general support expenses will be reduced accordingly.

Q. HOW WERE THE ESTIMATED COST SAVINGS QUANTIFIED FOR THIS AREA?

A. Miscellaneous overhead expenses were identified and divided by the total positions for which they were applicable. Between the two Companies, a total blended amount of approximately $9,000 was derived for these miscellaneous overheads per employee. The amount of the A&G expense per employee was then applied to the number of reduced positions in the corporate and headquarters areas to derive the total level of cost savings. The related merger savings were estimated at $1.4 million in the first year, $2.2 million in the second, and growing to $2.3 million when steady-state operations are achieved.

Q. COULD THESE MISCELLANEOUS OVERHEAD EXPENSE SAVINGS BE ACHIEVED ABSENT A MERGER?

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

b. Benefits

Q. HOW CAN COST SAVINGS RELATED TO BENEFITS ARISE FROM THIS MERGER?

A. A. Benefits savings typically arise from two sources: the consolidation of benefits plan administration and related costs and the reduction in the cost of the dollar of benefits obtained. The benefits administration costs can be reduced through the alignment of plan trustees and the management of multiple plans through a single administrator. Through the consolidation of the benefits plan themselves, the cost of benefits can also be reduced from aggregation of the plan members and the reduction in the unit cost of the benefit dollar procured. This reduction in expense relates to reducing the cost of the dollar of benefit procured and not the level of benefits provided, thus employee benefits are not reduced in any manner. This plan consolidation would be linked to existing contract expirations and the evaluation of national and regional providers from coverage, quality and cost perspectives.

Q. WHAT IS THE LEVEL OF BENEFITS RELATED COST SAVINGS?

A. The respective benefits administrative costs paid and benefits costs incurred by the Companies were reviewed to determine the opportunities for administrator and plan consolidation. The benefits costs level was reduced by 0.5% to reflect additional economies available upon consolidation of the programs. Additional savings opportunity was also identified from moving to an integrated administrator of the plans which also reflects economies of scale. The level of savings from the consolidation of the benefits program is estimated at $1.2 million in the second year growing to $1.3 million by the third year when steady-state operations is achieved. Again, this reduction does not imply any reduction in benefits levels for remaining employees.

Q. WOULD THESE SAVINGS IN BENEFITS BE AVAILABLE ABSENT THE MERGER?

A. No, they would not. These savings are specifically dependent on the integration of the benefits plans of the Companies and would not otherwise be available to the Companies without this combination being concluded.

c. Credit Facilities

Q. HOW CAN COST SAVINGS RELATED TO CREDIT FACILITIES ARISE FROM THIS MERGER?

A. These savings typically arise from the ability to reduce the amount of total credit facilities required for the cash flow or credit support needs of the business on a combined basis. By reducing the amount of the total credit facilities in place for the Companies to reflect their combined cash flow profile and credit support requirements, the associated administration and facility fees on undrawn balances can be avoided.

Q. WHAT IS THE LEVEL OF CREDIT FACILITIES RELATED COST SAVINGS?

A. The respective credit facilities in-place by the Companies were reviewed to determine the opportunities for elimination. The combination of the Companies identified approximately $2.33 billion in credit facilities from 20 financial institutions that could either be combined or eliminated. The level of savings from the reduction of credit facilities is estimated at $0.33 million in the second year growing to $0.34 million by the third year when steady-state operations is achieved.

Q. ARE THESE CREDIT FACILITIES SAVINGS AVAILABLE TO THE COMPANIES WITHOUT COMPLETING THIS TRANSACTION?

A. No. Absent the merger, the stand-alone credit support requirements of the Companies would remain unaffected, as would the current levels of the credit facilities. Thus, it is the merger that enables the reduction in the combined level of credit facilities.

d. Directors' Fees

Q. HOW ARE SAVINGS IN DIRECTORS' FEES DERIVED FROM UTILITY COMBINATIONS?

A. These savings result from the reduced number of total directors for the new company compared to that of WPS Resources and Peoples Energy today. The new Company will have a Board of Directors numbering sixteen directors. The elimination of four board members will reduce overall director fees for meetings, committee participation and travel for these individuals.

Q. HOW WERE COST SAVINGS ESTIMATES IN THIS CATEGORY DEVELOPED?

A. The number of directors for each company was identified along with the associated costs. Based on the average fees and expenses for directors at each Company, the total savings would amount to $0.9 million per year.

Q. ARE THE SAVINGS ASSOCIATED WITH DIRECTORS' FEES A DIRECT RESULT OF THE MERGER?

A. Yes. These savings are directly merger-related in that they are driven by merger-related reductions in the number of board members required by the new Company when compared to the existing two companies. These savings would not be achieved without the merger since neither of the Companies had a need or plans to reduce the total number of directors, thus this group would not have been affected on a stand-alone basis.

e. Facilities

Q. WHAT SAVINGS CAN BE REALIZED THROUGH CONSOLIDATION OF TOTAL CORPORATE FACILITIES?

A. Cost savings will arise in this category from the reduction of the total square footage needed to be maintained for the relevant employee base after adjustment for the reduced total employee level. This expense is variable with the number of employees and reflects the cost per square foot for space and related maintenance costs.

Q. WHAT WAS THE MAGNITUDE OF SAVINGS ASSOCIATED WITH FACILITIES CONSOLIDATION?

A. Because the location of the staff reductions will not be known until the integration process is further along, the average amount of square footage per employee for existing space and cost per square foot across both principal corporate facilities was developed for application against expected staff reductions. This cost per square foot was developed on a blended basis i.e., a weighted average of the two facilities costs. Thus, no decision was made about which facility would be most directly affected and the Companies will have the ability to locate functions and personnel in whichever location best suits their need for effective performance. This space would be sublet to another occupant at the prevailing market rate across the available locations. Based on this approach, facilities savings were estimated at $1.7 million in the first year, ramping up to a level of $2.7 million savings by the end of the third year following the merger, when steady-state operations is achieved.

Q. COULD THESE SAVINGS BE ACHIEVED ABSENT A MERGER?

A. No. The facilities consolidation savings are possible only as the result of the consolidation of the Companies and the resulting position reductions described above. If the Companies were to remain as separate corporate entities, then these savings could not otherwise occur.

f. Insurance

Q. PLEASE DESCRIBE THE RATIONALE OF HOW SAVINGS CAN BE ACHIEVED IN THE AREA OF INSURANCE.

A. Utilities generally require insurance coverage in the areas of property, directors' and officers' liability and excess casualty. On a stand-alone basis, each company independently carries insurance in these areas which it has obtained on a negotiated basis from external brokers or through self-insurance. A combined company may have a reduced risk profile because of its broader and more diverse asset base, which translates into lower premiums. Further savings may also be attainable through the ability to carry higher deductibles given the combined company's increased financial strength.

Q. HOW WERE THE SAVINGS IN THE AREA OF INSURANCE QUANTIFIED IN THIS TRANSACTION?

A. Savings on insurance premiums were calculated for property coverage, directors and officers coverage, fiduciary coverage and, liability coverage. These reductions were derived based on review of the costs of the different components of the insurance programs of the respective companies and review of experience in other mergers regarding actual savings negotiated with insurance brokers. In this transaction, it is expected that the above programs will be combined and savings in the range of 20 - 40%, by category, will be available across the respective insurance program elements, e.g., property, excess and general liability, workmens compensation, D&O liability etc. The total estimated savings for insurance is $2.0 million in the first year and growing with escalation thereafter.

Q. COULD THE SAVINGS THAT HAVE BEEN IDENTIFIED IN THE INSURANCE AREA BE ACHIEVED ABSENT A MERGER?

A. No. These savings are predicated directly on the assumption that there is a single company procuring insurance coverage on the basis of the combined risk profile of that entity.

g. Professional Services

Q. WHAT GIVES RISE TO SAVINGS IN THE AREA OF PROFESSIONAL SERVICES?

A. The combined company can reduce professional services activities through economies of scope, elimination of non-recurring duplicate services and increased utilization of a broader skill base. Audit costs and additional attest services (e.g., bond insurance letter, pension plan audits, stock issuance) can be reduced as a result of duplication. Similarly, legal expenditures (regulatory and corporate) and consulting expenditures can be avoided due to redundancy and duplication, and reduced by supplier rationalization and substitution of in-house resources for external services.

