

Exhibit No.:
Issues: Corporation Overhead Allocations
Employee Benefits Conversion
Proposed Regulatory Plan
Projected Merger Cost & Benefit
Overview-Regulatory Plan, Cost/Benefit Analysis
Transition Cost Recovery – FAS 106 Curtailment
Prior Regulatory Treatment – Re-engineering Costs
Witness: Steven M. Traxler
Sponsoring Party: MoPSC Staff
Type of Exhibit: Rebuttal Testimony
Case No.: EM-2000-369

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

STEVEN M. TRAXLER

UTILICORP UNITED INC.

AND

EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. EM-2000-369

Jefferson City, Missouri
June 2000

Exhibit No. 716
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**TABLE OF CONTENTS OF
REBUTTAL TESTIMONY OF
STEVE M. TRAXLER**

Overview of Staff Position on Cost/Benefit Analysis and Regulatory Plan 2

Proposed Regulatory Plan 9

Transition Cost Recovery – FAS 106 Curtailment 21

Re-engineering Project Costs Impact..... 28

Projected Savings/Costs from Consolidating Transmission, Distribution and
Administration and General/Customer Service and General Plant Functions 34

Overstatement of Merger Savings from Benefits Conversion 53

Results of Staff’s Ten-Year Merger Cost/Benefit Analysis..... 61

1 **REBUTTAL TESTIMONY**

2 **OF**

3 **STEVE M. TRAXLER**

4 **UTILICORP UNITED INC.**

5 **AND**

6 **EMPIRE DISTRICT ELECTRIC COMPANY**

7 **CASE NO. EM-2000-369**

8 Q. Please state your name and business address.

9 A. Steve M. Traxler, Noland Plaza Office Building, 3675 Noland Road,
10 Independence, Missouri 64055.

11 Q. By whom are you employed and in what capacity?

12 A. I am a Regulatory Auditor for the Missouri Public Service Commission
13 (Commission).

14 Q. Please describe your educational background.

15 A. I graduated from Missouri Valley College at Marshall, Missouri, in 1974
16 with a Bachelor of Science degree in Business Administration with a major in
17 Accounting.

18 Q. Please describe your employment history.

19 A. I was employed as an accountant with Rival Manufacturing Company in
20 Kansas City from June 1974 to May 1977. I was employed as a Regulatory Auditor with
21 the Missouri Public Service Commission from June 1977 to January 1983. I was
22 employed by United Telephone Company as a Regulatory Accountant from February
23 1983 to May 1986. In June 1986, I began my employment with Dittmer, Brosch &

Rebuttal Testimony of
Steve M. Traxler

1 Associates (DBA) in Lee's Summit, Missouri as a Regulatory Consultant. I left DBA in
2 April 1988. I was self-employed from May 1988 to December 1989. I came back to the
3 Commission in December 1989. My current position is Auditor V with the
4 Commission's Accounting Department.

5 Q. What is the nature of your duties while in the employ of this Commission?

6 A. I am responsible for assisting in the audits and examinations of the books
7 and records of utility companies operating within the state of Missouri.

8 Q. Have you previously testified before this Commission?

9 A. Yes, I have. A list of cases in which I have filed testimony is shown on
10 Schedule SMT-1 of this testimony.

11 Q. Have you filed testimony in rate proceedings involving a regulated utility
12 company in any jurisdictions besides Missouri?

13 A. Yes, I have also filed testimony in Kansas, Minnesota, Arizona, Indiana,
14 Iowa and Mississippi.

15 **Overview of Staff Position on Cost/Benefit Analysis and Regulatory Plan**

16 Q. Please summarize the Joint Applicants' Merger Application in this case.

17 A. The Merger Application filed by UtiliCorp United Inc. (UCU) and The
18 Empire District Electric Company (Empire) (together, Joint Applicants) reflects a
19 proposed "regulatory plan" which requests specific treatment of merger savings and costs
20 that can be summarized as follows:

21 (1) A rate moratorium is being requested for years 1-5 following the
22 effective date of rates established in Empire's State Line combined cycle unit rate
23 case projected to be filed in September 2000.

1 (2) Based upon a ten-year analysis of projected merger costs
2 and savings, UCU/Empire are requesting rate base treatment and
3 amortization of 50% of the merger acquisition premium beginning in the
4 sixth year following the requested five-year moratorium.

5 The UCU/Empire projected cost benefit analysis for years
6 6-10, purports to show merger savings sufficient to cover merger costs, a
7 return of and return on 50% of the merger acquisition premium and
8 additional savings of at least \$3.0 million per year which will be used as a
9 cost of service reduction for Empire ratepayers.

10 (3) The Joint Applicants are requesting approval of a
11 regulatory plan for specific rate treatment of merger savings expected
12 from the merger. Corporate overhead cost reductions for UCU's division,
13 Missouri Public Service (MPS) resulting from addition of St. Joseph Light
14 and Power Company (SJLP) and Empire are to be "ignored" by the
15 Commission in rate proceedings involving MPS during the ten-year period
16 following merger approval.

17 The cost reductions to Empire and SJLP resulting from an
18 improved equity ratio after the merger are also to be "ignored" by the
19 Commission in setting rates for the Empire and SJLP divisions in years 6-
20 10 following merger approval.

21 Finally, the regulatory plan assigns 100% of the energy
22 savings expected from the joint dispatch of the merged company's
23 generating facilities after the merger to Empire and SJLP. MPS ratepayers

Rebuttal Testimony of
Steve M. Traxler

1 are to receive no benefit from joint dispatch of the MPS, SJLP and Empire
2 generating facilities.

3 Q. What is the Staff's position regarding the proposed regulatory plan
4 requested by the Joint Applicants?

5 A. The regulatory plan, in the Staff's view, was developed in an effort to
6 have MPS, Empire and SJLP ratepayers subsidize merger costs and the portion of the
7 merger acquisition premium which cannot be recovered from projected merger savings.

8 The inequity of the regulatory plan is addressed in my testimony as well as the
9 testimony of Staff witnesses Mark L. Oligschlaeger, Cary G. Featherstone, Dr. Michael
10 S. Proctor and David P. Broadwater.

11 If the Commission "ignores" for ratemaking purposes, cost reductions from the
12 merger in the form of lower cost of capital for Empire and SJLP and lower corporate
13 overhead cost allocations to MPS, as requested by the regulatory plan, MPS, Empire and
14 SJLP ratepayers will subsidize merger costs and the merger acquisition premium by
15 approximately \$110 million over the ten-year period following merger approval
16 calculated as follows:

17	Assign 100% of energy savings to SJLP	\$ 6 million
18	Assign 100% of energy savings to Empire	\$ 5 million
19	Ignore reduction in UCU overhead costs allocated to MPS	\$ 78 million
20	Ignore improved equity ratio for SJLP	\$ 8 million
21	Ignore improved equity ratio for Empire	<u>\$ 13 million</u>
22	Increased revenue collected due to regulatory plan	<u>\$110 million</u>

23
24 The regulatory plan is intended to result in forced subsidization of merger
25 costs and the merger acquisition premium and is, therefore, detrimental to the ratepayers
26 of Empire, SJLP and MPS.

Rebuttal Testimony of
Steve M. Traxler

1 Q. Provide a brief summary of the Staff's position and recommendation
2 regarding whether savings from the merger will exceed the costs of the merger and
3 whether the proposed regulatory plan should be adopted.

4 A. After analyzing the assumptions used by UCU/Empire in projecting
5 merger costs and savings, the Staff position is that there are serious flaws in four areas:

6 (1) Based upon historical experience, the growth rate/inflation
7 rate used in projecting the annual increase in UCU's corporate overhead
8 costs is too low. Understating the growth rate for these costs has resulted
9 in an understatement of the impact of UCU's corporate overhead costs on
10 Empire's and SJLP's earnings after the merger.

11 (2) The projected savings from employee reductions is
12 overstated as a result of the failure to recognize Empire's normal, stand-
13 alone job vacancy experience. Staff Accounting witness Janis E. Fischer
14 is sponsoring an adjustment to reduce the Joint Applicants' projected
15 savings from employee reduction in order to eliminate this assumption
16 error.

17 (3) The Joint Applicants' project approximately \$198 million
18 in joint dispatch savings to Empire will occur over the ten-year period
19 following merger approval. Staff witness Proctor's position is that
20 approximately 97% of these savings can be achieved by Empire on a
21 "stand alone" basis (no merger assumption) and, therefore, should not be
22 used to offset merger costs in a cost/benefit analysis for this merger.

1 (4) In the projected savings from the conversion of Empire
2 employee benefit plans to those of UCU, UCU witness Robert B.
3 Browning assumed that the pre-merger funded status of the Empire
4 pension plan will remain unaffected by the merger. This assumption
5 contradicts the UCU plan to consolidate the Empire and SJLP pension
6 plan assets with those of UCU after the merger.

7 The Empire and SJLP pension plans are in a much better
8 funded position than the UCU plan, 155% and 223% respectively,
9 compared to 140% for UCU at January 1, 1999. Combining the pension
10 assets will result in a combined funded level of 144% under a
11 UCU/Empire combination and 153% under a UCU/SJLP combination.
12 The change to the post-merger funded status will increase pension cost for
13 Empire and SJLP and reduce the pension cost for all of UCU's other
14 regulated and non-regulated plan members. The Staff estimates the
15 detrimental impact on Empire to be approximately \$8.3 million over the
16 ten-year period following the merger closing.

17 (5) The Joint Applicants are relying on a projected net savings
18 for years 6-10, following the five-year moratorium, to demonstrate that the
19 UCU/Empire merger meets the "not detrimental to the public interest"
20 standard in Missouri.

21 Both the Joint Applicants' and the Staff's projected
22 cost/benefit analysis for years 1-5 indicate that merger savings will be
23 insufficient to cover merger costs plus a 50% recovery of the merger

Rebuttal Testimony of
Steve M. Traxler

acquisition premium. The Joint Applicants and the Staff's projections are set forth below:

	<u>UCU/Empire</u> 000's	<u>Staff</u> 000's
Net Merger Savings/(Costs) Years 1-5	\$ 68,662	(\$ 30,725)
Less 50% of Acquisition Premium	<u>(\$102,590)</u>	<u>(\$102,590)</u>
Net (Loss) – Years 1-5	<u>(\$ 33,928)</u>	<u>(\$133,315)</u>

My testimony will generally refer to projected merger costs and savings for years 6-10 because the projected results for these years are alleged to support the Joint Applicants' claim that the proposed UCU/Empire merger satisfies the "not detrimental to the public interest" standard in Missouri.

In summary, I will explain in my testimony that after appropriate adjustments are made to the UCU/Empire projected benefit analysis, the merger costs for years 6-10 exceed merger savings by approximately \$1.6 million annually. This is without consideration of recovery of the merger acquisition premium. The Staff's ten-year cost/benefit analysis, Schedule SMT-2, reflects that net merger savings are significantly less than the level required to recover 50% of the merger acquisition premium plus transaction costs, as requested by the Joint Applicants.

Q. Please describe the areas addressed in your rebuttal testimony.

A. My testimony will address the following areas:

- Detrimental aspects of proposed regulatory plan
- Transition Cost Recovery – FAS 106 Curtailment Cost
- Impact of UCU's Re-engineering Project Costs

Rebuttal Testimony of
Steve M. Traxler

- The Staff's projected merger impact on Empire's cost of service resulting from the consolidation of administrative and general, customer service, transmission, distribution and general plant functions and the corresponding allocation of UCU corporate overhead costs to Empire.
- Overstatement of projected merger savings from Employee Benefits Conversion as a result of the failure to calculate FAS 87 pension cost based upon the planned consolidation of Empire and UCU pension fund assets after the merger;
- The Staff's analysis of the net result of all projected merger costs and savings, under the Staff's assumptions. This analysis demonstrates that the proposed merger will be detrimental to Empire's ratepayers, absent the Staff's recommended conditions for merger approval.

Q. How does your testimony filed in this Merger Application compare to the testimony you filed earlier concerning the same issues in the UCU/SJLP merger application, Case No. EM-2000-292?

A. This testimony generally addresses the same areas covered in the testimony I filed in Case No. EM-200-292, and accordingly is very similar to my testimony for the UCU/SJLP merger. However, in some areas, I have expanded some of the arguments made on these issue areas beyond those made in my UCU/SJLP rebuttal testimony. In addition, this testimony addresses the areas outlined below:

- Joint Applicants' proposed transition cost treatment for a Financial Accounting Standard (FAS) 106 curtailment cost, pages 21-28.

Rebuttal Testimony of
Steve M. Traxler

- 1 • The Commission's prior treatment of UCU's re-engineering project costs
- 2 in Case No. ER-97-394, pages 28-33.
- 3 • Joint Applicants use of the Consumer Price Index for Urban Consumers
- 4 (CPI-U) for escalating UCU's corporate overhead costs, pages 43-48.
- 5 • Results of stranded cost study performed by PriceWaterhouseCoopers
- 6 related to Empire's current generation assets and capacity contracts,
- 7 pages 69 and 70.

8 **Proposed Regulatory Plan**

9 Q. Why is it necessary to analyze the expected costs and benefits that will

10 result from a merger of St. Joseph Light & Power Company (SJLP), The Empire District

11 Electric Company (EDE or Empire) and UtiliCorp United Inc. (UCU)?

12 A. The Commission is bound by a Missouri standard regarding the approval

13 of regulated utility company mergers. The Joint Applicants are required to demonstrate

14 that the proposed merger is not detrimental to the public interest. Therefore, to support a

15 merger the Joint Applicants (Empire, SJLP and UCU) and the Staff must be able to

16 conclude and recommend to the Commission that the proposed merger is not expected to

17 result in:

18 1. Higher utility rates for the customers of SJLP, Empire and

19 UlitiCorp's Missouri division, Missouri Public Service (MPS), as a result of the

20 merger; and

21 2. Deterioration in the level of customer service.

Rebuttal Testimony of
Steve M. Traxler

1 Q. Does the "not detrimental to the public interest" standard in Missouri
2 require that any of the Missouri customers of SJLP, UCU or Empire benefit from the
3 proposed merger?

4 A. No. The Joint Applicants do not have to demonstrate net benefits (savings
5 exceeding costs), or improved customer service. They do have to demonstrate: 1) that
6 costs resulting from the merger will not exceed the savings, resulting in higher utility
7 rates; and 2) that customer service will not deteriorate.

8 Q. Is it generally true that utility merger applications are presented by the
9 applicants on the basis that merger-related benefits will exceed costs?

10 A. Yes. In all of the previous major merger applications in Missouri, the
11 Joint Applicants projected that savings would exceed all transaction, transition and
12 consolidation costs plus an amortization of the merger premium acquisition adjustment.
13 The monies which exceeded the recovery of costs were then purported to be used for rate
14 mitigation for customers.

15 Q. With respect to this proposed merger between UCU and Empire, are the
16 Joint Applicants projecting savings which exceed transaction, transition and
17 consolidation costs plus the merger premium acquisition adjustment?

18 A. No. Reflected below are the Joint Applicants' projected savings and
19 merger-related costs over the ten-year period following the closing of the merger. The
20 amounts are separated between expected financial results for years 1-5 and 6-10,
21 respectively. Line 13 on page 11 reflects that projected savings will exceed projected
22 transition, transaction and consolidation costs by \$68.7 million in the first five years and
23 \$107.5 million in the second five years.

Rebuttal Testimony of
Steve M. Traxler

1 However, when recovery of the acquisition premium is also considered, the Joint
2 Applicants project a \$136.5 million net loss in years 1-5 and a \$77.8 million net loss in
3 years 6-10. A total net loss is expected of \$214.3 million during the first ten years
4 following approval of the merger.

	UCU/Empire Projected Merger	
	<u>Costs/Savings</u>	
	Years	Years
	1-5	6-10
	000's	000's
10 Operation & Maintenance Consolidation Savings	\$173,444	\$210,128
11 Additional Capital Costs to Implement Consolidation	<u>(18,986)</u>	<u>(\$ 5,553)</u>
12 Total Savings, Net of Costs to Achieve	\$154,458	\$204,575
13 Increase in Operation & Maintenance Expense -		
14 UCU Allocations	<u>(\$ 85,796)</u>	<u>(\$97,071)</u>
15 Total Savings Less Costs (Excluding Premium Amount)	\$ 68,662	\$107,504
16 Amortization of Total Acquisition Premiums	<u>(\$205,179)</u>	<u>(\$185,321)</u>
17 Net Loss – Years 1-5	<u>(\$136,517)</u>	
18 Net Loss – Years 6-10		<u>(\$ 77,817)</u>
19 Net Loss – Years 1-10		<u>(\$214,334)</u>

20
21 Q. Referring to the Joint Applicants' projected net loss from the merger of
22 \$214.3 million during the initial ten years after the merger closing, how can UCU and
23 Empire justify moving forward on a merger which is expected to cost shareholders
24 \$214.3 million during the first ten years following the merger closing?

