BEFORE THE PUBLIC SERVICE COMMISSION

STATE OF MISSOURI

TRANSCRIPT OF PROCEEDINGS

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In the Matter of the Joint Application of UtiliCorp United Inc., and St. Joseph Light & Power Company for Authority to Merge St. Joseph Light & Power Company with and into UtiliCorp United Inc., and, in Connection Therewith, Certain Other Related Transactions.) Case No. EM-2000-292

MORRIS WOODRUFF, Presiding,
REGULATORY LAW JUDGE.
SHEILA LUMPE, Chair
CONNIE MURRAY,
ROBERT G. SCHEMENAUER,
M. DIANNE DRAINER, Vice-Chair
KELVIN SIMMONS
COMMISSIONERS.

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JUDGE WOODRUFF: And it's my understanding from discussions with the parties before we went on the record that Dr. Proctor will be testifying for Staff first; is that correct?

MR. DOTTHEIM: Yes. That would be correct.

JUDGE WOODRUFF: You may call your witness.

MR. DOTTHEIM: Yes. The Staff would call Dr. Michael S. Proctor to the stand.

JUDGE WOODRUFF: You may inquire. Oh, I'm sorry. I need to swear him first.

(Witness sworn.)

JUDGE WOODRUFF: Now you may inquire.

MR. DOTTHEIM: As far as marking of Dr. Proctor's rebuttal testimony, it's been pre-marked as Exhibit No. 714.

JUDGE WOODRUFF: Yes.

MR. DOTTHEIM: And I have three copies.

JUDGE WOODRUFF: Go ahead.

(EXHIBIT NO. 714 WAS MARKED FOR IDENTIFICATION.)

MICHAEL S. PROCTOR testified as follows:

DIRECT EXAMINATION BY MR. DOTTHEIM:

Q. Would you please state your name for the record.

A. By name is Michael S. Proctor.

Q. And would you please identify your place of employment.

A. I'm employed by the Missouri Public Service Commission.

Q. You're the same Michael S. Proctor that caused to be filed rebuttal testimony and cross-surrebuttal testimony in this proceeding?

A. That's correct.

Q. Now, you have a copy of your rebuttal testimony that's been pre-marked as Exhibit 714?

A. Yes, I do.

Q. Dr. Proctor, at this time do you have any corrections to make to Exhibit No. 714? We're only taking up this morning the regulatory plan overall issue, but if you have corrections for the entire document, it probably would be beneficial if you would provide those this morning.

A. Okay. Yes. On page 32 at line 6 the sentence reads, Utility B will make a per unit profit of $30 a megawatt hour of minus 25. That should be minus 28. And that will equal a $2 per megawatt hour instead of a $5 per megawatt hour.

And then the next line giving a total profit of -- it should be $200 instead of $500. And in line 8, the next line, it should read $1,700 plus $200 equals $1,900.

Kind of corresponding with those corrections, back on Schedule 3.1 there's a table at the top of that schedule. Under the portion of that table you -- it's entitled Utility A, there are three numbers -- actually there are four, $20, $25, $18 and $30. And the $18 should be 28. And under Utility B there are two numbers, $25 and a $30 number. And the $25 number should be 28. And those are my corrections.

Q. Dr. Proctor, if I asked you the same questions that are in your rebuttal testimony today, would your answers as you've just corrected them be the same?

A. Yes, they would.

Q. Do you adopt Exhibit 714 as your rebuttal testimony in this proceedings?

A. Yes, I do.

MR. DOTTHEIM: At this time I'd like to offer Dr. Proctor for cross-examination and move Exhibit 714 into evidence, but I understand that it will not be received until -- if I understand correctly, until Dr. Proctor has testified on the last issue for which he is identified as a witness.

JUDGE WOODRUFF: Okay. If you'll keep track of when that is, and I'll try and keep track of it also as to when the schedule is coming in and mark it as offered at this point.

All right. He's been offered for

cross-examination, so we'll begin with Department of Natural Resources.

MS. WOODS: I have no questions. Thank you.

JUDGE WOODRUFF: AGP?

CROSS-EXAMINATION BY MR. CONRAD:

Q. Good morning, Dr. Proctor. I just have one question and it refers to your correction. The one that you were making on the -- you characterized it as a table?

A. Yes.

Q. Would you give me that page again, please?

A. It's Schedule 3.1. It's at the end of the testimony. The schedules are at the end of the testimony.

MR. CONRAD: Okay. All right. Thank you. That's all, your Honor.

JUDGE WOODRUFF: Thank you. And for Springfield? Not here today.

Public Counsel?

MR. MICHEEL: No questions of Dr. Proctor on this issue.

JUDGE WOODRUFF: Union Electric is also not here today.

Then for UtiliCorp?

MR. SWEARENGEN: Thank you.

CROSS-EXAMINATION BY MR. SWEARENGEN:

Q. Dr. Proctor, my question is really more focused on the topic that you're on the witness stand for this morning. I understand the subject is regulatory plan overall. And Mr. Dottheim, while we were off the record, indicated to me, I believe, that your testimony that you think fits that topic starts on page 15; is that correct?

A. That's correct.

Q. Policy implications and various methods for sharing merger savings?

A. That's correct.

Q. And that would end on what page?

A. It should end on page 22.

MR. SWEARENGEN: Okay. Thank you. That's all I have. Thanks.

JUDGE WOODRUFF: St. Joseph Light & Power?

MR. COMLEY: No questions. Thank you.

JUDGE WOODRUFF: Thank you. Questions from the Bench starting with Chair Lumpe?

CHAIR LUMPE: I'll pass.

JUDGE WOODRUFF: All right. And Commissioner Murray?

