

- 1                   2. Early retirement programs and cost efficiencies have resulted in  
2                   steady reductions in employee levels.
- 3                   3. Renegotiations and aggressive negotiation of fuel supply  
4                   contracts and railroad freight rates have resulted in a steady  
5                   decline in actual fuel costs which has contributed significantly to  
6                   cost savings.
- 7                   4. With reduction in construction programs from the levels of the  
8                   1970's and 1980's, utilities have experienced declining rate base,  
9                   and thereby decreasing revenue requirements.
- 10                  5. Shifting allocations involving multi-state jurisdictions can, and  
11                  do, cause declining jurisdictional costs and rate bases when  
12                  growth occurs in other jurisdictions as a result of adding new  
13                  customers, usage increases and adding service as a result of  
14                  mergers and acquisitions.
- 15                  6. Reductions in corporate income taxes have had a significant  
16                  impact on utilities' cost declines.

17 All these factors can have a substantial impact on rates, causing the need to review rates  
18 periodically. While Empire has not seen rate reductions, commencing in the mid-1980s, like  
19 some of the other electric utilities operating in this state after the completion of their generating  
20 unit construction programs, Empire customers have enjoyed the benefit of significantly lower  
21 rates than the national average and has among the lowest rates in the midwest region. Empire  
22 has experienced significant growth in the number of customers in its service territory. Empire  
23 has had to add generating capacity to meet this added load requirements. Currently, Empire is  
24 constructing a 500-megawatt natural gas combined cycle unit at its State Line Generating  
25 Station. Empire will have a 60% ownership interest in the combined cycle generating facilities  
26 and Western Resources will have the other 40% ownership interest. Empire's need for  
27 additional capacity in recent years has resulted in several rate cases being filed by Empire with  
28 the Commission by Empire. Despite the increases in rates, Empire still has among the lowest  
29 electric rates in the midwest region.

1           Once Empire completes its construction program, and as the efficiencies relating to  
2 productivity gains are realized, Empire should be in position to begin reflecting its declining  
3 costs in rates to its customers.

4           Q.     Has there been any recent reduction to Empire's fuel costs?

5           A.     Yes. In 1999, Empire experienced a reduction in fuel costs at the Iatan  
6 Generating Station due to KCPL renegotiating the fuel supply agreement at a substantial  
7 savings. This event is discussed in the rebuttal testimony of Staff Accounting witness  
8 V. William Harris.

9           Q.     Will the merger allow for future rate reductions?

10          A.     This is uncertain. Despite not having rate reductions in the past because of its  
11 construction needs resulting from its growth, Empire has been a low-cost provider of  
12 electricity in the state of Missouri. As indicated above, once Empire's construction program  
13 is complete, it should be in a position to see economies because of declining costs, if for no  
14 other reason than from its declining rate base as its generating facilities are depreciated.

15          While Empire has kept its rates in check, despite its heavy construction commitment,  
16 it may have an opportunity to reduce rates after the combined cycle unit is completed. The  
17 regulatory plan presented by UtiliCorp does not allow for any rate reductions for at least five  
18 years because of the proposed rate moratorium. To the extent Empire could reduce its rates  
19 after completing its construction program, it will not be able to do so because of the proposed  
20 regulatory plan.

21          UtiliCorp's savings tracking proposal, which is part of its regulatory plan, will not  
22 differentiate between merger and non-merger savings. Non-merger related savings certainly  
23 should not be retained by UtiliCorp to allow for the purpose of recovery of the acquisition

1 adjustment. Yet under the Joint Applicants' five-year rate moratorium, all savings, merger-  
2 related and non-merger related alike, will be used to pay-off a portion of the acquisition  
3 adjustment. To the extent that this proposed regulatory plan results in Empire's retention of  
4 non-merger related savings and does not allow any opportunity for Empire to reduce rates  
5 after the completion of the construction program, it is detrimental to Empire's customers.

6 For further discussion regarding the proposed regulatory plan, please see Staff  
7 witness Oligschlaeger's rebuttal testimony.

8 Q. If the potential for future Empire rate reductions will be reduced or  
9 eliminated, will that be a detriment to the public interest as a result of this merger?

10 A. Yes. To the extent Empire will continue to experience low costs, reductions in  
11 the cost of the capital structure and the cost of money, or increases in revenues for Missouri  
12 customers, then those items should result in future reductions in rates. If this merger adversely  
13 impacts Empire's ability to reduce rates in the future after the completion of its construction  
14 program, then Staff believes that this would be a detriment to the public interest resulting from  
15 the merger.

16 Q. Are Empire's rates currently low?

17 A. Yes. Empire has among the lowest electric rates in this region. It generates  
18 electricity on a low-cost basis and its corporate overheads are among the lowest in the region.  
19 For further discussion on the rate levels of Empire compared to the rate levels of other  
20 utilities in this region, refer to the rebuttal testimony of Staff witness Williams.

21 Q. UtiliCorp witness John W. McKinney states at page 17 of his direct testimony  
22 that "when the premium and resulting cost savings are appropriately analyzed together, the  
23 Commission will see that inclusion of the premium in the cost of service will not increase

1 Empire's rates, but in fact, it will lower them." Is this a reasonable view of what will be the  
2 actual results of UtiliCorp's regulatory plan?

3 A. No. What Mr. McKinney is failing to convey to the Commission in his  
4 comments is that under the Joint Applicants' regulatory plan, it would not be possible to lower  
5 rates for a period of at least five years. UtiliCorp wants rates frozen for five years, and  
6 sometime during the fifth year it will file a rate case. Up to then, all savings, merger and non-  
7 merger related, will be fully retained by UtiliCorp during the intervening five-year period. It is  
8 highly improbable that the Joint Applicants' regulatory plan will result in lower rates, especially  
9 if restructuring of the electric industry occurs in Missouri during the five-year moratorium as  
10 proposed under certain bills introduced in the legislature last session. If such restructuring  
11 occurs during the time frame of the Joint Applicants' Regulatory Plan, any future lowering of  
12 rates will be precluded. The opportunities for Empire's customers to experience any benefits of  
13 the merger may occur, will be greatly reduced if the substantial changes of restructuring occurs  
14 in the industry.

15 In fact, as discussed above, the best opportunity for Empire's rates to be reduced will  
16 be after the completion of its construction program. However, under UtiliCorp's proposed  
17 regulatory plan a reduction in rates will not be possible because rates will be "frozen" for a  
18 period of five-years. It would be during this time frame that the best opportunity exists to  
19 reflect in lower rates a lower revenue requirement for Empire. UtiliCorp's regulatory plan  
20 proposal is very unlikely to result in rates that are lower for Empire customers as  
21 Mr. McKinney indicates in his direct testimony.

22 Q. Has UtiliCorp had a history of advocating lower rates?

1           A.     No. As I have indicated above, UtiliCorp vigorously opposed reducing its  
2 Missouri Public Service division's electric rates in 1997. In fact, as a strategy to charge  
3 excess earnings as long as it could, UtiliCorp filed a rate increase case to delay any reduction  
4 in rates, Case No. ER-97-394. It is unlikely either Empire customers or St. Joseph customers  
5 will ever see future rate reductions given the history of UtiliCorp fighting attempts to reduce  
6 rates and given changes that may occur through electric restructuring.

7                   **COMMITMENTS MADE/ PROMISES KEPT**

8           Q.     UtiliCorp witness Robert Green states at page 18 of his direct testimony that  
9 "it has always been and continues to be UtiliCorp's position that Missouri ratepayers would  
10 not be adversely or detrimentally affected by our merger and acquisition strategy. That is  
11 just as true today as it was 15 years ago. Seeking premium recovery is not inconsistent with  
12 this position." Does Staff agree that UtiliCorp has maintained those commitments?

13          A.     No. The commitment Mr. Green is referring to is one that UtiliCorp made to  
14 the Missouri Commission that UtiliCorp would provide any upside benefits to Missouri  
15 customers and insulate those same customers from any downsides of UtiliCorp's merger and  
16 acquisition activities. The Commission, in its Report and Order in Case No. ER-90-101,  
17 referenced this pledge of UtiliCorp wherein the Commission stated that "[w]hen UtiliCorp  
18 was formed Company assured the Commission that the ratepayers would suffer no detriment  
19 from UtiliCorp's activities but would experience the benefits associated with UtiliCorp's  
20 activities." Re: Missouri Public Service, Case Nos. ER-90-101, et al., Report and Order,  
21 30 Mo.P.S.C. (N.S.) 320,350 (1990).

22               In fact, in a 1989 speech given by Mr. Richard C. Green, Jr., then UtiliCorp President  
23 and Chief Executive Officer, before the National Association of Regulatory Utility

Commissioners (NARUC), he identified the UtiliCorp philosophy regarding its growth strategies. In response to Public Counsel Data Request No. 216 in Case No. ER-90-101, UtiliCorp stated the "overall corporate strategy has been consistently implemented since the inception of the UtiliCorp name change. It is most comprehensively described in a speech before NARUC" as follows:

In 1983, [Mr. Richard C. Green] went to the Missouri Public Service Commission with a plan to add value for the customers and shareholders of my company. A principal component of this plan was to expand through utility acquisitions. Of course, the concern of the Missouri commission was whether this plan would be a detriment to Missouri ratepayers.

The Missouri commission has shown a willingness to allow us to pursue this plan because UtiliCorp made a commitment to flow only benefits to Missouri customers and not to pass on any new problems that may arise. At no time will we jeopardize our own financial integrity. We recognize that it is vitally important not to put Missouri's sound utility infrastructure at risk.

Six years later, this commitment still stands. Our record shows we have lived up to everything we have promised. This process has worked well. By taking a different regulatory approach, the Missouri Commission has allowed us to serve our customers better and build value for our shareholders.

UtiliCorp has followed a firm policy of not seeking to recover any of its acquisition-related premiums through rates. We have made a very persuasive case to investors that any premium costs or share dilution they experience will be for the short-term. We believe we can demonstrate that UtiliCorp will financially outperform the industry in the long-term.

[Source: OPC Data Request No. 216, Case No. ER-90-101; emphasis added]

The entire speech before the NARUC is attached as Schedule 4.

In response to a Data Request submitted in Case No. ER-90-101, UtiliCorp stated in reference to a question regarding commitments to pass on benefits, not problems/costs to Missouri consumers:

Mr. [Richard C.] Green's commitment to the Missouri commission was (1) **that premiums paid for utility acquisitions would not be recovered through Missouri rates**, and (2) that there would be no cross subsidization of the company's various division and subsidiary operations. These commitments have been kept.

**Premiums paid for acquired utility properties** are amortized by the corporation over varying periods of time and **are not being recovered through rate structures in any of our service jurisdictions**. In addition, each division and subsidiary exists as a stand-alone entity with its own allocated capital structure.

Benefits which have been passed along to Missouri ratepayers include: easier access to capital through lower debt costs and marketable equity securities; economies of scale in such areas as pension and health benefits, centralized purchasing and consolidations of computer and purchase contracts and other areas enumerated in Mr. Green's pre-filed direct testimony in this case.

[Source: Response to Data Request No. 368, Case No. ER-90-101; emphasis added]

Q. Has UtiliCorp understood that its merger and acquisition policies would have to develop without assurances of recovery of the merger premiums?

A. Yes. In March 1987, at an investor analyst meeting in San Francisco, Mr. Richard C. Green, Jr., made a statement regarding the recovery of merger premiums as it related to UtiliCorp's merger and acquisition strategies. Mr. Green stated the following:

No, how do we look at new acquisition properties is the question. No, its more the traditional utility sense because whether you like it or not, you're going to be traditionally regulated. So you've got to play by those rules and when you tack a premium on you got to know you're **not** going to be allowed to earn a return, so you've got to squeeze that out of other places. So you want to look at things differently and be more aggressive, but the realities of life is that that Commission is not there yet and they're going to do it the old traditional way...

[Source: Transcript of video relating to the San Francisco Analyst meeting March 1987 provided by UtiliCorp in response to Data Request No. 476 (Case No. ER-90-101); emphasis added]

Another example of this commitment not to seek recovery of acquisition premiums in rates is a May 21, 1990 interview with Mr. Richard Green by members of the Office of the

1 Public Counsel and Staff. Mr. Green indicated once again that UtiliCorp would exclude  
2 acquisition premium from rates. In the interview, Mr. Green was asked about the discussion  
3 he had with the Commissioners in early 1986, wherein he made his commitment to insulate  
4 the Missouri customers from the "downside risks" relating to UtiliCorp's merger and  
5 acquisition strategy:

6 In a meeting with the Commissioners and Staff members held at the  
7 Commission offices in Jefferson City in late 1985/ early 1986, Green  
8 stated that MOPUB's Missouri ratepayers would be insulated from all  
9 "downside risks" associated with the corporate M&A strategy. In part,  
10 those discussions with the Commission focused on UtiliCorp's need to  
11 receive timely financing authorization regarding its acquisition  
12 strategy. At that time, Green said he would be coming back before the  
13 Commission for additional financing for acquisitions. In the agenda  
14 meeting before the Commission, Mr. Green pledged that at no time  
15 would Missouri ratepayers be adversely or detrimentally impacted by  
16 UtiliCorp's M&A strategy. In the context of needing future financing,  
17 Green stated that all benefits would flow to the ratepayers and that  
18 they would be insulated from all "downside risks." In that meeting  
19 Mr. Green explained this meant that all benefits relating to a larger,  
20 less risky consolidated UtiliCorp would flow to Missouri ratepayers  
21 while these ratepayers would be insulated from any negative or  
22 detrimental impacts.

