service agreement services (under the SJLP brand name) offered by UtiliCorp's nonregulated ServiceOne affiliate. (Hyneman Rebuttal, Ex. 707, p. 57; See Id. at 57-69).

### C. Other Jurisdictions

#### 1. State Jurisdictions

In this section of the initial brief the Staff will address the authorities UCU and SJLP rely upon as supporting the recovery of the acquisition premium proposed in their regulatory plan. The Staff will then present an overview of how other jurisdictions have treated the recovery of acquisition premiums in recent decisions.[8] In their Joint Application (hereafter "JA") filed in this case, UCU and SJLP seek Commission approval of both a merger agreement and a regulatory plan. (JA 10-11). As proposed by UCU and SJLP, SJLP shareholders will receive $23.00 worth of UCU stock after the closing of the merger, regardless of the book value of SJLP stock. (JA Appendix 4, p. A-8, §2.01(b); JA 3 ¶ 4). Since $23.00 is greater than the book value of SJLP stock, UCU is offering a premium ("acquisition premium") for SJLP's stock. (JA 7 ¶ 15; McKinney Direct, Ex. 4, p. 14, l. 6-13; McKinney Direct, Ex. 4, p. 6, l. 17-19). The regulatory plan as proposed provides that UCU is to receive from ratepayers both recovery of and return on this acquisition premium. (JA 8 ¶ 15; McKinney Direct, Ex. 4, p. 6, l. 7 to p. 7, l. 17).

A part of the proposed regulatory plan is a five-year rate moratorium. (JA 7 ¶ 15; McKinney Direct, Ex. 4, p. 6, l. 10-12). During that five-year period merger synergies are to be applied against the acquisition premium (including as premium all costs related to the merger, i.e., transaction costs as well as transition costs). (McKinney Direct, Ex. No. 4, p. 5, l. 15 to p. 6,

---

[8] While the Staff has attempted to provide subsequent history for the cases it has cited, due to some of these cases having been recently decided and the difficulty in locating lower court opinions on review, there may have been lower court actions of which the staff is not aware.

l. 5; JA 7-8 ¶ 15). At the end of the five-year period SJLP is to file a rate case where it will seek inclusion of fifty percent (50%) of the unamortized (remaining) acquisition premium in rate base and that annual amortization of the acquisition premium be included in expenses allowed for recovery in cost of service. (JA 7-8 ¶15; McKinney Direct, Ex. No. 4, p. 6, l. 13 to p. 7, l. 5).

In support of their proposed treatment of the acquisition premium as part of their proposed regulatory plan, UCU and SJLP have cited to this Commission's cases of Re Kansas Power & Light Co., Case No. EM-91-213, Report And Order, 1 Mo.P.S.C. 3d 150, 156-57 (1991); 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); Re Union Electric Co., Case No. EM-96-149, Report And Order, 6 Mo.P.S.C.3d 28 (1996); and Re Western Resources Inc., Case No. EM-97-515, Report And Order (1999). These and related cases are discussed in the Overall Regulatory Plan section of this initial brief.

In an effort to bolster recovery of the acquisition premium as proposed in the regulatory plan, Mr. John W. McKinney, Vice President–Regulatory Services of UCU, has presented as figure 2 in his direct testimony a summary of jurisdictions that he asserts have allowed the recovery of at least some acquisition premiums. (McKinney Direct, Ex. 4, p. 21, l. 9 to p. 22, l.6). The legend in the lower left corner of that figure states: "NAWC Sourcebook Updated 6/23/97." As Staff Witness Janis E. Fischer, Regulatory Auditor for the Missouri Public Service Commission, has noted, Mr. McKinney's figure 2 correlates with a figure found in a publication titled: Sourcebook of Regulatory Techniques for Water Utilities, compiled by Ms. Janice A. Beecher, Ph.D., Indiana University, as an update for the Rates and Revenue Committee of the National Association of Water Companies (hereafter "NAWC Sourcebook"). (Fischer Rebuttal, Ex. 705, p. 59, l. 11 to p. 60, l. 9 and Sch. 5). In the introduction of the

NAWC Sourcebook Ms. Beecher states that the sourcebook is informational in nature and that it is based extensively upon a 1996 survey of commission staff members. Ms. Beecher states that the survey was broad in scope but not highly detailed and that commission staff provided a very general impression of regulatory policy. Ms. Beecher also states "the results should not be taken as a definitive statement of commission policy." (Fischer Rebuttal, Ex. 705, p. 60, l. 11 to p. 61, l. 2). As Ms. Fischer notes, the NAWC Sourcebook, including the figure she found, provides more detail than figure 2 presented by Mr. McKinney. (Fischer Rebuttal, Ex. 705, p. 61, l. 9 to p. 62, l. 4 and Sch. 5 & 6). Further, the sourcebook information is limited to water and sewer utility cases. Mr. McKinney made no response in his surrebuttal testimony (Ex. 5) contesting or refuting Ms. Fischer's assertions that figure 2 of his direct testimony (Ex. 4, p. 22) is simply taken from the NAWC Sourcebook figure attached to Ms. Fischer's rebuttal testimony (Ex. 705) as Sch. 5, and that it is limited to the acquisition premium treatment afforded to water and sewer utilities.

The information in figure 2 presented by Mr. McKinney does not appear to be particularly relevant to consideration of electric utility merger transactions. As noted by Ms. Fischer, because of problems typically found with small water and/or sewer utilities—problems such as inadequate finances or succession plans for small-investor or individually-owned companies—some jurisdictions have allowed acquisition adjustments related to these transactions in an effort to make takeovers of troubled water and/or sewer utilities more attractive. (Fischer Rebuttal, Ex. 705, p. 61, l. 17 to p. 62, l. 2). As an example, expression of this philosophy is found in the Florida Public Service Commission case of Re Bayside Utilities, Inc., Case No. PSC-99-1818-PAA-WS, Docket No. 981403-WS (Florida Public Service Commission, September 20, 1999). There, the Florida Commission, in declining to impose an

unsought negative acquisition adjustment that it considered as a necessary corollary to its practice of allowing positive acquisition adjustments (acquisition premiums) in appropriate circumstances, stated the following:

> In the absence of extraordinary circumstances, it is the practice of this Commission that the purchase of a utility at a premium or discount shall not affect the rate base calculation. . . . .
>
> * * * *
>
> . . . . By Order No. 25729, issued February 17, 1992, we acknowledged that the ability of the buyer to earn a return on an acquired utility's rate base provides an incentive for larger utilities to look for and acquire smaller, troubled systems.

Re Bayside Utilities, Inc. at p.4. Unlike a number of water and sewer utilities with which this Commission has become all too familiar, SJLP is not a troubled utility; therefore, the Commission should not rely upon figure 2 of UCU witness McKinney's direct testimony as a basis to support accepting UCU's and SJLP's proposal for recovery of the acquisition premium at issue in this case.

In his direct testimony, Mr. McKinney states, "Two decisions are very informative and have direct bearing on this case." (McKinney Direct, Ex. 4, p. 22, l. 2). One of these "decisions" is a policy change by the Massachusetts Department of Telecommunications and Energy (DTE), formerly the Department of Public Utilities (DPU), as expressed in Re establishing guidelines and standards for acquisitions and mergers of utilities, Case No. 93-167-A (Mass DPU August 3, 1994) (hereafter "Mergers & Acquisitions").[9] The other decision is Re Oklahoma Gas and Electric Company, 150 PUR4th 33 (Oklahoma Corporation Commission, February 25, 1994). Despite his statements that these decisions are "very informative" and "have

---

[9] The full text of the order may be viewed at the website address following: <http://www.state.ma.us/dpu/electric/93-167-a/93-167-a.htm>.

direct bearing on this case," Mr. McKinney's elucidation regarding the foregoing Massachusetts' "decision" is simply a statement that "[a]fter the generic hearings, the Department determined that where potential benefits for customers exist, it is not in the interest of the customers, the shareholders, or the state to maintain a barrier against mergers." (McKinney Direct, Ex. 4, p. 22, l. 7-10). His discussion of Re Oklahoma Gas and Electric Company is not quite so terse. With respect to that case he states the Oklahoma Corporation Commission established the following four merger criteria:

> 1. The public interest must be considered;
> 2. The purchase price must be reasonable;
> 3. The benefits to ratepayers must equal or exceed the cost of the acquisition premium; [and]
> 4. The transaction must be conducted at arm's length.

(McKinney Direct, Ex. 4, p. 23, l. 4-8). He then concludes that the instant transaction meets these above criteria. Mr. McKinney has slightly misstated the first criteria. That criteria is whether the transaction in question is in the public interest. Re Oklahoma Gas and Electric Company, 150 PUR4th at 65.

In his direct testimony Mr. McKinney states that Mr. Green, in his testimony, describes the generic guidelines and standards for acquisitions and mergers of utilities set out by the DPU in his testimony. (McKinney Direct, Ex. 4, p. 22, l. 3-5). Mr. Green relates in his testimony as follows:

> . . . . After years of denying the cost of acquisition premiums, in 1994 the Massachusetts Department of Telecommunications and Energy changed its long-standing policy and now will allow recovery of the premium on a case-by-case basis when denying recovery of that premium would prevent consummation of a merger that would otherwise be in the public interest.

(Green Direct, Ex. 2, p. 15, l. 15-19).

Mergers & Acquisitions, where the DPU/DTE made a fundamental shift in approach to treatment of acquisition premiums, was a generic case initiated by the DPU on its own motion on September 22, 1993. Over twenty parties participated in the case. The DPU issued its decision on August 3, 1994. Prior to this decision, merger proposals that envisioned earning an acquisition premium were regarded by the DPU as *per se* impermissible. (Mergers & Acquisitions, Subpart II A. ¶ 2). In the background section of the decision the DPU illuminated the forces driving it to re-examine its approach to acquisition premiums as follows:

> In the instant proceeding, in light of concerns over high utility rates which in part may be the result of duplicative facilities, functions, and services among Massachusetts utilities, the Department has sought to reexamine its current policy towards mergers or acquisitions and determine whether the public interest may better be served by specific policy changes that enhance efficient delivery of utility services in Massachusetts. We note that the issues raised by the Department in this proceeding are an important part of a multitude of issues the Department must consider to achieve its ultimate regulatory goal, which is to ensure that the utilities subject to the Department's jurisdiction provide safe and reliable service at the lowest possible cost to society. As we indicate below, the Department believes that cost-effective mergers are one of several means by which utilities may be able to reduce their cost of service, improve service reliability, and enhance their financial strength.
>
> * * * *
>
> In the sections that follow, the Department will articulate its policy regarding mergers or acquisitions. In reaching its overall policy, the Department will address specifically (1) the standard of review by which it will evaluate a proposed merger or acquisition, (2) the determination and recoverability of acquisition premiums, and (3) other issues related to mergers or acquisitions.

(Mergers & Acquisitions, Subpart II B ¶ 2). Massachusetts is a high-cost state for electricity, having residential rates of approximately 12 cents per kilowatt-hour (Fischer Rebuttal, Ex. 705,

p. 63, l. 4-7[10]). As stated by the Florida Public Service Commission at its website, this high residential electricity cost appears to be a primary force causing Massachusetts, and other states, to experiment with alternatives to traditional methods of regulating public utilities. (Fischer Rebuttal, Ex. 705, p. 62, l. 18 to p. 63, l. 17[11]). In contrast, Missouri is a substantially lower cost state with residential electric rates that average about 7.5 cents per kilowatt-hour. (Williams Rebuttal, Ex. 719, Sch. 4).

Staff witness Janis Fischer, in her rebuttal testimony, has extensively discussed both the DPU/DTE's guidelines and cases in which they have been applied. (Fischer Rebuttal, Ex. 705, p. 64, l. 3 to p. 69, l. 19). The main statutory standard in Massachusetts regarding mergers and acquisitions is that the transaction be "consistent with the public interest." (Mergers & Acquisitions, Subpart II A. ¶ 1). This equates to a "no net harm" standard. Re Eastern Enterprises, DPU/DTE Case No. 98-27, 188 PUR4th 225, 231 (Massachusetts DTE, September 17, 1998) (hereafter "Eastern-Essex Acquisition") (clarified by the DTE regarding cost allocation issues in DTE Case No. 98-27–A, September 25, 1998). In Mergers & Acquisitions, the DPU made a non-exclusive list of factors to consider in determining, on a case-by-case basis, whether a proposed merger or acquisition should be approved. That non-exclusive list included the following:

(1) effect on rates
(2) effect on the quality of service
(3) resulting net savings
(4) effect on competition

[10] Ms. Fischer's testimony references States' Electric Restructuring Activities Update, Ch. 4 Retail Competition, Subpart: What is Happening in Other States, from the Florida Public Service Commission's website. The text may be viewed at the following website address: <http://www2.scri.net/psc/general/publications/restructoc.html>.
[11] Ms. Fischer's testimony references States' Electric Restructuring Activities Update, Ch. 4 Retail Competition, Subpart: What is Happening in Other States, from the Florida Public Service Commission's website. The text may be viewed at the following website address: <http://www2.scri.net/psc/general/publications/restructoc.html>.

(5) financial integrity of the post-merger entity
(6) fairness of the distribution of resulting benefits between shareholders and ratepayers
(7) societal costs, such as job loss
(8) effect on economic development, and
(9) alternatives to the merger or acquisition

(Mergers & Acquisitions, Subpart II B; Fischer Rebuttal, Ex. 705, p. 66, l. 16-27).

The following language from Mergers & Acquisitions is enlightening on how the DTE reviews acquisition premiums in merger and acquisition cases:

> On the other hand, the Department will not automatically allow recovery of all premiums associated with each and every merger. Rather, we are requiring parties to demonstrate that the recovery of acquisition premiums is allowable as part of the general reckoning of cost and benefit under the G.L. c. 164, § 96 consistency standard. Adoption of a presumptive rule in favor of acquisition premiums might mislead shareholders to expect guaranteed recovery of merger-related costs, regardless of the existence of countervailing advantages. Moreover, a blanket policy favoring recovery of acquisition premiums might have the unintended consequence of preventing market forces from acting as a restraint against what may otherwise be considered unwarranted premium levels. Therefore, based on the foregoing, the Department finds that in the future it will on a case-by-case basis consider individual merger or acquisition proposals that seek recovery of an acquisition premium. Additionally, the Department will consider the appropriate level of a recoverable acquisition premium on a case-by-case basis.

(Mergers & Acquisitions, Subpart III C ¶ 3; Fischer Rebuttal, Ex. 705, p. 67, l. 5-22).

These guidelines have been applied by the DTE in at least four recent merger cases. These cases are Eastern-Essex Acquisition cited above, Joint Petition of Bay State Gas Company, Northern Indiana Public Service Company and NIPSCO Acquisition Company for approval by the Department of Telecommunications and Energy pursuant to G.L. c. 164, § 96, of the merger of Bay State Gas Company and NIPSCO Industries, Inc., Case No. DTE 98-31 (Massachusetts DTE, November 4, 1998)[12] (hereafter "NIPSCO-Bay State Acquisition"); Joint

---

[12] The text of the decision may be found at the website following: <http://www.magnet.state.ma.us/dpu/gas/98-31/98-31.htm>.

Petition of Eastern Enterprises and Colonial Gas Company for approval by the Department of Telecommunications and Energy pursuant to G.L. c. 164, § 96, of the merger between these two companies. Eastern Enterprises and Colonial Gas Company also seek the Department's approval of a Rate Plan for Colonial Gas Company, pursuant to G.L. c. 164, § 94, Case No. DTE 98-128 (Massachusetts DTE, July 15, 1999)[13] (hereafter "Eastern-Colonial Acquisition"); and Joint Petition of Boston Edison Company, Cambridge Electric Light Company, Commonwealth Electric Company and Commonwealth Gas Company for approval by the Department of Telecommunications and Energy pursuant to G.L. c. 164, § 94 of a Rate Plan, Case No. DTE 99-19 (Massachusetts DTE, July 27, 1999) (appeal to Massachusetts Supreme Court pending)[14] (hereafter "BEC-CES Acquisition"). The Massachusetts Attorney General and a group of large volume customers have appealed challenging whether the rate plan is in the public interest and the reliance of the DTE upon merger savings estimates in approving the merger. (Fischer Rebuttal, Ex. 705, p. 69, l. 16-19).

In Eastern-Essex Acquisition, the applicants proposed a rate plan consisting of a ten-year base-rate freeze and a five percent (5%) reduction in the burner-tip price of gas for Essex customers. Id. at p. 230; (Fischer Rebuttal, Ex. 705, p. 68, l. 10). The applicants also sought for Eastern shareholders the opportunity to retain $4.6 million per year for the ten-year life of the rate plan to compensate them for the earnings dilution those shareholders would suffer from the pooling of interests transaction. Id. at 250. The DTE accepted the applicants' argument that, although the proposed transaction was a pooling of interests transaction, because there was an estimated earnings dilution to Eastern Enterprises shareholders of $47.1 million, this earnings

[13] The text of the decision may be found at the website following: <http://www.magnet.state.ma.us/dpu/gas/98-128/98-128.htm>.
[14] The text of this decision may be found at the website following: <http://www.magnet.state.ma.us/dpu/electric/99-19/order.htm>.

dilution should be treated as an "acquisition premium" for purposes of evaluation by the DTE The DTE considered the factors set out in the guidelines and applied a "no net harm" standard of review. (Fischer Rebuttal, Ex. 705, p. 68, l. 22-23).

In NIPSCO-Bay State Acquisition, the applicants proposed a five-year base rate freeze for Bay State customers and modification of Bay State's earnings-sharing mechanism. The applicants asserted that the transaction, which was accounted as a purchase transaction, resulted in an acquisition premium of $310 million. (Fischer Rebuttal, Ex. 705, p. 68, l. 29 to p. 69, l. 1). The earnings sharing mechanism (hereafter "ESM") proposed by the applicants set a band for return on equity (hereafter "ROE") of 7.4 percent to 15.4 percent. If the ROE calculated under the ESM exceeded 15.4 percent, then the ratepayers would receive 25 percent of the earnings attributable to the difference between the calculated ROE and 15.4 percent. If the ROE calculated under the ESM was less than 7.4 percent, then Bay State would recover from ratepayers the amount to required make up 25 percent of the earnings difference attributable to the calculated ROE and 7.4 percent. The applicants sought to include annual amortization of the acquisition premium in the calculation of ROE for purposes of the ESM. The DTE observed that allowing an automatic increase in rates if ROE fell below 7.4 percent created a risk of a rate increase before the end of the five-year rate freeze and that because the applicants proposed to subtract the annual amortization of the acquisition premium from earnings in calculating return on equity for purposes of earnings sharing, it was unlikely the calculated ROE would exceed 15.4 percent. The DTE declined to approve the sharing plan for potentially eliminating the benefit of the rate freeze and adding further protection of the applicants from their own endogenous actions. However, the DTE approved the rate freeze and affirmed that the merged company could seek recovery of the acquisition premium in future rate cases. (Fischer Rebuttal,

Ex. 705, p. 69, l. 3-4). The DTE emphasized that NIPSCO and Bay State had represented that Bay State's ratepayers were not at risk for recovery of any of the acquisition premium during the five-year period of the rate freeze and that the DTE would hold them to this representation. In its decision, the DTE stated that due to decades of little or no acquisition or merger activity, investor-owned energy utilities were highly "Balkanized" and that such geographic fragmentation suggested inefficiencies both in avoidable overhead and ability to take market actions beneficial to customers, particularly market actions related to gas purchasing, corporate financing and staffing.

In Eastern-Colonial Acquisition, Eastern sought to acquire Colonial, a local distribution gas company. The acquisition was to be booked as a purchase transaction. The applicants proposed a ten-year base rate freeze and a 2.2 percent reduction in burner-tip gas price to Colonial customers. They also proposed to recover the acquisition premium and return on the acquiring company's cash investment over 40 years. The DTE determined the proposal included a $199.2 million acquisition premium. The amount of the premium to be recovered remaining at the end of the ten-year base rate freeze was to be determined based on the savings realized during the ten-year base rate freeze. The DTE approved the recovery of the acquisition premium over 40 years noting that the applicants had represented that ratepayers would not bear any risk that operational and synergy savings would be insufficient to cover the annual amortization of the acquisition premium. In response to the Attorney General's criticism that the DTE's policy on acquisition premiums had "propelled mergers" the DTE stated that while in and of themselves acquisition premiums could represent a cost to ratepayers, the DTE's basis for allowing premiums was that transactions otherwise in the public interest might not occur absent allowance

of the acquisition premium and that for such transactions the benefits captured often warranted the costs of the acquisition premiums.

In BEC-CES Acquisition, two holding companies owning energy utilities sought to merge. The transaction was to be treated as a purchase transaction. The DTE approved the applicants' rate plan to freeze distribution rates for four years and to amortize the acquisition premium of approximately $500 million over forty years. (Fischer Rebuttal, Ex. 705, p. 69, l. 12-13). Recovery of the acquisition premium was permitted and after the end of the four years, for subsequent ratemaking, merger savings net of merger costs would be taken into account. (Fischer Rebuttal, Ex. 705, p. 69, l. 11-12). Other than an extensive discussion regarding the novelty of the transaction from a standard of review standpoint, the DTE included in this decision essentially no discussion of the forces that led it to recognize recovery of the acquisition premium. As noted above, the Massachusetts Attorney General and a group of large volume customers have appealed this case to the Massachusetts Supreme Court challenging whether the rate plan is in the public interest and the reliance of the DTE upon merger savings estimates in approving the merger. (Fischer Rebuttal, Ex. 705, p. 69, l. 16-19).

As the foregoing shows, in a generic case established by the DPU due to high-energy rates and forces driving competition in the energy utility industry in Massachusetts, the DPU/DTE changed course from an approach of never allowing recovery of acquisition premiums to now approving the opportunity to recover acquisition premiums. While the DTE stated that the applicants would have the opportunity to seek recovery of unrecovered acquisition premiums in future rate cases, in none of these merger authorization cases did the DPU/DTE actually make a ratemaking decision regarding recovery of the acquisition premium in rates. UCU and SJLP seek such a guarantee from this Commission. (Tr. 203, l. 21 to Tr. 208, l. 19). Further, unlike

the DPU/DTE, this Commission previously has not *per se* barred recovery of acquisition premiums. Also unlike the situation in Massachusetts, this Commission has never held a generic case, where all interested parties would have an opportunity to provide meaningful input, for the purpose of establishing guidelines for the allowance of the recovery of acquisition premiums. (The Staff wants to be very clear that it is not suggesting that this Commission create a generic case for such a purpose.) As indicated above, energy rates in Missouri are generally lower than those of other geographic areas and, certainly, current rate levels for SJLP customers provide no basis for allowing recovery of any part of the acquisition premium as an inducement for this merger to close.

