

STATE OF MAINE PUBLIC UTILITIES COMMISSION

DOCKET NO. 2007-215

**CENTRAL MAINE POWER COMPANY,
REQUEST FOR NEW ALTERNATIVE RATE PLAN
("ARP 2008")**



Central Maine Power



An Energy East Company

**TESTIMONY OF
MICHAEL M. SCHNITZER
THE NORTHBRIDGE GROUP**

**Volume VIII
MERGER SAVINGS**

May 1, 2007

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MICHAEL M. SCHNITZER

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**CENTRAL MAINE POWER COMPANY
PREFILED DIRECT TESTIMONY OF
MICHAEL M. SCHNITZER
MERGER SAVINGS
May 1, 2007**

1 **I. INTRODUCTION AND OVERVIEW**

2
3 When Energy East Corporation (“Energy East”) merged with Central Maine
4 Power Company (“CMP” or the “Company”) it resulted in an acquisition premium of
5 over \$300 million.¹ Recognizing this significant investment, the Maine Public Utilities
6 Commission (the “Commission”) in its Order approving the merger provided the
7 Company’s shareholders the incentive to create and the opportunity to share in any
8 savings created by the merger, provided that this sharing not result in rates higher than
9 would have existed absent the merger and that Maine customers share in a reasonable
10 portion of the net savings.² Since the merger, CMP has realized at least \$85 million in
11 merger-enabled distribution system savings and more than two thirds of these savings –
12 and perhaps as much as 95% - have been passed on to customers through lower rates.
13 Now, as part of its proposed new alternative rate plan (“ARP 2008”), CMP seeks a
14 continued opportunity to share in these savings. Specifically, the Company requests that
15 it be permitted to include a cost of service adjustment equal to one half of the net
16 distribution O&M savings that have been achieved as a direct result of the merger in the

¹ For the purposes of this testimony, the “acquisition premium” refers to the premium Energy East paid over the market value of CMP’s stock just prior to the merger announcement. This value is close, but not equal, to the goodwill on the Company’s books, which is defined as the purchase price in excess of net book value of assets.

² See Order in Re: *CMP Group Inc. Request for Approval of Reorganization and of Affiliated Interest Transactions*, Docket No. 99-411 at 19-20 (Jan. 4, 2000) (“Merger Order”).

1 Company's five year revenue requirement and earnings review submitted through the
2 testimony of Eric Stinneford and Paul Dumais, and that this adjustment be taken into
3 account in the Commission's consideration of whether CMP's rates are and will remain
4 just and reasonable during the term of ARP 2008.

5 This testimony is offered to quantify the merger-enabled savings that have been
6 shared with customers to date and to support the reasonableness of CMP's proposed
7 sharing methodology under ARP 2008. As discussed in detail below, both the Merger
8 Order and sound economic principles support the treatment proposed by the Company in
9 this case.

10 **A. Qualifications of Witness**

11 This testimony regarding the proper disposition of the significant merger-enabled
12 savings is presented by Michael M. Schnitzer. Mr. Schnitzer is a co-founder and a
13 Director of The NorthBridge Group, Inc., an economic and strategic consulting firm
14 located in Concord, Massachusetts. Prior to that, he was a Managing Director of Putnam,
15 Hayes & Bartlett, which he joined in 1979. Throughout this time, his utility work has
16 focused on regulatory policy, finance, and industry restructuring issues.

17 He has testified before the Federal Energy Regulatory Commission ("FERC") and
18 a number of state commissions on issues relating to competitive restructuring and
19 wholesale market design, resource planning, incentive regulation and the provision of
20 default service to retail customers. Mr. Schnitzer holds a Master of Science degree in
21 Management from the Sloan School of Management of the Massachusetts Institute of
22 Technology, and a Bachelor of Arts degree in chemistry, with honors, from Harvard
23 College.

