

BEFORE THE
STATE OF VERMONT
PUBLIC SERVICE BOARD

_____)
Amended Joint Petition of Central Vermont)
Public Service Corporation ("CVPS"),)
Danaus Vermont Corp., Gaz Métro Limited)
Partnership ("Gaz Metro"), Gaz Métro inc.,)
Northern New England Energy Corporation)
("NNEEC") for itself and as agent for Gaz)
Métro's parents, Green Mountain Power)
Corporation ("GMP") and Vermont Low)
Income Trust for Electricity, Inc. ("VLITE"),)
for approval of: (1) the merger of Danaus)
into and with CVPS; (2) the acquisition by)
NNEEC of the common stock of CVPS;)
(3) the amendment to CVPS's Articles of)
Association; (4) the merger of CVPS into)
and with GMP; and (5) the acquisition by)
VLITE of a controlling interest in Vermont)
Electric Power Company, Inc.)
_____)

Docket No. 7770

Surrebuttal Testimony of

Michael P. Gorman

On behalf of

International Business Machines Corporation

Summary of Testimony

Mr. Gorman's testimony discusses the Petitioners' rebuttal testimony concerning the shared savings plan.

March 8, 2012



BRUBAKER & ASSOCIATES, INC.
CHESTERFIELD, MO 63017

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PUBLIC SERVICE BOARD

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VLITE of a controlling interest in Vermont
Electric Power Company, Inc.

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Surrebuttal Testimony of Michael P. Gorman

1 Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

2 A Michael P. Gorman. My business address is 16690 Swingley Ridge Road, Suite 140,
3 Chesterfield, MO 63017.

4 Q ARE YOU THE SAME MICHAEL P. GORMAN WHO PREVIOUSLY FILED
5 TESTIMONY IN THIS PROCEEDING?

6 A Yes. I filed direct testimony on January 20, 2012 on behalf of International Business
7 Machines Corporation ("IBM").

1 **Q PLEASE SUMMARIZE YOUR TESTIMONY IN THIS PROCEEDING.**

2 A I will respond to certain arguments and responses offered by Petitioners'¹ witnesses
3 Dawn D. Bugbee, Robert Hevert, and Robert Griffin.

4 **Q DID MS. BUGBEE RESPOND TO YOUR PROPOSAL CONCERNING RECOVERY**
5 **OF MERGER-RELATED COSTS AS PART OF THE PROPOSED SHARED**
6 **SAVINGS PLAN?**

7 A Yes. Ms. Bugbee asserts that I claimed that the Petitioners were inappropriately
8 seeking to recover all merger-related consolidation and integration costs in rates
9 while keeping as much as 90% of the associated benefits. She states that this claim
10 is incorrect. She believes that the Combined Company's² proposed regulatory plan
11 will treat merger-related cost increases and decreases within each of the three
12 categories in a symmetrical manner. She defines the three categories of costs as
13 follows:

- 14 1. Transaction, regulatory and costs to achieve the acquisition and merger.
15 These costs she maintains include transaction costs, bank fees, payment
16 to outside experts and lawyers, breakup fee for Fortis, and executive
17 change and control payments. She concludes that the Petitioners will not
18 seek to include these one-time costs in cost of service and the Petitioners'
19 rates for retail purposes.
- 20 2. The second category consists of integration-related operation and
21 maintenance ("O&M") expenses. These are costs incurred to produce the
22 claimed merger savings and are outlined in the direct testimony of
23 Petitioners' witness Robert Griffin. Ms. Bugbee states the Petitioners will
24 not seek to recover integration-related O&M costs in its base rates. She
25 claims that these costs will instead be netted against integration-related

¹The "Petitioners" are defined as CVPS, Danaus Vermont Corp., Gaz Metro, Gaz Metro inc., NNEEC for itself and as agent for Gaz Metro's parents, GMP and VLITE.

²The "Combined Company" is defined as the utility company that would result from the merger of GMP and CVPS.

