STATE OF MISSOURI
PUBLIC SERVICE COMMISSION
JEFFERSON CITY
December 14, 2000

CASE NO: EM-2000-292

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Enclosed find certified copy of a REPORT AND ORDER in the above-numbered case(s).

Sincerely,

Dale Hardy Roberts

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

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**

REPORT AND ORDER

Issue Date: December 14, 2000

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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**

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For **The Staff of the Missouri Public Service Commission**

REGULATORY LAW JUDGE: Morris L. Woodruff

REPORT AND ORDER

PROCEDURAL HISTORY

On October 19, 1999, UtiliCorp United Inc. (UtiliCorp) and St. Joseph Light & Power Company (SJLP) filed a Joint Application seeking authority to merge SJLP with and into UtiliCorp. Following the filing of the application, the Commission, on October 26, 1999, issued an Order and Notice that provided notice of the filing of the application and notified interested parties that if they wished to intervene they should file an application with the Commission on or before November 15, 1999. Timely applications to intervene were received from the City of Springfield, Missouri, through the Board of Public Utilities (Springfield), Union Electric Company, d/b/a AmerenUE (AmerenUE), the Missouri Department of Natural Resources (MDNR), and AG Processing Inc., a cooperative (AGP). On November 17, 1999, the Commission granted the applications to intervene of Springfield, AmerenUE, MDNR and AGP.

Following a prehearing conference held on December 9, 1999, and after the filing by various parties of competing proposed procedural schedules, the Commission, on December 21, 1999, issued an order adopting a procedural schedule that set this case for hearing on July 10 through July 14, 2000. On February 10, 2000, the Commission denied separate motions filed by the Office of the Public Counsel (Public Counsel) and MDNR that would have consolidated this case with Case No. EM-2000-369, which is the case established for consideration of UtiliCorp's proposed merger with The Empire District Electric Company (Empire). Testimony was prefiled by the various parties and an evidentiary hearing was held beginning on July 10 and continuing through July 14, 2000. Post-hearing briefs were filed on September 5, 2000, with reply briefs filed on October 3, 2000.

FINDINGS OF FACT

The Missouri Public Service Commission has considered all of the competent and substantial evidence upon the whole record in order to make the following findings of fact. The Commission has also considered the positions and arguments of all the parties in making these findings. Failure to specifically address a particular item offered into evidence or a position or argument made by a party does not indicate that the Commission has not considered it. Rather the omitted material was not dispositive of the issues before the Commission.

UtiliCorp is a Delaware corporation with its principal office and place of business located in Kansas City, Missouri. UtiliCorp is authorized to conduct business in Missouri through its Missouri Public Service (MPS) operating division and, as such, is engaged in providing electrical and natural gas utility service in Missouri to customers in its service areas. UtiliCorp has regulated energy operations in seven other states. UtiliCorp also operates in New Zealand, Australia and Canada. SJLP is a Missouri corporation with its principal office and place of business located in St. Joseph, Missouri. SJLP is engaged in the business of providing electrical, natural gas and industrial steam utility services in Missouri to customers in its service areas.

A. Approval of Merger:

UtiliCorp and SJLP argued that their proposed merger would not be detrimental to the public and would, in fact, be beneficial for the ratepayers of both companies. SJLP is one of the smallest investor-owned, publicly traded, electric utilities in the country. While SJLP has been able to provide relatively low-cost, reliable power to its customers in the past, the changing structure of the electric power system may make it more difficult for SJLP to continue to provide low-cost power in the future.

In large part, SJLP's difficulties in continuing to provide low-cost power result from the advent of competition in the wholesale electric market. UtiliCorp and SJLP's witness, Stephen L. Ferry, explained the impact of wholesale competition on SJLP:

> Prior to wholesale competition, the price of purchased power was regulated by the Federal Energy Regulatory Commission on a cost-plus basis. Even during periods of high demand and limited availability, the price would remain reasonably stable since it was tied to actual production cost. With the advent of wholesale competition, the price of purchased power is now market driven. The price will be whatever the market will bear, and during periods when demand approaches or exceeds supply, the price can be very volatile, rising very rapidly to levels much greater than the cost of generating the energy. Ferry Surrebuttal, Ex. 23, at p. 4

This volatility in the wholesale market may place a small company, such as SJLP, at a disadvantage because it may lack sufficient financial resources to compete with larger utilities for purchased power. The merger of SJLP with UtiliCorp will permit SJLP's customers to be served by a substantially larger utility better able to compete in the wholesale energy market.

Costs of Merger Exceed Benefits:

Several parties argued that the proposed merger would be detrimental to the ratepayers of both SJLP and UtiliCorp and for that reason it should not be approved by the Commission. In particular, Staff, joined by other parties, contended that the costs associated with the merger would exceed the savings attributable to the merger. If this is true, then the merger might be detrimental to the ratepayers of both companies because the cost of service for the combined company would be higher than it would have been without the merger and the higher cost of service would ultimately be reflected in higher rates.

Staff bases its arguments about increased cost of service on various adjustments it has made to the estimates of merger savings set forth by UtiliCorp and SJLP. Staff challenges the estimates of merger savings in two areas. First, Staff argues that most of the savings in the area of projected energy cost savings from the joint dispatch of the power supply of the merging companies that UtiliCorp and SJLP claim as a benefit of the merger could, in fact, be achieved by SJLP as a stand-alone company even if there is no merger. Second, Staff argues that UtiliCorp's and SJLP's assumption about the inflation rate for UtiliCorp's overhead costs results in a significant overstatement of the possible savings to be expected from the merger.

Staff's arguments are not convincing for several reasons. First, with regard to the projected savings from joint dispatch, Staff overestimates the extent to which SJLP, as a stand-alone company, could take advantage of increased sales opportunities in the wholesale generation market. The evidence presented by UtiliCorp and SJLP demonstrates that its savings assumptions were based on the premise that, absent a merger, UtiliCorp and SJLP would continue to generate approximately the same level of normalized wholesale volumes and margins over the ten-year study period as those generated in recent years. After the merger, it was assumed that the combined company would make all wholesale market sales at market rates and that the combined company would be able to increase its wholesale market penetration. Under this scenario the merger would result in both an increase in the volume of wholesale sales and an increase in profitability due to use of market-based rates.

Staff's argument assumes that SJLP, even without the merger, could make the same power sales on the wholesale market. Thus, according to Staff, the increased profit from those sales should not be counted as a benefit of the merger. Staff's assumption overstates SJLP's ability to compete in the wholesale market. SJLP has not been and is not now active in the wholesale market. SJLP does not currently have a wholesale marketing group dedicated to pursuing the wholesale market and does not have plans to create such a group. Even if it wished to develop such a marketing group, as one of the smallest investor-owned electric utilities in the nation, SJLP's size and limited resource mix could make it costly to develop and sustain an effective wholesale marketing group. Furthermore, SJLP elected not to separate its transmission and generation functions due to cost. Thus, it does not have FERC approval to sell energy at market-based rates and must sell its excess energy at cost-based rates. UtiliCorp's MPS division, on the other hand, has been an effective player in the wholesale market since 1996. It has separated its generation and transmission functions and can sell energy at market-based rates. MPS maintains a fully staffed wholesale marketing group to pursue opportunities in the wholesale market.

It is not reasonable to assume that SJLP could effectively and efficiently create the marketing knowledge and resources needed to operate in the wholesale market and obtain the same results as those that could be obtained after a merger with UtiliCorp. The evidence does not indicate precisely how much merger savings could be obtained through increased activity in the wholesale market, but it is reasonable to assume that there could be savings.

Staff's argument about the inflation rate for UtiliCorp's overhead costs is unpersuasive. In calculating the expected cost of future UtiliCorp corporate allocations that are to be charged to the SJLP operating division after the merger, UtiliCorp assumed that the corporate allocations would increase each year by an inflation rate of two and a half percent. Staff argued that an inflation factor of five percent was more appropriate given the much larger annual increases in corporate overhead costs allocated by UtiliCorp to its MPS operating division in previous years. If an inflation factor of five percent is used, then the level of estimated savings resulting from the merger will be reduced.

UtiliCorp responded by pointing out that Staff's review of corporate overhead costs was overstated by Staff's failure to take into account the fact that the large annual increases in corporate allocations experienced in previous years could be attributed to the increased operational cost of reengineering initiatives that were implemented in 1997, 1998 and 1999 over the entire UtiliCorp system.

