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November 21, 2000

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Missouri Public
Service Commission

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
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P. O. Box 360
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RE: Case No. EM-2000-369 -- In the Matter of the Joint Applications 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, Filed.

Dear Mr. Roberts:

Enclosed for filing in the above-captioned case are an original and eight (8) conformed copies of the **REPLY BRIEF OF STAFF.**

This filing has been mailed or hand-delivered this date to all counsel of record.

Thank you for your attention to this matter.

Sincerely yours,

Steven Dottheim

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SD/lb
Enclosure
cc: Counsel of Record

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Missouri Public Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION OF THE STATE OF MISSOURI

In the Matter of the Joint Applications 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, Filed	)))))))	Case No. EM-2000-369

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I. INTRODUCTION

The Staff in this reply brief has kept the same organization as in the Staff's initial brief in this case. There are some subject areas for which the Staff is not submitting a reply. This is the case because based on the initial briefs of UtiliCorp United Inc., and the other parties, the Staff sees no need to submit a response.

II. BURDEN OF PROOF AND LEGAL STANDARD SECTIONS

A. Burden Of Proof

B. Merger Legal Standard

At the outset the Staff will address a case which UtiliCorp chose not to cite in its initial briefs in either the instant case or the SJLP – UtiliCorp merger case, but raised for the first time in its reply brief in the SJLP – UtiliCorp merger case, and the Staff expects to see this case cited in UtiliCorp's reply brief in the instant case. So as to not be precluded from addressing that case, *State ex rel. Martigney Creek Sewer Co. v. Public Serv. Comm'n*, 537 S.W.2d 388 (Mo.banc 1976), the Staff would note that at page 13 of the UtiliCorp reply brief in the SJLP – UtiliCorp merger case, UtiliCorp asserted as follows:

> . . . In *State ex rel. Martigney Creek Sewer Company v. PSC* 537 S.W.2d 388 (Mo. 1976), the Missouri Supreme Court, in <u>discussing the transfer of utility assets under Section 393.190, RSMO</u>, discussed the Commission's duty to value a utility's property <u>for ratemaking purposes</u>. The Court, quoting from Priest, "Principles of Public Utility Regulation" said:
>
> > "When public utility property is acquired by another public service company, should any cost of acquisition in excess of 'the cost of such property to the person first devoting it to public service' be included in an original-cost rate base? Regulatory agencies which have said 'No' constitute a majority, <u>but there is much respectable authority to the contrary</u>. If the transaction was at arm's length, if it resulted in operating efficiencies, if it received regulatory approval as having been in the public interest, if it made possible a desirable integration of facilities, the 'excess' over original

> cost was capital dedicated to the public service. And that capital would seem entitled to amortization out of operating expenses, rather than 'below the line,' or out of income. The burden of proof may be onerous, but it has been met." (emphasis added). *Id.* at 399.

Clearly, UtiliCorp's request is not a radical departure from established norms. . . .

UtiliCorp chose not to quote the very next paragraph in *State ex rel Martigney Creek Sewer Co. v. Public Serv. Comm'n*, 537 S.W.2d 388 (Mo.banc 1976). Contrary to the impression that UtiliCorp wants to leave with the Commission, that very next paragraph makes clear that the Missouri Supreme Court was not adopting in any manner the acquisition adjustment/merger premium position advocated by UtiliCorp, EDE and SJLP in their merger cases now before the Commission. The Missouri Supreme Court stated that an acquisition adjustment question was not at issue in the *Martigney* case:

> The question is not directly involved in this case because no sale of assets has taken place and the court will not speculate on a hypothetical situation. Suffice it to say that more is involved in the valuation for rate-making purposes of an asset acquired from one utility by another utility at a price substantially in excess of its cost to the utility first donating the asset to public purpose than merely the sales price.

(537 S.W.2d at 399.) The *Martigney* case specifically deals with the questions whether donated plant, contributions in aid of construction and connection fees may be included in rate base for ratemaking purposes.

Finally respecting the *Martigney* case, the Staff would note that the legal standard referred to by Priest in "Principles Of Public Utility Regulation," in order for there to be recovery of the merger premium, is something more than the "not detrimental to the public interest" Missouri standard described by the Joint Applicants. Although the Joint Applicants assert at page 3 of their initial brief that "there is no requirement that the Commission find that ratepayers will be benefited from the [merger] transaction," the standard cited by Priest so requires.

Counsel for UtiliCorp in his opening comments questioned whether this Commission can bind future Commissions by accepting the Joint Applicants' proposed regulatory plan:

> Are we asking you to bind future Commissions? Well, we understand you probably can't do that. We recognize that when the premoratorium and post-moratorium rate cases are decided, you or another commission may not consider itself bound by your decision here in this merger case. Others may want to relitigate these rate issues, and perhaps they may be allowed to do that.
>
> However, the point is, just as in the Rolla gas certificate case, UtiliCorp needs some reasonable assurance in this merger case with Empire that the transaction will make economic sense.
>
> So what are we asking you to decide? We want you to approve the merger with Empire, of course. We want you to approve the regulatory plan and thereby establish some of the groundrules on a going-forward basis. And then we also want you to resolve now some of the other issues which are set out in John McKinney's surrebuttal testimony beginning at page 4.

(Vol. 2, Tr. 47-48). There is nothing in the initial brief of UtiliCorp addressing this issue. It will be interesting to see if there is anything in UtiliCorp's reply brief on this matter. Of course, the Staff will not be able to respond to it, as the issue did not appear in UtiliCorp's initial brief.

There is an issue which counsel for UtiliCorp addressed in his opening statement which UtiliCorp did address in its initial brief at page 14; that issue being whether the Commission can or should make ratemaking decisions in a merger case. Counsel for UtiliCorp commented as follows in his opening statement respecting Re UtiliCorp United Inc., 3 Mo.P.S.C.3d 127, Case No. GA-94-325, Report And Order (August 22, 1994):

> Now, we recognize that these requests concerning both the pre and post-moratorium rate cases are traditionally the types of issues which are deferred to rate cases. However, we want to make it perfectly clear that UtiliCorp needs your decision on these matters now in order to determine if the transaction makes economic sense. In other words, we need to know whether or not UtiliCorp

shareholders who bear all of the financial risks of this transaction will have a reasonable opportunity to recover their investment.

Now, as in the St. Joe case, others will argue here that you can't grant this request, you can't make rate case type decisions in a non-rate-case proceeding. And I think you will recall that, in connection with the St. Joe case, I referred to a specific instance in 1994, in fact, where you had done that very thing.

In a 1994 case, GA-94-325, you granted UtiliCorp a certificate to provide natural gas service in Rolla, Missouri, and in that case, in its application, in its evidence UtiliCorp argued that if it could not provide that natural gas service to Rolla, that it wouldn't make economic sense to UtiliCorp to provide that service unless it got approval on the front end for the subsequent ratemaking treatment for its costs to covert the Rolla customers from propane to natural gas.

And in granting to UtiliCorp the requested certificate, you also granted the ratemaking request, and you authorized UtiliCorp to account for the $300 maximum per customer conversion cost above the line and to include those costs in rate base.

And you went on to say, as you normally do, you made no finding as to the prudence or ratemaking treatment to be given any costs or expenses incurred as a result of granting of the certificate except those cost and expenses dealt with specifically in the body of the Report and Order. And in your decision you commended UtiliCorp for its candor in stressing the make or break nature of the ratemaking treatment of the conversion costs.

And that's exactly what we have here. We are telling you the importance of these ratemaking type decisions in this merger case, and we think that, based on at least this one prior decision, it is clear that our so-called ratemaking requests are not really a radical departure from what you have, in fact, done in the past.

Now, I think there is some confusion on this point. We're not asking you to actually set rates in this merger case. When the premoratorium rate case is filed and five years late when the post-moratorium rate case is filed, you will make decisions in those cases based on all relevant factors as you are required to do. All we are asking you to do now is to establish in advance some of the groundrules which will apply to those cases.

(Vol. 2, Tr. 43-45).

The discussion of this matter in UtiliCorp's initial brief at page 14 is consistent with UtiliCorp counsel's opening statement. The Staff responds that the Commission should not use its decision in Case No. GA-94-325 as the basis for fashioning, in the instant merger preceding, a truly major exception to the Commission's long-held practice of not deciding ratemaking issues in non-rate cases. Case No. GA-94-325 can be distinguished from the instant merger case. The caption of the case is as follows: In the Matter of the Application of UtiliCorp United, Inc., d/b/a Missouri Public Service, for Permission, Approval, and a Certificate of Convenience and Necessity Authorizing it to Construct, Install, Own, Operate, Control, Manage and Maintain a Gas Distribution System for the Public in the City of Rolla, Missouri and the Surrounding Unincorporated Area Located in Phelps County, Missouri.

The Staff asserts that Case No. GA-94-325 is distinguishable from the instant case on a number of grounds. The issues in the case were as follows: (1) the economic feasibility of natural gas to compete with propane as an energy source, the potential anticipated load, the potential anticipated number of customers, who will convert from propane to natural gas, and the expense necessary to complete and operate the proposed project, (2) the potential for subsidization of the proposed Rolla system by the remainder of the ratepayers in the MPS service territory, (3) the rates to be charged in the Rolla service area by MPS (MPS recommended the use of existing filed and approved gas rates for the Rolla service area -- MPS also proposed a potential surcharge should conversion not occur at projected levels) and (4) the granting of a variance from the Commission's promotional practice rules for the purpose of providing free installation and recalibration of existing customer equipment to facilitate and promote the conversion of the Rolla area from propane to natural gas (MPS indicated that an average of $300 per customer, on the customer's side of the meter, would be required for the conversion).

The Commission ruled as follows:

> ...The Commission sees no advantage in setting rates specific to the Rolla area prior to completion of construction and will, therefore, authorize for service in the Rolla area the existing filed and approved gas rates for the northern and southern

district of MPS, until such time as a general rate case is requested or a complaint filed.

Further no surcharge will be authorized in this case. The Commission is of the opinion that, should a financial problem arise that would provoke the levy of such a surcharge, such a financial problem would more appropriately be dealt with in a general rate proceeding.

3 Mo.P.S.C.3d at 132.

. . . .

. . . the Commission will grant a variance from the proposed prohibited promotional practice in these specifics: MPS will be allowed to provide a maximum of $300.00 free conversion, installation and recalibration, per customer, on the customer's side of the meter only. Any remaining customer conversion costs paid by the Company should be appropriately borne by the shareholders, and will be accounted for below the line.

This variance will be limited to a period of three years from the effective date of this order. As MPS proposes to complete the project in three years' time, this should be sufficient to ensure the necessary number of conversions. The Commission stresses that this variance is only for the proposed Rolla service area and will not be extended to any other UtiliCorp service area in Missouri.

Id. at 133.

The Commission noted that there are approximately 5200 households in Rolla itself. Therefore, if all of these households were on propane and decided to convert to natural gas in three years time, then the maximum conversion, installation and recalibration cost, on the customers' side of the meter would be $1.56 million. *Id.* at 129. This figure is immaterial in comparison to number of the dollars for which EDE – UtiliCorp want ratemaking treatment in the merger case ($275 million for the acquisition premium in the EDE – UtiliCorp merger case).

The Commission also noted that "[i]t is the official position, taken apparently after popular vote, that the City of Rolla is fully supportive of the application of UtiliCorp." *Id.* There has been no popular vote taken to determine that it is the official position of EDE's customers that they support the merger with UtiliCorp and support the payment in their electric rates of UtiliCorp's recovery of the acquisition adjustment that is being paid to EDE's shareholders.

In addition, it should not be lost sight of that in Case No. GA-94-325 the variance period was three years, while the EDE – UtiliCorp proposal in the instant merger case is for a regulatory plan period of ten years.

EDE – UtiliCorp view the "not detrimental to the public interest standard" as a de minimus matter. UtiliCorp states in its initial brief at pages 3-4 as follows respecting the applicable standard:

> 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 <u>will</u> 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 leave 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 <u>status quo</u>, with no change in rates or quality of service, at least for the <u>immediate future</u>, 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).[1]

(UtiliCorp Initial Brief, pp. 3-4; Emphasis in UtiliCorp's Initial Brief).

. . . .

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

> 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. 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.

UtiliCorp Initial Brief, pp. 4-5; Emphasis in UtiliCorp's Initial Brief).

. . . .

> . . . . 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. . . .

(UtiliCorp Initial Brief, p. 5).