25 A. Clearly, the Joint Applicants would not be attempting to justify this
26 merger to their shareholders if the projected financial results told the entire story
27 regarding the "regulatory plan" requested in the Merger Application.

28 The regulatory plan being proposed by the Joint Applicants is explained in detail
29 in the testimony of Staff witnesses Oligschlaeger, Featherstone, Broadwater and Proctor.

Rebuttal Testimony of
Steve M. Traxler

1 However, I will briefly explain how the proposed regulatory plan would force the
2 existing ratepayers of MPS, Empire and SJLP to subsidize the recovery of the acquisition
3 premium and merger costs that are not recovered through projected savings.

4 (1) UCU's administrative and general overhead costs, which benefit
5 all of its U.S. regulated and non-regulated divisions/subsidiaries, are currently allocated
6 to 27 separate divisions or subsidiaries. Adding SJLP and Empire to the organization
7 results in an immediate reduction in the allocation percent for these 27 divisions or
8 subsidiaries. UCU's existing Missouri regulated utility division, MPS, is one of the 27
9 existing entities that would benefit from a reduction in the allocation factor used to assign
10 UCU's overhead costs to MPS.

11 Under the regulatory plan, the Joint Applicants propose, they are requesting that
12 this cost allocation benefit to MPS be "ignored" in any rate case involving MPS during
13 the first ten years following the merger.

14 *This recommended ratemaking treatment for MPS is nothing more than a*
15 *backdoor approach to force UCU's existing Missouri customers to subsidize the net loss*
16 *from the merger referred to previously. This loss results because projected merger*
17 *savings are insufficient to cover all merger costs plus the acquisition premium.*

18 The Commission is being asked to "ignore" any UCU overhead allocation
19 reduction to MPS resulting from an acquisition of SJLP and/or Empire by UCU for the
20 next ten years.

21 MPS' allocated share of corporate overhead costs would be reduced by an average
22 of \$6.3 million annually as soon as Empire begins absorbing its allocated share of these
23 costs. Schedule SMT-3 reflects the additional cost to MPS ratepayers from this proposal.

Rebuttal Testimony of
Steve M. Traxler

1 Applicants' proposed regulatory plan requires the Commission to "ignore" this cost
2 reduction and, as a result, increase rates for UCU's existing MPS ratepayers by an
3 average of \$6.3 million annually. The total increase in MPS rates for the ten-year period
4 following the merger closing is approximately \$51 million, shown on line 16 of Schedule
5 SMT-3 attached to this testimony.

6 The fact that UCU is even considering such an unfair plan for its existing
7 Missouri ratepayers is a clear indication of the insufficient level of merger savings
8 expected from these mergers.

9 (2) Similarly, the Applicants propose that the Commission "ignore"
10 the capital structure impact in rate cases involving Empire and SJLP during the first ten
11 years following the merger closing. The regulatory plan includes a request that the
12 Commission treat Empire and SJLP as if they were separate Missouri electric utilities
13 with their own capital structure for the purpose of determining the rate of return used in a
14 rate case for the Empire and SJLP divisions.

15 The Empire and SJLP current pre-merger capital structures have higher equity
16 ratios than would UCU's consolidated capital structure following the merger. If the Joint
17 Applicants can get the Commission to "assume" that the Empire and SJLP pre-merger
18 capital structures still exist for the next ten years, then Empire and SJLP ratepayers will
19 be forced to subsidize the recovery of the merger acquisition premium and merger costs
20 not covered by merger savings. Staff witness Broadwater addresses the detrimental
21 aspects of this regulatory proposal in his rebuttal testimony. This proposal, if adopted,
22 would require Empire's ratepayers to subsidize the acquisition premium and other merger

Rebuttal Testimony of
Steve M. Traxler

1 costs by approximately \$2.5 million annually in the form of higher rates in years 6-10
2 following the moratorium.

3 (3) Joint Applicant witness Robert W. Holzwarth addresses the
4 projected merger savings that will result from:

5 a) jointly dispatching the combined generation units of
6 Empire, SJLP and MPS to obtain efficiency savings; and

7 b) a projected increase in the sale opportunities on the
8 interchange market resulting in higher interchange profits.

9 No witness, including Mr. Holzwarth, will deny that savings in the two areas
10 described above require the joint use of the generation assets of Empire and UCU's
11 Missouri division, MPS, assuming a UCU/Empire merger, and that any projected savings
12 from a merger involving SJLP, Empire and UCU result from the joint use of the
13 generation assets of all three utilities. Since the projected benefits from efficiency gains
14 and increased opportunities on the interchange market result from the use of joint
15 facilities, one would logically assume that such benefits would be jointly shared by UCU,
16 SJLP and Empire.

17 However, the word logical does not apply to the regulatory plan the Applicants
18 propose in this case. With the exception of some capacity cost savings, Mr. Holzwarth is
19 assigning 100% of all energy benefits resulting from the joint dispatch of the combined
20 generation assets to the SJLP and Empire ratepayers. The Commission is being asked to
21 assume that the MPS ratepayers, who have been paying depreciation and a rate of return
22 on MPS' Sibley generating station and other MPS generating facilities for the last 35

Rebuttal Testimony of
Steve M. Traxler

1 years, have no right to any benefits resulting from the joint use of these facilities after the
2 merger.

3 This proposal, if adopted, will also result in a forced subsidization of the
4 acquisition premium and merger costs by UCU's existing Missouri ratepayers. Staff
5 witness Proctor addresses this issue in his rebuttal testimony.

6 (4) The regulatory plan requires the measurement of merger costs and
7 savings for a five-year period following merger approval. The Joint Applicants have not
8 presented any detailed plan as to how they plan to separate non-merger savings from
9 merger savings. Inability to differentiate between non-merger and merger savings will
10 result in an increase in Empire's cost of service when non-merger savings are used to
11 offset merger costs.

12 Q. Please explain the proposed treatment, under the proposed regulatory plan,
13 for cost of service changes in years 1-5 following the merger closing, versus changes
14 occurring under the proposed regulatory plan in years 6-10.

15 A. Under the Joint Applicants' proposed regulatory plan, a five-year rate
16 moratorium is being proposed that includes years 1-5 following the effective date of rates
17 set in the State Line combined cycle unit rate case which is anticipated to be filed in
18 September 2000. All merger impacts on cost of service during years 1-5 are not
19 supposed to impact Empire's rate levels.

20 The Joint Applicants are attempting to demonstrate that the proposed merger
21 meets the "not detrimental to the public interest" standard by guaranteeing a \$3 million
22 net benefit to Empire ratepayers in the post-merger rate case with an effective date
23 corresponding to the expiration date of the five-year rate moratorium.

Rebuttal Testimony of
Steve M. Traxler

1 The proposed \$3 million net benefit is based upon the “average” net savings
2 projected for years 6-10 following the merger closing. It is important for the
3 Commission to understand that “actual” savings in the test year used for the post-merger
4 rate case will not, under the Joint Applicants’ or the Staff’s current projections, reflect
5 sufficient net savings to cover 50% of the merger acquisition premium and provide a
6 \$3 million net benefit to Empire’s ratepayers.

7 Not only is the Commission being asked by the Joint Applicants to approve the
8 Empire and SJLP mergers today based upon a ten-year projected cost/benefit analysis; it
9 is also being asked to set rates in the post-merger rate cases for both SJLP and Empire
10 based upon projected net savings to occur in years 6-10.

11 Only by using projected assumptions in the post-merger rate cases for SJLP and
12 Empire, can the Joint Applicants support the “guaranteed” \$1.6 million net benefit to
13 SJLP and \$3 million net benefit to Empire.

14 Q. Should the Joint Applicants’ inability to demonstrate sufficient “actual”
15 net savings in the post-merger rate cases for SJLP and Empire be a serious concern for
16 the Commission?

17 A. Yes, it should. Rates established for Missouri utilities have never been
18 based upon projected costs five years into the future. The Joint Applicants’ are
19 requesting that the Commission approve the SJLP and Empire mergers today based upon
20 projected assumptions for years 6-10 following the five-year moratoriums in both cases.

21 Additionally, as proposed by the Joint Applicants, the post-merger rate cases
22 planned for both Empire and SJLP after the end of the five-year moratoriums will

Rebuttal Testimony of
Steve M. Traxler

1 establish cost of service for those cases based upon projected merger savings for
2 years 6-10 following the five-year moratorium.

3 Q. What is the basis for your assertion that the proposed regulatory plans for
4 Empire and SJLP require that the cost of service used in setting rates in the post-merger
5 rate cases for Empire and SJLP is to be based upon projected merger costs and savings
6 for years 6-10 following the five-year moratorium requested under both regulatory plans?

7 A. Joint Applicants witness John W. McKinney, makes the following
8 statements in his direct testimony in Case Nos. EM-2000-292 and EM-2000-369:

9 4. Included in these rate filings will be the complete flow-
10 through of all test-year O&M synergies, adjusted to the
11 forward average level of savings for years 6 through 10 of
12 the regulatory plan, net of the costs to achieve the
13 synergies, resulting from the merger. (McKinney Direct
14 Testimony, EM-2000-292, page 6, emphasis added)

15
16 4. Included in the Post-Moratorium Rate Case filing will
17 be the complete flow-through of all test-year O&M
18 synergies, adjusted to the forward average level of savings
19 for 5 years following the rate moratorium, net of the costs
20 to achieve the synergies, resulting from the merger.
21 (McKinney Direct Testimony, EM-2000-369, page 7,
22 emphasis added)
23

24 Q. Should the Commission rely on the Joint Applicants' "guaranteed" net
25 benefit amounts of \$1.6 million for SJLP and \$3 million for Empire in making a decision
26 regarding the "not detrimental to the public interest" standard?

27 A. No. The Joint Applicants' readily admit that net benefit amounts
28 guaranteed to SJLP and Empire ratepayers are based on projected merger costs and
29 savings in determining the cost of service to be used in setting rates for SJLP and Empire
30 in the rate cases following the five-year moratoriums. Projected future costs have not

Rebuttal Testimony of
Steve M. Traxler

1 been included in cost of service for ratemaking purposes in Missouri due to their inherent
2 inaccuracy.

3 Likewise, a decision as to whether the proposed Empire and SJLP mergers satisfy
4 the "not detrimental to the public interest" standard should also not be based upon
5 reliance on so-called "guaranteed" benefits supported by using projected merger costs
6 and savings for a period ten years into the future.

7 Q. Does any proposal requiring the tracking of merger savings and costs
8 require a "base year" (or "base line") to be used for the purpose of attempting to measure
9 the amount of net savings/costs resulting from the merger?

10 A. Yes. In theory, a pre-merger "base year" which reflects pre-merger costs
11 is required to measure merger-related savings.

12 The Staff is opposed to any proposal that attempts to measure merger costs and
13 savings post merger. The reasons supporting our objections are addressed in detail in the
14 testimony of Staff witnesses Oligschlaeger, Fischer, Proctor and Featherstone.

15 Q. What "base year" is being proposed by UCU/Empire for the purpose of
16 tracking the merger savings and costs?

17 A. The 1999 budget for Empire is being proposed for this purpose.

18 Q. What "base year" is being proposed by the Staff for the purpose of
19 tracking merger costs and savings?

20 A. The only reason the Staff is recommending any base year for tracking
21 merger savings and costs is to avoid using the Empire 1999 budget, as proposed by
22 UCU/Empire, in the event the Commission rejects the Staff's primary position on this
23 issue. However, in the event the Commission does approve a merger tracking proposal,

Rebuttal Testimony of
Steve M. Traxler

1 the Staff is recommending that the cost of service calculation used in Empire's pre-
2 merger State Line rate case be used in lieu of the 1999 budget.

3 Q. Why is the Staff opposed to using the 1999 budget of Empire as a base
4 year to track merger costs and savings?

5 A. At best, a budget is nothing more than an estimate of projected events
6 12-14 months in the future. Given the volatility in the purchase power and interchange
7 market today, it is impossible to budget 12-14 months in advance.

8 The Joint Applicants' recommendation for using the 1999 Empire budget also
9 does not include a recommendation for truing-up budgeted amounts for significant
10 differences between "budgeted" and "actual" 1999 results, which makes it unsuitable as
11 an accurate base year to be used in tracking merger costs and savings.

12 Q. For year 1999, are you aware of any significant differences between
13 Empire's budget and actual results?

14 A. Yes. A maintenance outage for the Iatan generating unit was scheduled
15 for the Fall of 1999 and included in the 1999 budget at an amount of \$500,000 (Response
16 to Staff Data Request No. 154). The Iatan maintenance outage was canceled later in the
17 year and rescheduled for the Spring of 2000.

18 This one difference between actual and budgeted results in 1999 alone makes the
19 Empire 1999 budget unsuitable for the purpose of tracking merger costs and savings
20 resulting from a Commission order adopting such a proposal.

21 Using the 1999 Empire budget unadjusted, would "guarantee" \$500,000 in merger
22 savings that do not exist because it includes \$500,000 in maintenance expense that was
23 not incurred.

Rebuttal Testimony of
Steve M. Traxler

1 Q. What are the advantages of using the cost of service calculation for
2 Empire's planned pre-merger State Line rate case as a base year for tracking merger costs
3 and savings?

4 A. The 1999 Empire budget was not adjusted to reflect any differences
5 between actual and budgeted results for 1999 (Response to Staff Data Request 154).
6 However, the cost of service calculation resulting from Empire's State Line rate case will
7 include adjustments to reflect Empire's most current operating costs which include the
8 following:

9 Plant in Service
10 Accumulated Depreciation Reserve
11 Accumulated Deferred Income Tax Reserve
12 Materials and Supplies
13 Prepayments
14 Fuel Inventories
15 Deferred Charges Includible in Rate Base
16 Customer Deposits
17 Revenue Growth through the known and measurable date
18 Fuel and Freight Costs
19 Purchase Power Energy and Demand Costs
20 Payroll Costs
21 Payroll Vacancies as a Result of the Merger
22 Property Taxes
23 Payroll Taxes
24 Employer Benefits Costs
25 Elimination of Merger Costs
26 Disallowance of Dues, Donations, Charitable Contributions
27 PSC Assessment
28 Rate Case Expense
29 Weather Normalization
30 Maintenance Normalization
31 Disallowance of Nonrecurring Y2K Costs
32 Depreciation Expense
33 Current and Deferred Income Tax Expense
34 Cost of Capital/Rate of Return
35

1 Q. Please summarize the Staff's recommendation to use Empire's cost of
2 service calculation from its pre-merger, State Line rate case as a base year assuming the
3 Commission adopts the regulatory plan proposed by the Joint Applicants.

4 A. The regulatory plan proposed by UCU/Empire includes a recommendation
5 to track merger savings and costs for ten years after closing of the merger. The Joint
6 Applicants intend to demonstrate in Empire's post-merger rate case that future merger
7 savings exceed merger costs by an amount which will justify rate base treatment and
8 expense recovery for 50% of the merger acquisition premium. The Staff is strongly
9 opposed to the regulatory plan; however, in the event the Commission approves some
10 form of merger cost/savings tracking proposal, the "base year" required should be the
11 cost of service calculation resulting from a Commission order in Empire's planned pre-
12 merger rate case.

13 **Transition Cost Recovery – FAS 106 Curtailment**

14 Q. Are you the primary Staff witness on the recommended treatment for
15 transition costs resulting from the proposed UCU/Empire merger?

16 A. No. The Staff's primary witness on transition cost recovery is Accounting
17 witness James M. Russo. My testimony in this area addresses only one cost for which the
18 Joint Applicants' are requesting a ten-year amortization for financial reporting and rate
19 recovery. I will address the Joint Applicants' requested ten-year amortization of a
20 Financial Accounting Standard (FAS) 106 curtailment resulting from the merger.

21 Q. Provide a brief definition of the term "transition cost."

22 A. Transition costs are also referred to as "costs to achieve" and generally
23 represent costs incurred after the merger closing in order to combine/consolidate the two

Rebuttal Testimony of
Steve M. Traxler

1 companies. Post-merger costs considered transition costs by the Staff include severance
2 payments to officers or other key employees who will not be retained by the merged
3 company. Retention payments are also made to key employees to retain their services for
4 a pre-determined period of time following the merger closing. Additional transition costs
5 include the information technology (IT) related infrastructure and software conversion
6 costs necessary to consolidate the operations of the combined company. These are all
7 transition costs.

8 Q. Provide a brief description of FAS 106.

9 A. FAS 106, Accounting for Postretirement Benefits-Other than Pensions
10 (OPEBs), is the required accounting method for recognizing retiree benefit costs, other
11 than pensions. FAS 106 is used for both financial reporting and ratemaking purposes for
12 SJLP, Empire and UCU's Missouri division, MPS. FAS 106 is the accrual accounting
13 method for retiree medical, dental, vision and life insurance costs expected to be paid by
14 UCU between retirement and death and/or age 65, depending upon the hire date for the
15 employee.