The Commission does not need to determine an appropriate inflation factor for corporate allocations in order to decide this case. In any future rate case, the cost of UtiliCorp's corporate allocations will be a known factor. If, in that future rate case, those allocations are shown to be excessive, then the Commission will be able to consider that fact when setting the rates for UtiliCorp's SJLP operating division. Higher rates for SJLP's customers cannot result from this merger unless the Commission approves those rates in a future rate case.

Indeed, the same considerations apply to all of Staff's arguments about possible increased costs of service resulting from the merger. As Staff repeatedly testified, it is very difficult to speculate about what SJLP's cost of service might be in five or ten years. Staff used that fact to argue that merger savings could not be reliably established at this time. However, the same difficulty applies to Staff's argument about the costs of the merger exceeding the benefits. If UtiliCorp and SJLP's representations of merger savings are speculative, then so are Staff's representations of excessive merger costs. Speculation about what may happen in a future rate case is not a valid basis for refusing to allow UtiliCorp and SJLP to complete their merger.

Costs of Merger Exceed Benefits for Gas and Steam Services:

Although SJLP is primarily an electric company, it also provides natural gas service to several cities, and industrial steam to a number of industrial customers in St. Joseph. An argument was raised by AGP, one of SJLP's steam customers, suggesting that the costs of the merger would exceed the benefits obtained for the natural gas and steam customers of SJLP, even if costs did not exceed benefits for the company as a whole. It was argued that this is a clear detriment that should prompt the Commission to reject the proposed merger.

In support of this argument, AGP cited Exhibit 503, which is a summary of synergy benefits, net costs to achieve prepared by UtiliCorp and SJLP and provided in response to a data request submitted by counsel for AGP. AGP argues that while Exhibit 503 shows a benefit for SJLP's electric customers, it shows annual detriments of $34,000 for SJLP's steam customers and $35,000 for its natural gas customers.

Mr. John McKinney, testifying on behalf of UtiliCorp, stated that Exhibit 503 does not support AGP's argument. He indicated that the exhibit only shows a method of allocating the costs and the premiums to the various jurisdictional areas. He also indicated that the methodology that UtiliCorp proposes to use to allocate costs and premiums has changed since exhibit 503 was produced.

Exhibit 503 does not justify a finding that the UtiliCorp/SJLP merger should be blocked. The numbers set forth in Exhibit 503 are only preliminary estimates of how costs and premiums are to be allocated to the various operations of SJLP. Those numbers are not absolute results and may be changed. If those proposed allocations are unfair to SJLP's natural gas and steam customers they certainly can be changed. Indeed, Maurice Brubaker, witness for AGP, suggests that "even if the merger is permitted to go forward and even if the regulatory plan is approved in much the same form as proposed, adjustments to the allocations must be made to ensure that the gas and steam customers do not experience these detriments." Brubaker Rebuttal, Ex. 500, at p. 13. Clearly these proposed allocations can be changed to avoid a detriment to SJLP's gas and steam customers. In any event, UtiliCorp's internal allocation of costs and premiums cannot, by itself, create a detriment to any customer. Such a detriment could only occur if UtiliCorp were to adjust the rates charged to those customers to reflect an unfair allocation of costs and premiums. UtiliCorp cannot change its rates without the approval of the Commission and the Commission will ensure that the rates charged by UtiliCorp to its gas and steam customers are just and reasonable.

Increased Financial Risk for SJLP Ratepayers:

Public Counsel points out that SJLP's long-term debt bears a credit rating of A-. On the other hand, UtiliCorp's long-term debt bears a credit rating of BBB. After the merger the credit rating of the combined UtiliCorp/SJLP will likely be the BBB rating of UtiliCorp. Public Counsel argues that the downgraded credit rating will increase the cost of debt for SJLP's ratepayers above the cost of debt for SJLP absent the merger. Public Counsel argues that this will lead to higher rates for SJLP's ratepayers and constitutes a detriment that should lead to the rejection of the merger.

Public Counsel's argument is not persuasive. First, UtiliCorp's credit rating of BBB, while lower than SJLP's current rating, is still considered to be investment grade. There is no evidence to support that UtiliCorp is financially unstable or that the merger with UtiliCorp will put SJLP's ratepayers at any great risk. Second, no evidence was presented that would quantify the amount that the cost of debt attributable to SJLP would increase because of the merger. Indeed, there is no way to reliably quantify such an amount. Certainly there is no guarantee that SJLP's credit rating would remain at A- if the merger does not proceed. Third, the cost of debt is just one factor the Commission will consider when setting future rates for UtiliCorp's SJLP unit. If the company's cost of debt is unreasonable, appropriate adjustments can be made to protect the ratepayers. Finally, even if it is assumed that the merger will result in an increased cost of debt for SJLP's ratepayers, that fact alone does not require the Commission to reject the merger. The risk of an increased cost of debt is just one more factor for the Commission to weigh when deciding whether or not to approve the merger.

After considering all the evidence and the arguments of the parties, the Commission concludes that the merger between UtiliCorp and SJLP will not be detrimental to the public and should be approved. In addition to approving the merger itself, UtiliCorp and SJLP ask that the Commission approve what they refer to as a Regulatory Plan. The Commission will not do so for reasons fully explained in its Conclusions of Law.

B. Proposed Conditions on Approval:

Several parties identified what they believe to be particular problems with the merger as proposed. They ask that various conditions be imposed upon the Commission's approval of the merger so that the alleged problems will not create a detriment to ratepayers. Those various conditions will be addressed in turn.

Stranded Costs Condition:

Staff defines stranded costs as those costs presently charged by electric utilities in rates that may not be recoverable when and if electric utilities must set their prices based upon a competitive market. Obviously such a competitive market and resulting stranded costs will not occur unless the Missouri legislature or the United States Congress acts to deregulate the electric industry. Staff does not believe that SJLP is currently facing possible stranded costs because it appears that its electric generating assets are worth more in an unregulated marketplace than under continued regulation. However, Staff is concerned that "if electric restructuring occurs, it is possible that the Joint Applicants in the future may argue that any failure to recover UtiliCorp's valuation of SJLP's assets (i.e., the portion of the acquisition adjustment allocable to generation operations) would constitute a 'stranded cost'." Oligschlaeger Rebuttal, Ex. 713, at 55. Staff asserts that this possibility constitutes a detriment to the customers of SJLP and asks that the Commission require that UtiliCorp and SJLP commit not to seek recovery of such stranded costs in any future Missouri regulatory proceeding. Staff further recommends that that UtiliCorp and SJLP be required to commit not to seek or endorse legislation in Missouri that would mandate the recovery of all or a portion of the acquisition adjustment as part of claimed stranded costs.

The Commission will not attempt to impose the condition requested by Staff. If UtiliCorp ever attempts to recover stranded costs for its SJLP unit it will presumably have to do so before the Commission. If it asks for an inappropriate recovery, the Commission will deal with such a request at the time that it is made. Therefore, there is no need to impose a condition that would limit in advance UtiliCorp's ability to make an argument before the Commission.

Staff apparently fears that UtiliCorp will attempt an end-run around the Commission by seeking relief before the legislature. Thus, the second part of Staff's condition would have the Commission attempt to limit UtiliCorp's right to lobby the legislature to enact legislation regarding stranded costs. Staff does not indicate where the Commission would find the authority to forbid a utility from communicating with the legislature. The Commission will not impose the condition requested by Staff.

Pension Funds Condition:

Staff recommended that as a condition for approval of the merger, UtiliCorp be required to maintain SJLP's pre-merger pension plan funded status in order to eliminate a significant increase to SJLP's cost of service for pension costs resulting solely from a post-merger decision to combine SJLP's pension assets with those of UtiliCorp. At the hearing it was announced that Staff and UtiliCorp had reached an agreement regarding this issue. UtiliCorp agreed that in post-merger cases involving UtiliCorp's SJLP operating division, UtiliCorp will maintain the pre-merger funded status of the SJLP pension fund by accounting for it separately. UtiliCorp will, however, be allowed to combine the assets. The accounting on a going-forward basis would start with a market value of asset evaluation performed by SJLP's actuarial firm at the time of merger closing. On a going-forward basis the net rate of return (actual earned return income earned on the assets during the year less benefits paid) on the combined pension assets will be used.