23  
24 *Green said he concurred with the above assessment of that meeting,*  
25 *and still holds that view today. He said he has not only made that*  
26 *pledge but has kept it. Green said evidence of this was that at no*  
27 *time has or would UtiliCorp attempt to seek recovery in rate base,*  
28 *premiums (acquisition costs in excess of book value) paid for M&A*  
29 *properties by way of a positive acquisition adjustment.*

30  
31 Green believed it was reasonable that UCU make this commitment.  
32 There is no reason that a problem found elsewhere would provide a  
33 reason to seek higher rates from MOPUB's ratepayers. Green believes  
34 that the commitment not only can be made, but was, and still is being  
35 made.

36  
37 [Source: Richard Green May 21, 1990 interview in Case No. ER-90-101 – Response  
38 to Data Request No. 591; emphasis added]  
39



1           It is clear from the statements made to the Commission and elsewhere in speeches  
2 that in order to gain support for UtiliCorp's merger and acquisition growth strategy,  
3 UtiliCorp was willing commit to not seek recovery of merger premiums resulting from this  
4 growth strategy. While UtiliCorp can certainly change its position and go back on this  
5 commitment, as now appears to be the case with the proposed regulatory plan being pursued  
6 as outlined in Mr. McKinney's direct testimony, the fact of the matter is that UtiliCorp's  
7 merger and acquisition activities have not been questioned by this Commission over the  
8 many years that UtiliCorp's "hold harmless" merger and acquisition philosophy has been in  
9 place. Mr. Green sought support from the Commission when he needed the financing of  
10 UtiliCorp's growth strategy. He made a promise not to seek recovery of the merger  
11 premiums that resulted from this growth strategy. The Staff hopes UtiliCorp will reconsider  
12 its position relating to the regulatory plan that it has filed in this case and renew its pledges to  
13 not seek recovery of merger premiums from its Missouri customers.

14           UtiliCorp on numerous prior occasions made it clear it would not seek recovery of  
15 merger and acquisition premiums from its Missouri customers. Something has evidently  
16 happened to cause UtiliCorp to no longer honor its prior commitment it made to the  
17 Commission in the past regarding acquisition adjustment recovery. Regardless of the reasons  
18 for this change in position, the former position of UtiliCorp whereby it insulated its retail  
19 utility customers from the risks of UtiliCorp's merger and acquisition strategy was  
20 appropriate, and still is appropriate, if not more so considering all of the non-regulated  
21 activities of UtiliCorp as well as the changes occurring as a result of electric restructuring.  
22 UtiliCorp's growth strategy is even more pronounced today than it was just even a few years  
23 ago.

1           As this growth strategy intensifies, it seems UtiliCorp intends to ask this Commission  
2 to provide UtiliCorp assistance in these activities so that UtiliCorp's shareholders will be  
3 protected from earnings dilution. The Staff does not believe UtiliCorp's Missouri retail  
4 ratepayers should be placed in such a role of subsidizing UtiliCorp's merger and acquisition  
5 policies.

6           Q.     Was the earlier-referenced May 21, 1990 interview with Mr. Richard Green  
7 verified?

8           A.     Yes. Staff conducted several interviews of UtiliCorp officials in the 1990 rate  
9 case. As part of the process, before court stenographers were used, participants compiled  
10 their notes from the meeting and submitted these notes to each person interviewed for  
11 verification of accuracy. Mr. Green's interview was submitted for verification in Data  
12 Request No. 591 (Case No. ER-90-101), an excerpt from which appears above. The  
13 following statement was agreed to by UtiliCorp in order to authenticate the content of the  
14 interview write-up: "While not necessarily all-inclusive, the attached summary of the  
15 interview of Mr. Richard Green, as amended, is **accurate in all material respects** and  
16 represents factual information." [emphasis added]

### 17           CAPITAL STRUCTURE

18           Q.     Mr. McKinney indicates at page 28 of his direct testimony that part of the  
19 Joint Applicants' proposal in this case is for the Commission to agree to use Empire's  
20 existing stand-alone capital structure in UtiliCorp's future rate cases involving the  
21 post-merger Empire division. What does this proposal of the Joint Applicants relate to?

22           A.     This proposal seeks to "freeze" the capital structure of the pre-merger Empire in  
23 any future post-merger rate case respecting the Empire division of UtiliCorp. In effect, this

1 procedure results in any potential savings relating to the capital structure resulting from the  
2 merger to be fully retained by UtiliCorp and not be reflected for the post-merger Empire  
3 division of UtiliCorp. Mr. Fancher indicates that the "normalized capital structure" would be  
4 47.5% common equity and 52.5% debt. (According to page 28 of Mr. John McKinney's direct  
5 testimony, all future rate cases would "freeze" the capital structure at 52.5% common equity and  
6 47.5% debt. It is my understanding that Mr. Fancher's equity/debt relationship is the correct  
7 normalized level the Joint Applicants are proposing, not the one in Mr. McKinney's direct  
8 testimony). Essentially, this proposal would keep the capital structure for the Empire division of  
9 UtiliCorp at a level as though the merger never took place. Staff believes this proposal is  
10 patently unreasonable and is opposed to this recommendation. Staff views this as an attempt to  
11 capture, solely for shareholders, the merger benefits relating to one of the more substantive  
12 types of merger savings for UtiliCorp.

13 UtiliCorp is attempting to retain the benefits of any perceived lowering of capital costs  
14 through the use of a consolidated capital structure by proposing to impute a hypothetical  
15 stand-alone divisional capital structure to the post-merger Empire that will not actually exist  
16 after the merger takes place. Consequently, one of the major benefits of UtiliCorp's growth  
17 strategy (lower capital costs) will be denied to Empire's customers because UtiliCorp wants to  
18 retain all of the merger savings associated with the post-merger Empire capital structure. This is  
19 an example where UtiliCorp is picking and choosing what merger benefits to pass on to post-  
20 merger divisions' customers. The "frozen" capital structure is certainly not an example of  
21 UtiliCorp's former commitment to insulate ratepayers from the "downside risks" of its growth  
22 strategy and flow benefits to the customers.

1 Q. Why are merger benefits resulting from the post-merger capital structure  
2 changes considered to be one of the more substantive types of merger savings?

3 A. The merger savings associated with the post-merger capital structure are one of  
4 the more easily defined and easily achieved of any of the other purported merger savings  
5 categories. As discussed elsewhere in my rebuttal testimony, as well as in other Staff witnesses'  
6 testimony, merger savings are at best speculative. Merger savings are not easily identified or  
7 quantified with any degree of certainty. However, capital structure benefits will be immediate  
8 when the merger is finalized. Empire will cease to exist as a stand-alone entity and will then be  
9 capitalized by UtiliCorp's capital structure.

10 Q. Mr. McKinney states at page 29 of his direct testimony that absent the merger,  
11 Empire's capital structure would not have changed appreciably, and that retention of that capital  
12 structure results in no new cost to the existing Empire customers. Does Staff agree?

13 A. No. This would be tantamount to saying that if any aspect of the merger "results  
14 in no new cost to the existing Empire customers," then none of the merger benefits should be  
15 passed on to these customers. Typically, no merger proposal would be taken seriously by  
16 regulatory bodies if there were no prospects of merger savings benefiting customers.

17 Q. Will there be any benefits to Empire's post-merger financing costs from being  
18 part of a much larger UtiliCorp entity?

19 A. Yes, generally there are. In fact, in the very early stages of developing  
20 UtiliCorp's merger and acquisition strategy, financing the corporation through a larger  
21 organization was cited as one of the major benefits of this strategy.

22 Throughout the late 1980's, UtiliCorp's position was that one of the advantages and  
23 benefits to growing its business through its merger and acquisition strategy was better access to

1 the capital markets in financing its short- and long-term commitments. UtiliCorp asserted that  
2 this strategy had direct benefits in lowering UtiliCorp's risk and ultimately its cost of money.  
3 This strategy would have an effect of lowering overall revenue requirements because UtiliCorp  
4 requiring a lower return as a result of its diversification and growth strategy.

5 Q. Where did UtiliCorp indicate that one of the benefits of its growth strategy  
6 was a reduction in the cost of capital?

7 A. UtiliCorp has made the claim in internal documents and public documents that  
8 its growth strategy has resulted in lower capital costs. UtiliCorp stated that its growth strategy  
9 would provide significant benefits in lowering its cost of money. In a 1985 financing  
10 application filing approved by the Commission in Case No. EF-86-73, UtiliCorp received  
11 permission to acquire Peoples Natural Gas Company (Peoples) from InterNorth. In response to  
12 a data request in that case, UtiliCorp stated that a lower cost of capital was a benefit, which  
13 would be derived from the growth strategy. In response to Data Request No. 6 in Case  
14 No. EF-86-73, UtiliCorp stated the following:

15 The acquisition is expected to, after assimilation of the information by  
16 financial markets, lead to a reduction in capital costs for UtiliCorp  
17 United. This expected reduction in capital costs will eventually  
18 produce reductions in rates of return claimed by Missouri Public  
19 Service Company in proceedings before the Missouri Public Service  
20 Commission.  
21

22 [ Schedule 5, emphasis added]

23 In response to follow-up Data Request No. 6a, UtiliCorp stated:

24  
25 Based upon its utility business experience, management also  
26 concluded that UtiliCorp's capital costs should be reduced as the result  
27 of the acquisition because UtiliCorp should then be viewed more  
28 favorably by the financial community as it should be of a sufficient  
29 size so as the permit it to qualify for higher financial ratings than those  
30 now available to the Company absent the acquisition. Higher financial

1                   ratings should, in turn, lead to lower rates of return claimed in  
2                   regulatory proceedings.  
3

4                   [Schedule 6; emphasis added.]

5                   Even though UtiliCorp believed in 1985 that there would be reductions in capital costs  
6                   which would in turn reduce rates of return that UtiliCorp would request in future rate  
7                   proceedings, UtiliCorp has consistently requested in Missouri rate filings the use of a higher-  
8                   cost "divisional" stand-alone capital structure, similar in concept to the position UtiliCorp is  
9                   presenting in this merger case. Just as the use of a divisional capital structure has the effect of  
10                  increasing the revenue requirement UtiliCorp requests in MPS rate cases, the use of frozen pre-  
11                  merger Empire capital structure will have the same effect on post-merger Empire's divisional  
12                  revenue requirement.

13                Q.       Why or how does the UtiliCorp growth strategy result in lower cost of capital?

14                A.       UtiliCorp stated that one of the major benefits of its growth strategy is a  
15                  perception among investors that UtiliCorp is a less risky enterprise because of its diversification  
16                  efforts. This is due in part to the perception that spreading the risk of UtiliCorp's operations  
17                  throughout several regulatory jurisdictions to protect earnings from adverse regulatory decisions  
18                  of specific regulatory bodies, spreading the asset base over several states, and expanding the  
19                  earnings base between summer and winter peaking utilities, would result in greater earnings  
20                  stability. To the extent that this spreading of risk does result in a lowered cost of capital, then  
21                  that should be reflected in the rate structure of the existing MPS division as well as the  
22                  post-merger rate structure of the Empire division.

23                Q.       Does Staff believe that UtiliCorp's position relating to its proposed frozen  
24                  Empire capital structure is inconsistent with the commitment given by Mr. Richard Green  
25                  that benefits of the growth strategy will be given to Missouri customers?

1           A.     Yes. If Empire's post-merger rates are higher as a result of using the proposed  
2 frozen capital structure than by using UtiliCorp's consolidated capital structure, then one of the  
3 major benefits of UtiliCorp growth strategy will not be provided to customers of Empire.

4           Q.     Is the freezing of the capital structure for the post-merger Empire division  
5 similar to the divisional stand-alone capital structure presented by UtiliCorp in its 1997 rate  
6 increase case, Case No. ER-97-394?

7           A.     Yes. Both the position presented by UtiliCorp in its 1997 rate case and the  
8 frozen Empire pre-merger capital structure position being pursued by UtiliCorp in this case as  
9 identified in Mr. McKinney's direct testimony are intended to have the same results, an increase  
10 in a Missouri division's revenue requirement.

11          Q.     Did the Commission adopt in Case No. ER-97-394 UtiliCorp's position on a  
12 divisional stand-alone capital structure?

13          A.     No. The Commission rejected UtiliCorp's proposal in Case No. ER-97-394 just  
14 as it previously did in Case No. ER-90-101.

