Exhibit No.:	
Issues:	Merger Savings and Costs, Regulatory Plan
Witness:	Brubaker
Type of Exhibit:	Direct Testimony
Sponsoring Party:	MIEC
Company:	Union Electric Company
Case No.:	EM-96-149

Before the

Missouri Public Service Commission

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**

Direct Testimony of

MAURICE BRUBAKER

On Behalf of

Missouri Industrial Energy Consumers

FILED

MAY 7 - 1996

MISSOURI
PUBLIC SERVICE COMMISSION

May 1996
Project 6424

Brubaker & Associates, Inc.
St. Louis, Missouri 63141-2000

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Affidavit of Maurice Brubaker

State of Missouri)
) SS
County of St. Louis)

Maurice Brubaker, being first duly sworn on his oath, states:

1. My name is Maurice Brubaker. My business address is 1215 Fern Ridge Parkway, Suite 208, P. O. Box 412000, St. Louis, Missouri 63141-2000. I am a consultant in the field of public utility regulation and a principal in the firm of Brubaker & Associates, Inc.

2. Attached hereto and made a part hereof for all purposes is my Direct Testimony consisting of pages 1 through 15, and Appendix A, inclusive, all of which testimony has been prepared in written form for introduction into evidence in the above-referenced docket.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct.

Maurice Brubaker

Maurice Brubaker

Subscribed and sworn to before me this 6th day of May, 1996.

Carol Schulz

Notary Public

My Commission expires February 26, 2000

Before the

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Direct Testimony of Maurice Brubaker

Q **PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A Maurice Brubaker. My business mailing address is P. O. Box 412000, St. Louis, Missouri 63141-2000.

Q **PLEASE STATE YOUR OCCUPATION.**

A I am a consultant in the field of public utility regulation and a principal in the firm of Brubaker & Associates, Inc.

Q **PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

A This is included in Appendix A to my testimony.

Q **ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?**

A I am appearing on behalf of the Missouri Industrial Energy Consumers (MIEC). MIEC member companies purchase substantial amounts of power from Union Electric

Company (UE) in Missouri, and are vitally concerned with the proposed merger and its potential impacts.

Q HAVE YOU REVIEWED THE APPLICATION OF UNION ELECTRIC COMPANY, ALONG WITH THE SUPPORTING TESTIMONY AND EXHIBITS FILED IN THIS PROCEEDING?

A Yes. In addition, I have reviewed UE's and CIPS' (hereafter sometimes referred to collectively as the Utilities) responses to numerous data requests as well as the filings made with the Federal Energy Regulatory Commission (FERC) and the Illinois Commerce Commission.

Q PLEASE SUMMARIZE YOUR KEY FINDINGS AND RECOMMENDATIONS.

A These may be summarized as follows:

(1) During the first ten years under the proposed regulatory plan, UE wants shareholders to receive compensation equal to 100% of the estimated transaction costs and the premium paid for CIPS stock.

(2) After being fully compensated for transaction costs and the stock premium, UE wants to give shareholders 50% of the remaining net merger savings over the first ten post-merger years.

(3) Under the regulatory plan as proposed, UE wants a guarantee, up front, of the dollar amount of merger savings that would be flowed to shareholders, and does not propose to make any showing in future proceedings as to the amount of savings actually produced by the merger.

(4) The merger savings, as presented by UE, can only be regarded as extremely preliminary, and are not sufficiently precise or supported to warrant definitive use.

(5) Overall, the estimated net merger savings which would go to customers under UE's proposal are a relatively small percentage (1/2 of one percent) of the combined total revenues of the Utilities.

(6) Approval of the regulatory plan as proposed by UE would place all customers (of both CIPS and UE) at significant risk.

(7) Because of the "earnings sharing" plan in effect in Missouri, the result of the regulatory plan proposed in this proceeding could be to reduce the actual share of savings which flows to customers to 25% if UE's earnings fall in the range of 12.61% to 14.0%, and to zero if the earnings fall below 12.61%.

Based on the foregoing:

☞ **The Commission should not approve any specific regulatory plan in this proceeding. Rather, it should indicate to UE that it will permit recovery of merger costs in future proceedings if UE can demonstrate the existence of these costs and establish that savings which have resulted from the merger are larger than the costs for which recovery is sought.**

☞ **If the Commission does decide to approve a regulatory plan in this proceeding, then it should require that the "earnings sharing" plan be modified so that customers receive their intended share.**

☞ **If UE is to be permitted to make claims, in the future, for recovery of merger costs and a share of merger savings, then it is essential to define the starting point for the measurement of merger savings. Under these circumstances, UE should be required to undergo a complete rate case proceeding in order to establish appropriate costs and rate levels on a pre-merger basis. This is essential to avoid counting as merger savings those cost reductions and efficiencies that occurred prior to the merger. For example, if UE's current rates are $30 million higher than they would be based on a full pre-merger revenue requirement evaluation, then failure to adjust rates down to that level would build in $30 million which could erroneously be interpreted as merger savings in future periods.**

Q DOES THIS CONCLUDE A SUMMARY OF YOUR KEY FINDINGS AND RECOMMENDATIONS?

A Yes.

REGULATORY PLAN

Q PLEASE DESCRIBE THE REGULATORY PLAN PROPOSED BY UE.

A UE contends that $41 million will be expended for transaction costs, and that CIPS' shareholders will receive $232 million in the form of a market value premium on the stock price, in order to effectuate the merger.

The Utilities contend that over the first ten years they will produce $590 million of savings which they claim will be attributable solely to the merger. From the $590 million, the Utilities propose to assign $273 million to shareholders as compensation for transaction costs and to cover the merger premium. This leaves $317 million as net merger savings.

Further, the Utilities want to give 50% of these net merger savings, or $158 million, to shareholders; leaving approximately $158 million as the total amount available for customers over this ten-year period.

Q HOW DO THESE ESTIMATED NET MERGER SAVINGS WHICH THE UTILITIES WOULD PROPOSE TO PROVIDE TO CUSTOMERS COMPARE WITH THE COMBINED TOTAL REVENUES OF THE UTILITIES?

A The Utilities have total combined revenues of almost $3 billion. Accordingly, the customers' share of estimated net merger savings, which averages about $16 million over each of the first ten post-merger years, would be only about one-half of 1% (0.5%) of total revenues—an extremely small amount in relation to total sales.

Q **DOES UE PROPOSE ANY PLAN OR MECHANISM FOR DEMONSTRATING, IN THE FUTURE, THE EXTENT TO WHICH IT HAS CREATED SAVINGS AS A RESULT OF THE MERGER?**

A No, it does not. UE witness Rainwater contends at Page 24 of his Direct Testimony that tracking and documenting merger savings would be literally impossible. Instead, the Utilities want the Commission to approve, now, based on the evidence submitted so far, a specific ten-year plan containing preapproved amounts to be charged to customers and given to stockholders.

Q **DO YOU AGREE WITH MR. RAINWATER THAT IT WOULD BE DIFFICULT TO ACCURATELY TRACK MERGER SAVINGS OVER THE NEXT TEN YEARS?**

A I agree that a precise tracking would be difficult, and would require many assumptions. However, the Utilities are asking their regulatory commissions to approve charging customers $431 million over the next ten years. If they want that entitlement, then it is incumbent upon them to figure out a way to demonstrate that the savings created as a result of the merger exceed the amounts to be recovered.

Q **WHAT DANGER DOES THE PROPOSED PLAN POSE FOR CUSTOMERS?**

A The obvious danger posed is that customers may compensate stockholders at a predetermined level, but actually wind up worse off than they would have been absent the merger, if the estimated savings attributed to the merger are not in fact realized.

For example, if gross merger savings are estimated to be $1,000, and $750 is promised to shareholders, customers receive their $250 share only if the full amount of the expected merger savings is in fact realized. If actual merger savings are less than estimated, customers receive either a smaller share of the overall savings, or wind up being worse off because of having to support payments to shareholders that exceed the available merger savings.

Q **DOES UE HAVE IN PLACE AN "EARNINGS SHARING" PLAN IN MISSOURI?**

A Yes. An earnings sharing plan was adopted for UE, in its Missouri jurisdiction, last summer. Essentially, it contemplates a 50%/50% sharing of earnings between shareholders and customers if earnings are in the range of 12.61% to 14.0% on equity. Above 14% return on equity, 100% of the additional earnings is provided to customers, and below 12.61% there is no sharing.

Q **HOW DOES THIS EARNINGS SHARING PLAN AFFECT THE PROPOSED SHARING OF MERGER SAVINGS IN UE'S PROPOSED REGULATORY PLAN?**

A UE's proposed regulatory plan would provide, if all estimate are accurate, 50% of net merger savings to customers. If the result of the evaluation under the earnings sharing plan is that UE was earning in the range of 12.61% to 14.0%, then 50% of the 50% would be retained by shareholders, and the other 50% of the 50% would flow to customers, reducing their share of the estimated net merger benefits to 25%. Or, if UE's earnings were below 12.61% in a particular evaluation period, then no part of the estimated merger savings would flow to customers, all would be retained by shareholders.

Q WHAT DOES THIS INTERACTION IMPLY FOR THE EARNINGS SHARING PLAN OR THE PROPOSED REGULATORY PLAN?

A This clearly points out that should the Commission (against my recommendations) adopt the regulatory plan proposed by UE, that the earnings sharing plan must be modified so that the share of net savings which the regulatory plan identifies for customers could, in fact, actually flow to customers.

SAVINGS ESTIMATES

Q YOU HAVE NOTED THAT THE MERGER SAVINGS ARE STRICTLY ON AN ESTIMATED BASIS. HAVE YOU REVIEWED THE WORKPAPERS SUPPORTING THE ESTIMATED MERGER SAVINGS?

A Yes. I have reviewed the workpapers of Mr. Flaherty and the workpapers of Ms. Borkowski. Ms. Borkowski addresses the "electric production" savings, and Mr. Flaherty addresses the other areas of savings.

Q HOW MUCH HAVE THE UTILITIES ESTIMATED AS "ELECTRIC PRODUCTION" SAVINGS?

A Over the ten-year period they have estimated a total savings of approximately $84 million. The savings start out at approximately $8 million in the first year, decrease to about $6 million, and then increase to approximately $16 million by the tenth year.

Q DOES THE ANALYSIS PERFORMED BY THE UTILITIES DEMONSTRATE ELECTRIC PRODUCTION SAVINGS?

A No. The analysis performed by the Utilities is incomplete. The study does not consider the effects of economy or similar interchange between UE and CIPS on a pre-merger basis. It also does not consider interchange between CIPS and third parties on a pre-merger basis, nor does it fully consider interchange between the combined entity and third parties on a post-merger basis. Sales of power to other systems is also excluded.

Q WHAT IS THE IMPACT OF NOT FULLY ACCOUNTING FOR THE EFFECT OF ECONOMY INTERCHANGE?

A The effect is to overstate the cost savings. CIPS has relatively high fuel costs, and by ignoring the possibility of interchange on a CIPS stand-alone basis, the study forces CIPS to serve all of its own load with its own high cost generation. Then, when the systems are combined, apparent savings are created by allowing the lower cost UE generation to displace some of the higher cost CIPS generation. Since CIPS, as a stand-alone entity, can engage in economy transactions with UE, and with a variety of other systems—and in fact does—the electric production study produced by the Utilities in this proceeding overstates the cost to CIPS of serving its own load on a stand-alone basis, and thereby overstates the claimed production cost savings associated with the merger.

The exclusion of sales to other electric utility systems also makes the comparison unreliable. Currently (pre-merger) both CIPS and UE engage in substantial interchange transactions. Power is purchased from certain utility systems and effectively "marked up" and then resold to other utility systems. As a part of the merger, the utilities will file a single transmission tariff which will permit other utilities to engage directly in sales transactions with one another, without UE or CPS serving as the "middle man" in the sales transaction. Instead, UE/CIPS will receive revenue under the open access transmission tariff for the use of the transmission system, but will not receive a "markup" on the sales transaction itself. To the extent that the additional transmission revenue is less than the foregone "markup," the net effect of the merger on net cost of service will be negative. The modeling conducted by the utilities in this case is insufficient to disclose these consequences, and is therefore incomplete and unrepresentative. It should be given no weight.

Q **IN ADDITION TO ELECTRIC PRODUCTION SAVINGS, DO THE UTILITIES CLAIM SAVINGS IN A NUMBER OF OTHER CATEGORIES?**

A Yes. As previously noted, savings in these areas are outlined in the testimony of Mr. Flaherty. These are set forth by year, by category, on Page 2 of his Schedule 2.

Q **HAVE YOU REVIEWED THE UTILITIES' CONTENTION CONCERNING REDUCTIONS IN LABOR AND LABOR-RELATED COSTS?**

A Yes. The Utilities contend that, solely as a result of the merger, they will be able to reduce the number of employees by 295; resulting in annual labor savings ranging from \$3.7 million in 1997 to approximately \$30 million in the year 2006, and totaling \$196 million over the first ten-year post-merger period.

Q HAVE YOU HAD AN OPPORTUNITY TO REVIEW MR. FLAHERTY'S WORKPAPERS SUPPORTING THE REDUCTION IN THE NUMBER OF EMPLOYEES?

A Yes. The workpapers basically show the number of employees, by function and sub-function, for both CIPS and UE on a pre-merger basis, and then present a column of numbers totaling 295 that is characterized as the reduction as a result of the merger. There are no workpapers providing any detail with respect to the specific analysis which lead to the conclusion that this number of employees could be reduced solely, and only, as a result of the merger.

Q DO THE WORKPAPERS CONTAIN INFORMATION LABELED "INDUSTRY BENCHMARK-COMBINATION UTILITIES"?

A Yes. The workpapers include information which applies certain ratios or statistics to both UE and CIPS on a pre-merger basis, in order to determine the number of personnel involved in various functions of both Utilities if their performance were consistent with a survey conducted by a management consulting firm which benchmarks performance of combination utilities in terms of various measurements. In particular, the analysis looks at different categories of employees and determines what the number would be if UE and CIPS performed at a level equal to that typified by the bottom end of the top quartile (25%) of utilities, and again at the middle of the top quartile (top 12.5%) of the utilities used in the benchmark study.

The comparison looks at such measurements as number of employees in certain support functions as a percentage of total employees, number of employees in certain support functions per customer, number of employees in certain functions per million megawatthours of sales or million dekatherms of gas, etc.

Q WHAT WAS THE RESULT OF THIS BENCHMARKING?

A The benchmark study was quite revealing. It showed that to achieve performance at the bottom of the top quartile of the surveyed utilities, CIPS and UE would have had to reduce pre-merger employee levels by substantially more than the 295 employee reduction claimed for the merger. This suggests that the employee reductions attributed to the merger should have been achievable absent the merger.

At the very least, it should be recognized that if the two individual Utilities, on a pre-merger basis, have employees in addition to those actually required to effectively perform the job functions, it will be easier to "find" duplicate employees when the two organizations are merged. This could easily result in employee reductions that should have occurred even in the absence of the merger being counted toward merger savings.

Q TO WHAT EXTENT DID MR. FLAHERTY RELY UPON THIS BENCHMARK DATA?

A There is no indication that it was relied upon in developing the reduction in employees attributable to the merger. I assume, however, that it was included in the workpapers for some purpose, and the fact that it demonstrates that both Utilities were staffed at a level much higher than utilities performing at the top end should not go unnoticed.

Q ARE THERE ANY FOOTNOTES OR OTHER STATEMENTS THAT EXPRESS RESERVATIONS ABOUT THE USE OF THESE STATISTICS?

A No. The workpapers do not contain any cautions, caveats, or reservations concerning the applicability of these specific numbers to UE and CIPS. All the calculations which show that the reductions in employees necessary to reach the bottom or middle of the top quartile were performed by Mr. Flaherty, and not by me.

Q **HAVE YOU REVIEWED THE CLAIMED SAVINGS IN THE PROFESSIONAL SERVICES CATEGORY?**

A Yes. These claimed savings start out at a level of $4.4 million in 1997 and increase to $5.9 million in the year 2006, and total $51 million over the first ten years of the post-merger period.

Q **ARE THESE SAVINGS BASED ON A DETAILED ANALYSIS?**

A No. Only 27% of the estimated savings (that pertaining to regulatory and SEC legal fees and a reduction in audit fees) is the result of any specific analysis. The remaining 73% of the estimated savings was derived simply by applying a 5% or 10% reduction to expenditures in the engineering, other legal, collections and general consulting categories of the two companies as stand-alone entities. The workpapers do not provide any detail or basis to support these 5% and 10% savings estimates.

Q **HAVE YOU REVIEWED THE CLAIMED SAVINGS IN THE CONTRACT SERVICES CATEGORY?**

A Yes. The claimed savings in this area begin at $1.5 million in 1997 and increase to $3.9 million in 2006, totaling approximately $27 million over this ten-year period.

Q IS THERE ANY ANALYSIS TO DETERMINE THE ESTIMATED SAVINGS?

A No. The savings are estimated by applying 2% to the combined pre-merger costs of the two companies to capture purchasing economies, and by applying 4% to tree trimming expenses. There is no analysis provided to support either of these two savings percentages.

Q HAVE YOUR REVIEWED THE CLAIMED SAVINGS IN THE PROCUREMENT AND INVENTORY CATEGORIES?

A Yes. Procurement savings are estimated at $2.4 million in 1997, increasing to $4.7 million in 2006, and totaling $35 million over this ten-year period. No specific evaluation to determine savings is provided in the workpapers; rather, a 5% savings is assumed and applied to the total of stand-alone costs. No workpapers are provided to support the reasonableness of the assumed 5% savings.

The inventory reduction estimate is $760,000 per year for ten years, or a total of $7.6 million. It is based on a savings estimate of 10% of general materials inventory, as a reduction in investment, to which a carrying charge rate is applied to determine the estimated savings. No evaluation is included to support the 10% reduction.

Q DOES THE FACT THAT YOU HAVE NOT COMMENTED ON CERTAIN AREAS OF CLAIMED SAVINGS MEAN THAT YOU NECESSARILY AGREE WITH THE UTILITIES' ESTIMATES?

A No. I have commented on certain major areas of claimed savings as noted above for the purpose of demonstrating that the bases for these estimates are questionable. The fact that I have not commented on certain other categories of savings does not mean that I necessarily agree that the Utilities' estimates are reasonable.

Q WHAT IS YOUR OVERALL RECOMMENDATION?

A It is my recommendation that the Commission not preapprove recovery of any particular merger or merger-related costs in this proceeding. Rather, the Commission should indicate to the Utilities that it will permit recovery of valid merger costs in future proceedings if the Utilities are able to demonstrate the existence of these costs, and also to establish that the savings which have actually resulted from the merger are sufficient to more than recover the costs for which recovery is sought, and provide a fair result for customers.

NEED FOR A RATE PROCEEDING TO ESTABLISH PRE-MERGER RATE LEVELS ON A COST OF SERVICE BASIS

Q IF UE IS PERMITTED TO SEEK, IN FUTURE PROCEEDINGS, RECOVERY OF MERGER COSTS AND/OR A SHARE OF MERGER SAVINGS, WHAT SHOULD BE REQUIRED IN THE WAY OF A RATE DETERMINATION?

A If UE is to be permitted to request, in future proceedings, the opportunity to recover merger-related costs and/or a share of claimed merger savings, then it is important to begin with a set of rates that are based on pre-merger cost levels. This is necessary to avoid the potential for allowing UE to count, in future cases, reduction in costs as merger savings—when, in fact, those cost reductions had already been achieved prior to the merger. In other words, the base should be the rates as they would be set on a cost of service basis prior to consideration of any effects resulting from the merger. The test year should be the most recent test year otherwise appropriate for a full rate proceeding and, if necessary, adjustments should be made to eliminate any costs, or cost savings, attributable to the merger.

Unless the starting point is properly established on a pre-merger cost of service basis the measurement of merger savings will be impaired. For example, if UE's rates, pre-merger, turn out actually to be $30 million above where they would have been if established on a current cost of service basis, then potentially $30 million of what should have amounted to a cost-based rate reduction, but for the merger, could inadvertently be counted as merger savings—resulting in a reward to the Utilities. This problem can be solved by establishing the rates on a pre-merger cost of service basis.

Q DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A Yes, it does.

Qualifications of Maurice Brubaker

Q **PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A Maurice Brubaker. My business mailing address is P. O. Box 412000, St. Louis, Missouri 63141-2000.

Q **PLEASE STATE YOUR OCCUPATION.**

A I am a consultant in the field of public utility regulation and a principal in the firm of Brubaker & Associates, Inc.

Q **PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.**

A I was graduated from the University of Missouri in 1965, with a Bachelor's Degree in Electrical Engineering. Subsequent to graduation I was employed by the Utilities Section of the Engineering and Technology Division of Esso Research and Engineering Corporation of Morristown, New Jersey, a subsidiary of Standard Oil of New Jersey.

In the Fall of 1965, I enrolled in the Graduate School of Business at Washington University in St. Louis, Missouri. I was graduated in June of 1967 with the Degree of Master of Business Administration. My major field was finance.

From March of 1966 until March of 1970, I was employed by Emerson Electric Company in St. Louis. During this time I pursued the Degree of Master of Science in Engineering at Washington University, which I received in June, 1970.

In March of 1970, I joined the firm of Drazen Associates, Inc., of St. Louis, Missouri. Since that time I have been engaged in the preparation of numerous studies relating to electric, gas, telephone and water utilities. These studies have included analyses of the cost to serve various types of customers, the design of rates for utility services, cost forecasts, cogeneration rates and determinations of rate base and operating income.

I have testified before the regulatory commissions of Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Florida, Georgia, Guam, Hawaii, Illinois, Indiana, Iowa, Kentucky, Louisiana, Michigan, Missouri, New Jersey, New Mexico, New York, North Carolina, Ohio, Pennsylvania, Rhode Island, South Carolina, South Dakota, Texas, Utah, Virginia, West Virginia, Wisconsin and Wyoming.

The firm of Drazen-Brubaker & Associates, Inc. was incorporated in 1972 and assumed the utility rate and economic consulting activities of Drazen Associates, Inc., founded in 1937. In April, 1995 the firm of Brubaker & Associates, Inc. was formed. It includes most of the former DBA principals and staff. Our staff includes consultants with backgrounds in accounting, engineering, economics, mathematics, computer science and business.

We have prepared many studies relating to electric, steam, gas and water properties, including cost of service studies in connection with rate cases and negotiation of contracts for substantial quantities of gas and electricity for industrial use. In these cases, it was necessary to analyze property records, depreciation accrual rates and reserves, rate base determinations, operating revenues, operating expenses, cost of capital and all other elements relating to cost of service.

During the past five years, Brubaker & Associates, Inc. and its predecessor firm has participated in over 500 major utility rate cases and statewide generic investigations before utility regulatory commissions in 40 states, involving electric, gas, water, steam and telephone rates. Rate cases in which the firm has been involved have included more than 80 of the 100 largest electric utilities and over 30 gas distribution companies and pipelines.

In addition to our main office in St. Louis, the firm also has branch offices in Austin, Texas and Denver, Colorado.