BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of the application of Union Electric Company for an order authorizing: (1) certain merger transactions involving Union Electric Company; (2) the transfer of certain assets, real estate, leased property, easements and contractual agreements to Central Illinois Public Service Company; and (3) in connection therewith, certain other related transactions.	)	Case No. EM-96-149

AFFIDAVIT OF MARK BURDETTE

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Mark Burdette, of lawful age and being first duly sworn, deposes and states:

1. My name is Mark Burdette. I am the Public Utility Financial Analyst for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 19, Schedules MB-1 through MB-6, and Appendix A.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

Mark Burdette

Mark Burdette

Subscribed and sworn to me this 3rd day of May, 1996.

Bobbie J. Richards

Bobbie J. Richards
Notary Public

My commission expires November 3, 1996.

BOBBIE J RICHARDS
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. NOV 3,1996

REBUTTAL TESTIMONY

OF

MARK BURDETTE

UNION ELECTRIC COMPANY

CASE NO. EM-96-149

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Mark Burdette, P.O. Box 7800, Jefferson City, Missouri 65102.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Office of the Public Counsel of the State of Missouri (OPC or Public Counsel) as a Public Utility Financial Analyst.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND.

A. I received a Bachelor of Science in Electrical Engineering from the University of Iowa in Iowa City, Iowa in May 1988. I received a Master's in Business Administration with an emphasis in Finance from the University of Iowa Graduate School of Management in December 1994.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION?

A. Yes.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. I will address the alleged merger premium claimed by Union Electric and CIPSCO as part of their proposed merger.

Q. HAVE YOU PREPARED SCHEDULES IN SUPPORT OF YOUR TESTIMONY?

A. Yes. I have prepared an analysis consisting of 6 Schedules that are attached to this testimony. This analysis was prepared by me and is correct to the best of my knowledge and belief. Schedule MB-6, Union Electric 10 Year Historical Financial Information is included for completeness.

Q. WHAT IS THE REGULATORY BARGAIN BETWEEN UTILITY INVESTORS AND UTILITY RATEPAYERS?

A. The regulatory bargain is an attempt to balance the interests of public utility shareholders and ratepayers. A regulated public utility under efficient and economic management, providing service for the public good, is entitled to:

1) A reasonable opportunity to earn a return on the value of its property employed for the convenience of the public, comparable to the return of other enterprises with similar risks;

2) A return reasonably sufficient to assure financial soundness, support existing credit, and attract new capital.

Public utility ratepayers are entitled to quality service and fair and reasonable rates not subject to unnecessary, excessive, or above-cost charges.

Q. HOW ARE COST-BASED UTILITY RATES SET UNDER THIS REGULATORY BARGAIN?

A. Under cost-based regulation, a utility's rates are set to allow recovery of its reasonable and prudent operating expenses, depreciation, and taxes on a dollar for dollar basis. In addition, the utility is provided the opportunity, but not the guarantee, to earn a fair rate of return on the *depreciated or net book value of plant and other assets utilized to provide service to its customers* (the rate base). The method used to measure rate base in the state of Missouri is the net book value of utility plant assets and property deemed to be "used and useful" in providing service to the utility's customers. Net book value of assets is the original cost plus improvements less accumulated depreciation.

Clearly, actual or claimed investments made by a public utility which do not contribute to the net book asset base used to provide public service should not be included in rate base and are not eligible to earn a return.

Q. IS THE UTILITY'S AUTHORIZED RATE OF RETURN APPLIED TO THE MARKET VALUE OF THAT UTILITY'S RATE BASE OR TO THE MARKET VALUE OF SECURITIES ISSUED TO FINANCE RATE BASE ASSETS?

A. No. Providing an opportunity to earn a fair rate of return on used and useful assets requires identifying the **book value** of capital used to finance the assets, such as long term debt or common equity (the capital structure), and their associated cost rates. The rate base - rate of return methodology therefore provides the utility *the opportunity to earn a fair rate of return on the <u>actual amount of money invested</u> in assets which are used and useful in providing service.* Changes in the market value of rate-base assets are not relevant when calculating rate base. Similarly, market-price changes in the valuation of utility debt and equity securities are not reflected in rate base.

Q. IS THE SERVICE THE UTILITY PROVIDES ITS RATEPAYERS EFFECTED BY CHANGES IN MARKET VALUATION OF UTILITY ASSETS, DEBT, OR EQUITY SECURITIES?

A. No. Fluctuations in market valuations of rate base assets, debt instruments, or equity securities has zero effect on the service received by ratepayers.

Q. DO YOU BELIEVE THE REGULATORY BARGAIN, AS YOU HAVE DESCRIBED IT, AND THE RELIANCE UPON BOOK COSTS RATHER THAN MARKET VALUES IS UNDERSTOOD BY INFORMED INVESTORS WHO BUY AND SELL UTILITY COMMON STOCK?

A. Yes. Investors understand that within the regulatory framework there is a real and direct connection between book values and earnings power. The Value Line page (735) for Union Electric Company includes the notation, at the bottom of the page:

> (D) Rate Base: orig. cost depreciated. Rate allowed in MO on common equity in '95: 12.61%; earned on average com. eq. in '95: 13.1%. Regulatory Climate: Average.

