LAW OFFICES
BRYDON, SWEARENGEN & ENGLAND
PROFESSIONAL CORPORATION
312 EAST CAPITOL AVENUE
P.O. BOX 456
JEFFERSON CITY, MISSOURI 65102-0456
TELEPHONE (573) 635-7166
FACSIMILE (573) 635-0427

DAVID V.G. BRYDON
JAMES C. SWEARENGEN
WILLIAM R. ENGLAND, III
JOHNNY K. RICHARDSON
GARY W. DUFFY
PAUL A. BOUDREAU
SONDRA B. MORGAN
CHARLES E. SMARR

DEAN L. COOPER
MARK G. ANDERSON
TIMOTHY T. STEWART
GREGORY C. MITCHELL
BRIAN T. McCARTNEY
DALE T. SMITH

OF COUNSEL
RICHARD T. CIOTTONE

October 31, 2000

FILED[2]
OCT 31 2000
Missouri Public
Service Commission

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

Re: EM-2000-369

Dear Mr. Roberts:

Enclosed for filing on behalf of UtiliCorp United Inc. and The Empire District Electric Company, please find an original and eight (8) copies of UtiliCorp's and Empire's Initial Brief.

Copies of this filing will be provided to all parties of record.

Would you please see that this filing is brought to the attention of the appropriate Commission personnel.

I thank you in advance for your cooperation in this matter.

Sincerely yours,

James C. Swearengen

James C. Swearengen

JCS/lar
Enclosure
cc: All Parties of Record

DRAFT
10/30/00

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

In the matter of the Joint Application of UtiliCorp United Inc. and The Empire District Electric Company for authority to merge The Empire District Electric Company with and into UtiliCorp United Inc. and, in connection therewith, certain other related transactions.	)))))))	Case No. EM-2000-369

FILED
OCT 31 2000
Missouri Public
Service Commission

**INITIAL BRIEF OF UTILICORP UNITED INC. AND
THE EMPIRE DISTRICT ELECTRIC COMPANY**

**James C. Swearengen, Mo Bar #21510
Gary W. Duffy, Mo Bar #24905
Dean L. Cooper, Mo Bar #36592
Brydon, Swearengen & England PC
312 East Capitol Avenue
P.O. Box 456
Jefferson City, Mo 65102
573/635-7166
573/635-0427 (Fax)
Lrackers@brydonlaw.com**

TABLE OF CONTENTS

I. STATEMENT OF THE CASE

On December 15, 1999 UtiliCorp United Inc. ("UtiliCorp") and The Empire District Electric Company ("Empire") (sometimes jointly referred to as "Applicants"), filed a Joint Application with the Missouri Public Service Commission ("Commission") wherein the Applicants request authority to merge Empire with and into UtiliCorp, with UtiliCorp being the surviving corporation, all pursuant to the terms of an Agreement and Plan of Merger dated May 10, 1999 ("the Merger Agreement"). By its Order issued December 16, 1999, the Commission directed that notice of the Joint Application be provided to the public and that interested persons have an opportunity to intervene and participate in the Commission proceedings. Thereafter, various parties timely filed for leave to intervene and participate in this case. Evidentiary hearings were held before the Commission on September 11-15, 2000. At the conclusion of the hearings, briefs were ordered filed.

II. STATUTORY AUTHORITY AND COMMISSION STANDARD

The Joint Application was filed pursuant to Section 393.190, RSMo, 1994 which provides in pertinent part:

> 1. 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.

In determining whether to authorize a merger under § 393.190, RSMo, the Commission is required by law to determine whether the transaction is "detrimental to the public," the standard established by the Missouri Supreme Court in *State ex rel. City of St. Louis v. Public Service Commission*, 73 S.W.2d 393, 400 (Mo. 1934). Since 1934, this Commission has historically and repeatedly recognized the "not detrimental to the public" standard as the only test to apply in merger and acquisition cases[1] and the appropriateness of this test or standard is not an issue in this case.

In addition, there is no issue in this case as to what is meant by the term "detrimental to the public." "Detriment" means "higher rates and/or a deterioration in the level of customer service," and this is the manner in which this Commission has interpreted and applied the standard in prior cases. *See Laclede Gas Company* Case No. 17, 267, 92 P.U.R. 3rd 426. Also, the "public" involved in considering whether there is detriment is the "consuming public" or "ratepayers." *See In the matter of the application of Continental Water Company* 19 Mo. P.S.C. (N.S.) 192; *Re GTE Corporation* 121 P.U.R. 4th 54; *Re Kansas Power & Light Company* 126 P.U.R. 4th 385.

III. OVERVIEW

In recent years, Empire has followed the developments in the utility industry that have resulted in increased competition in the markets for electricity. These changes have impacted prospects for effective competition for companies the size of Empire visavis larger utilities. As a result, Empire began to develop strategic alternatives including possible business combinations. As other transactions were announced in the region, it became apparent that it would be advantageous for Empire to combine with a larger company. (Ex. 1, p. 4). UtiliCorp desires to accomplish this transaction to further its corporate strategy to make UtiliCorp a world-class utility in the mid-continent region. (Ex. 14, pp. 4-6). The goal of both companies is to build a larger and stronger Missouri-based utility with increased operational efficiencies which will ultimately benefit customers through continued high quality, low cost service. The companies are firmly convinced

[1]See Appendix A

that all stakeholders will benefit from the merger which will ensure that customers are served by a Missouri-based company and as a consequence the transaction will boost the long term economic development of Kansas City and the entire State. (Ex. 1, pp. 8-9; Ex. 14, pp. 6, 20).

The Commission must approve the proposed merger between UtiliCorp and Empire unless it is shown by competent and substantial record evidence that the transaction would be detrimental to the public interest. *See, State ex rel. St. Louis v. Public Service Commission,* supra. In other words, in order for the Commission to reject the proposal, it must be demonstrated that ratepayers will suffer higher rates and/or deterioration in the level of service. Conversely, there is no requirement that the Commission find that ratepayers will be benefitted from the transaction. *Id.*, 73 S.W.2d at 393.

Based on this standard, it is clear that the transaction must be approved. There is no evidence which would tend to show that UtiliCorp will be unable to provide safe and adequate utility service in the Empire service area. In fact, the evidence is that UtiliCorp will be able to provide safe and reliable service. Under UtiliCorp's proposed Regulatory Plan, the evidence is that there will be no increase in customer rates for a period of at least five years after the Pre-Moratorium rate case, the electric rate case which Empire will file on or about November 3, 2000.

The Commission has recognized that the status quo, with no change in rates or quality of service, at least for the immediate future, will satisfy the "not detrimental to the public interest test." *See Re Laclede Gas Company*, Case No. 17, 267, December 16, 1971; 92 P.U.R.3rd 426. The Missouri Supreme Court has held that utility customers are not guaranteed the status quo in the furnishing of their utilities. *See Public Service Commission of Missouri v. State,* 715 S.W.2d 482 (Mo. banc. 1986).

Upon the conclusion of the moratorium, in the context of the Post-Moratorium rate case, synergy savings that will be created from the merger will guarantee, at a minimum, a \$3.0 million reduction in cost of service for Empire's customers system-wide thus clearly creating a benefit from the transaction. (Ex. 4, p. 7).[2]

IV. THE TWO KEY QUESTIONS

There are two key questions which the Commission must decide in this case. The first is whether the merger should be approved under the "not detrimental" standard. The second is "if the merger is approved, under what conditions?"

Two overall arguments against the transaction have been raised by the other parties to this case. First, it is alleged that the costs of the transaction exceed the benefits and the merger should be denied on that basis. Second, it is alleged that if the merger is approved, the proposed Regulatory Plan under which the acquired properties would be operated is contrary to the public interest and should be rejected.

A. Should the Merger be Approved? -- Costs vs. Benefits

The threshold question of whether the merger should be approved, from the perspective of the Commission Staff ("Staff") and the Office of the Public Counsel ("Public Counsel"), is tied to the question of "Costs vs. Benefits." The "Costs vs. Benefits" question turns on whether under reasonable assumptions, the estimated merger savings exceed the estimated merger costs.

The Staff and Public Counsel argue that when "appropriate" adjustments are made to UtiliCorp's estimates of merger savings and costs, the savings do not exceed the costs and as a

---

[2]Empire provides electric service in Missouri, Kansas, Oklahoma and Arkansas.

consequence the transaction should be denied. UtiliCorp, on the other hand, submits that the overwhelming weight of the competent and substantial evidence demonstrates that merger savings will exceed the merger costs.

The question, however, is not really relevant to the Commission's decision whether to approve the merger because under the proposed Regulatory Plan UtiliCorp will bear the responsibility and risk of generating merger synergies, quantifying them properly and providing that information to the Commission in future rate proceedings. If UtiliCorp cannot create savings and prove to the Commission that these savings have resulted from the merger, then UtiliCorp will not be permitted to "fund" the premium with synergies and achieve any premium recovery through rates. Regardless, however, the existing Empire customers are guaranteed a system-wide \$3.0 million in reduction of cost of service.

In this regard, it should be kept in mind that as indicated under the Regulatory Plan a five year rate moratorium will be put in place at the conclusion of the Pre-Moratorium rate case. Obviously there will be no rate impact on customers during this five year rate freeze regardless of whether costs exceed benefits. Consequently, the "not detrimental to the public interest" test from a rate standpoint is clearly satisfied for this five year period. Moreover, under UtiliCorp's Regulatory Plan, the worst case scenario would be that none of UtiliCorp's projected merger synergies result. In those unlikely circumstances, while none of the premium costs would be included in rates, customers of the Empire operating unit would still receive a benefit because the Regulatory Plan guarantees an annual system-wide \$3.0 million cost of service reduction in years 6-10 after the conclusion of the Post-Moratorium rate case.

Finally, the Staff's argument that the costs of the transaction exceed the benefits, and thus, approval of the merger will necessarily result in higher rates for customers of the Empire unit, was in essence abandoned by the candid admission of the Staff's own witness, Mark Oligschlaeger, who testified on several occasions that if the merger were approved any effort to show that Empire rates would have been lower if the merger had not occurred cannot be demonstrated with reasonable accuracy. (Tr. 594-598).

Based on the evidence, the Commission should have no trouble in determining that the proposed merger meets the "no detriment" test; that reasonably anticipated benefits to customers will exceed costs; that under the proposed Regulatory Plan the customers will benefit through a cost of service reduction regardless; and that customers are ultimately protected, in any event, by the fact that rates for the Empire unit cannot increase without the Commission's authorization.

B. <u>The Regulatory Plan - - Summary</u>

Given that the proposed merger between UtiliCorp and Empire easily satisfies the "no detriment" test and should be approved, the proposed Regulatory Plan, the plan under which the acquired Empire properties will be operated, becomes the focus in this case. The Regulatory Plan can be summarized as follows:

- A five year rate moratorium for the Empire retail electric energy distribution unit will be put in place on the effective date of the Pre-Moratorium rate case. The Pre-Moratorium rate case will be timed to recover the costs associated with Empire's State Line Combined Cycle plant ("SLCC") which is now anticipated to be in service on or about June 1, 2001. Certain details concerning the Pre-Moratorium rate case, which are a part of the Regulatory Plan and for which Commission approval is sought in this merger docket, are set out on Appendix B.

- During the fifth year of the rate moratorium, UtiliCorp will initiate a general rate case for the retail electric operations of the Empire unit ("the Post-Moratorium rate case") with the new rates to take effect at the conclusion of the moratorium. The rate filing will include an accounting of the merger synergies realized during the moratorium period and the balance of the acquisition premium yet to be recovered;

- In the rate cases and for ratemaking purposes, fifty percent (50%) of the unamortized balance of the acquisition premium paid by UtiliCorp for Empire will be included in the rate base of Empire's retail electric operations and the annual amortization of this acquisition premium will be included in the expenses allowed for recovery in cost of service.[3] The return allowed on this premium, for the recovery period, will be based on the capital structure of sixty percent (60%) debt and forty percent (40%) equity.

- The balance of the retail electric, gas and steam rate bases will be allowed a return based upon an Empire unit capital structure as found and determined by the Commission in the Pre-Moratorium rate case.

- The allocation of UtiliCorp's corporate and intra-business unit costs to UtiliCorp's Missouri Public Service ("MPS") operating division shall exclude for ratemaking purposes the Empire factors from the methodology for the period covered by the Regulatory Plan.

(Joint Application paragraph 15; Ex. 4, pp. 6-8).

<u>What The Plan Is Designed To Do and Why It Is Necessary</u>

The Regulatory Plan is designed to make the merger transaction economically feasible from UtiliCorp's standpoint while at the same time ensuring that the Missouri customers of UtiliCorp and Empire are not exposed to any downside risk and that the Empire customers will realize some benefits as synergies materialize.

At the outset, it must be understood that UtiliCorp's shareholders will in effect invest approximately \$850-\$900 million to acquire the ownership of Empire. (Ex. 14, p. 8; Ex. 3, p. 3). This purchase price reflects a premium of approximately \$280 million (Ex. 3, p. 3). Were it not for the agreement to pay this acquisition premium, the merger agreement would not have been agreed to and the transaction would not take place. Stated another way, UtiliCorp's offer to pay the

[3] Provided that UtiliCorp proves to the Commission that merger synergies are at least equal to 50% of the premium costs and other Costs to Achieve the Synergies

premium to the Empire shareholders created the incentive for the merger transaction and thus can be seen as the precondition which makes the merger and the unlocking of the potential merger savings possible. (Ex. 14, p. 14; Ex. 3, pp. 3-4).

Given these facts, it is readily apparent that the entire risk of this transaction rests with UtiliCorp's shareholders. (Ex. 3, pp. 5-6). It is also equally clear that these shareholders would not have accepted such a risk unless they anticipated that the transaction would create value and allow them an adequate return on their investment (Ex. 14, p. 15). On the other hand, if the merger does not take place, the forecasted merger synergies, which will benefit Empire customers and allow UtiliCorp's shareholders to recover their costs, will not be realized. Consequently, the payment of the premium is the triggering event which will lead to the merger and the subsequent merger synergies. It is the payment of this premium by UtiliCorp's shareholders which creates the risk which necessitates a plan which will allow these shareholders a reasonable opportunity to recover their investment - - and that is what the Regulatory Plan is designed to accomplish. (Ex. 3, p. 3-10).

