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Missouri Public Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

In the Matter of the Joint Application of UtiliCorp United Inc. and St. Joseph Light & Power Company for Authority to Merge St. Joseph Light & Power Company With And Into UtiliCorp United Inc. and, in Connection Therewith, Certain Other Related Transactions.	)))))))	Case No. EM-2000-292

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113

Table of Contents

I. INTRODUCTION

The Staff is making the unusual recommendation in this merger proceeding that the Commission reject the application for merger of UtiliCorp and SJLP, even with conditions, because of the rather unusual circumstances of this case. As explained later in the instant initial brief, the evidence presented by the Joint Applicants in regard to merger savings and costs shows a shortfall in merger savings compared to merger costs for the first ten years following the merger, when just a few adjustments were made by the Staff to incorporate more reasonable assumptions. (Oligschlaeger Rebuttal, Ex. 713, pp. 40-41). It should be emphasized that no portion of the acquisition adjustment was reflected in the Staff's analysis. If it had been, the results of the merger cost/benefit analysis would have been much more negative from a customer perspective. The Staff is not aware of any other proposed major merger in this jurisdiction where the merging companies did not project that merger savings would exceed merger costs, again excluding acquisition adjustments. (Traxler Rebuttal, Ex. 718, p. 7). The Staff's position is that utilities seeking to justify a merger should at least be able to demonstrate a reasonable expectation that merger savings will exceed non-acquisition premium merger costs, both calculated under reasonable assumptions, in order for the Commission to approve the merger. Otherwise, if the merger seems to be inherently uneconomic (i.e., merger costs exceeding merger savings), then the ability of the Commission to protect customers in future rate proceedings from merger related rate detriment is not certain, particularly since there is no reliable way for the Commission to accurately "track" actual levels of achieved merger savings in future rate proceedings. For this reason, the Staff believes that any conditions the Commission might order to try to protect the public from detriment cannot be assured of completely insulating the public from potential merger detriment. (Oligschlaeger Rebuttal, Ex. 713, p. 41).

In the event the Commission makes a determination that the merger should be approved, the Staff has proposed several conditions that it believes may serve to mitigate, but not eliminate, potential public detriment from this merger (Oligschlaeger Rebuttal, Ex. 713, pp. 42, 56-57). The most important condition is that the acquisition adjustment be declared as a below-the-line item in future rate cases. These conditions are discussed in various sections of this brief. More generally, however, if the Commission makes a decision to approve this proposed merger, the Staff would encourage the Commission to maintain its traditional position of reserving all ratemaking findings regarding merger savings and costs to future SJLP and MPS rate proceedings. (The Staff is recommending below-the-line treatment in this case for the acquisition adjustment based upon its belief that the acquisition adjustment constitutes a detriment to the public interest, which needs to be addressed before any merger approval is granted. (Oligschlaeger Rebuttal, Ex. 713, pp. 20-21). The Staff urges the Commission to under no circumstances grant UtiliCorp the upfront ratemaking findings it is seeking through adoption of its regulatory plan. (Oligschlaeger Rebuttal, Ex. 713, pp. 43-45).

In the event the Commission desires to fashion an overall "regulatory plan" for all or part of UtiliCorp's Missouri utility operations respecting the proposed merger of SJLP and UtiliCorp, the Staff would direct the Commission to specific portions of the testimony of Mr. John W. McKinney and Mr. Mark L Oligschlaeger at the hearings in the instant case:

> [Mr. Swearengen]: I think when Mr. Dottheim crossed you earlier, he was asking you about the Western Resources/KCPL merger settlement agreement. And you mentioned in response to one of his questions that at a meeting you had the Staff said the Western Resources/KCPL merger stipulation would need to be the basis of any settlement of this merger case. Do you recall that?
>
> [Mr. McKinney]: That's basically the understanding that I came out of the meeting with. That's -- that's what they believed would take to settle this case, is for us to agree to the terms of that settlement.

> Q: And that was prior to the time the joint application which started this case was filed; is that correct?
>
> A: That's correct.

(Vol. 4, Tr. 478-79).

. . . .

> [Mr. Swearengen]: Mr. Oligschlaeger, if Mr. [sic] UtiliCorp and St. Joe had come in with a proposal consistent with the Western/KCP&L merger stipulation that Mr. Dottheim talked about yesterday, would the Staff have supported this merger?
>
> [Mr. Oligschlaeger]: Probably not, because our examination of the merger costs and the merger savings seemed to indicate a shortfall in the amount of net merger savings to be expected from this transaction, and that was not a finding that we made with the Western/KCP&L transaction.

(Vol. 6, Tr. 563-64).

The only provision of the Western Resources – KCPL Stipulation And Agreement that SJLP – UtiliCorp finds acceptable is one of the two rate moratorium provisions in that Stipulation And Agreement. The language that the Joint Applicants utilize (See McKinney Direct, Ex. 4, pp. 7-8) to address their proposed five-year rate moratorium, which they assert is based on the language in the Stipulation And Agreement in Case No. EM-97-515, the merger case of Western Resources, Inc. (Western Resources) and Kansas City Power & Light Company (KCPL), is not a complete reflection of the language in said Stipulation And Agreement, which was filed on July 19, 1999 and was approved by the Commission on September 2, 1999. Missing from the Joint Applicants' proposed language that "[t]he Staff of the Commission will not encourage or assist in the filing of any case with the Commission requesting a decrease in SJLP's (electric, gas or steam) retail rates or a rate credit or rate refund during the moratorium" (See McKinney Direct, Ex. 4, p. 8), which is reflective of language in "Section 11. Rate Case Moratorium," page 7 of the Case No. ER-97-515 Stipulation And Agreement (Attachment A to the Commission's September 2, 1999 Report And Order) is the following language in "Section 18. The Commission's Rights," page 20 of the Case No. ER-97-515 Stipulation And Agreement:

> Acceptance of this Stipulation and Agreement by the Commission shall not be deemed as constituting an agreement on the part of the Commission to forego, during the above identified periods, the use of any discovery, investigative or other power which the Commission presently has. For example, nonsignatories to this Stipulation and Agreement may file or request, or encourage or assist in any filing of a request for, an earnings investigation of Westar and, in response or on its motion, the Commission may direct the Staff to conduct an earnings investigation of Westar. Thus, nothing in this Stipulation and Agreement is intended to impinge or restrict in any manner the exercise by the Commission of any statutory right, including the right of access to information, or any statutory obligation. Nothing in this Stipulation and Agreement is intended to impinge, restrict or limit in any way Public Counsel's discovery powers, including the right to access information and to audit and investigate matters related to Westar or its successors.

(Vol. 4, Tr. 425-26; Emphasis added). The above language made clear that the Commission could direct the Staff to conduct an earnings investigation during the course of the moratorium period and could order a rate reduction during the course of the moratorium period if a nonsignatory to the Stipulation And Agreement filed or requested an earnings investigation of Westar.

"Section 18. The Commission's Rights" in the Case No EM-97-515 Stipulation And Agreement is not acceptable to SJLP – UtiliCorp. Mr. McKinney testified that although SJLP – UtiliCorp is not seeking to restrict the Commission or the Office of the Public Counsel, SJLP – UtiliCorp is seeking to restrict the Staff. In response it could be argued that by the manner in which SJLP – UtiliCorp is seeking to restrict the Staff, it is indeed seeking to restrict the Commission.

Mr. McKinney testified as follows in the instant proceeding:

> {Mr. McKinney]: I think my testimony in my direct on page 8 that we were at earlier addresses that point, if I could. Where -- in my testimony where I talk about this area, the only restriction that I do have there is a restriction on the Staff of the Commission will not encourage or assist in the filing of any case with a -- with the Commission requesting a decrease in St. Joe's rates. And that is the only limitation that I've put on in my testimony.

(Vol. 4, Tr. 426).

. . . . .

> [Chair Lumpe]: Go back to page 8 where you were asked a question, and I think your response was that you were only recommending that the Staff not be allowed to assist in filing any rate case. <u>Would that prohibit the Commission from asking the Staff to do an earnings investigation?</u>
>
> [Mr. McKinney]: <u>Yes. That's basically what is intended.</u> We've asked in this that the Commission and the Commission's Staff go with the moratorium. We realize that under statutes and regulation in this state that's the limit that we could ask you to do by law. We can't ask you to bind anybody that's not a party. But we can ask you not to entertain an earnings investigation on the company during the five-year period.
>
> Q. So you would be prohibiting the Commission from doing that; is that correct?
>
> A. Yes.

(Vol. 4, Tr. 435-36; Emphasis added).

. . . .

> [Commissioner Schemenauer]: The five-year moratorium would prevent the Commission from looking at a rate case during that five-year period? I mean, it would tie the Commission's hands?
>
> [Mr. McKinney]: It depended on who executed that case. If the Office of Public counsel did, no, it does not tie your hands. Or if a group of citizens -- counsel will have to help here -- 20, 25, I'm not sure what the number is. If they would bring a document in, a complaint or whatever and did the investigation of a payer case, you, of course, could hear that. You would have to under state statute.

Q. But if OPC brought a case in, would the Commission Staff be prevented as a result of this agreement from giving any testimony or looking at the company?

A. We've asked that be in part of the plan, that the Staff would not take part, yes.

Q. So it, in fact, would cripple anybody that would file a rate case?

A. Not necessarily. The OPC did it in 1987 to our company. In 1986 we reached a moratorium with the Staff and the Commission for a moratorium on lower rates. OPC was not part of that. Twelve months later OPC came in with a case and we ended up with another rate reduction the very next year.

(Vol. 4, Tr. 458-59).

. . . .

[Mr. Swearengen]: And I think I heard you say in response to a question from Chair Lumpe that -- on the one hand you said that all you were seeking was to prohibit the Staff from being involved in any proceedings seeking to reduce UtiliCorp's rates during the five-year period. And then later I thought I heard you say that the Commission could not entertain a complaint from anyone else.

[Mr. McKinney]: No. I'm sorry if I left that confusion. I believe --- and, again, I'm not a lawyer, but I think the Staff feels they need to go to the Commission, get the Commission's approval to go out and do a complaint case. And recently that's been my understanding.

What we're asking is the Staff not to engage in that activity during the five-year period. If the Office of the Public Counsel brings one in or a group of citizens brings one in, of course the Commission could hear that.

(Vol. 4, Tr. 479; Emphasis added).

. . . .

[Chair Lumpe]: The question about the prohibition on the Commission. Yes, indeed if Public Counsel were to bring the case or one of these entities that we just read, but as I understood you to say, it would prohibit the Commission from asking the Staff. And you still stand by that?

[Mr. McKinney]: Yes.

> Q. We would not be able to ask the Staff?
>
> A. That's what we're asking. That you not go out on your own motion and do it. Now, I -- looking at the forecast as everybody has in this case of St. Joe, I don't believe that's going to be a big concern, because there are rate cases pending during this five year period and I don't believe there's going to be any earnings investigation anyway.

(Vol. 4, Tr. 481-82).

The "Section 18. The Commission's Rights" language does not only appear in the Stipulation And Agreement filed on July 19, 1999 in Case No. EM-97-515 and approved by the Commission on September 2, 1999. Similar language appears in Paragraph 4 of the Stipulation And Agreement filed on January 26, 1999 in Case No. ER-99-313, In the Matter of the Stipulation and Agreement Reducing the Annual Missouri Retail Electric Revenues of Kansas City Power & Light Company, which the Commission approved in an April 13, 1999 Order Denying Intervention And Approving Stipulation And Agreement. The Commission's April 13, 1999 Order relates at page 2 that moratoriums on (1) the filing date of and (2) the effective date of rate increase and decrease cases by the signatories, the Staff, the Public Counsel and KCPL, were agreed to by the signatories. Nonetheless, Paragraph 4 of the Case No. ER-99-313 Stipulation And Agreement makes clear that the Commission may direct the Staff to conduct an earnings investigation during the course of the moratorium period and may order a rate reduction during the course of the moratorium period if a nonsignatory to the Stipulation And Agreement files or requests an earnings investigation of KCPL:

> Acceptance of this Stipulation And Agreement by the Commission shall not be deemed as constituting an agreement on the part of the Commission to forego, during the above identified periods, the use of any discovery, investigative or other power which the Commission presently has. For example, non-signatories to this Stipulation And Agreement may file or request, or encourage or assist in any filing of or request for, an earnings investigation of KCPL, and, in response or on its own motion, the Commission may direct the Staff to conduct an earnings investigation of KCPL. Thus, nothing in this Stipulation And Agreement is

> intended to impinge or restrict in any manner the exercise by the Commission of any statutory right, including the right of access to information, or any statutory obligation. Nothing in this Stipulation And Agreement is intended to impinge, restrict or limit in any way Public Counsel's discovery powers, including the right to access information and to audit and investigate matters related to KCPL or its successors.

The Commission's Order Denying Intervention And Approving Stipulation And Agreement in Case No. ER-99-313 is on review in the Circuit Court of Cole County on the basis of a Petition For Writ Of Review filed by GST Technologies Operating Company, Inc., d/b/a GST Steel Company (GST) (State ex rel. GST Technologies Operating Company, Inc., d/b/a GST Steel Company v. Public Serv. Cmm'n, Case No. 00CV323303, Div. II, Circuit Court of Cole County, Missouri). Some of the concerns expressed by GST in Case No. ER-99-313 appear related to the concerns that the Commissioners expressed in their questions to Mr. McKinney at the hearing in the instant proceeding regarding the moratorium facet of the Joint Applicants' regulatory plan. GST's concerns were summarized by the Commission in the Commission's April 13, 1999 Order Denying Intervention And Approving Stipulation And Agreement, at pages 8 and 12 as excerpted, respectively, below:

> . . . GST stated that the restrictions included in the Stipulation and Agreement limit the ability of Staff and the Public Counsel to participate in matters involving the rates not only of those retail customers that receive rate reductions as a result of the Stipulation and Agreement but also in matters relating to retail customers excluded from receiving the benefit of the Stipulation and Agreement, such as GST. It is this limitation that GST stated is unfair, unreasonably discriminatory and contrary to law. GST stated that the Stipulation and Agreement will preclude Staff and Public Counsel from taking any steps on their own to ensure the customers not covered by the Stipulation and Agreement continue to pay just and reasonable rates for electric service and that Staff and Public Counsel will not be able to offer assistance to these excluded customers. GST stated that it appears from its reading of the Stipulation and Agreement that Staff and Public Counsel will be prohibited from participating in any audit of KCPL that GST might undertake pursuant to its rights under its contract with KCPL. Therefore, GST requests that the Commission order Staff, Public Counsel and KCPL to revise their Stipulation and Agreement to clarify that retail electric customers of KCPL that are specifically excluded from the Stipulation and Agreement shall not have

their rights to participate before the Commission impinged in any way and that the Staff and Public Counsel shall be free to join with and/or assist those customers which are excluded as they see fit, in accordance with the law.

. . . .

The Commission finds that the Stipulation and Agreement filed by the signatory parties is reasonable. The Commission finds that the Stipulation and Agreement should be applied to the signatory parties but in no way restricts any non-signatory parties. Further, Staff and Public Counsel are not restricted from assisting or participating in actions which are raised by nonsignatory parties except for those that are strictly and narrowly specified in the Stipulation and Agreement.

The concerns raised by GST in Case No. ER-99-313 have been raised on more than one occasion previously. The Commission most recently addressed this matter in Case No. GC-97-497, Office of the Public Counsel, Complainant v. Missouri Gas Energy, a Division of Southern Union Company, a Delaware Corporation, Respondent, where the Public Counsel on May 13, 1997 filed a Complaint alleging that Missouri Gas Energy (MGE) unlawfully billed certain residential, small general service, and large general service customers during the months of November 1996 through February 1997, and sent residential customers bills for an unauthorized billing period.

On July 24, 1997, the parties including MGE, the Staff and Public Counsel filed a Unanimous Stipulation And Agreement settling all issues specified in Public Counsel's Complaint. A general provision appeared in the Stipulation And Agreement stating as follows:

"F. Neither the Office of the Public Counsel, the Commission Staff nor the Commission shall initiate, entertain, support, or otherwise assist in complaints or petitions seeking penalties against or damages from MGE, either before the Public Service Commission, the Courts or any body, regarding billing or meter reading issues arising, or that may arise, out of facts, events and circumstances occurring prior to August 1, 1997, except as required by the Sunshine Law (Chapter 610[2])."

[2] All statutory references are to the Revised Statutes of Missouri 1994 unless otherwise indicated.

On August 27, 1997, the Commission issued an Order Rejecting Stipulation And Agreement stating therein, in part, as follows:

> The Commission takes issue with the following sections contained in the instant Stipulation and Agreement:
>
> 1. The attempt to preclude the Commission's involvement in any complaints extending from MGE's purchase of Western Resources from 1993 to August 1, 1997;
>
> . . . .
>
> The Commission cannot agree to relinquish its statutory duties as proposed by the parties. The Commission is essentially a creation of the Legislature and, as such, is empowered by statute to carry out certain functions. Among the various statutory responsibilities incumbent on the Commission to perform are the setting of rates (Section 393.150, RSMo, the provision of safe and adequate service (Section 393.130, RSMo), the proper litigation of complaints (Section 386.400 RSMo), and other general powers (Section 393.150). The Commission cannot proceed in a manner contrary to the terms of a statute and may not follow a practice which results in nullifying the express will of the Legislature[3].
>
> It is plain from the language of the agreement and from the evidentiary hearing that the parties desire the Commission to waive all responsibility prior to the August 1, 1997 date for the proper hearing of complaints as well as the investigation of other service-related and rate-related matters. This the Commission cannot do. It is the expectation of the Legislature that the Commission will carry out its statutory responsibilities. For the Commission to abrogate those responsibilities would not be in the public interest.
>
> [3] State ex rel. Philipp Transit Lines, Inc. v. Public Service Commission, 523 S.W.2d 353 (Mo. App. 1975); State ex rel. Springfield Warehouse and Transfer Co. v. Public Service Commission, 225 S.W.2d 792 (Mo. App. 1950).

There is another less recent case of relevance to the question of the lawfulness of the regulatory plan proposed by the Joint Applicants. There was a legal challenge to the alternative regulation plan which the Commission offered Southwestern Bell Telephone Company (SWBT) in a 1993 earnings complaint case filed by the Staff. The Missouri Cable Television Association contended that the circuit court erred in finding that the Commission had authority to regulate SWBT under an alternative regulation plan, which included a rate increase case and rate decrease case moratorium, in finding that the question of lawfulness of the alternative regulation plan was moot because SWBT had rejected the offer. The Western District Court of Appeals agreed with the Commission that the legal challenge to the alternative regulation plan was rendered moot by SWBT's rejection of the alternative regulation plan proposed by the Commission. See State ex rel. Missouri Cable Television Assoc. v. Public Serv. Cmm'n, 917 S.W.2d 650, 652 (1996).

The Staff would note that the Commission found acceptable the Stipulation And Agreement in the Western Resources, Inc. (Western Resources) – Kansas City Power & Light Company (KCPL) merger, in Case No. EM-97-515, and as Mr. McKinney indicated, at one point prior to the Staff's investigation of the Joint Application of SJLP and UtiliCorp, the Staff viewed the terms of the Case No. EM-97-515 Stipulation And Agreement as potentially a reasonable resolution of the not yet filed request for Commission authorization to merge of SJLP and UtiliCorp. In the instant proceeding, some of the conditions agreed to by Western Resources – KCPL are conditions that the Staff has proposed if the Commission desires to approve the proposed merger and mitigate detriments identified by the Staff and other parties. In particular, due to different facts, not all of the provisions in the Case No. EM-97-515 Western Resources – KCPL Stipulation And Agreement are necessarily relevant to the SJLP – UtiliCorp merger. Nonetheless, the Commission may want to consider the various provisions in that Stipulation And Agreement. The Staff would reiterate that it is not affirmatively recommending that the terms of the Western Resources – KCPL Stipulation And Agreement be applied to the instant merger application because of concerns regarding the level of merger savings and costs estimated by the Joint Applicants in this case (Vol. 6, Tr. 564). The Staff is only referencing the prior Stipulation And Agreement in the event the Commission is looking for guidance as to how it might proceed in fashioning a regulatory plan for SJLP – UtiliCorp.

II. BURDEN OF PROOF AND LEGAL STANDARD SECTIONS

A. Burden Of Proof

1. Statute And Case Law: Burden Of Proof Is On The Joint Applicants

The Staff believes that there should be no dispute that the burden of proof, both production and persuasion, is on the Joint Applicants, the moving parties, in this proceeding. The case law identified in the section below indicates that this is the situation, and the Staff will further show in this section that this is the case.

The only reference to burden of proof in Chapter 386 is in Section 386.430 RSMo 1994, which states that in all proceedings arising under the provisions of the Public Service Commission Law or growing out of the exercise of the authority and powers granted therein to the Commission, the burden of proof is on any party adverse to the Commission or seeking to set aside any determination, requirement, direction or order of the Commission.

The only reference to burden of proof in Chapter 393 is in Section 393.150.2 RSMo 1994 which states that at any hearing involving a rate sought to be increased, the burden of proof to show that the proposed increased rate is just and reasonable is upon the public utility. The Commission's rules indicate that in other instances the burden of proof is also on the moving party. 4 CSR 240-2.110(5)(A) states, in part, that in all proceedings, except investigation proceedings, the applicant or complainant shall open and close. Thus, the party with the burden of proof has the right to open and close at hearing.

