

Exhibit No.:
Issues: Merger Costs, Injuries
and Damages Expense,
Advertising
Witness: Michael G. Gruner
Sponsoring Party: MoPSC Staff
Type of Exhibit: Direct Testimony
Case No.: EO-96-14

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

MICHAEL G. GRUNER

FILED
FEB 23 1999
Missouri Public
Service Commission

UNION ELECTRIC COMPANY

CASE NO. EO-96-14

Jefferson City, Missouri
February 1999

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22

DIRECT TESTIMONY
OF
MICHAEL G. GRUNER
CASE NO. EO-96-14
UNION ELECTRIC COMPANY

Q. Please state your name and business address.

A. Michael G. Gruner, 815 Charter Commons Dr., Suite 100B, Chesterfield,
Missouri 63017

Q. By whom are you employed and in what capacity?

A. I am employed by the Missouri Public Service Commission (MPSC or
Commission) as a Regulatory Auditor.

Q. Please describe your educational background.

A. I graduated from the University of Missouri-Columbia, receiving a
Bachelor of Science degree in Marketing in May of 1982. I have also
completed 27 hours of Accounting courses from the University of
Missouri-St. Louis and in May of 1989 passed the Uniform Certified
Public Accountant Examination.

Q. Please describe your employment background.

A. Prior to my employment with the Commission I was employed as an
internal auditor for the Lutheran Church Missouri Synod from 1989-91,
First Banks, Inc. from 1991-92 and from 1993-97 I was employed with

several temporary Accounting Agencies performing various accounting assignments.

Q. What has been the nature of your duties while in the employ of the Commission?

A. I have assisted with audits and examinations of the books and records of public utility companies operating within the State of Missouri. I participated in Case No. WR-97-382, St. Louis County Water Company, and five informal water rate proceedings.

Q. With reference to Case No. EO-96-14, have you reviewed the books and records of Union Electric Company (UE or Company)?

A. Yes, in conjunction with other members of the Commission Staff (Staff).

Q. What are your principal areas of responsibility in this case?

A. I am principally responsible for the adjustment to UE's third period earnings sharing credit calculation involving merger and acquisition costs, advertising expense, and injuries and damages expense.

Q. What adjustments to the Income Statement are you sponsoring?

A. I am sponsoring the following Income Statement adjustments:

Merger and Acquisition costs

Advertising expense

Injuries and Damages expense

MERGER & ACQUISITION COSTS

Q. Please explain the term "merger and acquisition costs".

1 A. Merger and acquisition costs for this case can be divided into two
2 categories: transaction costs or transition costs. Transaction costs are
3 costs directly related to bringing about the merger of UE and CIPSCO
4 Inc., for example: underwriting costs, legal fees, accounting fees, and
5 filing fees. Transition costs are costs incurred as a result of the merger to
6 achieve merger savings, for example: record keeping integration and
7 operations integration.

8 Q. Please explain how merger and acquisition costs relate to this case.

9 A. In Case No. EM-96-149, UE filed an application before the Commission
10 for an order requesting authorization of the merger of UE and CIPSCO
11 Inc. As part of the Stipulation and Agreement in that case it was
12 determined that actual prudent and reasonable merger transaction and
13 transition costs, then estimated to be \$72 million, would be amortized over
14 ten years beginning the date the merger closes. The annual amortization
15 costs was to be the lesser of (1) the Missouri jurisdictional portion of the
16 total UE amount of \$7.2 million; or (2) the Missouri jurisdictional portion
17 of the total UE unamortized amount of actual merger transaction and
18 transition costs incurred to date.