Q. HOW WERE SAVINGS IN THE AREA OF PROFESSIONAL SERVICES QUANTIFIED, AND WHAT WAS THEIR MAGNITUDE?

A. A. Expenditures, by category. e.g., accounting, legal, consulting, etc., were aligned between both companies to determine baseline professional fees. Each category was assessed based on the needs of the business, the nature of the services obtained, the level of third-party assistance obtained and the likely availability of internal resources to be deployed against these specific needs. The total savings resulting from these reductions was estimated at $5.8 million in the first year and growing thereafter.

Q. COULD THESE SAVINGS BE ACHIEVED ABSENT A MERGER?

A. No. They can only be achieved by consolidating the use of professional services within a single company. Otherwise, there will continue to be two different sets of independent auditors, two comprehensive sets of external legal counsel and two different sets of general consultants.

h. Shareholder Services

Q. HOW WILL THE MERGER OF THE COMPANIES IMPACT THE EXPENSES INCURRED FOR SHAREHOLDER SERVICES?

A. Cost savings will arise in this area with respect to both fixed and variable costs related to expenses for the annual report, annual meeting, proxy filings, securities registration and, other investor relations costs. These costs will be avoided in many cases as they are purely duplicative.

Q. HOW WERE THE SAVINGS IN THE AREA OF SHAREHOLDER SERVICES QUANTIFIED?

A. Costs were aligned, by category and compared to determine relative spend. These costs were also separated between fixed and variable levels and assessed across both companies. Duplicative costs, largely fixed, are reduced in following areas: annual report costs, stock transfer/registration fees and annual meeting costs; stock exchange fees and other outside services. Variable administration/postage costs, proxy services, stock transfer / registration fees and annual meeting costs were also reduced to reflect lower required costs and to reflect some overlap of investors. The total estimated savings in the area of shareholder services is approximately $0.8 million in the first year growing with escalation thereafter.

Q. COULD THESE SAVINGS BE ACHIEVED ABSENT A MERGER?

A. No. They can only be achieved by consolidating into a single company and thereby reducing the need for stand-alone costs to be incurred in the same areas.

4. <u>Information Technology</u>

Q. HOW WILL INFORMATION TECHNOLOGY SAVINGS ARISE FROM THE PROPOSED MERGER OF THE COMPANIES?

A. With the completion of the merger, the separate information technology operations of the Companies will be integrated which will allow the combined stand-alone operating and capital costs to be reduced. This cost reduction will occur from the standardization of the information technology architecture, rationalization of applications and planned projects and consolidation of the underlying infrastructure.

Q. WHAT AREAS ARE EXPECTED TO PROVIDE COST SAVINGS IN THE INFORMATION TECHNOLOGY FUNCTION?

A. Each company utilizes different systems and vendors for the principal applications areas of finance, human resources, supply chain, billing and work management. Rationalizing these individual backbone applications will provide for significant reduction in support and maintenance expenses. With WPS Resources using PeopleSoft and Peoples Energy using SAP, it is expected that the combined company will consolidate their platforms, thus reducing applications support costs and the need for continuing upgrades to the phased-out applications. Although no final decisions were made with respect to the complete inventory of applications between the companies, the merger will require that a single, common application in each area, such as work management and billing, be adopted across the business which will yield similar savings. Selecting specific applications to support the Companies going forward may result in the early termination of a particular application before it has been fully amortized.

Additionally, the standardization and consolidation of the infrastructure will enable the number of data centers to be reduced, as well as the number of servers used to support network computing. It is also expected that the number of workstations and related requirements for software will be reduced as the number of employees is reduced. Similarly, rationalization of the needs of the business will result in additional savings opportunities as the networks can be integrated between the companies, expenditures for communication devices reduced and plans for cellular, paging and other communications can be combined.

Q. WHAT ARE THE COMPONENTS OF THE SAVINGS IN THE INFORMATION TECHNOLOGY AREA?

A. Savings that will arise in the information technology area consist of both operation and maintenance expenses and carrying costs associated with either reduced capitalization of related expense or reduced capital expenditure levels. These savings thus reflect the reduced and avoided costs from standardization, rationalization and consolidation. In addition to the SAP-PeopleSoft application decision referred to above, other applications in the areas of supply chain, human resources, work force management and customer billing will also be consolidated. This application consolidation is expected to yield approximately $26 million in savings and $29 million in project cost avoidance related to these applications. Data centers will also lend themselves to consolidation and enable the Companies to reduce fixed costs in this area. This facility consolidation is expected to produce approximately $3 million in annual cost savings.

Capital savings reflect that approximately 40% of identified savings will be capitalized and amount to $1.1 million in the first year and grow to $10.8 million by the last year of the five-year period. These savings reflect a five-year amortization of applicable costs related to development and upgrading expenditure avoidance. For the operation and maintenance related expenses, savings are $5.8 million in the first year and grow to $12.8 million by the end of the five-year period. The level of savings total related to information technology is estimated at $6.8 million in the first year growing to $23.7 million in the fifth year.

Q. COULD THESE SAVINGS BE REALIZED BY THE COMPANIES WITHOUT THE MERGER?

A. No. There would be no opportunity to integrate the information technology infrastructure and consolidate applications in the absence of the merger. These savings, therefore, would not occur but for the merger.

5. <u>Supply Chain</u>

Q. MR. FLAHERTY, PLEASE DISCUSS THE COST SAVINGS THAT CAN BE CREATED THROUGH THE SUPPLY CHAIN.

A. Combining companies can achieve savings through the centralization of purchasing functions related to construction, operations and maintenance. The greater purchasing power and the relative quantity of both goods and services that can be obtained as a result of the combination of companies provide additional cost savings. With respect to the purchase of goods (i.e., materials and supplies), savings can be realized in the procurement of commodity items, consumable equipment, and other equipment for gas utilities. With respect to the procurement of services, particularly contract services such as engineering, construction and maintenance related services, expenditures can be consolidated through a combination and typically contracted from larger regional sources. Cost savings are created by achieving a lower per unit cost for the service provided due to a broader contract or the repackaging of work into more attractive options to the contractor. This work package realignment and volume purchasing of service is the primary method through which service procurement savings are realized.

a. Materials and Services

Q. WHAT ARE THE COST SAVINGS AVAILABLE FROM COMBINED PROCUREMENT OF MATERIALS AND SUPPLIES?

A. Procurement savings should result from larger purchasing volumes and the availability of greater purchasing power. Expected annual purchases for 2006 for gas-related items for the WPS Resources operating utilities are estimated at approximately $25 million, while for similar units of Peoples Energy it will be approximately $22 million. Savings represent a reduction in total materials costs from extending strategic sourcing across the broad range of operating categories. This amount was determined based on the experience of other companies, management's knowledge of vendors and potential approaches to material standardization and vendor concentration. This strategic sourcing improvement reflects permanent economies of scale through lower unit costs. Total savings in materials and supplies increase from $1.4 million in year one to $2.7 by the end of the five-year period.

Q. SHOULD ANY OF THESE AMOUNTS BE CAPITALIZED BY THE COMPANIES?

A. Yes. Approximately 60% of the materials and supplies savings have been allocated to capital accounts based on the combined Company's estimated capitalization rate for all materials and supplies. Once again, the levelized fixed charge rate was applied to convert the capital cost reductions into revenue requirement savings.

b. Contract Services

Q. WHAT IS THE NATURE OF SAVINGS FROM CONTRACT SERVICES AS A RESULT OF THE MERGER AND HOW WERE THEY QUANTIFIED?

A. Similar to consolidating materials and supplies purchasing volumes, the combined Company will be able to gain economies of scale from the aggregation of related work activities and increased purchasing power with service providers. Examples of these services include certain engineering, construction and maintenance services.