Black's Law Dictionary 196 (6^{th} ed. 1990) defines "burden of proof" as comprising two different concepts:

> In the law of evidence, the necessity or duty of affirmatively proving a fact or facts in dispute on an issue raised between the parties in a cause. The obligation of a party to establish by evidence a requisite degree of belief concerning a fact in the mind of the trier of fact or the court.
>
> Burden of proof is a term which describes two different concepts; first, the "burden of persuasion", which under traditional view never shifts from one party to the other at any stage of the proceeding, and second, the "burden of going forward with the evidence", which may shift back and forth between the parties as the trial progresses. Ambrose v. Wheatley, D.C.Del., 321 F.Supp. 1220, 1222.

It may be argued that the party having the burden of proof must initially meet its burden of producing evidence sufficient to establish a prima facie case. McCloskey v. Kopler, 46 S.W.2d 557, 563 (Mo.banc 1932); Drysdale v. Estate of Drysdale, 689 S.W.2d 67, 72 (Mo. App. 1985). It further may be argued that once a prima facie case has been established the burden of going forward with the evidence shifts to the adverse party. Nonetheless, even if the burden of going of forward with the evidence shifts, the burden of proof does not shift, absent a statutory provision to the contrary. Also, prima facie evidence does not require a verdict for the party whose contention it supports. Dehner v. City of St. Louis, 688 S.W.2d 15, 18 (Mo. App. 1985).[1]

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[1] A proper understanding of a party's proof obligations at least under Section 393.150 recognizes that the mere presentation by a utility of costs incurred does not constitute a prima facie showing of the reasonableness of the utility's claimed costs so as to shift the burden of proof to the party challenging the utility's proposed rates. As the Utah Supreme Court stated in Utah Dept. of Business Regulation v. Public Serv. Cmm'n, 614 P.2d 1242, 1245-46 (Utah 1980):

> In the regulation of public utilities by governmental authority, a fundamental principle is: the burden rests heavily upon a utility to prove it is entitled to rate relief and not upon the commission, the commission staff, or any interested party or protestant to prove the contrary. A utility has the burden of proof to demonstrate its proposed increase in rates and charges in just and reasonable. The company must support its application by way of substantial evidence, and the mere filing of schedules and testimony in support of a rate increase is insufficient to sustain the burden.

(Emphasis added).

Regardless of any asserted applicability of the above cases to the Commission, case law in Missouri is clear that where the facts relating to an issue are peculiarly within the control or knowledge of one party, the burden of production falls on that party. Possibly, the clearest statement of the law appears in Robinson v. Benefit Ass'n of Ry. Employees, 183 S.W.2d 407, 412 (Mo. App.1944):

> ". . . The general rule is well put by our Brother Graves in Swinhart v. Railroad, 207 Mo. loc. cit. [423] 434, 105 S.W. [1043], as follows: 'From them all,' said he (referring to the authorities in review) 'it is deduced that generally the burden is upon the plaintiff to make out his case. That if in the statement of his case negative averments are required, and the proof of such negative averments is not peculiarly within the knowledge and power of the defendant, then plaintiff must affirmatively establish such negative averments, but if, on the other hand, the

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(Footnote continued)

In Petition of Publ. Serv. Coordinated Transp., 5 N.J. 196, 74 A.2d 580, 591-92 (N.J. 1950), the New Jersey Supreme Court interpreted a statute containing language substantially identical to Section 393.150:

> Neither this Court nor the Board (of Public Utility Commissioners) can accept the books of account of a public utility at face value in a rate case in which reasonableness is always the primary issue . . .
>
> [The Board] was under a duty to go behind the figures shown by the companies' books and get at realities . . .
>
> It must be emphasized that ratemaking is not an adversary proceeding in which the applying party needs only to present a prima facie case in order to be entitled to relief. There must be proof in the record not only as to the amount of the various accounts but also sufficient evidence from which the reasonableness of the accounts can be determined. Indeed, R.S. 48:2-21 (d), N.J.S.A. specifically provides that "the burden of proof to show that the increase, change or alteration (in rates) is just and reasonable shall be upon the public utility making the same." Lacking such evidence, any *determination of rates must be considered arbitrary and unreasonable.*

(Emphasis added; Accord Florida Power Corp. v. Cresse, 413 So.2d 1187, 1190 (Fla. 1982)).

In a merger application before the Federal Energy Regulatory Commission (FERC), the applicant is required to fully disclose all material facts and to carry the burden of showing affirmatively that the merger is consistent with the public interest. Kansas City Power & Light Co., 53 FERC Para. 61,077 (1990); See Pacific Power & Light Co. v. FPC, 111 F.2d 1014, 1017 (9th Circ. 1940); See also Utah Power & Light Co., 41 FERC Para. 62,283 at 61,752 (1987).

> proof of such negative averments lies peculiarly within the knowledge or power of the defendant, then such negative averments will be taken as true unless the defendant speaks and disproves them. Of course, if the knowledge and power to produce the evidence is possessed equally, the plaintiff must make the proof.'"

Cf. Kenton v. Massman Construction Co., 164 S.W.2d 349, 352 (Mo. 1942)("A plaintiff asserting a negative generally has the burden of proof as to such matter along with the other issues on which he bases his case. But there appears to be an exception to this rule where the evidence on such a matter is peculiarly within the knowledge and control of the defendant."); Dwyer v. Busch Properties, Inc., 624 S.W.2d 848, 851 (Mo.banc 1982). This is a particularly appropriate rule in utility cases, since generally all of the facts and documents relevant to the issues are peculiarly within the utility's control. See City of Eldorado v. Public Serv. Cmm'n. 362 S.W.2d 680, 683-84 (Ark. 1962).

B. Merger Legal Standard

1. UtiliCorp And SJLP Must Show That The Transactions Are Not Detrimental To The Public Interest

The language of Section 393.190.1 states, in relevant part, as follows:

> No . . . electrical corporation . . . shall hereafter sell, assign, lease, transfer, mortgage or otherwise dispose of . . . the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public . . . without having first secured from the commission an order authorizing it so to do. Every such sale, assignment, lease, transfer, mortgage, disposition, encumbrance, merger or consolidation made other than in accordance with the order of the commission authorizing same shall be void....

The language of 4 CSR 240-2.060(7) states, in relevant part, as follows:

> In addition to the requirements of section (1), applicants for authority to sell, assign, lease or transfer assets shall include:
>
> . . . .
>
> (D) The reasons the proposed sale of the assets is not detrimental to the public interest:

No statutory or other standard appears in either Section 393.190 or 4 CSR 240-2.060 for determining whether a public utility's request for authorization to sell, assign, lease, transfer, mortgage or otherwise dispose of the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public should be granted by the Commission. The standard was determined by the Missouri Supreme Court in State ex rel. City of St. Louis v. Public Serv. Cmm'n, 73 S.W.2d 393 (Mo.banc 1934) which was the judicial review of a Commission Report And Order granting the Application of a foreign corporation, not licensed to do business in Missouri, to acquire and hold more than 10% of the stock of two Missouri utilities. In the underlying Commission case, Re Utilities Power & Light Corp., Case Nos. 6722 and 6723, 18 Mo.P.S.C. 1 (1930), Utilities Power & Light Corporation claimed that the requested transfer of stock to it from an intermediary holding company would simplify its corporate structure, result in tax savings, and have no effect on rates, service, or operations. 18 Mo.P.S.C. 3. The Commission held that the proposed transactions involving the mere transferring from an intermediary holding company to the parent holding company of more than 10% of the total capital stock of two Missouri public utility corporations could have "no detrimental effect upon the public interest." Id. at 4.

To determine the meaning of the applicable section in the Public Service Commission Law, the Court looked to the purpose of the Public Service Commission Act and stated:

> . . . The whole purpose of the act is to protect the public. The public served by the utility is interested in the service rendered by the utility and the price charged therefore; investing public is interested in the value and stability of the securities issued by the utility. (Citation omitted) . . .

73 S.W.2d at 399.

The Court stated that "[t]he owners of this stock [sought to be acquired] should have something to say as to whether they can sell it or not"; [t]o deny them that right would be to deny them an incident important to ownership of property"; and in such a situation "[a] property owner should be allowed to sell his property unless it would be detrimental to the public." 73 S.W.2d at 400. The Court noted that the state of Maryland has a statute "identical" to the Missouri statute and that the Maryland Supreme Court had determined "not detrimental to the public" to be the appropriate standard:

> The state of Maryland has an identical statute with ours, and the Supreme Court of that state in the case of Electric Public Utilities Co. v. Public Service Commission, 154 Md. 445, 140 A. 840, loc. cit. 844, said: "To prevent injury to the public good in the clashing of private interest with the public good in the operation of public utilities, is one of the most important functions of Public Service Commissions. It is not their province to insist that the public shall be benefited, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public detriment. 'In the public interest,' in such cases, can reasonably mean no more than 'not detrimental to the public'".

Re UtiliCorp United Inc., Case No. EM-91-290, Report And Order (1991) is a merger case of some relevance to the instant proceedings. Case No. EM-91-290 arose from the Application of UtiliCorp United Inc. and Colorado Transfer Company (CTC), a subsidiary of Centel Corporation engaged in generating, transmitting and distributing electricity in Kansas and Colorado, requesting authority for UtiliCorp to merge CTC with and into UtiliCorp. The Commission's September 13, 1991 Order Approving Merger states, in part, at page 2 that the Staff examined the acquisition price and concluded that it was reasonable based on the minimal premium paid as compared to the average market to book value ratio for electric utilities." "Ordered" item "6." on pages 4-5 of the Order Approving Merger states that no ratemaking determinations are being made in the context of Case No. EM-91-290 and the Commission reserves the right to consider the ratemaking treatment to be afforded these transactions in a later proceeding.

The Commission's Order Approving Merger at pages 2-4 also notes the Staff's oft-raised concerns about the dollar consequences for MPS of UtiliCorp's merger and acquisition activities, UtiliCorp's assurances that Missouri ratepayers would suffer no detriment from such activities and the Staff's recommendation that a showing of no detriment to Missouri ratepayers be based on a state-specific jurisdictional analysis:

> Staff has indicated that it believes UtiliCorp's merger with CTC will, in and of itself, have minimal impact on MPS' Missouri jurisdictional operations. However, Staff has also expressed concerns about UtiliCorp's merger and acquisition activities and their impact on Missouri ratepayers. Although UtiliCorp has assured the Commission in the past that Missouri ratepayers would suffer no detriment from its merger activities (See: *Re: Missouri Public Service Company,* Case No. ER-90-101, Report and Order, October 5, 1990, p. 46), it has produced no documentation to date concerning the effect on Missouri jurisdictional operations of its merger activities, including the proposed acquisition in question in this case.
>
> Because of its concerns, Staff has recommended that the Commission put UtiliCorp on notice that future approval of acquisitions will be subject to a showing of no detriment to Missouri ratepayers based on a state-specific jurisdictional analysis. Staff has also recommended that future merger applications be subject to the following conditions:
>
> a. All documentation generated relative to the analysis of the merger and acquisition in question must be maintained.
>
> b. The Company must present an estimate of the impact of the merger on its Missouri jurisdictional operations.
>
> c. The Company must provide an assessment of the relative risk regarding items that impact its Missouri operations.
>
> d. The Company must propose assurances or conditions that will address the overall merger components that pose the risk of being detrimental to the Missouri public interest.
>
> Staff has further recommended that the Commission reserve ruling on the question of ratemaking treatment.
>
> . . . .

> Nonetheless, the Commission is of the opinion that future decisions on acquisitions should be based on a Missouri jurisdictional analysis as such an analysis is needed to fully evaluate the possible impact on Missouri ratepayers. The Commission finds that the conditions proposed by Staff are reasonable and should be adopted.

"Ordered" item "6." on page 5 of the Order Approving Merger states that "future applications involving acquisitions and mergers shall be subject to the four conditions outlined in this Order."

Consistent with the Staff's position in other merger cases, the Missouri electric, natural gas, and steam customers of SJLP are the public that was of foremost concern to the Staff in its investigation of the Application of UtiliCorp and SJLP. If the analysis shows that this merger will result in adverse or negative impacts on SJLP's Missouri electric, natural gas, or steam customers, then the Commission should not approve the Joint Applicants' merger proposal or, in the alternative impose conditions sufficient to overcome the detriments of the merger. (Featherstone, Rebuttal, Ex. 704, pp. 16-17). Unlike other mergers that typically have been proposed in Missouri, where only one of the two utilities has Missouri service territory, the instant proposed merger has additional Missouri customers that must be considered because UtiliCorp provides electric and natural gas service to Missouri customers through its Missouri Public Service (MPS) division. Thus, the Commission also should evaluate the proposed merger using the not detrimental to the public interest standard as it relates to UtiliCorp's Missouri customers. (Id. at 18).

The Commission in 1983 applied the "not detrimental to the public interest" test to an Application of Kansas Power & Light Company (KPL) for authority to purchase all outstanding common stock of Gas Service Company (GSC). The Commission approved KPL's Application concluding that the proposed transaction was not detrimental to the public interest:

> The evidence shows that the proposed stock acquisition and merger between KPL Acquisition Corporation and GSC will not be detrimental to the public

> interest. It is apparent from the record that the status quo is, at the very least, to be maintained, at least for the immediate future, with no change in rates or conditions of service and no substantial changes in methods of operation. For the future, there appear to be reasonable prospects that the acquisition will not be detrimental to GSC and, therefore, its ratepayers, in the areas of financial integrity, enhanced managerial capability and economies of scale and operational efficiencies and other areas on which the Commission requested information.

Re Kansas Power & Light Co., Case No. GM-84-12, 26 Mo.P.S.C.(N.S.) 254, 257-58 (1983).

At a special meeting held on June 16, 199, SJLP's shareholders approved the proposed merger by the necessary two-thirds percentage with 68.6% participation and 96.3% of the shares that were voted being voted for the merger. (Featherstone, Rebuttal, Ex. 704, pp. 16-17). The Proxy Statement sent to all SJLP shareholders identified reasons why the SJLP Board approved the merger. The overwhelming majority of reasons why the SJLP Board approved the merger and recommended shareholder approval, as found in the Proxy Statement and the direct testimony of SJLP's President and Chief Executive Officer, Terry Steinbecker, dealt with SJLP ownership issues, i.e., "'maximizing shareowner value. '" Very little mention was given to SJLP's customers or employees. (Featherstone Rebuttal, Ex. 704, pp. 12-14).

It is uncertain whether the proposed merger will benefit SJLP employees as it will benefit SJLP shareholders. UtiliCorp announced that there would be in excess of 100 reductions in the number of SJLP employees as a result of the merger. This reduction represents almost one third of SJLP's employees as of December 31, 1998. For those employees that are fortunate and retain their jobs, there may be some benefits resulting from the merger. (Featherstone Rebuttal, Ex. 704, p. 14). SJLP's customers are the least likely sector to receive benefits from the proposed merger. SJLP's customers will have to wait nearly six complete years before any merger savings are returned to them through rates, and they will not have the opportunity for any rate reductions that might have resulted from productivity gains, technological improvements and other non-merger matters that might occur. SJLP customers have experienced several rate reductions over the last 15 years and SJLP customers enjoy among the lowest electric rates in the state. Under the regulatory plan proposed by the Joint Applicants, SJLP's rates will be frozen for at least five years after the proposed merger closes and at the end of the five-year period there will be a rate increase case filed for SJLP by UtiliCorp to address the recovery of the acquisition premium and any other rate matters. The Staff testified that to the extent that the proposed merger results in the elimination of rate reductions for SJLP's customers, the merger is a detriment to the public interest. (Id. at 14-15.)

A. Relevant Portions Of This Commission's Report And Order In The KPL/KGE Acquisition And Merger, Case No. ER-91-213

Other than the Missouri-American Water Company's recent merger case, Case No. WM-2000- , the only merger case that has gone to hearing for Commission determination in recent history was the Kansas Power & Light Company – Kansas Gas & Electric Company merger, Case No. EM-91-213. The following portions of the Commission's September 24, 1991 Report And Order in Case No. EM-91-213 clearly indicate that Missouri ratepayers was "the public interest" that was of concern to the Commission in that merger case:

> . . . the Commission determines that KPL's management should be permitted to proceed with the merger since there is no evidence in this case showing that the merger would interfere with KPL's capacity to render safe and adequate service to its Missouri ratepayers.

Re Kansas Power & Light Co., Case No. EM-91-213, 1 Mo.P.S.C.3d 150, 156 (1991); Mimeo at 8.

. . . .

> The Commission further believes it is important that Missouri ratepayers be shielded from any possible ill effects from the merger . . . . Because of these possibilities [that estimates of the cost savings might be unduly optimistic and many of the savings will not benefit Missouri ratepayers], along with the chance that A&G (Administrative and General) and capital costs might ultimately

increase, the Commission believes it is essential that Applicant understand that the Commission will take all necessary steps to protect Missouri ratepayers from any such ill effects.

1 Mo.P.S.C.3d at 156; Mimeo at 8-9.

. . . .

The Commission is not opposed to the concept of the savings sharing plan provided that only merger-related savings are shared. . . . To avoid any detriment to ratepayers it is imperative that only savings which would not have occurred absent the merger be shared by ratepayers with shareholders.

1 Mo.P.S.C.3d at 156-57; Mimeo at 9.

Second, the Commission will not permit costs generated by the merger to flow to Missouri ratepayers through increased A&G and capital costs. . . . the Commission places Applicant on notice that merger expenses will not be allowed to adversely affect the cost of service in Missouri.

Increases in capital costs due to a lower bond rating or other effects of the merger will not be allowed to increase Missouri rates. . . .

The Commission will direct its Staff to carefully audit KPL in future rate cases to screen out costs caused by the merger and to suggest methods, if necessary in future rate cases, such as those recommended herein, which might be used to shield Missouri ratepayers from costs arising from the merger.

The Commission will also direct KPL to keep its books so that costs associated with the merger are clearly segregated. . . .

1 Mo.P.S.C.3d at 157; Mimeo at 10.

. . . Staff believes that studying the allocation process to find the appropriate allocation formula is fundamental to protecting Missouri ratepayers from merger costs and fairly allocating savings to the Missouri jurisdiction.

. . . .

The Commission believes that, by committing itself to these protections for Missouri ratepayers, it is possible to find in this case no detriment to the public interest arising from the proposed merger as required by Missouri case law.

1 Mo.P.S.C.3d at 157-58; Mimeo at 11.

. . . the Commission has found that the savings sharing plan proposed by KPL as part of its merger application has the potential of exposing Missouri ratepayers to

> higher rates than would be the case without the merger which would be detrimental to the public interest. Therefore, the Commission has determined that the savings sharing plan should not be approved until the Commission can be assured that no nonmerger savings can seep into the pool of merger savings which would be shared between ratepayers and shareholders.
>
> The Commission has also found that there is the potential for a detrimental effect on Missouri ratepayers from the merger through increased A&G and capital costs. Therefore, the Commission, in order to shield Missouri ratepayers from such detriment, has made it clear to KPL that such costs will be carefully scrutinized in any future, postmerger rate case to assure that no such detriment is suffered by Missouri ratepayers.
>
> Based upon these findings and determinations, the Commission concludes that Missouri ratepayers will be shielded from any potential ill effects from the proposed merger and will suffer no detriment as a result. Therefore, the Commission concludes that, in the absence of a finding of detriment to the public interest, it may not withhold its approval of the proposed merger and will authorize KPL to acquire and merger with KGE.

1 Mo.P.S.C.3d at 159; Mimeo at 12-13.

Counsel for UtiliCorp in his opening statement and in his cross-examination of Staff witness Mark Oligschlaeger noted a 1971 Laclede Gas Company merger case. (Tr. 47-48, 564-65). Counsel for UtiliCorp maintained that the case is relevant for the instant proposed merger because the standard that the Commission applied was whether the merger maintains the status quo at least for the immediate future by there being no change in rates or conditions of service and no substantial changes in methods of operation. Mr. Oligschlaeger said that he was not familiar with the case and as a consequence did not know the context in which the Commission made the purported statements that Mr. Swearengen related. (Tr. 564-65). The 1971 Laclede case to which Mr. Swearengen referred is Re Laclede Gas Co., Report Ands Order, 16 Mo.P.S.C. (N.S.) 328 (1971). In that case, Laclede, Missouri Natural Gas Company (Missouri Natural), St. Charles Gas Corp. (St. Charles) and Midwest Missouri Gas Company (Midwest) sought to merge. After the consummation of the merger, Laclede was to be a single operating utility company consisting of four divisions, which comprised of the separate operating entities

Laclede, Missouri Natural, St. Charles and Midwest. Laclede proposed to refile the then current rates and rules of the respective companies with the only change being the name Laclede division replacing name Laclede Gas Company for the service territory being served by Laclede Gas Company. There was to be no substantial change in the operation of the respective divisions. No party other than the Applicants offered any evidence. Id. at 333. Not only did the Commission find that the status quo was to be maintained for the immediate future, the Commission also found that for the future, there appeared to be reasonable prospects of benefits to flow from the merger in the areas of financing and gas supply. Id. at 334. More importantly, counsel for UtiliCorp failed to note "Ordered: 6." of the Commission's Report And Order wherein the Commission explicitly stated that it would not make a ratemaking determination in the context of a merger case respecting any acquisition adjustment arising out of the merger or any prior transaction:

> *Ordered:* 6. That nothing herein shall be considered as a finding of the value of property for rate-making purposes, nor shall anything herein be considered as determining or indicating the treatment or disposition of any acquisition adjustment arising out of the merger or any prior transaction, the jurisdiction to find such value and to determine such treatment or disposition being specifically retained by the Commission.

Id. at 335.

III. OVERALL REGULATORY PLAN

A. Introduction

The various proposals contained within the Joint Applicants' regulatory plan are inappropriate and unacceptable in and of themselves, and generally will be addressed as discrete issues in this brief. However, the Staff believes that the Commission should consider the regulatory plan as a complete package, as well, in assessing the reasonableness of its various components for setting rates in Missouri. The Staff believes the clear underlying purpose of the proposed regulatory plan is to allow UtiliCorp to recover over the ten-year period of the plan, either directly or indirectly from the ratepayers of SJLP and MPS, most of the costs associated with the acquisition adjustment.