15          Q.     Is any other Staff members providing rebuttal testimony on UtiliCorp's  
16 proposal for a post-merger frozen capital structure for the proposed Empire division of  
17 UtiliCorp?

18          A.     Yes. Staff witness David P. Broadwater of the Commission's Financial Analysis  
19 Department will also provide testimony on this issue.  
20

21                   **SUMMARY AND CONCLUSIONS**

22          Q.     Please provide a summary and your conclusions.

1           A.     The real risk to customers of St. Joseph and Empire is not that they will ever  
2 receive merger savings from these mergers, or that they will never see future rate reductions; the  
3 real risk to the customers of these two low-cost utilities is that their electric rates will actually  
4 increase. UtiliCorp's Missouri Public Service division has residential rates comparable to the  
5 two utilities in this state that have nuclear power plants, KCPL and Union Electric. Empire and  
6 St. Joseph have the lowest retail electric rates currently in Missouri. If customers being served  
7 by these two utilities see their electric rates increase, that will be a detriment.

8           UtiliCorp has devised a regulatory plan, an extremely unique regulatory plan, to have  
9 the customers of Empire, St. Joseph and Missouri Public Service pay for the mergers being  
10 proposed in this proceeding and the St. Joseph merger proceeding. The regulatory plan  
11 proposed in each of the two merger applications is designed to force the customers of these three  
12 utilities to subsidize UtiliCorp's growth through a mergers and acquisitions strategy. The  
13 merger premiums being paid to Empire and St. Joseph, in addition to other merger costs agreed  
14 to by the three utilities, are designed to be recovered pursuant to the proposed regulatory plan.  
15 UtiliCorp developed its regulatory plan to accomplish two very important goals related to its  
16 "customers must pay for the merger" concept.

17           The first goal that UtiliCorp's regulatory plan must accomplish is for the shareholders to  
18 retain all merger and non-merger savings. The five-year moratorium is a device that, in part,  
19 accomplishes this goal. Moratoriums are typically used to allow companies an opportunity to  
20 indirectly recover a portion of any merger premium. In the case of Empire, the proposed  
21 moratorium must start only after the Empire rate increase case allows inclusion of the State Line  
22 combined cycle generating unit in rates, which is a rather unusual occurrence. Thus, Empire's  
23 rates have to be increased to reflect this capacity addition at the same time that UtiliCorp and



1 Empire are extolling the virtues of the merger generating significant merger savings. UtiliCorp  
2 also needs to increase the rates for Missouri Public Service for the addition of a future power  
3 plant to Missouri Public Service's rate base. Since both the Empire and Missouri Public Service  
4 rate cases will be required to be filed post-merger, UtiliCorp believed it had to develop  
5 approaches to ensure that no savings would be flowed-back to customers, notwithstanding these  
6 rate cases. Thus, the regulatory plans for both of these mergers includes provisions for  
7 "freezing" the capital structures for Empire and St. Joseph, "freezing" the benefits of joint  
8 dispatch in the fuel area for Missouri Public Service and "freezing" corporate allocations for  
9 Missouri Public Service. These features of the regulatory plans permit UtiliCorp shareholders  
10 to retain "savings" at the expense of the customers of these three utilities.

11 The second goal that UtiliCorp must pursue is to justify seeking direct recovery of the  
12 acquisition adjustment from Empire and St. Joseph customers at the end of the moratoriums.  
13 This feature of the regulatory plans is certainly the most detrimental to customers and is the  
14 most unique. The direct recovery of the acquisition adjustments at the end of the moratoriums  
15 would be unprecedented in Missouri public utility regulation.

16 UtiliCorp's regulatory plan is developed to capture all the savings for UtiliCorp and pass  
17 the costs of the merger back to its customers. This regulatory plan is intended to bind the  
18 Commission into ratemaking decisions for many years into the future. This proposal is  
19 unreasonable and inappropriate for customers, the group which has the least say in affecting the  
20 merits of the mergers. The proposed regulatory plan keeps savings away from customers and  
21 pushes merger costs into customer rates. The shareholders benefit from retaining savings while  
22 forcing customers to pay for the mergers.

1       The most significant element of the proposed regulatory plan is that UtiliCorp has  
2       designed it in such away that merger savings and non-merger savings are retained by UtiliCorp  
3       for the first five years of the moratorium and then provides for direct recovery from ratepayers  
4       of one-half of the acquisition adjustment starts. This is a highly unusual request, since generally  
5       moratorium periods are used to allow indirect recovery for a period of time with no direct  
6       recovery of the acquisition adjustment from customers.

7       UtiliCorp's proposed regulatory plans secure the preponderance of the merger and non-  
8       merger savings for its shareholders and ensure that the customers of Empire, St. Joseph and  
9       Missouri Public Service pay for the mergers. These plans shift the risks of both of these  
10      mergers to the three UtiliCorp Missouri divisions' respective customers.

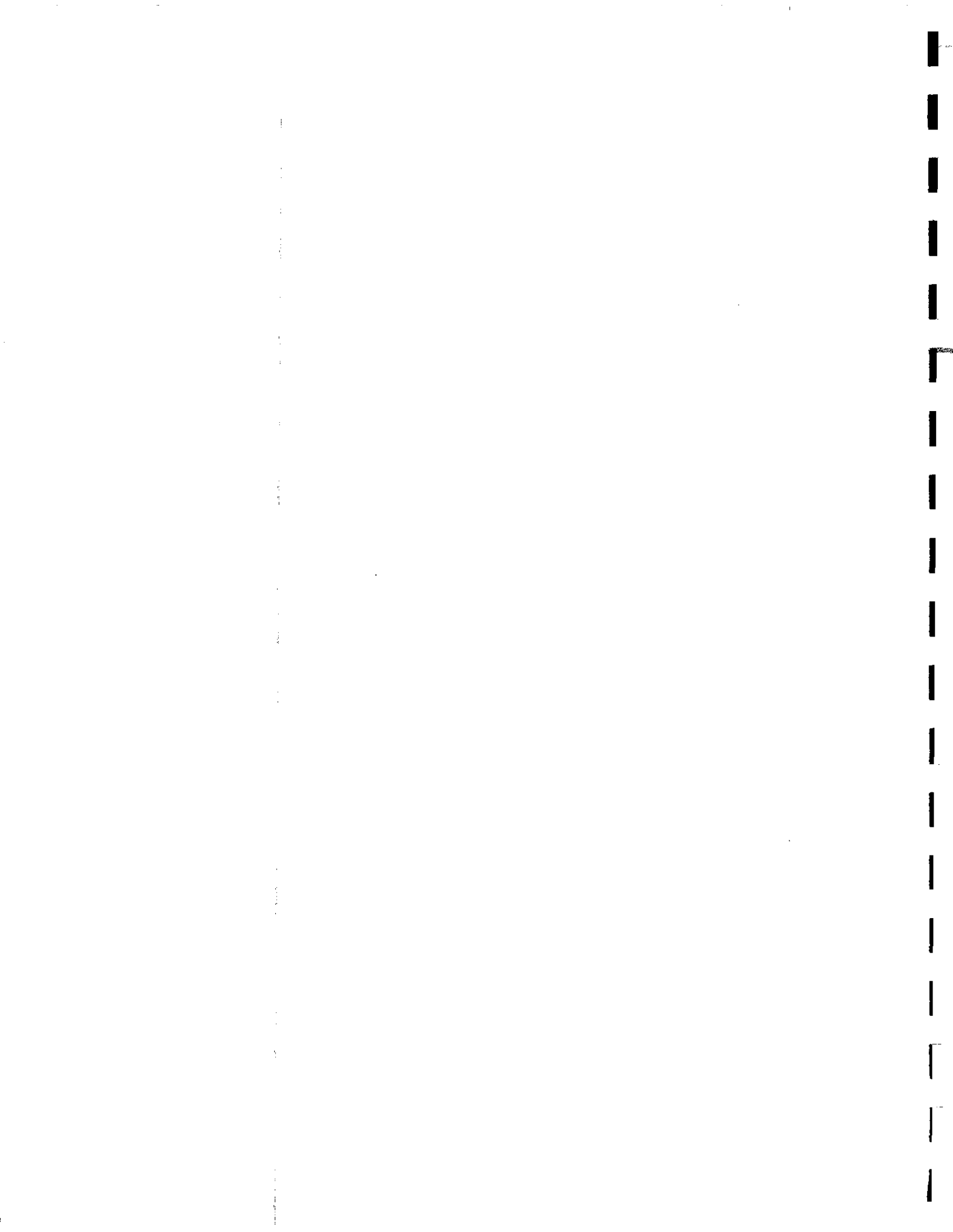
11      If UtiliCorp's proposed regulatory plan is approved, this will set a precedent for future  
12      mergers. UtiliCorp is very aggressive in pursuit of its growth through mergers and acquisition  
13      strategies. Adopting the regulatory plan will result in an even greater pressure to include more  
14      acquisition adjustments in the future with even greater merger premiums being negotiated. If  
15      utilities can successfully get their customers to subsidize growth strategies, then it can be  
16      expected that more and more mergers will take place at greater and greater risks to customers.

17      If acquisition adjustments are allowed to be directly recovered in rates, regulatory bodies  
18      will be forced to make determinations as to the value of the merger transaction. This  
19      Commission will have to review the actual merger transaction and merger consideration to  
20      ensure that the buying utility has not paid an excessive amount. This will place a greater burden  
21      on the Commission to identify the reasons why a merger is beneficial to the public, which is  
22      different than ensuring that the customers are not harmed.

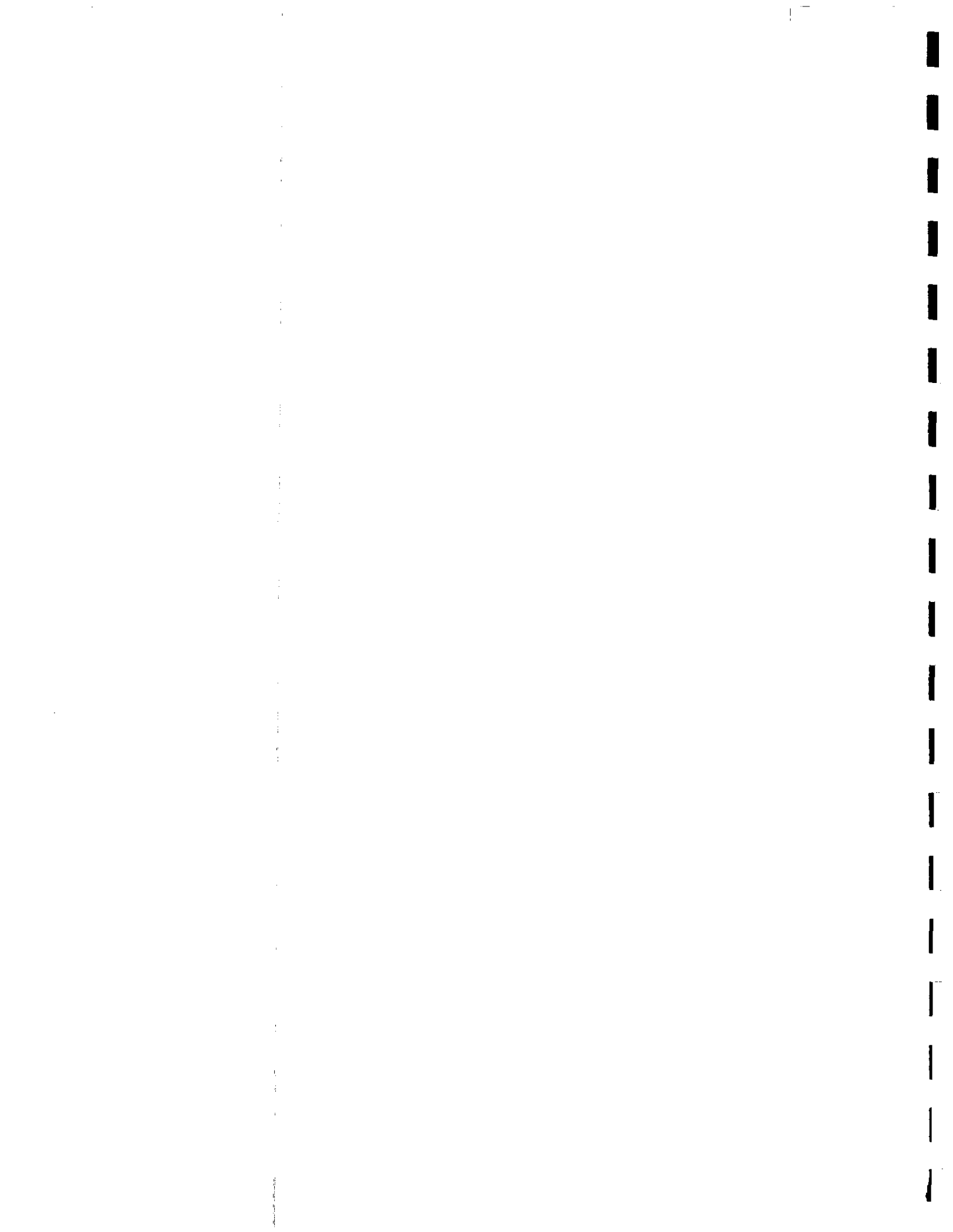
1           The Commission will have to identify the benefits of the merger relating to shareholder  
2 and customer interest, respectively. The acquisition adjustment will have to be allocated among  
3 the different ownership costs for the control premium and non-regulated activities. The  
4 acquisition adjustment should not be directly recovered in rates, but if the Commission adopts  
5 UtiliCorp's position, future merger applications and rate proceedings will have to address the  
6 many issues that will arise from the expectation that customers should pay for the growth  
7 strategies of utilities operating in this State. Staff believes this approach would be detrimental to  
8 the public interest and, therefore, this proposed merger and the proposed regulatory plan should  
9 be rejected and not adopted by the Commission.