The savings estimate also is dependent upon future negotiations with contractors and is similar to those estimated in prior transactions and represents purchasing power savings across the broad range of these services. The total gas-related items for the WPS Resources operating utilities for 2006 is expected to be $54 million, while for similar units of Peoples Energy they are estimated at $53 million. The Companies thus should be able to achieve additional economies of scale and scope from improved sourcing across all their vendors.

Some contract services savings should be considered capital savings. A capitalization rate of 18% was used to represent the level of contract services expenditures that would be assigned between O&M and capital accounts. These capital savings amounts were then converted to revenue requirements savings using the levelized fixed charge rate. The total estimated annual savings from contract services increase from $2.9 million in the first year to $3.6 million by the end of the five-year period.

6. Gas Supply

Q. HOW CAN COST SAVINGS BE ACHIEVED IN THE AREA OF GAS SUPPLY AND WHAT ARE THE ESTIMATED SAVINGS?

A. Gas supply savings may be realized as a result of combining overlapping asset positions and managing them on a portfolio basis. Savings accrue primarily from avoided capacity charges for the overlapping assets. The Companies maintain approximately 2.5 Bcf per day of system deliverability to meet peak day demands and have access to a portfolio of supply pipelines including ANR, NGPL, Northern Natural, Northern Border, Viking and others Preliminary gas supply savings were estimated based on approaching gas purchasing requirements on a "portfolio' basis, and therefore reducing total storage requirements for the combined entity. Steady-state savings are estimated at approximately $3.0 million in this area with the Companies to fully review the parameters and limitations of portfolio gas supply management during the integration process.

Q. COULD THESE SAVINGS BE ACHIEVED ABSENT A MERGER?

A. No. These savings are predicated directly on the integration of the gas supply requirements and managing the Companies supply positions on a portfolio basis, which would not be accomplished in the absence of the merger.

7. <u>Savings Comparison</u>

Q. ARE THE CATEGORIES OF SAVINGS IN THIS MERGER CONSISTENT WITH THOSE TYPICALLY IDENTIFIED IN UTILITY COMBINATIONS?

A. Yes, they are. There are, however, certain factors unique to this merger that affect the nature and level of synergies available.

Q. PLEASE ELABORATE ON THESE FACTORS.

A. Several factors typically affect the nature and level of merger synergies expected in utility combinations. These include: relative size (of the Companies), relative cost position, location, business mix, organization and management philosophy. Certain of these factors affect the quantified merger synergies in this merger:

- First, there are multiple, distinct service territories within which the WPS Resources and Peoples Energy operating utilities provide service. More proximate service territories normally would provide for additional savings opportunities e.g., reduction in facilities and sharing of relevant resources;
- Second, Peoples Energy is a gas only utility and does not have any electric utility operations similar to that of WPS Resources, thus there is no counterpart organization and the almost 1,250 electric generation, transmission and distribution personnel of these entities would be unaffected by the merger;
- Third, the relative scale of WPS Resources and Peoples Energy are different with WPS Resources having approximately 60% more corporate related personnel and 35% more field distribution personnel relative to Peoples Energy. This scale differential will tend to depress the level of available savings, particularly when the majority of the resources are in unaffectable areas, i.e., field crews.

These differences affect the alignment and comparability of the staffing levels and costs of operations. Accordingly, each of these differences needed to be considered in determining the potential level of savings opportunities available from the merger.

Q. HOW DO THE WPS RESOURCES AND PEOPLES ENERGY MERGER COST SAVINGS COMPARE TO THOSE IN OTHER TRANSACTIONS?

A. The anticipated cost savings from the merger of the Companies are within the range identified by other companies in other recent utility mergers. In particular, anticipated position reductions and non-fuel operations and maintenance ("O&M") expense reductions were reviewed -- two categories that provide a useful basis for comparative assessment of relative merger-related cost savings.

The approximate 6.0% position reduction amount from the merger of the Companies reflects the estimated total number of position reductions (approximately 300) compared to the total number of positions at both companies prior to the initiation of the merger (approximately 5,000 which reflects all the functions of the operating utilities in place). The 6.0% reduction amount falls below the average reduction figure of 8.3% and is limited by the lack of overlapping operations and certain operating composition differences between the Companies. In particular, none of the field workforce is affected by the combination, i.e., work volumes will not be reduced, thus those positions directly responsible for safety, reliability or service quality will not be reduced as a result of the merger. There is opportunity for consolidating certain back-office utility operations support functions; however, this does not offset the geographic distance which limits the level of potential field related reductions.

Similarly, the non-fuel O&M reduction amount of 7.8% that will result from the merger is also below the 9.4% average of the same publicly announced transactions. The differences in the operating company scope explained above are the principal reasons for the disparity between the WPS Resources and Peoples Energy merger O&M cost savings and the average cost savings from other recently proposed utility mergers and would be anticipated based on the specific facts of this transaction. This result is largely driven downward by the significant amount of field related generation, transmission and distribution O&M expense in the denominator that is not affected from this merger, as compared to prior transactions. The relative scale of functions where no overlap exists, such as in electric generation, transmission and distribution, further impact the comparison in a downward manner. Although not all of the saving elements found in other prior mergers are available in this transaction the cost savings and cost avoidances related to the WPSC and Peoples combination reflect those typically found within my previous industry experience.

VI. COSTS-TO-ACHIEVE AND PRE-MERGER INITIATIVES

Q. PLEASE DESCRIBE THE APPROACH TO ESTIMATING THE COSTS THAT WILL BE INCURRED WITH THE INTEGRATION OF THE TWO COMPANIES.

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

Q. PLEASE EXPLAIN THE PROCESS BY WHICH THE COSTS-TO-ACHIEVE WERE ESTIMATED BY THE COMPANIES.

A. The cost category analysis approach described above that was used to determine potential merger savings opportunities areas was also extended to the potential out-of-pocket costs associated with realizing the savings and closing the transaction. Specific identification of employee related separation cost was undertaken to identify the various elements that could be expected to be incurred. The out-of-pocket costs that will be incurred in merger integration such as, systems integration, regulatory processes, facilities integration, communication expenses and other miscellaneous expenses also were identified. In addition, certain non-cash costs were recognized in this transaction for technology expenditures related to prior systems installation that have not been fully recovered and are reflected on the balance sheets of the Companies. The methodology used by the Companies to develop the costs-to-achieve estimates was comprehensive, and similar to that used by other companies in estimating such costs.

Q. WHAT EXPENSES ARE ESTIMATED TO BE INCURRED TO MERGE THE COMPANIES?

A. Costs-to-achieve, before allocation between the regulated and non-regulated segments, are estimated at $178 million over the five-year period utilized, with the largest portion of these costs ($148 million) to be incurred over the first three years beginning in 2006. Certain costs-to-achieve will continue into succeeding years as annual payments will be required for items such as licenses. These cost estimates are consistent with estimates made by companies in other similar prior transactions and reflect differences in scale and scope and the unique circumstances of this merger.

Q. WHAT ARE THE PRIMARY COMPONENTS OF THE COSTS-TO-ACHIEVE THE ESTIMATED MERGER SAVINGS?

A. The primary components used to estimate costs-to-achieve were separation costs (estimated to cost $22.4 million), change-in-control ($15.3 million), relocation costs ($3.3 million), retention costs ($5.7 million), systems integration ($82.8 million), facilities integration ($3 million), internal and external communication expenses ($5.5 million), regulatory process and compliance costs ($10.5 million), integration costs ($6.1 million), Directors' and Officers coverage ($2.9 million), and transaction costs ($20.5 million).

