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Missouri Public
Service Commission

September 5, 2000

Public Service Commission
Truman State Office Building
Jefferson City, MO 65102

RE: *In the matter of Joint Application of UtiliCorp United, Inc. and St. Joseph Light & Power Company for Authority to Merge St. Joseph Light & Power Company with and into UtiliCorp United*
No. EM-2000-292

Dear Sir/Madam:

Enclosed for filing please find an original and 9 copies of an *Initial Brief of Missouri Department of Natural Resources.* Please stamp "filed" on the extra copy for my files. Thank you.

Sincerely,

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Attorney General

Deborah Neff for

SHELLEY A. WOODS
Assistant Attorney General

SAW:pah
Enclosure
c: Counsel of Record

FILED

SEP - 5 2000

Missouri Public Service Commission

Before the
Missouri Public Service Commission

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Re: Joint Application of UtiliCorp Inc. and St. Joseph Light & Power Company for Authority to Merge St. Joseph Light & Power Company with and into UtiliCorp United

Docket No. EM-2000-292

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INITIAL BRIEF

OF

MISSOURI DEPARTMENT OF NATURAL RESOURCES

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SUMMARY OF DNR ARGUMENT

The Missouri Department of Natural Resources (DNR) presents a traditional merger analysis in this proceeding. Under this analysis, the Missouri Public Service Commission (PSC) must begin its analysis of the pending merger by defining the markets that will be affected by the merger. After those markets are defined, the PSC must then determine whether the benefits of the merger are appropriately "passed-on" within each market. If, within a defined market, the merger results in adverse impacts that impede the passing-on of the benefits, or if the benefits of the merger are inappropriately passed-on to that market, the PSC must impose appropriate mitigation measures if the merger is to be approved.

In the pending proceeding, the Company did not seek to define appropriate markets. Indeed, the Company concedes that it did *not* consider the impacts of the merger on any particular market, but rather simply on the Company as a whole. The merger cannot be approved on such a record.

In contrast, DNR supported its identification of low-income consumers as a separate market. DNR used the traditional factors that go into market definition, including demand elasticity (or its surrogates) and the "practical indicia" articulated by the U.S. Supreme Court in *Brown Shoe*[1]. DNR then supported its conclusion that the merger will *both* result in adverse impacts to the low-income market that will impede the passing-on of benefits *and* inequitably pass-on benefits to the low-income market. Either of these results standing alone, and certainly the two results in combination, support the proposed mitigation measures DNR offers through the proposed Community Energy Partnership Program (CEPP).

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1 ***Brown Shoe Co. V. United States,*** 370 U.S. 294, 335, 82 S.Ct. 1502, 1529, 8 L.Ed.2d 510 (1962)

DNR's CEPP is a mechanism designed to remediate the two results which DNR found adversely affected the low-income market. The CEPP involves a package of remedies that includes energy efficiency, renewable energy, a periodic survey of low-income consumers, and a deployment of the BOSS / Chronicles software program. In addition, DNR proposes a reporting system through which specifically defined low-income universal service outcomes can be measured in a post-merger environment.

STATEMENT OF LEGAL PRINCIPLES

The First Step in Any Merger Analysis Involves Defining the Relevant Markets

In assessing any utility merger that comes before it for approval, the PSC must both: (1) delineate what the relevant markets are, and (2) determine the impacts of the merger on each market. The *first* step in assessing merger impacts, however, is a delineation of the relevant markets.

> The significance of the market definition issue is straightforward; a court must have a frame of reference within which to isolate and examine competitive effect. That frame of reference is a market--a place where buyers and sellers meet to engage in exchange.[2]

Establishing this "frame of reference" is not just good policy, it is legally required. The U.S. Supreme Court has held that "proper definition of the market is a *'necessary predicate'* to an examination of the competition that may be affected by the horizontal aspects of the merger,"[3] and a sound appraisal of the immediate and future impact of this merger must be based on a

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2 **Dunfee, *et al.*, "Bounding Markets in Merger Cases: Identifying the Relevant Competitors**," 78 *Nw. U. L. Rev.* 733 (1984) (citations omitted).

3 ***United States v. Philadelphia Nat'l Bank***, 374 U.S. 321, 362, 83 S.Ct. 1715, 1741, 10 L.Ed.2d 915 (1963)

"firm understanding of the structure of the relevant market."[4] "Without a definition of the relevant market, there is no way to measure [the]. . . ability [of the challenged transaction] to lessen or destroy competition."[5] Time after time, the Supreme Court (amongst others) has held that the definition of relevant markets is the critical first step in assessing the impacts of a proposed merger.[6]

Defining Markets is Not Simply an Antitrust Process, But Must be Done by State Utility Regulators as Well.

While market definition is obviously ubiquitous in antitrust analysis, it is not confined exclusively to antitrust litigation. State and federal *utility* regulators must engage in a market definition, as well, in assessing the impacts of proposed mergers under utility regulatory law. It is not a revolutionary concept that utilities serve multiple markets today. And, utility regulators routinely face the task of defining what those markets are in order to properly assess the appropriateness of mergers (or the need to qualify merger approval on regulatorily-imposed conditions). In the telecommunications industry, for example, distinction has been made between the intraLATA toll and local usage markets, as well as between residential and business markets. *Re: GTE Corporation*, Docket No. 98-0866, Slip Opinion (Illinois Commerce Commission,

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4 ***United States v. Philadelphia Nat'l Bank***, 374 U.S. 321, 362, 83 S.Ct. 1715, 1741, 10 L.Ed.2d 915 (1963).

5 ***Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.***, 382 U.S. 172, 177, 86 S.Ct. 347, 350, 15 L.Ed.2d 247 (1965).

6 *See e.g.*, ***Walker, Inc. v. Food Machinery***, 382 U.S. 172, 177, 86 S.Ct. 347, 15 L.Ed.2d 247 (1965); *see also*, ***Joe Westbrook, Inc. v. Chrysler Corp.***, 419 F.Supp. 824, 844 (N.D.Ga.1976); ***Southern Concrete Co. v. United States Steel Corp.***, 394 F.Supp. 362, 379 (N.D.Ga.1975), *aff'd*, 535 F.2d 313 (5th Cir. 1976), cert. denied, 429 U.S. 1096, 97 S.Ct. 1113, 51 L.Ed.2d 543 (1977).

October 29, 1999). The Public Utilities Commission of Ohio distinguished, in its merger evaluation, between the market consisting of competitive business services and the market consisting of basic local residential services. *Re: SBC Communications*, Case No. 98-1082-TP-AMT, 193 P.U.R. 4th 86 (PUCO, April 8, 1999).

Distinguishing between different markets is not unique to telecommunications, however. In its assessment of the impacts of the proposed merger application of Utah Power and Light, the Utah Public Service Commission recognized a market consisting of interruptible power customers, and considered how the merger would uniquely affect that market. *Re: Utah Power and Light Company*, Utah Public Service Commission, 97 P.U.R.4th 79 (September 28, 1988).

Having established the requirement -- not merely the need, but the requirement -- to define the relevant markets for purposes of a utility commission's merger analysis, it is necessary next to assess the legal principles applicable to defining the market.

"Markets" are to be Demarcated Using Established Legal Principles

"Markets" are not demarcated by cost causation principles that go into defining customer classes for ratemaking purposes. Instead, the delineation of an economically relevant market involves an assessment of the degree of product substitutability. A market is an "area of trading," that can be defined geographically or in terms of product differential.[7] For goods or service to be in the same "product market," they must be reasonably interchangeable in price, use and

7 Clarke, ***Competition as a Dynamic Process***, at 105 (1961).

quality.[8] In addition, for a market to exist, there must exist "a common group of buyers.[9] In its case, DNR addresses both aspects of these market definitions: (1) the interchangeability of services; and (2) the commonality amongst the sought-after buyers.

The Use of Elasticity and Functional Interchangeability

Differences in markets are generally *first* tested through the application of two closely-related tests: functional interchangeability and demand elasticity.[10] Market differences can be determined through an evaluation of the elasticity of consumer demand.[11] It is this elasticity through which one can measure the extent to which the market offers close substitutes.[12]

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8 Lipson, "Monopolization: Traditional Standards and Future Directions," 47 ***Antitrust Law Journal*** 1115, 1117 (1978).