The Joint Applicants' proposal is to seek direct recovery of 50% of the acquisition adjustment from SJLP ratepayers during Years 6-10 of the regulatory plan. While UtiliCorp is seemingly generous in not seeking direct recovery of all of the acquisition adjustment, any impression of generosity needs to be tempered by several facts. First, it is clear from a review of UtiliCorp witness Vern J. Siemek's Schedule VJS-1, which purports to show the Joint Applicants' estimates of merger savings and costs, that total merger savings over the first ten years of the transactions are not sufficient to cover 100% of the costs of the acquisition premium. (Vol. 6, Tr. 685). In short, UtiliCorp could not seek direct rate recovery of all of the acquisition adjustment because its estimated merger savings are not large enough to prevent clear customer detriment in that circumstance. In fact, the level of savings purportedly guaranteed to SJLP ratepayers under the regulatory plan, which is truly a minute amount, illustrates that the proposal to recover 50% of the acquisition adjustment directly is about as high a percentage as UtiliCorp could go in light of the magnitude of estimated merger savings available. Second, and notwithstanding the first fact, the regulatory plan in total is designed to allow UtiliCorp to recover a portion of the acquisition premium far in excess of 50%, and closer to 100% recovery over Years 6-10 of the regulatory plan.

The true level of premium recovery under the regulatory plan can be ascertained from information in the record in this proceeding. Mr. McKinney stated on the witness stand that the Joint Applicants' proposals to "freeze" the SJLP capital structure and MPS corporate allocators for ten years will provide UCU with indirect recovery of the acquisition adjustment (Vol. 6, Tr. 685-86; Vol. 4, Tr. 432-34). For this reason, the positive earnings impact on UCU that adoption of these proposals would create need to be added to the acquisition adjustment recovery amounts that would be allowed through direct recovery of half of the premium and through operation of the five-year rate moratorium.

On the witness stand, Mr. Siemek provided some of the quantifications necessary to calculate UCU's total acquisition adjustment recovery under the regulatory plan. For Years 1-5 following the merger, for direct recovery of the acquisition adjustment, Mr. Siemek indicated that SJLP – UtiliCorp would retain an annual average of $4.255 million of merger savings through operation of the rate moratorium (Vol. 7, Tr. 905-06). While SJLP's share of the acquisition premium is $6.758 million per year for Years 1-5, only $4.255 million is directly recovered because the average annual total synergies, net of costs to achieve and allocated costs, is $4.255 million per year for Years 1-5. (Siemek Direct, Ex. 7, Sch. VJS-1).

For Years 1-5 following the merger, Mr. Siemek also quantified the indirect recovery of the acquisition adjustment to UtiliCorp from the frozen MPS allocators proposal as being $2.394 million annually. (Vol. 7, Tr. 907). (This quantification is conservative because it does not reflect any annual escalation of the allocated amounts to MPS, for which both the Staff and UCU have asserted escalation is appropriate.) Finally, Staff witness David A. Broadwater provided a conservative estimate of the indirect recovery of the acquisition adjustment to UtiliCorp from the earnings benefit to UtiliCorp of the frozen capital structure proposal for Years 1-5 as being as being $1.7 million annually. (Broadwater Rebuttal, Ex. 703, p. 30).

Adding the recovery amounts of $4.255 million, $2.394 million and $1.7 million together provides an average premium recovery amount of $8.349 million for Years 1-5 of the regulatory plan. Since Schedule VJS-1 shows an average annual acquisition adjustment total cost of $13.516 million for Years 1-5, the evidence shows UCU's regulatory plan would allow 61.8% of the acquisition premium revenue requirement to be recovered during that period (if the Joint Applicants' estimated merger savings and merger costs amounts are accurate).

The evidence shows UtiliCorp's total recovery of the acquisition adjustment under the proposed regulatory plan is much higher in Years 6-10 of the merger because the average annual total synergies, net of costs to achieve and allocated costs, is in excess of the annual $6.104 million SJLP share of the acquisition premium costs for Years 6-10. (Vol. 7, Tr. 906). Again, Schedule VJS-1 to Mr. Siemek's direct testimony identifies that the proposed 50% direct recovery of the premium in those years would be worth an average of $6.104 million annually. Adding to that figure the previously discussed quantifications for the "frozen" corporate allocators and capital structure proposals of $2.394 million and $1.7 million, respectively, the total average annual acquisition adjustment revenue requirement recovery for Years 6-10 of the regulatory plan is $10.198 million. Schedule VJS-1 identifies the total average annual acquisition adjustment revenue requirement for Years 6-10 as being $12.208 million, meaning that UCU expects to recover approximately 83.5% of the total average annual acquisition adjustment revenue requirement from its SJLP and MPS ratepayers in those years through operation of the regulatory plan. (Again, that percentage is understated because it does not reflect annual escalation of the recovery UCU will receive from the "frozen" MPS allocators proposal.)

Given that the Staff is opposed to any direct recovery of the acquisition adjustment, it might be asked what difference does it make whether UtiliCorp is in fact seeking to receive total acquisition premium recovery of 50%, 60%, or 80%? It makes a great amount of difference when one considers the portion of the acquisition premium covered by non-regulated merger benefits. It has already been noted that the total merger benefits estimates offered by the Joint Applicants relating to their regulated public utility operations do not appear on their face to justify anywhere near to the actual purchase price paid by UtiliCorp for SJLP. For that reason alone, it clearly would appear that something else in addition to potential savings from regulated public utility operations is driving this transaction, and in turn driving some portion of the acquisition premium. The Staff believes that "something else" is the potential for significant non-regulated merger benefits to accrue to UtiliCorp through completion of this merger (Vol. 6, Tr. 575-76, 591-92, 580-81). Statements by Mr. Robert Green, Chief Operating Officer of UtiliCorp, to members of the financial community indicate an expectation of large non-regulated benefits created by future deregulation of the generating sector of the electric industry, and utilization of low-cost SJLP and EDE generating units to earn higher profits than possible today under current regulation (Hyneman Rebuttal, Ex. 707, pp. 28-29, 49-50). There is also evidence that UtiliCorp expects the SJLP and EDE transactions to create non-regulated synergies that would benefit its non-regulated telecommunications and utility construction ventures (Id. at 57-69). However, notwithstanding this clear expectation of non-regulated benefits and savings from the merger by UtiliCorp, UtiliCorp has stated that no estimates of non-regulated synergies or benefits from the disposition of SJLP's generating assets were prepared for this merger transaction (Tr. 909-11).

The Staff believes that if the Commission were to allow any recovery of the acquisition premium from ratepayers, there would need to be a determination made of the appropriate amount of the acquisition premium to allocate to nonregulated operations. The Joint Applicants have provided no quantification or other information whatsoever of what an appropriate below-the-line allocation of the acquisition premium to nonregulated operations should be. (Oligschlaeger Rebuttal, Ex. 713, pp. 13-14). When questioned on this point in the transcribed interviews by the Staff, both Messrs. Siemek and McKinney responded that any allocation to nonregulated operations was taken care of by UCU's request to only receive direct recovery of 50% of the acquisition adjustment (Id.). Beyond the fact that UtiliCorp has presented no evidence that the implied allocation of 50% of the acquisition adjustment to nonregulated operations is reasonable, the reality is that UtiliCorp's regulatory plan is designed to recover from SJLP and MPS ratepayers an amount of the acquisition adjustment far in excess of 50%, as previously demonstrated. The charging of regulated customers for an acquisition adjustment that is premised, at least in part, on nonregulated merger benefits that will accrue solely to shareholders, would be a classic cross-subsidy and anti-competitive. The fact that UtiliCorp is proposing to recovery 80% or more of the acquisition premium from ratepayers upon the expiration of its proposed five-year rate moratorium makes this potential inequity very likely. UtiliCorp's failure to propose and justify an adequate allocation of the acquisition adjustment to non-regulated operations means that UtiliCorp has failed to carry its burden of proof on the issue of the regulatory plan, and the regulatory plan proposal should be rejected by the Commission in its entirety for this reason alone.

The Joint Applicants frequently discuss in testimony and on the witness stand the purported ratepayer benefits to be derived from this merger transaction. The Joint Applicants assert that ratepayers will receive a benefit from merger savings of $1.6 million per year in Years 6-10 following the merger. Several points should be kept in mind when considering the adequacy of this amount. First, SJLP ratepayers receive absolutely no merger benefits at all for the first five years under the proposed regulatory plan. Schedule VJS-1, Line 1 shows a large category of estimated merger savings pertain to generating/joint dispatch functions; $5.216 million per year in Years 1-5 and $6.777 million per year in Years 6-10. Given the current environment and the many proposals nationwide for restructuring/deregulation of the generating function of the electric industry, there is a distinct possibility that SJLP ratepayers will never benefit from any of these savings if they have to wait a full five years or more to receive the benefits of the savings in rates (Oligschlaeger Rebuttal, Ex. 713, pp. 35-36).

The evidence in this case shows that the total amount of merger savings that the Joint Applicants estimate will be available to pass on to ratepayers is approximately $8 million ($1.6 million for five years) over the ten-year period of the regulatory plan. The $8 million in purported customer savings should be compared to the total estimated merger savings of approximately $184.265 million over the same ten-year period (Oligschlaeger Rebuttal, Ex. 713, p. 31). Per the Joint Applicants' own estimates, over 95% of total merger savings are proposed to be retained in order to allow for reimbursement of merger costs, primarily the acquisition adjustment, and also to reflect the allocation of additional corporate overheads to SJLP above the levels incurred by SJLP on a stand-alone basis. When one considers that the benefits allegedly to be flowed to ratepayers from this merger are all back-loaded (i.e., only are available in Years 6-10 following merger consummation), the comparative analysis of shareholder benefits to ratepayer benefits is even worse. When both total estimated merger savings and the share to be flowed to ratepayers under UtiliCorp's regulatory plan proposal are present valued, the share of total merger savings assigned to ratepayers under the regulatory plan shrinks to 3.34%. (Fischer Rebuttal, Ex. 705, p. 28).

The Staff can firmly state that such a division of merger savings pertaining to regulated utility operations is wholly inadequate and unfair to ratepayers, and contrary to the setting of just and reasonable rate levels. As Schedule VJS-1 makes clear, the allocation of minute savings to ratepayers is a result of a regulatory plan designed to ensure that UtiliCorp is fully reimbursed for what it considers to be reasonable merger costs, and that SJLP ratepayers pay in full the increased corporate overhead levels associated with membership in the UtiliCorp holding company, before one penny of savings can go to ratepayers. In contrast, the Staff has asserted in past merger and acquisition cases that any regulatory plan ordered by the Commission should be designed to ensure that at least 50% of available merger savings go to ratepayers, by regulatory lag or by some other means. If less than 50% is proposed to be assigned to ratepayers, then the utility should state compelling reasons why the public interest would justify such a distribution. (Oligschlaeger Rebuttal, Ex. 713, p. 33).

The Commission should also be wary of the Joint Applicants' purported $1.6 million level of "guaranteed" savings because that amount is based upon any number of objectionable premises (Oligschlaeger Rebuttal, Ex. 713, p. 25). Again, Schedule VJS-1 makes derivation of this particular amount very clear. By accepting this amount, the Commission would be implicitly accepting the Joint Applicants' positions that some recovery of the acquisition adjustment from ratepayers is reasonable and appropriate, that a minimum 50% recovery of the acquisition adjustment is the right assignment of this amount to ratepayers, that transactions costs should be recovered from ratepayers, that all "costs to achieve"/"transition costs" should be recovered from ratepayers (including executive severance packages), that all UtiliCorp corporate overhead costs allocated to the SJLP division should be recovered from SJLP ratepayers in full, and that assignment of only 3-4% of total merger savings to ratepayers over the ten years after the closing of the merger would be a reasonable result. Many of these positions are in conflict with long standing Commission practice. To make the effect of the Joint Applicants' requests even worse, the Commission is being asked to make ratemaking determinations outside of a rate proceeding, and without any opportunity to review the impact of the merger on the earnings of UtiliCorp in Missouri.

The purpose of the "guarantee" of a minimum revenue requirement benefit to ratepayers of $1.6 million per year for Years 6-10 is purportedly to protect ratepayers from detriment associated with the regulatory plan. (Oligschlaeger Rebuttal, Ex. 713, p. 25). The Joint Applicants needed to make this guarantee of imputing any shortfall in actual savings levels compared to estimated savings levels in cost of service in the Year 5 SJLP rate case, and in any succeeding SJLP rate cases for Years 6-10, thereby supposedly ensuring that SJLP ratepayers receive a merger benefit in rates, whether the merged entity can actually create that level of savings or not. Further, this minute, minimum customer merger benefit of $1.6 million per year for Years 6-10 is purportedly designed to ensure that merger savings flowed to ratepayers (actual or imputed) will always outweigh merger costs charged to ratepayers, thereby curing potential merger detriment to ratepayers from a rate perspective. On first glance, this proposal may seem to constitute a bona fide guarantee that no detriment to the public interest will occur, but there is no basis to believe that it will ensure that no detriment to the public interest will occur, or that the regulatory plan itself is not detrimental to the public interest.

Under the proposed regulatory plan of the Joint Applicants, the only way the Commission in reality can verify that merger savings purportedly flowed to ratepayers in rates are greater than the merger costs (including the acquisition adjustment) charged in rates to ratepayers is if the Commission has the ability to accurately identify, quantify and track actual merger savings. (Oligschlaeger Rebuttal, Ex. 713, p. 26). While this question is addressed more completely in the "Saving Tracking/Benchmark" portion of this initial brief, in the context it will suffice to say that no party has ever demonstrated such an ability to track merger savings to this Commission in the past, and that to the Staff's knowledge no successful system for tracking merger savings has ever been demonstrated in other jurisdictions, either. (Featherstone Rebuttal, Ex. 704, p. 67). More importantly, SJLP – UtiliCorp have chosen not to make a meaningful and complete proposal in this proceeding as to how they will actually track merger savings in the future. In particular, SJLP – UtiliCorp have failed to address in a detailed way the threshold question of how merger and non-merger impacts on SJLP earnings levels in the future are to be distinguished. In short, SJLP – UtiliCorp are asking the Commission to trust them on this issue; give them upfront approval for recovery of various merger costs in rates now, and trust that SJLP – UtiliCorp, or possibly even the Staff, will develop a workable mechanism to protect ratepayers from potential detriment related to inappropriate or unreasonable cost recovery at a later time. The Staff believes that some matters are far too important to be left to "trust." SJLP – UtiliCorp have neglected to develop and present a mechanism to protect ratepayers from potential detriment related to the proposed merger and even elements of its regulatory plan; for the latter reason alone, the proposed regulatory plan should be rejected and rejected in entirety.

Finally, not the least objectionable aspect of UtiliCorp's proposed regulatory plan is that it may function as a kind of "shell game", hiding merger savings from possible use to benefit ratepayers in rates. This point relates to the Joint Applicants' proposal to assign very little merger savings to UtiliCorp' Missouri Public Service division, while assigning the bulk of the savings to its proposed future SJLP division. Since SJLP is proposed to operate under a rate moratorium for five years, that means no UtiliCorp Missouri ratepayers will get any material benefit from the merger for that extended length of time. MPS, in contrast, has several planned rate increase cases in the next five years (Vol. 4, Tr. 434-35). The overall regulatory plan would provide for MPS ratepayers to pay in full any non-merger related cost increases giving rise to those rate applications, without any access to the offsetting potential benefits from the merger. This regulatory plan design suggests that UtiliCorp has truly been diligent in ensuring it will be allowed to retain the maximum amount of merger savings possible, without regard for its ratepayers' interests. (Oligschlaeger Rebuttal, Ex. 713, p. 38). This particular point is dealt with more fully in the "MPS Merger Savings Assignment" section of this brief.

B. Elements of the SJLP – UtiliCorp Regulatory Plan

The Joint Applicants are asking the Commission to turn a blind eye to the specifics of this merger because it involves a company, UtiliCorp United Inc. (UtiliCorp), which has its corporate offices in Missouri, Downtown Kansas City, Missouri to be more specific. The Joint Applicants could not have been more overt than the last paragraph in the prepared direct testimony of Mr. Robert K. Green, President and Chief Operating Officer of UtiliCorp which states:

> . . . The merger of SJLP and UtiliCorp and eventually The Empire District Electric Company is an extremely unique opportunity. This Commission has the opportunity to combine three low cost, privately owned electric utilities in the State of Missouri into an even stronger, more operationally efficient utility. The resulting synergies can only be created if these utilities are consolidated with the customers gaining the benefits. This intra-Missouri consolidation also preserves jobs in the state which would no doubt be lost if a non-Missouri based utility or company were involved. Finally, the disciplined growth strategy of UtiliCorp will continue to provide opportunities to enhance economic development in Missouri and the career advancement of all employees, as evidenced by our announcement earlier this year to create UtiliCorp's energy trading headquarters in downtown Kansas City and adding approximately 200 new jobs to the Missouri economy.

(Green Rebuttal, Ex. 2, pp. 21-22). Unmentioned by the Joint Applicants is that there will be reductions at SJLP in excess of 100 employees as the result of the merger. This reduction represents a significant part (almost one third) of the 339 employees SJLP employed as of December 31, 1998. (Featherstone Rebuttal, Ex. 704, p. 15; Vol. 3, Tr. 112-15).

The SJLP - UtiliCorp regulatory plan is comprised of the following key elements as they apply to SJLP:

(1) Five-year rate moratorium for SJLP electric, gas and steam customers once the merger is approved

(2) SJLP will file electric, gas and steam general rate increase cases in the fifth and final year of the moratorium intending that new rates will go into effect the sixth year after the closing of the merger. The operation-of-law dates of the SJLP electric, gas and steam rate cases will coincide with the end of the five-year moratorium. Commencing with the beginning of the sixth year after the closing of the merger, SJLP is authorized to recover in rates 50% of the acquisition adjustment (both a return of 50% of the unamortized portion of the acquisition adjustment as an above-the-line expense and a rate base return on 50% of the acquisition adjustment using an imputed capital structure of 47% long-term debt and 53% equity) and a ten-year amortization of both the transaction costs and the "costs to achieve" (transition costs), without rate base treatment

(3) UtiliCorp will guarantee SJLP customers at least an approximate $1.6 million reduction in revenue requirement from net merger savings in the Year 5 rate case and in any subsequent rate proceeding in Years 6-10 following the closing of the merger. The annual approximate $1.6 million reduction in revenue requirement for Years 6-10 is the guaranteed average estimated amount of annual merger savings for Years 6-10 net of the following: (a) 50% recovery of the acquisition adjustment; (b) recovery of other merger costs; and (c) the revenue requirement impact of inclusion of SJLP in UtiliCorp's corporate allocations system.

(4) The estimated savings amount used to determine the $1.6 million guaranteed average estimated amount of annual merger savings reducing revenue requirement for Years 6-10 reflects assignment of almost the entire amount of the SJLP - UtiliCorp merger savings to SJLP for ratemaking purposes, as opposed to allocating more of the merger savings to other divisions of UtiliCorp, such as MPS. The guaranteed merger benefit to customers is to be ensured by a method of tracking (quantifying) total benefits resulting from the merger.

(5) For any rate proceedings in Years 6-10 following the closing of the merger, a capital structure purporting to represent SJLP's pre-merger capital structure of 47% long-term debt and 53% equity is to be used to determine SJLP's revenue requirement.

(Oligschlaeger Rebuttal, Ex. 713, pp. 7-8, 12; McKinney Direct, Ex. 4, pp. 6-7).

Various of these elements are ratemaking determinations which the Joint Applicants want the Commission to decide outside the context of a rate case. The Staff is opposed to the Commission adopting the above proposals on their own merits and the Staff is opposed to the Commission adopting ratemaking determinations outside the context of a rate case. The Staff is not aware of any past occasion in which the Commission has been asked to make the kind of sweeping ratemaking decisions in a merger application as the Joint Applicants are asking the Commission to make in this proceeding. By asking the Commission to make upfront ratemaking commitments, the Joint Applicants the Joint Applicants are urging the Commission to break with long-standing Commission in order to encourage this particular transaction. The Staff believes that the appropriate regulatory policy is for the Commission to continue to take a "neutral" stance towards mergers and acquisitions, neither providing encouragement nor acting to discourage entities from devising potential combinations that make economic sense and are "not detrimental to the public interest." (Oligschlaeger Rebuttal, Ex. 713, pp. 43-44, 48-49).

UtiliCorp and SJLP negotiated a purchase price of $23 per SJLP common share outstanding. SJLP had approximately 8.2 million common shares outstanding at December 31, 1998 which results in a purchase amounting to $188.6 million. To this must be added approximately $4.6 million in transaction costs, which includes, among other things, the legal fees of SJLP and UtiliCorp and the banker fees of SJLP to complete the transaction. The annual amount of acquisition premium amortization expense that SJLP will charge to earnings is approximately $2.4 million ($97 million divided by UtiliCorp's proposed 40 year amortization period). (Hyneman Rebuttal, Ex. 707, p. 33).

The total revenue requirement impact of the $97 million acquisition adjustment over the 40 years that the cost will be reflected on UtiliCorp's books is approximately $368 million (tax grossed up amortization of $157 million and return on rate base of $211 million).[2] For the first ten years after the consummation of the merger, recognition of the acquisition adjustment will increase UtiliCorp's revenue requirement for SJLP's utility properties by about $133 million (tax grossed up amortization of $39 million and return on rate base impact of $94 million). The revenue requirement impact of UtiliCorp's regulatory plan proposal to recover 50% of the acquisition adjustment in Years 6-10 following the closing of the merger, is to increase the revenue requirement for SJLP by approximately $31.5 million (tax grossed up amortization of $9.8 million and return on rate base impact of $21.7 million). (Hyneman Rebuttal, Ex. 707, pp. 35-37).