Q. PLEASE DESCRIBE THE MEANS THE COMPANIES ANTICIPATE USING TO ACHIEVE THE ESTIMATED POSITION REDUCTIONS.

A. A major component of the merger cost savings is the reduction in work force which is primarily due to the elimination of duplicative functions and tasks. These reductions are expected by the Companies to be achieved through a variety of means including attrition, controlled hiring, work force redeployment, work realignment, and through voluntary separation or early retirement. For these targeted separations, out-of-pocket costs will be incurred to achieve the total position reductions.

Q. HOW WAS THE LEVEL OF COSTS-TO-ACHIEVE FOR POSITION REDUCTIONS CALCULATED?

A. The preliminary estimate used for the severance package calculation was three weeks of base pay per year of service (assuming an average of 17 years), plus eighteen months of health benefits from the date of separation. This estimate was based on similar programs previously offered by the Companies and will be refined during the integration process to meet the needs and considerations of the Companies as they develop the overall integration strategy. The separation package was applied to average salaries in affected groups and reflects approximately one year of salary for employees. For displaced executives, standard contract arrangements were utilized based on years of service and relative compensation levels.

The severance related programs that affect employees and executives are to be more fully defined during the transition process based on additional considerations of the management and human resources philosophy of the combined company and more specific analysis on the timing and location of reduced positions. Total separation costs were estimated at $37.8 million with an additional amount of $5.7 million for employee retention also identified to secure employees during the pre-close period for critical activities, such as in the information technology area.

Q. EXPLAIN THE NATURE OF RELOCATION COSTS.

A. To provide for efficient consolidation, certain functional areas will be centralized and thus require employee relocation to a new site. Based on the functional analysis, it was determined that a number of positions possibly would need to be relocated between the headquarters locations at an estimated cost of $3.3 million. The full cost of the actual relocation package to be offered to eligible positions has not yet been determined, as it ultimately will depend on the number of personnel that will move. The components of a relocation program could include moving expenses, house hunting costs, cost of living differentials, and closing costs. These cost estimates are consistent with estimates made by companies in prior similar transactions.

Q. EXPLAIN HOW SYSTEMS CONSOLIDATION AND TELE-COMMUNICATIONS NETWORKING COSTS WERE CALCULATED.

A. Significant effort will be expended by the Companies in integrating the information technology and services functions of the Companies. A principal element of these costs will relate to integrating the diverse applications of the Companies. In addition, the voice, data and video networks will also need to be integrated through expanded telecommunications capabilities, the data centers will be consolidated and elements of the network such as servers will be rescaled to meet the needs of the business.

Given the very different technology environments and back-bone applications within each company, substantial effort will be made to align platforms, rationalize vendors and reduce overlap. Particularly, the areas of consolidating enterprise resource planning (ERP) systems and moving to a common billing system will require focused attention and dedicated expenditure.

Integration costs for these areas were estimated at $82.8 million over the five-year period with some continuing costs thereafter. These cost estimates cover contract programming, hardware change out and conversion, potential T-1 capacity, and outside assistance and reflect scale, complexity, and platform differences. For example, the O&M and revenue requirements costs of applications consolidation is estimated at approximately $81 million and data center closure at $2 million. These costs will reflect both third-party costs for programming and conversion support, as well as, costs for changes in licensing fees and server capacity. These costs also include approximately $30 million for early retirement of certain existing applications that will occur from consolidation of applications. These costs occur in year four, after application consolidation and conversion have occurred and reflect the remaining unamortized development and installation costs that would have been amortized over future years.

These expenses associated with systems and communications integration are expected to principally be incurred in 2007 and 2008, but will carry through the full period to reflect additional hardware lease costs and licenses.

Q. CAN YOU DESCRIBE THE REGULATORY PROCESS AND COMPLIANCE COSTS-TO-ACHIEVE RELATED TO THE MERGER?

A. To successfully complete the merger, certain costs will be incurred for preparation and pursuit of regulatory filings, such as those related to the Securities and Exchange Commission, the Federal Energy Regulatory Commission, and the Department of Justice filings and the merger related cases before the various state regulatory jurisdictions. In addition, certain costs were incurred to satisfy expanded compliance and fiduciary requirements, such as in due diligence. These costs will include professional services for legal, tax, accounting and consulting assistance, including legal and other consulting fees incurred in negotiating the Merger Agreement, and certain other filing related costs and fees. Regulatory process and compliance costs are estimated at $10.5 million.

Q. PLEASE DESCRIBE THE ESTIMATED INTERNAL AND EXTERNAL COMMUNICATIONS COSTS-TO-ACHIEVE.

A. Communication expenses will arise from the need to disseminate merger information to the various stakeholders of the individual organizations and combined company. Informational releases, brochures, notices, etc. will be sent to employees, shareholders, rating agencies, and state and federal commissions to explain the specifics of the merger. The various vendors, supplier and contractors will also receive communications that address the merger and the manner in which contacts and business arrangements will be conducted. Additional costs will be incurred with respect to changing related infrastructure elements such as signage. These expenditures are estimated to total $5.5 million.

Q. WHAT IS THE NATURE OF THE INTEGRATION COSTS TO ACHIEVE?

A. These costs capture the out-of-pocket travel costs of internal employees groups in accomplishing the integration and relate to air, lodging and per diem expense. Additional support costs from third-parties for consulting assistance through this process are also reflected in this category. These costs are estimated at $6.1 million.

Q. PLEASE DESCRIBE THE DIRECTOR AND OFFICERS COVERAGE.

A. With separation from the Companies, an ongoing level of insurance expense will be incurred on behalf of the departing directors and officers. This expense is provided for in the Merger Agreement (attached as Attachment A to the Application) to provide adequate coverage to these individuals in the event of subsequent litigation to which they could become a party in view of their previous position with the Companies. These amounts have been estimated at $2.9 million and reflect a one-time premium incurrence.

Q. WHAT TYPE OF FACILITIES COSTS WILL BE INCURRED WITH RESPECT TO THE TRANSACTION?

A. The reduction in total staffing will free-up a certain amount of square footage currently utilized by the Companies. These incurred costs relate to the restacking of floor space to accommodate a different amount of total employees, by location, and cover related moves, refurbishment, construction and other leasehold improvements. These costs have been estimated at $3 million to realign the separate corporate facilities maintained by the Companies.

Q. PLEASE EXPLAIN THE TRANSACTION COST COMPONENT INCLUDED WITHIN THE TOTAL COSTS-TO-ACHIEVE.

A. Transaction costs include amounts paid to the investment banks for assistance with certain aspects of the merger. These costs specifically relate to fees paid for assistance in transaction structuring and negotiation and the provision of a fairness opinion to satisfy the needs of the Boards of Directors. Total transaction fees are estimated at $20.5 million for the above categories.

Q. PLEASE DESCRIBE THE APPROACH USED TO QUANTIFY THE PRE-MERGER INITIATIVES OVERLAP ADJUSTMENT

A. Discussions with management led to the identification of cost reduction initiatives within Peoples Energy that needed to be recognized to avoid double-counting in the synergies estimation process. The Peoples Energy cost reduction initiatives are based on holding O&M levels constant for the upcoming five year period, although the operating areas where such costs would be constrained have not yet been specified. These implied cost constraint and reductions could be achieved in a variety of means, such as through process improvement, reengineering, outsourcing, work elimination or contractor management To avoid potential duplication between the merger-related savings and Peoples Energy's cost reduction initiative savings, I reduced the total merger-related savings to reflect any potential overlap with potential Peoples Energy cost reduction initiatives. Although WPS Resources is continuously working to control costs, no adjustments for specific initiatives were identified to avoid potential double-counting of these programs with respect to the identified merger cost savings. The resulting potential overlap in cost savings are estimated at approximately $9 million in 2007 growing to $48 million by the end of the five year period.