9 Pace, "Relevant Markets and the Nature of Competition in the Electric Utility Industry," 16 ***Antitrust Bulletin*** 725, 725 (1971).

10 These are the principal tests that have been adopted by the Supreme Court, *see e.g.*, ***Brown Shoe Co. v. United States***, 370 U.S. 294, 325, 82 S.Ct. 1502, 1523-1524, 8 L.Ed.2d 510 (1962); ***United States v. E.I. DuPont de Nemours & Co.***, 351 U.S. 377, 76 S.Ct. 994, 100 L.Ed. 1264 (1956) ("Cellophane case"); ***United States v. Continental Can Co.***, 378 U.S. 441, 84 S.Ct. 1738, 12 L.Ed.2d 953 (1964); by the Eighth Circuit, ***United States v. Empire Gas Corp.***, 537 F.2d 296, 303-04 (8th Cir.1976), cert. denied, 429 U.S. 1122, 97 S.Ct. 1158, 51 L.Ed.2d 572 (1977); ***General Industries Corp. v. Hartz Mountain Corp.***, 810 F.2d 795 (8th Cir.1987); ***Schaben v. Samuel Moore & Co.***, 462 F.Supp. 1321, 1334 (S.D.Iowa 1978), aff'd, 606 F.2d 831 (8th Cir.1979); by other courts of appeals, ***American Crystal Sugar Co. v. Cuban-American Sugar Co.***, 259 F.2d 524 (2d Cir.1958); ***SmithKline Corp. v. Eli Lilly & Co.***, 575 F.2d 1056 (3d Cir.), cert. denied, 439 U.S. 838, 99 S.Ct. 123, 58 L.Ed.2d 134 (1978).

11 ***United States v. Archer-Daniels-Midland and Nabisco Brands, Inc.***, 695 F.Supp. 1000 (S.D. Iowa 1987), reversed on other grounds, 866 F.2d 242 (8th Cir. 1988).

12 Cochrane and Bell, ***The Economics of Consumption***, at 329 (New York 1956); see, Note, "The Market: A Concept in Antitrust," 54 ***Columbia Law Review*** 580 (1954).

Elasticity may serve as a surrogate measure for a number of different situations. It may indicate a lack of meaningful alternatives.[13] It may indicate the presence of high search costs associated with gains of uncertain magnitude or duration.[14]

A second test for a market is whether the services provided are interchangeable between two groups of customers.[15] If they are not, the customers for those products are not in the same market. A leading antitrust case defining the relevant "market" is *United States v. E.I. DuPont De Nemours*.[16] In *DuPont*, the United States charged the company with monopolizing or attempting to monopolize the cellophane industry. The relevant market, the *DuPont* Court said, "depends upon the availability of alternative commodities for buyers: *i.e.*, whether there is a cross-elasticity of demand between cellophane and the other wrappings." The interchangeability, the Court continued, "is largely gauged by the purchase of competing products for similar uses considering the price, characteristics and adaptability of the competing commodities."[17] A

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13 *See e.g.*, Pace, "Relevant Markets and the Nature of Competition in the Electric Utility Industry," 16 ***Antitrust Bulletin*** 725, 728 - 734 (1971) (residential energy users lack meaningful alternatives).

14 *See e.g.*, Hanson, *et al.*, ***Monitoring Competition: A Means of Regulating The Property and Liability Insurance Business***, at 124 - 125, National Association of Insurance Commissioners (May 1974) (search costs for least-cost property and casualty insurance are high.)

15 ***United States v. Empire Gas Corp.***, 537 F.2d 296, 303 (8th Cir.1976).

16 351 U.S. 377 (1956).

17 *Id.*, at 380 - 381.

"market," the Court concluded, is "composed of products that have reasonable interchangeability for the purpose for which they were produced--price, use and qualities considered."[18]

The Alternative Use of the *Brown Shoe* "Practical Indicia" of Markets

As an alternative to the use of demand elasticity and functional interchangeability as the tests to define markets, the U.S. Supreme Court established a series of "practical indicia" through its seminal *Brown Shoe* decision.[19] Among the practical indicia recognized by the Supreme Court as appropriate for defining a market were factors such as:

1. An industry or public recognition of the market as a separate economic unit.
2. A product's peculiar characteristics.
3. Distinct customers.

These "practical indicia" may stand as surrogates for the use of demand elasticity analysis.

"Ratepayers" and "Markets" are not the Same.

Customer classes for utility ratemaking purposes are not synonymous with markets for purposes of evaluating mergers. Customer classes are utility ratemaking mechanisms designed to provide cost recovery for a utility. These classes are designed based primarily upon cost-causation characteristics. These characteristics include energy, demand, customers and other characteristics associated with cost causation.

The fact that these cost-causation characteristics are not the same characteristics to be used in defining markets may be illustrated by reference, if nothing else, to one simple fact. As

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18 *Id.*, at 404 .

19 ***Brown Shoe v. United States***, 370 U.S. 294, 325 (1962).

described above, the most common, though by no means exclusive, test for determining a market is the elasticity of demand. The use of demand elasticity for ratemaking purposes, however, has a specific name: value-of-service pricing.[20] The cost-of-service principles used as the foundation for utility ratemaking in Missouri stand in sharp contrast to these value-of-service pricing principles. As can be seen, the definition of markets cannot be reconciled with the definition of customer classes. The very factor that is used primarily as the mechanism to define a "market" (elasticity) is a factor that has been explicitly rejected as a basis for cost-of-service ratemaking.

Merger Litigation Can Appropriately Consider Impacts on Subsets of Markets.

It is not necessary, in assessing whether merger savings are passed on to all customers, to lump all ratepayers together into one group for evaluation. A detailed discussion was presented above on how different ratepayers, taking different types of service, are considered to be in separate markets. Even within a single market, however, there may be sub-markets. In the SBC-Ameritech merger proceeding in Ohio, for example, one Commissioner noted that:

> the Commission stated in its October 15 entry that. . .the joint applicants needed to clarify how the issue of cost savings would be addressed in the future for those customer classes *or the areas of Ohio where competition has not developed* as the tool for the pass-through of cost savings. The Commission's staff concluded that, as long as the joint applicants continue to have captive ratepayers without competitive alternatives, such ratepayers should benefit

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20 No less an authority than James Bonbright states: "In the literature of economics, the value-of-service principle is taken most frequently to mean that principle of pricing under which the differences in the prices charged by a given enterprise for its various products are based not just on differences in the costs of production, but also on differences in the urgency (i.e., direct price elasticity) of demand." James Bonbright, *et al.* (1988). ***Principles of Public Utility Rates*** (2d ed.), at 135, Public Utility Reports: Arlington (VA).

from any increased synergies resulting from the merger. (emphasis added).[21]

This decision recognizes both: (1) subsets of ratepayers, and (2) subsets of geographic areas, in its merger market definition. In addition to this Ohio decision, however, it is established law that within a market, there may be a variety of submarkets that merit separate consideration.[22] "It is clear that these seven *[Brown Shoe]* criteria are litmus paper tests that must be held up against the proposed submarket in order to determine whether a relevant submarket exists. *If a sufficient number of those indicia are present, a valid submarket has been established.*"[23] Whether or not DNR has established low-income consumers as a separate "market," or whether low-income consumers are merely a "sub-market" of the broader residential market, has no legal consequence for the analysis that DNR is presenting.

Missouri's Utility Merger Law Requires the Passing-On of Benefits.

The basic law of Missouri is that the PSC may not withhold its approval of a proposed merger unless the merger is detrimental to the public interest. *Re: Kansas Power and Light Company*, 126 P.U.R.4th 385 (1991) (citations omitted). The mechanism for assuring that there is no detriment to the public interest is to determine whether the merger generates savings and whether those savings are appropriately passed-on to consumers. In *Kansas Power and Light*, the Commission ordered that "Kansas Power and Light Company be directed hereby to conduct a study to identify the appropriate allocation of costs and savings after the merger among the

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21 ***Re: SBC Communications, Inc.***, Case No. 98-1082-TP-AMT, 193 P.U.R. 4th 86, 131 (Jones dissent) (PUCO, April 8, 1999).

22 ***Brown Shoe***, *supra*.