The folly of adopting the EDE – UtiliCorp approach is that it requires the Commission and the parties to ignore the effect of the terms of the merger and any regulatory plan as long as rates are not increased and the quality of service does not deteriorate for some artificial period of time, regardless of whether the merger is uneconomic. A merger and any regulatory plan the terms of which resulted in the surviving utility filing for emergency rate relief at the end of a moratorium period would not be detrimental to the public interest under the EDE – UtiliCorp approach. The Commission's long applied standard for emergency rate relief, also referred to as interim rate relief, is "'where a showing has been made that the rate of return being earned is so unreasonably low as to show such a deteriorating financial condition that would impair a utility's ability to render adequate service or render it unable to maintain its financial integrity.'" *State ex rel. Laclede Gas Co. v. Public Serv. Comm'n*, 535 S.W.2d 561, 568-69 (Mo.App. 1976).

Another phenomenon might occur under the Joint Applicants' interpretation of the legal standard. Remember that the key for the Joint Applicants' interpretation of the legal standard is solely maintenance of the status quo, not the conference of a benefit in any manner. Therefore, the Commission would have to approve two rival merger proposals one of which maintained the status quo respecting customer rates and quality of service and the other of which did better than maintain the status quo. The Commission could not choose between the two proposals. Rather the Commission would have to approve both of the rival proposals. Or would EDE—UtiliCorp argue that merger terms and a regulatory plan that are better than merger terms and a regulatory plan that maintain the status quo mean in this particular instance that maintaining the status quo is detrimental to the public interest?

Fortunately, there is a Missouri Supreme Court case which indicates that the Joint Applicants' interpretation of the legal standard is not correct. State ex rel. Consumers Public Service Co. v. Public Serv. Comm'n, 352 Mo. 905, 180 S.W.2d 40 (Mo.banc 1944) is a decision of the Missouri Supreme Court in an appeal from a judgment of the Cole County Circuit Court. The judgment of the Cole County Circuit Court affirmed an order of the Commission authorizing the sale of electric properties by the Iowa Utilities Company to the Grundy Electric Cooperative. Appellants were Consumers Public Service Company, Missouri Public Service Corporation and Missouri Power & Light Company. A joint application had been made to the Commission by Iowa Utilities to sell and Grundy Electric Co-op to purchase that part of the electric system of Iowa Utilities located in Mercer County, Missouri. Consumers Public Service Company, Missouri Public Service Corporation and Missouri Power & Light Company objected to approval of the proposed sale.

The Missouri Supreme Court held as follows:

> Therefore, when two utilities can reasonably be said to be operating in the same general territory, and the question before the Commission is whether or not one of them should be allowed to take additional locations which either might make arrangements to serve, the other must be held interested in the matter in the sense the term 'interested' is used in Section 5689. That was the situation in this case. Both the Cooperative and the Consumers Company had lines approximately seven miles of the property sought to be acquired. Both were operating in the same area, even in the same county, in which this property was located and both (according to the evidence) had negotiated to acquire it and could make arrangements to do so and to operate it. **The question of which one should be permitted to acquire it must be decided on the basis of whose operation of the area would best serve the public interest under all the circumstances and not merely upon which could first obtain a contract for purchase.** A contract found to be against public interest or the Commission's regulatory policy could not be permitted to stand in this situation any more than a contract for unapproved rates. We hold that Consumers Company was sufficiently 'interested' to have the right to intervene and likewise the right to apply for a rehearing, when the Commission decided that a competitor could take over these new locations adjoining the general territory in which both were operating. Our conclusion also is that this company had the further right, because of such interest, to seek a review in the circuit court and appeal to this court from its adverse decision. The motion to dismiss must be overruled as to the Consumers Company.

180 S.W.2d at 46; Emphasis supplied.

The holding in the *Consumers Public Service Company* case is supported by a case cited by UtiliCorp at page 3 of its initial brief. UtiliCorp cites the case as follows: "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. [sic] 1986)." The Staff refers to this case as *Love 1979 Partners v. Public Serv. Comm'n*, 715 S.W.2d 482 (Mo.banc 1986). The case involves Union Electric Company's sale of its Downtown St. Louis steam heating facilities. After an evidentiary hearing, the Commission approved the transactions. Certain steam users successfully challenged in Cole County Circuit Court the Commission's Report And Order. The Missouri Supreme Court reversed the decree of the Circuit Court and sustained the Report And Order of the Commission. The Court indicated that the simple maintenance of the status quo for some artificial period, irrespective of the particular facts of the situation, is not necessarily the appropriate analysis required to be performed and that the Commission may choose among competing plans:

> The final suggestion is that the governing contracts will subject steam customers to unreasonable rate increases. **As we have said earlier, the customers are not entitled to a guarantee of the status quo in the furnishing of steam. The Commission could conclude that the present facilities are obsolescent and uneconomic**, and that rate increases would be anticipated even if UE were to continue the operation. It is also possible that UE would seek to discontinue the furnishing of steam, without the prospect of a successor, if it continued to lose customers. The contract documents provide for initial price increases, but with future increases to be controlled by a formula. The users complain of a "ratchet" effect, in which the new rates may go up but not down. **The Commission might well conclude, however, that the new level had to be guaranteed in order to provide a stable project, and that the over-all plan provides the most reliable method for assuring a continued, reliable and economical supply of steam.**

715 S.W.2d at 490; Emphasis supplied.

III. OVERALL REGULATORY PLAN

A. Elements of the EDE—UtiliCorp Regulatory Plan

The Staff has not wasted its time nor will the Staff chance trying the Commission's patience by listing the pages in UtiliCorp's initial brief where UtiliCorp claims that (i) EDE's customers are "guaranteed" an annual revenue requirement benefit of $3.0 million in Years 6-10 of the proposed regulatory plan, and that (ii) UtiliCorp's shareholders are assuming all of the risk of the transaction under the proposed regulatory plan. UtiliCorp goes as far as to say in its initial brief at page 34 that "[c]ustomers <u>cannot</u> be harmed" under the regulatory plan. All of this is rhetoric and is simply untrue.

UtiliCorp's claims depend upon the existence of a merger savings tracking mechanism that truly does what the Joint Applicants claim that it is able to do. Such a merger savings tracking mechanism does not exist presently, and there is no reasonable basis to believe that it will be devised in the next five years. Further, UtiliCorp's pledge not to expose its customers to merger related harm suffers from a glaring flaw: the "guarantee" of merger related rate benefits totally ignores the increased costs associated with corporate allocations that will be charged to EDE customers after the merger.

The EDE-UtiliCorp assertion that the Commission can ensure that customers are unharmed, and that in fact customers will receive a \$3.0 million annual benefit from the merger under the proposed regulatory plan (\$3.0 million is basically immaterial given the size of the transaction), is conceptually dependent upon the existence of a merger savings tracking system that is capable of accurately identifying and quantifying actual merger savings that may result from the EDE – UtiliCorp transaction (Oligschlaeger Rebuttal, Ex. 712, p. 32). The Joint Applicants have not taken the effort in this proceeding to put forward a formal proposal for tracking, or to demonstrate that tracking is indeed feasible. An essential linchpin of the regulatory plan, the customer protection mechanism, is entirely missing from UtiliCorp's proposal.

The constant refrain premise of the Joint Applicants' argument is that if the Commission does not find evidence of merger savings in future EDE rate proceedings in excess of merger costs, then no recovery of the acquisition adjustment should be allowed by the Commission and customers will still receive the guarantee of a \$3.0 million merger revenue requirement benefit. This scenario assumes that the Commission will have access to clear cut, indisputable evidence in future rate cases concerning the level of net merger savings embedded within a test year, and, therefore, will be able to determine whether the imputation of \$3.0 million in merger savings protects customers. Since clear-cut, indisputable evidence of merger savings will not be available to the Commission, the Commission, in actuality in future rate proceedings, will be invited by EDE – UtiliCorp to make guesses about the level of net merger savings, and/or make assumptions that certain calculations will produce actual net merger savings amounts, even if there is no empirical evidence justifying the assumptions. These are not hypothetical scenarios; both the recent UtiliCorp rate proceeding in Kansas for its West Plains division, and the tracking "example" offered by UtiliCorp witness Jerry D. Myers in his surrebuttal testimony, Ex. 13, Sched. JDM-1, indicate it is UtiliCorp's intent to offer, at best, completely speculative evidence concerning the existence of alleged merger savings in an attempt to recover the acquisition adjustment. Both the West Plains case in Kansas and Mr. Myers' surrebuttal testimony, Ex. 13, Sched. JDM-1, are addressed in detail in the Savings Tracking/Benchmarking section of this reply brief.

Real, tangible detriment will occur to EDE customers from the proposed regulatory plan. The Commission will not have the benefit of an accurate quantification of actual merger savings in future EDE rate cases. In the event that the Commission attempts to make what it believes to be reasonable assumptions as to the merger savings achieved, then the quantification resulting from those assumptions will be greater or less than actual merger savings achieved, which is an amount that essentially is unknowable. If the Commission assumes a level of merger savings that exceeds actual savings, then the $3.0 million revenue requirement guarantee will not work the way that EDE – UtiliCorp purport that it will work. Customers will receive the benefit in rates of less than the amount of merger savings assumed and customers conceivably could experience a detriment, i.e., net merger costs passed on in rates to them. If the assumed level of merger savings exceeds actual merger savings by more than $3.0 million, then there is a merger detriment even with EDE – UtiliCorp's merger savings guarantee. This is the potential for customer detriment under the proposed regulatory plan.

It is also possible that the Commission may assume the existence of merger savings in an amount less than actual merger savings achieved, which conceptually would negatively impact UtiliCorp's earnings. Since EDE – UtiliCorp is proposing under the regulatory plan to reserve for itself upfront 96-97% of the total merger savings during the first ten years of the merger, the Staff believes that the risk of misidentifying the amount of actual net merger savings achieved will fall on customers much more heavily than it might fall on EDE – UtiliCorp shareholders.

There is another way in which real, tangible detriment will likely fall on EDE customers, if the proposed regulatory plan is adopted. UtiliCorp touts the minimum $3.0 million revenue requirement guarantee as protecting customers from harm related to its proposal to directly recover the acquisition premium in rates. In fact, on page 21 of its initial brief, UtiliCorp states: "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." Unfortunately, this alleged protection from the detriment, when savings are not adequate, of paying for the acquisition adjustment and costs to achieve in rates, does not protect EDE customers from the detrimental impact of being included in the UtiliCorp corporate allocations scheme.

This detriment can be easily demonstrated by referring to Schedule VJS-1, attached to UtiliCorp witness Vern J. Siemek's direct testimony. (Ex. 6, Sched. VJS-1). Schedule VJS-1 is a summary of regulated costs and savings estimated by UtiliCorp to result from the EDE transaction over the first ten years following the merger and EDE's pre-moratorium rate case. The average amount of estimated operating expense savings for Years 6-10 following the merger and EDE's pre-moratorium rate case is shown to be $42.026 million annually (Section I, Line 6). This amount is offset by net capital costs associated with the transactions (including an amortization of transaction costs and transition costs) of $1.111 million annually (Section II, Line 5), net allocated corporate costs of $19.415 million annually (Section IV, Line 4), and the cost associated with 50% of the premium of $18.533 million annually (Section VII). (All of these cost numbers are estimated averages for Years 6-10.) Taking the average estimated savings amount for Years 6-10 and deducting these various merger costs derives the oft-discussed net annual $3.0 million merger benefit allegedly guaranteed to customers.

The number that the Commissioners should focus on is the net annual cost that is to be charged EDE customers as a result of their inclusion in the UtiliCorp corporate cost allocation scheme. The allocated UtiliCorp corporate costs amounts to $19.415 million annually in additional costs for Years 6-10, per Ex. 6, Sched. VJS-1, Section IV, Line 4 (and amounts to $17.159 million annually for Years 1-5 of the merger). No party has argued that EDE customers would be exposed to these additional costs absent the merger. Therefore, these allocated UtiliCorp corporate costs clearly should be considered incremental to the merger. This amount (Ex. 6, Sched. VJS-1, Section IV, Line 4) is larger than the amount related to direct recovery of half of the acquisition adjustment over Years 6-10 of the Regulatory Plan. (Ex. 6, Sched. VJS-1, Section VII; Oligschlaeger Rebuttal, Ex. 712, p. 39). Yet the Joint Applicants' alleged commitment to impute additional savings in future rate case test years in order to offset the impact of the merger premium and costs to achieve clearly is not intended by EDE – UtiliCorp to apply to, nor does it in fact offset the increased revenue requirement that the allocation of UtiliCorp corporate costs will put on EDE customers. Note again the wording in UtiliCorp's initial brief at page 21 concerning the "worst case scenario": "...customers will not be asked to pay for any of the premium costs or costs to achieve the transaction."[2] (Emphasis added). Then compare that statement to the numbers set out in Ex. 6, Sched. VJS-1, in which both premium costs and costs to achieve are clearly distinguished from the allocated UtiliCorp corporate costs shown in Section IV of Ex. 6, Sched. VJS-1.