1 Mr. Schnitzer's current CV is attached as Exhibit MMS-1.

2 **B. Summary of Conclusions**

3 The balance of this testimony provides the support for the following five
4 conclusions:

- 5 1) Since the merger between CMP and Energy East was completed in 2000,
6 CMP has realized between \$85 and \$96 million in distribution system merger-
7 enabled net savings (\$2007 NPV) net of productivity improvements that might
8 have been achieved absent the merger.
- 9 2) The majority of these merger-enabled savings — 68% to 95% — have been
10 passed on to customers through the lower rates resulting from the merger
11 enhanced productivity offset factors used in ARP 2000, with the remainder
12 accruing to shareholders.
- 13 3) These savings have not been realized without investment and risk. The
14 merger with CMP required Energy East to pay a premium of approximately
15 \$300 million above market value. Under the Merger Order, there has been no
16 “guaranteed” recovery of the merger premium, but instead the Company has
17 been at risk for producing the savings in which it has had an opportunity to
18 share.
- 19 4) A continued opportunity to share in the merger savings is good public policy
20 and is clearly warranted. A sharing of merger savings beyond the term of
21 ARP 2000 was explicitly contemplated by the Commission when the merger
22 was approved and all the conditions in the Merger Order have been, and
23 continue to be, met. In light of the significant level of customer savings that

1 have been created, a 50/50 sharing of merger-enabled savings to be realized
2 during the seven year term of the proposed new ARP strikes a fair balance
3 between the interest of customers and shareholders, and provides proper
4 incentives for potential future mergers and other efficiency enhancing
5 activities.

6 5) In the context of the proposed ARP 2008, the Company's proposal to include
7 a cost of service adjustment equal to one half of the net distribution O&M
8 savings that have been achieved as a direct result of the merger for the
9 purposes of the Commission's determination of whether rates under ARP
10 2008 are within a just and reasonable range is a reasonable and appropriate
11 rate-making technique.

12
13

1 **II. REALIZED MERGER SAVINGS DURING ARP 2000**

2 **A. Achieved Annual Merger Savings**

3 Company witnesses Eric Stinneford and Paul Dumais have sponsored testimony
4 that documents annual net merger-enabled savings realized by CMP in amounts ranging
5 from \$(0.8) million in 2001 to \$24.2 million anticipated in 2008. *See* Exhibit ENS/PAD-
6 11. These amounts include O&M and capital savings, net of both one-time and ongoing
7 costs to achieve them. Of this amount, 84% accrues to the distribution business. This
8 calculation of net merger-enabled savings also incorporates a reduction to take into
9 account estimated cost savings that might have been achieved absent the merger,
10 assuming a 1% “but for” level of annual productivity improvement, which, as discussed
11 below, was the productivity offset in CMP’s ARP 1995 and proposed by the Company as
12 appropriate for ARP 2000 in the absence of the merger. As shown in Exhibit MMS-2,
13 the net merger-enabled savings accruing to distribution achieved between 2001 and 2007
14 in \$2007 present value terms is equal to \$96 million, assuming a 7.5% discount rate
15 (equal to the Company’s proposed after-tax weighted average cost of capital). The 2008
16 annual net synergy savings (using the same calculation method) for distribution has been
17 calculated by Messrs. Stinneford and Dumais as \$20.3 million, and are expected to grow
18 at the rate of inflation during the term of ARP 2008. To establish a conservative lower
19 bound on the amount of merger-enabled savings, CMP, at my request, also calculated the
20 stream of annual net synergy amounts assuming a non-merger productivity factor of 1.5%

1 as well.³ This calculation results in net merger-enabled savings ranging from \$(1.2)
2 million in 2001 to \$18.3 million in 2008.

3 **B. Sharing Of Merger Savings During ARP 2000**

4 During the seven year term of ARP 2000 ending December 31, 2007, CMP's
5 distribution rates have changed annually by the difference between inflation (in this case
6 the GDP-PI), and a productivity offset factor. The productivity offset factor in the plan
7 ranged from 2.0% in 2002/03 to 2.90% in 2007. This productivity offset factor can be
8 thought of in two pieces. First is the amount that would have been specified in the ARP
9 absent a merger, and second is the additional amount that was put in place anticipating
10 that the merger had the potential to provide savings in addition to normal efficiency
11 gains.