COMMISSIONER MURRAY: I don't have a lot of questions for Dr. Proctor. I didn't realize he was up first today so I wasn't prepared for him. Good morning, Dr. Proctor.

THE WITNESS: Good morning.

COMMISSIONER MURRAY: Let's see here. I know when I read your testimony the first time, I did have some questions, but let me pass for right now.

JUDGE WOODRUFF: Commissioner Schemenauer?

COMMISSIONER SCHEMENAUER: Thank you.

QUESTIONS BY COMMISSIONER SCHEMENAUER:

Q. Good morning.

A. Good morning.

Q. I had a question on the rate freeze.

A. Yes.

Q. If the rate freeze were in effect and legislation to deregulate the electric market or restructure it passed, how would that -- how would that effect the overall agreement that is being proposed?

A. The agreement that the company's proposing, my understanding is that if legislation passed and retail competition came into place at some point in the future, that the company would then need to come forth at that point and propose an alternative regulatory plan to what they've proposed here.

One reason for that is -- the company's view is that there are significant savings from joint dispatch of generation. And, of course, if you move to regulatory -- I'm sorry, to retail competition, then whatever savings are there from joint dispatch would go to the non-regulated entity.

And if you're using the savings from that joint dispatch to off set a -- in this case an acquisition adjustment and all of a sudden you've taken those savings and you've put them over in a non-regulated entity, then I think you have to do some compensation on the other side and not leave a liability there for what remains as the regulated entity. So that's the type of thing that I think would have to occur.

Now, how they would specifically do that, as I understand, would be open. It's just that the plan at that point would need another filing.

Q. Okay. And if I understand the rate freeze according to the testimony yesterday, the five-year freeze was to allow the company to recover their acquisition premium or part of it. They expect to recover half of it, I guess, in the first five years. The cost to achieve, none of that would be recovered with the rate freeze through the synergies that they predict will occur in the first five years?

A. No. I think it's a combination of things. The cost to -- depending upon how you define the cost to achieve. If you mean a cost outside of the acquisition premium --

Q. And that's the way the testimony --

A. Right.
Q. -- is broken down. They have, I think, $92 million acquisition premium and then there was a litany of costs to achieve that I don't remember if someone suggested they be expensed immediately, somebody said no, they ought to be amortized, somebody said they ought to be in the rate base. So I know that's all up in the air, but that whole area is going to take, according to the testimony, 10 years --
A. Yes.
Q. -- for them to recover those costs?
A. Their plan is a 10-year plan, that's correct. And those costs are -- well, costs and savings that they've looked at are over that 10-year period. So during the first five years -- they put in a rate freeze, hopefully, they achieve some of the merger savings during that first five years.

At the end of that five years, I believe their plan is to provide the Commission or -- a measurement of what has been achieved to go forward from that point with rate cases for St. Joe Light & Power. And one thing that really needs to be clarified, I think, is the 1.6 million that they're committing to is not a rate decrease for St. Joe. What it is is a decrease in revenue requirements for St. Joe Light & Power.

So if costs have gone up -- in fact, St. Joe's rates may go up, but they are committing to 1.6 million decrease in the cost of service, whatever that cost of service may be.

Q. Even an inflationary increase?

A. Yes.

Q. If we have a competitive market, an open market in the electric industry in Missouri, why should they ask for protection and reimbursement of their acquisition costs? Why shouldn't they just be thrown to the wolves like the rest of them?

A. That's a good question. That's probably one that the company ought to answer, but we're in this -- we're in this -- I don't know whether I'd want to call it a transitionary period or a period of uncertainty where we don't have retail competition, but we -- it might come at some point in the future.

I think if we had retail competition today, a lot of what they are calling merger savings would attribute to a deregulated generation company. Okay? And to the extent that they could recover through profits through that generation company the dollars, that portion would not need to be recovered from the regulated company. But we're not there yet. And so their proposal, in order to recover it, is to include it as an adjustment for the total company at this point in time.

Q. These agreements with companies are -- or they seem like they're relatively simple at first, but as they're in force, there seems to be a whole lot of areas that somebody didn't mean this and that. And I'm not indicating I would be in favor of recovering any acquisition costs, because I -- well, I'm up in the air on that, but to make it simpler for the Commission to look at, why didn't they just construct a T-account and put the debts for all the expenses they want to cover and credits for all the synergies they expect to gain and let us look at that instead of this web that we're looking at?

A. Again, I think that's a very good question. I don't know if I -- I don't know if I can answer that. Part of it is because -- I suspect that the regulatory plan was viewed as such an integral part of this merger by the company. At least that's what appears to me to be in testimony and appears to me to be what I'm hearing today.

That it was such an integral part in recovery of the acquisition premium, was such an integral part of this particular merger, that it is really hard to just separate pure benefits and costs from a plan to recover those costs that the company has put forth.

Q. Is it kind of like a computer program, the program has a lot of back doors but only the programmer knows where they are?

A. Well, that's probably true, yeah.

COMMISSIONER SCHEMENAUER: That's all I have. Thank you very much, sir.

JUDGE WOODRUFF: Commissioner Simmons?

COMMISSIONER SIMMONS: I have no questions at this time, your Honor.

JUDGE WOODRUFF: Chair Lumpe?

QUESTIONS BY CHAIR LUMPE:

Q. I have my thoughts together. Thank you. The number of years we've heard mentioned about the change is rapid, and you mentioned uncertainty --

A. Uh-huh.

Q. -- and that's why I'm a little nervous about the number of years that this plan is in place, the five-year moratorium and then ten more years out. If change is so rapid and the potential legislation at either level, federal or state, that time line sort of bothers me. Do you have insight about that?

