BEFORE THE ARIZONA CORPORATION COMMISSION

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Commissioner

IN THE MATTER OF THE REORGANIZATION	)	DOCKET NO. E-04230A-03-0933
OF UNISOURCE ENERGY CORPORATION	)	
	)	

SURREBUTTAL

TESTIMONY

OF

JOHN ANTONUK

PRESIDENT

THE LIBERTY CONSULTING GROUP

JUNE 11, 2004

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Mr. Antonuk's surrebuttal testimony discusses the commitments the Mr. Pignatelli's rebuttal testimony offers. Mr. Antonuk provides Staff's view that the applicants have satisfactorily addressed many, but not all of the issues raised in direct testimony. Mr. Antonuk lists those additional conditions that Staff believes are necessary to assuring that risks under the proposed acquisition do not constitute customer harm.

Mr. Antonuk further discusses the importance of utility equity levels, utility debt reduction, and protection from affiliates and affiliate lendors with respect to bankruptcy. Through his testimony, Staff proposes three specific, additional financial conditions designed to address these issues, noting that their adoption is necessary to provide adequate customer protection against harm under the new ownership structure. His testimony also notes that, even after Mr. Pignatelli's commitments on behalf of applicants, there remains a need for a condition requiring prior Commission approval of non-utility investments.

Mr. Antonuk's testimony also addresses Staff's continuing belief that the Commission should make provision for an outside audit of utility operations. There is not at present a sound basis for concluding that the applicants' commitments to minimum capital and O&M expenditures will prove sufficient as circumstances evolve in the future. His testimony also adds several specific clarifications and enhancements with respect to affiliate issues, including the need for filing a code of conduct, the adoption of a definition of what constitutes a utility affiliate that is appropriate for the ownership structure proposed here, and limitations on general and limited partnership changes in the absence of Commission approval. He repeats Staff's insistence that all waivers of affiliate interest requirements granted previously must independently justified by the applicants before they are extended to the post-acquisition period. His testimony also offers two narrow clarifications in the areas of board of director independence and community support.

Mr. Antonuk's testimony concludes by stating that adoption of the changes and conditions expressed in his testimony would persuade Staff that there has been adequate mitigation of risks under the acquisition as proposed. He observes, however, that the acquisition would not provide any discernible, immediate price, quality, or reliability of service benefits to customers. It would, however, provide immediate benefit to shareowners, in the form of a stock price premium.

Introduction

Q. Are you the same John Antonuk who filed direct testimony in these proceedings?

A. Yes.

Q. What is the purpose of this surrebuttal testimony?

A. The purpose of this testimony is to respond to the rebuttal testimony of Mr. Pignatelli.

Q. Can you summarize Staff's position as represented in your direct testimony?

A. Staff recommended that the Commission not approve the transaction as proposed. Staff believes that the applicants should be required to commit to certain conditions before the Commission considers approving the transaction. I discussed those conditions at length in my direct testimony.

Q. Did the Company subsequently propose any conditions?

A. Yes, Mr. Pignatelli discusses the applicants' proposed conditions in his rebuttal testimony. Those conditions address many of Staff's concerns substantially and sufficiently. There remain, however, several areas that require more commitment than what the applicants have so far offered.

Q. In what areas are additional commitments necessary and appropriate?

A. The most significant attention is required in the financial area. Mr. Pignatelli's testimony did propose conditions that would provide some of the types of protections addressed in Staff's direct testimony. The issues that remain to be addressed include assuring minimum equity levels for TEP, guaranteeing TEP debt reduction, and providing more substantial protection to TEP from the insolvency of Saguaro or UniSource.

Financial Issues

Q. What financial conditions did Staff's direct testimony address?

A. Staff's direct testimony discussed the following financial conditions:

1. Maintenance of minimum utility equity capital ratios
2. Attainment of targeted credit-strength improvements
3. Separate negotiation and structure of financings and financing arrangements for the utility operations
4. Full segregation of utility funds
5. No pledge of utility assets, financial support, or cash flow for other than utility benefit
6. Protection from bankruptcy and insolvency of affiliates
7. Prohibition on inter-company loans
8. Protection of Commission oversight, authority and reporting requirements regarding financial matters.

Q. Which of Staff's conditions did the Company address?

A. The Company's proposed conditions sufficiently address items 4, 5, 7, and 8.

Q. Did the Company offer specific conditions regarding minimum equity levels, credit-strength improvements, separately negotiated and structured financing, or bankruptcy protection?

