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October 31, 2000



Mr. Dale H. Roberts
Secretary/Chief Regulatory Law Judge
Public Service Commission
P. O. Box 360
Jefferson City, MO 65102

**RE: UtiliCorp United Inc. and Empire District Electric Company
Case No. EM-2000-369**

Dear Mr. Roberts:

Enclosed for filing in the above-referenced case please find the original and eight copies of **Initial Brief of the Office of the Public Counsel and HC pages.** Please "file" stamp the extra-enclosed copy and return it to this office.

Thank you for your attention to this matter.

Sincerely,

John B. Coffman
Deputy Public Counsel

JBC:jb

cc: Counsel of Record

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

FILED[3]

OCT 3 1 2000

Missouri Public
Service Commission

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| **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, Filed** | **)** | |

# INITIAL BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL


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October 31, 2000

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## I. INTRODUCTION

UtiliCorp United ("UCU" or "Utilicorp") and Empire District Electric Company ("Empire") (jointly, the "Joint Applicants") filed their Joint Application to merge Empire with and into UCU on December 15, 1999 pursuant to Section 393.190.1 RSMo. 1994. The Joint Application was a result of an Agreement and Plan of Merger ("the Merger Agreement") executed on May 10, 1999, by UCU and Empire. (Joint Application, Appendix 4). Pursuant to the Merger Agreement, Empire shareholders will receive a fixed value of $29.50 per share for the Empire common stock which will be converted into shares of UCU common stock when the merger is closed. UCU will also assume Empire's existing debt obligations in the approximate amount of $345 million.

The Joint Application stated that as of December 31, 1998, Empire had approximately 17 million weighted average common shares outstanding and UCU had approximately 80 million weighted average common shares outstanding. Based upon this number of shares outstanding, the amount of equity that UCU will issue in order to exchange shares of its common stock for Empire's stock is estimated to be $505 million. This taken together with the indebtedness of Empire to be assumed by UCU, brings the total cost of the Merger to approximately $850 million. (Joint Application ¶5). UCU will assume the tax basis of all the assets and liabilities of Empire and will then treat Empire operations as a separate division for operating purposes.

In its prepared testimony supporting the Joint Application to merge, Empire and UCU requested that the Commission approve the merger of Empire into UCU. Part and parcel of Joint Applicants' request to merge (but not a requirement of the Merger Agreement itself) is a so-called "Regulatory Plan" with a duration of ten (10) years. (Joint Application ¶15). Joint Applicants request that this Commission approve the proposed Regulatory Plan in this merger proceeding and thus make several ratemaking judgements designed to allow UCU to recover the premium that would be paid for Empire stock through regulated electric rates.

The evidentiary hearings in this matter were held before the Missouri Public Service Commission ("Commission") on September 11 through 15, 2000 in Jefferson City, Missouri.

## II. LEGAL STANDARD FOR MERGER APPROVAL

Before a Missouri public utility like Empire can sell assets that are necessary or useful in the performance of its duties to the public, it must first obtain approval from this Commission. Section 393.190.1 RSMo. 1994 states in pertinent part:

> No gas corporation, electrical corporation, water corporation or sewer corporation shall hereafter sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public, nor by any means, direct or indirect, merge or consolidate such works or system, or franchises, or any part thereof, with any other corporation, person or public utility, without having first secured from the commission an order authorizing it so to do.

The Commission may not approve the requested disposition of assets unless it can be shown by the applicant that such disposition is not detrimental to the public interest. The "not detrimental to public interest" standard was first articulated in State ex rel. City of St. Louis v. Public Service Commission, 73 S.W.2d 393 (Mo. banc 1934). The Court in City of St. Louis stated:

> To prevent injury to the public, in the clashing of private interest with public good in the operation of public utilities, is one of the most important functions of Public Service Commissions. It is not their province to insist that the public shall be *benefited*, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public *detriment*. In the public interest, in such cases, can reasonably mean no more than "not detrimental to the public."

Id. at 400. When reviewing the Joint Application in this matter, the Commission should thus utilize the "not detrimental to public interest" standard.

In the context of this proceeding the "public" that should not be detrimentally affected by the proposed merger transaction are the Missouri customers taking and receiving service from the UCU and Empire operations. This Commission in its decision in the Matter of the Application of the Kansas Power and Light Company and KCA Corp. for approval of the acquisition of all classes of the capital stock of Kansas Gas and Electric Company (hereinafter "KPL/KGE merger") identified the "public" within the appropriate standard as Missouri ratepayers, stating:

> Based upon these findings and determinations, the Commission concludes that Missouri ratepayers will be shielded from any potential ill effects from the proposed merger and will suffer no detriment as a result. Therefore, the Commission concludes that, in the absence of a finding of detriment to the public interest, it may not withhold its approval of the proposed merger and will authorize KPL to acquire and merge with KGE.

1 Mo.P.S.C. 3d 150, 159 (1991). Thus, to be approved by this Commission, the proposed merger should not be detrimental to Empire's ratepayers nor detrimental to UCU's ratepayers in Missouri.

At this juncture it is important to point out that a merger proceeding is not a general rate case proceeding. The Commission's statutory obligations in a proceeding in which rates or components of rates are determined are much different from the Commission's obligations in a merger proceeding. In recognition of these differences and the requirements of Missouri statutes, this Commission has consistently reserved the right to consider the appropriate ratemaking treatment of merger transactions for rate case proceedings.[1] (See for example: Re: United Telephone Company, 23 Mo.P.S.C. (N.S.) 323, 326 (1979) Ordered ¶8; Re: St. Louis County Water, 27 Mo.P.S.C. (N.S.) 55, 58 (1984) Ordered ¶4; Re: Kansas City Power and Light, 28 Mo.P.S.C. (N.S.) 498, 505 (1986) Ordered ¶6; Re: UtiliCorp United, Inc. d/b/a Missouri Public Service, 29 Mo.P.S.C. (N.S.) 3, 6 (1986) Ordered ¶5; Re: Arkansas Power & Light, 30 Mo.P.S.C. (N.S.) 244, 247 (1990) Ordered ¶3; Re: Alltel/Missouri Telephone, 1 Mo.P.S.C.3d 92, 95 (1991) Ordered ¶3; Re: Union Electric/Arkansas Power & Light/Sho-Me Power Corp., 1 Mo.P.S.C.3d 96, 106 (1991) Ordered ¶19; Re: Union Electric/Cape Girardeau, 1 Mo.P.S.C.3d 290, 291 (1992) Ordered ¶5; Re Contel of Arkansas/GTE of Arkansas, 1 Mo.P.S.C.3d 448, 450 (1992) Ordered ¶5; Re: Union Electric Company, 1 Mo.P.S.C.3d 501, 508 (1992) Ordered ¶6; Re: Union Electric Company, 1 Mo.P.S.C.3d 187, 193 (1993) Ordered ¶11; Re: Missouri-American Water, 2 Mo.P.S.C.3d 305, 313 (1993) Ordered ¶3; Re: Kansas Power and Light, 1 Mo.P.S.C.3d 150, 161 (1991) Ordered ¶11; Re: Missouri Gas, 3 Mo.P.S.C. 3d 216, 228 (1994) Ordered ¶4; Re: Missouri-American Water, Case No. WM-2000-222 (Slip. Opin., March 16, 2000) Ordered ¶4.

[1] Counsel for UCU recognized this consistent Commission treatment in his opening statement. (Tr. 43, l. 18-21).

## III. APPROVAL OF UCU'S PROPOSED REGULATORY PLAN IN THIS PROCEEDING IS BEYOND THE COMMISSION'S STATUTORY AUTHORITY.

Before discussing the merits of UCU's proposed Regulatory Plan, Public Counsel believes the Commission must determine whether or not the Commission possesses the statutory authority to approve the proposed Regulatory Plan in a merger proceeding. Public Counsel believes the Commission lacks authority to approve the proposed Regulatory Plan in this proceeding because it consists of ratemaking issues that cannot be determined by a Commission order in a contested merger case.

The Commission "is purely a creature of statute" and its "powers are limited to those conferred by the [Missouri] statutes, either expressly, or by clear implication as necessary to carry out the powers specifically granted." State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission, 585 S.W.2d 41, 47 (Mo. banc 1979). Nothing in Section 393.190 RSMo. 1994 allows the Commission to order a regulatory plan to be implemented as a result of a contested merger proceeding. In fact, approval of the Regulatory Plan proposed by UCU in this contested proceeding would result in this Commission abdicating its statutory authority to set just and reasonable rates in violation of Sections 393.270(3) & (4) and 386.390.1 RSMo. 1994.

The Joint Applicants request that the Commission approve their proposed Regulatory Plan. UCU Witness John McKinney makes it very clear that rate determinations are being proposed:

> We are requesting that in the context of this merger proceeding the Commission expressly authorize and approve the proposed regulatory plan including recovery of the Assigned Premium as described. (emphasis added) (J. McKinney Surrebuttal, Ex. 5, p. 8, l. 14-16).

The key components of the ten-year Regulatory Plan as set out in paragraph 15 of the Joint Application are as follows:

- A five-year rate moratorium for the Empire unit will be put in place, but not until after the effective date of new rates that would result from a "Pre-Moratorium Rate Case." The Joint Applicants ask that several determinations regarding this rate case be ordered now in this merger case, including test year, update, and true-up periods, in-service criteria for Empire's State Line Combined Cycle Plant (SLCC") which is anticipated to be in service on June 1, 2001, a list of the categories that would be adjusted in revenues, rate base, and expense, an agreement that the return on equity would be based on Empire as a stand-alone entity, and an agreement that all open positions in existence because of the merger be built into the cost of service.

- During the fifth year of the rate moratorium, UCU will initiate general rate cases for the electric operations of the Empire unit with the new rates to take effect at the end of the moratorium period. These rate filings will specifically set out an accounting of the synergies realized during the moratorium as a result of the merger and the balance of the acquisition premium not covered by said synergies.

- In the context of said rate cases, and for ratemaking purposes, fifty percent (50%) of the unamortized balance of the premium will be included in the rate bases of the Empire unit's electric operations and the annual amortization of the premium will be included in the expenses allowed for recovery in cost of service.

- In the context of said rate cases, UCU would have the Commission pre-determine that the return on any premium-portion of rate base be calculated in the post-moratorium rate case using a capital structure of 60% debt and 40% equity regardless of any changes to the actual capital structure. The return allowed on the balance of the rate bases will be based on the Empire unit capital structure as determined in the pre-moratorium rate case. In the proposed pre-moratorium rate case, and for the entire ten-year regulatory plan that would follow, UCU also suggests that the Commission pre-approve what they call a "normalized capital structure," consisting of 52.5% debt and 47.5% common equity, regardless of any changes to the actual capital structure.