Mr. McKinney refers in his direct testimony, Exhibit 4, at page 23, to the Oklahoma Corporation Commission (OCC) and an Oklahoma Gas and Electric Company (OG&E) acquisition case where the OCC adopted four criteria for allowing acquisition adjustments. Although Re Oklahoma Gas and Electric Company, Cause Nos. PUD 900000898, PUD 910001055, PUD 900001005, Order No. 380443, 150 PUR4th 33 (OCC 1994) addresses the criteria applied by the OCC for allowing recovery of acquisition adjustments, it is not a merger case where the OCC approved the recovery of an acquisition premium. The OCC Order arose from multiple OCC Staff filings challenging, among other things, the reasonableness of transportation and other charges paid by OG&E to its wholly owned subsidiary Enogex, Inc. (Enogex), and OG&E then passed on these charges OG&E's customers through OG&E's fuel adjustment clause. In September 1986 OG&E acquired what later became Enogex. The assets of this unregulated, acquired company included an intrastate pipeline system and gas processing plant, which serviced the natural gas gathering and transmission needs of the gas-fired electric

generating facilities of OG&E. OG&E accounted for the transaction as a purchase using the fair market value of the assets. (Id. at 65).

OG&E/Enogex took the position that for ratemaking purposes, the OCC should consider the total purchase price paid for Enogex's predecessor as the value of the purchased assets, i.e., that the purchased price paid was equal to the fair value of the pipeline. The premium above book was treated as a rate base cost for Enogex. A portion of the premium costs was recovered by Enogex through rates charged OG&E, and OG&E passed along the costs to ratepayers through its fuel adjustment clause. 150 PUR4th at 65.

The OCC Staff asserted that the transaction whereby OG&E acquired the assets of the unregulated, acquired company failed the standard test for rate base treatment of an acquisition premium. The Staff analysis concentrated on whether the acquisition premium constituted the least cost method of ensuring delivery of an adequate quantity of electricity, on a reliable basis, to OG&E's customers at reasonable prices. 150 PUR4th at 65. The OCC determined that a portion of the acquisition premium would be permitted to be passed along to OG&E ratepayers. The OCC stated in part as follows:

> . . . The Commission further finds that the transaction was in the public interest, the price paid was reasonable, the benefits to ratepayers were equal to or greater than the premium level which the Commission allows for rate treatment, and the transaction was conducted at arm's-length. Furthermore, the acquisition is deemed to have been the least cost alternative available to OG&E. These factors were analyzed when the purchase occurred. [Citation omitted.]
>
> The parties concur that the acquisition premium amounts to a purchase price of $133,056,188 above the depreciated book value of the Mustang transportation pipeline and natural gas processing facilities.
>
> However, this amount will not be passed along to the ratepayers in its entirety. Allocation of the acquisition premium is necessary to reflect the share of the acquisition premium which fairly can be recovered from ratepayers. . . . [T]his allocation is shown from the record to be determined by two factors: (1) statistical and financial analysis regarding the split between the transportation and

> processing segments, and (2) policy considerations involving the choice to pass a portion of the benefits and burdens of the transportation segment along to the ratepayers.

(150 PUR4th at 67.)

Staff witness Janis Fischer testified that the SJLP – UtiliCorp merger does not meet the criteria applied by the OCC for recovery of acquisition premiums. She noted that in particular the Staff has concluded that the total merger savings will not exceed the merger premium in the case of the instant proposed merger. (Fischer Rebuttal, Ex. 705, p. 71, l. 9-13).

After an extensive survey of approaches taken in other jurisdictions, the Staff has found that state regulatory bodies have taken a number of different approaches to acquisition adjustments. Based on the Staff's review, the status of deregulation of the electric industry in the state can be a major factor in how and when the state regulatory body treats recovery of acquisition premium. Fischer Rebuttal, Ex. 705, p. 71, l. 16-23.

Often the issue of acquisition adjustment is not reached because the merging utilities do not seek recovery of an acquisition premium. (Fischer Rebuttal, Ex. 705, p. 71, l. 18). In some cases where recovery of the acquisition premium is sought, the regulatory bodies outright decline to allow recovery of acquisition premiums. (Fischer Rebuttal, Ex. 705, p. 71, l. 19-20). In other cases, the regulatory bodies decline to address recovery of the acquisition premium in the merger case and defer the matter to a subsequent rate case. Another approach the Staff found is for the regulatory body to decline to allow recovery of any part of the acquisition premium until savings are demonstrated. (Fischer Rebuttal, Ex. 705, p. 71, l. 20-21).

The Staff found the following recent cases where the applicants did not seek direct recovery of any acquisition premium: Re SCANA Corporation, Docket Nos. G-5, Sub 400 and G-43, 198 PUR4th 158 (North Carolina Utilities Commission, December 7, 1999) (Pre-filed

testimony commitment to exclude acquisition premium and merger costs from acquired company's accounts for ratemaking purposes) (This case is discussed extensively by Staff witness Hyneman in his rebuttal testimony as being similar to the instant case in many important respects (Ex. 707, p. 54, l. 1 to p. 56, l. 13).); Central Illinois Light Company, Docket No. 98-0882, (Illinois Commerce Commission, March 10, 1999)[15] (The applicants asserted there would be no merger savings; the Illinois Commission, required by statute to address the issues, ordered that any premium be recorded below-the-line on the holding company's books and that any merger savings could be considered for possible recovery in future rate cases); In the matter of: Joint Application of PowerGen plc, LG&E Energy Corp., Louisville Gas and Electric Company and Kentucky Utilities Company for Approval of a Merger, Case No. 2000-095 (Kentucky Public Service Commission, May 15, 2000)[16] (The applicants asserted that acquired companies would not be required to record any part of the merger premium of 58% over market value on their books and the Kentucky Commission ordered as conditions of merger approval that all transaction-related costs, including the cost of purchase and premium paid be excluded for ratemaking purposes and from the rates of the acquired companies, and that in the future the companies not seek a return on equity higher than they would have absent the merger).

The Staff found the following cases where the parties reached a settlement in which the utility companies forewent recovery of acquisition premium: Re PacifiCorp, Docket No. 20000-EA-98-141, — PUR4th —, (Wyoming Public Service Commission, November 17, 1999) (The parties stipulated no acquisition premium would be included in rate base and the Wyoming Commission ordered that at least $4 million in savings would be allocated to Wyoming

---

[15] The text of this decision may be found at the website following: <http://www.icc.state.il.us/icc/doclib/sel/0310_ord980882.doc>.

[16] The text of this decision may be found at the website following: <http://www.psc.state.ky.us/agencies/psc/orders/052000/2000095_15.pdf>.

ratepayers for ratemaking purposes, regardless of whether actually achieved. Although invited several times to engage in ratemaking in the merger case, the Commission declined stating such issues should be taken up in a rate case.); Re Enron Corp., UM 814, Order No. 97-196, 177 PUR4th 587 (Oregon Public Utility Commission, June 4, 1997) (The parties agreed that Oregon ratepayers would bear no merger costs, would be held harmless from any effects of the merger and guaranteed that Oregon ratepayers would receive merger benefits totaling $141 million. The merger benefits were implemented by a $105 million refund/credit and a $9 million decrease in cost of service for each of four years).

In Re Atlantic City Electric Company, BPU Docket No. EM97020103, OAL Docket No. PUC4935-97, 183 PUR4th 22 (New Jersey Board of Public Utilities, January 7, 1998) (followed in Re Orange and Rockland Utilities, Inc., Docket No. EM98070433, 193 PUR4th 448 (New Jersey Board of Public Utilities, April 1, 1999), the New Jersey Board, in a contested case, rejected the applicants' proposal to offset the acquisition premium against merger savings to be shared and ordered that ratepayers receive merger savings over a ten-year period through two rate reductions. The New Jersey Board also rejected allowing executive severance packages and name change costs as offsets to merger savings. No other merger costs were discussed in the decision.

The Staff found the following cases where the regulatory body did not address in the merger case the issue of acquisition premium, instead deferring it to a future rate case: Re Northern Utilities, Inc., Docket No. 98-216, 187 PUR4th 71 (Maine Public Utilities Commission June 12, 1998) (The Maine Commission approved a stipulation where the parties agreed the applicants would be allowed in future cases to request the amortization of the acquisition premium in rates and that the Maine Commission permit such recovery to the extent the

applicants could demonstrate benefits to ratepayers of the merger equal or exceed the premium sought to be amortized.); Joint Application of Energy East Corporation and Connecticut Energy Corporation for Approval of a Change of Control, Docket Number 99-07-20 (Connecticut Department of Public Utility Control, December 16, 1999)[17] (The applicants did not seek inclusion of the amortization of acquisition premium for ratemaking purposes and asserted the merger would have no direct impact on rates. Instead the applicants proposed that the amount of the amortization and remaining unamortized balance of acquisition premium be considered when the Connecticut Department determined in the future whether actual earnings are subject to the proposed earnings sharing mechanism. The Department declined to address the earnings sharing mechanism in the merger case and stated it would consider the issue of acquisition premium in a rate proceeding, declining in the merger case to obligate ratepayers to fund any portion of the acquisition costs or allow any portion of the acquisition premium to be considered in setting rates.)

In Application of Wisconsin Energy Corporation for Approval to Acquire the Stock of WICOR, Inc., Docket Nos. 9401-YO-100 and 9402-YO-101 (Wisconsin Public Service Commission, March 15, 2000)[18] the Wisconsin Commission found that the applicants had failed to substantiate sufficient system or economic benefits to obtain direct recovery of the acquisition premium as the applicants requested. The Wisconsin Commission allowed, for financial purposes, 60%, about $478 million, of the premium to be recorded on the books of the acquired company and stated the applicants would have the opportunity to indirectly recover the

---

[17] The text of this decision may be found at the website following: <http://www.dpuc.state.ct.us/FINALDEC.NSF/0d1e102026cb64d9852564480069 1cfe/0fe51200d5ab9cf78525684a004dc132?OpenDocument&Highlight=0,99-07-20>.

[18] The text of this decision may be found at the website following: ; <http://www.psc.state.wi.us/orders/download/2000/9401100.doc>.

acquisition premium during the five-year rate restriction period (rate-freeze period) and, at the end of that five years, make a showing to attempt to retain more merger synergy savings. The Wisconsin Commission stated it would not authorize recovery of the transaction costs and that it would not authorize that the unrecovered acquisition premium be treated as stranded costs.

**2. Federal Energy Regulatory Commission (FERC)**

The Staff would note the FERC policy respecting acquisition premiums. In an Order Establishing Further Proceedings issued on July 26, 2000 in Sierra Pacific Power Co., Nevada Power Co. and Portland General Electric Co., 92 FERC Para. 61,069, Docket No. EC00-63-000, the FERC stated that "the [Nevada Public Utilities Commission (Nevada Commission)] will continue to have jurisdiction over retail rates in Nevada and can therefore address its concerns regarding the appropriate recovery of any acquisition premium through retail rates." The FERC, referring to itself as the "Commission," further stated as follows:

> The Nevada Commission, in its request for the Commission to examine the proposed merger's effect on the retail market in Nevada, seeks clarification that it retains authority to set retail rates, and possibly disallow costs, including the acquisition premium, at the state level. [Footnote omitted.] We note that the Transaction would not appear to limit the Nevada Commission's authority to set retail rates. As explained by Applicants, the Nevada Commission would continue to have jurisdiction over retail rates and the ability to address any attempt by Sierra or Nevada Power to recover the acquisition premium in a rate subject to the Nevada Commission's jurisdiction. [Footnote omitted.]

In FERC Order No. 2000, the FERC's Final Rule on Regional Transmission Organizations, issued December 20, 1999 in Docket No. RM99-2-000, FERC Statutes and Regulations, Para. 31,089 at 31,195, the FERC declined to follow the suggestion of a number of commenters that the FERC adopt new policies for acquisition adjustments that would provide assurances to purchasers of transmission facilities that acquisition premiums would be recoverable through transmission rates. In footnote 661, the FERC commented "See Minnesota

Power & Light Company and Northern States Power Company, 43 FERC Para. 61,104 at 61,342 (1988), for a discussion of the Commission's existing policies with respect to the ratemaking treatment for acquisition premiums. See also Duke Energy Moss Landing LLC, et al., 83 FERC Para. 61,318 (1998)."

Minnesota Power & Light Co. and Northern States Power Co., 43 FERC Para. 61,104 at 61,342-43, reh'g denied, 43 FERC Para. 61,502, reconsideration denied, 44 FERC Para. 61,302 (1988) was, in essence, a request for a declaratory judgment respecting an acquisition adjustment. Minnesota Power & Light Co. (Minnesota Power) and Northern States Power Co. (Northern States), among other things, sought authorization for Northern States to merge and consolidate certain facilities proposed to be sold to it by Minnesota Power, and petitioned for a declaratory order finding that the proposed sale and purchase was prudent and assuring Northern States that it would recover in wholesale rates the acquisition adjustment. The FERC, declining to issue a declaratory order, stated, among other things, that it would not decide the issue of the ratemaking treatment of the acquisition adjustment outside of the case where Northern States sought to reflect the acquisition adjustment in rates:

> . . . We take this opportunity to advise Northern States that recovery of the acquisition costs will turn on an analysis of the benefits conferred on ratepayers and the overall prudence of its investment decision; however, that issue is appropriately considered in a proceeding where Northern States proposes to reflect the acquisition adjustment in its rates.

43 FERC at 61342.

. . . .

> . . . A utility whose actions were prudent when made runs no risk as a result of the Commission's declining to make an advance determination as to the prudence of its actions. On the other hand, advance prudence determinations pose the risk that the Commission will become involved in day-to-day utility management decisions. In these circumstances, we shall deny the Applicant's petition for a declaratory order as premature at this time. In accordance with Commission precedent, any inquiry as to the prudence of the utilities' decisions should occur at

> such time as the companies actually seek to reflect the effect of the proposed transactions in rates.

43 FERC at 61,343.

The FERC related that its accounting policy toward acquisition adjustments:

> . . . was adopted in response to widespread abuses in the electric utility industry that arose through the practice of selling properties at large profits to other public utilities followed by the acquiring utility's inflating plant accounts (and rate base) by the premium paid. The result of this practice was that ratepayers paid higher rates for electric service but received no increase in benefits.

43 FERC at 61,342.

In Duke Energy Moss Landing LLC, et al., 83 FERC Para. 61,318 (1998), the FERC accepted for filing, suspended and set for hearing reliability must-run rate schedules that Duke Energy Corporation (Duke Energy) filed in connection with its purchase of the Moss Landing and Oakland reliability must-run electric generating facilities from Pacific Gas & Electric Company (PG&E), and summarily dismissed a proposed acquisition adjustment. This FERC filing was part of a transaction in which three affiliates of Duke Energy (Duke Energy Moss Landing, Duke Energy Oakland and Duke Energy Morro Bay) acquired from PG&E its facilities at Moss Landing, Oakland and Morro Bay in order to participate in the unbundled electric power generation market in California.

In summarily denying Duke Energy Moss Landing's proposed acquisition adjustment, the FERC concluded that the traditional criteria to evaluate the rate recovery of acquisition adjustments, which was established to address an industry regime in which vertically integrated utilities had monopoly power and an obligation to serve wholesale customers, do not apply in the competitive environment in which Duke Energy made its decision to purchase the PG&E units and under which it would sell power from those units:

> . . . the monopoly supplier had an obligation to plan for and acquire the necessary assets to ensure that it could reliably meet the needs of its captive customers and, in return, the supplier had the assurance that its rates would recover the costs that it prudently incurred for that purpose plus the opportunity to earn a reasonable (but limited) rate of return.
>
> In the situation before us, however, California is moving to reliance on a competitive power market. Customers are no longer captive and no generator has an obligation to plan to meet customer loads, or to acquire assets for that purpose. Indeed, Duke Energy's opportunity to purchase these generating units from PG&E – and its incentive to do so – results from a restructuring that, for the most part, relies on market-based rates throughout the State of California. While it is true that the units purchased by Duke Energy will operate under must-run conditions part of the time and will therefore be under cost-based regulation part of the time, the acquisition premium is associated with units that will make sales at market-based rates and Duke Energy will have the opportunity to recover its acquisition premium through the market-based rates that it will receive when the units are *not* operating as must-run. [Footnote omitted.]

83 FERC at 62,304.

The FERC noted that even if it were to apply the traditional criteria in the Duke Energy Moss Landing case it did not believe that Duke Energy would be able to meet the traditional criteria:

> We note that even if we were to apply the traditional criteria in this case, we do not believe that Duke Energy would be able to meet these criteria. This is because Duke Energy's claimed benefits (reduction of stranded costs, extension of the unit's useful life, assumption life, assumption of environmental obligations, and contribution to a functioning competitive market by ensuring reliability) either are not the type of factors we have traditionally considered, are non-quantifiable, and/or do not raise issues of fact that can be resolved by a hearing.

83 FERC at 62,304 fn. 40.

Although, as seen above, some regulatory bodies have indicated a merger approval applicant can seek certain rate treatment of the acquisition premium in the future, none of the foregoing jurisdictions has conducted ratemaking in the context of a merger case. The request of UCU and SJLP for this guarantee appears unprecedented, as well as unwarranted.

The Staff has cited all the above cases, not because it in any way endorses the particular treatment of acquisition premiums granted by a state regulatory body, but to present to this Commission some sense of recent state regulatory decisions regarding acquisition adjustments and to demonstrate there is no discernable general trend toward allowing recovery of merger premiums in customer rates.

**D. Fair Value**

Finally, Mr. McKinney in his direct testimony, Exhibit 4, page 27 refers to the concept of "Fair Value rate base," and states that "the majority of rate cases today are decided on an original coat basis, and Missouri is normally regarded as an original cost state." He notes that the United States Supreme Court and the Missouri Supreme Court "have stated in at least two opinions that the Commission is to consider Fair Value information in the setting of rates when that information is provided by the utility" and opines that "the Commission has the right to use its judgment to set the value of property at the level they believes [sic] is proper based upon the total evidence provided to them." (Id.).

Section 393.230 RSMo contains the valuation authority vested in the Commission by the General Assembly. A number of decisions exist which interpret the statute and establish general criteria for the Commission to follow. See, e.g., State ex rel. Joplin Water Works Co. v. Public Serv. Comm'n, 495 S.W.2d 443, 445-46 (Mo. 1973); State ex rel. Dyer v. Public Serv. Comm'n, 341 S.W.2d 795, 798-99 (Mo. 1961); State ex rel. City of St. Louis v. Public Serv. Comm'n, 329 Mo. 918, 47 S.W.2d 102, 105-17 (Mo.banc 1930). The courts have broadly interpreted the phrase "fair value" as applied to the valuation of utility property. Consequently, the Commission has been given great latitude in determining both the value of a utility's property and the proper return to be earned thereon.

The prominent decision is State ex rel. Missouri Water Co. v. Public Serv. Comm'n, 308 S.W.2d 704 (Mo. 1957). In that case, the Missouri Supreme Court extensively examined the Commission's authority under Section 393.230 and identified parameters for the exercise of that authority. For example, at 308 S.W.2d at 717 the Court affirmed the principle first enunciated in State ex. rel. City of St. Joseph v. Public Serv. Comm'n, 325 Mo. 209, 30 S.W.2d 8, 10 (1930), that:

> There is no fixed rule for determining the fair value of property for ratemaking purposes. *All facts which shed light on the questions must be given due consideration. . . .*

(Emphasis original.)

Based on this principle, the Court at 308 S.W.2d at 719 stated that:

> Consequently, we must and do hold that in determining the price to be charged for (in this instance) water (§393.270, Par. 4) the fair "value of the property" of the water company which the Commission is empowered to ascertain under §393.230, Par. 1, is a relevant factor for consideration in the establishment of just and reasonable rate schedules and must be considered in its proper relationship to all other facts that have a material bearing upon the establishment of "fair and just" rates as contemplated by our statutes and decisions. [Citations omitted.]

In State ex rel. Joplin Water Works Co. v. Public Serv. Comm'n, supra, the Court at 445 elaborated on its holding in Missouri Water Co.:

> The Missouri Water Company case, supra, recognizes that the "fair value" which it requires the Public Service Commission to determine involves an exercise of judgment and is not the product of a simple formula. Consequently, Commissioner Jones expressed the proper function of the evidentiary hearing, i.e., to permit the commission to ascertain the facts upon which it would exercise its judgment in arriving at a fair value rate base. Therefore, the absence of testimony from staff witnesses would not preclude a determination of fair value, if the evidence presented did include the facts required in order to arrive at such determination.
>
> Similarly, the rejection of testimony by appellant's witnesses of fair value would not preclude a finding of fair value otherwise supported by the evidence presented.

The holdings in the above cases, especially the Missouri Water Co. and Joplin Water Works decisions, make it clear that the appellate courts of this State have not used the phrase "fair value" in a restrictive, technical sense, denoting a particular formula of ratemaking, but rather have interpreted the phrase to mean that the valuation decision reached by the Commission must be just and reasonable, based upon a consideration of all relevant factors. All valuation decisions need not adhere to one particular methodology. However, whatever determination is made must be based on consideration of all relevant factors, and must not be result of regulatory expediency. The question of the lawfulness of a particular valuation therefore hinges on two primary considerations: (1) are the rates which result from the valuation just and reasonable as required by law, and (2) is the valuation decision based on a consideration of all relevant evidence presented on the record.

The weight of judicial authority imposes no requirement on the Commission that rates are to be set based solely upon a reasonable return on fair value rate base. Instead, the Commission is given great latitude in determining both the fair, i.e. equitable, value of a utility's plant in service, as well as the reasonable return which should be earned thereon. The sole limitations placed on the Commission's exercise of its discretion are: (1) the rates which result must be just and reasonable, and (2) all relevant facts must be considered in reaching the rate of return decision.

It should be noted that in State ex rel. Kansas City Power & Light Co. v. Public Serv. Comm'n, 615 S.W.2d 596 (Mo.App. 1981)(KCPL), Kansas City Power & Light Company conceded that the fair value rate base issue was not reviewable due to mootness; KCPL had received interim and permanent rate increase which superseded the rates in question. KCPL

argued that despite the conceded mootness of the issue, the Court should retain jurisdiction because the legal issue presented was of public interest, was likely to recur, had not been determined by a fixed principle of law, and would not otherwise be reached by an appellate court. The Missouri Court of Appeals, Western District noted that virtually the same claim was made in State ex rel. Laclede Gas Co. v. Public Serv. Comm'n, 600 S.W.2d 222 (Mo.App. 1980), appeal dismissed, 449 U.S. 1072, 101 S.Ct. 848, 66 L.Ed. 2d 795 (1981)(Laclede) wherein review was denied by the Missouri Court of Appeals because of mootness. (615 S.W.2d at 597).

