

Exhibit No.:
Issue: Synergies
Witness: Frank A. DeBacker
Sponsoring Party: UtiliCorp United Inc.
Case No.: EM-2000-369
Date Prepared: August 23, 2000

MISSOURI PUBLIC SERVICE COMMISSION
Case No. EM-2000-369

Surrebuttal Testimony

of

Frank A. DeBacker

Jefferson City, Missouri

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
SURREBUTTAL TESTIMONY OF FRANK A. DEBACKER
ON BEHALF OF UTILICORP UNITED INC.
CASE NO. EM-2000-369**

1 Q. Please state your name and business address.

2 A. My name is Frank A. DeBacker and my business address is 10750 East 350 Highway,
3 Kansas City, Missouri 64138.

4 Q. By whom are you employed and what is your present position?

5 A. I am employed by UtiliCorp United Inc. ("UtiliCorp") as Vice President, Fuel and
6 Purchased Power in its domestic regulated electric utility operations..

7 Q. Are you the same Frank A. DeBacker who previously adapted the direct testimony of
8 Robert W. Holzwarth in this proceeding involving the merger of UtiliCorp with The Empire
9 District Electric Company ("EDE", together sometimes referred to as "Applicants")?

10 A. Yes I am.

11 Q. How does your surrebuttal testimony filed in this case compare to the surrebuttal testimony
12 you filed in the UtiliCorp and St. Joseph Light & Power Company, Case No. EM-2000-
13 292?

14 A. Except for quantitative differences between the two cases, my testimony is very similar to
15 that which I filed in Case No. EM-2000-292 and in some areas it is identical.

16 Q. What is the purpose of your surrebuttal testimony in this proceeding?

17 A. My surrebuttal testimony will respond to the rebuttal testimony of the Missouri Public
18 Service Commission Staff ("Staff") with respect to the following areas:

- 1 • First, I will address the results of the analysis of the merged system power costs and the
2 recommended conditions for approval of the merger presented by Staff Witness Mr.
3 Tom Y. Lin in his rebuttal testimony.
- 4 • Second, I will address those sections of Staff Witness Dr. Michael S. Proctor’s rebuttal
5 testimony where he:
- 6 • Assumes that the wholesale energy market is perfectly competitive; and,
7 • Concludes that “What the Applicants call energy cost savings represent, in large
8 part, energy cost-related opportunities rather than merger-related savings;” (*Proctor*
9 – *page 5, line 1*) and as a result recommends that, “only \$6.95 million of the Merger
10 Applicants’ estimate of energy cost-related savings be included as merger-related
11 ...” (*Proctor – page 5, line 12*).
- 12 • Third, I will also address Dr. Proctor’s proposed changes to the Applicants’ Electric
13 Allocations Agreement and his attachment thereto titled Regulatory Plan for Energy
14 Costs (*Proctor, Schedule 4.2*).
- 15 • Finally, I will address the Staff’s apparent disregard of the capacity savings resulting
16 from the merger.

17 Q. Have you reviewed the rebuttal testimony of Mr. Tom Y. Lin?

18 A. Yes I have.

19 Q. Do you have a general response to the analysis contained in his testimony?

20 A. Yes. Except for the scenarios specifically requested by Dr. Proctor, I have no material
21 disagreements with Mr. Lin’s analysis. Mr. Lin and I used essentially the same database

1 and software to determine the impact of the proposed merger on power costs. As noted in
2 his testimony, Mr. Lin made several minor changes to the input assumptions that for the
3 most part had minor impact on the results. In fact, Mr. Lin's results are quite close to the
4 Applicants' results in all scenarios with the exception of those scenarios requested by Dr.
5 Proctor.

6 Q. Which scenarios did Dr. Proctor instruct Mr. Lin to prepare?

7 A. Essentially, Dr. Proctor instructed Mr. Lin to prepare scenarios using the assumption that
8 each stand-alone company had the same wholesale sales opportunities as the merged
9 company.

10 Q. Do you have a response with respect to this assumption?

11 A. Yes. I do not agree with this assumption.

12 Q. What merger conditions did Mr. Lin recommend the Commission order?

13 A. Mr. Lin recommended that:

- 14 • "MPS and EDE must continue to provide the historical actual hourly generation, energy
15 purchases and sales data, and other information for the MPS and EDE divisions of UCU
16 required under Commission Rule 4 CSR 240-20.080 in electronic format assessable by
17 a spreadsheet program"
- 18 • "...that the Commission may access and require without the necessity of subpoena the
19 production of all accounts, books, contracts, records, documents, memoranda, papers,
20 and employees of UtiliCorp United, Inc....".

