

Schedule No.:
Issues: Merger Savings/Merger
Costs/Ratemaking Treatment
Witness: Gary L. Rainwater
Type of Exhibit: Surrebuttal Testimony
Sponsoring Party: Union Electric Co.
Case No.: EM-96-149

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. EM-96-149

SURREBUTTAL TESTIMONY

OF

GARY L. RAINWATER

**St. Louis, Missouri
June 3, 1996**

MISSOURI PUBLIC SERVICE COMMISSION

STATE OF MISSOURI

In the matter of the Application)
of Union Electric Company for an)
order authorizing: (1) certain)
merger transactions involving) Case No. EM-96-149
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.)

AFFIDAVIT OF GARY L. RAINWATER

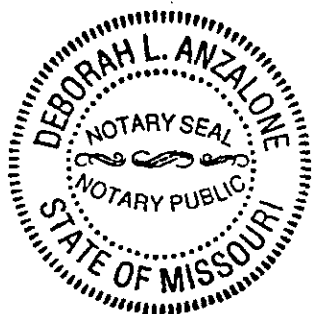
State of Missouri)
) SS.
City of St. Louis)

Gary L. Rainwater, being first duly sworn on his oath, states:

1. My name is Gary L. Rainwater. I work in the City of St. Louis, Missouri, and I am Vice President of the Corporate Planning Function of Union Electric Company.
2. Attached hereto and made a part hereof for all purposes is my Surrebuttal Testimony consisting of pages 1 through 6, 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.

Gary L. Rainwater
Gary L. Rainwater

Subscribed and sworn to before me this 31 day of May 1996.



Deborah L. Anzalone
Notary Public

DEBORAH L. ANZALONE
NOTARY PUBLIC—STATE OF MISSOURI
ST. LOUIS COUNTY
MY COMMISSION EXPIRES APR. 18, 1998

1 UNION ELECTRIC COMPANY

2 CASE NO. EM-96-149

3 SURREBUTTAL TESTIMONY OF GARY L. RAINWATER

4 **Q. Please state your name and business address.**

5 A. My name is Gary L. Rainwater, and my business address is
6 1901 Chouteau Avenue, St. Louis, Missouri 63103.

7 **Q. By whom are you employed and in what position?**

8 A. I am employed by Union Electric as Vice President of Corporate
9 Planning.

10 **Q. Are you the same Gary L. Rainwater who previously filed direct
11 testimony in this case?**

12 A. Yes, I am.

13 **Q. What is the purpose of your testimony?**

14 A. The purpose of my testimony is to rebut portions of the testimony of
15 Mr. Thomas M. Imhof and Mr. Mark L. Oligschlaeger, Commission Staff witnesses,
16 and to rebut a portion of Mr. Maurice Brubaker's testimony on behalf of the
17 Missouri Industrial Energy Consumers.

18 **Q. Regarding Mr. Imhof's testimony, Mr. Imhof states that, with one
19 exception, actual "costs to achieve" incurred by UE to effectuate the merger
20 should be included in rates. The one exception is that Mr. Imhof believes
21 costs related to executive severance packages should be excluded from
22 rates. Please comment.**

23 A. Mr. Imhof argues in his testimony that the cost of executive severance
24 packages should be excluded from rates because they are created only for the
25 personal protection of executives and Company stockholders. That is an incorrect
26 conclusion. The primary purpose of severance plans is to ensure that key
27 executives have sufficient financial security to make objective decisions during a
28 merger. Without such plans, sound executive decision making could be

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1 compromised. Executives could potentially put their own self interests ahead of
2 their company's interests, making decisions that ultimately increase costs to
3 customers. An example would be an executive who could attempt to structure the
4 merged organization in a way that protected his own job, but added cost to the
5 company which would be borne by customers. Executive severance packages
6 provide insurance, or a preventive measure, that helps companies avoid the costs
7 of poor executive decisions. Our view is that it would be imprudent not to provide
8 such severance plans.

9 **Q. Regarding Mr. Oligschlaeger's testimony, Mr. Oligschlaeger**
10 **notes that Deloitte & Touche's merger savings estimate was by necessity**
11 **broad brush and not sufficiently detailed to support an estimate of merger**
12 **savings. Do you agree?**

13 A. The Deloitte & Touche savings estimate was by necessity
14 accomplished at a high level. However, I do not agree with Mr. Oligschlaeger's
15 conclusion that lack of detail means the results are inadequate to support an
16 estimate of merger savings.

17 The fact that the Deloitte & Touche analysis was restricted to major savings
18 categories logically leads to the conclusion that it is a conservative estimate, that a
19 more detailed estimate would likely verify even more savings, and that the
20 Companies' actual merger savings will likely exceed the Deloitte & Touche
21 estimate. Viewing the likelihood of greater savings in the context of the
22 Companies' proposed Shared Savings Plan, it would also be logical to conclude
23 that customers are likely to receive even greater benefits from the merger than the
24 Companies originally estimated. It was appropriate, however, to verify the Deloitte
25 & Touche estimate by completing a more detailed analysis of merger savings.

26 **Q. Have the Companies performed a more detailed estimate of**
27 **merger savings?**

28 A. Yes. In April the Companies completed their merger transition

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1 planning. As part of that effort, the Companies developed a much more detailed
2 estimate of merger savings. That detailed study verifies the conclusion I noted
3 above, that the original study was conservative and that more detailed analysis
4 would substantiate greater savings. The Companies' updated merger savings
5 analysis indicates that actual net savings will exceed the Deloitte & Touche
6 estimate by almost \$140 million. Mr. Craig Nelson, who will become Ameren's Vice
7 President of Merger Implementation upon completion of the merger, will testify in
8 more detail to the updated savings estimate.