There is other evidence that UtiliCorp's regulatory plan does not protect EDE customers from detriment associated with increases in revenue requirement relating to allocations of UtiliCorp corporate costs. The direct testimony of UtiliCorp witness John McKinney contains the following questions and answers:

> Q. How do you address the concern about the need to exactly track the synergies?
>
> A. As the Commission knows, synergies need only to be proved to reach the proposed hurdle level in each subsequent rate proceeding. Only if the synergies fall short would there be an adjustment. That adjustment would result in a lower percentage of premium being included in the Empire's electric rate base for recovery. Any synergies above that hurdle level would be used to reduce rates during the normal course of the rate proceeding and result in even lower costs to the customers.
>
> Q. What do you mean by "hurdle level"?
>
> A. The hurdle level is the cost impact resulting from the premium.

(John McKinney Direct, Ex. 4, pp. 10-11; Emphasis added).

This quote from John McKinney's testimony makes it very clear that UtiliCorp's alleged commitment to track merger savings so as to ensure customers are not detrimentally harmed by the merger through rates only applies to the merger premium, not to corporate cost allocation impacts on EDE customers. This is shown by John McKinney's statement that UtiliCorp only

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[2] Cost to achieve", as the term is used by UtiliCorp in Schedule VJS-1, Ex. 6, includes both what the Staff considers to be true "costs to achieve" and what the Staff calls "transaction costs." The term "costs to achieve" in Schedule VJS-1, Ex. 6, in this section of the reply brief does not constitute agreement by the Staff with UCU's definition of "costs to achieve." See Hyneman Rebuttal, Ex. 705, pp. 38-42 for an explanation of how the Staff defines "costs to achieve" and "transaction costs".

intends to track sufficient savings to reach the so-called "hurdle level", and that the "hurdle level" equals the cost impact of the premium. Further, John McKinney's statements also make clear that UtiliCorp only intends to impute additional savings into a rate case test year through an adjustment if there is a shortfall between "proved" merger savings and the acquisition adjustment, not if there is a shortfall between "proved" merger savings and total merger costs, including additional corporate overheads charged to EDE customers.

Based upon the above testimony respecting the operation of UtiliCorp's proposed regulatory plan, a truer picture of the "worst case scenario" for EDE's customers can be brought into view from the merger. Again, based entirely on the EDE – UtiliCorp's own estimates contained within Ex. 6, Sched. VJS-1, and assuming that UtiliCorp could not prove up any merger savings to the Commission's satisfaction, the following impact on EDE ratepayers will result. UtiliCorp would impute an amount of merger savings in a rate proceeding necessary to offset the amount of 50% premium recovery, the amortization of costs to achieve, and the guaranteed \$3.0 million customer benefit. However, as previously indicated, EDE customers also will encounter an average increase of approximately \$17.159 million annually in the allocation of UtiliCorp corporate costs to EDE, solely as a result of the merger. This allocations impact amount is shown to be representative of Years 1-5 on Schedule VJS-1, and would be captured in the EDE – UtiliCorp planned Year 5 post-moratorium EDE rate case, since that rate proceeding will probably utilize a Year 4 test year.

Another example of potential harm to EDE customers under the Regulatory Plan relates to EDE's water operations. UtiliCorp witness John McKinney stated in testimony that "UtiliCorp will ensure none of the costs of the transaction will be assigned to the water operations and the rates of the water operations will not be increased as a result of the merger."

(John McKinney Direct, Ex. 4, p. 8). However, at the hearings, John McKinney stated that EDE's water operations would be included in UtiliCorp's corporate cost allocation process, and that it was uncertain whether allocation of corporate costs would lead to an increase or decrease in EDE water rates:

> [Mr. Dottheim]: . . . [I]s it correct that the proposed five-year rate moratorium for Empire will not include Empire's water operations?
>
> [John McKinney]: That is correct.
>
> Q. Does that mean that Empire's water rates can be increased over the five-year period for which there is a rate moratorium for Empire's electric rates?
>
> A. Yes. The rates - - the water operation is not impacted in any regard by the regulatory plan.
>
> Q. Do you know if there are any plans for a water rate case within the next five years?
>
> A. We have not made an analysis of those as of this point in time. During due diligence, at that point Empire was selling the water operations to another company, and so when we were evaluating Empire to make our bid, it was assumed the water properties would be sold to another party.
>
> That transaction has since not gone forward. So the water properties will come with it. **I don't believe the water properties at this time are earning a very good return.** It will be my responsibility to take a look at that and determine after the merger is closed if a rate case is needed, and at that point in time we'll take a look and we'll make that determination.
>
> **Q. Will Empire's water operations be assigned some portion of the UtiliCorp corporate allocations to be charged to Empire after the merger?**
>
> **A. Yes.**
>
> Q. Is it possible that being included in the overall corporate allocation process may lead to an increase in cost of service for Empire's water operations?
>
> A. We haven't made that evaluation. Anything is possible. It's very possible that it'll result in a decrease. Like I said, we have not made that analysis, so I can't judge either way.

(Vol. 3, Tr. 457-60; Emphasis added). Given the overall corporate cost allocation effects to EDE identified on UtiliCorp witness Vern J. Siemek's Schedule VJS-1, it is exceedingly hard to believe that inclusion in UtiliCorp's corporate cost allocations system will not increase the total expenses of EDE's water operations. In any case, UtiliCorp's proposed regulatory plan does not in any way protect EDE's water customers from detriment associated with increased rates, attributable solely to the merger and UtiliCorp's corporate cost allocations system.

The guaranteed revenue requirement offset would only cover \$3.0 million of the \$17.159 million allocation of UtiliCorp corporate costs, leaving EDE customers with approximately \$14.159 million in increased costs and rates. Such an event is an undisputed detriment, based entirely on the Joint Applicants' own estimates of merger costs, and is a detriment for which the proposed regulatory plan offers no solution whatsoever. Furthermore, the numbers used above to estimate the impact of the allocation of UtiliCorp corporate costs on EDE customers are conservative and likely understated because UtiliCorp has underestimated the appropriate escalation rate to apply to the allocation of UtiliCorp corporate costs, based upon the historical levels of these costs allocated to MPS. (Traxler Rebuttal, Ex. 716, pp. 45-47; Traxler Rebuttal Replacement Pages, Ex. 719, pp. 43-44, 48).

To further focus on the issue whether the proposed regulatory plan protects customers from detriment relating to the recovery of the merger premium, the operation of the Joint Applicants' "frozen" capital structure proposal needs to be considered and the question of the effect of the proposed regulatory plan on MPS' customers must be considered. The Joint Applicants contend that under their proposed regulatory plan, the merged company will not seek direct recovery of the acquisition premium to the extent that it cannot prove the existence of merger related savings. However, the Joint Applicants expect to receive a significant amount of recovery of the acquisition premium indirectly through setting EDE's rates at an artificially high level through the "frozen" EDE capital structure mechanism and through setting MPS' rates at an artificially high level through the "frozen" allocation of UtiliCorp corporate costs to MPS. (Vol. 3, Tr. 462-63). These elements of the Joint Applicants' proposed regulatory plan are not tied in any way to the demonstration of the existence of merger savings. Thus, UtiliCorp could fail to prove up even so little as a penny in actual merger savings and still achieve a significant level of recovery of the acquisition adjustment through its regulatory plan rate proposals respecting the EDE capital structure and the allocation of UtiliCorp corporate costs to MPS.

UtiliCorp claims at page 12 of its initial brief that it is only seeking that the Commission continue a policy of considering the issue of acquisition adjustment recovery, as it claims was pronounced by the Commission in several past cases. However, UtiliCorp does request "one additional consideration" that being that "the Commission, in the context of this merger case, . . . explicitly state the method under which any premium recovery in the future Post-Moratorium rate case will occur." First, it should be noted that EDE – UtiliCorp has not in its regulatory plan limited itself to only one EDE post-moratorium rate case. UtiliCorp is seeking that the Commission make ratemaking commitments now that would apply to any EDE rate proceeding in the five years following the post-moratorium rate case.

The Staff disagrees that the cases cited by UtiliCorp in its initial brief at pages 11-12 mean what UtiliCorp claims that they mean in regard to the regulatory plan proposed by EDE – UtiliCorp. Further, what UtiliCorp is asking that the Commission order concerning rate treatment of merger costs in this case goes well beyond what other utilities have requested in past merger cases, and certainly goes well beyond any past acts of this Commission regarding the treatment of merger savings and costs. Put simply, what UtiliCorp is seeking from the Commission in the instant merger case is unprecedented, besides being unwarranted.

The two cases cited by the Joint Applicants as precedent for the requested treatment of merger costs in this proceeding do not support the EDE – UtiliCorp position in the instant case. *Re Kansas Power & Light Company,* Case No. EM-91-213, Report And Order, 1 Mo.P.S.C.3d 150 (1991), the Kansas Power & Light Company (KPL) – Kansas Gas & Electric Company (KGE) merger case, involved a request for a mechanism by which sharing of alleged merger savings between shareholders and customers could be accomplished. KPL did not request from the Missouri Commission direct recovery of the acquisition premium associated with its purchase of KGE, much less try to bind the Commission to specific recovery of the acquisition premium in future KPL rate proceedings. *Re Missouri-American Water Company,* Case Nos. WR-95-205 and SR-95-206, Report And Order, 4 Mo.P.S.C.3d 205 (1995) involved, in a rate increase case, a request by Missouri-American Water Company (MAWC) for rate recovery of an acquisition adjustment associated with MAWC's acquisition of Missouri Cities Water Company (MCWC). MAWC did not request upfront recovery of the acquisition adjustment in its preceding purchase and merger cases pertaining to the MCWC acquisition, nor did MAWC they ask the Commission to set the ground rules or make any upfront commitments regarding the method of recovery of the acquisition adjustment prior to Case Nos. WR-95-205 and SR-95-206. (Neither did MAWC make any such ratemaking requests in its recent purchase application before the Commission regarding United Water Missouri in Case No. WM-2000-222.) In the instant case, UtiliCorp is not seeking to follow past precedent; it is instead seeking to go well beyond, in a radical and unjustified way, what the Missouri Commission has previously indicated.

On its face, UtiliCorp's request that the Commission merely commit to recovery of the acquisition adjustment if UtiliCorp can "prove" the existence of merger savings may not seem to be unreasonable. The Staff would disagree that direct recovery of the acquisition adjustment is warranted even if merger savings could be satisfactorily proven. (Oligschlaeger Rebuttal, Ex. 712, pp. 26-27). However, in actuality the Joint Applicants are seeking far more from the Commission in this merger case than a simple commitment to consider future direct recovery of an acquisition adjustment. EDE – UtiliCorp are asking that the Commission fix, upfront, the EDE capital structure to be used in future EDE rate proceedings for a period of ten years. EDE – UtiliCorp are asking that the Commission fix, upfront, the treatment of UtiliCorp corporate allocations in MPS rate proceedings for a period of ten years. EDE – UtiliCorp are asking that the Commission agree, upfront, that recovery of and on 50% of the unamortized acquisition adjustment is an appropriate direct recovery of the acquisition adjustment in future EDE rate proceedings, in addition to UtiliCorp's indirect recovery of the acquisition adjustment.

To support its request for direct recovery of 50% of the unamortized acquisition adjustment, UtiliCorp has provided absolutely no evidence as to what percentage of the acquisition premium it would be appropriate to allocate to its regulated operations and what percentage of the acquisition premium it would be appropriate to allocate to its non-regulated operations. UtiliCorp has acknowledged that estimated regulated operations synergies (cost savings) are not sufficient to allow UtiliCorp to recover the acquisition adjustment in entirety over the ten-year period covered by the proposed regulatory plan. (Vol. 2, Tr. 201; Vol. 5, Tr. 587). Some level of non-regulated benefits must be assumed by UtiliCorp to justify the acquisition premium paid for the merger. (Vol. 3, Tr. 405-06). Nonetheless, UtiliCorp has failed to present any evidence at all of what it estimates potential non-regulated synergies from this merger to be, including benefits associated with a possible sale of EDE's generating assets in the future. Notwithstanding this failure, UtiliCorp seeks that this Commission pre-approve direct recovery of 50% of the unamortized EDE premium of $275 million now, and far more than 50% of the unamortized acquisition premium when the indirect recovery mechanisms of the frozen capital structure and the frozen corporate allocator are taken into account. (Siemek Surrebuttal, Ex. 7, Sched. VJS-5). If for no other reason, the Commission, at a minimum, should reserve any determination regarding the treatment of merger costs to future rate proceedings because there is no evidence in this proceeding as to what an appropriate allocation of the acquisition adjustment to EDE – UtiliCorp non-regulated operations should be.