1 savings, and that the net savings will be shared with customers in
2 accordance with the Petitioners' proposed shared savings plan.

- 3 3. The third cost category relates to the Combined Company's cost of service
4 including return on rate base, power costs, and non-O&M expenses, some
5 of which will be reduced as a result of the integration. She concludes that
6 there will be no change in the treatment of these costs, and they will be
7 used as cost of service to develop the Combined Company's revenue
8 requirement in the Alternative Regulation Plan.

9 She concludes that while the impacts of the merger costs are divided into
10 separate categories for ratemaking purposes, within each category she believes there
11 is a symmetrical treatment between the savings benefits and the costs to achieve
12 those benefits. Therefore, Ms. Bugbee believes my claim that the Combined
13 Company is charging customers for 100% of merger costs while retaining some of the
14 merger benefits is simply inaccurate. (Bugbee Rebuttal Testimony at 1 and 2).

15 **Q PLEASE RESPOND TO MS. BUGBEE'S TESTIMONY CONCERNING MERGER-**
16 **RELATED COSTS.**

17 A In her categorization of three types of Combined Company costs, we are in
18 agreement with costs in Category 1 and 3. I agree that the Category 1 costs should
19 not be recovered from utility ratepayers. This first category of costs represents
20 transaction costs incurred between shareholders to transfer control of CVPS to GMP.
21 These costs are not related to providing utility service and therefore should not be
22 included in the cost of service to set utility rates.

23 Also, I agree with her that a third cost category, related to the costs incurred to
24 provide service, should be recovered from utility customers, provided the costs are
25 reasonable and prudent.

1 Our disagreement lies in Ms. Bugbee’s second category of costs. The second
2 category of costs relates to transaction integration costs, and represents the cost
3 incurred to produce expected merger savings. The Petitioners will incur these costs
4 in an effort to reduce the Combined Company’s cost of service. Our disagreement
5 concerns whether or not the Petitioner’s proposed regulatory treatment of these
6 Category 2 costs in a proposed sharing savings plan is fair. The Petitioners’
7 proposed shared savings plan significantly favors shareholders. Further,
8 Ms. Bugbee’s claim that the proposed shared savings plan treats merger costs and
9 benefits symmetrically is erroneous.

10 **Q WHY IS THE SECOND CATEGORY OF COSTS NOT TREATED**
11 **SYMMETRICALLY WITHIN THE PETITIONERS’ PROPOSED SHARED SAVINGS**
12 **PLAN?**

13 **A** The Petitioners propose to include integration-related O&M expense in the
14 Petitioners’ Actual O&M expenses. Under the Petitioners’ shared savings plan, as
15 illustrated in Mr. Griffin’s direct testimony at 4, savings are measured only after Actual
16 O&M is fully recovered. In the Petitioners’ plan, savings are the positive difference
17 between “Adjusted” O&M expenses (or as referred to by Petitioners’ witness
18 Mr. Hevert, “but for” O&M expenses), and the Actual O&M expenses.

19 To the extent the “Adjusted” O&M expenses are greater than the Actual O&M
20 expenses, all integration costs will be fully recovered, and the net difference will be
21 termed “savings.” The savings will then be shared among customers and investors
22 during the first six years of the merger.

1 Importantly, integration-related O&M expenses will be included in the
2 Petitioners' Actual O&M expenses and will be fully recovered by the Petitioners
3 before any amount of claimed savings is identified under the Petitioners' shared
4 savings plan methodology. As such, Ms. Bugbee's claim that there is a symmetrical
5 treatment of costs/benefits is without merit. Instead, the Petitioners get all savings up
6 to the Integration O&M costs first, and share savings only if any are measured.

7 Simply put, it is not a symmetrical regulation plan to ask customers to pay all
8 of the costs to achieve savings, and then split the savings claimed to have been
9 achieved between investors and customers.