10           Q.     Does this conclude your rebuttal testimony?

11           A.     Yes, it does.







Cary G. Featherstone

SUMMARY OF RATE CASE INVOLVEMENT

<u>Year</u>	<u>Case No.</u>	<u>Utility</u>	<u>Type of Testimony</u>	<u>Disposition</u>
1980	Case No. ER-80-53	St. Joseph Light & Power Company (electric)	Direct	Stipulated
1980	Case No. OR-80-54	St. Joseph Light & Power Company (transit)	Direct	Stipulated
1980	Case No. HR-80-55	St. Joseph Light & Power Company (industrial steam)	Direct	Stipulated
1980	Case No. GR-80-173	The Gas Service Company (natural gas)	Direct	Stipulated
1980	Case No. GR-80-249	Rich Hill-Hume Gas Company (natural gas)	No Testimony filed	Stipulated
1980	Case No. TR-80-235	United Telephone Company of Missouri (telephone)	Direct Rebuttal	Contested
1981	Case No. ER-81-42	Kansas City Power & Light Company (electric)	Direct Rebuttal	Contested
1981	Case No. TR-81-208	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal Surrebuttal	Contested
1981	Case No. TR-81-302	United Telephone Company of Missouri (telephone)	Direct	Stipulated
1981	Case No. TO-82-3	Investigation of Equal Life Group and Remaining Life Depreciation Rates (telephone-- depreciation case)	Direct	Contested

<u>Year</u>	<u>Case No.</u>	<u>Utility</u>	<u>Type of Testimony</u>	<u>Disposition</u>
1982	Case Nos. ER-82-66 and HR-82-67	Kansas City Power & Light Company (electric & district steam heating)	Direct Rebuttal Surrebuttal	Contested
1982	Case No. TR-82-199	Southwestern Bell Telephone Company (telephone)	Direct	Contested
1983	Case No. EO-83-9	Investigation and Audit of Forecasted Fuel Expense of Kansas City Power & Light Company (electric-- forecasted fuel true-up)	Direct	Contested
1983	Case No. ER-83-49	Kansas City Power & Light Company (electric)	Direct Rebuttal Surrebuttal	Contested
1983	Case No. TR-83-253	Southwestern Bell Telephone Company (telephone)	Direct	Contested
1984	Case No. EO-84-4	Investigation and Audit of Forecasted Fuel Expense of Kansas City Power & Light Company (electric-- forecasted fuel true-up)	Direct	Contested
1985	Case Nos. ER-85-128 and EO-85-185	Kansas City Power & Light Company (electric)	Direct	Contested
1987	Case No. HO-86-139	Kansas City Power & Light Company (district steam heating-- discontinuance of public utility)	Direct Rebuttal Surrebuttal	Contested
1988	Case No. TC-89-14	Southwestern Bell Telephone Company (telephone-- complaint case)	Direct Surrebuttal	Contested



<u>Year</u>	<u>Case No.</u>	<u>Utility</u>	<u>Type of Testimony</u>	<u>Disposition</u>
1989	Case No. TR-89-182	GTE North, Incorporated (telephone)	Direct Rebuttal Surrebuttal	Contested
1990	Case No. GR-90-50	Kansas Power & Light - Gas Service Division (natural gas)	Direct	Stipulated
1990	Case No. ER-90-101	UtiliCorp United Inc., Missouri Public Service Division (electric)	Direct Surrebuttal	Contested
1990	Case No. GR-90-198	UtiliCorp United, Inc., Missouri Public Service Division (natural gas)	Direct	Stipulated
1990	Case No. GR-90-152	Associated Natural Gas Company (natural gas)	Rebuttal	Stipulated
1991	Case No. EM-91-213	Kansas Power & Light - Gas Service Division (natural gas-- acquisition/merger case)	Rebuttal	Contested
1991	Case Nos. EO-91-358 and EO-91-360	UtiliCorp United Inc., Missouri Public Service Division (electric-- accounting authority orders)	Rebuttal	Contested
1991	Case No. GO-91-359	UtiliCorp United Inc., Missouri Public Service Division (natural gas)	Memorandum Recommendation	Stipulated
1993	Case Nos. TC-93-224 and TO-93-192	Southwestern Bell Telephone Company (telephone-- complaint case)	Direct Rebuttal Surrebuttal	Contested
1993	Case No. TR-93-181	United Telephone Company of Missouri (telephone)	Direct Surrebuttal	Contested

<u>Year</u>	<u>Case No.</u>	<u>Utility</u>	<u>Type of Testimony</u>	<u>Disposition</u>
1993	Case No. GM-94-40	Western Resources, Inc. and Southern Union Company (natural gas-- sale of Missouri property)	Rebuttal	Stipulated
1994	Case No. GM-94-252	UtiliCorp United Inc., acquisition of Missouri Gas Company and Missouri Pipeline Company (natural gas--acquisition case)	Rebuttal	Contested
1994	Case No. GA-94-325	UtiliCorp United Inc., expansion of natural gas to City of Rolla, MO (natural gas-- certificate case)	Rebuttal	Contested
1995	Case No. GR-95-160	United Cities Gas Company (natural gas)	Direct	Contested
1995	Case No. ER-95-279	Empire District Electric Company (electric)	Direct	Stipulated
1996	Case No. GA-96-130	UtiliCorp United, Inc./Missouri Pipeline Company (natural gas-- certificate case)	Rebuttal	Contested
1996	Case No. EM-96-149	Union Electric Company merger with CIPSCO Incorporated (electric and natural gas-- acquisition/merger case)	Rebuttal	Stipulated -
1996	Case No. GR-96-285	Missouri Gas Energy Division of Southern Union Company (natural gas)	Direct Rebuttal Surrebuttal	Contested
1996	Case No. ER-97-82	Empire District Electric Company (electric-- interim rate case)	Rebuttal	Contested
1997	Case No. EO-97-144	UtiliCorp United Inc./Missouri Public Service Company (electric)	Verified Statement	Commission Denied Motion

<u>Year</u>	<u>Case No.</u>	<u>Utility</u>	<u>Type of Testimony</u>	<u>Disposition</u>
1997	Case No. GA-97-132	UtiliCorp United Inc./Missouri Public Service Company (natural gas – certificate case)	Rebuttal	Contested
1997	Case No. GA-97-133	Missouri Gas Company (natural gas – certificate case)	Rebuttal	Contested
1997	Case Nos. EC-97-362 and EO-97-144	UtiliCorp United Inc./Missouri Public Service (electric)	Direct	Contested
1997	Case Nos. ER-97-394 and EC-98-126	UtiliCorp United Inc./Missouri Public Service (electric)	Direct Rebuttal Surrebuttal	Contested
1997	Case No. EM-97-395	UtiliCorp United Inc./Missouri Public Service (electric-application to spin-off generating assets to EWG subsidiary)	Rebuttal	Withdrawn
1998	Case No. GR-98-140	Missouri Gas Energy Division of Southern Union Company (natural gas)	Testimony in Support of Stipulation And Agreement	Contested
1999	Case No. EM-97-515	Kansas City Power & Light Company merger with Western Resources, Inc. (electric acquisition/ merger case)	Rebuttal	Stipulated (Merger eventually terminated)
2000	Case No. EM-2000-292	UtiliCorp United Inc. merger with St. Joseph Light & Power Company (electric, natural gas and industrial steam acquisition/ merger case)	Rebuttal	Pending

AUDITS WHICH WERE SUPERVISED AND ASSISTED:

<u>Year</u>	<u>Case No.</u>	<u>Utility</u>
1986	Case No. TR-86-14 (telephone)	ALLTEL Missouri, Inc.
1986	Case No. TR-86-55 (telephone)	Continental Telephone Company of Missouri
1986	Case No. TR-86-63 (telephone)	Webster County Telephone Company
1986	Case No. GR-86-76 (natural gas)	KPL-Gas Service Company
1986	Case No. TR-86-117 (telephone)	United Telephone Company of Missouri
1988	Case No. GR-88-115 (natural gas)	St. Joseph Light & Power Company
1988	Case No. GR-88-116 (industrial steam)	St. Joseph Light & Power Company

THE STATE CORPORATION COMMISSION  
OF THE STATE OF KANSAS

BEFORE COMMISSIONERS: MICHAEL LENNEN, CHAIRMAN  
RICHARD C. (PETE) LOUX  
PHILLIP R. DICK

IN THE MATTER OF THE JOINT APPLICATION )  
OF THE KANSAS POWER AND LIGHT COMPANY )  
AND THE GAS SERVICE COMPANY FOR A ) DOCKET NO.  
CERTIFICATE AUTHORIZING THE KANSAS ) 138,495-U  
POWER AND LIGHT COMPANY TO ISSUE )  
PROMISSORY NOTES AND FOR AN ORDER )  
AUTHORIZING THE KANSAS POWER AND LIGHT )  
COMPANY TO ACQUIRE ALL OF THE COMMON )  
STOCK OF THE GAS SERVICE COMPANY. )

JOINT SUBMISSION BY KPL AND GAS SERVICE  
PURSUANT TO ORDER OF SEPTEMBER 20, 1983

ON SEPTEMBER 20, 1983, THE STATE CORPORATION COMMISSION OF THE STATE OF KANSAS, UPON THE JOINT APPLICATION OF THE KANSAS POWER AND LIGHT COMPANY ("KPL") AND THE GAS SERVICE COMPANY ("GAS SERVICE"), AUTHORIZED THE ACQUISITION BY KPL OF THE COMMON STOCK OF GAS SERVICE FOR \$16.00 CASH PER SHARE. IN THAT ORDER, THE COMMISSION DIRECTED KPL AND GAS SERVICE TO PROVIDE, WITHIN ONE HUNDRED TWENTY (120) DAYS OF THE TRANSACTION'S CLOSING, A LEGAL ANALYSIS OF WHETHER THE COMMISSION SHOULD CONSIDER ADJUSTING THE RATE BASE OF GAS SERVICE TO REFLECT THE PURCHASE PRICE OF GAS SERVICE COMMON STOCK. THE CLOSING DATE OF THE TRANSACTION WAS DECEMBER 28, 1983. KPL AND GAS SERVICE HEREWITH SUBMIT THIS LEGAL ANALYSIS IN COMPLIANCE WITH THE COMMISSION'S ORDER.

I. INTRODUCTION

KPL ACQUIRED GAS SERVICE STOCK IN A TWO-STEP CORPORATE PROCEDURE. FIRST, KPL PURCHASED THE STOCK TENDERED BY GAS SERVICE SHAREHOLDERS PURSUANT TO KPL'S TENDER OFFER. SECOND, TO OBTAIN THE REMAINING GAS SERVICE SHARES, KPL MERGED INTO GAS SERVICE A NEWLY-FORMED, WHOLLY-OWNED SUBSIDIARY OF KPL, KP&L ACQUISITION CORP. KPL THEREBY BECAME THE OWNER OF 100% OF THE OUTSTANDING GAS SERVICE COMMON STOCK. ALL GAS SERVICE SHAREHOLDERS RECEIVED \$16.00 PER SHARE. THE TRANSFER OF COMMON STOCK OWNERSHIP WAS EFFECTED AT APPROXIMATELY 89% OF NET BOOK VALUE.

~~GAS SERVICE WAS THE SURVIVING CORPORATION OF THE MERGER WITH KPL ACQUISITION CORP.~~ AND IS NOW OPERATED AS A WHOLLY-OWNED SUBSIDIARY OF KPL. THE ACQUISITION HAS NOT CHANGED THE CAPITAL STRUCTURE OF GAS SERVICE. BECAUSE GAS SERVICE IS THE SURVIVING CORPORATION, ALL OF ITS CORPORATE RIGHTS, POWERS, PRIVILEGES, AND FRANCHISES REMAIN UNDISTURBED. THE CERTIFICATES OF CONVENIENCE AND NECESSITY GRANTED TO GAS SERVICE BY THE COMMISSION AND ALL THE COMMISSION'S ORDERS PERTAINING TO GAS SERVICE REMAIN IN FULL FORCE AND EFFECT. ALL OF GAS SERVICE'S CONTRACTURAL RIGHTS AND LIABILITIES CONTINUE.