Given the agreement of the parties, the Commission will impose the agreed upon condition.

Access to Books and Records Condition:

Public Counsel argues that the proposed merger will result in increased size, scope and complexity of transactions between UtiliCorp and its affiliates. Public Counsel recommends that, as a condition to its approval of the merger, the Commission require UtiliCorp to agree to provide Public Counsel and Staff access to the books, records, employees and officers of all corporate entities for which UtiliCorp or its wholly-owned subsidiaries have an ownership interest of 10 percent or more. UtiliCorp replies that the access sought by Public Counsel is already mandated by Commission rule and that it is not necessary to require it to pledge to comply with a rule that it is already legally obligated to obey.

The Commission has promulgated extensive rules to govern transactions between utilities and their affiliates. For electric utilities that affiliate transaction rule is found at 4 CSR 240-20.015. That rule addresses the concerns raised by Public Counsel. So long as that rule is in effect there is no reason to extract a promise from UtiliCorp that it will comply with the regulation. Its compliance is already expected and required. The affiliate transactions rule has been challenged in court by several utilities, although not by UtiliCorp. If the validity of the rule is upheld, then UtiliCorp will continue to be bound to comply with the rule. If the rule is struck down by a reviewing court, then there is no reason to attempt to force UtiliCorp to continue to comply with a rule that would not apply to any other utility in this state. The requested condition regarding access to books and records will not be imposed.

Affiliate Transaction Condition:

Public Counsel proposed that, as a condition to its approval of the merger, the Commission require UtiliCorp to agree to comply with the Commission's affiliate transaction rule. In its initial brief, Public Counsel asks that the Commission state in any order approving the merger that the Commission will "commit to close scrutiny of the merged entity with regard to compliance with the terms of the Commission's affiliate transaction rules." (Initial Brief of the Office of the Public Counsel at

p. 41) UtiliCorp replies that it will, of course, comply with all the Commission's regulations and that it should not be required to pledge to do so.

As previously indicated with regard to the books and records condition, there is no reason to extract a promise from UtiliCorp that it will comply with the regulations of the Commission. The Commission will continue to scrutinize UtiliCorp for compliance with the affiliate transaction rules, as it does all other utilities in this state that are required to comply with those rules. The Commission will not impose the requested affiliate transaction condition.

Income Taxes Condition:

Staff indicated that neither it nor UtiliCorp expect that the merger transaction will be ruled a taxable event by the Internal Revenue Service (IRS) to SJLP. However, Staff expressed concern that if the IRS were to determine that the merger transaction is a taxable event to SJLP, then SJLP would be required to extinguish its accumulated deferred income taxes, which for ratemaking purposes is treated as a reduction to rate base. This would result in a detriment to SJLP's ratepayers. UtiliCorp agreed that if the merger is determined to be a taxable event and deferred taxes of SJLP are thereby lost, UtiliCorp will include an amount equal to those deferred taxes in future SJLP rate proceedings as an offset to rate base.

Given the agreement of the parties, the Commission will impose the agreed upon condition.

Surveillance Condition:

Surveillance data reporting is a tool that is used by the Commission Staff to closely monitor the finances of public utilities for over-earnings. Staff requested that UtiliCorp be required to submit separate surveillance data reports for UtiliCorp's MPS and SJLP divisions after the merger. UtiliCorp agreed to continue to file separate surveillance reports for UtiliCorp's MPS and SJLP operating divisions following the closing of the merger.

Given the agreement of the parties, the Commission will impose the agreed upon condition.

Customer Service Indicators Condition:

Staff is concerned that the pressures and dislocations associated with the merger might lead to a decrease in the quality of service that UtiliCorp would provide to the former customers of SJLP. In order to protect SJLP's customers, Staff proposed that UtiliCorp be required to adopt several changes to its customer service program. Specifically, Staff asked the Commission to require UtiliCorp to:

1. Continue to track and monitor the level of customer complaints separately for the MPS and SJLP divisions after the merger;
2. Continue a Service Guarantee Program, initiated by SJLP in 1997, by which SJLP credits $25.00 to a customer's account if it fails to provide specified services within a specified time;
3. Continue SJLP's policy of administering monthly transactional surveys of its customers;
4. Provide monthly reports to Staff regarding Call Center Abandoned Call Rate (ACR), Call Center Average Speed of Answer (ASA), Distribution Reliability Customer Average Interruption Duration (CAIDI), Distribution Reliability System Average Interruption Frequency Index (SAIFI), and Distribution Reliability System Average Interruption Duration Index (SAIDI). Staff also recommends that UtiliCorp be required to provide information regarding

staffing level at Customer Call Centers and that UtiliCorp be required to spend reasonable and appropriate amounts within the next year to improve customer service relating to any performance indicator that did not meet expectations;

5. Establish specified objectives that UtiliCorp would be required to meet for its ACR and ASA indicators; and

6. Maintain the SAIFI, SAIDI and CAIDI reliability measures separately for the MPS and SJLP divisions.

UtiliCorp replies to Staff's proposed requirements by pointing out that UtiliCorp has provided quality service in Missouri for more than 80 years. UtiliCorp argues that there is no reason to believe that it will not continue to provide quality service after the merger and that it would be unfair to require it to comply with remedial measures and reporting requirements that are not required of every other utility in Missouri.

As UtiliCorp indicates, it does have a history of providing quality service to its Missouri customers. The evidence presented by Staff indicated that the service provided by UtiliCorp to the customers of its MPS division differed somewhat from that provided by SJLP to its customers. However, that evidence did not show that the customer service currently provided by MPS was substantially inferior to that provided by SJLP. Staff's witness, Deborah Bernsen, conceded that "both companies are doing a pretty good job in terms of what is coming into our consumer services department for complaints. Both show a trend downward and both figures are relatively - they are reasonable." The mere fact that UtiliCorp seeks to acquire SJLP does not require that the Commission endeavor to micromanage UtiliCorp's customers service program by imposing special conditions that are not applicable to the other utilities in this state.

Certainly the Commission expects that its Staff will continue to monitor the level of customer service provided by UtiliCorp in both its MPS and SJLP divisions. If Staff notes problems with the level of service provided by UtiliCorp, it has the responsibility to bring those problems to the attention of the Commission through all appropriate means. However, with one exception, the Commission will not impose the conditions on the merger requested by Staff.

The only customer service condition that the Commission will impose is a requirement that UtiliCorp provide Staff with monthly reports for one year following the merger. It is certainly possible that the merger process could cause disruptions in the level of service that both UtiliCorp and Staff expect to be provided to UtiliCorp's customers. While Staff could obtain the information it needs to monitor customer service levels by performing repeated audits on UtiliCorp, the regular reporting of information by UtiliCorp is the most efficient and effective method by which Staff can fulfill its responsibility to monitor the quality of service UtiliCorp is providing to its customers.

Gas Supply RFP Condition:

Staff asked that the Commission require UtiliCorp to continue to issue requests for proposals (RFPs) for procuring natural gas for resale. Staff explained that an RFP is a document that UtiliCorp or SJLP would send to natural gas suppliers requesting a price quote for gas supply for the MPS division of UtiliCorp or for the SJLP division of UtiliCorp. Staff indicated that both UtiliCorp and SJLP currently issue RFPs. UtiliCorp agreed to issue RFPs for natural gas for resale which include price ceilings, price floors, fixed prices and index pricing and provide documentation of analysis of these bids to Staff as part of its annual ACA audit process.

Given the agreement of the parties, the Commission will impose the agreed upon condition.

Gas Peak Load Study Condition:

Staff asked that UtiliCorp be required to perform a peak design day study to ensure that UtiliCorp has evaluated the newly acquired SJLP system for adequate and reasonable natural gas supply and transportation to meet the heating needs of its SJLP division residential customers and other retail customers. UtiliCorp agreed to conduct a peak design day study of the SJLP natural gas distribution system to be completed 90 days after the effective date of the Commission's Report and Order approving the merger of UtiliCorp and SJLP, subject to data availability.

Given the agreement of the parties, the Commission will impose the agreed upon condition.