16 UCU plans to begin converting Empire's FAS 106 benefits to those of UCU
17 following the initial 18-month period after the merger closing.

18 Q. What is a "plan curtailment" as defined by FAS 106?

19 A. Paragraph 96 of FAS 106 defines a "plan curtailment" as follows:

20 96. For purposes of this Statement, a curtailment is an
21 event that significantly reduces the expected years of future
22 service of active plan participants or eliminates the accrual
23 of defined benefits for some or all of the future services of
24 a significant number of active plan participants.
25 Curtailments include:
26

Rebuttal Testimony of
Steve M. Traxler

1 a. Termination of employees' services earlier than
2 expected, which may or may not involve closing a facility
3 or discontinuing a segment of a business

4 b. Termination or suspension of a plan so that employees
5 do not earn additional benefits for future service. In the
6 latter situation, future service may be counted toward
7 eligibility for benefits accumulated based on past service.

8
9 Q. What is the primary cause for the projected recognition of a FAS 106
10 curtailment during years 2001-2003 following the merger closing?

11 A. UCU expects a reduction in Empire's non-union employee level from 331
12 at January 1, 2000 to 179 at January 1, 2003. (Response to Staff Data Request No. 175).

13 The increase in retirees as a result of the planned employee reduction increases
14 the accrued liability for retiree benefit costs under FAS 106. Schedule SMT-4 line 4,
15 reflects the impact on the FAS 106 liability, by year, from 2001 through 2003. The total
16 impact of the plan curtailment, \$2,732,422, is reflected on Schedule SMT-4, line 4,
17 Column F.

18 Q. What is the source for all amounts reflected on Schedule SMT-4?

19 A. All amounts reflected on Schedule SMT-4 were taken from UCU witness
20 Browning's Schedules RBB-6 and RBB-8.

21 Q. How is the FAS 106 plan curtailment projected for years 2001-2003
22 related to the recovery of transition costs in this merger case, EM-2000-369?

23 A. UCU witness Vern J. Siemek has characterized the \$2.7 million FAS 106
24 Plan Curtailment cost as a transition cost as reflected in Siemek Schedule VJS-2, line 12.

25 Mr. Siemek is proposing to amortize transition costs over a ten-year period
26 following the merger closing.

Rebuttal Testimony of
Steve M. Traxler

1 Q. Why is the Staff opposed to treating the FAS 106 curtailment cost as a
2 transition cost to be amortized over a ten-year period?

3 A. The Staff is opposed to treating the FAS 106 curtailment cost as a
4 transition cost for the following grounds:

5 1) The FAS 106 curtailment cost occurs during the proposed years
6 1-5 moratorium following the merger closing. Treating the FAS 106 curtailment cost as
7 a transition cost in years 6-10 violates the regulatory plan proposed by the Joint
8 Applicants in this case. The transition cost treatment proposed by Mr. Siemek will result
9 in recovery of 50%, or \$1.4 million of the total curtailment cost, from Empire ratepayers
10 during years 6-10 following the moratorium.

11 This proposed regulatory treatment is in direct conflict with the intent of the
12 proposed regulatory plan for years 1-5. Under the proposed regulatory plan, Empire's
13 rates were not to be increased or decreased as a result of changes to its cost of service
14 occurring during the moratorium for years 1-5.

15 FAS 106 OPEBs cost is a normal cost of service item used in setting rates for
16 Empire and every other major utility in Missouri. Including a cost of service change,
17 which occurred during the proposed moratorium period, in rates set after the moratorium
18 violates the regulatory plan proposed by the Joint Applicants.

19 2) Mr. Siemek's proposed transition cost treatment for the FAS 106
20 curtailment cost is unfair and inconsistent in that Mr. Siemek is proposing to include only
21 a cost increase in retiree benefits costs, occurring during the moratorium. The headcount
22 reduction, projected for years 1-5 of the moratorium, will result in a significant reduction
23 in employee benefit costs.

Rebuttal Testimony of
Steve M. Traxler

1 Mr. Siemek has ignored a \$3.2 million reduction in employee benefit costs,
2 during the moratorium, which results largely from the same headcount reduction causing
3 the FAS 106 curtailment cost of \$2.7 million.

4 Under Mr. Siemek's proposal, shareholders keep all of the FAS 106 and
5 employee benefits savings during the moratorium. Empire's ratepayers receive none of
6 the savings, but have to pay \$1.4 million of the FAS 106 curtailment cost as a result of
7 treating this item as a transition cost, amortized over ten years.

8 Q. What is the basis for your previous statement that the projected headcount
9 reduction during the years 1-5 moratorium is the primary cause for a significant reduction
10 in employee benefit costs during the moratorium?

11 A. This assertion is based upon the direct testimony of UCU witness
12 Browning. The savings amounts resulting from the reduction in employee benefit costs
13 reflected on Schedule SMT-4, line 1, were taken from Mr. Browning's Schedule RBB-8.

14 On page 7, lines 13-17 of his direct testimony, Mr. Browning describes the results
15 reflected on his Schedule RBB-8:

16 Active employee health, welfare, 401(k) and Employee
17 Stock Contribution Plan ("ESCP") cost impacts are
18 estimated on Schedule RBB-8. The result of this analysis
19 indicates an overall reduction of associated costs by
20 (\$625,583) in 2001, (\$285,254) in 2002 and (\$467,716) in
21 2003 and beyond, over the base year costs of 1999. The
22 primary driver for reduced costs is headcount reductions.
23 [emphasis added]
24

25 Q. Why is there a direct relationship between an increase in FAS 106 OPEB's
26 cost and the decrease in employee benefit costs for medical, dental, vision, life insurance,
27 etc.?

Rebuttal Testimony of
Steve M. Traxler

1 A. The headcount reductions for Empire's non-union employees projected
2 during the years 1-5 moratorium reduce the non-union employee levels and, at the same
3 time, increase Empire's retiree levels subject to retiree benefits accounted for under
4 FAS 106.

5 Lower employee levels result in a lower cost for providing medical, dental, vision
6 and life insurance for employees. Correspondingly, the headcount reduction increases
7 the number of Empire retirees receiving these FAS 106 OPEB benefits after retirement.

8 Mr. Siemek's proposed transition cost treatment for the FAS 106 curtailment cost
9 of \$2.7 million increases Empire's cost of service in years 6-10 by 50% of the
10 \$2.7 million total, or approximately \$1.4 million. However, the corresponding reduction
11 in employee benefit costs projected during the years 1-5 moratorium of \$3.2 million is
12 ignored by Mr. Siemek for ratemaking purposes in years 6-10 after the moratorium.

13 Consistent treatment of both savings and costs would dictate a \$50,000 annual
14 reduction in Empire's post-moratorium cost of service, instead of the annual increase of
15 \$270,000 proposed by Mr. Siemek.

16 Q. Are there other savings in FAS 106 OPEB costs that are projected to occur
17 during the proposed years 1-5 moratorium?

18 A. Yes, very significant savings. The conversion of Empire's FAS 106
19 OPEB benefits to those of UCU and other assumption changes are projected to result in
20 additional FAS 106 OPEB cost reductions of \$8.3 million during the years 1-5
21 moratorium. Schedule SMT-4, line 2 reflects the Joint Applicants' projected reduction in
22 FAS 106 costs during the years 1-5 moratorium resulting from benefits conversion.

Rebuttal Testimony of
Steve M. Traxler

1 Q. Have these additional FAS 106 savings, projected to occur during the
2 proposed moratorium, also been ignored by Mr. Siemek in proposing to treat the
3 FAS 106 curtailment cost as a transition cost?

4 A. Yes. Schedule SMT-4, line 3, Column F reflects UCU witness
5 Browning's total projected savings from reductions in both employee and retiree benefit
6 costs during the proposed years 1-5 moratorium.

7 Under Mr. Siemek's proposal, the UCU/Empire shareholders would retain 100%
8 of the \$11.5 million in savings projected for years 1-5. However, Empire's ratepayers
9 would receive none of the savings during the moratorium and would be forced to pay
10 \$1.4 million of the FAS 106 curtailment cost in rates set for years 6-10 following the
11 moratorium.

12 Q. Please summarize your testimony regarding the Joint Applicants'
13 proposed transition cost recovery of the FAS 106 curtailment cost occurring during the
14 proposed moratorium.

15 A. Under the Joint Applicants' proposed moratorium for years 1-5, Empire's
16 rates are not supposed to be impacted by changes to normal cost of service components
17 considered for ratemaking purposes.

18 Employee benefit and FAS 106 retiree benefit costs are both normal cost of
19 service components considered for ratemaking purposes.

20 Mr. Siemek's proposed transition cost treatment for a \$2.7 million FAS 106
21 curtailment cost violates the Joint Applicants' proposed regulatory plan because
22 transition cost treatment will increase Empire's post-moratorium rates by \$1.4 million for
23 a change in cost of service occurring during the proposed moratorium for years 1-5.

Rebuttal Testimony of
Steve M. Traxler

1 However, Mr. Siemek has ignored \$11.5 million in savings in the employee and retiree
2 benefits area during the moratorium, which is inconsistent and unfair to Empire's
3 ratepayers.

4 The Commission should reject Mr. Siemek's proposed transition cost treatment
5 for the FAS 106 curtailment cost projected to occur during the years 1-5 moratorium.

6 **Re-engineering Project Costs Impact**

7 Q. On page 11, lines 7-11, of his direct testimony, UCU witness John W.
8 McKinney asserts that UCU's Missouri division, MPS, benefited from the flow-through
9 in rates of past cost reductions resulting from UCU's re-engineering projects. Do you
10 agree with this assertion?

11 A. No. I do not agree with Mr. McKinney's assertion that the rates
12 established in MPS's last rate proceeding, Case No. ER-97-394, reflected cost reductions
13 from UCU's re-engineering projects. As the Staff witness in Case No. ER-97-394
14 responsible for quantifying the cost of UCU's re-engineering projects, I can state that Mr.
15 McKinney's assertion is factually incorrect.

16 Q. Provide a brief explanation of UCU's re-engineering projects that
17 impacted cost of service used in setting rates in Case No. ER-97-394.

18 A. Re-engineering, or Project BTU (Building Tomorrow's UtiliCorp) as it
19 was called internally by UCU, refers to a decision made in 1995 to invest approximately
20 \$117 million in capital costs for the purposes outlined below:

- 21 1. Replacement of outdated operating systems;
- 22 2. Standardization of operating systems throughout the organization; and

Rebuttal Testimony of
Steve M. Traxler

3. Addition of functionality, flexibility and scalability necessary for UCU
to function in a competitive market.

MPS's filing in Case No. ER-97-394 was based upon a request to amortize MPS's
allocated share of \$26 million in re-engineering costs over four years. The re-engineering
projects included in MPS's allocated share of \$26 million and the amount recommended
for rate base treatment by the Staff are reflected below:

	MPS Request 000's	Included In Rate Base 000's
Customer Call Center	\$ 1,011	\$ 1,011
Computer Aided Dispatch (CAD)	\$ 2,417	\$ 0
Automated Mapping/Facilities Management (AM/FM)	\$ 1,582	\$ 0
Customer Information System (CIS)	\$ 5,588	\$ 0
Enterprise Support Costs	\$ 4,938	\$ 4,938
Project Management (Capitalized Salaries/ Overheads)	\$ 6,630	\$ 2,540
Architecture/Infrastructure Costs	<u>\$ 4,132</u>	<u>\$ 1,582</u>
Total	\$26,298	\$10,071

Q. Please explain the significant difference between the Staff's recommended
rate base amount of \$10 million and MPS's request of \$26 million.

A. MPS's \$26 million request included recovery of \$16 million in budgeted
project costs. Only \$10 million of MPS' \$26 million request represented re-engineering
project costs in service as of September 30, 1997, the true-up date established for
Case No. ER-97-394.

Q. With regard to the \$10 million in re-engineering project costs that were
included in rate base, did the cost of service used in setting rates in Case No. ER-97-394
also reflect savings related to these projects as asserted by Mr. John McKinney in his
direct testimony for this current merger, Case No. EM-2000-369?

Rebuttal Testimony of
Steve M. Traxler

1 A. With the exception of some minor cost savings resulting from closing a
2 few business offices, none of the projected savings expected from the re-engineering
3 projects were reflected in the cost of service and used in setting rates in Case No.
4 ER-97-394, because none of the projects included in the \$10 million recommended by the
5 Staff were completed until after the December 1996 test year. Additionally, no cost of
6 service adjustments made to reflect known and measurable changes through
7 September 30, 1997 included an adjustment reducing cost of service to reflect projected
8 savings from UCU's re-engineering projects.

9 Q. Is it accurate to state that MPS's customer rates were "increased" as a
10 result of UCU's re-engineering projects in Case No. ER-97-394, as opposed to being
11 "reduced" as asserted by Mr. McKinney in this Case No. EM-2000-369?

12 A. Yes. Rates established in Case No. ER-97-394 included rate base
13 treatment for \$10 million in re-engineering project costs and \$581,000 in additional
14 depreciation expense related to these plant additions. The only offsetting savings were
15 the plant/payroll reductions related to closing a few business offices. These cost
16 reductions did not offset the additional revenue requirement impact of increasing rate
17 base and depreciation expense by \$10 million and \$581,000, respectively.

18 Mr. McKinney's has produced no evidence to support his assertion in the current
19 case, that MPS' ratepayers have benefited from the "flow through" of savings related to
20 UCU's re-engineering projects.

21 Q. Please identify the re-engineering projects that were not complete and in
22 service as of September 30, 1997, the true-up date established in Case No. ER-97-394.

Rebuttal Testimony of
Steve M. Traxler

1 A. As stated previously, \$16 million of MPS' requested \$26 million in
2 re-engineering costs were not included in rate base in Case No. ER-97-394 because they
3 were not in service as of September 30, 1997. Those projects and their actual completion
4 dates are reflected below:

	<u>"Budgeted"</u> <u>Costs</u> <u>000's</u>	<u>In Service</u> <u>Date</u> <u>000's</u>
Automated Mapping/Facilities Management	\$ 1,582	Budgeted 3 rd Quarter 2000
Computer Aided Dispatch	\$ 2,417	October 1998
Customer Information System	\$ 5,588	1 st Quarter-2000
Project Management Costs	\$ 4,090	2 nd Quarter 1998
Architecture/Infrastructure	<u>\$ 2,550</u>	2 nd Quarter 1998
"Budgeted" Re-engineering Costs	<u>\$16,227</u>	

[Source: Kris Paper Rebuttal Schedule KP-1, Case No. ER-97-394 and the response to
Staff Data Request No. 595, Case No. EM-2000-292]

Of the total \$26 million amount requested by MPS in Case No. ER-97-394, 62%
(\$16 million) was not in service by the September 30, 1997 true-up date. None of the
above projects were even in service by March 6, 1998, the date of the Commission's
Report and Order in Case No. ER-97-394.

Q. Have any parties been the beneficiaries of any savings resulting from
UCU's re-engineering projects?

A. MPS's customers are paying higher rates as a result from UCU's
re-engineering projects, because the cost increase of \$10 million in capital costs and
\$581,000 in depreciation expense included in rates from Case No. ER-97-394 far
exceeded the savings from closing a few business offices. Any net savings resulting from
UCU's re-engineering projects have therefore benefited UCU's shareholders, not MPS's

Rebuttal Testimony of
Steve M. Traxler

1 ratepayers. Since any net savings that have occurred have done so after the
2 September 30, 1997 true-up date used in Case No. ER-97-394, these net savings have not
3 yet resulted in lower rates for MPS's ratepayers. UCU's shareholders have received the
4 entire benefit of any net savings as an increase in the earned return on equity and an
5 increase in cash flow since rates were established in Case No. ER-97-394.

6 Q. Please summarize your testimony regarding Mr. McKinney's assertion
7 that MPS's ratepayers have benefited from the flow-through of savings resulting from
8 UCU's re-engineering projects.

9 A. On page 11, lines 5-11 of Mr. McKinney's direct testimony he compares
10 the anticipated benefits of the proposed merger between UCU and Empire to the benefits
11 which have been previously flowed through to MPS' customers resulting from UCU's re-
12 engineering projects.

13 My testimony establishes the following facts that contradict Mr. McKinney's
14 assertion:

15 (1) Only \$10 million of the \$26 million total requested by MPS in
16 Case No. ER-97-394 involved projects that were completed and included in rate
17 base. None of the adjustments made to reflect MPS's cost of service as of
18 September 30, 1997 captured cost savings from these projects, with the exception
19 of some business office closings. The savings from some isolated business office
20 closings did not offset the significant increase in cost of service resulting from the
21 inclusion of \$10 million in capital costs in rate base and the increase in
22 depreciation expense by \$581,000 annually. Rates established in Case No.