A. Yes. I -- the major concern that I expressed in my testimony is that this regulatory plan stretches over a period of 10 years. In that 10-year period Missouri Public Service customers will see no benefits from this merger. That concerns me greatly about the proposed regulatory plan. And that's one of the -- one of the major concerns, is that we treat Missouri Public Service customers as if a merger did not take place for the next 10 years.

Frankly, I think that's just way too long. I mean, I'm comfortable with the concept of sharing over a -- some short period of time that's reasonable, but I -- that was a major concern that I had, was that there was no sharing for the Missouri Public Service customers and that -- you know, maybe if that was for a three-year period of time, I would have felt a little bit more comfortable with that, but for a 10-year period of time, I'm just totally uncomfortable.

Q. You also talked about measuring the savings, and I got -- I have a strong impression that this is sort of a guess and by gosh on the savings. And I think you said it's impossible to measure merger savings on an ex-post basis, which is being proposed, as I gather?

A. That's correct.

Q. And you talk about benchmarking. How would you go about -- I think you have some discussion on page 19 about that, but if you would sort of clarify that a little bit for me?

A. Well, benchmarking is basically a method to -- some people would call it indexing, benchmarking, those -- those terms may have specific meanings to specific people, but generally the concept is that you set out ahead of time the target, okay.

We -- our targeted level for overhead expenses or targeted level for fuel or whatever it is, this is -- this is our target. And if we're going to do some sharing, the sharing's going to be based upon how well we do in terms of achieving that target. Okay?

And so if we -- if we overachieve, if we do better than the target level or the benchmark level, then there's an additional sharing that goes to the company, so it provides an incentive to achieve the savings that have been estimated.

On the other side of it, if we don't do as well as the targets or the benchmark, then the company doesn't get to share as much in those merger savings, and so there's, in essence, a penalty. So there becomes a real incentive for the company to achieve that which they have said they can achieve at the outset.

Q. How did they arrive at those targets? Is that subject to agreement and discussion, in other words, or do you just say, Company, set some targets and we'll assess them, or shouldn't there be some sort of discussion and agreement on whether those targets are rational?

A. Yes. Absolutely. And that's what's making benchmarking difficult. And part of it is here's our budget of where we would be without the merger. Here's what we believe will be the merger savings. The combination of those two produce the target.

So if we think overhead expenses for the combined -- for each of the stand-alone companies before the merger five years out are going to be, let's say, $30 million and the claim is made by the company that they can achieve $5 million savings in overhead, okay, then the target would be 25 million.

What makes it difficult is coming to some kind of an agreement about whether or not the budget that has been projected is a reasonable level as a starting point. But you have that any time you claim there are going to be savings, any time you -- that are going to occur in the future, you're going to have to struggle through either making assumptions about what it would have been without the merger in order to try to measure the savings ex-post, or sit down beforehand and say, Here's a reasonable target, here's a reasonable level that we're shooting for beforehand, and we believe this to be reasonable for whatever reasons. And once you come to that understanding, then you -- then you can set that as a target and you can measure off of it.

Q. Would doing a rate case to set a benchline or a benchmark be appropriate? In other words, you could set -- if you were over earning, you could set a target and it would be easy to meet, wouldn't it?

A. Right. I think if you start with the rate case, then -- and based upon what you expect in terms of the reasonable assumptions about growth and reasonable assumptions about where expenses and investments are going to be going in the future -- and now, I'm not talking about a 10-year period because the further you get out, the more unreasonable these things can become.

Q. I was going to say, wouldn't you want some shorter period --

A. Yes.

Q. -- in between to do adjustments maybe instead --

A. You could. But the other thing is you -- there are probably things that you can't control. Okay? And so you kind -- you need to work that in as well. What are things that are outside of the control of the utility that need to be taken into account when you're putting together this budget and this estimate? And you may have to adjust for those things.

Q. That argues then for a shorter time line?

A. Yes. I think it does.

CHAIR LUMPE: Okay. Thank you, Dr. Proctor.

JUDGE WOODRUFF: Commissioner Murray?

COMMISSIONER MURRAY: Thank you.

QUESTIONS BY COMMISSIONER MURRAY:

Q. Good morning again, Dr. Proctor.

A. Good morning.

Q. We've talked about the concept of sharing the merger savings and the merger costs --

A. Yes.

Q. -- and the difficulty of tracking the savings.

A. Yes.

Q. If you were to look at just allocating both the costs and the savings to either the shareholders or the ratepayers --

A. Uh-huh.

Q. -- would the tracking be just as difficult?

A. Yes.

Q. So that --

A. Tracking the cost usually is not very difficult because those are things that occur. It's tracking the savings, because the savings is the difference between what actually did occur and what would have occurred absent the merger. The problem is, what do you use as the basis for what would have occurred absent the merger?

Q. And with the plan that is proposed here, for the first 10 years all of the costs that would be allocated to ratepayers as well as all of the savings to ratepayers would go only to the St. Joseph Light & Power customers; is that correct?

A. That's correct.

Q. And as I've read everyone's testimony on this, I keep struggling with the reason for that. Why would the other customers of UtiliCorp not share in any of the costs or any of the savings during that first 10 years?

A. Well, let me first clarify. It's not all the other customers of UtiliCorp.

Q. It's the Missouri customers?

A. It's the Missouri Public Service customers. Because the other non-Missouri customers do share through -- by adding St. Joe, the allocations of overhead costs are reduced to other service territories. It's only in the case of Missouri Public Service that the company has stated we want to keep the allocation to Missouri Public Service of overhead costs the same as it is currently. So that's the only -- I think the answer to that is to fund the acquisition adjustment. I think that's the answer.

Q. And in order to fund it by not having Missouri Public Service customers share in the savings would allow -- would that allow the company to somehow charge some of the expenses to Missouri Public Service without providing any of the benefits?