Q. HOW WAS THIS IMPACT RELATED TO THE MERGER SAVINGS?

A. Total estimated O&M savings in year five are $72 million, or 7.8% of the forecasted year five O&M. This amount was assumed to apply across the various operating entities that contributed to the overall savings on a weighted basis reflecting their relative cost levels. Accordingly, the total cost savings were reduced to reflect the assumption that some of the planned cost reductions of Peoples Energy would affect the starting cost baseline for the synergies analysis. In effect, the planned cost reduction initiative of Peoples Energy is assumed to overlap at the same level as the identified merger savings affect the initial baseline. This reflects the fact that the planned cost reduction of Peoples Energy applied to a broader cost base than was affected by the merger. As a result of this calculation, I assumed that there would be overlap between the merger-related savings and People's initiatives in proportion to the merger savings impact on the total cost baseline, or $0.7 million in the first year and growing to roughly $3.8 million by the last year of the quantification period.

Q. WHAT IS THE RESULTING PRE-MERGER INITIATIVES ADJUSTMENT?

A. Based on the approach described above, I have adjusted the five year merger savings downward by $11 million over five years to reflect the estimated overlap between the merger savings and Peoples Energy's stand-alone planned cost reduction.

VII. <u>ALLOCATION OF COST SAVINGS AND COSTS-TO-ACHIEVE</u>

Q. WHAT IS THE GENERAL PURPOSE OF ALLOCATING COST SAVINGS AND COSTS-TO-ACHIEVE?

A. In any multi-jurisdictional merger the allocation of savings and costs-to-achieve is required to assign savings and costs-to-achieve to specific jurisdictions. Additionally, there are elements of the corporate and regulated savings and costs-to-achieve that support both regulated and non-regulated business operations. A properly developed allocation approach enables the savings and costs-to-achieve to be assigned in a transparent manner to those different business types.

Q. WERE THERE SPECIFIC ADDITIONAL OBJECTIVES THAT WERE CONSIDERED DURING THE DEVELOPMENT OF THE ALLOCATION APPROACH FOR THE WPS RESOURCES – PEOPLES ENERGY MERGER?

A. Yes. There were two primary objectives that the allocation approach needed to satisfy. First, the approach needed to be flexible enough to properly address over 25 different categories of savings and costs-to-achieve. Second, the allocation approach needed to be comprehensive. This is critical since savings and costs-to-achieve categories could impact regulated and non-regulated businesses, the gas and electric businesses and each jurisdiction that the operating companies will serve.

Q. IS THE ALLOCATION APPROACH DESCRIBED INTENDED TO BE USED AS PART OF ANY FUTURE COST-OF-SERVICE FILING?

A No. A more detailed method that would provide a fair basis for allocation of ongoing total O&M will be developed by the Companies. The allocation approach developed for this proceeding is only intended to provide a fair basis for allocation of savings and costs for purposes of estimating savings distribution in this proceeding, and is not intended to be a permanent basis for allocations.

Q. WHAT FACTORS WERE CONSIDERED DURING THE DEVELOPMENT OF THE ALLOCATION APPROACH?

A. The process used to develop the allocations began with developing an understanding of how the Companies currently allocate costs. The current allocation bases covered a broad set of approaches including one, two and three factor formulas with factors including payroll, assets, and direct billing.

Another key consideration used to develop the allocation approach was how costs are incurred in the merger-affected areas. This is important in that the respective allocation approaches and factors are not well-aligned. To address this, an understanding of how costs were incurred was first necessary to be developed. This allowed me to bridge differences in allocation approach and factors between the Companies in a manner that is consistent with how the costs are incurred.

After gathering the allocation bases for each entity, I reviewed the different allocation approaches and factors utilized to understand where the approaches and factors were similar and where they varied. I also mapped the savings and costs-to-achieve categories to the allocation methods currently being employed. However, since different approaches were utilized by the Companies, this activity simply was undertaken to compare allocation bases.

The final consideration used in developing an allocation approach for the corporate and regulated savings and costs-to-achieve was to determine how different categories of savings impact the regulated and non-regulated segments of the business. For example, savings related to utility staffing do not impact the non-regulated businesses and, thus should not contribute to non-regulated savings. Conversely, savings associated with director's fees should be allocated across the regulated and non-regulated businesses since the Companies' directors have governance responsibilities for the overall enterprise.

Q. PLEASE DESCRIBE THE PROPOSED ALLOCATION APPROACH.

A. The proposed allocation approach is based on using four-levels of allocation factors. The first level of allocation factors determine the split of related corporate and headquarters savings between regulated and non-regulated operations. As stated earlier, savings and costs-to-achieve that only impact regulated operations are 100% directed to the regulated businesses.

The second level allocation factors are used to allocate the remaining regulated savings and costs-to-achieve between the electric and gas utility segments. While some of the savings only impact gas operations (e.g., utility staffing and gas supply), many of the savings categories are corporate in nature and provide benefits to all regulated operations, including electric operations.

The third level allocation factors are used to assign both gas and electric savings and costs-to-achieve from level two to the state jurisdictions. Since gas and electric operations vary by jurisdiction, some savings and costs-to-achieve are only allocated to selected jurisdictions. For example, only Michigan and Wisconsin contain electric operations so savings that are allocated to electric operations are only assigned to those jurisdictions.

The fourth level allocation factors are used to assign state level allocated savings and costs to achieve from Illinois to Peoples Gas Light and Coke and North Shore Gas

Company. These allocations are required to match benefits with specific customer groups within Illinois.

Q. IS IT APPROPRIATE TO ALLOCATE PORTIONS OF THE REGULATED AND CORPORATE SAVINGS TO THE NON-REGULATED BUSINESSES?

A. Yes. Savings are available from the corporate areas that support the two companies' overall and individual businesses. These costs are incurred centrally on behalf of all business elements and are subsequently allocated out to the business segments. Post-closing of the merger, the level of allocations from the corporate areas will go down since they will be reduced in scale and, thus, additional savings to the non-regulated business will be created.

Q. SINCE THE MERGER SAVINGS DO NOT INCLUDE ANY OVERLAPPING ELECTRIC UTILITY OPERATIONS, IS IT APPROPRIATE TO ALLOCATE ANY SAVINGS OR COSTS-TO-ACHIEVE TO THE ELECTRIC OPERATING SEGMENTS?

A. Yes. The rationale is similar to the allocation of corporate and regulated savings to non-regulated businesses. Since savings are available from the corporate areas that support the two companies' overall operations, including electric and gas utility operations, savings should accrue to both the electric and gas operating units.

Q. WHAT ALLOCATION FACTORS WERE UTILIZED?

A. The allocation factors savings categories are shown in Table 2, and the allocation factors for costs-to-achieve categories are shown in Table 3.

TABLE 2: Savings Allocation Factors

Categories	Level I Reg. vs. Non-Reg.	Level II Gas vs. Electric	Level III By State	Level IV Illinois Operating Company
Staffing				
Corporate	Net PPE and Payroll			
Utility	Reg.	Gas	Field Employees and Customers	
Corporate and Administrative Programs				
Administrative and General Overhead	Net PPE and Payroll			
Benefits	Payroll			
Credit Facilities	Net PPE and Operating Expenses			
Directors' Fees	Net PPE			
Facilities	Payroll			
Insurance	Net PPE			
Professional Services	Net PPE and Payroll			
Shareholder Services	Net PPE			
Information Technology				
Information Technology (Reg.)	Reg.	Net PPE and Payroll		
Information Technology (Corporate)	Net PPE and Payroll			
Supply Chain (Gas Only)				
Contract Services	Reg.	Gas	Net PPE	
Materials & Supplies	Reg.	Gas	Net PPE	
Fuel				
Gas Supply	Reg.	Gas	Net PPE	

TABLE 3: Costs-to-Achieve Allocation Factors

Categories	Level I Reg. vs. Non-Reg.	Level II Gas vs. Electric	Level III by State	Level IV Illinois Operating Company
Cost to Achieve				
Separation Costs	Payroll			
Retention Costs	Payroll			
Relocation Costs	Payroll			
System integration Costs	Net PPE and Payroll			
Directors & Officers Liability Tail Coverage	Net PPE			
Regulatory Process Costs	Net PPE and Operating Expenses			
Facilities Integration	Payroll			
Internal / External Communications	Net PPE and Payroll	Net PPE, Payroll and Customer		
Integration Costs	Net PPE and Payroll	Net PPE, Payroll and Customer		
Transaction Costs	Net PPE and Payroll	Net PPE and Customer		
Pre Merger Initiatives				
Utility	Reg.	Net PPE and Customer		

Q. WHAT WAS THE RESULT OF THIS ALLOCATION APPROACH?

A. This approach led to a series of percentages that allowed the allocation of total savings and costs-to-achieve to the regulated and unregulated segments, gas and electric, each of the states and the state of Illinois operations. Table 4 shows the resultant savings allocation percentages for each of the four allocation levels.