A. Mr. Pignatelli's testimony did address them partially, but not fully. His testimony expresses the following commitments:

- At closing, UniSource Energy will make an equity contribution of up to $168 million, and repay the $95 million inter-company note from UniSource Energy to TEP. The utility would then use the cash infusion to reduce debt and improve its equity capitalization from approximately 25 percent to 40 percent, as calculated by the Commission's rate-case method.

- TEP, UNS Electric, and UNS Gas will not, without Commission approval, issue dividends that comprise more than 75 percent of its current year's earnings if its equity capitalization equals less than 40 percent of total capital.

- TEP will continue its policy to reduce outstanding debt and lease obligations. In addition to making scheduled payments for lease obligations and debt interest, TEP will continue to make an average of $30 million of annual voluntary debt and lease prepayments and buybacks between 2005 and 2008.

Q. What is Staff's concern about minimum equity levels for TEP?

A. We believe that adequate measures to mitigate the potential for equity reductions at TEP are very important. TEP needs to build its equity capital as a percentage of total capital from its current position and further from the position that will immediately follow the acquisition. Short-term improvement to TEP's equity capital and equity ratio is a positive feature of the proposal before the Commission in these proceedings. However, TEP's equity position needs not only to be built, but also to be maintained as it strengthens.

As proposed, the transaction does not contain protections against the diminution of utility subsidiary equity in the event that it is needed to support the finances or operations of other elements of the family of entities. The applicants have testified to plans and expectations that utility equity will remain at no less than the immediate post-acquisition levels. They have discussed debt-reduction efforts that should also cause the equity ratio to increase. Their testimony, however, stops short of assuring that equity will remain at minimum levels or that expected debt reductions and resulting equity ratio increases will necessarily take place.

Q. Is Staff aware of any valid concerns underlying the applicants' hesitance to agree to firm minimum equity levels?

A. Yes; we understand concerns about the potential for poorer than expected utility operating results on occasion (*i.e.*, an annual operating loss that would cause an equity reduction) and we understand that write-downs or write-offs (*e.g.*, a prudence disallowance or an accounting change) could reduce utility equity capital. A firm, minimum-equity ratio requirement would force an equity injection if events such as these would reduce the equity ratio to a level below the minimum requirement.

Q. Is Staff prepared to offer a proposal that would reasonably accommodate such concerns, while providing sufficient mitigation of the risk to utility equity levels?

A. Yes; those equity ratio levels should not be exposed to a significant risk of falling. Moreover, there should be reasonable assurances that they will rise in the future. It is this rise that will form the most important element of progress in improving utility credit strength to sounder levels. We would find acceptable a condition that does not force equity injections, provided that the utility is protected from all forms of equity distributions (*i.e.*, forms other than only dividends) to the parent or affiliate entities, and further provided that there is a clear and measurable requirement to continue reducing net debt levels over time. Therefore, we propose the following two conditions:

> *TEP will not make an equity capital distribution of any type (except for otherwise permitted distributions from earnings) in the event that TEP's equity capital, measured under the ACC rate-case method is or would fall below 40 percent of total TEP capital or the level achieved through compliance with the TEP debt-reduction condition, absent the prior approval of the Commission.*
>
> *Unless otherwise first approved by the Commission, TEP will make total net reductions in its long-term debt and capital lease debt of at least $500 million by the end of calendar year 2008. At least $300 million of the net*

> *reduction in long-term debt and capital-lease debt shall occur by the end of calendar year 2005. The required net reductions in TEP's long-term debt and capital lease debt shall be in addition to lease debt amortization included in currently scheduled capital-lease obligations.*

Q. How do these recommended conditions compare with applicant statements in these proceedings?

A. Commitments of this type are generally consistent with the testimony of the applicants. The first merely expands the "no dividend" condition already made by the applicants by precluding payments or equity distributions other than dividends. The second uses the debt-reduction projections made available in these proceedings by the applicants.

Q. What projections are those?

A. We reviewed a January 2004 presentation by TEP to potential lenders. The presentation included forecasts of expected debt reduction for TEP through 2008. The forecasted debt reductions included repayment of first mortgage debt in 2004 and 2008, investments in lease debt, and scheduled mandatory lease-debt amortization. The Company indicated that it would pay off TEP debt of about $263 million in conjunction with the acquisition transaction and that it expected to pay off additional TEP first mortgage bonds of roughly $138 million by 2008. The Company also noted an average of $30 million in annual voluntary lease debt buybacks between 2005 and 2007.