In the Laclede case, Laclede Gas Co. appealed the Commission's fair value rate base determination, but by the time the appeal reached the Court of Appeals, Laclede had applied for and received a subsequent rate increase. The Court of Appeals held in the Laclede case that the argument relating to fair value presented no viable legal issue and in conjunction with the prohibition against retroactive rate making was moot. (600 S.W.2d at 226). The Court of Appeals in the KCPL case held that the fair value issue did not present a principle of law that was novel and the fair value issue would be resolved on the basis of existing law and the application of those principles to the facts of the case. Thus, the Court of Appeals state that the arguments put forth for retention of the case despite its mootness were not persuasive. (615 S.W2d at 598).

In Duquesne Light Co. v. Barasch, 488 U. S. 299, 109 S.Ct. 609, 102 L.Ed.2d 646 (1989) (Duquesne Light) the United States Supreme Court reviewed a Pennsylvania law that required that electric rates be set without consideration of expenditures for electric generating facilities, which were planned but never constructed, even though the expenditures were prudent and reasonable when incurred. The Duquesne Light decision cites Federal Power Comm'n. v. Hope

Natural Gas Co., 320 U. S. 591, 64 S.Ct. 281, 88 L.Ed. 333 (1944)(Hope). In the Hope decision, the Supreme Court abandoned "fair value" (i.e., the actual present value of assets employed in the public service) as the only constitutionally accepted method of setting utility rates. The Court held that "prudent investment" or "historical cost" is a valid basis on which to set utility rates. The Hope Court stated that "it is not theory but the impact of the rate order which counts", i.e., "it is the result reached not the method employed that is controlling." 64 S.Ct. at 287-89.

In the Duquesne Light case, the Supreme Court affirmed that no single ratemaking methodology, whether it be "prudent investment," "fair value," or some other methodology, is required by the Constitution. The Court noted that "[t]he Constitution within broad limits leaves the states free to decide what rate-setting methodology best meets their needs in balancing the interests of the utility and the public." 109 S.Ct. at 620.

**VI. Corporate Allocations**

This section of the Staff's brief deals with the projected level of UCU's corporate overhead costs subject to allocation to all of UCU's divisions, including SJLP in the event of a merger. Before discussing this specific issue, Staff would remind the Commission that the Staff is also raising additional issues regarding the proposed Regulatory Plan impact on the UCU corporate overhead cost allocation in future rate cases involving the MPS division. These issues are addressed in Staff's brief in the section called "Frozen" MPS Allocation Factor.

The Joint Applicants presented a 10-year cost/benefit analysis in their direct testimony (Siemek Direct, Ex. 7, Sched. VJS-1). The analysis purports to demonstrate sufficient merger savings in years 6 through 10 to cover all merger costs for those years, including a 50% amortization of the acquisition premium, and to provide a minimum $1.6 million reduction in revenue requirement for SJLP customers. This section of the brief will address the inflation

factor used to project UCU's total corporate overhead costs used in the 10-year analysis, as well as the Joints Applicants' suggestion that the projection of UCU's corporate costs is unimportant at this time.

The Staff takes issue with the Joint Applicants regarding the 2.5% inflation rate used to project UCU's corporate overhead costs for the 10-year merger cost/benefit analysis. Although, in his prefiled testimony UCU witness Siemek offers no supporting documentation, the 2.5% figure allegedly reflects the Consumer Price Index for an urban consumer. (Siemeck Surrebuttal, Ex. 8, p. 6, lines 1-3). An index of the prices a consumer pays for goods and services, however, is a poor indicator of the increases in corporate allocations that UCU can be expected to impose upon its operating divisions. Such increases are primarily a function of usage of corporate resources, or of the simple need to allocate corporate costs of, in this case, an aggressive, growth-oriented corporation to its operating divisions.

The Commission has in the past rejected the use of general, non-company specific indices as a means of projecting various categories of utility costs, including corporate allocations. In its Report and Order in Consolidated Case Nos. TC-93-224 and TO-93-192, for example, the Commission rejected Southwestern Bell's ("SWB's") proposed use of the Gross National Product Implicit Price Deflator ("GNP-IPD") for such a purpose. As one of its reasons for rejecting the proposal, the Commission stated, in Section B, "Nonwage Expenses," the following: "Additionally, the Commission views the proposal to adjust nonwage items for the GNP-IPD as an inflation adjustment. The evidence is not convincing that this type of national indicator reflects what has actually occurred concerning SWB nonwage expenses. The Commission has traditionally rejected these types of adjustments as not known and measurable and not company-specific. The Commission finds that the evidence in this case is lacking to

show a direct relationship with SWB's current operations and the GNP-IPD." In light of the foregoing, it makes far more sense to look to actual historical data on UCU's corporate allocations for guidance.

In his testimony, Staff witness Steve Trailer challenged Mr. Siemek's assumption of a 2.5% inflation rate for corporate allocations, based on the fact that the actual historical rate of inflation of UCU corporate overhead costs allocated to its existing Missouri division (MPS) has been far higher than 2.5% in recent years. (Traxler Rebuttal, Ex. 718, pp. 25-29). Mr. Traxler's Revised Schedule SMT-5 (Ex. 725, lines 12-14) shows average annual increases in UCU's corporate overhead costs to MPS since 1995, for various multi-year time frames, as follows:

| | |
|---|---|
| 4-year average increase (1996-1999): | 45.7% |
| 3-year average increase (1997-1999): | 20.0% |
| 2-year average increase (1998-1999) | 6.2% |

As the figures clearly demonstrate, regardless of whether one looks at a two-, a three-, or a four-year average, a corporate allocations growth rate far in excess of UCU's proposed 2.5% rate is warranted.

In his Surrebuttal testimony, UtiliCorp witness Siemek dismissed as a distortion the use of actual historical figures for this purpose, on the basis that they were abnormally high due to the increased operational costs associated with reengineering initiatives that were implemented during the years in question. According to Mr. Siemek, such costs cannot be expected to continue into the future. (Siemeck Surrebuttal, Ex. 8, pp. 5-6). In particular, Mr. Siemek identifies the 1998 and 1999 cost comparisons as "flawed" by this failure to consider the operational costs of these re-engineering initiatives. (Siemeck Surrebuttal, Ex. 8, p. 5, lines 17-

19). Mr. Siemek did not, however, include in his Surrebuttal testimony the dollar impact of this effect. In fact, there is no record evidence of any attempt by UtiliCorp to quantify the year-by-year impact of the subject re-engineering expenditures, either in total or specifically with respect to MPS. Furthermore, apart from the issues of whether, and the amount by which, Staff's 1998 and 1999 cost comparisons are too high, Mr. Siemek's concern was limited to the years 1998 and 1999. No similar assertion was made regarding the years 1996 and 1997. Staff witness Traxler's calculations show growth rates in corporate allocations to MPS in 1996 and 1997 of 160.2% and 53.7% respectively. (Revised Sched SMT-5, Ex. 725, line 11).

In light of this historical experience with an actual Missouri division of UCU, Mr. Traxler recommends a 5% inflation rate for the purpose of estimating the corporate overhead costs to be allocated to the SJLP division, post-merger. It can be argued, based on UtiliCorp's historical experience, that even a 5% inflation rate assumption is too low. Schedule SMT-5 reflects that in no year since 1995 has MPS experienced a growth rate as low as 2.5%. Certainly, then, the 2.5 % inflation figure used by the Joint Applicants in projecting corporate allocations is unreasonably low and should therefore be rejected in favor of Staff's far more reasonable recommendation of 5%.

Using a more realistic 5% inflation rate for corporate overhead costs allocated to SJLP reduces the Joint Applicants' projected total net merger savings in years 6 through 10 by approximately $18 million, based respectively upon the Staff's and the Joint Applicants' projections, as shown in Schedule SMT-3A. (Ex. 729, Cols. B and F, line 15).[19] As noted herein in the Section dealing with the "Overall Regulatory Plan," Staff's projection of the net "savings"

[19] Staff's projected net UCU corporate operating costs allocated to SJLP of $70.546 million (Col. F) minus Joint Applicants' net UCU corporate operating costs allocated to SJLP of $52.560 million (Col. B) equals $17.896 million.

in years 6 through 10 as a result of the merger is a negative $4.1 million, prior to any recognition of 50% of the acquisition premium. (SMT-3A, Ex. 729, Col. F, line 16). The Joint Applicants project a savings net of merger costs, prior to recognition of 50% of the acquisition premium, of $38.4 million. (SMT-3A, Ex. 729, Col. B, line 16). The difference is $42.5 million, and the $18 million reduction in net merger savings resulting from adoption of Staff's more realistic 5% inflation rate for corporate overhead costs constitutes over 40% of that $42.5 million difference.

UCU witness Siemek further testified that the assumption for inflation is "unimportant at this time." He based this assertion on the fact that the actual inflation rate will become known in post-moratorium rate cases, and UtiliCorp will deal appropriately with the issue at that time. (Siemeck Surrebuttal, Ex. 8, p. 7, lines 12-17). The problem with Mr. Siemekk's rationale is that the Commission must consider now the "not detrimental to the public interest" standard on which its ruling on the proposed merger is based, and not five years from now. That ruling can only be made on the basis of projected costs and savings. The Commission, if it is to approve the subject transaction, must satisfy itself now that the Joint Applicants have met the legal standard and that savings will, at a minimum, be sufficient to cover merger costs. It should be remembered that it is UCU's's intention to include all merger costs, including 50% of the acquisition premium, and all merger savings in the determination of cost of service for SJLP in the post-moratorium rate case .

As a specific example of why the Commission must concern itself now with this issue, consider the detrimental impact of UCU's higher corporate overhead cost impacts on SJLP, Staff witness Traxler addresses the increase in cost for General Plant facilities for the SJLP division post merger. ( Traxler Replacement Pages, Ex. 721, p. 24, lines 3-23; Traxler Rebuttal, Ex. 718, p. 25, lines 1-3). Mr. Traxler explains that SJIP's cost for General Plant facilities will increase

71.5 % as a result of the additional overhead cost allocation for general plant facilities from UCU. (Traxler Replacement Pages, Ex. 721, page 24, lines 18-20).

Mr. Traxler's calculation of the 71.5 % increase in SJLP's cost for General Plant facilities is reflected on Replacement Schedule SMT-2. (Traxler Replacement Pages, Ex. 721, Sched. SMT-2). Line 20 of Schedule SMT-2 shows SJLP's current revenue requirement for its General Plant facilities to be $3,188,986 annually. Line 25 of Schedule SMT-2 reflects that the additional cost to SJLP post merger from UCU's allocated cost for General Plant facilities is $2,279,000. This represents a 71.5% increase over the pre-merger cost level, as shown on line 26 of Schedule SMT-2.

As Mr. Traxler points out in his testimony, SJLP customers are currently receiving adequate service at a fair price. Increasing their costs for General Plant facilities by 71.5% results solely from the merger with UCU and is, in Staff's opinion, completely unnecessary. (Traxler Replacement Pages, Ex. 721, p. 24, lines 21-23 ; Traxler Rebuttal, Ex. 718, p. 25, lines 1-3).

With the foregoing in mind, the Staff would note the following: Even setting aside the question of recovery of acquisition adjustment, Staff's analysis reflects that projected merger costs will exceed savings by $4.1 million over the years 6 through 10 in total. (Sched. SMT-3A, Ex. 729, Col. F, line 22). This means that SJLP customers would be subject to a rate increase strictly as a result of the merger. Furthermore, inclusion of 50% of the acquisition premium, as requested by the Joint Applicants, would increase the net savings deficiency by an additional $30.5 million for years 6 through 10. (Sched. SMT-3A, Ex. 729, Col. B, line 21).

## VII. "FROZEN" MPS ALLOCATION FACTOR

The Corporate Allocations section of the Staff's brief deals with the projected level of UCU's corporate overhead costs subject to allocation to all of UCU's divisions, including SJLP, following the proposed merger. In this section, the negative impacts of the Joint Applicants' proposed regulatory plan on the allocations of corporate overhead costs to MPS, with resultant detrimental impacts on the MPS ratepayers, will be discussed.

Prior to addressing Staff's specific concerns, a brief clarification is in order. On cross-examination, Joint Applicants witness McKinney stated that perhaps there is a little misunderstanding; that, in fact, the Joint Applicants are not proposing to freeze MPS's corporate allocation factor, but rather, "What we're doing is not changing it for the components St. Joe might impact it by." (Tr. 443, lines 9-13). The Staff asserts, for the benefit of any party who might be confused, that when it speaks of a "frozen" allocation factor for MPS, it is referring to the fact that the Joint Applicants propose not to change that factor as a result of the SJLP acquisition. It is of course entirely possible that UCU could undergo another organizational change, such as another acquisition, which, in turn, could result in a change in the MPS allocation factor. However, the Staff hastens to point out that the only organizational change at issue in this case is the SJLP acquisition, and it is undisputed that the Joint Applicants propose not to change the MPS corporate allocation factor as a result of the SJLP acquisition.

Staff is concerned that the Joint Applicants' regulatory plan, if approved, will negatively affect corporate overhead costs allocated to MPS, to the detriment of MPS's ratepayers, in two respects. (Tr. 401, lines 20-22). The first of these stems from the Joint Applicants' intention, as indicated in the previous paragraph, to "freeze" MPS's corporate allocation factor to exclude the impact of the SJLP acquisition. Thus, under the regulatory plan, the allocation factor will not be

reduced as a result of the SJLP merger, even though the normal and natural effect of the transaction would be to reduce the factor for all 27 of UCU's previously existing divisions (both regulated and non-regulated), including MPS. (Traxler Rebuttal, Ex. 718, p. 9, lines 11-18). The Joint Applicants do not dispute this normal result; in fact, Joint Applicants witness McKinney acknowledged it in oral testimony, stating, "So by bringing those in, that does change the allocation factors to MPS and would lower them." (Tr. 844, lines 16-18). Mr. McKinney's acknowledgment is essentially echoed in oral testimony by Joint Applicants witness Myers, who stated, "However, for general ledger purposes those -- the percentage most likely would for cost allocation purposes be somewhat less because St. Joe is included in the formula." (Tr. 977, lines 6-9).

Although the Joint Applicants plan not to reflect the impact of the SJLP merger in the MPS allocation factor, Staff witness Traxler points out that costs allocated to MPS, "for financial reporting purposes will reflect a lower allocation of UCU's corporate costs." (Tr. 402, lines 7-8). Mr. Myers agrees with Mr. Traxler's assertion. (Tr. 977, lines 9-13).

Staff witness Traxler provided an analysis of the dollar impact on MPS ratepayers of the Joint Applicants' intention to freeze the MPS cost allocation factor at its pre-SJLP merger value. Replacement Schedule SMT-8 (Ex. 721, line 16) shows that, absent this artificial "freeze," MPS could expect to reflect a cumulative reduction in revenue requirements of $27,787,162 for the eight years (through 2010) following its next rate case. (Traxler Rebuttal, Ex. 718, p 10, lines 15-17). Inasmuch as the Joint Applicants do not plan to reflect MPS's actual allocated share of UCU's costs, this amounts to an effective average annual increase in revenue requirement of $3,473,395. (Replacement Sched. SMT-8, Ex. 721, line 17). It should be noted that, in his Surrebuttal testimony, Joint Applicants witness Siemek at least admits that a total of $22 million

will be collected from MPS during this time frame. (Siemek Surrebuttal, Ex. 8, p. 11, lines 13-15). Staff considers the $28 million a more reasonable estimate because it assumes a 5% inflation rate for corporate overhead costs, as opposed to the Joint Applicants' 2.5% assumption. (See section herein on "Corporate Allocations.")

The Joint Applicants' proposed ratemaking treatment regarding corporate allocations to MPS is not only abnormal and completely artificial, but it is inconsistent with the manner in which all UtiliCorp mergers/acquisitions have been handled in prior MPS rate cases. UCU has never requested that one of its divisions be excluded from the calculation of its allocation factors in any prior rate case for MPS. Staff takes the position that the Joint Applicants' deviation from past practice in this case makes no sense. Moreover, this proposed deviation from cost-based ratemaking results in a higher cost of service imposed upon UCU's MPS division, causing a detriment to MPS ratepayers to the tune of almost $3.5 million per year. As Mr. Traxler stated in his Rebuttal testimony, "This recommended ratemaking treatment for MPS is nothing more than a backdoor approach to force UCU's existing Missouri customers to subsidize the net loss from the merger, referred to previously, which results because projected merger savings are insufficient to cover all merger costs and the acquisition premium." (Traxler Rebuttal, Ex. 718, pp. 9-10). The Commission should therefore reject this attempt to have MPS customers subsidize the merger acquisition premium.

The second effect that works a detriment on MPS under the proposed regulatory plan was identified by Mr. Traxler on the witness stand. (Tr. 402-403). It stems from the fact that holding the MPS corporate allocation factor at its pre-merger value following completion of the subject transaction with SJLP manifestly will not result in MPS receiving the same corporate overhead charges it would have received had there been no merger. The reason is that the pool of

corporate charges is going to increase under the regulatory plan; hence, a division saddled with an unchanging allocation factor will automatically bear higher corporate overhead costs than it would have borne in the absence of a merger.

Staff witness Traxler's revised Schedule SMT-3 shows that the UCU corporate allocations pool will increase by a total of $39,244,000 over 10 years as a result of the merger with SJLP.[20] (SMT-3, Ex. 729, Col. C. [or D], line 12 plus line 13). It should be emphasized that both the Joint Applicants and the Staff agree on this dollar amount. If, then, UCU's allocation factor for MPS, currently about 25%, is held constant with respect to the impact of the SJLP merger, MPS's share of UCU's corporate overhead costs can be expected to increase by nearly $10 million over the 10-year time frame. Obviously, MPS ratepayers will suffer a detriment under such a proposal. (Tr. 403, lines 4-8).

The Joint Applicants' response to Staff's contention is that incremental increases in corporate overhead costs attributable to the addition of SJLP will be the subject of a tracking system to be developed by UCU. In his Surrebuttal testimony, Joint Applicants witness Myers stated: "Additionally, as we proposed in our regulatory plan, the customers of MPS should not suffer a detriment from the SJLP merger and, as a result, allocations of corporate costs to MPS should not include the incremental costs of absorbing SJLP operations." (Myers Surrebuttal, Ex. 19, p. 6, lines 2-5). Witness McKinney testified that such costs will go "only to St. Joe" and will not impact MPS. (Tr. 450, lines 7-8). During cross-examination witness Myers states, in answer to a question as to whether MPS will absorb any of such costs, "As I understand the regulatory plan, adjustments would be made so that in future ratemaking purposes for Missouri Public Service that that (sic) did not occur." (Tr. 976, lines 18-21).

---

[20] $25,683,000 plus $13,561,000 transferred from SJLP to UCU's Enterprise Support Function ("ESF") and Intra Business Unit ("IBU") departments, respectively.

As argued vigorously in the section herein dealing with tracking systems ("Savings Tracking"), the Staff is highly skeptical that such a system can ever be successfully developed. Furthermore, the Joint Applicants have presented no concrete proposal regarding how their tracking system will work, so as to ensure that MPS customers will not be detrimentally impacted by the increase in UCU corporate overhead costs resulting from the proposed merger. In effect, the Commission is being asked to accept on blind faith the Joint Applicants' assurances that the MPS ratepayers will not experience a detriment. The Commission should find these assurances wholly lacking and therefore unpersuasive.

In summary, the Joint Applicants are seeking Commission approval of a regulatory plan under which the ratepayers of MPS can expect to be impacted detrimentally in two ways. First, in rate cases involving MPS during the 10-year period following approval of the subject merger, MPS's rates will be increased approximately $28 million as a result of allocating UCU's corporate costs on an assumption that the SJLP division does not exist. Second, notwithstanding the Joint Applicants' hollow assurances to the contrary, MPS can expect to be detrimentally impacted by the undisputed 10-year increase of more than $39 million in corporate overhead pool costs resulting from the addition of SJLP costs to the allocation pool. In light of the "not detrimental to the public interest" standard, the Commission should reject the Joint Applicants' regulatory plan on this basis.

## VIII. "FROZEN" CAPITAL STRUCTURE

As part of their regulatory plan, the Joint Applicants propose that "the balance of the retail electric, gas and steam rate bases" (i.e., all of SJLP's rate base *except* the acquisition premium) will be allowed a return based on an SJLP capital structure consisting of 47% debt and 53% equity. (McKinney Direct, Ex. 4, p. 7, lines 1-14; McKinney Direct, Ex. 4, p. 28, lines 1-7).

Mr. McKinney testified that this capital structure should continue to be used "for the period covered by the regulatory plan." (McKinney Direct, Ex. 4, p. 7, lines 10-12). Under cross-examination, Mr. McKinney said that the 53/47 capital structure would apply only to the second five years of the regulatory plan. (Vol. 6, Tr. 786, lines 6-20). He repeated this position in response to a question from the bench. (Vol. 6, Tr. 790, lines 9-20).

Mr. McKinney emphasized that UCU was only proposing to freeze the *capital structure* at a debt-to-equity ratio of 53/47, *not the costs.* SJLP's rates, which are currently set using a capital structure of 53% common equity and 47% long-term debt, would be frozen during the first five years following the merger (due to the proposed rate moratorium), and the capital structure would be frozen during the second five years following the merger. (Vol. 6, Tr. 788, line 19 – Tr. 789, line 1). Therefore, the effect of this proposal would be to freeze the capital structure for 10 years following the proposed merger. Mr. McKinney acknowledged that the 53/47 debt-to-equity ratio that he referred to is "hypothetical." (Vol. 6, Tr. 788, lines 14-15).

Even though freezing SJLP's capital structure was only one of the components of the Joint Applicants' regulatory plan, Mr. McKinney stated that it is a "totally critical" component of the regulatory plan. "If we change one [component] in one direction, we're going to have to change another one in another direction and come up with a completely different plan so the total economics work out the same," he testified. (Vol. 6, Tr. 789, lines 9-23).

This "totally critical" component of the regulatory plan is unacceptable to the Staff, and the Commission should reject it, because it amounts to nothing more than an attempt to indirectly recover a portion of the acquisition premium from the ratepayers. Implementing this component of the regulatory plan would come at an excessive cost to the ratepayers, as explained below. Changing another component of the regulatory plan "so the total economics work out the same"

would therefore be just as inappropriate as approving the proposal to "freeze" the capital structure would be.