TABLE 4: Savings Allocation Factors

Categories	Level I Reg. vs. Non-Reg.	Level II Gas vs. Electric	Level III Illinois	Level IV PGLC	Level IV NSG
Staffing					
Corporate	87.48%	55.04%	70.34%	87.84%	12.16%
Utility	100.00%	100.00%	63.60%	86.22%	13.78%
Corporate					
Administrative and General Overhead	87.48%	55.04%	70.34%	87.84%	12.16%
Benefits	86.75%	49.78%	71.51%	89.04%	10.96%
Credit Facilities	82.42%	49.76%	61.79%	86.99%	13.01%
Directors' Fees	88.21%	60.30%	69.17%	86.67%	13.33%
Facilities	86.75%	49.78%	71.51%	89.04%	10.96%
Insurance	88.21%	60.30%	69.17%	86.67%	13.33%
Professional Services	87.48%	55.04%	70.34%	87.84%	12.16%
Shareholder Services	88.21%	60.30%	69.17%	86.67%	13.33%
Information Technology					
Information Technology (Reg.)	100.00%	55.04%	70.34%	87.84%	12.16%
Information Technology (Corporate)	87.48%	55.04%	70.34%	87.84%	12.16%
Supply Chain (Gas Only)					
Contract Services	100.00%	60.30%	69.17%	86.67%	13.33%
Materials & Supplies	100.00%	60.30%	69.17%	86.67%	13.33%
Fuel					
Gas Supply	100.00%	100.00%	57.49%	82.50%	17.50%

The net savings distribution is derived by multiplying the percentages across the table for each category (i.e., for corporate staffing the calculation for Peoples Gas = 87.48% x 55.04% x 70.34% x 87.84% = 29.7% of total corporate staffing savings)

Additionally, the same approach led to a similar set of percentages for each of the cost to-achieve categories as illustrated in Table 5 below.

TABLE 5: Costs-to-Achieve Allocation Factors

Categories	Level I Reg. vs. Non-Reg.	Level II Gas vs. Electric	Level III Illinois	Level IV PGLC	Level IV NSG
Cost to Achieve					
Separation Costs	86.75%	49.78%	71.51%	89.04%	10.96%
Retention Costs	86.75%	49.78%	71.51%	89.04%	10.96%
Relocation Costs	86.75%	49.78%	71.51%	89.04%	10.96%
System integration Costs	87.48%	55.04%	70.34%	87.84%	12.16%
Directors & Officers Liability Tail Coverage	88.21%	60.30%	69.17%	86.67%	13.33%
Regulatory Process Costs	82.42%	49.76%	61.79%	86.99%	13.01%
Facilities Integration	86.75%	49.78%	71.51%	89.04%	10.96%
Internal / External Communications	87.48%	62.51%	66.62%	87.95%	12.05%
Integration Costs	87.48%	62.51%	66.62%	87.95%	12.05%
Transaction Costs	87.48%	68.87%	64.17%	87.56%	12.45%
Pre-Merger Initiatives					
Utility	100.00%	68.87%	64.17%	87.56%	12.45%

The jurisdictional split of allocable savings is shown in Table 6 and a summary of the results of the allocation of costs savings and costs-to-achieve to the respective jurisdictions, particularly to Illinois, can be found in Applicants' Ex. TJF-1.4, TJF-1.5 and TJF-1.6.

TABLE 6: Net Corporate and Regulated Allocation Results – Five Year View

Jurisdiction	Gross Savings ($ millions)	Costs–to-Achieve And Pre-Merger Initiatives ($ millions)	Net Savings ($ millions)
Illinois	$141	($64)	$77
Michigan	$23	($11)	$12
Minnesota	$14	($6)	$8
Wisconsin	$164	($84)	$80
Non-Regulated	$31	($24)	$7
Total	$373	($189)	$184
Operating Utility Allocation			
PGLC	$123	($56)	$67
NSG	$18	($8)	$10

VIII. CONCLUSION

Q. BASED UPON YOUR EXPERIENCE ARE THE SAVINGS IDENTIFIED BY THE COMPANIES ATTAINABLE ?

A. Yes. Based upon my experience with other mergers and upon my interaction with executives and middle management at both Companies the methodology used to estimate potential savings is consistent with that usually adopted by other companies in similar situations. The cost savings and costs-to-achieve that have been identified are reasonably attainable provided that the management of the companies integrate operations in a manner consistent with their plans and with similar processes used by other companies in similar transactions.

Q. DOES THIS CONCLUDE YOUR PREPARED DIRECT TESTIMONY?

A. Yes, it does.

SUMMARY OF REGULATED UTILITY EXPERIENCE

Alaska Public Utilities Commission
- Anchorage Sewer Utility

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

Arkansas Public Service Commission
- FPL Group, Entergy Corporation, WCB Holding Corp. and Entergy Arkansas, Inc. – Docket No. 00-329U

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
- Pacific Enterprises and ENOVA Corporation - Application No. A-96-10-038

Clark County
- Washington Public Power Supply

District of Columbia, Public Service Commissions
- Baltimore Gas and Electric Company and Potomac Electric Power Company - Formal Case No. 951

Colorado Public Utilities Commission
- Public Service Company of Colorado and Southwestern Public Service Company - Docket No. 95A-513EG

Delaware Public Service Commission
- Atlantic City Electric Company and Delmarva Power & Light Company - Docket No. 97-65

Federal Energy Regulatory Commission
- Baltimore Gas and Electric Company and Potomac Electric Power Company - Docket No. EC96-10-000
- IES Utilities Inc., Interstate Power Company, Wisconsin Power & Light Company, South Beloit Water, Gas & Electric Company, Heartland Energy Services and Industrial Energy Applications, Inc. - Docket No. EC96-13-000
- Trans-Alaska Pipeline System - Docket No. OR78-1
- Middle South Energy, Inc. - Docket No. ER-82-483-00

- Middle South Energy, Inc. - Docket No. ER-82-616-000
- Kansas Power and Light Company and Kansas Gas and Electric Company - Docket No. EC91-2-000
- Southwestern Public Service Company and Public Service Company of Colorado - Docket No. EC96-2-000
- The Washington Water Power Company and Sierra Pacific Power Company - Docket No. EC94-23-000
- Northern States Power Company and Wisconsin Energy Corporation - Docket Nos. EC95-16-000 and ER95-1357-000
- Midwest Power Systems Inc. and Iowa-Illinois Gas and Electric Company – EC95-4
- Ohio Edison Company, Pennsylvania Power Company, The Cleveland Electric Illuminating Company, and The Toledo Edison Company – ER97-412-000
- Atlantic City Electric Company and Delmarva Power & Light Company – EC97-7
- Union Electric and Central Illinois Public Service Company – EC-96-7-000

Federal Power Commission

- Organization and Operations Review

Florida Public Service Commission

- Florida Power & Light Company and Entergy Corporation – Docket No. 001148

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-Illinois Gas and Electric Company and Mid-American Company Energy - Docket No. 94-0439
- Central Illinois Public Service Company, CIPSCO Incorporated and Union Electric Company - Docket No. 95-0551