UtiliCorp entered into this transaction with the expectation that, based upon prior actions of the Commission, it would have a reasonable opportunity for premium recovery. (Ex. 14, p. 15). Consequently, to give it this opportunity, UtiliCorp, through its Regulatory Plan, proposes a five year rate freeze to take effect after the Pre-Moratorium rate case. By retaining the savings generated during years one through five of the moratorium, UtiliCorp hopes to offset and thereby fund or recover a portion of the costs which it incurred to create the merger. During these first five years, the risks of the transaction, however, rest entirely with the shareholders of UtiliCorp given the fact that rates to Empire customers will be frozen, and thus will not provide a source for additional revenues. (Ex. 3, pp. 5-6).

Thereafter, pursuant to the Regulatory Plan, in year six in the Post-Moratorium rate case, UtiliCorp will seek recovery of up to fifty percent of the unamortized balance of the premium ("the Assigned Premium"). <u>UtiliCorp will be allowed rate recovery of the Assigned Premium, however, only if the merger savings created by the transaction at least meet that cost</u>. If UtiliCorp cannot demonstrate that the incremental value created and realized from the transaction is at least equal to fifty percent of the unamortized balance of the premium, UtiliCorp's shareholders will bear the difference. If UtiliCorp, for some reason, is unable to create the incremental value or merger savings AND unable to prove these savings to the Commission in the Post-Moratorium rate case, customers of the Empire unit are guaranteed at least a system-wide $3.0 million reduction in cost of service in any event and therefore, are not at risk. <u>Once again, the financial risk for this transaction rests squarely on the shoulders of UtiliCorp's shareholders.</u> (Ex. 3, pp. 5-6).

Other aspects of the Regulatory Plan are also designed to help make the economics of the transaction work. For example, it is proposed that the return allowed on the premium should be based on a capital structure of 60% debt and 40% equity, and the balance of the Empire rate base be allowed a return based on the capital structure for Empire determined by the Commission in the Pre-Moratorium rate case. In addition, consistent with the overall concept of recovering premium from merger-created synergies, it is proposed that the allocation of UtiliCorp's corporate costs to MPS should exclude the Empire factors. This exclusion neutralizes the allocation factors, so that the merger-related benefits of the transaction do not go to MPS customers who are not asked to bear any of the merger costs.

Other Options to the Regulatory Plan

While the proposed Regulatory Plan is designed to help make the economics of the merger work from UtiliCorp's standpoint, it is by no means the only possible way to accomplish this goal. In other words, this plan is not a "take it or leave it" proposition from UtiliCorp's standpoint. This was made clear by UtiliCorp witness Robert K. Green in his direct testimony.

> Q. Is this regulatory plan proposal the only acceptable model?
>
> A. Not necessarily. UtiliCorp is very willing to consider other models that create comparable win-win situations for both customers and shareholders. We believe the proposed model accomplishes this goal and also addresses the Commission concern of not discouraging "companies from actions which produce economies of scale and savings which can benefit ratepayers and shareholders alike." (Ex. 14 p. 20).

The point which should not be lost here is that if the Commission rejects some or all of the aspects of the regulatory plan, some other mechanism to make the transaction economically feasible to UtiliCorp will have to be implemented if the Commission wants the merger to go through.

In summary, while UtiliCorp's proposed Regulatory Plan is not necessarily the only acceptable approach, this plan or some other comparable model that will create certainty by clearly allowing UtiliCorp's shareholders a reasonable <u>opportunity</u> to obtain a return on their investment, is <u>absolutely essential</u> to the financial viability and thus the completion of this merger.

The Components of the Regulatory Plan

The Pre-Moratorium Rate Case

The details concerning the Pre-Moratorium rate case have been discussed previously.

The Moratorium

The rate moratorium is a key component of the proposed Regulatory Plan. After the Pre-

Moratorium rate case, for five years UtiliCorp will not file any case with the Commission requesting a general increase or decrease in the electric rates for the Empire operating unit unless there is the occurrence of a significant, unusual event, such as: an act of God; a significant change in federal or state tax law; a significant change in federal or state utility law or regulation; or an extended outage or shutdown of a major generating unit or units which has a major effect on Empire jurisdictional operations. During the five year moratorium period, the Staff of the Commission will not encourage or assist in the filing of any case with the Commission requesting a decrease in Empire's electric retail rates or a rate credit or rate refund. During the moratorium period, however, UtiliCorp may file for approval of mutually agreed to special contracts with its customers and other tariff items that would cause no change in rates. (Ex. 4, pp. 6-9).

Nothing in the proposed moratorium would prohibit the Public Counsel or any other proper party from initiating a complaint with the Commission with respect to rates or any other subject. The Staff, however, would be prohibited from assisting in any fashion with the processing of any complaint concerning rates, and could not participate or otherwise be involved with any such case. (Ex. 5, pp. 12-13).

The Acquisition Adjustment

A major component of the proposed Regulatory Plan is the treatment requested with respect to the acquisition adjustment in the Post-Moratorium rate case.

The Commission has indicated in prior cases that it is not opposed to considering an acquisition adjustment and has said that it does not want to discourage companies from actions that would produce economies of scale and other savings to both ratepayers and shareholders. *See Re Kansas Power & Light Company*, Case No. EM-91-213 (1991); *Re Missouri American Water Co.*, WR-95-205, November 21, 1995; *Re Missouri American Water Co.*, WM-2000-222, March 16, 2000.

In this case involving its proposed merger with Empire, UtiliCorp is asking the Commission to continue this policy and to look at the issue of premium recovery on a case by case basis when the issue is raised in a rate proceeding.

UtiliCorp is also asking for one additional consideration. That is, UtiliCorp requests the Commission, in the context of this merger case, to explicitly state the method under which any premium recovery in the future Post-Moratorium rate case will occur. As proposed by UtiliCorp, that method requires UtiliCorp to prove merger savings equal to fifty percent of the unamortized balance of the premium. If the Commission finds that UtiliCorp has met its burden of proof, it will be allowed to include the Assigned Premium in rate base and to include the annual amortization of the Assigned Premium in expenses for ratemaking purposes. In other words, UtiliCorp is asking the Commission to reaffirm its existing policy on premium recovery, and to go one step further to state that if UtiliCorp meets its burden of proof of demonstrating merger savings in the future rate case, UtiliCorp will be granted the requested rate treatment of the Assigned Premium and related amortization.

The Commission should understand that from UtiliCorp's perspective, the premium it is paying to acquire Empire should be partially funded by the synergies being created from the transaction because these synergies would not have been available if the transaction had not occurred. As a consequence, the requested ratemaking treatment for the premium is not unreasonable. By agreeing to pay a premium for the Empire stock, UtiliCorp's shareholders have assumed the entire risk of this transaction and are therefore entitled to a reasonable opportunity to secure a return of their investment. An "opportunity", however, is not a "guarantee" of premium recovery. Quite the opposite is true. If UtiliCorp cannot prove the merger synergies, UtiliCorp will not be entitled to recovery of the Assigned Premium. (Ex. 4, p. 10; Ex. 3, pp. 5-6).

Capital Structure and Allocations

As previously indicated, the Regulatory Plan also provides that in the Post-Moratorium rate case the return allowed on the Assigned Premium be based on a UtiliCorp capital structure of sixty-percent (60%) debt and forty percent (40%) equity ratio, and the return allowed on the balance of the rate base be based on an Empire standalone unit capital structure as determined in the Pre-Moratorium rate case. The basis for this aspect of the plan is that absent the merger, the Empire capital structure would not have changed significantly. As a consequence, retaining that capital structure results in no new costs to the Empire customers. (Ex. 4, p. 29). Further, in the Post-Moratorium rate case, the allocation of UtiliCorp's corporate and intra-business unit costs to UtiliCorp's MPS operating division will exclude the Empire factors. This step should be taken so that MPS customers will continue to be allocated their existing level of corporate costs after the merger, consistent with the service they receive. It would be unfair to have MPS customers gain this benefit without also incurring their share of the costs. (Ex. 4, pp. 29-30).

Summary

UtiliCorp recognizes that certain components of its Regulatory Plan i.e. the Pre-Moratorium rate case issues; the indication from the Commission about how the Assigned Premium will be treated if UtiliCorp meets its burden of proof; the capital structure items; and the MPS allocation, are traditionally the types of issues which are deferred to rate cases. <u>That traditional approach, however, will not work in this case. In this case, UtiliCorp must have a decision on these matters</u>

now in order to determine if the proposed transaction makes economic sense and can therefore be closed.

The Commission has determined in the past so called "rate case issues" in non-rate case proceedings. In *Re UtiliCorp United, Inc.*, Case No. GA-94-325 (1994), the Commission, in a certificate case, approved the ratemaking treatment for the costs to convert Rolla, Missouri gas customers from propane to natural gas. In that case, UtiliCorp argued that it would not make economic sense to convert these customers from propane to natural gas unless it was sure it would be able to recover the costs in a future rate case. The Commission commended UtiliCorp for its candor in letting the Commission know that the ratemaking treatment of the conversion costs was of a "make or break" nature. In its order in the certificate case approving the ratemaking treatment of those costs, the Commission stated:

> That UtiliCorp, through its operating company, is authorized to account for the above-stated $300.00 maximum per customer conversion costs above the line, *and include those costs in rate base.*
>
> * * *
>
> The Commission makes no finding as to the prudence or ratemaking treatment to be given any costs or expenses incurred as the result of the granting of the certificate to operate in the above-described service area, *except those costs and expenses dealt with specifically in the body of this Report and Order.*

Id. (Emphasis added.)

Also on point is a Report and Order issued by the Commission on November 13, 1973 in Case No. 17,873, a proceeding involving an application by Laclede Gas Company for an order determining the amounts of certain acquisition adjustments and permitting the transfer of those amounts from certain accounts and further permitting the amortization of those accounts over 40 years as an operating expense. (In this regard, Laclede's request was much more aggressive than

UtiliCorp's in this case. Laclede asked for a specific ratemaking determination while UtiliCorp only seeks a reasonable opportunity to obtain a favorable ratemaking determination at a later date.) In its Report and Order, the Commission determined the amounts of the acquisition adjustments in question, approved the transfer of the total acquisition adjustment from account 186 to account 114, and approved a 40 year amortization of the acquisition adjustment. Laclede's request for authority to charge the amortization against operating expenses, a "rate case" type issue, was contested and the Commission found against Laclede on the grounds that no showing had been made which would justify the inclusion of the acquisition adjustment in the operating expenses of the company.

In other words in the Laclede case, the Commission made a decision on the ratemaking treatment to be afforded an acquisition adjustment outside the context of a rate case. This is clearly additional precedent for the proposition that the Commission does have this authority and has in fact in the past made "rate case" type decisions outside the context of a rate proceeding. The concept is neither novel nor unlawful.

In essence, UtiliCorp, in the present case, is asking that the Commission do nothing more than it has done in these prior cases when it made "rate" decisions in non-rate case proceedings.

UtiliCorp entered into the Merger Agreement with the understanding that based on past Commission decisions, it would have a <u>reasonable opportunity</u> for premium recovery through approval of its proposed Regulatory Plan. UtiliCorp understands that even with this approval, the Commission is guaranteeing neither full nor even partial premium recovery. In subsequent rate cases, UtiliCorp will have the burden to prove up the merger savings equal to the Assigned Premium for which recovery is sought. Recovery won't happen automatically. UtiliCorp is willing to take these risks.

In any event, the public is not harmed by this proposal. The quality of service will not change, rates will stay the same for a five year period and multiple rate cases planned by Empire will be avoided. At the end of that time period, UtiliCorp guarantees a $3.0 million Empire system-wide cost of service reduction in the Post-Moratorium rate case. The risk of the transaction, even under the Regulatory Plan, rests entirely with UtiliCorp.

V. ISSUES WHICH MUST BE DECIDED

In addition to the items discussed above, there are several other issues which must be decided in the context of this merger case in order for UtiliCorp to determine if the transaction will be economically feasible. It is essential that UtiliCorp knows: (1) whether or not the Commission believes that tracking merger savings is possible and if so the appropriate "benchmarks" or starting points to measure merger savings; (2) whether the $100 million "potential energy cost savings" will be designated by the Commission as "merger related'" and (3) whether the starting point to determine the amount of the premium to be considered for recovery, the Assigned Premium, is the entire $280 million. (Ex. 5 pp. 24-27).

As indicated, without a ruling now on these issues, UtiliCorp cannot determine whether the merger with Empire will be economically feasible and should be closed. For instance, if the Commission believes it is impossible for UtiliCorp to track merger savings, UtiliCorp will be unable to meet its burden of proof in the Post-Moratorium rate case and will be unable to recover the Assigned Premium. A part of this tracking issue involves a determination now of a savings tracking "baseline" or "benchmark" for purposes of measuring future merger savings with respect to certain items. If these benchmarks are not established now, proving up merger savings will be extremely difficult. Also, if the Commission does not believe that the $100 million projected energy cost savings are merger related, UtiliCorp needs this ruling now as the economic feasibility of the transaction as proposed depends on these savings being considered as merger related in a future rate case. For the same reason, UtiliCorp also needs to know whether the entire premium, of approximately $280 million will be considered as the basis to calculate the Assigned Premium which, in turn, will be considered for rate recovery. (Ex. 5, p. 25).

VI. OTHER ISSUES

What follows is a discussion of the various contested issues in the order in which they appear in the List of Issues filed with the Commission in this case on August 23, 2000.

1. Does the proposed merger and related transactions and proposals satisfy the not detrimental to the public interest standard required for the approval of mergers by the Commission?

Yes. There is no evidence that UtiliCorp cannot provide safe and reliable electric and water service in the Empire service area. Consequently, the level of that service will not deteriorate as a result of the merger. Rates for electric service will be frozen at existing levels for five years and will not increase as a result of the merger. A guaranteed Empire total company $3.0 million reduction in annual cost of service will occur.

UtiliCorp is fully qualified, in all respects, to own and operate the electric and water systems currently owned and operated by Empire and to otherwise provide sufficient and efficient, safe, reliable and affordable electric and water service.

UtiliCorp now owns and operates gas distribution systems in eight states and electric distribution facilities in four states and serves approximately 828,000 gas and 365,000 electric customers in the United States. UtiliCorp's service territory is largely rural and suburban and is comprised of 22,879 miles of gas distribution pipes and 15,200 miles of electric distribution line.

(Ex. 16, p. 2).[4]

UtiliCorp's MPS operations provide service to approximately 202,000 electric and 48,000 gas customers in Missouri. These customers are served by 1,029 miles of gas distribution main and by 6,344 pole miles of electric distribution line. The MPS gas and electric distribution properties are serviced by 326 customer and network field employees. The MPS gas and electric distribution facilities are comparable to Empire's facilities in that they are well maintained and geographically dispersed. Both companies have a history of low cost, customer focused service. (Ex. 16, p. 3). UtiliCorp's MPS operations are characterized by high customer service standards and a reliable electric network. (Ex. 17, pp. 4-15).