10 **Q DID GMP ASSERT THAT IT WAS GUARANTEEING SAVINGS TO CUSTOMERS**
11 **AS A MERGER COMMITMENT?**

12 **A**At page 7 of Robert Griffin's rebuttal testimony, he states that the Combined
13 Company's proposal to provide customers \$144 million of savings is a guaranteed
14 commitment to customers, not a best-effort commitment as I testified. Mr. Griffin
15 asserts that if after the first 10 years of the merger agreement, customers have not
16 received \$144 million of savings, GMP will then ask the Board to approve a plan to
17 pass these savings on to customers. This request of the Board would presumably be
18 made only after the initial 10-year term, and only if \$144 million of savings have not
19 already been returned to customers over that term.

1 Q DO YOU HAVE ANY COMMENTS CONCERNING THE PETITIONERS'
2 PROPOSAL TO "GUARANTEE" THIS AMOUNT OF SAVINGS?

3 A Yes. While I believe the Petitioners' proposal for a guarantee is an improvement to
4 its original plan, I would note that the \$144 million of guaranteed savings is not a
5 guarantee to credit savings to customers during the first 10 years of the merger.
6 Rather, the guarantee is a credit equal to \$144 million but over an unspecified period
7 of time.

8 Again, Mr. Griffin states that if the merger does not produce \$144 million of
9 savings during the first 10 years, the Petitioners will design a plan for Board review
10 and approval to complete this ratepayer commitment. This will happen if customers
11 do not receive \$144 million of savings in the first 10 years.

12 Q DID MR. HEVERT COMMENT ON YOUR CLAIMS CONCERNING THE
13 PETITIONERS' PROPOSED SHARED SAVINGS PLAN?

14 A Yes. At page 30 of his testimony, he maintains that in any given year in which there
15 are no savings, the incremental merger cost will not be included in GMP's cost of
16 service and retail rates. He states that the Combined Company's merger-related
17 costs will be fully recovered only if there are merger-related savings that offset the
18 costs. Assuming that Mr. Hevert's statement is a commitment on behalf of the
19 Petitioners, the Petitioners have committed to limit their cost of service over the 10-
20 year period to include no more than the Adjusted O&M expenses estimated in the
21 shared savings plan.

1 Q DOES MR. HEVERT'S PROMISE, THAT O&M EXPENSES WILL NOT BE
2 INCLUDED ABOVE THE "ADJUSTED" O&M EXPENSES, IN ORDER TO ENSURE
3 CUSTOMERS DO NOT PAY MORE UNDER THE MERGER, HAVE MERIT?

4 A The ability to effectively implement and ensure customers receive this protection is at
5 very best problematic. This is true for several reasons. First, the Petitioners have
6 failed to provide any estimate of what the integration costs will be. (See Response to
7 DPS:PET.1-63). To the extent we do not know what these integration costs are, we
8 cannot determine how they will have impacted Actual O&M expenses.

9 Second, the Petitioners' "Adjusted" O&M expense methodology will not
10 reliably estimate what the O&M expenses would have been absent the merger. I
11 discussed this in my direct testimony at pages 11-12. Indeed, the Petitioners'
12 proposed trending O&M analysis simply does not adequately quantify verifiable
13 merger savings. Actual O&M cost could be impacted by productivity gains,
14 technological advances and other cost savings opportunities that are not related to
15 the merger. Hence, Actual O&M could be lower than the Adjusted O&M for reasons
16 unrelated to the merger. As a result, there is no way to verify Mr. Hevert's assertion
17 that customers will only pay integration-related costs to the extent that merger
18 savings are realized.

19 Q DOES MR. HEVERT'S ASSESSMENT OF THE SHARED SAVINGS PLAN
20 CHANGE YOUR RECOMMENDATION TO REJECT THE SHARED SAVINGS
21 PLAN?

22 A No. As Mr. Hevert's testimony makes clear, the Combined Company will recover its
23 merger-related costs first, before any estimate of merger-related savings is passed on

1 to customers. Mr. Hevert does suggest that the Combined Company is at risk for
2 recovering merger-related costs to the extent those costs are not at least offset by
3 merger-related savings. However, the Combined Company's test for establishing
4 merger-related savings is uncertain and falls short of establishing bona fide savings
5 that were created only because of the merger.