Indiana Utility Regulatory Commission

- IPALCO and PSI Resources

Iowa Utilities Board
- Midwest Resources Inc., Midwest Power Systems Inc. and Iowa-Illinois Gas and Electric Company - Docket No. SPU-94-14
- IES Industries Inc., Interstate Power Company, WPL Holdings, Inc. – Docket No. SPU-96-6

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 and Kansas City Power and Light - Docket No. 190,362-U
- Western Resources, Inc. and Kansas City Power and Light - Docket No. 97-WSRE-676-MER

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

Louisiana Public Service Commission
- American Electric Power Company, Inc., Southwestern Electric Power Company and Central and South West Corporation – Docket No. U-23327
- Entergy Louisana, Inc. and Entergy Gulf States, Inc. Merger with FPL Group, Inc. – Docket No. U-25354

Maryland, Public Service Commission of
- Baltimore Gas and Electric Company and Potomac Electric Power Company – Order No. 73405, Case No. 8725

Massachusetts Department of Telecommunications and Energy
- Boston Edison, Cambridge Electric Light Company, Commonwealth Electric Company and Commonwealth Gas Company – Docket D.T.E. 99-19

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
- Entergy Mississippi, Inc., Entergy Corporation, FPL Group, Inc. and WCB Holding Corporation – Docket No. 2000-UA-925

Missouri Public Service Commission

- Union Electric Company - Case Nos. ER-84-168 and EO-85-17
- Union Electric Company and Central Illinois Public Service Company - Case No. EM-96-149
- 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
- Western Resources and Kansas City Power and Light – EM 97-515

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 Jersey Board of Public Utilities

- Atlantic City Electric Company and Delmarva Power & Light Company - Docket No. EM-97-020103

New Mexico Public Service Commission

- Public Service Company of New Mexico
- Southwestern Public Service Company and Public Service Company of Colorado - Case No. 2678

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

New York, State of, Public Service Commission

- Long Island Lighting Company and Brooklyn Union Gas Company - Case 95-G-0761

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
- American Electric Power Company, Inc., Public Service Company of Oklahoma and Central and South West Corporation – Cause No. PUD-980000444

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 & 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
- Southwestern Public Service Company and Public Service Company of Colorado - Docket No. 14980
- FPL Group, Inc. and Entergy Corporation – Docket No. 23335
- Reliant Energy HL&P – Docket No. 22355

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
- Puget Sound Power and Light Company and Washington Natural Gas Company – UE-960195

Washington Metropolitan Area Transit Authority
- D.C. Transit

Wisconsin Public Service Commission
- Northern States Power Company and Wisconsin Energy Corporation – 6630-UM-100 and 4220-UM-101
- WPL Holdings, IES Industries Inc., Interstate Power Company, Inc. - Docket No. 6680-UM-100

Wyoming Public Service Commission
- Cheyenne Light, Fuel and Power Company (Southwestern Public Service Company and Public Service Company of Colorado) - Docket Nos. 20003-EA-95-40 and 30005-GA-95-39
- 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

FIVE-YEAR SUMMARY OF POTENTIAL MERGER COSTS SAVINGS

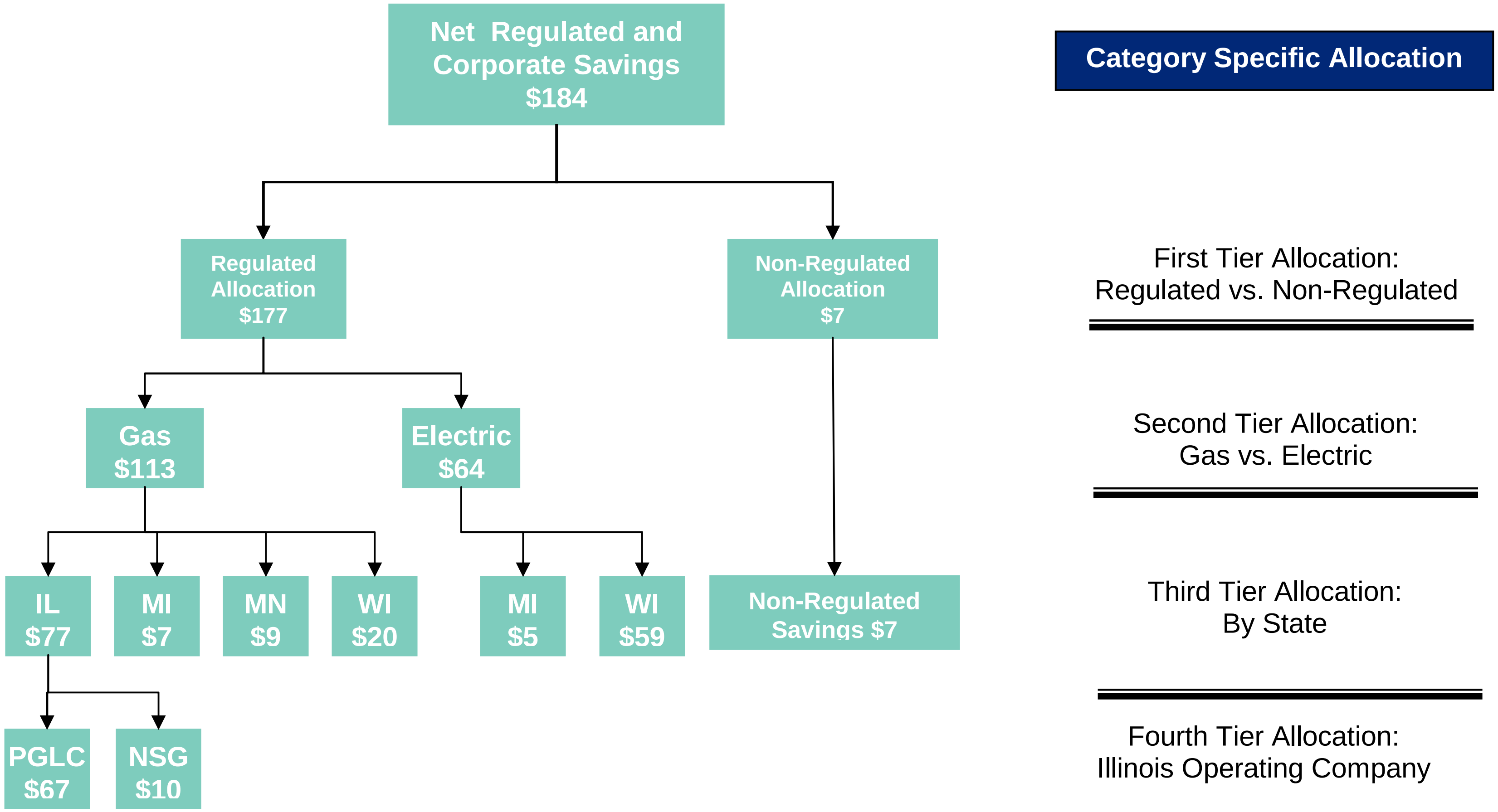
Potential Areas ($ in 000s)	Year 1 2007	Year 2 2008	Year 3 2009	Year 4 2010	Year 5 2011	5-Year Total
Regulated and Corporate						
Staffing						
Corporate	$ 20,053	$ 29,733	$ 31,369	$ 33,080	$ 34,869	$ 149,105
Utility	1,749	4,088	4,624	5,184	5,769	21,414
Total	$ 21,802	**$ 33,821**	**$ 35,993**	**$ 38,264**	**$ 40,638**	**$ 170,519**
Corporate & Administrative Programs						
Administrative & General Overhead	$ 1,422	$ 2,171	$ 2,231	$ 2,291	$ 2,354	$ 10,469
Benefits	0	1,240	1,318	1,400	1,488	5,446
Credit Facilities	329	338	347	357	366	1,737
Directors' Fees	938	963	989	1,016	1,043	4,950
Facilities	1,678	2,663	2,736	2,811	2,888	12,776
Insurance	1,996	2,051	2,108	2,166	2,226	10,548
Inventory	0	0	0	0	0	0
Professional Services	5,818	5,979	6,144	6,313	6,487	30,740
Regulatory Affairs	0	0	0	0	0	0
Shareholder Services	753	774	796	818	841	3,983
Transportation	0	0	0	0	0	0
Total	**$ 12,935**	**$ 16,179**	**$ 16,668**	**$ 17,173**	**$ 17,694**	**$ 80,648**
Information Technology						
Information Technology (Capital)	$ 1,056	$ 2,821	$ 5,428	$ 8,100	$ 10,840	$ 28,244
Information Technology (O&M)	5,788	8,812	12,204	12,510	12,822	52,127
Total	**$ 6,834**	**$ 11,633**	**$ 17,632**	**$ 20,610**	$ 23,662	**$ 80,371**
Supple Chain						
Contract Services	$ 2,883	$ 3,054	$ 3,229	$ 3,409	$ 3,593	$ 16,167
M&S Purchases	1,415	1,729	2,052	2,384	*2,726*	10,306
Total	**$ 4,298**	**$ 4,783**	**$ 5,281**	**$ 5,793**	**$ 6,319**	**$ 26,473**
Fuel						
Gas Supply	$ 3,000	$ 3,000	$ 3,000	$ 3,000	$ 3,000	$ 15,000
Total	**$ 3,000**	**$ 3,000**	**$ 3,000**	**$ 3,000**	**$ 3,000**	**$ 15,000**
Gross Corporate and Regulated Savings	**$ 48,869**	**$ 69,416**	**$ 78,574**	**$ 84,839**	**$ 91,314**	**$ 373,011**
Total Costs-to-Achieve	**($ 108,787)**	**($ 29,893)**	**($ 10,325)**	**($ 28,947)**	**($ 61)**	**($ 178,012)**
Pre-Merger Initiatives	**($ 717)**	**($ 1,453)**	**($ 2,206)**	**($ 2,979)**	**($ 3,770)**	**($ 11,125)**
Net Corporate and Regulated Savings	**($60,635)**	**$ 38,072**	**$ 66,043**	**$ 52,913**	**$ 87,483**	**$ 183,874**
Gross Total Non-Regulated Savings	**$4,814**	**$5,335**	**$5,921**	**$6,167**	**$6,424**	**$28,661**
Costs-to-Achieve	**($2,334)**	**($3,097)**	**($749)**	**($2,113)**	**($1)**	**($8,297)**
Total Non-Regulated Savings	**$2,480**	**$2,237**	**$5,178**	**$4,054**	**$6,423**	**$20,364**
Net Regulated, Corporate and Non-Regulated Savings	**($58,156)**	**$40,307**	**$71,214**	**$56,967**	**$93,906**	**$204,238**