12 While the amount that would have been specified absent a merger cannot be
13 known with certainty, there is evidence to suggest that it would have been in the range of
14 1.0 to 1.2% per year. First, the rate plan in place for CMP prior to ARP 2000 had a
15 productivity factor of 1.0% as ordered by the Commission in 1995.⁴ Second, between
16 February 1998 and February 2000, Bangor Hydro had in place a similar rate structure
17 with a productivity offset factor of 1.2%.⁵ Third, as part of the Company's ARP 2000

³ This 1.5% productivity offset significantly exceeds the productivity offsets in ARP1995 and anticipated for ARP2000 without taking into account the merger savings. As shown in the testimony of Dr. Mark Lowry, expected productivity gains in the industry going forward are less than one third this amount and, in fact, are substantially below the productivity offsets included in CMP's prior ARPs.

⁴ Central Maine Power Company, Order approving *Proposed Increase in Rates* ("ARP1995"), Docket No. 92-345(II) at 8 (Jan. 10, 1995).

⁵ Bangor Hydro-Electric Company, Order on *Proposed Increase in Rates*, Docket No. 97-117 at 67 (Feb. 9, 1998).

1 filing, the Company's productivity factor witness, Dr. Malkholm, testified that 1.0% was
2 an appropriate annual productivity factor in the absence of a merger.

3 The difference between the productivity offset factor in ARP 2000 and this 1.0 to
4 1.2% level provided customers a guaranteed level of merger savings. By calculating the
5 cumulative magnitude of rate relief provided to customers from this component of the
6 price cap formula, one can determine what share of actual merger savings were delivered
7 to customers between 2001 and 2007 in the form of lower rates.

8 Exhibit MMS-3 shows that using a 1% productivity factor for non-merger
9 efficiencies, customers received rate savings related to the merger totaling \$91 million
10 (\$2007 NPV). This equals 95% of the total merger synergy benefits of \$96 million
11 received assuming a 1% non-merger productivity factor. Alternatively, assuming that the
12 non-merger productivity factor would have been 1.5%, a number higher than the
13 available evidence would support, customers received \$57 million, or 68% of the
14 available net merger savings of \$85 million.

15 **C. Realization Of Savings Involved Investment And Risk**

16 Energy East acquired CMP in 2000 for \$29.50 per share, or \$955 million. This
17 represents approximately a \$300 million premium above the market value of the equity of
18 CMP prior to the announcement of the transaction. One can use this \$300 million
19 investment as a reasonable starting point against which to compare the savings received
20 by shareholders. The \$300 million is the investment that Energy East made, at least in
21 part, in exchange for the opportunity to create and share in merger savings. The
22 shareholders' share of the merger saving quantified in Exhibit MMS- 3 ranges from \$5 to
23

1 \$27 million, depending on the “but for” productivity assumption, during the ARP 2000
2 period in \$2007.

3 While customers received a guaranteed level of rate reduction enabled by the
4 merger through ARP 2000, actual merger savings were by no means guaranteed simply
5 by CMP’s completion of the merger, but rather were created through the Company’s
6 efforts thereafter. Furthermore, the investment was made without any guarantee of
7 recovery of the merger premium. The Company was at risk for creating any net merger
8 savings that it had the opportunity to share in under the terms of the ARP 2000.

1 **III. A 50/50 SHARING DURING CMP'S PROPOSED NEW ARP IS**
2 **APPROPRIATE.**
3

4 As discussed in the testimony of Messrs. Stinneford and Dumais, CMP proposes
5 as part of ARP 2008 to include for ratemaking purposes a cost of service adjustment
6 equal to one half of the annual net distribution O&M savings that have been achieved as a
7 direct result of the merger that will continue during the seven year term of the new plan.
8 This proposal raises three questions addressed in this part of the testimony: first, whether
9 as a general policy matter, it is appropriate for the Company to have an opportunity to
10 share in achieved merger savings; second, whether a "post-merger" opportunity for
11 sharing of merger savings in this rate plan is appropriate; and third, if so, what level of
12 sharing opportunity is reasonable.