- The allocation of UCU's corporate and intra-business unit costs to MPS shall exclude the Empire factors from the methodology for the period covered by the regulatory plan.

(Joint Application ¶15). Each of these "key components" of the proposed Regulatory Plan are beyond the Commission's statutory authority to approve within the context of this contested merger proceeding.

## A. Pre-Moratorium Rate Case

This component of the Regulatory Plan is unlike any component contained in the UCU/SJLP regulatory plan proposed in Case No. EM-2000-292. The Joint Applicants are asking that the rate moratorium proposed in this merger case be mandated at a rate level that will not even be known at the conclusion of this case—not until the conclusion of a yet-to-be-filed "pre-moratorium rate case." The effective date of this potential pre-moratorium rate case is also still unknown. This rate case was planned to be filed around September 1, 2000 (Ex. 8, p. 3, l. 7), but such a case has not yet been filed. Moreover, no notice has been issued to the public in this case as would be required in a general rate case, notifying potentially affected customers of the request.

While a party may negotiate a proposal that would bind its actions in future case, the Commission cannot bind a party with regard to what position it may take on an issue in a future case. Prejudging a component of the potential pre-moratorium rate case now, before the future parties to that case have an opportunity to analyze it and present testimony on it is beyond the Commission's authority as well as unfair from a regulatory standpoint.

UCU wants the Commission to make a commitment in this case that it will allow cost increases for certain components (SLCC plant) while making a commitment to exclude certain cost decreases (e.g., reductions in personnel at UCU's Empire operating division) that could offset the expected increases. (Ex. 201NP, p. 25, l. 12-19). This is exactly the unfair and lopsided type of rate treatment ("single-issue ratemaking") that was struck down by the Missouri Supreme Court in State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission ("UCCM"), 585 S.W.2d 41, 49 (Mo. banc 1979). UCU's proposals regarding the pre-moratorium rate case would preclude the Commission from looking at "all relevant factors" when setting rates for the Empire division in violation of state law. Section 393.270(4) RSMo. 1994.

## B. Five-year Rate Moratorium

The centerpiece of UCU's ten-year Regulatory Plan is its request that following a pre-moratorium rate case, a five-year rate moratorium for the former Empire service territory would be put in place. UCU proposed this five-year rate case moratorium so that it may realize synergies and the benefits of the merger to justify the $275 million premium it paid to Empire shareholders and the costs of affecting the transaction. UCU is seeking to bind the Commission and its Staff from taking any action with regard to any Empire overearnings during this five year period. (Tr. 454-455).

The Public Service Commission Act establishes the machinery for continuous regulation of public utilities, as changes in conditions require, in order to protect utility customers. The Missouri Supreme Court describes this continual process in State ex rel. Chicago, R.I. & P. RR Co. v. Public Service Commission, 312 S.W.2d 791, 796 (Mo. 1958):

> Its [Commission's] supervision of the public utilities of this state is a continuing one and its orders and directives with regard to any phase of the operation of any utility are always subject to change to meet changing conditions, as the commission, in its discretion may deem to be in the public interest.

By approving UCU's requested five-year moratorium this Commission would be unable to meet its continuing obligation to regulate the Empire division of UCU in light of any changing conditions that may present themselves. The statutory obligations the Commission would be abandoning if it approved UCU's proposed five-year rate moratorium can be found in Sections 386.390.1 and 393.270(3) RSMo. 1994.

Section 386.390.1 sets out the Commission's complaint procedure. This statutory section gives the Commission explicit authority to request that a complaint be initiated regarding rates, stating:

> 1. Complaint may be made by the commission of its own motion, or by the public counsel, or any corporation or person, chamber of commerce, board of trade, or any civic, commercial, mercantile, traffic, agricultural or manufacturing association or organization, or any body politic or municipal corporation, by petition or complaint in writing, setting forth any act or thing done or omitted to be done by any corporation, person or public utility, including any rule, regulation or charge heretofore established or fixed by or for any corporation, person or public utility, in violation, or claimed to be in violation, of any provision of law, or any rule or order or decision of the commission; provided, that no complaint shall be entertained by the commission, except upon it own motion, as to the reasonableness of any rates or charges of any gas, electrical, water, sewer or telephone corporation, unless the same be signed by the public counsel or the

mayor or the president or chairman of the board of aldermen or a majority of the council, commission or other legislative body of any city, town, village or county, within which the alleged violation occurred, or not less than twenty-five consumers or purchasers, or prospective consumers or purchasers, of such gas, electricity, water, sewer or telephone service. (Emphasis added).

This statutory section clearly states that the Commission can entertain a complaint regarding the reasonableness of any rates "upon its own motion." By requesting this Commission bind itself to a five-year rate/complaint case moratorium, UCU requests the Commission specifically relinquish its statutory responsibilities. The Commission cannot proceed in such a manner or enter an order that is contrary to the terms of a statute and thus follows a practice which results in nullifying the express will of the Missouri Legislature. State ex rel. Springfield Warehouse & Transfer Company v. Public Service Commission, 225 S.W.2d 792, 794 (Mo. App. 1950). By approving a binding five-year rate/complaint moratorium the Commission would be nullifying the express will of the Legislature that the Commission have the continuing authority to file a complaint "upon its own motion."

In fact, this Commission recently recognized that it cannot relinquish its statutory duties. In Case No. GC-97-497, Office of the Public Counsel v. Missouri Gas Energy, this Commission correctly rejected a Unanimous Stipulation and Agreement presented by Missouri Gas Energy, Public Counsel and Staff that had the following provision:

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

In rejecting the proposed Unanimous Stipulation and Agreement, the Commission stated:

> The Commission cannot agree to relinquish its statutory duties as proposed by the parties. The Commission is essentially a creation of the Legislature and, as such, is empowered by statute to carry our certain functions. Among the various statutory responsibilities incumbent on the Commission to perform are the setting of rates (Section 393.150, RSMo), the provision of safe and adequate service (Section 393.130, RSMo), the proper litigation of complaints (Section 386.400 RSMo), and other general powers (Section 393.150). The Commission cannot proceed in a manner contrary to the terms of a statute and may not follow a practice which results in nullifying the express will of the Legislature.
>
> It is plain from the language of the agreement and from the evidentiary hearing that the parties desire the Commission to waive all responsibility prior to the August 1, 1997 date for the proper hearing of complaints as well as the investigation of other service-related and rate-related matters. This the Commission cannot do. It is the expectation of the Legislature that the Commission will carry out its statutory responsibilities. For the Commission to abrogate those responsibilities would not be in the public interest.(Footnote excluded).
>
> Order Rejecting Stipulation and Agreement, Case No. GC-97-497, p. 3-4 (August 27, 1997).[2]

The request in GC-97-497 was similar to UCU's request in this proceeding. In GC-97-497, the stipulating parties wrongfully attempted to bind the Commission from entertaining complaints regarding billing and metering issues with respect to MGE for events occurring prior to August 1, 1997. In this merger proceeding, UCU--contrary to the wishes of Public Counsel, Staff and ICI/Praxair--seeks to bind the Commission from filing a complaint on its own motion or from directing its Staff pursuant to Section 386.240 from initiating an earnings investigation or filing a complaint regarding the Empire division of UCU for five years after a pre-moratorium rate case. To accept such a proposal would be contrary to this Commission's statutory responsibilities.

[2] Chair Lumpe, Vice Chair Drainer, Commissioner Murray and former Commissioner Crumpton all concurred in rejecting the stipulation and agreement.

The statutory scheme set-up by the legislature contemplates that the Commission when carrying out its statutory duty to review rate levels may also act via its staff. Section 386.240 RSMo. 1994 provides:

> **Powers of the commission, how exercised.** – The commission may authorize any person employed by it to do or perform any act, matter or thing which the commission is authorized by this chapter to do or perform; provided, that no order, rule or regulation of any person employed by the commission shall be binding on any public utility or any person unless expressly authorized or approved by the commission.

Approval of UCU's requested five-year moratorium would prevent the Commission from properly utilizing its Staff to review Empire's rate levels for a period of five years. Such a moratorium on the ability of this Commission to exercise its regulatory authority over Empire's rates is contrary to this Commission's statutory authority.

UCU's attempt to prevent the Commission Staff from filing a complaint with respect to rates for the Empire's division of UCU is also contrary to the requirements of 4 CSR 240-2.070(1) which states:

> (1) The commission on its own motion, the commission staff through the general counsel, the office of the public counsel, or any person or public utility who feels aggrieved by a violation of any statute, rule order or decision within the commission's jurisdiction may file a complaint. The aggrieved party, or complainant, has the option to file either an informal or a formal complaint.

(Emphasis added). This rule clearly gives the Staff of the Commission through the General Counsel the authority to file complaints.

The rules of the Commission, which have been duly promulgated pursuant to proper delegated authority, have the force and effect of law. State ex rel. Springfield v. Public Service Commission, 812 S.W.2d 827 (Mo. App. 1987), overruled on other grounds by Missouri Municipal League v. State, 932 S.W.2d 400 (Mo. banc 1996). The Commission duly promulgated 4 CSR 240-2.070(1), specifically granting its Staff authority through the general counsel to file a complaint. A valid rule or regulation promulgated by a public administrative agency is binding on the agency. 73 C.J.S. Section 93 Pub. Ad. Law and Pro., p. 621. Acceptance of UCU's five-year moratorium would unlawfully nullify the Staff's ability to independently file a complaint pursuant to 4 CSR 240-2.070(1), and would cause the Commission to violate its own duly promulgated rules.

Moreover, the proposed five-year moratorium violates Section 393.270(3). This Section states:

> 3. The price fixed by the commission under sections 393.110 to 393.285 shall be the maximum price to be charged by such corporation or person for gas, electricity or water for the service to be furnished within the territory and for a period to be fixed by the commission in the order, not exceeding three years, except in the case of a sliding scale, and thereafter until the commission shall, upon its own motion or upon the complaint of any corporation or person interested, fix a higher or lower maximum price of gas, electricity, water or sewer service to be thereafter charged. (Emphasis added).

This statute appears to allow the Commission to set rates only in a rate case proceeding and only for a period not exceeding three years.[3] However, the Commission's authority to impose a rate moratorium in a contested proceeding was challenged in State ex rel. Jackson County v. Public Service Commission, 532 S.W.2d 20 (Mo. App. 1976). (hereinafter "Jackson County").

The Jackson County case dealt with a rate request by Missouri Public Service Company ("MoPub")[4] in Case No. 18,180 in which the Commission granted MoPub a rate increase of $5.5 million. Prior to entering its Report and Order in Case No. 18,180, the Commission had granted

[3] As pointed out early in this Brief, this is not a rate case proceeding but a merger proceeding. The Commission clearly has no statutory authority to make ratemaking determinations in a contested merger proceeding.
[4] Missouri Public Service Company is the predecessor of UCU.