Applicants' Ex. TJF-1.2

FIVE-YEAR COSTS-TO-ACHIEVE BY CATEGORY

Potential Areas ($ in 000s)	Year 1 2007	Year 2 2008	Year 3 2009	Year 4 2010	Year 5 2011	5 Year Total
Regulated and Corporate						
Cost to Achieve						
Separation Costs	$ 14,785	$ 7,625	$ 0	$ 0	$ 0	$ 22,409
Change-in-Control Costs	15,393	0	0	0	0	15,393
Retention Costs	5,672	0	0	0	0	5,672
Relocation Costs	3,325	0	0	0	0	3,325
System Integration Costs	21,185	22,268	10,325	28,947	61	82,786
Directors & Officers Liability Tail Coverage	2,860	0	0	0	0	2,860
Regulatory Process Costs	10,500	0	0	0	0	10,500
Facilities Integration	3,000	0	0	0	0	3,000
Internal / External Communications	5,500	0	0	0	0	5,500
Integration Costs	6,066	0	0	0	0	6,066
Transaction Costs	20,500	0	0	0	0	20,500
Total Costs-to-Achieve	**($ 108,787)**	**($ 29,893)**	**($ 10,325)**	**($ 28,947)**	**($ 61)**	**($ 178,012)**

ALLOCATION OF REGULATED AND CORPORATE SAVINGS NET OF COSTS-TO-ACHIEVE



5 YEAR TOTAL POTENTIAL SAVINGS DETAIL (O&M/REVENUE REQUIREMENTS)

Regulated Gas IL

Potential Areas ($ in 000s)	Year 1 2007	Year 2 2008	Year 3 2009	Year 4 2010	Year 5 2011	5 Year Total
Staffing						
Corporate	6,792	10,070	10,624	11,809	11,809	50,499
Utility	1,112	2,600	2,941	3,297	3,669	13,620
Total	**7,904**	**12,670**	**13,565**	**14,501**	**15,479**	**64,119**
Corporate & Administrative Programs						
Administrative & General Overhead	482	735	755	776	797	3,546
Benefits	-	383	407	432	460	1,682
Credit Facilities	83	86	88	90	93	440
Directors' Fees	345	354	364	374	384	1,821
Facilities	518	822	845	868	892	3,945
Insurance	734	755	776	797	819	3,945
Inventory	0	0	0	0	0	0
Professional Services	1,971	2,025	2,081	2,138	2,197	10,411
Regulatory Affairs	0	0	0	0	0	0
Shareholder Services	277	285	293	301	310	1,465
Transportation	0	0	0	0	0	0
Total	**4,410**	**5,445**	**5,608**	**5,777**	**5,951**	**27,191**
Information Technology						
Information Technology (Reg)	2,178	3,687	5,558	6,435	7,333	25,192
Information Technology (Corporate)	409	714	1,109	1,351	1,599	5,182
Total	**2,587**	**4,401**	**6,668**	**7,786**	**8,932**	**30,374**
Supply Chain (Gas Only)						
Contract Services	1,202	1,274	1,347	1,422	1,499	6,743
Materials & Supplies	590	721	856	994	1,137	4,298
Total	**1,793**	**1,995**	**2,203**	**2,416**	**2,636**	**11,042**
Fuel						
Gas Supply	1,725	1,725	1,725	1,725	1,725	8,624
Energy Sourcing	0	0	0	0	0	0
Total	**1,725**	**1,725**	**1,725**	**1,725**	**1,725**	**8,624**
Gross Corporate and Regulated Savings	**18,419**	**26,236**	**29,768**	**32,204**	**34,722**	**141,350**
Cost to Achieve						
Total Costs-to-Achieve	**(36,052)**	**(9,896)**	**(3,497)**	**(9,804)**	**(21)**	**(59,269)**
Pre-Merger Initiatives						
Total PMI	**(317)**	**(642)**	**(975)**	**(1,316)**	**(1,666)**	**(4,917)**
Net Corporate and Regulated Savings – IL	**(17,950)**	**15,698**	**25,297**	**21,082**	**33,035**	**77,164**

Applicants' Ex. TJF-1.5

ILLINOIS ALLOCATED SAVINGS AND COSTS-TO-ACHIEVE

Operating Company Allocations ($ in 000's)	Year 1 2007	Year 2 2008	Year 3 2009	Year 4 2010	Year 5 2011	5 Year Total
Gross Corporate and Regulated Savings						
PGLC	16,038	22,886	25,982	28,112	30,315	123,332
NSG	2,381	3,350	3,786	4,092	4,407	18,019
	18,419	**26,236**	**29,758**	**32,204**	**34,722**	**141,350**
Cost to Achieve and PMI						
PGLC	(32,048)	(9,283)	(3,925)	(9,764)	(1,477)	(56,498)
NSG	(4,321)	(1,255)	(547)	(1,356)	(210)	(7,688)
	(36,369)	**(10,538)**	**(4,472)**	**(11,120)**	**(1,687)**	**(64,186)**
Net Corporate and Regulated Savings – IL						
PGLC	(16,010)	13,603	22,057	18,348	28,838	66,834
NSG	(1,940)	2,095	3,240	2,736	4,197	10,330
	(17,950)	**15,698**	**25,297**	**21,082**	**33,035**	**77,164**