NEWMAN, COMLEY & RUTH
PROFESSIONAL CORPORATION
ATTORNEYS AND COUNSELORS AT LAW
MONROE BLUFF EXECUTIVE CENTER
601 MONROE STREET, SUITE 301
P. O. BOX 537
JEFFERSON CITY, MISSOURI 65102-0537

ROBERT K. ANGSTEAD
MARK W. COMLEY
CATHLEEN A. MARTIN
STEPHEN G. NEWMAN
JOHN A. RUTH
D. GREGORY STONEBARGER
ALICIA EMBLEY TURNER

TELEPHONE: (573) 634-2266
FACSIMILE: (573) 636-3306

October 3, 2000

The Honorable Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102-0360

FILED[2]
OCT 3 2000
Missouri Public
Service Commission

Re: Case No. EM-2000-292

Dear Judge Roberts:

Enclosed for filing in the above referenced matter, please find the original and eight copies of the Reply Brief of St. Joseph Light & Power Company.

Please contact me if you have any questions regarding this filing. Thank you.

Very truly yours,

NEWMAN, COMLEY & RUTH P.C.

By: Mark W. Comley
Mark W. Comley
comleym@ncrpc.com

MWC:ab
Enclosure
cc: Office of Public Counsel
General Counsel's Office
Gary L. Myers
James C. Swearengen
Stuart W. Conrad
Karl Zobrist
Shelley A. Woods
William J. Niehoff
Jeffrey A. Keevil

FILED[2]

OCT 3 2000

Missouri Public Service Commission

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of the Joint Application of UtiliCorp United Inc. and St. Joseph Light & Power Company for authority to merge St. Joseph Light & Power Company with and into UtiliCorp United Inc. and, in connection therewith, certain other related transactions.	)))))))	Case No. EM-2000-292

REPLY BRIEF OF ST. JOSEPH LIGHT & POWER COMPANY

Mark W. Comley #28847
Newman, Comley & Ruth P.C.
601 Monroe Street, Suite 301
P.O. Box 537
Jefferson City, MO 65102
(573) 634-2266
(573) 636-3306 FAX
comleym@ncrpccom

Gary L. Myers #26896
Vice President, General Counsel and Secretary
St. Joseph Light & Power Company
520 Francis Street
P.O. Box 998
St. Joseph, MO 64502
(816) 387-6205
(816) 387-6332 FAX

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BEFORE THE PUBLIC SERVICE COMMISSION
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REPLY BRIEF
OF ST. JOSEPH LIGHT & POWER COMPANY

GENERALLY

The initial briefs of the parties have directed most of their attention to the components of the regulatory plan proposed by UtiliCorp United. The elements of this plan were first described by Mr. John McKinney in his direct testimony. (Ex. 4, McKinney Direct, page 6). SJLP has already expressed its position on UtiliCorp's regulatory plan in its separate statement of position on the issues submitted for Commission consideration in this case. SJLP supports the position taken by UtiliCorp on the regulatory plan. Even so, SJLP shall limit its reply brief to issues which it deems discretely its own to advance in this matter, a practice it followed in the crafting of its initial brief, and will leave to the chief architect of the regulatory plan the task of responding to the opposing arguments, all of which are, in SJLP's estimation, utterly without merit.

JOINT DISPATCH

The Staff devotes seven pages of its brief to a contention that the Joint Applicants have overestimated the power supply cost savings they can anticipate as a result of the merger. Mr. Frank DeBacker estimated the cost savings from combining the power supply functions of UtiliCorp and

SJLP to be over $110 million. (Ex. 14, DeBacker Direct, page 16) Staff agreed that there would be a cost savings as a result of the merger, but differs with the amount. Staff's estimate is a sparse $6.8 million.