MoPub an increase in Case No. 17,763. The Commission provided in "Ordered 3" of its Report and Order in Case No. 17,763 as follows:

> 3. That the prices, charges, rates and tariffs filed herein shall be the maximum to be charged by Missouri Public Service Company for electric service to be furnished within its territory *for a period of at least two years from the effective date of this Order* except in the case of sliding scales and automatic adjustments as heretofore or hereafter approved by this Commission pursuant to § 393.270, ¶3, RSMo. 1969. (Emphasis added.)

Jackson County at 23.

The rate increase Ordered by the Commission in Case No. 18,180 occurred prior to the expiration of the moratorium period ordered in Case No. 17,763.

The Circuit Court sustained the City of Kansas City and Jackson County's Motion for Immediate Reversal, Stay, Injunction or Impoundment of Funds, stating in part:

> 1. The report and order of respondent [Commission] in its No. 18,180 is reversed for noncompliance with Section 393.270 V.A.M.S.

MoPub sought review of the Circuit Court's decision in the Supreme Court.

The Supreme Court in Jackson County noted that the issue of whether the Commission, per Section 393.270(3), could establish a rate moratorium in a contested case was one of first impression. Jackson County at 29. After reviewing Section 393.270(3), the Supreme Court determined the Commission had the authority to change or abrogate its prior order which imposed a two-year moratorium on further electric rate increases by MoPub. The Court found the Commission's orders are always subject to change and to "rule otherwise would make §393.270(3) of questionable constitutionality as it potentially could prevent alteration of rates confiscatory to the company or unreasonable to the consumer." Jackson County at p. 29-30. (emphasis added).

In this proceeding, UCU requests that this Commission bind itself and its Staff at a minimum to a five-year rate moratorium. As the Supreme Court noted, the Commission cannot and should not bind itself to certain rates. The Commission should reject UCU's Regulatory Plan because the five-year moratorium is inconsistent with this Commission's statutory authority.

## C. Recovery of Merger Premium

In the context of this merger proceeding, UCU seeks pre-approval allowing recovery of the "assigned premium" in the post moratorium rate cases assuming UCU demonstrates the alleged synergy savings.[5] (Ex. 4, pp. 19, l. 11-15). In this proceeding UCU is seeking explicit Commission approval and commitment regarding a specific rate component, the assigned premium, for recognition in a rate case proceeding five years in the future. (Tr. 579-580). Commission pre-approval for recovery of the assigned merger premium is beyond the Commission's statutory authority.

Determination of the specific rate treatment to be accorded the assigned merger premium is not appropriate in this merger proceeding. Such pre-approval would be contrary to the

[5] At the end of the five-year rate moratorium, approximately $206 million of the unamortized acquisition premium will still remain. In the post-moratorium rate case, fifty percent of this amount, the "assigned premium," would be included in rate base and the amortization of the "assigned premium" will be included in expenses. (Ex. 202NP, 72-73).

requirement of Section 393.270(4) RSMo. 1994 which requires the Commission to consider all relevant factors in setting rates. See: State ex rel. Midwest Gas Users' Association v. Public Service Commission ("Midwest Gas Users"), 976 S.W.2d 470, 479 (Mo. App. 1998); State ex rel. Missouri Water Co. v. Public Service Commission, 308 S.W.2d 704, 719 (Mo. 1957). Section 393.270.4 RSMo. 1994, which defines the Commission's duties as to ratemaking, states:

> 4. In determining the price to be charged for gas, electricity, or water the commission may consider all facts which in its judgment have any bearing upon a proper determination of the question although not set forth in the complaint and not within the allegations contained therein, with due regard, among other things, to a reasonable rate of return upon capital actually expended and to the necessity of making reservations out of income for surplus and contingencies.

The Commission "is purely a creature of statute" and its "powers are limited to those conferred by the [Missouri] statutes, either expressly, or by clear implication as necessary to carry out the powers specifically granted." UCCM, 585 S.W.2d 41, 47 (Mo. banc 1979); State ex rel. City of West Plains v. Public Service Commission, 310 S.W.2d 925, 928 (Mo. banc 1958). Those powers include the duty to consider all relevant factors when setting just and reasonable rates. UCU's proposal regarding the assigned merger premium would preclude the Commission from looking at "all relevant factors" when setting rates for the Empire division of UCU in subsequent rate cases.

According to UCU, the only factor the Commission could consider in a rate case is the synergy savings. If UCU produces synergy savings it is guaranteed recovery of the "assigned merger" premium irrespective of any other factors. The Commission is legally required to look at all relevant components of the overall cost-of-service and not isolate single issues as requested by UCU in this merger proceeding.

This Commission is obliged is to set just and reasonable rates and in doing so the Commission must look at all known and measurable conditions that exist at the time the rates are being set. Approval of UCU's requested treatment of the assigned merger premium in this proceeding is beyond the Commission's authority and contrary to the requirements of Section 393.270(4) RSMo. 1994.

## D. Frozen Capital Structure

In the context of this merger proceeding, UCU seeks pre-approval of two capital structure proposals--in a scheme that is more complicated than the frozen capital structure proposal of the applicants in the UCU/SJLP merger case. In the proposed pre-moratorium rate case, and for the entire ten-year regulatory plan that would follow, UCU suggests that the Commission pre-approve what they call a "normalized capital structure," consisting of 52.5% debt and 47.5% common equity, regardless of any changes to the actual capital structure. (Ex. 8, p. 4, l. 13-15). UCU would additionally lock-in Empire's cost of capital for the first five years of the Regulatory Plan. Secondly, UCU would have the Commission proposes that the return on any premium-portion of rate base be calculated in the post-moratorium rate case using a capital structure of 60%debt and 40% equity regardless of any changes to the actual capital structure. (Ex. 4, p. 7, l. 15-17). Commission pre-approval of a capital structure for a ten-year period is beyond the Commission's statutory authority.

Approval of a specific capital structure for use in the Empire divisional rate cases for a period of ten years is not appropriate in this merger proceeding. Such pre-approval would be contrary to the requirement that the Commission consider all relevant factors in setting rates. State ex rel. Midwest Gas Users' Association, supra.

UCU's requests to "freeze" Empire's capital structure for a period of ten years would clearly and unlawfully preclude the Commission from looking at "all relevant factors" when determining the capital structure for Empire in subsequent rate case proceedings. The Commission is required to look at all relevant components of the overall cost-of-service and not "lock in" a certain capital structure for a period of ten years as requested by UCU in this merger proceeding.

This Commission's obligation is to set just and reasonable rates and in doing so the Commission must look at all known and measurable conditions that exist at the time the rates are set. Approval of UCU's requested capital structure for Empire in this proceeding is beyond the Commission's authority and contrary to the requirements of Section 393.270(4) RSMo. 1994.

## E. Frozen Corporate Allocation

In the context of this contested merger proceeding, UCU requests that during the ten-year period of its proposed Regulatory Plan that the allocation of UCU's corporate and intra-business unit cost to its Missouri Public Service ("MoPub") division exclude the Empire factors from the methodology. Commission pre-approval of this "frozen corporate allocation" is beyond this Commission's statutory authority.

Determining a specific allocation factor for use in subsequent MoPub rate proceedings is not appropriate in this merger proceeding. Such pre-approval would be contrary to the requirement that the Commission consider all relevant factors in setting rates. State ex rel. Midwest Gas Users' Association, supra.

UCU's request to "freeze" the allocation of UCU's corporate and intra-business unit costs to MoPub for a ten-year period would preclude this Commission from looking at "all relevant factors" in MoPub's subsequent rate case proceedings. The Commission is required to look at all relevant components of the overall cost-of-service and thus cannot legally lock in a certain allocation factor for a period of ten years as requested by UCU in this merger proceeding.

This Commission's obligation is to set just and reasonable rates and in doing so the Commission must look at all known and measurable conditions that exist at the time the rates are set. Approval of UCU's request to "freeze" the allocation factor for MoPub in this proceeding is beyond the Commission's authority and contrary to the requirements of Section 393.270(4) RSMo. 1994.

## F. Adoption of the Proposed Regulatory Plan Violates the Spirit of the Public Service Act.

UCU's request that the Commission approve and adopt a ten-year Regulatory Plan in this proceeding is contrary to the "spirit" of the Public Service Commission Act. The purpose of the Act is to provide continuous regulation of public utilities in the State of Missouri. The Supreme Court in State ex rel. Jackson County v. Public Service Commission, 532 S.W.2d 20, 29 (Mo. banc 1975), cited with approval Illinois Bell Tel. Co. v. Illinois Commerce Commission, 414 Ill. 275, 111 N.E.2d 329 (1953). In the Illinois Bell Tel. Co. case the Illinois Supreme Court stated:

> The construction contended for seems to be in conflict with the spirit of the act. One of its primary purposes was to set up machinery for continuous regulation as changes in conditions require. It appears to be inherent in the act itself.

Id. at 333.

After citing the Illinois case, the Supreme Court stated "[t]he statute of Illinois is different from that of Missouri, but we think the 'spirit of the act' analysis is logical and should be the standard in this state." Jackson County at 29. The Court in Jackson County found that "the very purpose of having the Commission is to have an agency with such expertise as to be sensitive to changing conditions . . ." Jackson County at 30. UCU would have this Commission abandon the "very purpose" of the Commission's existence and lock itself into a ten-year Regulatory Plan, ignoring any and all changing conditions on a going forward basis. Adopting such a proposal would be wholly contrary to the "spirit" of the Public Service Commission Act.

The Commission's principal interest is to serve and protect ratepayers. State ex rel. Crown Coach Co. v. Public Service Commission, 179 S.W.2d 123, 126 (Mo. 1944). As a result of the Commission's obligation to serve and protect ratepayers, the Commission cannot commit itself to a position that because of varying conditions and occurrences over time, may require adjustment to protect the ratepayers. State ex rel. Chicago, Rock Island & Pacific Railroad v. Public Service Commission, 312 S.W.2d 791, 796 (Mo. 1958). Nonetheless, UCU requests the Commission commit itself to a Regulatory Plan for a period of ten years. Simply put, the Commission should reject as unlawful UCU's proposed Regulatory Plan.

## IV. DETRIMENTS TO THE PUBLIC INTEREST AS A RESULT OF THE MERGER ITSELF

The Commission must first address whether the underlying "merger and related transactions" should be approved (apart from consideration of the Joint Applicants' proposed "Regulatory Plan" and all other proposed ratemaking issues). The Commission's merger standard, pursuant to the prevailing judicial interpretation of Section 393.190 RSMo. 1994, permits authorization of a proposed merger only if it will not cause a detriment to the public interest, as discussed earlier in Section II of this Brief. To be approved, the merger must be free of public detriments. The Commission should, as it has in past cases, interpret the "public interest" in this context as referring to the utility customers that are served by the Joint Applicants. In this case, Public Counsel placed into the record considerable evidence supporting its belief that significant detriments would result from the merger itself, necessitating a rejection of the merger as described below.