23 ***Harnishfeger Corp. v. Paccar, Inc.***, 474 F.Supp. 1151, 1155 (E.D. Wis. 1979), *aff'd without opinion*, 624 F.2d 1103 (7th Cir. 1979). (emphasis added).

various jurisdictions in which Kansas Power and Light operates and to submit the preliminary results of such study to the Commission's Energy Department. . ." *Kansas City Power and Light,* 126 P.U.R. 4th at 393. The Commission further ordered that "the parties to this case be directed hereby to meet for the purpose of attempting to devise a merger savings track plan (MTSP) which will ensure that all nonmerger savings can be excluded *from the merger savings to be shared between ratepayers and shareholders.*" (*Id.* at 393, emphasis added).

This merger standard squarely places Missouri in the group of states that apply a "consumer welfare" standard of merger analysis. Moreover, the standard creates a "consumer welfare" standard, that has implicit within it a "passing-on" requirement to be implemented as part of the merger consideration process by the PSC.

The Consumer Welfare Standard Requires a "Passing-On" of United, Merger Savings.

As with other types of horizontal merger, the Companies argue the proposed Utilicorp United, Inc. and St. Joseph Light and Power Company (Utilicorp/SJLP) merger benefits society because it generates "efficiencies." These efficiencies arise as a result of the synergies created by a combination of two or more firms. In this case, DNR addresses certain issues raised by these claimed synergies.

The goals of a merger review may be broken down into two primary schools of thought. On the one hand, some economists adopt an "allocative efficiency" view of the world. Under this view, a merger should be approved if the transaction creates net positive efficiencies, thus increasing total wealth on a societal basis irrespective of into whose pocket the newly created wealth goes. On the other hand, there is the "consumer welfare" approach to evaluating mergers. This model asserts that the purpose of merger reviews is to prevent increases in consumer prices due to the exercise of market power.[24] The merger standard discussed above firmly places Missouri into the consumer welfare model.[25]

To recognize efficiencies, the consumer welfare model demands that efficiency benefits be passed-on to consumers. The requirement that merger efficiencies be passed-on to consumers has been repeatedly applied. Typical is the district court's reaction to the United Tote's claim that the merger of two manufacturers of off-track betting equipment would yield efficiencies in research and development, ability to raise capital, and managerial practices. ". . .even if the merger resulted in efficiency gains, there are no guarantees that these savings would be passed-on to the consuming public."[26] So, too, is the district court's holding in *Staples* typical. In approving the FTC's request for a temporary injunction, the district court found that "the defendants' projected pass through rate --the amount of projected savings that the combined company expects to pass on to consumers in the form of lower prices–is unrealistic."[27]

The function of the passing-on requirement is to mandate that consumers benefit directly from a merger. While the passing-on requirement takes on different forms of statement in

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24 Fisher and Lande, "Efficiency Considerations in Merger Enforcement," 71 ***California L.Rev***. 1580, 1592 (1983).

25 When courts require that benefits be passed-on to consumers, they are adopting a consumer welfare standard. Greaney, "Regulating for Efficiency in Health Care through the Antitrust Laws," 1995 ***Utah L.Rev.*** 465, 495 (1995).

26 ***U.S. v. United Tote, Inc.,*** 768 F.Supp. at 1084-1085.

27 ***FTC v. Staples Inc.***, 970 F.Supp. 1066, 1090 (D.D.C. 1997).

various legal opinions, the commonality within all opinions is the mandate that the mergers must "benefit" consumers[28]

Passing-on Analysis Must Take a Merger's Impacts on Services into Account.

Any analysis of how a merged firm will pass-on merger benefits to consumers must take into account the impacts that the merger has on the provision of service. The service impacts resulting from a merger are referred to, in merger law, as "non-price attributes" of the merger. It is not merely the "quality" of service that is to be taken into account. What is to be taken into account involves the type, number, level and quality of service. Merger law consistently recognizes this notion of service-adjusted prices.[29]

Impacts on Service Need Not Affect All Customers to Require Consideration in Merger Proceedings.

No question exists but that the impact that a merger has on the number, type, level and quality of service need not affect all consumers to become a factor to consider in an assessment of merger impacts. Consider, for example, the case of *Nelson v. Monroe Regional Mediical Center.*[30] In *Nelson*, plaintiffs challenged a merger that allowed the merged firm to refuse to treat them except on an emergency basis. This result, according to the 7th Circuit Court of Appeals, was a reduction in output (denying non-emergency care to plaintiffs). According to the court, the

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28 ***FTC v. University Health., Inc.***, 938 F.2d 1206, 1223 (11th Cir. 1991); ***U.S. v. Long Island Jewish Medical Center***, 983 F.Supp. 121, 146, 149 (E.D.N.Y. 1997).

29 *See e.g.*, ***Roland Mach. Co. v. Dresser Indus.***, 749 F.2d 380, 395 (7th Cir. 1984); ***Little Caeser Enter. v. Smith***, 1997-1 Trade Cases (CCH) 79,736; 79,755 (E.D. Mich. 1997).

30 925 F.2d 1555 (7th Cir. 1991), cert denied, 502 U.S. 903, 112 S.Ct. 285, 116 L.Ed.2d 236 (1991).

antitrust analysis would take cognizance of this injury. Judge Cudahy's concurrence specifically states that turning away this "high maintenance," less profitable, more demanding client represented "the very essence of antitrust injury. Although perhaps not a matter of major moment in dollars and cents, the merger and the related refusal to deal strike at the very heart of the evils addressed by the antitrust laws."[31]

Nelson presents the identical types of harms that have been identified with the UtiliCorp/SJLP merger. As one commentator noted, "*Nelson* implicitly recognizes that even though mergers and other forms of competitive collaboration can achieve important benefits for the majority of consumers, they can also create providers that can safely ignore the needs of the uninsured and the hard-to-treat."[32] In considering the passing-on of benefits for UtiliCorp/SJLP, these sub-markets of "high maintenance," less profitable, more demanding clients must be addressed, as DNR discusses in this brief.

DISCUSSION OF THE RECORD EVIDENCE

One piece of record evidence stands out above all else in assessing the propriety of the merger now pending before the PSC.

> The review of impacts arising from the proposed merger has taken place to date with no consideration of the differences in the markets served. The analysis in the direct case has assumed that the merger impacts would arise in the same fashion, and perhaps even to the same degree, for all markets served.

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31 925 F.2d at 1568 (Cudahy concurring).

32 Jacobs, "Rural Health Care and State Antitrust Reform," 47 ***Mercer L.Rev.*** 1045, 1048 (1996).

(Colton Rebuttal, at 7). Given that concession by the Company (Tr. 824 - 825, Vol. 6), the *only* record evidence on the definition of markets, and on the impacts which the merger has on those markets, is that introduced by DNR.

Low-Income Customers Represent a Separate Market

DNR established that low-income consumers represent a separate market, whether one uses the legal test of elasticity or whether one uses the "practical indicia" articulated by *Brown Shoe.*

Elasticity and the low-income market: It is generally recognized that the elasticity of demand is positively associated with the income of consumers. DNR witness Colton testified:

> A number of consumer-side factors distinguish residential customers generally and low-income customers specifically as separate markets. In particular, the elasticity of demand distinguishes these two markets as separate markets. . .The elasticity of demand measures the extent to which consumers can and will turn to substitutes if the price of a product increases. It considers, for example, the ability of consumers to turn to reasonable alternatives to the product in question. It considers the price sensitivity of the product in question as well. There can be no serious dispute that residential customers generally, and low-income customers in particular, have fewer alternatives, and lower price sensitivity, than large user customers in the commercial and industrial classes.

(Colton Rebuttal at pp. 8 - 9). Even aside from a direct measure of demand elasticity, however, Colton testified that the surrogates used for elasticity support the conclusion that low-income consumers are a separate market as well.

> Elasticity can serve as a surrogate measure for a number of different market characteristics. Low elasticity can indicate a lack of meaningful alternatives. It can indicate the presence of high search costs associated with gains of uncertain magnitude or duration. It can indicate high hurdle rates. Demand elasticity is one of the primary measures by which to distinguish different markets.

(Colton Rebuttal at p. 9). Colton finally noted that elasticity is an important consideration in defining markets even within the monopoly situation of a distribution utility.