A. I think the concept -- and now you're asking really a very detailed question about what might happen in a rate-making proceeding. I would say the concept was -- was to hold Missouri Public Service customers harmless. And by that I mean that they would not see any higher rates or lower rates from the merger then what they would see absent the merger.

Now, of course, that's -- in practice that's extremely difficult to do. I'm much more comfortable with an index-type of thing in which benefits are shared among -- among the various jurisdictions.

Q. As the company has proposed, would Missouri Public Service customers share in the savings after the 10-year period assuming there were --

A. They haven't said. But I assume that they would, yes. At that point you would just go with actual costs and to the extent that there were savings there, they would share in those.

In other words, one of the things that I can't -- well, one of the things that I assume is that after the 10-year period, the normal allocations formula for allocating overhead costs would apply to Missouri Public Service. They wouldn't be held to the old allocation formula. So they -- they would get some benefit from that.

See, when you add -- when you add an additional unit to allocate these overhead costs to, then the existing units, their percentage allocation should go down. In this case, for 10 years that wouldn't happen.

Q. And after 10 years I would think it would be even more difficult to track any merger-related savings?

A. I don't think there's any intention to track savings at that point. It's just whatever the costs are. But we will go back -- we will apply the regular allocation formula at that point.

Q. Tell me about your opinion of incentive regulation and -- or is this not an appropriate time to ask you that?

A. No. I think it fits. I -- I struggle with incentive regulation as a concept. Incentive reg-- and that's because anything that we come up with is going to have some flaws in it. There's -- I don't think there's any perfect system. I don't think the rate of return system is perfect.

Traditional economics would say there -- there is an incentive to over invest and there is an incentive to under utilize technology in the traditional regulatory concept. Incentive rate-making, I think by itself there's a tendency for the utility to cut costs at all costs and maybe cut performance. And that concerns me.

So people have talked about performance-based rate-making. And what that means is that now we are going to -- we're not just going to share profits as an incentive, but we're going to measure performance. And if you don't perform well, we're going to cut the sharing.

The problem is trying to list all of the areas of performance and in trying to measure all of those. Clearly we struggle with that concept in even -- every business does in terms of providing incentives for its employees and that type of thing. It's not easy, but I think it can be done.

My preference is to go to specific areas where you can measure and give incentives and to focus on those. And my testimony happens to deal, in this particular case, with -- with the production costs area. And a big issue in this particular case is the profits that this utility -- merged utility can earn in the off-system sales market, the wholesale -- competitive wholesale market.

And there may be incentives there to do it, there may be no incentives to do it. Regulatory lag may be enough of an incentive to do it without putting it in a specific incentive plan. Problem with regulatory lag is that once you do it, it kind of becomes a benchmark and costs are lowered by that.

And where the sharing -- the sharing concept or incentive concept allows the -- gives the utility to -- an incentive to keep doing this; not just to do it, collect some profits for a short period of time and then have its costs lowered. So I have mixed feelings about it, but I think in certain situations it can work.

Q. Thank you for answering that. I think -- it seems like one of the most difficult things and not just related to merger savings, but related to regulation in general is the ability to measure and the ability to agree on what it is you're measuring.

A. That's --

Q. And actually the criteria by which to measure. So that's not just a problem with merger-related savings; is that correct?

A. That's correct.

COMMISSIONER MURRAY: Thank you for your testimony.

JUDGE WOODRUFF: Commissioner Simmons?

COMMISSIONER SIMMONS: Yes. Thank you, your Honor.

QUESTIONS BY COMMISSIONER SIMMONS:

Q. Good morning, Dr. Proctor.

A. Good morning.

Q. You'll have to bear with me for a little while. I'm kind of new, and I know I won't get away with that much longer, so I'm going to take advantage of it now.

Just as I got all geared up to understand energy cost-related savings, I noticed in your rebuttal testimony that you'd rather use the terminology energy cost-related opportunities?

A. That's correct.

Q. Could you expand on that and give me the differences between the two?

A. Yes. The company uses the terminology energy cost-related savings because in their view the merger is producing savings that wouldn't be there absent the merger. That -- and that amounts to about $100 million over a 10-year period.

That can be split almost 50/50 between opportunities in the off-system sales market -- increased opportunities in the off-system sales market, I should say, and what they would call joint dispatch savings. So those are the two categories that make up the 100 million, and it's pretty close to 50 million in each category.

My view of the world is a little bit different, I guess, than the company's. My view of the world is that the wholesale market is evolving and is expanding and is -- with what the Federal Energy Regulation Commission is doing with regional transmission is becoming more and more fully competitive.

And in a fully competitive market you produce opportunities. You produce more opportunities for companies to decrease their costs and increase their profits.

Decrease their costs because they have more opportunity to buy cheaper power to replace their more expensive generation. And more opportunities for profits in that they can sell -- when they have the cheaper generation, they can sell it in the wholesale market and make more money on it.

Q. Would you characterize energy cost-related opportunities as being much more broader in nature and is that --

A. Has a broader view of what the market is. The savings concept has a view -- I think a fairly narrow view of what that market is.

Q. In your testimony earlier, you talked about Missouri Public Service customers not receiving any of the savings. Would that also mean that they would not receive any of the opportunities also?

A. That's correct.

COMMISSIONER SIMMONS: Thank you. That's all the questions I have.

JUDGE WOODRUFF: I have no questions, so we'll now go to recross. And starting with Department of Natural Resources?

MS. WOODS: I have nothing. Thank you.

JUDGE WOODRUFF: AGP?

MR. CONRAD: Just a couple follow-ups, your Honor, and I'll try to be brief.