## A. Increased Financial Risk Would Increase the Cost of Debt to Empire District Electric Company Customers

Although virtually ignored by the Joint Applicants, the record contains undisputed evidence that the proposed merger itself would increase the cost of debt ultimately charged to the current customers of Empire and ultimately impact their rates negatively.

UCU maintains a capital structure with more debt and less equity than the capital structure of Empire. (Ex. 200, p. 11, l. 11-12). Furthermore, UCU long-term debt carries a credit rating of BBB-far below Empire rating of A-. Id. at lines 13-14. UCU's current cost of debt is greater than Empire cost of debt. Value Line Investment Survey shows that UCU paid $190 million to interest on $2234.2 million of long term debt, for a rate of 8.5% as of 9/30/99. Value Line shows that Empire paid $23.0 million in interest on long-term debt of $345.9 million, for a rate of approximately 6.65% as of September 30, 1999. (Ex. 200, p. 14, l. 12-16). Each of these financial indicators is proof that UCU is a much more risky company than Empire.

The difference in financial risk is significant enough such that the financial community has taken serious note.

On May 11, 1999, Duff & Phelps Credit Rating Company placed Empire on "Rating Watch – Down" after the announcement of the proposed merger between Empire and UCU (Ex. 200, p. 11-12). A report by PRNewsire (**http://www.prnewswire.com**) states:

> Duff & Phelps Credit Rating Co. (DCR) has placed the credit ratings of The Empire District Electric Company (EDE) on Rating Watch – Down following today's announcement of its acquisition by UtiliCorp United, Inc. (UCU).
>
> The rating action reflects UCU's current plan to assume EDE's debt obligations. **Following the merger, the credit quality of EDE's debt obligations would reflect that of UCU due to the debt assumption.** [Emphasis added] Id.

In regards to Empire's November 1999 issuance of $100M in Senior Unsecured Notes, PRNewswire reported the following:

> Duff & Phelps Credit Rating Co. (CDR) has assigned a rating of 'A' (Single-A) to The Empire District Electric Company's (EDE) $100 million issuance of senior unsecured notes . . .
>
> **The rating is on Rating Watch – Down due to the proposed acquisition of EDE by UtiliCorp United, Inc. (UCU).** Post-closing, the debt obligations of EDE would be assumed by UCU and thus would reflect the credit quality of UCU. UCU's unsecured debt rating is 'BBB' (Triple-B). [Emphasis added] Id.

This warning of a ratings change is a significant indication of how the financial markets view the risks associated with the proposed merger.

The foregoing indications of a change in risk are solely the result of a change of ownership of the Empire. The assets serving this area and the ability of those assets to be used to provide useful utility service would not change; however, a proposed change in ownership for those assets, in itself, has been sufficient reason for Duff & Phelps to prepare the market for a decline in credit rating.

The record in this case contains excerpts from Standard & Poor's most recent report on UCU, dated January 2000, explaining the basis for the less favorable credit ratings for UCU:

> The company's acquisition strategy and focus on unregulated opportunities, the unpredictability of future acquisitions, and the capital requirements associated with these acquisitions impair credit quality. Furthermore, the credit profile of unregulated operations are weaker than the utility's core business.
>
> • • •
>
> As the nonregulated businesses continue to grow more quickly than the utility operations, UtiliCorp's financial profile will have to strengthen to compensate for the increased business risk.
>
> • • •
>
> **Financial policy: Aggressive.** The company has grown through acquisitions, which have generally been successful but have put pressure on the balance sheet. Although management's proactive approach to managing the transition to competition from regulation is commendable, its acquisitions strategy (including

plans to increase nonregulated operations which now account for about one-third of earnings), the unpredictability of future acquisitions, and the capital requirements associated with these acquisitions impair credit quality.

• • •

**Capital Structure.** Management's aggressive attitude regarding debt leverage and off-balance-sheet obligations appears in the balance sheet ratios, where total debt to capital approaches 60% and it projected to decrease only moderately in the future. Some ebbing in the attitude towards leverage has been manifested at times, but Standard & Poor's believes that management's historic affinity for the use of leverage is still present and will limit credit quality in the future.

• • •

Ibid., pp. 1-7; Ex. 200, p. 13, l. 8-34.

As this analysis indicates, Standard & Poor's recognizes several factors in UCU business practices which would continue to put negative pressure on future ratings if the proposed merger is approved.

While Public Counsel does not believe that the Commission should let the ratings of financial institutions drive ratemaking decisions, they do serve as credible evidence of a real change in risk that would occur if the proposed merger is approved and serve as substantial evidence of a detriment to the public. The greater risk associated with UCU's long-term debt will lead directly to an increased cost of debt generally above the cost of debt currently paid by Empire. (Ex. 200, p. 14, l. 8-11). This greater risk will have an impact upon ratemaking calculations and would constitute a clear detriment to the public interest as compared to the status quo enjoyed by Empire's customers. Id.

The record in this case contains no evidence of a condition that the Commission could use to mitigate this significant detriment, and therefore, the proposed merger must be denied.

## B. The Proposed Merger Would Undoubtedly Increase The Vertical, Horizontal, And Retail Market Power That Would Be Wielded To The Detriment Of Ratepayers.

A discussion of market power terms benefits from clear definition. Public Counsel uses in its analysis the following definitions which were developed by consensus of the diverse group of stakeholders participating in the Commission's own Education Working Group to the Task Force on Retail Electric Competition established in Case No. EW-97-245. The Group presented these definitions to the Commission in its August 14, 1998 Working Group Report:

> **Market power** is the ability of a firm, alone or in concert with other firms, to profitably maintain the price of a product above the competitive market level for an extended period of time. Suppliers with vertical or horizontal market power could charge unfair prices and realize excessive profits.
>
> **Vertical market power** involves the ability of a firm to control an essential element in the vertical production chain and, through that control, cause competitors to be at a disadvantage through either restricted access or higher costs for the products or services required to produce and deliver the specific product.
>
> **Horizontal market power** exists when a single firm or small group of firms have the ability to affect the price of a product. In the case of a single firm, horizontal market power is present when a firm dominates a market where entry barriers protect it from competition. In the case of a small group of firms, horizontal market power can occur through explicit collusive behavior or through strategies that jointly maximize the self-interest of each of the firms.
>
> Ibid., Appendix, p. 5. (Ex. 201NP, p. 62-63).

Public Counsel presented evidence of the increase in vertical and horizontal market power that would result from the proposed merger in this case. Public Counsel examined the configuration and cost structure of UCU's, St. Joseph Light & Power's ("SJLP's"), and Empire's generation supply portfolios and identified the potential for increased horizontal market power in generation markets. (Ex. 201NP, p. 63-64). Public Counsel also pointed out how the proposed merger would further UCU's stated intention to further expand its Mid-continent footprint as additional network acquisition opportunities arise, and at the same time prevent its neighboring utilities from expanding their footprint in UCU's backyard. (Ex. 201NP, p. 13, 63).

Public Counsel believes that UCU's acquisition of the low cost generation supply portfolios of SJLP (378 MW) and Empire (878 MW) are likely to be just the beginning of future network and generation asset acquisitions in the region surrounding Missouri and Kansas. (Ex. 201NP, p. 63, l. 25-29). Public Counsel believes that the acquisition of the low cost SJLP and Empire generating assets alone is sufficient to increase UCU's market power in future deregulated generation retail markets significantly above the level that would exist absent the merger. (Ex. 201NP, p. 64, l. 1-4). It should also be kept in mind that UCU's new 600 MW Pleasant Hill plant will probably become part of the same generating portfolio at a later date, once UCU's other plants are removed from its rate base. Id., l. 4-6.

Public Counsel is not alone in identifying market power detriments from the proposed merger. Staff witness Michael S. Proctor commented on the potential for horizontal market problems in the form of "load pockets," isolating portions of the merged system form a competitive supply of power, if Missouri implements retail competition. (Proctor Rebuttal, Ex.713, p. 59). Springfield witness Whitfield A. Russell also expounds upon the public detriments related to market power problems that would result from the proposed merger. (Ex. 300, p. 48-57).

Vertical market power would also be enhanced by the proposed merger through increased joint ownership of generation and transmission assets. Transmission owning utilities can exert some influence on the outcome of generation markets when they have complete discretion to plan, operate, and control interconnection of new suppliers to transmission systems within their service territories. (Ex. 201NP, p.64, l. 16-18). Staff witness Proctor also testifies that vertical market power is a relevant concern with regard to this merger. (Ex. 713, p. 60).

The Federal Energy Regulatory Commission (FERC) took some initial steps to address this problem in FERC Orders 888 and 889. The FERC, however, has not decided that these initial steps were sufficient for the purposes of encouraging non-discriminatory access to the transmission system. Since that time the FERC has been exploring additional means of encouraging or requiring utilities to join Regional Transmission Organizations (RTOs). (Ex. 201NP, p. 64-65). Moreover, even with open access to transmission service on a non-discriminatory basis, a utility can restrict the amount of service it offers to favor its own generation, and with pancaked rates, incumbent utilities maintain an unfair advantage. (Ex. 713, p. 60).

The "Order Conditionally Authorizing Mergers," issued by the FERC on July 26, 2000 in UCU and St. Joseph Light & Power Company; UCU and Empire District Electric Company, Docket Nos. EC00-27-000 et al, found that the Joint Applicants had not shown that horizontal and vertical market power would not occur. Ibid. at 9-12. To address this detriment, the FERC imposed the condition that, consistent with FERC Order No. 2000, that UCU transfer control of their transmission facilities to an approved Regional Transmission Organization (RTO). Id. pp. 12-13. The FERC stated that this requirement "may be helpful" in addressing the market power concerns raised, but did not state to what degree market power will be mitigated from this condition. The FERC noted that the proposed merger would be further reviewed by state utility commissions. Id., pp. 17-18.

Public Counsel further presented evidence of an increase in **retail market power** that would also result from the proposed merger through the sale of energy and other value-added services bundled together with electric generation service. (Ex. 201HC, pp. 66-77). The public interest will not be significantly impacted by retail market power in the sale of energy and energy-related services until retail wheeling (direct access to competitive generation service) is permitted by law in Missouri; however, the acquisition of this type of market power **prior** to deregulation will amplify the harm from it that occurs after deregulation. (Ex. 201NP, p. 67, 15-24).