Rebuttal Testimony of
Steve M. Traxler

1 ER-97-394 were higher than they would have been, absent consideration of
2 UCU's re-engineering projects.

3 (2) The remaining \$16 million in re-engineering project costs were not
4 completed and in service until well after the Commission's March 6, 1998 Report
5 and Order in Case No. ER-97-394.

6 Adjustments made to cost of service in Case No. ER-97-394 most
7 certainly did not capture "future" savings expected from these re-engineering
8 projects.

9 (3) All actual net savings that may have occurred, due to UCU's
10 re-engineering projects, have benefited UCU's shareholders through increased
11 equity returns and cash flow occurring after the March 6, 1998, effective date for
12 rates established in Case No. ER-97-394.

13 Q. Will SJLP and Empire experience a reduction in cost of service as a result
14 of UCU's significant investment in re-engineering project costs?

15 A. No. Including SJLP and Empire in UCU's corporate overhead allocation
16 process after the merger, results in an increase in general plant of \$16 million for SJLP
17 and \$28 million for Empire. The general plant amounts allocated to SJLP and Empire
18 from UCU include the capital costs related to UCU's re-engineering projects.

19 The post-merger revenue requirement impact on SJLP and Empire ratepayers is
20 approximately \$2.3 million and \$3.9 million annually, respectively. Schedule SMT-5
21 reflects the calculation of the \$3.9 million increase for Empire.

Projected Savings/Costs from Consolidating Transmission, Distribution and Administration and General/Customer Service and General Plant Functions

Q. Before discussing the Joint Applicants' specific projected merger savings and costs, please explain UCU's corporate structure and method for assigning its corporate overhead costs to its regulated and non-regulated divisions/subsidiaries.

A. UtiliCorp is a multinational corporation with regulated and non-regulated operations in the United States, Canada, New Zealand, Australia and the United Kingdom. UCU has regulated gas and electric operations in the states of Missouri, Kansas, Nebraska, Colorado, Iowa, Michigan and Minnesota.

For a number of years, UCU has pursued a strategy of consolidating common functions for its domestic operations. UCU's international operations are run autonomously and are assumed to have little impact on the allocation of UCU's corporate overhead costs to regulated and non-regulated operations in the United States.

Enterprise Support Functions (ESF) refers to departments such as Executive, Treasury, Finance and Accounting at UCU, which support all of the domestic divisions and subsidiaries, both regulated and non-regulated.

IntraBusiness Unit (IBU) Departments consolidate functions on nine lines of basic businesses at UCU. As an example, management functions for the Electric Transmission function for all states are consolidated at UCU's corporate headquarters. The executive management cost for Production Facilities in Missouri, Kansas and Colorado is consolidated at UCU headquarters, as another example.

Q. How many separate non-regulated operations in the United States are also included in the allocation of ESF overhead costs?

Rebuttal Testimony of
Steve M. Traxler

1 A. The allocation model, used by both the Staff and the Joint Applicants to
2 estimate the impact of UCU corporate overhead allocations on the cost of service of
3 Empire includes the following non-regulated operations/activities:

- 4 • UtilCo. Group, Inc.
- 5 • Aquila Energy Corporation
- 6 • Aquila Energy Marketing Corporation
- 7 • GSS Mid Continent
- 8 • PNG Pipeline
- 9 • Global Securities Resources
- 10 • Service Today-General
- 11 • CL-General
- 12 • Missouri Pipeline
- 13 • Missouri Gas Pipeline
- 14 • Regulated Utilities – non-regulated activity
- 15 • Omega Pipeline
- 16

17 Q. How are UCU's corporate ESF and IBU overhead costs allocated to its
18 numerous domestic regulated and non-regulated operations?

19 A. Each ESF and IBU department allocates its costs based upon the
20 calculation of allocation factors using historical data considered to be the primary cost
21 driver for the particular costs incurred.

22 Most of the ESF Department costs, which benefit all domestic regulated and non-
23 regulated operations, are allocated using a general allocator based upon the average of
24 gross margin, payroll and net plant.

25 Q. Which Federal Energy Regulatory Energy Commission (FERC) functional
26 expenses categories are consolidated by UCU's centralized structure?

27 A. The FERC functional expense areas for which consolidation occurs at the
28 UCU headquarters level are reflected below:

- 29 • Production/Management Expenses
- 30 • Transmission/Management Expenses

Rebuttal Testimony of
Steve M. Traxler

- 1 • Distribution/Management Expenses
- 2 • Customer Accounts Expense
- 3 • Customer Service and Information Expense
- 4 • Sales Expenses
- 5 • Administrative and General Expenses (A&G)
- 6 • Payroll Taxes
- 7 • General Plant Investment and Depreciation Costs
- 8

9 The A&G and Customer-related functions are consolidated to a greater degree
10 than the Production, Transmission and Distribution functions.

11 Q. Did you prepare an analysis in an effort to determine whether UCU's
12 corporate structure had resulted in cost savings for MPS when compared to similar costs
13 for Empire?

14 A. Yes. In response to Staff Data Request No. 591, Case No. EM-2000-292,
15 UCU provided the UCU corporate overhead costs allocated to MPS from July through
16 December 1999. Approximately 70% of the allocated costs were related to the Customer
17 and A&G functions. I prepared a six-year analysis for the years 1994-1999 for the
18 following expense functions for both SJLP and MPS's electric operations:

- 19 • Customer Accounts Functions
- 20 • Customer Service and Information Functions
- 21 • Sales Functions
- 22 • A&G Functions
- 23

24 Schedules SMT-6-1 and SMT-6-2 reflect the results of my six-year analysis for
25 Empire and MPS. The impact of any unusual and/or non-recurring events were excluded
26 from the analysis for both MPS and Empire.

27 Q. Why was it necessary to adjust the Empire and MPS historical results, in
28 specific years, to eliminate the impact of unusual and/or non-recurring events?

Rebuttal Testimony of
Steve M. Traxler

1 A. Determining cost of service for ratemaking purposes is based upon the
2 fundamental premise that cost of service should represent the utility's normal, ongoing
3 cost of providing service. Adjustments are routinely made by both the utility company
4 and the Staff to eliminate the impact of unusual and/or nonrecurring events on the cost of
5 service. Any attempt to compare the historical results of one utility company with
6 another, Empire and MPS in this case, also requires consideration of the impact of
7 unusual and/or nonrecurring events.

8 Schedule SMT-6-1, lines 10 and 11, describe two adjustments made to Empire's
9 historical results for 1995 and 1999. Schedule SMT-6-2, lines 9, 10 and 11 describe three
10 adjustments made to MPS's historical result for 1997, 1998 and 1999.

11 Q. Do the adjustments referred to in your last answer represent examples of
12 adjustments, which are routinely made in determining cost of service for ratemaking
13 purposes?

14 A. Yes.

15 Q. What were the results of your analysis of the Customer Service and A&G
16 functions of UCU's MPS division and Empire?

17 A. The results of my analysis of MPS's and Empire's electric operations for
18 the years 1994-1999 are reflected below:

	1994 - 1999	
	<u>Empire</u>	<u>MPS</u>
Average \$/Customer-Customer Service A&G Costs	\$135	\$201

Rebuttal Testimony of
Steve M. Traxler

1 On an average cost per customer basis, Empire's annual costs for the customer
2 service and A&G functions were \$66 less than those of MPS from 1994-1999. Stated as
3 a percentage, Empire's costs were 33% less than MPS's every year, on average.

4 Q. Do the results of your analysis raise a concern regarding the risk that
5 Empire's annual cost of service may increase after the merger as a result of UCU's
6 corporate structure?

7 A. Yes they do. In addition to MPS's customer service and A&G costs being
8 higher, UCU's corporate structure presents other risks to Empire's customers that do not
9 exist at the current time for Empire.

10 Q. What additional risks for Empire's customers result from a merger with
11 UCU?

12 A. Earlier in my testimony, I listed 12 non-regulated UCU divisions/
13 subsidiaries that receive an allocated share of UCU's corporate overhead costs. In every
14 instance where a regulated utility consolidates functions that are jointly used by its
15 regulated and non-regulated operations, there is an incentive for the utility to subsidize its
16 non-regulated operations by allocating a disproportionate share of its overhead costs to its
17 regulated operations.

18 Q. What is your experience involving rate proceedings with UCU's MPS
19 division?

20 A. Since returning to the Commission in 1989, I have been directly involved
21 as the lead auditor in three rate cases involving MPS: Case Nos. ER-90-101, ER-93-37
22 and ER-97-394. Two of those cases, Nos. ER-90-101 and ER-97-394, went to hearing.

Rebuttal Testimony of
Steve M. Traxler

1 Q. Was the fairness of UCU's corporate overhead costs allocation at issue in
2 those proceedings?

3 A. Yes, in every case since 1990, UCU's corporate overhead cost allocations
4 to MPS has been a seriously contested issue.

5 As an example, the corporate overhead cost issues raised by the Staff in the most
6 recent MPS case, Case No. ER-97-394 are listed below:

<u>Overhead Cost</u>	<u>Allocated to MPS</u>
Governmental Affairs	\$ 399,794
Public Affairs	\$ 254,444
TransUCU (Corporate Jet)	\$ 515,922
Severance Costs	\$ 142,662
Common Plant Allocation	\$ 517,000
Mergers & Acquisitions	\$ 726,122
Discretionary Bonus	\$ 147,787
Ernst & Young Synergy Study	<u>\$ 46,627</u>
Total Value of Issues that went to Hearing	\$2,795,358
Marketing Costs Disallowance (accepted by UCU)	<u>\$3,763,253</u>
Total Corp. Overhead Issues	<u>\$6,558,611</u>

17
18
19
20
21
22
23
24 The Staff's position on all of the above issues were accepted by the Commission
25 with the exception of the Common Plant Allocation issue.

26 Q. Do you anticipate having to raise these same issues in future rate
27 proceedings involving the MPS, SJLP and Empire divisions of UCU, assuming UCU's
28 proposed mergers with SJLP and Empire are approved?

29 A. Yes. Based on past experience, I expect to continue to devote significant
30 time and resources to identify the portion of UCU's corporate overhead costs, allocated to
31 its regulated divisions in Missouri, that have nothing to do with providing regulated
32 electric and gas service in this state.

Rebuttal Testimony of
Steve M. Traxler

1 Q. Who will bear the costs of outside consultants and Staff resources devoted
2 to auditing UCU's corporate overhead costs in future cases?

3 A. Although I have not attempted to quantify the costs of auditing UCU's
4 post-merger corporate overhead costs, these audit costs, whatever they are, will be
5 reflected in the SJLP and Empire division's Commission assessment and rate case
6 expense, both of which will be recovered from the SJLP and Empire ratepayers,
7 assuming the proposed mergers are approved. These additional audit costs related to rate
8 cases involving the SJLP and Empire divisions, post-merger, are costs that do not exist
9 for SJLP and Empire ratepayers today.

10 Q. Earlier in your testimony, you identified the functional cost areas that are
11 impacted by UCU's corporate overhead allocations. How will the allocation of
12 depreciation and carrying costs (rate of return) related to UCU's general plant facilities
13 impact Empire's cost of service?

14 A. The allocation of UCU's numerous corporate headquarters facilities and
15 significant investment in infrastructure necessary to consolidate its non-regulated and
16 regulated operations in seven states, will increase Empire's cost of service significantly.

17 Q. Have you calculated the increase to Empire's cost of service resulting
18 from UCU's allocation of general plant investment and related depreciation costs to
19 Empire?

20 A. Yes. Schedule SMT-5 reflects that Empire's current cost of depreciation
21 and carrying costs (rate of return) related to its investment in general plant is \$4.8 million
22 annually, reflected on line 18 of Schedule SMT-5. Line 23 reflects the increase in
23 general plant depreciation expense and carrying costs based upon the projected cost

Rebuttal Testimony of
Steve M. Traxler

1 increases sponsored by Joint Applicant witness Siemek. Line 23 reflects that Empire's
2 cost of service will increase an additional \$3.9 million annually as a result of being
3 allocated a share of UCU's general plant and infrastructure costs. Line 24 illustrates that
4 this increase represents an 81.5% increase over Empire's current cost of service for
5 general plant and related depreciation expense.

6 Q. In your opinion, do Empire's ratepayers need to pay an additional
7 \$3.9 million annually for UCU's General Plant investment costs in order to continue to
8 receive safe and adequate service at just and reasonable rates?

9 A. No. This specific cost of service increase occurs only as a result of the
10 additional plant investment and infrastructure costs necessary for UCU to consolidate its
11 regulated and non-regulated operations in seven states.

12 Q. Is there any dispute between the Staff and the Joint Applicants as to
13 whether Empire's cost of service will increase as a result of allocating UCU's corporate
14 overhead costs to Empire after the merger?

15 A. No. This is one area that both sides agree upon. However, there is
16 significant disagreement as to the magnitude of the incremental increase to Empire's cost
17 of service resulting from UCU's corporate overhead allocations.

18 Q. What are the differences between the Joint Applicants' and the Staff's
19 projected merger costs and savings resulting from the consolidation of functions in the
20 Transmission, Distribution, Customer Service, A&G, and General Plant functions?

21 A. Joint Applicant witness Siemek sponsors Schedule VJS-1, which reflects
22 the Joint Applicants' total projected merger costs and savings. Attached to this rebuttal
23 testimony is my Schedule SMT-2, which duplicates witness Siemek's Schedule VJS-1

Rebuttal Testimony of
Steve M. Traxler

1 and also reflects the Staff's projected merger costs and savings for comparison. The
2 significant differences between Joint Applicants' and the Staff's projected merger costs
3 and savings are reflected on Schedule SMT-2. Lines 2, 3, 4 and 5 of Schedule SMT-2
4 reflect the projected savings in the Transmission, Distribution, Customer Service, A&G
5 and General Plant functions. The projected merger savings in these functional areas
6 result from projected reductions in personnel and related payroll taxes by consolidating
7 some of Empire's existing operations at the UCU corporate level.

8 The projected merger costs and savings resulting from consolidating some of
9 Empire's current operations is summarized below as reflected on Schedule SMT-2.
10 Lines 14, 15 and 16 of Schedule SMT-2 reflect the increase in Empire's cost of service
11 resulting from consolidating existing functions at Empire and the allocation of UCU's
12 corporate overhead costs allocated back to Empire:

13 **Schedule SMT-2**

14 15 Line No.		Years 6-10	
		UCU/Empire	Staff
		000's	000's
16	2 A&G/Customer Service Savings	\$ 39,688	\$ 49,388
17	3 Distribution Savings	\$ 28,915	\$ 35,983
18	4 Transmission Savings	\$ 4,837	\$ 6,018
19	5 Staff Adjustment-1999 Budgeted Positions	\$ 0	(\$ 7,215)
20	7 Total Merger Savings	\$ 73,440	\$ 84,174
21			
22	14 Empire Direct Costs Transferred to ESF Depts.	\$ 25,405	\$ 25,405
23	15 Empire Direct Costs Transferred to IBU Depts.	\$ 14,777	\$ 14,777
24	16 ESF & IBU Depts. Allocated Back to Empire	<u>(\$137,253)</u>	<u>(\$170,796)</u>
25	17 Empire Cost (Increase) from UCU Allocations	(\$ 97,071)	(\$130,614)
26	Net Cost (Increase) to Empire-Lines 7 & 17	<u>(\$ 23,631)</u>	<u>(\$ 46,440)</u>
27	Average Cost (Increase) Per Year	<u>(\$ 4,726)</u>	<u>(\$ 9,288)</u>
28			

29 Q. Do the amounts summarized in your last answer indicate that both the
30 Joint Applicants and the Staff expect a significant increase in Empire's post-merger cost

Rebuttal Testimony of
Steve M. Traxler

1 of service due to the net impact of consolidation and allocating UCU's corporate
2 overhead costs to Empire?

3 A. Yes. UCU/Empire is projecting a \$23.6 million net increase to Empire's
4 cost of service during years 6-10 after the merger closes which amounts to \$4.7 million
5 annually.

6 The Staff is projecting a \$46.4 million net increase in Empire's cost of service,
7 which amounts to \$9.3 million annually during years 6-10 following the merger closing.
8 Under the proposed regulatory plan, Empire's rates are not to be impacted by the merger
9 until after the moratorium for years 1-5 expires.

10 Q. What assumption differences account for the approximate \$22.8 million
11 difference between the Staff and UCU/Empire projected cost increase from UCU's
12 corporate overhead allocations and consolidation of existing Empire operations for years
13 6-10 following the merger closing?

14 A. UCU witness Siemek has assumed a 2.5% annual inflation rate in
15 projecting the annual increase in: 1) savings, 2) costs transferred from Empire to UCU
16 and 3) UCU corporate overhead costs allocated back to Empire after the merger. I do not
17 consider the 2.5% inflation factor appropriate to apply to UCU's corporate overhead
18 costs.

19 Q. In your opinion, should the inflation rate assumption for the UCU
20 overhead costs allocated back to Empire after a merger also be representative of UCU's
21 actual historical experience?