21 Q. Do you agree with Mr. Lin's recommendation?

1 A. MPS and EDE agree that they should be held to the same reporting standards as other
2 utilities under the jurisdiction of this Commission and will comply with any and all
3 reporting requirements established by the Commission.

4 Q. Have you reviewed the rebuttal testimony of Staff Witness Dr. Proctor?

5 A. Yes I have.

6 Q. Do you agree with his conclusions regarding energy cost savings; i.e.: that “What the
7 Applicants call energy cost savings represent, in large part, energy cost-related opportunities
8 rather than merger-related savings;...” and that “... only \$6.95 million of the Merger
9 Applicants’ estimate of energy cost-related savings be included as merger-related ...”?

10 A. No, I do not.

11 Q. Why not?

12 A. Dr. Proctor used a very simplistic and unrealistic assumption in order to arrive at this
13 conclusion. He assumed that the wholesale market is in essence perfect and that both
14 UtiliCorp and EDE each had equal access to the wholesale market. This assumption is
15 not realistic, does not take into account the Federal Energy Regulatory Commission’s
16 (“FERC”) rules concerning this activity, and is not supported by the EDE or UtiliCorp
17 internal forecasts of this activity.

18 Q. What is the position of UtiliCorp and EDE concerning merger related energy cost
19 savings?

20 A. As stated in Mr. Holzwarth’s testimony, the position of the Joint Applicants is that the total
21 merger related power supply cost savings over the ten-year analysis period are

1 approximately \$169.1 million (\$156.2 million in energy related savings and \$12.9 million
2 in capacity related savings).

3 Q. What causes the difference between the UtiliCorp/EDE estimates of \$169.1 million in
4 energy related savings and Dr. Proctor's argument that only \$6.95 million in energy related
5 savings are related to the merger?

6 A. The vast majority of the difference rests with Dr. Proctor's assumption concerning
7 wholesales sales volumes and margins. He assumes that there exists a perfect wholesale
8 market and that UtiliCorp's Missouri Public Service ("MPS") operating division, EDE
9 and the merged company will participate in that market on the same basis, i.e.: each entity
10 will be able to sell at the market price and have the same level of market penetration.

11 Q. How do you respond to this assumption?

12 A. I do not agree with it.

13 Q. Why?

14 A. This assumption is unrealistic. The wholesale energy market is not perfect and the abilities
15 and opportunities of each of the market participants are not equal. The actual experience of
16 each of UtiliCorp and EDE in the wholesale market since 1996 is a clear example of the
17 different approaches taken by each on a stand-alone basis and this historical perspective
18 should be taken into account when important assumptions are formulated. Dr. Proctor has
19 apparently chosen not to take the actual experience of each of the companies into account
20 when he formulated this basic assumption.

21 Q. Please describe the wholesale assumptions used by UtiliCorp and EDE in connection
22 with the proposed merger?

1 A. First, on a stand-alone basis it was assumed that both entities would continue to generate
2 approximately the same level of normalized wholesale volumes and margins over the 10-
3 year study period as those generated in recent years. This assumption was supported by
4 the internal forecasts of each entity, and the fact that EDE had not actively participated in
5 the deregulating wholesale market to the same extent as MPS. Second, after the merger,
6 it was assumed that the combined company would make all wholesale market sales at
7 market rates, and that the combined company would be able to increase its wholesale
8 market penetration. Thus, the merger would not only result in an increase in the volume
9 of wholesale sales, but an increase in the overall profitability due to use of market-based
10 rates.

11 Q. What is the basis for the Applicants' wholesale sales assumption for EDE and MPS as
12 individual stand-alone companies?

13 A. This assumption is supported by an examination of the facts surrounding each company's
14 approach to the deregulation of the wholesale market and each company's internal
15 forecasts.