Market Power Conditions:

Several parties expressed concerns about whether the merger would result in UtiliCorp acquiring greater horizontal or vertical retail market power. Before this issue can be discussed, it is important to understand the meanings of the terms, horizontal and vertical market power. The testimony of Ryan Kind, Public Counsel's witness, presents definitions of these terms developed by this Commission's Education Working Group to the Task Force on Retail Electric Competition, established in Case No. EW-97-245. Those definitions are as follows:

> Market Power is the ability of a firm, alone or in concert with other firms to profitably maintain the price of a product above the competitive market level for an extended period of time. Suppliers with vertical or horizontal market power could charge unfair prices and realize excessive profits.
> *Vertical* market power involves the ability of a firm to control an essential element in the vertical production chain and, through that control, cause competitors to be at a disadvantage through either restricted access or higher costs for the products or services required to produce and deliver the specific product.
> *Horizontal* market power exists when a single firm or small group of firms have the ability to affect the price of a product. In the case of a single firm, horizontal market power is present when a firm dominates a market where entry barriers protect it from competition. In the case of a small group of

firms, horizontal market power can occur through explicit collusive behavior or through strategies that jointly maximize the self-interest of each of the firms.

Kind Rebuttal, Ex. 201, p. 40-41

Staff, Public Counsel, AGP, and Springfield argue that the merger will permit UtiliCorp to exercise greater vertical and horizontal retail[1] market power to the possible future detriment of the public.[2] In order to deal with these possible detriments, various parties asked the Commission to impose various conditions on its approval of the merger.

1. Staff proposed that UtiliCorp and SJLP be required to join the same regional transmission entity that meets the eleven ISO principles enumerated in FERC Order No. 888 before the October 15, 2000 deadline imposed by FERC Order No. 2000. UtiliCorp replied that it would meet the FERC deadline for joining a regional transmission entity and indicated that it did not believe that it should be required to announce its intentions any sooner than any other utility. It is unclear as to whether Staff meant that UtiliCorp and SJLP should join the same regional transmission entity before the deadline or simply that it should be required to comply with the deadline. However, the deadline is now past and this proposed condition is moot.

2. Staff is concerned that harmful horizontal market power could develop in load pockets following the advent of retail electric competition. Load pockets are geographic areas within the service territories where the transmission system will not allow competitive generation to provide services to a significant percentage of end-use customer loads on a year-round basis. Staff proposed that UtiliCorp should be required to agree to submit a study showing what percentage of load can

[1] The merger may also affect wholesale market power. However, wholesale market power is an area that is subject to regulation by FERC and will not be addressed in this Report and Order.

[2] Retail market power could become a detriment only if retail electric competition is authorized in Missouri. Currently SJLP and UtiliCorp are subject to cost-based regulation and that status will continue after the merger.

be served from competitive generation sources throughout their merged service territory. Staff would require UtiliCorp to prepare and present this study at the time that retail competition is approved in Missouri. UtiliCorp replied that it would be willing to perform such a study if ordered to do so at the time that retail electric competition is instituted but that it should not be ordered to perform such a study at this time.

Staff and other parties request that the Commission order UtiliCorp to perform market power studies at some future time when retail electric competition may become a reality in Missouri. However, no one can possibly know when, or if that competition will arrive. Neither can anyone predict what form that competition may take. None of the parties have provided a satisfactory explanation of why the Commission should order the completion of these studies now, in this Report and Order, rather than waiting until the circumstances of retail electric competition become more clear. Under these circumstances the Commission will not impose the condition sought by Staff. If, at the time that retail electric competition becomes a reality, it finds that a market power study is needed, the Commission will exercise its authority to order the completion of any needed studies.

3. Public Counsel suggests that UtiliCorp should be compelled to agree to the same market power conditions that were approved by the Commission in the KCPL/Western Resources merger case, Case No. EM-97-515. Those conditions would require UtiliCorp to do the following:

a. Agree to perform a horizontal market power study that meets specified conditions. The market power study would be performed at the time that retail electric competition is commenced in Missouri;

b. Address vertical market power concerns by agreeing to become a member of a Regional Transmission Organization;

c. Agree to various restrictions on its retail market power including restrictions on the use of the name of SJLP for marketing of unregulated products and services provided by UtiliCorp or its affiliates; and

d. Agree that it will not propose or otherwise support legislation in Missouri designed to prohibit or substantially limit the Commission from addressing market power issues.

UtiliCorp replies that the KCPL/Western Resources merger was a different case with different circumstances and there is no reason to impose those conditions upon UtiliCorp in this merger case.

The KCPL/Western Resources merger was a very different case from this merger. The primary difference is that the earlier merger was resolved through the filing of a stipulation and agreement. That means that the merging parties agreed to the imposition of those conditions. The lack of agreement in this case most clearly impacts the proposed condition that would limit UtiliCorp's right to propose or support legislation. While a party can certainly agree not to propose or support certain legislation it is not clear that the Commission has the authority to order a utility to refrain from exercising its right to petition the legislature.

With regard to the other proposed conditions, the Commission has previously indicated that it will not now order the performance of market power studies. UtiliCorp is already obligated to become a member of an RTO by FERC order 2000. Finally, any necessary restrictions on UtiliCorp's retail market power may be imposed at such time as it is no longer subject to cost-based regulation. Public Counsel's proposed conditions will not be imposed upon UtiliCorp.

4. Springfield argued that the merger of SJLP and UtiliCorp would create a detriment to the public in that it would give the resulting entity the opportunity, ability and incentive to utilize scarce electrical transmission resources for its own use, leaving other utilities no economic alternatives for delivery of needed power supplies. Springfield suggests

several conditions that should be imposed to avoid these detriments. Those conditions are closely related to Springfield's concerns about transmission access and reliability and will be discussed along with those issues in the Conclusions of Law.

Load Research Condition:

Staff raised an issue regarding the Load Research programs maintained by UtiliCorp and SJLP. Load Research refers to a program designed to provide hourly electric load data for use in calculating hourly class loads. A load research program helps the utility understand how its customers use energy. The cost of generating electricity varies by the hour or even shorter intervals. However, electrical use for most customers is measured by the month because monthly data is used for billing. A load research program permits the utility to more closely measure how certain classes of customers actually use electricity during the month and during the day so that appropriate rates can be established.

Staff is pleased with SJLP's current load research program and is less pleased with UtiliCorp's current load research program for its MPS division. Staff would like to see MPS's program brought up to the level of SJLP's program and to that end has proposed that UtiliCorp be required to agree to:

1. continue to treat the SJLP service territory separately from the MPS service territory for load research purposes;

2. maintain SJLP's load research program at its current standard of timeliness and quality;

3. provide hourly class load data, selected individual customer hourly load research data for the SJLP service territory and the checks and balances performed on that data to the Staff on an on-going basis;

4. improve MPS' current load research program to match the current SJLP standard of timeliness and quality; and

5. provide hourly class load data, selected individual customer hourly load research data and checks and balances performed on that data for the MPS service territory to the Staff on an on-going basis.

UtiliCorp replied that it does intend to treat MPS and SJLP separately for load research purposes for as long as they have separate rate structures. UtiliCorp agrees that SJLP currently has an excellent load research program. UtiliCorp also indicates that it is taking steps to improve the load research program for MPS. However, UtiliCorp disagrees with Staff's other proposed conditions regarding its load research program. UtiliCorp argues that it would be unfair to hold its load research program to a higher standard than is applied to other similar utilities. UtiliCorp suggests that if Staff believes that higher standards are needed it should determine those standards through consultation with the industry as a whole. UtiliCorp also argues that it should not be required to periodically report its research data to Staff because such a requirement would be unnecessarily costly.

The Commission expects that UtiliCorp will continue to provide high quality load research for both its SJLP and MPS divisions. While Staff indicates that SJLP's load research program is superior to that of UtiliCorp, it did not present any evidence to indicate that UtiliCorp's current program, or the program it plans to use after the merger, fails to comply with any statute, regulation or industry standard. The Commission will not attempt to micromanage UtiliCorp's business by ordering that it hire a certain number of workers for its load research program. Neither will it attempt to establish any firm standards for UtiliCorp to meet. If Staff believes that such standards are necessary, it should use the rulemaking process to establish those standards for all similarly situated utilities. UtiliCorp will not be singled out for special scrutiny. For these reasons, the Load Research Conditions suggested by Staff will not be imposed upon UtiliCorp.