9 **Q. One of the faults Mr. Oligschlaeger finds with the Deloitte &**
10 **Touche estimate of merger savings is that insufficient time was spent on that**
11 **study. How much additional time was spent on the updated study?**

12 A. As Mr. Nelson explains in his testimony, the updated study involved
13 the efforts of more than 400 people over a period of more than seven months. It is
14 as complete and thorough an analysis of merger savings as the Companies could
15 ever hope to perform.

16 **Q. Is Mr. Oligschlaeger aware of the Companies' revised savings**
17 **estimate and the amount of work expended in that effort?**

18 A. Yes.

19 **Q. Does Mr. Oligschlaeger have an opinion of that study?**

20 A. Yes. Mr. Oligschlaeger's opinion regarding that estimate, as he
21 pointed out on page 17 of his testimony, is that no amount of detail or support will
22 ever be sufficient to satisfy him. He holds that view because he believes that in
23 setting rates " the appropriate policy is to base future rate levels on actual savings
24 results from the merger rather than rely on estimates."

25 **Q. Do you agree that setting rates based on actual merger savings**
26 **is the appropriate policy standard for the Commission to use in this case?**

27 A. Not entirely. An appropriate policy must be based on a standard that
28 can be met. Since it is not possible to determine merger savings without the use of

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1 estimates, Mr. Oligschlaeger may be advocating an impossible standard. If the
2 Commission were to adopt such a standard, it could effectively deny the Company
3 any possibility of completing the merger in a way that allows stockholders to
4 recover their cost of the merger.

5 **Q. Does Mr. Oligschlaeger recognize that it is not possible to**
6 **determine actual merger savings, even through the use of so called “tracking**
7 **mechanisms”?**

8 **A.** Yes. Mr. Oligschlaeger agrees with my direct testimony that such a
9 determination is not possible. Savings can be estimated prior to a merger, as the
10 Companies have already done in great detail as part of our merger transition
11 planning. Alternatively, savings can be estimated or reestimated following a
12 merger by comparing actual combined costs against estimated stand-alone costs.
13 In either case, determining merger savings necessarily involves the use of
14 estimates. Both Mr. Oligschlaeger and the Company are well aware of that fact.

15 **Q. Given the possibility that the Staff would argue that future rates**
16 **must be based on actual merger savings rather than estimated merger**
17 **savings, why has the Company structured its Shared Savings Plan in a form**
18 **that relies on estimates?**

19 **A.** The Company structured its plan based on a shared savings concept
20 because we felt that was the fairest and most reasonable method we could devise.
21 It would allow stockholders to recover their merger costs, while allowing customers
22 to also benefit from the merger. As I have noted above, it is not possible to
23 determine merger savings without the use of estimates. Therefore, it is not
24 possible to develop a structured approach to share merger savings over a ten-year
25 period without the use of estimates.

26 **Q. Mr. Oligschlaeger maintains that Staff’s ratemaking proposal**
27 **reflects actual merger savings and costs in rates. Do you agree?**

28 **A.** I do not agree in regard to costs. Staff’s proposal does not recognize

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1 the merger premium as a cost, even though the premium will be the most significant
2 and critical cost necessary to accomplish the merger.

3 In regard to savings, Staff's proposal would allow stockholders to share
4 actual merger savings, but only through the remaining term of the Company's
5 experimental alternative regulatory plan. If the merger closes at the end of
6 March, 1997, that would provide a possibility of sharing for a period of 15 months.
7 However, it would provide absolutely no possibility of stockholders recovering their
8 cost to accomplish the merger. At best, assuming all merger savings accrued to
9 stockholders during that period, it would allow less than ten percent of cost
10 recovery.

11 **Q. How would the Staff's proposal allow for merger cost recovery**
12 **after the alternative regulatory plan expires?**

13 A. It apparently would not provide for any continuing cost recovery.
14 Furthermore, in view of Mr. Oligschlaeger's opinion that it is inappropriate to base
15 rates on estimates of merger savings, and in view of the fact that actual merger
16 savings cannot be determined without the use of estimates, Staff would presumably
17 propose that all merger savings flow to customers at the expiration of the
18 alternative regulatory plan.

19 **Q. Has Staff proposed to do so?**

20 A. No, but Mr. Oligschlaeger's arguments that actual merger savings
21 cannot be determined, and that estimated savings should not be included in rates
22 as a matter of policy, would lead to that result by default. The Commission's
23 acceptance of Staff's proposal could effectively deny stockholders any chance of
24 recovering more than 90 percent of their merger investment.

25 **Q. In regard to Mr. Brubaker's testimony, Mr. Brubaker recommends**
26 **that UE be required to file complete rate case proceedings to establish a**
27 **baseline for use in determining UE's post-merger rates. Please comment.**

28 A. It is unclear exactly what Mr. Brubaker is attempting to accomplish in

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1 this proposal. If his aim is to use a general rate case as the basis for a tracking
2 mechanism, I fail to see how that would work.

3 If Mr. Brubaker's objective is to set new baseline rates prior to the expiration
4 of the Company's alternative regulatory plan, that would be entirely unnecessary in
5 light of the existence of that plan.

6 If Mr. Brubaker's objective is to set post-merger rates without including the
7 portion of merger savings necessary to allow stockholders to recover their costs,
8 then that objective is equally inappropriate. Our stockholders will make a
9 substantial investment to complete this merger. They deserve an opportunity to
10 recover that investment.

11 Q. Does that conclude your surrebuttal testimony?

12 A. Yes.