In calculating the Staff's estimate of the savings, Dr. Proctor assumed "that there exits a perfect wholesale market and that MPS, SJLP and the merged company will participate in that market on the same basis, i.e.: each entity will be able to sell at the market price and have the same level of market penetration." (Ex. 20, DeBacker Surrebuttal, page 5). Mr. DeBacker rejected Dr. Proctor's assumption because the "wholesale market is not perfect and the abilities and opportunities of each of the market participants are not equal." (Ex, 20, DeBacker Surrebuttal, page 5) Staff has not expressly disagreed with Mr. DeBacker's assessment of the wholesale market. Instead, the Staff has made the bold statement that SJLP is able to "overcome the disparity in 'abilities' on a stand-alone basis, without the need for the merger, if it only chooses to do so" (Staff's Initial Brief, page 146); and from there contends that much of the savings estimated could be accomplished without the merger.

The confidence the Staff has expressed in SJLP's potential to shed its disabilities in the wholesale generation market is kind but is not reassuring. For the Commission to accept Staff's statement of SJLP's "abilities," it must believe that a company that is not active already in the wholesale market; which does not currently have a wholesale marketing group and has no plans to create such a group; and has not separated its transmission and generation functions[1], can easily reverse each of those characteristics and thereafter **effectively** compete. The Commission would also need to summarily reject the testimony of Mr. Steinbecker, President of SJLP, who stated:

[1]Ex. 20, DeBacker Surrebuttal, pages 6-7.

> SJLP's board of directors and officer group have, for some time, been concerned about the ability of SJLP to continue to compete effectively and to provide high quality service at low rates given the relatively small size of its operations. **This is of particular concern when it comes to the market for the generation of power.** Ultimately this size disadvantage will result in higher prices for our customers than would otherwise have been the case. Additionally with respect to future deregulated markets, SJLP is also at a disadvantage as it lacks the mass, scope or unique market niche which will allow it to compete effectively in the evolving competitive environment on a long term basis. Ultimately these circumstances will translate into disadvantages for our customers. [emphasis added]

Ex. 1, Steinbecker Direct, pages 6-7)

The Staff further contends that SJLP lacks a wholesale marketing group because it *elected* to do so, and made the election *due to cost*. SJLP believes, and feels it joins many who justly share the same belief, that not engaging in a certain practice because of its high cost could be a sign of prudence. It is unclear what Staff believes in. For example, it argues:

> The cost of developing a qualified wholesale marketing group is certainly a factor that is worthy of consideration. This alone is not, however a sufficient reason for this Commission to approve a plan that would require the customers of the Joint Applicants to pay one-half–or even more than one-half–of the $92 million acquisition premium that UCU agreed to pay to SJLP's shareholders. **To authorize such a proposal would be to reward the SJLP shareholders for the passive course that the management of SJLP has chosen to follow.** [emphasis added]

Staff's Initial Brief, pages 147-148. Staff seems to applaud the SJLP board of directors for considering the high cost of the wholesale marketing group then labels the board as passive in that it failed to develop one. There is no merit to the Staff's argument. First, the evidence on the first day of the hearing illustrates unquestionably that SJLP's board of directors and officer group are anything but passive. The decision to merge with UtiliCorp was not made overnight, and was the product of careful thought and evaluation over a span of five years or more. Second, the evidence in this case underscores that with respect to the wholesale generation market, the board of directors of SJLP has taken a **prudent** course, and if there should be a reward for it, the customers and the shareholders should not be excluded from receiving it.

Staff also claims that the cost for SJLP to "achieve the same level of 'abilities' that [Missouri Public Service] now possesses," could be $2 million a year, or a total of $20 million over the ten year period studied in the regulatory plan. Staff says, "[t]hat would be a very good investment, indeed, if it is all that is required to increase the energy cost savings from $6.8 million to $100 million. (Staff's Initial Brief, page 148) SJLP contends that the $20 million Staff mentions is not "all that is required." What Staff has neglected to thoughtfully consider in making these declarations is the degree and extent of loss which a company may incur as it invests in the development of marketing group and other staff. Conveniently overlooked is Mr. DeBacker's warning that his estimate of the possible cost to SJLP in obtaining trading talent comparable to UtiliCorp's did not include,

> the change in management attitude to take on the risk that exists in the trading world today and the impact of the possible financial losses that have been incurred by other utilities that have not been as successful as UtiliCorp. These losses can be substantial and have a large impact on the utility's bottom line. To insure the risk factor is minimized, a utility entering this trading activity will need to ensure a proper Risk Management program is established. I have not included this additional cost in my estimate.