Establishing a condition requiring a minimum total net reduction in TEP long-term debt and capital-lease debt of $500 million by year-end 2008 is appropriate. The first $300 million should occur by the end of 2005. It would be composed of the $263 million debt reduction at closing ($168 million in debt reduction and $95 million in note repayment) and the first year reduction of $30 million in lease debt. The balance of $200 million by the end of 2008 would consist of the $138 million reduction in TEP bonds and $60 million in other debt and lease prepayments.

Q. Was such a condition discussed in Staff's direct testimony?

A. No; that testimony focused on firm, minimum-equity requirements and on credit-strength improvements (*i.e.* the first two of the eight financial areas listed earlier in this testimony). We propose this alternative now as a means for addressing the reluctance of the applicants to agree to the kinds of conditions discussed in the direct testimony. We believe that the approach set forth here will mitigate the risks that this acquisition presents, while addressing the concerns of the applicants. Should the Commission impose these proposed conditions, then we would conclude that the first two of the eight areas of concern listed in Staff's direct testimony have been met as well.

Q. Does Staff believe the Company's proposed conditions fully addressed concerns about protection of the utilities from bankruptcy or insolvency of Saguaro or UniSource Energy?

A. This area was the sixth of those eight numbered financial issues. Mr. Pignatelli's testimony addresses the bankruptcy issue, but only partially. First, he proposes to amend organizational documents to create separateness that would bar the utility from entering into any guarantee, pledging assets, or holding out its credit on behalf of an affiliate. These proposals also address item 5 above, and do so in a manner that we consider sufficient to meet the issues raised under item 5. They will also in some measure address concerns about bankruptcy at the parent level.

Mr. Pignatelli's rebuttal testimony also commits to a condition stating that the utilities will not file for bankruptcy protection without the vote of a designated independent director. This language does not address what would happen to the utilities in the event of a bankruptcy of Saguaro or UniSource, nor does it discuss the potential actions of their creditors.

We believe that more precise language is required to provide TEP and the other utilities bankruptcy protection from affiliates, the parent, and creditors of them. We propose the following bankruptcy condition to provide protection for the utilities from the holding company and LBO creditors. It is similar to a condition of the recent Texas-New Mexico Power transaction. The specific language that we propose is:

> *All Saguaro and UniSource debt will include separateness covenants, which will remain effective as long as TEP and UES are owned by Saguaro and UniSource, and which will state that: (a) Saguaro and UniSource, and separately TEP and its utility affiliate UES, are being operated as separate corporate and legal entities, and that lenders to Saguaro and UniSource, in agreeing to make loans, are relying and have relied solely on the creditworthiness of Saguaro and UniSource based on the assets and equity interests owned by those entities. The repayment of Saguaro and UniSource indebtedness will be made solely from the assets of Saguaro and UniSource and not from any assets or pledge of assets of TEP or UES. Saguaro, UniSource, and their respective lenders will not take any steps for the purpose of procuring the appointment of an administrative receiver or the making of an administrative order for instituting any bankruptcy, reorganization, insolvency, wind up or liquidation, or any like proceeding under applicable law which includes TEP or UES or any of the assets or liabilities of these utilities; and (b) Saguaro and UniSource agree that any future material indebtedness will comply with the foregoing restrictions.*

Q. If the Commission imposes the conditions regarding minimum equity levels, debt reduction, and protection from bankruptcy, does Staff believe that the proposed transaction will leave TEP, between now and 2008, in a position that does not create more substantial risks than would exist under current ownership and requirements?

A. Yes; the Company's analysis indicated that TEP would have $182 million less debt at the end of both 2004 and 2008 than it would in the absence of the acquisition. Therefore, debt reduction could be increased and accelerated in real terms, which would mitigate the risks of an ownership change like that proposed here. Our additional proposed conditions are designed to provide assurances that debt reductions will actually happen, and that they will cause an increase in the TEP equity ratio. They also will protect the utilities against potential financial problems from bankruptcy at higher corporate levels.

Q. The remaining item (the third) from the preceding numbered list of financial issues concerns separate negotiation and structuring of financial instruments. Are further commitments or actions required to address it?

A. No; we believe that the adoption of the three previous conditions detailed above will adequately address this issue.

Q. Does this testimony reflect a fundamental change in the Staff's position about targeting specific improvements in the credit strength of the utilities and their affiliates after the acquisition at issue here?