> The elasticity of demand helps to define a market even within the monopoly situation of a distribution electric and natural gas utility. Low-income customers are less likely to fuel switch. They are less likely to have dual fuel capabilities. They are less likely to reduce consumption. As a result, higher rates and lower levels of service can be imposed with less likelihood to the monopoly utility that consumers will respond by reducing their usage or moving to alternative fuels or fuel suppliers.

(Colton Rebuttal at p. 9).

The "practical indicia" of Brown Shoe: Aside from elasticity and product interchangeability, the U.S. Supreme Court's *Brown Shoe* decision and its progeny have recognized several "practical indicia" of separate markets (or sub-markets). DNR demonstrated that low-income utility consumers meet these "practical indicia," including:

1. *An industry or public recognition of the market as a separate economic unit.* This is certainly true in Missouri for low-income consumers. There is an industry and public recognition of low-income consumers as a separate market (or as a sub-market). Specific procedural protections are provided to low-income consumers with respect to winter service disconnections and the negotiation of payment plans. Special hardship funds are collected for low-income customers facing service terminations. Special energy efficiency programs have been implemented. Not only did DNR witnesses Jackson and Randolph introduce evidence of the industry and public recognition in their direct testimony, but so did Company witness Pella in his surrebuttal.

2. *A product's peculiar characteristics.* As DNR established, the service demanded by low-income consumers is different from the service demanded by residential consumers generally. It would be easy to conclude that the "service" provided by

an electric utility is solely the "service" of providing kWh to the consumer. This approach, however, is too narrow standing alone. (Colton Rebuttal, at p. 10). Colton testified:

> There are multiple service components that low-income consumers use that distinguish them from the residential market generally. The services provided through the Company involving the treatment of payment-troubles are more likely to be used by low-income consumers than by residential customers as a whole. The services provided through the Company involving the need to make personal contact with the Company, whether to deal with payment-troubles or to make monthly payments, distinguish low-income customers from the residential class generally. The services involving the provision of information about public bill-paying assistance distinguish low-income customers from the residential class generally.

(Colton Rebuttal at pp. 10 - 11).

Distinct customers. The reason that there is public and industry recognition of low-income consumers as a separate market, as well as unique characteristics to the service offered to low-income consumers is because low-income consumers are distinct consumers. DNR established: "We know that low-income customers served in Missouri routinely face unaffordable electric and natural gas bills. We know that, at the average 1998 residential bill for UtiliCorp ($899), a LIHEAP recipient with an annual income of $6,000 would bear an electric burden of 15%; with an income of $4,000, the electric burden would be 22%; at $8,000, the burden would be 11%. Given the average 1998 residential electric bill for SJLP, the burdens would be 12%, 17% and 9% respectively. These are simply electric burdens. Home heating burdens are in addition to these electric burdens. These energy burdens tend to lead to payment-troubles with the corresponding need for the customer to avail themselves of Company services." (Colton Rebuttal, at p. 11).

In sum, low-income consumers represent a separate market for merger analysis. Since in order to appropriately review the impacts that will arise as a result of this proposed merger, it is necessary for the PSC to consider all of the relevant markets, the PSC must consider the impacts on the low-income market. In reviewing the proposed merger, therefore, the PSC must: (1) assess whether the merger will generate adverse impacts that impede, at best, the passing-on of merger-related savings in the low-income market; and (2) consider whether the mechanism which the Company has proposed to distribute the dollars of synergy-induced savings disproportionately fails to distribute those savings to the low-income market. We next turn to a review of the record evidence on these issues.

Low-Income Consumers Will be Adversely Affected by the Proposed Merger

The proposed merger of SJLP with UtiliCorp will unquestionably have an adverse impact on the services offered to UtiliCorp low-income consumers. The low-income customers of UtiliCorp are in substantial need of services provided through UtiliCorp customer service representatives. "Low-income consumers frequently require assistance in dealing with their payment troubles. Low-income consumers rely upon the company to deliver a variety of services, including, but not limited to, the negotiation of payment plans, the negotiation of deposits, and the avoidance of service disconnections for nonpayment." (Colton Rebuttal, at p. 17). DNR identified specific affirmative harms that the merger will cause, to the detriment of low-income consumers. "These harms arise from consolidation, remoteness, inflexibility, dilution, and standardization." (Colton Rebuttal, at p. 13).

The Problem of Consolidation

The first adverse impact that Mr. Colton, DNR's witness, identified was the impact which he called "consolidation."

> Consolidation refers to the process of combining functions and offices so that a larger geographic area can be served with a smaller staff in fewer offices. As a company -- be it health care, financial services, or electric utility-- expands its geographic service territory, however, the customer and institutional base to whom it is accountable becomes bigger as well. The larger group to which the firm is accountable is less focused on specific services responding to individualized or localized needs.

(Colton Rebuttal at p. 13).

DNR identified several unique characteristics facing SJLP's Missouri consumers:

> SJLP's residential customers have a more limited safety net of service providers, thus increasing the potential for payment troubles. This safety net includes not only energy assistance providers, but providers of other helping-services (such as food banks and rental assistance) that low-income customers often use as a mechanism to help address their home energy payment troubles.
>
> The SJLP service territory has a lack of local media, thus making consumer education about helping services more difficult. Education about local service providers must be more targeted and more selective than blanket media coverage by large market media outlets.

(Colton Rebuttal at pp. 15 - 16).

Colton then tested the service that would be provided to low-income consumers by the merged SJLP/UtiliCorp company in light of these localized needs.

> In educating customers about winter heating assistance, it is necessary not only to make low-income consumers aware of the assistance generally, but to educate them as to the specific means through which to access the specific energy assistance programs. This involves providing both program names and agency contacts. I know this based on my 20 years of experience in the field. The need was confirmed, as well, by a Penn State University study which identified the concept of "effective knowledge." "Effective knowledge" involves not only conveying information, but teaching consumers how to use that information as well. Consumers must know how to act upon the information they are given. Consumers

> must not have an awareness of energy assistance, in general, but their knowledge must be sufficient to allow them to act. Simply knowing about energy assistance in general is insufficient to provide help if the customers cannot name the specific program where help can be obtained. People who are unaware of programs or who cannot name an agency which they can contact for assistance most likely do not have effective access to help when they need it.

(Colton Rebuttal at pp. 16 - 17).

UtiliCorp, however, does not respond to the localized needs evidenced by the lack of local media and the more limited safety net of providers. Instead, this large multi-state, multi-national company simply does everything the same in providing information about possible winter heating assistance. The Company, for example, publishes a bi-monthly customer service newsletter distributed by UtiliCorp in the states of Colorado, Nebraska, Missouri, Iowa, Minnesota, Michigan and Kansas. The November 1999 newsletter, largely devoted to addressing high winter bills, was identical for all states. No specific (or local) knowledge was provided about how to contact local service providers. "If a customer did not know how to seek out local help before receiving the newsletter, they would not know after receiving the newsletter either." (Colton Rebuttal, at p. 17).

The Problem of Remoteness

The direct case presented by the Company in this proceeding reported that one major area of synergy savings involves the consolidation of the SJLP call center into a larger center serving the larger company. (Colton Rebuttal, at p. 20). DNR explained that increasing the distance between the company call center and the low-income customer will have direct and immediate adverse impacts on the ability of the low-income customer to retain service when faced with payment troubles.

1. Remote negotiations generally occurring by telephone have resulted in greater difficulties in reaching agreement on the immediate and long-term actions which the customer needs to take to avoid service termination. To the extent that the merger increases the physical distance between the utility offering service and the low-income consumer needing to negotiate deferred payments or the avoidance of a service disconnection for nonpayment, the merger will make it more difficult for those consumers to obtain favorable terms.

2. Low-income payment negotiations often depend on the personal relationship between the service provider and the customer service representative. This relationship results in the creation of a trusting relationship and a shared sense of morés (involving customer and company responsibilities). A move to remote customer call centers obliterates these relationships, thus making it more difficult to reach mutually beneficial payment agreements.

3. Low-income crisis resolution often results from referrals to local private sources of energy and non-energy assistance providers. These might include local churches, local community-based organizations, and local providers of services such as food banks and crisis rental assistance. It is virtually impossible for a merged call center to track these local sources of assistance for the low-income payment-troubled customer. Indeed, separate calls to the UtiliCorp 1-800 number did not result in the identification of information about local private energy assistance funds in Missouri, Kansas, Nebraska, Colorado, Michigan or Iowa, the locations about which I inquired.