RECROSS-EXAMINATION BY MR. CONRAD:

Q. Dr. Proctor, I believe in discussion with Commissioner Schemenauer you clarified something, and I wanted to be sure that I understood what you said about -- and I think the question was about the 1.6 million.

A. Okay.

Q. And my understanding of your statement was that it was a reduction in revenue requirement that was being guaranteed rather than a reduction in rates itself --

A. That's correct.

Q. -- is that right?

So if I understand that, if something else in that period of time, whatever that something else might be --

A. Right.

Q. -- went up at least 1.6, but let's hypothesize 1.6 million, and this reduction were applied, then it would just be a wash. And I think your point was that if it went up -- that something else went up let's say more than 1.6 million, you might then still see an increase in rates -- real rates that customers pay in St. Joe. Do I have that correct?

A. You have that correct, yes.

Q. Okay. Now, change gears a second. Commissioner Schemenauer also asked you something about the competition and the status of that. Were you here yesterday for most of the day?

A. For a portion of the day, yes.

Q. Well, let me just ask you rather than ask you if you heard what they were saying. In any of the proposals that you have seen regarding deregulation, either in this state or any others, have you seen any of those suggest that the wires and the poles, the distribution system itself, was to be deregulated?

A. No. Almost all of the deregulation that has been proposed before state legislatures or has been passed have focused on the generation. Now, there are folks out there who believe that the transmission system can be deregulated, but I have not seen any proposals. I have -- I know there are also folks out there that believe the distribution systems can be deregulated, but I have not seen those proposals.

Q. Now, currently the transmission system is regulated, you'd agree, by FERC?

A. Jointly by FERC and State Commissions.

Q. And the market for generation, how would you characterize that as being regulated or deregulated?

A. It varies by state. The wholesale markets are basically deregulated. And when I say "basically deregulated," there are still instances where utilities can only sell at regulated prices in the wholesale market, but for the most part most utilities have gotten permission from the FERC to sell at deregulated prices in that market.

Q. Well, now to follow-up on what I understood Commissioner Schemenauer's question to be, this proposal has been criticized on the basis that it is using the regulated part of the company's business or the companies' business, both Mo Pub and St. Joe Light & Power as opposed to, in effect, funding an enhancement of the competitive position of the combined entity in a market which is either partially or almost fully deregulated. Would you comment on that criticism?

A. Well, I think certainly when you look at the way it -- this merger was evaluated and where the synergies are produced, if you want to call it that, and you look at $100 million in the generation sector and you ask yourself, Where's that coming from and what's producing it and where are we going to be three years from now and who's going to get the benefits from that, the answer is pretty clear.

You know, three years from now we're in a totally deregulated scenario. Then the benefits will go to the generation company, the deregulated generation company. And I think that's where -- that's where -- at least my understanding of what you're talking about is coming from. The benefits are very short lived if -- if we -- if we move to deregulation.

On the other hand, if we don't -- if, say, for 10 years -- for the next 10 years we remain regulated, there's very little benefit that's going to the regulated site, because most of it's going to pay off the acquisition premium. I think that's the real complaint.

Q. Now, finally Commissioner Murray asked you a couple of questions about how the other Missouri customers -- or let's say the non-Missouri UtiliCorp customers were sharing. And you used the term "fund the acquisition adjustment." Do you remember that?

A. Yes.

Q. I missed that in your testimony. It may have been there, but would you help me understand what you mean when you say, "Fund the acquisition adjustment"?

A. Well, if you're allocating all of the merger savings to St. Joe Light & Power and you've booked the acquisition adjustment, then you're using -- you're essentially using that allocation to that company in order to produce the profits to pay off the acquisition adjustment is the way I view it.

Now, I realize post-merger that -- that it really doesn't matter whether I book this thing with St. Joe or I book it with UtiliCorp or where I book it. I mean, you know, it's there. My -- what I was really speaking about was why weren't Missouri Public Service customers getting any benefit from this merger over a 10-year period? That's -- you know, that was my complaint.

MR. CONRAD: Okay. Thank you, your Honor.

JUDGE WOODRUFF: Springfield's not here, so we'll go to Public Counsel.

RECROSS-EXAMINATION BY MR. MICHEEL:

Q. Yes, Dr. Proctor. Commissioner Schemenauer asked you numerous questions about the five-year rate freeze. Do you recall those questions?

A. Yes.

Q. And he also asked you some questions about what would happen if the generation was spun off. Do you recall those questions?

A. Yes.

Q. Do you know whether or not St. Joe Light & Power Company has a stranded generation benefit?

A. Well, St. Joe Light & Power is one of the lowest cost utilities in the state.

Q. So --

A. And -- and we -- whether there's stranded benefits -- by that I think you mean if we separate their generation out as a component and compare it to what we think the market price for electricity is going to be, I think there -- they will be well below the market price for electricity.

Q. Do you have any -- have you seen any information just to give me an idea of magnitude of that amount?

A. Well -- and this is from memory. When we worked the last couple of years with the state legislature on this, we attempted some separation in terms of what were filed in their annual filings and -- to try to get a feel for this.

In that you have -- you have to allocate some overhead costs, so you have to make some assumptions. My recollection of that is that we -- and this was historical, and I don't know what have happened to those costs since then, but St. Joe, my recollection, with overhead allocations, was under 2 1/2 cents a kilowatt hour.

At the time we did this, I think most people believed that the market price was going to be something over that, something maybe even in excess of 3 cents a kilowatt hour.

Q. Commissioner Schemenauer also asked you about the regulatory plan. Have you seen any information in the regulatory plan presented by applicants that indicates that it would definitely cease the 10-year plan if there were legislation?