6 **Q IF THE SHARED SAVINGS PLAN IS REJECTED, DO YOU SUPPORT THE**
7 **PETITIONERS' REQUEST TO RECOVER MERGER-RELATED INTEGRATION**
8 **COSTS?**

9 A To the extent the merger-related integration costs are reasonable and prudent, and
10 there is a strong probability of creating integration-related savings, then I believe the
11 costs to achieve those savings should be recovered from ratepayers. My objection
12 relates to the Petitioners recovering all of these integration-related costs, and then
13 keeping a portion of claimed savings. Rather, the Petitioners should be allowed to
14 recover reasonable integration-related costs, but all merger savings should be
15 passed on to customers. I believe this is an appropriate and balanced regulatory plan
16 because the Combined Company and customers are treated fairly and symmetrically.

17 Specifically, under my proposal, ratepayers and investors both benefit
18 because investors are made whole for all reasonable and prudent costs incurred
19 related to providing utility service, and the utility and ratepayers are both better off
20 because the utility's cost structure is more competitive. A competitive utility keeps
21 rates low and helps stabilize utility earnings and cash flow because consumption
22 variance may be reduced.

1 However, in order to clearly demonstrate that integration-related O&M
2 expenses are reasonable, the Combined Company should be required to clearly
3 identify what those merger integration costs are, and show that they are reasonable.
4 To the extent it fails to make this demonstration, then only costs that are shown to be
5 reasonable and prudent should be included in the Combined Company's cost of
6 service.

7 If, however, the Board ultimately decides to approve some savings sharing
8 formula, then to the extent that investors benefit from any savings, the investors
9 should also bear a portion of the costs incurred to achieve those savings.

10 **Q IF THE BOARD CHOOSES TO APPROVE A SHARED SAVINGS PLAN**
11 **STRUCTURED SIMILAR TO THE PETITIONERS' PROPOSAL, HOW COULD IT**
12 **BE MODIFIED TO INCLUDE A SHARING OF THE COST TO ACHIEVE**
13 **INTEGRATION O&M EXPENSES?**

14 **A** This could be accomplished by the Combined Company clearly identifying all
15 integration-related O&M expenses. A portion of these O&M expenses could then be
16 excluded from the Combined Company's actual O&M expenses prior to measuring
17 savings. Then the Combined Company's savings methodology could be used to
18 determine the amount of savings that will be shared between investors and
19 customers. The Combined Company then would recover its portion of the integration
20 O&M expenses from the amount of shared savings allocated to it in this process.
21 Ultimately, the Combined Company's net savings would be the difference between
22 the amount of savings allocated to the Combined Company, less the integration O&M
23 expense not passed on to retail customers.

1 For example, consider the shared savings table included on page 4 of Mr.
2 Griffin's Direct Testimony. In that table, the first shared savings period for a full
3 calendar year ends October 1, 2013. In that 12 month period, Mr. Griffin estimated
4 an Adjusted O&M expense of \$126,075 and an Actual O&M expense of \$114,201.
5 Petitioners have stated that integration costs would be included in the Actual O&M.
6 (See A.DPS:PET.1-55). With these projections, Mr. Griffin estimates achieved
7 savings of \$11,874, which are realized after all integration costs have been recovered
8 in Actual O&M. If integration costs in this case were estimated to be \$5,000 and were
9 removed from Actual O&M, achieved savings would increase to \$16,874.

10 In this instance, customers would receive revised savings of \$1,687 (\$500
11 more than Petitioners estimated) and 10% of the \$5,000 integration costs, or \$500,
12 for net shared savings of \$1,187. Further, customers would then pay Actual O&M of
13 only \$109,201 (\$114,201 less \$5,000 of integration costs) not the full Actual O&M of
14 \$114,201 as proposed by the Petitioners. The net changed benefit to customers
15 relative to the Petitioners' proposal would be a reduction to Actual O&M of \$5,000,
16 which represents the removal of integration costs from Actual O&M. Customers
17 would pay \$500 of integration costs in the split of integration costs and savings.

