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AUG 17 2005

PUBLIC SERVICE
COMMISSION

Kate E. Moriarty
Assistant General Counsel

VIA OVERNIGHT DELIVERY

August 16, 2005

Ms. Elizabeth O'Donnell
Executive Director
Kentucky Public Service Commission
211 Sower Boulevard
P.O. Box 615
Frankfort, Kentucky 40602-0615

Re: Joint Application of Duke Energy Corp., Duke Energy Holding Corp., Cougar Acquisition Corp., Cinergy Corp., The Cincinnati Gas & Electric Company and The Union Light, Heat and Power Company for Approval of a Transfer and Acquisition of Control
Case No. 2005-00228

Dear Ms. O'Donnell:

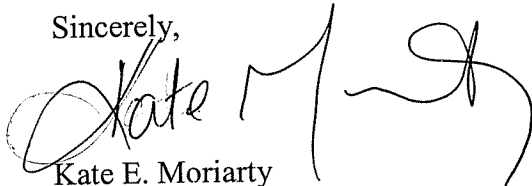
Enclosed please find an original and twelve copies of the Direct Testimony of Paul M. Anderson on behalf of Joint Applicants' to be docketed in the above-referenced case.

Mr. Anderson's Testimony is being submitted in accordance with the supplemental procedural schedule set forth as Appendix A to the Commission's Order of August 11, 2005.

Please file-stamp and return the two extra copies in the enclosed over-night envelope.

If you have any questions, please call me at (513) 287-3075.

Sincerely,



Kate E. Moriarty
Assistant General Counsel

KEM/sew

cc: All interested parties (with encl.)

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

Joint Application of Duke Energy Corporation,)
Duke Energy Holding Corp., Deer Acquisition)
Corp., Cougar Acquisition Corp., Cinergy Corp.,)
The Cincinnati Gas & Electric Company, and)
The Union Light, Heat and Power Company for)
Approval of a Transfer and Acquisition)
of Control)

Case No. 2005-00228

DIRECT TESTIMONY OF

PAUL M. ANDERSON

ON BEHALF OF

JOINT APPLICANTS

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I. INTRODUCTION AND PURPOSE

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. Paul M. Anderson, 526 South Church Street. Charlotte, North Carolina 28202.

3 **Q. WHAT IS YOUR CURRENT POSITION?**

4 A. I am Chairman of the Board and the Chief Executive Officer of Duke Energy
5 Corporation (“Duke Energy”).

6 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL
7 BACKGROUND.**

8 A. I received a Bachelor of Science degree in mechanical engineering from the
9 University of Washington and a Master of Business Administration degree from
10 Stanford University. I became Chairman of the Board and Chief Executive
11 Officer of Duke Energy in 2003 after I had retired as Managing Director and
12 Chief Executive Officer of BHP Billiton, Ltd, an Australian company and BHP
13 Billiton PLC, a U.K.-listed company in 2002. BHP Billiton was formed by the
14 merger of BHP and Billiton PLC. Prior to the merger, from 1998 until 2001, I
15 was Managing Director and Chief Executive Officer of BHP.

16 Before joining BHP, I was President and Chief Operating Officer of Duke
17 Energy from 1997 to 1998, following the merger of Duke Power and PanEnergy
18 in 1997. At the time of that merger, I was Chairman, President and Chief
19 Executive Officer of PanEnergy and had served in various leadership roles within
20 PanEnergy since 1977. Prior to joining PanEnergy, I was with Ford Motor
21 Company from 1969 to 1977, where I held various positions in the company’s

1 planning, marketing, product engineering and finance areas. I also served as
2 Chief Financial Officer for Inland Steel from 1990 to 1991.

3 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
4 **PROCEEDING?**

5 A. Duke Energy, Cinergy Corp. and The Union Light Heat and Power Company
6 (“ULH&P”) have applied to the Commission for approval of a change in control
7 of ULH&P resulting from the merger of Duke Energy and Cinergy. From time to
8 time, I will refer to the combined company as “New Duke Energy.” In his
9 testimony, Mr. Richard J. Osborne provides the Commission with an introduction
10 to Duke Energy and discusses the strategic, policy and financial reasons that
11 support the merger. My testimony, therefore, focuses generally on the three
12 issues that the Commission asked me to address in its August 9, 2005 Order.
13 Those issues are (1) quantification of merger savings and allocation of such
14 savings to ratepayers and shareholders; (2) the post-merger vision of New Duke
15 Energy as it relates to the regulated, unregulated and non-utility businesses; and
16 (3) electric deregulation. The quantification of merger savings and the allocation
17 to Kentucky ratepayers are discussed in more detail in the testimony of other
18 witnesses as noted herein.

II. COST SAVINGS/ALLOCATIONS

1 **Q. PLEASE DESCRIBE THE COST SAVINGS AND COSTS TO ACHIEVE**
2 **SUCH SAVINGS THAT ARE EXPECTED AS A RESULT OF THE**
3 **MERGER?**

4 A. The testimony of Mr. Thomas J. Flaherty describes the expected level of merger
5 savings. As Mr. Flaherty details, the overall gross cost savings in the corporate,
6 shared services and regulated business support areas over the first five years
7 following the close of the merger are expected to be approximately \$1.3 billion.
8 The savings are expected to result from labor reductions in corporate,
9 administrative, and operating areas, as well as cost savings in areas such as
10 information technology and supply chain.

11 Of course, there are costs associated with achieving these savings. For
12 corporate, shared services and regulated business support areas, approximately
13 \$696 million in out-of-pocket costs to achieve merger savings were identified
14 related to the close of the merger and the realization of estimated cost savings. As
15 described in more detail in the testimony of Mr. Flaherty, the types of costs to
16 achieve include: systems integration, facilities integration, separation, relocation,
17 retention, internal and external communication, regulatory process and
18 compliance, transition, directors' and officers' insurance coverage, and
19 transaction costs.

20 **Q. HOW ARE THE NET SAVINGS ALLOCATED AMONG THE**
21 **DIFFERENT OPERATING COMPANIES?**

1 A. The estimated net savings (that is, savings less costs) were allocated to ULH&P
2 and other companies of New Duke Energy using cost causation principles. Mr.
3 Flaherty and Mr. Blackwell provide additional detail on this process.

4 **Q. WHAT IS ULH&P'S SHARE OF THE NET MERGER SAVINGS, AND**
5 **HOW WILL ULH&P'S RETAIL GAS AND ELECTRIC CUSTOMERS**
6 **REALIZE SUCH SAVINGS?**

7 A. Mr. Ficke's testimony sets forth the estimated savings allocated to ULH&P over
8 the first five years and how those savings will be flowed back to ULH&P
9 customers. Basically, ULH&P proposes to pass through to its customers a share
10 of these estimated net savings, prior to the commencement of the next base rate
11 case, in return for approval of the deferral and prompt recovery of the underlying
12 costs to achieve. Mr. John P. Steffen's testimony explains the required authority
13 for deferred accounting and certain other details of the proposed rate treatment for
14 the savings and costs.

15 **Q. HOW DOES THIS PROPOSAL BENEFIT BOTH RATEPAYERS AND**
16 **SHAREHOLDERS?**

17 A. This proposal benefits ratepayers by allowing them to see the benefits of merger
18 savings in their gas and electric bills much earlier than they would otherwise see
19 them. In addition, ULH&P is taking any performance risk as we are proposing to
20 share these benefits based on our upfront estimates of savings regardless of
21 whether ULH&P actually achieves the savings.

22 The proposal also benefits the New Duke Energy and its investors,
23 because it provides that ULH&P can recover the costs to achieve the merger

1 savings in a timely manner. Because ULH&P and its investors bear the risk that
2 ULH&P may not achieve the estimated merger savings, it is reasonable that there
3 be a sharing of net benefits, and that the sharing percentages ramp up over time.

III. POST-MERGER VISION

4 **Q. WHAT WERE THE STRATEGIC OBJECTIVES THAT LED DUKE**
5 **ENERGY TO PURSUE A MERGER WITH CINERGY?**

6 A. We must build a stronger company to better serve customers and to effectively
7 compete as the regulated and unregulated industries in which we operate continue
8 to consolidate. Duke Energy is a diversified energy company with a portfolio of
9 natural gas and electric businesses, both regulated and unregulated, and an
10 affiliated real estate company. The merger will create a stronger platform for our
11 regulated and unregulated businesses. Our increased size will position us for
12 further consolidations in the electric industry. After the combination, Duke
13 Energy's electric and gas businesses would each be large enough to stand alone - -
14 giving us the flexibility to examine the value in separating our electric and gas
15 businesses in the future.

16 The transaction will add value to Duke Energy with higher earnings after
17 the first full year of operation. The benefits will increase further in future years
18 through the realization of cost efficiencies. These efficiencies and management's
19 commitment to capture them will enable the combined company to offer attractive
20 energy prices to its retail customers, competitive prices and services in its
21 wholesale businesses, and will better position the New Duke Energy to attract the
22 capital needed to assure reliability and expansion.

1 Cinergy offered a complementary fit of assets and skills to meet our
2 strategic objectives. In addition, Cinergy's management is experienced and
3 highly capable, with a very similar vision for the future of the energy business.

4 **Q. WHAT IS THE POST-MERGER VISION OF NEW DUKE ENERGY AS**
5 **IT RELATES TO THE REGULATED BUSINESSES?**

6 A. Once combined, Duke Energy will operate one of the five largest electric
7 businesses in the United States and, combined with the gas operations, will be one
8 of the largest diversified utility and gas operations in North America. This scale
9 and the combination of the expertise of the two corporations provides value to
10 customers. We anticipate that the significant synergies created by the merger will
11 lower the overall cost structure of the combined company. As is discussed in
12 detail in the testimony of Mr. Flaherty, these cost savings should permit future
13 electric rates to be lower than would otherwise have been the case without the
14 merger. Furthermore, New Duke Energy's vision for the regulated businesses is
15 that the merger will also allow us to reduce risk to the regulated operations as a
16 whole from exposure to local conditions. The combination achieves this by
17 adding diversity of service areas, climates, and economic and competitive
18 conditions while at the same time continuing the provision of safe reliable service
19 to our customers.