Addressing this point in his surrebuttal testimony, UtiliCorp witness John McKinney stated the following:

> Q. At page 19 of his rebuttal testimony, Mr. Oligschlaeger says that UtiliCorp and EDE have presented no evidence concerning an appropriate assignment of the acquisition adjustment to non-regulated operations. He also questions why more than 50% of the premium should not be assigned to non-regulated operations. How do you respond?
>
> A. These claims are really not relevant to this proceeding. I say this because the standard is "no public detriment." So long as EDE's customers experience the status quo or better in terms of service and rates, the fact that any or all of the acquisition premium might be recovered by UtiliCorp through rates should not really matter.

(John McKinney Surrebuttal, Ex. 5, p. 12).

Never mind the incredible, but implicit assertion by John McKinney that it does not matter if captive regulated EDE customers pay in rates a portion of an acquisition premium based on UtiliCorp's expectation of non-regulated benefits, if customers' rates do not increase. As long as UtiliCorp is seeking authorization to include 50% of the unamortized acquisition adjustment directly in rates in the next EDE rate proceeding, and this is what EDE – UtiliCorp is seeking to do, it is indeed highly relevant what are the future expected benefits to UtiliCorp on the non-regulated side of the proposed transactions.

B. EDE Rate Cases

In its initial brief at page 23, UtiliCorp states "[t]he five year rate moratorium, proposed as 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. 30)." The surrebuttal testimony of EDE witness Robert B. Fancher identifies the following rate increase cases:

> In the Empire projection provided to UtiliCorp during due diligence review, Empire indicated that rate cases were scheduled to be filed in 1999, 2000 and 2003. The 1999 rate filing was not made, however, because of concerns about its possible interference with the merger case. Currently, the 2000 rate filing will proceed because of the expected June 2001 in-service date of Empire's State Line Combined Cycle ("SLCC") generating unit. That filing will be made in the in the fall of this year. Without the merger, Empire would file another electric rate case in 2002. . . .

(Fancher Surrebuttal, Ex. 10, p. 3; the rate increase case projected to be filed in 2002 by EDE is also referred to in the above quote as being filed in 2003 by Mr. Fancher). The Staff disagrees that EDE's assumptions and analysis about rate relief present meaningful evidence regarding merger/regulatory plan benefit to EDE's customers.

EDE is presumably providing safe and adequate service at just and reasonable rates without having filed a 1999 rate case. Mr. Fancher testified that the rate increase case filed by EDE on November 3, 2000 (Case No. ER-2001-299) is occurring regardless of the merger, in order to seek to include in rates EDE's share of the State Line Combined Cycle unit. Therefore, the only possible "avoided" rate case due to the merger referenced in the Joint Applicants' testimony is the one referred to in Mr. Fancher's surrebuttal testimony as being projected to be filed in 2002. At the hearings, Mr. Fancher stated that EDE's projection of the need for rate relief in 2002 was based upon the results of a financial model, which incorporated budgeted revenue and expense levels as projected in 1998 and a specific desired return on common equity (ROE). The projected "rate relief" for 2002 functions merely as a "plug number" in the financial model to allow EDE to reach its projected ROE target for that year. (Vol. 3, Tr. 496-97). Mr. Fancher also conceded at the hearings that the 2002 rate case was uncertain, and that no rate relief would be necessary "[i]f the revenues were significantly greater than what we projected…" (Vol. 3, Tr. 494).

EDE's claims that it will be able to avoid future rate increases if the merger is approved are ironic, in one sense. The Staff has submitted evidence that UtiliCorp's current Missouri electric rates for its MPS division are considerably higher than the current electric rates of EDE (Williams Rebuttal, Ex. 717, pp. 6-14). For this reason, the Staff is very concerned that one consequence of the merger may be a long-term trend in which EDE rates gradually increase to MPS rate levels. One reason for this concern is the much greater amount of corporate overhead costs currently incurred by UtiliCorp compared to a stand-alone EDE. A portion of the UtiliCorp corporate overhead costs will be allocated to EDE after the merger is completed. (*Id.* at 14). Schedule VJS-1, attached to the direct testimony of UtiliCorp witness Vern J. Siemek (Ex. 6), clearly shows that UtiliCorp acknowledges that the EDE division of UtiliCorp will experience substantial increased costs in the area of corporate overheads as a result of the merger.

IV. EDE PRE-MORATORIUM RATE CASE

V. MERGER COSTS/BENEFITS

On pages 5-6 of its initial brief, UtiliCorp states that "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 [sic] 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)." UtiliCorp is mischaracterizing the Staff's position on this point.

Consistent with the Staff's position on tracking, it is the Staff's position that the Commission in any future EDE rate proceeding will not be presented with clear-cut, indisputable evidence that merger savings have exceeded merger costs. This will be because of the inherent difficulty in identifying and quantifying in those future cases savings specifically attributable to the merger. However, because this will also be the case relative to measuring merger costs for comparison to merger savings, the Staff strongly disagrees that this means that any allegation that merger costs will exceed merger savings is irrelevant or has been abandoned by the Staff in this proceeding. Rather, the fact that the Commission will not have clear-cut, indisputable evidence presented to it at the time of a later rate proceeding makes it vital that the Commission examine and seriously consider the evidence on this point now. It is for this reason that if the Commission believes that the Staff's evidence is persuasive that reasonably estimated merger costs will exceed reasonably estimated merger savings, the Commission should deny the Joint Applicants' request for merger approval.

If merging utilities cannot demonstrate a reasonable expectation that savings caused by the merger will exceed merger costs, then such a transaction should be denied approval because of the ultimate, very high likelihood of a detrimental rate impact on customers. (Oligschlaeger Rebuttal, Ex. 712, pp. 49-50). That fact that the means do not now exist to make an accurate comparison of merger costs to merger savings for future rate cases means that the Commission should not take the heavy risk that in some way in the intervening five (5) years developments will occur that will permit the Staff and UtiliCorp to solve the tracking problems. Since the KPL-KGE merger case in 1990-1991, the tracking problem has not been solved. Therefore, it is not reasonable to assume that the tracking problem will be solved during the course of the EDE moratorium. If the merger is approved by the Commission, the risk of increased rates will be placed squarely on the customers' shoulders, with no reliable means of protecting customers in future rate proceedings by accurately tracking the relationship of merger savings to merger costs.

VI. ACQUISITION ADJUSTMENTS / ACQUISITION PREMIUMS

A. EDE – UtiliCorp Proposal

On page 25 of its initial brief, UtiliCorp claims that its investment in purchasing EDE should be looked at in the same light as other utility expenditures and "include those expenditures which are alleged to bring about cost efficiencies in cost of service for ratemaking purposes." Of course, this assumes that the main purpose motivating UtiliCorp in its acquisition of EDE was the creation of regulated operations savings that could be used to benefit customers. As discussed in the rebuttal testimony of Staff witness Cary G. Featherstone, the Staff does not believe that customer interests drove this merger transaction in any material way for UtiliCorp and EDE. (Featherstone Rebuttal, Ex. 702, pp. 16-18). Furthermore, the Commission must take into account the consideration that potential non-regulated benefits related to this merger must have been significant to UtiliCorp's perception of the desirability of entering into this merger.

(Vol. 3, Tr. 405-06). The analysis suggested by UtiliCorp in its initial brief to justify recovery of the premium (i.e., comparison of merger savings to the costs asserted to be necessary to create the savings, including the acquisition adjustment) misses the basis of the need for regulatory oversight. If an appropriate portion of the acquisition adjustment is not allocated to non-regulated operations, UtiliCorp customers will cross-subsidize in rates the non-regulated ventures of UtiliCorp.

At page 29 of its initial brief, UtiliCorp cites two past merger cases, Case No. EM-96-149, Union Electric Company (UE) and CIPSCO, Inc., and Case No EM-97-515, Western Resources, Inc. (Western Resources) and Kansas City Power and Light Company (KCPL), as implicit support for adoption of its proposed regulatory plan. Neither case provides Commission precedent for UtiliCorp's radical requests of the Commission in this merger proceeding.

Respecting Case No. EM-96-149, UtiliCorp states that "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." (UtiliCorp Initial Brief, p. 29). The "target return" referred to was actually set by the Commission in Case No. ER-95-411 in July 1995, a full month before UE even announced the proposed merger with CIPSCO, Inc. In its Report And Order in the merger docket, Case No. EM-96-149, the Commission did approve a settlement calling for a second three-year earnings sharing plan for UE using a similar "target return" to that set in Case No. ER-95-411. There is no reference whatsoever in either the Stipulation And Agreement or the Report And Order in Case No. EM-96-149, directly or indirectly, tying the second "target return" mechanism to allowing a direct or indirect recovery of the merger premium for that transaction.

For Case No. EM-97-515, UtiliCorp states that "a rate freeze was established for a period of time that allowed for a full or partial recovery of the acquisition adjustment" (UtiliCorp Initial Brief, p. 29). The Stipulation And Agreement in Case No. EM-97-515 did call for a rate moratorium of approximately three-years duration following the merger closing, an approach the Staff had indicated it finds is acceptable under some circumstances as a means to allow merging utilities to retain the benefit of merger savings for some period. (Oligschlaeger Rebuttal, Ex. 712, p. 63). In addition, the Western Resources – KCPL settlement called for below-the-line treatment of the acquisition adjustment resulting from that transaction.

At pages 17 and 28 of its initial brief, UtiliCorp claims that it needs a Commission determination in this proceeding that the full amount of the acquisition adjustment of approximately $275 million will be the basis for future decisions concerning recovery of the acquisition premium. If the Commission reserves all ratemaking decisions regarding this merger to subsequent rate proceedings, then all questions regarding rate treatment of the acquisition adjustment should be reserved for those proceedings, including the appropriate quantification of the acquisition adjustment for rate purposes. Various Staff witnesses filed testimony on different aspects of the acquisition adjustment and raised and addressed questions concerning whether rate recovery should be given to all (or 50% of the unamortized amount) of the acquisition premium, if the Commission were to decide that any rate recovery is warranted. For example, Staff witnesses Charles R. Hyneman and Michael S. Proctor addressed in their rebuttal testimony the various components of the acquisition adjustment/merger premium and testified that no component should receive rate recovery.

Mr. Hyneman discussed in his rebuttal testimony a three-component concept of merger premiums, none of which should be recovered from customers. He identified the three components as follows:

(1) Unrealized gain on assets – the increase in book value to market value inherent in the purchase price;

(2) Control premium – the portion of the merger premium paid to the acquiring company's shareholders that can be attributed to the valuable rights of ownership due to controlling the operations of the combined company

(3) Payment for strategic/financial benefits and synergies – strategic and financial benefits attained by the acquiring company above what can be produced from both companies remaining independent

(Hyneman Rebuttal, Ex. 705, pp. 61-62). By any reasonable standard, responsibility for control premiums should rest with the acquiring company's shareholders, not its customers. (*Id.*, pp. 89-90). Mr. Hyneman provided testimony that control premiums are often estimated as constituting 20% to 30% of the merger premiums paid by acquiring companies and that the Staff estimates that the control premium in the EDE – UtiliCorp merger could be approximately 20%. He also testified that the 39% merger premium negotiated by EDE with UtiliCorp is on the high end of premiums paid in recent mergers. (*Id.*, pp. 64-66). UtiliCorp President and Chief Operating Officer Robert K. Green stated in his direct testimony that the average merger premium for industry mergers from January 1998 through February 1999 was 27%. The difference between a 27% merger premium and the 39% merger premium that UtiliCorp agreed to pay EDE is approximately $43 million. (*Id.* at 66).

Staff witness Michael S. Proctor separated the acquisition adjustment into components (one part measured by the difference between the net book value of EDE assets and the pre-merger value of EDE stock, and a second part measured by the difference between the pre-merger value of EDE stock and UtiliCorp's offer price for the stock), and identified why neither component should receive rate recovery. (Proctor Rebuttal, Ex. 713, pp. 6-12).

For these reasons, if the Commission rejects the Staff's recommendation that any approval of the merger be conditioned on below-the-line treatment of the acquisition adjustment, the Commission should not make any findings concerning future recovery of the acquisition adjustment that would impair parties' ability to argue that all or some of the acquisition adjustment should be excluded from rates in future rate proceedings.

On page 28 of its initial brief, UtiliCorp states that a Commission decision to exclude the acquisition premium from rate recovery would "likely discourage beneficial mergers from occurring." The Staff disagrees with this unsupported assertion. The record in this case is uncontroverted that the Commission has never allowed direct recovery of an acquisition adjustment in past cases. (Featherstone Rebuttal, Ex. 702, p. 29). Notwithstanding this fact, there has not been a dearth of proposed merger and acquisition transactions in this state in the last several years. Most all of these transactions have closed, even with the involved utilities agreeing to forego direct recovery of acquisition adjustments, presumably because the companies believed the economics of the transactions were still favorable overall to the combined utility (Featherstone Rebuttal, Ex. 702, pp. 54-59).