A. My understanding was that the conditions of the regulatory plan were subject to change at the time of retail competition. Now, I -- I can't tell you specifically whose testimony that was in. I think it was in John McKinney's testimony, but --

Q. Commissioner Murray asked you about incentive regulation. Do you recall those questions?

A. Yes.

Q. Do you believe that utilities already have a large incentive to cut costs to improve customer satisfaction due to the anticipation of retail competition?

A. Well, they say they do.

Q. And --

A. Do I believe they do? Yeah.

Q. Can incentive regulation do much to encourage additional cost cutting in our current environment where utilities are preparing themselves for competition?

A. It could. It -- I think it depends. It depends upon what functions and areas that you're talking about. My concern with that, though, is that it may also produce much lower quality services. It may not show up for three or five years.

Q. I believe Commissioner Murray asked you about the Missouri Public Service division and the frozen allocation issue. Do you recall those?

A. Yes.

Q. In your view, would there be savings to Missouri Public Service customers assuming that the St. Joe Light & Power allocations were included in the corporate allocations for UtiliCorp?

A. When you say saving -- would they get a lower allocation? Yes.

Q. And that would lower the cost of those --

A. That would lower the cost, yeah.

Q. Do you have an opinion about whether or not failure to include St. Joe Light & Power in the corporate allocation -- overall corporate allocations is a detriment of this proposal?

A. Depends on what you mean by "detriment."

Q. It could result in higher costs to the Missouri Public Service division ratepayers?

A. I don't know.

MR. MICHEEL: Thank you very much.

JUDGE WOODRUFF: All right. Union Electric again is not here, so we'll go to UtiliCorp.

MR. SWEARENGEN: Thank you, your Honor.

RECROSS-EXAMINATION BY MR. SWEARENGEN:

Q. Dr. Proctor, I think in response to a question from Commissioner Schemenauer you said if retail competition happens, the company would need to come forward -- come to the Commission with a new plan?

A. Yes.

Q. What is your understanding of what that new plan would be?

A. I don't know.

Q. You don't have any idea?

A. I don't have any idea what that plan would be.

Q. Was your answer in response to the notion that should the company desire to spin off its generation units -- and when I say "the company," I'm assuming that the merger goes forward and we're talking about --

A. Combined.

Q. -- the combined MPS/St. Joe Light & Power Company. Should that occur, would the company have to come to the Commission for authority to put those generation plants in an unregulated entity?

A. Yes.

Q. Okay. And should that happen, would it be possible that perhaps some or even all of the premium associated with this acquisition be assigned to those generating units?

A. That's certainly a possibility.

Q. Would that be something that the Staff of the Commission might support?

A. We would certainly consider it.

Q. Okay. And would that be something that the

Commission would have to approve?

A. Yes.

Q. And should that happen, should the company come forward with a plan to transfer the generating units to another entity and the premium be assigned, what effect would that then have on the retail customers?

A. From a regulated standpoint --

Q. Yes.

A. -- from what was left in the wires company?

A. Yes.

Q. I think the impact of it would need to be looked at on a divisional basis. And I'm a little bit concerned about the impact on St. Joe ratepayers at that point. And my concern has to do with the fact St. Joe has the lowest overhead costs of any utility in the state.

And that when you put the overhead allocations in and you take away the cheap generation, their rates, in fact, may go up. And so what we may need to do is -- we might need to do some adjusting there. And I don't know how to do that and I don't want to get into proposals for that.

Q. I understand that. So at least your initial thought might be that with respect to St. Joe Light & Power Company, there may be some adverse impact on the customer in moving the generation out?

A. That's correct.

Q. I guess my question was really focused on the premium aspect of it.
A. Right.
Q. If you took that premium cost away from the retail side and put it over on the unregulated generation side, would that have an effect of lessening any adverse impact you might see on the St. Joe retail side?
A. Compared to the regulatory plan?
Q. Yes. Assuming that the regulatory plan is approved and those costs are being reflected in the rates.
A. Actually, I'm not -- I'm not sure.
Q. That's fine.
A. I'm honestly not sure.
Q. That's fine.
A. On the surface it sounds reasonable, that it would mitigate some of those impacts. On the other hand, if all of the -- all of the savings are being allocated to St. Joe and the savings are outweighing the acquisition premium -- and when I say "savings," I mean net savings.
Q. I understand.
A. And those are outweighing the premium and if you -- if you're taking -- see, you're taking a portion of those savings away and you're taking all of the -- of the premium. So it depends on how those two balance as to what its overall impact is.

Q. I understand. And the point really is, if that would ever occur, if UtiliCorp after the merger, would ever decide to come to the Commission with such a proposal, there would be an opportunity to thrash out all of those issues --

A. Yes.

Q. -- at that time?

A. Yes.

MR. SWEARENGEN: Fine. Thank you. That's all I have.

JUDGE WOODRUFF: St. Joseph Light & Power?

MR. COMLEY: No questions. Thank you.

JUDGE WOODRUFF: Thank you. And over to redirect, Staff?

MR. DOTTHEIM: Yes. Just a few questions.

REDIRECT EXAMINATION BY MR. DOTTHEIM:

Q. Dr. Proctor, you were asked by the Bench, I think in part by Commissioner Schemenauer, about restructuring --

A. Yes.

Q. -- legislation and UtiliCorp coming back before the Commission?

A. Yes.

Q. Are you familiar with any bills that were introduced in the last legislative session that, if passed, would have removed the Commission's jurisdiction over restructuring or the estimate of generation facility?

A. Yes.

Q. Dr. Proctor, you were asked any number of questions from the Bench regarding the premium paid for SJLP's assets. If part of the premium paid for SJLP's assets relates to a future expectation of competitive gains relating to SJLP's generating assets, should the Commission wait for a formal proposal to form an EWG exemption wholesale generator to allocate the premium to non-regulated operations?