Tariff Conditions:

Staff recommends that if the merger is approved, rather than filing entirely new tariffs for its SJLP unit, UtiliCorp should file an adoption notice adopting the tariffs on file for SJLP. UtiliCorp agreed that after the closing of the merger it would file with the Commission an adoption notice in SJLP's electric, gas, and steam tariffs containing language similar to that found at page 3 of the rebuttal testimony of Daniel I. Beck.

There is no dispute between the parties and Staff does not ask the Commission to actually order UtiliCorp to make any specific changes to its tariffs. Daniel Beck's testimony instead indicates that while UtiliCorp could file a new set of tariffs it would be more efficient to file an adoption notice. Since no specific condition has been requested and there is no dispute between the parties, no such condition will be ordered.

Gas Safety Program Condition:

Staff asked that UtiliCorp be required to continue a five-year natural gas yard line replacement program to which SJLP and Staff agreed in 1999. SJLP agreed to replace 162 yard lines by January 1, 2005. UtiliCorp indicated that after the closing of the merger, it will complete the agreed upon yard line replacement program.

Given the agreement of the parties, the Commission will impose the agreed upon condition.

Fuel Energy Cost Information Condition:

Staff and UtiliCorp agreed that after the closing of the merger, UtiliCorp will provide historical actual hourly generation, energy purchases and sales data, and other information required by Commission Rule

4 CSR 240-20.080 in electronic format accessible by a spreadsheet program for both the MPS and SJLP units of UtiliCorp. UtiliCorp will also provide access to such additional documents as may be necessary for the Staff to analyze fuel and energy costs.

Given the agreement of the parties, the Commission will impose the agreed upon condition.

Energy Conditions:

The Missouri Department of Natural Resources alleged that the merger between UtiliCorp and SJLP would result in disproportionate harm to the low-income customers of UtiliCorp and SJLP. MDNR proposed that the Commission impose numerous conditions upon the merger in order to alleviate that alleged harm. MDNR proposed that UtiliCorp be required to:

1. Enter into a partnership with MDNR and other interested parties to market and leverage funds for the development of energy efficiency programs;

2. Develop or retain low-income service packages to meet customer needs, reduce energy costs and provide a return to UtiliCorp;

3. Offer additional renewable energy options to Missouri customers;

4. Target outreach to customers that are income eligible and encourage them to take advantage of the opportunity to reduce energy consumption and to improve home affordability;

5. Amend the cooperative agreement between UtiliCorp and Kansas City, Missouri to permit averaging unit cost within the agreement to maximize the opportunity to assist customers;

6. Eliminate tying the dollar amount to specific measures to maximize the energy conservation measures installed in each home and shall permit any energy efficient measure that is deemed cost-effective as a

result of computer analysis, as stated in the agreement between UtiliCorp and Kansas City, Missouri;

7. Permit energy-efficiency assistance to all eligible households and allow funds to be spent on non-electric appliances;

8. Implement a 25-site Benefit Outreach and Screening Software (BOSS) pilot project, and expand the program, as appropriate, if found to successfully deliver benefits to low-income customers;

9. Implement a base load and space heating electric energy efficiency program directed toward high use payment-troubled, low-income customers.

10. Implement a pilot solar energy program directed toward high use low-income customers;

11. Implement a periodic survey process through which the merged company will take pro-active efforts to identify which of its payment-troubled customers represent low-income households;

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

UtiliCorp replied that it opposed making acceptance of any of MDNR's proposals a condition upon approval of the merger. UtiliCorp indicated that it is willing to discuss with MDNR and other parties options for additional or different types of programs related to energy and low-income weatherization or assistance as long as discussions also involve methods of recovery of increased costs for these programs. UtiliCorp indicated that it intends to continue to participate in low-income and energy efficiency programs and supports a number of them currently through funding and other measures.

MDNR argues that the Commission must impose the conditions it has listed in order to avoid possible detriment to UtiliCorp's low-income customers. MDNR suggests that the Commission must "define the markets that will be affected by the merger" and then "determine whether the benefits of the merger are appropriately 'passed-on' within each market." (Initial Brief of Missouri Department of Natural Resources at p. 1) MDNR argues that the low-income customers currently served by SJLP and UtiliCorp are a separate market that will be harmed because the benefits of the merger will not be fairly passed on to them.

MDNR's framework for analyzing this merger is based on that used by Federal Courts in evaluating mergers under federal anti-trust laws. Obviously, this is not an anti-trust case and this Commission is not obligated to follow federal precedent established for the application of anti-trust laws. Nevertheless, the Commission agrees that it should consider the possible impact of the merger on all the customers of SJLP and UtiliCorp when making its determination of whether or not the proposed merger is detrimental to the public. However, it is not clear that low-income customers can properly be considered as a separate class when considering the impact of the merger.

Low-income customers have not previously been accorded status as a separate class of consumer when utility rates are designed. Standard rate design treatment attempts to match revenue requirement determination with cost causation by class. In other words, the class of consumers that causes a cost to a utility should be required to pay those costs through rates. The evidence presented by MDNR suggests that low-income consumers have special problems that UtiliCorp should address through additional programs. Those programs of course bear a cost. Thus, if the Commission were to require UtiliCorp to institute costly new programs to better serve its low-income consumers, without subsidization from other classes of consumers, it might be necessary to increase the rates charged to the class of low-income consumers in order to pay for those programs. Obviously, such a result would not be practical or desirable from the standpoint of the low-income consumers. But neither would it be fair and reasonable for the Commission to order UtiliCorp to institute such programs without giving it an opportunity to recover the cost of those programs through rates. As previously indicated, this case is not about establishing rates. It is not about adjusting UtiliCorp's class cost of service.

MDNR suggests that such programs could be paid for through the passing on of the synergy benefits of the merger to the consumers. However, absent a rate or complaint case, UtiliCorp is under no obligation to pass any merger savings on to consumers. MDNR's proposed conditions will not be imposed upon UtiliCorp. MDNR also argues that the Commission should impose conditions on the merger to require UtiliCorp to institute additional energy efficiency programs. It suggests that the flow of money out of Missouri to pay for non-renewable sources of energy is a detriment to the public and suggests that UtiliCorp be required to make a commitment to renewable energy sources. While the increased use of renewable energy may be a laudable goal, MDNR has not made any showing that would link renewable energy to this merger. The fact that UtiliCorp is seeking to merge with SJLP will not increase the reliance of the resulting company on non-renewable energy. There is no evidence that this merger will cause any detriment with regard to the use of renewable energy sources and MDNR's proposed conditions will not be imposed upon UtiliCorp.

Public Counsel's Regulatory Plan Condition:

Public Counsel proposes that the Commission adopt an alternative to the regulatory plan proposed by UtiliCorp. Public Counsel suggests that UtiliCorp should be required to file a rate case for each of its Missouri operating divisions within one year of the approval of both the merger between UtiliCorp and SJLP and the merger between UtiliCorp and Empire. UtiliCorp opposed this condition.

Public Counsel's proposed condition is unnecessary. UtiliCorp can decide for itself when it wishes to propose rate adjustments for its Missouri operations. If Public Counsel believes that UtiliCorp is over-earning, it is free to bring an appropriate complaint. The Commission will not upset that balance by arbitrarily ordering UtiliCorp to institute a rate case at a particular time.

CONCLUSIONS OF LAW

The Missouri Public Service Commission has reached the following conclusions of law:

A. Requirements for Approval of the Merger:

UtiliCorp and SJLP have asked the Commission to approve their merger pursuant to the provisions of Section 393.190.1, RSMo 1994.[3] In interpreting the requirements of this statute, the Commission and the courts that have reviewed its decisions, have consistently held that a proposed utility merger must be approved if such approval is in the public interest. This does not mean that the public must receive a benefit from the proposed merger. Instead, the Missouri Supreme Court has established a standard that holds that the requirement that the merger be "in the public interest" can mean no more than that the merger is "not detrimental to the public." *State ex rel. City of St. Louis v. Public Service Commission,* 335 Mo. 448, 459, 73 S.W.2d 393, 400 (Mo. banc 1934). Therefore, the Commission is required to approve this merger if it can be shown that the merger will not be not detrimental to the public.