The Staff would remind the Commission that its decision on the acquisition adjustment issue in this proceeding will have ramifications on other positions that the Commission has taken on other issues. One such issue is the rate treatment of "gains on sales" when a utility sells and disposes of assets previously used in the provision of service. The Commission has traditionally held that gains on sales (the excess of the sale proceeds over the net book value of the assets sold) should be kept by utility shareholders, and not used to reduce revenue requirement for ratepayers. (Hyneman Rebuttal, Ex. 705, p. 54). The connection of this issue to this case is that gains on sales are the "flip-side" of acquisition adjustments, i.e., EDE's gain on sale equals UtiliCorp's acquisition adjustment. If the Commission adopts the Joint Applicants' position on acquisition adjustments, then EDE's shareholders will receive the benefit of the gain on sale of the EDE assets, while EDE's – UtiliCorp's customers get charged for the monies paid by UtiliCorp to enrich EDE's shareholders through the acquisition premium. (*Id.* at pp. 56-57). This would be a "lose / lose" situation for ratepayers.

The Commission should maintain a neutral stance towards merger and acquisition transactions, and not open itself up to the strategy of trying to "incent" mergers through the granting of rate treatment that "incents" mergers and acquisitions. (Oligschlaeger Rebuttal, Ex. 712, p. 62). The "incenting" of mergers will only serve to encourage utilities to engage in mergers and acquisitions less economic than previously under the Commission's merger and acquisition actions.

On pages 29-30 of its initial brief, UtiliCorp states: "A large number of states have permitted rate recovery of a portion or all of the cost of acquisitions." The support for this assertion is Figure 2, the chart of the National Association of Water Companies, which appears in the direct testimony of UtiliCorp witness John W. McKinney. The information in Figure 2 pertains only to water utilities, and water utilities are in a significantly different economic situation than electric utilities respecting the issue of the recovery of acquisition adjustments. (Fischer Rebuttal, Ex. 703, pp. 72-75). The Staff's research regarding other jurisdictions' treatment of acquisition adjustments indicates that many utilities do not seek direct recovery of acquisition premiums at all, and that those utilities that do seek rate recovery of acquisition premiums, they do not necessarily seek such rate recovery or are authorized such rate recovery concurrently in the merger and acquisition proceeding in which approval of the merger or acquisition is being sought and is authorized.

B. Purchase vs. Pooling Accounting

On page 7 of its Initial Brief, UtiliCorp explains that the regulatory plan is necessary to allow its shareholders to recover the estimated $275 million acquisition premium. UtiliCorp states that "[w]ere it not for the agreement to pay the acquisition premium, the merger agreement would not have been agreed to and the transaction would not take place." (UtiliCorp Initial Brief, p. 7). These comments do not address that UtiliCorp would not have had to reflect the acquisition adjustment on its books, but for conscious choices it made to reflect the UtiliCorp – EDE transaction as a "purchase" transaction. The reasons that UtiliCorp chose to account for this transaction as a purchase are addressed in the Staff's initial brief. If UtiliCorp had taken reasonable actions to use the pooling of interests method of accounting for the merger, there would be no need for the regulatory plan because an acquisition adjustment would not exist. UtiliCorp recognized this fact in its proposed merger with Kansas City Power & Light Company in 1996. (Hyneman Rebuttal, Ex. 705, pp. 14-15). EDE (and MPS) customers should not suffer the detriment of rate recovery of the acquisition adjustment due to UtiliCorp's particular decisions on accounting for the merger transaction.

VII. CORPORATE ALLOCATIONS

This section deals with the projected level of UCU's corporate overhead costs subject to allocation to all of UCU's divisions, including EDE, in the event of a merger. In particular, the Staff raised the issue of the inflation factor used by the Joint Applicants in projecting UCU's total corporate overhead allocations during the 10-year period. In its Initial Brief, UCU mounts only a token defense of its use of a 2.5% inflation factor, alleging that 2.5% is reasonable and that, in any event, the inflation rate is "largely irrelevant" because in the EDE division's post-moratorium rate case, the actual inflation rate will be reflected. (UCU Brief at 46).

The Staff certainly does not consider the issue of an appropriate inflation factor to be "largely irrelevant". Why should it be any less relevant than the numbers that are being inflated? Indeed, why did the Joint Applicants submit <u>any</u> of their projections of the costs and benefits associated with the subject merger?

The answer to all of these questions is that the Commission must consider <u>now</u>, and not five years from now, the "not detrimental to the public interest" standard on which its ruling on the proposed merger is based. That ruling can only be made on the basis of <u>projected</u> costs and savings. The Commission, if it is to approve the subject transaction, must satisfy itself now that the Joint Applicants have met the legal standard and that savings will, at a minimum, be sufficient to cover merger costs. (Traxler Rebuttal, Ex. 716, p. 9, lines 9-21). That, of course, is the reason that the Staff and the other parties have spent countless hours poring over all of the Joint Applicants' projections, which include the inflation rate applied to UCU's corporate overhead allocations.

Staff recommends a 5% inflation rate, which is twice as large as that used by the Joint Applicants. (Traxler Rebuttal, Ex. 716, p. 47, line 22). The impact of the inflation rate differential is significant. By using Staff's recommended 5% inflation rate for corporate overhead allocations to EDE, the Joint Applicants' projected total net merger savings in years 6 through 10 is reduced by approximately $33.5 million. (Traxler Replacement Pages, Sched. SMT-2, Ex. 719, line 17, Col. C less Col. D). As noted in Staff's Initial Brief, this represents more than 25% of the difference ($127.5 million) between the Staff's projections in years 6 through 10 (prior to any recognition of the acquisition premium) and those of the Joint Applicants. (Traxler Replacement Pages, Ex. 719, Sched. SMT-2, Col. D, line 18 and Col. C, line 18, respectively; Staff Initial Brief at 148).

Staff is not surprised that UCU seeks to dismiss the inflation rate issue as "largely irrelevant." UCU offered no evidence to support its use of an indicator relating to the prices urban consumers can expect to pay for goods and services (Consumer Price Index-Urban) as a basis for projecting the growth in UCU's corporate overhead allocations to an operating division. Moreover, the Commission has in the past rejected the use of a national indicator in estimating various categories of utility costs, including corporate allocations, in favor of techniques that involve known and measurable and company-specific data. *In the Matter of Proposals to Establish an Alternate Regulation Plan for Southwestern Bell Telephone Company* 2 Mo. P.S.C. 3d 479, 491 (1993).

Nor did UCU offer any evidence, either in pre-file testimony or on the witness stand, to support its assertion that, because of the presence it of three non-recurring projects---i.e., 1) the 1995 centralization of many previously autonomous Enterprise Support Functions, 2) the 1997 reorganization of UCU's distribution functions from geographical units to a functionalized basis, and 3) the implementation in 1997, 1998 and 1999 of various re-engineering initiatives (Siemek Surrebuttal, Ex. 7, p. 5, lines 20-23, p. 6, lines 1-8)---the costs considered by Staff witness Traxler in developing his recommended inflation rate were fatally distorted. (Tr. 629, lines 12-16; Tr. 636, lines 21-24). Nevertheless, Staff witness Traxler was able to obtain from UCU data regarding re-engineering costs, which he then removed from the overall dollars, allocated to MPS in developing Staff's 5% inflation rate recommendation.

In particular, Mr. Traxler's Revised Schedule SMT-7 (Ex. 719, lines 5-7) shows average annual increases in UCU's corporate overhead costs to MPS since 1995, for various multi-year time frames, as follows:

4-year average increase (1996-1999): 45.7%

3-year average increase (1997-1999): 20.0%

2-year average increase (1998-1999): 6.2%.

Removal of the re-engineering costs reduces these three percentages to 41.2%, 15.4% and 4.9% respectively. (Ex. 720, p.2).

Thus, regardless of whether one looks at a two-, a three-, or a four-year average, and regardless of whether re-engineering costs are included, actual historical experience clearly suggests that a corporate allocations growth rate far in excess of UCU's proposed 2.5% rate is warranted. Accordingly, Mr. Traxler's selection of a 5% estimated inflation rate for corporate allocations is eminently reasonable. Therefore, the Commission, in deciding whether the projected costs and savings meet the "not detrimental to the public interest" standard, should rely on Mr. Traxler's projected costs for UCU's corporate cost allocations, which are based on a 5% inflation rate.

VIII. "FROZEN" MPS ALLOCATION FACTOR

This section addresses the negative impacts of the Joint Applicants' proposed regulatory plan in regard to the rate treatment of allocations of corporate overhead costs to MPS, with resultant detrimental impacts on the MPS ratepayers. The Staff asserts that the Joint Applicants' regulatory plan, if approved, will negatively affect corporate overhead costs allocated to MPS, to the detriment of MPS's ratepayers. In particular, by artificially "freezing" MPS's corporate allocation factor to exclude the impact of the EDE acquisition, the Joint Applicants would be denying MPS and its ratepayers the normal and natural effect of the transaction, which is a reduction in UCU corporate allocations to MPS. (Traxler Rebuttal, Ex. 716, p. 12, lines 4-13). At the same time, costs allocated to MPS, for financial reporting purposes will reflect a lower allocation of UCU's corporate costs. (Traxler Rebuttal, Ex. 716, p. 12, lines 21-23). Staff calculates that the detrimental effect on MPS ratepayers of collecting in rates amounts in excess of MPS's actual costs will amount to an average of more than $6.3 million per year. (Traxler Rebuttal, Ex. 716, Sched. SMT-3, line 17).

UCU argues in its Initial Brief that the post-merger MPS allocation factor should be calculated assuming the non-existence of the then-new EDE division, thereby preventing MPS from enjoying a normally expected reduction in allocated overhead, "because the MPS customers are not being asked to bear any of the costs, including premium costs, related to the merger. Therefore, in future rate cases, the allocation factors should not be impacted by the Empire unit." According to UCU, the regulatory plan provides for both costs and associated savings to flow to the EDE division. (*Id.*). UCU states that it would be "unfair" if MPS customers were to gain the benefit of the reduced corporate allocation without also incurring its share of the costs. (*Id.* at 13). UCU further argues that, "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." (*Id.* at 47).

In response, the Staff asserts that UCU's corporate overhead allocation contrivance amounts to an attempt to shift merger costs to MPS. (Traxler Rebuttal, Ex. 716, p. 12, lines 14-17). The EDE/UCU merger should be economic on its own, without indirectly requiring MPS ratepayers to pay for the acquisition premium through over-collection in rates of corporate overhead costs. Setting rates for MPS by using a UCU allocator that excludes EDE results in a UCU overhead cost to MPS that does not exist in reality. UCU has never, in a previous rate case involving MPS, asked the Commission to ignore the impact of another division on its allocated costs to MPS. Presumably, in those prior cases UCU did not regard it as "unfair" to allocate to MPS its actual share of corporate overhead costs, based upon allocation factors that considered all of UCU's other divisions. Not reflecting the actual reduction in MPS corporate allocated costs in rates will mean, in a real way, that MPS customers will be financing a portion of the merger premium, yet will receive no (or an immaterial level of) merger savings. This result would be clearly detrimental to MPS customers. (Tr. 415-416).

Furthermore, if MPS were to receive said actual share of corporate overhead costs, contrary to UCU's assertion, MPS would, in fact, also be absorbing its actual share of the costs of the merger, in the form of higher pool costs, right along with the associated savings. These additional pool costs amount to more than $75 million over 10 years. (Traxler Rebuttal, Ex. 716, Sched. SMT-2, Col. A [or B], line 14 plus line 15). In addition, authorizing the use of such a methodology would require the Commission to deviate from "cost-based rates" for rate cases involving MPS. As noted above, MPS's rates will be increased by an average of more than $6.3 million annually for non-existent UCU corporate overhead costs to MPS.

UCU's Initial Brief does not address a second adverse effect on Missouri ratepayers; namely, that which results when the MPS allocator is "frozen at approximately 25% and applied to a higher overhead cost "pool". The Joint Applicants did, however, offer testimony suggesting that a tracking system would be implemented to ensure that EDE would not receive a share of such increase in UCU's corporate overhead cost pool resulting from the merger. (Myers Surrebuttal, Ex. 13, p. 5, lines 14-18). The Staff, however, remains highly skeptical that such a system can ever be successfully developed. Furthermore, the Joint Applicants have presented no concrete proposal regarding how their tracking system will work, so as to ensure that MPS customers will not be detrimentally impacted by the increase in UCU corporate overhead costs resulting from the proposed merger. Accordingly, Staff asserts that MPS ratepayers can expect a detrimental impact amounting to an average of approximately $19 million per year in connection with the allocation of the higher UCU corporate overhead pool costs resulting from the merger even if one assumes that the allocation factor to MPS is frozen with respect to the EDE addition. The $19 million annual increase in UCU costs allocated to MPS from higher UCU "total pool" costs can only be fairly offset by using the lower allocation factor that results by adding the EDE division.