A. Help me with the context. Is the context one in which we don't have retail competition legislation?

Q. Let's take that first.

A. Okay. And so as I understand the question, an EWG -- should an EWG have been a part of this filing? In other words, if the company's -- a major portion of what the company views as major savings is coming in the generation sector through increased opportunities, if the company -- should they have formed an EWG and made that as a part of the proposal for this merger in order to recover the acquisition premium?

Q. Yes.

A. They could have done that. I haven't really thought that through to say that -- and I'm not sure your question is would I have supported that.

Q. No. It's not a question of whether you would support that.

A. Okay.

Q. But is that the type of proposal that you think should be put before the Commission in order to address that situation; that is, the EWG option, as far as trying to address -- as regarding attempting to address the allocation of the premium to non-regulated operations?

A. It's more straightforward, yes. It's a more straightforward way of treating that. It's not one that I'm particularly comfortable with in a regulated context because there's -- well, we've struggled with the whole concept of utilities coming in prior to retail competition and filing EWG proposals, as I'm sure UtiliCorp is well aware of. I mean, they attempted -- they made such a filing a couple years ago.

What's -- what's at issue there? Just -- I'll make it just as straight as I can. If a company has strong assets, generation assets and can make profits in the generation market and ratepayers have paid for those generation assets over time, then who should get the benefit of those profits in that strong wholesale market?

That's the issue as I see it. Should it be split off and put into a deregulated company to -- to enjoy those benefits and taken away from the customers who have paid for that plant over time? And I -- I think that's the fundamental issue. I don't know if I'm answering your question.

MR. DOTTHEIM: Thank you.

JUDGE WOODRUFF: Anything further?

MR. DOTTHEIM: No.

JUDGE WOODRUFF: All right. Thank you. You may step down.

I understand the next witness then is going to be Lyle Miller.

MR. COMLEY: Yes, your Honor. And I want to take the opportunity to thank the Commission and parties for allowing Mr. Miller to go out of order. He has a schedule to keep and we're grateful.

MR. COMLEY: This is Exhibit 25.

(EXHIBIT NO. 25 WAS MARKED FOR IDENTIFICATION.)

(Witness sworn.)

JUDGE WOODRUFF: You may inquire.

MR. COMLEY: Thank you, Judge.

LYLE D. MILLER testified as follows:

DIRECT EXAMINATION BY MR. COMLEY:

Q. Mr. Miller, would you kindly give your full name to the court reporter, please.

A. My name is Lyle D. Miller.

Q. Mr. Miller, by whom are you employed?

A. Morgan Stanley, Dean Winter.

Q. What is your portion with Morgan Stanley, Dean Winter?

A. I'm the principal in the mergers and acquisition department.

Q. Mr. Miller, were you the same Lyle Miller who caused to be prepared for this case a set of rebuttal -- surrebuttal testimony rather in written form which has been previously marked for this proceeding as Exhibit 25?

A. Yes.

Q. And do you have a copy of it with you?

A. I do.

Q. Do you have any additions or corrections to your testimony today?

A. I have only one correction here on page 8 -- I believe it's page 8 -- at the top of the page where we give the formula for unlevered beta. There should be a line or division line between levered beta and the formula below that.

Q. Very well. Are there any other additions or corrections?

A. No, sir.

Q. Mr. Miller, if I were to ask you the questions that are contained in Exhibit 25, would your answers be the same today as you've corrected them?

A. Yes, they would.

MR. COMLEY: Your Honor, I'd offer into evidence Exhibit 25 and offer Mr. Miller for cross-examination.

JUDGE WOODRUFF: Exhibit No. 25 has been offered into evidence. Is there any objection?

Hearing none, it will be received into evidence.

(EXHIBIT NO. 25 WAS RECEIVED INTO EVIDENCE.)

JUDGE WOODRUFF: And for cross-examination we'll start with UtiliCorp.

MR. SWEARENGEN: No questions.

JUDGE WOODRUFF: UE, not here. Natural Resources?

MS. WOODS: I have no questions. Thank you.

JUDGE WOODRUFF: AGP?

MR. CONRAD: We have no questions, your Honor. Thank you.

JUDGE WOODRUFF: Thank you. City of Springfield is not here. Pubic Counsel?

MR. MICHEEL: No.

JUDGE WOODRUFF: Staff?

MR. DOTTHEIM: Just a few brief questions.

JUDGE WOODRUFF: Proceed then.

CROSS-EXAMINATION BY MR. DOTTHEIM:

Q. Mr. Miller, does Morgan Stanley perform any other services for St. Joseph Light & Power other than the services that have been provided or are being provided in relation to the merger with UtiliCorp?

A. We haven't since then. I -- I don't believe Morgan -- this is just based on my knowledge. I don't believe Morgan Stanley had prior to this. Dean Winter might have prior to our merger.

Q. Do you happen to know what those services might have been?

A. I don't specifically. You know, I'd speculate they'd be probably as part of an underwriting group for financing.

Q. Has Morgan Stanley previously provided any services to UtiliCorp?

A. We have. Again, more as an underwriter or participant in an underwriting group.

Q. Is Morgan Stanley presently providing any services to UtiliCorp?

A. We are presently, I can tell you, in the early stages of a few engagements, more of a strategic nature, so I can't really comment, but they are a client of the firm as are most -- frankly, most major utilities.

MR. DOTTHEIM: Thank you, Mr. Miller.

JUDGE WOODRUFF: Thank you. I have no questions from the Bench. That means there's no need for recross. And is there any redirect?

MR. COMLEY: Thank you, Judge. No redirect.

JUDGE WOODRUFF: Thank you. You may step down, and thank you for making the trip from New York.

THE WITNESS: Thank you.