13 **A. Sharing Merger Savings Is Appropriate Generally.**

14 With respect to the first question, as a matter of policy it is appropriate for the
15 Company to have an opportunity to share in achieved merger savings. This Commission
16 has long recognized that customers benefit when the company has an incentive to
17 improve its efficiency and productivity. The rate plans that have been put in effect, such
18 as the ARP 2000, are evidence of this fact. Those plans are designed to provide stronger
19 efficiency incentives than more typical cost of service regulation, and customers have
20 benefited through lower rates, which have been stable and predictable. But there is a
21 class of potential efficiency improvements for which the ARP structure, by itself, may
22 not provide adequate incentives. I refer to the efficiencies associated with economies of
23 scale and/or scope that are typically realized through mergers.

24 These savings can be significant, as discussed above, but they require a significant
25 investment to achieve, an investment that is not typically considered part of a company's

1 cost of service. For that reason, it is appropriate as a general policy matter for the
2 Commission to provide an incentive for companies to realize the efficiencies that can
3 result from mergers or acquisitions. This can be accomplished in a number of ways,
4 including performance-based ratemaking, an adder to ROE, or recovery of an acquisition
5 premium in rates. For example, the Massachusetts DTE allowed the NSTAR companies
6 to recover an acquisition premium in rates.⁶ The Kentucky Public Service Commission
7 has used a “surcredit mechanism” that shares estimated merger savings 50/50 between
8 utility customers and investors.⁷

9 Through the interplay of the Merger Order and ARP 2000, this Commission
10 appears to have chosen instead to use performance based ratemaking to provide CMP the
11 incentives to realize the potential efficiencies from the merger. By building in a higher
12 productivity offset than would otherwise have been appropriate, and allowing the
13 Company to retain achieved savings above the offset, the Commission put in place an
14 incentive for the Company to achieve significant savings, on the one hand, while
15 ensuring that customers would benefit on the other.

16 **B. Sharing of Merger Savings Going Forward Remains Appropriate.**

17 With respect to the question of whether a continued sharing opportunity is
18 appropriate, the answer is “yes,” for several reasons.

⁶ Massachusetts Department of Telecommunications and Energy, Joint Petition of Boston Edison Company, Cambridge Electric Company, Commonwealth Electric Company and Commonwealth Gas Company for approval by the Department of Telecommunications and Energy pursuant to G.L. c.164 § 94 of a Rate Plan, Docket No. DTE 99-19, July 27, 1999, p. 42.

⁷ Kentucky Public Service Commission, In the Matter of Kentucky Utilities Company’s and Louisville Gas and Electric Company’s Plan to Address the Future of the Merger Surcredit Approved by the KPSC in Case No 1997-00300, Case Nos. 2002-00429 and 2002-00430, Order dated October 16, 2003, pp. 1-2.

1 First, a continuation of the sharing opportunity was explicitly contemplated in the
2 Merger Order, where the Commission stated: "...to the extent that a merger actually
3 results in demonstrable cost savings, it would be reasonable to use a portion of those
4 savings to offset the cost of undertaking the merger, including the premium,"⁸ Exhibits
5 MMS-2 and 3 clearly show that the Company has not only created merger savings, but
6 that customers have already received substantial rate savings as compared with the likely
7 alternative absent a merger. There is no indication that the Commission intended to limit
8 the sharing opportunity to the term of ARP 2000, nor would it have been sound policy for
9 it to have done so.