Rebuttal Testimony of
Steve M. Traxler

1 A. Yes. UCU's current historical experience provides the best source of
2 information for determining an appropriate growth/inflation rate for the costs subject to
3 consolidation.

4 Q. Did you also prepare a historical analysis of UCU's growth rate for
5 corporate overhead costs?

6 A. Yes. In response to Staff Data Request No. 594, Case No. EM-2000-292,
7 UCU provided the Staff with total ESF and IBU Department costs for 1995-1999 and the
8 amount that was allocated to UCU's MPS division. The results of my analysis are
9 reflected on Schedule SMT-7 and are summarized below:

<u>Annual % Increase in UCU ESF & IBU Dept. Costs</u>	<u>Average Annual Increase</u>
1996-1999 - Four-Year Average	87.6%
1997-1999 - Three-Year Average	24.4%
1998-1999 - Two-Year Average	6.3%

19 Please note that the above percent increases are not the total for the four-year
20 period, but represent the average annual increase in every year.

21 MPS' allocated share of UCU's corporate overhead costs has increased from
22 \$10.3 million in 1995 to \$46.5 million in 1999. A \$36.5 million annual increase in four
23 years is significant from any point of view.

24 Q. Given the actual growth in UCU's corporate overhead costs allocated to
25 MPS and the significant increase being projected by both UCU/Empire and the Staff for
26 Empire as a result of the merger, should the calculation of an appropriate growth/inflation
27 rate favor Empire's current ratepayers?

Rebuttal Testimony of
Steve M. Traxler

1 A. It certainly should. The "not detrimental to the public interest" standard
2 that applies to this Merger Application addresses the question of whether or not the cost
3 of providing utility service to Empire's customers will increase as a direct result of the
4 merger with UCU. With that in mind, I certainly do not consider Mr. Siemek's 2.5%
5 inflation rate for UCU's corporate overhead costs reasonable given the significant annual
6 cost increases experienced by UCU's Missouri division, MPS, since 1995.

7 Q. You mentioned previously that Mr. Siemek used a 2.5% growth/inflation
8 assumption for UCU's corporate overhead costs allocated back to Empire. What data did
9 Mr. Siemek rely on as support for the 2.5% growth assumption?

10 A. Mr. Siemek relied upon the Consumer Price Index for Urban Consumers
11 (CPI-U) published by the Federal Bureau of Labor Statistics.

12 Q. Does the Staff consider the CPI-U index appropriate for estimating the
13 annual increase of Empire's post-merger cost of service resulting from UCU's corporate
14 overhead allocations?

15 A. No. When one examines the data used by the Federal Bureau of Labor
16 Statistics in calculating the CPI-U index, it becomes readily apparent that the index has
17 nothing to do with the buying habits of a major electric utility like UCU.

18 Q. What is the CPI-U intended to measure?

19 A. Attached as Schedule SMT-8 is a three-page explanation of the CPI index
20 with specific references to the CPI-U recommended by Mr. Siemek for adjusting UCU's
21 corporate overhead costs. This three-page document was obtained from the Federal
22 Bureau of Labor Statistics, the federal agency responsible for its calculation.

Rebuttal Testimony of
Steve M. Traxler

1 The first paragraph on Schedule SMT-8-1 provides the following definition:

2 The Consumer Price Index (CPI) is a measure of the
3 average change in prices paid by urban consumers for a
4 fixed market basket of goods and services. Because the
5 CPI is a statistical average, it may not reflect your
6 experience or that of specific families or individuals,
7 particularly those whose expenditure patterns differ
8 substantially from the "average" urban consumer.
9

10 Q. What specific consumer goods and services are measured by the CPI-U
11 index, which is being proposed by Mr. Siemek to adjust UCU's corporate overhead costs
12 to reflect annual increases during the ten-year period following the merger closing?

13 A. Schedule SMT-8-2 reflects the following goods and services as being
14 included in the calculation of the CPI-U:

<u>Expenditure Category</u>	<u>Relative Importance to CPI-U Avg.</u>
Food and beverages	16.3%
Housing	39.6%
Apparel and upkeep	6.3%
Transportation	17.5%
Medical Care	5.8%
Entertainment & Recreation	6.0%
Education & Communication	5.4%
Other goods and services	<u>5.8%</u>
	100%

28 Q. In your opinion is it reasonable to consider a major electric utility
29 company to be an "average urban consumer" as defined by the CPI-U index?

30 A. Certainly not. The expenditures of a major electric utility, which include
31 spending millions of dollars in repairing boiler tube leaks, replacing turbine generator
32 blades or hiring outside contractors to trim trees around power lines, have little to do with
33 the buying habits of an "average urban consumer."

Rebuttal Testimony of
Steve M. Traxler

Any person reading the testimony on this issue should simply consider the following question. What possible relationship exists between expenditures made by an "average urban consumer" for housing, food and beverages, clothing, medical care and entertainment and the expenditures of a major electric utility company like UCU? I think the answer is clear when you examine the historical relationship between MPS' annual increase in allocated costs from UCU and the CPI-U index for the same time period.

Q. How do the CPI-U growth rates for 1996, 1997, 1998 and 1999 compare to MPS's historical growth rates related to corporate overhead costs allocated from UCU?

A. The CPI-U growth rates and MPS's actual growth rates related to UCU's corporate overhead allocations are reflected below:

	<u>CPI-U Growth Rate</u>	<u>UCU Overhead Allocation to MPS</u>
1996	3.3%	160.2%
1997	1.7%	53.7%
1998	1.6%	8.8%
1999	2.7%	3.5%

It is clear from the above comparison that the CPI-U Index used by Mr. Siemek in calculating UCU's corporate overhead costs bears no resemblance to the actual increases experienced by MPS from 1996 through 1999.

Even the Staff's recommended use of a 5% growth rate could be characterized as too low given MPS's actual experience from 1996 through 1999.

Q. What growth/inflation rate are you recommending be used for the purpose of projecting UCU's corporate overhead costs for the ten-year period following the closing of the merger?

Rebuttal Testimony of
Steve M. Traxler

1 A. Based on MPS's actual experience regarding allocated Overhead Costs
2 from UCU, I believe that a 5% growth rate is the lowest growth rate that should be used.
3 MPS actual growth rate was 3.5% in 1999 as reflected on Line 4 of Schedule SMT-7.
4 However, based upon MPS' experience in the last three years, a rate of 20% or more
5 could be justified.

6 The only year since 1995 that MPS's allocated overhead costs from UCU did not
7 exceed 5%, by a significant amount, was 1999.

8 The primary purpose of analyzing the UCU/Empire projected merger costs and
9 savings is to make a recommendation as to whether a merger with UCU is anticipated to
10 be not detrimental to Empire's ratepayers. I believe a 5% growth rate to be the minimum
11 assumption suitable for this objective. Referring to Schedule SMT-7, once more, the
12 average growth rate for 1998 and 1999 of 6.2% also exceeds my 5% assumption.

13 Q. What impact did your inflation rate assumption have on the projected
14 savings by UCU/Empire related to the consolidation of the functional expense areas
15 identified on pages 10 and 11 of this rebuttal testimony?

16 A. Assuming a 5% inflation rate for both merger costs and savings, from
17 consolidation, the Staff's projected savings are higher than those of the Joint Applicants
18 for years 6-10 by \$10.7 million as reflected on lines 2, 3, 4 and 5, Column D of Schedule
19 SMT-2.

20 Q. Referring again to Schedule SMT-2, please explain the adjustment on
21 line 5, Staff Adjustment – 1999 Budgeted Positions.

22 A. This adjustment is sponsored by Staff witness Fischer and is addressed in
23 detail in her rebuttal testimony. Witness Fischer considers the Joint Applicants'

Rebuttal Testimony of
Steve M. Traxler

1 projected savings from employee reductions to be overstated as a result of the failure by
2 the Joint Applicants to include a normal vacancy assumption in their synergy analysis.

3 Q. Does the Staff have any motivation for making a negative
4 recommendation regarding a UCU/Empire merger other than whether the Empire and
5 MPS ratepayers will experience rate increases as a direct result of the merger with UCU
6 (i.e., if merger costs exceed merger savings)?

7 A. No. The goal of the Staff's analysis of the projected impact of a
8 UCU/Empire merger on Empire and MPS ratepayers is to use assumptions which can be
9 supported by historical experience and which allocate merger costs and merger savings
10 fairly between Empire and MPS ratepayers.

11 As stated previously, the regulatory plan being proposed by the Joint Applicants
12 will, if adopted, result in higher rates for Empire, SJLP and MPS ratepayers. The
13 detrimental impacts of the proposed regulatory plan are also addressed in the testimonies
14 of Staff witnesses Oligschlaeger, Featherstone, Proctor and Broadwater. I will estimate
15 the approximate detrimental impact on Empire and MPS ratepayers later in this
16 testimony.

17 Q. Please summarize the analysis performed by both the Joint Applicants and
18 the Staff regarding the impact on Empire's cost of service of consolidating some existing
19 Empire Transmission, Distribution, Customer Service, Administrative & General, and
20 General Plant/Depreciation functions at UCU after the merger.

21 A. Referring to page 42 of this rebuttal testimony, both the Joint Applicants
22 and the Staff expect a significant increase to Empire's cost of service as a result of
23 consolidating existing Empire functions and allocating UCU's corporate overhead costs

Rebuttal Testimony of
Steve M. Traxler

1 to Empire. The Joint Applicants reflect an increase of \$23.6 million for years 6-10. The
2 Staff's calculations result in an increase of \$46.4 million based upon a more reasonable
3 inflation rate assumption for UCU overhead costs allocated back to Empire.

4 Q. Given that both the Joint Applicants and the Staff are projecting an
5 increase in Empire's cost of service as a result of consolidation and allocation of UCU's
6 corporate overhead costs, how do UCU/Empire address this detrimental impact in their
7 merger application?

8 A. UCU/Empire is proposing a regulatory plan that results in the forced
9 subsidization of merger costs and the acquisition premiums by MPS, Empire and SJLP
10 ratepayers. The detrimental impact of this proposed regulatory plan is addressed in this
11 rebuttal testimony beginning on page 8 and in the rebuttal testimonies of Staff witnesses
12 Oligschlaeger, Featherstone, Broadwater and Proctor. Additionally, the Joint Applicants
13 are projecting savings in the joint dispatch and employee benefits conversion areas to
14 offset the negative impact from UCU's corporate overhead allocation.

15 Q. In summary, will UCU/Empire's projected merger savings in the joint
16 dispatch and benefits conversion areas offset the detrimental impact on Empire's cost of
17 service resulting from consolidation of existing Empire functions and allocation of
18 UCU's corporate overhead costs back to Empire?

19 A. No. UCU/Empire's projected savings in the joint dispatch and benefits
20 conversion areas are significantly overstated and, therefore, will not offset the admitted
21 detrimental impact on Empire's cost of service resulting from functional consolidation of
22 existing Empire operations and the allocation of UCU's corporate overhead costs to
23 Empire. The projected savings in the joint dispatch and benefits conversion areas are

Rebuttal Testimony of
Steve M. Traxler

1 grossly overstated for the reasons addressed in Dr. Proctor's testimony on projected joint
2 dispatch savings and in my testimony regarding UCU/Empire's projected savings from
3 benefits conversion.

4 Q. Does a comparison of the residential rates of MPS with those of SJLP,
5 Empire and other electric utility companies in Missouri support a contention that UCU's
6 corporate structure has resulted in higher electric rates for MPS?

7 A. Yes, I think it does. Reflected below are the residential rates per KWH in
8 1999 for MPS, SJLP, Empire and the two electric utilities in Missouri with nuclear power
9 plants, Kansas City Power & Light (KCPL) and AmerenUE (Union Electric).

	<u>Cents Per KWH</u>
10 St. Joseph Light & Power Co.	.060288
11 Empire District Electric Company	.065458
12 AmerenUE (Union Electric)	.073380
13 Kansas City Power & Light Co.	.075582
14 UtiliCorp United (Mo. Public Service)	.075736
15	
16	

17 The SJLP and Empire residential rates are considerably lower than MPS rates and
18 the rates for the two companies with nuclear generating facilities, Union Electric and
19 KCPL.

20 Q. Please comment on the relationship between MPS' residential rate and
21 those for Union Electric and KCPL.

22 A. The impact of the significant capital costs of a nuclear generation plan on
23 rates is common knowledge throughout the industry. One would expect KCPL's and
24 Union Electric's rates to be considerably higher than those of SJLP and Empire.

25 With regard to MPS' rate, the obvious question is why does MPS, with no nuclear
26 investment, have a residential rate which exceeds those of Union Electric and KCPL. It

Rebuttal Testimony of
Steve M. Traxler

1 is certainly the Staff's view that MPS' higher than expected residential rate is due in part
2 to UCU's corporate structure.

3 Q. Are both the Joint Applicants and the Staff projecting a significant
4 increase in SJLP's and Empire's cost of service after the merger, as a result of UCU's
5 corporate overhead costs?

6 A. Yes. UCU is projecting a net increase for Empire after projected savings
7 of \$4.7 million annually for years 6-10 following the proposed moratorium. Staff
8 considers the \$4.7 million increase to be understated as a result of using a 2.5% growth
9 rate for UCU's corporate overhead costs. The Staff considers the 2.5% growth rate to be
10 unrealistic based upon MPS' historical experience.

11 Staff is projecting an annual increase in Empire's cost of service of \$9.3 million
12 annually as a result of UCU's higher corporate overhead costs net of projected savings.

13 Q. If UCU/Empire are not successful in realizing their level of projected
14 merger savings in the joint dispatch and benefits conversion areas, will the residential
15 rates of SJLP and Empire increase to a level equal to or higher than those of MPS?

16 A. Yes. The cost increases to SJLP and Empire resulting from UCU's
17 corporate overhead costs and amortization of the merger acquisition premiums are known
18 and certain costs.

19 The Joint Applicants projected savings in the joint dispatch and benefits
20 conversion areas are not only speculative, they are based upon erroneous assumptions in
21 the Staff's view.

1 In summary, if the SJLP and Empire mergers are approved as structured by the
2 Joint Applicants, it is a certainty, in the Staff's view, that a significant increase in the
3 rates of SJLP and Empire will result.

4 **Overstatement of Merger Savings from Benefits Conversion**

5 Q. What merger savings are being projected by UCU/Empire as a result of
6 converting existing Empire benefit plans to UCU benefit plans?

7 A. Referring to Schedule SMT-2, Line 6, Column C, UCU/Empire is
8 projecting \$28.5 million in merger savings during years 6-10, as a result of converting
9 existing Empire benefit plans to those of UCU, following the merger closing.

10 Q. Do you consider \$28.5 million in projected savings from benefits
11 conversion to be realistic?

12 A. No. The merger savings from Benefits Conversion is overstated as a
13 result of including \$4.6 million in Pension Cost reductions, which accrue to all of UCU's
14 other divisions/subsidiaries as a result of combining the pension assets of Empire and
15 UCU after the merger.

16 Q. What specific assumption by UCU witness Browning has resulted in an
17 overstatement of merger savings related to the conversion of the Empire pension plan to
18 the UCU plan?

19 A. In calculating the Financial Accounting Standard No. 87 (FAS 87) pension
20 cost for the Empire division, Mr. Browning has assumed that Empire's pension cost
21 would be based upon the funded status of the Empire plan prior to the merger. This
22 assumption is inconsistent with how UCU has treated the pension assets of all other

Rebuttal Testimony of
Steve M. Traxler

1 regulated acquisitions. Additionally, no UCU/Empire witness has committed to
2 calculating Empire's FAS 87 pension cost based upon its pre-merger funded status.

3 Q. Is Mr. Browning's pension cost calculation, which is based upon Empire's
4 pre-merger funded status, consistent with a UCU/SJLP data request response regarding
5 the treatment of pension assets after the merger?

6 A. No. In response to Staff Data Request No. 186, Case No. EM-2000-292,
7 UCU/SJLP stated as follows: "In general since it is most cost effective to merge all trust
8 assets into one trust (eliminates dual trust, audit and administrative costs), it is UCU's
9 intent over time to merge the SJLP pension trusts into the UCU master trust." (Emphasis
10 added.)

11 Q. Are you aware of any other evidence that would support your conclusion
12 that UCU plans to consolidate the Empire, SJLP and UCU pension assets after the
13 merger?

14 A. Yes. On May 14, 1999, UCU filed its Merger Registration Statement, See
15 Form S-4, filed by UCU with the Securities and Exchange Commission.

16 Paragraph (g) of Merger Registration Statement includes the following statement:

17 The execution of, and the performance of the transactions
18 contemplated in, this Agreement will not . . . result in the
19 triggering or imposition of any restrictions or limitations on the
20 right of UCU, the Company or any of its Subsidiaries to amend or
21 terminate any Company Employee Plans and **receive the full**
22 **amount** of any **excess assets** remaining or resulting from such
23 amendment or termination, subject to applicable taxes. (emphasis
24 added.)