11. A STOCK PURCHASE CANNOT AFFECT VALUATION OF THE RATE BASE BECAUSE THERE IS NO TRANSFER OF UTILITY PROPERTY X

THE COMMISSION HAS THE "DUTY TO ASCERTAIN THE REASONABLE VALUE OF ALL PROPERTY OF ANY [REGULATED PUBLIC UTILITY] WHENEVER IT DEEMS THE ASCERTAINMENT OF SUCH VALUE NECESSARY IN ORDER TO ENABLE THE COMMISSION TO FIX FAIR AND REASONABLE RATES...." K.S.A. 66-128. THE RATE BASE OF A PUBLIC UTILITY REPRESENTS THE REASONABLE VALUE OF ALL PROPERTY WHICH IS IN SERVICE AND DEVOTED TO THE PUBLIC USE. SOUTHWESTERN BELL TELEPHONE CO. V. KANSAS STATE CORPORATION COMMISSION, 192 KAN. 39, 386 P.2D 515 (1963).<sup>1</sup> BECAUSE THE VALUE OF THE CORPORATION'S PROPERTY REMAINS UNCHANGED AS THE CORPORATION'S STOCK IS BOUGHT AND SOLD, THE TRANSFER OF A UTILITY'S STOCK, THE INDICIA OF OWNERSHIP IN A CORPORATE ENTITY WHOSE STOCKHOLDERS ARE SEPARATE AND DISTINCT FROM THE ENTITY ITSELF, DOES NOT AFFECT THE VALUE OF ITS PROPERTY IN SERVICE AND DEVOTED TO THE PUBLIC USE. THUS, NO RECALCULATION OF THE UTILITY'S PROPERTY, OR RATE BASE, IS APPROPRIATE.

THE CURRENT RATE BASE OF GAS SERVICE IS DERIVED FROM THE ORIGINAL COST OF THE PROPERTY WHEN FIRST DEDICATED TO PUBLIC

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<sup>1</sup>THE DUE PROCESS CLAUSE OF THE FOURTEENTH AMENDMENT TO THE U.S. CONSTITUTION REQUIRES REGULATORS TO FIX RATES THAT AS A MINIMUM "ENABLE THE COMPANY TO OPERATE SUCCESSFULLY, TO MAINTAIN ITS FINANCIAL INTEGRITY, TO ATTRACT CAPITAL, AND TO COMPENSATE ITS INVESTORS FOR THE RISKS ASSUMED...." FEDERAL POWER COMMISSION V. HOPE NATURAL GAS CO., 320 U.S. 591, 605 (1944).

USE. THE PURCHASE OF ITS STOCK DOES NOT AFFECT ORIGINAL COST. A NEW STOCKHOLDER DOES NOT PURCHASE THE ASSETS OF THE CORPORATION. NOR DOES A CHANGE IN, OR SUBSTITUTION OF STOCKHOLDERS ESTABLISH A NEW BUSINESS ENTITY. TRANSFER OF OWNERSHIP OF COMMON STOCK DOES NOT AFFECT THE OWNERSHIP OF THE CORPORATION'S PROPERTY, WHICH STILL BELONGS TO THE CORPORATION.<sup>2</sup>

IN A STOCK TRANSFER, NO ASSETS ARE REMOVED FROM PUBLIC SERVICE OR TRANSFERRED TO ANOTHER BUSINESS ENTITY. THE SAME ASSETS WILL CONTINUE TO BE USED TO PROVIDE THE SAME SERVICES TO THE SAME RATEPAYERS AND THE ASSETS WILL REMAIN SUBJECT TO THE SAME RATE-MAKING JURISDICTION OF THE SAME REGULATORS. THIS CONTINUITY MAKES A RECALCULATION OF GAS SERVICE'S RATE BASE INCONGRUOUS.

ASIDE FROM THE LEGAL ISSUES RAISED BY THE COMMISSION'S INQUIRY, REVALUATION OF UTILITY PLANT MEASURED BY THE PRICE PAID FOR COMMON STOCK WOULD PRODUCE PRACTICAL DIFFICULTIES OF POTENTIALLY SIGNIFICANT DIMENSIONS. REVALUATION, WHETHER ON A STOCK ACQUISITION OR PURCHASE OF UTILITY ASSETS, ~~WOULD~~ ULTIMATELY TEND TOWARD HIGHER COSTS TO CONSUMERS, SINCE IT WOULD PROVIDE NO INCENTIVE TO MAKE ACQUISITIONS AT LESS THEN BOOK VALUE. IF IT IS APPROPRIATE TO WRITE DOWN RATE BASE WHEN STOCK IS PURCHASED BELOW BOOK VALUE, IT WOULD BE EQUALLY CORRECT TO WRITE UP RATE BASE WHEN THE STOCK IS ACQUIRED AT A PREMIUM. THIS PROBLEM WILL BE EXPANDED ON IN THE DISCUSSION THAT FOLLOWS

IT SHOULD BE BORNE IN MIND THAT, EXCEPT FOR THE MAGNITUDE OF THE TRANSACTION, KPL'S ACQUISITION OF GAS SERVICE'S OUTSTANDING COMMON STOCK IS NO DIFFERENT IN KIND FROM DAY TO DAY TRADING BY SMALLER INVESTORS. THE PRICE IS, IN BOTH INSTANCES, BASED ON AN EVALUATION OF THE EARNING POWER OF THE ASSETS OF THE UTILITY AS

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<sup>2</sup>CF. RE ROCHESTER GAS & ELECTRIC CORP., 41 PUB. UTIL. REP. (PUR) 4TH 463 (N.Y. P.S.C. 1981) (ASSETS OF MERGED UTILITY VALUED AT BOOK VALUE BEFORE MERGER RATHER THAN MUCH LOWER MARKET VALUE OF STOCK RECEIVED IN EXCHANGE); RE COMMONWEALTH EDISON CO., 66 PUB. UTIL. REP. (PUR) 3D 417 (F.P.C. 1966) (ASSETS OF MERGED UTILITY ACCOUNTED FOR AT BOOK RATHER THAN HIGHER PURCHASE PRICE).

THOSE ASSETS ARE EMPLOYED AND TREATED FOR RATEMAKING PURPOSES. THIS INVESTOR EVALUATION BECOMES NOT ONLY FRUITLESS, BUT COUNTER-PRODUCTIVE IF IT IS USED AFTER THE FACT TO REVALUE THE RATE BASE UPON WHICH A FAIR RATE OF RETURN IS DETERMINED.

THE FACTS OF THIS CASE ARE VERY SIMILAR TO THOSE OF IN RE TOWNE HILL WATER CO., 422 A.2D 927 (VT. 1980). THERE ALL OF THE STOCK OF A UTILITY WAS ACQUIRED BY A SOLE STOCKHOLDER FOR \$27,025, SUBSTANTIALLY LESS THAN THE NET ORIGINAL COST OF THE PLANT AND EQUIPMENT OF \$41,194. UPON THE UTILITY'S REQUEST FOR A RATE INCREASE, THE PUBLIC SERVICE BOARD DETERMINED THAT THE AMOUNT OF THE STOCKHOLDER'S INVESTMENT WAS INDICATIVE OF THE VALUE OF THE PROPERTY DEVOTED TO PUBLIC SERVICE AND RECALCULATED THE RATE BASE TAKING INTO ACCOUNT THE PURCHASE PRICE OF THE STOCK. ON APPEAL, THE VERMONT SUPREME COURT REVERSED, HOLDING THAT CONSIDERATION OF THE STOCK'S PURCHASE PRICE WAS IMPROPER. THE COURT REJECTED THE BOARD'S CONCLUSION THAT THE PURCHASE PRICE OF THE UTILITY'S STOCK REFLECTED THE VALUE OF THE UTILITY'S PROPERTY. ~~THE COURT DECLINED TO TREAT THE PURCHASE OF STOCK AS A PURCHASE OF PROPERTY.~~

THE BOARD'S FINDING THAT THE STOCKHOLDER'S INVESTMENT IN THE COMPANY WAS LESS THAN THE HISTORIC COST IS NOT GERMANE TO THE DETERMINATION OF A RATE BASE. THE PROPERTY IN QUESTION WAS NOT ACQUIRED [AT THE TIME OF THE STOCK TRANSFER]. ORIGINAL ACQUISITION AND DEVOTION TO PUBLIC USE IS THE TIME OF "INVESTMENT" IN THAT PROPERTY. THE STOCKHOLDER PURCHASED STOCK EXPECTING A REASONABLE RETURN ON THAT INVESTMENT, NO MORE AND NO LESS. WHETHER HE PURCHASED THE STOCK AT A DISCOUNT OR AT A PREMIUM IS IRRELEVANT.

Id. AT 929. THE COURT WAS NOT CONVINCED BY THE BOARD'S CONTENTION THAT THE NET ORIGINAL COST RATE BASE VALUATION WOULD ALLOW THE WATER COMPANY A WINDFALL. IT REASONED THAT THE RATE BASE IS ONLY ONE VARIABLE: "IT IS SIMPLY IMPOSSIBLE TO MEASURE WHETHER A GIVEN RATE OF RETURN IS REASONABLE OR UNREASONABLE WHOLLY WITHOUT REFERENCE TO A RATE BASE." Id.



111. EVEN IF STOCK PURCHASE COULD BE EQUATED WITH ASSET PURCHASE, RATE BASE SHOULD REPRESENT ORIGINAL COST WHEN ASSETS FIRST DEDICATED TO PUBLIC SERVICE BY GAS SERVICE

EVEN IF THE NATURE OF THIS TRANSACTION COULD BE DISREGARDED, AND TREATED AS A PURCHASE OF THE ASSETS OF GAS SERVICE, THERE SHOULD BE NO CHANGE IN THE RATE BASE IN RECOGNITION OF THE GENERAL RULE THAT THE RATE BASE REPRESENTS THE ORIGINAL COST OF UTILITY PROPERTY WHEN DEDICATED TO PUBLIC USE REGARDLESS OF THE PRICE AT WHICH IT IS PURCHASED BY ANOTHER UTILITY. SEE RE SOUTHWESTERN BELL TELEPHONE CO., 19 PUB. UTIL. REP. (PUR) 4TH 1, 11 (KAN. S.C.C. 1977). ACCORD MONTANA POWER CO. V. FERC, 599 F.2D 295 (9TH CIR. 1979); RE UTAH POWER AND LIGHT CO., 53 PUB. UTIL. REP. (PUR) 4TH 461, 469 (UTAH P.S.C. 1983); RE DAVENPORT WATER CO., 76 PUB. UTIL. REP. (PUR) 3D 209, 217 (IA. S.C.C. 1968).

IN KANSAS THE RATE BASE IS NOT RECALCULATED EVEN WHEN THE ASSETS ARE PURCHASED AT LESS THAN THE ORIGINAL COST. IN RE SOUTHWESTERN BELL TELEPHONE CO., THIS COMMISSION DETERMINED THAT THE REASONABLE VALUE OF PROPERTY PURCHASED FROM OTHER UTILITIES WAS NOT ITS PURCHASE PRICE BUT RATHER THE HIGHER ORIGINAL COST TO THE FIRST ENTITY WHICH DEVOTED THE PROPERTY TO PUBLIC SERVICE. 19 PUB. UTIL. REP. (PUR) 4TH AT 11. THE COMMISSION ACCEPTED STAFF'S PROPOSED ADJUSTMENT TO INCREASE THE UTILITY'S RATE BASE FROM THE PURCHASE PRICE OF PROPERTY ALREADY DEVOTED TO PUBLIC SERVICE TO ITS ORIGINAL COST WHEN FIRST DEVOTED TO PUBLIC SERVICE. THE COMMISSION CONSIDERED THE INCREASE TO BE "A TRADITIONAL ADJUSTMENT WHICH RECOGNIZES FOR RATE-MAKING PURPOSES THAT THE RATE BASE SHOULD BE THE ORIGINAL COST OF PLANT WHEN DEDICATED TO PUBLIC USE REGARDLESS OF PRICE AT A SUBSEQUENT SALE." Id. ACCORD, PROVIDENCE GAS CO. V. BURMAN, 376 A.2D 687 (R.I. 1977) (PROPERTY INCLUDIBLE IN RATE BASE AT BOOK VALUE, NOT LOWER PURCHASE PRICE).