(Colton Rebuttal at pp. 17 - 18).

Experience with similar results in other locations, Colton testified, has been decreased success in completing payment plans, increased cash security deposits, and an increase in the rate of service terminations for nonpayment. (Colton Rebuttal, at p. 17). In addition, SJLP imposes a late fee on unpaid bills, thus imposing a direct financial cost on low-income consumers who remain in arrears because of the harms arising from remoteness. (Colton Rebuttal, at pp. 20 - 21).

The Problem of Standardization and Loss of Flexibility

In explaining the synergy savings it expects to generate through this merger, the Company indicated that one major area of savings will occur because of "the switch of SJLP customer service operations to the use of the UtiliCorp standard platform to be used by the merged companies relating to customer service." (Colton Rebuttal, at p. 20). "This move to standardized processes can be expected to result in adverse impacts to low-income customers." (Colton Rebuttal at p. 20).

DNR pointed out that this standardization and resulting loss of flexibility will deny low-income customers essential services such as levelized payment plans. Low-income customers virtually uniformly would benefit from their enrollment in levelized monthly billing plans. Not only do such plans take the winter peak out of home energy bills, but they create equal monthly payments that low-income customers can more easily incorporate into their monthly budgets. The levelized plans of Missouri Public Service, however, are less available to low-income customers than are the levelized plans of SJLP. Missouri Public Service Tariff Rule 6.05(B) provides that if a customer has been late on three or more payments within the past 12 months, the customer is not eligible to participate in the Company's levelized budget billing plan. SJLP does not have a similar restriction. Given the greater propensity of low-income customers to be late on multiple payments each year, the move to standardized customer service processes will harm low-income customers. (Colton Rebuttal at p. 20).

DNR pointed out that this standardization and resulting loss of flexibility will impose real financial costs on low-income customers, already burdened with bills that represent an unaffordable percentage of income. While Missouri Public Service Rule 6.09 imposes a late payment charge of 1.5% per month on any unpaid bill, SJLP Rule 5.04 provides for a late payment charge of 1.25% per month. For both companies, the late payment charge is considered to be a customer service rule and not a "rate." (Colton Rebuttal at pp. 20 - 21).

DNR noted that this standardization and resulting loss of flexibility will harm low-income customers as the Companies "standardize their customer service operations and procedures." "Even beyond the tariff provisions identified above, customer service is directly affected by a range of policy and operational decisions which, while affecting customer access to service, are not set out in tariffs. They are, instead, embodied in documents such as customer service staff procedures manuals." (Colton Rebuttal at p. 21).

Colton explained the problem in some detail. The standardization results in the utility:

> being "less focused on specific services responding to individualized or localized needs." (Colton Rebuttal at p. 13).
>
> engaging in "a reduced emphasis on, and focus upon, the specific needs of particular states and localities and the local norms of treating payment-troubled customers." (Colton Rebuttal at p. 14).

"My work with local providers of service to low-income utility customers has found this to be true in areas such as negotiating payment plan terms, establishing creditworthiness, and responding to inability to pay." (Colton Rebuttal at p. 14). "Processes can become more standardized and less flexible either by limiting the demonstrations through which a customer may establish creditworthiness, limiting the processes internal to the Company through which a customer may remedy a finding of non-creditworthiness, or limiting the creditworthiness decisionmaking that may occur at the operational level without need for higher management approval." (Colton Rebuttal at p. 19).

Colton noted that:

> The negotiation of deferred payment plans is one such process. Standardized payment plans, in particular, tend to harm low-income consumers. An increased use of standardized payment plans precludes the ability to respond to the unique situations of particular consumers. Increased payment problems arise as a result.

(Colton Rebuttal at p. 19).

> Low-income consumers often exhibit characteristics that utility companies consider to be adverse credit indicators. Low-income consumers more frequently tend to have bad credit reports for non-utility transactions; are less frequently homeowners; are less frequently financial service customers (checking and banking accounts); and are more frequently recipients of collection treatment. All of these characteristics tend to push low-income customers into a need to establish creditworthiness or to secure bill payment. (Colton Rebuttal at pp. 19 - 20).

As the processes through which customers (or potential customers) can establish creditworthiness become more standardized and less flexible, however, low-income consumers will be harmed. This harm may be in the form of higher prices (such as higher cash deposits) or in the outright denial of service (in the absence of a deposit)." (Colton Rebuttal at p. 19).

Even aside from the specific harms identified by DNR witness Colton -- taking the form of reduced services and higher prices (through cash deposits and late payment fees) -- one additional impact of taking away the local decisionmaking by local customer service representatives based on individualized factors is to constrain the rights conferred upon low-income customers by PSC regulations. At present, low-income customers have certain legal rights under PSC regulations, including:

1. Low-income customers not only have the right to a deferred payment arrangement for arrears, but have the right to have their individual circumstances taken into account in determining what constitutes an "affordable" deferred payment plan;
2. Low-income customers not only have the right to a deposit not exceeding a maximum amount set by regulation, but have the right to have their

individual circumstances taken into account in deciding what size their cash security deposit will actually be;

3. Low-income customers not only have the right to be free from cash security deposits upon a demonstration of creditworthiness, but have the right to have their individual circumstances taken into account in any determination of creditworthiness.

Whenever the PSC regulations require an exercise of discretion in Missouri, the required use of the uniform consolidated data processing system will constrain that discretion. The PSC consumer protection regulations require UtiliCorp customer service representatives to exercise discretion within ranges. Words such as "up to," "at least," and "not to exceed" confer upon Missouri customers a legal right to have decisions made based upon their individual circumstances, and confer upon UtiliCorp customer service representatives a legal obligation to exercise their discretion based upon a consideration of those individual circumstances. Whenever PSC regulations *allow* discretionary decisions to be made about which actions or inactions should occur on the part of UtiliCorp customer service representatives --for example, state utility regulations allow, but do not require, the disconnection of service upon nonpayment--[33] the discretion of the UtiliCorp customer service representative to consider the individual's circumstances is constrained by the uniform data processing system. Whenever consumer protections granted by the PSC regulations require the exercise of judgment based upon individualized circumstances --for example, the terms of deferred payment plans are to be based upon a consideration of the individual's ability-to-pay; the level of a cash deposit required is to

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33 4 CSR 240-13.050(1)

be based upon satisfactory proof of creditworthiness-- the discretion of the UtiliCorp customer service representative to consider the individual's circumstances is constrained by the uniform data processing system.

In sum, the merger constrains the rights conferred upon Missouri customers to have their individualized circumstances taken into account and imposes upon UtiliCorp customer service representatives the obligation to instead work within the constraints of a standardized multi-state data processing system. After the merger, payment-troubled Missouri consumers, who are disproportionately low-income, will be harmed because their right to have their individual circumstances taken into account will have been reduced.

The Problem of Dilution

Aside from the problems associated with consolidation, DNR identified harms accruing to low-income payment-troubled customers as a result of dilution as well. The proposed merger will dilute the resources available to low-income payment-troubled customers of SJLP as the blending of low-income and customer service resources between SJLP and UtiliCorp will likely divert resources from SJLP low-income customers who are less well off than Missouri Public Service low-income customers.

> Dilution of resources available to low-income SJLP ratepayers will occur because the low-income customers in SJLP communities such as St. Joseph live with marginally lower incomes than the similarly situated customers in UtiliCorp communities such as Kansas City. While Kansas City has 27.4% of its households with incomes below $15,000, St. Joseph has 34.6% of its households below $15,000. While Kansas City has 24% of its residents living below 150% of Poverty Level, St. Joseph has 27% of its residents living below 150% of Poverty Level.

(Colton Rebuttal at p. 24).

Through the merger, the companies are combining customer service operations, reducing customer service personnel, and diluting the resources to help address those payment problems. As Colton stated: "combining the customer service functions of the two Companies will direct more resources toward the existing UtiliCorp service territory and fewer resources toward the lower income SJLP customers." (Colton Rebuttal at p. 25).

The conclusion is inescapable. The merged company will be devoting fewer resources to its payment-troubled population. At the same time these resource reductions are occurring, UtiliCorp is being combined with a company that has substantially greater affordability problems and substantially more significant payment-troubles. As a result of the combined effect of this reduction in resources directed toward an increase in payment-troubles, the resources available to deal with the existing UtiliCorp payment troubles will be diluted.