Missouri Public Service (MPS), the Missouri jurisdictional retail electric service division of UtiliCorp United Inc. (UtiliCorp), will also experience financial effects from the proposed merger, but the Joint Applicants have not proposed an explicit regulatory plan for MPS respecting the assignment of merger costs and savings. Nonetheless, the implicit regulatory plan for MPS, based upon the specific terms of the SJLP - UtiliCorp regulatory plan, appears to be as follows:

> (1) Only a minimal portion of estimated merger savings were assigned to MPS for rate purposes by the Joint Applicants, with nearly all of merger savings assigned to the SJLP. With the exception of this very small amount of savings in the generation/joint dispatch area, MPS is to be treated in future rate proceedings as essentially being unaffected by the SJLP - UtiliCorp merger.
>
> (2) For rate purposes, MPS's allocated level of UtiliCorp corporate costs is to be calculated as if the SJLP merger transaction had not taken place.

[2] The IRS does not allow in a tax-free business combination an income tax deduction for goodwill / acquisition adjustment amortization expense. Therefore, to calculate the total impact of acquisition adjustment amortization expense on net income (before taxes), the before-tax amortization must be grossed up for income taxes to reflect the non-deductibility of the acquisition adjustment. (Hyneman Rebuttal, Ex. 707, p. 35).

(Oligschlaeger Rebuttal, Ex. 713, pp. 7-8).

The Staff opposes the Joint Applicants' regulatory plan, and recommends that the Commission reject it in entirety as "detrimental to the public interest" for the following principal reasons:

(1) The proposed recovery of the acquisition adjustment, even at the purported 50% level, would require that UtiliCorp's Missouri customers inappropriately pay for costs properly assignable to UtiliCorp's shareholders. The Commission should not be influenced in its decision regarding recovery of the acquisition premium by UtiliCorp's false assertion that it is only seeking recovery of 50% of the revenue requirement effect of the acquisition premium. A significant factor in the existence and amount of the merger premium that UtiliCorp agreed to is UtiliCorp's perception of the benefits offered in nonregulated areas by the proposed transaction.

(2) The proposed regulatory plan will actually result in the Joint Applicants receiving recovery of far more than 50% of the acquisition premium, when the impact of "regulatory lag" and the Joint Applicants' proposal concerning "freezing" the SJLP capital structure and "freezing" the MPS corporate allocators are properly taken into account.

(3) The Joint Applicants' proposal will require customers to pay for merger transaction costs, which should be treated in a similar manner to the acquisition premium and should be assigned in entirety to shareholders. In addition, the proposed regulatory plan will allow recovery from ratepayers of certain "costs to achieve" (transition costs) that also should be assigned to shareholders, such as executive severance payments ("golden parachutes").

(4) UtiliCorp/SJLP's proposal to use a "frozen" stand-alone SJLP capital structure in rates after the merger is implemented will deny customers any benefit from what should be a major source of savings to them, the substitution of a lower-cost UtiliCorp capital structure for a higher-cost SJLP capital structure. The Staff estimates that the additional revenue requirement for SJLP ratepayers resulting from a pre-merger SJLP capital structure of 47% long-term debt and 53% equity rather than a consolidated UtiliCorp capital structure of 60% long-term debt and 40% equity is $1.7 million on an annual basis. (Oligschlaeger Rebuttal, Ex. 713, p.23).

(5) The "guarantee" of the Joint Applicants that SJLP ratepayers will receive a minimum merger benefit of an approximate $1.6 million reduction to the SJLP revenue requirement for Years 6-10 after the closing of the merger is based on their assertion that they will have the ability to measure and quantify actual merger savings starting in the fifth year after the closing of the merger.

However, the Joint Applicants have failed to present any detailed plan for "tracking" merger savings in their testimony, so the purported ability to track merger savings is completely unsupported in actuality and is illusory. Conceptually, the difficulty in attempting to identify and quantify actual achieved merger savings on an after-the-fact basis is that it requires a comparison of (a) actual financial results achieved by an entity which exists as a result of a merger to (b) projected financial results for an entity which ceased to exist as a result of the same merger. The Joint Applicants are inviting subjective, self-serving speculation in rate proceedings, with no objective facts or standards available to guide the Commission in judging the savings tracking claims. Having not submitted a proposal for tracking purported merger savings, the Joint Applicants have not submitted a proposal to address the aforementioned problems. The most that the Joint Applicants have done is to present the testimony of Mr. Jerry D. Myers on UtiliCorp's ability to track merger costs using state-of-the-art accounting systems. The problem with merger savings tracking is not the degree of sophistication of accounting systems, but the inherent lack of knowledge people have of the effect of events and actions that did not occur. (Oligschlaeger Rebuttal, Ex. 713, pp. 26-28).

(6) The Joint Applicants' plan will result in UtiliCorp customers in Missouri receiving the benefit of only a very small, insignificant portion of total merger savings during the first ten years after the closing of the merger. The vast majority of the savings will be retained by UtiliCorp to pay off the acquisition adjustment or will be offset by the detrimental impact of increased corporate cost allocations from UtiliCorp to SJLP customers. Schedule VJS-1 to the prepared direct testimony of the Joint Applicants' witness Vern J. Siemek shows that total purported merger savings for the first 10 years after the closing of the merger is $184.265 million. Schedule VJS-1 also shows that SJLP's ratepayers receive no merger savings for Years 1-5 after the merger's closing because of the rate moratorium under Joint Applicants' regulatory plan and that SJLP's ratepayers should expect $1.6 million a year in merger savings for Years 6-10 (i.e., approximately $8.0 million). Thus, the ratepayers' share of total merger savings under the Joint Applicants' regulatory plan is approximately 4.3% ($8.0 million / $184.265 million), or 3.34% when the calculation is performed on a net present value basis. Under the Joint Applicants' regulatory plan, 95.7% of the merger savings is retained by UtiliCorp to allow it to recover directly in rates 50% of the acquisition premium. (Oligschlaeger Rebuttal, Ex. 713, pp. 31-32.).

(7) The regulatory plan is premised upon the ability of UtiliCorp to recover from SJLP customers significant amounts of total UtiliCorp administrative and general (A&G) costs compared to SJLP's stand-alone A&G levels. Not only is this recovery from SJLP ratepayers of a significant portion of UtiliCorp's A&G expenses counter-intuitive to legitimate expectations of what should result from a merger of two utilities, but the increase in A&G expenses that

would be borne by SJLP customers is in not related to the provision of safe and adequate service at just and reasonable rates.

(8) The regulatory plan would result in a disproportionate amount of purported merger savings being assigned to SJLP customers at the expense of MPS customers who have historically paid a portion of the costs associated with the "economies of scale" which in part cause the asserted potential savings from this proposed transaction to exist in the first place. In addition, this assignment of purported merger savings will pass most of said savings to SJLP which under the Joint Applicants' proposal will operate under a rate moratorium, while not assigning any material portion of purported merger savings to MPS which under the proposed plan will seek increases in rates during the next several years. Also, this assignment of purported merger savings will result in most of the savings going to SJLP's customers who already pay significantly lower rates in Missouri than MPS customers who have relatively high rate levels.

Merger savings are projected to result from jointly dispatching the generating units of SJLP and UtiliCorp (and Empire). Merger savings also are projected by the Joint Applicants as a result of an increase in sale opportunities on the interchange market leading to higher interchange profits. With the exception of some capacity cost savings, all of the energy savings expected from the joint dispatch of the merged companies' generating facilities are assigned to SJLP (and Empire). MPS ratepayers are to receive no benefit from the joint dispatch of the MPS and SJLP (and Empire) generating facilities. (Traxler Rebuttal – Replacement Pages, Ex. 721, p. 3; Traxler Rebuttal, Ex. 718, pp. 11-12, 43 ; Vol. 4, Tr. 379-83).

(9) Approximately 89% of the $60.0 million in joint dispatch savings projected by the Joint Applicants' over the 10 years of the proposed regulatory plan can be achieved by SJLP on a "stand alone," no merger assumption basis, and, therefore, should not be used to offset merger costs in a cost/benefit analysis of the merger. (Traxler Rebuttal – Replacement Pages, Ex. 721, p. 4, 44).

(Oligschlaeger Rebuttal, Ex. 713, pp. 9-11, 22).

After the appropriate adjustments are made to the SJLP – UtiliCorp cost benefit analysis of the proposed merger, merger costs exceed merger savings by a significant amount. (Traxler Rebuttal – Replacement Pages, Ex. 721, pp. 3-4). Staff witness Steve M. Traxler testified that although in all previous major merger applications in Missouri, the applicants projected that savings would exceed all transaction, transition, consolidation and acquisition premium, in the instant SJLP – UtiliCorp proposed merger, this is not the situation. The Staff's analysis reveals that SJLP – UtiliCorp merger savings do not exceed merger-related costs over the 10-years of the regulatory plan, even before the acquisition premium is considered. The Joint Applicants' own numbers show that even though they are projecting that savings will exceed projected transition, transaction and consolidation costs by $21.3 million in the first five years and $38.4 million in the second five years, when recovery of the acquisition premium is considered, the Joint Applicants' project a ($46.3 million net loss) in Years 1–5 and a ($22.6 million net loss) in Years 6–10. Thus, the Joint Applicants project a total ($68.9 million net loss) during the first 10 years following the closing of the merger. (Traxler Rebuttal, Ex. 718, p. 7; Traxler Rebuttal – Replacement Pages, Ex. 721, p. 8; Ex. 729).

The difference between SJLP – UtiliCorp and the Staff in projected net merger savings and merger costs for the 10-year period covering the SJLP – UtiliCorp regulatory plan is as follows:

		Years	
	1–5 **millions**	**6–10** **millions**	**1–10** **millions**
UCU-SJLP Net Merger Savings/Costs	$21.276	$38.406	$59.682
Staff Net Merger Savings/Costs	($8.735)	($4.097)	($12.832)
Difference between Staff & UCU-SJLP	$30.011	$42.503	$72.514

(Ex. 729). There are three issues which are the basis for the very significant difference between SJLP – UtiliCorp and the Staff: (1) the proper allocation of Joint Dispatch Savings to SJLP and MPS, (2) the proper growth/inflation rate of UtiliCorp Corporate Overhead Costs Allocations and (3) Transaction and Transition Costs assigned to ratepayers. (Traxler Rebuttal, Ex. 718, p. 43; Traxler Rebuttal – Replacement Pages, Ex. 721, pp. 44-45).

C. Further Legal Questions Respecting Joint Applicant's Regulatory Plan

The Staff in its opening statement to the Commission at the commencement of the evidentiary hearing in this proceeding indicated that the instant case raised a number of serious legal questions; one in particular that the Commission had encountered in the last year respecting Union Electric Company's (UE) first experimental alternative regulation plan (EARP). The question for the instant proceeding based upon events in the UE litigation in Case No. E0-96-14, which is now on review in Cole County Circuit Court, is if the Commission were to adopt the SJLP – UtiliCorp regulatory plan, would a contract be established between UtiliCorp and the Commission, respecting UtiliCorp's regulatory plan. The Staff offers the following discussion for the Commission's consideration and response from UtiliCorp and the other parties to the instant proceeding, which include UE.

The Commission in its May 13, 1999 Order in Case No. E0-96-14 (In the Matter of the Monitoring of the Experimental Alternative Regulation Plan of Union Electric Company) at pages 6-7 stated the following:

> The Commission finds that UE's claim that the state was a party to a contract fails because the Commission is not bound by the earlier Commission decision. The courts have ruled that there is no application of the doctrine of stare decisis to administrative tribunals. State ex rel GTE North v. Missouri PSC, 835 S.W.2d 356, 371 (Mo. App. 1992) (quoting State ex rel Churchill Truck Lines Inc. v. Public Service Comm'n., 734 S.W.2d 586 (Mo. App. 1987); City of Columbia v. Missouri State Board of Mediation 605 S.W.2d 192 (Mo. App. 1980). The Courts have clearly stated that "public utilities have no authority to enter into a contracts which cannot be modified or revoked by the state." State ex rel. Capital City Water Company v. Pub. Serv. Comm'n, 850 S.W.2d 903 (citing 64 Am. Jur.2d Public Utilities Sec. 81 (1992). . .

In addition to these cases cited by the Commission, the Staff would suggest that the Commission consider the following analysis offered by the Staff.

Another relevant case respecting the effect of the Commission adopting the Joint Applicants' regulatory plan is State ex rel. Jackson County v. Public Serv. Comm'n, 532 S.W.2d 20 (Mo. banc 1975), cert. denied, 429 U.S. 822, 97 S.Ct. 73, 50 L.Ed.2d 84 (1976). In this case regarding a general rate increase filed by Missouri Public Service Company (MPS), Case No. 18,180, Jackson County tried to invoke an announcement made by the Commission, on the Commission's own, in the Commission's Report And Order in the immediately preceding MPS rate increase case, Case No. 17,763, that there would be a moratorium on rate increases for MPS for a period of at least two years from the effective date of the Report And Order. The Missouri Supreme Court in its review of the Commission's Report And Order in Case No. 18,180 noted that the parties to Case No. 17,763 did not address the moratorium issue during the proceedings in Case No. 17,763. The moratorium issue was apparently added by the Commission on its own. The Commission, in ordering in its December 14, 1973 Report And Order in Case No. 17,763 a two-year period of repose on rate increases, stated that the two-year moratorium was based upon a thorough analysis of the updated and projected test year presented in the case. There was no judicial review of the Commission's Report And Order imposing the moratorium in Case No. 17,763. Id. at 21-23.

On August 4, 1974, MPS filed revised tariffs, eventually docketed as Case No. 18,180, requesting increased rates for electric service. Various motions to dismiss the tariffs were filed premised on the two-year moratorium adopted by the Commission on its own in MPS's prior rate case. A hearing was held at which evidence was submitted indicating that circumstances had changed in MPS's operations since the Commission's Report And Order of December 14, 1993. The Commission issued Orders overruling/denying motions to dismiss MPS's revised tariffs. The Commission found that MPS had adduced sufficient evidence to establish a prima facie showing of substantial and altered circumstances. On June 13, 1975, the Commission authorized an increase in rates. 532 S.W.2d at 21-23.

The City Of Kansas City and the County of Jackson sought judicial review of the Commission's decision. The Missouri Supreme Court stated that a moratorium was in conflict with the spirit of the Public Service Commission Law, that spirit being continuous regulation to meet changes in conditions as required by these changes in conditions. The Court quoted from a Missouri Supreme Court decision in State ex rel. Chicago, Rock Island, & Pacific Railroad Company, 312 S.W.2d 791, 796 (Mo.banc 1958) as follows:

> "Its [Commission's] supervision of the public utilities of this state is a continuing one and its orders and directives with regard to any phase of the operation of any utility are always subject to change to meet changing conditions, as the commission, in its discretion, may deem to be in the public interest." To rule otherwise would make §393.270(3) of questionable constitutionality as it potentially could prevent alteration of rates confiscatory to the company or unreasonable to the consumers. [Citation omitted.]

532 S.W.2d at 29; See also, State ex rel. General Tel. Co. v. Public Serv. Comm'n, 537 S.W.2d 655, 661-62 (Mo. App. 1976)[3]; State ex rel. Arkansas Power & Light Co. v. Public

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[3] In the General Telephone case, the Court of Appeals held that the Commission's decision in a prior General Telephone Company case had no binding effect in a subsequent General Telephone Company case:

> Insofar as the conclusion in the 1962 case is concerned, it has no binding effect in a future rate case. A concise statement of the applicable rule is found in 2 Davis, Administrative Treatise Section 18.09, 605, 610, (1958), as follows:
>
> > "* * * For an equity court to hold a case so as to take such further action as evolving facts may require is familiar judicial practice, and administrative agencies necessarily are empowered to do likewise. When the purpose is one of regulatory action, as distinguished from merely applying law or applying law or policy to past facts, an agency must at all times be free to take such steps as may be proper in the circumstances, irrespective of its past decisions. * * * Even when conditions remain the same, the administrative understanding of those conditions may change, and the agency must be free to act * * *." (Footnotes omitted.)
>
> Clearly the commission in this case was not bound by the action in the 1962 case.

537 S.W.2d at 661-62.

Serv. Comm'n, 736 S.W.2d 457, 462 (Mo. App. 1987); State ex rel. Associated Natural Gas Co. v. Public Serv. Comm'n, 706 S.W.2d 870, 880 (Mo. App. 1985); State ex rel. St. Louis v. Public Serv. Comm'n, 47 S.W.2d 102, 105 (Mo.banc 1931); Marty v. Kansas City Light & Power Co., 259 S.W. 793, 796 (Mo. 1923).

The Jackson County case is well known to the utilities regulated by the Commission and the entities that are regular intervenors in rate cases and excess earnings complaint cases. The Jackson County decision was rendered in 1975. Since then many parties have entered into stipulations and agreements containing moratoriums and the Commission has approved those stipulations and agreements, all knowing full well the holding of the Missouri Supreme Court in the Jackson County case.

There was a challenge to the alternative regulation plan that the Commission offered to Southwestern Bell in 1993 in the Commission's December 17, 1993 Report And Order in the Staff's excess earnings complaint case against Southwestern Bell, Case No. TC-93-224, which was consolidated with a case established to consider alternative regulation proposals for Southwestern Bell to replace the Southwestern Bell Incentive Regulation Experiment (SBIRE), Case No. TO-93-192. In the case at the Commission level, Missouri Cable Television Association (MCTA), the Midwest Independent Coin Payphone Association (MICPA) and the Attorney General of the State of Missouri took the position that the Commission does not have the statutory authority to adopt a form of alternative regulation for Southwestern Bell. Re Southwestern Bell Telephone Co., Report And Order, Case Nos. TC-93-224 and TO-93-192, 2 Mo.P.S.C.3d 479, 570-72 (1993). The Commission offered Southwestern Bell an alternative regulation plan which the Commission titled the Accelerated Modernization Plan (AMP). (Id. at 575). Southwestern Bell declined the Commission's offer. Re Southwestern Bell Telephone

Co., Order Concerning Applications For Rehearing, Case Nos. TC-93-224 and TO-93-192, 2 Mo.P.S.C.3d 590 (1994). MCTA sought judicial review of the Commission's offer of a form of alternative regulation to Southwestern Bell. The Western District Court of Appeals dismissed MCTA's appeal on the grounds that it was moot since Southwestern Bell had rejected the Commission's offer of a form of alternative regulation and also held that the appeal did not meet one of the exceptions to the mootness doctrine. State ex rel. Missouri Cable Television Ass'n v. Public Serv. Comm'n, 917 S.W.2d 650, 652 (Mo. App. 1996).

Missouri Gas Energy v. Public Service Comm'n, 978 S.W.2d 434 (Mo. App. 1998), involves appellate review of a decision of the Commission in a 1996 Missouri Gas Energy (MGE (a division of Southern Union Company)) rate increase case, Case No. GR-96-285, wherein the Commission determined, according to the Western District Court of Appeals, that the carrying cost rates for an accounting authority order (AAO) granted in 1994 in Re Missouri Gas Energy, Accounting Authority Order, Case No. GO-94-234, 3 Mo.P.S.C.3d 201 (1994) should be for ratemaking purposes the weighted average short-term debt interest rate for allowance for funds used during construction (AFUDC) of 4% for 1994 and 6% for 1995 and 1996, instead of the 10.54% rate which was requested by MGE in its Application for an AAO in Case No. GO-94-234 and authorized by the Commission in the AAO it issued in 1994. This 1994 AAO was preceded by several other AAOs, all for the same purpose of capitalizing and deferring recognition of certain costs respecting the utility's investment in new service lines and mains. This construction was occurring for the utility to comply with the Commission's gas line safety rules promulgated in 1989 in response to federal legislation. These two earlier AAOs had been granted in 1989 and 1992, in Case No. GO-90-51 and Case No. GO-92-185, respectively. 978 S.W.2d at 436-37.

The 1989 AAO was granted to MGE's predecessor, Kansas Power & Light Company, which later changed its name to Western Resources, Inc. (KP Western). The carrying cost authorized in 1989 was 10.96%, but in a 1991 rate case the carrying cost was reduced by the Commission to 10.54%, which is the overall weighted cost of capital that the Commission determined in Re Kansas Power & Light Co., Report And Order, Case No. GR-91-291, 1 Mo.P.S.C.3d 235, 252 (1992). This same carrying cost of 10.54% was utilized by the Commission as the carrying cost for the 1992 AAO, Case No. GO-92-185. A 1993 KPL Western rate increase case, Re Western Resources Inc., Report And Order, Case No. GR-93-240, 2 Mo.P.S.C.3d 378, 381-82 (1993),ended in a settlement. While the 1993 rate increase case was pending, Southern Union Company agreed to purchase from KP Western, and KP Western agreed to sell to Southern Union Company, KP Western's Missouri utility operations and facilities. Re Western Resources, Inc., d/b/a Gas Service and Southern Union Co., d/b/a Missouri Gas Energy, Report And Order, Case No. GM-94-40, 2 Mo.P.S.C.3d 598 (1993). Missouri statutes require Commission approval of such a transfer. As part of the settlement, the Staff agreed to continue to support the deferral through AAOs of the costs of the changeout of gas service lines and mains for safety reasons. 978 S.W.2d at 436-38.