THIS CARRYOVER OF BOOK VALUE IS AN APPROPRIATE VALUATION METHOD BECAUSE ORIGINAL COST IS AN APPROPRIATE DETERMINANT OF REASONABLE VALUE, AND BECAUSE THE PURCHASE PRICE OF GAS SERVICE'S

STOCK DOES NOT ACCURATELY REFLECT THE VALUE OF ITS ASSETS. FIRST, EVEN ASSUMING THAT THE PURCHASE PRICE OF GAS SERVICE'S ~~STOCK ACCURATELY REFLECTED THE MARKET VALUE OF ITS ASSETS~~ THERE IS NO SOUND REASON FOR DEVIATING FROM THE ORIGINAL COST OR BOOK VALUE METHODOLOGY ADOPTED OR GIVEN GREAT WEIGHT IN KANSAS AND MOST OTHER JURISDICTIONS. SEE, E.G., FEDERAL POWER COMMISSION V. HOPE NATURAL GAS CO., 320 U.S. 591 (1944); RE SOUTHERN BELL TELEPHONE & TELEGRAPH CO., 30 PUB. UTIL. REP. (PUR) 4TH 261 (S.C. 1979); RE NEW YORK TELEPHONE CO., 84 PUB. UTIL. REP. (PUR) 3D 321 (N.Y. 1970); RE PACIFIC TELEPHONE & TELEGRAPH CO., 53 PUB. UTIL. REP. (PUR) 513 (CAL. 1964); SOUTHWESTERN BELL TELEPHONE CO. V. KANSAS STATE CORPORATION COMMISSION, 192 KAN. 39, 386 P.2D 515 (1963). THE PRIMARY REASON FOR THE GENERAL PREFERENCE OF THE NET BOOK VALUE OVER MARKET VALUE IS THAT IT IS READILY ASCERTAINABLE WHILE MARKET VALUE IS MUCH MORE DIFFICULT TO COMPUTE. KANSAS PLACES GREAT VALUE ON THE ORIGINAL COST OF UTILITY PROPERTIES PRECISELY BECAUSE IT IS READILY ASCERTAINABLE. SEE, E.G., RE SOUTHWESTERN BELL TELEPHONE CO., 34 PUB. UTIL. REP. (PUR) 3D 257 (KAN. S.C.C. 1960), AFF'D, SOUTHWESTERN BELL TELEPHONE CO. V. KANSAS STATE CORPORATION COMMISSION, 192 KAN. 39, 386 P.2D 515 (1963); RE UNITED TELEPHONE CO. OF KANSAS, 27 PUB. UTIL. REP. (PUR) 3D 128 (KAN. S.C.C. 1958). BECAUSE THE MARKET VALUE OF ASSETS SELDOM CHANGES PRECISELY IN ACCORDANCE WITH DEPRECIATION, DEPRECIATED ORIGINAL COST IS OFTEN NOT AN ACCURATE PROXY OF CURRENT FAIR MARKET VALUE. NONETHELESS, ORIGINAL COST ACCOUNTING IS EMPLOYED TO AVOID THE DIFFICULTIES OF MORE SUBJECTIVE METHODS OF PROPERTY VALUATION. THE USE OF THE DEPRECIATED ORIGINAL COST VALUATION METHOD PROVIDES AN OBJECTIVE METHOD OF VALUATION WITHOUT THE NEED FOR INDEPENDENT ASSESSMENTS OF THE FAIR MARKET VALUE OF ACQUISITIONS. \*

THE UNFORTUNATE RESULT OF UTILIZING PURCHASE PRICE IN THIS CASE WOULD BE TO ENCOURAGE THE FUTURE TRANSFER OF PROPERTIES AT A PREMIUM ABOVE ORIGINAL COST REGARDLESS OF FAIR MARKET VALUE. FOR

EXAMPLE. HAD KPL PAID ABOVE BOOK VALUE FOR GAS SERVICE'S STOCK, GAS SERVICE'S RATE BASE WOULD HAVE INCREASED, RESULTING IN GREATER COSTS TO CONSUMERS. ONE REASON FOR THE APPLICABILITY OF ORIGINAL COST CONCEPT TO ACQUISITIONS WAS TO PREVENT UTILITIES FROM ARTIFICIALLY INFLATING THEIR RATE BASES BY ACQUIRING PROPERTIES AT UNREALISTICALLY HIGH PRICES. SEE RE UNITED GAS PIPE LINE CO., 25 F.P.C. 26, 64 (1961). EXCEPTIONS TO ORIGINAL COST VALUATION WHERE THE PURCHASE PRICE OF ASSETS EXCEEDS NET BOOK VALUE GENERALLY REQUIRE A SHOWING THAT BENEFITS ACCRUE TO THE ACQUIRING PUBLIC UTILITY AND ITS RATEPAYERS SUFFICIENT TO JUSTIFY DEVIATION FROM ORIGINAL COST. SEE, E.G., MISSISSIPPI EX REL. ALLAIN V. MISSISSIPPI PUBLIC SERVICE COMMISSION; RE PUBLIC SERVICE CO. OF NORTH CAROLINA, 55 PUB. UTIL. REP. (PUR) 4TH 53 (NO. CARO. U.C. 1983); RE DAVENPORT WATER CO., 76 PUB. UTIL. REP. (PUR) 3D 209 (IA. S.C.C. 1968); RE MONMOUTH CONSOLIDATED WATER CO., 75 PUB. UTIL. REP. (PUR) 3D 225 (N.J.P.U.C. 1968).

SECOND—THE PURCHASE PRICE OF THE COMMON STOCK OF GAS SERVICE WAS A COMPOSITE OF MANY FACTORS, INCLUDING CREDIT WORTHINESS, MARKET VALUE, EARNINGS, SALES, MANAGEMENT, REPUTATION WITH REGULATORS AND THE PUBLIC, AND GENERAL BUSINESS PROSPECTS.<sup>3</sup> IN THIS CASE, THE MARKET VALUE OF THE STOCK WAS INFLUENCED MORE BY THE POOR FINANCIAL RECORD OF GAS SERVICE THAN BY THE VALUE OF THE ASSETS DEVOTED TO PUBLIC USE. THE FACT THAT GAS SERVICE STOCK ONLY COMMANDED A PRICE LESS THAN NET BOOK VALUE

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<sup>3</sup>IT IS UNIFORMLY RECOGNIZED THAT THE PURCHASE PRICE OF UTILITY PROPERTY DOES NOT REFLECT ITS MARKET VALUE. SEE E.G., STATE EX REL. SOUTHWESTERN BELL TELEPHONE CO. V. MISSOURI PUBLIC SERVICE COMMISSION, 262 U.S. 276, 292 (1923) (BRANDEIS, J., CONCURRING OPINION) ("IT IS IMPOSSIBLE TO FIND AN EXCHANGE VALUE FOR A UTILITY, SINCE UTILITIES, UNLIKE MERCHANDISE OR LAND, ARE NOT COMMONLY BOUGHT AND SOLD IN THE MARKET."); ARIZONA CORPORATION COMMISSION V. ARIZONA WATER CO., 335 P.2D 412 (ARIZ. 1959) (PUBLIC UTILITIES NOT ROUTINELY SOLD ON MARKET; MARKET VALUE DEPENDENT UPON REGULATED RATE OF RETURN; LARGE TAX SAVINGS FACTOR IN BELOW BOOK PURCHASE PRICE). SEE ALSO, TOWN OF JAMESTOWN V. KENNELLY, 100 A.2D 649 (R.I. 1953) (PURCHASE PRICE ONE FACTOR; PROPERTY'S FAIR VALUE EQUALLED 165% OF PURCHASE PRICE).

SHOULD NOT BAR KPL FROM THE RIGHT TO A REASONABLE RETURN ON THE FAIR VALUE OF THE UNDERLYING PROPERTY.

IV. DEVALUATION OF GAS SERVICE RATE BASE TO REFLECT CURRENT STOCK VALUE CONSTITUTES UNCONSTITUTIONAL TAKING

PARTICULARLY IN A REGULATED INDUSTRY THERE IS THE ADDITIONAL PROBLEM OF THE INTERDEPENDENCE BETWEEN RATES AND MARKET VALUE. SPECIFICALLY, THE MARKET VALUE OF AN ASSET DEPENDS UPON THE REVENUE IT GENERATES, AND IN A REGULATED INDUSTRY THE AMOUNT OF REVENUE IS DEPENDENT ON THE LEVEL OF RATES SET BY REGULATORS. SEE HOPE NATURAL GAS CO., 320 U.S. AT 601. IF GAS SERVICE'S RATE BASE WERE WRITTEN DOWN TO 80% OF NET BOOK VALUE TO REFLECT THE VALUE OF ITS STOCK IN 1983, THE MARKET WOULD DROP TO COMPENSATE FOR GAS SERVICE'S REDUCED EARNING POWER. THIS WOULD IN TURN PRODUCE A FURTHER REDUCTION IN RATE BASE TO THE NEW MARKET VALUE WHICH WOULD CAUSE A STILL FURTHER REDUCTION OF EARNING POWER AND THUS OF MARKET VALUE. SUCH A SELF-FULFILLING PROPHECY EVENTUALLY DRIVES THE MARKET VALUE TO ZERO AND DESTROYS THE UTILITY. THIS INTERDEPENDENCE BETWEEN RATES AND MARKET VALUE COULD RENDER THE ADJUSTMENT OF GAS SERVICE'S ASSETS TO THE MARKET VALUE OF STOCK AN UNCONSTITUTIONAL TAKING WITHOUT COMPENSATION.

COMMON STOCKS, PREFERRED STOCKS AND FIRST MORTGAGE BONDS OF ALL PUBLICLY HELD UTILITIES IN KANSAS, INCLUDING KPL, ARE BOUGHT AND SOLD NEARLY EVERY DAY AT PRICES WHICH FLUCTUATE NEARLY EVERY DAY. SOME ARE TRADED ABOVE BOOK VALUE AND SOME BELOW BOOK VALUE. COMMISSION CONSIDERATION OF A RATE BASE ADJUSTMENT IN THIS CASE WOULD, IF PERMITTED TO STAND, LOGICALLY DICTATE SIMILAR ADJUSTMENTS--UP OR DOWN--FOR EACH UTILITY REGULATED BY THE COMMISSION IN EACH RATE CASE. THE COMMISSION, OF COURSE, HAS NEVER BASED RATE BASE VALUATION ON THE FLUCTUATING TRADING PRICE OF A UTILITY'S STOCKS OR BONDS. CLEARLY, IT SHOULD NOT CONSIDER SUCH UNWARRANTED AND UNLAWFUL ADJUSTMENTS FROM HENCEFORTH.

THIS INQUIRY HAS CONFIRMED THE PROPRIETY OF COMMISSION USE OF ORIGINAL COST AS THE BASIS OF THE VALUE OF PROPERTY DEVOTED TO UTILITY SERVICE.

WHEREFORE, KPL PRAYS THAT THE COMMISSION NOT COMMENCE PROCEEDINGS TO CONSIDER WHETHER OR NOT THE RATE BASE OF GAS SERVICE SHOULD BE ADJUSTED IN ORDER TO REFLECT THE COST OF ASSETS PURCHASED.

DATED AT TOPEKA, KANSAS THIS 20 DAY OF APRIL, 1984.

THE KANSAS POWER AND  
LIGHT COMPANY AND THE GAS  
SERVICE COMPANY

BY David S. Black  
DAVID S. BLACK, ESQUIRE  
SENIOR VICE PRESIDENT, LAW

BY John K. Rosenberg  
JOHN K. ROSENBERG  
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ATTORNEYS FOR THE KANSAS POWER  
AND LIGHT COMPANY AND THE GAS  
SERVICE COMPANY

Larry  
Phil

RECEIVED

BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI

JAN 24 1989

In the matter of U.S. Water Lexington, )  
Missouri, Inc. to file tariffs designed )  
to effectuate a general revenue increase )  
attributable to the meter rate for water )  
service provided to customers inside and )  
outside of the City of Lexington, )  
Missouri. )

ACCOUNTING DEPT.  
PUBLIC SERVICE COMMISSION

Case No. WR-88-255

INITIAL BRIEF OF  
U.S. WATER/LEXINGTON, MISSOURI, INC.

FILED

JAN 23 1989

PUBLIC SERVICE COMMISSION

Gary W. Duffy  
HAWKINS, BRYDON, SWEARENGEN  
& ENGLAND P.C.  
312 East Capitol Ave.  
P. O. Box 456  
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Attorneys for  
U.S. Water/Lexington, Mo. Inc.

January 23, 1989

"normal" years. There can be no dispute that 1987 is abnormal with 20.3 percent, and any use of that year's figures will unreasonably skew the percentages. The manager of USW has testified that it has little or no funds with which to pursue major construction activity in 1989, absent almost all of the rate increase request being granted (Exhibit 9, p. 2), so there is no competent and substantial evidence that 1989 and future years will be a repeat of 1987. The evidence requires that the Commission find 12 percent to be an appropriate percentage to utilize for this purpose.

#### IV. Negative Acquisition Adjustment

Staff calculated \$1,601,987 as a reasonable figure for net original cost rate base for USW, and USW has not challenged that figure in this case. However, Public Counsel proposes, by imputing interest to the promissory note representing the majority of the purchase price of USW from Missouri Water Company, to reduce net rate base by \$382,312. When given full effect, this reduces the revenue requirement of USW by \$74,079 when a 12.25 percent return is considered and income taxes are computed based upon 100 percent equity. USW opposes this adjustment. The Staff is not proposing any acquisition adjustment.