18 The difference to the Petitioners is that they would not recover the \$5,000 of
19 Integration O&M as a component of Actual O&M, but would recover \$500 of the
20 integration cost from customers by netting 10% of the cost against customers'
21 allocated savings. The Petitioners would pay 90% of the integration costs of \$5,000,
22 and receive 90% of gross savings of \$16,874 for net savings of \$10,687 (90% of
23 (\$16,874 - \$5,000)). The Petitioners also will recover \$500 of integration costs from
24 customers via the net savings split. The Petitioners' net savings will still be \$10,687,

1 but their Actual O&M recovery would be reduced by \$5,000 – the integration O&M
2 costs – but they will recover \$500 of integration cost from customers via the net
3 savings split. This example illustrates a symmetrical treatment of integration costs
4 and integration savings, which is different than what the Petitioners have proposed.

5 **Q IS MR. HEVERT’S ASSESSMENT OF OTHER REGULATORY PLANS**
6 **CONSISTENT WITH YOUR RISK RETURN TRADEOFF FOR MERGER-RELATED**
7 **COSTS?**

8 A Yes, it is. Indeed, Mr. Hevert’s assessment seems to be generally consistent with
9 mine. In many instances, shareholders were put at risk for recovering merger-related
10 costs by rate freezes, which included rate reductions during certain initial terms of the
11 merger period. During those rate freeze periods, companies were able to retain all
12 savings realized during that rate freeze period. In these cases, customers benefitted
13 from a rate freeze or even rate reduction, and investors benefitted from realization of
14 all cost reductions realized during that period.

15 In this proceeding, the Petitioners’ proposed shared savings plan does not
16 benefit ratepayers and shareholders equally. In significant contrast, the Petitioners’
17 plan in this case provides full integration-related cost recovery to shareholders first,
18 and then all claimed savings would be estimated thereafter and shared during the first
19 six years of the merger. The Petitioners’ plan is not symmetrical, and is not balanced.
20 Therefore, the shared savings plan should be rejected.

1 **Q PETITIONERS' WITNESSES MARY G. POWELL AND LAWRENCE J. REILLY**
2 **STATE AT PAGE 11 OF THEIR REBUTTAL TESTIMONY, THAT GMP WILL NOT**
3 **ACCEPT THE PROPOSAL TO HAVE AN INDEPENDENT BOARD MEMBER FOR**
4 **NORTHERN NEW ENGLAND ENERGY CORPORATION ("NNEEC"). THEY**
5 **BELIEVE THAT THE PETITIONERS SHOULD NOT RELINQUISH ANY OF THEIR**
6 **DISCRETION TO ELECT BOARD MEMBERS AND TO DO SO AS I SUGGESTED,**
7 **WOULD BE AN INAPPROPRIATE INTRUSION INTO GMP'S GOVERNANCE.**
8 **PLEASE RESPOND.**

9 **A I agree with the Petitioners that their acceptance of a commitment for an independent**
10 **Board member(s) would restrict the ultimate governance of GMP. However, that is**
11 **effectively the purpose for the commitment.**

12 The concern I have raised is whether or not the Board members will govern
13 GMP for the primary benefit of regulated utility operations in Vermont. If the Board
14 members are also Board members of Gaz Metro, GMP will likely be viewed by all
15 Board members as part of the consolidated Gaz Metro organization, and GMP's cash
16 flows and resources will be available to maximize the value of Gaz Metro to its
17 shareholders (limited partners). An independent Board member would give some
18 voice to GMP's obligation to Vermont, and its obligation to ensure that the cash flows
19 and resources of GMP will be utilized to meet its regulated utility service obligations.

20 **Q DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

21 **A Yes.**