In total, under the proposed regulatory plan, customers of MPS will be detrimentally impacted in the amount of approximately $25.3 million ($6.3 million plus $19 million) per year. For the reasons stated, the Commission should reject UCU's labored and wholly artificial and unprecedented scheme for allocating its overhead costs to MPS in the wake of the proposed UCU/EDE merger.

IX. FROZEN" CAPITAL STRUCTURE

In their Initial Brief, the Joint Applicants stated: "The reason for the 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." (Initial Brief of the Joint Applicants, p. 46). This statement is based upon the false premise that UtiliCorp knows how Empire will finance its operation in the coming years. In fact, UCU does not know, and cannot know that the capital structure for Empire as a stand-alone company "would not have changed appreciably."

Furthermore, the 47.5% common equity, 52.5% long-term debt capital structure that UtiliCorp wishes to preserve for the next 10 years was not an actual capital structure at any relevant time. It is, rather, the Empire capital structure that is to be determined in Empire's Pre-Moratorium Rate Case. Or, more accurately, it is the capital structure that the Joint Applicants *hope* to establish in that case. The Joint Applicants are asking that the capital structure for the new Empire Division be "frozen" at the "normalized Empire only capital structure" – 47.5% common equity and 52.5% long-term debt.

This capital structure has *never* been established. And even if the Joint Applicants are successful in establishing it next year, in Empire's Pre-Moratorium Rate Case, it would already be five years old, when the "frozen" capital structure first takes effect in 2006, and would be 10 years old before the "frozen" capital structure ends in 2011.

The "frozen" capital structure that UtiliCorp seeks to use would bear little relationship to the reality of how the new Empire Division would be financed. This new division would not be financed as a separate entity, but as a part of UtiliCorp. It would be UCU, not Empire, that would have the obligation to repay the loans that are used to finance Empire's operation, and it would be the shareholders of UtiliCorp, not Empire's shareholders, that would be providing the equity capital to support the Empire Division. The Commission should not "freeze" Empire's capital structure, but should use the capital structure of UtiliCorp.

Even if there would be, as UCU claims, "no new or increased cost" as a result of the implementation of this part of the Regulatory Plan, that does not mean that there would be no detriment to the public interest. The Staff submits that if the financing costs that the ratepayers have to pay are greater than the financing costs that UCU incurs in support of its new Empire Division, there is a detriment to the public.

X. MERGER SAVINGS

XI. JOINT DISPATCH

The Joint Applicants addressed the issue of joint dispatch savings at pages 34-38 of their Initial Brief, as Issue No. 10. The Joint Applicants' argument there begins with a false and unsubstantiated claim regarding the Staff's assumptions, stating, at page 34, that 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." This statement is wrong, for several reasons, as follows.

First, the Staff never stated that it assumed a "perfect" wholesale market. Second, UtiliCorp has not defined what it means when it uses the term "a perfect wholesale market." Third, the Staff used the same assumptions regarding the prices and economic opportunity for off-system sales as those used by the Joint Applicants.

The fundamental difference between Staff and the Joint Applicants with regard to the wholesale market for electricity is that the Staff does not agree with the Joint Applicants' assumption that without this merger, the two stand-alone companies will face the same economic opportunities in the wholesale market as they have experienced historically. Instead, the Staff's position is that the two stand-alone companies will face the same economic opportunities in the wholesale market as the merged company. Indeed, if this is not the case, then the merger has resulted in increased market power for the merged entity.

While the brief of the Joint Applicants contains much with which the Staff disagrees, it does in fact point out the heart of this issue, which is: *Is the historical performance of Empire and MPS the proper basis from which to measure changes that are directly attributable to the merger?*

The following are examples of this "historical performance" criteria from the Joint Applicants' brief:

> "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." (Initial Brief of Joint Applicants, pp. 34-35).

> "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 …" (Initial Brief of Joint Applicants, p. 35).

> "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." (Initial Brief of Joint Applicants, p. 36).

> "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." (Initial Brief of Joint Applicants, p. 36).

The Staff's position on the question of whether historical performance is the proper basis from which to measure changes that are directly attributable to the proposed merger is clear.

First, Empire's generation position has significantly changed from its historical position. Empire is adding combined cycle capacity through its current capacity expansion plan, and will therefore be in a much better position to take advantage of market sales opportunities in the off-system sales market than it has historically been able to do. (Proctor Rebuttal, Ex. 713, p. 35, lines 1-7). Thus, the argument that historical performance should be the basis against which to measure the impact of the merger clearly has failed to account for Empire's changed circumstances. As Empire will have significantly more excess generation to sell in the wholesale market than it has had in the past, it will become more profitable for Empire to participate in that market.

Second, the Joint Applicants acknowledge that the elimination of "transmission limitations," through Empire's interconnections into the SPP region, and the "increased availability of capacity for sale into the wholesale markets" are the primary reasons that the Joint Applicants will enhance their market opportunities via the merger. (Initial Brief of Joint Applicants, p. 36). As stated in the previous paragraph, the Staff agrees that Empire will have increased capacity available to sell into the wholesale markets; however, this is not due to the merger. The Staff contends that most of the benefits of an enhanced transmission system will be provided by the implementation of regional transmission organizations ("RTOs"), and that FERC Order No. 2000 will adequately promote the implementation of RTOs. The Joint Applicants have agreed to join an RTO. (Kreul Direct, Ex. 24, p. 12, line 10 – p. 13, line 5). In response to cross-examination, Joint Applicants witness Frank DeBacker stated: "What we're really talking about here is the increased number of interconnections that the combined company will have with other entities and the larger geographic area that it will cover." (Vol. 5, Tr. 806, lines 17-20). However, through a regional tariff, under an RTO, all of these interconnections with other entities would be available to both EDE and to MPS, on a stand-alone basis. Thus, the Commission must determine whether it is the merger or the establishment of RTOs that will, in fact, expand the market opportunities of the Joint Applicants. The Staff's position is that with the elimination of pancaked transmission rates via RTOs, the merger will add little to increase economic opportunities in the wholesale electricity markets.

Third, the Joint Applicants claim that Empire's historical lack of involvement in competitive wholesale markets can only be changed if there is a change in Empire's management's "attitude" to be more involved in the wholesale market, and if there is an investment of approximately $1.17 million dollars per year ($3.5 million divided by 3 years). (Initial Brief of Joint Applicants, p. 37). The Staff's contends, however, that if the economic opportunity to make additional profits in the wholesale market (after paying the cost of implementing such activities) *already* exists for Empire, then Empire *as a stand-alone company* has the obligation to both its shareholders and its ratepayers to engage in such activities.

In their original filing, the Joint Applicants did not state how much Empire saves by not engaging in additional wholesale activities. The Staff has therefore not been able to review the claim that this savings amounts to the $1.17 million per year figure that is mentioned above. However, assuming that this figure is correct, additional savings of $11.7 million could be added to the Staff's savings estimate of $6.95 million over a 10-year period. The resulting total savings ($18.65 million over 10 years) is still significantly less than the $169 million in "savings" that the Joint Applicants claim the merger will produce.

XII. ELECTRIC ALLOCATIONS AGREEMENT

XIII. SAVINGS TRACKING

A. UtiliCorp's "Burden" on the Tracking Issue

The Staff recommends that the Commission take no steps to set up a savings tracking mechanism for the UtiliCorp - EDE merger in this application. If the Commission adopts the Staff's recommendation to not approve the merger, or if the Commission adopts the Staffs fallback recommendation to treat the acquisition adjustment below-the-line, then the tracking issue is moot in any event. However, even if the Commission were to decide to reserve all ratemaking decisions regarding the acquisition adjustment and other merger costs and savings to subsequent rate proceedings, the Staff would still recommend that no findings should be made in this application regarding a future tracking method.

UtiliCorp claims that approval of a specific tracking system by the Commission is not critical for approval of the merger in this case (UtiliCorp Initial Brief, pp. 38). However, UtiliCorp is clearly seeking piecemeal approval of some aspects of a future savings tracking mechanism by the Commission at this time in the current docket, namely in the area of "benchmarks" (*Id.* at 44-45). The Staff disagrees with this strategy of attempting to tie down some aspects of a tracking method now while leaving other aspects undefined until a later rate proceeding. In the event the Commission does not decide future rate treatment of the acquisition adjustment in this case, UtiliCorp properly will have the burden of justifying any future rate recovery of this amount that is sought. If UtiliCorp attempts to justify rate recovery of the acquisition adjustment by citing alleged merger savings in a later rate proceeding, that burden should include UtiliCorp putting forth a proposal for identifying and quantifying alleged merger savings, a proposal which would presumably include a comparison of pre-merger and post-merger cost levels for certain expense categories or for the EDE division in total. It should be UtiliCorp's responsibility to justify the existence of purported merger savings in the future, including proposals for appropriate savings benchmarks, if applicable. It is not the job of the Staff, other parties, or ultimately the Commission to help UtiliCorp to carry this future burden by making upfront, piecemeal recommendations or determinations now as to certain aspects of the desired tracking approach.

In any case, UtiliCorp's emphasis on the Commission needing to establish tracking benchmarks upfront is misplaced. Benchmarks will serve only as a starting point for examining the question of whether actual merger savings exist and, if so, how much. (Traxler Rebuttal, Ex. 716, p. 18). They in no way will resolve the questions of how one can distinguish merger and non-merger savings and accurately quantify the savings amounts. Ordering benchmarks in this proceeding will not move the parties or the Commission at all towards establishing a workable savings tracking system. UtiliCorp's position on benchmarks in this case appears to be more related to an interest in setting up a mechanical system for identifying "presumed" merger savings than in dealing with the real conceptual issues of how actual merger savings can be identified in the first place.

B. Benchmarking Agreements

At pages 44-45 of its Initial Brief, UtiliCorp discusses its' alleged need for the Commission to make various determinations regarding "benchmarks" or "baselines" for various categories of costs in this proceeding. Because the Staff recommends the Commission not decide savings tracking issues in this docket, the Staff likewise recommends that the Commission not establish benchmarks or baselines in this case. However, in the event that the Commission decides it is appropriate to establish savings tracking benchmarks in this application, the Staff believes use of an actual cost of service calculation for EDE would be better than relying on the 1999 EDE budget for that purpose, as the Joint Applicants have generally proposed. UtiliCorp is requesting approval of different benchmarks for three different cost of service categories. For all operation and maintenance expenses except for fuel/purchased power and employee benefits, UtiliCorp is seeking to use the 1999 EDE budget as a benchmark. The Staff believes the cost of service ordered by the Commission in DED's planned pre-moratorium rate case would be more accurate and representative for this purpose, if benchmarks are ordered in this case (Traxler Rebuttal, Ex. 716, pp. 18-21).

Second, UtiliCorp is advocating that a comparison of fuel model results between a stand-alone UCU and EDE assumption and a combined company assumption be used as a benchmark in the fuel and purchased power expense area. UtiliCorp's Initial Brief notes "[d}iscussions are continuing with Staff to stipulate this issue." (Joint Applicants' Initial Brief, p. 53). The Staff disagrees with this characterization of the status of this issue. While the Staff and UtiliCorp agree on the use of a joint dispatch and stand-alone dispatch models for the purpose of a joint dispatch agreement, there are fundamental disagreements concerning the assumptions that go into the stand-alone dispatch models and how the results of the stand-alone models are to be applied. The Staff's position is that the market assumptions going into the stand-alone dispatch models should be the same as for the joint dispatch model and that the results of the stand-alone model should be used to allocate the costs and any savings from the joint dispatch model among the divisions. UtiliCorp's position is that the market assumption going into the stand-alone dispatch models reflect the market conditions prior to the merger and that the results from the joint dispatch model be subtracted from the results of the stand-alone dispatch models to calculate the merger savings. These merger savings would then be allocated to non-MPS divisions (i.e., EDE and/or SJLP). The major differences in results between these two approaches are that: 1) the UtiliCorp approach will show significantly more merger savings than the Staff approach because it will attribute all changes in market conditions to the merger; and 2) the UtiliCorp approach ignores the stand-alone approach in the allocation of costs to the division by excluding any merger savings to the MPS division. The Staff and UtiliCorp have these two fundamental disagreements concerning the magnitude and allocations of merger savings and have not attempted to resolve these differences through continuing discussions.