16 Q. Please describe the EDE facts.

17 A. The facts concerning the EDE wholesale operations are as follows:

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- EDE has not been and is not now active in the wholesale market.
 - As one of the smaller investor owned electric utilities in the nation with approximately 1,100 megawatts of power supply resources under management. *EDE's* size and limited resource mix make it very costly to develop and sustain an effective wholesale marketing group.
 - EDE elected not to separate its transmission and generation functions due to cost, thus, it does not have approval to sell at market rates and must sell its excess energy

1 at cost based rates.
2

3 • EDE does not currently have a wholesale marketing group dedicated to pursuing the
4 wholesale market and does not have plans to create such a group.
5

6 Q. Please describe the MPS facts.

7
8 A. The facts concerning the MPS wholesale operations are:

9 • MPS has been active in the wholesale market since 1996 and has been selling at
10 market rates.

11 • MPS, as required by FERC, has separated its generation and transmission functions.

12 • MPS maintains a fully staffed wholesale marketing group to pursue opportunities in
13 the wholesale market.

14 • The MPS wholesale operations are contained within the UCU regulated electric
15 operations, which manages approximately 2,400 megawatts of power supply
16 resources located in three states and two reliability councils.

17 Q. What do you conclude from these facts?

18 A. MPS has been and continues to be much more active in the deregulation wholesale
19 market than EDE. This MPS activity both in terms of volumes and margins has reached a
20 plateau, in part due to transmission limitations. The operations of the combined
21 company, with its enhanced transmission capabilities, will allow it to expand its efforts in
22 the wholesale market much more efficiently than either of the companies could do
23 separately. The reality of this situation is quite the opposite of the assumption used by
24 Dr. Proctor to arrive at his projection of merger related energy savings of only \$6.8
25 million.

1 Q. Please describe the wholesales sales assumptions used by UtiliCorp and EDE for the
2 operation of the combined company.

3 A. It was assumed that UtiliCorp would be able to increase its wholesale market penetration
4 and increase the profit margin on wholesale sales. The increase in wholesale profit
5 margin is due UtiliCorp's proven ability to sell at the prevailing market price. The
6 increase in market penetration and sales activity are primarily due to the transmission
7 interconnects that the new combined company will have via the interconnections that
8 EDE has with other utilities in the Southwest Power Pool ("SPP") and the Southeast
9 Reliability Council ("SERC"), and the increase in available capacity for sale into the
10 wholesale market.

11 Q. Please describe the FERC requirements for the separation of generation and transmission
12 activities.

13 A. The FERC issued Order No. 889 on April 24, 1996 which included provisions, (Section
14 37.4 (a) (1), that stated that "the employees of the Transmission Provider engaged in
15 transmission system operations must function independently of its employees, or the
16 employees on any of its affiliates, who engage in Wholesale Merchant Functions". The
17 Order continued by stating; Section 37.4 (b) (1) "Prohibitions. Any employee of the
18 Transmission Provider, or any employee of an affiliate, engaged in wholesale merchant
19 functions is prohibited from: (i) conducting transmission system operations or reliability
20 functions; and (ii) having access to the system control center or similar facilities used for
21 transmission operations or reliability functions that differs in any way from the assess
22 available to other open access Transmission Customers."

1 Q. On an annual basis, how much does it cost MPS to comply with the FERC rules of
2 separation between generation and transmission?

3 A. MPS has functionally separated its generation and transmission since the issuing of the
4 FERC order referenced above. Over the past 3 years, our wholesale trading operations
5 has had an annual operating budget averaging \$3.5 million and annual capital
6 expenditures (software and equipment) averaging \$1 million.

7 Q. What would you expect EDE to spend to comply with these FERC rules?

8 A. EDE trading operation would be somewhat smaller than UCU's but due to the separation
9 of the dispatch and transmission function and the obtaining of comparable trading talent
10 would possible cost EDE in the area of \$1+ million per year.

11 Now this does not include the change in management attitude to take on the risk that
12 exists in the trading world today and the impact of the possible financial losses that have
13 been incurred by other utilities that have not been as successful as UCU. These losses
14 can be substantial and have a large impact on the utilities bottom line. To ensure the risk
15 factor is minimized, a utility entering this trading activity will need to ensure a proper
16 Risk Management program is established. I have not included this additional cost in my
17 estimate.

18 Q. Did Dr. Proctor take the EDE limitations and the additional operation expense and
19 experience required into account in formulating his basic assumptions concerning the
20 EDE capability in the wholesale market?

1 A. Apparently not. EDE has quite simply not made the investment in the necessary
2 equipment and personnel nor acquired the risk management expertise required to make
3 Dr. Proctor's assumption realistic.

4 Q. Do you agree with Dr. Proctor's proposed changes to the Electric Allocations Agreement
5 of UtiliCorp and EDE?

6 A. Dr. Proctor makes several editorial changes, which for the most part serve to clarify the
7 language of the agreement. The companies generally agree with these changes. There
8 are three changes proposed by Dr. Proctor with which UtiliCorp and EDE do not agree.

9 Q. What is the first point of disagreement?

10 A. The first point of disagreement is the percentages that Dr. Proctor proposes be applied to
11 allocate the reductions in the cost of the energy required to serve the on-system energy
12 needs of MPS and EDE. Dr. Proctor proposes that a portion of the on-system energy
13 savings be allocated to MPS and a portion allocated to EDE. UtiliCorp and EDE's
14 position is that 100% of the savings in on-system energy costs should be allocated to
15 EDE.

16 Q. Why?

17 A. Allocation of 100% of the on-system energy savings to EDE is appropriate because:

- 18 • It is the addition of the EDE power supply portfolio that produces the cost savings;
19 and,
20 • Allocation of 100% of the savings places the benefits with the division incurring the
21 cost, including the cost of the premium and the other costs incurred to combined the
22 companies and realize the synergies.

1 Q. What is the second point of disagreement?

2 A. The second point of disagreement the allocation percentage that Dr. Proctor proposes to
3 use to allocate margins from off-system energy sales between the divisions. Dr. Proctor
4 proposes that margins from all off-system energy sales be allocated 84.6% to MPS and
5 2.9% to EDE. The position of UtiliCorp and EDE is that 100% of the margins from
6 incremental off-system energy sales should be allocated to EDE.

7 Q. What do you mean by "incremental off-system sales"?

8 A. By "incremental off-system sales", I mean off system sales that are above and beyond
9 those that could have been made by MPS and EDE on a stand-alone basis.

10 Q. What are the reasons for the position of UtiliCorp and EDE?

11 A. Allocation of 100% of the incremental margins from off -system sales to EDE is
12 appropriate for two reasons:

- 13 • First, these incremental margins would not be possible except for the addition of the
14 EDE power supply portfolio and transmission assets.
- 15 • Allocation of 100% of the incremental margins to EDE places the benefits with the
16 division incurring the cost, including the cost of the premium and the other costs
17 incurred to combined the companies and realize the synergies.

18 Q. Earlier in your testimony, you stated that Staff apparently disregards the capacity savings
19 associated with the merger. Please explain.

20 A. In Mr. Holzwarth's testimony, he shows a capacity savings of \$12.9 million over the 10-
21 year analysis period (see the table in the center of page 19 of Mr. Holzwarth's testimony).

22 As Mr. Holzwarth states on page 6, line 11 of his testimony, this savings results from

1 “Combining the loads of two systems into a single control area reduces the amount of
2 capacity required due to the natural diversity between the load profiles of the two
3 systems. This reduction in the amount of required capacity reduces the overall power
4 supply cost to the combined system.” On page 23, line 3 of Dr. Proctor’s rebuttal
5 testimony where he outlines the components of power supply cost savings, Dr. Proctor
6 seems to agree with Mr. Holzwarth when he states: “Second, with respect to joint
7 capacity planning for the merged utilities there are potential savings from combining the
8 loads for purposes of determining peak load capacity requirements. These savings are
9 specifically related to the diversity of load (the assumption that the MPS and EDE loads
10 do not reach their peaks at the same time).”

11 In spite of his apparent agreement, Dr. Proctor choose not include the capacity component
12 of power supply savings in any of his analysis and it does not appear in any of the analysis
13 of other Staff witnesses.

14 Q. Does this conclude your surrebuttal testimony?

15 A. Yes.

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the Matter of the Joint Application of)
UtiliCorp United Inc. and The Empire)
District Electric Company for Authority to)
Merge The Empire District Electric) Case No. EM-2000-369
Company with and into UtiliCorp United)
Inc., and, in Connection Therewith, Certain)
Other Related Transactions.)

County of Jackson)
)
State of Missouri)

AFFIDAVIT OF FRANK A. DEBACKER

Frank A. DeBacker, **being first duly sworn**, deposes and says that he is the witness who sponsors the accompanying testimony entitled surrebuttal testimony; that said testimony was prepared by him and or under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.


Frank A. DeBacker

Subscribed and sworn before me this 21 day of August, 2000.


Notary Public

My Commission Expires:

ALEXA NUNNERY
Notary Public – State of Missouri
County of Jackson
My Commission Expires May 4, 2004