A. No; the question now, as it was when we filed the direct testimony, is how best to secure that improvement in a manner that:

- Is at least consistent with what might be expected under the status quo
- Will mitigate the ownership-change risks discussed in the direct testimony.

If the Commission were to order the ring-fencing conditions we have proposed, we believe the credit rating agencies over time would place more emphasis on the utilities' own, internal credit characteristics. The UniSource utility entities would gradually become significantly more attractive credit risks. Under those circumstances, it is reasonable to expect that this acquisition will not impede, but may well advance, steady improvement in utility credit strength.

Q. What is Staff's reaction to the Company's proposed condition to limit non-utility investments?

A. Mr. Pignatelli stated that Saguaro LP, Saguaro Holdings, and UniSource Energy would not, without prior Commission approval, make any new, material non-regulated, non-utility investments (other than investments in Millennium ventures) that are not part of the electric energy business or that are not reasonably related to business activities derived from the changes in the electric industry as a result of competition. This position is sound at the conceptual level, but requires more definition. Holding companies and utilities have entered into a wide variety of businesses as a reasonably direct result of increasing utility competitiveness. The applicants' proposed standard will create no bright, distinct line that this Commission can use to determine compliance.

We believe that all non-utility investments of material size should require Commission approval. We, therefore, recommend that this Commission impose a condition requiring prior approval of any material investment in any business, other than those required to provide utility service.

Reliability Issues

Q. What conditions did Mr. Pignatelli's rebuttal testimony offer in response to Staff's discussion of reliability assurances?

A. Staff's direct testimony recommended that the applicants agree to a management and operations audit that would begin within 18 months of closing. The purpose of such an audit would be to determine whether the Company has continued to make the capital and O&M expenditures necessary to provide safe, efficient, and reliable service.

Mr. Pignatelli's rebuttal testimony does not address that proposal, but does offer a commitment to spend for the years 2005 through 2008 a minimum aggregate amount of $1.5 billion in O&M expenses and capital expenditures for TEP, UNS Electric, and UNS Gas combined.

Q. Do the commitments offered by Mr. Pignatelli's respond fully to issues raised by Staff's direct testimony?

A. We are simply not in the position at this time to determine if $1.5 billion in capital and O&M over four future years for all three utilities will prove to be adequate. There are several reasons.

The first reason is that we have not had the time or the information needed to assess the overall reasonableness of projected capital and operations and maintenance expenditures. Neither have we had an opportunity to examine how those projections relate to past expenditures, or the equally important question of how well the utilities have been able to address the ultimate drivers of utility service reliability by making expenditures at those levels.

The second reason is that customer and usage growth appear to be major determinants of the adequacy of future expenditures in the utility serving areas at issue here. Relatively strong growth projections imply greater potential volatility or variability in future investment, operating, and maintenance needs. The resulting uncertainty makes it all the more difficult to determine in this year what it will take to keep service at adequate levels in future years. It is typical for utility planning and budgeting to balance system growth and system maintenance needs. Should the former prove more substantial (either broadly across the serving territories or even more narrowly in selected portions of them), today's estimates may prove to be poor indicators of future needs.

The third reason is that there have been rate freezes for a number of years. They will continue for a significant number more. Atypical expenditure patterns and discontinuities in spending levels give reason for concern in such situations. As a result, what a company has spent historically is not necessarily a good indicator of future requirements, even where future growth has a much less substantial influence than it may have here.

For these reasons, we are not in a position to say whether the $1.5 billion amount is enough for the 2005 to 2008 time period. Moreover, we believe that even the utilities and their managers are not in a position to give strong assurances that this is so, across so long a period. These are the same reasons that led us to conclude in the direct testimony that a focused management and performance audit offers the best mechanism to determine if O&M and capital activities and expenditures are appropriate when they are made and under the circumstances that exist at that time.

It should not be presumed that the Commission will eventually require such an audit, or that it will require the expenditure of the full amount that our direct testimony would require to be allotted. We expect that there will be continuing Commission observation of direct and indirect service-quality inputs (effort expended) and outputs (traditional reliability performance measurements). We would also encourage the utilities to engage in regular and substantial dialogue about what is being spent, what is being accomplished, and what variations are being observed in the sources and amounts of customer and usage growth, for example. Such observation and dialogue will bear on the continuing need for such an outside examination, and will help to assure that its scope and the resources required to complete any needed review are sufficient without being excessive.

The ability of this approach to respond to changes in external circumstances and to what is being observed about company performance should prove significantly more responsive to the observed need, when compared with pre-set spending floors.

