

1 **Cost Savings and Merge r Costs**

2
3 **Q. Could you now summarize the merge r costs estimate d by CP&L?**

4 A. Mrs. Hancock begins by explaining that the cost savings she identified in her testimony

5
6 are net of estimated costs to implement the planned initiatives giving rise to the
7 cost savings. For instance, these costs include an estimated \$25 million in
8 information systems costs, benefit plan consolidation costs, and facilities costs
9 necessary to place the combined company in position to implement and capture
10 the cost saving initiatives. [Hancock Direct, p. 11].
11

12 In addition to the costs required to implement initiatives leading to the merger savings, Mrs.
13 Hancock estimates that incremental transaction costs, such as investment banking fees,
14 attorneys, consultants and regulatory costs, will be \$35 to \$40 million. These costs are
15 included in the Company's estimated goodwill. Finally, the Company estimates that transition
16 costs, such as employee separation packages and relocation costs, retraining, and facilities
17 consolidation, will be \$110 to \$125 million. Mrs. Hancock explains that these costs are
18 generally expensed as incurred.
19

20 However, if specific criteria are met, costs such as relocation and severance
21 related to FPC employees could be considered transaction costs and included
22 in the purchase price. In addition, some transition costs could be related to
23 acquiring fixed assets and, if appropriate, such costs would be capitalized. [Id.,
24 p. 12].
25

26 **Q. Have these cost estimates bee n revise d by the Company?**

27 A. Yes. In response to Staff Data Requests, CP&L provided updated estimates of total merger
28 costs, broken down into 19 categories. [Revised Response to Staff DR 1-14]. Total merger
29 costs, as provided in this response, amount to *****Proprietary**
30 **Proprietary*****. It appears that at least *****Proprietary** **Proprietary***** of
31 these costs are included as offsets to the Company's calculation of the estimated merger savings
32 and synergies.

1 **Q. If a rate case were held in the future, how would these costs typically be treated for**
2 **rate-making purposes?**

3 A. The answer would depend upon a number of different factors, including the timing of the rate
4 case. Many of these costs would probably be included as “above the line” costs of providing
5 utility service, and thus would tend to increase the utility’s revenue requirement. However, some
6 of the costs might be classified as non-recurring costs, or they might be categorized as “below
7 the line” costs attributable to shareholders, and thus would not be considered for rate-making
8 purposes. As a general principle, ratepayers are expected to reimburse costs which are
9 incurred for their benefit, but they are not asked to reimburse costs which are primarily or
10 exclusively incurred for the benefit of shareholders.

11
12 For example, executive separation costs may be incurred as a result of payments to corporate
13 officers and upper management who leave the firm when a merger is consummated. These
14 “golden parachutes” are often authorized by shareholders as a necessary cost of consummating
15 a merger. Although shareholders may feel that the cost is modest relative to the amounts they
16 stand to gain from the transaction, the magnitude of such payments may be large when
17 viewed in a traditional cost of service context. From a regulatory perspective, it may be difficult
18 to rationalize having ratepayers reimburse multi-million dollar payments to executives who are
19 leaving the firm. Whether viewed as rewards for helping the selling shareholders gain a windfall
20 upon the sale of their stock, or as a necessary lubricant to overcome the reluctance of the
21 selling firm’s top executives to recommend the elimination of their jobs, “golden parachute”
22 payments can most appropriately be viewed as “below the line” costs which are the
23 responsibility of shareholders.

24
25 Less clear-cut examples are the discretionary “retention payments” which are made to certain
26 directors, officers, and/or employees to ensure that these individuals remain with the company
27 until a merger is complete. In some cases, retention bonuses are paid to officers who will later

1 receive a substantial severance package. In other cases, retention bonuses are paid to
2 employees who will remain with company after the merger. Either way, these bonuses can be
3 viewed as an extraordinary cost which is incurred during an extraordinary event in the
4 corporate history. To the extent such payments are necessary in ensuring a smooth transition
5 period, they might be viewed as a reasonable and necessary cost of doing business which can
6 appropriately be charged to ratepayers. Sometimes, however, they might be viewed as costs
7 associated with a change in the ownership of the firm, and therefore treated "below the line."
8