Finally, for benefits savings, the Staff advocates use of the 1999 actual EDE cost of service as a benchmark, instead of actuarial estimations of stand-alone EDE benefit costs over the ten-year period of the regulatory plan, as recommended by UtiliCorp. (Traxler Rebuttal, Ex. 716, p. 20).

C. UtiliCorp's Current Accounting System

On pages 39-42 of its Initial Brief, UtiliCorp engages in a lengthy discussion of its current accounting system and its alleged ability to track "incremental" costs to UtiliCorp associated with the EDE transaction. However, all of this discussion is irrelevant to the question of whether UtiliCorp can actually identify and quantify actual merger savings allegedly resulting from the EDE merger. Even if UtiliCorp's Peoplesoft system does have all of these characteristics, the UtiliCorp brief nowhere asserts that the accounting system has the capability of (1) ascertaining what EDE's actual cost of service would have been on a stand-alone basis during the course of the regulatory plan; or (2) determining what impact the EDE merger had on the financial results of UtiliCorp, when compared to the myriad of other internal and external non-merger forces affecting UtiliCorp's earnings. Without answers to these questions, no one can claim an ability to accurately track savings. (Oligschlaeger Rebuttal, Ex. 712, pp. 33; Featherstone Rebuttal, Ex. 702, pp. 72-76).

There are several examples in the record of this proceeding of how the savings claimed by UtiliCorp as resulting from this merger could be achieved by EDE on a stand-alone basis in the future. Both relate to estimated savings from employee reductions. One source of estimated employee reductions, much remarked upon at the hearings, were the reductions associated with

UtiliCorp's proposal to utilize two-man teams for certain field maintenance and repair functions, compared to EDE's current practice of using three-man teams for these purposes. The relevant point to make here is the statement at the hearings by Mr. Myron McKinney, EDE's Chief Executive Officer, that EDE itself would consider moving toward use of two-man teams in future years if it were to remain on a stand-alone basis (Tr. 156-157). Similarly, the Joint Applicants have claimed that EDE has already experienced some level of merger savings through the reductions in its workforce since the merger was announced in 1999 (Fancher Direct, Ex. 8, p. 5; Tr. 507). However, Mr. Fancher indicated at the hearings that EDE might not choose to fill all of its current employee vacancies in the event the merger with UtiliCorp is not consummated (Tr. 509). Both of these situations illustrate that some of the Joint Applicant's purported merger savings in fact may be achievable by EDE on a stand-alone basis, and therefore would not be incremental to the merger at all. Nonetheless, UCU's efforts to "track" merger savings would almost certainly claim these employee reductions as valid merger savings.

UtiliCorp's initial brief at page 42 states:

> Because UtiliCorp's system will track EDE'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).

"Ex. 13" is the surrebuttal testimony of UtiliCorp witness Jerry E. Myers. In his surrebuttal testimony, Mr. Myers' follows up this discussion by providing an example of how such a tracking process would work, which appears in his surrebuttal testimony as Schedule JDM-1. Schedule JDM-1 is a tracking method, though the Joint Applicants are careful not to call it a formal proposal for tracking. This method does not provide any means by which merger and non-merger components of the total savings amounts can be disaggregated, which is the fundamental tracking question. Even beyond that criticism, a closer examination of Mr. Myers' Schedule JDM-1 is in order for what it seems to reveal about the Joint Applicants' attitude towards tracking.

First, it is apparent that Schedule JDM-1 represents an interest by UtiliCorp in setting up a mechanical process to derive merger savings. By agreeing on a set of calculations, and then assuming the results of those calculations represent merger "savings" or the starting point for determining merger savings, UtiliCorp would like for the Commission to believe that it will be able to avoid most of the inherent difficulties in meeting its burden for proving the existence of merger savings.

Second, Mr. Myers' surrebuttal testimony at pages 3-4 makes clear that other parties will have, in effect, the burden of proving the existence of non-merger savings in the context of the tracking method contained in Schedule JDM-1. If non-merger savings can be proven or agreed to by the parties, then the amount of non-merger savings is to be subtracted from "total" savings, with the remainder assumed to be merger savings. Under this approach, savings are assumed to be merger related unless otherwise shown not to be.

If any tracking system is to be considered by the Commission, the Staff urges that the Commission place the burden of demonstrating the existence of merger savings clearly on the party seeking acquisition adjustment recovery. The reasons why UtiliCorp might like to avoid such a burden are demonstrated in the history of its 1999 West Plains rate proceeding in Kansas.

D. West Plains Energy Kansas Case

UtiliCorp does have some prior history in regard to making claims for merger savings in order to justify rate recovery of an acquisition adjustment that may be of interest to the Commission. In Kansas, in a 1999 rate proceeding, Re: UtiliCorp United Inc., d/b/a West Plains

Energy Kansas, Docket No. 99-WPEE-818-RTS, No. 10 Order On Application, 198 PUR4th 397 (January 19, 2000), UtiliCorp sought recovery of an acquisition adjustment associated with its 1991 purchase of former Centel properties, now known as "West Plains Energy Kansas." To justify the requested rate recovery, UtiliCorp presented alleged evidence of merger savings in seven separate areas. These areas included savings associated with reduced coal contract costs at a power plant in which West Plains was a minority owner, and labor reductions. 198 PUR4th at 404-06. Mr. John McKinney was a witness for UtiliCorp on this issue. *Id.* at 403. As previously recounted for the Commission, the Kansas Corporation Commission (KCC) rejected most of the claimed savings amounts, noting among other things in regard to the coal contract that the majority owner of the power plant in question had sufficient incentive on its own to seek fuel cost reductions. The KCC determined that alleged merger savings purportedly related to employee reductions appeared to be the norm in the current electric industry, and were no more than cost reductions that a prudent utility would seek to achieve, merger or no merger. *Id.* at 404-06.

Several aspects of the KCC Order may be of particular interest to the Missouri Commission. First, the KCC made clear exactly what the test for accepting claims of merger savings was: "...the Applicant failed to carry its burden of proof with respect to these claimed savings and failed to establish that the coal cost savings would not have been created but for the Centel acquisition." 198 PUR4th at 404. The burden was clearly placed on UtiliCorp, and the test was proof of savings that would not be possible but for the merger. As shown in Schedule JDM-1 to Mr. Myers surrebuttal testimony, Ex. 13, UtiliCorp appears to be suggesting tracking methods that would put the burden of proving savings are not merger-related on other parties. The record is also clear in this proceeding that UCU is including in its estimated merger savings amounts, alleged savings that in fact would be possible without the merger (i.e., off-system sales opportunities).

Second, the KCC Order indicates how speculative the entire process is of attempting to identify merger savings after the fact. The Joint Applicants will no doubt point out that the KCC did accept some of UCU's claims of merger savings, and allowed West Plains recovery of almost one-half of the claimed acquisition adjustment on that basis. 198 PUR4th 405-06. (The KCC did not allow rate base treatment of any portion of the acquisition adjustment. *Id.* at 404.) In respect to its agreement with West Plains on several categories of merger savings, the KCC stated the following:

> . . . After several rounds of testimony, the conflicting evidence concerning acquisition savings indicates that the amount of annualized savings recoverable, as stated in paragraphs 15 and 16 above, ranged from zero percent to 100% of the acquisition premium. [Citations omitted.] The Commission evaluated specific areas of claimed savings and finds that the Centel acquisition created approximately $2,350,000 of annual savings. The $2,350,000 savings falls at or near the midpoint of the range of testimony provided in this proceeding. Based on the record in this proceeding, and recognizing that a docket was not opened earlier to determine merger savings, the Commission believes that the midpoint of the range of the evidence provides a substantive basis alone to support the Commission's finding . . . .

198 PUR4th at 406.

This excerpt from the KCC Order illustrates in several respects the inherent lack of clarity in seeking to make after-the-fact quantifications of merger savings. First, the range of savings estimates offered by the parties show the inescapable subjectivity of the process, and also that parties to a rate proceeding are unlikely to come to any agreements regarding savings estimates. Further, it is striking that the KCC felt obliged to rely, at least in part, on a calculated midpoint in the savings estimates offered in coming to its determinations on merger savings. Again, this suggests that this type of process will not give this Commission a great deal of confidence that hard facts will be available in the future to make definitive determinations in future rate cases as to allegations of merger savings achieved. In this light, UtiliCorp's claims that customers will be absolutely protected from detriment under its regulatory plan should be assessed.

E. Summary

The Staff continues to assert that after-the-fact attempts to identify and quantify actual savings resulting from a merger are very difficult, and practically impossible to do. Therefore, a regulatory plan dependent upon the ability to track merger savings to protect customers should be rejected for that reason alone. The Staff recommends, in the case the Commission leaves merger savings and cost rate issues to a future rate proceeding, that the Commission make no findings at this time regarding any aspect of a future merger savings tracking method, and make clear it is UCU's sole responsibility to propose any such plan in future rate proceedings.

XIV. MPS SAVINGS ASSIGNMENT

On page 13 of UtiliCorp's initial brief, in relation to future reductions in UtiliCorp corporate allocation factors that the MPS division will experience, UtiliCorp states that "it would be unfair to have MPS customers gain this benefit without also incurring their share of the costs."

This statement is an inaccurate description of the effect of the EDE – UtiliCorp proposed regulatory plan on MPS customers. It is very clear that the intent of the regulatory plan is to take MPS off cost-based ratemaking as it applies to UtiliCorp corporate allocation factors in order to allow UtiliCorp a means of indirectly recovering a portion of the acquisition adjustment. (Vol. 3, Tr. 462). If MPS' rates are to be held higher than they otherwise would be, specifically to allow for acquisition adjustment recovery, then it should be evident that MPS' customers in fact will be paying part of the merger premium. (Vol. 3, Tr. 415-16). This makes UtiliCorp's unwillingness to provide MPS' customers a material portion of the purported merger savings, unfair and inappropriate.

XV. TRANSACTION COSTS AND COSTS TO ACHIEVE

A. The Regulatory Treatment of Transaction Costs

Among the issues in this case is the question of the appropriate regulatory treatment of certain costs that the Staff labels "Transaction Costs." These are costs directly associated with the completion of the merger transaction, including, for example, "fees paid for legal, banking and consulting services necessary to close the transaction." (Russo Rebuttal, Ex. 715, p. 3, lines 1-4). In proposing the regulatory treatment of transaction costs, UCU groups them with "costs to achieve," which the Staff defines as costs that the Joint Applicants would incur in order to combine the systems and processes following an approval and execution of the merger. In its Initial Brief, UCU states that transaction costs should be recoverable in rates, arguing that "[f]ailure to deduct these costs from resulting merger synergies would result in overstating synergies that could not otherwise be achieved absent the merger" and that transaction costs "should be given rate recognition by allowing UtiliCorp to retain merger benefits equal to these costs." (UCU Brief at 49).

Staff's position is that transaction costs are separate and distinct from costs to achieve (Russo Rebuttal, Ex. 717, p. 5, lines 15-16). Transaction costs are <u>directly</u> related to the actual acquisition transaction, and for the most part, occur during the time leading up to and including the execution of the transaction, while costs to achieve are normally incurred after the transaction is completed. (Russo Rebuttal, Ex. 715, p. 12, lines 18-19). Transaction costs, which are more standardized, less discretionary, and often more easily quantified than costs to achieve, result directly from the decision of the shareholders to enter into a merger and are therefore closely tied to the acquisition (or merger) premium (*i.e.*, the amount by which the acquisition price exceeds the net book value of the acquired assets). In fact, "[t]ransaction costs are referred to as 'direct costs of the merger' and are coupled with the merger premium to make up the amount of the acquisition adjustment to be recorded on the utility company's balance sheet." (Hyneman Rebuttal, Ex. 705, p. 38, lines 17-19). Thus, like the acquisition premium, transaction costs are "ownership" costs. (*Id.*). As such, they are a matter of concern strictly to UCU's shareholders, and not its customers, who, in their capacity as ratepayers, have no ownership interest in the Company. The shareholders elect to incur both the acquisition premium and the costs directly associated with the merger transaction as a way to increase the value of their investment. (Russo Rebuttal, Ex. 715, p. 7, lines 6-10). "Both the USOA and GAAP (APB 16) require that transaction costs be treated the same as the merger premium." (Hyneman Rebuttal, Ex. 705, p. 38, lines 19-21). Ratepayers, on the other hand, are neither considered nor involved in the decision whether to merge. (*Id.* at 39-40). In light of the foregoing, it follows that transaction costs should receive the same regulatory treatment as the acquisition premium; namely, they should be excluded from rate recovery. Ownership issues are strictly a shareholder concern; therefore, costs associated with ownership should be borne by the shareholders.