Affiliate Issues

Q. What conditions did Staff's direct testimony discuss regarding affiliate relationships?

A. Staff believes that the applicants should agree to a sufficiently broad interpretation of the term "affiliate," which should include any companies in which the general and limited partners (or their related entities) have a substantial interest. UniSource should develop and submit for Commission approval an appropriate Code of Conduct and a Cost Allocation Manual governing the interactions of TEP, as well as UNS Gas and UNS Electric, with affiliates. The applicants should also provide justification for continuing any of the waivers to the Affiliated Interest Rules adopted in prior Commission orders, as well as for any additional waivers being sought.

Q. Did Mr. Pignatelli propose any conditions to address these issues?

A. The Company proposed to review its Cost Allocation Manual, and to include appropriate provisions to govern transactions and interactions between the utilities, on one hand, and UniSource Energy, Saguaro Holdings, Saguaro LP, any of Saguaro LP's partners, or any person controlled by any of Saguaro LP's partners, on the other hand. The Company agreed to submit the revised manual to the Commission Staff for review.

To address Staff's concerns regarding waivers to the Affiliated Interest Rules, the Company agreed that, to the extent that any condition to the Commission's approval of the merger differs from the terms of a prior waiver to the Affiliated Interest Rules obtained by UniSource Energy, the terms of the merger conditions would be controlling. The Company also stated that Saguaro Holdings and Saguaro LP would request from the Commission any new waivers to the rules they wish to obtain.

The Company also offered a condition related to customer privacy, stating that the utilities would not share certain customer-related information with UniSource Energy, Saguaro Holdings, Saguaro LP, any of Saguaro LP's partners, or any person controlled by any of Saguaro LP's partners.

Q. Did these proposed conditions address Staff's concerns regarding affiliate issues?

A. They addressed some but not all of them. There has been no mention of a revised Code of Conduct, which we still believe to be required and appropriate. In addition, Mr. Pignatelli's proposed condition regarding waivers to the Affiliated Interest Rules puts the burden on the Commission to counteract existing waivers, rather than placing the burden on the Company to justify them as appropriate in the new circumstances that the acquisition will produce. We believe that the applicants should continue to have the burden to demonstrate affirmatively why and how each prior waiver to be continued will satisfy the public interest under these new circumstances. There should be an opportunity for response after such a demonstration is made. The effect of this recommendation is to continue the general applicability of prior orders, except that no waivers will apply, except for those specifically approved by the Commission in this or in subsequent proceedings.

We also believe that there needs to be attention to the definition of the term "affiliate" for purposes of transaction control, monitoring, and reporting. Utility affiliates for these purposes should include more than just those entities that are "controlled" by the Saguaro limited partners. These limited partners are but specific funds of much larger entities. Control by those larger entities, not the funds themselves, is the more significant area of regulatory focus. Staff, therefore, believes that the definition of "affiliates" for these purposes should also include the higher-level entities that house or sponsor the funds that will serve as Saguaro's limited partners. It should also include those that these higher-level entities in turn control. These higher-level entities are J.P. Morgan Partners, LLC ("JPMP"), Kohlberg Kravis Roberts & Co., L.P. ("KKR") and Wachovia Capital Partners ("WCP").

<u>Governance, Oversight, and Community Presence Issues</u>

Q. What conditions did Staff propose in the areas of governance, oversight, and community presence?

A. Staff's recommendations were as follows:

- UniSource should retain a utility-level board with substantial outside membership

- The new owners should commit to keeping the headquarters in Tucson indefinitely, and seek Commission approval before moving them

- There should be no change in the general partner and no material change in the limited partnership interests without Commission approval

- New owners should provide full access to all records regardless of the affiliate creating or possessing them, to the extent related to matters directly and indirectly affecting utility operations, including, without limitation, documents related to costs, to financing, to strategic and operational plans, and to governance

- Applicants should make firm their commitments regarding community support.

Q. Did Mr. Pignatelli propose conditions to address Staff's concerns?

A. The Company addressed nearly all of Staff's concerns in these areas. Mr. Pignatelli's rebuttal testimony committed to separating the boards of directors of TEP, UES, UNS Electric, and UNS Gas, and to a board with a minimum of five persons. Two of them will be Arizona residents, and two will be independent of UniSource Energy, Saguaro Holdings, Saguaro LP, and any Saguaro LP partners. The Company agreed that it would not move its current utility headquarters from where they reside now, without prior Commission approval. The Company also stated that it would continue to maintain operating locations and field offices in Arizona as appropriate.