[3] Section 393.190.1, RSMo 1994 provides in relevant part as follows:

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

What then does it mean for the Commission to find that the proposed merger is "not detrimental to the public"? Furthermore, who is "the public" that is to be protected from detriment? The parties suggest that the public that the Commission is obligated to protect is the ratepayers and the detriments from which they are to be protected are higher rates or a deterioration in the level of customer service. Certainly the Commission has utilized those definitions in past cases. See e.g. *Laclede Gas Company*, 16 Mo P.S.C. (N.S.) 328 (1971). There does not, however, appear to be any controlling authority that would firmly limit the Commission to those definitions. Nevertheless, the Commission will generally adhere to those definitions in this decision.

B. Burden of Proof:

Who then has the burden of proving that this merger is not detrimental to the public? The Missouri Supreme Court has stated that "the relevant inquiry in determining which party has the burden of proof is to identify who, as is disclosed from the pleadings, asserts the affirmative of an issue. Generally that party has the burden of proof." *Anchor Centre Partners, Ltd. V. Mercantile Bank, N.A.*, 803 S.W.2d 23, 30 (Mo. banc 1991); *see also* *Dycus v. Cross*, 869 S.W.2d 745 (Mo. banc 1994). The joint applicants, UtiliCorp and SJLP, are asserting that their merger will not be detrimental to the public. Therefore, they have the burden of proving that assertion. However, simply assigning the general burden of proof on UtiliCorp and SJLP does not resolve all questions about burden of proof.

UtiliCorp and SJLP must prove that their proposed merger is not detrimental to the public. However, other parties have asserted that the merger is detrimental in one or more specific areas. It is not enough for a party to assert that a detriment exists and demand that UtiliCorp and SJLP prove them wrong.

While the burden of proof never shifts throughout a trial, the burden of going forward with evidence may shift if a prima facia case is made. *Anchor Centre Partners* at 30. Therefore, the parties asserting that the merger is detrimental to the public in a particular way have the burden of going forward by presenting sufficient evidence to support their particular assertions.

C. The Regulatory Plan:

UtiliCorp summarizes its proposed regulatory plan as follows:

1. Upon the closing of the merger, a five-year rate moratorium for the SJLP operating division will be put in place (Rate Freeze);

2. During the fifth year of the rate moratorium, UtiliCorp will initiate general rate cases for the retail electric, gas and steam operations of the SJLP division with the new rates to take effect at the conclusion of the moratorium. The rate filings will include an accounting of the merger synergies realized during the moratorium period and the balance of the acquisition premium yet to be recovered (5th year rate case);

3. In the rate cases and for ratemaking purposes, fifty percent (50%) of the unamortized balance of the acquisition premium paid by UtiliCorp for SJLP will be included in the rate bases of the SJLP division's retail electric, gas and steam operations and the annual amortization of the acquisition premium will be included in the expenses allowed for recovery in cost of service, provided that UtiliCorp proves to the Commission that merger synergies are at least equal to 50% of the premium costs and other costs to achieve the synergies. The return allowed on this premium, for the recovery period, will be based on the capital structure of

sixty percent (60%) debt and forty percent (40%) equity (Partial Recovery of Premium in Rates);

4. The balance of the retail electric, gas and steam rate bases will be allowed a return based upon a SJLP division capital structure of forty-seven percent (47%) debt and fifty-three (53%) equity for the period covered by the Regulatory Plan which approximates the capital structure recommended by the Staff in SJLP's last rate case (frozen capital structure);

5. The allocation of UtiliCorp's corporate and intra-business unit costs to UtiliCorp's MPS division shall exclude for ratemaking purposes the SJLP factors from the methodology for the period covered by the Regulatory Plan (MPS Allocations).

UtiliCorp asserts that approval of this regulatory plan is necessary to allow its shareholders the opportunity to recover the $270 million dollar investment required to acquire the ownership of SJLP. Every element of the regulatory plan drew sharp opposition from the other parties.

The Five-Year Rate Moratorium:

UtiliCorp proposed that after completion of the merger, the rates for the SJLP division would be frozen for a period of five years. UtiliCorp would be bound to not request a rate increase during those five years barring certain unforeseen catastrophic circumstances that might justify a rate increase. In return, UtiliCorp asks that the Commission order that its rates not be decreased during the same five years. Such a rate freeze would allow UtiliCorp to recover at least a portion of its investment through the effect of regulatory lag. In other words, UtiliCorp anticipates that its cost of service will go down because of the savings resulting from the merger. It wants assurance that the Commission will not reduce its rates until it has had a chance to benefit from that decreased cost of service.

The Commission has approved a rate freeze as part of other merger cases. However, in each case the rate freeze was a part of a stipulation and agreement submitted for the Commission's approval by all the parties. In this case, UtiliCorp is asking that the Commission impose a rate freeze on unwilling parties. For a number of reasons, UtiliCorp's request cannot be granted.

First, the imposition of a five-year rate freeze would be contrary to the Commission's statutory obligation to provide continuous regulation of the public utilities of this state. In describing the authority and responsibility of the Public Service Commission, the Missouri Supreme Court has stated that the Commission is:

> a fact finding body, exclusively entrusted and charged by the legislature to deal with and determine the specialized problems arising out of the operation of public utilities. . . . Its supervision of the public utilities of this state is a continuing one and its orders and directives with regard to any phase of the operation of any utility are always subject to change to meet changing conditions, as the commission, in its discretion, may deem to be in the public interest.

State ex rel. Chicago, R. I. & P. R. Co. v. Public Service Commission, 312 S.W.2d 791, 796 (Mo. 1958). In rejecting a proposed stipulation and agreement that would have limited the Commission's ability to entertain complaints against a Missouri utility, the Commission stated as follows:

> The Commission cannot agree to relinquish it statutory duties as proposed by the parties. The Commission is essentially a creation of the Legislature and, as such, is empowered by statute to carry out certain functions. Among the various statutory responsibilities incumbent on the Commission to perform are the setting of rates (Section 393.150, RSMo), the provision of safe and adequate service (Section 393.130, RSMo), the proper litigation of complaints (Section 386.400, RSMo) and other general powers (Section 393.150). The Commission cannot proceed in a manner contrary to the terms of a statute and may not follow a practice which results in nullifying the express will of the Legislature.

Public Counsel v. Missouri Gas Energy 6 Mo. P.S.C. 3d 464, 465 (1997). The views expressed by the Commission in that earlier case are still appropriate. Imposition of a five-year rate freeze would purport to deprive the Commission of the legislatively imposed duty to adjust UtiliCorp's rates to meet changing conditions. The Commission will not agree to relinquish its statutory duties.

Second, even if the Commission were willing to agree to a five-year rate moratorium, it is apparent that such a rate moratorium could not be effective to actually freeze UtiliCorp's rates. Section 386.390.1, RSMo, 1996, permits the Commission, the Office of the Public Counsel, municipal and county officials, or a group of not less than twenty-five ratepayers, to bring a complaint before the Commission seeking to challenge the reasonableness of the rates charged by an electrical corporation. The Commission clearly cannot prevent the Office of the Public Counsel, municipal or county officials or qualifying groups of ratepayers from bringing a rate complaint against UtiliCorp within the proposed five-year moratorium. John McKinney, testifying on behalf of UtiliCorp acknowledged as much, but he asked that the Commission bar its Staff from participating in or assisting in any complaint brought by another party. Further, he asked that the Commission not "entertain an earnings investigation on the company during the five-year period." Essentially then, UtiliCorp would have the Commission go through the motions of providing a fair hearing for a rate complaint brought during the five-year rate moratorium, but it would expect the Commission to have prejudged that complaint in favor of UtiliCorp. Obviously, such a practice would be both illegal and unethical.

The Commission cannot prevent appropriate parties from bringing a rate complaint during the five-year rate moratorium, nor can it prevent UtiliCorp or even a future Commission from violating such a moratorium. In a 1975 case, *State ex rel. Jackson County v. Public Service Commission*, 532

S.W.2d 20 (Mo. banc. 1975) the Missouri Supreme Court reversed a circuit court decision that would have prevented the Commission from granting a rate increase during a two-year moratorium established by the Commission in a previous rate case. The court held that "to rule otherwise would make section 393.270(3) of questionable constitutionality as it potentially could prevent alteration of rates confiscatory to the company or unreasonable to the consumers." *Jackson County* at 29-30. Therefore, UtiliCorp would be free to seek increased rates and the Commission would be free to establish revised rates despite the existence of a moratorium.