SJLP follows a conservative philosophy in financing its operations. The ratio of 53% common equity to 47% long-term debt that Mr. McKinney mentioned is approximately equal to the ratio that the Staff proposed in SJLP's last rate case. SJLP's current capital structure is even more conservative, with more than 58% common equity and less than 42% long-term debt. (Broadwater Rebuttal, Ex. 703, p. 25, lines 17-23). Staff witness Broadwater revealed the company's targeted capital structure in highly confidential testimony on page 26 of his rebuttal testimony. (Broadwater Rebuttal, Ex. 703HC, p. 26, lines 1-3).

UtiliCorp, on the other hand, utilizes a capital structure that is much more highly leveraged. UCU's total debt to capital was approaching 60% in January 2000. "The consensus is that UtiliCorp will fund its operations with approximately 40% common equity on a going forward basis," Staff witness Broadwater testified. (Broadwater Rebuttal, Ex. 703, p. 28, lines 18-19). And UtiliCorp's chief executive officer, Richard C. Green, Jr., stated that UCU is still very comfortable with a 40% common equity/60% debt capital structure. (Broadwater Rebuttal, p. 28, line 18 – p. 29, line 20).

UtiliCorp's preference for a highly leveraged capital structure enables it to acquire capital at the relatively low rates that are available for debt financing, rather than the relatively high rates that are required for equity financing. However, when UCU comes before the Commission, it utilizes every available opportunity to try to obtain a rate of return that is based upon a capital structure that is much more heavily dependent upon equity financing. If the Commission allows UtiliCorp to achieve this result, the effect will be just the opposite of the beneficial effects that UtiliCorp has claimed will result from its merger and acquisition strategy.

For about the last 15 years, UtiliCorp has touted its merger and acquisition strategy as a means to obtain better access to capital markets, thereby reducing its risk and the cost of money. The company said this would have the net effect of reducing UCU's revenue requirements. (Featherstone Rebuttal, Ex. 704, p. 88, line 20 – p. 89, line 9). Fifteen years ago, UtiliCorp said , in answers to a data request, that: "This expected reduction in capital costs will eventually produce reductions in rates of return." (Featherstone Rebuttal, Ex. 704, p. 89, lines 18-27). And again, in response to another data request in the same case, UtiliCorp said: "Higher financial ratings should, in turn, lead to lower rates of return claimed in regulatory proceedings." (Featherstone Rebuttal, Ex. 704, p. 90, lines 1-10).

UCU has promised for 15 years that it will pass along to its ratepayers the benefits of its greater access to capital markets. But now it seeks to freeze the capital structure of SJLP at pre-merger levels, thereby denying its ratepayers the very benefits that it has promised.

The method that UtiliCorp has chosen to use, in this case, to try to achieve the higher rate of return that it desires is "freezing" the capital structure of SJLP at approximately the equity/debt ratio that exists for SJLP today, while ignoring the fact that the merged companies' financing would actually come, not from SJLP, but from UtiliCorp. UtiliCorp seeks to have the benefit of financing its operations predominantly with relatively cheap debt financing, while simultaneously obtaining the benefit of billing its ratepayers based upon a *mythical* capital structure consisting of predominantly equity financing. The Commission should not tolerate a shell game such as this.

In fact, the "frozen capital structure" – 53% equity and 47% debt – would not exist anywhere. Rather, the frozen capital structure would establish a future rate of return based upon conditions that existed in the past. This is wrong for two reasons: First, one cannot know what

the capital structure of SJLP would be in the future, nor what the capital structure of UCU will be in the future; one can only know what capital structure existed in the past. (Broadwater Rebuttal, Ex. 703, p. 26, line 4 – p. 27, line 9). Second, if the Commission adopts this proposal, it would be bound to apply a capital structure that does not exist.

This is actually at least the fourth time UCU has attempted to execute a strategy similar to this. The prior cases are: ER-97-394, ER-93-37 and ER-90-101. (Broadwater Rebuttal, Ex. 703, p. 31, lines 14-21). In two of those prior cases, the Commission found that UtiliCorp's consolidated capital structure should be used, rather than assigning a hypothetical capital structure to UtiliCorp's MPS division.

In Case No. ER-97-394, the Commission said: "[T]he consolidated capital structure as proposed by the Staff accurately reflects the correct capital structure of UtiliCorp itself, and therefore MPS, during the actual test year." (See the fuller discussion of Case No. ER-97-394 in Broadwater Rebuttal, Ex. 703, p. 31, line 16 – p. 33, line 29). This was similar to the view the Commission had expressed several years earlier, in Case No. ER-90-101, where it said: "[I]t is more reasonable to use the consolidated capital structure for MPS than it is to assign a hypothetical capital structure to MPS." (See the fuller discussion of Case No. ER-90-101 in Broadwater Rebuttal, Ex. 703, p. 33, line 30 – p. 34, line 31, and specifically at p. 34, lines 1-4).

As stated by Staff witness Broadwater: "[UtiliCorp's proposal to freeze SJLP's capital structure] is simply a way for UtiliCorp to artificially increase the cost of service to St. Joseph ratepayers, therefore, allowing UtiliCorp to recover, in part, the acquisition premium they paid to St. Joseph shareholders." (Broadwater Rebuttal, Ex. 703, p. 35, line 25 – p. 36, line 2).

In the present case, UCU seeks to freeze SJLP's strategy at 53% equity and 47% debt. This ratio is significantly different that the capital structure of UCU, which is presently about

40% equity and 60% debt, and which probably will remain so. In fact, the financing for SJLP will come from UtiliCorp, and not from SJLP, so the present, stand-alone, capital structure of SJLP is irrelevant to the question of what rate of return UCU will require for its SJLP division in the future.

The difference between the revenue requirement that results from using the frozen capital structure and the revenue requirement that results from using UCU's actual capital structure may be very significant. Applying the frozen capital structure during the period covered by the regulatory plan may be very expensive for SJLP's ratepayers. As shown in Schedule 22 to Mr. Broadwater's rebuttal testimony, the extra revenue requirement that results from using the frozen capital structure would amount to approximately $1.7 million per year, or a total of $17 million over the ten-year life of UCU's proposed regulatory plan, if SJLP's return on equity remains at the 10.75% level that was established in SJLP's last prior rate case. This difference balloons to $2.7 million per year, or a total of $27 million over the ten-year life of the regulatory plan, if the Commission uses UCU's targeted capital structure. (Broadwater Rebuttal, Ex. 703, p. 30, lines 3-20; Broadwater Rebuttal, Ex. 703, Sch. 22).

The Joint Applicants argue that the frozen capital structure is appropriate, because SJLP's capital structure "would not have changed appreciably" but for the merger. (McKinney Direct, p. 28, lines 8-11). By maintaining this position, the Joint Applicants are, in essence, saying that one of the supposed principal benefits of the merger – a lower cost of capital – should not be shared with the ratepayers to any extent. The Staff contends, however, that if the ratepayers receive no benefit from the merger, there is no reason why the Commission should approve it. The Commission does not exist merely to improve the earnings of the Joint Applicants; rather, it must be concerned about the impact of the proposed merger on the ratepayers, as well.

Another argument against the frozen capital structure relates to the fact that UCU's risk should actually decrease as a result of this proposed merger, for reasons set forth in the rebuttal testimony of Staff witnesses Featherstone and Broadwater. (Featherstone Rebuttal, Ex. 704, p. 90, lines 20-27; Broadwater Rebuttal, p. 30, lines 8-11 and p. 30, line 20 – p. 31, line 13). UtiliCorp claims that a major benefit of its growth strategy is that its risk decreases because of its diversification efforts. If the risk decreases, the company should be able to obtain debt and equity financing at lower rates, and the required costs of capital should correspondingly decrease. (Featherstone Rebuttal, Ex. 704, p. 90, lines 20-29). Yet UCU proposes, instead, to maintain the cost of capital at the level that SJLP required prior to the merger.

It should be noted that neither of the Joint Applicants offered any testimony in opposition to the rebuttal testimony of either Mr. Broadwater or Mr. Featherstone on the Frozen Capital Structure issue.

The Commission should reject the Joint Applicants' proposal of a frozen capital structure. If the Commission approves the proposed merger, the rates of the SJLP division after merger closing should reflect the prudent actual costs of financing the SJLP division – i.e., UtiliCorp's actual capital structure, assuming it is found to be prudent.

## IX. MERGER SAVINGS

### A. Merger savings estimates are unreliable

*Overview*

UtiliCorp claims the merger with St. Joseph Light and Power (SJLP) will result in total estimated savings of $184.3 million over a ten-year period. (Fischer Rebuttal, Ex. 705, p. 4 (Response to Staff Data Request No. 1)). Based on the Joint Applicants' witnesses McKinney, Myers and Siemek, UtiliCorp not only believes that it will achieve significant savings from the

merger, but asserts that it will be able to identify and quantify actual merger synergies to demonstrate in future rate proceedings that these savings exceed the costs relating to the merger. (Id. at 5). Staff asserts that for several reasons, discussed below, the Joint Applicants' savings estimates are unreliable and lack credibility for the argument that the UtiliCorp/SJLP merger is not detrimental to the public interest.

**B. Estimates are unreliable because they were done hastily without full and complete analysis**

The Joint Applicants' developed the merger savings estimates from transition team reports. (Heider, Tr. 698). Seven such teams, comprised of employees of SJLP and UtiliCorp, were created (Heider Direct, Ex. 11, p. 2 and Sch. VMH-2), and among other tasks, they reviewed and validated the initial estimated merger savings developed during the due diligence process. (Fischer Rebuttal, Ex. 705, pp. 9, 22). A Steering Committee comprised of UtiliCorp and SJLP operational and human resource personnel will review the teams' work. (Heider Direct, Ex. 11, p. 2). Staff interviews of members of the transition teams indicate that there were difficulties in matching up the business functions of SJLP to similar functions within UtiliCorp. (Fischer Rebuttal, Ex. 705, p. 21). Staff witness Janis Fischer stated that the level of analysis for development of the estimated merger savings was not as detailed as that for preparing an annual UtiliCorp budget. (Id. at 20-21). The teams began to meet in July and the estimates they produced are contained in Joint Applicants witness Vern Siemek's Schedule VJS-1, filed on October 19, 1999. (Heider, Tr. 698). However, the transition team process has been ongoing and refinements to a final integration implementation plan, with updated merger savings estimates, were not scheduled to be available until August 1, 2000. (Heider, Tr. 698). Joint Applicants witness Vicki Heider stated, in fact, that final savings estimates would not be ready for Steering Committee review any sooner than September 1, 2000. (Heider, Tr. 699). Ms.

Heider stated that it was possible that the steering committee could further revise the recommendations of the transition teams. (Heider, Tr. 699). Nearly one-year after the original tentative savings estimates were submitted, the Commission has no final or even updated estimates available to review for reliability.

### C. Estimates are unreliable because they are largely based on reductions in a two-utility merger scenario rather than the planned three-utility merger scenario

The merger savings calculations do not contemplate an eventual three-company merger of UtiliCorp, SJLP and Empire District, except in the areas of general joint dispatch savings and in allocated corporate costs. (Fischer Rebuttal, Ex. 705, p. 15).

Ms. Fischer testified that there is a possibility that additional economies of scale may be generated when the three companies are merged. (Fischer Rebuttal, Ex. 705, p. 16). A three-way merger would allow for additional savings though purchase of larger quantities, sharing of project costs for Missouri-specific activities and sharing personnel instead of outsourcing. (Id.) However, the effect a three-way merger will have on labor costs are unknown. (Id. at 23-24). In surrebuttal testimony, Mr. Siemek attempted to respond to the criticisms on this point by stating his belief that there would be no further economies of scale benefits from a three-way merger than from the SJLP and Empire District mergers considered separately. (Siemek Surrebuttal, Ex. 8, pp. 8-9). However, Mr. Siemek gave no indication that either the UtiliCorp – SJLP or the UtiliCorp – EDE transition teams had even been asked to consider this question when they developed their estimated synergy amounts.

### D. Estimates are unreliable because they do not reflect the separate impact of the merger on electric, natural gas and steam operations

The Joint Applicants have not provided a separate analysis of the merger savings for electric, natural gas and steam operations of the merged company. (Siemek Surrebuttal, Ex. 8,

pp. 16-17). Allocations are the basis for distributing the assets and expenses of a multi-operating unit utility to each business function to determine the respective function's cost of service. Without an allocation analysis, the Commission cannot assess merger impacts on specific operating units. (Id. at 18).

**E. Estimates of labor savings are unreliable because they may be achievable on a stand-alone basis, without the merger**

The transition teams' analyses concentrated on the labor expenses of SJLP and a major portion of the projected merger savings come from SJLP labor reductions. (Fischer Rebuttal, Ex. 705, p. 22; Siemek Direct, Ex. 7, p.11 and Sch. VJS-1).

The Joint Applicants' provided transition team work papers and reports in response to Staff Data Request Nos. 1 and 109. Ms. Fischer states that this information does not provide any explanations for the position reductions and that subjective decisions were made using assumptions that tended to increase the number of positions to be eliminated. (Fischer Rebuttal, Ex. 705, pp. 22-23).

Ms. Fischer testified that employee reductions at UtiliCorp have occurred in the past on a stand-alone basis through "re-engineering," and also have been done on a smaller scale at SJLP. She believes that many of the planned labor reductions might occur absent the merger, and cites as an example 80 employees that will be eligible for early retirement at SJLP in the next two years will present an opportunity for employee reductions. Savings from those retirements may occur notwithstanding the merger. (Fischer Rebuttal, Ex. 705, p. 25).

**F. Savings estimates are overstated because they are not discounted to present value**

The Joint Applicants' used a 2.5% inflation rate in their merger savings calculations, which has a cumulative effect that inflates the savings. (Fischer Rebuttal, Ex. 705, p. 26). On

the other hand, according to Ms. Fischer's testimony, costs to achieve the merger are largely current costs. (Id.). Because cost savings estimates have been "escalated" based on the assumed inflation rate--which produces a favorable comparison of merger savings to merger costs—it would be appropriate to discount the estimates to a common point in time to derive a present value of estimated savings. (Id. at 26-27).

Ms. Fischer's present value analysis of the UCU/SJLP estimated merger savings extends through the year 2010 and uses the company's weighted cost of capital for the compounded interest rate. This is an appropriate interest rate because if merger savings are generated, the additional cash flow would be available for UtiliCorp to use so that it could avoid meeting its cash needs by getting financing from the debt and equity markets. If required to seek financing, that weighted capital cost is what UtiliCorp would have to pay to secure needed funds. (Fischer Rebuttal, Ex. 705, pp. 27-28).

The net present value of savings from 2001 through 2010, using an 11.37% discount rate, is $102.3 million, compared to the Joint Applicants' estimated savings of $184.3. (Fischer Rebuttal, Ex. 705, p. 28; Sch. 2). Accordingly, the Companies' overstate the merger savings by $81.94 million. (Id.).

**G. Commission should disregard Joint Applicants' merger savings estimates when considering if the merger is not detrimental to the public interest**

Staff concerns with specific categories of the Joint Applicants' estimated merger savings are addressed in separate sections of this initial brief. These concerns include Staff witness Proctor's critique of estimated generational joint dispatch savings associated with the merger, and Staff witness Traxler's concerns on estimated employee benefit savings, which have led to a settlement of that issue area. Where the Staff believes merger savings estimates can be made

under more reasonable assumptions than used by the Joint Applicants, revised estimates have been offered. (Ex. 729, Traxler Revised Schedule SMT-3A).

More generally, the Staff recommends that the Commission recognize that the Joint Applicants' estimated merger savings are by definition and necessity speculative and uncertain of occurrence, even without taking into consideration the Staff's criticisms of UtiliCorp's estimated amounts recounted above. Moreover, as discussed more fully in the section of the Brief entitled "Merger Savings Tracking Benchmark," there is no known method by which the Commission or other parties can reliably determine in the future whether any level of estimated merger savings will be attained in actuality. For these reasons, the Staff believes the Commission should disregard the Joint Applicants' estimated merger savings levels when assessing the claims of the Staff and other parties to this proceeding that approval of the merger will be detrimental to the public interest.

## X. JOINT DISPATCH

The Joint Applicants contend that if the UtiliCorp and SJLP continue to operate as stand-alone entities, their total power supply costs over the ten-year period from 2000-2010 will amount to $1,731,241,000. (Holzwarth Direct (subsequently adopted by Joint Applicants witness DeBacker), Ex. 14, p. 16, lines 10-14). However, they claim that if they are allowed to merge, the total power supply costs over the same ten-year period will be only $1,620,556,000. (*Id.*) Thus, according to the Joint Applicants, the ten-year savings in power supply costs, if the merger is approved, will be $110,685,000. (*Id.*) On the basis of this analysis, the Joint Applicants claim that the "merger savings" from the joint dispatch agreement will exceed $110 million.

The Staff contends, on the other hand, that the "merger savings" are much smaller – only about $6.8 million. (Proctor Rebuttal, Ex. 714, p. 40, line 18 – p. 41, line 4). The Staff calculated this "merger savings" on the basis of production model runs by Staff witness Lin, using RealTime® software – the same software that the Joint Applicants used in their production model runs.

This difference in the projection of the "merger savings" is so dramatic as to make it seem that the claimed "merger savings" are almost illusory. It is therefore important to investigate the cause of the disagreement between the Staff and the Joint Applicants.

Joint Applicants witness DeBacker testified, however, that he did not have any material disagreement with Staff witness Lin. In fact, he concurred with the results Mr. Lin obtained, *given the assumptions that Mr. Lin used* in performing his run. Mr. DeBacker attributed the vast difference between the Joint Applicants' estimate of merger savings and the Staff's estimate of merger savings almost entirely to the "scenarios" requested by Staff witness Proctor. See, e.g., the following excerpt from Mr. DeBacker's surrebuttal testimony:

> Q. Do you have a general response to the analysis contained in [Mr. Lin's]testimony?
>
> A. Yes. Except for the scenarios specifically requested by Dr. Proctor, I have no material disagreements with Mr. Lin's analysis. Mr. Lin and I used essentially the same database and software to determine the impact of the proposed merger on power costs. As noted in his testimony, Mr. Lin made several minor changes to the input assumptions that for the most part had minor impact on the results. In fact, Mr. Lin's results are quite close to the Applicants' results in all scenarios with the exception of those scenarios requested by Dr. Proctor.
>
> Q. Which scenarios did Dr. Proctor instruct Mr. Lin to prepare?
>
> A. It is my understanding that Dr. Proctor instructed Mr. Lin to prepare scenarios using the assumption that each stand-alone company had the same wholesale sales opportunities as the merged company.

It is therefore fair to say that the testimony of Joint Applicants witness DeBacker essentially attributes all of the vast difference in the two estimates of merger savings to the difference between the scenarios used by Mr. DeBacker and those used by Dr. Proctor.

Mr. DeBacker claimed that: "Dr. Proctor used a very simplistic and unrealistic assumption in order to arrive at this conclusion." (DeBacker Surrebuttal, Ex. 20, p. 4, lines 6-7). He added the following: "The vast majority of the difference rests with Dr. Proctor's assumption concerning wholesale sales volumes and margins. He assumes that there exists a perfect wholesale market and that MPS, SJLP and the merged company will participate in that market on the same basis, i.e.: each entity will be able to sell at the market price and have the same level of market penetration." (DeBacker Surrebuttal, Ex. 20, p. 4, line 20 – p. 5, line 2).

Mr. DeBacker finds this assumption to be faulty. He asserts: "The wholesale energy market is not perfect and the abilities and opportunities of each of the market participants are not equal." (DeBacker Surrebuttal, Ex. 20, p. 5, lines 6-7).

This assertion is at the heart of the dispute between the Joint Applicants and the Staff regarding the issue of merger savings.

The Joint Applicants contend that the "abilities and opportunities" that SJLP possesses as a stand-alone company are far less than the "abilities and opportunities" that MPS possesses, and they are far less than those that the Joint Applicants will possess after the conclusion of the merger. This "abilities and opportunities" gap is so great, in fact, that it accounts for virtually all of the difference between the $100 million that the Joint Applicants expect to obtain as a result of the merger and the $6.8 million that the Staff expects to occur as a result of the merger.

The Staff, on the other hand, contends that SJLP can overcome the disparity in "abilities" on a stand-alone basis, without the need for the merger, if it only chooses to do so. And the

disparity in "opportunities" can also be eliminated, without the necessity of a merger, by implementation of the recently adopted FERC Order 2000.

According to Joint Applicants witness DeBacker, the differences in the "abilities" of SJLP and those of MPS relate to the following:

- "SJLP has not been and is not now active in the wholesale market" (DeBacker Surrebuttal, Ex. 20, p. 6, line 10), whereas "MPS has been active in the wholesale market since 1996" (DeBacker Surrebuttal, Ex. 20, p. 6, line 27).
- "SJLP does not currently have a wholesale marketing group dedicated to pursuing the wholesale market and does not have plans to create such a group," (DeBacker Surrebuttal, Ex. 20, p. 6, lines 22-23), and it would be "very costly [for SJLP] to develop and sustain an effective wholesale marketing group," (DeBacker Surrebuttal, Ex. 20, p. 6, lines 11-13), whereas "MPS maintains a fully staffed wholesale marketing group to pursue opportunities in the wholesale market" (DeBacker Surrebuttal, Ex. 20, p. 7, lines 1-2).
- "SJLP elected not to separate its transmission and generation functions due to cost" and cannot sell its excess energy at market rates (DeBacker Surrebuttal, Ex. 20, p. 6, lines 18-20), whereas MPS "has separated its generation and transmission functions" (DeBacker Surrebuttal, Ex. 20, p. 6, line 29).

To summarize the foregoing, the Joint Applicants contend that SJLP lacks the "abilities" that MPS possesses because SJLP has *elected* not to develop these abilities *due to cost*, and it therefore does not now have a qualified wholesale marketing group. The cost of developing a qualified wholesale marketing group is certainly a factor that is worthy of consideration. This alone is not, however, a sufficient reason for this Commission to approve a plan that would

require the customers of the Joint Applicants to pay one-half – or even more than one-half – of the $92 million acquisition premium that UCU agreed to pay to SJLP's shareholders. To authorize such a proposal would be to reward the SJLP shareholders for the passive course that the management of SJLP has chosen to follow.

Furthermore, it would be relatively inexpensive for SJLP to achieve the same level of "abilities" that MPS now possesses. Mr. DeBacker testified that for SJLP to do so "would probably cost SJLP in the area of $1+ million per year." (DeBacker Surrebuttal, Ex. 20, p. 7, line 21 – p. 8, line 20). Mr. DeBacker also testified, however, that this estimate of cost did not include certain risk management expenses, which he made no attempt to quantify. But even if one assumes that the total cost to SJLP of acquiring these "abilities" amounts to $2 million per year, the total cost over the ten-year period from 2000-2010 would still be only $20 million. That would be a very good investment, indeed, if it is all that is required to increase the energy cost savings from $6.8 million to $100 million.