In essence, the Public Counsel proposes that the ratepayers be given the benefit resulting from the fact that this utility was arguably purchased for less than depreciated original cost. Since the Public Counsel is opposed to having the ratepayers bear any

responsibility in the opposite situation, i.e. where a utility is purchased for more than net original cost, the Public Counsel position on this issue may be succinctly put as follows: "Heads, the ratepayers win; tails, the shareholders lose."

USW believes that it is inappropriate for the Commission to accept the Public Counsel's proposal for several reasons. First, and obviously of great importance to USW, is that acceptance of the proposal would financially cripple the company because it would - wipe out almost all of the increase in rates that even the Staff is proposing here. Considering the current cash flow position of USW as testified to by its accountants, such an action would cause very serious consequences.

Second, the acceptance of the proposal is not appropriate ratemaking treatment either in general, or in this specific instance. As explained by Mr. Drees in his rebuttal testimony (Exhibit 6), the Commission specifically approved the sale of this utility from Missouri Water Company to U.S. Water/Lexington, Missouri, Inc. in Case No. WM-84-37, by Order dated October 21, 1983.<sup>6</sup> That the sale price was below the net book value of the assets was clearly stated in the fourth paragraph of the order, so all parties were aware of that. The sale price was stated as \$1,186,139 plus accounts receivable. The net book value of the assets was \$1,207,014. The order went on to state that the sale would result in a small loss to Missouri Water Company, and that

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<sup>6</sup> A copy of the order appears as Schedule 1 to Exhibit 19.



its shareholders would bear that loss and incur the tax effect of the sale. (Order, p. 1)

Further, the materials furnished to the Commission clearly stated that the parties did not intend to treat the transaction in the manner proposed by Mr. Riley here. Mr. Drees provided copies of those accounting materials in his Schedule LFD-4.1 and 4.2 attached to Exhibit 6. Beginning at the bottom of Schedule LFD-4.1 appears the following text:

The purchase price described in the foregoing is less than the "rate base" of the assets acquired as determined by the Missouri Public Service Commission (PSC). Management does not intend to discount the purchase obligation to present value as required by generally accepted accounting principles. If the notes were stated at present value, the cost of utility plant would be reduced by approximately \$425,000. ... Should the PSC elect to reduce the Company's "rate base" to cash expended plus the present value of the purchase obligation, projected levels of revenue would be adversely affected and projected operating results and cash increase might be materially overstated.

Thus, the very argument that Mr. Riley is making here five years later was explicitly laid out for the Commission. It was put on notice that any reduction in rate base on this basis would adversely affect projected revenues. This supports the statements made by Mr. Drees that if the investor had known this acquisition adjustment were going to be made, he would have been advised not to make the purchase. (Tr. 202)

Instead, the Commission in its Order made no mention of requiring the rate base to be reduced due to the sale price, or to consider the present value of the non-interest bearing note. Instead, it made a specific finding of the rate base, and

specifically approved the sale at the specified sale price. And conspicuously absent from the Order of October 21, 1983 was the usual disclaimer concerning an order's impact for ratemaking purposes. Thus, USW believes that the Commission fully understood the special circumstances surrounding these properties; that Missouri Water was so anxious to rid itself of them that it took a loss on the sale and that special financing with a non-interest bearing note was appropriate to achieve a sale of the properties. - For the Commission to find exactly to the contrary five years later would be to perpetrate the cruelest of hoaxes.

As mentioned, a negative acquisition adjustment would not be appropriate for general ratemaking principles either. Mr. Drees provided a brief review of the situations which gave rise to the "original cost when first devoted to public service" rules. (Exhibit 6, p. 6) This principle has served to protect ratepayers from utilities selling at inflated prices and then seeking to have the regulators revalue the properties at the higher level, just to produce greater profits. Although there are always exceptions, Mr. Drees concludes that sales of utility property at higher than net book value should be borne by the shareholders. USW is under the impression that is the general principle utilized by this Commission, although there may have been a few exceptions.

A review of authorities from other jurisdictions highlights the beneficial effect of the original cost principles. In Re New York Telephone Company, 5 PUR 3d 53 (1954), the New York Public Service Commission was faced with a utility's arguments that it

should consider evidence of market value in rate base evaluation. This Commission emphasized the unacceptable circularity in valuing the property of an earnings-related enterprise on the basis of purchase price. It said, at p. 44:

Long and well-established fundamentals should not be lightly brushed aside in the absence of the most compelling reasons or clearly demonstrable error.

In competitive enterprise, free from regulation, the value of any commercial property is usually measured by its capitalized prospective earnings. In the utility field, of course, there is no free competition.

In determining the value of a telephone company's plant, we cannot use the standards of competition in the industry because these do not exist. There is however, another standard of competition and that is competition in the money market for capital. If the rates fixed are too low and the income is insufficient, there will be a flight of capital from the telephone industry to other types of investment. The converse is equally true.

The Court in Vincennes Water Supply Company v. Public Service Commission, P.U.R.1930B, 216, 219-220, 34 F.2d 5, rejected the use of market value of securities in determining the value of utility property.

Such questions as capitalization and the amount and kind of securities and the market value of the same, can have, in any event, only remote evidential value. In many instances, capitalization bears no particular relation to invested or present value, and the market price of securities depends upon the rates charged for service. If rates are lowered by regulatory bodies, the market value of securities will fall. If rates are raised, within reasonable limits, the value of securities will rise. As pointed out by some Commission, to determine the value of a public utility for rate-making purposes, the using of the market value of securities to make such determination, would involve reasoning in a circle. It is usually now held to be not a legal basis for determining present value, as is pointed out in the case of Monroe Gas Light & Fuel Co. v. Michigan Public Utilities Commission (D.C. 1923) 292 Fed. 139, 150 PUR 1923E, 66T."

If the purchaser paid too much for his stock, the public should not, as a result, be imposed upon by rates

to fix a reasonable return upon such purchase price. If the purchaser paid too little, he is entitled to the benefit of his bargain. To determine value from the purchase price of stock at private sales is, as indicated above, to reason in a circle, for if rates charged be unreasonably low, the value of the property upon that basis is depressed; if unusually high, it is inflated. The test always is the present fair value of the property. As the Supreme Court says in the case of McCardle v. Indianapolis Water Co. (1926) 272 U.W. 499, 410, 71 L.Ed. 154, PUR 1927A, 15, 23, 47 S.Ct. 144, 148, "It is well established that value of utilities properties fluctuate, and that owners must bear the decline and are entitled to the increase." (emphasis supplied)

- More recently, the Vermont Supreme Court said in Re Towne Hill Water Co., 422 A.2d 927 (1980):

Generally rate base is determined by the formula that so-called historical or original cost plus capital improvements minus depreciation equals the net value of the property. Using the cost of the 1973 acquisition of the capital stock would substitute a new original cost

... The Board's finding that the stockholder's investment in the company was less than the historic cost is not germane to the determination of a rate base. The property in question was not acquired in 1973. Original acquisition and devotion to public use is the time of "investment" in that property. The stockholder purchased stock expecting a reasonable return on that investment, no more and no less. Whether he purchased the stock at a discount or a premium is irrelevant.

We are unimpressed by the Board's contention that calculating a rate of return on the rate base which the Company argues for will allow the Company a windfall. It is simply impossible to measure whether a given rate of return is reasonable or unreasonable wholly without reference to rate base.

We therefore have several valid arguments for rejecting the Public Counsel's position on this issue: (1) the specific terms of the sale of these properties were approved by the Commission five years ago, with all relevant facts disclosed, and no mention by the Commission of any negative acquisition adjustment (2) the

circularity of reasoning inherent in deviating from net original cost valuation of rate base, not to mention the demands that would be placed on the Commission by other utilities for corresponding treatment if that were to occur; (3) the reasoning expressed that if an investor pays too much, the ratepayer is shielded, while if the investor pays "too little", he should be entitled to the benefit of his bargain; and finally, (4) that the impact of such an adjustment on this utility would be extremely severe and mean that it would not be able to meet its debt service payments.

#### V. Management Fee

As indicated earlier, there was a "management fee" discussed and approved in the October 1983 order approving the sale and transfer. On page 2 of the order, the Commission specifically recognized how the management agreement would function and how the fee would be calculated:

U.S. Utilities Management & Services, Inc. will manage the water facilities under the agreement and will receive a fee equal to the lesser of: 15 percent of the actual costs of providing water service to the customers of the system, the rate of return on equity allowed by the Commission, or the cash available after the payment of all expenses of operation, exclusive of the management fee itself. (Exhibit 6, pp. 9-10)

The management agreement itself was made a part of the record in WM-84-37, and was described in the direct testimony of Frank Hawkins. (Exhibit 6, p. 10) The agreement has been in place, and payments have been made from USW to U.S. Utilities Management & Services, Inc. ("the management company") since the inception of

DATA INFORMATION REQUEST  
UTILICORP UNITED, INC.  
MISSOURI PUBLIC SERVICE DIVISION  
CASE NO. ER-90-101

REC'D

Requested From: Brad Lewis  
Date Requested: March 6, 1990  
Information Requested:

MAR 06 1990

GLC

Provide the most complete available written overall corporate strategy statement for Utilicorp, including explanations of strategy changes that have occurred since the inception of the Utilicorp name change and a statement of any anticipated future changes in corporate strategy that are now planned.

Requested By: Michael L. Brosch

Information Provided: SEE ATTACHED

The attached information provided to the consultants and technical staff of the Office of the Public Counsel in response to the above data information request is accurate and complete, and contains no material misrepresentations or omissions, based upon present facts of which the undersigned has knowledge, information or belief. The undersigned agrees to immediately inform the consultant and technical staff of The Office of the Public Counsel if, during the pendency of Case No. ER-90-101 before the Commission, any matters are discovered which would materially affect the accuracy or completeness of the attached information.

If these data are voluminous, please (1) identify the relevant documents and their location (2) make arrangements with requester to have documents available for inspection in the Utilicorp United, Inc., Missouri Public Service Division, Kansas City, Missouri office, or other location mutually agreeable. Where identification of a document is requested, briefly describe the document (e.g., book, letter, memorandum, report) and state the following information as applicable for the particular document: name, title, number, author, date of publication and publisher, addresses, date written, and the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies or data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control or within your knowledge. The pronoun "you" or "your" refers to Utilicorp United, Inc., Missouri Public Service Division and its employees, contractors, agents or others employed by or acting in its behalf.

Date Response Received: 3/21/90

Signed By: Brad Lewis

Prepared By: Williams

DATA INFORMATION REQUEST  
MISSOURI PUBLIC SERVICE  
CASE NO. ER-90-101

Requested From: Brad Lewis

Date Received: March 6, 1990

Information Requested: Provide the most complete available written overall corporate strategy statement for UtiliCorp, including explanations of strategy changes that have occurred since the inception of the UtiliCorp name change and a statement of any anticipated future changes in corporate strategy that are now planned.

Requested By: Michael L. Brosch

Information Provided: The overall corporate strategy has been consistently implemented since the inception of the UtiliCorp name change. It is most comprehensively described in a speech before the NARUC by Mr. Richard C. Green, Jr. (attached). Other descriptions of strategy can be found in the company's Annual Report to Shareholders and Form 10-K.

Date Provided: March 23, 1990

## FRAMING REGULATION IN AN ERA OF UTILITY TRANSITION

When UtiliCorp was formed in 1985, not many people understood what we were trying to accomplish. We had been doing business successfully for about 70 years as Missouri Public Service Company. Our mission had been to keep the lights on and the gas flowing, to make sure our rates were affordable and that our shareholders were earning reasonable returns.

Those original business objectives haven't changed under UtiliCorp. But we've added one important element. Today, we are out to become a value-added utility--a good, tough competitor in what is becoming a market-driven industry.

About five years ago we saw that we needed to react to a new reality in our industry. That reality was, and is, competition. It forced us to ask ourselves: "What is our best strategy to meet this challenge?" The answer was simple. We had to grow.

That presented us with a second question: "Should this growth occur within our industry or outside of it?" In our minds, the answer again was clear. Our best hope for success was to stay with the business we knew--the utility business.

Most everyone here has some familiarity with the forces that have changed the way that gas and electric utilities must do business today.

The electrics have been whipsawed by unstable capital markets, high interest rates, rapid inflation and volatile fuel prices. Today, we are faced with



environmental pressures and technological changes. This had a chilling effect on new power plant construction and consequently, some regions of the country now face capacity shortages. At the same time, economic conditions and federal laws have allowed the emergence of independent power producers and cogenerators that now may compete for some of the utilities' largest customers.

On the gas side, years of well-meaning but ill-conceived regulations have created great imbalances of supply and demand. In the late 1970s, artificially low prices for gas transported across state lines led to shortages on the East Coast. The resulting political pressures culminated in the Natural Gas Policy Act--a law that created some extreme pricing disparities for old and new gas. Pushed by fears of being caught again with inadequate supplies, pipelines began locking into the take-or-pay contracts that have proven to be so burdensome today. Gas utilities also face the competitive threat of losing their largest customers to system bypass.