However, in the event the Commission decides that recovery of transaction costs in rates should be permitted, Staff would recommend that they be amortized over a period of 40 years (Russo Rebuttal, Ex. 715, p. 8, lines 13-20), as opposed to the 10-year period proposed by the

Joint Applicants.[3] As noted in Staff's Initial Brief, transaction costs are closely tied to the transaction itself, and the Joint Applicants are already recommending a 40-year time frame for amortization of the merger premium. (Staff Brief at 196). Since transaction costs are conceptually very similar to the premium, there is no reason to give transaction costs more favorable treatment than the Joint Applicants themselves are proposing for the premium (*i.e.*, 40-year amortization).

Moreover, in the event the Commission decides, notwithstanding the Staff's recommendation, to permit recovery of transaction costs, Staff would recommend that 50% of such costs be allocated to UtiliCorp's non-regulated operations, on the basis that the Joint Applicants failed to provide Staff with any information concerning a reasonable allocation of the acquisition adjustment to such operations. (Russo Rebuttal, Ex. 715, p. 9, lines 3-10). In support of its recommendation, the Staff offered considerable evidence that a significant portion of the benefits the Joint Applicants expect to realize from this merger pertain to non-regulated operations. (Hyneman Rebuttal, Ex. 705, pp. 69-90). Based on that evidence, some portion of merger transaction costs should be assigned below the line to non-regulated operations. UCU argues that a portion of the transaction costs is assigned implicitly to non-regulated operations, asserting that UCU's proposed 10-year amortization yields only a 60% payback of the transaction costs. According to UCU, the result is actually an under-allocation of transaction costs to non-regulated operations, "[s]ince the regulated operations of Empire are significantly more than 60% of total operations…". (UCU Brief at 50).

The question, however, is not what percentage of <u>EDE's</u> operations are regulated; rather, it is what percentage of the benefits flowing from the merger can be expected to accrue to <u>UCU's</u>

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[3] As noted in the Staff's Initial Brief at page 196, the Joint Applicants are, however, proposing to amortize bond solicitation costs and banker fees over 40 years.

non-regulated operations. Again, based on the evidence indicating that the relevant percentage is substantial, Staff continues to recommend that at least 50% of the transaction costs associated with the subject merger be assigned below the line to UCU's non-regulated operations. The recommended 50% allocation is conservative because UCU has provided no evidence to the Commission to indicate that even 50% of the total benefits from this transaction would apply to regulated operations.

B. The Regulatory Treatment of Costs to Achieve

As suggested earlier, "costs to achieve," as distinguished from transaction costs, are costs that will arise in the merged utilities as they take advantage of opportunities for potential savings presented in the post-acquisition environment. Such costs are typically associated with consolidating and integrating various operations, systems, practices, and procedures. The Staff believes reasonable and prudent levels of costs to achieve should be considered for recovery because of their direct relationship to potential merger-related customer savings. (Russo Rebuttal, Ex. 715, p. 12, lines 5-8).

The Joint Applicants propose that costs the Staff characterizes as "costs to achieve" be amortized over 10 years. (Siemek Direct, Ex. 6, p. 8, lines 11-12). The Staff, however, recommends that these costs be expensed in the period in which they occur, as a means of offsetting any merger savings actually realized during the same time period. (Russo Rebuttal, Ex. 715, p. 12, lines 8-10). This treatment would allow the Joint Applicants to seek recovery of costs to achieve incurred within a test year set for a future rate proceeding.

Although the Staff generally supports consideration of costs to achieve for recovery in rate cases, if the Commission is inclined to make rate determinations in this proceeding, Staff is opposed to the inclusion in cost of service of some of the specific items proposed by the Joint

Applicants; in particular, the amounts estimated for the "Officers Severance/retention" ($1,406,000) packages, the "Paid Advisory Board" ($250,000), and the "Curtailment Costs for Retiree Medical Plan" ($2,732,000). (Russo Rebuttal, Ex. 715, p. 11; Traxler Rebuttal, Ex. 716, p.23, lines 15-17).

With respect to "Officers Severance/Retention," and the "Paid Advisory Board," UCU argues respectively that: a) these costs are the price for eliminating the salaries of the then-former EDE executives, and b) the establishment of the Paid Advisory Board is necessary to accomplish the merger. (UCU Brief at 50-51). In so arguing, UCU is, in effect, raising an "umbrella" by purporting to show that overall the proposal is economically justified and then seeking to include under that umbrella various implicated costs, regardless of whether they are prudent and benefit the ratepayer.

The Staff, however, is hardly inclined to abandon its normal practice of scrutinizing the various cost elements as to their prudence and their connection to the ratepayers, and instead to "open the gates" and agree to inclusion in cost of service simply because some allegedly associated synergies of greater value can be identified. The fact is that executive severance amounts are <u>not</u> expended for the purpose of creating merger savings. They are paid to ensure management "neutrality" in merger transactions, so that the interests of the shareholders are represented fairly. (Russo Rebuttal, Ex. 715, p. 15, lines 18-21). Moreover, these payments are made pursuant to contracts with EDE executives by EDE itself. UCU, the party with an interest in fostering merger savings, had no role in establishing these payments. Accordingly, the Officers' Severance/Retention program is strictly an ownership issue, and the costs associated with these "golden parachutes," which amount to approximately three times the executive's salary (Russo Rebuttal, p. 15, lines 11-12), should legitimately be borne by the shareholders, and not by the ratepayers. Similarly, the cost of the Paid Advisory Board, which will be involved in charitable activities and possibly economic development, and which is merely advisory in nature, constitutes an inappropriate and unnecessarily duplicative cost, and should therefore be excluded from recovery in rates. (Staff Brief at 198).

A final concern raised by Staff in the area of costs to achieve is UCU's proposed regulatory treatment of a Financial Accounting Standard ("FAS") 106 curtailment resulting from the merger. FAS 106 is the accrual accounting method for retiree retirement benefits other than pension ("OPEBs")---i.e., medical, dental, vision and life insurance costs---expected to be paid by UCU between retirement and death and/or age 65, depending upon the hire date for the employee. (Traxler Rebuttal, Ex. 716, p. 22, lines 12-15). A curtailment refers to, among other things, "an event that significantly reduces the expected years of future service of active plan participants or eliminates the accrual of defined benefits for some or all of the future services of a significant number of plan participants." (Traxler Rebuttal, Ex. 716, p. 22, lines 20-24)

The Joint Applicants are attempting to treat a FAS 106 curtailment cost as a cost to achieve (also known as a "transition cost") and to amortize it over a 10-year period. UCU's brief justifies the ten-year amortization on the basis that the synergies from headcount reductions, which resulted in the recognition of the FAS 106 curtailment, are reflected in the entire ten-year period following merger approval. In their view matching this curtailment cost with the related synergies is appropriate. (UCU Brief at 50-51).

The Staff's primary objection to treating the FAS 106 curtailment cost as a transition cost, amortized over 10 years, is that it violates the commitment, under the proposed regulatory plan, that Empire's cost of service in the post moratorium rate case not be affected by changes in cost of service which occur during the year 1-5 moratorium. (Traxler Rebuttal, Ex. 716, page 24, lines 5-18). FAS 106 post retirement benefit costs are a normal cost of service item used in setting Empire's rates. UCU's proposed ten-year amortization allocates 50 % of the $ 2.7 million curtailment cost to years 6-10, which will result in rate recovery from Empire's ratepayers in the post moratorium rate case expected in year 6 (2006). However, the proposal ignores the fact that there are offsetting benefits to the Joint Applicants directly associated with the curtailment; namely, reduced employee benefits costs associated with the head count reduction. This amounts to $3.2 million during the moratorium (years 1-5). It is inconsistent with the matching principle of accounting and patently unfair for the Joint Applicants to propose a scheme for recovering half of the curtailment cost from ratepayers, post moratorium, while ignoring and thereby confiscating the whole of the $3.2 million reduction in employee benefits expense, which more than offsets the $2.7 million increase in curtailment cost. (Traxler Rebuttal, Ex. 716, p. 24, lines 19-23, p.25, lines 1-3).

Furthermore, FAS 106 requires recognition of a plan curtailment in the year of occurrence. UCU witness Browning's Schedule RBB-6 correctly reflects that FAS 106 would require recognition of the curtailment cost in years 2000, 2001, 2002 and 2003 all of which occur prior to the end of the moratorium at the end of year 2005. (Browning Direct, Ex. 19).

The Joint Applicant's proposed ten-year amortization period for the FAS 106 curtailment cost is therefore fundamentally unfair in that it violates both a) the proposed regulatory plan, which allows the merged company to keep all savings during the moratorium period (years 1-5) to offset costs incurred during that same period, and b) the required accounting treatment under FAS 106, which requires expense recognition in the year of occurrence.

For the reasons stated, it would be wholly inappropriate to allow the Joint Applicant's to keep the aforementioned $3.2 million in employee benefits savings during the moratorium, while at the same time deferring recognition of the FAS 106 curtailment so that 50% is recovered in rates set after the moratorium. Accordingly, the Commission should order that the entire $2.7 million cost be recognized during the moratorium, with no amortization and recovery from ratepayers in years 6-10.

XVI. CUSTOMER SERVICE INDICATORS

UtiliCorp argues that there is no need for supplemental merger conditions regarding reporting requirements or potential remedial action by it concerning customer service standards after the merger. However, given the uncertainty regarding the continuation of service quality following a merger, it is Staff's opinion that a regular reporting of information is the most efficient and effective method to monitor service quality. A regular reporting system, specified in advance, would provide the Company with exact information on the type, the format and the frequency of such information. Therefore, Staff desires that this information to be provided to it on a monthly basis should the Commission approve the merger (Kiebel Rebuttal, Ex. 707, p. 17, lines 9-11). In Staff's judgment, it is in the best interest of all parties, the companies and consumers, for the Commission to order such a formal reporting requirement, so each is aware of the information to be provided, the format of the information and the timing of the reports.

The Company has argued in the past that it is unfair to single it out for customer service reporting requirements when they do not apply to all other Missouri utilities. However, the Company's response implicitly assumes that there are not differences between merging utilities and non-merging utilities in terms of customer service concerns. However, as Staff witness Kiebel points out, this is not the case. (Kiebel Rebuttal, Ex. 707, p. 4, line 20 through p. 5, line 4.) As merging companies may face greater incentives to cut back on expenditures pertaining to customer service in order to pay for acquisition adjustments, Staff believes that there is good reason to demand greater information in this area from merging utilities than is currently requested from non-merging utilities. Other companies requesting mergers before this Commission have agreed to reporting requirements similar to those being requested of UtiliCorp. These companies include: Western Resources, Inc. and Kansas City Power & Light Company, Case No. EM-97-515; Southern Union and Pennsylvania Enterprises, Inc., Case No. GM-2000-49; and Atmos Energy Corporation and Arkansas Western Gas Company, Case No. GM-2000-312 (Kiebel Rebuttal, Ex. 707, pp. 6-7).

XVII. LOAD RESEARCH CONDITION

The Joint Applicants argue that this docket is not the appropriate place to "... establish quality control standards and checks and balances." (Initial Brief of Joint Applicants, p. 67). They recommend, instead, that the Commission "... allow its Staff to set up a work group representing all electric utilities that will be affected by these [load research] standards . . ." (Pella Surrebuttal, Ex. 17, p. 17, lines 1-14; Initial Brief of Joint Applicants, p. 67).

To the contrary, the Staff believes that addressing this issue in this case is both relevant and timely. A failure to address the issue now will allow UCU to unilaterally lower the standards for EDE (and for St. Joseph Light & Power, as well), if UCU assumes operational control of the existing load research programs of both entities. In the Staff's view, doing so would be detrimental to the regulatory process and would not be in the public interest. (Mantle Rebuttal, Ex. 710, p.2, line 6 – p. 3, line 11). UCU's proposed task force is unnecessary and is simply a delaying tactic. The Staff is not proposing new load research standards. The Staff's proposal is that the Commission order UCU to *maintain* the load research standards *currently in place* at Empire District Electric Company (and St. Joseph Light & Power Co.).

XVIII. STRANDED COSTS

XIX. MARKET POWER AND TRANSMISSION ACCESS AND RELIABILITY

XX. FERC ORDER CONDITIONALLY AUTHORIZING MERGERS OF SJLP AND UTILICORP AND EMPIRE AND UTILICORP

XXI. CONCLUSION

Wherefore for the above stated reasons and the reasons stated in the Staff's initial brief, the Staff requests that the Commission adopt the Staff position on each and every issue presented in the instant proceeding.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed or hand-delivered to all counsel of record as shown on the attached service list this 21st day of November 2000.

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