With regard to the different levels of "opportunities" that are available to the two companies, Mr. DeBacker said the following: "The operations of the combined company, with its enhanced transmission capabilities, will allow it to expand its efforts in the wholesale market much more efficiently than either of the companies could do separately." (DeBacker Surrebuttal, Ex. 20, p. 7, lines 6-9). Mr. DeBacker later repeated this emphasis on the importance of "enhanced transmission capabilities," saying: "The increase in market penetration and sales activity are primarily due to the transmission interconnects that the new combined company will have via the interconnections that SJLP has with other utilities in the Mid-Continent Area Power Pool ('MAPP'), and the increase in available capacity for sale into the wholesale market." (DeBacker Surrebuttal, Ex. 20, p. 7, lines 17-20).

The Staff contends that most of these benefits of an enhanced transmission system will be provided by the implementation of regional transmission organizations ("RTOs"), and that FERC Order No. 2000 will adequately promote the implementation of RTOs.

The Federal Energy Regulatory Commission issued FERC Order No. 2000 on December 20, 1999. This order amended the FERC's "regulations under the Federal Power Act (FPA) to advance the formation of Regional Transmission Organizations (RTOs)." (Ex. 726, cover sheet). The FERC stated that its goal in issuing the order was "to promote efficiency in wholesale electricity markets and to ensure that electricity consumers pay the lowest price possible for reliable service." (Ex. 726, cover sheet).

Mr. DeBacker did not say, in his surrebuttal testimony, why the merged companies would be able to obtain "enhanced transmission opportunities" that would not be available to the two companies as stand-alone companies. However he did acknowledge, on cross-examination, that "enhanced transmission opportunities" would include the elimination of pancaked transmission rates, and that it would also include increased access to bulk power markets because of additions and upgrades to a transmission system. (Vol. 7, Tr. 932, line 13 – Tr. 933, line 3).

These are exactly the effects that FERC Order No. 2000 is designed to accomplish. FERC Order No. 2000 included a section entitled "Existence of Barriers and Impediments to Achieving Fully Competitive Electricity Markets," portions of which were admitted into evidence in this case as Ex. 727. In the conclusion to this section of its order, the FERC identified two major areas where barriers to a fully competitive market exist. They are engineering and economic inefficiencies and continuing opportunities for undue discrimination. (Ex. 727, pp. 62-70).

The FERC said that the sources of the engineering and economic inefficiencies involve, among other things, planning and investing in new transmission facilities and pancaking of transmission access charges. (Ex. 727, p. 62). FERC Order No. 2000 then summarized the FERC's view regarding the existing barriers to a fully competitive market as follows:

> In summary, we affirm our conclusion in the NOPR that economic and engineering inefficiencies and the continuing opportunity for undue discrimination are impeding competitive markets. As noted below, we conclude that RTOs will remedy these impediments and that it is essential for the Commission to issue this Rule.

In Section III-B of FERC Order No. 2000, portions of which are reproduced as Ex. 728, the FERC discussed benefits that RTOs can offer to address the remaining barriers and impediments to a fully competitive market. In the conclusion to this section of the order, the FERC states that RTOs will provide the benefits that it described in the NOPR, and others that commenters mention. These benefits include: elimination of rate pancaking, more efficient planning for transmission investments, and fewer opportunities for discriminatory transmission practices by the vertically integrated utility. (Ex. 728, pp. 89-90).

If all of these benefits of an enhanced transmission system will be provided by the implementation of RTOs, it is hard to imagine what additional benefits would be provided by the merger of the Joint Applicants. The Staff therefore submits that the claimed "enhanced transmission opportunities" do not justify the approval of the proposed merger, because the Joint Applicants can just as readily obtain these opportunities as stand-alone companies.

The Staff submits that SJLP either has or can acquire both the "abilities" and the "opportunities" that are necessary to achieve the claimed "merger savings" without actually merging with UtiliCorp. The vast majority of the "merger savings" that the Joint Applicants claim are not related to the merger at all. As Staff witness Proctor testified: "[O]nly $6.8 million

of the $100 million of these energy cost-related opportunities are true merger savings. If the Commission adopts a regulatory sharing plan that includes the [Joint] Applicants' estimate, it should be for reasons other than sharing in true merger savings." (Proctor Rebuttal, Ex. 714, p. 52, lines 6-9).

## XI. ELECTRIC ALLOCATIONS AGREEMENT

The Joint Applicants proposed a form of agreement for allocating power resources and costs "to achieve optimal economies consistent with reliable electric service ... and to establish the basis for capacity commitments" after the merger of the companies. The document the Joint Applicants proposed to use for this purpose was entitled "SJLP – MPS Electric Allocations Agreement." It was attached to the direct testimony of Joint Applicants witness Holzwarth, identified as Schedule RWH-10, and consisted of six pages. (Holzwarth Direct, Ex. 14, Sch. RWH-10).

In his Rebuttal testimony, Staff witness Proctor suggested certain modifications to the proposed Electric Allocations Agreement. Schedule 4.1, attached to this rebuttal testimony shows the changes Dr. Proctor proposed, and Schedule 4.2 shows the proposed Electric Allocations Agreement as modified. (Proctor Rebuttal, Ex. 714, Schedules 4.1 and 4.2).

Joint Applicants witness DeBacker then accepted all but three of Dr. Proctor's proposed changes. (DeBacker Surrebuttal, Ex. 20, p. 9, line 11 – p. 11, line 13). The remaining areas of disagreement include the following:

1. Required membership in reliability councils;
2. Allocation of on-system energy cost savings, between MPS and SJLP; and
3. Allocation of profits from off-system energy sales between MPS and SJLP.

With respect to Issue No. 1 above, the Staff maintains that if MPS and SJLP are in different reliability councils, they should both be required to satisfy whichever capacity margin requirement is the more stringent.

With respect to Issue No. 2 above, the Joint Applicants propose that *100 percent* of the on-system energy savings related to the merger be allocated to SJLP. Likewise, with respect to Issue No. 3, they propose that *100 percent* of the profits from incremental off-system sales be allocated to SJLP. The rationales that the Joint Applicants offer in support of these two proposals are virtually identical. The Joint Applicants claim that:

- It is the addition of the SJLP power supply portfolio and transmission assets that produces the cost savings or the incremental profits; and
- Allocation of 100% of the savings, or of the incremental profits, places the benefits with the division incurring the cost, including the cost of the premium and the other costs incurred to combine the companies and realize the synergies.

(DeBacker Surrebuttal, Ex. 20, p. 10, lines 12-18).

The first reason given above is fallacious, for the reason stated by Dr. Proctor in his rebuttal testimony. (Proctor Rebuttal, Ex. 714, p. 46, lines 4-10). There is no more reason to say that the addition of the SJLP power supply portfolio produces the cost savings than there is to say that the addition of the MPS power supply portfolio produces the cost savings. It would seem to be equally valid to allocate 100% of the cost savings, or incremental profits, to MPS, as it is to allocate them to SJLP.

One might ask how the Joint Applicants decided to bestow all of these benefits upon SJLP. The answer may be found in the Joint Applicants' regulatory plan. As Dr. Proctor observed: "The true rationale for the allocation of one hundred percent of these energy cost-

related opportunities to SJLP is that it is a part of the regulatory plan sponsored by UCU witness John W. McKinney." (Proctor Rebuttal, Ex. 714, p. 46, lines 11-13).

Under the regulatory plan, SJLP would be under a rate freeze for the first five years of the ten-year plan, and would be prohibited from filing a rate case during this time. Allocating the cost savings and incremental profits to SJLP would ordinarily reduce the revenue requirement of SJLP; but with a rate freeze in place, there would not be a corresponding reduction in rates.

MPS, on the other hand, would not be subject to the rate freeze, so it would be permitted to seek rate increases throughout the ten-year term of the regulatory plan. But since no cost savings or incremental profits would be allocated to MPS, its revenue requirement might increase and rate increases might be authorized.

The Joint Applicants would thus benefit, under the regulatory plan, by allocating all cost savings and incremental profits to SJLP – even though MPS would obviously be making a significant contribution to achieving any cost savings or incremental profits that are, in fact, realized.

In the words of Dr. Proctor, "under the regulatory plan proposed by the Joint Applicants, MPS ratepayers would not share in any energy cost-related opportunities from the merger for a ten-year period from the consummation of the merger." (Proctor Rebuttal, Ex. 714, p. 46, line 22 – p. 47, line 2).

The Electric Allocations Agreement proposed by the Joint Applicants should therefore be revised. It would be far more logical and reasonable for this agreement to reflect, as Dr. Proctor proposes, "an equitable sharing of the energy costs from the joint dispatch of the power supply resources of the two previously separate systems." Specifically, the energy costs should be

"allocated between MPS and SJLP in proportion to the stand-alone costs calculated for each system in the same month." (Proctor Rebuttal, Ex. 714, p. 43, lines 1-16).

## XII. SAVINGS TRACKING

### A. Savings Tracking Cannot Be Done Objectively, So No Merger Savings Can Be Conclusively Proven

*Overview*

Merger tracking is a post-merger process where the merged entity asserts that specific transactions relating to the merger can be identified, verified and the dollar amount quantified. This process purportedly can show if a merger is successful from a savings/synergies perspective. The differences between "tracked" post-merger cost-reduction transactions of the merged entity and the pre-merger baseline of the standalone pre-merger company are noted to show purported merger savings. (Fischer Rebuttal, Ex. 705, p. 29; Featherstone Rebuttal, Ex. 704, pp. 63-64).

The Joint Applicants propose to track merger savings for use in rate cases to be filed in Year 5 following the merger. (Oligschlaeger Rebuttal, Ex. 713, p. 26). These savings will allegedly "ensure" a minimum of $1.6 million annually in rate relief in years 6 to 10 following the merger. (Id.).

The Joint Applicants' will "track" merger savings generated by the merger by using PeopleSoft accounting software. This is the software that UtiliCorp uses for its present accounting system. (Fischer Rebuttal, Ex. 705, p. 29). Many utilities use this brand of software to capture the costs and revenues of the operations of its different companies and specific business units. (Id.). PeopleSoft provides a means to categorize expenses to very specific cost centers. However, UtiliCorp employees subjectively make the decisions where costs should be booked and how costs are accounted for. (Id. at 38).

For reasons discussed below, Staff recommends rejection of the proposal for merger savings tracking.

**B. Savings tracking is impractical and unrealistic because of the subjectivity involved**

Tracking merger savings on an after-the-fact basis requires a comparison between actual financial results achieved after a merger and what the financial results would have been for an entity if the merger had not taken place. This requires guesswork on someone's part to come up with a hypothetical scenario in order to quantify actual merger savings. For the guesswork, one must assume either that the stand-alone pre-merger entity's financial results can be frozen at a point in time for a period of years, or that one can project prospectively what that entity would have done on a stand-alone basis post-merger, so that the pre-and post-merger situations can be compared. The first assumption is unrealistic in that no entity remains frozen in place for years at a time, and the second assumption involves totally subjective speculation as to the future actions of an entity based on hypothetical situations. (Oligschlaeger Rebuttal, Ex. 713, p. 27).

Utilities are complex organizations with overlapping activities and functional areas. They are dynamic organizations that operate in ever-changing environments. Utilities are constantly organizing and reorganizing functions to streamline activities and obtain efficiencies. Utilities change to obtain efficiencies through implementation of new processes and technologies. It is not realistic to believe that a company will be able to measure the merger related savings from non-merger related savings in an after-the-fact fashion when there are so many changes that occur during the normal course of operations. Further, it is not realistic to isolate savings from merger and non-merger related causes. It is very difficult to determine and measure the "cause and effect" relationship that exist between taking an action and identifying and measuring the effects of that action and not taking an action and identifying and measuring

the effects of the nonaction. (Featherstone Rebuttal, Ex. 704, p. 65). This inherent problem is even worse in the case of a company such as UtiliCorp, which is continually engaged in merger and acquisition activity. How can the cost impacts of one merger be distinguished from that of others? (Fischer Rebuttal, Ex. 705, pp. 51-52).

Disagreements and disputes will occur between the parties as to how to measure, quantify and verify the merger savings. An efficiency one party will assert is the result of a merger, another may view as nothing more than an operational efficiency, addressing a pre-existing condition of an on-going concern. (Featherstone Rebuttal, Ex. 704, pp. 65-66).

Joint Applicants' witness Jerry Myers, in a transcribed interview with Staff, stated that the PeopleSoft system would have the capability of tracking non-merger related savings and make a distinction between those that are merger related. Staff witness Janis Fischer interpreted that to mean that if UtiliCorp employees can make the distinction between non-merger and merger-related savings and tell PeopleSoft where to capture it, PeopleSoft could "track" the savings. The software accounting system itself would not be able to make the distinction. Ms. Fischer testified that the PeopleSoft accounting system is not the problem in determining accurately the merger and non-merger related savings; the problem is inherent to the human intervention required for the coding of every possible merger and non-merger related transaction. (Id. at 35, 39-40).

**C. No real tracking methodology proposed**

Joint Applicants' witnesses McKinney and Myers direct testimony fails to give any substantive description of how cost tracking is actually going to be accomplished. Mr. McKinney only gives a very general conceptual discussion about how savings tracking will work to guarantee merger benefits to customers. (Oligschlaeger Rebuttal, Ex. 713, p. 27).

Mr. Myers explained how UtiliCorp will track merger savings using PeopleSoft accounting software. (Fischer Rebuttal, Ex. 705, pp. 30-31). During a transcribed Staff interview, Mr. Myers provided a document to illustrate his understanding of how UtiliCorp will identify merger savings. The document was apparently developed for informational purposes to discuss merger savings tracking during the Staff interview of Mr. Myers. (Id., at 31 and Sch. 3; Myers Surrebuttal, Ex. 19, Sch. JDM-1). The purpose of the document was to demonstrate how the savings "tracking process" would work. (Id. at 31; Tr. 968). Admittedly, Mr. Myers' intent was not to portray numbers that would allow detailed examination of budget relationships at a department level. (Tr. at 968).

The document illustrates the line item components in the merger savings equation: the SJLP and UtiliCorp 1999 budget baselines and the UtiliCorp incremental cost, all with an assumed inflation rate of 3% added for each year out from 1999 to 2004. The St. Joseph 1999 budget baseline represents the expenses that St. Joseph budgeted for 1999 and the UtiliCorp 1999 baseline represents its budgeted expenses for 1999. The UtiliCorp incremental costs represent St. Joseph overhead costs that will become part of UtiliCorp's ESF and IBU allocations that are distributed throughout the UtiliCorp organization. The UtiliCorp baseline and incremental will be added together and a portion of the sum will be allocated to SJLP and deducted from the SJLP baseline. This difference represents the alleged merger savings. UtiliCorp baseline and incremental costs will be coded by UtiliCorp employees using the PeopleSoft accounting system, but the SJLP baseline will not be coded to PeopleSoft. The actual savings will not be identified in the system since they represent the difference between the uncoded SJLP baseline and SJLP portion of the sum of the UtiliCorp baseline and incremental costs. (Fischer Rebuttal, Ex. 705, p. 32).

Ms. Fischer testified that the tracking method described by Mr. Myers in his testimony and Schedule JDM-1 of his surrebuttal testimony (See also Fischer Rebuttal, Ex. 705, Sch. 3) will not be able to distinguish between merger and non-merger savings. (Fischer Rebuttal, Ex. 705, pp. 32-33). The changes in costs as the companies move out in time from the 1999 baselines will be indistinguishable from merger savings. In essence, "merger savings" will be calculated as the difference between an escalated pre-merger SJLP budget and post-merger costs allocated to the SJLP division of UtiliCorp. Using this approach, UtiliCorp will be able to take "credit" for savings unrelated to the merger, such as increased employee productivity, changes due to technological efficiencies, and additional acquisitions. (Id. at 33).

Apparently responding to the Staff's criticism on this point, Mr. Myers addressed the question of distinguishing merger and non-merger earnings in his surrebuttal testimony. (Myers Surrebuttal, Ex. 19, pp. 3-4). Conceding that his surrebuttal schedule JDM-1 will produce a bottom line result containing both merger and non-merger "savings," Mr. Myers proposed a method for separating the two. He proposed that UtiliCorp would provide dollar estimates of the value of "improvements in technology" and "changes in regulatory requirements" and then subtract those estimates form the pool of "savings" calculated according to schedule JDM-1. The remaining savings would be assumed to be "merger-related." The Staff would then review and audit the non-merger savings quantifications (Id. at 4).

Mr. Myers admits this approach will not be "100% accurate." (Myers Surrebuttal, Ex. 19, pp. 3-4). The Staff believes this approach to distinguishing merger and non-merger savings, such as it is, has no validity at all. It misses entirely the point of the Staff's criticisms of savings tracking efforts, i.e., that there is no reasonable and objective way by which UtiliCorp, the Staff or any other party can derive estimates of non-merger savings compared to merger

savings after-the-fact, and then claim these estimates can be "audited." Mr. Myers' suggested process would be simply an exercise in taking UtiliCorp's guesses as to achieved merger and non-merger savings, compare them to Staff's guesses, and asking the Commission to decide which guess is "better." Without any attempt to go into more detail than Mr. Myers does as to how UtiliCorp's proposed identification of merger-related savings would work in practice, the Staff still believes UtiliCorp has failed to define its method for tracking merger saving in the future.

Staff also believes that the use of any baseline for tracking purposes will require a complete Staff review to determine what adjustments must be made to normalize expenses. (Fischer Rebuttal, Ex. 705, pp. 44-45). Staff is concerned about Joint Applicants' use of the SJLP 1999 budget as the baseline to which future expenses will be compared in determining if merger savings have occurred or at what amount. (Id. at 43). The 1999 budget variances demonstrate that the use of SJLP's 1999 budget as a baseline may allow non-merger savings to be "tracked" as merger savings. (Id. at 44 and Sch. 4). At this time, the Staff believes that it and the Joint Applicants have agreed that if the Commission orders a specific tracking benchmark in this proceeding, the benchmark should be the Staff's updated cost-of-service calculation for SJLP. This calculation reflects major impacts on SJLP earnings through the end of 1999, and also reflects certain revisions from the filed amount as a result of the comments of the Joint Applicants.

The transition teams will identify payroll and non-payroll costs that will become incremental costs of UtiliCorp after the merger. Procedures will be communicated to key UtiliCorp departments regarding the proper tracking of these incremental costs. The Joint Applicants have not provided to Staff any written procedures to support that the coding process

has been determined. Without an analysis of these procedures for company staff that demonstrate coding and allocations of St. Joseph costs into the UtiliCorp accounting system, Staff cannot verify that a tracking mechanism exists. This fact is another reason Ms. Fischer concluded that UtiliCorp in actuality doesn't have a concrete tracking proposal. (Fischer Rebuttal, Ex. 705, p. 31).

In this proceeding, UtiliCorp has not been shy about telling the Commission exactly what determinations it expects the Commission to make now concerning its regulatory plan. (McKinney Surrebuttal, Ex. 5, pp. 12-17). Interestingly enough, the ordering of a specific savings tracking methodology is not one of those determinations. Mr. Jerry Myers states "approval of a specific tracking system is not critical to approval of the merger. Under the proposed regulatory plan, in future rate proceedings, UtiliCorp will have the burden to quantify merger savings." (Myers Surrebuttal, Ex. 19, p. 6).

During cross-examination, Mr. Myers further explained why the Joint Applicants did not provide to the Commission a detailed and specific plan to track merger savings:

> Q. Would it be accurate to state that some of the details of the UtiliCorp proposed system for tracking future merger savings have yet to be developed?
>
> A. They have conceptually been developed, but they have not been formally documented.
>
> Q. Do you know why they haven't been formally documented yet?
>
> A. First of all, the transactions have not been approved. Secondly, the changes that would be necessary to track the incremental cost component, but not that significant. It can be implemented at a very short time frame.
>
> Q. So it was not viewed as being important to have the tracking system for merger savings formally documented for purposes of the hearings in this case?
>
> A. We do believe they are important. We have not documented.
>
> ....

Q. Has there ever been a schedule such that the formal documentation of the merger savings tracking system would be available for presentation in these proceedings?

A. In term of scheduling, you mean time line?

Q. Yes, time line.

A. No, there has not.

Q. And at the present time, what is the time line that they are on?

A. Upon approval of the transaction, we will be able to implement those procedures, document and implement those procedures, communicate those.

Q. They will not be formally documented prior to the approval of the transaction?

A. They could be formally documented and communicated prior to the transaction.

Q. Is that the present plan?

A. There is not a present plan.

(Tr. 966-967).

Even though UtiliCorp believes it is important to formally document the merger tracking system, it did not bother to provide the Commission the opportunity to review any tracking system the Company intends on using in the future. In very revealing testimony, UtiliCorp indicates it does not have a present plan. Given the importance of the $1.6 minimum revenue requirement benefit in protecting customers from merger-related detriment (i.e., rate increases)—a benefit which is to be ensured solely through a savings tracking mechanism—the failure of the Joint Applicants to propose a detailed saving tracking procedure is reason enough to reject the regulatory plan in its entirety.

**D. Inability to Track Savings Means that Non-Merger Savings Available to SJLP on a Stand-Alone Basis Can Be Imputed as Merger Related Savings**

Staff believes that UtiliCorp has an incentive to show all savings are merger related since an integral part of their proposed regulatory plan depends on tracking merger savings. (Featherstone Rebuttal, Ex. 704, pp. 65-66; Fischer Rebuttal, Ex. 705, p. 49). In a transcribed interview with Staff (cited in Ms. Fischer's Rebuttal Testimony, Ex. 705, p.p. 49-50), Joint Applicants' witness Vern Siemek states that other than tracking savings to cover the $1.6 million minimum "savings" guarantee for post-merger years 6-10, defining merger and non-merger related savings is not very important. (The Staff notes for clarification that all savings and cost elements listed on Schedule VJS-1 would need to be tracked, not just the amount of $1.6 million in net savings.)

Ms. Fischer testified that the ability to accurately determine non-merger related savings from merger savings is important because ratepayers typically get the benefits of non-merger savings through cost of service reductions that ultimately reduce rates. Applying savings toward the regulatory plan proposed by UtiliCorp without clearly separating merger savings from non-merger savings would jeopardize the flow of non-merger savings to ratepayers, regardless of the merger. Customers expect to benefit from the actions of a prudent management operating the utility. When costs increase, customers are generally asked to pay for those increased costs through increased rates. Accordingly, it is equally expected that customers receive the benefits in reduced rates when costs decrease. (Fischer Rebuttal, Ex. 705, pp. 50-51).