10 In fact, in the Merger Order, the Commission discussed the Company seeking the
11 recovery of merger costs, including the acquisition premium, at a later date, and expressly
12 listed the conditions necessary for such an offset of merger costs:

13 If net efficiency savings from the merger can be demonstrated, we will
14 allow recovery of the acquisition premium through rates subject to the
15 following limitations:

16
17 a) The acquisition premium will not be considered in any way where the
18 effect of including the premium in any rate calculations would be to
19 increase rates above levels that would exist absent the merger (in other
20 words, there must be demonstrable benefits available to ratepayers
21 sufficient to offset all merger related-costs); and

22
23 b) Maine ratepayers receive a reasonable portion of the net savings from
24 the merger.⁹

25
26 The Company's proposal for sharing merger-enabled savings will satisfy both of
27 these criteria: the proposal shares only those savings created in excess of what would
28 otherwise have been achieved absent the merger, thus preserving the condition that rates

⁸ Merger Order at 19.

⁹ Merger Order at 19.

1 are lower than they otherwise would have been; and a 50/50 sharing of such savings
2 provides customers a reasonable portion of those savings.

3 By the standard articulated by the Commission in the Merger Order -- "... our
4 most basic task is to ensure that rates will not be higher (and service quality will not
5 deteriorate) as a result of the merger" (Merger order pg. 21) -- the merger has been and
6 continues to be a success. As discussed above, the merger has resulted in demonstrable
7 benefits for customers. Assuming a 1.0 to 1.5% range for the annual level of a non-
8 merger productivity improvement, customers have received cumulative rate savings of
9 \$57 to \$91 million on a net present value basis above what would have been achievable
10 absent a merger.

11 Second, under CMP's specific circumstances, a continued opportunity for sharing
12 is appropriate to provide an opportunity for the Company to share in the gains created
13 proportional to the required level of investment. To date, most of the benefits have
14 accrued to customers and shareholder recovery, relative to the investment required, has
15 been modest. To provide a sharing opportunity proportional to the investment, a sharing
16 opportunity beyond the term of ARP 2000 is required, as the Merger Order itself
17 contemplated.

18 Third, continued sharing of merger savings under these circumstances is good
19 public policy. It will indicate that the Commission continues to support transactions and
20 investments which benefit customers, and will provide a reasonable opportunity for the
21 investors to share in those gains.¹⁰ This in turn will provide investors with the proper

¹⁰ See, e.g., Merger Order at 18, citing Order in *Bangor Hydro-Electric Company and Stonington and Deer Isle Power Company, Joint Application to Merge Property*, Docket No. 87-109 at 2 (Nov. 10, 1987) ("Experience... shows that significant cost savings can be achieved in certain

1 incentives to make further investments in efficiency-creating mergers which would
2 provide further benefits to customers.

3 In light of these facts, a continued opportunity for the Company to share in
4 merger-related savings is both appropriate and reasonable.

5 **C. A 50/50 Sharing is Appropriate Under the Circumstances.**

6 The Merger Order requires that customers receive a “reasonable portion” of any
7 sharing in merger-enabled savings. CMP proposes to share the savings realized during
8 the term of ARP 2008 on a 50/50 basis with customers. The proposed 50/50 sharing
9 level is reasonable, for two reasons.

10 First, the Company’s performance in effectuating the merger has been excellent,
11 and the resulting savings substantial. Going forward, the Company’s distribution revenue
12 requirement will be \$18 to \$20 million lower than it would have been absent the merger,
13 and this figure will increase each year with inflation. This level of annual savings
14 translates to an overall 13 to 14 percent reduction in O&M costs. This level of
15 performance suggests that a significant sharing opportunity for the Company is
16 appropriate.

17 Second, as discussed above, customers to date have received far more than 50%
18 of the realized merger savings while the level of shareholder recovery to date, relative to
19 the investment required and the risks assumed, has been modest. The merger required a
20 substantial investment by the Company, and the Company also assumed the risk that
21 savings could be achieved in excess of the agreed to productivity offsets. To date, the
22 Company’s share ranged from \$5 to 27 million. The Company proposes to include for
23 ratemaking purposes a cost of service adjustment equal to one half of the annual net

1 distribution O&M savings that have been achieved as a direct result of the merger. Given
2 the level of savings achieved and the continued level of on-going savings provided to
3 customers during ARP 2008, this is a reasonable and appropriate request

4 Based on these considerations, a 50/50 sharing of the merger-enabled savings
5 during the seven year term of APR 2008, as quantified in the testimony of Messrs.
6 Stinneford and Dumais, strikes an appropriate balance between shareholders and
7 customers, is in keeping with good economic policy, and will demonstrate the
8 Commission's continued support for investments that are beneficial to customers.