In the Commission's 1997 MGE rate increase case, Re Missouri Gas Energy, Report And Order, Case No. GR-96-285, 5 Mo.P.S.C.3d 437, 465 (1997), the Commission determined that the carrying cost rates for an accounting authority order (AAO) granted in 1994 in Case No. GO-94-234 should be 4% for 1994 and 6% for 1995 and 1996 rather than the 10.54% which was utilized by the Commission when the AAO was granted in 1994 in Re Missouri Gas Energy, Accounting Authority Order, Case No. GO-94-234, 3 Mo.P.S.C.3d 201 (1994). MGE citing United States v. Winstar, 518 U.S. 839, 116 S.Ct. 2432, 135 L.Ed.2d 964 (1996) argued in essence that the Commission was contractually bound from reducing the carrying cost from the 10.54% utilized in the Commission's 1994 Order approving the settlement. MGE asserted that there was "'no doubt that an agreement like the Settlement Agreement in this case would be considered a binding and enforceable contract if the only parties to it had been private parties.'" 978 S.W.2d at 438. The Court held that the agreement referred to by MGE, which also dealt with the issue of the transfer of assets and ownership of the utility from KP Western to MGE, merely permitted MGE to continue to use the 10.54% figure allowed in KP Western's AAO. The Court commented that even if the facts elevated the actions of the Commission to invoking contract obligations, "[MGE] can point to no language in the Agreement to Transfer Assets that would support the result it wishes to obtain." Id.

Citing State ex rel. Office of Public Counsel v. Public Serv. Comm'n, 858 S.W.2d 806 (Mo. App. 1993), which is an earlier Western District Court of Appeals decision on AAOs, the Court stated that AAOs are not final, are dependent upon further action in a ratemaking case and create no expectation that the deferral terms within them will be followed in a ratemaking proceeding. The Court noted that "[t]he whole idea of AAOs is to defer a final decision on current extraordinary costs until a rate case is in order," where the utility is allowed to make a case that the deferred costs should be included. 978 S.W.2d at 438. The Court even commented that there was language in the 1994 AAO concerning MGE which provided the appropriate caveat that the Commission reserved the right to consider the ratemaking treatment to be accorded the expenditures covered by the AAO in a later proceeding. Thus, there is no authority for the proposition put forth by MGE that the Commission is bound by the terms of an AAO. Id.

MGE cited and the Court addressed United States v. Winstar Corp., 518 U.S. 839, 116 S.Ct. 2432, 135 L.Ed.2d 964 (1996). In Winstar, a change in regulatory policy after an entity had acted in reliance on the prior regulatory policy, and the change in policy would render the entity immediately insolvent if the change in policy were upheld, caused the U.S. Supreme Court to not permit the regulatory agency to change policy and penalize the entity that had acted in reliance on the continuation of the prior policy. The Western District Court of Appeals held that MGE's reliance on Winstar was misplaced in that the Commission had made no binding promises respecting the AAO in approving the voluntary transfer of assets and ownership of the utility from KP Western to MGE, and even if the facts in the MGE case elevated the actions of the Commission to invoking contract obligations, there is no language in the agreement for the transfer of ownership of the utility that would bind the parties and the Commission to the carrying cost of 10.54%. 978 S.W.2d at 438.

The Winstar case involves the savings and loan industry crisis of the late 1970's, the 1980's and the early 1990's. The case is of interest from a number of perspectives, including its discussion of the purchase method of accounting for mergers.

The Supreme Court decision relates that the Federal Savings and Loan Insurance Corporation (FSLIC) lacked the funds to liquidate all of the failing savings and loans and the Federal Home Loan Bank Board (Bank Board) chose to avoid the insurance liability by encouraging sound savings and loans and outside investors to acquire failing savings and loans through "supervisory mergers." Under the purchase method of accounting the acquiring entity is permitted to designate the excess of the purchase price over the fair value of all identifiable assets acquired as an intangible asset called "goodwill." Goodwill recognized as resulting from a FSLIC-sponsored supervisory merger was referred to as "supervisory goodwill." In addition regulators let acquiring institutions amortize the goodwill asset over a period of up to 40 years. Supervisory goodwill was important to sound savings and loans for at least two reasons: (1)

supervisory goodwill was counted toward the reserve requirement of acquiring institutions (this accounting treatment was necessary to make the transaction even possible because the institution resulting from the merger would have been insolvent from the start if goodwill did not count toward regulatory net worth) and (2) the goodwill asset was permitted to be amortized by the acquiring institutions over periods of up to 40 years (this amortization over long periods in conjunction with the accretion of the discount respecting the loans acquired as assets of the failed savings and loans allowed the acquiring savings and loans to appear more profitable than they in fact were). 116 S.Ct. at 2442-44.

When the efforts of the early and mid-1980's proved unsuccessful in resolving the savings and loan industry crisis, Congress enacted the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). FIRREA required savings and loans to maintain core capital in an amount not less than 3% of the savings and loan's total assets and defined core capital to exclude unidentifiable intangible assets such as goodwill. Many savings and loans that had acquired failed savings and loans in exchange for supervisory goodwill immediately fell out of compliance with regulatory capital requirements, making them subject to seizure by regulators. 116 S.Ct. at 2446.

The Government insisted that the evidence that the parties understood that goodwill arising from the transactions would be treated as satisfying regulatory requirements reflected statements of then current federal regulatory policy rather than contractual undertakings. The Supreme Court found the Government's interpretation of the relevant documents as mere statements of policy to be fundamentally implausible. If supervisory goodwill and capital credits had not been available for purposes of meeting regulatory capital requirements, the merged savings and loan would have been subject to regulatory noncompliance and penalties from its very inception. The Government also was obligated to permit such supervisory goodwill to be amortized over the period for which agreement had previously been reached. Under the circumstances, there is no doubt that the parties intended to settle regulatory treatment of these transactions as a condition of their agreement. The Court did not disagree that the relevant documents should be read as contractual commitments, not mere statements of policy. 116 S.Ct. at 2448-52.

The savings and loans did not argue that the agreements in question limit the Government's future exercises of regulatory authority to enact a subsequent bar to using supervisory goodwill and capital credits to meet regulatory capital requirements. They claimed that the Government assumed the risk that subsequent changes in the law might prevent them from performing, and agreed to pay damages in the event that such failure to perform causes the savings and loans financial injury. Thus, the doctrine of unmistakability is not applicable. This doctrine states that the sovereign power governs all contracts subject to the sovereign's jurisdiction and will remain intact unless surrendered in unmistakable terms. 116 S.Ct. at 2453.

The Supreme Court held the unmistakability doctrine was not applicable. The Court stated that the agreements have been read as solely risk-shifting and so long as a contract is reasonably construed to include a risk-shifting component that may be enforced without effectively barring the exercise of the sovereign power, the enforcement of the risk allocation raises nothing for the unmistakability doctrine to protect against, and there is no reason to apply it:

> . . . the contracts have not been construed as binding the Government's exercise of authority to modify banking regulation or of any other sovereign power, and there has been no demonstration that awarding damages for breach would be tantamount to any such limitation.

> As construed by each of the courts that considered these contracts before they reached us, the agreements do not purport to bind the Congress from enacting regulatory measures, and respondents do not ask the courts to infer from silence any such limit on sovereign power...The contracts have been read as solely risk-shifting agreements and respondents seek nothing more than the benefit of promises by the Government to insure them against any losses arising from future regulatory change. . . .

116 S.Ct. at 2458, 2457.

MGE also made an equitable estoppel argument for continuation of the 10.54% carrying cost, asserting that the 1993 settlement and the 1994 AAO cause the equitable estoppel doctrine to be dispositive. The Western District Court of Appeals, noting that equitable estoppel is not ordinarily applicable to the government, identified the elements of equitable estoppel as follows, as it applies to a government entity:

(1) a statement or act by the government entity inconsistent with the subsequent government act;

(2) the citizen relied on the act;

(3) injury to the citizen;

(4) the governmental conduct complained of must amount to affirmative misconduct;

(5) there must be exceptional circumstances and a manifest injustice will result;

(6) equitable estoppel will not be invoked if it will interfere with the proper discharge of governmental duties, curtail the exercise of the State's police power or thwart public policy; and

(7) equitable estoppel is limited to situations were public rights must yield because private parties have greater equitable rights.

978 S.W.2d at 439; See 850 S.W.2d at 910. "The party claiming equitable estoppel has the burden of proof and every fact creating the estoppel must be established by clear and satisfactory evidence. *Van Kampen*, 685 S.W.2d at 625." 850 S.W.2d at 910.

Another case of interest is State ex rel. Missouri Cable Telecommunications Ass'n. v. Public Serv. Comm'n, 929 S.W.2d 768 (1996) which was an appeal of a circuit court order declaring a settlement agreement among the Commission, Southwestern Bell and OPC to be unlawful. The origin of the case was that at the conclusion of the SBIRE, the Staff and OPC performed earnings investigations of Southwestern Bell and filed excess earnings complaint cases with alternative regulation proposals. The Commission ordered a rate reduction and offered Southwestern Bell a new alternative regulation plan, which Southwestern Bell rejected. Judicial review was sought by Southwestern Bell, AT&T Communications of the Southwest, Inc. (AT&T), and the Missouri Cable Telecommunications Association (MCTA). While the consolidated cases were pending before the circuit court, the Commission, Southwestern Bell and OPC entered into a settlement agreement. MCTA, AT&T and MCI Telecommunications Corporation filed applications for rehearing with the Commission which were denied. They then sought judicial review in circuit court and Midwest Independent Coin Payphone Association (MICPA) intervened. The circuit court held the settlement agreement to be illegal and unenforceable. The Commission, Southwestern Bell and OPC appealed to the Western District Court of Appeals. 929 S.W.2d at 769-71.

The Commission, Southwestern Bell and OPC argued that the settlement agreement was not an order of the Commission as that term is used in Sections 386.500 and 386.510 and therefore was not reviewable. 929 S.W.2d at 772. The Commission asserted that the settlement agreement was a non-binding expression of the signatories' intent and only served to implement its previous order, not to constitute a separate order. 929 S.W.2d at 773. MCTA, AT&T, MCI and MICPA contended that once review was initiated from the Commission's December 1993 Report And Order, exclusive jurisdiction was in the circuit court and the Commission was without jurisdiction to alter or modify its Report And Order and the settlement agreement accordingly was void and without effect. 929 S.W.2d at 772.

The Court held that the settlement agreement constituted an order or decision of the Commission and the Commission lacked jurisdiction to enter into the settlement agreement outside the court proceedings because exclusive jurisdiction was vested in the circuit court at that time. The Court further stated that the settlement agreement violated one of the purposes for vesting exclusive jurisdiction in the circuit court while review is pending "which is to ensure that those interested in the outcome of the case as intervenors have a forum to be heard." 929 S.W.2d at 774.

UE may assert that the MCTA case is relevant to the instant case for the following reason. Even though the Western District Court of Appeals stated that it need not decide whether the Commission has the authority to enter into settlement agreements with public utility companies, but would proceed as if the Commission may do so, the Court noted that Missouri courts generally treat settlement agreements as contracts:

> . . . Missouri courts generally treat settlement agreements as contracts and we find no reason to view this settlement agreement any differently. See *Daily v. Daily*, 912 S.W.2d 110, 114 (Mo. App. 1995); *Ayotte v. Pillsbury Co.*, 871 S.W.2d 139, 142 (Mo. App. 1994); *Park Lane Med. Ctr. V. Blue Cross/Blue Shield,* 809 S.W.2d 721, 724 (Mo. App. 1991). If the settlement agreement is a contract, then it is binding. If it is binding, the provisions of this settlement agreement, some being regulatory in nature, have the effect of operating as a regulatory plan. If it has the effect of a regulatory plan, then there are no practical differences between the settlement agreement here and the usual order or decision entered by the PSC after a public hearing. If it is an order, then it is reviewable by this court.

929 S.W.2d at 774, 773.

The MCTA case dealt with a settlement agreement among the Commission and some, but not all, other parties to a writ of review proceeding in circuit court respecting a Commission

Report And Order. Thus, the Commission was the respondent-party to a circuit court case. The act before the Western District Court of Appeals for review was not based on the Commission serving in its fact finder role, but was based on the Commission acting as a respondent-party to a circuit court case. Therefore, the MCTA decision should not be read as indicating that when the Commission is acting as a fact-finder respecting a stipulation and agreement/settlement agreement submitted to it for approval, the Commission enters into a contractual obligation with the parties to the agreement if it approves the agreement.

IV. MERGER COSTS / BENEFITS

The Joint Applicants are attempting to justify the "not detrimental to the public interest" standard by purporting to demonstrate net savings, in the SJLP post-moratorium rate case, to result in a minimum cost of service benefit to SJLP ratepayers of $1.6 million per year for Years 6–10 of the regulatory plan. (McKinney Direct, Ex. 4, p. 7; Siemek Direct, Sch. VJS-1, Line VIII). Under the proposed regulatory plan, the SJLP post-moratorium rate case will have an operation-of-law date which will coincide with the end of the 5-year moratorium (Years 1–5 of the regulatory plan) and the beginning of Years 6–10 of the regulatory plan. (McKinney Direct, Ex. 4, p. 6).

The Staff has expressed significant concern regarding (1) the accuracy of the Joint Applicants' projected merger costs and savings purported to support approval of the merger and (2) the intended use of "projected" savings for Years 6–10 in support of the $1.6 million guaranteed minimum benefit to SJLP ratepayers in the post-moratorium rate case.

The Staff submitted revised Schedule SMT-3A (Ex. 729) at the hearing on July 13, 2000 in order to reflect the impact of the settlement of the FAS 87 Pension Cost issue. (Vol. 7, Tr. 998-1000, 958-64). Schedule SMT-3A reflects both the full 10-year (Years 1– 10) and Years 6–

10 projected merger costs and savings amounts determined separately by the Joint Applicants and the Staff. Column B of Schedule SMT-3A reflects the Joint Applicants' projected merger costs and savings for Years 6–10. The projected amounts for Years 6–10 are purported by the Joint Applicants to show an average net benefit of $1.6 million per year to SJLP ratepayers for those years. (Ex. 729, Line 23, Col. B). Line 16, Column B reflects the Joint Applicants' projected net merger savings of $38.4 million for Years 6–10 (i.e., total synergies (savings), net of costs to achieve and other merger costs and allocated corporate costs), prior to recovery of the amortization of 50% of the acquisition premium. The amortization of 50% of the acquisition premium for Years 6 – 10 amounts to $30.5 million. (Ex. 729, Line 21, Column B). Reducing the net merger savings of $38.4 million by $30.5 million, which represents the amortization of 50% of the acquisition premium of $73 million (Ex. 729, Line 21, Column B), leaves $7.9 million in net savings available to be used as a cost of service reduction for SJLP ratepayers. Since the $7.9 million in net savings is the total for the five years comprising Years 6–10 of the regulatory plan, one fifth of that amount, i.e., $1.6 million, would be used as a cost of service reduction in the post-moratorium rate case for the SJLP division of UtiliCorp.

The Staff has taken issue with the Joint Applicant's projected merger costs and savings for Years 6–10 in three areas, Joint Dispatch Savings (Proctor Rebuttal, Ex. 714), UtiliCorp's Corporate Overhead Costs allocated to the SJLP division post-merger (Traxler Rebuttal, Ex. 718), and the recovery of Transition and Transaction Costs (Russo Rebuttal, Ex. 717). Column F of Schedule SMT-3A reflects the Staff's projected merger costs and savings for Years 6–10. Line 16 of Column F reflects a negative $4.1 million in net merger "savings," i.e., $4.1 million in net merger "costs," as opposed to the $38.4 million in net merger savings projected by the Joint Applicants. Both of these amounts are prior to the amortization of 50% of the merger acquisition premium reflected on Line 21. The $42.5 million difference between the Staff's and Joint Applicants' projections for Years 6–10 can be summarized as follows based upon the amounts reflected for both parties on Schedule SMT-3A, Exhibit 729:

	(millions)
Joint Applicants' projected net savings for Years 6–10	$38.4
Difference in projected Joint Dispatch Savings between Joint Applicants and Staff	($32.0)[4]
Difference in Transaction/Transition Cost recovery between Joint Applicants and Staff	$7.5[5]
Difference in UtiliCorp Overhead Costs allocated back to SJLP between Joint Applicants and Staff	($18.0)[6]
Staff's projected net savings for Years 6–10	($4.1)

Staff witness Michael Proctor considers all but $1.8 million of the Joint Applicants' projected $33.8 million in Joint Dispatch savings (Sch. SMT 3A, Ex. 729, Line 1, Columns B and F) to be obtainable by SJLP on a stand-alone basis. (Proctor Rebuttal, Ex. 714, p. __). Therefore, $32 million of the projected Joint Dispatch savings are non-merger related and should not be considered in a decision as to whether this proposed merger meets the not detrimental to the public interest standard.

Staff witness Steve Traxler addresses in his rebuttal testimony the issue raised by him regarding the inflation rate assumption used for UtiliCorp's corporate overhead costs to be

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4 Joint Applicants' Line 1, Column B $33.9 million less Staff's Line 1, Column F $1.8 million equals ($32.0) million.

5 Joint Applicants' Line 8, Column B ($7.5) million less Staff's Line 8, Column F $0.0 equals $7.5 million.

6 Joint Applicants' Line 15, Column B ($52.6) million less Staff's Line 15, Column F ($70.5) million ($18.1) million.

allocated to the SJLP division post-merger. Joint Applicants witness Vern Siemek assumed an inflation rate of 2.5% to escalate UtiliCorp's corporate overhead costs to be allocated to SJLP in his 10-year merger cost/benefit analysis. (Traxler Rebuttal – Replacement Pages, Ex. 721, p. 27). By understating/under-projecting the UtiliCorp corporate overhead costs to be allocated to SJLP, the Joint Applicants have overstated/over-projected the net savings from the proposed merger by $18 million and understated/under-projected SJLP's future cost of service relating to the allocation of UtiliCorp's overhead costs to the SJLP. The Staff refutes the 2.5% inflation rate assumption of the Joint Applicants as being too low based upon an analysis of UtiliCorp's actual historical increase in corporate overhead costs allocated to its MPS division. The Staff believes that the actual annual escalation of UtiliCorp corporate overhead costs in recent years is the best indicator of what will likely be the escalation of corporate overhead costs allocated to SJLP after the proposed merger. MPS' allocated share of UtiliCorp's corporate overhead costs has increased from $10.3 million in 1995 to $46.5 million in 1999. (Id. at 29). The Staff's analysis reflects UtiliCorp's actual experience regarding its allocation of overhead costs to MPS from 1995 through 1999, showing the average annual increase in UtiliCorp's corporate overhead costs allocated to MPS using 1995 as the first year from which average annual increases in the UtiliCorp corporate overhead costs allocated to MPS are measured. (Ex. 725; Vol. 7, Tr. 870-72). Calculation of the average annual increases in UtiliCorp's corporate overhead costs allocated to MPS reveals the following:

Annual increase in UtiliCorp corporate overheads costs allocated to MPS from UtiliCorp 1995-1996	160.2%
Annual increase in UtiliCorp corporate overheads costs allocated to MPS from UtiliCorp 1996-1997	53.7%
Annual increase in UtiliCorp corporate overheads costs allocated to MPS from UtiliCorp 1997-1998	8.8%

Annual increase in UtiliCorp corporate overheads costs allocated to MPS from UtiliCorp 1998-1999	3.5%
1996-1999 4-year average annual increase in UtiliCorp's corporate overhead costs allocated to MPS using 1995 as the first year from which the annual increase is measured	45.7%
1997-1999 3-year average annual increase in UtiliCorp's corporate overhead costs allocated to MPS using 1996 as the first year from which the annual increase is measured	20.0%
1998-1999 2-year average annual increase in UtiliCorp's corporate overhead costs allocated to MPS using 1997 as the first year from which the annual increase is measured	6.2%

(Id.; Ex. 725).

UtiliCorp's actual historical experience regarding its MPS division shows that the Joint Applicants' use of a 2.5% inflation rate is inappropriately understated. Staff witness Traxler has conservatively utilized a 5% inflation rate for the purpose of estimating the corporate overhead costs that will be allocated from UtiliCorp to the SJLP division post-merger. Based upon UtiliCorp's historical experience with the MPS division, as shown above, it can be argued that even a 5% inflation rate assumption is too low. As noted earlier, using the much more likely 5% inflation rate for UtiliCorp's corporate overhead costs allocated to SJLP reduces the Joint Applicants' projected net merger savings in Years 6–10 alone by $18 million. (Traxler Rebuttal, Ex. 718, p. 30; Ex. 725).

In summary, the proposed SJLP-UtiliCorp merger does not meet the not detrimental to the public interest standard because after the Joint Applicants' projected results are adjusted to reflect more reasonable assumptions and appropriate ratemaking principles respecting the Joint Dispatch savings, the UtiliCorp Corporate Overhead Cost Allocations and the Transaction / Transition costs areas, total merger costs exceed total merger savings by $4.1 million for Years

6–10 reflected above. Additionally, this projected detrimental impact on the SJLP cost of service occurs prior to the proposed amortization of 50% of the acquisition premium. The amortization of 50% of the acquisition premium for Years 6–10 is reflected on schedule SMT-3 A, Line 21, Column B as amounting in total to $30.5 million. Adding the $30.5 million cost of the amortization of 50% of the acquisition premium to Staff's projected $4.1 million of negative net merger savings, i.e., net merger "costs," results in a total net merger cost of $34.6 million for Years 6–10. It is the Staff's position that savings from this proposed merger are not adequate to cover the merger costs that will result for the SJLP division, causing a need for rate relief solely as a result of the SJLP – UtiliCorp merger.

Regarding the Joint Applicants' proposed guaranteed $1.6 million net benefit to SJLP ratepayers to be reflected in the post-moratorium rate case, the Staff has additional concerns regarding the validity of the basis of this assumption. As discussed above, the Staff does not consider the $1.6 million in net savings to be a reasonable expectation due primarily to the Joint Applicants' erroneous assumptions in the Joint Dispatch and UtiliCorp Corporate Overhead Cost Allocations areas.

The additional concern regarding this $1.6 million benefit guarantee is that the Joint Applicants' own projections indicate that actual merger savings are not expected to be sufficient by the date of the post-moratorium rate case to cover merger costs, the 50% merger premium amortization and the $1.6 million guaranteed minimum benefit to SJLP ratepayers. The $1.6 million guaranteed amount is based upon a projected net savings level for the Years 6–10. The proposal is described in Joint Applicants' witness John McKinney's direct testimony (Ex. 4), page 6, lines 20 to page 7, line 9:

> 4. Included in these rate filings will be the complete flow-through of all test-year O&M synergies, adjusted to the forward average level of

saving for years 6 through 10 of the regulatory plan, net of the costs to achieve the synergies, resulting from the merger.

5. Fifty percent (50%) of the unamortized balance of the acquisition premium paid by UtiliCorp for SJLP will be included in the rate bases of the SJLP unit's retail electric, gas and steam operations and the annual amortization of this acquisition premium will be included in the expenses allowed for recovery in cost of service in these cases. The return allowed on this premium, for the recovery period, will be based on the capital structure of 60% debt and 40% equity as established by Mr. Siemek in his synergy study; <u>the net effect of item #4 and #5 is a guaranteed minimum reduction in the SJLP requirement of $1.6 million</u>.

(Emphasis added).

The Commission is being asked to accept a projected net savings amount for Years 6–10 as sufficient evidence to support the $1.6 million guaranteed benefit to SJLP ratepayers. The Joint Applicants expect the Commission to approve this merger and the regulatory plan at the present based upon projected amounts for Years 6–10, and additionally to set rates based upon projected amounts in the post-moratorium rate case to go into effect at the end of Year 5 of the 10-year regulatory plan. The $1.6 million guaranteed benefit to SJLP ratepayers, which is the Joint Applicants' basis for satisfying the not detrimental to the public interest standard, is based upon projected assumptions now and will be based on projected assumptions again in the rate case in which the Joint Applicants are supposed to effectuate the $1.6 million guaranteed benefit. Mr. Traxler testified that projections that far into the future should not be relied upon and such projections require that the Commission abandon setting cost based rates for SJLP. (Tr. 395).

V. ACQUISITION ADJUSTMENTS / ACQUISITION PREMIUMS

A. SJLP - UtiliCorp Proposal And Commission History

The proposed transaction is a voluntary action by the managements of SJLP and UtiliCorp based on management's perception of their shareholders' interests. UtiliCorp appears to have been motivated, in part, by the perception that benefits in nonregulated areas of its operations are expected to occur as a result of this proposed transaction. Among other things, SJLP's existing generating facilities are considered to be low-cost units with a potential market value in an unregulated electricity generation marketplace in excess of their net book value. The perceived value of these assets would be a reason why UtiliCorp would be willing to pay a significant acquisition premium for SJLP. (Oligschlaeger Rebuttal, Ex. 713, pp. 13-15).

Mr. Robert K. Green, President and Chief Operating Officer of UtiliCorp, stated in his direct testimony that UtiliCorp considered transferring the generation assets of SJLP and UtiliCorp to an exempt wholesale generator (EWG), but because of concerns that arose respecting property tax assessments of EWGs and the "not detrimental to the public interest" standard, UtiliCorp concluded that an EWG proposal would jeopardize the merger. Mr. Green clearly indicated that the EWG transaction has not been abandoned by UtiliCorp in that he requests that the Commission work jointly with UtiliCorp to address these tax concerns in the 2000 Missouri Legislature. (Green Direct, Ex. 2, p. 21). Respecting the issue of the acquisition premium, it is also worth noting that Mr. Green testified that had the generation assets of SJLP and UtiliCorp been transferred to an EWG, it would have been appropriate to "place the burden of recovering a significant portion of the acquisition premium on the merchant capabilities of the EWG." (Id.). It is appropriate to allocate a portion of the acquisition premium to nonregulated operations regardless of whether there is presently a transfer of assets to an EWG because the perceived future value of these assets as an EWG contributed to the acquisition premium. (Oligschlaeger Rebuttal, Ex. 713, p. 15).

The Joint Applicants have not contended that the public interest requires them to enter into the proposed merger in order to provide safe and adequate service. As a consequence, they must argue for the inclusion of the acquisition premium in rates on the basis that the cost savings to be experienced by ratepayers as a result of the merger exceed the increase in rates associated with the acquisition premium. This analysis is biased against the interests of ratepayers. While the amount of an acquisition premium is for the most part known with certainty at the time that a merger closes, merger savings, in contrast, are very speculative and difficult, perhaps impossible, to accurately measure. The assertion by applicants that merger savings exceed merger costs requires "a leap of faith" by others and places the risk of not attaining merger savings projections on the ratepayers rather than the acquiring entity. (Oligschlaeger Rebuttal, Ex. 713, p. 20).

At least two electric investor-owned utilities have argued for the use of net original cost for ratemaking purposes. In 1983, when Kansas Power & Light Company (KPL, the predecessor of Western Resources, Inc.) acquired the Gas Service Company (Gas Service, the predecessor of Missouri Gas Energy) at below book value and subsequently when KPL merged Gas Service into KPL, KPL did not use or advocate any valuation of Gas Service other than net original cost. (Featherstone Rebuttal, Ex. 704, p. 36).[7] KPL acquired Gas Service at approximately 89% of net book value in 1983 by purchasing all of the outstanding common stock of Gas Service and then operating it as a wholly owned subsidiary of KPL. KPL never advocated the use of a negative acquisition adjustment to value Gas Service's rate base in setting rates at any time that it owned Gas Service. (Id. at 36). Whereas neither the Missouri Commission nor its Staff treated the Gas Service acquisition by KPL at below book value for ratemaking purposes, the KCC and the KCC Staff did. Since this Commission did not "write down" the Gas Service assets,

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[7] See Re Kansas Power & Light Co., Case No. GM-84-12, 26 Mo.P.S.C.(N.S.) 254 (1983). In 1985, KPL acquired all of the outstanding 8 1/2% preferred stock of Gas Service. See Re Kansas Power & Light Co., Case No. GF-85-182, Order Authorizing Acquisition Of Stock (1985). In 1985, KPL merged Gas Service with and into KPL. See Re Kansas Power & Light Co., Case No. GM-85-186, 27 Mo.P.S.C.(N.S.) 381 (1985).

customers paid higher rates to KPL under the original cost theory than if below book values were used to determine rate base. Thus, KPL benefited from this Commission's use of original cost theory by collecting higher rates from Missouri customers for assets that, in effect, were overstated. (Id. at 37).

In a June 13, 1986 Order in Docket No. 148,312-U, the KCC treated the Gas Service acquisition by KPL on a total company basis at an effective cost below book value of $8.4 million on a total company basis and adopted for ratemaking purposes an amortization of negative goodwill. This treatment had the effect of increasing revenues and thus decreasing the revenue requirement. (Featherstone Rebuttal, Ex. 704, p. 39).

In 1983 when KPL and Gas Service sought the KCC's authorization of KPL's acquisition of all of the common stock of Gas Service, the KCC authorized the transaction and directed KPL and Gas Service to submit in Docket No. 138,495-U a legal analysis of whether the KCC should consider adjusting the rate base of Gas Service to reflect the purchase price of Gas Service common stock at approximately 89% of net book value. In a Joint Submission, KPL and Gas Service argued that Gas Service's rate base should not be adjusted, but should be left at net original cost, stating in part as follows:

> The Commission has the "duty to ascertain the reasonable value of all property of any [regulated public utility] whenever it deems the ascertainment of such value necessary in order to enable the Commission to fix fair and reasonable rates...." K.S.A. 66-128. The rate base of a public utility represents the reasonable value of all property which is in service and devoted to the public use. [Citation and footnote omitted.]. Because the value of the corporation's property remains unchanged as the corporation's stock is bought and sold, the transfer of a utility's stock, the indicia of ownership in a corporate entity whose stockholders are separate and distinct from the entity itself, does not affect the value of its property in service and devoted to the public use. Thus, no recalculation of the utility's property, or rate base, is appropriate.
>
> The current rate base of Gas Service is derived from the original cost of the property when first dedicated to public use. The purchase of its stock does not

affect original cost. A new stockholder does not purchase the assets of the corporation. Nor does a change in, or substitution of stockholders establish a new business entity. Transfer of ownership of common stock does not affect the ownership of the corporation's property, which still belongs to the corporation. [Footnote omitted.].

In a stock transfer, no assets are removed from public service or transferred to another business entity. The same assets will continue to be used to provide the same services to the same ratepayers and the assets will remain subject to the same ratemaking jurisdiction of the same regulators. This continuity makes a recalculation of Gas Service's rate base incongruous.

Aside from the legal issues raised by the Commission's inquiry, revaluation of utility plant measured by the price paid for common stock would produce practical difficulties of potentially significant dimensions. Revaluation, whether on a stock acquisition or purchase of utility assets, would ultimately tend toward higher costs to consumers, since it would provide no incentive to make acquisitions at less then [sic] book value. If it is appropriate to write down rate base when stock is purchased below book value, it would be equally correct to write up rate base when the stock is acquired, at a premium . . . .

. . . .

Even if the nature of this transaction could be disregarded and treated as a purchase of the assets of Gas Service, there should be no change in the rate base in recognition of the general rule that the rate base represents the original cost of utility property when dedicated to public use regardless of the price at which it is purchased by another utility. [Citations omitted.].

In Kansas the rate base is not recalculated even when the assets are purchased at less than the original cost. [Citation omitted.]. This Commission determined that the reasonable value of property purchased from other utilities was <u>not</u> its purchase price but rather the higher <u>original cost</u> to the first entity which devoted the property to public service. [Citation omitted.]. The Commission accepted Staff's proposed adjustment to increase the utility's rate base from the purchase price of property already devoted to public service to its original cost when first devoted to public service. The Commission considered the increase to be "a traditional adjustment which recognizes for rate-making purposes that the rate base should be the original cost of plant when dedicated to public use regardless of price at a subsequent sale." [Citation omitted.].

This carryover of book value is an appropriate valuation method because original cost is an appropriate determinant of reasonable value, and because the purchase price of Gas Service's stock does not accurately reflect the value of its assets. First, even assuming that the purchase price of Gas Service's stock accurately reflected the market value of its assets, there is no sound reason for deviating from the original cost or book value methodology adopted or given great weight

> in Kansas and most other jurisdictions. [Citations omitted.]. The primary reason for the general preference of the net book value over market value is that it is readily ascertainable while market value is much more difficult to compute. Kansas places great value on the original cost of utility properties precisely because it is readily ascertainable. [Citations omitted.]. Because the market value of assets seldom changes precisely in accordance with depreciation, depreciated original cost is often not an accurate proxy of current fair market value. Nonetheless, original cost accounting is employed to avoid the difficulties of more subjective methods of property valuation. The use of the depreciated original cost valuation method provides an objective method of valuation without the need for independent assessments of the fair market value of acquisitions.
>
> The unfortunate result of utilizing purchase price in this case would be to encourage the future transfer of properties at a premium above original cost regardless of fair market value. For example, had KPL paid above book value for Gas Service's stock, Gas Service's rate base would have increased, resulting in greater costs to consumers. One reason for the applicability of original cost concept to acquisitions was to prevent utilities from artificially inflating their rate bases by acquiring properties at unrealistically high prices. [Citation omitted.]. Exceptions to original cost valuation where the purchase price of assets exceeds net book value generally require a showing that benefits accrue to the acquiring public utility and its ratepayers sufficient to justify deviation from original cost. [Citations omitted.].
>
> . . . .
>
> Common stocks, preferred stocks and first mortgage bonds of all publicly held utilities in Kansas, including KPL, are bought and sold nearly every day at prices which fluctuate nearly every day. Some are traded above book value and some below book value. Commission consideration of a rate base adjustment in this case would, if permitted to stand, logically dictate similar adjustments--up or down--for each utility regulated by the commission in each rate case. The Commission, of course, has never based rate base valuation on the fluctuating trading price of a utility's stocks or bonds. Clearly, it should not consider such unwarranted and unlawful adjustments from henceforth.
>
> This inquiry has confirmed the propriety of Commission use of original cost as the basis of the value of property devoted to utility service.

(Featherstone Rebuttal, Ex. 704, Schedule 2). KPL's position at that time was clear: if the KCC were to consider the negative adjustment to value Gas Service's rate base, then that position would "logically dictate similar adjustments – up or down – for each utility regulated by the [Kansas] Commission in each rate case." (Id.).

Although the Staff has not previously proposed a negative acquisition adjustment, the Office of the Public Counsel did so in the 1988-1989 rate increase case of U.S. Water/Lexington, Missouri, Inc. The water company and the Staff agreed to an original cost rate base. The Commission rejected the Public Counsel's negative acquisition adjustment recommendation. Thus, a negative acquisition adjustment was not used to reduce the water company's rate base, or to reflect a negative amortization to the water company's cost of service. Re U.S. Water /Lexington, Missouri, Inc., Case No. WR-88-255, 29 Mo.P.S.C. (N.S.) 552, 555-56 (1989). In that proceeding the Commission's former Chief of Economic Research, John C. Dunn, testifying on behalf of the water company stated at page 22 of his rebuttal testimony that the Commission had traditionally rejected the use of positive acquisition adjustments for ratemaking purposes. Mr. Dunn strongly argued that the appropriate and traditional ratemaking theory relating to acquisition adjustments is the use of net original cost:

> Further, the Commission has historically adopted a policy of original cost ratemaking. Regardless of purchase prices, when properties are bought and sold, the Commission has, unless there were compelling circumstances otherwise, regulated on the basis of original cost. There are numerous properties within the state which have been acquired at prices above original costs. The Commission has routinely rejected the use of the purchase price when it is greater than original cost. It appears to me to be entirely unreasonable for the Commission to now take an asymmetrical position and adopt purchase price as the appropriate standard when the purchase price occurs below original cost. Either Missouri is original cost ratemaking, or it is not.

(See Featherstone Rebuttal, Ex. 704, pp. 39-40). In its initial brief, the attorneys for the water company argued the concept of "net original cost" rate base, stating, in part, as follows:

> ...a negative acquisition adjustment would not be appropriate for general ratemaking principles either. Mr. Drees provided a brief review of the situations which gave rise to the "original cost when first devoted to public service" rules. (Exhibit 6, p. 6) This principle has served to protect ratepayers from utilities selling at inflated prices and then seeking to have the regulators revalue the properties at the higher level, just to produce greater profits. Although there are always exceptions, Mr. Drees concludes that sales of utility property at higher than net book value should be borne

> by the shareholders. USW is under the impression that is the general principle utilized by this Commission, although there may have been a few exceptions.

(Id. at 40 and Schedule 3). It should be noted that Mr. Dunn on numerous occasions has appeared in Missouri and other states on behalf of UtiliCorp and MPS. He appeared before this Commission most recently as a rate of return witness for UtiliCorp and MPS in the rate increase case, Case No. ER-97-394. (Id. at 41).

It is the Staff's position that if it is inappropriate to use a negative requisition adjustment to establish rates, then it is equally inappropriate to use a positive acquisition adjustment. Fairness would require that consistent treatment be given for both positive and negative acquisition adjustments. (Id. at 39). Acceptance of a positive acquisition adjustment would be a reversal of long-standing Commission precedent.

The use of net original cost to determine rate base valuation for ratemaking purposes provides consistency in establishing utility rates. According to Mr. Dunn at page 23 of his rebuttal testimony, it also provides utilities the incentive to acquire utility properties of troubled utilities where it would be in the public interest for troubled utilities to be acquired by another company:

> . . . troubled properties would never be sold. Here, the Commission was confronted with a troubled property and a buyer willing to purchase that troubled property for less than original cost assuming original cost regulation. That difference was part of the incentive in the transaction. Without the incentive associated with this opportunity, the property would have never changed hands and improvements wouldn't even have been contemplated.
>
> If the Commission adopts an asymmetrical policy in this proceeding where it uses the lower of purchase price or original cost to make rates, no potential buyer would even consider purchasing a troubled property in Missouri.

(Featherstone Rebuttal, Ex. 704, p. 41).

Authorizing utilities to recover in rates acquisition premiums would be inconsistent with the position that the Commission has consistently taken on gains on sales. The Commission has not flowed to ratepayers any gains on the sale of utility property. The Commission has permitted the shareholders of the selling utility to realize the entire benefit of the gain on the basis of the following rationale in Re Kansas City Power & Light Co., Case No. ER-77-118, 21 Mo.P.S.C.(N.S.) 543, 576 (1977):

> It is the Commission's position that ratepayers do not acquire any right, title and interest to Company's property simply by paying their electric bills. It should be pointed out that Company investors finance Company while Company's ratepayers pay the cost of financing and do not thereby acquire an ownership position. Therefore, the Commission finds that the disposal of Company property at a gain does not entitle its ratepayers to benefit from that gain nor does the disposal of Company property at a loss require that Company's ratepayers absorb that loss.

See Re Southwestern Bell Tel. Co., Case Nos. TC-89-14, et al., 29 Mo.P.S.C.(N.S.) 607, 628-30 (1989); Re Missouri Cities Water Co., Case No. SM-87-8, 29 Mo.P.S.C.(N.S.) 178, 180-83 (1987); Re Kansas City Power & Light Co., Case Nos. EO-85-185 and EO-85-224, 28 Mo.P.S.C.(N.S.) 228, 253-56 (1986); Re Associated Natural Gas Co., Case No. GM-81-368, 26 Mo.P.S.C.(N.S.) 237 (1983); Re Missouri Cities Water Co., Case Nos. WR-83-14, WM-82-147, WM-82-192, and SR-83-15, 26 Mo.P.S.C.(N.S.) 1, 10-19 (1983).

The Staff maintains that it would be inequitable for the shareholders of the selling utility to receive the benefit of any gain from the sale of utility property, and for the utility buying the utility property to be authorized to recover from its ratepayers any premium or excess costs above net book value. The utility's ratepayers are disadvantaged and treated unfairly, if the seller's gain is taken below-the-line and the buyer's premium is placed above-the-line. (Featherstone Rebuttal, Ex. 704, pp. 42-43; See Hyneman Rebuttal, Ex. 707, pp. 45-48).

The net original cost approach also appropriately addresses the situation where a Commission regulated utility would sell utility property to another utility and later reacquire the very same properties through a merger or acquisition. Such a situation occurred with Union Electric Company. On March 12, 1992, UE filed an application with the Commission, creating Case No. EM-92-225, to sell its Iowa properties to Iowa Electric Light & Power Company (Iowa Electric). On March 31, 1992, UE also filed an application with the Commission, creating Case No. EM-92-253, to sell its northern Illinois facilities to CIPSCO. The Commission authorized the sale of these properties in Re Union Electric Co., Case Nos. EM-92-225 and EM-92-253, Report And Order, 1 Mo.P.S.C.3d 501 (1992).

The gain on UE's northern Illinois property was approximately $4.8 million and the gain on the Iowa property was approximately $29.2 million. (Featherstone Rebuttal, Ex. 704, p. 44). CIPSCO established an acquisition adjustment of approximately $4.9 million for the northern Illinois property. UE treated the gain on the northern Illinois property below-the-line for ratemaking purposes, i.e., the gain from the sales of the northern Illinois property was flowed entirely to UE's shareowners. The merger between UE and CIPSCO had the effect of bringing the property back to UE shareowners. UE reacquired the northern Illinois properties. By its merger application filed with this Commission, UE sought to charge ratepayers the merger premium that CIPSCO had paid to UE for the UE northern Illinois property. This would have been inconsistent with the treatment given by UE to the gain on the sale of this northern Illinois property. (Id. at 45-46).

Contrary to an assertion by John McKinney of UtiliCorp, disallowance of merger premiums has not prevented mergers or acquisitions from occurring in Missouri. (Featherstone Rebuttal, Ex. 704, pp. 46-47). If any merger or acquisition involving a utility with service territory in Missouri has failed to be consummated, it is not because of no direct recovery in rates of a merger premium. KPL agreed to pay an amount in 1991 for KGE which exceeded net book value, resulting in an acquisition adjustment of approximately $388.7 million. In authorizing the merger, the Commission ultimately did not provide for the recovery in rates of merger premium. A list of merger/acquisition filings with this Commission that resulted in negotiated settlements, in which the utilities agreed not to seek recovery of the merger premium in rates, follows:

(1) Re GTE Corporation, Case No. TM-91-123, Report And Order, 30 Mo.P.S.C.(N.S.) 461 (1991) – GTE Corporation acquired Contel Corporation, which became a wholly owned subsidiary of GTE Corporation – "Inasmuch as the merger will be accounted for as a 'pooling of interests,' GTE North and the Contel operating companies will not seek to recover in any future Missouri rate case filings or investigations of earnings any increased amounts in the equity base of the merged corporate parents which could be inflated by an acquisition adjustment." Attachment A (Stipulation And Agreement) to the Commission's Report And Order; Id. at 465.

(2) Re Union Electric Co., Case Nos. EM-91-29 and EM-91-404, Report And Order, 1 Mo.P.S.C.3d 96 (1991); Case No. EO-87-175, Report And Order, 30 Mo.P.S.C.(N.S.) 406 (1990) – Union Electric Company acquired portions of the Missouri property of Arkansas Power & Light Company – "The amount of any acquisition premium (i.e., the amount of the purchase price above net book value) paid by UE to APL for the electric properties of APL shall be treated below the line for ratemaking purposes in Missouri and shall not be sought to be recovered by UE in rates in any Missouri proceeding, and the Joint Application should be considered as amended in this regard." Attachment A (Stipulation And Agreement) to the Commission's Report And Order; 1 Mo.P.S.C.3d at 108.