Summary of Harms That Will Impede the Passing-On of Benefits.

The harms identified above have legal consequences within the context of a merger proceeding. The passing-on requirement, discussed in detail above, and imposed upon the PSC by Missouri law, dictates that the review of a proposed merger consider whether the merger will result in *adverse* impacts that will impede the passing-on of benefits to particular markets. This is precisely the situation with the proposed merger now pending before the PSC. The proposed merger will result in adverse impacts that impede the passing-on of merger-related benefits to the low-income market. Indeed, the proposed merger will generate specific affirmative harms to the detriment of low-income consumers.

Low-income consumers frequently require assistance in dealing with their payment troubles. Low-income consumers rely upon the company to deliver a variety of services, taking into account their individual circumstances, including, but not limited to, the negotiation of payment plans, the negotiation of deposits, and the avoidance of service disconnections for nonpayment. For all of the reasons outlined above, the merger will necessarily reduce the legal rights conferred upon payment-troubled customers, will reduce the services available to low-income customers, and will increase the costs imposed upon low-income customers (either in the form of late payment fees or increased cash security deposits). These adverse impacts, standing alone, but certainly in combination with the added merger effect of disproportionately denying low-income consumers their fair share of merger benefits, justify the implementation of CEPP as described below.

Low-Income Consumers Receive a Disproportionately Small Share of the Efficiencies Generated by the Proposed Merger

DNR conclusively established in its testimony that due to the unique attributes of low-income consumers, these consumers will receive a disproportionately small share of the merger benefits unless specific actions are taken to capture and distribute those benefits. The merger proposal initially involves "sharing" the savings generated by the merger with customers through the mechanism of a rate freeze. This mechanism, in effect, allocates merger savings back to individual customers on a per unit of energy basis. If a customer uses more energy, under the theory of distributing benefits via a rate freeze (or a rate rollback in the longer-term), which the Company claims will happen, a customer receives a higher proportion of the savings returned to him or her in the form of a bill that is lower than it would have been without the merger.

Low-Income Consumers Receive a Disproportionately Small Share of Merger Savings.

According to Company witness Siemek, one of the major areas of merger savings lies in the area of general and administrative synergies. (Siemek Direct at pp. 10 - 11). These savings include "eliminating activities needed by SJLP as a stand alone entity that are not needed separately as a division of UtiliCorp." (Siemek Direct at p. 11). An example of such an activity that will be eliminated, as cited by witness Siemek, is "information systems for billing, financial reporting and managing operations." (Id.; cf., Siemek Direct at p. 14). Siemek reports that there will also be operating costs savings "from eliminating the separate departments for SJLP and utilizing staff for existing and projected vacancies of approved UtiliCorp positions." (Siemek Direct at p. 13). In addition to these Information System synergies, Company witness Siemek testified that a major area of synergy savings comes in the distribution area. (Siemek Direct at p. 17). Included within these distribution savings are synergies relating to the use of Company call centers. (Id.)

A distribution of savings generated from such activities on a per unit of energy basis, however, provides a disproportionately small benefit to low-income consumers.

> Customer service costs are incurred as a function of numbers of customers. Indeed, the allocation of customer service costs on the basis of both usage (in units of energy) and sales (in dollars of revenue) are inappropriate as cost allocators for customer service costs. In addition, the proper cost allocation for CIS projects involves the number of customer bills. The proper allocation of IS savings involving distribution and delivery is the number of customers. If benefits are produced based on numbers of customers or customer bills, but distributed on a per unit of energy basis, those customers (or classes of customers) with higher consumption will receive a disproportionately *high* share of the benefits and those customers with lower consumption will receive a disproportionately *low* share.

* * *

> Clearly, if you have a certain sum of benefits that are causally related to numbers of customers and you distribute those benefits *between* customer classes (*e.g.*, industrial, commercial) on the basis of units of energy, some "residential" benefits will be distributed to the high use industrial and commercial customers. The same is true *within* a ratepayer class as well. If you have residential savings (such as customer service savings) that are produced on the basis of numbers of customers, and if you then distribute those benefits on the basis of units of energy consumption, there will be a disproportionate distribution of benefits to high use customers.

(Colton Rebuttal at pp. 27 - 28).

It is universally found that low-income customers use less energy on a per household basis than do average residential customers. Consider, for example, the Residential Energy Consumption Survey (RECS) prepared by the Energy Information Administration of the U.S. Department of Energy (EIA/DOE). The RECS reports that for the New England Census Division of the Northeast Census Region --this is the Census Division of which Missouri is a part-- energy consumption by low-income households is less than that for the average household. According to the annual report to Congress by the Low-Income Home Energy Assistance Program (LIHEAP), a program within the Administration for Children and Families of the U.S. Department of Health and Human Services (ACF/HHS), energy consumption by low-income consumers is only 87% as high as for the average household. (Colton Rebuttal at pp. 28 - 29, and Schedules RDC-4, RDC-5 and RDC-6).

> This disparity in merger savings has a direct adverse impact on low-income consumers. One can thus compare the low-income "share" of merger savings *generated* as a function of numbers of customers but which are, in fact, *distributed* on a per unit of energy basis. . .low-income customers represent 20% of all customers, while they represent only six percent (6%) of all electric use. On a per thousand dollar basis, therefore, if benefits are distributed on the basis of usage (6%). . .rather than numbers of customers (20%), low-income customers will "lose" roughly $140.

(Colton Rebuttal at pp. 29 - 30).

Summary of Harms Resulting from the Inequitable Sharing of Merger Savings.

The distribution of a disproportionately small share of the merger savings to low-income consumers violates the principle that merger synergies be passed-on to consumers in a fair and equitable fashion. This disproportionate sharing of savings, standing alone, violates the passing-on requirement. However, when viewed in combination with the affirmative harms discussed above, this inequitable sharing shows that the companies have not shown that the merger is in the public interest.

DNR's Proposed community Energy Partnership is an Appropriate Mechanism through which to Remediate both the Affirmative Harms Caused by the Merger and the Inequitable Aharing of Savings.

DNR's Proposed Community Energy Partnership Program (CEPP) Mitigates the Adverse Impacts Found to Result from this Proposed Merger.

DNR's CEPP is a mechanism designed to remediate the two results which DNR found adversely affected the low-income market. The CEPP involves a package of remedies that includes:

1. Implementation of a 25-site BOSS pilot project, with a commitment to expand the program as appropriate if found to successfully deliver benefits to low-income customers;
2. Implementation of a space heating and base load energy efficiency program directed toward high use payment-troubled low-income customers;
3. Implementation of a pilot solar energy program directed toward high use low-income customers;

4. Implementation of a periodic survey process through which the merged Company will take proactive efforts to identify which of its payment-troubled customers represent low-income households;

5. Implementation of an Outcome-based Performance Reporting System (OPRS) through which the customer service outcomes to low-income customers can be systematically tracked over time.

The CEPP components are all specifically designed to remediate the two issues identified by DNR: (1) the creation of affirmative harms, and (2) the misallocation of benefits. The CEPP components break the line of causation between the merger and the harm. The impacts of the CEPP components are to reduce the need for relying on the merged Company's customer service network and mitigate the problems associated with consolidation, remoteness and dilution.

BOSS / Chronicles

The proposed BOSS program remediates the harms caused by the merger by providing the Company with the ability to respond to payment troubles with flexibility, integration and personalization. It provides the company with flexibility, through the capacity to customize both the types of response and the degree of response to individual circumstances. It provides the Company with the ability to call upon different resources to deal with individual customer's specific inability-to-pay problems. It will enhance the ability of the Company to match specific resources with specific problems. It will enhance the ability of the Company to identify individual needs and craft an appropriate individualized response to those needs. Each of these addresses the harms specifically imposed by the merger on low-income consumers.

Energy Efficiency

The proposed space heating and base load energy efficiency program remediates the harms caused by the merger as well. DNR proposed an energy efficiency program for low-income high use payment-troubled customers modelled after the Smart Comfort Program implemented by Duquesne Power Company. (Colton Rebuttal at p. 36).