JUDGE WOODRUFF: All right. Who was next? Are we going to go back to the original -- to Mr. McKinney then?

MR. COMLEY: Yes. I think that's the case. And I think Mr. Swearengen's not here.

JUDGE WOODRUFF: Let's go ahead and take a break. We can go off the record.

(A RECESS WAS TAKEN.)

JUDGE WOODRUFF: Merger cost and benefits with Mr. McKinney; is that correct?

MR. SWEARENGEN: That's correct. I'd call Mr. McKinney at this time.

(Witness sworn.)

(EXHIBIT NOS. 4, 5 AND 27 WERE MARKED FOR IDENTIFICATION.)

JUDGE WOODRUFF: You may inquire.

MR. SWEARENGEN: Thank you.

DIRECT EXAMINATION BY MR. SWEARENGEN:

Q. Would you state your name for the record, please.

A. John W. McKinney.

Q. Mr. McKinney, by whom are you employed and in what capacity?

A. I'm employed by UtiliCorp United, Inc., as vice president regulatory services.

Q. Did you cause to be prepared for purposes of this proceeding certain direct testimony, certain surrebuttal testimony and certain supplemental direct testimony?

A. Yes, I did.

Q. And is it your understanding that your direct testimony has been marked as Exhibit 4, your surrebuttal testimony as Exhibit 5, and your supplemental direct testimony as Exhibit 27?

A. That's my understanding.

Q. Do you have any changes that you wish to make with respect to any of those testimonies at this time?

A. No, I do not.

Q. If I ask you the questions which are contained in those testimonies, would your answers today be the same?

A. Yes, they would be.

MR. SWEARENGEN: At this time I would offer into evidence Exhibits 4, 5, and 27. I would tender the witness for cross-examination and remind the Bench and the parties that yesterday there were several areas of inquiry that were reserved and directed to Mr. McKinney, and I think if the parties want to ask questions in those areas at this time, that would be appropriate. I would have no objection.

JUDGE WOODRUFF: As far as offering exhibits, are we going to handle this the same way Staff did with theirs?

MR. SWEARENGEN: That's fine.

JUDGE WOODRUFF: It will be actually -- I'll ask for objections after he's had a chance to testify in all areas.

MR. SWEARENGEN: That's fine. Thank you.

JUDGE WOODRUFF: He has been offered for cross-examination and, again, we'll begin with St. Joseph Light & Power.

MR. COMLEY: No questions. Thank you.

JUDGE WOODRUFF: And UE is not here. Department of Natural Resources?

MS. WOODS: No questions. Thank you.

JUDGE WOODRUFF: AGP?

MR. CONRAD: Yes, sir. We have a couple of follow-ups in some areas that have been assigned to Mr. McKinney by his boss.

CROSS-EXAMINATION BY MR. CONRAD:

Q. Mr. McKinney, first, let me ask you, do you have a copy of Exhibits 502 and 503?

A. No, I do not.

Q. Let me see if I can get you one.

MR. CONRAD: Permission to approach the wus-- permission to approach the witness, your Honor.

JUDGE WOODRUFF: I understood what you were trying to get out. You may.

BY MR. CONRAD:

Q. Mr. McKinney, I'm giving you copies of Exhibits 502 and 503. And take a moment and re-familiarize yourself with them. You may have seen them from yesterday. If you would, let me know when you're ready to go.

A. Yes, fine. I've seen them before.

Q. Let's look at 502 first, please. And just to kind of orient where we were, I think we had agreed with Mr. Green -- or he had agreed with us that the approximate value of the acquisition premium that he was presenting was about $92 to $93 million?

A. That's what's estimated today, yes.

Q. Now, looking at the annual detail, which is the third and final page of this packet that is marked and has been admitted as Exhibit 502, would you agree with me that the numbers that are shown in positive numbers are assertions of benefits and the numbers that are shown in parens would be costs or dis-benefits?

A. Generally, that's what it would show. Depends on what area they're in, but in general.

Q. Well, if we vary from that, you'll let me know?

A. Yes.

Q. Would you agree with me that on this exhibit -- and really I'm looking at like -- Roman Numeral I and then 6, Total O and M line toward the middle. We see a total. Would you agree with me that about 81 million -- 81.3 million to be more precise, is the proposed benefit that would be retained over that first five years of the plan?

A. I believe that's what was -- the estimated benefits in September of '99 when this data request was responded. That's been updated since then.

Q. And moving on down to area 2 and line 5, Total Capital Savings and, parens, Costs, the estimated costs to achieve based on this exhibit are roughly 13.2 million?

A. The total capital costs, yes.

Q. Okay.

A. 13.3 million.

Q. Now, the line that's identified as Roman Numeral III, Total Synergies Net of Cost to Achieve, that's the 68 million that we've talked about before. Correct?

A. That's correct.

Q. Okay. Now, continuing on down in that same column, the 12,050 and the 6,157 numbers that correspond to area 4 and lines 1 and 2 under area 4, would you agree with me that those are reductions in costs that are being projected to St. Joe Light & Power?

A. They're St. Joe Light & Power direct costs that are being transferred to what we could classify as corporate. They're costs that will continue, but they're transferred. The savings in that area or reductions is up under Roman Numeral I, line 2. Those are the pure savings or drops. The others are just a transfer.

Q. Now, would the number that's on line 3, which is in parens and so I take it using our convention that that's a cost, that's an allocation of a cost that's being transferred to St. Joseph Light & Power and to its cost of service. Correct?

A. That's correct. That's one item.

Q. Does that leave a net of roughly 47 million of additional costs that are being transferred to SJLP that SJLP does not now incur?

A. That was the estimate at that time, yes.

Q. Now, let me back you up just a row or two back to the Total Synergies, net of Cost to Achieve row. And