25 Q. Does the statement referenced in your last answer lead you to conclude
26 that UCU is serious about protecting its rights to the benefits from the excess assets in the
27 SJLP and Empire pension plans?

Rebuttal Testimony of
Steve M. Traxler

1 A. Yes. That is quite clear. UCU desires to avoid any restrictions on the use
2 of the excess pension assets in the Empire and SJLP plans.

3 Q. Please define the term "excess assets" as applied to the assets in a defined
4 benefit pension plan?

5 A. The legal obligation which must be funded in accordance with the
6 Employee Retirement Income Security Act (ERISA) of 1974 is referred to as the
7 Accumulated Benefit Obligation (ABO), which represents the accrued liability of all
8 benefits earned to date by employees. Required minimum contributions are established
9 under ERISA to ensure funding of the ABO. The market value of assets which exceeds
10 the ABO is considered "excess assets."

11 When a plan is terminated and a new plan takes its place, ERISA requires that
12 assets equal to the ABO of the old plan be transferred to the new plan. The excess assets
13 above the ABO can be used by the corporation for any purpose it sees fit.

14 The employees participating in a defined benefit plan have no legal right to the
15 pension assets which exceed the ABO.

16 Q. Are there any financial benefits to UCU under Mr. Browning's
17 assumption that Empire's pension assets will be kept separate and distinct and not
18 combined with those of UCU after the merger?

19 A. No. It is unlawful to remove assets from a pension plan for general use,
20 except in the case of a plan termination like that described above. Using the excess assets
21 in Empire's pension fund for general use by the corporation requires a termination of the
22 existing plan and a transfer of assets equal to the ABO to another plan. However, if a
23 termination occurs, UCU could use the excess pension assets for any purpose it desires.

Rebuttal Testimony of
Steve M. Traxler

1 Referring again to the statement in my previous answer from the Merger Registration
2 Statement, UCU has made it clear that the merger transaction will not restrict it from
3 terminating any employee pension plan in order to receive the full amount of any excess
4 amounts remaining.

5 This concern is completely inconsistent with UCU witness Browning's
6 assumption that the full amount of Empire's pension assets will be kept separate and not
7 combined with the UCU pension assets for purposes of calculating FAS 87 pension cost
8 after the merger.

9 Q. Would UCU benefit from the excess Empire pension assets under an asset
10 consolidation assumption, even if 100% of the Empire pension assets are transferred to
11 the UCU fund?

12 A. Yes. This is the scenario I am addressing in this case based upon UCU's
13 historical experience with other regulated acquisitions.

14 Since Empire's Pension plan has a higher funding ratio than the UCU Pension
15 plan, (155% at January 1, 1999 compared to UCU of 140% funding at January 1, 1999)
16 adding the Empire pension assets to the UCU plan improves the funded status to 144%
17 for all existing regulated and non-regulated participants in the plan. This results in lower
18 pension costs and increased earnings for the existing plan participants (excluding
19 Empire).

20 The opposite is true for Empire. Empire's funded status at January 1, 1999 of
21 155% drops to 144% after the merger if the pension funds are combined. If left
22 unchallenged by the Missouri Public Service Commission, Empire will experience a
23 significant increase in pension cost that must be recovered in rates from Empire

Rebuttal Testimony of
Steve M. Traxler

1 ratepayers while all of UCU's other regulated and non-regulated plan members are
2 experiencing a windfall profit at the expense of Empire ratepayers. My testimony in this
3 case quantifies the financial detriment to Empire ratepayers under such an assumption.

4 Q. Briefly explain why combining the UCU and Empire pension assets for
5 FAS 87 calculations after the merger results in lower pension costs for UCU's other
6 divisions/subsidiaries at the expense of Empire ratepayers.

7 A. Schedule SMT-9, attached to my rebuttal testimony, reflects the funded
8 status for the Empire and UCU pension plans as of January 1, 1999. The funded status is
9 calculated by dividing the market value of the pension fund assets by the ABO which
10 represents the liability for pension benefits earned to date. The January 1, 1999 funded
11 status for Empire pension plan was the assumption used by UCU witness Browning.

12 Schedule SMT-9 reflects the following funded status calculations:

13	Funded Status – Empire Pension Plan	155%
14	Funded Status – UCU Pension Plan	140%
15	Funded Status – Combined UCU/Empire	144%
16		

17 The Funded Status of a pension plan has a direct impact on annual pension
18 expense calculated under FAS No. 87. FAS 87 is used for determining pension cost for
19 ratemaking purposes for both MPS and Empire.

20 The expected rate of return assumption used in calculating pension cost under
21 FAS 87 is calculated by applying an expected earned return (from investing the assets)
22 times the market value of the assets at the beginning of the plan year.

23 The expected rate of return on the pension fund assets from investments income
24 and appreciation is used as an offset to the annual service cost, interest cost and prior
25 service costs included in the FAS 87 calculation.

Rebuttal Testimony of
Steve M. Traxler

1 A reduction in the funded status of the plan results in an increase in pension cost
2 under FAS 87 as a result of the lower expected income and appreciation.

3 The reduction in the funded status of Empire's pension plan from 155%, on a
4 stand-alone basis, to 144% on a combined basis will result in an increase in pension cost
5 in Empire's cost of service under a UCU/Empire merger assumption. However, all of
6 UCU's other regulated and non-merger plan participants will experience a reduction in
7 pension costs at the expense of Empire's ratepayers.

8 UCU/Empire witness Browning has overstated merger savings expected from
9 converting Empire's existing pension plan, by not reflecting the significant increase in
10 pension cost for Empire ratepayers resulting from consolidating the pension assets of
11 Empire and UCU after the merger for purposes of calculating FAS 87 pension cost.

12 Q. Why is it a valid assumption that UCU will combine Empire pension
13 assets with those of UCU after the merger in contrast to Mr. Browning's "stand-alone"
14 assumption for calculating FAS 87 pension cost?

15 A. UCU has two incentives for doing so, neither of which considers the
16 detrimental impact on Empire's ratepayers resulting from pension asset consolidation:

17 (1) As Mr. Browning explains in his direct testimony, UCU plans to
18 convert Empire's benefit plans, including the pension plan, over to the UCU plan.
19 Under such an assumption, it would logically follow that UCU plans to combine
20 the assets of the UCU and Empire pension plans after conversion.

21 (2) The most important reason for assuming that UCU will combine
22 the Empire and UCU pension assets is UCU's historical treatment involving its
23 other regulated utility divisions. If UCU is permitted to combine the pension

Rebuttal Testimony of
Steve M. Traxler

1 assets of Empire and UCU in calculating FAS 87 pension costs, the earnings for
2 its other divisions/subsidiaries participating in the UCU plan will increase
3 approximately \$617,000 annually because of the lower allocated pension costs.
4 Conversely, Empire's pension cost will increase approximately \$617,000 annually
5 and that would require an additional revenue recovery from Empire ratepayers.

6 Q. What has UCU's historical experience been regarding pension plan
7 conversion for its other regulated acquisitions?

8 A. UCU has the following regulated divisions, all of which were previous
9 acquisitions of existing utility companies, similar to the situation regarding Empire and
10 SJLP:

- 11 • Kansas Public Service
- 12 • Michigan Gas Utilities
- 13 • Peoples Natural Gas – Colorado
- 14 • Peoples Natural Gas – Iowa
- 15 • Peoples Natural Gas – Kansas
- 16 • Peoples Natural Gas – Minnesota
- 17 • Peoples Natural Gas – Nebraska
- 18 • Northern Minnesota Utilities
- 19 • West Plains Energy – Colorado
- 20 • West Plains Energy – Kansas
- 21 • West Virginia Power - Sold December 31, 1999
- 22

23 Without exception, the pension fund assets for these regulated acquisitions were
24 combined with the UCU pension fund assets at some date following the acquisition by
25 UCU. The combined funded status is the assumption used by UCU in calculating
26 FAS 87 pension cost for all divisions and subsidiaries included in the UCU pension plan.

27 Q. Please illustrate how the difference in the funded status of the Empire and
28 UCU pension plans impacts pension costs for Empire if UCU and Empire merge.

Rebuttal Testimony of
Steve M. Traxler

1 A. Schedule SMT-10 reflects the impact on Empire's pension cost for 1999
2 resulting from reducing Empire's actual funded status of 155% at January 1, 1999
3 (Schedule SMT-9) to the combined UCU/Empire funded status of 144% (Schedule
4 SMT-9).

5 Line 9 of Schedule SMT-10 reflects that Empire's pension cost for 1999 would
6 increase \$617,384 in 1999 based on an assumed funded status for the combined pension
7 assets of Empire and UCU after the merger of 144%

8 Q. How did you calculate the total value of UCU witness Mr. Browning's
9 overstated merger savings from benefit plan conversion?

10 A. In response to Staff Data Request No. 137, Mr. Browning provided the
11 annual growth assumptions he used in calculating the merger savings for pension plan
12 conversion. I used Mr. Browning's growth rates for each year. I applied Mr. Browning's
13 growth rates to the increase in pension cost calculated on Schedule SMT-10 of \$617,384.
14 The result was an increase in pension cost to Empire of approximately \$8.3 million for
15 the ten-year period after the merger and \$4.6 million during years 6-10 following the
16 proposed moratorium.

17 Q. But isn't it true that UCU's other regulated and non-regulated
18 divisions/subsidiaries would, in fact, be the recipients of \$8.3 million in savings under a
19 merger assumption for UCU and Empire?

20 A. Absolutely, and that is the problem. Mr. Browning has failed to reflect the
21 detrimental impact on Empire's ratepayers resulting from a pension asset combination in
22 a merger with UCU. UCU/Empire are required under the "not detrimental to the public
23 interest" standard in Missouri to demonstrate that the proposed merger will not result in

Rebuttal Testimony of
Steve M. Traxler

1 increased rates for the MPS and Empire ratepayers as a direct result of the merger. The
2 UCU/Empire Merger Application does not reflect the \$8.3 million increase in pension
3 cost to Empire as a result of consolidating the Empire and UCU pension assets during the
4 ten-year period following the merger closing.

5 Q. Is the Staff recommending, as a condition to the merger, that UCU be
6 required to maintain Empire's pre-merger pension plan funded status in order to eliminate
7 the increase to Empire's cost of service resulting solely from a post-merger decision to
8 combine Empire's pension assets with those of UCU in calculating FAS 87 pension cost?

9 A. Yes. The detrimental impact of a post-merger decision to combine SJLP's
10 pension assets with those of UCU in calculating FAS 87 pension cost must, in the Staff's
11 view, be addressed now as a condition to the merger.

12 Additionally, UCU/Empire's projected merger savings in its Application must be
13 reduced by \$8.3 million for the ten-year period following the merger approval in order to
14 reflect the increase in pension cost to SJLP ratepayers. Merger savings projected for
15 years 6-10 must be reduced by \$4.6 million.

16 **Results of Staff's Ten-Year Merger Cost/Benefit Analysis**

17 Q. Are you the Staff witness responsible for summarizing the financial
18 impact of the Staff's recommended adjustments to the UCU/Empire net benefits
19 analysis?

20 A. Yes. UCU witness Vern Siemek summarized the Applicants' ten-year
21 projected merger costs and savings on Schedule VJS-1 attached to his direct testimony.

22 I have duplicated Mr. Siemek's summary schedule on Schedule SMT-2 attached
23 to this rebuttal testimony.

Rebuttal Testimony of
Steve M. Traxler

1 Q. Briefly explain how the UCU/Empire and Staff results regarding projected
2 merger costs and savings are reflected on your Schedule SMT-2.

3 A. The organization of Schedule SMT-2 was set up to mirror Mr. Siemek's
4 Schedule VJS-1 for ease of presentation and comparability. Columns (A) and (B) reflect
5 the summary of the ten-year cost/benefit analysis performed by the Joint Applicants and
6 the Staff.

7 Q. What is the purpose of Columns on (C) and (D) on Schedule SMT-2?

8 A. Under their proposed regulatory plan, UCU/Empire are not planning a rate
9 case for the Empire division until the end of year 5 of the moratorium. UCU/Empire, as
10 part of the regulatory plan, have "guaranteed" \$3.0 million in net savings to Empire's
11 ratepayers to be reflected in cost of service in that case.

12 Column (D) reflects the Staff's projected merger costs and savings for years 6-10,
13 which are comparable to the UCU/Empire 6-10 year levels in Column (C).

14 As addressed earlier in my testimony, the Joint Applicants are attempting to
15 address the "not detrimental to the public interest" standard by "guaranteeing" that rates
16 established in Empire's post-moratorium rate case will include sufficient net merger
17 savings to recover 50% of the merger acquisition premium amortization and provide an
18 additional \$3 million in net savings to be used as a cost-of-service reduction in the rate
19 case.

20 The \$3.0 million guaranteed benefit to Empire's ratepayers is based upon
21 budgeted/projected savings for years 6-10 following the moratorium. The Commission is
22 being asked to approve this merger based upon budgeted assumptions ten years into the
23 future.

1 Additionally, the Commission is being asked to deviate from cost-based rates in
2 the post-moratorium rate cases for both Empire and SJLP by including projected net
3 merger savings levels for years 6-10. Their requests under the proposed regulatory plans
4 for Empire and SJLP, if adopted, will represent the first time that rates for a Missouri
5 utility are based upon projected assumptions five years beyond the historical test year.

6 Q. What are the primary areas of disagreement between the Staff and
7 UCU/Empire regarding expected benefits/costs from this merger?

8 A. The primary areas of disagreement are as follows:

9 (1) Allocation treatment of joint dispatch; UCU/Empire are assigning
10 100% of energy cost savings, from joint dispatch, to Empire ratepayers and
11 ignoring the fact that these savings, according to UCU/Empire witness Holzwarth,
12 result from the joint use of MPS and Empire generating assets. With regard to
13 savings that occur, as a result of the merger, Dr. Proctor is correctly allocating
14 these benefits to both MPS and Empire consistent with the joint use of the assets
15 used to generate the savings;

16 (2) Assumed growth/inflation rates (UCU corporate overhead allocations
17 and consolidation of existing Empire operations);

18 (3) Whether transition costs and the acquisition premium should be
19 recoverable in rates;

20 (4) Whether UCU/Empire's projected savings could be accomplished by
21 Empire on its own under a "no merger" assumption. Savings which would occur
22 on their own, without the merger, are non-merger savings and should not be
23 assumed to offset merger costs. Dr. Proctor's primary disagreement with the Joint

Rebuttal Testimony of
Steve M. Traxler

Applicants in the area of joint dispatch savings is that the projected savings can be achieved by Empire on a "stand-alone" basis without the merger.

(5) Overstatement of savings from employee reductions as a result of the failure to recognize a normal job position vacancy rate.

Referring to Line 18 of Schedule SMT-2, the differences in projected net merger savings and merger costs (excluding the acquisition premium) are as follows:

	Years 1-10	Years 6-10
	<u>\$ 000's</u>	<u>\$ 000's</u>
UCU/Empire Net Merger Savings/Costs	\$176,166	\$107,504
Staff Net Merger Savings/(Costs)	<u>(\$ 38,839)</u>	<u>(\$ 8,113)</u>
Difference between Staff & UCU/Empire	<u>(\$215,005)</u>	<u>(\$115,617)</u>

Q. How can you explain the monumental difference in the projected amounts reflected in your last answer?

A. There are five issues that account for such a significant difference in the ten-year projections of the Staff and UCU/Empire which are summarized below:

	Years 1-10	Years 6-10
	<u>(\$000's)</u>	<u>(\$000's)</u>
UCU/Empire Net Merger Savings/Costs	\$176,166	\$107,504
<u>Staff Issues:</u>		
Proper Allocation of Joint Dispatch Savings to MPS & Empire	(\$192,388)	(\$102,977)
Staff Adjustment-1999 Budgeted Positions	(\$ 12,869)	(7,215)
Increase in Consolidation/UCU Overhead Allocations due to use of Appropriate Growth/Inflation Rate	(\$ 21,547)	(\$ 15,594)
Disallowance of Transaction Costs Assigned to Shareholders	\$ 20,120	\$ 14,808
Overstatement of Pension Benefits Conversion	<u>(\$ 8,320)</u>	<u>(\$ 4,639)</u>
Staff Excess of Merger Costs over Merger Savings	<u>(\$ 38,839)</u>	<u>(\$ 8,113)</u>

1 Q. Are any of the significant differences identified in your last answer related
2 to the proper mathematical calculation of specific amounts?

3 A. No. In every instance the Staff is challenging the validity of UCU/Empire
4 assumptions as they relate to:

5 (1) **Fairness** to both Empire and MPS's ratepayers - joint dispatch
6 allocations should result in fair assignment of savings from joint dispatch to MPS
7 and Empire ratepayers.

