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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Review of Florida Power Corporation's Earnings, Including Effects Of Proposed Acquisition of Florida Power Corporation by Carolina Power & Light

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CONFIDENTIAL

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

ON BEHALF OF FLORIDA POWER CORPORATION

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mutual sharing. In other words, all stakeholders are much better off if neither side benefits at the expense of the other, and both sides benefit from their joint relationship. That is precisely what the FPC regulatory plan seeks to accomplish. Shareholders recover the costs of completing the merger to the extent that synergy savings are sufficient to cover the expense. Furthermore, FPC has strong incentives to beat this spread. Regardless, customers are guaranteed an immediate and recurring $5 million retail rate credit for 15 years. Because savings are greater than the amount of the transaction and transition costs, both sides are better off; a classic win-win situation based on "splitting the savings."

Q. AT PAGE 23 OF HER DIRECT TESTIMONY, MS. DISMUKES ASSERTS THAT $43.1 MILLION OF THE $175 MILLION IN PROJECTED SYNERGY SAVINGS ARE ATTRIBUTABLE TO PROGRESS ENERGY'S NONREGULATED AFFILIATES. PLEASE RESPOND TO HER ASSERTIONS.

A. It is not clear from Ms. Dismukes' testimony if she disputes or agrees with her own breakdown of the synergies attributable to Progress Energy's nonregulated operations. She is clear in her observation that FPC is getting the smallest share of synergies. However, she does not dispute Mr. Myers' testimony with respect to the way the synergy breakdown and allocation was developed. Further, Ms. Dismukes fails to recall that the percentage of the transaction costs that FPC seeks to recover from these savings is exactly equal to the percentage of synergies it expects to receive. In other words, if FPC is under represented on the savings side, it would similarly be under allocated on the transaction cost side. Ms. Dismukes does speculate that "it is possible that the premium paid for FPC's stock relates to the enhanced potential for profits from future unregulated operations." This is, to some extent, undoubtedly true. And it is also true that these same unregulated enterprises will be assigned the responsibility to recover 43.1% of the transaction costs.

Q. AT PAGES 24-25 OF HER DIRECT TESTOMONY, MS. DISMUKES STATES THAT IN ONLY ONE OF THE STATE ORDERS THAT YOU ATTACHED AS EXHIBIT CJC-2 DID THE COMMISSION PERMIT THE RECOVERY OF AN ACQUISITION PREMIUM. PLEASE RESPOND TO HER ASSERTION.

A. Ms. Dismukes is simply setting up a convenient straw person to knock down. Her entire discussion of acquisition premium recovery in other jurisdictions is misguided and irrelevant. First, I must point out that I offered Exhibit CJC-2 to show examples of states in which the respective state Commissions had followed a front-end loading transaction cost recovery principle in designing their regulatory plans to share merger savings. As can be seen from reviewing CJC-2, in most of these cases the Commission allowed the merging utility to keep a portion of (i.e., share) the merger savings to pay for the transaction costs associated with the merger. Thus, most of these regulatory commissions recognized the need to allow merging utilities the opportunity to recover their transaction the state of deregulation in the industry, I think that it is very uncertain when, or even if, deregulation will actually occur at the retail level. Certainly, the California experience has put a damper on retail deregulation initiatives across the country. Furthermore, deregulation is not a precise concept. Most now realize that the "devil is in the details" of any deregulation transition plan.

Q. AT PAGE 13 OF HER DIRECT TESTIONY, MS. BROWN STATES THAT THE EXECUTIVE SEVERANCE PAYMENTS WERE NOT REASONABLE. DO YOU AGREE?

A. No. It is customary for valuable and key executives to have in place change in control provisions in their contracts that pay them multiples of their annual salaries if they lose their positions through a merger. Without such provisions, executives would demand higher current compensation and would be loath to explore merger opportunities that might cause them to lose their position. Consequently, with such provisions in place, key executives are encouraged to seek out and complete mergers that will benefit shareholders and customers. Consequently, I disagree with Ms. Brown that these transition expenses are unreasonable. To the contrary, these are reasonable and necessary costs, without which this merger and other beneficial mergers would likely not occur.

Q. AT PAGES 13-14 OF HER DIRECT TESTIMONY, MS. BROWN ARGUES THAT THE ALLOCATION OF MERGER SYNERGIES SHOULD REFLECT THAT ABOUT $31.5 MILLION OF THE MERGER

RELATED GENERATION SAVINGS ACCRUE TO SHAREHOLDERS. DO YOU CONCUR WITH HER STATEMENT?

A. No. First, the $31.5 million in savings that Ms. Brown asserts accrues to shareholders reflect the fact that income taxes capture 38.575% of gross synergy. Second, these after-tax cost saving synergies are being used to pay the transaction and transition costs associated with the merger. These are costs that have been incurred. The key to understanding FPC's proposed regulatory plan is to focus on the net synergy savings, those savings that remain after paying all the costs necessary to secure the savings. FPC's customers are guaranteed an annual $5 million rate credit, and have additional opportunities to receive even greater savings under the ESM that I recommended in my Direct Testimony.

Q. AT PAGE 14 OF HER DIRECT TESTIMONY, MS. BROWN ALSO SUGGESTS THAT GREATER REVENUE SYNERGIES ARE SUPPORTED BY THE PRODUCTION FUNCTION AND THAT ADDITIONAL TRANSACTION AND TRANSITION COSTS SHOULD BE ALLOCATED TO THE SHAREHOLDERS TO RECOGNIZE THIS SUPPORT. SHE FURTHER ASSERTS THAT SHARED SERVICES SUPPORTS THE PRODUCTION FUNCTION, MEANING THAT ADDITIONAL TRANSACTION AND TRANSITION COSTS SHOULD BE ASSIGNED TO THIS FUNCTION. PLEASE COMMENT.

A. I disagree with Ms. Brown. FPC personnel have gone to great lengths to fairly allocate the synergies to the business units where the savings will