> The Smart Comfort program is targeted to low-income non-electric-heating customers with monthly bills exceeding $70. Trained company personnel visit qualified homes to provide energy education on energy saving opportunities specific to the customer's home, as identified by a walk-through energy audit. New refrigerators are provided if metering at the time of the premise visit identifies the existing appliance as being energy inefficient. Duquesne has found that the primary technical sources of savings include lighting, refrigerator replacement and replacing water beds with conventional bedding.

(Colton Rebuttal at p. 37). The program is highly cost-effective in its own right. It has generated mean energy reduction (pre- to post-) of 37 percent. The average utility program cost in 1994 was approximately $1,100 per household, which resulted in an average annual bill reduction of $356 per household. The levelized cost of saved energy to the utility is approximately $0.03/kWh of saved energy. (Colton Rebuttal at p. 37).

As a remediation mechanism, however, the program is extraordinarily successful. In addition to the energy savings, the program was found to have a substantial positive impact on arrears. During the pilot stage of the program, participants had paid an average of 78 percent of their total billing prior to their program participation. After participating in the program, customers were paying 106 percent of the total billing (meaning that they were paying their entire current bill plus retiring arrears). (Colton Rebuttal at p. 38).

> This program has several attributes which commend its adoption. First, it is specifically directed toward mitigating the merger harms. . .It is directed toward payment-troubled customers who otherwise would be calling upon the reduced

> services of the company. Second, it has a proven track record of success in helping customers to address those payment-troubles. We thus *know* that it will succeed in doing what it purports to do: moving low-income customers away from a reliance on those services. Third, it generates substantial and demonstrated additional benefits to the company. This program, in other words, can accomplish the mitigation which the Department of Natural Resources seeks while at the same time helping to improve the company's competitive position, which is what it seeks. Finally, it directs the mitigation measures toward, and achieves the benefits for the Company from, a class of customers that is not historically reached through low-income weatherization initiatives, *i.e.*, low-income electric baseload customers.

(Colton Rebuttal at p. 38).

Renewables Pilot

The renewables pilot is an appropriate remedy for the passing-on problems identified by DNR in this proceeding as well. When PV can reach the necessary critical mass for reducing the cost and thus the payback time, it promises to address not only affordability concerns, but environmental concerns as well. Moreover, distributing merger synergy savings to low-income customers in the form of a PV pilot will allow the merged Company to test a mechanism for addressing affordability concerns that addresses many of the issues DNR identified in its testimony. PV is a low-maintenance installation. It does not require complex interactions between customers and machines to deliver its benefits. It does not readily break down. If these qualities persist, the ease of maintenance, both rural and urban, will be a significant value to this resource. With respect to solar hot water, these technologies are proven. What is not yet understood as well is the viability of these installations in rental situations and existing low-income housing stock of various kinds. (Colton Rebuttal at p. 40).

Low-Income Tracking

The low-income survey process will help to remediate the harms caused by the merger. This process is designed to identify the low-income payment troubled customers on the Company's system. At present, the Company has no information that allows it to track whether the customer service outcomes identified above will arise for low-income consumers in particular. Because of the customer service implications associated with being able to identify and track these customers, DNR has proposed an affirmative, proactive process that provides for such identification and tracking. (Colton Rebuttal at p. 41).

Outcome-Based Performance Tracking

The Outcome-based Performance Reporting System (OPRS) is the final remediation measure. For all of the reasons DNR has outlined above (with respect to consolidation, remoteness, a lack of flexibility, dilution, and standardization), substantial evidence exists that the merger will adversely affect customer service relative to the payment troubles of low-income customers. I have proposed a series of remedies to mitigate those harms. In addition, however, the Company's *performance* should be tracked. As described above, "satisfactory" performance is when performance relative to the low-income population is no worse than performance relative to the total Company residential customer population. (Colton Rebuttal at p. 43).

DNR's Proposed Energy Efficiency Program Should be Adopted as Mechanism through which Merger Benefits Can be Passed-on to Residential Ratepayers.

In addition to the CEPP, the Department of Natural Resources would not oppose the proposed SJLP/UtiliCorp merger, so long as:

> there are no detrimental impacts on the price of energy to low-income and residential customers;

> the companies make every reasonable attempt to offer and provide cost-effective energy-efficiency programs for both residential and low-income residential customers; *and*
>
> the companies make every reasonable attempt to evaluate and implement potential alternative- or renewable-energy-based electric generation projects,
> in the event that the proposed merger is approved by the PSC.

(Randolph Rebuttal at p. 4).

These merger conditions are important because a merger must ensure that there is no detriment to the public. Missouri, however, imports in excess of 95 percent of all of its primary energy resources to sustain the state's economy, its basic day-to-day activities, and its quality of life. Missouri ranks as the 16th largest consumer of energy per capita in the nation, spending more than $10 billion each year. Missouri citizens spend nearly 11 percent of their income on energy. "Most of this money leaves Missouri because of our dependence on energy from sources outside of Missouri." (Randolph Rebuttal at p. 6). The merger of a local utility such as SJLP with a multi-state, multi-national company such as UtiliCorp will exacerbate this economic drain from the state and will thus result in a detrimental impact to the state unless specifically mitigated.

The energy efficiency and renewable proposal advanced by DNR will mitigate the harms identified as arising from the merger. As Anita Randolph, Director of the Missouri Energy Center (a component of DNR) testified: "Increased availability and use of many of these renewable and alternative energy sources can increase Missouri's energy independence, keep more energy dollars at home, and help Missourians make environmentally sound energy choices." (Randolph Rebuttal at p. 8). Randolph testified: "Energy efficiency and increased use of alternative energy benefit the Missouri economy by keeping energy dollars closer to home and giving us diverse energy choices that strengthen our energy independent." (Randolph Rebuttal at p. 9).

In addition to responding to the adverse impacts of the merger on draining economic resources from the state, the energy efficiency and renewable proposal by DNR will generate several positive benefits as well.

> A first set of positive benefits, in addition to redressing the harms of the merger resulting from the dollar drain identified above, involves environmental impacts. "Energy, the environment, and the economy are inextricably linked," she said. "Energy production and use account for more than 75 percent of air pollution. Electric power plants were the state's leading source of carbon emissions from primary consumption of fossil fuels in 1990. As Missourians use energy, we annually emit about 133 million tons of carbon dioxide into the air." (Randolph Rebuttal at pp. 7 - 8).
>
> A second set of positive benefits, in addition to redressing the harms of the merger resulting from the dollar drain identified above, involves benefits to low-income consumers.
>
> > Roughly 355,000 low-income housing units remain to be weatherized in Missouri. The Weatherization Assistance Program serves approximately 2,000 units statewide each year. If this rate continues, if no weatherized home ever needs to be re-weatherized, and if no expansion in Missouri's low-income population occurs, these un-weatherized homes will all be treated with energy-efficiency improvements by the year 2109, roughly 109 years. Clearly, on-going and additional sources of low-income energy efficiency services are needed.
> >
> > In the SJLP service territory in particular, there are more than 18,500 elderly citizens eligible for assistance, of whom 6,000 are handicapped. At current resource levels, it would take approximately 205 years to serve the St. Joseph Light & Power low-income residential clients. (Randolph Rebuttal at p. 11).

In sum, DNR established that the ongoing consumption of electric power has an adverse economic impact on the state of Missouri as dollars are drained from the state's economy. Through this merger, those adverse impacts will be exacerbated as a small local utility is merged with a multi-state, multi-national company. As a remediation measure, or at least a measure that can mitigate these impacts, DNR has proposed that the merger be conditioned on the offer of additional residential energy efficiency investments by the merged company. These investments will directly remediate the adverse economic impacts that have been identified.

> Well-designed energy efficiency programs have been shown to produce substantial economic benefits for local and state economies. The Missouri Statewide Energy Study prepared by Missouri's Environmental Improvement and Energy Resources Authority concluded that energy efficiency would 'sustain more employment opportunities than either the continued current level of energy use or the development of new energy supplies.'

(Randolph Rebuttal at pp. 20 - 21). Accordingly, DNR requests that, in addition to the CEPP discussed above, any merger approval be specifically conditioned on UtiliCorp establishing a specific partnership with the Missouri Energy Center to market and leverage funds for the development of residential energy efficiency programs. This partnership should include a process that will identify cost-effective energy efficiency programs and that will implement those programs were appropriate. (Randolph Rebuttal at p. 25).