19 Q. Please explain Staff's adjustment to this level of merger and acquisition
20 cost.

21 A. Based on the Company's responses to Staff's Data Request Nos. 23 and
22 55 in this proceeding, actual transaction costs as of June 30, 1998 were
23 \$25,620,950 and a new estimate for transition costs was determined to be

1 \$41,000,000. Staff totaled these costs, multiplied that amount by the
2 Company's Missouri jurisdictional allocation factor of 86.13%, the
3 allocation factor for merger and acquisition costs is based on the
4 Company's response to Staff Data Request No. 31. Staff then divided the
5 result by ten to calculate the annual amortization of merger and acquisition
6 cost of \$5,738,062. This amount was then compared to the Company's
7 booked amortization of \$6,201,307, based on the 1996 estimate of
8 transition and transaction costs of \$72 million, and an adjustment was
9 made to reduce the expense by the amount of the difference. This
10 difference was then divided in half to reflect the fact that only six months
11 of expense was included from the merger closing date, January 1, 1998 to
12 the end of the third sharing period on June 30, 1998. This calculation
13 appears on Schedule 1, attached to this testimony.

14 Q. Why is this adjustment appropriate?

15 A. This adjustment is appropriate because use of the actual transaction costs
16 incurred and the Company's most current estimate of transition costs more
17 accurately reflects an appropriate level of amortization costs than a level
18 based on outdated estimates from 1996. Also, this adjustment is
19 consistent with the Stipulation and Agreement in Case No. EM-96-149.

20 **ADVERTISING EXPENSE**

21 Q. Please explain your adjustment to advertising costs.

22 A. The Staff's adjustment relates to advertising costs associated with the
23 Company's name change to AmerenUE. Although these costs were not

1 included in the Company's estimate of transition costs, they were incurred
2 as a direct result of the merger. If there had been no merger there would
3 be no need for the Company to promote a new corporate name. Therefore,
4 these costs should be treated in the same manner as other transition costs,
5 and amortized over ten years.

6 Q. How did you determine which advertising costs were merger related and
7 should be amortized?

8 A. In response to Staff Data Request No. 50, the Company indicated it had
9 incurred \$206,837 of direct costs associated with the name change. Staff
10 also reviewed all television, radio and print advertisements produced for
11 or during the third sharing period and identified seven advertisements,
12 which were directly related to the merger. These advertisements are
13 attached to this testimony as Schedule 2. The costs associated with these
14 advertisements, and the direct costs identified in response to Staff Data
15 Request No. 50 totaled \$1,198,124. Staff multiplied this cost by the
16 Company's Missouri jurisdictional electric allocation factor of 88.38% to
17 calculate its adjustment of \$1,005,957. Consistent with the treatment of
18 other transition costs this amount will be included in expense over a ten-
19 year period beginning January 1, 1998. This adjustment only reflects six
20 months of amortization costs during the third sharing period from the
21 merger closing date, January 1, 1998, to the end of the period, June 30,
22 1998.

INJURIES AND DAMAGES EXPENSE

Q. Please explain injuries and damages expense.

A. The Company maintains a reserve to pay claims for injuries and damages which occur during the year and for possible future claims against the Company. The reserve represents funds accumulated and set aside to pay claims for medical costs, workmen compensation costs and lawsuits relating to injuries and damages. UE is self-insured for these costs.

Accruals to increase the reserve are expensed and actual claims are charged against the reserve balance when paid. During the first two sharing periods the Company incurred approximately \$5,950,000 and \$6,670,000 in injuries and damages expense, respectively. However, in the third sharing period the expense increased to \$20,270,000. When Staff questioned the Company as to the nature of this dramatic increase to the amount, having tripled in just over two years, the Company explained that an exceptionally high number of large claims had been settled during the third sharing period. Also, the Staff was told that because of this increasing trend in litigation, the reserve balance was increased to offset possible future claims.

Q. Please explain Staff's adjustment to injuries and damages expense.

A. The Staff's adjustment can be best examined in two separate segments. The first portion is designed to bring the reserve to an appropriate level. Staff calculated the average reserve balance for the first two sharing periods, \$13,111,697, and adjusted the third sharing period's beginning

1 reserve balance, \$12,576,986, to reflect this level. This adjustment
2 increases the injuries and damages expense by \$534,711. In the second
3 segment of the Staff's adjustment, injuries and damages expense is limited
4 to the amount of actual claims paid for the sharing period by comparing
5 the payments, \$17,160,897, to the provision for the third sharing period of
6 \$20,270,000. This part of the adjustment reduces the reserve balance by
7 \$3,109,103. The net result of combining these two segments is a
8 reduction in injuries and damages expense of \$2,574,392. This amount is
9 multiplied by the Company's Missouri jurisdictional allocation factor of
10 88.38%, which results in an adjustment of \$2,275,248. This calculation
11 appears on Schedule 3, attached to this testimony.