As the deregulation experience in California and other states has shown, new entrants may be slow to contest a newly-opened market, especially during the transition when metering is still performed by the billing is still performed by the incumbent and the recovery of significant stranded costs leaves little margin for profits. (Ex. 201NP, pp.67-68). It is also important to recognize that retail market power is not an issue that FERC has traditionally analyzed and so the Commission cannot simply rely upon federal regulation to address it.

This Commission has recognized in a recent merger case that market power is a valid concern with regard to retail (aggregator) factors as well as with regard to generation:

> The Commission finds that there are sufficient facts in evidence for it to be concerned about horizontal market power for both generation and aggregation. The Commission also finds that that these concerns are in part related to the merger of the two companies, but are also related to conditions that should be considered before implementing retail competition.

Union Electric/Central Illinois Public Service Company, 6 Mo. P.S.C. 3rd 28, 39 (1997).

Incumbent electric providers have numerous advantages that can make it difficult for new entrants to pry customers away from their former monopoly providers. Id. These retail market power advantages in the sale of energy and energy-related services can result from a number of factors listed below:

1) Customer inertia to stay with the former monopoly provider.
2) Incumbent utility brand name.
3) Customer relationships established by providing information and advice on energy matters to Key Accounts and other large customers.
4) Sale of energy-related and other value-added products to customers before and after direct access.
5) Ability to price extra services below cost if structural separation or strong affiliate transaction rules are not in place to prevent this.
6) Privileged access to customer information (names, usage patterns, credit history, tendency to buy additional products, and profiles of large customers) without compensating the regulated operation for this information (if affiliate rules don't prevent this from occurring).
7) Privileged access to customer communication channels such as billing inserts, contacts with new customers, and customer service calls.
8) Special contracts that lock in large customers for some period of time after direct access becomes available.

(Ex. 201NP, pp. 68-69).

Both of the Joint Applicants have market power resulting from most of the eight factors listed above. If the Joint Applicants are combined, then the market power in each of the following areas would be additive and would be increased. (Ex. 201NP, p.69-70). A discussion of how each of these factors applies to this case can be found in the rebuttal testimony of Public Counsel witness Ryan Kind. (Ex. 201HC, p.70-77).

In order for providers to compete effectively in the market for retail generation service (with the possible exception of market niches for products like green power), retail generation service will probably have to be bundled together with other value-added services including: natural gas, conservation and load management services, distributed generation, home and business security services, appliance warranty and rental services, telecommunications services, internet services, and entertainment services. (Ex. 201NP, p.76, l. 1-7). While this bundling may not occur immediately (with the exception of natural gas for large customers) upon the opening of generation markets to retail competition, it is likely to develop fairly rapidly, in part due to the emergence of technologies that facilitate the joint provision of these services. (Ex. 201NP, p. 76, l. 7-10).

By either supplying customers with a bundle of services now or being prepared to offer a bundle of services once direct access is permitted, utilities create barriers to entry. If the incumbent is already offering, or is prepared to offer, a bundle similar to what the new entrant can offer, then the new entrant will have more difficulty getting customers to switch from the incumbent. (Ex. 201NP, p.76, l. 11-19). While bundling services is a fairly common practice in non-regulated industries, it raises special concerns in industries that are expected to soon undergo a transition from regulated monopolies to competition.

Given that retail market power will increase as a result of the proposed merger, the potential barriers to entry that would be generated and the competition that would be stifled is a definite detriment to the public interest. Thus the Commission should not approve the merger unless retail market power, as well as horizontal and vertical power, is adequately mitigated.

Public Counsel has proposed market power conditions (discussed *infra* in Section VII.C. of this Brief) designed to mitigate vertical, horizontal, and retail market power. In Public Counsel's view, if adopted in total, the detriments associated with the increases in UCU's market power that are described herein could be largely mitigated, if not eliminated. (Ex. 201NP, p.77).

## C. The Projected Costs of the Proposed Merger Outweigh the Projected Benefits.

The Commission Staff has conducted a thorough analysis of the projected costs of the proposed merger and the projected benefits of the proposed merger. This analysis is contained primarily in the rebuttal testimony of Staff witness Steve M. Traxler (Ex. 716HC, pp. 34-70). If anything, this Staff analysis is generous to the Joint Applicants, but it still points out enough serious flaws in the Joint Applicants' analysis of projected ten-year merger savings and costs that it becomes obvious that costs will indeed exceed savings in each of the ten years. From this perspective alone, the proposed merger is detrimental to the public interest and should be rejected.

Staff points out that the Regulatory Plan is designed to require ratepayers to subsidize the merger acquisition premium by approximately $110 million over the ten-year period. (Ex. 716, p. 4, 11-22). Staff begins with Schedule VJS-1 of UCU witness Siemek's direct testimony (Ex. 6), and points out several serious flaws in the cost/benefit analysis contained in it. The growth rate/inflation rate used in projecting the annual increase in UCU's corporate overhead costs is too low based upon historical experience, resulting in an understatement of these costs on Empire after the merger. (Ex. 716, p. 5, l. 6-10). Staff also believes that approximately 97% of the Joint Applicants' project savings over the ten-year period following merger approval could be achieved by Empire on a "stand-alone" basis, and thus should not be used to offset merger costs. (Ex.716, p. 5, l. 17-22).

After the necessary corrections are made to Schedule VJS-1, the results show that total merger costs exceed total merger by $8.1 million for years 6-10 of the Regulatory Plan. (Ex. 716, pp. 68-70). Staff 's analysis is that the savings resulting from the merger is not likely to even be close to covering the merger costs. Id. This result does not even take into account the Joint Applicants' proposed acquisition adjustment which would only serve to exacerbate the detriment to the public. (See Section V of this Brief). These calculations were also performed before the Stipulation and Agreement reached between UCU, Empire, and the Empire District Electric Company Retired Employees and filed on October 18, 2000 (after the evidentiary hearing), providing an extension of the retiree health care benefits that were otherwise to be discontinued as a result of the merger. While Public Counsel does not oppose this Stipulation and Agreement, it should be noted that it will serve to further reduce projected merger savings.

Public Counsel believes that the "synergies" estimates developed by the Joint Applicants are even more faulty in that they fail to quantify the substantial synergies that UCU intends to achieve in the non-regulated areas of deregulated retail generation service, possible sales of generating assets with market values greatly in excess of book values, power marketing synergies, and telecom synergies. (Ex. 201NP, pp. 35-36). UCU has not quantified in its estimates the value that its shareholders are likely to receive in the future from acquiring

Empire's low cost generation assets. (Ex. 201HC, p. 26-30). Furthermore, despite the fact that UCU data request responses claim that it has performed no studies of the potential for non-regulated synergies, Public Counsel's evidence shows that this claim is not credible. (Ex. 201HC, pp. 36-43).

UCU's synergy estimates are also faulty in their recognition of regulated savings that would not be attributable to a merger. Exhibit 208HC, the UEG Strategic Plan for 1998-2003 shows **

** This upward trend should not be attributed to the synergies of any merger with Empire.

Revealing evidence of the potential options that UCU may pursue with Empire investments are found in the transcript of a couple of conference calls that UCU senior executives held with financial analysts in the first quarter of this year. (Ex. 201NP, p. 16, l. 17-25). On April 15, 2000, Bob Green held a "2000 Conference Call" (the 2000 Call) with Salomon Smith Barney, and on February 8, 2000, Rick Green, Bob Green, and Peter Lowe (UCU CFO) held a "1999 Year End Conference Call" (the 1999 Call) with investment analysts. Transcripts of the conference calls were found on UCU's internet web site (www.utilicorp.com) in the Presentations Section of the Investor Information Area. (Ex. 201NP, p.17, l. 1-4). In the 2000 Call, Bob Green makes the following statements:

> First of all, our network strategy, where we essentially are taking advantage of the trend towards privatization and liberalization of energy markets around the world. We have bought utilities in Australia, New Zealand and Canada outside the U.S. **We've also acquired two distribution assets here in the U.S., St. Joe Power & Light and Empire District. We believe we can significantly enhance the value of those assets by disaggregating, breaking apart some embedded businesses, and repositioning them.** We've done that in Australia. Since 1995, our IRR in

> terms of that investment is over 30% and what we've done is break out the retail energy business and we will joint venture that with Shell at a value significantly above what we paid for it. We've built a telecom business leveraging our right-of-way in the power business...(emphasis added)
>
> (Ex. 201NP, p. 48-49).
>
> • • •
>
> But take a look at the mid-continent footprint that we're building on the network side of the business. With the St. Joe and the Empire acquisition, we've brought together some very attractive low-cost generation assets, and we have added some contiguous distribution networks that afford us a significant opportunity for synergies and efficiencies. 75% of those benefits are going to come from the supply side.
>
> And over time, we will look to restructure the supply-side assets and potentially take them out of rate base and provide more of an upside. It might be that the easiest path is to sell some of those assets so we can establish a market value and avoid a stranded cost to base with the regulator; and then redeploy that capital strategically on the energy grid in other generation assets or other growth investments.
>
> And again, this just highlights the service territories that we've acquired with St. Joe and Empire.
>
> (Ex. 201NP, p. 49).

It seems quite clear from the above statements, that UCU is considering the full range of options, including the sale ("monetization") of some of its soon-to-be acquired generating assets, in order to bring significant unregulated earnings to the bottom line for its shareholders.

Furthermore, UCU's potential non-regulated earnings in the telecom industry is clearly linked to its regulated electric strategies. In the 2000 Call, Bob Green admitted that "we've built a telecom business leveraging our right-of-way in the power business." (Ex. 201NP, p. 54, l. 6-9). UCU recognizes that it will be acquiring with the proposed merger 300 miles of fiber optic lines installed by Empire employees that can be used in the same way. (Ex. 201NP, p. 54, l. 9-17) (Tr. 133).

Despite the fact that the Joint Applicants have proposed a regulatory plan through which ratepayers pay a significant portion of the acquisition premium that was necessary to acquire the assets of Empire, including telecom assets, the Joint Applicants have made no proposal to share any of the expected non-regulated earnings associated with its telecom initiatives. A significant amount of detail regarding this strategy was revealed in the 1999 Call:

> We expect to offer voice services this year. And it really is our biggest venture into telecom. And it is a strategy we think we can replicate. We think we can replicate it in a place like Calgary, taking advantage of our power distribution position. **We think we can replicate it in Missouri. Empire has 300 miles of fiber**. (Emphasis added)
>
> We think we can implement this strategy in the Empire service territory. We think we can implement it in and around Kansas City. And we're developing the business plan and identifying the right partners to make this strategy most successful in these different markets. But as we look at buying network assets, the telecom overlay will be a key part of the value proposition. (Emphasis added)
>
> . . .
>
> We will continue to pursue this telecom strategy that has emerged out of Australia. **There is significant potential with the assets we're acquiring at Empire and St. Joe to create an Australian-like telecom play in the mid-continent.** (Emphasis added)
>
> **And as I said, we've got I think 300 miles of fiber at Empire, and a significant business at St. Jo that we think we can build, based on our Australian experience, into a real growth vehicle for UtiliCorp.** (Emphasis added)
>
> (Ex. 201NP, p.57).