DNR would propose that the process begin within 30 days after entry of a final order in this proceeding. If no collaborative agreement has been reached by December 31, 2000, the Energy Center and UtiliCorp should submit proposals to the PSC within 30 days after that deadline for determination by the PSC of what level of residential energy efficiency funding is justified as a means to implement the requested partnership.

Programmatic Remedies are Common in Merger Cases.

Programmatic merger conditions such as those advocated by DNR in this proceeding are a common response to the types of problems identified by DNR. In California, for example, the SBC/Pacific Bell merger was specifically conditioned on the implementation of a Community Partnership Commitment, under which PacBell promised to fund $80+ million in education and community technology projects over the next ten years. (A description of the Community Partnership Commitment was provided at Colton Rebuttal, Schedule RDC-8.) Similarly, in Ohio, based on testimony regarding the disproportionate sharing of merger savings for the poor, the stipulated agreement endorsing the proposed SBC/Ameritech merger was conditioned on Ameritech's funding a $12+ million commitment to consumer education, technology diffusion, and community computer centers.[34]

These telecommunication merger agreements were specific responses to specific adverse impacts that would have been caused or substantially exacerbated by the proposed mergers. The mergers were explicitly proposed as one mechanism to facilitate the development and distribution of high technology telecommunication services. The information presented in the merger proceedings, however, demonstrated the existing and widening technology gap for low-income consumers. As a result, the benefits of the merger were found to be largely denied to low-income consumers. The Community Partnership Agreement, as well as the Ameritech-Ohio programmatic

34 I/M/O Joint Application of SBC Communications Inc, SBC Delaware, Inc., Ameritech Corporation and Ameritech Ohio for Consent and Approval of a Change of Control, Case No. 98-1082-TP-UNC, Public Utility Commission of Ohio (1999).

commitments, were the mechanisms for assuring that the adverse effects of each merger, which impeded the passing-on of merger benefits, were redressed.

The programmatic responses have not been confined to telecommunications cases. For example, in February, 2000, the Colorado Public Utilities Commission (PUC) approved a settlement between Public Service Company of Colorado (PSCO) and low-income groups addressing a host of low-income issues. The settlement of the PSCO merger included funding for (1) low income energy assistance; (2) low income energy efficiency programs; (3) computers and training to energy assistance agencies to review a client's account, determine an appropriate assistance amount, and communicate financial commitments to PSCO customer services staff; and (4) a pilot low-income rate affordability project directed toward testing cost-effective means of delivering rate assistance to low-income consumers. In addition, the settlement required the company to make annual reports on low-income payment troubles, including termination of service, payment agreements, arrears, PSC complaints, energy efficiency and rate affordability program impacts.

Finally, as DNR witness Colton noted, programmatic remedies are common responses to adverse impacts that adversely affect distinct markets in a merger setting. Consider, for example, the recent merger of Butterworth Health Corporation with Blodgett Memorial Medical Center in Michigan.[35] In that proposed merger, the principal claim of "efficiency savings" involved claims of "capital avoidance." Concerns were raised, however, that the capital avoidance really involved

35 946 F.Supp. 1285 (W.D. Mich. 1996), *aff'd per curiam*, 121 F.2d 708 (6th Cir. 1997).

excluding the offer of products and services that consumers would otherwise demand from an unmerged hospital.

In response to these concerns, the federal court hearing a challenge to the merger required the merging hospitals to enter into a consent decree to implement a "Community Commitment" plan proposed by the hospitals as a condition of allowing the merger to proceed. The Community Commitment provided a binding commitment by the hospitals "not to raise prices *or otherwise injure the community*. . ." (emphasis added). The Community Commitment has five elements: (1) a freeze on prices and charges; (2) a freeze on prices to managed care plans to pre-merger levels; (3) a commitment to limit margins; (4) a commitment to the medically underserved and needy;[36] and (5) a commitment to governance of the merged hospitals with community input. In the decision approving the merger, the court found that the hospitals' Community Commitment plan *partially* described how efficiencies achieved would benefit all consumers. The court required the merging hospitals to enter into the consent decree partially to ensure that they complied with the plan's commitment to pass along benefits to consumers.

Similarly, the merger of two corporate parents of three hospitals in central Pennsylvania was only allowed by the Pennsylvania Attorney General's office on the condition that the merged entity pass on at least 80% of the net savings to consumers through reduced prices (or limited actual price increases for existing services), and low-cost or no-cost health care programs for the indigent;[37] In addition, Massachusetts settled its objections to the merger of that state's second

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36 The merged company will provide a minimum of $6.0 million each fiscal year to assist the underserved and general community. The funds are distributed through 30 specific programs to address specific locally-identified needs.

37 ***Pennsylvania v. Providence Health Sys.***, No. 4CV-94-772, 1994 WL 374424, at (continued...)

and third largest HMOs on the latters' agreement to freeze group rates for one year, double enrollment in the Medicare risk program, and spend $4 million on services placed at risk by the merger, such as health care for the homeless, violence prevention, and AIDS prevention.[38]

While DNR Has Proposed that the Costs be Netted Against Merger Savings, That is Not the Only Mechanism for Treating the Expenses Associated with DNR's Proposed CEPP.

DNR has proposed that the costs of its Community Energy Partnership Program (CEPP) be paid out of merger savings. (Colton Rebuttal at p. 51).

This process, however, is not the exclusive process that can be used as a mechanism for paying for the programmatic costs. An additional mechanism, for example, would be to capitalize the costs and amortize those costs over a longer period of time. It would be possible to fully expend the CEPP budget in the first three years, capitalize it, and amortize it over ten years if the PSC wanted each year of expenditures to be less.

Amortizing the costs of the CEPP in this fashion makes eminent sense. The affirmative harms generated by the merger may be viewed as economic externalities arising as a result of the merger. When viewed in this fashion, the costs of the CEPP are merely remediation costs, or part of the costs to achieve the merger savings. The cost of programs to remediate the externalities could rationally be considered costs to achieve and could be amortized over some period of time.

It would be possible, even, to allow the Company to defer netting the CEPP program costs against merger savings until *after* its proposed rate freeze. In this fashion, the Company is

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[37](...continued)
2-3 (M.D. Pa. May 26, 1994); *see also*, ***Pennsylvania v. Capital Health Sys. Servs.***, No. CIV.A.4:CV-95-2096, 1995 WL 787534 (M.D.Pa. Dec. 15, 1995).

[38] Merging HMOs Agree to State Plan on Social Spending, Contract Approvals, 4 ***Health L. Rep. (BNA)*** 6 (Jan. 20, 1995).

allowed to keep the merger savings during those rate freeze years as a means of recouping its acquisition premium. Moreover, the deferred costs could be amortized over a reasonable period of time, the length of which could be a litigated issue (if need be) in the rate case at the end of the stayout period.

Summary and Conclusions.

Merger analysis requires defining the markets that will be affected by the merger and deter-mining the impacts of the merger on those markets. DNR has demonstrated that there is a distinct low income market (or submarket). DNR has further demonstrated that the merger will cause adverse impacts on the low income market. These adverse impacts impede the passing-on of merger savings to the low income market.

DNR has further demonstrated that merger synergy savings are not being fairly allocated to the low income market. The distribution of such a disproportionately small share of savings violates the Missouri requirement that a just and reasonable amount of savings be received by all UtiliCorp customers.

The harms resulting from the adverse impacts of the merger and the unfair allocation of merger benefits to low income customers provide independent grounds for the programmatic merger remedies proposed by DNR. The Commission should therefore condition approval of the merger on the adoption, in whole or in part, of the proposed Community Energy Partnership Program.

In addition to the low-income specific harms identified by DNR, DNR has demonstrated that one harm of the proposed merger is the further economic drain caused by exporting energy dollars out-of-state. As a small local utility is merged into a large, multi-state, multi-national company, Missouri dollars will flow out-of-state, thus weakening the economy, reducing the number of available jobs, and reducing spendable income. DNR established that an appropriate remediation measure for these merger-induced harms is the funding of residential energy efficiency through a partnership between the Missouri Energy Center and the merged companies. The specific dollar commitments to be made through partnership is proposed to be determined by a collaborative process to be convened within 30 days of the entry of a final order in this proceeding, with resource to the PSC should agreement not be reached by December 31, 2000.

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