Following the closing of the merger, UtiliCorp will continue to operate Empire's properties as a separate and distinct retail distribution unit. Electric and water customers of Empire will continue to experience quality day-to-day service at reasonable rates from essentially the same personnel now serving them. The merger should be entirely transparent to these customers. Unless otherwise ordered by the Commission, UtiliCorp will utilize Empire's current rates, rules, regulations and other tariff provisions and will continue to provide service to the Empire customers under those rates, rules, regulations and other tariff provisions until such time as they may be modified according to law. (Ex. 14, pp. 9-10; Ex. 4, pp. 3-4).

As indicated, the rate moratorium is a key element of the proposed Regulatory Plan. Under the proposed moratorium, for five years after the Pre-Moratorium rate case UtiliCorp will not file

[4]Subsequent to filing of its testimony, UtiliCorp sold its West Virginia gas and electric operations (24,000 and 26,000 customers, respectively), but this disposition in no way lessens UtiliCorp's qualifications to serve the Empire customers.

any case with the Commission requesting a general increase or decrease in the rates for the Empire operating unit. Exceptions would be the occurrence of a significant, unusual event. During this same moratorium period, the Staff of the Commission would be prohibited from encouraging or assisting in the filing of any case with the Commission requesting a decrease in Empires retail rates or a rate credit or rate refund. During the moratorium period, however, UtiliCorp would have the right to file for approval of mutually agreed to special contracts with its customers and other tariff items that would cause no change in rates. (Ex. 4, pp. 8-9).

Nothing in the proposed moratorium, however, would prohibit the Public Counsel or any other proper party from initiating a complaint with the Commission with respect to rates or any other proper subject. The Staff, however, would be prohibited from assisting in any fashion with the processing of any complaint concerning rates, and could not participate or otherwise be involved with any such case. (Ex. 4, pp. 8-9; Ex. 5, pp. 12-13).

During the fifth year of the rate moratorium, UtiliCorp will prepare and file a general rate case for the retail electric operations of the Empire unit. This rate case will have operation of law dates which coincide with the conclusion of the moratorium. The filing by UtiliCorp in connection with this case will include an accounting of the synergies realized during the moratorium and the balance of the acquisition premium that is yet to be recovered. Also included in this rate filing will be the complete flow-through of all test-year O&M synergies, adjusted to the forward average level of saving for years 6 through 10 of the Regulatory Plan, net of the costs to achieve the synergies, resulting from the merger. Fifty percent (50%) of the unamortized balance of the acquisition premium paid by UtiliCorp for Empire will be included in the rate base of the Empire unit's retail electric operations and the annual amortization of this acquisition premium will be included in the expenses allowed for recovery in cost of service in these cases. The return allowed on this premium, for the recovery period, will be based on the capital structure of 60% debt and 40% equity. The net effect of this will be a guaranteed system-wide minimum reduction in Empire's cost of service of $3.0 million. (Ex. 4, p. 6-7).

Merger Costs/Benefits:

2. Under reasonable assumptions, do estimated merger savings exceed estimated merger costs?

Yes, but this issue is not critical to approval of the merger under the proposed regulatory plan. UtiliCorp will bear the responsibility and risk of generating merger synergies, quantifying them properly and providing that information to the Commission in future rate proceedings. If UtiliCorp cannot prove any merger synergies, then it will not achieve any premium recovery through rates. Empire customers, however, are guaranteed a $3.0 million reduction in cost of service in any event.

The Staff and Public Counsel argue that when "appropriate" adjustments are made to UtiliCorp's estimates of merger savings and costs, the savings do not exceed the costs and as a consequence the transaction should be denied. It is the position of UtiliCorp, on the other hand, that merger savings will exceed the merger costs. (See Ex. 6). Moreover, the resolution of this issue is really not critical to the approval of the merger in any event. That is because, under the proposed Regulatory Plan, UtiliCorp will bear the responsibility and risk of generating merger synergies, quantifying them properly and providing that information to the Commission in future rate proceedings. If UtiliCorp cannot create savings and prove to the Commission that these savings have resulted from the merger, then UtiliCorp will not achieve any premium recovery through rates. The existing Empire customers, however, are guaranteed a $3.0 million reduction in cost of service regardless.

As explained previously, under the Regulatory Plan, after the Pre-Moratorium rate case, a five year rate moratorium will be put in place. Customers will not experience the projected levels of rate activities of an independent Empire or any other "adverse" rate impacts during this five year rate freeze period regardless of whether costs exceed benefits and consequently will not experience any "detriment" from a rate standpoint during this period. If the worst case scenario develops and none of UtiliCorp's projected merger synergies result, customers will not be asked to pay for any of the premium costs or costs to achieve the transaction. These same customers would, however, receive a benefit because the Regulatory Plan guarantees an annual $3.0 million cost of service reduction in years 6-10 after the Pre-Moratorium rate case.

The record evidence clearly demonstrates that reasonably anticipated benefits from the proposed merger will exceed costs. Under the proposed Regulatory Plan, customers will enjoy a cost of service reduction in any event. Finally, customers are ultimately protected by the fact that rates cannot increase without Commission approval.

3. If under reasonable merger assumptions, estimated merger savings do not exceed estimated merger costs should the merger be approved as being not detrimental to the public interest?

Yes. There will be no rate changes until after year five after the Pre-Moratorium rate case and then only with approval of the Commission. At that time, Empire's customers are guaranteed a total company $3.0 million reduction in cost of service regardless. (See discussion under Point 2 supra)

Regulatory Plan - Overall:

4. Should the Companies' proposed regulatory plan for treating merger related savings and costs in rates be adopted in total as not detrimental to the public interest?

Yes. No aspect of the plan is detrimental to the public interest. Safe and reliable service will be maintained. There will be no rate changes after the Pre-Moratorium rate case until the Post-Moratorium rate case five years later and then only with Commission approval. At that time, Empire's electric customers are guaranteed a $3.0 million total company reduction in cost of service. UtiliCorp bears the risk of generating merger synergies, quantifying them properly and providing that information to the Commission in future rate proceedings.

The evidence shows that after the merger is closed, UtiliCorp will continue to provide safe and reliable service in the former Empire service territory. (Ex. 16, Ex. 17).

Once again, after the Pre-Moratorium rate case, a five-year rate moratorium for the former Empire properties will be put in place. During the fifth year of that rate moratorium, UtiliCorp will file a rate case for the electric operations of the Empire unit. That filing will document how merger synergies exceed costs, including the premium costs for which rate recovery is requested. In the context of those rate cases, and for ratemaking purposes, fifty percent (50%) of the unamortized balance of the merger premium, the Assigned Premium will be included in the rate base of the Empire unit's electric operations. In addition, the annual amortization of the Assigned Premium will be included in the expenses allowed for recovery in cost of service. In other words, at the end of the five year rate moratorium, thirty-four fortieths (34/40) of the premium will remain to be amortized. In the Post-Moratorium rate case, if UtiliCorp meets its burden of proof, fifty percent of this thirty-four fortieths (34/40), the Assigned Premium, will be included in rate base and the amortization of the Assigned Premium will be included in expenses. At that time, Empire's customers are guaranteed a $3.0 million reduction in cost of service. (Ex. 5, pp.6-8).

UtiliCorp's plan for treating merger related savings and costs in rates should be approved. As indicated, it is absolutely essential to the successful completion of this transaction that UtiliCorp's shareholders have a reasonable opportunity to obtain a return on their investment. The savings which will be generated by this merger would never exist absent the willingness of the shareholders to pay a premium for the Empire properties. The entire risk of this transaction therefore rests with these shareholders. That is to say, in the Post-Moratorium rate case, UtiliCorp bears the risk of generating merger synergies, quantifying them properly and proving these facts to the Commission. There is no detriment to the public if UtiliCorp's plan for treating merger related savings and costs in rates is adopted.

5. Should Empire be placed under a rate "moratorium" for Years 1-5 after the Pre-Moratorium rate case?

Yes. The moratorium will benefit Empire's customers by avoiding rate increases which would result from a standalone Empire.

The five year rate moratorium, proposed as a part of the Regulatory Plan, will benefit customers of the Empire unit because, without the merger, Empire expects future rate increases to take place during this period. (Ex. 10, p. 3). Under the moratorium, however, these rate cases will be avoided as UtiliCorp, unless certain events occur, will not file any case with the Commission requesting a general change in the rates for the Empire operating unit, as explained previously. Simply holding rates constant is itself a benefit.

Once again, while the proposed moratorium is similar to other moratoriums approved by the

Commission, there is a key difference that provides the potential for an additional customer benefit. Although the Staff is prohibited from being involved in any case requesting a decrease in the rates of the Empire operating unit during the moratorium, nothing would prohibit the Public Counsel or other proper party from initiating such a case. In other words, the moratorium would only bind UtiliCorp and the Staff. (Ex. 5, pp. 12-13).

Acquisition Adjustment:

6. Should the amortization of one-half of the acquisition adjustment and the return on the unamortized portion of one-half of the acquisition adjustment be treated above-the-line for rate purposes in Years 6-10 following the Pre-Moratorium rate case as the Companies propose?

Yes. This is a critical component of the Regulatory Plan, approval of which is necessary in order for the merger to make economic sense from UtiliCorp's standpoint.

This issue is perhaps the most discussed aspect of this entire case. The Commission should remember, however, that UtiliCorp's shareholders, who have agreed to pay the premium which will make this transaction and its related synergies possible, bear all of the risk. These shareholders just want a reasonable <u>opportunity</u> to have favorable ratemaking treatment of the Assigned Premium if those synergies are proven. In this regard, as indicated, UtiliCorp is requesting that first the Commission approve the amortization of the acquisition adjustment above the line beginning after the Pre-Moratorium rate case. (This amortization will not impact rates or customers.) Then, after five years of this amortization, in the Sixth Year after the Pre-Moratorium rate case, in the context of the Post-Moratorium rate case, fifty percent (50%) of the unamortized premium, the Assigned Premium, will be included in the rate base of the Empire unit and the amortization of the premium will be included in the cost of service, provided that UtiliCorp meets its burden of proof in that rate case by showing that the merger savings created by this transaction meet the cost of the Assigned Premium. If UtiliCorp cannot prove to the Commission that this incremental value created from the merger is at least equal to one half of the premium, UtiliCorp shareholders will bear the difference and the customers will receive a $3.0 million cost of service reduction. Clearly, UtiliCorp's shareholders bear the entire financial risk for this transaction as customers of the Empire unit will realize a $3.0 million reduction in cost of service in any event.

In determining whether it should grant UtiliCorp's request for this prospective acquisition adjustment ratemaking treatment, the Commission should evaluate the reasonableness of the proposal in terms of the merger benefits which are anticipated to be generated through synergies from merging the companies. In the Post-Moratorium rate case, if UtiliCorp is able to demonstrate that synergies resulting from the merger meet or exceed the premium costs for which ratemaking treatment is sought, the Assigned Premium will be more than offset by those synergies and is a reasonable cost for inclusion in rates.

Stated another way, the requested ratemaking treatment for the Assigned Premium should be viewed in the same light as other costs. Generally, regulatory commissions include those expenditures which bring about cost efficiencies in cost of service for ratemaking purposes. Such ratemaking treatment is considered to be appropriate and reasonable because savings from the efficiencies are flowed through to customers. Likewise, ratemaking treatment for the premium cost and related merger savings should be treated in the same manner as other utility cost saving initiatives. (Ex. 4, p. 17).

In considering this issue it is incorrect of the Commission to assume that the proposed treatment of the Assigned Premium will result in increased rates. Increased rates cannot occur because of the cost savings which will result from the UtiliCorp/Empire merger. In other words, the impact on revenue requirements related to a premium should not be viewed separately and in complete isolation from the other elements of a merger. On the contrary, the cost savings resulting from merger synergies should be considered and measured against the cost of the premium, which is the essence of the Regulatory Plan. The rates of the Empire unit will actually be lower than they would have been without the merger if UtiliCorp can demonstrate that the incremental value created and realized by the merger exceed the Assigned Premium. (Ex. 4, p. 17).

The Staff argues that including the Assigned Premium in utility rates is improper because it will provide incentives for negotiating utilities to settle on a higher purchase price for a transaction, but this view results from an erroneous "all or nothing" approach to premium recovery. When the ratemaking treatment of the Assigned Premium is to be judged for its reasonableness based on the value of aggregate merger benefits, the purchasing utility clearly has an incentive to minimize the amount of any premium because it cannot reasonably expect to receive full cost of service recognition for the premium if synergies do not support the full cost. (Ex. 4, p. 18).

When the utility realizes that the premium will be evaluated by this Commission for reasonableness based on the synergies produced, the utility accepts the risk of not recovering the premium in rates.[5] On the other hand, by making a policy decision not to include premium in rates, regulators could create disincentives for mergers which may bring about net benefits for customers.

[5]In fact, as a part of its decision in this merger case, UtiliCorp seeks a determination as to the amount of the $280 million premium which will be considered for rate recovery.

(Ex. 4, p. 18). In this regard, it is clear from its prior pronouncements that this Commission has not made such a policy decision. Rather, this Commission evaluates the ratemaking treatment of a merger premium or acquisition adjustment on a case by case basis. UtiliCorp is asking for a continuation of the present policy, but with assurances on the front end in this case that if the appropriate evidentiary standards are met, the requested rate treatment of the Assigned Premium will be allowed.

When a commission chooses to evaluate the reasonableness of a premium for ratemaking purposes, it is simply fulfilling its responsibility to set just and reasonable rates. The review process for the premium should be viewed no differently than the review process which a commission would undertake for the consideration of the reasonableness of investments and expenses generally. Obviously, it is common practice for regulators to pass cost savings on to customers through the ratemaking process. In so doing, commissions customarily allow rate treatment for the investments and expenses used to develop the savings. Likewise, this Commission should consider a reasonable premium as simply an investment made to develop merger savings. Therefore, the premium, in this case the Assigned Premium, deserves rate recognition if synergies meet or exceed premium costs and net synergies are passed on to customers. (Ex. 4, p. 19).

Determining the reasonableness of a premium does not mean that the Commission needs to be a part of merger negotiations. The Commission should simply determine the reasonableness of the premium just as it determines the reasonableness of other investments and expenses incurred by utilities. For example, it is common for regulators to evaluate the reasonableness of electric plant investment based on capacity needs and other economic and accounting criteria. Generally, the regulator performs this evaluation without participating in the management decisions which lead to these investments. (Ex. 4, pp. 19-20).