(Ex. 20, DeBacker Surrebuttal, pages 8-9) Staff made no effort to include the cost of a Risk Management program in its estimate either.

In its initial brief, SJLP highlighted the testimony of Stephen Ferry, Manager, Systems Operations and Planning for SJLP, who explained in detail how SJLP's relatively small size translated into the potential for higher prices for the company's customers. SJLP will not repeat the discussion of Mr. Ferry's subject here, but rather refers the Commission to pages 6 through 7 of its Initial Brief. SJLP faces, and will continue to face absent this merger, competitive forces which inevitably will drive the cost of service up to the customer.

The Staff's optimism about SJLP's abilities to break into the wholesale generation market is completely unjustified and begs the credulity of the Commission. Even if SJLP were to undertake the massive task to change its decisions regarding participation in the wholesale generation market, there is no guarantee that it could turn a profit. The Commission is already aware that wholesale generation is a high risk enterprise which depends upon high volumes to overcome low margins. The Company cannot choose not to make a loss. As Mr. DeBacker has testified, the market is not perfect, therefore, it can be as unforgiving as it is generous. The Commission should wholly reject Staff's contention that SJLP can simply choose to enter the wholesale generation market on a stand alone basis and achieve the same power supply cost savings anticipated in this merger.

THE TRACKING OF MERGER SAVINGS

1. Purported non-merger savings achievable by an independent SJLP.

On pages 161- 164 of its initial brief, the Staff asserts that non merger savings available to SJLP on a stand alone basis could be imputed as merger related savings by UtiliCorp in the rate case proposed by the regulatory plan in year 5 following the merger. Staff's assertions presuppose that SJLP will indeed have some kind of savings it can effectuate while separated from UtiliCorp. The Staff contends that there are several examples of such stand alone savings and relies on the rebuttal testimony of Janis E. Fischer in making the claim. Each of those examples is scrutinized below.

a. **PeopleSoft for Human Resources**

At page 53 of her rebuttal testimony (Ex. 705), Ms. Fischer was asked whether the use of PeopleSoft for Human Resources (HR) application by UtiliCorp will result in cost savings. She testified that she believed it would, even though UtiliCorp had stated to her that no savings would be realized from the implementation of the software. As to UtiliCorp's statement that no savings would be realized, she testified:

> This contradicts PeopleSoft's own data from their web page promotional documents. PeopleSoft illustrates examples of ways cost savings can be generated through efficiencies created by the implementation of its software. For example:
>
> > A Duke energy PeopleSoft Profile, states that the use of PeopleSoft in its HR function has allowed them to need fewer people creating economies of scale and productivity.
> >
> > As another example: Entergy stated in another PeopleSoft Profile that HR allowed them to cut their human resource staffing by 30%.
>
> These savings will be available to UtiliCorp when the Employee Service Station is implemented. The self-service functionality of the HR software allows employees access to their personnel data through a HR home page.

(Ex. 705, Fischer Rebuttal, page 53-54.)

On the basis of the web page promotions, Ms. Fischer concluded that UtiliCorp would truly experience cost savings from use of the software, and those savings would be distributed to all of its divisions, one of which would be SJLP if it were allowed to merge. She remarked:

> St. Joseph will receive an allocation for HR. These non-merger UtiliCorp savings will be passed through to St. Joseph with the allocation process and become merger savings to St. Joseph. **St. Joseph on a stand-alone basis could have implemented the same HR software and attained a non-merger savings for the same technology benefits that will now be counted as merger related savings.** [emphasis added]

(Ex. 705, Fischer Rebuttal, page 54)

Although Ms. Fischer's endorsement of PeopleSoft HR software would be greatly appreciated by its manufacturer, that endorsement cannot be a substitute for a thorough investigation into the advantages of the software for the joint applicants. Something more than the unchallenged customer satisfaction statements on the manufacturer's web site should serve as a basis for concluding that both UtiliCorp and SJLP will reap substantial savings from the implementation of the software product.

If Ms. Fischer had inquired of SJLP about PeopleSoft HR she would have discovered that SJLP would not be invited to join Duke Energy and Entergy on the web page. SJLP witness, Janet Pullen, was asked in her surrebuttal testimony whether she agreed with Ms. Fischer's statement that SJLP could have implemented PeopleSoft HR and attained a non-merger related benefit. Her answer was a simple "no." She went on to explain:

> Q. Has SJLP ever considered implementing PeopleSoft HR software?
>
> A. Yes. In 1997, SJLP considered upgrading its human resources/payroll system. PeopleSoft was one of the packages which was reviewed by the implementation team.
>
> Q. Did the team recommend implementation of the PeopleSoft HR software?
>
> A. No, the team determined that its benefits (either payroll or combination human resources/payroll) did not justify its cost for a company of SJLP's size.
>
> Q. Does the size of a company have any impact on how much a company can save from implementing a software product?
>
> A. Yes, Economies of scale are often the key to overall savings from a labor-saving application. Generally, a company must have a certain number of employees to expect savings which result in a reasonable payback period to justify the cost of software.
>
> Q. Does Ms. Fischer state why she believes that PeopleSoft HR software could save money for SJLP?

A. Apparently she accepted the examples on PeopleSoft's advertising web site which she quotes on page 53 of her testimony.

Q. Was your analysis in more depth than reviewing claims on a web site?

A. Yes.

(Ex. 24, Pullen Surrebuttal, pages 8-9)

Assuming as true that both Duke Energy and Entergy had good results with PeopleSoft, that alone cannot guarantee similar results for all companies, including SJLP. The Commission should be satisfied with the determination of SJLP's implementation team that the benefits to be derived from PeopleSoft HR were not justified by its cost. Much more than reliance on web site testimonials went into the study. Stand alone savings from PeopleSoft implementation are not available to SJLP.

b. **Automated Meter Reading**

At page 54 of her rebuttal, Ms. Fischer stated that yet another savings area SJLP could realize on a stand alone basis was automated meter reading (AMR). She noted that the Information Technology Transition Team formed by SJLP and UtiliCorp had listed in its Project Status Report, which had been disclosed to the Staff by data request, the upgrade of the ITRON meter reading system used by SJLP. She testified that "[f]uture technological advances would allow St. Joseph opportunities to generate savings with AMR systems in the future on a stand alone basis, just like any other utility would experience." (Ex. 705, Fischer Rebuttal, page 54) Ms. Fischer was mistaken on several points.

The Project Status Report to which Ms. Fischer referred addressed the ITRON hand-held meter system but that is not an Automated Meter Reading system. The hand held system allows the meter reader to punch in a reading instead of writing it down on paper. SJLP has used a hand held meter reading system since 1988 and the upgrade referred to in the report was a typical systems upgrade and nothing extraordinary. An "automated meter reading system" or AMR allows a utility to electronically probe a meter for a reading or for other purposes, without having to send a meter reader to the location. SJLP conducted studies already on the implementation of AMR and until recently, those studies showed that the costs outweighed the value of the benefits. A study in 1998 showed that costs and benefits were nearly the same. (Ex. 24, Pullen Surrebuttal, page 10)

SJLP has concluded that AMR is not a cost savings technology for the company. Certain of the benefits are dependent on a deregulated utility environment, which does not exist in Missouri, and given the current state of the technology, AMR is nothing more that a "break-even proposition," not a cost-savings opportunity. (Ex. 24, Pullen Surrebuttal, page 10).

c. **Internet Billing System/Fleet Replacement**

Ms. Fischer contended that SJLP could benefit on a stand alone basis from implementation of an Internet bill paying system. (Ex. 705, Fischer Rebuttal, page 55). Ms. Pullen quickly disagreed, pointing out that the benefit of such systems is in the form of improved customer service, not in cost reductions. In order to achieve any cost reduction, a high level of customer penetration would be required. Ms. Pullen knew of no U.S. utility that had claimed savings from the use of an Internet based bill paying system. (Ex. 24, Pullen Surrebuttal, page 11). Implementation of an Internet bill paying system is not a conceivable cost savings device for SJLP.