1 **IV. CMP'S PROPOSED METHODOLOGY TO SHARE 50% OF**
2 **THE MERGER ENABLED SAVINGS THROUGH ARP 2008 IS**
3 **REASONABLE AND APPROPRIATE.**
4

5 Most of the potential merger-enabled synergy savings have already been
6 achieved, and are fully reflected in the Company's test year cost of service. Thus, under
7 "normal" ratemaking, all of the ongoing value of achieved synergies would be passed
8 through to customers, and the opportunity for the Company to share in these ongoing
9 benefits would be nil. To create an ongoing opportunity for the Company to share in
10 these benefits, the Company proposes to effect a 50/50 sharing of the measured net
11 merger-enabled savings by including a cost of service adjustment equal to one half of the
12 distribution portion of the annual net O&M savings that have been achieved as a direct
13 result of the merger on the test-year O&M expense line and using that level of expense as
14 part of the Commission's determination that CMP's rates over the life of the proposed
15 new ARP will be just and reasonable. This approach does not guarantee that the
16 Company will recognize this share of savings as income, nor does it provide any direct
17 recovery in rates of the acquisition premium.

18 While there may be several alternative approaches to making rates that include a
19 share of merger savings in the current case, the method proposed by CMP is both
20 straightforward and reasonable.

21 While the Company is not requesting full recovery of the acquisition premium in
22 rates, and as discussed below is not asking for anywhere near the magnitude of such
23 recovery, its proposal is consistent with the Merger Order. As discussed above, the
24 Company has met the conditions for the recovery of the acquisition premium articulated
25 in the Merger Order. Rather than effect the recovery through the amortization of the

1 acquisition premium, which is not permitted under current accounting rules and at a
2 minimum would require a number of Commission approved accounting adjustments,
3 CMP's proposed methodology results in a pro forma adjustment to only one line in the
4 Company's revenue requirement calculation, and results in an opportunity for the
5 Company to share in the benefits it created with its investment.

6 Full recovery of the acquisition premium in rates would result in a revenue
7 requirement well in excess of what is proposed here. The first component in rates of such
8 a request would be the amortization of the roughly \$300 million acquisition premium. If
9 returned over a period of 30 years, this would equal approximately \$10 million per year.
10 The second, and larger component in rates would be the return on the unamortized
11 acquisition premium. At a 12.7% pre-tax weighted average cost of capital (see Exhibit
12 ENS/PAD-8), this would equal \$38.1 million in the first year for a total increase in
13 revenue requirements of \$48.1 million. However, the Company is not requesting this
14 level of shareholder recovery, but instead the seeks for recognition of roughly \$9 million
15 per year through its proposed adjustment to O&M expense.

MICHAEL M. SCHNITZER

Director

Michael Schnitzer is a co-founder and Director of The NorthBridge Group. He focuses on management consulting and works with clients in regulated industries to address strategy issues central to maximizing performance. Helping clients develop effective responses to increasingly deregulated markets is central to Mr. Schnitzer's work for electric and gas utilities. He has developed initiatives in marketing, pricing, regulatory relations and supply planning. He also has broad experience in utility reorganizations, having served as a financial advisor to secured parties in three utility bankruptcies and has developed and evaluated a wide array of restructuring proposals. Mr. Schnitzer's project assignments have included:

- Helped develop and analyze alternative restructuring plans, including resolution of such issues as residual vertical and horizontal market power, stranded costs, and ultimate organization of the competitive market for generation.
- Analyzed the financial opportunities afforded by restructuring – including leverage, sale/leaseback and splitting off generating assets – to develop strategies for improving competitiveness and increasing shareholder value.
- Analyzed and developed various rate plans designed to return stranded costs to utilities, including appropriate length of transition periods, true-ups, access charges, and the like.
- Assessed transmission capacity and helped develop economically efficient transmission tariffs, including policies for encouraging economic transmission expansions.
- Estimated the likely price of competitive new generation for cogenerators and IPPs as a basis for assisting utilities in planning their pricing, capacity additions, and marketing plans.
- Assessed pricing and shareholder value under alternative regulatory treatments, and formulated several proposals for rate case settlement.
- Analyzed rate levels and asset values under alternative financial structures and ratemaking treatments.
- Assessed short- and long-term opportunities in the wholesale electricity market and developed marketing plans and proposals for specific candidate buyers.
- Analyzed the economics of completing current utility construction programs and evaluated alternative ratemaking treatments of new generating capacity.
- Assessed regulatory policy issues associated with privatization of the electric supply industry in the United Kingdom, including policies to accomplish access to the transmission system.
- Analyzed the economics of municipal takeover of a portion of the franchise area versus continued service by a utility.

MICHAEL M. SCHNITZER

Director (2)

Mr. Schnitzer has testified before the public utility commissions of Arkansas, Delaware, Indiana, Maine, Maryland, Massachusetts, New Hampshire, New Mexico, New York, Ohio, Pennsylvania, Rhode Island, Texas, Vermont, and Wisconsin. He is a former adjunct research fellow at the Energy and Environmental Policy Center, John F. Kennedy School of Government, Harvard University.

Before joining NorthBridge, Mr. Schnitzer was a Managing Director at Putnam, Hayes & Bartlett, Inc., where he co-directed the firm's regulated industry practice. Prior to that he was a member of the executive staff of the Appalachian Mountain Club. His experience as assistant to the executive director included the development of financial models and organizational strategic plans, as well as the negotiation of multi-party real estate transactions and the settlement of environmental litigation.

Mr. Schnitzer received an A.B. in chemistry, with honors, from Harvard University, and an M.S. in management from the Sloan School, Massachusetts Institute of Technology.

NPV of Synergy Savings at 1.0% and 1.5% Productivity Offset Factors

Inflation Rate For 2008+ Synergies 2.25%
Discount Rate 7.50%

	1.00%									
	<u>Case</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
T&D O&M		(1,292)	820	12,024	15,312	18,352	19,800	20,551	20,946	21,417
T&D Capital		<u>504</u>	<u>631</u>	<u>1,379</u>	<u>2,751</u>	<u>2,969</u>	<u>3,095</u>	<u>3,173</u>	<u>3,231</u>	<u>3,303</u>
Total		(788)	1,451	13,404	18,064	21,320	22,895	23,724	24,177	24,721
84% Total Distribution Share		(662)	1,219	11,259	15,173	17,909	19,232	19,928	20,308	20,765

	<u>\$2000</u>	<u>\$2007</u>
NPV through 2007	\$57,812	\$95,913
NPV through ARP 2008	\$126,748	\$210,281

	1.50%									
	<u>Case</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>	<u>2009</u>
O&M		(1,889)	(83)	10,810	13,772	16,496	17,623	18,314	18,670	19,090
Capital		<u>471</u>	<u>583</u>	<u>1,318</u>	<u>2,677</u>	<u>2,883</u>	<u>3,002</u>	<u>3,077</u>	<u>3,133</u>	<u>3,204</u>
Total		(1,418)	501	12,127	16,449	19,378	20,624	21,391	21,803	22,293
84% Total Distribution Share		(1,191)	420	10,187	13,817	16,278	17,324	17,969	18,314	18,727

	<u>\$2000</u>	<u>\$2007</u>
NPV through 2007	\$51,197	\$84,938
NPV through ARP 2008	\$113,364	\$188,077