12 Q. What is the Staff's justification for proposing this adjustment?

13 A. In Case No. ER-95-411, the Stipulation and Agreement states in section
14 3.f.vii:

15 UE, Staff, OPC and other signatories reserve the right to bring
16 issues which cannot be resolved by them, and which are related to
17 the operation or implementation of the Plan, to the Commission for
18 resolution. Examples include disagreements as to the mechanics of
19 calculating the monitoring report, alleged violations of the
20 Stipulation and Agreement, alleged manipulations of earnings
21 results, or requests for information not previously maintained by
22 UE. An allegation of manipulation could include significant
23 variations in the level of expenses associated with any category of
24 cost, where no reasonable explanation has been provided.

25
26 This adjustment is appropriate for several reasons. It allows the Company
27 recovery of its actual injuries and damages payments in the third sharing
28 period and also allows an additional amount to maintain an adequate
29 reserve balance. Although the reserve declined during much of the third

1 sharing period, UE made a large accrual at the end of the sharing period
2 designed to restore the balance and cover possible future payments, which
3 brought the reserve to its highest level ever. The Staff believes it would
4 be inappropriate to reflect both the unusually high injuries and damages
5 claims paid by or assessed against UE in this period and an increase in the
6 additional accrual which brings the reserve to its highest level ever. Even
7 considering the Staff's proposed adjustment, the level of injuries and
8 damages expense allowed by the Staff's proposed adjustment, the level of
9 injuries and damages expense allowed by the Staff in the third sharing
10 period is 272% above the average annual expense booked during the first
11 two sharing periods. To be conservative, the Staff chose to adjust the
12 additional accrual from the third sharing period expense.

13 Q. Has the Commission previously addressed this item?

14 A. Yes, there is precedent in past proceedings for normalization of injuries
15 and damages expense when there are increases/fluctuations in these cost
16 form year-to-year. Such an adjustment was presented and adopted by the
17 Commission in Case No. EC-87-114.

18 Q. Does this conclude your direct testimony?

19 A. Yes, it does.

AMEREN UE
CASE NO. EO-96-14
MERGER & ACQUISITION COSTS

<u>Original Estimate</u>	<u>Allocation Factor %</u>	<u>Annual Amortization Merger Cost</u>	<u>Missouri Annual Amortization Merger Cost</u>	<u>Missouri Electric</u>
Missouri Electric	86.13%	6,201,360	6,201,307	6,201,307
Illinois Electric	7.52%	541,440		
FERC Electric	3.43%	246,960		
Total Electric	97.08%	6,989,760		
Missouri Gas	2.88%	207,360	207,453	
Illinois Gas	0.04%	2,880		
Total Gas	2.92%	210,240		
TOTAL	100.00%	7,200,000	6,408,760	

Actual Transaction Costs thru 6/98 (DR # 55)	25,620,950
Revised Estimated Transition Costs (DR # 23)	41,000,000

Revised Total	66,620,950
Missouri Electric Allocation Factor	86.13%

Missouri Electric Portion	57,380,624	/10 =	5,738,062
---------------------------	------------	-------	-----------

Adjustment to Reduce Expense

	(5,738,062)
(a)	2 = (2,869,031)

(a) amortization began 1/98 therefore only 6 months of Amort. as of the end of the third Sharing Period.

TBWA **Chiat/Day**

AmerenUE :60 Radio

"Just Another Day" Revised 11/24/97

AVO: On Jan. 13, 1998 Union Electric changed its name to AmerenUE. And that's all that changed. The earth still rotated at a speed of 29.79 kilometers per second at a distance of 93.2 million miles from the sun. The gravitational pull of the moon caused the tides to come in and go out, twice. The sun rose in the east. And here at home 254,000 bagels were toasted. 4.4 million numbers were crunched. 365,000 cheeseburgers were consumed along with 20,808 gallons of diet soda.