8 (2) **Accuracy** based upon historical experience - the growth/inflation
9 rate used for UCU corporate overhead allocations should reflect UCU's historical
10 experience. The 1999 budget should reflect a normal vacancy assumption for
11 unfilled positions.

12 (3) **Validity** as to whether the cost is something that ratepayers should
13 be paying for in rates - acquisition premium, specific transition costs assignable
14 to shareholders or amounts for non-merger savings should be excluded from a
15 merger cost/benefit analysis. Dr. Proctor considers approximately 97% of UCU
16 witness Holzwarth's joint dispatch energy savings to be non-merger savings
17 available to Empire on a "stand-alone" assumption.

18 (4) **Contradictory** as to the stated intent of how the merged company
19 plans to treat an item after the merger - Mr. Browning's "stand-alone"
20 assumption regarding Empire's pension assets after the merger contradicts the
21 stated intention of UCU/Empire to combine the pension assets of Empire with
22 those of UCU after the merger. It contradicts UCU's current practice of
23 calculating FAS 87 pension cost based upon a "combined" asset assumption.

Rebuttal Testimony of
Steve M. Traxler

1 Q. Based on the results of the Staff's analysis of projected merger savings
2 and costs, will this merger as proposed, result in higher rates for Empire's ratepayers?

3 A. Yes, it is the Staff's position that the UCU/Empire merger savings are
4 significantly overstated. The Staff believes that merger costs will exceed benefits and
5 result in higher rates for Empire ratepayers. Additionally, as stated previously in my
6 testimony, as well as in the testimonies of Staff witnesses Oligschlaeger, Featherstone,
7 Proctor and Broadwater, the proposed UCU/Empire regulatory plan is considered
8 detrimental to the MPS, Empire and SJLP ratepayers.

9 Staff witness Oligschlaeger addresses the conditions necessary to eliminate the
10 detrimental impact of the UCU/Empire merger on MPS and Empire ratepayers.

11 I have addressed the detrimental impact of a pension asset consolidation on
12 Empire ratepayers in this rebuttal testimony.

13 Q. Referring to Schedule SMT-2, please explain the significance of line 25,
14 Column (C).

15 A. Column (C) reflects Joint Applicants' witness Siemek's summary of
16 projected merger costs and savings for years 6-10, following the five-year moratorium.

17 As discussed earlier in my testimony, the Joint Applicants are attempting to
18 demonstrate that the UCU/Empire merger meets the "not detrimental to the public
19 interest" standard based upon the projected results for years 6-10 following the
20 moratorium.

21 Line 24, Column (C) reflects the Joint Applicants \$14.8 million in projected net
22 savings for years 6-10 after the recovery of the return on and amortization of the
23 acquisition premium.

Rebuttal Testimony of
Steve M. Traxler

1 The average annual net savings projected for years 6-10 by the Joint Applicants is
2 \$2.9 million, line 25, Column (C) of Schedule SMT-2. The \$2.9 million average net
3 savings represents the \$3 million "guaranteed" net benefit to Empire ratepayers discussed
4 on page 7 of Joint Applicants' witness John W. McKinney's direct testimony.

5 Q. Do the Joint Applicants anticipate being able to demonstrate "actual" net
6 savings of \$3.0 million in Empire's post-moratorium rate case?

7 A. No. My rebuttal testimony (page 16-17) reflects Mr. John McKinney's
8 statement identifying the intended use of the "forward average level of savings for
9 5 years following the rate moratorium." The Joint Applicants are requesting that the
10 Commission adopt a regulatory plan, which requires the use of projected merger costs
11 and savings for ratemaking purposes in the post-moratorium rate cases for both Empire
12 and SJLP.

13 Q. Does the Staff believe that compliance with the "not detrimental to the
14 public interest" standard can be determined based upon projected assumptions in the
15 post-moratorium rate cases for Empire and SJLP?

16 A. No. The Commission has never set rates for regulated utilities based upon
17 projected assumptions extending five years beyond the test year used in a rate case.

18 Q. Does the approval of this merger, based upon projected assumptions,
19 create considerable downside risks to Empire's ratepayers?

20 A. Yes. Using projected assumptions to demonstrate compliance with the
21 "not detrimental to the public interest" standard carries more downside risk than using
22 such assumptions for setting rates.

Rebuttal Testimony of
Steve M. Traxler

1 Once a decision is made allowing these two companies to merge based upon
2 projected assumptions, the merger, if consummated, it cannot be reversed in the event
3 that the projected assumptions do not result in the expected net merger savings. The
4 requested recovery of \$93 million in merger acquisition costs in years 6-10 is a known
5 and certain cost. The projected merger savings for years 6-10 are not known or certain.

6 Q. Please summarize the Staff's projected merger costs and savings for years
7 6-10 and how they compare to the \$3 million in net merger savings projected by the Joint
8 Applicants.

9 A. Line 18, Column (D) of Schedule SMT-2 reflects that merger costs are
10 projected by the Staff to exceed savings by \$8.1 million for the five-year period 6 through
11 10. Adding the 50% recovery of the acquisition adjustment results in net merger costs of
12 \$101 million for years 6-10.

13 The Staff's position is that the net savings from this merger will not be remotely
14 close to being sufficient to cover merger costs and the requested 50% recovery of the
15 merger acquisition premium.

16 Q. In your view, does the proposed merger between UCU and Empire make
17 economic sense to the shareholders of UCU?

18 A. No. The merger savings are not sufficient to cover merger costs and the
19 merger acquisition premium. Even if we assume that the merger generates 100% of the
20 projected savings and the regulatory plan is approved, merger savings will not recover the
21 costs of this merger projected for the ten-year period following the merger closing.

22 Q. What is the basis for the assumption in your previous answer that even if
23 the Commission adopts the Joint Applicants' proposed regulatory plan and accepts all

Rebuttal Testimony of
Steve M. Traxler

assumptions used for their ten-year cost/benefit analysis, merger savings and the additional revenue recovered under the regulatory plan will not recover merger costs plus the return on, and amortization of, the acquisition premium.

A. The net loss to UCU's shareholders during the ten-year period following the merger closing can be calculated as follows:

	Total Years 1-10 (<u>\$000's</u>)
Joint Applicants' projected Net Merger Savings	\$176,166
Additional revenue from MPS ratepayers, resulting from adoption of regulatory plan (Ignore reduction in Corporate Overheads to MPS)	\$ 50,630
Additional revenue from MPS ratepayers from assigning 100% of Energy Savings to Empire	\$ 4,859
Additional revenue from Empire ratepayers resulting from adoption of regulatory plan (Ignore Cost of Capital reduction to Empire)	<u>\$ 12,500</u>
Total Net Merger Savings and Revenue from regulatory plan	\$ 244,153
Ten-Year Amortization of, and Return on, Acquisition Premium	<u>(\$390,500)</u>
Net (Loss) to UCU Shareholders	<u>(\$146,347)</u>

Q. Given the uneconomic nature of the proposed UCU/Empire merger, even under the Joint Applicants' assumptions, is it Staff's opinion that UCU gave considerable consideration to the value of Empire's generation assets under a deregulation assumption?

A. Yes. It is clear, based on the Joint Applicants' own assumptions, that this merger is not economic for a minimum of ten years following the merger closing in a regulated environment. It is, therefore, likely that UCU management placed considerable value on a deregulated market assumption.

Rebuttal Testimony of
Steve M. Traxler

1 Q. Has the Staff seen evidence, which supports the supposition that UCU has
2 valued the Empire acquisition based upon the future value of Empire's generation assets
3 in a deregulated market?

4 A. Yes. In response to Staff Data Request No. 19, Case No. EM-2000-145,
5 (In the Matter of the Application of the Empire District Electric Company for Permission
6 and Authority to Transfer a Partial, Undivided Interest in Certain Generation Facilities,
7 Land and Related Property) UCU/Empire provided a stranded cost study performed by
8 PriceWaterhouseCoopers. PriceWaterhouseCoopers is also the firm retained by UCU to
9 perform the benefits conversion analysis for the Empire and SJLP merger cases. The
10 results of the PriceWaterhouseCoopers study indicated **
11 ** related to Empire's existing generation assets and purchase power capacity
12 contracts as reflected below:

13 **
14 _____
15 _____
16 _____ **

17 Q. Should Empire's ratepayers be required to pay a return on, and
18 amortization of, an acquisition premium, which results in part from UCU's anticipated
19 valuation of Empire's generation assets assuming deregulation?

20 A. No. Any additional profits that UCU may receive from operating
21 Empire's generation assets in a deregulated market will accrue solely to shareholders.
22 Any acquisition premium related to these anticipated profits should, therefore, be borne
23 solely by shareholders.

24 Q. Does this conclude your rebuttal testimony?

25 A. Yes, it does.

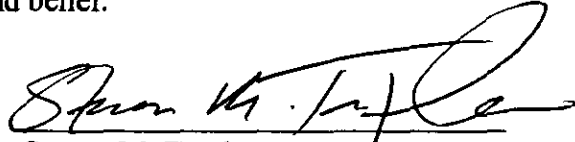
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Joint Application of)
UtiliCorp United Inc. and The Empire District)
Electric Company For Authority To Merge The)
Empire District Electric Company With and Into) EM-2000-369
UtiliCorp United Inc. and, In Connection)
Therewith, Certain Other Related Transactions,)
Filed.)

AFFIDAVIT OF STEVEN M. TRAXLER

STATE OF MISSOURI)
)
COUNTY OF COLE) ss.

Steven M. Traxler, is, of lawful age, and on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 70 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.


Steven M. Traxler

Subscribed and sworn to before me this 21st day of June, 2000.



SHARON S WILES
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. AUG. 23, 2002

Steve M. Traxler

SUMMARY OF RATE CASE INVOLVEMENT

<u>Year</u>	<u>Case No.</u>	<u>Utility</u>	<u>Type of Testimony</u>	
1978	Case No. ER-78-29	Missouri Public Service Company (electric)	Direct Rebuttal	Contested
1979	Case No. ER-79-60	Missouri Public Service Company (electric)	Direct Rebuttal	Contested
1979		Elimination of Fuel Adjustment Clause Audits (all electric utilities)		
1980	Case No. ER-80-118	Missouri Public Service Company (electric)	Direct Rebuttal	Contested
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 & Power Company (industrial steam)	Direct	Stipulated
1980	Case No. TR-80-235	United Telephone Company of Missouri (telephone)	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 Rebuttal	Stipulated
1982	Case No. ER-82-66	Kansas City Power & Light Company	Rebuttal	Contested
1982	Case No. TR-82-199	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal	Contested
1982	Case No. ER-82-39	Missouri Public Service	Direct Rebuttal Surrebuttal	Contested

<u>Year</u>	<u>Case No.</u>	<u>Utility</u>	<u>Type of Testimony</u>	
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
1991	Case No. EM-91-213	Kansas Power & Light - Gas Service Division (natural gas)	Rebuttal	Contested
1993	Case Nos. ER-93-37	UtiliCorp United Inc. Missouri Public Service Division (electric)	Direct Rebuttal Surrebuttal	Stipulated
1993	Case No. ER-93-41	St. Joseph Light & Power Co.	Direct Rebuttal	Contested
1993	Case Nos. TC-93-224 and TO-93-192	Southwestern Bell Telephone Company (telephone)	Direct Rebuttal Surrebuttal	Contested
1993	Case No. TR-93-181	United Telephone Company of Missouri	Direct Surrebuttal	Contested
1993	Case No. GM-94-40	Western Resources, Inc. and Southern Union Company	Rebuttal	Stipulated
1994	Case Nos. ER-94-163 and HR-94-177	St. Joseph Light & Power Co.	Direct	Stipulated
1995	Case No. GR-95-160	United Cities Gas Co.	Direct	Contested
1995	Case No. ER-95-279	Empire Electric Co.	Direct	Stipulated
1996	Case No. GR-96-193	Laclede Gas Co.	Direct	Stipulated
1996	Case No. WR-96-263	St. Louis County Water	Direct Surrebuttal	Contested
1996	Case No. GR-96-285	Missouri Gas Energy	Direct Surrebuttal	Contested
1997	Case No. ER-97-394	UtiliCorp United Inc. Missouri Public Service (electric)	Direct Rebuttal Surrebuttal	Contested
1998	Case No. GR-98-374	Laclede Gas Company	Direct	Settled

<u>Year</u>	<u>Case No.</u>	<u>Utility</u>	<u>Type of Testimony</u>	
1999	Case No. ER-99-247 Case No. EC-98-573	St. Joseph Light & Power Co.	Direct Rebuttal Serrebuttal	Settled
2000	Case No. EM-2000-292	UtiliCorp United Inc. and St. Joseph Light & Power Merger	Rebuttal	Case Pending

Utilicorp / Empire Electric Company
Summary of Synergy Benefits, net of Costs to Achieve

UCU / Empire Projected Merger Cost / Benefit Analysis

UCU / Empire Projected Merger Cost / Benefit Analysis		UCU/Empire Total All 10 Years 000's (A)	Staff Total All 10 Years 000's (B)	UCU/Empire Total Years 6 - 10 000's (C)	Staff Total Years 6 - 10 000's (D)
Operating Costs - Current Dollars					
1	Dispatch / Generation Savings	\$ 197,885	\$ 5,496	\$ 108,238	\$ 5,261
2	General & Administrative / Customer Accounts Savings	\$ 74,766	\$ 88,084	\$ 39,688	\$ 49,388
3	Distribution Savings	\$ 52,319	\$ 61,915	\$ 28,915	\$ 35,983
4	Transmission Savings	\$ 8,572	\$ 10,166	\$ 4,837	\$ 6,018
5	Staff Adjustment - 1999 Budgeted Positions	\$ -	\$ (12,869)	\$ -	\$ (7,215)
6	Conversion to Utilicorp Benefits	\$ 50,030	\$ 41,709	\$ 28,450	\$ 23,811
7	Total O & M Savings	\$ 383,572	\$ 194,502	\$ 210,128	\$ 113,246
Capital Savings (Costs)					
8	Depreciation - Interconnect / SCADA / T&D	\$ (408)	\$ (408)	\$ 978	\$ 978
9	Amortization of Transaction / Transition Costs	\$ (29,618)	\$ (9,498)	\$ (14,808)	\$ -
10	Return on Interconnect SCADA / T&D	\$ 5,487	\$ 5,487	\$ 8,277	\$ 8,277
11	Return on Transaction / Transition Costs	\$ -	\$ -	\$ -	\$ -
12	Total Capital Savings (Costs)	\$ (24,539)	\$ (4,419)	\$ (5,553)	\$ 9,255
13	Total Synergies, net of Costs to Achieve	\$ 359,033	\$ 190,083	\$ 204,575	\$ 122,501
Net Enterprise Support Functions Allocated to Empire					
14	Empire Direct Costs transferred to ESF Departments	\$ 47,859	\$ 47,859	\$ 25,405	\$ 25,405
15	Empire Direct Costs transferred to IBU Departments	\$ 27,838	\$ 27,837	\$ 14,777	\$ 14,777
16	ESF and IBU Departments Allocated Back to Empire	\$ (258,564)	\$ (304,619)	\$ (137,253)	\$ (170,796)
17	Net UCU Corporate Overhead Depts. Allocated to Empire	\$ (182,867)	\$ (228,923)	\$ (97,071)	\$ (130,614)
18	Total Synergies, net of Costs to Achieve and Allocated Costs	\$ 176,166	\$ (38,839)	\$ 107,504	\$ (8,113)
Premium Costs					
19	Return on Premium	\$ (274,034)	\$ -	\$ (127,088)	\$ -
20	Amortization of Premium	\$ (69,880)	\$ -	\$ (34,940)	\$ -
21	Reflect non-tax deductibility of Premium	\$ (46,586)	\$ -	\$ (23,293)	\$ -
22	Total Premium Cost	\$ (390,500)	\$ -	\$ (185,321)	\$ -
23	SJLP Share of Premium Costs - 50 %	\$ (195,250)	\$ -	\$ (92,661)	\$ -
24	Synergies, net of 50 % of Premium	\$ (19,084)	\$ (38,839)	\$ 14,844	\$ (8,113)
25	Average per Year	\$ (1,908)	\$ (3,884)	\$ 2,969	\$ (1,623)
26	Inflation Rate - UCU ESF / IBU Dept. Costs and Savings Estimates	5.0%			
27	Inflation Rate - Empire Costs Transferred to UCU	2.5%			

Utilicorp / Empire Electric Merger

Merger Case No. EM 2000-369

Additional Revenue collected from MPS Ratepayers under the Proposed Regulatory Plan