20 **Q. YOU MENTIONED POTENTIALLY SEPARATING THE GAS AND**
21 **ELECTRIC BUSINESSES. PLEASE EXPLAIN THAT FURTHER.**

22 A. In the course of evaluating the merits for merging with Cinergy, we realized that
23 New Duke Energy's electric and gas businesses would each be large enough to

1 stand alone. To clarify, when I say the gas businesses, I do not mean separating
2 out ULH&P's gas distribution business. Instead, I am talking about Duke
3 Energy's existing gas businesses. While there continues to be some internal work
4 on evaluating the separation option, we are primarily focused on obtaining the
5 approvals needed to merge Cinergy and Duke Energy as well as integrating the
6 two companies. The size of the resulting New Duke Energy affords us the
7 opportunity to consider whether separating the electric and gas pipeline
8 businesses create value. No determination has been made.

9 **Q. WHAT IS THE POST-MERGER VISION OF NEW DUKE ENERGY AS**
10 **IT RELATES TO THE UNREGULATED AND NONUTILITY**
11 **BUSINESSES?**

12 A. The merger allows for the consolidation of certain Cinergy and Duke Energy
13 unregulated business. For example, the merger enables us to combine the trading
14 and marketing and merchant generating businesses of each company. A key part
15 of this consolidation involves the transfer to CG&E of the five Duke Energy
16 North America ("DENA") merchant generating facilities located in the Midwest.
17 DENA's gas generation in the Midwest complements Cinergy's coal generation.
18 The combination of these assets and operations will create a competitive trading
19 and marketing organization on a larger scale and with greater fuel and geographic
20 diversity- an organization better able to meet customer needs in the 21st Century.

IV. ELECTRIC DEREGULATION

21 **Q. PLEASE EXPLAIN YOUR VIEW ON ELECTRIC DEREGULATION IN**
22 **GENERAL AND IN KENTUCKY SPECIFICALLY.**

1 A. Energy markets should be structured to meet the needs of each state and region. I
2 am pleased to see the Federal Energy Regulatory Commission cite the need to
3 recognize regional differences in the structuring of transmission grids; that simply
4 reflects the reality of the marketplace and will enable wholesale power markets to
5 support the variety of retail models we see developing across the country.
6 Retail competition has been adopted by several states, but the pace of retail
7 competition slowed substantially after a series of well-publicized stumbling
8 blocks. Even in many states with retail competition, residential switching has
9 been slow to develop. Some states have even reversed plans to introduce retail
10 competition. Wholesale markets also have evolved to notably different degrees in
11 different regions.

12 Duke Energy serves customers in markets with robust wholesale competition and
13 in markets with much less wholesale activity. We serve customers in states
14 choosing retail competition and those without such options. Our model of broad,
15 cost effective capabilities enables us to meet customer needs under a very diverse
16 set of regulatory structures. The Commonwealth of Kentucky has chosen a path
17 for its retail power business, and we are comfortable with that path and committed
18 to provide excellent value in electric service consistent with that regulatory
19 regime.

V. CONCLUSION

20 **Q. PLEASE SUMMARIZE YOUR TESTIMONY?**

21 A. In summary, as shown in the testimony of other witnesses for Duke Energy,
22 Cinergy and ULH&P, the combination of Duke Energy and Cinergy, and the

1 resulting synergies, will create a new, diversified, financially stronger company
2 with increased financial flexibility, efficiencies, productivity, and lower costs.
3 We believe that the New Duke Energy will provide value to customers,
4 shareholders and all of our stakeholders, and we are committed to making the
5 combined company a success.


6 **Q. DOES THIS CONCLUDE YOUR PREPARED DIRECT TESTIMONY?**

7 **A. Yes.**

VERIFICATION

State of North Carolina)
)
County of Mecklenburg) SS:

The undersigned, Paul M. Anderson, being duly sworn, deposes and says that he is Chairman of the Board and Chief Executive Officer of Duke Energy Corporation, that he has personal knowledge of the matters set forth in the foregoing testimony, and that the answers contained therein are true and correct to the best of his information, knowledge and belief.

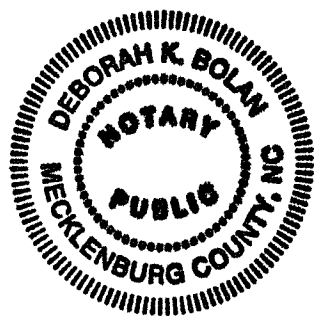


Paul M. Anderson, Affiant

Subscribed and sworn to before me by Paul M. Anderson on this 15th day of August, 2005.



NOTARY PUBLIC



My Commission Expires: 10-29-07