The Company agreed to provide full access to Sage Mountain, Saguaro LP, and Saguaro Holdings records on the same basis as it provides those of UniSource Energy and the utilities. The testimony addresses continuation of charitable and community support at a level equal to or greater than the amount spent in calendar year 2003. Mr. Pignatelli also states that the new owners, Saguaro LP, would not permit a change in the permanent general partner without prior Commission approval.

Q. In what areas did the Company not adequately address Staff's concerns?

A. The Company's proposed condition regarding changes in limited partners should be clarified and expanded. According to Mr. Pignatelli, Saguaro LP will not permit any ownership change among its limited partners without prior Commission approval, if such a change would result in any new limited partner's obtaining more than 10 percent of the economic interest in Saguaro LP. We interpret this commitment to mean that Commission approval is required for a new limited partner, but that existing limited partners may sell each other interests without approval, and that affiliates of them can acquire limited partner interests. We believe that all changes in limited partnership shares should require Commission approval, given the closer role that the owners will have here, as compared with the role of traditional owners of publicly traded utility companies.

Under the condition submitted by Mr. Pignatelli, it is not clear whether those owning or controlling the general partner could transfer their sell membership shares in Sage Mountain to others without Commission approval. Staff therefore recommends that there be a condition precluding a direct or indirect change in the general partner *or in the membership or ownership thereof* without prior Commission approval. The italicized language shows the difference from what Mr. Pignatelli's rebuttal testimony proposed.

We also have one other concern about the clarity of the commitments addressed in Mr. Pignatelli's rebuttal testimony. We read the intent of the director independence commitment to mean that a director will not qualify as independent unless such a director would be considered independent of:

- All UniSource entities
- Saguaro Holdings

- Saguaro LP
- The Saguaro LP general partner
- The Saguaro LP limited partners

If this understanding is correct, then we believe that Mr. Pignatelli's testimony fully addresses the issue of distinct boards, provided it is clear that there must also be independence from JPMP, KKR, and WCP and the entities that they control.

Finally, it should be made clear that the commitment to continued community support includes not only monetary contributions, but also continuation of non-cash resources made available at corporate direction and continuation of corporate support in promoting employee community involvement.

Recovery of Transaction and Holding-Company Costs

Q. Did Staff propose conditions regarding non-recoverability of merger and affiliated costs?

A. Yes; as discussed in the direct testimony, Staff believes that the new owners should agree not to seek recovery of partnership costs of the merger transaction or post-merger operations, or any portion of the acquisition premium or associated merger transaction costs from customers.

Q. Did the Company offer conditions in this area?

A. Yes. Mr. Pignatelli proposes two conditions that will preclude recovery of these costs in any future Arizona rate proceeding. We believe these conditions addressed our concerns in this area.

Customer Harm and Benefit

Q. Please summarize the effects that would result from the adoption of the conditions proposed by Mr. Pignatelli's rebuttal testimony as supplemented by what Staff has proposed in this testimony.

A. The effect would be mitigation of the risks that this proposed acquisition poses for the coming years, particularly 2005 through 2008. It is difficult to project effects beyond that time. This is so for two reasons. First, the rate proceedings expected to come around that time are likely to include a broad reconsideration of utility financial circumstances, needs, required public-interest protections, and other regulatory parameters. Second, the acquirers have given reason to expect important changes in their ownership, for example through a sale or refinancing of their interests. Predicting the "exit strategy" they will pursue, when precisely they will pursue it, or what this Commission's role and response might be are speculative.

This leaves the short run as the period on which we can focus meaningful attention. We see nothing in the proposal that will produce short-run, tangible benefits for customers in terms of rates or service. Even the financial risk mitigation our recommendations are designed to address takes on practical substance primarily as time passes.

Shareowners will capture a significant premium above market for their shares. We can discern no similar benefit to customers in terms of improved price, quality, or reliability of service in the immediate term. Moreover, it is not realistic at this time to project such improvements in the next 3-5 years.

At a minimum, the adoption of Staff's proposed conditions is necessary to mitigate increased risk for and potential harm to the companies' customers. Unless Staff's conditions and changes as set forth in this testimony are adopted, in addition to the conditions proposed by Mr. Pignatelli, Staff would oppose the transaction. Even if these conditions and changes are adopted, in the absence of comparable benefits to customers Staff, at best, would be neutral regarding approval of the transaction.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.