In this case, the evidence is clear that the price which UtiliCorp will pay for the Empire stock is fair and reasonable. It resulted from an arm's length negotiation, and is comparable to industry norms. (Ex. 14, pp. 11-12). Again, as indicated, UtiliCorp must know now whether the entire premium in the approximate about of $280 million will be considered as the basis for determining rate recovery of the Assigned Premium in the Post Moratorium rate case.

Some may argue that this Commission should establish a precedent of disallowing premium in the cost of service as this would eliminate any need to test the purchase price for reasonableness. This view ignores the fact that a regulatory commission is charged with the responsibility of determining the reasonableness of utility rates. While arbitrarily excluding a premium from rate determination may make the review process simple for Staff's and regulators, this approach would be contrary to the obligation to serve the public interest as it would likely discourage beneficial mergers from occurring. Such an across-the-board policy could deprive utility customers of merger benefits because shareholders are not permitted to recover reasonable investments just because the costs are an acquisition premium. (Ex. 4, p. 20).

Some may claim that unregulated companies are placed at a disadvantage when compared to regulated utilities if premium recovery is allowed in rates. This argument does not withstand close scrutiny, however. In the case of the unregulated firm, there is not a regulatory commission with oversight and the ability to require that merger savings be flowed to customers. Therefore, the unregulated firm can recover the premium through its ability to keep the merger savings. The regulated utility is at a disadvantage since regulators could pass all of the cost savings to the customers and, at the same time, not allow rate recovery of a merger premium. The effect of this treatment is to lower the utility's earnings below the level it would otherwise achieve absent the merger. (Ex. 4, pp. 19-20).

As indicated, this Commission has stated that it is not opposed to the consideration of acquisition adjustment for ratemaking purposes. *See Re Missouri American Water Co.*, Case No. WR-95-205, 4 Mo. P.S.C. 3d 205 (November 21, 1995). Specifically, the Commission has indicated that it is not opposed to the concept of a savings sharing plan (as part of an acquisition adjustment request) provided that only merger-related savings are shared. *Id. See also Re Kansas Power & Light Company*, Case No. EM-91-213, 126 P.U.R. 4th 385, 1 Mo. P.S.C. 3d 150 (September 24, 1991). The Commission has also stated that it does not wish to prevent companies from producing economies of scale and savings which can benefit ratepayers and shareholders alike. *Id.* In the past, the Commission has evaluated each merger on its own merits and has concluded that different circumstances have necessitated different approaches and solutions. In one case, an earnings sharing grid was approved with target returns set high enough to allow for full or partial recovery of the premium or acquisition adjustment. *Re Union Electric Company*, Case No. EM-96-149, 176 P.U.R. 4th 201, 6 Mo. P.S.C. 3d 28 (February 21, 1997). In another case a rate freeze was established for a period of time that allowed for a full or partial recovery of the acquisition adjustment *Re Western Resources Inc.*, Case No. EM-97-515, (September 2, 1999).

Once again, UtiliCorp urges the Commission to continue its open-minded policy and to approve a plan or procedure which will give UtiliCorp a reasonable opportunity for premium recovery through the synergies created by the merger.

A large number of states have permitted rate recovery of a portion or all of the cost of acquisitions. Such rate recovery, however, is generally limited to savings and most of the decisions focus on sharing the net benefits. The Massachusetts Department of Public Utilities ("Department"), set forth generic guidelines and standards for acquisitions and mergers of utilities. *Re Guidelines and Standards for Acquisitions and Mergers of Utilities,* 155 P.U.R. 4th 320 (Mass. August 3, 1994). After an evaluation of those guidelines, the Department determined that where potential benefits for customers exist, it is not in the interest of those customers, the shareholders of the utility, or the state to maintain a barrier against mergers. *Id.*

The Oklahoma Corporation Commission, in *Re Oklahoma Gas and Electric Co.*, 150 P.U.R. 4th 33 (Okla. Feb. 25, 1994) established the following criteria for determining whether to allow recovery of an acquisition premium:

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

(Ex. 4, pp. 23-24).

If this Commission followed these criteria, the UtiliCorp/Empire transaction would be approved. The proposed merger is clearly an arm's length transaction between the parties. The evidence shows that the purchase price is reasonable. (Ex. 2, pp. 11-12). The transaction is not detrimental to the public interest and, in fact, should create net benefits for customers and shareholders. If the UtiliCorp/Empire merger does not take place, benefits which could accrue to the customers of both companies will not be realized.

Rate base treatment and/or cost of service treatment for acquisition premiums has been allowed by various regulatory commissions under a variety of circumstances, most commonly:

1) when acquisitions represent an essential or desirable part of an integration of facilities program devoted to serving the public better;

2) when acquisitions are clearly in the public interest, because operating efficiencies offset the excess price over net original cost; and

3) when acquisitions are determined to involve arm's-length bargaining.

(Ex. 4, pp. 23-24).

The Tennessee Public Service Commission allowed both rate base and cost of service treatment for acquisition adjustments of a telephone company where the acquisitions were found to be in the best interest of the public and not for the purpose of inflating the rate base. (79 P.U.R. 3rd 499 Tenn. Aug. 1, 1969). In a 1955 Virginia Supreme Court of Appeals decision, the Court ruled that the Virginia State Corporation Commission had properly allowed both rate base and cost of service treatment for an amount paid at arm's length bargaining in excess of original cost. (8 P.U.R. 3rd 120 Va. Apr. 25, 1955). As far back as 1946, the Louisiana Public Service Commission allowed rate base and cost of service treatment for an electric company's acquisition adjustments stating that the criteria specified above had been met. (65 P.U.R. (NS) 18 La. July 29, 1946). In that case, the Louisiana Commission stated:

> The owners of a public utility are entitled to earn and receive a fair rate of return upon the money prudently invested in property used and useful in rendering public service. Money is prudently invested, even though it is in excess of the original cost of the property purchased, if the excess of purchase price over original cost was paid as the result of arm's-length bargaining between nonassociated buyer and seller, if the excess was necessary for the integration of the property into a larger and more efficient system, and if the purchase necessitating the excess did or reasonably should have resulted in public benefit by improvement of service to customers or in lowered rates or both better service and lowered rates. This integration cost or excess of purchase price over original cost termed in prescribed system of accounts as 'Utility Plant Acquisition Adjustments' should remain a part of the prudent investment during the life of the physical property to which it was applied, and its extinguishment from the investment when and if required by the Commission, should

> be accomplished by amortization through annual charges to Operating Revenue Deductions during the life of the property remaining after the date of the purchase which created the excess. (65 P.U.R. (NS) 23 La. July 29, 1946). (Ex. 4, pp. 26-27).

More recently, commissions have begun to apply this sharing principle. The Kansas Corporation Commission in *Re Kansas Power & Light Co.*, 127 P.U.R.4th 201 (1991), established a policy with regard to acquisition adjustments. To the extent that savings can be shown by the applicant in a merger case, the acquisition premium will receive ratemaking treatment in a future rate case. The Kansas Commission stated:

> The Commission cannot ensure the recovery of the AP. The Commission can only ensure the opportunity to recover the AP. The Commission believes the appropriate regulatory treatment of the AP is to tie the potential recovery of the AP to benefits that will be realized by ratepayers as a result of the merger. In this case, the Amount of the AP to be included in rates shall be tied to the savings reasonably projected to be generated by the merger. Applicants in future merger cases will have the burden of quantifying benefits that will accrue to ratepayers as a result of the merger. The Commission will not necessarily limit benefits to operating cost savings but will look at a variety of factors in determining ratepayer benefits. For example, Utility A is acquired by Utility B and Utility B is able to bring financial strength to make improvements to Utility A; Utility B may be allowed to include in its rates an AP commensurate with the improvements it was able to effect through its financial strength.
>
> In this case where ratepayer benefits are tied to synergies that can be generated from cost cutting measures and synergies resulting from the overlapping service territories, to identify and quantify savings becomes a critical component of Applicants' burden of proof. The savings to be generated by the acquisition must be reasonably identified and capable of quantification, otherwise the Commission has no reasonable way to assess whether there are benefits for ratepayers.

(Ex. 4, p. 26).

The point of all this is that there is sound authority and ample precedent to allow premium recovery. UtiliCorp urges the Commission to continue its policy of considering premium recovery on a case by case basis in the manner of the policy followed by the Kansas Corporation Commission.

7. Should the amortization of the acquisition begin at the closing of the merger between Empire and UCU?

Yes. This amortization is required by sound accounting principles and is a critical component of the Regulatory Plan..

8. Should any portion of the acquisition adjustment ever be included in rates for (a) "recovery of" the acquisition adjustment (amortization of the acquisition adjustment) and (b) "return on" the acquisition adjustment (rate base component of the unamortized balance of the acquisition adjustment)?

Yes. This is a critical component of the Regulatory Plan approval of which is necessary in order for the merger to make economic sense from UtiliCorp's standpoint. (See discussion above). The ability of UtiliCorp to include these costs in rates without adversely affecting customers will be provided by the merger-related synergies UtiliCorp achieves AND proves to the Commission in the Post-Moratorium rate case.

Estimated Merger Savings:

9. Should the Companies' estimate of merger savings and merger costs be relied upon by the Commission in its findings regarding the Merger Application?

Yes, because they are reasonable. However, under the Regulatory Plan, Empire's electric rates will be frozen for five years after the Pre-Moratorium rate case. Later, in the Post-Moratorium rate case, UtiliCorp will bear the responsibility and risk of quantifying the actual merger synergies and proving those synergies to the Commission. Nonetheless, UtiliCorp must know now whether certain savings will be considered to be merger related in order to determine the economic viability of the transaction.

This issue is discussed under Point 2 <u>supra</u>. In summary, whether or not estimated merger savings exceed estimated merger costs is not critical to the approval of this merger because under the Regulatory Plan the entire financial risk of the transaction rests with UtiliCorp. Customers <u>cannot</u> be harmed. If the estimated synergies are not realized, it won't matter as customers of the Empire unit are guaranteed a $3.0 million reduction in cost of service in any event.

10. Does the Companies' estimate of generation/joint dispatch savings reflect only impacts directly attributable to the merger?

Yes. The bulk of the estimated savings are directly attributable to UtiliCorp's ability to sell power at market-based rates and to more efficiently use and sell Empire capacity and energy.

This issue is extremely critical. It is the position of UtiliCorp that the total merger related energy cost savings resulting from this transaction are approximately $104 million. The Staff, on the other hand, claims that only $6.8 million in energy savings are related to the merger. The reasons for this difference and the Staff's erroneous assumptions are explained by UtiliCorp witness Frank DeBacker in his surrebuttal testimony. (Ex. 18).

The main reason for the difference in positions is the Staff's assumption concerning wholesale sales volumes and margins. The Staff wrongly assumes that there exists a perfect wholesale market and that MPS, Empire and the merged company will participate in that market on the same basis. In other words, it is assumed that each entity will be able to sell at the market price and have the same level of market penetration. (Ex. 18, pp 5-6).

This Staff assumption is unrealistic, however, because the wholesale energy market is not perfect and the abilities and opportunities of each of the market participants are not equal. The actual experience of UtiliCorp and Empire in the wholesale market since 1996 is a clear indication of the different approaches taken by each on a stand-alone basis. This historical track record should be considered and given great weight. The Staff inexplicably ignored the actual experience of each of the companies when making its assumption.

The wholesale assumptions used by UtiliCorp and Empire in connection with the proposed merger are explained by Mr. DeBacker. (Ex. 18). First, it was assumed that on a stand-alone basis, both entities would continue to generate approximately the same level of normalized wholesale volumes and margins over the next 10 years as those generated in recent years. This assumption was supported by UtiliCorp and Empire internal forecasts, and the fact that Empire had not actively participated in the deregulated wholesale market to the same extent as MPS. Second, after the merger, it was assumed that the combined company would make all wholesale market sales at market rates, and that the combined company would be able to increase its wholesale market penetration. Thus, the merger would not only result in an increase in the volume of wholesale sales, but an increase in the overall profitability due to use of market-based rates. (Ex. 18, pp. 5-6).

The basis for the wholesale sales assumption for Empire and MPS as individual stand-alone companies is supported by an examination of the facts surrounding the approach of each company to the deregulation of the wholesale market and internal forecasts.

The facts concerning the Empire wholesale operations are as follows:

- Empire has not been and is not now active in the wholesale market.
- As one of the smallest investor owned electric utilities in the nation, its size and limited resource mix make it very costly to develop and sustain an effective wholesale marketing group.
- Empire does not currently have a wholesale marketing group or risk management function dedicated to pursuing the wholesale energy and does not have plans to create such groups. (Ex. 18, pp. 6-7).

The facts concerning the MPS wholesale operations are as follows:

- MPS has been active in the wholesale market since 1996 and has been selling at market rates.
- MPS, as required by FERC, has separated its generation and transmission functions.
- MPS maintains a fully staffed wholesale marketing group and risk management function to pursue opportunities in the wholesale market. (Ex. 18, pp. 6-7).

These facts clearly demonstrate that MPS has been and continues to be much more active in the deregulated wholesale market than Empire. MPS's activity, both in terms of volumes and margins, has reached a plateau, in part due to transmission limitations. The operations of the combined company, with its enhanced transmission capabilities, will allow it to expand its efforts in the wholesale market much more efficiently than either of the companies could do separately. The reality of this situation is quite the opposite of the assumptions used by the Staff to arrive at its projection of merger-related energy savings of only $6.8 million. (Ex. 18, p. 7).

With respect to the wholesale assumptions used by UtiliCorp and Empire for the operation of the combined company, it was assumed that UtiliCorp would be able to increase its wholesale market penetration and increase the profit margin on wholesale sales. The increase in wholesale profit margin is due to UtiliCorp's ability to sell at market-based rates versus cost-based rates. The increase in market penetration and sales activity are primarily due to the transmission interconnects that the new combined company will have via the interconnections that Empire has with other utilities in the Southwest Power Pool ("SPP"), and the increase in available capacity for sale into the wholesale market. (Ex. 18, p. 8).

On April 24, 1996, the FERC issued Order No. 889 which included Section 37.4(a)(1), which states: "...the employees of the Transmission Provider engaged in transmission system operations must function independently of its employees, or the employees on any of its affiliates, who engage in Wholesale Merchant Functions." Section 37.4(b)(1) of the Order stated: "Prohibitions. Any employee of the Transmission Provider, or any employee of an affiliate, engaged in wholesale merchant functions is prohibited from: (i) conducting transmission system operations or reliability functions; and (ii) having access to the system control center or similar facilities used for transmission operations or reliability functions that differs in any way from the access available to other open access Transmission Customers." (Ex. 18, p. 8).

MPS has functionally separated its generation and transmission since the issuance of FERC Order 889, but not without cost. Over the past three years, MPS's wholesale trading operations have had an annual operating budget averaging $3.5 million and annual capital expenditures (software and equipment) averaging $1 million. (Ex. 18, p. 9).

The Empire trading operation would be somewhat smaller than UtiliCorp's, but due to the separation of the dispatch and transmission function and obtaining comparable trading talent, it would possibly cost Empire in the area of $1 million per year to comply with the FERC Order. (Ex. 18, p. 9). Moreover, before this could happen, Empire would have to undergo a change in management attitude to accept the considerable risk that exists in the trading world today and recognize the impact of the possible financial losses that have been incurred by other utilities that have not been as successful as UtiliCorp. These losses can be substantial and have a large impact on the utility's bottom line. To minimize risks, a utility entering this trading activity would need to ensure a proper Risk Management program is established with an additional associated cost. (Ex. 18, p. 9).

Apparently the Staff did not take into account the Empire limitations and the additional operational expense and experience Empire would have incurred in formulating the Staff's basic assumptions concerning Empire's capability in the wholesale market. The facts are that Empire has neither made the investment in the necessary equipment and personnel nor acquired the risk management expertise required to make the Staff's assumption realistic.

11. Does the Companies' estimate of merger savings reflect the expected operation of the UCU and Empire pension plans following closing of the merger?

Yes. UtiliCorp and Empire agree that in post-merger cases involving Empire, UtiliCorp will maintain the pre-merger funded status of the Empire pension fund by accounting for it separately. UtiliCorp will, however, be allowed to combine the assets. The accounting on a going forward basis would start with a market value of assets evaluation performed by Empire's actuarial firm at the time of merger closing. On a going forward basis, the net rate of return (actual earned return income on the assets during the year less benefits paid) on the combined pension assets will be used.

Savings Tracking/Benchmark:

12. Should the Companies' proposal for utilizing a savings tracking system for identifying and quantifying merger related savings in Years 6-10, after the Pre-Moratorium rate case, be adopted?

Yes, but approval of a specific tracking system is not critical to approval of the merger. In future rate proceedings, UtiliCorp will have the burden to demonstrate that it has been able both to track and quantify merger savings.

UtiliCorp's proposal for adopting a savings tracking system for identifying and quantifying merger related savings beginning in years 6-10 after the Pre-Moratorium rate case should be adopted. However, approval of a specific savings tracking system is not critical to merger approval. As indicated, under its proposed Regulatory Plan, UtiliCorp will have the burden to show in the Post-

Moratorium rate case that it has been able to both track and quantify merger savings.

UtiliCorp believes that it will be able to meet this burden. Because of its multi-jurisdictional presence and the various associated regulatory reporting requirements, UtiliCorp now tracks each of its business operations that has its own unique rate structure as a separate business unit on its general ledger. (Ex. 12, p.5) In Colorado for example, UtiliCorp operates both a gas utility business (Peoples Natural Gas) and an electric utility business (WestPlains Energy). Because these operations have unique rate structures and require separate regulatory reporting, UtiliCorp tracks them separately on its general ledger. The Peoples Natural Gas operation is reflected as PND and the West Plains electric operation is reflected as WCD (distribution) and WCG (generation). (Ex. 12, p. 5).

UtiliCorp's current practice shows that it has the financial system to support the tracking of costs and revenues specific to the former Empire operations. After the merger is closed, the Empire operations will be set up as a separate business unit in UtiliCorp's financial system for its generation and distribution functions. (Ex. 13, p. 1). UtiliCorp's financial system currently tracks support costs in unique departments which are included in three business units identified in UtiliCorp's Chart of Accounts as UtiliCorp, UED and UPS. The costs are allocated to the operating units using a series of allocation steps referred to as Enterprise Support Allocations ("ESF") and Intra-Business Unit Allocations ("IBU"). Costs are allocated using either specific cost drivers like employees or using a general three-factor formula commonly referred to as the Massachusetts Formula. (Ex. 12, p. 6).

Post-merger, the cost pools utilized in the ESF and IBU allocations will consist of the costs necessary to support UtiliCorp operations which existed prior to the Empire merger and the incremental costs incurred by those support departments to absorb the Empire operations post-merger. These incremental costs can be broadly classified into two categories, payroll and non-payroll. It is anticipated that most of the incremental support costs will be payroll in nature. In addition, a substantial portion of the non-payroll costs will be charged directly to Empire as being directly related to that business unit. (Ex. 12, p. 7).

With regard to payroll related costs, UtiliCorp's employee requisition form will be revised so it will indicate that the requisition is for an employee to support the additional work created by the merger with Empire. The requisition will include documentation explaining the facts and circumstances regarding the position, why it is needed and how it relates to the support of Empire operations. (Ex. 12, p. 7). For example, UtiliCorp currently has a centralized accounts payable function for its domestic utility business and corporate headquarters. Its experience to date has shown that one person can process 1200 invoices per month. If, as the result of the Empire merger, it is estimated that accounts payable will be required to process at least an additional 1200 invoices per month, then at least one additional accounts payable clerk would become necessary and requested using the process discussed previously. (Ex. 12, pp. 7-8).

Each employee of UtiliCorp currently completes a biweekly timesheet which indicates the proper allocation of productive and non-productive time, i.e. vacation, holiday, sick leave. UtiliCorp also utilizes a Project Cost system that allows the tracking of specific activities whether the activity is a capital activity or an activity that is recorded in operations and maintenance. Each department requesting additional personnel to support the incremental operations of the Empire unit will be assigned an "activity number." This activity number will be specific to that department. For example, "Incremental A/P Personnel-Empire," will be used by the Accounts Payable clerk that is hired and designated as providing support to Empire operations. This activity, along with similar activities related to other departments (payroll, property, human resource, information technology, general ledger, etc.) that will be required to hire personnel, will be summarized under one project number, for example, "Empire Incremental Costs." The "Project" in the Project Cost system is a summation tool that allows for the summarization of multiple activities included under that Project. (Ex. 12, p. 8).

The immediate supervisor of each employee is ultimately responsible for the proper reporting and coding of time. Employees are instructed by supervisors on the proper coding of time. Each employee will code his or her productive time in this manner until instructed otherwise. The work of the Transition Teams will also provide additional support for the reasonableness of the costs being incurred. (Ex. 12, pp.8-9).

Upon accepting another position, an employee will discontinue use of Empire specific coding and begin coding his or her productive time consistent with the new work. The individual replacing that employee will begin using the Empire specific coding immediately upon hire. (Ex. 12, p. 9).

With regard to the indirect costs of increased ESF and IBU employees such as benefits, payroll taxes, UtiliCorp utilizes automated loadings designed to charge the full cost of that employee (benefits, incentive, payroll taxes) to the same account or activity used by them in charging their direct labor hours. For example, UtiliCorp currently uses a 21% loading factor which represents the estimated cost of employee benefits. This factor is applied to each dollar of direct payroll and charged to the same account/activity as the direct payroll. As a result, any person charging their time to one of the special-purpose activities will also have that time loaded for benefits, payroll taxes, etc. (Ex. 12, p. 9).

Incremental costs other than payroll will be accounted and tracked as well. As indicated earlier, a significant portion of non-payroll costs will be directly charged to the Empire operation and would not require allocation. Non-payroll incremental costs that are more generic in nature can be tracked in the same fashion as payroll costs utilizing the same activity numbers established in our discussion of payroll costs. If additional analysis is needed, then costs determined to be incremental during analysis can be transferred to the activity utilizing a general journal entry. An example of a non-payroll cost that may require analysis is the incremental cost of supplies needed to bill Empire customers. Billing envelopes, for example, would be purchased in bulk and used in the billing process. A cost per bill would be developed and applied to the number of bills sent to Empire customers. The resulting dollar amount would then be transferred, via journal entry, to the specific activity established for that support function. Costs such as depreciation/maintenance on the billing system would not be considered to be incremental and thus would not require analysis. (Ex. 12, p. 10).

Costs of the stand-alone Empire pre-merger are being reviewed by UtiliCorp transition teams. Those teams will determine which costs would be necessary to continue to provide quality service to Empire's customers post-merger and which of those costs will become incremental costs to UtiliCorp as discussed above. Because UtiliCorp's financial system will track the operations of Empire in a separate general ledger business unit, post-merger costs associated with operating that system can be easily determined, including both direct costs as well as allocated costs, and compared to the pre-merger cost level as determined by the transition teams. (Ex. 12, p. 10).

Because UtiliCorp's system will track Empire's operations separately from the rest of UtiliCorp's operations, the results can be compared to the baseline determined by the Commission in this case. The results of that comparison could represent total savings, both merger related and non-merger related. (Ex. 13, p. 3).

13. If the Commission finds that establishing a merger savings tracking system is necessary, should this tracking system be in place for Years 1-5, as well as for Years 6-10, after the closing of the merger?

No. UtiliCorp will have the burden in future rate proceedings beginning with the case filed in Year Five after the Pre-Moratorium rate case to demonstrate to the Commission that it has been able to both track and quantify a merger savings. UtiliCorp should have the discretion to determine how it will meet that burden.

From UtiliCorp's standpoint, the approval of a specific tracking system is not critical in order for the merger to go forward. In other words, it is not necessary for the Commission to establish <u>now</u> a merger savings tracking system for both Years 1-5 or for Years 6-10. The burden of tracking and proving merger savings will rest with UtiliCorp in any future rate case. (Ex. 13, p. 6).

14. Should the Companies' proposal for establishing a guaranteed merger revenue requirement benefit to Empire customers of at least $3.0 million for each year of Years 6-10, following the Pre-Moratorium rate case, be adopted?

Yes, assuming that all other elements of the Regulatory Plan are approved. This guarantee will benefit customers in the Empire service territory.

This element of the Regulatory Plan was developed to demonstrate to the Commission UtiliCorp's level of confidence that synergies would exceed costs such that Empire customers would receive cost reduction benefits in addition to the rate freeze.

As indicated previously, customers of the Empire unit will realize a benefit as a result of the $3.0 million cost of service guarantee. If UtiliCorp's Regulatory Plan is not adopted, however, there is no guarantee.

15. If "yes" to question 14 above, what period of time should be used as a "baseline" for the purpose of measuring future merger savings?

For benefits costs related to synergies, the proper starting point is year-by-year projections. For fuel and purchased power, the proper starting point is year-by-year projections. For other operating and maintenance costs, the proper starting point is the 1999 Empire budget.

For benefits costs related to synergies, the year-by-year starting point reflects the complex nature of the various elements of benefits costs, particularly pension and retiree medical costs, as well as correcting estimates of future costs. Mr. Browning's surrebuttal testimony, Exhibit 20, provides a more detailed explanation of the complexity that is incorporated in these calculations.

For fuel and purchased power, the year-by-year projections are reflected in the "real time model", which incorporates the complexities of fuel costs, capacity availability, purchased power contracts and growth opportunities in sales detailed in Mr. DeBacker's surrebuttal, Exhibit 28. Discussions are continuing with Staff to stipulate this issue.

For other operating and maintenance costs, the correct starting point is the 1999 budget of Empire as the proper "baseline" to calculate the merger-related synergies. That starting point was consistently used by the transition teams in developing their projected synergies. The 1999 budget was selected as the baseline because it was the most current information on expected Empire operating costs available to all the transition teams. This enabled the transition teams to have the benefit of the best and most current view of Empire operating managers of Empire costs to operate and in a form that facilitates management of those costs going forward. Neither of the examples cited by Staff are valid adjustments of the synergies because the chosen and proposed starting points properly reflected them. In addition, management's ability to monitor and ensure that the synergies are accomplished is much improved by using an operations budget that actually shows what a department is spending. The costs of many departments become intermixed when converted to FERC accounts. It would add an unneeded layer of complexity to start from adjusted FERC accounts and then translate back into manageable department targets. Any additional complexity that is not necessary such as attempting to translate backward from FERC accounts should be avoided. Budgeted amount can be relied upon for purposes of establishing a savings tracking "baseline" for other operating and maintenance costs. Discussions are continuing with Staff on the acceptability of utilizing the Pre-Moratorium rate case level of other operating and maintenance costs.

The starting point to measure merger-related savings must be resolved in this proceeding. UtiliCorp needs to know the ground rules on measuring merger-related synergies now in order to determine the likely financial impact and thus the economics of the transaction prior to closing.

16. Should actual or budgeted amounts be used for purposes of establishing a savings tracking "baseline"?

Budgets should be used for other operating and maintenance costs. See Point 15.

17. If a baseline actual amounts is adopted, what baseline and what adjustments to the "baseline" are appropriate for this purpose?

Staff has not proposed any baseline actual amounts for Empire. See also response to Point 15. Discussions are continuing with Staff on utilizing the Pre-Moratorium rate case costs for the other operating and maintenance costs.

Frozen Capital Structure:

18. Should Empire divisional customer rates in Years 6-10, after the Pre-Moratorium

rate case, be calculated, as proposed by the Companies, using the stand-alone Empire capital ordered by the Commission in the Pre-Moratorium rate case?

Yes. This is a critical component of the Regulatory Plan.

The reason for this proposal is that, absent the merger, the capital structure for Empire as a continued stand-alone company would not have changed appreciably and as a consequence using UtiliCorp's proposal will result in no "new" cost for the Empire customers. (Ex. 4, p. 29). In addition, because UtiliCorp will be converting 100% of Empire existing equity to UtiliCorp equity, no decrease in the equity investment actually occurs. (Ex.). Because no new or increased costs will be passed on to Empire customers, this part of the Regulatory Plan is clearly not detrimental to the public interest. As a result, the Commission should approve it. (Ex. 4 pp. 28-29).

Corporate Allocations:

19. Do the Companies' allocation of escalated corporate overhead costs to the Empire division represent a reasonable assumption as to an escalation rate to be applied to these allocated costs?

Yes. However, this projected inflation rate is largely irrelevant because the actual experience will be used in the Post-Moratorium rate case.

The allocation of escalated corporate overhead costs to the Empire division represents a reasonable assumption as to an escalation rate to be applied to these allocated costs. The actual UtiliCorp overhead costs will be used in the Post-Moratorium rate case. (See Ex. 4, pp. 6-8).