Q. DO CHANGES IN MARKET VALUE OF A UTILITY'S COMMON STOCK EQUITY IMPACT AUTHORIZED EARNINGS?

A. No. Shareholders but not ratepayers participate in the market price fluctuations associated with common stock investments. Authorized earnings do not change with fluctuations in the market price of common stock. To increase the authorized level of earnings a utility must either be authorized a higher rate of return on its existing rate base or grow rate base by investing capital in assets used and useful in providing utility service to customers. Market value of common equity is not allowed a return, does not change the established authorized rate of return, and does not impact the book value of assets.

Q. DO CHANGES IN MARKET VALUE OF A UTILITY'S COMMON STOCK EQUITY CHANGE THE CLAIM ON COMPANY ASSETS OR THE LEVEL OF OWNERSHIP INTEREST HELD BY THE SHAREHOLDER?

A. No. A share of utility common stock represents a claim on the income earned and book value of the assets of the utility after claims of creditors and any preferred stock investors are satisfied. Change in the market price of a share of common stock does not change the claim on assets in rate base or the income earned on such assets for the shareholder.

The shareholder may sell that share or buy others on the open market for the going price. Although each share owned might have had a different purchase price, they all represent an equal portion of the book value of the utility's assets. Any actual changes in the book value of the company or its underlying assets or rate base will be absorbed equally among all outstanding shares of common stock *regardless of the price paid for that stock by the owner*.

Q. WHAT DETERMINES THE MARKET VALUATION OF A UTILITY COMPANY'S COMMON STOCK?

A. The market valuation of a utility's common shares is determined primarily by investors' expectations about future earnings of the company. Other factors can influence market valuation, including interest rate changes, perceived quality of management, or even unfounded rumors about the company or its industry.

Q. WHY IS THE INVESTOR-DETERMINED MARKET VALUATION OF A PUBLIC UTILITY NOT THE STANDARD USED TO QUANTIFY RATE BASE?

A. Factors that can affect market share price do not necessarily affect the utility's ability to provide public service or the valuation of a utility's plant assets. Therefore, market valuations should not be included in rate base.

If two investors own a share of stock in the same company those two shares have the same market value. However, their individual rates of return, based on initial investments, are different if different initial amounts were paid to acquire the shares. Therefore, from a market-price perspective, equal treatment of all shareholders is not possible unless each and every shareholder is tracked and given a return based on the market price that individual paid for her investment in stock.

The rate of return applied to book value is equal for all shares and easily interpreted by each shareholder regardless of market price paid for the stock.

Q. IS THE COST-BASED APPROACH TO UTILITY REGULATION BASED ON A LONG HISTORY OF JUDICIAL PRECEDENT AND REVIEW?

A. Yes. The United States Supreme Court addressed original-cost rate base in Duquesne Light Company et.al. v. David M. Barasch et.al. (488 U.S. 299) in 1989. The court stated:

> At one time it was thought that the Constitution required rates to be set according to the actual present value of the assets employed in the public service. This method, known as the "fair value" rule, is exemplified by the decision in Smyth v. Ames, supra. Under the fair value approach, a "company is entitled to ask...a fair return upon the value of that which it employs for the public convenience," while on the other hand, "the public is entitled to demand...that no more be expected from it for the use of [utility property] than the services rendered by it are reasonably worth." In theory the Smyth v. Ames fair value standard mimics the operation of the competitive market. To the extent utilities' investments in plant are good ones (because their benefits exceed their costs) they are rewarded with an opportunity to earn an "above-cost" return, that is, a fair return on the current "market value" of the plant. To the extent utilities' investments turn out to be bad ones (such as plants that are canceled and so never used and useful to the public), the utilities suffer because the investments have no fair value and so justify no return.
>
> Although the fair value rule gives utilities strong incentive to manage their affairs well and to provide efficient service to the public, it

> suffered from practical difficulties which ultimately led to its abandonment as a constitutional requirement. In response to these problems, Justice Brandeis had advocated an alternative approach as the constitutional minimum, what has become known as the "prudent investment" or "historical cost" rule. He accepted the Smyth v. Ames eminent domain analogy, but concluded that what was "taken" by public utility regulation is not specific physical assets that are to be individually valued, but the capital prudently devoted to the public utility enterprise by the utilities' owners. Under the prudent investment rule, the utility is compensated for all prudent investments at their actual cost when made (their "historical" cost), irrespective of whether individual investments are deemed necessary or beneficial in hindsight. The utilities incur fewer risks, but are limited to a standard rate of return on the actual amount of money reasonably invested.
>
> Forty-five years ago in the landmark case of the Federal Power Commission v. Hope Natural Gas Co., this Court abandoned the rule of Smyth v. Ames, and held that the "fair value" rule is not the only constitutionally acceptable method of fixing utility rates. In Hope we ruled that historical cost was a valid basis on which to calculate utility compensation. ("Rates which enable [a] company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate their investors for the risks assumed certainly cannot be condemned as invalid, even though they might produce only a meager return on the so called 'fair value' rate base.") We also acknowledged in that case that all of the subsidiary aspects of valuation for rate-making purposes could not properly be characterized as having a constitutional dimension, despite the fact that they might affect property rights to some degree. Today we reaffirm these teachings of Hope Nat. Gas: "[I]t is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry...is at an end. The fact that the method employed to reach that result may contain infirmities is not then important."

Q. IS THE MERGER OF UNION ELECTRIC COMPANY AND CENTRAL ILLINOIS PUBLIC SERVICE COMPANY A POOLING OF INTERESTS TRANSACTION?

A. Yes. The direct testimony of Donald E. Brandt, Senior Vice President - Finance and Corporate Services, Union Electric Company, says:

> This exchange of shares is expected to qualify as a tax-free exchange and to be accounted for as a pooling of interests. (Brandt-Direct, pg. 3, lines 9-11.)

The direct testimony of Warner L. Baxter, Assistant Controller, Union Electric Company, says:

> The terms of the transaction meet the specified conditions for the pooling of interests method. Therefore the pooling of interests method will be followed for financial reporting purposes. *The receipt by Union Electric and CIPSCO of a letter from their respective independent accountants stating that the merger will qualify for the pooling of interests method is a condition precedent to the consummation of the merger.* (Baxter-Direct, pg. 4, lines 5-9.) [emphasis added]

Q. PLEASE EXPLAIN THE POOLING OF INTERESTS METHOD OF COMBINING COMPANIES.

A. A pooling-of-interests transaction involves exchanging equity shares in one company for shares in another company. The owners of the merging companies "pool" the assets and liabilities of the separate companies together, and the financial statements of the involved companies are summed. The new company adds the historical, original-cost amounts of assets and liabilities, as they appear on the books of the separate companies, and records these values on the new books. The combined rate base also will be a summation. According to <u>Accounting Principles Board Opinion No. 16</u>:

> The pooling of interests method accounts for a business combination as the uniting of the ownership interests of two or more companies by exchange of equity securities. No acquisition is recognized because the *combination is accomplished without disbursing resources of the constituents*. Ownership interests continue and the former bases of accounting are retained. The recorded assets and liabilities of the constituents are carried forward to the combined corporation at their recorded amounts. Income of the combined corporation includes income of the constituents for the entire fiscal period in which the combination occurs. The reported income of the constituents for prior periods is combined and restated as income of the combined corporation. (APB 16, paragraph 12) [emphasis added]

Q. DO CERTAIN CRITERIA HAVE TO BE MET FOR A TRANSACTION TO QUALIFY AS A POOLING OF INTERESTS?

A. Yes. One key requirement for a transaction to qualify as a pooling of interests is the shareholders of the acquired company (or both companies) **exchange** their shares for shares in the parent company. They become shareholders of the parent, or combined, company. This is in contrast to The Purchase Method where shareholders of one company **sell** their equity stake to the other company. According to Accounting Principles Board Opinion No. 16:

> The pooling of interests method of accounting is intended to present as a single interest two or more common stockholder interests which were previously independent and the combined rights and risks represented by those interests. *That method shows that stockholder groups neither withdraw or invest assets but in effect exchange voting common stock in a ratio that determines their respective interests in the combined corporation.* (APB 16, paragraph 45) [emphasis added]

Q. DO UNION ELECTRIC AND CIPSCO UNDERSTAND THE TERMS AND CONDITIONS OF A POOLING OF INTERESTS TRANSACTION?

A. Yes, apparently they do. The direct testimony of Warner L. Baxter, Assistant Controller, Union Electric Company, contrasts pooling of interests with outright purchase (pg. 2, line 17 through pg. 4, line 12). And, Baxter goes so far as to say:

> The receipt by Union Electric and CIPSCO of a letter from their respective independent accountants stating that the merger will qualify for the pooling of interests method is *a condition precedent to the consummation of the merger.* (Baxter-Direct, pg. 4, lines 7-9.) [emphasis added]

If Union Electric and CIPSCO are willing to make pooling of interests treatment a condition for the merger, it is reasonable to think they understand the terms of and differences between the types of treatment available.

Q. WHAT IS A MERGER PREMIUM?

A. A merger premium, or positive acquisition adjustment, is the amount over market value the acquiring company is willing to pay for the equity securities of the acquired company.

Q. ARE THE COMPANIES CLAIMING A MERGER PREMIUM IN THIS PROCEEDING?

A. Yes. UE and CIPSCO claim a $232,000,000 merger premium. The companies define the merger premium as the difference between the market valuation of all CIPSCO shares on 8/11/95 and the market valuation of 1.03 times an equal number of UE shares on 8/11/95. The companies assume Ameren's post-merger per-share market price will be equal to the

8/11/95 UE per-share market price. This is just an *estimate* of the market valuation of the currently nonexistent Ameren common shares which will be issued to replace the CIPSCO shares. UE and CIPSCO estimate that the post-merger per-share market value of Ameren shares will be equal to the pre-merger share price of Union Electric shares on 8/11/95.

Q. HOW IS A MERGER PREMIUM TREATED IN A POOLING OF INTERESTS TRANSACTION.

A. "Merger premium" is a misnomer in a pooling of interests transaction. Regardless of what the difference in market values ultimately is, it will not be recognized on the books and records of Ameren using pooling of interests. Recognition of valuation differences between the original stock and the newly issued shares is within the exchange ratio. According to Accounting Principles Board Opinion No. 16:

> ...Accounting by the pooling of interests method for business combinations arranged through the issuance of common stock is based on existing accounting concepts and is not an occasion for revising historical costs. Both constituents usually have elements of appreciation and of goodwill which are recognized and offset, at least to some extent, in setting the exchange ratio of common stock. (APB 16, paragraph 31)

Q DOES POOLING OF INTERESTS PROVIDE FOR AN AMORTIZATION OF A MERGER PREMIUM TO THE INCOME STATEMENT AS AN EXPENSE?

A. No. A pooling of interests transaction requires no adjustments to the value of assets, does not allow recording a merger premium, and therefore does not allow amortization of that merger premium as an expense. The direct testimony of Douglas W. Kimmelman, Vice President at Goldman, Sachs & Co., says:

> A stock swap transaction is less costly than a cash acquisition as it does not leverage the company, is tax-free to shareholders, *and does not involve the banking of goodwill which, when amortized, would serve to increase expenses.* (Kimmelman-Direct, pg. 3, lines 13-15.) [emphasis added]

Any difference in market valuation of the newly issued shares and the retired shares is incorporated in the exchange ratio agreed to by both sets of shareholders before the consummation of the merger. A pooling of interests merger transaction is simply an exchange of shares at the agreed to exchange ratio.

Q. GIVEN POOLING OF INTERESTS, IS THE TREATMENT PROPOSED BY THE COMPANIES OF THE $232M DIFFERENCE IN EQUITY-MARKET VALUATIONS APPROPRIATE?

A. No. The companies propose recovery of the claimed premium by amortizing over a ten year period. Pooling of interests does not recognize the difference in market valuations as a premium or an investment and does not allow amortization of that difference.

Q. WHAT INCOME TAX CONSEQUENCES DO THE COMPANIES EXPECT DUE TO THE CLAIMED INVESTMENT IN THE MERGER PREMIUM?

A. The companies expect no income tax consequences and recognize the transaction as a tax-free exchange of equity securities for shareholders. The direct testimony of Donald E. Brandt, Senior Vice President - Finance and Corporate Services, Union Electric Company, says:

> This exchange of shares is expected to qualify as a tax-free exchange and to be accounted for as a pooling of interests. (Brandt-Direct, pg. 3, lines 9-11.)

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The proposed merger transaction involves no investment or withdrawal of assets by any shareholder which could effect taxes.

Q. DOES THE CLAIMED MERGER PREMIUM CONSTITUTE A CAPITAL INVESTMENT?

A. No. The merger premium is a snapshot of the difference in market valuation of two sets of equity shares calculated at a particular point in time and represents zero capital investment and zero increase in assets. If the snapshot had been taken one day earlier or later, the calculation of the difference in market valuations could be different although the value of the assets remains constant.

Q. DOES THE CLAIMED MERGER PREMIUM REPRESENT AN INVESTMENT OR AN INCREASE IN ASSETS USED AND USEFUL IN PROVIDING UTILITY SERVICE?

A. No. The assets of the merged company will be the simple addition of the assets previously held by UE and CIPSCO. This transaction is a *trade of equity securities* with an estimated market value difference of $232M. The assets represented by the common shares of Ameren will be the same assets currently owned by the shareholders of UE and CIPSCO. There is no new investment. The total book value of all Ameren shares after the merger equals the sum of the book values of all UE and CIPSCO shares before the merger. The ability to provide utility service, as measured by original-cost rate base, has not changed due to the alleged investment of $232M.

The transaction results in a net shift of equity interest from one set of Ameren investors to another due to the exchange ratios of 1.0 shares of Ameren per share of UE and 1.03 shares of Ameren per share of CIPSCO; *equity claims of Ameren investors **as a whole** have not changed.*

Q. HAS THE ISSUE OF MERGER PREMIUM OR ACQUISITION ADJUSTMENT BEEN ADDRESSED PREVIOUSLY BY THE MISSOURI PUBLIC SERVICE COMMISSION?

A. Yes.

Q. TO YOUR KNOWLEDGE, HAS THE MPSC EVER ALLOWED AN ACQUISITION ADJUSTMENT IN A COST OF SERVICE STUDY ON WHICH RATES WERE BASED?

A. No.

Q. DOES THE EXCLUSION OF ACQUISITION ADJUSTMENTS FOR PUBLIC UTILITIES HAVE SUPPORT IN FINANCIAL LITERATURE?

A. Yes. Accounting for Public Utilities by Hahne and Aliff states:

> The general rule related to the acquisition adjustment of utility plant previously used in the utility function is that the rate base component for the plant includes only the original cost of the property to the first owner devoting the property to public service.

Q. WHY IS IT APPROPRIATE TO EXCLUDE A MERGER PREMIUM FROM RATE BASE AND COST OF SERVICE?

A. As stated previously, under cost-based regulation, a utility's rates are set to allow recovery of its operating expenses, depreciation, and taxes on a dollar for dollar basis, and the opportunity, but not the guarantee, to earn a fair rate of return on the depreciated or net book value of plant or other assets utilized to provide service to its customers (the rate base).

Simply transferring ownership of used and useful utility assets does not increase the ability of those assets to provide public service. As ratepayers are captives of the monopoly utility providing service, the ratepayer has no viable alternative to obtain utility service. The regulatory bargain between ratepayer and public utility would be violated if the ratepayer was subject to increased cost of service simply because the new utility owner chose to acquire the utility assets at a price greater than net original cost.

Q. HOW WOULD THE INCLUSION OF A MERGER PREMIUM EFFECT RATEPAYERS?

A. First, including a merger premium in rate base increases the overall level of authorized earnings (authorized rate of return multiplied by rate base) for the public utility leading to increased rates. Second, the amortization of a merger premium would increase the utility's level of expenses and, therefore, cost of service, also resulting in increased rates for ratepayers.

The increased rate base (and resulting increase in authorized earnings) and the increased cost of service each lead to increased rates for ratepayers. However, these higher rates are not the result of an increase in the utility's ability to provide service as measured by rate base assets.

Q. WOULD THESE RATE INCREASES RESULT FROM THE PURCHASING PUBLIC UTILITY INCREASING THE USEFULNESS OF THE ASSETS?

A. No. The assets are the same regardless of ownership. The ability of public utility assets to be used and useful in providing utility service to ratepayers is not enhanced by paying too much for them.

Q. HAS THE INVESTMENT COMMUNITY EXPRESSED AN OPINION CONCERNING THE SHAREHOLDERS OF CIPSCO AND UE COMMON EQUITY AND THE PROPOSED MERGER?

A. Yes. Concerning CIPSCO common equity shareholders, Value Line states:

> CIPSCO shareholders stand to be well rewarded. Aside from gaining ownership in a financially stronger and more competitive company, they will receive an immediate annual dividend hike of 46¢ a share, to $2.50 a share. The recent share price appears to adequately reflect the benefits of the proposed merger. (page 702)

Concerning UE common equity shareholders, Value Line states:

> Patient investors would do well to hold their shares in anticipation of the alliance. Though the merger provides UE with no initial increase in the dividend, savings from the combination should stimulate earnings growth and allow payout hikes greater than those UE would attain as a stand-alone company. (page 735)

Value Line's recommendation for UE shareholders is to simply hold on to their shares to reap the rewards from the merger.

Q. IS UNION ELECTRIC COMPANY CURRENTLY OPERATING UNDER AN ALTERNATIVE REGULATION PLAN?

A. Yes. The company is currently operating under a sharing plan which is detailed in the Stipulation and Agreement filed in ER-95-411. Relevant pages of this Stipulation and Agreement are attached as Appendix A.

Q. PLEASE GIVE AN OVERVIEW OF SCHEDULE MB-3.

A. Schedule MB-3 calculates the percentage of merger-related savings which would be returned to ratepayers through UE's alternative regulation sharing grid under various regulatory treatments of claimed merger-related savings, transaction/transition costs, and the alleged merger premium. Although the current sharing plan expires in 1998, for comparison purposes Schedule MB-3 assumes the plan stays in effect through the year 2000.

MB-3, page 1, summarizes the levels of merger-related savings, above a base case, flowing to ratepayers and the company under three scenarios.

MB-3, page 2, (scenario 1) represents the merger transaction as proposed by UE, including recovery of the alleged merger premium and one-half net merger savings.

MB-3, page 3, (scenario 2) represents the same scenario as page 2 with the exception that UE is not allowed recovery of the alleged merger premium.

MB-3, page 4, (scenario 3) does not allow recovery of the alleged merger premium and does not allow explicit recovery of one-half net merger savings. Rather, all savings, net of transaction costs, are allowed to flow through the alternative regulation sharing grid.

Q. IS SCHEDULE MB-3 INTENDED TO PROVIDE DETAILED ESTIMATES OF UE'S RATE BASE AND NET OPERATING INCOME THROUGH THE YEAR 2000?

A. No. The purpose of the analysis is to show **relative** levels of savings returned to ratepayers under various regulatory treatments of claimed merger-related savings, transaction/transition costs, and the alleged merger premium. Realistic levels of and changes in rate base and net operating income (NOI), calculated from information supplied by UE, were used in the analysis in order to add validity. The *changes* in savings levels between scenarios are the focus of the analysis.

Q. HOW WERE PRO FORMA RATE BASE AND NET OPERATING INCOME CALCULATED ON SCHEDULE MB-3?

A. The 1996-2000 Rate Base and NOI pro forma estimates were calculated as follows:

NOI: The 31 January 1996 Monthly Financial Report submitted by UE to the MPSC shows total company NOI of ** __________ **, page 1, and Missouri retail electric NOI of ** __________ **, page 3. Missouri retail electric NOI therefore represents

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** ______ ** of company total (** ____________________ **). This percentage was used as UE's Missouri retail electric allocation factor for NOI.

Union Electric Company pro forma financial statements for the years 1996-2000 (company response to OPC DR 521, page 3a) shows total company NOI for years 1996-2000. These NOI estimates were multiplied by the Missouri retail electric allocation factor (** ______ **) to arrive at NOI estimates for the years 1996-2000 on Schedule MB-3. For example, UE's pro forma NOI for 1996 is ** _______ ** (million), multiplied by the allocation factor ** ______ ** gives Missouri retail electric NOI of ** ________ ** which is shown as 1996 NOI on Schedule MB-3.

Rate Base: The 31 January 1996 Monthly Financial Report submitted by UE to the MPSC shows Missouri retail electric rate base of ** ___________ ** (page 3). Company response to OPC DR 521, page 11, shows Union Electric Company balance sheet for 1995 and pro forma balance sheets for years 1996-2000. These balance sheets have a row labeled "Net Utility Plant in Service" with values for years 1995-2000. Percentage changes for Net Utility Plant in service were calculated for each year. The percentage change from 1995 to 1996 (** ______ **) was applied to the 1/31/96 Missouri retail electric rate base (** ________________________________ **) to calculate the 1996 rate base as shown on Schedule MB-3 (** ____________________________ **). 1997 rate base on Schedule MB-3 (** ________ **) was calculated by multiplying the 1996 rate base (** ________ **) by the percentage change in Net Utility Plant in Service from 1996 to 1997 (** ______ **). Rate base for years 1998-2000 were calculated similarly. Percentage changes are as follows:

Years	% change
1995 to 1996:	** ______ **
1996 to 1997:	** ______ **
1997 to 1998:	** ______ **
1998 to 1999:	** ______ **
1999 to 2000:	** ______ **

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Q. PLEASE CONTINUE EXPLAINING SCHEDULE MB-3.

A. Missouri Electric Total Savings were taken from Total Savings, Rainwater-Direct, Schedule 8 (also shown on Schedule MB-1), multiplied by UE's Missouri retail electric allocation factor of **______**, Rainwater-Direct, Schedule 9, page 2. Missouri Electric Transaction Costs were taken from Transaction Costs, Rainwater-Direct, Schedule 8, multiplied by the allocation factor, **______**. Merger Premium entries were taken from Merger Premium, Rainwater-Direct, Schedule 8, multiplied by the allocation factor, **______**.

Half Net Missouri Electric Savings entries on Schedule MB-3 were calculated as follows:

Missouri Electric Total Savings
minus Missouri Elec. Transaction Costs
minus Merger Premium
Equals: Net Merger Savings (not shown on MB-3)
Divided by 2 equals:
Half Net Missouri Electric Savings

This calculation on Schedule MB-3 is identical to the calculation of Net Merger Savings and 1/2 Net Merger Savings shown on Schedule 8, Rainwater-Direct, except here Rainwater's data have been scaled by the allocation factor, **______** in order to analyze Missouri retail electric jurisdiction values only.

"Net" NOI was calculated as shown on Schedule MB-3.

Return on Rate Base equals "net" NOI divided by Rate Base.

Return Portion to LTD and Preferred: Refer to Schedule MB-2.

Capital Structure: Refer to Schedule MB-2.

Achieved Cost of Common Equity: equal to Return Portion to Common Equity divided by Common Equity % (see Appendix A).

Sharing Grid Return to Ratepayers is based on the formulas in the alternative regulation sharing plan in effect for UE (see Appendix A).

Nonincremental percentage of savings to ratepayers equals the savings returned to ratepayers divided by the Missouri Electric Total Savings.

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The "Base Case" calculations in Schedule MB-3 use the same rate base and NOI values as the different merger scenarios, but do not include any merger-related savings or costs. Base case savings have been deducted from the savings levels on the bottom of pages 2-4, which are summarized on Schedule MB-3, page 1.

Q. WHY WAS A BASE CASE INCLUDED IN THE ANALYSIS ON SCHEDULE MB-3?

A. The base case calculates non-merger-related savings returned to ratepayers under the rate base and NOI assumptions. The levels of savings returned to ratepayers, net of base case, are therefore incremental values due to merger-related effects only.

Q. WHAT DOES SCHEDULE MB-3 SHOW?

A. Schedule MB-3 shows that when UE's earnings place it within the sharing grid, savings levels flowing to ratepayers are drastically effected by the regulatory treatment given the alleged merger premium and by including some savings in cost of service. Savings benefits to ratepayers the first year (1997) range from **____** under UE's proposal, to **____** if all savings are allowed to flow through the current sharing plan. Under UE's proposal and the rate base and NOI assumptions used on Schedule MB-3, ratepayers receive **____** of the savings in years 1998 and 1999.

For all four years covered on schedule MB-3, ratepayers receive **____** of the total merger-related savings under UE's proposal, and **____** if all savings are allowed to flow through the current sharing plan.

Q. HAS UE SUPPLIED UPDATED SAVINGS AND TRANSACTION COST ESTIMATES?

A. Yes. Company response to Staff DR 72 (updated) supplies updated estimates, which are shown on schedule MB-4. Schedule MB-4 also shows transaction costs allocated over the next ten years in proportion to the estimated savings in each year.

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Q. WERE THESE ESTIMATES ANALYZED IN ADDITION TO THE ORIGINAL ESTIMATES APPEARING IN RAINWATER - DIRECT, SCHEDULE 8?

A. Yes. An identical analysis was performed. This analysis is shown on schedule MB-5.

Q. WHAT DOES SCHEDULE MB-5 SHOW?

A. Although the exact savings levels returned to ratepayers are different, the percentage of savings flowing to ratepayers using updated estimates of savings and costs for each scenario are similar to the percentages using original estimates. Under UE's proposed regulatory treatment, ratepayers receive ** ____ ** of the merger-related savings in 1997, ** ____ ** in 1998, ** ____ ** in 1999, and ** ____ ** in 2000. This compares with the levels from schedule MB-3 of ** ____ ** of the merger-related savings in 1997, ** ____ ** in 1998, ** ____ ** in 1999, and ** ____ ** in 2000.

For all four years covered on schedule MB-5, ratepayers receive ** ____ ** of the total merger-related savings under UE's proposal, and ** ____ ** if all savings are allowed to flow through the current sharing plan. Again, using original estimates, these totals are ** ____ ** and ** ____ **.

Q. WHAT CONCLUSIONS CAN YOU DRAW FROM YOUR ANALYSIS OF THE MERGER TRANSACTION AS PROPOSED BY UNION ELECTRIC AND CIPSCO?

A. The regulatory treatment proposed by UE of merger transaction/transition costs and the alleged merger premium assures the company recovery of its claimed actual investment and the alleged merger premium regardless of whether any savings are actually achieved. After these amounts are deducted from the estimated savings and depending on where the company is in the current sharing grid, the company would then have first claim on any remaining merger related savings before ratepayers have an opportunity to benefit.

Ratepayers' ability to actually achieve a 50/50 sharing of net merger savings claimed by UE is highly questionable under the company's proposal.

NP

BURDETTE - Rebuttal

EM-96-149

Union Electric / CIPS Merger

Summary of Merger Savings, Investment, and Present Value Calculations

Summary of Merger Savings ($000s)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
Corporate and Administrative	$ 19,070	$ 17,800	$ 19,185	$ 20,618	$ 22,103	$ 19,705	$ 20,361	$ 21,040	$ 21,744	$ 22,472	$ 204,098
Staffing	$ 3,703	$ 7,768	$ 12,216	$ 17,070	$ 22,351	$ 23,684	$ 25,063	$ 26,492	$ 27,970	$ 29,500	$ 195,817
Electric Production	$ 7,752	$ 6,412	$ 6,419	$ 5,652	$ 5,756	$ 6,441	$ 6,348	$ 10,446	$ 13,346	$ 15,567	$ 84,139
Materials Purchasing	$ 4,619	$ 5,077	$ 5,551	$ 6,041	$ 6,548	$ 7,073	$ 7,617	$ 8,179	$ 8,762	$ 9,364	$ 68,831
Natural Gas	$ 3,091	$ 3,215	$ 3,343	$ 3,477	$ 3,616	$ 3,761	$ 3,911	$ 4,068	$ 4,230	$ 4,399	$ 37,111
Total Gross Savings	$ 38,235	$ 40,272	$ 46,714	$ 52,858	$ 60,374	$ 60,664	$ 63,300	$ 70,225	$ 76,052	$ 81,302	$ 589,996
Transaction Costs	$ 2,655	$ 2,796	$ 3,244	$ 3,670	$ 4,192	$ 4,213	$ 4,396	$ 4,877	$ 5,282	$ 5,646	$ 40,971
Merger Premium	$ 15,038	$ 15,838	$ 18,373	$ 20,790	$ 23,746	$ 23,860	$ 24,897	$ 27,622	$ 29,913	$ 31,979	$ 232,056
Total Merger Investment	$ 17,693	$ 18,634	$ 21,617	$ 24,460	$ 27,938	$ 28,073	$ 29,293	$ 32,499	$ 35,195	$ 37,625	$ 273,027
Net Merger Savings	$ 20,542	$ 21,638	$ 25,097	$ 28,398	$ 32,436	$ 32,591	$ 34,007	$ 37,726	$ 40,857	$ 43,677	$ 316,969

Merger Investment ($000s)

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
Total Merger Investment	$ 17,693	$ 18,634	$ 21,617	$ 24,460	$ 27,938	$ 28,073	$ 29,293	$ 32,499	$ 35,195	$ 37,625	$ 273,027
Half of Net Merger Savings	$ 10,271	$ 10,819	$ 12,549	$ 14,199	$ 16,218	$ 16,296	$ 17,004	$ 18,863	$ 20,429	$ 21,839	$ 158,485
Net Allocation to Cost of Service	$ 27,964	$ 29,453	$ 34,166	$ 38,659	$ 44,156	$ 44,369	$ 46,297	$ 51,362	$ 55,624	$ 59,464	$ 431,512
Net Available to Customer	$ 10,271	$ 10,819	$ 12,549	$ 14,199	$ 16,218	$ 16,296	$ 17,004	$ 18,863	$ 20,429	$ 21,839	$ 158,485

Source: Rainwater - Direct, Schedule 8.

Present Value Calculations ($000s) of Company claimed Merger Investment and Gross Savings

Discount Rate 9.52%

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	Total
Present Value of Total Merger Investment	$ 16,155	$ 15,535	$ 16,456	$ 17,001	$ 17,731	$ 16,268	$ 15,499	$ 15,701	$ 15,525	$ 15,155	$ 161,026
Present Value of Gross Merger Savings	$ 34,911	$ 33,575	$ 35,560	$ 36,740	$ 38,316	$ 35,154	$ 33,493	$ 33,927	$ 33,548	$ 32,747	$ 347,971

Present Value of Total Merger Investment	$	161,026
Present Value of Gross Merger Savings	$	347,971
Present Value of Merger:	$	186,945

Discount rate from company response to OPC DR 2002.

BURDETTE - Rebuttal
EM-96-149
Union Electric / CIPS Merger

Common Equity	$ 2,319,197	53.92%		
LTD	$ 1,763,613	41.00%	7.17%	2.94%
Preferred	$ 218,497	5.08%	6.14%	0.31%
	$ 4,301,307	100.00%		3.25%

Company's Cost of LTD and Preferred: $\boxed{\textbf{3.25\%}}$

Source: OPC DR 2005

BURDETTE - Rebuttal
EM-96-149
Union Electric / CIPS Merger

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Schedule Which Consists

of Pages 1 - 4

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HIGHLY CONFIDENTIAL

REVISED SAVINGS AND TRANSACTION DATA

Summary of Total Merger Savings and Transition Costs

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EM-96-149
Union Electric / CIPS Merger

Union Electric
10 Year Historical Financial Information

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	Average	Last 5 yr. Average
Return on Equity	18.16%	16.79%	14.08%	14.03%	14.16%	14.99%	13.70%	13.01%	13.84%	13.23%	13.92%	13.75%
Earnings per share	$ 2.96	$ 2.91	$ 2.56	$ 2.61	$ 2.74	$ 3.01	$ 2.83	$ 2.77	$ 3.01	$ 2.95	$ 2.62	$ 2.91
Dividends per share	$ 1.86	$ 1.92	$ 1.94	$ 2.02	$ 2.10	$ 2.18	$ 2.26	$ 2.335	$ 2.395	$ 2.46	$ 2.05	$ 2.33
Payout Ratio	62.84%	65.98%	75.78%	77.39%	76.64%	72.43%	79.86%	84.30%	79.57%	83.22%	75.80%	79.88%
Book Value per share	$ 17.07	$ 17.99	$ 18.56	$ 19.14	$ 19.79	$ 20.62	$ 21.19	$ 21.60	$ 22.22	$ 22.71	$ 19.20	$ 21.67

Capital Structure

	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	Average	Last 5 yr. Average
Common Equity	37.10%	39.80%	42.80%	45.60%	48.30%	51.90%	53.50%	52.60%	52.60%	53.90%	45.06%	52.90%
Preferred Stock	11.10%	9.10%	7.70%	5.30%	5.20%	5.40%	5.40%	5.20%	5.10%	5.10%	7.49%	5.24%
Long Term Debt	51.80%	51.10%	49.50%	49.10%	46.50%	42.70%	41.10%	42.20%	42.30%	41.00%	47.45%	41.86%
	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Source: Union Electric 1995 Annual Report to Shareholders

3. **Experimental Alternative Regulation Plan**

a. An Experimental Alternative Regulation Plan ("the Plan") will be instituted and the Commission will create a new docket to facilitate that Plan ("Plan Docket") in its Report and Order approving this Stipulation and Agreement. All signatories to this Stipulation and Agreement shall be made parties to the Plan Docket, as intervenors or as a matter of right, without the necessity of taking further action.

b. The following "Sharing Grid" is to be utilized as part of the Plan:

Earnings Level (Missouri Retail Electric Operations)	Sharing Level	Sharing Level
	UE	Customer
Up to and including 12.61% Return on Equity (ROE)	100%	0%
That portion of earnings greater than 12.61% up to and including 14.00% ROE	50%	50%
That portion of earnings greater than 14.00% ROE	0%	100%

c. The Plan will be in effect for a full three year period. For purposes of this Plan, there shall be three (3) "Sharing Periods." The first Sharing Period shall be from July 1, 1995 through June 30, 1996; the second, from July 1, 1996 through June 30, 1997; and the third, from July 1, 1997 through June 30, 1998. UE may not file an electric rate

UNION ELECTRIC COMPANY
CAPITAL STRUCTURE AND
EMBEDDED COST OF DEBT AND PREFERRED

BEGINNING OF SHARING PERIOD

	(i) Capital Structure (Dollars)	(ii) %	(iii) Embedded Cost	(iv) Wgtd Avg Cost
Common Stock Equity *			N/A	N/A
Preferred Stock				col. (ii)
Long-Term Debt				times
Short-Term Debt	(if applicable)			col. (iii)
Total Capitalization				
Return Portion Related to Debt and Preferred				Sum col. (iv)

END OF SHARING PERIOD

	(v) Capital Structure (Dollars)	(vi) %	(vii) Embedded Cost	(viii) Wgtd Avg Cost
Common Stock Equity *			N/A	N/A
Preferred Stock				col. (vi)
Long-Term Debt				times
Short-Term Debt	(if applicable)			col. (vii)
Total Capitalization				
Return Portion Related to Debt and Preferred				Sum col. (viii)

Return Portion Related to Debt and Preferred
Average Beginning and End of Sharing Period

Average Common Stock Equity *
Beginning and End of Sharing Period (%)

* Since common dividends payable at the end of a quarter and preferred dividends payable during the subsequent quarter are removed from common equity in their entirety during the first month of every quarter, the balance for common stock equity for the end of the first or second month in each quarter (if used as the beginning or end of the sharing period) should be adjusted from actual book value. The balance for the end of the first month in the quarter should be adjusted by adding back two-thirds of the quarterly preferred and common dividend. The balance for the end of the second month in the quarter should be adjusted by adding back one-third of the quarterly preferred and common dividend.

UNION ELECTRIC COMPANY
12 MONTHS ENDED XX / XX / XX

	TOTAL ELECTRIC	MISSOURI JURISDICTIONAL
Plant in Service	$	$
Reserve for Depreciation		
Net Plant		
Add:		
Fuel and Materials & Supplies		
Cash Working Capital		
Prepayments		
Less:		
Income Tax Offset (Staff Method)		
Interest Expense Offset (Staff Method)		
Customer Advances		
Customer Deposits		
Accumulated Deferred Income Taxes:		
Account 190		
Account 282		
(A) Total Rate Base	$	$
(B) Net Operating Income	$	$
(C) Return on Rate Base ((B) / (A))	%	%
(D) Return Portion Related to Debt & Preferred	%	%
(E) Return Portion Related to Common Equity ((C) – (D))	%	%
(F) Equity Percentage of Capital Structure	%	%
(G) Achieved Cost of Common Equity ((E) / (F))	%	%