Staff has determined several examples of non-merger savings that may occur at both UtiliCorp and SJLP within the next few years. UtiliCorp **________________________ ________________________** and it could realize cost savings from the corporate-wide implementation of PeopleSoft for Human Resources software. (Fischer Rebuttal, Ex. 705HC, pp. 52-54). SJLP should realize stand-alone savings through the implementation of automated

meter reading as it is upgrading the ITRON meter reading system. It also may be able to generate cost savings through the **_________________________________________**

Further, SJLP could implement a fleet replacement policy of five-years/125,000 miles on a stand-alone basis and realize non-merger savings, although the UtiliCorp/SJLP transition team has identified this as something to be implemented post-merger with any savings noted as merger-related. (Id. at 55). There will probably be many opportunities for savings in the next five years for both UtiliCorp and SJLP that cannot be identified at this time, and will not be attributable to the merger.

Staff believes that savings will continue to accrue to UtiliCorp in the next several years due to its company re-engineering efforts under Project BTU ("Building Tomorrow's UtiliCorp"), implemented in 1996. These types of non-merger savings will be difficult or impossible to differentiate from merger savings on a going-forward basis, post-merger. Efficiencies developed through the Project BTU re-engineering will be amplified through the SJLP and Empire District mergers, making re-engineering non-merger saving nearly impossible to separate form merger savings. (Fischer Rebuttal, Ex. 705, pp. 56-57).

Ms. Fischer testified that SJLP, while it has not undergone a formal re-engineering since 1994, has had a restructuring that resulted in the elimination of eight positions and the addition of three new positions, for a net reduction of five positions. This type of stand-alone saving through labor force reduction is possible in the future. (Fischer Rebuttal, Ex. 705, p. 58).

Staff believes that there is no mechanism available that can segregate merger savings from savings generated from re-engineering or other cost-saving methods employed on a stand-alone company basis. The UtiliCorp/SJLP merger savings "tracking" proposal cannot be relied upon because the estimates contain savings generated from re-engineering and other cost-saving

methods. A commitment to achieve the levels of proposed savings does not mean that the level of savings, if achieved, are totally merger-related. (Fischer Rebuttal, Ex. 705, p. 58).

**E. Other Merger Tracking Attempts Have Failed**

UtiliCorp attempted to track merger savings following their acquisition of West Plains Energy Kansas (West Plains) from Centel in 1991. In Docket No. 175,457-U, the Kansas Corporation Commission (KCC) allowed UtiliCorp to acquire the electric assets of Centel subject to stipulated conditions. The stipulation contained a two-year rate moratorium, a reduction in UtiliCorp's initial rate tariffs, a refund to retail ratepayers within the West Plains service territory and prohibited UtiliCorp form seeking rate recovery of any acquisition premium beyond the level of savings generated by the acquisition. In that case, UtiliCorp did not propose a method for identifying and quantifying merger savings in the initial acquisition case. The determination of any acquisition premium, the recovery of such costs and the issue of an appropriate measuring mechanism for the merger savings were deferred until the UtiliCorp's next rate case. (Fischer Rebuttal, Ex. 705, pp. 46-47).

When the issue of documenting the actual merger savings was brought before the KCC to justify recovery of an "acquisition premium," UtiliCorp attempted to include a multitude of cost savings that the KCC ultimately decided were not merger related. (Fischer Rebuttal, Ex. 705, p. 46). The following excerpts from the KCC rate case decision (Docket No. 99-WPEE-818-RTS) are instructive:

> 18. The largest claimed savings is based upon the position that the Applicant (UtiliCorp) was entirely responsible for the reduced coal costs at the Jeffrey Energy Center . . . It appears that the primary reason for coal cost savings is Western's motivation to lower its coal costs and that the Applicant benefited from Western's efforts... Moreover, the Applicant failed to carry its burden of proof with respect to these claimed savings and failed to establish that the coal cost savings would not have been created but for the Centel acquisition.

. . .

> 20. . . . The third source of claimed savings is a Power Plant Matrix Agreement, which resulted in staff reductions and increasing plant capacity factors . . . The evidence does not show that these savings would not have been realized but for the Centel acquisition or that the savings related to a sharing of personnel with West Plains . . . It appears that this type of employee reduction was in line with prudent utility management.
>
> 21. The fourth source of claimed merger savings is power plant savings from efficiency programs recently implemented by the Applicant in 1998. Similarly, the applicant claimed savings in a general workforce reduction implemented by the Applicant four years after the Centel assets were acquired. It appears from the evidence that these types of claimed savings are the result of good utility management and consistent with industry standards. The evidence does not establish that these recent corporate changes and restructuring efforts were related to the Centel acquisition.
>
> . . .
>
> 24. The final source of claimed cost savings is a general workforce reduction implemented by the Applicant starting in 1995. This reduction is said to involve 60 positions and is claimed to reduce costs by over $4.6 million . . . It appears that the workforce reductions were the result of general economic changes in the electric industry that were forcing all electric utilities to make such workforce reductions.
>
> 25. . . . In addition, the Commission notes that West Plains initially failed to provide adequate evidence and testimony to document their claimed savings and this failure unfortunately complicated and prolonged these proceedings.

(Emphasis added; Fischer Rebuttal, Ex. 705, p. 48, containing excerpts from KCC Order on Application, Docket No. 99-WPEE-818-RTS, pp. 18, 20, 21, 24-25)

Staff believes that the experience of the West Plains case relates to the present UtiliCorp/SJLP case in that UtiliCorp will attempt to mix non-merger savings with merger savings in the present merger case, just as it did in the West Plains case. (Fischer Rebuttal, Ex. 705, p. 49).

In the "Acquisition Adjustment" section of this initial brief, information pertaining to an attempt by Kansas Power & Light Company (KPL) to track merger savings in Missouri in Case No. EM-91-213 is presented. In that proceeding, the Staff also argued conceptually against proposals to track merger savings, because such efforts would be very difficult and perhaps impossible to perform successfully. In a later rate proceeding, KPL abandoned any attempt to track merger savings in Missouri. This history is set out in more detail in the "Acquisition Adjustment" section of this initial brief.

## XIII. MPS SAVINGS ASSIGNMENT

If this merger is approved, one decision the Commission must make at some point is how any resulting merger savings should be assigned between the UtiliCorp Missouri divisions, MPS and SJLP, for ratemaking purposes.

UtiliCorp's proposal as to the division of merger savings between SJLP and MPS is a simple one: assign all merger savings to SJLP (with one minor exception). Mr. McKinney asserted this is an appropriate assignment of merger savings because all merger costs are being assigned to SJLP (Tr. 440–441). The only exception to the Joint Applicants' proposed treatment is the relatively minor savings estimated to occur in the generation capacity area, which are proposed by the Joint Applicants to be evenly split between MPS and SJLP (Tr. 441). On the witness stand, UCU witness Vern J. Siemek estimated that generation capacity savings would amount to approximately $3 million over the first ten years of the merger (Tr. 909).

The Staff strongly disagrees that, if this merger is approved, that all or nearly all of any resulting savings should be assigned solely to the SJLP division of UtiliCorp. There are several reasons for this position.

First, Mr. Steinbecker in his direct testimony asserts that one benefit of this merger is that it allows for the creation of economy of scale benefits (Steinbecker Direct, Ex. 1, p. 9).

"Economies of scale" are per unit cost reductions that result from an increasing size of the unit. Because UtiliCorp after the merger will be a bigger company than either the pre-merger UCU or the stand-alone SJLP, the Joint Applicants allege that some of the merger savings relate to the combined entities' increased size (Oligschlaeger Rebuttal, Ex. 713, p. 37). None of these alleged merger savings would even be possible unless both pre-merger utilities are combined together through the merger transaction.

For this reason, simple fairness and equity argue that both entities deserve a fair apportionment of merger savings. Both utilities' ratepayers have historically paid in rates the costs of the individual entities for which reductions are now possible, in theory, due to the merger (Oligschlaeger Rebuttal, Ex. 713, p. 38). It would be blatantly unfair and unreasonable to assign all merger savings to one entity, benefiting only one set of customers. A particularly clear example of this potential inequity is in the joint dispatch/generation savings estimated by the Joint Applicants in this case. Joint dispatch savings are caused by bringing two sets of formerly separate generating resources together. Should MPS customers, who have historically paid for the costs of MPS' generating stations through depreciation expense and a rate base return on those facilities, be totally ignored when those same generating facilities allow, in part, the possibility of merger savings when combined with SJLP generating resources? The answer is clearly no.

The second reason the Staff is opposed to the assignment of a grossly disproportionate amount of savings to the SJLP division is the relative rate levels of the two utilities. Staff witness Philip K. Williams submitted evidence in his rebuttal testimony from several sources that current MPS rates are, in general, considerably higher than current SJLP customer rates (Williams Rebuttal, Ex. 719, p. 6-14). The Staff fears that one consequence of the merger would be a long-

term trend of SJLP rates increasing towards MPS level. (Id. at 12-13). In respect to this issue, however, the Staff does not believe it is appropriate to flow all or almost all merger savings to UCU's proposed SJLP customers currently paying relatively low rates, while completely ignoring UCU's MPS customers currently paying relatively high utility rates (Oligschlaeger Rebuttal, Ex. 713, p. 38). Again, this proposal fails the fundamental just and reasonable test.

As previously mentioned, UCU attempts to justify this wholly inappropriate proposed assignment of merger savings by asserting that all of the merger costs, including the acquisition premium, are being assigned to SJLP. Therefore, according to UCU, since the merger savings should follow the costs, all savings likewise should go to SJLP. In response, the Staff notes that the assignment of all merger savings to SJLP is a choice made by UCU; it is not mandatory. (Tr. 886). The fundamental unfairness and unreasonableness of ignoring MPS almost entirely in assigning merger savings is a much more important matter than consistency with a UtiliCorp decision to assign all merger costs to SJLP. The Staff is not opposed to a reasonable assignment of merger transition costs to MPS along with a fair and reasonable portion of merger savings.

The Joint Applicants have argued that not assigning any merger costs or savings to MPS leaves that division in a status quo situation in respect to the merger, therefore protecting MPS customers from detriment (Tr. 440). However, it is not true that MPS customers will not pay for any portion of the acquisition adjustment in rates under the proposed regulatory plan. As discussed elsewhere in this initial brief, UCU has conceded that its proposal to "freeze" MPS' corporate allocators from the impact of the SJLP transaction will lead to indirect recovery of part of the acquisition adjustment (Tr. 685-868). That proposal would lead to the MPS division being taken off cost-based ratemaking in future rate cases for the express purpose of allowing UCU certain indirect recovery of the acquisition premium. The Staff would submit that the frozen

allocators proposal of UCU will lead to recovery of a significant merger cost (part of the acquisition adjustment) through MPS customer rates, and that this treatment cannot reasonably and fairly be considered leaving MPS customers unaffected by the merger. In this light, the proposal to assign all merger savings to SJLP is even more unfair and unreasonable.

For the above reasons, the Staff urges the Commission to reject UtiliCorp's proposed arbitrary assignment of almost all merger savings to the SJLP division. If the Commission approves this merger, it should direct that any future merger savings should be shared in a just and reasonable manner between SJLP and MPS.

## XIV. TRANSACTION COSTS AND COSTS TO ACHIEVE

At issue in this case is the regulatory treatment of certain costs that the Staff labels "Transaction Costs." These are costs directly associated with the completion of the merger transaction, including, for example, "fees paid for legal, banking and consulting services necessary to close the transaction." (Russo Rebuttal, Ex. 717, p. 2, lines 13-15). The Joint Applicants argue that these costs are no different than "Costs to Achieve"[21] because they are all necessarily incurred in order to achieve the synergies potentially available as a result of the merger; that unless these transaction costs are incurred, no synergies will be possible. (Siemek Surrebuttal, Ex. 8, p. 12, line 9). Accordingly, the Joint Applications propose that transaction costs receive the same regulatory treatment as costs to achieve.

The Staff takes the position that transaction costs are separate and distinct from costs to achieve and that, in part because of these distinctions, transaction costs should receive an altogether different regulatory treatment.

---

[21] The Staff defines "Costs to Achieve" as "...costs that the Companies will incur in order to combine the systems and processes of SJLP and UtiliCorp after a merger is approved." (Russo Rebuttal, Ex. 717, p. 7, lines 20-21).

**A. Transaction costs are different from costs to achieve in that they are part of the overall cost of the transaction itself.**

Unlike costs to achieve, transaction costs are directly associated with a merger or acquisition transaction. Indeed, Accounting Principle Board Opinion No. 16 defines costs of a business combination accounted for by the method chosen by Joint Applicants (the "purchase method") as direct costs of the acquisition. (Russo Rebuttal, Ex. 717, p. 2, line 20). "Under the 'purchase' 'method of accounting for a business combination, direct out-of-pocket and incremental costs of the combination, including finders' fees and fees paid to outside consultants for accounting, legal, engineering investigations and appraisals, are considered direct costs of the acquisition." (Russo Rebuttal, Ex. 717, pp. 2-3).

The direct connection is easily appreciated when one considers that an acquisition can, in fact, occur irrespective of whether the acquisition partners incur any costs to achieve. On the other hand, an acquisition without the standard transaction costs is almost inconceivable. Costs of such items as legal, banking, and consulting services normally must be incurred in order to complete the transaction. Transaction costs, then, are more standard in nature, and may seen as "hoops" that the acquisition partners must "jump through" in order to consummate the deal itself. Indeed, when one refers to transaction costs, specific types of costs are quite likely to spring to mind. The same, however, cannot necessarily be said of costs to achieve, which are often unique to the particular business combination, and as such, are inherently more discretionary and thus often reflect a greater degree of creativity on the part of the merger partners regarding the types and amounts of expenditures. Lending further support to the argument that transaction costs are fundamentally different from costs to achieve is the fact that transaction costs are generally incurred during the time leading up to and including the execution of the transaction, while costs

to achieve are normally incurred after (and sometimes long after) the transaction is completed. (Russo Rebuttal, Ex. 717, p. 10, lines 14-18).

**B. The regulatory treatment of transaction costs**

Given that transaction costs are a necessary and integral component of the transaction itself, it follows that the arguments advanced by the Staff as to why the acquisition premium---i.e., the amount by which the acquisition price exceeds the net book value of the acquired assets---should not be recoverable in rates are applicable also to the regulatory treatment of transaction costs. (Russo Rebuttal, Ex. 717, p. 6, lines 1-3). Like the acquisition premium, transaction costs are incurred primarily to further the interests of the shareholders and not the ratepayers. The shareholders, after all, are seeking to enter into the particular transaction as a way to increase the value of their investment. (Russo Rebuttal, Ex. 717, p. 2, lines 9-11). Any resultant benefit to the ratepayers is of secondary concern. Moreover, when a prospective business combination between regulated utilities also involves non-regulated operations, the companies have a real incentive to seek, to the extent possible, to have the combination financed out of the regulated operations. Therefore, the shareholders, who are in the first instance the primary beneficiaries of any business combination, should bear the costs to consummate the transaction. Further, "the recovery of transaction costs, as stated in APB Opinion 16, is associated with the acquisition premium in purchase transactions and therefore should not be the responsibility of the ratepayers." (Russo Rebuttal, Ex. 717, p. 6, lines 6-8). Finally, like the acquisition premium but unlike costs to achieve or future savings, transaction costs represent up-front outlays of "hard" dollars that are rather easy to measure (Russo Rebuttal, Ex. 717, p. 6, lines 12-13). Again considering that these transactions are entered into primarily for the benefit of the shareholders,

it is unreasonable to expect ratepayers to bear the burden of known transaction costs in exchange for the hope of being able to realize a portion of some potential future savings.

It should also be noted that a Commission decision in the instant case not to permit rate recovery of transaction costs is consistent with its recent rulings with respect to this issue. In April of this year, for example, in a case involving the acquisition by Atmos Energy Company of Arkansas Western Gas Company d/b/a Associated Natural Gas Company (Case No. GM-2000-312), the Commission approved a Unanimous Stipulation and Agreement, by the terms of which there will be no recovery of transaction costs. Likewise, in the merger case involving Kansas City Power & Light Company and Western Resources, Inc. (Case No. EM-97-515), the Stipulation and Agreement, approved by the Commission on September 2, 1999, called for no recovery of transaction costs.

Notwithstanding the Staff's position to the contrary, in the event that the Commission decides that recovery of transaction costs in rates should be permitted, Staff would recommend that they be amortized over a period of 40 years. (Russo Rebuttal, Ex. 717, p. 6, line 21). This is in contrast to the Joint Applicants' proposal that transaction costs be amortized along with costs to achieve over a period of 10 years. The Joint Applicants are, however, proposing a 40-year amortization of acquisition premium dollars. Inasmuch as transaction costs are, in essence, a necessary and integral component of the acquisition transaction itself, the 40-year time frame would be consistent with the Joint Applicants' own recommendation where the acquisition premium is concerned. If the Commission determines that amortization of transaction costs (or, for that matter, costs to achieve) for inclusion in rates should be allowed, Staff agrees with the Joint Applicants' proposal that any unamortized not be included in rate base.

The Staff further recommends, in the event the Commission decides to permit recovery of transaction costs, that 50% of such costs be allocated to UtiliCorp's non-regulated operations, "on the basis that the Joint Applicants have not provided to the Staff any information concerning a reasonable allocation of the acquisition adjustment to non-regulated operations." (Russo Rebuttal, Ex. 717, p. 7, lines 12-13). As addressed herein in the section on "Acquisition Adjustment," the Staff believes the evidence shows that a significant portion of the benefits the Joint Applicants expect from this merger pertain to non-regulated operations. Based on that evidence, some portion of merger transaction costs should be assigned below-the-line to non-regulated operations.

### C. The Regulatory Treatment of Costs to Achieve

"Costs to Achieve," as distinguished from transaction costs, are costs that will arise in the merged utilities as they take advantage of opportunities for potential savings presented in the post-acquisition environment. Such costs are typically associated with consolidating and integrating various operations, systems, practices, and procedures. The Staff believes reasonable and prudent levels of costs to achieve should be considered for recovery because of their direct relationship to potential merger-related customer savings. (Russo Rebuttal, Ex. 717, p. 10, lines 18-21).

The Joint Applicants propose that costs to achieve be amortized over 10 years. (Siemek Direct, Ex. 7, p. 8, line 4). Staff, however, "recommends that these costs be expensed in the period in which they occur, thereby offsetting any merger savings actually realized during the same time period." (Russo Rebuttal, Ex. 717, p. 10, lines 4-6). This treatment would allow the Joint Applicants to seek recovery of costs to achieve incurred within a test year set for a future

rate proceeding. Staff disputes the statement contained in the question on line 8, p. 14 of Siemek's surrebuttal testimony, i.e., contrary to that statement, Mr. Russo does NOT recommend 40-year amortization of ANY costs to achieve, as Staff defines such costs. In fact Mr. Russo does not even recommend such treatment of transaction costs, except in the event the Commission endorses recovery thereof. In the event the Commission decides that an amortization of costs to achieve is appropriate, the Staff would agree with the Joint Applicants' 10-yr. amortization proposal, with no inclusion of the unamortized balance in rate base.

Furthermore, if the Commission were to authorize rate treatment in this proceeding, Staff takes the position that some of the items listed by the Joint Applicants under costs to achieve should not be allowed recovery through rates. Specifically, the Commission should not permit rate recovery of the amounts estimated for the "Officers Severance/Retention" ($3,232,913) packages, the "Supplemental Executive Retirement Plan," or "SERP" ($1,620,000), and the "Paid Advisory Board" ($432,000). Together these items amount to $5,284,913 and account for approximately half of the Joint Applicants' total estimated so-called costs to achieve. (Russo Rebuttal, Ex. 717, p. 9). Each of these cost items is discussed below:

1. Officers Severance/Retention: In Staff's view, these packages, which, in essence, provide what are frequently dubbed "golden parachutes" to top executives, are not legitimately recoverable in rates. As noted earlier, business combinations are put together primarily for the benefit of the shareholders. The Officers Severance/Retention packages, which are designed to ensure the executives' neutrality in the event of a takeover attempt that may be of interest to shareholders, should therefore be viewed as insurance policies for the shareholders. To require ratepayers to foot the bill for such "insurance premiums" would be patently unfair. (Russo Rebuttal, Ex. 717, p. 14, lines 3-12). In addition, on the witness stand, Mr. Terry Steinbecker,

CEO of SJLP, indicated that the severance packages for executives provided for total severance benefits of three times the executives' annual salary, an amount in excess of the severance benefits available to SJLP rank and file employees. (Tr. 103-104). Severance packages of this magnitude, above the levels offered to other SJLP employees who potentially may lose their jobs, is not warranted for rate purposes.

2. SERP: The Supplemental Executive Retirement Plan is an additional retirement program for executives beyond the SJLP regular pension benefit. These packages have essentially the same "golden parachute" role as the Officers Severance/Retention packages. (Russo Rebuttal, Ex. 717, p. 12, lines 22-24). Accordingly, the cost of funding them should likewise be borne by the shareholders and not the ratepayers. Furthermore, as pointed out by Mr. Russo in his Rebuttal testimony (Russo Rebuttal, Ex. 717, p. 12, line 24), the Joint Applicants were unable to offer Staff any explanation as to why SERP costs were included in costs to achieve in the first place. Joint Applicants witness Siemek argues that SERP costs are currently included in SJLP's cost of service and that this was never raised as an issue in any prior rate case. However, in the past the plan apparently was considerably underfunded. It is only now, in connection with the merger currently before the Commission, that UCU attempts to cure that underfunding with a large infusion of cash into the plan, to be furnished by the ratepayers. UCU's attempt to have the ratepayers finance the SERP in this after-the-fact fashion should be rejected by the Commission.

3. Paid Advisory Board: The Paid Advisory Board will be composed of former members of St. Joseph Light & Power's Board of Directors. Its existence is to be limited to a term of three years. The role of the Advisory Board has not yet been fully sorted out; however, the Direct testimony of UCU witness Robert K. Green (Sched. 1 attached thereto) indicates that

the Board will advise UCU on such matters as charitable contributions, which are not included in rates, and economic development, which are subject to a cost/benefit analysis before rate recovery is permitted. (Russo Rebuttal, Ex. 717, p. 12). In fact, UCU is obligated, under its agreement with SJLP, to continue charitable contributions at pre-merger levels for the first five years following the merger anyway. (Green Direct, Ex. 2, Sch. RKG-1, p. A-36). In brief, there is no evidence that ratepayers will be benefiting in any way from the activities of the Paid Advisory Board. (Russo Rebuttal, Ex. 717, p. 12). Witness Siemek's statement that ten years of SJLP's Board of Directors are being replaced by three years of an Advisory Board (Siemek Surrebuttal, Ex. 8, p. 13, line 1) is no consolation when one considers that UCU apparently expects SJLP ratepayers to pay for part of the cost of the UCU Board of Directors as well as duplicative costs associated with the Paid Advisory Board. Given that no ratepayer benefits have been identified from the establishment of the Paid Advisory Board, the Staff recommends, therefore, that the costs of the Board be excluded from recovery in rates.