How should regulators respond to these changing conditions? There are many compelling arguments in favor of deregulating the industry--adopting a market-based approach for dealing with these challenges. At UtiliCorp, we are not convinced that utilities can be entirely deregulated. Because gas and electricity are vital commodities, utilities will always remain under some obligation to provide service.

However, Adam Smith's invisible hand of competition is clearly at work. For that reason, flexible regulatory approaches will be necessary. At UtiliCorp,

We believe that regulations should be designed and implemented to allow for the emergence of value-added utilities. This can be accomplished through a process of re-regulation, and not necessarily de-regulation.

It is our view that the basic mission and objectives of regulation should not change significantly during this time of transition. Regulatory agencies will still strive to protect the least powerful end user. Regulation also will need to fulfill its other vital function—helping American industry remain competitive through access to reliable and reasonably priced gas and electric service.

Flexible regulatory approaches will allow utilities to compete effectively for customers, to expand their businesses in new ways and to grow through the prudent acquisition of other utilities. Regulators can best protect the public interest by moving in sync with the evolution of the industry.

What do I mean when I say re-regulation? It is simply a matter of changing perspective—an approach in which the commissions view regulation in a new light while applying the same traditional, fundamental values.

In 1983, I went to the Missouri Public Service Commission with a plan to add value for the customers and shareholders of my company. A principal component of this plan was to expand through utility acquisitions. Of course, the concern of the Missouri commission was whether this plan would be a detriment to Missouri ratepayers.

The Missouri commission has shown a willingness to allow us to pursue this plan because UtiliCorp made a commitment to flow only benefits to Missouri

customers and not to pass on any new problems that may arise. At no time will we jeopardize our own financial integrity. We recognize that it is vitally important not to put Missouri's sound utility infrastructure at risk.

Six years later, this commitment still stands. Our record shows we have lived up to everything we have promised. This process has worked well. By taking a different regulatory approach, the Missouri commission has allowed us to serve our customers better and build value for our shareholders.

Change and competition are happening now. It can't be stopped at this point in time. The utility industry faces the risk of having competition skim the cream business away from its customer base. State regulators have a real opportunity to set the tone on utility regulation and thereby play a part in this changing environment.

State commissions could perhaps face reductions in their jurisdictional authority if they ignore the changes that are already in motion. Partnerships need to be created between utilities and their state regulators. The traditional attitudes of each will need to change. The force that binds us together is our mutual responsibility to maintain this country's utility infrastructure to meet future needs.

This is hard work. Change does not come easily. While re-regulation will keep in place the fundamental values of regulation, it calls for us to try new approaches--to experiment. These approaches could range from flexible rate structures to the support of a specific acquisition or acquisition program.

Because any new regulatory approach cannot be guaranteed initial success, commitment will be a key ingredient in the process.

Will the same fundamental regulatory values still apply as regulators evaluate mergers and acquisitions? We believe they will. In many cases, regulators will find that a merger or acquisition represents an opportunity to drive an even better bargain for customers. They can demand improvements in service and take steps to insure prudent management of the assets for years. In many cases, a reasonable and economic rate structure can be negotiated as part of the acquisition.

Should regulators consider the economic health of the combined companies in evaluating an acquisition's impact on customers? It is our view that this may be a part of regulatory responsibility. An acquisition that weakens the financial outlook for the combined entity may very well have a long-term detrimental impact on customers. On the other hand, an acquisition that strengthens a company financially can reduce the cost of capital and indirectly benefit customers in many ways.

We are convinced that the growth strategy we've adopted is our best hope of living up to our responsibility to provide affordable and reliable utility service. We have significant new incentives to keep rates at affordable levels. Yet, There must be a balance between the demands of the customer and demands of the shareholder. Meeting the needs of one group to the exclusion of the other will ultimately hurt everyone concerned.

For several years, UtiliCorp has been aggressively seeking new utility operations in this country and other countries, and expanding in non-regulated areas of the utility business. Five years ago, this was a somewhat non-traditional approach. Today, more and more utilities seem to be adopting similar business plans. We believe it's a strategy that will best prepare us for the future.

UtiliCorp has followed a firm policy of not seeking to recover any of its acquisition-related premiums through rates. We have made a very persuasive case to investors that any premium costs or share dilution they experience will be for the short-term. We believe we can demonstrate that UtiliCorp will financially outperform the industry in the long-term.

What do I mean when I say UtiliCorp is in better position to serve its customers by building financial strength?

By becoming a larger and more diversified entity, UtiliCorp achieves economies of scale in such areas as financing costs, employee retirement and health benefits, centralized purchasing, consolidations of billing and computer services and, not insignificantly, negotiation of gas purchase contracts.

We are continually asked whether we are better off now than if we had continued to do business solely as Missouri Public Service. The answer is absolutely yes.

To illustrate that, we can point to some costs that would be very burdensome right now if Missouri Public Service was a stand-alone company. We are presently looking at financing about \$100 million for power plant life extension

and acid rain compliance projects. Because of our size, UtiliCorp can carry those costs on its books as short-term debt and convert it to long-term when interest rates and market conditions are right. As Missouri Public Service, we would have been required to finance those projects immediately with long-term debt regardless of market conditions. Those projects would have represented about a third of our total capitalization, instead of the one-eighth that we're looking at now. As you can see, our size gives us the potential to save millions of dollars.

In addition to the benefits we realize as a larger, more diversified and more competitive company, we believe our various constituencies also benefit.

Acquisitions in the utility industry truly have to be in the public interest before they can occur. We must convince customers that an acquisition won't adversely affect rates. We must convince regulators that regulated operations are not subsidizing non-regulated businesses. We must convince the respective boards of directors and shareholders that we have the financial resources to consummate a deal. And, we must convince our potential new employees that they won't lose their jobs or see their benefits reduced.

We have a deeply ingrained incentive to ensure that regulation accomplishes its mission. We are out to prove that we can do an outstanding job of managing the utility operations we acquire. Both our customers and our shareholders will benefit. We know that regulators are watching us carefully--to see that we live up to our service obligations and any other promises we have made in the process of an acquisition. In short, we are deeply committed to

serving the public interest. I can say with no hesitation that our track record proves that.

The driving force in our industry is to become more competitive by following whatever formula it takes. We are learning that we need to focus on service and the price of the product. That market-driven philosophy will create quality utilities, responsive to the needs of their customers and to the performance demands of their shareholders.

Clearly, the merger and acquisition movement will be subject to a considerable amount of regulation. Not only will state regulators pass judgement on these transactions, many constituencies will be represented through the intervention process. Again, the need for balance must be emphasized. We must submit a balanced package of benefits for everyone when pursuing a utility acquisition.

At UtiliCorp, we are now having the good fortune to see acquisition opportunities come our way because of the way we've done past transactions. We have pursued all of our opportunities on a non-adversarial basis, we have lived up to our promises and commitments and we have retained existing management and employees. Today, at any given time, we may be screening a half-dozen opportunities that are being presented to us.

Our acquisition program is not cutting into our commitment to maintain the integrity of our systems. In 1984, our construction expenditures were equal to

about 10.3 percent of revenues. In 1988, construction spending was 11.7 percent of revenues.

We are committed to improving the communities we serve through active economic development programs and civic involvement by employees. We believe that strengthening the local economies of our service areas and generally improving the quality of life will pay business dividends.

In conclusion, I would like to challenge the regulatory community to consider ratemaking approaches that will allow utilities to continue fulfilling their vital obligations. We must be allowed to become better competitors, to diversify through acquisitions and to start up non-regulated utility businesses.

My message is one of partnership. Utilities and regulators need to make the commitments necessary to deal with change. This is not an option. The process has started and the momentum is increasing. Other industries have recently gone through dramatic transitions and now it is our turn. We control very important commodities.

We would be wise to learn from the experiences of other industries as we work together to manage our time of transition so that customers, employees and shareholders all benefit.



Utilicorp United, Inc.  
EF 86-73

No. 6

Data Information Request

Requested From: Dale J. Wolf  
Date Requested: 11/15/85  
Information Requested: \_\_\_\_\_

Please provide documentation (including work papers) of quantitative and qualitative considerations used to determine that this stock issuance is in the public interest and that it is necessary "in order that Applicant may continue to render adequate and efficient public utility service to its present and future customers" (Item No. 10 in Company's Application).

Specifically provide benefits and costs accruing to Missouri customers associated with the purchase of Peoples Natural Gas Company, and the methods by which these benefits and costs will be passed along to Missouri customers.

Requested By: Bruce Schmidt, Office of Financial Analysis  
Information Provided: See Attached.

The information provided to the Missouri Public Service Commission Staff in response to the above information request is accurate and complete, contains no material misrepresentations or omissions based upon present facts known to the undersigned. The undersigned agrees to immediately inform the Missouri Public Service Commission, if any matters are discovered which would materially affect the accuracy or completeness of the information provided in response to the above information request.

Signed By:

Julia A. Samayoa

cc: \_\_\_\_\_

Proceeds from the sale will be used to replenish internally generated funds which were used for repayment of short-term debt incurred for construction, which construction was necessary for the Company to render adequate and efficient service. The internally generated funds were also used to pay taxes, to pay for coal and for other significant items. Thus, the sale is in the public interest.

Proceeds will also be used to acquire Peoples Natural Gas Company. The acquisition of Peoples should assure the realization of all economies of scale available to Missouri Public Service Company and UtiliCorp United, both in the administrative and operational areas. The acquisition is expected to, after assimilation of the information by financial markets, lead to a reduction in capital costs for UtiliCorp United. This expected reduction in capital costs will eventually produce reductions in rates of return claimed by Missouri Public Service Company in proceedings before the Missouri Public Service Commission.

LAW OFFICES

HAWKINS, BRYDON & SWEARENGEN

PROFESSIONAL CORPORATION

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ROBERT L. HAWKINS, JR.  
DAVID V.G. BRYDON  
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WILLIAM R. ENGLAND, III  
ROBERT L. HAWKINS, III  
JOHNNY K. RICHARDSON  
STEPHEN G. NEWMAN  
MARK W. COMLEY  
GARY W. DUFFY  
VICKI J. GOLDAMMER  
PAUL A. BOUDREAU

December 6, 1985

Mr. Cary Featherstone  
Missouri Public Service Commission  
P. O. Box 360  
Jefferson City, Missouri 65102

Re: Case No. EF-86-73

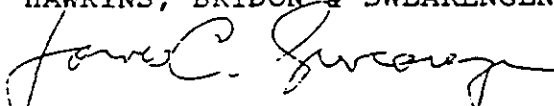
Dear Mr. Featherstone:

Enclosed is a copy of Data Request No. 6a in the  
above-referenced case.

Very truly yours,

HAWKINS, BRYDON & SWEARENGEN P.C.

By:

  
James C. Swearengen

JCS/da  
Enclosure

Utilicorp United, Inc.

EF 86-73

No. 6a

Data Information Request

Requested From: Dale J. Wolf

Date Requested: 12/2/85

Information Requested: Respecting Company's response to MPSC Staff Data Information Request No. 6 in Case No. EF 86-73, please provide all analyses, studies, reports, etc., that Utilicorp United, Inc. relied on to support its statements:

The acquisition of Peoples should assure the realization of all economies of scale available to Missouri Public Service Company and Utilicorp United, both in the administrative and operational areas. The acquisition is expected to, after assimilation of the information by financial markets, lead to a reduction in capital costs for Utilicorp United. This expected reduction in capital costs will eventually produce reductions in rates of return claimed by Missouri Public Service Company in proceedings before the Missouri Public Service Commission.

Requested By: Gary Featherstone

Information Provided: \_\_\_\_\_

The information provided to the Missouri Public Service Commission Staff in response to the above information request is accurate and complete, and contains no material misrepresentations or omissions based upon present facts known to the undersigned. The undersigned agrees to immediately inform the Missouri Public Service Commission, if any matters are discovered which would materially affect the accuracy or completeness of the information provided in response to the above information request.

Signed By: \_\_\_\_\_

John R. Baker

Date Received: \_\_\_\_\_

No study exists upon which UtiliCorp relied to support the statements contained in its response to Data Request No. 6 concerning economies of scale, reduction in capital costs and reduction in rate of return claimed. The statements and conclusions are based on common sense and business judgment.

Prior to making the offer to acquire the Peoples assets, UtiliCorp's management considered whether or not benefits might result from the acquisition which could accrue to UtiliCorp and to the Company's customers. Based upon its utility business experience, management concluded that as a result of the acquisition, economies of scale in operations should result which should, in turn, lead to benefits to existing customers. Based upon its utility business experience, management also concluded that the acquisition should diversify UtiliCorp's operations in such a manner that fluctuations in weather should not create as significant an impact on earnings as now exists, thus resulting in financial benefits to the Company and ultimately its customers. Based upon its utility business experience, management also concluded that UtiliCorp's capital costs should be reduced as the result of the acquisition because UtiliCorp should then be viewed more favorably by the financial community as it should be of a sufficient size so as to permit it to qualify for higher financial ratings than those now available to the Company absent the acquisition. Higher financial ratings should, in turn, lead to lower rates of return claimed in regulatory proceedings.