Third, even if all the legal barriers to an effective rate moratorium could be surmounted, a five-year rate moratorium would not be good public policy either from the perspective of UtiliCorp or its ratepayers. Robert K. Green, President and Chief Operating Officer of UtiliCorp, testified that the electric utility marketplace has seen "phenomenal change" since he became president of UtiliCorp in 1996. Certainly there is no reason to believe that the pace of change will diminish in the next five years. The cost of fuel might fluctuated significantly, plans for possible deregulation of the electric industry are under consideration in the legislature and there is always the possibility of an unforeseen event such as the June, 2000 unplanned outage at SJLP's Lake Road generating plant. Attempting to lock in a rate now to remain in effect until 2006 simply is not fair to either UtiliCorp or its ratepayers and is not good public policy.

Other Aspects of the Regulatory Plan:

In addition to the proposed five-year rate freeze, UtiliCorp's proposed regulatory plan would have the Commission establish, in this case, several facts that would be used to establish UtiliCorp's rates in a post-moratorium rate case. In particular, UtiliCorp would have the Commission decree that for the post-moratorium rate case, it would utilize a hypothetical capital structure for the SJLP unit based on a capital structure of fifty-three percent equity and forty-seven percent long-term debt. Such a capital structure would be similar to the hypothetical capital structure that Staff proposed for SJLP in its most recent rate case.

UtiliCorp utilizes a more highly leveraged capital structure closer to forty percent equity and sixty percent debt. UtiliCorp's preference for a capital structure more reliant on long-term debt enables it to acquire capital at the relatively low rates that are available for debt financing, rather than the relatively high rates that are required for equity financing. By utilizing, for ratemaking purposes, a hypothetical capital structure that overstates the use of equity financing, UtiliCorp would receive a higher rate than it would otherwise receive and thus would be able to recover a portion of the acquisition premium. UtiliCorp argues that because SJLP's capital structure probably would not change absent the merger, the use of a hypothetical capital structure would merely maintain the status quo for SJLP's ratepayers and thus would not be a detriment to them.

Similarly, UtiliCorp asks the Commission to declare that in post-moratorium rate cases the allocation of UtiliCorp's corporate and intra-business unit costs to UtiliCorp's MPS operating division would exclude the SJLP factors. Thus, UtiliCorp asks the Commission to ignore the effect that the addition of the SJLP division to UtiliCorp would have on the costs allocated to MPS. The fact that the SJLP division had been added to the UtiliCorp corporate structure would tend to reduce the amount of corporate and intra-business unit costs that would be allocated to each of UtiliCorp's operating divisions. By ignoring the addition of the SJLP division, UtiliCorp's plan would have the effect of preventing a decrease in the MPS division's cost of service and would keep the rates paid by

MPS's ratepayers somewhat higher than they might otherwise be if the addition of the SJLP division were allowed to be included. UtiliCorp argues that such a result is fair because those corporate allocations will not be reduced if the merger is not completed.

In addition, UtiliCorp asks the Commission to determine that it will be allowed to recover transaction costs and costs to achieve associated with the merger. Again, UtiliCorp argues that such costs are part of the costs that must be incurred to achieve the savings that will result from the merger.

Essentially, in each matter, UtiliCorp asks the Commission to state now how it will rule on certain issues in future rate cases. The Commission will not do so. Section 393.270.4, RSMo 1994 provides that when the Commission determines the rate that can be charged by a utility, it "may consider all facts which in its judgment have any bearing upon a proper determination of the question . . . , with due regard, among other things, to a reasonable average return upon the value of the property actually used in the public service and to the necessity of making reservations out of income for surplus and contingencies." The law is quite clear that when determining a rate the Commission is obligated to review and consider *all* relevant factors, rather than just a single factor. *See.* *State ex rel. Missouri Water Co. v. Public Service Commission*, 308 S.W.2d 704 (Mo. 1957); *State ex rel. Utility Consumers' Council of Missouri, Inc. v. Public Service Commission*, 585 S.W.2d 41 (Mo banc 1979); and *Midwest Gas Users' Association v. Public Service Commission*, 976 S.W.2d 470 (Mo. App. W.D. 1998). To consider some costs in isolation might cause the Commission to allow a company to raise rates to cover increased costs in one area without realizing that there were counterbalancing savings in another area. Such a practice is justly condemned as single-issue ratemaking. *Midwest Gas Users' Association* at 480.

In order to avoid single-issue ratemaking, the Commission has avoided making decisions about rate case matters outside of the context of a rate case. In fact, the Commission typically includes language in non-ratemaking cases that specifically provides that the ratemaking treatment to be afforded a transaction will be considered in a later proceeding. The ratemaking factors that UtiliCorp asks the Commission to decide in this case can only be properly considered within the context of all relevant factors in a subsequent rate case. The Commission will not engage in single-issue ratemaking and will decline UtiliCorp's invitation to prejudge certain factors that can only be properly considered in a future rate case.

Recovery of the Acquisition Premium:

UtiliCorp's shareholders agreed to pay $23 per share to acquire SJLP's stock. That purchase price is approximately 36 percent above the trading value of SJLP's stock just before the merger was announced. Thus, UtiliCorp's offer creates an acquisition premium of an estimated $92 million. UtiliCorp's proposed regulatory plan asks that the Commission find, in this case, that UtiliCorp should be allowed to include in the rate bases of the SJLP division's retail electric, gas and steam operations in a future rate case, up to fifty percent of the unamortized balance of the acquisition premium paid by UtiliCorp for SJLP. UtiliCorp proposes that this recovery would be contingent upon UtiliCorp proving to the Commission that merger synergies are equal to fifty percent of the premium costs and other costs to achieve the synergies. In other words, UtiliCorp asks that it be allowed to recover from SJLP's ratepayers, through its rates, the acquisition premium it paid to purchase SJLP, to the extent that the ratepayers would benefit from the savings arising from the merger.

In asking the Commission to decide in this case how it will treat its request for recovery of its acquisition premium, UtiliCorp is asking the Commission to prejudge a ratemaking factor outside a ratemaking case. As previously indicated, the Commission will not do so. The Commission will give due consideration to a proposal to provide for recovery of a merger premium if that proposal is presented in a rate case.

The matter of the acquisition premium is also not properly before the Commission. It is a matter for a rate case. Therefore, the Commission will not address the matter of the acquisition premium in this case.

D. Transmission Access and Reliability Conditions:

Springfield raised numerous issues regarding the possible effects that the merger would have on the transmission of electricity within and between the service territories of UtiliCorp's MPS division and SJLP, and on the transmission of electricity destined to other electric service providers, such as Springfield. Springfield presented expert testimony that purported to show that the merger and the ensuing joint dispatch of the electricity resources of the merged companies could have negative effects upon the flow of electricity on the transmission system of the combined company and surrounding electric service providers. Springfield proposed several conditions that would require UtiliCorp to further study the flow of electricity and would require UtiliCorp to take steps to correct any problems identified by those studies. UtiliCorp replied that the FERC has exclusive jurisdiction over these issues and that they should not be addressed by this Commission.

The question of whether the Commission has jurisdiction over the transmission access and reliability issues raised by Springfield is answered through a review of applicable federal law. In 1935, Congress passed the Federal Power Act, which created Federal jurisdiction over the "transmission of electric energy in interstate commerce and the sale of such energy at wholesale in interstate commerce." 16 U.S.C. §824(a) That act also provides that the various states retain jurisdiction over "facilities used in local distribution or only for the transmission of electric energy in intrastate commerce." 16 U.S.C. §824(b) In 1996 the FERC issued Order No. 888, which interprets the Federal Power Act as leaving regulation of only bundled retail transmissions[4] to the various states. FERC's order asserts federal jurisdiction over all unbundled retail transmissions as well as wholesale transmissions. The FERC, in Order No. 888, adopted a seven factor test to determine whether the activities of the facility in question are used for local distribution and thus are subject to state jurisdiction. That seven factor test is as follows:

(1) Local distribution facilities are normally in close proximity to retail customers.

(2) Local distribution facilities are primarily radial in character.