Ms. Fischer raised the idea that SJLP could amend its fleet replacement policy to a five-year/125,000 mile plan. According to Ms. Fischer's understanding of the UCU/SJLP distribution transition team recommendations, the parties intended to implement this policy as a possible cost savings method. Ms. Pullen however made it plain that the transition team recommendation was unrelated to concerns of cost savings. The policy change was recommended merely to bring SJLP's fleet replacement policy into parallel with UtiliCorp's. Furthermore, Ms. Pullen stated that meaningful savings would not necessarily be produced from SJLP's conversion to the policy. She explained that what might be appropriate for the combined entity, might not be prudent for SJLP. SJLP has not conducted a detailed study on the matter, and neither has the Staff. There is no proof that cost savings would accrue to SJLP by an independent adoption of the UC fleet replacement policy, and SJLP contends that the Commission cannot consider that policy as a means for SJLP to experience cost savings on a stand alone basis.

d. **Labor Force Reductions**

In its response to Staff data request number 16, SJLP reported that its restructuring efforts in 1996 resulted in the elimination of eight positions and the addition of three new positions, for a net reduction of 5 positions. Based upon this data request response, Ms Fischer predicted that further reduction in labor costs would be available to SJLP in the future. (Ex. 705, Fischer Rebuttal, page 55) SJLP cannot agree with her forecast.

SJLP again directs the Commission to Ms. Pullen's surrebuttal testimony. She demonstrates that SJLP takes very seriously the need to introduce greater efficiencies into the provision of utility service, and careful thought and study are given each possibility. Some have been approved and some have been rejected. SJLP submits that at this time, it has virtually exhausted the possible approaches to further reduction of its costs on an independent basis, and reductions in work force that are unrelated to the merger are not feasible. On SJLP's immediate horizon is the applied for merger, and as this record will amply support, the only reductions SJLP, and the Staff, can verify or predict at the moment, are those which occur in anticipation of the merger (which are many) and those that will occur as a result of the merger.

CONCLUSION

On the basis of this reply and what has been argued in SJLP's initial brief, SJLP respectfully renews its request that the Commission approve the application for merger with UtiliCorp.

Respectfully submitted,

Gary L. Myers #26896
Vice President, General Counsel and Secretary
St. Joseph Light & Power Company
520 Francis Street
P.O. Box 998
St. Joseph, MO 64502

Mark W. Comley #28847
NEWMAN, COMLEY & RUTH P.C.
601 Monroe Street, Suite 301
P.O. Box 537
Jefferson City, MO 65102-0537
(573) 634-2266
(573) 636-3306 FAX

Attorneys for St. Joseph Light & Power Company

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing document was sent by U.S. Mail, postage prepaid, or hand delivered, on this 3rd day of October, 2000, to:

Office of Public Counsel
P.O. Box 7800
Jefferson City, MO 65102

James C. Swearengen
Brydon, Swearengen & England
P.O. Box 456
Jefferson City, MO 65102-0456

Karl Zobrist and Christine Egbarts
Blackwell Sanders Peter Martin
Two Pershing Sq., Suite 1100
2300 Main St.
Kansas City, MO 64108

Stuart W. Conrad
Finnegan, Conrad & Peterson
3100 Broadway, Suite 1209
Kansas City, MO 64111

Shelley A. Woods
Mo. Attorney General's Office
P.O. Box 899
Jefferson City, MO 65102

General Counsel's Office
Mo. Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

William J. Niehoff
Ameren Services Co.
(MC 1310)
PO Box 66149
St. Louis, MO 63166-6149

Jeffrey A. Keevil
Stewart & Keevil
1001 Cherry St., Suite 302
Columbia, MO 65201

Mark W. Comley

Mark W. Comley