And AmerenUE is still the same reliable power company you've come to depend on over the years. We've always been there when you needed us and we're not about to change now. Our focus is still on you, the customer. And it always will be. The atmosphere is still composed mainly of nitrogen and oxygen. Dogs will still chase cats, cats will still chase mice and the sun will still set in the west.

Ameren UE. We're always there.

*"A rose by any other name
would smell as sweet."*

WHAT DOES THAT HAVE TO DO WITH YOUR ENERGY COMPANY?

We're glad you asked.

Because Union Electric

recently merged with CIPS,

an Illinois-based energy company.

And as of January 13,

we're officially changing

from UE to AmerenUE.

Fortunately, that's all we're

changing. We'll still be the same reliable

energy company you've come to depend on

over the years. Except now we'll be in a

position to provide you with even better

customer service. Not only will we

continue to focus on your needs but

those of the community as well.

Services for speech- and

hearing-impaired customers,

Braille billing and our

Customer Assistance

Program are just a few of the

ways we're trying to serve you

better. So no matter what name we

go by, you can rest assured that every

time you flip a switch, push a button or

turn on a light, it will work. AmerenUE.

We're always there. For more infor-

mation, call 1-800-552-7583 or visit our

website at www.ameren.com.



OUR NEW NAME MIGHT NOT
AFFECT YOUR BUSINESS. BUT THE
SERVICES WE OFFER WILL.

*Union Electric is now AmerenUE. And part of
our new commitment is providing an expanded
range of energy services for your business.
Such as our Energy Savings Partnership (ESP).
Designed for large commercial customers, ESP
can help you lower your company's energy costs,
while improving your productivity and ability to
meet environmental regulations. For more infor-
mation about how our ESP program can help
you, call Bob Keller at 314-554-4500. And for
even more cost-cutting ideas in the future, look
to AmerenUE.*



**YOUR UTILITY COMPANY IS PROUD
TO ANNOUNCE OUR NEW NAME.
AND OUR NEW COMMITMENT.**

*Union Electric has merged with Central
Illinois Public Service to become AmerenUE.
You'll still get the same responsive service.
Competitive rates. And an expanded range of
energy services for your business, like elec-
trical efficiency audit programs, assistance in
productivity, end-product quality consultation
and more. With the new name, you'll also
find renewed dedication to always provide
reliable service at fair prices. So get to know
the AmerenUE name. And expect more from
us in the future.*



Here's a stock tip.
If you're looking for
**UNION ELECTRIC
OR CIPSCO,**
Check under "A."

That's "A" for Ameren. Which, as you probably already know, is the name of the company formed by the merger between Union Electric and CIPSCO Incorporated. A merger that was finalized December 31, 1997. And the result is a bigger, stronger energy company that is better prepared to meet the challenges of a changing world. If you're interested in learning more about the merger, you can call 1-800-255-2237 or visit our home page at www.ameren.com. To find out more about Ameren on electronic databases, use our new ticker symbol AEE.



AMEREN - UE
CASE NO. EO-96-14
INJURIES & DAMAGES

Expense	12 Mos. Total - 6/96	12 Mos. Total - 6/97	12 Mos. Total - 6/98
Injuries & Damages Expense	\$5,950,000	\$6,670,000	\$20,270,000

AMEREN - UE
CASE NO. EO-96-14
INJURIES AND DAMAGES

Average Balance 7/1/95 to 6/30/97	13,111,697
Add: Payments	17,160,897
Less: Balance Beginning of the 3rd Sharing Period	(12,576,986)
Less: Provisions	<u>(20,270,000)</u>
Adjustment to Injuries & Damages for 3rd Year of Sharing Period	(2,574,392)
Missouri Jurisdictional Allocational Factor	<u>X 88.38%</u>
Total adjustment	<u><u>(2,275,248)</u></u>