(3) Power flows into local distribution systems; it rarely, if ever, flows out.

(4) When power enters a local distribution system, it is not reconsigned or transported on to some other market.

(5) Power entering a local distribution system is consumed in a comparatively restricted geographical area.

(6) Meters are based at the transmission/local distribution interface to measure flows into the local distribution system.

(7) Local distribution systems will be of reduced voltage.

[4] "Vertically integrated utilities use their own facilities to generate, transmit, and distribute electricity to their customers. Traditionally the customer paid one combined rate for both the power and its delivery, thus the industry refers to such sales as 'bundled'." *Transmission Access Policy Study Group v. F.E.R.C.,* 225 F3d 667, 691 (D.C. Cir. 2000)

FERC's interpretation of the Federal Power Act was recently upheld by the United States Court of Appeals for the District of Columbia Circuit in *Transmission Access Policy Study Group v. F.E.R.C.,* 225 F.3d 667 (DC Cir. 2000).

If FERC's seven factor test is applied to the issues raised by Springfield, it is apparent that Springfield's concerns do not relate to unbundled retail transmissions as they are defined by the FERC. Springfield's fundamental concern is that the merger will disrupt the flow of wholesale power that it receives through the service territories of UtiliCorp and SJLP. The Commission will not attempt to determine the validity of Springfield's concerns and will instead defer to the jurisdiction of the FERC.

Springfield's issues regarding transmission access and reliability concern the transmission of power across service territories for purpose of wholesale deliveries. They are properly regulated by the FERC and are not subject to regulation by this Commission. For that reason the conditions proposed by Springfield regarding transmission access and reliability will not be imposed.

E. Jurisdiction

UtiliCorp is an "electrical corporation," a "gas corporation" and a public utility as those terms are defined in Section 386.020, RSMo Supp. 1999, and is subject to the jurisdiction of the Commission pursuant to Section 386.250, RSMo Supp. 1999. SJLP is an "electrical corporation," a "gas corporation, a "heating company" and a "public utility as those terms are defined in Section 386.020, RSMo Supp. 1999, and is subject to the jurisdiction of the Commission pursuant to Section 386.250, RSMo Supp. 1999.

Based upon the Commission's review of the applicable law and its findings of fact, the Commission concludes that the proposed merger between UtiliCorp and SJLP is in the public interest because it is not detrimental to the public.

IT IS THEREFORE ORDERED:

1. That St. Joseph Light & Power Company is authorized to merge with and into UtiliCorp United Inc. with UtiliCorp United Inc. being the surviving corporation, and to otherwise accomplish the merger, all as more particularly described in and pursuant to the terms of the Agreement and Plan of Merger.

2. That St. Joseph Light & Power Company is authorized, through the merger, to transfer to UtiliCorp United Inc. all the properties, rights, privileges, immunities and obligations of St. Joseph Light & Power Company, including, but not limited to, those under St. Joseph Light & Power Company's certificates of public convenience and necessity, works, systems and franchises, and all securities, evidences of indebtedness and guarantees, effective as of the date of the closing of the merger.

3. That UtiliCorp United Inc. is authorized to acquire and assume the stocks and bonds, other indebtedness and other obligations of St. Joseph Light & Power Company, all as more particularly described in and pursuant to the terms of the Agreement and Plan of Merger.

4. That St. Joseph Light & Power Company and UtiliCorp United Inc. are authorized to perform in accordance with the terms of the Agreement and Plan of Merger.

5. That St. Joseph Light & Power Company is authorized to terminate its responsibilities as a public utility in the State of Missouri as of the effective date of the merger.

6. That UtiliCorp United Inc., the surviving corporation, is authorized to provide electric, natural gas and industrial steam service in the current service territories of St. Joseph Light & Power Company in accordance with the rules, regulations, rates and tariffs of St. Joseph Light & Power Company as may be on file with and approved by the Commission as of the effective date of the merger, except as otherwise provided for herein or as otherwise ordered by the Commission. Further that the transfer of all St. Joseph Light & Power Company's customers to UtiliCorp United Inc. is authorized as contemplated by Section 393.106, RSMo 1994.

7. That the Regulatory Plan proposed by UtiliCorp United Inc. is rejected.

8. That St. Joseph Light & Power Company and UtiliCorp United Inc. are authorized to enter into, execute and perform in accordance with the terms of all other documents and to take any and all actions which may be reasonably necessary and incidental to the performance of the Agreement and Plan of Merger.

9. That the Commission's approval of the merger of St. Joseph Light & Power Company with and into UtiliCorp United Inc. is subject to UtiliCorp United Inc.'s agreement to the following conditions:

a. That in post-merger cases involving UtiliCorp United Inc.'s St. Joseph Light & Power Company operating division, UtiliCorp United Inc. will maintain the pre-merger funded status of the St. Joseph Light & Power Company pension fund by accounting for it separately.

b. That if the merger is determined to be a taxable event and deferred taxes of St. Joseph Light & Power Company are thereby lost, UtiliCorp United Inc. shall include an amount equal to those deferred taxes in future rate proceedings for its St. Joseph Light & Power Company operating division as an offset to rate base.

c. That UtiliCorp United Inc. shall continue to file separate surveillance reports for its Missouri Public Service and St. Joseph Light & Power Company operating divisions following the closing of the merger.

d. That for one year following the closing of the merger, UtiliCorp United Inc. shall provide the Staff of the Commission with monthly reports regarding Call Center Abandoned Call Rate (ACR), Call Center Average Speed of Answer (ASA), Distribution Reliability Customer Average Interruption Duration (CAIDI), Distribution Reliability System Average Interruption Frequency Index (SAIFI), and Distribution Reliability System Average Interruption Duration Index (SAIDI).

e. That UtiliCorp United Inc. shall issue Requests for Proposals (RFPs) for natural gas for resale which include price ceilings, price floors, fixed prices and index pricing and provide documentation of analysis of these bids to the Staff of the Commission as part of its annual ACA audit process.

f. That UtiliCorp United Inc. shall conduct a peak design day study of the St. Joseph Light & Power Company natural gas distribution system to be completed and provided to Staff 90 days after the effective date of this report and order.

g. That UtiliCorp United Inc. shall, after the closing of the merger, complete the five-year natural gas yard line replacement program to which St. Joseph Light & Power Company and the Staff of the Commission agreed in 1999.

h. That UtiliCorp United Inc. shall provide historical actual hourly generation, energy purchases and sales data, and other information required by Commission Rule 4 CSR 240-20.080 in electronic format accessible by a spreadsheet program for both the Missouri Public Service and St. Joseph Light & Power Company operating divisions of UtiliCorp United Inc. UtiliCorp United Inc. shall also provide access to such additional documents as may be necessary for the Staff of the Commission to analyze fuel and energy costs.

10. That any evidence the admission of which was not expressly ruled upon is admitted into evidence.

11. That any objection that was not expressly ruled upon is overruled.

12. That any motions not expressly ruled upon are denied.

13. That nothing in this order shall be considered a finding by the Commission of the value for ratemaking purposes of the transactions herein involved.

14. That the Commission reserves the right to consider any ratemaking treatment to be afforded the transactions herein involved in a later proceeding.

15. That this Report and Order shall become effective on December 24, 2000.

BY THE COMMISSION

Dale Hardy Roberts

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

(S E A L)

Lumpe, Ch., Drainer, Schemenauer, and Simmons, CC.,
concur and certify compliance with the provisions
of Section 536.080, RSMo 1994.
Murray, C., absent

Dated at Jefferson City, Missouri,
on the 14th day of December, 2000.

ALJ/Sec'y: Woodruff/Boyce

12-8
Date Circulated

EM-2000-292
CASE NO.

Lumpe, Chair

Drainer, Vice Chair

Murray, Commissioner

Schemenauer, Commissioner — I have a lot of changes

KS
Simmons, Commissioner

12-14
Agenda Date

Action taken: 4-0AA

Must Vote Not Later Than ______

STATE OF MISSOURI
OFFICE OF THE PUBLIC SERVICE COMMISSION

I have compared the preceding copy with the original on file in this office and I do hereby certify the same to be a true copy therefrom and the whole thereof.

WITNESS my hand and seal of the Public Service Commission, at Jefferson City, Missouri, this 14th day of December 2000.

Dale Hardy Roberts

Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge