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November 21, 2000

Dale Hardy Roberts
Missouri Public Service Commission
P.O. Box 360
Jefferson City, MO 65102

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Missouri Public Service Commission

Re: Case No. EM-2000-369

Dear Mr. Roberts:

Enclosed for filing on behalf of UtiliCorp United Inc. and The Empire District Electric Company, please find an original and eight (8) copies of a Reply Brief in the referenced case.

Copies of this filing will be provided to all parties of record.

Would you please see that this filing is brought to the attention of the appropriate Commission personnel.

I thank you in advance for your cooperation in this matter.

Sincerely yours,

James C. Swearengen

James C. Swearengen

JCS/lar
Enclosure
cc: All Parties of Record

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Joint Application of UtiliCorp United Inc. and The Empire District Electric Company for authority to merge with and into UtiliCorp United Inc. and, in connection therewith, certain other related transactions.	)	Case No. EM-2000-369

REPLY BRIEF OF UTILICORP UNITED INC. AND THE EMPIRE DISTRICT ELECTRIC COMPANY

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I. INTRODUCTION AND OVERVIEW

This Reply Brief is submitted in response to the Initial Briefs of the Staff of the Missouri Public Service Commission ("Staff"), the Office of the Public Counsel ("Public Counsel"), the City of Springfield ("Springfield"), the Missouri Department of Natural Resources ("DNR"), Praxair, Inc. ("Praxair") and International Brotherhood of Electric Workers Local 1474 ("IBEW").

In deciding this case, the Commission is faced with two fundamental and overriding issues. The first is whether the proposed merger between UtiliCorp and Empire should be approved under the "not detrimental to the public interest" legal standard. The second is what conditions, if any, should be placed on the transaction.

UtiliCorp respectfully submits that the merger meets the legal standard and must be approved on that basis. UtiliCorp also submits that the conditions which should attach to the approval are those set out in its Proposed Regulatory Plan - - conditions which are designed to make the transaction economically feasible to UtiliCorp's shareholders who bear the risk of the transaction.

With respect to the Regulatory Plan, it is important to remember that UtiliCorp's shareholders will invest approximately $850-900 million to acquire the ownership of Empire. (Ex. 3, p. 3). This equates to a $29.50 per share purchase price which is about 27% above Empire's stock trading value just before the merger was announced (Ex. 14, p. 12). This purchase price reflects a premium of approximately $280 million, an amount based on the difference between the book value and the contract price. This amount is referred to as the "acquisition premium." (Ex. 3, p. 3). <u>The transaction would not take place absent this premium</u>

which is a precondition to the merger and the unlocking of the potential merger savings. (Ex. 14, p. 11). It is the payment of this premium by UtiliCorp's shareholders, however, which creates the risk which necessitates a plan which will allow these shareholders a reasonable opportunity to recover their investment. UtiliCorp entered into this transaction with the expectation that, based upon prior actions of this Commission, it would have a reasonable opportunity for premium recovery - - and that is what the Regulatory Plan is designed to accomplish. (Ex. 14, p. 11).

II. ARGUMENT

The Staff's Initial Brief presents several arguments as to why the Commission should reject the merger as "detrimental to the public interest." (See Initial Brief of Staff at 38-40.) By responding to these arguments raised by the Staff, UtiliCorp will address essentially the substance of all the issues raised in the initial briefs of the other parties. Moreover, it should be noted that while the Staff's Initial Brief is some 228 pages in length, nowhere in that document does the Staff attempt to apply the applicable legal standard to the involved facts. Given the Staff's opposition to this transaction, the reason for this failure is readily apparent. An application of the legal standard to the facts demonstrates that the merger must be approved.

The Applicable Legal Standard

Because of the failure of the Staff to apply the legal standard to the facts, it is worthwhile to revisit that standard.

In determining whether to authorize a merger under § 393.190 RSMo, the Commission is required by law to decide whether the transaction is "detrimental to the public," the standard established by the Missouri Supreme Court in *State ex rel. City of St. Louis v. Public Service Commission*, 73 S.W.2d 393 (Mo. 1934). In that case, the Missouri Supreme Court stated:

> To prevent injury to the public, in the clashing of private interest with public good in the operation of public utilities, is one of the most important functions of Public Service Commissions. It is not their province to insist that the public shall be *benefited*, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public *detriment*. "In the public interest," in such cases, can reasonably mean no more than "not detrimental to the public." (Italics supplied.)

Id. at 400.

In its decision emphasizing that a regulatory commission must not affirmatively find that a change in ownership of a utility is in the public interest, the Missouri Supreme Court said:

> "[t]he owners of this stock should have something to say as to whether they can sell it or not. To deny them that right would be to deny to them an incident important to ownership of property . . . A property owner should be allowed to sell his property unless it would be detrimental to the public." (Emphasis added: Citations omitted.)

Id.

The judicially established "not detrimental to the public" standard is the test which this Commission has always applied in merger and acquisition cases.[1] While the standard is not an issue in this proceeding, the failure of the Staff to recognize and properly apply it is a fatal flaw to the Staff's case.

Not only is the legal standard not at issue, there is also no issue in this case as to what is meant by the term "detrimental to the public." "Detriment" means "higher rates and/or a deterioration in the level of customer service." *See Laclede Gas Company* Case No. 17, 267, 92 P.U.R. 3rd 426. The Staff agrees with this definition as indicated by the testimony of its witness Steve M. Traxler (Ex. 718, p. 7 Tr. 388). Moreover, "the public" involved in considering

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[1]See Appendix A of Initial Brief of UtiliCorp

whether there is detriment is the "consuming public" or "ratepayers." *See In the matter of the application of Continental Water Company 19 Mo. P.S.C. (N.S.) 192; Re GTE Corporation 121 P.U.R. 4th 54; Re Kansas Power & Light Company*, 126 P.U.R. 4th 385, 1 Mo. P.S.C. 3d 150; *City of St. Louis*, 73 S.W.2d 400. The Staff also agrees that this is the proper definition of "the public" as indicated by the testimony of its witness Cary G. Featherstone (Ex. 702 p. 23).

Consistently throughout its 228 page brief, the Staff complains of aspects of the proposed Regulatory Plan, the plan under which UtiliCorp will operate the acquired properties, that are too beneficial for UtiliCorp; are not beneficial enough for the former customers; are not beneficial enough for UtiliCorp's existing Missouri Public Service ("MPS") customers; or transfer too little benefit to the Missouri customers as a whole. These arguments underscore the Staff's failure to come to grips with the appropriate legal standard and therefore must fall on deaf ears before the Commission. As the Missouri Supreme Court has held, it is not the Commission's duty to ensure that the public benefits from a merger. *City of St. Louis*, 73 S.W.2d at 400. The Commission's only duty is to make certain the merger does not prove detrimental to the public. Moreover, and perhaps more incredible is that fact that these arguments raised in the Staff's Initial Brief run counter to the testimony of its own witness, Steve M. Traxler, who admitted in his rebuttal testimony that UtiliCorp and Empire <u>did not have to demonstrate net benefits or improved customer service</u>. (Ex. 716, p. 10). In other words, the Staff concedes the principle that the status quo for the consuming public satisfies the legal standard for merger approval. Unfortunately in its brief the Staff ignores the applicable legal standard and its own evidence and by doing so, wastes the Commission's time by submitting 228 pages of essentially irrelevant argument.

The Two Key Questions

As indicated at the outset of this brief, there are really only two overriding issues in this case. The first is whether the merger should be approved and the second is under what conditions.

A. The Merger Should Be Approved

The Staff and Public Counsel argue that the costs of the merger will outweigh its benefits, and therefore, the merger is "detrimental to the public interest" and should not be approved. (Initial Brief of Staff at 1, 73; Initial Brief of Public Counsel at 21, 31.) The arguments are premised on the notion that the estimated merger savings exceed the estimated merger costs and that when "appropriate" adjustments are made to UtiliCorp's estimates of merger savings and costs to "incorporate more reasonable assumptions," the savings will not exceed the costs. As a consequence these parties urge that the transaction be denied. This argument must fail, however, because the overwhelming weight of the competent and substantial record evidence demonstrates that the merger savings will exceed the merger costs and therefore, the merger should be allowed to go forward on this basis alone.

Moreover, there is a second, independent reason why the arguments of the Staff, Public Counsel and others on this point must fail. That is the fact that the question is not relevant to approval of the merger in any event because, under the proposed Regulatory Plan, UtiliCorp will bear the responsibility and risk of generating merger synergies, quantifying them properly and providing that information to the Commission in future rate proceedings. If UtiliCorp cannot create savings and prove to the Commission that these savings have resulted from the merger, then UtiliCorp will not be permitted to achieve any premium recovery through rates. Regardless, however, under the Regulatory Plan, customers of the Empire operating unit are guaranteed a $3.0 million system-wide reduction in cost of service.

A brief review of the evidence demonstrates that UtiliCorp's position on this point is correct. First, under the Regulatory Plan, a five year rate moratorium will be put in place upon the closing of the merger.[2] (Ex. 4, pp. 7). As a consequence, there will be no rate impact on customers during this five year rate freeze regardless of whether costs exceed benefits during this time. In other words, the public cannot possibly suffer a detriment from a rate standpoint for the initial five year period after the merger as the status quo will be preserved. It should also be noted that the Pre-Moratorium rate case concerning Empire's State Line Combined Cycle Plant ("SLCC") now under construction will be filed regardless of the merger, so it will not have an effect on the status quo. After the rate freeze, if none of UtiliCorp's projected merger synergies result, no premium costs will be included in rates at the end of the moratorium. However, customers of the Empire unit will still receive a benefit because the Regulatory Plan guarantees an annual $3.0 million cost of service reduction in years 6-10 after the merger is closed.

As a part of its argument on this point, the Public Counsel claims that because UtiliCorp has more long term debt than Empire, its risk is greater, and therefore, the customers of the Empire unit will be subject to higher rates in the future. (Initial Brief of Public Counsel at 24). This argument fails on two points. First, it assumes that the Commission, in some future rate case, will act unlawfully or unreasonably and pass on inappropriate costs to customers. Second,

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[2]The proposed moratorium is described at page 18-19 of UtiliCorp's Initial Brief. It prevents UtiliCorp and the Staff from taking action, but does not prohibit other proper parties from bringing a complaint against UtiliCorp's rates. (Tr. 454, 464, 472)

the argument ignores the fact that it is anticipated that these customers will be the beneficiaries of lower rates as a result of the merger because of economies of scale and other merger savings which have been articulated by UtiliCorp throughout this proceeding and which will be demonstrated in any future rate cases. Simply stated, the Public Counsel cannot now show with any degree of certainty that this difference in long term debt will have any impact on future rates; and therefore cannot show any detriment to the public.

Finally, this overall argument, that the costs of the transaction will exceed the benefits, and thus, the merger will necessarily result in higher rates for customers of the Empire unit, was in essence abandoned by the Staff when its witness testified that if the merger were approved, any after-the-fact effort to show in a subsequent rate case five years in the future that Empire rates would have been lower if the merger had not occurred would involve "an exercise in speculation." (Tr. 532-35).

Given that the argument of the Staff and Public Counsel on this point is grounded in guesswork and speculation, the Commission must find that the proposed merger meets the "no detriment" test and approve it. Furthermore, it is clear that reasonably anticipated benefits to customers will exceed costs; that under the proposed Regulatory Plan the customers will benefit through a cost of service reduction regardless; and that customers are ultimately protected, in any event, by the fact that rates for the Empire unit cannot increase without the Commission's authorization.

B. <u>**The Conditions of the Merger**</u>

The Staff, Public Counsel, Springfield, Praxair, and IBEW assert that the proposed Regulatory Plan has deficiencies that make the merger detrimental to the public. However, the laundry list of reasons the Staff presents to the Commission in its Initial Brief, which essentially cover all of the points raised by the parties, has been refuted by the evidence presented in this case and the arguments set out in UtiliCorp's Initial Brief. In addition, many of the assertions by the Staff and other parties regarding the Regulatory Plan are irrelevant to this merger proceeding.

These arguments, as summarized by the Staff at pages 38-40 of its Initial Brief, are as follows:

- the requested rate treatment for the acquisition premium unfairly assigns costs to customers instead of to UtiliCorp's shareholders;
- the Regulatory Plan will result in UtiliCorp receiving more than 50% of the acquisition premium;
- the Regulatory Plan will require customers to pay for merger transition costs;
- the frozen stand-alone Empire capital structure will deny customers any benefit of savings from the merger;
- the Regulatory Plan bases its merger benefits on tracking merger savings;
- the plan will result in an insignificant portion of the merger savings flowing to Missouri customers;
- the Regulatory Plan will increase administrative and general costs that would be borne by Empire customers and is not related to service;
- the Regulatory Plan will result in a disproportionate amount of savings being assigned to Empire customers at the expense of MPS customers; and
- 89% of the joint dispatch savings can be achieved by Empire on a "stand-

alone" basis. (Initial Brief of Staff at 38-40.)

The Staff and Public Counsel also assert that the issues involving the Pre-Moratorium rate case issues which are a part of the Regulatory Plan, do not deserve consideration in that this case concerns a merger, not rates, and the Commission would be unable, in this proceeding, to determine "all relevant factors."

UtiliCorp's reply to these arguments and others follows:

1. The Acquisition Adjustment

The impetus for the challenge of the Staff and Public Counsel to the proposed merger is the treatment requested for the acquisition premium as set out in the Regulatory Plan. This requested treatment has given rise to an emotional response apparently because this Commission has never previously authorized the <u>direct</u> rate recovery of premium, although it has allowed indirect recovery of such costs. The Staff, Public Counsel, Springfield, Praxair, and IBEW however, fail to present any compelling argument, based on sound regulatory principles, as to why this Commission should not grant the request to give UtiliCorp a <u>reasonable opportunity</u> to make the economics of the proposed transaction work.

Once again, the Commission should remember that it is UtiliCorp's shareholders who have agreed to pay the premium which will make this merger and its related synergies possible <u>and that these shareholders bear all of the risk of the transaction</u>. UtiliCorp's shareholders simply want a <u>reasonable opportunity</u> to have favorable ratemaking treatment of fifty percent (50%) of the unamortized premium, ("the Assigned Premium") if the synergies from the merger are developed and proven.

In this regard, as indicated, under its Regulatory Plan UtiliCorp is requesting first that the

Commission approve the amortization of the acquisition adjustment above the line beginning at the closing of the merger. Then, after five years of this amortization, in the sixth year after the merger is closed, in the context of the Post-Moratorium rate case, the Assigned Premium will be included in the rate base of the Empire operating unit and the amortization of the premium will be included in the cost of service, provided that UtiliCorp meets its burden of proof in that rate case by showing that the merger savings created by this transaction meet or exceed the cost of the Assigned Premium. (Ex. 4, p. 10). If UtiliCorp cannot prove to the Commission that the incremental value created from the merger is at least equal to the Assigned Premium, UtiliCorp shareholders will bear the difference. If, however, in the Post-Moratorium rate case UtiliCorp is able to demonstrate that synergies resulting from the merger meet or exceed the Assigned Premium, the requested ratemaking treatment for the Assigned Premium should be granted. Customers of the Empire unit will receive a $3.0 million cost of service reduction in any event. Clearly, under its proposal, UtiliCorp's shareholders have the entire financial risk for this transaction.

This is the central feature of the Regulatory Plan. UtiliCorp is simply asking the Commission, in this case, to reaffirm its policy on premium recovery AND to state that if UtiliCorp meets its burden of proof of demonstrating merger savings in the future rate case, the requested rate treatment of the Assigned Premium and related amortization will be authorized. (Ex. 5, p. 9).

Historically, this Commission has included in rates those expenditures which bring about cost efficiencies in cost of service. Such ratemaking treatment is appropriate and reasonable because savings from the efficiencies are flowed through to customers. Likewise, the requested ratemaking treatment for the Assigned Premium should be viewed in the same manner as other utility cost saving initiatives. (Ex. 4, p. 17).

In considering this issue, the Commission should not automatically assume that the proposed treatment of the Assigned Premium will result in increased rates. Such an assumption is particularly inappropriate in this case because it fails to take into account the cost savings which will result from the merger. In other words, the cost savings resulting from merger synergies should be considered and measured against the cost of the Assigned Premium. If UtiliCorp can meet its burden of proof and demonstrate that the incremental value created and realized by the merger exceeds the Assigned Premium, the rates of the Empire unit will actually be lower than they would have been otherwise. (Ex. 4, pp. 17).

The Staff argues that including the Assigned Premium in utility rates is improper because it will provide incentives for negotiating utilities to settle on a higher purchase price for a transaction. This argument, however, ignores the fact that under the Regulatory Plan in this case, the ratemaking treatment of the Assigned Premium is to be judged for its reasonableness based on the value of aggregate merger benefits. Under these circumstances, UtiliCorp, or any other purchasing utility, clearly has an incentive to minimize the amount of any premium paid because it cannot reasonably expect to receive full cost of service recognition for the premium if synergies do not support the full cost. (Ex. 4, p. 18).

The Staff's argument on this point is also without merit because when a utility realizes that any premium will be evaluated by this Commission for reasonableness based on the synergies produced, the utility accepts the risk of not recovering the premium in rates. (Ex. 4, p. 18). Based on its prior pronouncements, this Commission has indicated that it will, in fact, evaluate the ratemaking treatment of a merger premium or acquisition adjustment on a case by case basis. In this proceeding, UtiliCorp is simply asking for a continuation of the present policy, but with assurances on the front end in this case that if the appropriate evidentiary standards are met, the requested rate treatment of the Assigned Premium will be authorized in the Post-Moratorium rate case five years in the future.

By evaluating the reasonableness of UtiliCorp's request, this Commission will be fulfilling its responsibility to set just and reasonable rates. The review process for the rate recovery of the Assigned Premium should be viewed no differently than the process which this Commission undertakes in a rate case for the consideration of the reasonableness of investments and expenses generally. Obviously, it is common practice for this Commission to pass cost savings on to customers through the ratemaking process. And in so doing, the Commission usually allows rate treatment for the investments and expenses used to develop savings. In this regard, this Commission should consider the premium in this transaction as simply an "investment" to develop merger savings. When seen in this light, the premium, in this case the Assigned Premium, will deserve rate recognition if synergies meet or exceed the cost of the Assigned Premium and net synergies are passed on to customers. (Ex. 4, p. 19).

Determining the reasonableness of a premium does not mean that the Commission needs to be a part of merger negotiations. Rather, the Commission should simply exercise its duty to determine the reasonableness of the premium just as it determines the reasonableness of other investments and expenses incurred by utilities. (Ex. 4, p. 19-20).

In this case, the evidence demonstrates that the $29.50 per share price which UtiliCorp will pay for the Empire stock is fair and reasonable. It resulted from an arm's length negotiation, and is comparable to industry norms. (Ex. 3, pp. 14). In connection with this, as indicated previously, UtiliCorp must know now whether the entire $280 million premium will be considered as the basis for determining rate recovery of the Assigned Premium in the Post-Moratorium rate case.

Once again, it must be emphasized that this Commission has previously stated its policy that it is not opposed to the consideration of acquisition adjustment for ratemaking purposes. *See Re Missouri American Water Co.*, Case No. WR-95-205, 4 Mo. P.S.C. 3d 205. This Commission has said that it is not opposed to the concept of a savings sharing plan (as part of an acquisition adjustment request) provided that only merger-related savings are shared. *Id. See also Re Kansas Power & Light Company*, Case No. EM-91-213, 126 P.U.R. 4th 385, 1 Mo. P.S.C. 3d 150 (September 24, 1991). This Commission has also said that it does not wish to prevent companies from producing economies of scale and savings which can benefit ratepayers and shareholders alike. *Id.*

The Commission's policy finds support in Missouri case law. In *State ex rel Martigney Creek Sewer Company v. PSC*, 537 S.W.2d 388 (Mo. 1976), the Missouri Supreme Court, <u>in discussing the transfer of utility assets under §393.190, RSMo</u>, discussed the Commission's duty to value a utility's property <u>for ratemaking purposes</u>. The Court, quoting from Priest, "Principles of Public Utility Regulation" said:

> "When public utility property is acquired by another public service company, should any cost of acquisition in excess of 'the cost of such property to the person first devoting it to public service' be included in an original-cost rate base? Regulatory agencies which have said 'No' constitute a majority, <u>but there is much respectable authority to the contrary</u>. If the transaction was at arm's-length, if it resulted in operating efficiencies, if it received regulatory approval as having been in the public interest, if it made possible a desirable integration of facilities, the

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

Clearly, UtiliCorp's request is not a radical departure from established norms. In fact, in the past, this Commission has evaluated each merger on its own merits and has concluded that different circumstances have necessitated different approaches and solutions. In one case, an earnings sharing grid was approved with target returns set high enough to allow for full or partial recovery of the premium or acquisition adjustment. *Re Union Electric Company*, Case No. EM-96-149, 176 P.U.R. 4th 201, 6 Mo. P.S.C. 3d 28. In another case, a rate freeze was established for a period of time that allowed for a full or partial recovery of the acquisition adjustment. *Re Western Resources Inc.*, Case No. EM-97-515, (September 2, 1999). Once again in this case, UtiliCorp urges the Commission to continue its policy of considering rate recovery of premium on a case by case basis and to approve the proposed Regulatory Plan, or some other plan or procedure which will give UtiliCorp a reasonable opportunity for premium recovery.

The Staff would have the Commission believe that it does not have the authority to determine this issue in a merger case and the Public Counsel contends that there is nothing in §393.190 RSMo specifically authorizing any ratemaking determinations in a merger case. (Initial Brief of Public Counsel at 4). The statute, however, clearly does not prohibit such a determination. In fact, the Commission in the recent past ruled on a "rate-case" issue in a non-rate case proceeding. (*See Re UtiliCorp United Inc.*, Case No. GA-94-325 (1994). There are other instances in which the Commission has established depreciation rates outside the context of a rate case, which depreciation rates were later reflected in cost of service.

Also on point is a Report and Order issued by the Commission on November 13, 1973 in Case No. 17,873, a proceeding involving an application by Laclede Gas Company for an order determining the amounts of certain acquisition adjustments and permitting the transfer of those amounts from certain accounts and further permitting the amortization of those accounts over 40 years as an operating expense. (In this regard, Laclede's request was much more aggressive than UtiliCorp's in this case. Laclede asked for a specific ratemaking determination. Here UtiliCorp only seeks a reasonable opportunity to obtain a favorable ratemaking determination at a later date.) In its Report and Order, the Commission determined the amounts of the acquisition adjustments in question, approved the transfer of the total acquisition adjustment from account 186 to account 114, and approved a 40 year amortization of the acquisition adjustment. Laclede's request for authority to charge the amortization against operating expenses, a "rate case" type issue, was contested and the Commission found against Laclede on the grounds that no showing had been made which would justify the inclusion of the acquisition adjustment in the operating expenses of the company.

In other words in the Laclede case, the Commission made a decision on the ratemaking treatment to be afforded an acquisition adjustment outside the context of a rate case. This is clearly additional precedent for the proposition that the Commission does have this authority and has in fact in the past made "rate case" type decisions outside the context of a rate proceeding. The concept is neither novel nor unlawful.

In the event UtiliCorp meets its burden of proof in the Post-Moratorium rate case and the Commission allows rate recovery of the Assigned Premium, this Commission will be acting in a manner consistent with the regulatory principles discussed by the Missouri Supreme Court in the

Martigney Creek case, supra. The Commission would also be acting in a manner consistent with other states which have, in fact, permitted rate recovery of a portion or all of the cost of acquisitions.

The Massachusetts Department of Public Utilities determined that where potential benefits for customers exist, it is not in the interest of those customers, the shareholders of the utility, or the state to maintain a barrier against mergers. *Re Guidelines and Standards for Acquisitions and Mergers of Utilities*, 155 P.U.R. 4th 320.

The Oklahoma Corporation Commission, in *Re Oklahoma Gas and Electric Co.*, 150 P.U.R. 4th 33 (Okla. Feb. 25, 1994) established the following criteria in determining whether to allow rate recovery of an acquisition premium:

1) The public interest must be considered.
2) The purchase price must be reasonable.
3) The benefits to ratepayers must equal or exceed the cost of the acquisition premium.
4) The transaction must be conducted at arm's length.

(Ex. 4, p. 23).

Rate base treatment and/or cost of service treatment for acquisition premiums has been allowed by regulatory commissions under various circumstances, including:

1) when acquisitions represent an essential or desirable part of an integration of facilities program devoted to serving the public better;

2) when acquisitions are clearly in the public interest, because operating efficiencies offset the excess price over net original cost; and

3) when acquisitions are determined to involve arm's-length bargaining.

(Ex. 4, p. 23-24).

The Tennessee Public Service Commission allowed both rate base and cost of service treatment for acquisition adjustments of a telephone company where the acquisitions were found to be in the best interest of the public and not for the purpose of inflating the rate base. (79 P.U.R. 3rd 499, Tenn. 1969). *Re United Inter-Mountain Telephone Company.*

In a 1955 Virginia Supreme Court of Appeals decision, the Court ruled that the Virginia State Corporation Commission had properly allowed both rate base and cost of service treatment for an amount paid at arm's length bargaining in excess of original cost. (8 P.U.R. 3rd 120, Va. 1955). *Board of Supervisors of Arlington County v. Virginia Electric and Power Company.*

In 1946, the Louisiana Public Service Commission allowed rate base and cost of service treatment for an acquisition adjustments. *Louisiana Public Service Commission v. Louisiana Power & Light Company* (65 P.U.R. (NS) 18, La. 1946). In that case, the Louisiana Commission stated:

> The owners of a public utility are entitled to earn and receive a fair rate of return upon the money prudently invested in property used and useful in rendering public service. Money is prudently invested, even though it is in excess of the original cost of the property purchased, if the excess of purchase price over original cost was paid as the result of arm's-length bargaining between nonassociated buyer and seller, if the excess was necessary for the integration of the property into a larger and more efficient system, and if the purchase necessitating the excess did or reasonably should have resulted in public benefit by improvement of service to customers or in lowered rates or both better service and lowered rates. This integration cost or excess of purchase price over original cost termed in prescribed system of accounts as 'Utility Plant Acquisition Adjustments' should remain a part of the prudent investment during the life of the physical property to which it was applied, and its extinguishment from the investment when and if required by the Commission, should be accomplished by amortization through annual charges to Operating Revenue Deductions during the life of the property remaining after the date of the purchase which created the excess. (65 P.U.R. (NS) 23).

In 1991, the Kansas Corporation Commission in *Re Kansas Power & Light Co.*, 127 P.U.R.4th 201, established a policy with regard to acquisition adjustments which in essence provides that to the extent that savings can be shown, the acquisition premium will receive ratemaking treatment in a future rate case. In that case, the Kansas Commission stated:

> The Commission cannot ensure the recovery of the AP. The Commission can only ensure the opportunity to recover the AP. The Commission believes the appropriate regulatory treatment of the AP is to tie the potential recovery of the AP to benefits that will be realized by ratepayers as a result of the merger. In this case, the amount of the AP to be included in rates shall be tied to the savings reasonably projected to be generated by the merger. Applicants in future merger cases will have the burden of quantifying benefits that will accrue to ratepayers as a result of the merger. The Commission will not necessarily limit benefits to operating cost savings but will look at a variety of factors in determining ratepayer benefits. For example, Utility A is acquired by Utility B and Utility B is able to bring financial strength to make improvements to Utility A; Utility B may be allowed to include in its rates an AP commensurate with the improvements it was able to effect through its financial strength.
>
> In this case where ratepayer benefits are tied to synergies that can be generated from cost cutting measures and synergies resulting from the overlapping service territories, to identify and quantify savings becomes a critical component of Applicants' burden of proof. The savings to be generated by the acquisition must be reasonably identified and capable of quantification, otherwise the Commission has no reasonable way to assess whether there are benefits for ratepayers.

More recently, in *Re UtiliCorp United Inc. dba West Plains Energy Kansas* 198 P.U.R. 4th 397 the Kansas Corporation Commission allowed UtiliCorp to recover in rates $2.35 million of some $5 million of the annual cost of the acquisition premium in connection with UtiliCorp's acquisition of electric assets from Centel Corporation. The burden of proof was on UtiliCorp in that case to demonstrate that the claimed savings would not have been created except for the Centel acquisition, the same burden of proof which UtiliCorp will be expected to meet under its proposed Regulatory Plan in this case. The issue was not so complex that the Kansas Commission could not deal with it, the fear expressed by the Staff in this case.

The point of all this is that there is sound Missouri authority and ample precedent from other jurisdictions to allow not only the establishment of standards under which premium will be afforded rate-making treatment, but also cases in which premium recovery has been allowed. UtiliCorp urges the Commission to continue its policy of considering premium recovery on a case by case basis. In addition, UtiliCorp simply wants an indication from the Commission that if UtiliCorp meets its burden, the requested rate treatment will be authorized thereby giving UtiliCorp a reasonable opportunity to achieve its goal.

2. Previous Merger Cases

A theme throughout the Staff's Initial Brief is that this merger case is somehow "different" than other merger cases presented to this Commission and that this "difference" requires the Commission to reject the merger proposal. This argument is less than compelling, without logic, and ignores the law. Once again, in Missouri the law is that if the transaction is not detrimental to the public, it should be approved.

The Staff maintains on several different occasions in its 228 page document that it knows of no other Missouri case in which the applicants did not project that savings from the merger would exceed the merger costs. Even assuming that the Staff is correct in its assertion with respect to this case, which UtiliCorp denies, the point is totally irrelevant. Nowhere in its Initial Brief does the Staff even attempt to argue that the proposal is contrary to established Missouri law. Nowhere does the Staff present a case from another jurisdiction where a claim that anticipated costs exceed anticipated benefits automatically invalidates a merger attempt.

What is clear from all of this is that the real problem with this case, from the standpoint of the Staff and Public Counsel, is the fact that UtiliCorp continues to press for the opportunity to recover some premium costs directly through rates, and has been unwilling to drop this request as a condition of merger approval. As has been explained previously, UtiliCorp cannot give in to this demand. The proposed Regulatory Plan, with its reasonable opportunity for premium recovery, or some other approach which will give UtiliCorp a reasonable opportunity to obtain a return on its investment, is absolutely essential to the financial viability of this transaction. (Ex. 3, p. 10). In this regard, UtiliCorp really seeks a result no different than this Commission afforded Union Electric Company when it approved its merger with CIPSCO and at the same time authorized an extension of a "sharing plan" designed to allow UE to earn and keep up to 12.6% return on equity. (*See Re Union Electric Company*, supra).

3. Costs to Achieve

The Staff claims that customers will bear the brunt of the involved transition costs, or "costs to achieve" the merger. This assertion is an overstatement. While it is true the Regulatory Plan will allow UtiliCorp to recover some of its costs in rates, the savings in synergies will far outweigh those costs and the customers will experience a net reduction in cost of service. Public Counsel also argues that it is inappropriate for ratepayers to pay for transition costs. (Initial Brief of Public Counsel at 37.) This argument, however, fails because it has nothing to do with the legal standard the Commission is required to apply to this merger. Once again, ratepayers will experience no detriment from the merger if they pay some of the transition costs, because under the Regulatory Plan this will only happen if merger synergies exceed the Assigned Premium and costs to achieve, resulting in a net benefit to ratepayers.

Under its proposal, UtiliCorp will recover in rates the costs to achieve the transaction such as those costs associated with executive severance payments. Specifically, executive severance payments approximating three years of salaries will be incurred in order to realize the synergies from eliminating the salaries of those executives over the ten years of the Regulatory Plan. To reflect in cost of service the synergies from the elimination of ten years of executive salaries, while at the same time not reflecting the executive severance costs needed to achieve those savings, would not be fair. Only minimal allocations of UtiliCorp's costs will be allocated to Empire, so the net costs of executives will be clearly much less under UtiliCorp, even with the executive severance costs. Moreover, actual rate recovery of executive severance costs is projected to be less than half the actual costs due to the time value of the recovery and the shortfall of synergies during the five year moratorium period. (Ex. 7, p. 33).

In addition, UtiliCorp should recover in rates the costs of the Advisory Board. The Advisory Board is provided for in the merger agreement and is necessary to accomplish the transaction. The cost of three years of the Advisory Board replaces the cost of ten years of the Empire Board of Directors. Again, not to recognize the merger-required costs of the Advisory Board, while at the same time passing on the related synergies to customers, would clearly not be fair. Also with respect to this item, actual cost recovery is projected to be less than half the actual costs due to time value of the recovery and the shortfall of synergies during the moratorium. (Ex. 7, p. 33).

UtiliCorp intends to track those "costs to achieve" that are deemed eligible for rate treatment to ensure rate recovery. While the Staff is technically correct in suggesting that the customers will pay for some of these costs, these same customers will receive a net gain because of the merger. In the final consideration, there is no detriment to the public resulting from UtiliCorp's proposal for "costs to achieve."

4. Frozen Capital Structure

The Staff argues that the frozen capital structure proposal contained in the Regulatory Plan will deny customers any of the benefits which result from the merger. This assertion is incorrect and reflects a basic misunderstanding of the proposal. First, customers of the Empire operating unit will benefit from the merger through the guaranteed $3.0 million in reduction of cost of service in any event. Further, the applicable standard is whether the merger is detrimental to the public interest, not whether customers get a benefit. In this regard, the Staff does not assert that the frozen capital structure proposal will be a detriment; only that it will not result in a benefit. Again, the Staff and others miss the point. Missouri is a "no detriment" state. The status quo is acceptable. The frozen capital structure will accomplish this.

The rates for the Empire unit in Years 6-10 post-merger should be calculated using the stand-alone Empire capital structure that is currently 47.5% equity, 52.5% debt. (Ex. 8, p. 4). The reason for this structure is that, absent the merger, the capital structure for Empire as a continued stand-alone company would not change appreciably and as a consequence using this 47.5% equity, 52.5% debt equity capital structure will result in no "new" cost for the Empire customers. (Ex. 4, p. 28). In addition, because UtiliCorp will be converting a sufficient amount of Empire existing equity to UtiliCorp equity to cover Empire's current equity, no decrease in the equity investment actually occurs. (Ex. 2, pp. 5-6). Because no new or increased costs will be passed on to Empire customers, this aspect of the Regulatory Plan is clearly not detrimental to the public interest.

5. Tracking Merger Savings

The heart of the challenge of the Staff and Public Counsel to the Regulatory Plan is a claim that the guaranteed $3.0 million in savings is a "fiction" because the savings tracking methods are speculative. The Staff claims "the problem with merger savings tracking is not the degree of sophistication of accounting systems, but the inherent lack of knowledge people have of the effect of events and actions that did not occur." (Initial Brief of Staff at 39.)

The Staff misses the point. Even if UtiliCorp is unable to meet its burden of proof in the Post-Moratorium rate case either because of a lack of synergies or an inability to track and prove them, customers of the Empire unit still obtain a $3.0 million reduction in cost of service. <u>And because the Staff admits that in that Post-Moratorium rate case it will be impossible for the Staff to prove that rates for the Empire unit would have been lower absent the merger, it really doesn't matter whether or not savings can be tracked.</u> UtiliCorp accepts the burden of proving synergies, and if it cannot do so effectively, it will not obtain rate recovery of the Assigned Premium. A savings of $3.0 million, however, is still guaranteed.

While UtiliCorp has presented a thorough method of tracking savings, the approval of a specific tracking system, however, is not critical to approval of the merger. As indicated, under its proposed Regulatory Plan, UtiliCorp will have the burden to show in the Post-Moratorium rate case that it has been able to both track and quantify merger savings. UtiliCorp believes that it will be able to meet this burden. For a complete discussion on the methods UtiliCorp plans on implementing to track merger savings, and the benchmark values, see Initial Brief of UtiliCorp, at 38-45.

Finally on this point, UtiliCorp has recently been successful in demonstrating to the Kansas Corporation Commission merger savings sufficient to allow direct rate recovery of a portion of an acquisition premium. (*See In Re UtiliCorp United Inc. dba West Plains Energy*

Kansas, supra). If nothing else, the recent Kansas case indicates that merger savings are real and demonstrable and not a "fiction" as alleged by the Staff.

6. Savings to Missouri Customers

The Staff asserts that the merger savings realized by customers will be insignificant. Simply put, this claim is irrelevant. While UtiliCorp disagrees with the merits of Staff's argument on this point, given that the forecasted savings have been detailed at every step in this process, the argument does not matter. The applicable standard is whether the merger is detrimental to the public interest. In other words, even assuming the Staff is correct, the public will not experience a detriment which is the lawful standard. Under Missouri law, the merger is not required to benefit customers as witness Traxler admitted.

7. More Savings to Empire Customers than MPS Customers

Although the Staff apparently does not believe the savings are significant, it argues that Empire customers will get a proportionally higher share of those savings than MPS customers and somehow this should result in the Commission rejecting the merger. Again, this argument ignores the "no detriment to the public interest" test. Furthermore, they ignore the sound rationale behind this aspect of the Regulatory Plan.

As previously indicated, one of the purposes of the Regulatory Plan is to ensure that savings are passed on to customers of the Empire unit to offset the costs resulting from the transaction which are also assigned to that unit. In other words, no merger-related benefits are flowed to MPS customers because those customers are not being asked to pay any of the merger-related costs.

8. Pre-Moratorium Rate Case

The specifics of the Pre-Moratorium Rate Case are outlined in the Joint Application and the testimony of Empire Witness Robert Fancher. (Exhibit 8) It is imperative that the Commission consider the Pre-Moratorium Rate Case issues in conjunction with this merger case in order to remove the uncertainty surrounding those issues which might make the transaction economically unfeasible.

Empire is constructing the State Line Combined Cycle Plant ("SLCC"), a 500-mw plant of which 300-mw will belong to Empire. This construction will represent the single largest investment in Empire's history and is a significant addition to its rate base. The Commission must recognize this investment and include its cost in rates before the proposed Rate Moratorium can be implemented. (Ex. 8, p. 2). The uncertainty of this matter may frustrate this merger as a whole. Further, as discussed below, the Commission has the authority to consider "rate issues" in merger cases, as it has done so in the past.

The Staff raises several issues with the proposed SLCC "in-service criteria." It is important to address this matter now because Empire may not recover the costs of SLCC through rates until that plant is fully operational and used for service. In accordance with the proposal of the Joint Applicants, the Commission should agree to allow these costs to be reflected in the Pre-Moratorium rate case if the following criteria are met:

- Staff shall timely conduct a physical inspection of SLCC;
- SLCC's plant manager shall attest that pre-operational testing has been completed in accordance with current procedures;
- Liability for final payment of equipment and construction contracts is recorded on

Empire's books, in the form of contractual amounts paid or retained, pending final resolution of outstanding issues (if any);

- The generating unit shall demonstrate its ability to start and operate;
- The generating unit shall demonstrate its ability to smoothly and successfully shut down when prompted by the unit operator initiating such command;
- The generating unit shall operate within 5% of Empire's intended rated capability during the settlement period;
- Only minor changes in unit controls shall be made during the settling period;
- The settling period shall last for a period of two (2) hours during which normal, steady state operation at Empire's intended rated capability shall be established; and
- The generating unit shall operate in a normal steady condition for a period of two (2) hours at the demonstrated Pool rated capacity. (Ex. 9, p. 3).

These proposed "in service criteria" will assist the Commission in determining whether to allow the SLCC plant to be included in the rate base in the Pre-Moratorium rate case. It is important that this issue be resolved now, prior to closing of the merger, so that this uncertainty will be removed.

9. Market Power Conditions

Springfield discusses alleged transmission constraints under this heading in its initial brief at pages 3-5. Springfield contends on page 5 that UtiliCorp is "not willing to commit themselves to identify and resolve problems prior to merging."

UtiliCorp has performed a study (discussed in more detail under the Transmission Access heading, *infra*). The study does not show any detriment from the merger. The important point to remember here is that UtiliCorp has committed to not reduce Available Transmission Capacity (ATC) in the region as a result of the merger. (Tr. 1134) In fact, with the construction of the new 161 kV Nevada to Montrose line interconnecting the MPS and Empire systems if the merger is approved, it stands to reason that ATC in the region would actually <u>increase</u>. (Tr. 1134) It is like building another highway to ease traffic congestion. An increase in ATC will benefit the entire region. A formal study is not needed to reach that intuitive conclusion. (Tr. 1152) Even Springfield's consultant admits that such a line would greatly benefit Springfield's ability to receive its scheduled power from the Montrose plant. (Ex. 300, p. 44; Tr. 1152) Therefore, Springfield's criticisms should be dismissed.

The Staff indicates at page 220 of its brief that UtiliCorp should be required to commit to join a single regional transmission organization ("RTO") before the October 15, 2000 deadline of FERC Order No. 2000. The passage of time has overtaken this topic. Although it is not in the record in this case, UtiliCorp has notified FERC that it intends to join the Midwest ISO. Therefore, this should not longer be an issue in contention.

Public Counsel says in its brief (at page 49) that this may be the best and only opportunity for the Commission to require actions that "mitigate the detriments of increased market power... ." UtiliCorp responded to these arguments in the briefs in the SJLP case and will not repeat those here. UtiliCorp has already committed that it will comply with requirements ordered by the Commission for studies at that future time. At this point, it is only speculation as to when and if retail competition will occur. UtiliCorp should not be expected to agree now to complete a study under conditions that may be contrary to conditions the Commission believes are appropriate when any future study may be ordered.

10. Transmission Access and Reliability

The issue under this heading is not significantly different from the issue discussed in the case involving the merger with St. Joseph Light & Power Company.

As in the SJLP case, Springfield was the most outspoken party on the issue. As compared to the SJLP case, however, more attention was given to the details of the issue. The result is that it is clear that Springfield's arguments should not be accepted by the Commission. No credible evidence was produced that the merger will actually bring about a detrimental effect on the transmission system or the ratepaying public.

As in the SJLP case, Springfield still seems to be most concerned about the possible effect of the merger on a future capacity purchase it has made with Kansas City Power & Light Company out of KCPL's Montrose plant. It became known in this proceeding that the future purchase consists of the right to about 50 MW out of the plant over a ten year period commencing sometime in 2001. (Tr. 1169) A significant fact for purposes of this case is that Springfield has <u>not</u> obtained a firm contract transmission path for this capacity and energy. (Tr. 1170) In other words, Springfield has not arranged for the actual delivery of the capacity and energy yet. Springfield's consultant indicated that he thought Springfield intended to use "network service" through the Southwest Power Pool ("SPP") to obtain the delivery of the capacity and energy. (Tr. 1169)

As the Commission knows from the SJLP case, UtiliCorp had SPP perform a study to see whether it would be feasible for UtiliCorp to use SPP's network service to dispatch the Empire, MPS and SJLP systems. That approach would be an alternative to UtiliCorp building physical connections between its MPS division and SJLP and Empire. The SPP study was performed without including the transmission line connections UtiliCorp says it will build after the merger. (Tr. 1124)

After reviewing the results of the SPP study, and another study UtiliCorp performed on its own which included the proposed transmission line connections and appropriate dispatch, UtiliCorp has determined not to take network service from SPP due to its cost. Mr. Kreul of UtiliCorp said that it was determined that "for us to acquire network service under the SPP ... that we would have to spend a lot of money outside of our territory..." constructing electrical transmission facilities.[3] Mr. Kreul also said the SPP "would not have the facilities to provide the network service that we request." (Tr. 1113) As a result, UtiliCorp has determined that it "can still achieve the same system integrity by spending money in our own system by interconnecting the two systems with a 161 kV interconnect." (Tr. 1114)

The aforementioned intention of Springfield to rely on SPP network service for its Montrose purchase, the fact that Springfield has not contracted for firm transmission service, and UtiliCorp's reluctance to unnecessarily spend a lot of money outside of its system to reinforce the remote SPP transmission network appears to explain why Springfield is so interested in the topic of transmission reliability. The facts clearly indicate that Springfield wants this Commission to somehow order UtiliCorp to be a part of SPP so that UtiliCorp will have to spend

[3] This was also confirmed by Mr. Florom, who agreed with Springfield's counsel that UtiliCorp would have had to make "very high payments" for reinforcements of the transmission system. (Tr. 1143-1144)

money to upgrade facilities in SPP outside of UtiliCorp's territory, which in turn will primarily benefit Springfield. Staff witness Dr. Proctor properly characterized this as a situation where "UCU is being asked to subsidize the rest of the market." (Ex. 714, p. 7) This is the wrong approach. If Springfield wants a greater "firmness" and priority for its future wholesale power transactions with KCPL, Springfield ought to arrange for and pay for that itself. It is not the Commission's statutory role to protect Springfield from hypothetical problems by making UtiliCorp, SJLP and Empire ratepayers fund solutions to Springfield's problems.

UtiliCorp's Study Did Properly Analyze the Region

Springfield claims the merger applicants "have not analyzed the impact of their combined uses of the region's transmission system ... ." (Springfield brief, p. 6) This is incorrect. UtiliCorp performed a study which analyzed the SPP region's transmission systems. (Tr. 1157) It analyzed the effect on systems other than UtiliCorp, including Empire, KCPL, all facilities of 115 kV and above in the Western Resources system, all relevant facilities in the Associated Electric Cooperative system, and other facilities normally included in contingency analyses performed by Empire. (Tr 1125-1126; 1157)

The UtiliCorp study was significantly different in its underlying assumptions from the SPP study. (Ex. 26, p. 6; Tr. 1124) The SPP study did not include the system upgrades (i.e., transmission line construction) proposed by UtiliCorp for interconnecting the control areas of SJLP, Empire and MPS. (Ex. 714, p. 7) It also assumed that 200 MW of transfer capability would be required between the systems. (Ex. 714, p. 4-5) Further, it assumed a "worst case" dispatch scenario which does not represent a true joint economic dispatch of the what the systems might be experiencing. (Tr. 1149) The study performed by UtiliCorp included those new proposed facilities and had a more realistic assumption for joint economic dispatch. UtiliCorp's transmission engineer, Mr. Florom, said that inclusion of the proposed facilities is a "significant difference" that "drastically affects the ability of the system to transfer energy between the separate operating systems." (Ex. 26, p. 6) Both Mr. Kreul and Mr. Florom testified that the UtiliCorp study did look at the impact on the region. (Tr. 1115, 1126) Mr. Florom testified that the UtiliCorp study looked at the regional system at its most "stressed" time. He said he has heard no criticisms of the study that leads him to believe, as the only experienced transmission system engineer testifying on the issue, that the study needs to be re-done. (Tr. 1149-1150)

Springfield incorrectly criticizes Mr. Florom in its initial brief because Springfield has confused the issue of what facilities were included in the study with which were closely analyzed by the study. Springfield claims at page 6 that Mr. Florom "could not recall what facilities were included in UCU's study... ." Mr. Florom testified as to whose systems were included in the study. (Tr. 1125-1126) He named five different systems that were analyzed. He was then asked which particular facilities of Associated Electric Cooperative ("AEC") were "looked at" in the model. (Tr. 1126) He said: "I don't have that list in front of me. I'm sorry." He was then asked to identify the specific facilities that were normally included in Empire's normal contingency analysis. (Tr. 1127) He made the same reply: "Again, I don't have a list of that in front of me. I'm sorry." (Tr. 1127) Springfield's counsel apparently did not really want to know what those specific facilities were, because he chose not to pursue it further by asking Mr. Florom to go to the effort of finding that documentation. That does not impeach the validity of the study. Springfield's misunderstanding of load flow analysis does explain its confusing rationale, though.

Springfield also incorrectly criticizes Mr. Florom when it claims on page 6 of its brief that the SPP study "included facilities that UCU's study did not include." Springfield cites to pages 1126-1127 in the transcript as support for its assertion. Springfield has apparently overlooked the following testimony by Mr. Florom appearing on page 1127 of the transcript:

> All the facilities in the SPP study and the UtiliCorp study were included in both models. All facilities are there. They're based on the same base cases. So when you say are they included, yes, they are included in both studies.

Therefore, the facilities examined in both studies were the same (with the exception of the previously mentioned proposed new transmission lines of UtiliCorp) and Springfield's assertion is incorrect. Springfield is confusing the inclusion of the facilities in the model with the *monitoring* of the facilities in the operation of the computer model, which is a different thing.

Additional Load Flow Studies are Not Needed

Springfield says it supports the Staff in wanting the Commission to order a "region-wide load flow study" that "can be requested of the SPP by UCU." (Springfield's brief, p. 6) This proposal, and the recommendation of the Staff for further load flow studies before the Commission decides this case, is simply overkill and justification for the Staff to further delay the merger. The essence of the Staff recommendation is to spread out the study over the entire year.

The UtiliCorp study with the new transmission lines included, and SPP study without the new lines, already examine the region at peak load conditions, and show no problems of concern or significance. If there are no problems at the peak load conditions when everything is strained, logically there are not going to be problems when there is plenty of available capacity on the system during non-peak conditions. Mr. Florom explained that both Empire and UtiliCorp are generation-deficient companies which means they have to buy capacity at peak times in order to meet their customers' requirements. (Ex. 25, p. 8) This means that at the present time (i.e., pre-merger), both companies would have already loaded up all of their generation facilities. He said this will be the case post-merger also. Therefore, there will not be massive amounts of energy being transferred from one company to the other over regional transmission facilities after the merger. Neither company will have excess capacity to transfer to the other one on peak. Therefore, modeling the system at peak for a post-merger scenario using a pre-merger dispatch was entirely appropriate. (Ex. 25, p. 9) It gives an accurate picture of what the post-merger situation would be.

Performing a year-round study, such as the Staff is recommending, would not provide any relevant new information and would simply delay the resolution of this case for potentially months while the study is performed and then additional rounds of testimony are filed, as the Staff recommends at page 222 of its brief. Given that the information for the peak-day, is already available, requiring UtiliCorp to do the study the Staff recommends would be like requiring someone to test whether your car starts every day during the summer to determine if it will start on the coldest morning in the winter.

Further, even if such a study were determined to be needed, SPP may not be a "disinterested party" to turn to for the production of such a study. According to Mr. Kreul, "SPP is scampering for membership, and one could make the argument that the results could be leaned in one direction to assure that we would be a part of SPP." (Tr. 1115-1116) Contrary to the assertion of Springfield in the footnote on page 3 of its brief, the Staff has not said that the study "should" be performed by SPP. Dr. Proctor said "Such a study can be requested of the SPP by UCU." (Ex. 714, p. 8)

UtiliCorp's System is Not "Weak and Unreliable"

Springfield's witness claims the MPS system of UtiliCorp is "weak and unreliable." (Springfield brief at 6) If that were really true, there undoubtedly would have been published reports of problems in the service territory during the last heat wave around Labor Day. There were none. That is because Springfield's witness is relying on the hypothetical results of a computer model which shows a potential problem on the Sibley to Duncan transmission line in a "worst-case" scenario. He also made inconsistent and incorrect comparisons which led to conclusions that were not applicable to the situations he described. (Ex. 25, p. 5-8)

Mr. Florom explained that this was nothing of immediate significance. "UtiliCorp recognizes the Sibley to Duncan line does overload under certain conditions." (Tr. 1153) There is currently an operating procedure in place to alleviate that overload. Also, that line is scheduled to have the conductors replaced in 2001. (Tr. 1153-1154) Implementing the operating procedure, which involves changing the amount of generation at either the Sibley or Greenwood plants, eliminates the problem. (Tr. 1154) So will changing the conductors. This does not prove that the system is weak or unreliable.

In contrast to Springfield's claim, Mr. Florom testified that the SPP Base Cases for Summer 2000 and Summer 2001, which are provided to all SPP members (including Springfield) do not show any criteria violations in the MPS transmission system. (Ex. 25, p. 5) He explained that these documents show that there are no voltage criteria violations on the MPS system projected for those time periods. "These are healthy voltages and are not in violation of the UtiliCorp and SPP criteria of 95% for base case voltages (non-contingency)." (Ex. 25, p. 5)

Reservation of Internal Dispatch on OASIS

Springfield argues for other onerous conditions to the merger that should be rejected by the Commission. One is that UtiliCorp should be required to reserve transmission capacity on OASIS for its own internal dispatch. As Mr. Florom explained, this is not the purpose of, nor a requirement of, the federally-mandated OASIS system, and it would be unduly restrictive to UtiliCorp. (Ex. 25, p. 2) Mr. Florom said "If FERC had intended OASIS to report internal transmission events, it could and would have so provided in Order 889. It did not." (Ex. 25, p. 2) This request of Springfield also appears to be motivated by the Montrose purchase, discussed earlier, and should be considered by the Commission in that light. The Commission should also consider that the Nevada to Asbury line to be constructed as a result of the merger, and which Springfield even wants the Commission to "order" UtiliCorp to build[4], would benefit Springfield's ability to get transmission service.

All of the above, and other concerns raised by Springfield that are not addressed specifically here because they are of the same unsubstantiated and hypothetical flavor, are simply Springfield's attempt to get something for nothing. If Springfield can convince the Commission to strap UtiliCorp with onerous and unnecessary conditions that ultimately benefit Springfield's ability to purchase wholesale power at a lower cost than otherwise, Springfield will be the winner and the UtiliCorp ratepayers, who have to pay for that, will be the long-term losers. Springfield

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[4] Springfield brief, p. 8.

has made all these same arguments to the FERC, who ultimately has jurisdiction over the transmission systems. The FERC was not impressed with the merits of the arguments. The Commission should similarly reject Springfield's arguments here for what they are – self-serving and motivated solely by financial concerns. Springfield already has a proper forum if it considers that it has been wronged by some future transmission situation. The FERC has the authority to remedy any harm it may find.

DNR / Energy Efficiency

UtiliCorp and Empire agree with DNR that the legal standard applicable here is the "not detrimental to the public interest" standard found in *City of St. Louis*, supra. However, having made this statement, the DNR continues on to state that Missouri law "dictates that the review of a proposed merger consider whether the merger will result in *adverse* impacts that will impede the passing-on of benefits to particular markets." (DNR Brief, p. 12). The DNR brief is incorrect in its apparent conclusion that there must be a "passing-on of benefits."

The Missouri Supreme Court's focus in decided the *City of St. Louis* case was its recognition the Commission's jurisdiction over the sale of private property is limited. In describing the standard to be used, the Supreme Court stated as follows:

> The owners of this stock should have something to say as to whether they can sell it or not. To deny them that right would be to deny them an incident important to ownership of property. *City of Ottawa v. Public Service Commission*, 130 Kan. 867, 288 P. 556. A property owner should be allowed to sell his property unless it would be detrimental to the public.
>
> The state of Maryland has an identical statute with ours, and the Supreme Court of that state in the case of *Electric Public Utilities Co. v. Public Service Commission*, 154 Md. 445, 140 A. 840, loc. cit. 844, said: "To prevent injury to the public, in the clashing of private interest with the public good in the operation of public utilities, is one of the most important functions of Public Service

> Commissions. It is not their province to insist that the public shall be *benefitted,* as a condition to change ownership, but their duty is to see that no such change shall be made as would work to the public *detriment.* 'In the public interest,' in such cases, can reasonably mean no more than 'not detrimental to the public.'"

State ex rel. City of St. Louis v. Public Service Commission, 73 S.W.2d 393, 400 (Mo.banc 1934).

Consequently, based upon this case law, the Commission has previously found that it "is unwilling to deny private, investor owned companies an important incident of the ownership of property unless there is compelling evidence on the record tending to show that a public detriment will occur." In the Matter of *Missouri Gas Company*, et al., 3 Mo.P.S.C. 3d . 216, 221 (Case No. GM-94-252) (October 12, 1994). The "passing-on" standard suggested by DNR has no basis in the case law.

DNR obviously has concerns about the plight of low-income residents of the state. So do UtiliCorp and Empire, and so undoubtedly does the Commission. That topic, however, is much broader than a merger between two utility companies. Other than speculation by DNR's witnesses, there was no hard evidence that the merger of Empire and UtiliCorp will detrimentally affect low-income customers in the Empire territory. However, the customers after this merger will continue to receive at least the same level of electric and natural gas service, or better, than they received before. The electricity will flow through the same wires and the customers can contact the same local offices and personnel.

The facts are that UtiliCorp will offer the same assistance and programs to the type of customers targeted by DNR as Empire does today. Field offices in Empire's territory will be equipped with adequate staffing levels to continue to provide local focus and personal contact.

(Ex. 17, p. 23). Each customer service associate has a listing of assistance agencies by state available to them via its ATLAS computer system. (Id.). The associates as trained in the use of this information and should be able to identify the social agencies available for UtiliCorp's customers. (Id. at 23-24). Moreover, call center associates can put customers in Empire's service territory in contact with local service representatives. (Id. at p. 24). UtiliCorp is flexible in dealing with customers and is also less strict in collection policies than Empire. (Id. at p. 23-24).

DNR suggests that the effect of the proposed merger will be to distribute a "disproportionately small share of the merger savings to low-income consumers" in violation of the "principle that merger synergies be passed-on to consumers in a fair and equitable fashion." (DNR Brief, p. 15-16). DNR goes on to propose a "Community Energy Partnership" to address its perceived inequitable sharing of savings. (DNR Brief, p. 16-17).

First, as indicated above, there is no requirement that merger synergies result or be "passed-on," only that there be no detriment. Second, it is not clear that a new low-income consumer class should be established for ratemaking purposes. DNR witness Colton readily admits that the typical low-income consumer places greater demands on the utility through more frequent payment troubles, more personnel contact requirements and more bill paying information. (Ex. 17, p. 21). They also typically consume less energy than the average residential customer. (Id.). Thus, as a class, they generate less revenue while requiring a higher cost of service. (Id.).

Some subsidy exists in this regard and will continue to exist as the result of the use of classes in ratemaking and the Commission may well intend to maintain the existing low-income subsidies, or as Mr. Colton suggests, increase them. (Ex. 17, p. 22). However, this is not the proper forum to make class subsidy adjustments or to implement the programs recommended by Mr. Colten. (Id. at p. 22, 25). Any such action should be developed within the context of an overall rate review and full cost of service study where a clear determination of cost recovery and cost assignment can be made. (Id.).

The DNR further suggests that the proposed merger be conditioned upon UtiliCorp and this Commission investigating and implementing more renewable and alternative energy resources. This proposal does not conform to the standard which the Commission has to apply in this merger application. This is because there are certain production facilities at both UtiliCorp and Empire that currently make use of renewable resources. (Ex. 17, p. 30). After the merger, those facilities will continue to be operated as they are currently. (Id.). No detriment in this regard would ensue.

While UtiliCorp does not believe these recommendations should be a condition of the merger, it does support the concept of the investigation of alternatives and agrees that over time movement should be made toward implementation of more renewable resources as sources of fuel. (Id. at p. 30, 31). UtiliCorp would commit to entering into a partnership with this Commission, the OPC and the DNR to investigate the potential for introduction of new production facilities using renewable resources as a fuel source. (Id. at p. 30-31). In fact, UtiliCorp has exhibited its commitment to this type of process previously as it was the first utility in the state to introduce a green power tariff. (Id. at p. 31). The process of moving toward these goals is, however, unrelated to this merger and should take place outside of the merger process.

Labor Protective Provisions/Conditions

IBEW Local 1474 ("IBEW") has filed a lengthy initial brief in an attempt to support its proposed "Labor Protective Provisions." These Labor Protective Provisions are primarily designed to protect a certain class of employees of Empire from what is perceived to be potential adverse employment consequences.

IBEW attempts to support its proposed conditions through the use of speculation as to possible outcomes while ignoring the fact that many of the possibilities which it fears exist even in the absence of a merger. Thus, the IBEW seeks to obtain through this merger proceeding the imposition of Labor Protective Provisions as additional protection that they would not have in the absence of the merger.

The IBEW brief addresses its view that the Commission has the jurisdiction and legal authority to impose the proposed Labor Protective Provisions. This argument is in response to testimony provided by UtiliCorp witness Robert Browning wherein he pointed out that labor relations are governed by many provisions of federal law such as the National Labor Relations Act ("NLRA") (29 USC 151, et seq.), the Occupational Safety and Health Act ("OSHA") (29 USC 651, et seq.), and the Employee Retirement Income Security Act ("ERISA") (29 USC 301, and other sections). (Ex. 20, p. 7). Whether or not these federal provisions formerly "preempt" state regulation as suggested by UtiliCorp, it cannot be denied that these provisions address many of the subjects of the proposed Labor Protective Provisions.

In this case, there currently exists a collective bargaining agreement ("CBA") which governs the relationship between Empire and the IBEW. There is a careful (albeit imperfect from both sides) balance between the respective rights of parties that leads to the execution of a

CBA. (Ex. 20, p. 6). Any Labor protective provisions covering union employees would tilt the balance almost totally to labor's side, by imposing provisions beyond those agreed to by the parties, when the provision of such benefits is normally part of the give and take of the collective bargaining process. (Id. at p. 8). Thus, whether or not the Commission determines it is preempted from implementing the Labor Protective Provisions by federal law, it should consider very carefully how far it wishes to step into the collective bargaining process and how much of that process it wishes take out of the hands of the parties.

The IBEW attempts to get the Commission's attention through its allegation that UtiliCorp will not provide safe and reliable services to the Empire area. This allegation is pure speculation that has no basis in fact. UtiliCorp is a utility with a long history of providing safe and reliable service in the State of Missouri. It is UtiliCorp's intention to operate Empire's assets consistent with UtiliCorp's current operation and business model, if the merger is approved. (Ex. 28, p. 1). UtiliCorp has based its projections and conclusions regarding the Empire territory on its extensive history of successfully operating electric networks in the State of Missouri, elsewhere in the United States and internationally. (Id. at p. 2).

In preparing its plans, UtiliCorp used several of its employees with many years of utility experience to conduct a detailed evaluation of Empire's business to validate that UtiliCorp's business model was applicable to Empire's environment. (Id.). This evaluation included visiting the service territory, visiting with employees, and a review of Empire's operating information, review of Empire's historical experiences and projections for the future. (Id.). In the end, the information was shared with Empire employees for additional feedback. (Id.).

The result of this work is an operation model that is well thought through and based upon experience and actual circumstances. There is nothing from this process or the Commission's experience with UtiliCorp to indicate that UtiliCorp will not provide safe and reliable service within the Empire service territory.

Customer Service Indicators

The Staff recommends that certain service level indicators be used to track the level of service being provided to the customer, that this information be submitted to the Staff on a quarterly basis and that a mechanism for remedial action be adopted should the Company's performance be unfavorable.

As stated in the Companies' initial brief, these requirement are not necessary in this case. It is UtiliCorp's obligation, without supplemental conditions, to deliver quality service to all customers and manage the business by utilizing all available data and monitoring tools, while taking into account customer feedback. UtiliCorp has a solid track record of providing qualify service in Missouri for more than 80 years. The information used to manage the level of customer service is available for inspection at any time upon request by the Commission. (Ex. 17, p. 7).

Additionally, the Commission already has remedial measures at its disposal to address substandard performance in the area of customer service, should the need arise. Customer service is a subject within the Commission's jurisdiction and the Commission has a variety of statutes and regulations designed to assist it in exercising this jurisdiction. It is doubtful that the Commission has the authority to order, on a prospective basis, remedial standards inconsistent with those found in the Commission's statutes, without the utilities' consent.

The Staff asserts that the Commission has taken these types of steps previously by stating that these types of procedures have been "recommended and agreed to" in previous merger transactions. (Staff Brief, p. 202). The key is the fact that the procedures were "agreed to." It is one thing for the Commission to utilize a remedial procedure agreed to by a utility, it a completely different situation to require such a procedure over a utility's objection.

Other Arguments Raised in Opposition to the Merger and Regulatory Plan

Pooling v. Purchase Accounting. The Staff devotes ten pages of its 228 page brief on the differences between "pooling" and "purchase" accounting. (Initial Brief of Staff at 87-97.) Its main contention is that pooling accounting would lead to more benefits resulting from the merger. The Staff does not claim that by using the purchase method of accounting UtiliCorp's proposal is detrimental to the public. Therefore, the argument is not relevant. However, UtiliCorp has demonstrated through testimony that the pooling method is not even an option in this transaction. In fact, the Generally Accepted Accounting Principles mandate that, given the circumstances, UtiliCorp use the purchase accounting method in this case. The pooling method would have run afoul of the guidelines and would have placed the entire merger in jeopardy. (Ex. 11). That fact is not refuted by Staff.

Electric Allocations Agreement. Again, the Staff argues that MPS will not be allocated the same benefits as Empire and again, this argument is not relevant. As described in the Initial Brief of UtiliCorp and Empire, these costs and profits should flow to Empire to offset the merger costs. This is of particular importance when it comes to profits from off-system sales which represent a significant portion of the anticipated merger savings.

As has been explained previously, energy costs and profits from off-system sales associated with the joint dispatch of both the MPS and the Empire power supply resources should be allocated to the Empire operating unit because these incremental margins would not be possible except for the addition of the Empire power supply portfolio and transmission assets. Moreover, allocation of 100% of the incremental margins to Empire places the benefits with the operating unit which has incurred the costs, including premium costs, necessary to combine the companies and bring about the synergies. (Ex. 18, p. 11). UtiliCorp's decision to concentrate both the merger benefits and the merger costs in the Empire operating unit is appropriate and makes sense for the reasons indicated and will also simplify matters by avoiding issues concerning the allocation of premium and other costs to existing MPS customers.

Administrative and General Costs. The Staff contends that the Regulatory Plan will allow UtiliCorp to recover A&G costs at a much higher rate than would be recovered compared to Empire's stand-alone A&G levels. This Staff contention results from a misinterpretation by Staff of the exhibits of the Joint Applicants as pointed out in Mr. Siemek's surrebuttal testimony. (Ex. 7, p. 7). The Staff's assertion is false and in addition ignores the fact that no costs can flow through rates without the Commission's consent. Furthermore, the Staff makes no real effort in its brief to support this assertion.

Affiliate Transactions Condition. UtiliCorp will comply with all lawfully promulgated and effective Commission rules.

Load Research Condition. UtiliCorp continues to believe that this docket is not an appropriate place to establish quality control standards and checks and balances related to load research. (Ex. 17, p. 17). Any load research data requirements must take into account the tradeoffs between expense and accuracy. (Ex. 17, p. 19). UtiliCorp suggests that providing load research data on an "as needed" basis, rather than an "on-going" basis as requested by the Staff, better reflects this balance. "As needed" means having data available when needed by UtiliCorp or the Commission Staff. (Ex. 17, p. 19). It also means having data that is statistically valid and meets industry standards for accuracy and quality. (Id.). UtiliCorp wants to work with the Staff to define the appropriate level of accuracy so that UtiliCorp can then manage its collection activities to meet those standards. (Id. at 20).

The Staff has voiced concerns as to the staffing level that will be used by UtiliCorp to address load research stating that "Joint Applicants have demonstrated a desire to do as little as they can get away with." (Staff Brief, p. 210). Staffing levels, and establishing Staffing levels that will allow UtiliCorp to operate in the most efficient manner possible, are a part of UtiliCorp job in managing its collection activities, as well as its other activities. It is the foundation from UtiliCorp must build its Load Research program. (Id. at 20). If it is determined in the future that needs require additional personnel, then it is UtiliCorp's job to address those needs at that time. (Id.).

UtiliCorp is willing to participate either as a part of an electric utility work group or, to meet individually with the Staff to discuss load research requirements. Either process would better address the needs and costs of load research than would Commission-ordered standards resulting from this docket. The standards established from such a provision would then form the basis for UtiliCorp's resulting staffing decisions.

<u>Public Counsel's Regulatory Plan Condition</u>. This plan is unacceptable to UtiliCorp as it would render the proposed merger economically unfeasible.

<u>Access to Books and Records Condition</u>. There is no reason for the proposed condition because legally an agreement to comply with a lawful rule is redundant. UtiliCorp agrees to

comply with all lawfully promulgated and effective Commission rules. (Ex. 5, p. 17).

Conclusion

This Reply Brief has demonstrated that this merger is not detrimental to the public interest, the standard that must drive the Commission's decision in this case. Opposing parties, especially the Staff, have simply attempted to confuse the issues in this case by arguing, again and again, that the merger is not beneficial enough or that the merger is different than other mergers. These arguments are absolutely irrelevant to the task at hand. The Commission must approve the merger if it finds that it is not detrimental to the public interest and no record evidence of such detriment exists. With respect to conditions, UtiliCorp respectfully submits that its Regulatory Plan, or some other comparable model that will create certainty by allowing UtiliCorp's shareholders a reasonable opportunity to obtain a return on their investment, is absolutely essential to the financial viability and thus, the completion of the transaction.

In the final consideration, the Commission should approve the merger between UtiliCorp and Empire and the proposed Regulatory Plan. The "no public detriment" standard is clearly satisfied. The merger as proposed will benefit all stakeholders and the long term economic development of the State of Missouri.

Respectfully submitted,

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Certificate of Service

I hereby certify that a true and correct copy of the above and foregoing document was sent by U.S. Mail, postage prepaid, or hand-delivered, on this 21ST day of November, 2000, to all parties of record.

James C. Swearengen