(3) Re Southern Union Co., Case No. GM-94-40, Report And Order, 2 Mo.P.S.C.3d 598 (1993)(Report And Order is published in 2 Mo.P.S.C.3d, but the Stipulation And Agreement, Attachment A to the Report and Order, is not published) – Southern Union Company (Missouri Gas Energy) acquired Gas Service from Western Resources, Inc. (Kansas Power & Light Company) – "Comparison of the concerns of the Staff and OPC and the resultant conditions in the Stipulation and Agreement indicate that major concerns of the parties were at least partially alleviated. . . . The acquisition cost itself, called a purchase premium, will clearly not be passed on to the ratepayer." Id. at 602. Pages 2-3 of the Stipulation And Agreement state, in part, as follows: "The amount of any acquisition adjustment (i.e., the amount of the purchase price above net book value) paid by Southern Union to Western Resources for

the gas properties of Western Resources shall be treated below the line for ratemaking purposes in Missouri and neither amortization nor inclusion of the premium in rate base shall be sought to be recovered by Southern Union in rates in any Missouri proceeding."

(4) Re Union Electric Co., Case No. EM-96-149, Report And Order, 6 Mo.P.S.C.3d 28 (1996) – Union Electric Company acquired CIPSCO – "UE has agreed that it will not seek to recover the asserted merger premium of $232 million in rates in any Missouri proceeding. The merger premium represents the portion of the purchase price that exceeds the current book value of the acquired company's assets or market value of the acquired company's stock." Id. at 31.

(5) Re Atmos Energy Corporation, Case No. GM-97-70, Report And Order, 6 Mo.P.S.C.3d 164 (1997)(Report And Order is published in 6 Mo.P.S.C.3d, but the Stipulation And Agreement is not published) – Atmos acquired United Cities Gas Company – "Under the terms of the Stipulation and Agreement, Atmos has agreed that it will not seek recovery of any asserted merger premium in rates in any Missouri proceeding. [Citation omitted.]" Id. at 166.

(6) Re Western Resources Inc., Case No. EM-97-515, Report And Order (1999) – Western Resources Inc. acquired Kansas City Power & Light Company – "The parties have agreed that the amount of any asserted merger premium, i.e., the amount of the purchase price above the net book value, paid by Western Resources for KCP&L shall not be recoverable in rates. The parties further agreed that the Joint Applicants, including Westar, shall not seek to recover the amount of any asserted acquisition premium resulting from this transaction in rates in any Missouri proceeding and the joint application should be considered amended on this issue. In addition, the parties agreed that Westar shall not seek to recover in Missouri the amount of any asserted acquisition premium in this transaction as being a 'stranded cost' regardless of the terms of any legislation permitting the recovery of stranded cost from ratepayers. The parties further agreed that it is unnecessary to develop a post-merger savings quantification tracking mechanism with respect to the instant merger and that none shall be proposed in future proceedings in Missouri." Report And Order, p. 4.

(7) Re Atmos Energy Corporation, Case No. GM-2000-312, Report And Order, Mo.P.S.C.(N.S.) (2000) – Atmos Energy Corporation acquired the facilities of Associated Natural Gas Company in Missouri – "The amount of any asserted acquisition premium (i.e., the amount of the total purchase price above net book value), including transaction costs, paid by Atmos for ANG properties or incurred as a result of the acquisition shall be treated below the line for ratemaking purposes in Missouri and not recovered in rates." Page 8 of Attachment 1 (Stipulation And Agreement) to the Commission's April 20, 2000 Order Approving Stipulation And Agreement.

The unconsummated merger between UtiliCorp and Kansas City Power & Light Company (KCPL) comprising Case No. EM-96-248 affords an example of a pooling of interest transaction involving UtiliCorp. Although this transaction was abandoned because Western Resources, Inc. ultimately outbid UtiliCorp for KCPL, it provides an example of a pooling of interests transaction involving UtiliCorp. (Oligschlaeger Rebuttal, Ex. 713, p. 17). (The initial public announcement of the SJLP – UtiliCorp merger transaction made reference to the fact that the combination was to be accounted for as a pooling transaction and not a purchase transaction. Several months later the Joint Applicants changed the treatment of the transaction to a purchase because of stock options issued by UtiliCorp in late 1998. (Id. at 16).) Acquisition adjustments arise from transactions that are accounted for using the purchase method of accounting. Acquisition adjustments do not arise from transactions that are accounted for using the pooling method of accounting. Purchase transactions are in essence sales of assets by one entity to another. Pooling transactions conceptually are a combining of shareholder interests by previously separated companies through an exchange of stock. No additional investment (acquisition adjustment) is recorded on the combined entity's books of account under a pooling of interests transaction, as compared to the accounting respecting a purchase transaction. (Id. at 15).

UtiliCorp witness Mr. Robert K. Green cited in his direct testimony (Ex. 2) at page 12 the Commission having articulated in Case Nos. WR-95-205 and SR-95-206, respecting Missouri-American Water Company, and Case No. EM-91-213, respecting Kansas Power & Light Company (now Western Resources, Inc.), a policy position on acquisition premium recovery such that "[UtiliCorp] assumed that the Commission would provide UtiliCorp with a reasonable opportunity to recover the acquisition premium." (Green Direct, Ex. 12, p.11). Mr. Green's discussion of those cases is very attenuated. In actuality, neither of these cases indicates that those Commissions would have been disposed to approve the SJLP – UtiliCorp regulatory plan. In Re Missouri-American Water Company, Case No. WM-93-255, Report And Order, 2 Mo.P.S.C.3d 305 (1993), Missouri-American Water Company (Missouri-American) sought Commission approval to acquire 100% of the common stock of Missouri Cities Water Company (Missouri Cities). Stating that this request was the main issue in the case, the Commission noted that although the Public Counsel took no position on the main issue "[t]he Office of the Public Counsel did, however, express concern, along with the Staff, regarding any anticipated acquisition adjustment as a result of the possible merger of the buyer and the seller." Id. at 308. The Commission emphasized that the only issue before it in this case was the request for approval or rejection of the proposed sale of stock, and related that "[t]he Commission takes no position on the prudence or value of the acquisition, any anticipated acquisition adjustment, rate increase, or merger of the two systems. These issues must be dealt with at the appropriate time, and in the appropriate case." Id. at 311. In "Ordered" item "3.", the Report And Order stated that "the Commission specifically makes no finding, and takes no position in regard to the treatment, for ratemaking purposes, to be afforded any acquisition cost incurred in this transaction. The Commission reserves the right to consider, in full, any potential merger, and resulting costs, which might be contemplated as the result of this transaction." Id. at 313.

Missouri-American and Missouri Cities filed Case No. EM-95-150 to obtain the Commission's authority to merge Missouri Cities into Missouri-American. The Commission authorized the merger. Case Nos. WR-95-205 and SR-95-206 were filed by Missouri-American for the purpose of increasing the water and sewer rates for the merged company. Re Missouri-American Water Co., Case Nos. WR-95-205 and SR-95-206, Report And Order, 4 Mo.P.S.C.3d

205 (1995). In the context of Case Nos. WR-95-205 and SR-95-206, Missouri-American sought recovery of an acquisition adjustment /merger premium of $4,392,316. The Staff, OPC and all of the intervenors opposed recovery of the acquisition adjustment. The Commission found that Missouri-American's quantification of the alleged benefits of the acquisition omitted or underestimated the costs of the acquisition to Missouri-American's customers and rejected Missouri-American's proposal for above-the-line ratemaking recognition of the Missouri-American acquisition adjustment:

> . . . The Commission finds the testimony of [Staff witness] Boltz to be competent and substantial for the showing that instead of savings alleged by the Company, the reverse is true.
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> . . . .
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> . . . The Commission finds the testimony of Boltz to be competent and substantial for the proposition that the Company's argument as to the acquisition adjustment does not portray an entirely accurate scenario.
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> The Commission finds in this case that the Company has failed to justify an allowance for the acquisition adjustment. . . . The Commission finds it is appropriate that the excess purchase costs over and above the net original cost of the Missouri Cities Water Company properties be booked to USOA Account 114 (Utility Plant Acquisition Adjustments) and amortized below the line over 40 years to USOA Account 425 (Miscellaneous Amortization).

Id. at 217.

As the Commission is well aware, Missouri-American's merger and acquisition activity did not end in 1995. On September 8, 1999, Missouri-American and United Water Missouri, Inc. (United Water) filed a joint application, establishing Case No. WM-2000-222, for authority for Missouri-American to acquire 100% of the common stock of United Water. The purchase price included an acquisition premium. (Re Missouri-American Water Co., Case No. WM-2000-222, Report And Order, p. 9 (2000)). The Staff recommended that the Commission approve the proposed acquisition, but that the Commission make the determination that Missouri-American would not be allowed to seek recovery of the merger premium in a future rate proceeding. The Staff characterized the possible future recovery by Missouri-American of the merger premium from ratepayers as a present detriment to the public. (Id. at 5).

The Commission held that the matter of the acquisition adjustment was not properly before the Commission in that it is a proper matter for a rate case and Case No. WM-2000-222 was not a rate case. The Commission stated that since Case No. WM-2000-222 was not a rate case, the Commission would not address the matter of the acquisition adjustment in Case No. WM-2000-222. (Case No. WM-2000-222, Report And Order at 7). The Commission related that "[t]he Commission reads State ex rel. City of St. Louis v. Public Service Commission, *supra*, 335 Mo. at 459, 73 S.W.2d at 400, to require a direct and present public detriment," and that "[t]he acquisition premium, which [Missouri-American] may seek to recover from ratepayers in a rate case yet to be filed, is not a present detriment." (Id.; See Concurring Opinion of Chair Sheila Lumpe). The Commission authorized Missouri-American to acquire 100% of the common stock of United Water, made no finding as to the value for ratemaking purposes of the properties, transactions or expenditures involved and reserved the right to consider in a later proceeding any ratemaking treatment to be afforded the properties, transactions and expenditures. (Id. at 10-11).

There is another Commission case where a merged company sought ratemaking recognition of purported merger savings and said proposal was rejected by the Commission. In 1996, MGE filed for a general rate increase, which established Case No. GR-96-285. Re Missouri Gas Energy, a division of Southern Union Co., Case No. GR-96-285, Report And Order, 5 Mo.P.S.C.3d 437 (1996)(remanded on other grounds). MGE argued that the unanimous Stipulation And Agreement in its merger case, GM-94-40, permitted it to request recovery of

50% of the achieved, ongoing savings resulting from Southern Union Company's acquisition of Western Resources' Missouri properties. MGE sought that an amount equal to one-half of purported identified, achieved and ongoing savings be recognized and treated as an expense for ratemaking purposes. Id. at 460. The Staff charged that MGE's proposal "'imputes' expenses to ratepayers which were not actually incurred by MGE." Id. at 461. The Staff recommended rejection of MGE's proposal on a number of grounds and the Commission rejected MGE's proposal:

> . . . Staff recommends that the Commission reject MGE's proposal because it does not represent appropriate or proper ratemaking policy because the alleged savings are not adequately quantified by MGE; the proposal is not fair and equitable; utilities other than MGE have also downsized without expecting any sharing of related savings; the alleged cost reductions benefited MGE at least up until any rate changes resulting from this proceeding; the proposal represents the equivalent of an incentive plan without any safeguards; the proposal shifts risks of MGE's cutbacks and related cost reductions to its customers; the proposal represents an attempted recovery of the acquisition premium from Case No. GM-94-40; and the proposal would take MGE off of cost of service ratemaking (cost-based rates). [Citation omitted.] The Staff further argues that adoption of MGE's proposal would reward the Company for providing a lower quality of service while at the same time requesting ratepayers to pay higher than cost-based rates.
>
> The Commission finds that MGE's acquisition savings adjustment should be rejected in total because adoption of this adjustment would be contrary to the provision of natural gas service based on the costs of providing such service and because MGE's experimental gas cost incentive mechanism already rewards MGE's shareholders for making financially sound gas procurement decisions.

Id.

Unlike UtiliCorp's proposal in the instant case, KPL in Case No. EM-91-213 did not request direct recovery of the acquisition premium in rates. In response to Staff Data Request No. 147 in Case No. EM-91-213, KPL stated that its proposed treatment of merger costs and benefits was based on a number of considerations, including "the jurisdiction's prior treatment of both negative and positive acquisition adjustments." Although the Commission stated its interest in the merger savings sharing concept proposed by KPL in Case No. EM-91-213, no part of the cost savings tracking system (CSTS) was ever implemented. The Commission stated in its Report And Order as follows:

> . . . the Commission will not approve at this time the savings sharing proposal. Staff has persuasively argued that KPL has a strong incentive to view savings as merger–related even if they are not and to classify them in the CSTS so as to increase the pool of savings subject to the sharing plan. Staff demonstrated several flaws in the CSTS which could allow nonmerger savings to seep into the pool of savings to be shared.
>
> The Commission is not opposed to the concept of the savings sharing plan provided that only merger–related savings are shared. The Commission does not wish to discourage companies from actions which produce economies of scale and savings which can benefit ratepayers and shareholders alike. However, the Commission wishes to ensure that savings which would have been offset against the cost of service without the merger, benefit ratepayers one hundred percent. To avoid any detriment to ratepayers it is imperative that only savings which would not have occurred absent the merger be shared by ratepayers with shareholders.
>
> . . . [T]he Commission will direct the parties to meet for the purpose of attempting to devise a method of tracking merger-related savings. If the parties are unable to agree on such a system within sixty days, the Commission will hold a hearing to gather the information necessary to decide if any tracking plan can exclude nonmerger-related savings and, if so, which system would be best suited to this purpose.
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> Re Kansas Power & Light Co., Case No. EM-91-213, Report and Order, 1 Mo.P.S.C. 3d 150, 156-57 (1991).
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> . . . .
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> IT IS THEREFORE ORDERED:
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> 9. That the parties to this case be directed hereby to meet for the purpose of attempting to devise a merger savings tracking plan (MSTP) which will ensure that all nonmerger related savings can be excluded from the merger savings to be shared between ratepayers and shareholders. The parties will file this plan with the Commission for its approval on or before November 22, 1991.

Id. at 161.

On December 13, 1991, the Commission in Case No. EM-91-213 issued a two page Order Adopting Staff's Suggestion And Closing Docket. The Commission's December 13, 1991 Order noted that rather than filing with the Commission on November 22, 1991 a merger savings tracking plan, which would ensure that all nonmerger related savings could be excluded from the merger savings to be shared between ratepayers and shareowners, the Staff and KPL filed pleadings proposing procedural schedules and, among other things, the Staff suggested that the merger savings tracking plan issue be decided in KPL's next rate case. In responsive pleadings Public Counsel supported and KPL did not oppose the Staff's suggestion that the merger savings tracking plan issue be decided in KPL's next rate case. The Commission adopted the Staff's suggestion, stating as follows:

> Based upon these pleadings, the Commission determines that Staff's suggestion should be adopted, to forego consideration of this issue in this docket. If KPL wishes to have the possibility of receiving a share of the merger savings it may use a system it considers appropriate for excluding nonmerger savings from the pool of savings which might be shared and present that approach to the Commission in its next rate case complete with the amounts to be shared. At that time the Commission will consider whether the device employed by KPL is sufficiently foolproof to permit sharing of merger savings with shareholders.

(Featherstone Rebuttal, Ex. 704, p. 69).

By KPL's next Missouri rate case, Case No. GR-93-240, KPL had taken the name Western Resources, Inc. In that case, Western Resources' Controller, Jerry D. Courington, indicated that Western Resources had discontinued the use of the cost savings tracking system because of "'the level of effort necessary to measure the savings and maintain the tracking system was relatively high when compared to the expected level of merger related savings in the jurisdictions in which it would be used.'" (Featherstone Rebuttal, Ex. 704, p. 70, quoting Courington direct testimony in Case No. GR-93-240, pp. 14-15). Mr. Courington recognized in his direct testimony that merger costs and savings netted each other out with the Missouri allocated costs being "virtually unaffected in total by the merger." (Id. quoting Courington direct testimony in Case No. GR-93-240, p. 15). Western Resources made no adjustments in Case No. GR-93-240 to reflect in rates any recovery of the asserted acquisition premium associated with the KGE merger. (Id.)

Returning to the KPL-KGE merger case, EM-91-213, the Staff would note that although Commissioner Allan G. Mueller did not oppose the merger of KPL and KGE, he dissented from the Commission's decision to adopt a savings sharing plan. Commissioner Mueller identified the reasons that he opposed KPL's sharing plan as follows (1 Mo.P.S.C.3d at 163-65):

1. A merger savings tracking plan cannot be developed that would accurately distinguish nonmerger savings from merger savings, and a multijurisdictional tracking plan cannot be developed that would be sufficiently sophisticated to protect the interests of Missouri ratepayers.

2. Adoption of the proposed sharing plan sends the wrong signal to companies regarding mergers and acquisitions. Companies will be less concerned about bargaining for the lowest possible price for assets purchased, if they know that the Commission will permit that ratepayers instead of shareowners pay the acquisition premium.

3. Adoption of the proposed sharing plan will create the impression that the Commission promotes mergers.

4. Fairness requires that the Commission should reject the sharing plan because KPL did not offer to share with ratepayers the benefit when it purchased the Gas Service Company below its book value.

5. KPL's management did not deserve the reward of having its shareholders receive 50% of the merger-related savings. KPL denied the Commission access to a full range of information on the propriety of the merger because it did not have available for the Commission the conservative scenario which was developed by Morgan Stanley for KGE.

"While I believe KPL barely carried the burden of proof to show no detriment to the Missouri ratepayers, given the safeguards this Commission has committed itself to, I do not believe that the case offered to this Commission by KPL deserves the reward implied by even contemplating approval of the sharing plan."

(1 Mo.P.S.C.3d at 164-65).

It should be abundantly clear and not be necessary to address, but given the nature of the Joint Applicants' attack on the Staff's opposition to the direct recovery of merger premiums, the Staff will note that the Western Resources – KCPL merger failed because of the negative effect of Western Resources' Protection One investment on the Western Resources stock price, not because of Western Resources' – KCPL's agreement not to seek in Missouri the direct recovery of the merger premium that Western Resources agreed to pay for acquiring KCPL or the terms of the Kansas Corporation Commission's authorization of the merger. (Featherstone Rebuttal, Ex. 704, pp. 54-63). The Western Resources – KCPL merger agreement permitted KCPL to terminate the merger if Western Resources' common stock price fell below $29.78 or if the merger was not completed by December 31, 1999. (Id. at 57-58). On December 31, 1999, Western Resources' common stock price closed at $16.94 per share, and on January 3, 2000, when KCPL announced its termination of the merger, Western Resources' common stock price was $16.50 per share. (Id. at 55, 59, 61). KCPL's financial advisor was unable to provide an opinion that the proposed transaction was fair to KCPL's shareholders from a financial point of view. (Id. at 61-62). The January 3, 2000 letter from A. Drue Jennings of KCPL to David Wittig of Western Resources also stated, in part, that "[i]n light of the continuing problems at Protection One, this important strategic rationale for the proposed merger no longer appears to exist." (Id. at 62).

The Staff has previously identified UtiliCorp as a utility that operates in the Missouri jurisdiction which has a very aggressive acquisition and merger corporate philosophy which also had a policy of not requesting recovery of any acquisition premiums. Mr. Richard C. Green, Jr., Chairman of the Board, Chief Executive Officer, and President of UtiliCorp stated in a meeting with the Commission in late 1985, early 1986 that MPS' ratepayers would be insulated from all downside risks associated with UtiliCorp's acquisition and merger strategy. He further indicated that all benefits of any acquisition and merger would be flowed to the ratepayers. Mr. Green reiterated this policy in a 1990 interview with the Staff and Public Counsel during the course of the Staff's and Public Counsel's audit of MPS' 1989-1990 rate increase case. He said that at no time had UtiliCorp sought, nor would UtiliCorp seek to recover acquisition premiums from ratepayers in any of the jurisdictions in which it operates. In MPS' 1990 electric rate increase case, the Commission held as follows regarding the UtiliCorp corporate office/acquisition and merger expense issue:

> The evidence indicates that Company has removed from its A&G costs most of the known expenses associated with M&A activities. The Commission believes that UtiliCorp's expenses for M&A activities should be removed from the expenses reflected in MPS's rates. When UtiliCorp was formed [sic] Company assured the Commission that the ratepayers would suffer no detriment from UtiliCorp's activities but would experience the benefits associated with UtiliCorp's activities. The commission believes that it is inconsistent with this pledge to include M&A costs in the expenses reflected in MPS's rates. The Commission is of the opinion that it is inappropriate for MPS's ratepayers to pay for these activities which have little to do with MPS's goal, of providing safe and adequate electric service in Missouri. Therefore, the Commission finds that the $70,280 of additional costs for M&A activities should be excluded from the cost of service. Finally, the Commission is concerned that Company has not been accounting for these costs separately. Accordingly, the Commission will direct Company to account for M&A costs separately so that they can be readily excluded in future rate cases from A&G costs reflected in MPS's rates.

Re Missouri Public Service, Division of UtiliCorp United Inc., Case Nos. ER-90-101, et al., Report And Order, 30 Mo.P.S.C.(N.S.) 320, 350-51 (1990).

The Staff's concerns about giving ratemaking treatment to acquisition premiums would not be resolved if the acquisition were an arm's length transaction (i.e., no affiliation or tie between the negotiating parties). The lowest possible or some otherwise appropriate purchase price may not necessarily be attained under an arm's length transaction. If the purchasing utility believes that there will be ratemaking recognition of an acquisition premium, there may be inadequate incentive for the purchasing utility to negotiate the best possible sales terms or an approximation thereto, or to even walk away from a bad offer or unfavorable negotiations. (Featherstone Rebuttal, Ex. 704, pp. 32-33).