Line No.			Year	Annual Reduction UCU Allocated Costs to MPS
1	Projected Reduction in ESF Department Costs allocated to MPS - Empire Merger			\$ (2,509,000)
2	Projected Reduction in IBU Department Costs allocated to MPS - Empire Merger			\$ (1,853,000)
3	Total Projected Reduction in Corporate Overhead Costs allocated to MPS		1999	\$ (4,362,000)
4	Growth Rate assumption for UCU Corporate Overhead Costs	5.0%	2000	\$ (4,580,100)
5		Merger Approval	2001	\$ (4,809,105)
6			2002	\$ (5,049,560)
7		MPS - New Rates	2003	\$ (5,302,038)
8			2004	\$ (5,567,140)
9			2005	\$ (5,845,497)
10			2006	\$ (6,137,772)
11			2007	\$ (6,444,661)
12			2008	\$ (6,766,894)
13			2009	\$ (7,105,238)
14			2010	\$ (7,460,500)
15	Reduction in UCU Costs allocated to MPS - due to the Empire Merger			\$ (50,629,741)
16	Additional Revenue collected from MPS - due to "Ignoring" MPS cost reduction			\$ 50,629,741 =====
17	Avg. Annual Increase in MPS Rates			\$ 6,328,718 =====

Utilicorp / Empire Merger
Case No. EM 2000-369

Analysis of Early Retirement Impact on Employee and Retiree Benefit Costs

Description	2001	2002	2003	2004	2005	Total
	(A)	(B)	(C)	(D)	(E)	(F)
1 Reduction in Employee Benefit Costs - Headcount Reductions	\$ (482,637)	\$ (597,594)	\$ (718,048)	\$ (718,048)	\$ (718,048)	\$ (3,234,375)
2 Reduction in FAS 106 costs - Conversion of Empire to UCU Benefits	\$ (227,733)	\$ (1,850,108)	\$ (1,953,667)	\$ (2,073,214)	\$ (2,186,640)	\$ (8,291,362)
3 Total Savings - Benefits Conversion & Headcount Reduction	\$ (710,370)	\$ (2,447,702)	\$ (2,671,715)	\$ (2,791,262)	\$ (2,904,688)	\$ (11,525,737)
4 Increase in Accrued FAS 106 costs - Headcount Reduction	\$ 2,537,319	\$ 269,620	\$ (74,624)	\$ -	\$ -	\$ 2,732,315
5 Net Savings during Moratorium - Years 2001-2005	\$ 1,826,949	\$ (2,178,082)	\$ (2,746,339)	\$ (2,791,262)	\$ (2,904,688)	\$ (8,793,422)
	=====	=====	=====	=====	=====	=====

Source: Browning Schedules RBB-6 and RBB-8, EM 2000-369

UtiliCorp United, Inc.\ Empire Electric Company Merger

Analysis of General Plant & Depreciation - December 31, 1999

Line No.	Account Number	Missouri Plant-in-Service December 31, 1999	Depreciation Rate	Depreciation Expense	
1	389.000	\$ 615,532	0.00%	\$	-
2	390.000	\$ 7,749,603	4.68%	\$	240,238
3	391.000	\$ 6,127,851	4.67%	\$	428,950
4	392.000	\$ 5,114,761	9.00%	\$	317,115
5	393.000	\$ 296,526	4.57%	\$	14,826
6	394.000	\$ 1,837,109	3.67%	\$	80,833
7	395.000	\$ 743,645	3.00%	\$	25,284
8	396.000	\$ 7,966,612	6.71%	\$	310,698
9	397.000	\$ 8,137,002	4.76%	\$	398,713
10	398.000	\$ 156,009	3.88%	\$	5,616
11	Total	\$ 38,744,650	4.22%	\$	1,822,273
12	Empire - Investment in Gneral Plant at December 31, 1999				\$ 38,744,650
13	Less Accumlated Depreciation Reserve at December 31, 1999				\$(16,285,134)
14	Net Investment in General Plant - Empire				\$ 22,459,516
15	Carrying Cost based upon Rate of Return in Case No. ER 97 - 81				13.100%
16	Annual Revenue Requirement on Empire's Investment in General Plant				\$ 2,942,197
17	Add annual Depreciation Expense - Empire				\$ 1,822,273
18	Total Annual Cost - Depreciation and Rate of Return on General Plant				\$ 4,764,469
19	UCU Investment in General Plant allocated to Empire (Siemek Workpaper VJS 4-3)				\$ 27,900,000
20	Annual Depreciation Expense - Average Depr. Rate - DR 297, EM 2000-292				1.42%
21	Increase in Empire's annual Depreciation Expense on General Plant				\$ 396,180
22	Rate of Return on Empire's Share of UCU's General Plant (Siemek WP I -2 D)				\$ 3,488,000
23	Total Increase in Empire's Cost of Service - UCU's General Plant Allocation				\$ 3,884,180
24	Percent Increase in Empire's Cost of Service				81.5%

Source: DR 1, EM 2000-369
DR 513, EM 2000-369

Utilicorp / Empire Electric Company
Merger Case No. EM 2000-369

Analysis of Customer and Administrative & General Expenses - Empire Electric

Line No.	Description	Empire 1994	Empire 1995	Empire 1996	Empire 1997	Empire 1998	Empire 1999
1	Customer Accounts Expense	\$ 3,711,807	\$ 3,915,023	\$ 4,270,740	\$ 4,364,206	\$ 4,984,506	\$ 4,161,501
2	Customer Assistance & Information	\$ 831,716	\$ 855,179	\$ 776,689	\$ 728,135	\$ 654,212	\$ 739,734
3	Sales Expense	\$ 702,753	\$ 632,258	\$ 673,062	\$ 701,258	\$ 710,585	\$ 615,722
4	Administrative & General Expense	\$ 10,610,072 (1)	\$ 12,528,819	\$ 9,756,894	\$ 9,548,227	\$ 9,969,497 (2)	\$ 10,544,649
5	Total Electric Expense - FERC 900 Accounts	\$ 15,856,348	\$ 17,931,279	\$ 15,477,385	\$ 15,341,826	\$ 16,318,800	\$ 16,061,606
6	Retail Electric Customers	111,616	115,993	119,100	121,653	123,918	126,496
7	Average Cost per Electric Customer - Missouri	\$ 142	\$ 155	\$ 130	\$ 126	\$ 132	\$ 127
8	Average Annual Cost per Customer - 1994 - 1999						\$ 135

9 Source: DR 507 and 512 EM 2000-369

10 (1) Excludes \$3.7 million for Voluntary Early Retirement Program - DR 163

11 (2) 1999 reduced by \$ 4.7 million to eliminate merger costs - (DR 512, EM 2000-369)

Utilicorp / Empire Electric Company
Merger Case No. EM 2000-369

Analysis of Customer and Administrative & General Expenses - Missouri Public Service (MPS)

Line No.	Description	MPS 1994	MPS 1995	MPS 1996	MPS 1997	MPS 1998	MPS 1999
1	Customer Accounts Expense	\$ 4,842,570	\$ 4,491,960	\$ 5,575,264	\$ 6,538,346	\$ 5,996,988	\$ 5,202,667
2	Customer Assistance & Information	\$ 882,226	\$ 553,207	\$ 200,073	\$ 214,789	\$ 206,480	\$ 279,671
3	Sales Expense	\$ 1,161,708	\$ 7,215,960	\$ 1,259,448	\$ 1,089,909	\$ 982,933	\$ 785,570
4	Administrative & General Expense	\$ 24,807,282	\$ 28,085,547	\$ 34,962,936 (1)	\$ 33,960,655 (2)	\$ 29,979,356 (3)	\$ 30,582,707
5	Total Electric Expense - FERC 900 Accounts	\$ 31,693,786	\$ 40,346,674	\$ 41,997,721	\$ 41,803,699	\$ 37,165,757	\$ 36,850,615
6	Retail Electric Customers	179,970	184,144	188,614	192,931	197,418	202,124
7	Average Cost per Electric Customer - Missouri	\$ 176 =====	\$ 219 =====	\$ 223 =====	\$ 217 =====	\$ 188 =====	\$ 182 =====
8	Average Annual Cost per Customer - 1994 - 1999						\$ 201
9	(1) Reduced 1997 Rents Expense by \$2.7 million to eliminate non-recurring accounting change. (DR 291)						
10	(2) Increased 1998 926 expense \$4.4 million to eliminate Deferred Credit write off related to prior years. (DR 277)						
11	(3) Increased 1999 925 expense \$1.6 million to eliminate prior year reserve adjustment (DR 298).						

Utilicorp / Empire Electric Merger
Case No. EM 2000-369

Analysis of UCU Corporate Overhead Costs - allocated to MPS

Line No.	UCU Corporate Overhead Costs - allocated to MPS	1995	1996	1997	1998	1999
1	ESF Department Costs allocated to MPS	\$ 9,304,100	\$ 25,407,000	\$ 31,560,797	\$ 30,501,487	\$ 34,368,908
2	IBU Department Costs allocated to MPS	\$ 1,010,882	\$ 1,428,779	\$ 9,696,027	\$ 14,403,754	\$ 12,105,621
3	Total Costs UCU Overhead Costs allocated to MPS	<u>\$ 10,314,982</u> =====	<u>\$ 26,835,779</u> =====	<u>\$ 41,256,824</u> =====	<u>\$ 44,905,241</u> =====	<u>\$ 46,474,529</u> =====
4	Percent Increase per Year		160.2%	53.7%	8.8%	3.5%
5	Average Increase - 1996 - 1999			4 yr. Average	1996 - 1999	87.6%
6	Average Increase - 1997 - 1999			3 yr. Average	1997 - 1999	24.4%
7	Average Increase - 1998 - 1999			2 yr. Average	1998 - 1999	6.3%

Source: Data Request 594, EM 2000-292

Consumer Price Indexes



The Consumer Price Index--Why the Published Averages Don't Always Match An Individual's Inflation Experience

The Consumer Price Index (CPI) is a measure of the **average** change in prices paid by urban consumers for a fixed market basket of goods and services. Because the CPI is a statistical average, it may not reflect your experience or that of specific families or individuals, particularly those whose expenditure patterns differ substantially from the "average" urban consumer.

Because it is not practical to obtain a census of prices for all consumer transactions in the United States, the CPI uses a carefully designed set of samples to estimate prices. These samples are the product of accepted statistical procedures to make the CPI representative of the prices paid for all goods and services purchased by urban consumers. Some of these samples include:

- Urban areas selected from all U.S. urban areas,
- Selected households within each selected urban area,
- Retail establishments from which these consumers purchased goods and services,
- Specified and unique items--goods and services purchased by these consumers, and
- Housing units selected from each urban area for the shelter component of the CPI.

Therefore, the CPI is an average of many diverse households and not a reflection of any particular one.

While several factors can result in the national CPI being different from *your* price experience, one major factor is how *you* actually spend your money. Estimates of expenditures reported in the Consumer Expenditure Survey for each consumer good or service are used to produce "expenditure weights" for the CPI. These weights give each good or service in the CPI an importance relative to all the other goods and services in the market basket. For example, an increase of 5 percent in housing costs is more important than the same increase for telephone charges, because most consumers spend more for housing than for telephone service. Similarly, if you spend more than the average person on medical care and recreation, and prices rise sharply for these goods and services, the increase in your personal expenditures and personal price index would be larger than the increase for the average consumer. Because the CPI is a comprehensive measure, it contains items that are included in some individuals' buying patterns and excluded from others. For example, if you are a homeowner, you are more likely to buy major appliances such as refrigerators and laundry equipment than would a renter.

The CPI divides the consumer market basket into eight major groups of goods and services. You can estimate the approximate difference in *your* expenditure pattern by estimating your relative expenditures for major groups of consumer goods and services. You could then compare them to the CPI groups' relative importance data, which are approximately the weights used in CPI estimation. For example, the approximate weights for the eight major groups in the CPI for All Urban Consumers (CPI-U) are listed below under the CPI-U average column. If your expenditure pattern is sharply different from the CPI average, the same price changes for the same expenditure categories would result in different price change measures for the total market basket. An example of a hypothetical expenditure pattern for a consumer with high expenditures for medical care appears in the tabulation that follows.

Expenditure category	Relative Importance	
	CPI-U average (Dec. 1999)	Hypothetical individual
Total (all items)	100.0	100.0
Food and beverages	16.3	20.5

Housing	39.6	25.0
Apparel	4.7	4.5
Transportation	17.5	13.5
Medical care	5.8	25.0
Recreation	6.0	4.0
Education and communication	5.4	3.0
Other goods and services	4.7	4.5
Total, all items	100.0	100.0

Let's assume that there is a price increase of 5 percent for food and beverages and 10 percent for medical care costs, with no price changes for the other expenditure categories. This would result in a price index increase in the national CPI of 1.5 percent. However, it would result in an increase of 3.5 percent for the hypothetical individual's price index. The calculations for the national CPI and the hypothetical individual are shown in the following two tabulations.

National CPI-U average

Expenditure category	Relative Importance, CPI-U average (Dec.1991)		Relative price change		New relative expenditure
Food and beverages	16.3	x	1.05	=	17.1
Housing	39.6	x	1.00	=	39.6
Apparel	6.3	x	1.00	=	4.7
Transportation	17.5	x	1.00	=	17.5
Medical care	5.8	x	1.10	=	6.4
Recreation	6.0	x	1.00	=	6.0
Education and communication	5.4	x	1.00	=	5.4
Other goods and services	5.8	x	1.00	=	5.8
Total, all items	100.0				102.5
102.5/100.0 = 2.5 percent increase					

Hypothetical individual

Expenditure category	Relative Importance, hypothetical individual		Relative price change		New relative expenditure
Food and beverages	20.5	x	1.05	=	21.5
Housing	25.0	x	1.00	=	25.0
Apparel	4.5	x	1.00	=	4.5
Transportation	13.5	x	1.00	=	13.5
Medical care	25.0	x	1.10	=	27.5
Recreation	4.0	x	1.00	=	4.0
Education and communication	3.0	x	1.00	=	3.0
Other goods and services	4.5	x	1.00	=	4.5
Total, all items	100.0				103.5
103.5/100.0 = 3.5 percent increase					

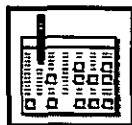
The area in which you live also can affect your price experiences. You should not expect the national or a regional CPI to always mirror your price experiences. It is possible, for example, that sharp price increases in one area are offset by lower prices in other areas, resulting in a more moderate price change published for the Nation or a region. Because the typical consumer does not have enough time to seek out the lowest price for each good or service purchased, he or she may pay more for a good or service than would another consumer in a retail outlet in a different part of the metropolitan area, region or country.

Another factor in whether you think the CPI reflects your price experience is that most consumers notice price changes in those goods and services purchased frequently. These items, such as food, clothing, and gasoline, have relatively large price swings because of the seasonal influences in supply and demand. Less attention is paid to many items (such as most household appliances) that are purchased infrequently, which often have relatively stable prices.

The CPI is used extensively to adjust incomes, lease payments, retirement benefits, food stamp and school lunch benefits, alimony, and tax brackets. The CPI, because of the many ways in which it is used, affects nearly all Americans. Because the CPI is based on the buying habits of the "average" consumer, it may not be a perfect reflection of your individual price experience. However, the CPI is the most economically feasible method for providing a statistic that is the most useful in all its applications.

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For further information, access the CPI internet site.



CPI Home Page



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**Utilicorp / Empire Merger
Case No. EM 2000-369**

Analysis of UCU and Empire Pension Plans - Funded Status

Line No.		Empire Total	Funded Status %
1	Market Value of Assets - Jan. 1, 1999	\$ 94,990,193	155%
2	Accumulated Benefit Obligation	\$ 61,161,774	
3	Excess of Assets over ABO	\$ 33,828,419 =====	
		Utilicorp	
4	Market Value of Assets - Jan. 1, 1999	\$220,468,431	140%
5	Accumulated Benefit Obligation	\$157,764,000	
6	Excess of Assets over ABO	\$ 62,704,431 =====	
		Utilicorp/Empire Combined	
7	Market Value of Assets - Jan. 1, 1999	\$ 315,458,624	144%
8	Accumulated Benefit Obligation	\$ 218,925,774	
9	Excess of Assets over ABO	\$ 96,532,850 =====	

**Source: DR 139 - EM 00-369
DR 165 - EM 00-292**

Utilicorp / Empire Merger Case EM 00-369

Increase in Annual Pension Cost to Empire Customers Resulting from Dillutive effect of Combining Pension Fund Assets

Line No.			
1	Empire	Pension Asset Balance - January 1, 1999	\$94,990,193
2		Expected Rate of Return Assumption	9.00%
3		Reduction to Pension Cost - Empire Stand Alone	<u>\$8,549,117</u> =====
4	Empire	Pension Asset Balance - January 1, 1999	\$94,990,193
5		Dillutive Impact of Combining Pension Fund Assets with UCU	<u>(\$6,859,825)</u>
6		Empire Assets adjusted to reflect UCU, Empire Combined - Funded Status of 144%	<u>\$88,130,368</u>
7		Expected Rate of Return Assumption	9.00%
8		Reduction to Pension Cost - Empire/UCU combined	<u>\$7,931,733</u> =====
9		Increase in Annual Pension Cost to Empire Customers	<u>\$617,384</u> =====

Source: DR 139 EM 2000-369