Furthermore, some of the synergies (e.g., generation) included in the Joint Applicants' synergy calculations are likely to accrue <u>only to shareholders</u> if electric restructuring occurs. If the electric industry in Missouri is restructured prior to the end of the ten-year period used by the Joint Applicants to calculate merger synergies, then ratepayers will start paying market-based rates instead of cost-based rates for generation service. Once this occurs, shareholders will receive the full benefits of all reductions related to electric supply synergies and consumers will no longer receive any of these benefits. Similarly, the shareholders will benefit from reductions in Administrative and General expenses and other costs that are allocated among the distribution, transmission, and generation functions once restructuring occurs and rates are unbundled into the distribution, transmission, and generation components.

## V. TRANSACTION/TRANSITION COSTS

As part of its merger proposal Joint Applicants seek to recover both transaction and transition costs. Schedule VJS-2, attached to witness Siemek's direct testimony (Ex. 6) identifies transaction and transition costs of $33,159,800. The transaction costs total $19,274,000 of which $7,347,000 are for bankers fees and $11,927,000 are listed as other transaction costs. The transition costs total $13,885,800 of which $6,451,300 are primarily for severance and retention payments, executive retirement payments, and costs for a paid advisory board. The remainder of the transition cost total, $2,702,500, is for Information Technology System conversion costs. (Ex. 202, p. 74, l. 1-7).

Most of the transaction costs were incurred by and for the benefit of Empire by Empire, but UCU, in its proposal, is requesting that it be allowed to recover those costs from ratepayers. The bankers fees, bond solicitation costs, most legal costs and proxy vote costs were all incurred by Empire in order to consummate its agreement with UCU. These items represent approximately 85% of the total transaction costs shown on Schedule VJS-2. (Ex. 202NP, p. 74, l. 9-15; Source: MPSC DR No. 1 and 100, Schedule VJS-2-3). Allegorically, it's as if UCU answered a classified advertisement offering for sale an automobile for the price of a hundred dollars. UCU buys the car and then tells its customers it needs to be reimbursed for the price of the automobile and also for the cost of the classified advertisement. UCU says, "No we didn't place or pay for the advertisement but you need to reimburse us for it anyway." (Ex. 202, p. 74, l. 17-21).

Public Counsel believes that it is inappropriate for ratepayers to reimburse UCU for costs Empire shareholders incurred to sell their common stock at a premium of approximately 38.8%. Those costs are directly linked to Empire's efforts to increase shareholder value thus, they should remain with the shareholders. Just as the cost of the classified advertisement would remain the responsibility of the individual that decided to sell the automobile and placed the advertisement.

Likewise, Public Counsel also believes it is inappropriate for ratepayers to pay transition costs for severance pay, executive retirement payments, and costs for a paid advisory board. These costs should not be the responsibility of ratepayers but of shareholders.

Public Counsel opposes any consideration of Empire's Officer's Severance/Retention Plan for any ratemaking determination. Empire's Severance agreements provide top executives with approximately three times their annual salary if a change in control occurs. (Ex. 715, p. 15,

l. 6-15; Tr. 136-138). These costs are of the same nature as "golden parachutes." Payment of "golden parachutes" to Empire senior management should not be required of Empire's ratepayers. Such "golden parachutes" provide no benefit to ratepayers. Nor should ratepayers be required to pay any of the $250,000 related to the Advisory Board of Directors, which also provides no benefit to ratepayers. (Ex. 715, p. 14, l. 8-12). The Board has absolutely no authority, UCU is not required to follow the Advisory Board's recommendation, and is wholly redundant to UCU's Board of Directors. (Ex. 715, pp. 14-15).

## VI. FROM A REGULATORY STANDPOINT, THE COMMISSION SHOULD REJECT UCU'S PROPOSED REGULATORY PLAN.

Assuming *arguendo* that this Commission believes it possesses the statutory authority to adopt the ten-year Regulatory Plan proposed by UCU, the Commission should still reject the Regulatory Plan because adopting such a plan is contrary to sound regulatory principals.

### A. Recovery of Merger Premium

As discussed earlier in this brief, UCU has requested that a decision be made in this proceeding allowing it to recover the assigned merger premium. The total merger premium (sometimes called acquisition premium) is approximately $275 million. (Ex. 202, p. 9, l. 16-20).

Public Counsel believes from a regulatory standpoint it would be inappropriate to approve UCU's request for a merger premium in this proceeding or any other future proceeding.

UCU's position in this case is that a pre-determination regarding the acquisition adjustment is a "critical component of the Regulatory Plan approval of which is necessary in order for the merger to make economic sense." (UCU's Statement of Position, p. 3). UCU witness Green states that UCU assumed that the Commission would provide "a reasonable opportunity to recover the acquisition premium." (Ex. 14, p. 15, l. 1-2). Implicit in UCU's position is that the Commission would give UCU recognition that it will be granted an indication that the premium will be recovered within the bounds of the Report and Order issued in this merger proceeding.

UCU witness Green states a belief that the Commission would entertain a request for recovery of the merger premium based upon the Commission's decision in Case No. EM-91-213 and Case No. WR-95-205/SR-95-206. (Ex. 14, p. 15, l. 10-19). These two cases while indicating that the Commission would consider recovery of a merger premium, do not support UCU's belief that the opportunity to recover a merger premium would be granted in this merger proceeding. In fact, these cases stand for the proposition that merger premium recovery, if granted at all, should be determined in a rate case proceeding--not a merger proceeding.

The first case cited by witness Green is Re: Kansas Power and Light and KCA Corp. for approval to merger with Kansas Gas and Electric ("KPL/KGE"), 1 Mo.P.S.C.3d 150 (1991). In the context of this merger proceeding between KPL and KGE, KPL was not requesting recovery of the merger premium in the merger proceeding. KPL was only requesting the Commission permit it to institute a program of sharing merger savings between shareholders and ratepayers with each receiving 50 percent. KPL/KGE at p. 154. The Commission rejected KPL's request. Id. at p. 156. In fact, the Commission explicitly did not approve any ratemaking treatment in that proceeding stating in Ordered paragraph 11:

> 11. That nothing in this order shall be considered as a finding by the Commission of the reasonableness of the expenditures herein involved or of the value for ratemaking purposes of the properties herein involved or as an acquiescence in the value placed upon said properties by Kansas Power and Light Company. Furthermore, the Commission reserves the right to consider the ratemaking treatment to be afforded these transactions, the resulting cost of capital and any proper adjustment to the cost of capital resulting therefrom in any later proceeding.

KPL/KGE at p. 161.

The next case cited by witness Green and UCU was WR-95-205/SR-95-206. Re: Missouri-American Water Company, 4 Mo.P.S.C.3d 205 (1995). Even a cursory review of this case demonstrates Missouri-American made its request to recover the merger premium in a rate case proceeding and not a merger proceeding. In the stock acquisition case that preceded the rate case disposed of in Case No. WR-95-205/SR-95-206, the Commission specifically deferred consideration of the recovery of the merger premium until a rate case proceeding stating in Ordered paragraph 3:

> 3. That the Commission specifically makes no finding, and takes no position in regard to the treatment, for ratemaking purposes, to be afforded any acquisition cost incurred in this transaction. The Commission reserves the right to consider, in full, any potential merger, and resulting costs, which might be contemplated as the result of this transaction.

Re: Missouri-American Water Company, 2 Mo.P.S.C.3d 305, 313 (1993).

The Commission has consistently not made a determination of the recovery of a merger premium within the bounds of a merger case. Witness Green's and UCU's assertions that the

Commission indicated it would consider approving recovery of a merger premium within the bounds of a merger proceeding are simply wrong.

As recently as March of this year, the Commission reaffirmed its policy of not making a decision about recovery of a merger premium in a merger case stating:

> The matter of the acquisition adjustment is also not properly before the Commission in this case. That is a matter for a rate case, as the Applicants point out. This is not a rate case. Therefore, the Commission will not address the matter of the acquisition premium in this case.

In the matter of Joint Application of Missouri-American Water and United Water Missouri, Inc., Case No. WM-2000-222 (Slip Opin. p. 7, Mar 16, 2000). The Commission also explicitly in Ordered paragraph 4 of WM-2000-222 stated that no ratemaking treatment had been determined. The Commission should not now change its consistent policy of deferring these issues to a rate case proceeding.

Moreover, pre-approving recovery of the merger premium would be contrary to the notion that rate base should be based upon original cost of property when the property was dedicated to public use. The use of "original cost" to set rates is not only the predominant form of regulation, but the only form which has been employed by the Commission. (Ex. 202, p. 18, l. 4-9). Approving recovery of the merger premium would result in rates being set inconsistent with original costs. (Ex. 202, pp. 14-19).

The merger premium consists of nothing more than a financial transaction that values the excess purchase cost over and above the net original cost of the Empire properties. (Ex. 202, p. 20, l. 1-5). In and of itself, the merger premium does not provide any additional benefits to Missouri ratepayers. (Ex. 202, p. 20, l. 5-7). Highly Confidential discovery responses obtained

20, l. 1-5). In and of itself, the merger premium does not provide any additional benefits to Missouri ratepayers. (Ex. 202, p. 20, l. 5-7). Highly Confidential discovery responses obtained by Public Counsel reveal that UCU recognizes that the premiums paid for **

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If this Commission allows or approves recovery of the merger premium in this proceeding, a public detriment will be created. Approval of merger premium recovery would be a public detriment because the costs for service to ratepayers would be higher on a going forward basis than if the sale of Empire had not occurred. (Ex. 202, p. 21, l. 1-7). From a regulatory perspective, the Commission should reject UCU's proposal to approve recovery of the merger premium.

## B. Frozen Capital Structure

From a regulatory perspective, the Commission should also reject UCU's request to "freeze" the divisional capital structure of Empire for a period of ten years. The Joint Applicants propose that Empire's rates in the "pre-moratorium rate case" and during the entire ten-year Regulatory Plan be based upon a "normalized capital structure" consisting of 52.5% debt and

The Joint Applicants propose that this capital structure be "frozen" regardless of the actual capital structure in place or how it might change and regardless of changes in the industry or the economy—a clear violation of just and reasonable rates. (Ex. 200, p.2-4). Moreover, it would be "frozen" only as to regulation; UCU would be under no obligation to actually maintain such a structure. (Ex. 200, p. 4, l. 17-19).