20. Following the closing of the merger, should MPS divisional customer rates be calculated using levels of UtiliCorp corporate overhead allocated costs that assume the non-inclusion of Empire in the UtiliCorp corporate structure?

Yes. This is a critical component of the Regulatory Plan which provides that no merger-related benefits will be realized by MPS customers who are not asked to pay merger-related costs.

Following the closing of the merger, MPS divisional customer rates should be calculated using corporate overhead allocated costs, assuming the exclusion of Empire in the UtiliCorp corporate structure. This component is important to the Regulatory Plan because including the Empire factors will artificially shift the existing Empire overhead savings relating to the merger to the MPS Customers. MPS customers should continue to be allocated their existing level of UtiliCorp corporate costs because the MPS customers are not being asked to bear any of the costs, including premium costs, related to the merger. Therefore, in future MPS rate cases, the allocation factors should not be impacted by the Empire unit. (Ex. 4, p. 28-29).

MPS *Savings Assignment:*

21. Should no or very little merger savings and costs be reflected in the MPS divisional customer rates after the closing of the merger, as proposed by the Companies?

Yes. This is a critical component of the Regulatory Plan which provides that costs will primarily flow to Empire customers along with the savings to offset said costs. There is no requirement that the transaction produce benefits for MPS's existing customers.

None of the savings and costs should be reflected in the rates for the MPS division after the closing of the merger. As previously indicated, one of the purposes of the Regulatory Plan is to ensure that savings are passed on to customers of the Empire unit to offset the costs resulting from the transaction which are also assigned to that unit. In other words, no merger-related benefits are flowed to MPS customers because those customers are not being asked to pay any of the merger-related costs. Further, under the well-established "no detriment" merger standard, there is no requirement that MPS customers realize a benefit in order for the transaction to be approved.

Electric Allocations Agreement:

22. How should the energy costs and profits from off-system sales associated with the joint dispatch of MPS and Empire power supply resources be allocated between these two post-merger UtiliCorp divisions?

These costs and profits should all flow to Empire to offset the merger costs.

Energy costs and profits from off-system sales associated with the joint dispatch of MPS and Empire power supply resources should flow to Empire to offset the merger costs. Allocation of 100% of the incremental margins from off-system sales to Empire is appropriate for two reasons. (Ex.18, p.11.) First, these incremental margins would not be possible except for the addition of the Empire power supply portfolio and transmission assets. Second, allocation of 100% of the incremental margins to Empire places the benefits with the division incurring the cost, including the cost of the premium and the other costs incurred to combine the companies and realize synergies. (Ex. 18, p. 11). In other words, UtiliCorp's decision to concentrate both the merger benefits and the merger costs in the Empire unit simplifies matters and avoids issues of premium allocations to existing customers.

23. Should the Electric Allocations Agreement include the specific calculations for *estimating energy cost savings from joint dispatch and increased profits from off-system sales?*

No.

The Electric Allocations Agreement should not include specific calculations for estimating energy cost savings from joint dispatch and increased profits from off-system sales. UtiliCorp proposes that the calculation for those savings be based on the Electric Allocations Agreement, but the calculations should be separate from the agreement and refined through the use of other models. (Ex. 26, pp. 18-19).

24. Should the Companies recover in rates the transaction costs associated with the merger?

Yes. They are a part of the costs to achieve the merger synergies.

"Transaction" costs along with "transition" costs are necessary to achieve the merger and any resulting synergies. Failure to deduct these costs from resulting merger synergies would result in overstating synergies that could not otherwise be achieved absent the merger. (Ex. 6, p. 7; Ex. 7, p. 29). These costs should be given rate recognition by allowing UtiliCorp to retain merger benefits equal to these costs. (Ex. 7, p. 29).

25. If yes to question 24, over what period of time should these costs be amortized into cost of service?

Ten years for all costs except for Empire bankers' fees and bond solicitation costs which are amortized over 40 years.

Except as indicated, UtiliCorp proposes to recover these costs over a 10 year amortization period. This time period is appropriate as it is a commonly used period for projecting synergies from mergers. There is no lawful requirement that they be amortized over a longer period (Ex. 7, p. 35). Amortizing the costs to achieve over 10 years means that it is likely customers will actually pay less than half of these costs. (Ex. 7, p. 33). UtiliCorp has voluntarily elected to amortize bankers' fees and bond solicitation costs over forty years as those costs most closely parallel premiums which are amortized over forty years.

26. If yes to question 24, what portion of transaction costs should be assigned to nonregulated operations?

The proposed Regulatory Plan includes an implicit and appropriate assignment of a portion of the transaction costs to nonregulated operations.

Empire's nonregulated businesses are self-contained entities which will not realize any significant benefit from the synergies resulting from the merger. Moreover, UtiliCorp's proposal already implicitly reduces the allocation of these costs to the regulated operations to a lower level of costs than can be justified. This is true because the current value of incurring costs which are recovered over a ten year period, with no carrying costs, as UtiliCorp has proposed, yields a payback of approximately 60% of the initial expenditure. That recovery is reduced further by the shortfall of synergies during the rate moratorium. Since the regulated operations of Empire are significantly more than 60% of the total operations, the implicit assignment of costs to achieve to regulated operations, as proposed by UtiliCorp, actually under-allocates costs to the regulated operations. (Ex. 7, pp. 34).

Costs to Achieve:

27. Should the Companies recover in rates the "costs to achieve" associated with executive severance payments?

Yes. Executive severance payments approximating three years of salaries will be incurred in order to realize the synergies from eliminating the salaries of those executives over the ten years of the Regulatory Plan. To reflect the synergies from the elimination of ten years of the executive salaries, while not reflecting the executive severance costs needed to achieve those savings, would clearly not be fair. Cost recovery of the executive severance costs is already projected to be less than half the actual costs incurred due to time value of the recovery and the shortfall of synergies during the moratorium (Ex. 7, p. 33).

28. Should the Companies recover in rates the costs of the "paid advisory board?"

Yes. The Advisory Board is a condition set out in the merger agreement and is necessary to accomplish the merger. In addition, the cost of three years of the Advisory Board replaces the cost of ten years of the Empire Board of Directors. To not recognize the merger-required costs of the Advisory Board while reflecting the related synergies would clearly not be fair. Cost recovery is already projected to be less than half the actual costs incurred due to time value of the recovery and the shortfall of synergies during the moratorium. (Ex. 7, p. 33).

29. Should the Companies recover in rates FAS 106 curtailment costs through a ten-year amortization?

Yes. The benefit of the curtailment cost extends to the entire 10-year period that is covered by UtiliCorp's Regulatory Plan. Staff recognizes (Traxler page 23, lines 9-12) that the curtailment costs are directly caused by the position reductions that create the synergies reductions that extend for the entire ten years of the Plan. The synergies are significantly higher in years 6-10 than in years 1-5. ($11.5 million). In spite of those synergies, Staff would have UtiliCorp absorb the entire $2.7 million of curtailment costs against the benefits of $11.5 million during years 1-5 (41% of the synergies), while customers receive a benefit of $16.5 million during years 6-10 (59% of the synergies) at no cost. Under UtiliCorp's proposal, the curtailment cost will be amortized evenly over 10 years, which results in an even split of $2.7 million cost between the two 5-year periods even though the benefits to the customers in years 6-10 are much higher than during years 1-5. The original treatment is more than fair.

Deferral and amortization of the curtailment cost over ten years is entirely consistent with the Regulatory Plan. That plan defers costs during the moratorium that will yield benefits during the entire ten years. Almost all of the Costs to Achieve (including severances, retention costs, and

IT transition costs) are incurred in the moratorium period and amortized over the ten years of the plan.

UtiliCorp's proposed treatment of curtailment costs is appropriate and it recognizes the impact of the regulatory process on accounting principles. It is no different than the requested treatment of severance costs.

30. For those "costs to achieve" that are deemed eligible for rate recovery, how should they be accounted for pending consideration in a future general rate proceeding?

These costs should be tracked to ensure rate recovery.

31. Should various determinations concerning the test year, update and true-up periods, capital structure, ratemaking treatment of merger savings and costs, and other items related to Empire's planned Pre-Moratorium rate proceeding be made by the Commission in this proceeding?

Yes.

32. Should the in-service criteria applicable to Empire's planned State Line Combined Cycle Unit be determined by the Commission in this proceeding?

Yes.

33. If the answer is "yes" to questions (2), what in-service criteria should be adopted?

The Southwest Power Pool criteria.

Market Power:

34. Will a post-merger UtiliCorp possess more horizontal, vertical, or retail market power?

No. There has been no evidence presented which demonstrates that UtiliCorp will possess significantly more market power than it possesses today, prior to the merger. Neither FERC nor this Commission has required market power studies prior to this point, which implies that it should not be a concern in evaluating whether the merger is in the public interest. Indeed, FERC ruled that the merger "will not create or enhance the ability of the merged company to raise prices or decrease output in downstream electricity markets." *Order Conditionally Authorizing Mergers*, FERC Dockets EC00-27-000 et al., p. 9 (July 26, 2000). Nevertheless, the FERC did require that the applicants "submit a revised competitive analysis six months prior to commencement of integrated operations." *Id.* at p. 11. Therefore, if adverse situations are indicated by that comprehensive market power study, as ordered by the FERC, then the FERC will have the authority and the opportunity to deal appropriately with any concerns at that time.

35. Will the merger allow the Companies to take valuable, limited transmission capacity necessary for other Missouri utilities to maintain deliveries under their purchased power contracts?

No. There is no reduction of Available Transmission Capacity ("ATC"). UtiliCorp witness Dennis Florom testified in response to concerns raised by Springfield that there does not appear to be any real basis for its concerns. To the contrary, he testified that with additional planned construction (the LR-Nashua line and the Nevada-Asbury line), the ATC in these regions could actually be increased because of a change in the direction of the power flows. (Ex. 25, p. 11, Tr. 1134, 1152). In any event, Springfield's concerns at this time only amount to speculation about what might occur. If they ever actually materialize, Springfield would be able to seek redress at the FERC, since the FERC has exclusive jurisdiction over these matters. *Transmission Access Policy Study Group, et al., v. FERC,*[6] (D.C. Cir. 2000) – F.3d – ; 16 U.S.C. § 824(b). The FERC is

[6] Since this is a recent opinion which has not yet been published in the official reporter, access to the opinion can be gained through the Internet at the following URL: http:/pacer.cadc.uscourts.gov/common/opinions/200006/97-1715a.txt

obviously monitoring the situation considering the condition that it placed on its approval of the merger. *Order Conditionally Authorizing Mergers*, supra, p. 11.

Transmission Access and Reliability:

36. Have the Companies conducted and provided adequate studies of the impact of the proposed merger upon transmission facilities within, and interconnecting with, the State of Missouri, and upon all providers of electric service in the State, to prove that the proposed merger is not detrimental to the public interest?

Yes. This is a matter under the jurisdiction of the FERC and this information has been filed with the FERC. As noted above, the FERC conditionally approved the merger based on the information already provided, and required that additional information be provided six months prior to any actual implementation of transmission changes. In so doing, the FERC said that it "will review the applicant's revised analysis along with any proposed mitigation, and use its authority under section 203(b) of the FPA (Federal Power Act) if necessary to impose any conditions necessary to mitigate potential adverse competitive effects." *Order Conditionally Authorizing Mergers*, supra, p. 12. Therefore, there is no reason and no basis for this Commission to duplicate the analysis to be performed by the FERC.

37. Will the proposed merger provide the Companies the ability to gain unduly preferential priority of access to limited transmission facilities and/or exercise their post-merger transmission access anti-competitively, to the detriment of other customers in the State and therefore to the detriment of the public?

No. This is a matter under the jurisdiction of the FERC and information concerning this matter has been filed with the FERC. See the discussion regarding Point 36 above.

38. Could a post-merger UtiliCorp re-functionalize its transmission facilities in anti-competitive ways to the detriment of the public?

No. UtiliCorp post-merger will follow FERC guidelines as articulated in the 7 factor test.

Evaluation of transmission facilities using the FERC standard is on-going. This is a matter under the jurisdiction of the FERC and the FERC is monitoring it, as set out in the discussion under Point 36 above.

39. Do the Companies being merged adhere to a single, consistent set of standards for designing and operating their transmission facilities and, if no, would not adhering to a single, consistent set of standards for designing and operating their transmission facilities be detrimental if the merger is approved?

The Companies each adhere to NERC planning and operating standards. UtiliCorp has agreed to comply with the criteria of any RTO that it joins. At this time, it has agreed to comply with the Southwest Power Pool criteria. (Tr. 1131-1132). In any event, this is a matter within the exclusive jurisdiction of the FERC as regards wholesale transmission situations, and as the FERC recognized repeatedly, if a situation occurs, anyone may file a section 206 complaint with the FERC. *Order Conditionally Authorizing Mergers*, supra, p. 13.

Stranded Costs:

40. Would ratepayers be harmed if UtiliCorp were allowed to include any portion of the acquisition adjustment in its future calculation of stranded costs?

The determination of stranded costs will be made in the future by the General Assembly and the Commission.

Synergies in Unregulated Operations:

41. Are some of the synergies (e.g., generation) included in the 10-year merger synergy calculations likely to accrue primarily to shareholders if electric restructuring occurs in Missouri prior to the end of the 10-year period used to calculate the merger synergies?

The General Assembly and Commission will determine conditions of electric restructuring in Missouri and in so doing will exercise its judgment on the assignment of merger synergies. If generation synergies are no longer available to Empire customers as a result of electric restructuring in Missouri, the ability to recover premium costs will also be reduced by the Regulatory Plan.

42. Will UtiliCorp receive additional benefits from the proposed merger that are not reflected in the 10-year merger synergy calculations?

UtiliCorp will pass on benefits to customers under its proposed Regulatory Plan and it is UtiliCorp's intent to maximize merger benefits to such an extent that they exceed estimates.

Affiliate Transactions:

43. Will UtiliCorp's affiliate transactions, as a result of the proposed merger, increase in size and scope and thus become more complex and difficult to monitor, while at the same time - it will become more important to monitor such transactions to ensure compliance with standards?

No. The Commission recently promulgated rules to address conduct and record keeping concerning affiliate transactions. Compliance with these rules will neither be made more, nor less, complex as a result of the proposed merger.

Energy Efficiency:

44. Will the proposed merger have a detrimental impact on low-income weatherization and therefore on the public?

No. UtiliCorp participates and provides funding to low-income weatherization and energy efficiency programs and plans to continue support of those programs in the future. (Ex. 17, pp. 25-27).

45. Will the proposed merger have a detrimental impact on other energy efficiency assistance and therefore on the public?

No. UtiliCorp currently supports several programs that promote energy efficiency in Missouri such as the Department of Energy's Motor Challenge program; financing of condensing units and heat pumps; the Technical Partners program; and, energy audits for residential, commercial and industrial customers. (Ex. 17, pp. 26-27). UtiliCorp is willing to discuss other/additional programs, including methods for funding, outside of the merger proceeding with the MDNR Energy Center and other interested parties. (Ex. 17, p. 27). In addition, see the discussion found under Point 84 below.

46. Will the proposed merger have a detrimental impact on the use of renewable energy resources and therefore the public?

No. There are certain production facilities, both at UtiliCorp and Empire, that currently make use of renewable resources. After the merger, those facilities will continue to be operated as they are currently. (Ex. 17, p. 30). UtiliCorp recently introduced renewable wind energy to Missouri customers and will look for opportunities to introduce renewable energy in the future. (Ex. 17, p. 24). It was the first utility in the state to introduce a green power tariff and remains committed to being environmentally responsible. (Ex. 17, p. 31). Further, see the discussion found under Point 84 below.

Empire Retiree Benefits:

47. If the Commission approves the Companies', Public Counsel's or any regulatory plan, should the plan be modified to include provision for continuation and funding of Empire Retiree health, life and accidental death/dismemberment insurance, and surviving spouse benefits, in order for it to comply with law and otherwise satisfy the not detrimental to the public interest standard for approval of the merger?

On October 18, 2000, UtiliCorp, Empire and the Empire Retirees filed with the Commission a Stipulation and Agreement which addresses this issue. The Commission should approve the terms of that Stipulation and Agreement in addressing this issue.

48. Should the calculation of merger costs/benefits include the treatment accorded Empire Retiree health, life and accidental death/dismemberment insurance, and surviving spouse benefits?

Yes. These are part of the synergies to achieve.

Empire Health Insurance Trust Account Assets:

49. Does the proposed merger's treatment or disposition of the Empire health insurance trust account assets comply with law and otherwise satisfy the not detrimental to the public interest standard?

On October 18, 2000, UtiliCorp, Empire and the Empire Retirees filed with the Commission a Stipulation and Agreement which addresses this issue. The Commission should approve the terms of that Stipulation and Agreement in addressing this issue.

Labor Protective Provisions:

50. If the Commission approves the Companies', Public Counsel's or any regulatory plan, should the plan be modified to include "Labor Protective Provisions" protecting current employees of Empire from adverse employment consequences, including termination and loss of employment, in order for it to comply with law and otherwise satisfy the not detrimental to the public interest standard for approval of the merger?

No. IBEW Local 1474 witness Courtney has suggested that based on his speculation as to possible outcomes and irrespective of what actions may otherwise be lawfully taken by Empire's management, that the Commission should unilaterally impose certain "Labor Protective Provisions."

First, Mr. Courtney proposed that in order to protect the interests of bargaining unit employees the Commission order, as a condition of the merger, that there be no elimination of bargaining unit jobs. (Ex. 100, p. 21). In the alternative, he proposes that the Commission determine when jobs can and cannot be eliminated based on its review of studies, evidence and documentation and that UtiliCorp be required by the Commission to provide training to those eliminated. (Ex. 100, p. 21-22).

Second, Mr. Courtney proposed that the Commission require UtiliCorp to maintain medical insurance coverage for bargaining unit employees with no increase in the percentage of employee contributions that is currently required. (Ex. 100, p. 25). Lastly, Mr. Courtney requested a condition that UtiliCorp not terminate or adversely change the retirement plan, retirement funding or retirement benefits affecting bargaining unit members or, in the alternative, that the retirement benefits of currently employed bargaining unit members be grandfathered until their retirements. (Ex. 100, pp. 25-26).

A significant flaw in the IBEW's proposal is that the conditions are not truly merger related. All three proposed conditions seek to eliminate uncertainty for employees that exists today, with or without the merger. There is currently a collective bargaining agreement in effect which provides some protection for bargaining unit employees (or does not in instances where no such protections were agreed to by the parties. (Ex. 20, p. 9)). UtiliCorp has stated that it would recognize the IBEW as the representative of the bargaining unit at Empire and that the existing collective bargaining agreement will be assumed by UtiliCorp following the merger. (Ex. 31, pp. 1-2; Ex. 20, p. 9).

What the IBEW wants is extra protection. They want a better deal post-merger than they have today. The standard to be applied by the Commission does not require this. Under UtiliCorp's proposal, the status quo, in terms of management's ability to make decisions, is maintained after the merger. The proposed Labor Protective Provisions are not necessary to reach this result and should not be ordered by the Commission.

51. Should the calculation of merger costs/benefits include the treatment accorded "Labor Protective Provisions" protecting current employees of Empire from adverse employment consequences, including termination and loss of employment?

Yes, if the Commission decides to include "Labor Protective Provisions" in its final order.

52. If the adoption of conditions by the Commission cannot in the view of particular parties eliminate in total the situation that the proposed merger is detrimental to the public interest, but regardless of this view of particular parties, the Commission decides to approve the proposed merger, should the Commission adopt any or all of the following conditions, as part of its approval of the Companies' merger?

See the discussion below.

Stranded Costs Condition:

53. Should the Staff's proposed condition regarding elimination of the acquisition adjustment from future stranded cost calculations be adopted?

No. This is a matter for the General Assembly and Commission when stranded costs are defined.

Pension Funds Condition:

54. UtiliCorp agrees that in post-merger cases involving UtiliCorp's Empire operating division, UtiliCorp will maintain the pre-merger funded status of the Empire pension fund by accounting for it separately. UtiliCorp will, however, be allowed to combine the assets. The accounting on a going forward basis would start with a market value of assets evaluation performed by Empire's actuarial firm at the time of merger closing. On a going forward basis, the net rate of return (actual earned return income earned on the assets during the year less benefits paid) on the combined pension assets will be used.

Access to Book and Records Condition:

55. Should the Public Counsel's condition that the merged entity be required to allow Public Counsel and the Staff access to its books, records, employees and those of its wholly owned subsidiaries, be adopted?

No. However, UtiliCorp agrees to comply with all lawfully promulgated and effective Commission rules.

56. Should the Public Counsel's condition that the merged entity be required to agree to comply with the Commission's affiliate transaction rules, be adopted?

No. Legally an agreement to comply with a lawful rule is redundant. However, UtiliCorp agrees to comply with all lawfully promulgated and effective Commission rules. (Ex. 5, p. 21).

Income Taxes Condition:

57. UtiliCorp agrees that if the merger is determined to be a taxable event and deferred taxes of Empire are thereby lost, UtiliCorp be required to include an amount equal to those deferred taxes in future Empire rate proceedings as an offset to rate base.

Surveillance Condition:

58. UtiliCorp agrees to continue to file separate surveillance reports for UtiliCorp's MPS and Empire operating divisions following the closing of the merger.

Customer Service Indicators Condition:

59. Should the Staff's proposed conditions regarding measurement, reporting and potential imposition of remedial action concerning certain customer service indicators be adopted?

No. It is UtiliCorp's obligation, without supplemental conditions, to deliver quality service to all customers and manage the business by utilizing all available data and monitoring tools, while taking into account customer feedback. UtiliCorp has a solid track record of providing qualify service in Missouri for more than 80 years. This is further evidenced by the fact that there has been a downward in the number over customer complaints over the last three years, although the overall number of customers served has increased. Because actions to improve performance have been a foundation of UtiliCorp's management philosophy and responsibility and exhibited by UtiliCorp, a Commission order requiring remedial procedures is not warranted or necessary. (Ex. 17, p. 7).

Market Power Conditions:

60. Respecting vertical market power, should the Staff's condition that the Companies be required to commit to join a single regional transmission entity before the October 15, 2000 deadline of FERC Order No. 2000, be adopted?

No. FERC's deadline of October 15, 2000 has been met. As discussed by the FERC in regard to this same topic, the Companies have several choices as to which RTO (Regional Transmission Organization) to join. The Companies should be given the same latitude as all other public utilities under FERC Order 2000 regarding the timing of their statement of intentions with respect to the specific RTO they intend to join. No compelling reason exists to single out UtiliCorp and Empire here and treat them differently than any other public utility subject to the same deadline. The FERC agreed with this notion, and said: "We accept Applicants' commitment to join an RTO ... and rely on it in approving these mergers." *Order Conditionally Authorizing Mergers*, supra, p. 51.

61. Respecting horizontal market power, should the Staff's condition that at the time retail competition becomes lawful in Missouri the Companies be required to agree to submit a study showing what percentage of load throughout their merged service territory can be served from competitive generation sources, be adopted?

No. UtiliCorp will comply with requirements ordered by the Commission for studies at that time. At this point, it is only speculation as to when and if retail competition will occur. Further, UtiliCorp should not be expected to agree now to complete a study under conditions that may be contrary to conditions the Commission believes are appropriate at the appropriate future time when such a study is ordered. (Ex. 4, p. 32).

62. Respecting horizontal market power, should Public Counsel's condition that the Companies be required to agree that they will be subject to the same Horizontal Market Power Provisions that were approved by the Commission in Case No. EM-97-515 be adopted?

No. The Commission has determined that it is not the time for this study. UtiliCorp has stated it will comply with the requirements at the time a study is ordered. Further, UtiliCorp should not be expected to agree now to complete a study under conditions that may be contrary to conditions the Commission believes are appropriate at the future time when such a study is ordered. (Ex. 4, p. 32).

63. Respecting vertical market power, should Public Counsel's condition that the Companies be required to agree to join a Regional Transmission Organization (RTO) under the same Vertical Market Power Provisions that were approved by the Commission in Case No. EM-97-515 be adopted?

No. Case No. EM-97-515, concerning Western Resources, was a different case with a different set of conditions and circumstances and its provisions are not applicable here. The Companies are subject to the requirements of the FERC in regard to joining and RTO, as noted above. Further, the FERC has found that special conditions argued by intervenors are not appropriate in this regard. *Order Conditionally Authorizing Mergers*, supra, p. 51.

64. Respecting retail market power, should Public Counsel's condition that the Companies be required to agree that they will subject to the same Retail Market Power Provisions that were approved by the Commission in Case No. EM-97-515 be adopted?

No, for the reasons previously stated.

65. Respecting horizontal, vertical, and retail market power, should Public Counsel's condition that the Companies be required to agree that they will be subject to the same Market Power Legislation Provisions that were approved by the Commission in Case No. EM-97-515 be adopted?

No, for the reasons previously stated.

66. Respecting transmission capacity, should Springfield's proposed conditions regarding Transmission Access and Reliability (which are set forth in detail herein under the heading "Transmission Access and Reliability Conditions") be adopted?

No. See discussion below.

Transmission Access and Reliability Conditions:

67. (a) Should the Commission order the Joint Applicants to conduct production cost, load flow and stability studies of the impact of the proposed merger upon transmission facilities within, and interconnecting with, the State of Missouri, and upon all providers of electric service in the State, prior to approval of the merger and if so, what should such studies contain? (b) Should the Joint Applicants be ordered to provide these studies in hard copy and electronic form to the other parties, and should the Commission keep this case open until such time as the studies have been completed and all parties have been allowed sufficient time to review/analyze and file comments in this case on such studies? (c) Should the Joint Applicants be required to construct and/or upgrade, at their expense, transmission facilities necessary to insure that their integrated operation will not adversely impact others? (d) If the answer to (c) is yes, what transmission facilities?

No. These questions relate to FERC jurisdictional issues. *Transmission Access Policy Study Group, et al., v. FERC,* (D.C. Cir. 2000) – F.3d – ; 16 U.S.C. § 824(b). The FERC has examined closely the issues and the conditions proposed by Springfield as Springfield is an intervenor in the merger case before the FERC and submitted copies of its previously filed Missouri testimony. In fact, the FERC determined that a sufficient response is to require UtiliCorp to file a supplemental market power analysis. This is not a matter over which this Commission has subject matter jurisdiction.

68. Should the Commission impose conditions on the merger such that:

- **The Joint Applicants be required by the Commission to commit that with respect to any and all generating resources associated with any one of their existing four control areas (including purchased generating resources) serving load in any other control area of the merging companies, the merging companies should waive or not assert (i) native load priority on scheduling and curtailing non-firm network transmission service; (ii) the native load preference arguably accorded to bundled retail loads over wholesale loads under the decision in <u>Northern States Power Co., v. FERC</u>, 176 F.3d 1090 (8th Cir. 1999); and (iii) use of any native load priority that will enable any one of the merging companies to import power through constrained interfaces so as to free up its local generating resources for off-system sales?**

No. Same response as under Point 35.

- **The Joint Applicants not be allowed to combine any or all of their existing control areas without first submitting their plans for such combinations to peer group review and approval by the SPP ISO/RTO and the affected regional reliability councils?**

No. UtiliCorp and Empire will submit their plans to FERC for approval. See the discussion under Point 35 and Exhibit 25.

- **The merged Companies be required to schedule all power flows and/or reserve transmission capacity on the relevant OASIS for purposes of carrying out any internal dispatch between what are now four geographically isolated pockets of load and generation in four separate control areas of the merging companies, to implement real-time monitoring of intra-company flows associated with internal dispatch, to report continuously the amount of such flows on its OASIS and to make all reasonable efforts to limit internal dispatch to levels at or below the transmission capacity reserved for purposes of carrying it out?**

No. The merged companies will continue to comply with FERC Orders 888 and 889. See the discussion under Point 35 and Exhibit 25.

- **If the burdens on Springfield attributable to internal dispatch of the Joint Applicants turn out to be substantial (i.e., a substantial increase in curtailments of Springfield's firm schedules from Montrose), the merged company be required to reimburse Springfield for the incremental costs to Springfield of re-dispatching Springfield's generating resources that are attributable to the post-**

merger integrated operations of the Joint Applicants' separate systems?

No. See the discussion under Point 35 and Exhibit 25. Springfield must take any such issues to FERC for evaluation because FERC has subject matter jurisdiction over such transmission issues.

- **The merged company be required to put all of its transmission facilities in Missouri and Kansas under the control of the SPP ISO/RTO in a single zone under the SPP transmission tariff and that the merged company join - and maintain membership in - the SPP ISO/RTO and be required to file an integrated open access transmission tariff ("OATT") and an integrated transmission rate for their four control areas in Missouri and Kansas?**

No. The SPP petition for approval for ISO status by FERC was unanimously defeated in May. The merged company will join a FERC-approved RTO. See the discussions under Point 60.