## XV. Customer Service Indicators

It is the responsibility of the Staff of the Commission to assess what impact a merger of St. Joseph Light and Power with UtiliCorp might have on the service that customers of SJLP currently enjoy. In that light, three employees of the Staff submitted testimony to the Commission about their findings on this most important issue.

Staff witness Deborah Ann Bernsen stated in her rebuttal testimony that "[t]he financial pressures associated with a merger may encourage a company to engage in expense reduction efforts that may impact service quality." (Bernsen Rebuttal, Ex.702, p. 2, lines 14-16). Bernsen also addressed other customer service quality issues in her rebuttal testimony and on the stand at the evidentiary hearing.

She testified at the hearing that "[t]he complaint per 1,000 are .55 for 1999 for MoPub, and they are .36 for St. Joe Light and Power." (Tr. 1100, lines 19-21.) In the event the Commission approves the proposed merger, "[t]he Staff believes that [the PSC Consumer Services Department] should continue to track and monitor this indicator level of complaints per 1,000 customers for both the MPS and the SJLP operating divisions of UtiliCorp." (Bernsen Rebuttal, Ex.702, p. 7, lines 1-3.)

"[T]he Service Guarantee Program that SJLP began in 1997 and presently provides to its customers" should be continued. (Bernsen Rebuttal, Ex.702, p. 7, lines 13-14.)

Bernsen also testified that "[i]n 1997, SJLP began administering a transactional survey of customers on a monthly basis... [t]he surveys attempt to elicit the customer's opinion on a number of items pertaining to the recent experience that the customer had with SJLP. The survey includes questions concerning the wait the customer encountered, as well as questions rating the knowledge, courtesy and communications skills of the SJLP representative the customer spoke to. SJLP continues to utilize these surveys and publishes a quarterly summary of results. These results assist SJLP in determining how the level of service it is providing is perceived by the customer." (Bernsen Rebuttal, Ex.702, p. 8, lines 1-9.) Bernsen believes that these should be continued as well in the event of a merger.

Bernsen also recommended in her rebuttal testimony that UtiliCorp periodically provide to the Commission performance indicators in the following areas of customer service: Call Center Abandoned Rate ("ACR"); including call volumes; Call Center Average Speed of Answer ("ASA"); Distribution Reliability Customer Average Interruption Duration ("CAIDI"); Distribution Reliability System Average Interruption Frequency Index ("SAIFI"); and

Distribution Reliability System Average Interruption Duration Index ("SAIDI"). (Bernsen Rebuttal, Ex. 702, p. 10, lines 7-15.)

"UtiliCorp should provide to the Staff actual monthly performance information regarding the indicators on a calendar year quarterly basis beginning on January 1 following the effective date of the merger. Information should be reported on each Missouri operating division or for the Missouri divisions as a whole." (Bernsen Rebuttal, Ex.702, p. 10, lines. 4-7.) "Within 90 days after the end of the calendar year, UtiliCorp should submit a draft report to the Staff which should include actual performance on these indicators for the year, explanation of any deviations where performance fell below the levels of performance set by the Commission measures, actions to be undertaken to eliminate the deviations below the levels of performance set by the Commission, and estimates of the cost of such actions." (Bernsen Rebuttal, Ex.702, p. 10, lines. 16-20.) Bernsen further testified "[i]f the actual performance is unfavorable compared to the established performance indicator, then UtiliCorp should be required to provide a written explanation to the Staff as to why its performance did not meet the acceptable levels established by the Commission. UtiliCorp also should be required to provide an estimate of any cost to improve its performance to an acceptable level of the performance indicator. In addition, UtiliCorp should be required to expend a reasonable and appropriate amount within the next year to improve the performance indicator to the identified level. UtiliCorp should credit to customers a like amount during the subsequent year for the year in which the indicator was exceeded." (Bernsen Rebuttal, Ex.702, p. 11, lines 14-23.) "The Staff is also recommending that UtiliCorp be required to include information on the staffing levels in the Customer Call Centers at both UtiliCorp and SJLP. This information will allow Staff to monitor the changes in the levels of Call Center staff at both UtiliCorp and SJLP as the transition to a single Customer Call

Center occurs." (Bernsen Rebuttal, Ex.702, p. 11, lines 3-7.) There is precedent for these proposed procedures in recent stipulations entered into by utilities seeking approval of mergers. (Bernsen Rebuttal, Ex. 702, p. 3, lines 9-23, p. 4, lines 1-3).

At the evidentiary hearing, in response to a question, UtiliCorp witness Stephen L. Pella answered: "Q. In going back to your comments on reporting, do you have any idea what the cost would be involved in regular reporting? A. No, I do not." (Tr. 1087, lines 16-19.) Pella also expressed UtiliCorp's opposition to formal reporting of customer service indicators, claiming that information is available to Staff upon request at any time. (Pella Surrebuttal, Ex. 10, p. 10, lines 19-21.) He also noted that, in regard to reliability indices, that UtiliCorp believes that a penalty system should only be instituted if it would apply to all Missouri electric utilities. (Pella Surrebuttal, Ex. 10, p. 15, lines 18-20.)

Staff disagrees with UtiliCorp's implicit complaint that it is somehow unfair to impose requirements on it because it is going through a merger that the Commission would not impose on non-merging utilities. As previously noted, mergers may have the impact of increasing financial pressures on utilities who undertake them. Therefore, it is not unreasonable to take additional steps to ensure adequate quality of service from merging utilities than from utilities not engaged in this activity.

Although at the evidentiary hearing he stated that there was "some work done in the mid '90s at UtiliCorp that attempted to derive what derivers of customer satisfaction might most relate to"(Tr. 1061, lines 20-23), UtiliCorp witness Pella admitted that ""[I]'m not aware of any actual survey of Missouri customers." (Tr. 1063, lines 1-2.)

UtiliCorp witness Pella stated at the evidentiary hearing, referring to the present SJLP office in St. Joseph, "the office is not closing." (Tr. 1094, line 19.) However, this did not refer

to the Call Center located in St. Joseph. Pella further testified at the hearing that none of the 16 service representative and 2 supervisors in St. Joseph at present will have a job there after the merger. (Tr. 1093, lines 14-15.)

At the hearing, regarding the Service Guarantee Program UtiliCorp witness Pella testified in response to a question as follows: "Q. So it's not – as far as you know it's not UtiliCorp's intention to continue the $25 account credit? A. Correct." (Tr. p. 1083, lines 19-22.)

Staff witness J. Kay Niemeier addressed the ACR and ASA indicators in her rebuttal testimony. She defined ACR as 'the percentage of telephone calls that are terminated after being placed in the network queue when contacting the company's Call Center by Telephone." (Niemeier Rebuttal, Ex. 712 HC, p. 4, lines. 14-16). She further testified that "[a]s stated in the response to Staff Data Request No. 3903, UtiliCorp's actual ACR was **______________ _____** for years 1997, 1998 and 1999, respectively... In response to Staff Data Request No. 3903, UtiliCorp stated that its ACR objective was a range of **_________**for years 1997, 1998 and 1999." (Niemeier Rebuttal, Ex. 712 HC, p. 5, lines 1-3, 5-6.) Niemeier also testified "[t]he Staff is concerned with the ACR objective set by UtiliCorp having such a broad range. UtiliCorp achieved an ACR within its own objective range for 1998 only... The Staff found that SJLP's ACR objective of less than 5% was achieved during both years 1998 and 1999." (Niemeier Rebuttal, Ex. 712 HC, p. 9, lines 11-13, 15-16.) The ACR should be set at **___** for UtiliCorp. (Niemeier Rebuttal, Ex. 712 HC, p. 19, line 12.)

Niemeier went on to state "[w]hen setting objectives, certain criteria must be addressed. The objectives should be: 1) clearly defined; 2) challenging but realistic; and 3) measurable. The ACR objective set by UtiliCorp for years 1997, 1998 and 1999 does not meet these three

criteria. The ACR figure is of great importance to Staff because it reflects the significance a company places upon responding to its customers' calls." (Niemeier Rebuttal, Ex. 712 HC, p. 5, lines 8-13.) Niemeier further stated that, should the pending merger be approved, "the Staff recommends that the Commission set UtiliCorp's ACR objective at **__**. The Staff would propose that a variance of 50 basis points be added to this objective for purposes of implementing remedial actions as outlined in the testimony of Staff witness Bernsen. This will result in a maximum allowable level of **____**. This variance will allow for occurrences outside of UtiliCorp's control that may impact the attainment of the obje

Rebuttal, Ex. 712 HC, p. 10, lines 17-23.)

In describing Voice Response Unit ("VRU") systems, Niemeier testified "SJLP's VRU system begins taking customers' calls only after all customer services representatives are busy taking calls. This VRU system is referred to as a 'back-end' method. By using the back-end method on the VRU system, SJLP customers receive a 'live voice' when their call is answered by an available customer service representative which may be when the call is first answered. Only if a customer service representative is not available, does the VRU system place the customer's call into the queue and route the call to the next available customer service representative." (Niemeier Rebuttal, Ex. 712 HC, p. 7, lines 1-7.) "Most VRU systems, such as the UtiliCorp VRU system, utilize a 'front-end' method, meaning all calls received are first processed through the VRU system. When the front-end VRU system is used, all calls are placed into the queue and the calls are then forwarded to the next available customer service representative. When the front-end VRU system is used, the customer service representative is not permitted to answer any of the calls immediately." (Niemeier Rebuttal, Ex. 712 HC, p. 7, lines 8-13.) "SJLP believes that customers prefer to hang up immediately (VRU hang ups), when

the call is not answered by a customer service representative, and call again at a later time in hopes of reaching a customer service representative. SJLP also believes that many of the customers that hang up as soon as they realize they will not speak to a customer service representative (VRU hang ups) are repetitive calls. The customer continues calling and hanging up after realizing that his/her call is being answered by the VRU...

4.26% and 4.07% for years 1998 and 1999, respectively...SJLP stated that its ACR objective was less than 5% for the years 1998 and 1999." (Niemeier Rebuttal, Ex. 712 HC, p. 7, line 17 through p. 8, line 1, 4-5, 8-9.) "SJLP attempts to have its customer service representatives directly answer as many calls as possible. It is only when all customer service representatives are busy answering calls that customers' calls are received by the VRU system and forwarded to the next available customer service representative. SJLP believes that its customers are accustomed to SJLP's VRU system, which often allows them to speak directly to a customer service representative when their call is received at the Call Center instead of to a VRU system." (Niemeier Rebuttal, Ex. 712 HC, p. 9, lines 1-8.)

At the evidentiary hearing in this matter, UtiliCorp witness Pella admitted that "[t]he call will be answered by a prompter...an automated menu selection" (Tr. 1067, lines 1, 22.)

Concerning the issue of ASA Niemeier stated, "UtiliCorp's ASA objective is not an effective objective, as it does not provide a specific target for which UtiliCorp can strive." (Niemeier Rebuttal, Ex. 712 HC, p. 13, lines 16-17.) "Staff recommends that UtiliCorp set an exact figure for its ASA objective instead of an ASA objective with a range. A specific ASA objective would allow employees an exact number for which to strive." (Niemeier Rebuttal, Ex. 712 HC, p. 16, lines 20-22.) It should be set at **________**, with a variance of 5%. (Niemeier Rebuttal, Ex. 712 HC, p. 17, lines 8-9.) "UtiliCorp's actual ASA was **________________________

______** for years 1997, 1998 and 1999, respectively." (Niemeier Rebuttal, Ex. 712 HC, p. 14, lines 3-4.)

It should be noted here that the UtiliCorp and SJLP ACR and ASA statistics are not comparable. This fact compelled Staff to take into consideration a variety of issues in order to set reasonable indicators of performance for ACR and ASA indicators.

Staff witness James L. Ketter stated in his rebuttal testimony that "[a] computer-aided dispatching system utilized by UtiliCorp allows service technicians to work remotely by providing information to the service truck. Communication between the Customer Call Center and the truck would update and provide better information to the workers which would speed response to customer needs." (Ketter Rebuttal, Ex. 708, p. 6, lines 14-17.) This technology is a great tool in providing efficient response to outages and in response to customer needs. "Implementation of this technology in the SJLP service area is subject to further analysis to determine the feasibility of utilizing this computer-aided dispatch in the SJLP service area." (Ketter Rebuttal, Ex. 708, p. 6, lines 19-21.) Communication across the SJLP territory is necessary to operate this system of a direct link to the service truck. However, "[t]he feasibility of expanding this system into the SJLP service area has not been established." (Ketter Rebuttal, Ex. 708, p. 6, line 23, through p. 7, line 1.) Offering this technology to the SJLP area could have a positive benefit to SJLP customers, if it can be economically implemented.

In discussing SAIFI, SAIDI, and CAIDI, Ketter said SAIFI, SAIDI and CAIDI "will help define the quality of service provided and bring attention to any positive or negative impact that a merger of utility systems might bring." (Ketter Rebuttal, Ex. 708, p. 8, lines 17-18.) "My recommendation, should the merger of UtiliCorp and SJLP be approved, is that UtiliCorp be directed to maintain the SAIFI, SAIDI and CAIDI reliability measures separately for the MPS

and SJLP divisions, and provide this information to the Staff as outlined in the Rebuttal Testimony of Staff witness Bernsen. The Staff will monitor this information, as well as the complaints received from customers, to help ensure that customers continue to receive reliable electric service. Further, I recommend that a rolling three-year average of the SAIFI, SAIDI and CAIDI indices be used as the appropriate indicators for distribution reliability of service after the merger." (Ketter Rebuttal, Ex. 708, p. 9, lines 3-11.) Ketter further testified that in terms of duration, there was considerably more duration interruption for UtiliCorp than for SJLP. (Tr. 1117, lines 9-12.) Again, as the measurements for UtiliCorp and SJLP are not consistent, Staff must have separate measurements in order to make informed conclusions concerning performance.

## XVI. LOAD RESEARCH CONDITION

In the event that the Commission approves the proposed merger of UtiliCorp and SJLP, the Staff proposes that five conditions regarding the production of load research data be imposed. The conditions are that the Commission order UCU to:

1. Continue to treat the SJLP service territory separately from the MPS service territory for load research purposes;

2. Maintain SJLP's current load research program at its current standard of timeliness and quality;

3. Provide hourly class load data, selected individual customer hourly load research data for the SJLP service territory and the checks and balances performed on that data to the Staff on an ongoing basis;

4. Improve MPS's current load research program to match the current SJLP standards of timeliness and quality; and

5. Provide hourly class load data, selected individual customer hourly load research data and the checks and balances performed on that data for the MPS service territory to the Staff on an ongoing basis.

(Mantle Rebuttal, Ex. 710, p. 11, line 20 – p. 12, line 12).

With regard to Condition No. 1, above, the Company has agreed with the Staff's proposal (Pella Surrebuttal, Ex. 10, p. 16, lines 19-23; see also UCU's Statement of Position, p. 15), so the Commission should order the implementation of this condition.

Condition No. 2 (timeliness and quality of SJLP's load research program) and Condition No. 4 (timeliness and quality of MPS's load research program) may be examined together. The Staff is very satisfied with SJLP's load research program, and believes the Joint Applicants should be required to continue to meet these high standards of quality.

Staff witness Mantle testified that "SJLP definitely has the best load research program" in regard to its timeliness and quality, which is due in part to its quality control. (Mantle Rebuttal, Ex. 710, p. 8, lines 5-10). Ms. Mantle noted that SJLP's most current class load data was only two months old (Mantle Rebuttal, Ex. 710, p. 8, lines 13-14), and the class load data easily passed "sanity checks" (Mantle Rebuttal, Ex. 710, p. 8, lines 4-5). In addition, Ms. Mantle said she found the SJLP personnel to be "very concerned with the quality of SJLP's class loads and receptive to ferreting out reasons for errors." (Mantle Rebuttal, Ex. 710, p. 8, lines 15-16).

However the Staff is not satisfied with MPS's load research program, and believes it needs to be improved. For example, Ms. Mantle noted that MPS's most current class load data was two years old (Mantle Rebuttal, Ex. 710, p. 8, line 15), the data that MPS provided to the Staff often contained "obvious errors" (Mantle Rebuttal, Ex. 710, p. 9, lines 7-10), and MPS made no attempt to correct the erroneous data (Mantle Rebuttal, Ex. 710, p. 9, lines 18-21).

UCU proposes to consolidate the load research programs in a single department. The same small staff will provide load research services for both SJLP and MPS. It is virtually inevitable in such a situation that there will be a "leveling" of the services provided. That is, the timeliness and quality of the services that are provided with respect to SJLP will be the same as the timeliness and quality of the services that are provided with respect to MPS. If the timeliness and quality of the two load research programs are indeed "leveled," as is likely, the Commission should insist that the MPS load research program be brought up to the current level of the SJLP program, rather than allowing the SJLP load research program to be brought down to the current level of the MPS program. If the SJLP program degrades to the level of the MPS program, it will be a detriment to the ratepayers and to the regulatory process.

Unfortunately, UCU has not demonstrated a commitment to this process, raising doubts about whether it will maintain the SJLP load research program at its present level. The staffing that the Joint Applicants propose is inadequate for this purpose, and the Joint Applicants have demonstrated a desire to do as little as they can get away with.

SJLP presently has three personnel working full-time on load research. (Mantle Rebuttal, Ex. 710, p. 10, lines 1-5, quoting UCU witness Siemek). UtiliCorp has "probably 0.8" full-time equivalent employees ("FTE") performing load research. (Vol. 7, Tr. 1151, lines 6-19 and Tr. 1153, lines 12-14). This less-than-one FTE must do load research for not only MPS, but also for West Plains, Kansas and West Plains, Colorado. This less-than-one FTE does, however, have the assistance of an outside firm, namely Quantum Consulting, which assists with the data collection. (Vol. 7, Tr. 1151, line 20 – Tr. 1152, line 14). Thus the Joint Applicants *presently* utilize 3.8 FTE plus the services of an outside consultant to perform load research for SJLP (at a

level that is satisfactory to Staff) *as well as* for MPS (at a level that is not satisfactory to Staff), *and for* West Plains, Kansas and West Plains, Colorado.

The Joint Applicants propose to terminate the services of the outside consultant. (Pella Surrebuttal, p. 17, lines 1-4; Vol. 7, Tr. 1153, line 23 – Tr. 1154, line 12). The Staff supports this decision, for the reasons stated by Ms. Mantle. (Mantle Rebuttal, Ex. 710, p. 10, line 13 – p. 11, line 16). In addition, the Joint Applicants propose to add two FTE, thus bringing the total staff to 2.8 FTE. This staff, which would be smaller than the present staff at SJLP, would have to perform the load research for SJLP, as well as for MPS and for West Plains, Kansas and for West Plains, Colorado – and it would have to do it all in-house, without the assistance of Quantum Consulting. The conclusion is inescapable that this will result in a degradation of service.

The Joint Applicants maintain that the Commission should not specify the size of staff they must use, but should rather look to the results they obtain. (Pella Surrebuttal, p. 19, lines 4-6). There is merit in this argument. However, the Joint Applicants have offered no explanation of how 2.8 FTE will be able to do the work previously done by 3.8 FTE *plus* the work of the outside consultant, and simultaneously improve the timeliness and quality of the MPS load research data. Nor does the Staff know of any reason why the Joint Applicants should be expected to perform such a remarkable feat despite a reduction in staff. In fact, this is just one example of how UCU seeks to limit its expenditures, with little regard for the quality of the load research services that it obtains.

The Commission should order the Joint Applicants to maintain SJLP's load research program at its present standard of timeliness and quality, and order them to improve MPS's load research program to match this standard of timeliness and quality.

Condition No. 3 above (the need for class load data and load research data from SJLP) and Condition No. 5 above (the need for class load data and load research data from MPS) may also be examined together. With respect to these two conditions, the Staff maintains that UCU should be required to provide Staff with class load data and selected individual customer load research data for both SJLP and MPS on an ongoing basis. Unfortunately, UtiliCorp objects that providing such data would be "unnecessarily costly" to the company. (Pella Surrebuttal, Ex. 10, p. 19, lines 13-15).

Providing class load data and load research data on an ongoing basis is the best way to assure that this data is available for analysis when the Staff needs it. (Mantle Rebuttal, Ex. 710, p. 12, line 19 – p. 13, line 6).

SJLP currently meets this standard. As a result, the Staff can obtain needed data from SJLP within 20 days through the data request process. This data is rarely more than two months old, it contains few obvious errors, and when errors are found, SJLP personnel have been quick to investigate the problems. (Mantle Rebuttal, Ex. 710, p. 13, lines 7-14.

MPS, on the other hand, has been unable to provide the needed data within 20 days after Staff requests it. This is because the data requests ask for data that MPS does not possess, since MPS does not compute the hourly class load data and hourly load research data on an ongoing basis, as SJLP does. (Mantle Rebuttal, Ex. 710, p. 13, lines 14-22).

The Joint Applicants oppose the Staff's recommendation that they provide hourly class load data for both companies on an ongoing basis. Joints Applicants witness Pella states, vaguely, that UCU intends to ensure that load research data is available for "appropriate business uses" (which are, apparently, to be identified by UCU), and for rate case analysis. (Pella Surrebuttal, Ex. 10, p. 19, lines 7-13). But he adds: "[A]ny requirement to provide load research

data on an on-going basis does not take into account the tradeoff between expense and accuracy and would be unnecessarily costly." (Pella Surrebuttal, Ex. 10, p. 19, lines 13-15).

On cross-examination, Mr. Pella said that he did not know whether estimating class loads for all hours of the year is necessary for rate case analysis. (Vol. 7, Tr. 1157, lines 13-16). And although he said UCU would comply with Commission orders to produce data in a rate case, he said he was not in a position to say whether UCU would develop such data upon the Staff's request, in the absence of a Commission order to do so. Furthermore, he said he did not know whether UCU would be able to produce the data within the time allotted for responding to data requests. (Vol. 7, Tr. 1157, line 17 – Tr. 1158, line 16). Ms. Mantle testified that the data request process "has not worked well" with MPS in the past, and that MPS generally requires more than 20 days to provide the requested data. (Mantle Rebuttal, Ex. 10, p. 13, lines 15-22).

UCU agrees with Staff witness Mantle's recommendation for quality control and checks and balances, but suggests that these matters should be addressed in a work group, to be organized by the Staff. (Pella Surrebuttal, Ex. 10, p. 17, lines 5-18). The Staff is not opposed to participating in such a work group, but believes the responsibility for sponsoring such a group should fall upon UCU.

The Staff respectfully submits that the best way to insure that the needed data is available to the Staff on a timely basis in a rate case is to require both of the Joint Applicants to provide hourly (8760) class load data, individual customer hourly load research data and the checks and balances performed on that data on an ongoing basis.

## XVII. STRANDED COSTS

This proposed Staff condition to the merger, in the event the Commission decides to approve UtiliCorp's and SJLP's application, pertains to the possibility that the acquisition

adjustment from this merger may be claimed as a component of "stranded costs" in the future by UCU.

"Stranded costs" are defined as costs presently charged by electric utilities in rates that may not be recoverable when and if electric utilities must set their prices based upon a competitive electric market (Oligschlaeger Rebuttal, Ex. 713, p. 54). As the Commission knows, stranded costs have proven to be a particularly controversial aspect of legislative and regulatory policy when jurisdictions undertake electric restructuring.

Stranded costs are measured as the difference between the value of assets reflected in regulated rates and the value of the assets in a competitive marketplace. Since UtiliCorp has chosen to pay a purchase price for SJLP higher than the underlying net book value of SJLP's assets, a risk exists that any write-up of the SJLP asset values due to this merger transaction may increase the differential between future regulated rate levels and the competitive market rate that would result from a decision of the Missouri Legislature, or possibly the United States Congress, to restructure the electric industry. The end result of the SJLP- UtiliCorp merger could be an increased level of stranded costs, that could conceivably be charged to SJLP and/or MPS customers. The Staff views this situation as a known detriment arising from this merger application, that should be addressed now by imposing conditions upon any approval of the merger.

No party to this case has argued that SJLP's generating assets are likely to be less valuable in a competitive market than they are under the current regulatory regime. In fact, there is considerable evidence that SJLP and UtiliCorp expect the opposite situation to be true (Hyneman Rebuttal, Ex. 707, pp. 28-29, 49-50). It is possible that payment of a large acquisition premium for the SJLP properties may, in and of itself, cause any future market derived electric

rate to be less than rate levels reflecting full or partial recovery of the acquisition adjustment. To the extent that this transaction causes SJLP customers potential exposure to stranded costs where there was no exposure before the merger, then that situation on its face is detrimental to SJLP customers. If a portion of the acquisition adjustment associated with the SJLP transaction is charged to MPS customers in the future, the detrimental situation is the same, because MPS customers would not have been exposed to these stranded costs without the merger taking place.

To ensure that neither SJLP or MPS customers are exposed at a later date to this particular merger-related risk, the Staff recommends that the Commission order as a condition to any merger approval that the Joint Applicants commit not to seek recovery in any future Missouri regulatory proceeding of any portion of the acquisition adjustment under the claim that such costs represent a "stranded cost." This of course would not ensure that UtiliCorp would not seek to overturn such a condition at a later time through legislation. (Oligschlaeger Rebuttal, Ex. 713, p. 55).

The only argument offered by UtiliCorp opposing this condition is to infer that the Commission would somehow be pre-empting the Legislature in attempting to define "stranded costs" by imposing such a condition. (McKinney Surrebuttal, Ex. 5, p.16; Tr. 797-798). This argument is misplaced. First, the Commission's adherence to the "not detrimental to the public interest" standard requires that known detriments to the public interest must be resolved before any merger approval is granted. The Staff believes that potential exposure to stranded costs by either SJLP or MPS customers occurring solely as a result of this merger (and the acquisition adjustment) is clearly a known detriment now, which should be addressed by the Commission now.

On the witness stand, Mr. McKinney admitted he did not expect the acquisition adjustment would ever cause a positive stranded cost situation for UtiliCorp customers. (Tr. 799). Therefore, the Staff believes that acceptance of the Staff's proposed conditions on this issue would both be prudent in protecting customers from detriment and would not likely be consequential to UtiliCorp in any event.

## XVIII. MARKET POWER AND TRANSMISSION ACCESS AND RELIABILITY

Staff witness Michael S. Proctor testified that analysis of horizontal market power for the SJLP – UtiliCorp merger is not critical. Based on his review of the market power work that was performed for the Staff in the Western Resources, Inc. – Kansas City Power & Light Company merger and the Joint Applicants' filing on market power at the Federal Energy Regulatory Commission (FERC) there appears to be little incremental value in performing additional horizontal market power studies on market concentration for this proposed merger. Nonetheless, horizontal market power can exist in the SJLP and MPS service territories in the form of load pockets (i.e., geographic areas within the service territories where the transmission system will not allow competitive generation to provide services to a significant percentage of the end-use customer loads on a year-round basis). Thus, Dr. Proctor recommended that with respect to potential horizontal market power related to load pockets, as a condition for Missouri Commission approval of the merger, the Joint Applicants should be required to agree to submit, if and when retail competition becomes lawful in Missouri, a study showing what percentage of load can be served from competitive generation sources throughout the merged service territory. (Proctor Rebuttal, Ex. 714, pp. 56-58).

Respecting vertical market power, the most critical restriction that a supplier can impose is on the use of the transmission system. Even under FERC Order No. 888 and FERC Order No.

889, which require transmission open access, as long as (1) transmission service is provided on a utility-by-utility basis, the utility can restrict the amount of service it offers to favor its own generation, and (2) pancaked transmission rates apply, incumbent utilities maintain an unfair competitive advantage. Recently issued FERC Order No. 2000 seeks to address these two matters by requiring FERC jurisdictional utilities to either join a regional transmission organization (RTO) or explain what efforts and obstacles have prevented the utility from doing so. Thus, Dr. Proctor recommended that as a condition of Missouri Commission approval of the proposed merger, the SJLP and MPS should make a commitment to join the same RTO (either the Southwest Power Pool (SPP) RTO or the Midwest Independent System Operator (MISO) RTO) that meets the eleven separate independent system operator (ISO) principles enumerated in FERC Order No. 888 before the October 15, 2000 deadline of FERC Order No. 2000. He stated that the addition of Empire District Electric Company (EDE) to the merger makes the decision respecting which RTO to join more complicated but does not necessarily result in the merged utility having to join a specific regional transmission entity. (Proctor Rebuttal, Ex. 714, pp. 58-61).

In response to a request to SPP by UtiliCorp for network service, SPP performed a regional study of load flows with respect to UtiliCorp jointly dispatching the MPS, SJLP and EDE generating units, but the study was based on transfer capability among the unconnected three service territories rather than a joint economic dispatch of the MPS, SJLP and EDE generating units. UtiliCorp itself developed a minimum cost plan to jointly dispatch the generating units of MPS, SJLP and EDE to meet the coincident loads of MPS and the two prospective new divisions of UtiliCorp. Based upon his review of the two different plans, which will be noted in greater detail below, Dr. Proctor testified that: (1) although he recommends that

the Commission support region-wide optimization of the transmission system, he cannot recommend that the Commission support the SPP proposal for providing network service to UtiliCorp based on regional pricing policies that, for example, require UtiliCorp to pay the full incremental cost of an upgrade without any revenue recovery from the market's use of the incremental transfer capability created by the upgrade; and (2) he cannot recommend that the Commission support the UtiliCorp proposal for connecting MPS, SJLP or EDE until it is clear that the UtiliCorp plan does not have detrimental effects on the regional grid. (Proctor Cross-Surrebuttal, Ex. 715, pp. 1-3). (Proctor Cross-Surrebuttal, Ex. 715, pp. 1-2, 4, 7-8).

UtiliCorp's minimum cost plan to jointly dispatch the generating units of MPS, SJLP and EDE to meet the coincident loads of the three divisions appears to be: (1) to lease from KCPL an upgraded 161 kV line connecting MPS' Nashua substation to SJLP's Lake Road substation and (2) construct a new 161 kV line connecting MPS' Nevada substation with EDE's Asbury generating unit. Dr. Proctor recommended that in order to determine the impact of the UtiliCorp minimum cost plan on the regional grid, the Commission should require that UtiliCorp have a region–wide load flow study performed that models the load-flow impacts of UtiliCorp's proposal to connect MPS, SJLP and EDE. UtiliCorp can request that SPP perform such a study. This SPP study would be significantly different from the one performed by SPP in response to UtiliCorp's request for network service. This new study would involve a determination of whether UtiliCorp's plan to connect the MPS, SJLP and EDE systems meets SPP's regional transmission planning criteria "3.3.2. Planning Assessment Studies." Under "3.3.2. Planning Assessment Studies," a utility is required to contact the Transmission Assessment Working Group "whenever new facilities are in the conceptual planning stage so that optimal integration

of any new facilities and potentially benefiting parties can be identified." (Proctor Cross-Surrebuttal, Ex. 715, pp. 2, 8).

Dr. Proctor stated that the Commission should require UtiliCorp to file the results of the SPP study in the instant case as supplemental direct testimony. Each party should be given no more than four weeks to file rebuttal testimony, and UtiliCorp should be permitted two weeks to file surrebuttal testimony. A hearing on this specific issue should then occur. (Proctor Cross-Surrebuttal, Ex. 715, p. 9).

Addressing this recommendation in greater detail, the Staff would note that Springfield City Utilities has raised two concerns about UtiliCorp's minimum cost plan to jointly dispatch the generating units of MPS, SJLP and EDE to meet the coincident loads of the three divisions that are not just specific to Springfield City Utilities:

> Allowing UtiliCorp to jointly dispatch MPS, SJLP and EDE will use transmission transfer capability within the region that will not be replaced through the proposed upgrades and construction included in the UtiliCorp plan. This could negatively impact Missouri utilities and retail customers and any utility or power marketer wanting to transmit power through the northern SPP region in two ways:
>
> 1. A reduction in transfer capability in the region will make it more difficult for Missouri utilities and any utility or power marketer wanting to carry out transactions in the off-system energy markets and could result in higher costs.
>
> 2. A reduction in transfer capability within the region may result in higher transmission costs to transmit power already purchased long-term.

(Proctor Cross-Surrebuttal, Ex. 715, pp. 1-3). Due to the assumptions used by SPP in modeling the impact of combining the MPS, SJLP and EDE systems not being the assumptions upon which SPP should have performed the modeling, Dr. Proctor testified that the SPP study does not conclusively show the validity of the two concerns identified by Mr. Russell. (Id. at 6).

Dr. Proctor related that load flow studies for the region need to be performed using what are called "base case" inputs from all utilities within the region. UtiliCorp had SPP perform a regional study of load flows with respect to UtiliCorp jointly dispatching the MPS, SJLP and EDE generating units. However, the SPP study was performed under the assumption that MPS, SJLP and EDE generating units would not be connected and that 200 megawatts of transfer capability between the three systems would be needed to carry out the joint dispatch. The SPP study looked at "worse case" scenarios to implement 200 megawatts of transfers for ten years of network service for the MPS, SJLP and EDE systems. (Proctor Cross-Surrebuttal, Ex. 715, pp. 4-5).

Dr. Proctor stated that the SPP study did not look at the region assuming that MPS, SJLP and EDE were interconnected and that the MPS, SJLP and EDE generating units were being jointly economically dispatched. The SPP study based on "worse case" scenarios showed what transmission upgrades would be needed in order to restore the security of the regional system to acceptable levels when the "worse case" transfers take place. Although some of these SPP upgrades were in the UtiliCorp post mergers control area, many of the upgrades were in the control areas of other utilities within the entire SPP region. SPP is proposing to apply incremental cost pricing to UtiliCorp for the entire upgrade even though UtiliCorp would not receive any revenues from the market's use of that portion of the upgrade not used by UtiliCorp. SPP in effect is asking UtiliCorp to subsidize the rest of the market. UtiliCorp found the net present value of the upgrades to the SPP network to be higher that the cost of its own plan to interconnect MPS, SJLP and EDE. (Proctor Cross-Surrebuttal, Ex. 715, pp. 4-6).

As previously noted, due to the assumptions used by SPP in modeling the impact of combining the MPS, SJLP and EDE systems not being the assumptions upon which SPP should

have performed the modeling, Dr. Proctor testified that the SPP study does not conclusively show that the UtiliCorp plan results in reducing the transfer capability within the region as predicted by Mr. Russell. He stated that it is not possible to reach conclusions regarding a comparison of the costs of the UtiliCorp plan and the SPP plan until corrections are made to the SPP study and the SPP incremental pricing policy. (Proctor Cross-Surrebuttal, Ex. 715, pp. 6-7).

## XIX. FERC ORDER CONDITIONALLY AUTHORIZING MERGERS OF SJLP AND UTILICORP AND EMPIRE AND UTILICORP

UtiliCorp, SJLP and Empire filed an application under Section 203 of the Federal Power Act (FPA) on November 23, 1999 for disposition of their FERC jurisdictional facilities through proposed mergers. The FERC reviewed the proposed mergers under the FERC's Merger Policy Statement, Inquiry Concerning the Commission's Merger Policy Under the Federal Power Act: Policy Statement, Order No. 592, 61 Fed. Reg. 68,595 (1966), FERC Stats. And Regs. ¶ 31,044 (1996), reconsideration denied, Order No. 592-A, 62 Fed. Reg. 33,341 (1997), 79 FERC ¶ 61,321 (1997) (Merger Policy Statement). On July 26, 2000, the FERC issued an Order Conditionally Authorizing Mergers, subject to UtiliCorp, SJLP and Empire submitting a revised competitive analysis six months prior to commencement of integrated operations, at which time, according to the FERC, it will use its authority under FPA Section 203(b) to impose any conditions necessary to mitigate potential adverse competitive effects. UtiliCorp United Inc. and St. Joseph Light & Power Co., Docket Nos. EC00-27-000 and EC00-27-001, UtiliCorp United Inc. and Empire District Electric Co., Docket Nos. EC00-28-000 and EC00-28-001, Order Conditionally Authorizing Mergers, 92 FERC ¶61,067 (2000), Mimeo at 1.

FPA Section 203(a) requires that the FERC approve a proposed merger if it finds that the merger "will be consistent with the public interest." 92 FERC ¶61,067, Mimeo at 4. The

FERC's 1996 Merger Policy Statement provides that the FERC "will generally take account of three factors in analyzing proposed mergers: (a) the effect on competition; (b) the effect on rates; and (c) the effect on regulation." Id. at 5. The FERC found that the proposed mergers with the Applicants' mitigation commitments, as conditioned by the FERC in the instant July 26, 2000 Order Conditionally Authorizing Mergers, are consistent with the public interest. Id.

Regarding the effect on regulation, the FERC stated that its concern about the effect of the merger on state regulation went to the effect on state regulation where a state does not have authority to act on a merger and the state raises concerns about the effect on state regulation. 92 FERC ¶61,067 at 17. UtiliCorp, SJLP and Empire stated that the proposed mergers would be submitted to the appropriate state commissions and they would have a full opportunity to review the proposed mergers. The FERC found that there was no indication that the proposed mergers would have an adverse effect on state regulation, and no commenter contended otherwise. Id. at 18.

Regarding the proposed mergers' effect on rates, the FERC stated that the concerns of Intervenors ICI Explosives and AG Processing about retail ratepayer protection would not be addressed since the proposed mergers had been submitted to the state commissions with jurisdiction over the retail rates of the operating utilities. 92 FERC ¶61,067, Mimeo at 15-16.

Also regarding the proposed mergers' effect on rates, UtiliCorp, SJLP and Empire proposed a wholesale ratepayer protection plan. UtiliCorp, SJLP and Empire proposed that transmission customers taking service under the UtiliCorp, SJLP and Empire open access transmission tariffs and all wholesale requirements customers would be held harmless from rate increases resulting from the mergers for five years following consummation of the mergers. However, UtiliCorp, SJLP and Empire stated in their application that for purposes of the hold

harmless commitment, the costs related to newly constructed transmission facilities would not be considered to be merger-related costs. 92 FERC ¶61,067, Mimeo at 14. City Utilities of the City of Springfield, Missouri (Springfield) and Kansas Electric Power Cooperative Power, Inc. (KEPCo) contested the exclusion of costs related to newly constructed transmission facilities from the hold harmless provision. Springfield argued that since UtiliCorp, SJLP and Empire plan to construct new transmission facilities to integrate their operations, the costs of such new or upgraded transmission facilities are clearly merger related and should be included in the hold harmless provision. Id. at 15.

The FERC specifically held that such transmission facilities costs are merger-related and therefore should be part of the hold harmless commitment:

> . . . . We agree with Springfield and KEPCo, and find that the transmission costs associated with new interconnection facilities to permit system integration would clearly be merger-related costs. Therefore, we will condition the proposed mergers on Applicants' revising their hold harmless provision to hold transmission customers harmless from the costs of the new transmission facilities, including the interconnection facilities to allow Applicants to integrate their operations.

92 FERC ¶61,067, Mimeo at 17.

Regarding the proposed mergers' effect on competition, the application did not include an analysis of the effect of any system integration on the horizontal aspects of the proposed mergers. 92 FERC ¶61,067, Mimeo at 5. The Director, Division of Corporate Applications, Office of Markets, tariffs and Rates, requested by letter on April 17, 2000 that UtiliCorp, SJLP and Empire provide additional information and as amended competitive analysis. Id. at 4. UtiliCorp, SJLP and Empire revised their analysis to reflect their proposed system integration under two alternative scenarios involving the construction of a transmission line connecting SJLP and Missouri Public Service and a transmission line connecting Empire with Missouri

Public Service. One integration option would place the interconnected systems of the merged companies under the Southwest Power Pool (SPP) regional tariff and the second integration option would place the interconnected systems of the merged companies under the Midwest Independent Operator (MISO) regional tariff. Id. at 5.

UtiliCorp, SJLP and Empire filed their response to the April 17, 2000 letter on May 19, 2000. 92 FERC ¶61,067, Mimeo at 4. The FERC in its July 26, 2000 Order Conditionally Authorizing Mergers found that UtiliCorp, SJLP and Empire had not shown that their proposed mergers will not adversely affect competition as a result of consolidating generation facilities (horizontal effects) or consolidating generation and transmission facilities (vertical effects):

> Applicants' revised analysis shows that without system integration, merger-induced increases in market concentration do not exceed the thresholds specified in the Merger Policy Statement. Under the integration scenarios, however, Applicants' results show that merger-induced increases in market concentration, as measured by the Herfindahl-Hirschman Index (HHI), exceed the thresholds (i.e., fail the screen) in the Missouri Public Service, West Plains-Energy-Kansas (West Plains), Empire, KCP&L, and Sunflower Electric Corp. (Sunflower) markets using economic capacity. . . .

Id. at 6.

The FERC held that since UtiliCorp, SJLP and Empire will not integrate their systems until mid- to late 2002, when the proposed new transmission facilities are in service, there is no reason to require at this time mitigation in this case. The FERC conditionally approved the proposed mergers, subject to UtiliCorp, SJLP and Empire submitting a revised competitive analysis six months prior to competitive operations, in which, among other things, it proposes remedies necessary to mitigate any adverse competitive effects identified. 92 FERC ¶61,067, Mimeo at 11. The FERC stated that it "will review Applicants' revised analysis, along with any proposed mitigation, and use its authority under section 203(b) of the FPA if necessary to impose any conditions necessary to mitigate potential adverse competitive effects." Id. at 12.

The FERC accepted the commitment of UtiliCorp, SJLP and Empire to join a regional transmission organization (RTO) consistent with the requirements of Order No. 2000 and stated that it relied on this commitment in approving the mergers. It noted that under Order No. 2000, UtiliCorp, SJLP and Empire must make a filing on or before October 15, 2000, in which they will propose to transfer operational control of their transmission facilities to a FERC-approved RTO on or before December 15, 2001. 92 FERC ¶61,067, Mimeo at 13.

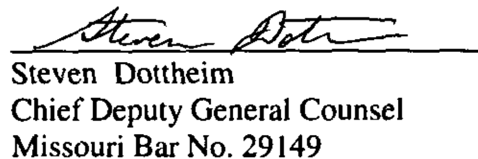
Finally, it should be noted that the FERC commented in its Order Conditionally Authorizing Mergers that in their application, UtiliCorp, SJLP and Empire stated that the merger of UtiliCorp and SJLP would be recorded using the pooling of interests method of accounting and the application did not specify which method of accounting will be used to account for the merger of UtiliCorp and Empire. 92 FERC ¶61,067, Mimeo at 18.

## XX. CONCLUSION

Wherefore for the above stated reasons, the Staff requests that the Commission adopt the Staff position on each and every issue presented in the instant proceeding.

Respectfully submitted,

DANA K. JOYCE
General Counsel
Missouri Bar No. 28553



Steven Dottheim
Chief Deputy General Counsel
Missouri Bar No. 29149

Keith R. Krueger
Deputy General Counsel
Missouri Bar No. 23857

Dennis L. Frey
Associate General Counsel
Missouri Bar No. 44697

Bruce H. Bates
Assistant General Counsel
Missouri Bar No. 35442

Nathan C. Williams
Assistant General Counsel
Missouri Bar No. 35512

Attorneys for the Staff of the
Missouri Public Service Commission
P. O. Box 360
Jefferson City, MO 65102
(573) 751-7489 (Telephone)
(573) 751-9285 (Fax)
sdotthei@mail.state.mo.us

**Certificate of Service**

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 6th day of September 2000.

**Service List for**
**Case No. EM-2000-292**
**September 6 2000**

Office of the Public Counsel
P.O. Box 7800
Jefferson City, MO 65102

James Swearengen/Paul Boudreau
Brydon, Swearengen & England, PC
PO Box 456
Jefferson City, MO 65102

Karl Zobrist/Christine Egbarts
Blackwell Sanders Peper Martin LLP
Two Pershing Square, 2300 Main, Ste. 1100
Kansas City, MO 64108

Stuart Conrad
Finnegan, Conrad & Peterson, LC
3100 Broadway, Ste. 1209
Kansas City, MO 64111

Shelley Woods/Jeremiah Nixon
Assistant Attorney General
PO Box 899
Jefferson City, MO 65102

Jeffrey Keevil
Stewart & Keevil, LLC
1001 Cherry St., Ste. 302
Columbia, MO 65201

James Cook
Ameren Services Company
1901 Chouteau Ave., PO Box 66149 (MC1310)
St. Louis, MO 63166-6149

Gary Myers, Vice President,
General Counsel, & Secretary
St. Joseph Light & Power Company
PO Box 998
St. Joseph, MO 64502

Mark Comley
601 Monroe St., Ste. 301
Jefferson City, MO 65101