Obviously, customers should pay just and reasonable rates based on the utility's actual cost of service. Capital structure should also be representative of the manner in which the utility has financed its assets. This is true because regulatory financial analysts use the capital structure to make recommendations regarding the utility's cost of capital and, ultimately, the returns the utility will have the opportunity to earn. (Ex. 200, p. 4-5).

The costs and relative proportions of each component in the capital structure should be similar to the actual way in which the utility has financed its assets so that the utility has the opportunity to earn its cost of capital. A gross mismatch between the capital structure used to set rates and the actual way in which the utility assets are financed could lead to the utility either earning windfall profits or failing to earn its cost of capital. It could also lead to Missouri ratepayers paying costs beyond the actual cost of service for the utility. (Ex. 200, p. 5, l. 1-6).

UCU attempts to justify "freezing" the capital structure for Empire by asserting "[a]bsent the merger, the capital structure [proposed Empire structure] would not have changed appreciably." (Ex. 1, p. 29, l. 4). UCU's claim is not supported by historical evidence. There is no support for UCU's contention that Empire's capital structure would not have changed appreciably absent the merger, because empirical evidence shows that dramatic changes to the capital structure of both companies have occurred over the past ten years. (Ex. 200, p. 8, l. 7-19).

According to Value Line Investment Survey, UCU's common equity ratio has ranged from a high of 49.5% in 1998 to a low of 39% in 1995. This is an absolute swing of more than 10 percentage points in three years, or a relative increase of 26.92% from 1995 to 1998. Id. Empire's common equity ratio has also changed over the past ten years, from a high of 51.9% in 1992 to a low of 40.4% in 1999. That represents an eleven percentage point absolute change in only three years, or a relative change of 22%. Id.

The Joint Applicants also alter the relative levels of capital structure components and the makeup of individual components. For example, in times of low interest rates a company might take on more debt than usual, or it might refinance older, higher-interest debt. These sorts of changes are captured during rate cases so that current rates can be based on as current a capital structure as possible. (Ex. 200, p. 9, l. 1-10). UCU's proposal in this case removes any and all opportunity for capital structure changes to be appropriately reflected in rates for a ten-year period.

Finally, presetting the capital structure for Empire for ten years creates the possibility that UCU could achieve extra profits. To the extent that the actual financing of the assets contained less than 47.5% equity, yet rates were based on an equity level of 47.5%, UCU would collect a return greater than its cost of capital (assuming equity costs are greater than debt costs). (Ex. 200, p. 9, l. 16-20).

It would be contrary to sound regulatory policy and detrimental to the public interest for the Commission to lock in rates based on a capital structure that will not be updated for potentially ten years or more regardless of the actual financing used to support the business. The Commission should reject all of UCU's proposals regarding frozen capital structure.

## C. Frozen Corporate Allocation

As a matter of regulatory policy the Commission should reject UCU's proposal to exclude the Empire factors from UCU's allocation of corporate and intra-business unit costs to MoPub during the ten years covered by the proposed Regulatory Plan. Freezing the allocation factor for all rate cases involving MoPub would result in an arbitrary and non-existent cost level regarding UCU's corporate and intra-business costs being assigned to MoPub's customers.

UCU is asking that any UCU overhead allocation reduction to MoPub resulting form the acquisition of SJLP and/or Empire be ignored for ten years. (Ex. 716, p. 12, l. 11-14). This is simply another backdoor attempt to force ratepayers to subsidize the acquisition premium. Adopting such a proposal would be poor regulatory policy and would be detrimental to UCU's MoPub divisional ratepayers. This Commission should reject UCU's proposal to "freeze" the allocation factor of corporate and intra-business costs to MoPub during the ten years covered by the proposed Regulatory Plan.

## D. Pre-Moratorium Rate Case

As discussed earlier, Public Counsel does not believe that it is legal for the Commission to pre-judge any ratemaking issues in the context of a contested merger case. To do so would be outside of the statutory authority granted to the Commission in Section 393.190 RSMo. 1994. Moreover, no notice has been issued to the public in this case as would be required in a general rate case. Public Counsel contends that no pre-determination of ratemaking components would be legal or binding on ratepayers in any future pre-moratorium rate case.

Needless to say, it would be a serious detriment to the public if, on a single-issue basis, certain ratemaking components are singled out for determination in this case and thus, as a regulatory mater, the requests regarding pre-determination of issues that would be part of the pre-moratorium rate case should also be rejected. Moreover, the Joint Applicants are asking for pre-judgments that are blatantly unbalanced. UCU wants the Commission to make a commitment in this case that it will allow cost increases for certain components (SLCC plant) while making a commitment to exclude certain cost decreases (e.g., reductions in personnel at UCU's Empire operating division) that could offset the expected increases. (Ex. 201NP, p. 25, l. 12-19). This is not an even-handed proposal and would result in unjust and unreasonable rates.

## VII. CONDITIONS THAT SHOULD BE ADOPTED IF THE MERGER IS APPROVED

If the Commission rejects Public Counsel's primary recommendation and approves the proposed merger, the Commission should impose the following conditions upon the merged UCU as part of its report and order in this case. By proposing these conditions, Public Counsel does not concede that the proposed merger is in the public interest or even that its corresponding detriments could be completely mitigated by adopting these conditions. It is also important to recognize that Public Counsel identified one detriment for which no proposed condition could mitigate--the increased financial risk that would charged to debt owed on the assets currently serving Empire customers.

However, each of the following proposed conditions is designed to eliminate, or to some degree mitigate, certain detriments that the record indicates would result from the merger. It is inherently logical that if the Commission may not approve a merger that would be detrimental to the public interest, then it may conditionally approve a merger under requirements that serve to mitigate the public detriment identified. In fact, if the Commission approves a merger, it must impose any such conditions that would be necessary to render the merger not detrimental to the public interest. As such, these conditions are not mandates that would be involuntarily imposed and would in no way infringe upon any legal rights. The Joint Applicants wold have the choice to reject a conditional merger approval if it was believed that it would be undesirable to proceed under the conditions required to mitigate a public detriment. On the other hand, consumers would have no such choice, but to accept the Commission's judgment in this merger case.

## A. Affiliate Transactions Condition

If the proposed merger is approved, the size, scope, and complexity of UCU's affiliate transactions will increase. UCU has entered into recent contractual relationships with its affiliates that create the possibility for cross subsidy and affiliate abuse. (Ex. 201HC, p. 74, l. 14-23). One of the motivations for the proposed merger is the acquisition of low-cost generation assets that could be used to support the power marketing activities of UCU's affiliate, Aquila. (Ex. 201NP, p. 13, l. 8-11). As discussed earlier in this Brief, UCU plans to begin non-regulated telephony and fiber optic operations in Missouri.

Given the size, scope and complexity of the affiliate transactions that will occur if the merger is approved, Public Counsel recommends that the Commission state in any order approving the merger that it will commit to <u>close scrutiny</u> of the merged entity with regard to compliance with the terms of the Commission's affiliate transaction rules. 4 CSR 240-20.015. This condition will help mitigate some of the detriments associated with market power in the retail merchant function and the harm from cross-subsidies that can occur between regulated and non-regulated operations. (Ex. 201NP, p. 7, l. 6-10). Public Counsel further recommends that the Commission require as a condition of the merger that UCU never propose to charge the Empire division customers for access to the Empire fiber optic system, because Empire's non-regulated operations have never provided any compensation whatsoever to the regulated operations for the use of its right of way, poles, ducts, and underground conduit. (Ex. 201NP, p. 7, l. 11-15).

## B. Access to Books and Records Condition

Also, as a result of the increased size, scope and complexity of the affiliate transactions that would occur if the proposed merger is approved, Staff and Public Counsel will need additional assurances regarding access to the books, records, employees, and officers of the affiliates of UCU and its wholly-owned subsidiaries. Therefore, Public Counsel recommends, as a condition to any merger approval, that the merged entity agree to provide such access to all corporate entities for which UCU or its wholly-owned subsidiaries have an ownership interest of 10% or more. (Ex. 201NP, p. 7, l. 1-5). This condition will serve to mitigate the detriments of the merger associated with the recognition of possible cross subsidies for ratemaking purposes and provide the ability to mitigate various market power concerns in the future.

It is only reasonable that if the Commission is to approve a merger that will greatly complicate the job of monitoring affiliate relationships, and accordingly, complicate the Commission's job of ensuring just and reasonable rates to regulated customers, then the merged entity should be required to agree to provide such access to these non-regulated entities. This condition will ensure adequate monitoring is possible and that the Commission has sufficient information to fulfill its statutory obligations.

## C. Market Power Conditions

If the proposed merger is approved, Public Counsel believes that the opportunity presented by this case is the best, and perhaps only, opportunity that the Commission will have to require actions that will mitigate the detriments of increased market power described *supra* in Section IV of this Brief. This increased market power is almost certain to impact consumers negatively in a restructured environment--the likelihood of which is driving the proposed merger, even by admission of the Joint Applicants.

The Joint Applicants appear to take the position that the detriments associated with increased market power are not ripe because Missouri has not yet restructured its electric industry; but at the same time, UCU's actions and words appear to assume that such change is inevitable. The surrebuttal testimony of UCU witness Robert K. Green characterizes a future transition of the electric industry into a restructured, competitive environment as "most likely." (Ex. 3, p. 4, l. 18-20). Public Counsel believes that, in protecting the public, the Commission should not wait until it is too late to address these detriments.

UCU argues that any market power remedies can be addressed at a later date by the Commission when restructuring is mandated. In addressing the substantial Public Counsel evidence of market power harm, UCU witness Green attempts to reassure the Commission in his surrebuttal testimony that it can wait to address this harm:

> . . . [W]hether by our initiative or as part of a changing industry, the break-up of the integrated Missouri jurisdictional utility would require Commission approval. The potential for the harm implied in this lengthy testimony can only be realized with the Commission's blessing.
>
> Ibid., p. 5, l. 1-4.

Unfortunately, this may not be the case. Future legislative developments could preclude the Commission from the ability to approve of restructuring decisions. There is no guarantee that there will be sufficient opportunity to address market power concerns before some competitive changes are mandated. It does not seem wise to wait and watch inevitable harms develop and harm the public before taking action. On the other hand, if restructuring does not occur as many predict it will, no irreparable harm will occur to the Joint Applicants or to the public as a result of the recommended market power conditions.

In order to address horizontal market power detriments, Public Counsel proposes that the Commission approve the merger only if the Joint Applicants are willing to agree to the same horizontal market power conditions approved in the KCPL/Western Resources merger case, Case No. EM-97-515. (Ex. 201NP, p. 5, l. 5-23; Attachment 1, pp. 1-6). The provisions that were included in the Stipulation and Agreement for the KCPL/Western Resources merger have been modified in Attachment 1 cited above so that they will refer to the Joint Applicants in this case, instead of referring to KCPL and Western Resources.

The Commission addressed vertical market power concerns in the UE/CIPS merger case (Case No. EM-96-149) by requiring Union Electric to make reasonable efforts to join an ISO (Independent System Operator). In that case, both Staff and Public Counsel witnesses filed testimony stating that the merger was likely to amplify vertical market power problems, especially if retail wheeling becomes available in Missouri. On pages 15 and 16 of its Report and Order in that case, the Commission stated the following:

> The Commission finds that there are sufficient facts in evidence to be concerned about the potential increase in market power from the proposed merger. The merger could have a significant adverse impact on the degree of competition within UE's Missouri service territory due to limited transfer capability for imported power, as well as the disincentives caused by pancaked transmission rates. In order to eliminate pancaked transmission rates, Ameren would need to belong to a regional transmission group having a region-wide transmission rate. To address the vertical market power concern that Ameren could use its transmission system to restrict competition from other generation, the regional transmission group should be an entity that will independently operate the transmission systems of the vertically integrated utilities in the region.
>
> UE/Central Illinois Public Service Company, 6 Mo. P.S.C. 3rd 28, 38, issued on February 21, 1997.

In the Ordered section of its Report and Order in that case, the Commission set forth specific procedures for UE to follow in joining an ISO and in requesting Commission approval to do so. Id., pp. 40-41.

The Commission also addressed vertical market power in Case No. EM-97-515, in which it approved a Stipulation and Agreement that required Western Resources, Inc. to join an RTO under certain specified conditions. This decision forms the basis of Public Counsel's recommendation to mitigate vertical market power problems if the proposed merger is approved. Public Counsel recommends that the Commission condition any approval of the proposed merger on the Joint Applicants' willingness to join an RTO under essentially the same conditions that the Commission ordered in Case No. EM-97-515, in which it approved a Stipulation and Agreement that required Western Resources to join an RTO. These proposed conditions are set out on pages six through eight of Attachment 1 to Exhibit 201NP.

By requiring UCU to join an RTO now, before retail competition arrives, the Commission will be helping to foster an environment whereby wholesale competition can develop under conditions that do not threaten the security of the transmission grid. (Ex. 201NP, p. 66, l. 16-18). The Commission's action on this issue is also necessary to assure that all market participants have access to transmission service operated by an independent entity under terms and conditions that are not perceived to be discriminatory. (Ex. 201NP, p. 66, l. 19-21).

Staff witness Proctor also recommends that the Joint Applicants be required to commit to join an RTO as a condition of merger approval, and he emphasizes that the separate utilities should commit to joining the same RTO that meets the eleven ISO principles enumerated in

FERC Order 888 before the October 15, 2000 deadline of FERC Order No. 2000. (Ex. 713, p. 60-61).

As with horizontal and vertical market power, retail market power concerns can be largely mitigated by adopting retail market power conditions similar to those approved by the Commission in Case No. EM-97-515. These recommended conditions require the Joint Applicants to agree to certain reasonably tailored restrictions on the use of name brand and logo for unregulated products and services. (Ex. 201NP, Attachment, pp. 8-9).

Although Public Counsel would prefer all of its market power conditions to be approved, adoption of some of these market power conditions would be preferable to no conditions whatsoever. The Commission should adopt each of the proposed conditions that it believes to be reasonable and necessary to protect consumers.

## D. Public Counsel's Regulatory Conditions

The record in this case contains evidence of many detriments to the public interest, primarily detriments that would serve to negatively impact the rates paid by the current customers of UCU and Empire. These detriments will only be compounded and magnified if the Joint Applicants' so-called "Regulatory Plan" is also approved. Therefore, if the Commission decides to approve the underlying merger despite evidence of these detriments, Public Counsel proposes a regulatory condition that should be approved in lieu of the Joint Applicants

Regulatory Plan. (Ex. 203, p. 5, l. 5-15; Ex. 201NP, p. 5-6). Public Counsel also proposes regulatory conditions that should be approved if the Commission also approves the ill-advised Regulatory Plan of the Joint Applicants. (Ex. 201NP, pp. 28-34).

Unlike the Joint Applicants' Regulatory Plan, Public Counsel's proposed Regulatory Condition does not ask the Commission to pre-determine any component of ratemaking, (something that is beyond this Commission's statutory authority and extremely ill-advised). Rather, Public Counsel suggests that the Commission merely require the merged entity to subject itself to traditional rate of return regulation. As a condition of any merger approval, Public Counsel believes that the Joint Applicants should be required to commit to filing a general rate case for UCU's total Missouri electric operations one year after the final determination of both the proposed merger that is the subject of this case and the final determination of the proposed merger between UCU and Empire District Electric Company, whichever is later. (Ex. 203, p. 5, l. 7-12).

For purposes of this regulatory condition, the "final determination" of each merger would be satisfied on the date that each merger was consummated or on the date when the parties involved with each merger agree to abandon efforts to merger. Id, p. 6, l. 9-14. This condition would further require UCU to agree not to unilaterally withdraw this general rate request. Id, p. 5, l. 10-11. The Commission should also make it clear, as a part of this condition, that any request or recommendation by other parties for a reduction in the merged entity's revenue requirement for total Missouri electric operations would be ruled upon within the context and eleven-month time frame of the required general rate proceeding. Id at 5, l. 11-13.

The Joint Applicants have prospered under Missouri's traditional rate of return regulation and were aware of the regulatory environment in our state when they chose to enter into the proposed merger. It would be unwise for the Commission to send signals to the utility industry that it either promotes or discourages mergers that are clearly designed to enhance shareholder value. If this merger is to be approved, the costs and benefits of the merger should be fairly allocated pursuant to well-established rules of regulatory ratemaking. While the Joint Applicants' Regulatory Plan would impose a myriad of harms upon the ratepaying public, Public Counsel's regulatory condition would at least mitigate some of the harms associated with this merger by allowing some of the savings generated by the merger to be shared with electric consumers.

The Joint Applicants' proposed Regulatory Plan envisions three separate service territories filing independent rate cases. This separation creates opportunities for rates to be set in a manner under which the total revenues received from the three service areas would be in excess of the total revenue requirement for UCU's Missouri electric operations, thereby "gaming the system." (Ex. 203, p. 7, l. 14-21). An over-collection of revenues could result from the use of different test years, fuel modeling, payroll annualization including overtime, cost of capital, as well as the use of different study periods for corporate allocations. Id, p. 7, l. 18-21. Public Counsel's regulatory condition would mitigate this detriment by requiring a traditional rate case to be filed based upon UCU's total electric operations.

If the Commission approves the Joint Applicants' proposed Regulatory Plan as well as the merger itself (contrary to recommendation of Public Counsel and the other parties), Public Counsel further recommends another regulatory condition. The Commission should condition its approval of the merger on UCU's willingness to agree that it will commit to: (a) not sell or otherwise dispose of its interest in any of Empire's generation assets for the next 30 years and (b) offer generation services to its customers at cost based (rather than market based) rates for the next 30 years. (Ex. 200NP, pp. 28-29).

UCU argues that its proposed plan is reasonable because customers will be receiving significant synergies from the proposed merger that will keep rates below the level which would exist absent the merger. UCU claims that it would not be to equitable to force shareholders to pay all or most of the acquisition premium while ratepayers are receiving significant benefits from the merger. OPC's recommendation is designed to insure that the opposite of this does not occur. (Ex. 200NP, p. 29, l. 11-16). UCU's witness John McKinney made the following statements on this subject in his direct testimony:

> We believe customers should be a principal beneficiary if a utility devises a more efficient way of providing service. (Ex. 1, p. 11, l, 5)
>
> Sharing [of benefits] is proposed because it is clearly fair to all concerned. (Ex. 1, p. 12, l. 19)
>
> We know of no economic system or model where it is considered fair or reasonable to assign all the costs to one party or stakeholder in a transactioni and give all of the benefits to another. (Ex. 1, p. 13, l. 7)
>
> Finally, our filing demonstrates that benefits will continue to flow after the transaction (premium) and transaction costs have been covered. Any other outcome could only be considered unfair and unreasonable. (Ex. 1, p. 13, l. 19)
>
> Therefore, the premium deserves rate making recognition if savings are passed on to ratepayers. (Ex. 1, p. 19, l. 17)

If the Commission accepts UCU's argument that sharing merger benefits means customers should pay a significant portion of the acquisition premium through UCU's proposed regulatory plan or a similar plan, then the Commission should ensure that those benefits are actually there for customers to enjoy. Unless OPC's cost-based generation merger condition is accepted by the Commission (and agreed to by the Company), those benefits will no longer be there for ratepayers to enjoy once the Missouri legislature decides to deregulate retail generation service in Missouri. Empire, UCU, and Public Counsel all expect this to happen fairly soon.

On February 8, 2000 Bob Green participated in a conference call with utility analysts where he stated that:

> with the St. Joe and the Empire acquisition, we've brought together some very attractive low-cost generation assets, and we have added some contiguous distribution networks that afford us a significant opportunity for synergies and efficiencies. 75% of those benefits are going to come from the supply side.

(Ex. 200NP, p. 30, l. 13-17).

Since UCU believes that 75% of the merger benefits "are going to come from the supply side," the Company should be willing to commit to ensuring that ratepayers will continue to receive those benefits over an extended period of time (i.e. the remaining life of the low cost generating assets that are being acquired from Empire) by agreeing to the cost based generation merger condition that OPC has proposed. If UCU will not agree to such a condition, it then becomes obvious that they are simply asking ratepayers to help the Company fund its investments in soon-to-be-deregulated low cost generation assets which will have no benefit for consumers. (Ex. 200NP, p. 30, l. 18-25).

Consumers will receive no benefits from generation supply synergies because the only period of time when these assets are likely to still be used to provide regulated cost-based generation service to UCU's customers is during the first five years after the close of the merger. Of course, UCU's proposed regulatory plan provides that its rates will be frozen for the first five years. After that time, generation service will likely be sold at market-based rates for frozen at rate levels that existed at the time the restructuring legislation is passed for a short transition period. (Ex. 201NP, p. 31, l. 3-9).

## VII. Conclusion

The Commission should reject the proposed merger because it is detrimental to the public interest for the reasons described in Section IV of this brief. However, if the Commission does approve the merger, it should absolutely reject the Joint Applicants' Regulatory Plan because its adoption would be legally unauthorized (Section III), as well as unreasonable from a regulatory perspective (Section V).

In lieu of the Regulatory Plan, the Commission should require the merged entity to subject itself to traditional rate of return regulation by filing a rate case under the terms of Public Counsel's recommended regulatory condition. Furthermore, the Commission should adopt Public Counsel's other recommended conditions which are designed to mitigate the detriments that would be associated with the merger.

Respectfully submitted,

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## CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been mailed or hand-delivered to the following this 31st day of October, 2000:

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