The Staff would note what might be viewed by the Commission and merging companies as a major unintentioned consequence of a Commission decision that merger premiums should be directly recovered in the ratemaking process: the presentation for Commission determination of the issue what is the appropriate price at which the target utility should have been acquired, assuming that the acquisition was appropriate from all other perspectives. The Staff and Public Counsel have broached this matter, in part, in their cases in this proceeding (why did UtiliCorp raise its offer price from $22.50 to $23.00? See the rebuttal testimony of Charles Hyneman and Roberta McKiddy.) because of UtiliCorp's effort through its proposed regulatory plan to recover directly from ratepayers the merger premium. Including merger premiums directly in rates as UtiliCorp is proposing places on the Commission and its Staff the matter of determining what is the appropriate acquisition price. (Featherstone Rebuttal, Ex. 704, pp. 33-34).

Staff witness Michael S. Proctor testified that the adoption by the Commission of a policy of treating acquisition premiums as a merger cost and permitting their direct recovery would (1) remove incentives for utilities to minimize the amount of the acquisition premium and (2) would not mirror what occurs for non-regulated businesses. (Proctor Rebuttal, Ex. 714, p. 3). Dr. Proctor related that the acquisition premium of $92.2 million can be viewed as being comprised of two distinct components:

> Component 1: the difference between the market price per share (market value) of the common equity of SJLP and the price per share of the common equity of SJLP representing the book value of SJLP's assets (book value)

Market Value – Book Value
($17.125/share-$11.76/share)*(8.2 x 10^6 shares) = **$44.0 x 10^6**

Component 2: the difference between what will be paid by UtiliCorp per share of SJLP common equity to acquire SJLP and the market price per share of SJLP common equity

Acquisition Payment – Market Value
($23.00/share-$17.125/share)*(8.2 x 10^6 shares) = **$48.2 x 10^6**

(Proctor Rebuttal, Ex. 714, p. 6).

When the assets of a utility are sold, the difference between market value and book value of the shares of common equity should not be treated as a recoverable cost of the merger. If the merger is not detrimental to the public interest, then the earnings potential of the utility being acquired should not decrease due to the merger. Since the market value of the common equity of the company being acquired represents the market's evaluation of the earnings potential of the company being acquired and the earnings potential has not decreased due to the merger, the merger results in the same, if not better, earnings potential for the entity which is acquiring the target company. Thus, if new shareholders could have acquired the stock of the utility, they would have paid the market evaluation of the earning's potential of the stock that is either the same or better than it was prior to the merger. There is no loss of value in the stock to new shareholders that needs to be recovered through a devise that increases earnings, such as adding to rate base the difference between market value and book value. Existing shareholders should not be thought of as having an investment cost equal to a book value that is lower than the market price paid by the acquiring entity. What existing shareholders historically paid for their shares is a sunk cost to the existing shareholders, and is not relevant to current investment decisions or to what is required as an offer price to sell shares to the acquiring company. (Proctor Rebuttal, Ex. 714, pp. 9-10).

When the assets of a utility are sold, the difference between the acquisition payment and the market value of the stock of the acquired utility should not be treated as a recoverable cost of the merger. In order for the SJLP - UtiliCorp merger to occur, at least two-thirds of SJLP's current shareholders must have agreed to the sales price offered by UtiliCorp. Thus, the acquisition price represents the offer price that is expected to cause at least two-thirds of current SJLP shareholders to sell based on their overall evaluation of expected earnings, opportunity costs and required risk premiums. The market value of the acquired utility represents the value placed on future earnings at the margin. The lowest asking price would be slightly above the current market price, and the acquisition price would be at or above the asking price for two-thirds of the current shareholders. The reason that a company seeking to acquire another company is willing to make an offer that is higher than what other companies are willing to offer is that it sees higher earnings potential, has a lower opportunity cost, or has a difference risk preference than the other companies seeking to acquire another company. (Proctor Rebuttal, Ex. 714, pp. 10-11).

Dr. Proctor testified that regulatory policy should be based on a parallel to what would happen in competitive markets and mergers involving nonregulated businesses offer no recovery of acquisition adjustments. (Proctor Rebuttal, Ex. 714, p. 14). In nonregulated businesses, the acquiring company would look at the earnings potential from acquiring the target company and compare that to other opportunities in making a decision respecting how much to offer to acquire the company in question. In nonregulated businesses, the future earnings potential does not includes some recovery of the difference between an acquisition premium and either market value or book value of the common stock, although an increase in earnings potential can be a factor in the price that the acquiring company is willing to offer the shareholders of entity sought to be acquired. Id. at 12.

Dr. Proctor stated that UtiliCorp has an incorrect causal chain:

> UtiliCorp's incorrect causal chain: The acquisition premium causes a certain level of recovery of the synergies from the merger.
>
> Correct causal chain: A certain level of recovery of the synergies from the merger causes a cap on the offer price for the entity which is to be acquired.

(Proctor Rebuttal, Ex. 714, p. 14). The effect of UtiliCorp's incorrect causal chain is an increase in the price that companies would be willing to offer to merge with other companies. (Id. at 13).

Dr. Proctor related that a known policy of allowing recovery of an acquisition premium would result in companies bidding higher for utility companies because of the higher expected earnings that would occur because of a regulatory policy of allowing recovery of the acquisition premium. The synergies expected from the merger should place a cap on what any company would be willing to offer, but where recovery of the acquisition premium is guaranteed as a regulatory policy, there is no such cap and it is impossible to determine where the bidding would stop. A regulatory policy of recovery of acquisition premiums would result in mergers occurring that otherwise might not take place. Dr. Proctor stated that "[a]s a general economic principle, whether a merger occurs should be based on the potential economic gain in the market from the merger, and not on a regulatory policy of adding earning incentives to the market through allowing recovery of an acquisition premium." (Proctor Rebuttal, Ex. 714, p. 14). Since the Commission has not previously permitted recovery of an acquisition premium, it would be presumptuous for a company to make an offer based on the assumption of merger. Id. at 15.

B. Pooling vs. Purchase

Business entities are required to comply with Accounting Principles Board Opinion No. 16 (APB 16), entitled *Business Combinations*, as promulgated by the Financial Accounting Standards Board (FASB). Depending on the nature and characteristics of the merger, APB 16 allows for two completely different methods of accounting for business combinations. The two methods are referred to as the purchase method and the pooling of interests method. (Hyneman Rebuttal, Ex. 707, p. 5). Purchase accounting rules reflect the substance of the merger as one company actually purchasing the assets of another company. The pooling of interests rules reflect that the transaction is not a purchase of assets, but a combination of the shareholder interests in the net assets of the combining companies. (Id. at 5). APB 16 requires that the structure and terms of a proposed merger meet 12 specific conditions to qualify for pooling of interests accounting treatment. If the structure or terms of the merger transaction violates or does not meet any of the 12 pooling conditions, the merger is treated as a purchase for accounting purposes. (Id. at 7-8).

Purchase accounting rules for business entities other than utilities require the acquiring company to record the purchase of the acquired company's assets and liabilities at the fair market value (FMV) on the date of combination. Any excess of the purchase price over the fair market value of the individual net assets acquired is recorded as "goodwill." (Hyneman Rebuttal, Ex. 707, p. 5). The term "goodwill" is generally not used for regulated utilities. For regulated utilities, the excess of the purchase price over the net book value (NBV) is the "gain on sale" or the "acquisition adjustment"/"acquisition premium." The term "acquisition adjustment" is applied only to regulated utilities. (Id. at 2, 6, 40)

The Staff uses the terms "acquisition adjustment"/"acquisition premium" to represent the difference between the purchase price UtiliCorp agreed to pay for SJLP's assets, less the net book value of those assets. The term "merger premium," as commonly used, can mean either the purchase price in excess of the book value or the purchase price in excess of the market value of the net assets acquired. Unless otherwise indicated, when used by the Staff, the term merger premium means the purchase price in excess of the book value of the net assets acquired. The Staff believes that merger transaction costs should be added to the merger premium to derive the quantification of the acquisition adjustment used for rate purposes. (Hyneman Rebuttal, Ex. 707, pp. 4, 6, 35). APB 16 and the FERC USOA require that transaction costs be included along with the purchase price to determine the overall cost to acquire plant assets. (Id. at 33).

In a pooling of interests merger, no valuation adjustments are made and no goodwill or acquisition adjustment is recorded. The book values of the two companies are simply brought together to produce a set of combined financial records. The merger transaction is considered to be between the shareholders and not the companies themselves. Pooling of interest accounting rules are designed to reflect the substance of a transaction as a combination of two ownership groups into a single ownership group. The combining stockholder groups neither withdraw nor invest assets but merely exchange common stock in a ratio that determines their respective interests in the combined corporation. (Hyneman Rebuttal, Ex. 707, pp. 6-7).

The distinction between a merger accounted for as a pooling of interests and a merger accounted for as a purchase is that a purchase is not considered as a joining of stockholder groups, but an acquisition of one company by another company. Since the merger is deemed to be a purchase, APB 16 requires the assets acquired to be revalued from current book value to current fair value. Any amount of the purchase price that is not allocated in revaluing the assets is recorded as a separate intangible asset called goodwill. For utility companies, the total amount of the acquisition price (including transaction costs) over the book value (original cost less depreciation and amortization) of the acquired assets is recorded as an acquisition adjustment. Generally, utilities are not permitted to revalue their assets in any type of ownership change, but must use the original cost of the investments as the value of the assets on their books. The acquisition adjustment is used to reflect the difference between the original cost of the assets and the purchase price paid to acquire those assets. (Hyneman Rebuttal, Ex. 707, pp. 6-7).

For many businesses, pooling of interests accounting for a merger is preferable to purchase accounting for a merger. In a merger accounted for as a pooling of interests, there is no creation of goodwill, and for regulated utilities there is no creation of an acquisition adjustment, which, when amortized to expense, causes a reduction in earnings. The avoidance of this reduction in earnings is the primary reason why pooling of interests is considered for many businesses the preferred method of accounting for mergers. (Hyneman Rebuttal, Ex. 707, pp. 9-10).

The pooling of interest accounting method is especially beneficial for regulated utility companies and utility customers. Ratepayers are not benefited under purchase accounting if recovery of an acquisition adjustment is sought in rates because recovery of the acquisition adjustment in rates will lead to higher rates than would be the case under pooling of interests accounting. Rate recognition of an acquisition adjustment will also reduce the portion of any actual merger savings that would be available to reduce the utility's cost of service. (Hyneman Rebuttal, Ex. 707, p. 10).

Thus, for utilities which use purchase accounting for the transaction, the amortization of the acquisition adjustment creates an expense that puts downward pressure on earnings. If significant, the financial effect of the acquisition adjustment may cause a utility to seek additional revenues and/or cost reductions in an amount equal to the required return "on" and the annual amortization "of" the acquisition premium. (Hyneman Rebuttal, Ex. 707, p. 10).

UtiliCorp prior to the instant proceeding has recognized in a filing with this Commission the benefits of the pooling of interests method. In a merger application with KCPL before this Commission, which established Case No. EM-96-248 on June 7, 1996, UtiliCorp identified the ratemaking benefits of the pooling of interests accounting method. One of the benefits touted by UtiliCorp and KCPL was that since there was no acquisition adjustment, they would not have to seek recovery of an acquisition adjustment in rates. (Hyneman Rebuttal, Ex. 707, p. 11).

In approving the Amended Merger Agreement with KCPL in 1996, the UtiliCorp Board of Directors specifically stated that the availability of the pooling of interests accounting method was one of the factors that led it to approve the merger agreement. The Board specifically noted that the pooling of interests method "avoids the reduction in earnings which would result from the creation and amortization of goodwill under purchase accounting" (Hyneman Rebuttal, Ex 707, p. 14, quoting from KCPL SEC Form S-4A, June 25, 1996).

The use of pooling of interest accounting was so important to the merger that UtiliCorp and KCPL agreed that each was to use all reasonable efforts to allow the accounting for the transactions to be effected as a pooling of interests in accordance with GAAP and applicable SEC regulations and "use all reasonable efforts to achieve such result (including taking such commercially reasonable actions as may be necessary to cure any or circumstances that could prevent such transactions from qualifying for pooling-of-interests accounting treatment)." (Id. at 14-15; Similar language was used in the February 1997, Western Resources – KCPL merger agreement. (Id. at 15-16).).

UtiliCorp witness John W. McKinney makes the assertion at page 14 of his prepared direct testimony (Ex. 4) that regardless of whether or not the merger is recorded as a purchase or a pooling of interests, a merger premium exists when the value of the consideration paid exceeds the book value of the consideration received. Staff witness Hyneman responded that although Mr. McKinney may be theoretically correct that a merger premium could exist in a pooling of interests merger, such a merger premium would not be the type of merger premium that would be a concern in the instant merger case. Mr. Hyneman explained that if UtiliCorp recorded the merger with SJLP as a pooling of interests, there would be no acquisition adjustment, and thus, no acquisition adjustment issue in this case. This is exactly what happened in the 1996 UtiliCorp-KCPL proposed merger discussed above. In that merger application before this Commission, UtiliCorp clearly advised this Commission that because this merger was to be accounted for as a pooling of interests, there is no requirement to seek ratemaking recovery of an acquisition adjustment. (Hyneman Rebuttal, Ex. 707, pp. 16-17).

Moreover, there are instances where electric utilities with retail operations in Missouri, in communications with shareholders and in filings before this Commission, have explicitly stated that no merger acquisition premium exists in a pooling of interests merger transaction:

(1) First Amended Joint Application of KCPL and UtiliCorp, Case No. EM-96-248, p. 10, para. 18.

Prepared direct testimony, p. 8, of Steven W. Cattron, KCPL Vice President of Marketing and Regulatory Affairs in Case No. EM-96-248.

(2) Prepared direct testimony, p. 6, of James F. Purser, of Atmos Energy Corporation, Vice President and Chief Financial Offer in Case No. GM-97-70.

(3) November 13, 1995 UE letter to shareholders respecting proposed pooling of interests merger with CIPSCO.

(Hyneman Rebuttal, Ex. 707, pp. 16-18).

The SJLP – UtiliCorp merger was originally intended to be and was announced as a pooling of interests merger. However, less than two months after the merger was announced as a pooling of interests transaction the method of accounting was changed to a purchase transaction. UtiliCorp witness Jerry D. Myers, adopting the prepared direct testimony of Dan J. Streek, testified that the merger had been announced as a pooling of interests transaction prior to a complete analysis of the pooling of interests conditions having been performed. UtiliCorp ultimately determined that its issuance of employee stock options in November 1998 was an "alteration of equity" under APB 16, paragraph 47, potentially violating one of the conditions for pooling accounting, and thus preventing the merger from being recorded as a pooling of interests. (Hyneman Rebuttal, Ex. 707, pp. 18-20).

APB 16, paragraph 47(c) prohibits a combining company from altering the equity interests of shareholders "in contemplation" of effecting the proposed business combination to be accounted for as a pooling of interests. Under APB accounting interpretations, there is a presumption that any alteration of equity interests of shareholders within two years of initiation of a business combination or between initiation and consummation is in contemplation of effecting the business combination. According to a book published by Arthur Andersen entitled, <u>Accounting For Business Combination, Interpretations of APB Opinion No. 16, Business Combinations</u>, this presumption can be overcome. (Hyneman Rebuttal, Ex. 707, pp. 21-22).

Mr. Myers, the UtiliCorp Director of Corporate Reporting, and Mr. Robert B. Browning, the UtiliCorp Vice President of Human Resources stated in response to a Staff data request that "the issuance of options in November 1998 was not done in contemplation of the SJLP merger," and "'there was no relationship between this option issuance and the SJLP merger, which was announced two months later.'" (Hyneman Rebuttal, Ex. 707, p. 22). Despite this steadfast belief to the contrary, UtiliCorp did not even attempt to persuade the SEC that its November 1998 issuance of stock options was not done in contemplation of the merger with SJLP. UtiliCorp related in response to a Staff data request that rather than consult with the SEC, UtiliCorp relied on the opinion of its independent auditors and interpretations present in published literature. (Id. at 23).

There are serious consequences to the loss of the ability to use the pooling of interests accounting method. In this case, the consequences are the imposition of a $97 million acquisition adjustment and a potential $133 million after-tax increase in SJLP's cost of service over 10 years. Given these serious negative consequences, the Staff believes that UtiliCorp should have made a serious attempt to retain the ability to use the pooling of interests method by aggressively arguing its case to the SEC that the November 1998 stock option issuance was not done "in contemplation" of the SJLP merger. (Hyneman Rebuttal, Ex. 707, p. 23).

Even if UtiliCorp argued its case before the SEC and lost, there was still another way that UtiliCorp could have retained the use of the pooling of interests method. This would have required UtiliCorp to cancel or rescind the November 1998 stock options. The November 1998 stock options could not have been exercised until November 1999, which was at least six months after UtiliCorp concluded that the stock option issuance violated the pooling of interests conditions. However, UtiliCorp chose not to cancel or rescind the November 1998 stock options because, as it advised the Staff in response to a Staff data request, it "did not feel this would have been in the best interest of employee morale and there were still uncertainties with regard to the eventual consummation of the transaction." (Id. at 24).

Mr. Richard Green in a letter to the recipients of the November 1998 stock options explained that the purpose of the Employee Stock Plan is to "'heighten our collective focus on UtiliCorp's stock price.'" (Hyneman Rebuttal, Ex. 707, p. 21). Thus, the benefits of pooling of interests accounting were sacrificed in an effort to raise UtiliCorp's stock price. It is not appropriate for SJLP's ratepayers to have to absorb the detrimental aspects of the loss of the pooling of interests accounting, when the reason for the loss was to increase UtiliCorp shareholder value and stock price. (Id.).

There is another facet to UtiliCorp's choice not to cure the problem purportedly created by the November 1998 issuance of stock options. It is the Staff's view that UtiliCorp's decision not to take action to address the issue whether pooling of interests accounting was available to UtiliCorp after the November 1998 issuance of stock options actually may have been dictated by UtiliCorp's consideration of whether to dispose of SJLP's generating assets after the merger. APB 16, paragraph 48(c) precludes a company using the pooling of interests accounting method from disposing of a significant part of the assets of the combining utilities within two years after the combination. There is irrefutable indication that UtiliCorp has been considering disposing of some or all of SJLP's generating assets after the merger. Mr. Robert Green's February 8, 2000 discussion with financial analysts concerning this matter at the 1999 Year-end Review Conference Call was shown on UtiliCorp's website (www.utilicorp.com). (Hyneman Rebuttal, Ex. 707, p. 28). Mr. Robert Green discusses the potential sale of the SJLP generation assets as follows:

> But take a look at the mid-continent footprint that we're building on the network side of the business. With the St. Joe and the Empire acquisition, we've brought together some very attractive low-cost generation assets, and we have added some contiguous distribution networks that afford us a significant opportunity for synergies and efficiencies. 75% of those benefits are going to come from the supply side.

> And over time, we will look to restructure the supply-side assets and potentially take them out of rate base and provide more of an upside. It might be that the easiest path is to sell some of those assets so we can establish a market value and avoid a stranded cost to base [debate] with the regulator; and then redeploy that capital strategically on the energy grid in other generation assets or other growth investments.

(Id. at 29). Mr. Robert Green further addressed this matter in a March 15, 2000 Conference Call with Salomon Smith Barney (March Conference Call) found on UtiliCorp's Internet website under Investor Information, Presentations. He described how UtiliCorp intends to disaggregate some of SJLP's embedded utility businesses and reposition them as nonregulated businesses:

> We've also acquired two distribution assets here in the U.S., St. Joe Power & Light and Empire District. We believe we can significantly enhance the value of those assets by disaggregating, breaking apart some embedded businesses, and repositioning them. We've done that in Australia. Since 1995, our IRR in terms of that investment is over 30% and what we've done is break out the retail energy business and we will joint venture that with Shell at a value significantly above what we paid for it.

(Id. at 57-58).

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(Hyneman Rebuttal, Ex. 707, pp. 57-58).

UtiliCorp's clearly-stated intention to disaggregate and reposition its newly acquired generation assets from SJLP would have to be delayed for at least two years after merger closing. This restriction on UtiliCorp's business operations imposed by APB 16 may very well have been the reason UtiliCorp decided to abandon, or not to try to retain the use of the pooling of interests accounting method to record the SJLP merger.

Since UtiliCorp is seeking to recover in SJLP's utility rates the merger premium that it is paying for SJLP, consistency would require that UtiliCorp also propose above-the-line treatment of any gains on the sale of the SJLP Missouri jurisdictional assets. The acquisition premium paid by the acquiring utility is the gain on sale realized by the selling utility. If it is appropriate for UtiliCorp to charge the cost of the acquisition adjustment to SJLP's ratepayers, then it is appropriate for UtiliCorp to credit SJLP's ratepayers with the gains on the sale of these assets, should UtiliCorp dispose of these assets. (Hyneman Rebuttal, Ex. 707, pp. 47-48).

UtiliCorp's merger with SJLP also is beneficial to certain of UtiliCorp's nonregulated affiliates. Additional benefits to UtiliCorp include outsourcing of SJLP construction and maintenance work to UtiliCorp's nonregulated Quanta Resources, Inc. (Quanta) affiliate; acquisition of SJLP's rights of way and fiber optic cable network to support UtiliCorp's own investment in nonregulated telecommunications operations (telecom); and direct access to SJLP's 63,000 electric and 6,400 natural gas customers to sell the home energy appliance and