Sharing of Synergies Between Customers and Shareholders
During ARP 2000

Non-Merger Productivity Factor = 1.0%

	<u>7/01-6/02</u>	<u>7/02-6/03</u>	<u>7/03-6/04</u>	<u>7/04-6/05</u>	<u>7/05-6/06</u>	<u>7/06-6/07</u>	<u>7/07-6/08</u>
Productivity Offset in ARP	2.28%	2.00%	2.25%	2.75%	2.75%	2.75%	2.90%
Non-Merger Portion	<u>1.00%</u>	<u>1.00%</u>	<u>1.00%</u>	<u>1.00%</u>	<u>1.00%</u>	<u>1.00%</u>	<u>1.00%</u>
Merger Portion	1.28%	1.00%	1.25%	1.75%	1.75%	1.75%	1.90%
Core Distribution Revenue	\$ 234,593,676	\$ 246,176,380	\$ 251,238,378	\$ 227,114,277	\$ 233,919,215	\$ 240,936,791	\$ 248,164,895
Rate Year Merger Portion	\$3,002,799	\$2,461,764	\$3,140,480	\$3,974,500	\$4,093,586	\$4,216,394	\$4,715,133
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Customer Calendar Year Portion	\$1,501,400	\$2,732,281	\$2,801,122	\$3,557,490	\$4,034,043	\$4,154,990	\$4,465,763
Customer Cumulative Merger Portion	\$1,501,400	\$4,233,681	\$7,034,803	\$10,592,293	\$14,626,336	\$18,781,326	\$23,247,089
Total Synergies Created	(\$661,627)	\$1,218,815	\$11,259,154	\$15,173,368	\$17,909,039	\$19,231,630	\$19,928,377
Shareholder Share	(\$2,163,027)	(\$3,014,866)	\$4,224,351	\$4,581,075	\$3,282,704	\$450,305	(\$3,318,712)

<u>NPV Rate</u>	<u>Synergy Split During ARP 2000</u>	<u>Pre-tax '07</u>	<u>To-date split</u>
7.50%	Total synergies npv	\$95,913,268	
	Customer share npv	\$91,288,216	95%
	Shareholder share	\$4,625,053	5%

Non-Merger Productivity Factor = 1.5%

	<u>7/01-6/02</u>	<u>7/02-6/03</u>	<u>7/03-6/04</u>	<u>7/04-6/05</u>	<u>7/05-6/06</u>	<u>7/06-6/07</u>	<u>7/07-6/08</u>
Productivity Offset in ARP	2.28%	2.00%	2.25%	2.75%	2.75%	2.75%	2.90%
Non-Merger Portion	<u>1.50%</u>	<u>1.50%</u>	<u>1.50%</u>	<u>1.50%</u>	<u>1.50%</u>	<u>1.50%</u>	<u>1.50%</u>
Merger Portion	0.78%	0.50%	0.75%	1.25%	1.25%	1.25%	1.40%
Core Distribution Revenue	\$ 234,593,676	\$ 246,176,380	\$ 251,238,378	\$ 227,114,277	\$ 233,919,215	\$ 240,936,791	\$ 248,164,895
Rate Year Merger Portion	\$1,829,831	\$1,230,882	\$1,884,288	\$2,838,928	\$2,923,990	\$3,011,710	\$3,474,309
	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>
Customer Calendar Year Portion	\$914,915	\$1,530,356	\$1,557,585	\$2,361,608	\$2,881,459	\$2,967,850	\$3,243,009
Customer Cumulative Merger Portion	\$914,915	\$2,445,272	\$4,002,856	\$6,364,465	\$9,245,924	\$12,213,774	\$15,456,783
Total Synergies Created	(\$1,191,363)	\$420,433	\$10,187,075	\$13,817,100	\$16,277,739	\$17,324,440	\$17,968,741
Shareholder Share	(\$2,106,279)	-\$2,024,838	\$6,184,218	\$7,452,635	\$7,031,815	\$5,110,666	\$2,511,958

<u>NPV Rate</u>	<u>Synergy Split During ARP 2000</u>	<u>Pre-tax '07</u>	<u>To-date split</u>
7.46%	Total synergies npv	\$84,937,893	
	Customer share npv	\$57,446,151	68%
	Shareholder share	\$27,491,743	32%