- **UtiliCorp be required to (i) set aside transmission capacity for Capacity Benefit Margins (CBM) and Transmission Reserve Margins (TRM) and (ii) to waive any future claims for CBM and TRM?**

No. UtiliCorp will use prudent practices as specified by NERC guidelines (North American Electricity Reliability Council) to reserve CBM and TRM (Exhibit 25, p. 9). See the discussion under Point 35.

69. Should UtiliCorp be required to not seek refunctionalization of any currently categorized transmission lines of the merging companies that operate at or above 69 kV?

No. UtiliCorp currently uses the FERC 7 factor test in the classification of transmission versus distribution. The FERC 7 factor test is not based solely on voltage but usage and other characteristics as well. This matter is within the exclusive jurisdiction of FERC.

70. Should the Joint Applicants be required (i) to establish and implement a single standard for transmission system design and operation for the entirety of the merged company and (ii) to comply with the Southwest Power Pool Criteria?

No. FERC has exclusive jurisdictional authority over transmission issues such as this. The Joint Applicants will continue to comply with the FERC Orders 888, 889 and 2000.

Load Research Condition:

71. Should the Staff's proposed conditions regarding production of load research data, following closing of the merger, be adopted?

No, this proposed condition should not be a part of a Commission order although UtiliCorp does agree with the Staff testimony in some aspects. For example, UtiliCorp agrees that the Empire territory should be treated separately from the MPS service territory for load research purposes, as long as MPS and Empire have separate rate structures. (Ex. 17, p. 16). Also, consistent with the Staff recommendation, UtiliCorp is planning to bring its load research program in-house and discontinue its vendor contract once all the needed systems are in good working order. (Id.).

However, UtiliCorp does not agree that this docket is an appropriate place to establish quality control standards and checks and balances. (Ex. 17, p. 17). Any load research data requirements must take into account the tradeoffs between expense and accuracy. (Ex. 17, p. 19). Without balancing these items, the process would be unnecessarily costly without creating ratepayer and shareholder value. (Id.).

UtiliCorp is willing to participate either as a part of an electric utility work group or, to meet individually with the Staff to discuss load research requirements. Either process would better address the needs and costs of load research than would Commission-ordered standards resulting from this docket.

Fuel Energy Cost Information Condition:

72. After the closing of the merger, UtiliCorp agrees to provide historical actual hourly generation, energy purchases and sales data, and other information required by Commission Rule 4 CSR 240-20.080 in electronic format accessible by a spreadsheet program for both UtiliCorp and Empire. UtiliCorp will also provide access to such additional document as may

be necessary for the Staff to analyze fuel and energy costs.

Energy Conditions:

73. Should the Commission approve DNR's proposed condition that UtiliCorp must enter into a partnership with MDNR and other interested parties to market and leverage funds for the development of energy efficiency programs?

See the discussion found under Point 84 below.

74. Should the Commission approve DNR's proposed condition that UtiliCorp must develop or retain low-income service packages to meet customer needs, reduce energy costs and provide a return to UtiliCorp?

See the discussion found under Point 84 below.

75. Should the Commission approve DNR's proposed condition that UtiliCorp must offer additional renewable energy options to Missouri customers?

See the discussion found under Point 84 below.

76. Should the Commission approve DNR's proposed condition that UtiliCorp must target outreach to customers that are income eligible and encourage them to take advantage of the opportunity to reduce energy consumption and to improve home affordability?

See the discussion found under Point 84 below.

77. Should the Commission approve DNR's proposed condition that UtiliCorp must amend the cooperative agreement between UtiliCorp and Kansas City, Missouri to permit averaging unit cost within the agreement to maximize the opportunity to assist customers?

See the discussion found under Point 84 below.

78. Should the Commission approve DNR's proposed condition that UtiliCorp must eliminate tying the dollar amount to specific measures to maximize the energy conservation measures installed in each home? Should the Commission approve DNR's proposed condition that any energy efficient measure that is deemed cost-effective as a result of computer analysis, as stated in the agreement between UtiliCorp and Kansas City, Missouri, shall be permitted?

See the discussion found under Point 84 below.

79. Should the Commission approve DNR's proposed condition that UtiliCorp must permit energy-efficiency assistance to all eligible households? Should the Commission approve DNR's proposed condition that UtiliCorp must allow funds to be spent on non-electric appliances?

See the discussion found under Point 84 below.

80. Should the Commission approve DNR's proposed condition that UtiliCorp must implement a 25-site Benefit Outreach and Screening Software (BOSS) pilot project, and must expand the program, as appropriate, if found to successfully deliver benefits to low-income customers?

See the discussion found under Point 84 below.

81. Should the Commission approve DNR's proposed condition that UtiliCorp must implement a base load and space heating electric energy efficiency program directed toward high use payment-troubled low-income customers?

See the discussion found under Point 84 below.

82. Should the Commission approve DNR's proposed condition that UtiliCorp must implement a pilot solar energy program directed toward high use low-income customers?

See the discussion found under Point 84 below.

83. Should the Commission approve DNR's proposed condition that UtiliCorp must implement a periodic survey process through which the merged company will take pro-active efforts to identify which of its payment-troubled customers represent low-income households?

See the discussion found under Point 84 below.

84. Should the Commission approve DNR's proposed condition that UtiliCorp must implement an Outcome-based Performance Reporting System (OPRS) through which the customer service outcomes to low-income customers can be systematically tracked over time?

No. UtiliCorp opposes Points 73 through 84 being made conditions to approval of the merger. UtiliCorp is willing to discuss with the MDNR and other parties options for additional or different types of programs related to energy and low income weatherization or assistance, as long as discussions also involve methods of recovery of increased costs for these programs. UtiliCorp intends to continue to participate in low income and energy efficiency programs and supports a number of them currently through funding and other measures.

UtiliCorp witness Steve Pella discussed the various proposals made by DNR in depth in his Surrebuttal Testimony. (Ex. 17, pp. 20-35). This discussion indicates that UtiliCorp already participates in a number of programs designed to benefit "low income" customers. DNR's proposals bring up potentially problematic issues of subsidies between customer classes. As Mr. Pella testified, "this is not the proper forum to make class subsidy adjustments. Any such action should be developed within the context of an overall rate review and full cost of service study." (Ex. 17, p. 22). It would raise questions concerning the Commission's subject matter jurisdiction and come dangerously close to confiscation of UtiliCorp's assets for the Commission to order UtiliCorp to participate and fund programs of the nature discussed by DNR without a mechanism in place for UtiliCorp to recover the costs of such programs.

Public Counsel Regulatory Plan Condition:

85. If the Commission approves the proposed merger, should Public Counsel's Regulatory Plan be approved?

No. The Public Counsel's Regulatory Plan would render the proposed transaction economically unfeasible.

Empire Retiree Benefits Condition:

86. Should the retirement health, life and other insurance benefits and surviving spouse benefits, currently applicable to Empire Retirees be "grandfathered" in as a condition of approval of the merger?

On October 18, 2000, UtiliCorp, Empire and the Empire retirees filed with the Commission a Stipulation and Agreement which addresses this issue. The Commission should approve the terms of that Stipulation and Agreement in addressing this issue.

Labor Protective Provisions Condition:

87. Should the Commission require, as a condition of approval of the merger, the imposition of "Labor Protective Provisions" protecting current employees of Empire from adverse employment consequences, including termination and loss of employment, as a result of the merger?

No. See the discussion at Point 50 above.

VII. CONCLUSION

In the final consideration, the Commission should approve the merger between UtiliCorp and Empire and the proposed Regulatory Plan. The "no public detriment" standard is clearly satisfied. The merger as proposed will benefit all stakeholders and the long term economic development of the State of Missouri.

Respectfully submitted,

James C. Swearengen #21510
Gary W. Duffy #24905
Dean L. Cooper #36592
Brydon, Swearengen & England P.C.
P.O. Box 456
Jefferson City, MO 65102-0456
Telephone (573) 635-7166
Facsimile (573) 635-0427
E-Mail Lrackers@brydonlaw.com

Attorneys for UtiliCorp United Inc. and
The Empire District Electric Company

Certificate of Service

I hereby certify that a true and correct copy of the above and foregoing document was sent by U.S. Mail, postage prepaid, or hand-delivered, on this 31st day of October, 2000, to all parties of record.

APPENDIX A

See eg. Re UtiliCorp United, EM-2000-358, February 7, 2000; *Re Union Electric Co. d/b/a AmerenUE*, EM-99-106, December 30, 1998; *Re UtiliCorp United*, GM-98-531, July 21, 1998; *Re Southern Union* Co., GM-98-146, November 12, 1997; *Re Southern Union*, GM-97-341, June 25, 1997; *Re MCI Telecommunications Corp., Inc.*, TM-97-274, April 22, 1997; *Re Bill Gold Investments, Inc.*, SM-97-139, December 6, 1996; *Re World Com*, TM-97-93, December 13, 1996; *Re Union Electric Co.*, EM-97-61, October 29, 1996; *Re Union Electric Co.*, Em-96-149, February 21, 1997; *Re Southern Missouri Gas Co.*, GM-96-175, April 9, 1996; *Re Green Hills Telephone Co.*, TM-95-323, August 29, 1995; *Re Riverside Utility Co.*, SM-95-308, November 28, 1995; *Re UtiliCorp United*, EM-95-303, July 11, 1995; *Re GTE Midwest Inc.*, TM-95-163, July 11, 1995; *Re Missouri American Water Co.*, WM-95-150, December 22, 1994; *Re GTE Midwest Inc.*, TM-95-142, July 11, 1995; *Re GTE Midwest Inc.*, TM-95-135, July 11, 1995; *Re GTE Midwest Inc.*, TM-95-134, July 11, 1995; *Re Citizens Communications Corp.*, TM-95-130, December 20, 1994; *Re Eastern Missouri Telephone Co.*, TM-95-87, December 12, 1995; *Re UtiliCorp United*, EM-95-84, July 30, 1997; *Re Missouri Gas Co.*, GM-94-252, October 12, 1994; *Re Merger of GWC Corp.*, WM-94-191, March 10, 1994; *Re Union* Electric, EM-94-90, December 3, 1993; *Re C. Ivan Davis and Willodean Davis d/b/a Davis Water Co.*, WM-94-61, September 24, 1993; *Re Western Resources Inc. d/b/a Gas Service*, GM-94-40, December 29, 1993; *Re Union Electric Co.*, EM-93-341, September 10, 1993; *Re Union Electric Co.*, EM-93-243, May 25, 1993; *Re Cuivre River Electric Service Co.*, EM-93-167, June 11, 1993; *Re GTE North Inc.*, TM-93-1, December 18, 1992; *Re UtiliCorp United*, EM-92-268, May 20, 1992; *Re Sho-Me Power*, EM-92-157, February 28, 1992; *Re Missouri Telephone Co.*, TM-91-348, September 13, 1991; *Re Kansas Power & Light*, EM-91-213, September 24, 1991; *Re Arkansas Power & Light Co.*, EM-91-29, September 19, 1991; *Re Kansas City Power & Light*, HM-90-4, December 29, 1989; *Re Trigen-Kansas City Energy District Energy Corp.*, HM-90-5, December 29, 1989; *Re Crystal Springs Development Co. Inc.*, SM-89-114, December 28, 1988; *Re Oak Tres, Inc.*, WM-89-73, November 22, 1988; *Re W.P.C. Sewer Co.*, SM-89-45, December 16, 1988; *Re UtiliCorp United*, EM-87-26, March 20, 1987; *Re UtiliCorp United*, EM-87-21, October 20, 1986; *Re Kansas City Power & Light*, EM-86-121, June 2, 1986; *Re Missouri Water Co. of Independence, Missouri*, WM-86-95, March 14, 1986; *Re Kansas Power & Light Co.*, GM-85-186; *Re Union Electric Co.*, HM-84-38; *Re Kansas Power & Light*, GM-84-12, September 12, 1983; *Re Companies Comprising the Union Electric System*, EM-83-248, December 15, 1983; *Re Lake St. Louis Sewer Co.*, SM-81-325, March 9, 1982; *Re St. Joseph Light & Power Co.*, Case No. 18,179, November 21, 1974; *re Drexel Telephone Co.*, Case No. 18,156, October 21, 1974; *Re Continental Water* Co., Case No. 18, 143, August 14, 1974; Re *Doniphan Telephone Co.*, Case No. 17,762, June 15, 1973; *Re Continental Water Co.*, Case No. 17,735, May 2, 1973; *Re Continental Telephone Co.*, Case No. 17,535, October 31, 1972; *Re Allied Telephone Company*, Case No. 17,434, April 28, 1972; *Re United Telephone Co.*, Case No. 18, 617, December 12, 1979; *Re Ferrellgas, Inc.*, Case No. 17, 968, March 5, 1974; *Re Continental Water Co.*, Case No. 17,735, May 2, 1973; *Re Pevely Water Co.*, Case No. 17,472; September 1972; *Re Middle South Utilities, Inc.*, Case No. 16,794, October 3, 1969; *Re Laclede Gas Co.*, Case No. 15, 404, December 11, 1963.

APPENDIX B

- The test year will be the last 12 months of operation of Empire as an independent company or the 12 months ending 12-31-00, whichever is earlier

- The test year will be updated, adjusted or trued-up to at least 6-1-01 or the in-service/commercial operation date of SLCC, whichever is later

- The in-service/commercial operation criteria for SLCC will be established in the merger docket

- The update or adjustment period for the test year or the items to be trued-up will include the SLCC plant along with the following, directly associated adjustments only:

  - Rate base

    - SLCC plant and associated transmission plant, less accumulated depreciation

  - Revenues

    - Customer growth

  - Expenses

    - Fuel associated with customer growth
    - O&M (fixed and variable for SLCC)
    - Depreciation for SLCC
    - Property taxes for SLCC
    - Incremental demand charges for purchased power contracts
    - The cost of gas and the fixed gas transportation charges for SLCC
    - Wage rates

- The capital structure for the Pre-Moratorium rate case will be the normalized capital structure of Empire

- The return on equity for the Pre-Moratorium rate case will be based on Empire as a stand-alone entity

- All open positions that are in existence because of the UtiliCorp/Empire merger will be built into the cost of service in the Pre-Moratorium rate case as if the positions are filled

- No synergies from the UtiliCorp/Empire merger will be flowed through the cost of service in the Pre-Moratorium rate case

- No costs of the UtiliCorp/Empire merger, transition or transaction costs, will be recovered through the cost of service in the Pre-Moratorium rate case