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EM-2000-369

REBUTTAL TESTIMONY

OF

RYAN KIND

Submitted on Behalf of
the Office of the Public Counsel

UTILICORP UNITED INC.
AND
THE EMPIRE DISTRICT ELECTRIC COMPANY MERGER

Case No. EM-2000-369

Exhibit No. 201
Date 9-15-00 Case No. EM-2000-369
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June 21, 2000

NP

**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 UtiliCorp United)
Inc., and, in Connection Therewith, Certain)
Other Related Transactions.)

Case No. EM-2000-369

AFFIDAVIT OF RYAN KIND

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

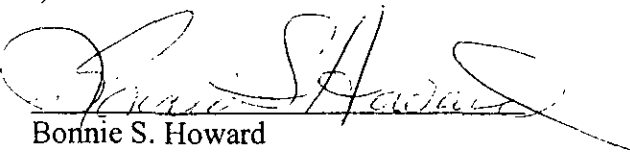
Ryan Kind, of lawful age and being first duly sworn, deposes and states:

1. My name is Ryan Kind. I am Chief Utility Economist for the Office of the Public Counsel.
2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 81 and attachments.
3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.



Ryan Kind

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



Bonnie S. Howard
Notary Public

My commission expires May 3, 2001.

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REBUTTAL TESTIMONY
OF
RYAN KIND

UTILICORP UNITED, INC. AND

EMPIRE DISTRICT ELECTRIC COMPANY

CASE NO. EM-2000-369

1 **Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.**

2 A. Ryan Kind, Chief Energy Economist, Office of the Public Counsel, P.O. Box 7800,
3 Jefferson City, Missouri 65102.

4 **Q. PLEASE SUMMARIZE YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND.**

5 A. I have a B.S.B.A. in Economics and a MA in Economics from the University of
6 Missouri-Columbia (UMC). While I was a graduate student at UMC, I was employed as
7 a Teaching Assistant with the Department of Economics, and taught classes in
8 Introductory Economics, and Money and Banking, in which I served as a Lab Instructor
9 for Discussion Sections.

10 My previous work experience includes three and one-half years of employment with the
11 Missouri Division of Transportation as a Financial Analyst. My responsibilities at the
12 Division of Transportation included preparing transportation rate proposals and testimony
13 for rate cases involving various segments of the trucking industry. I have been employed
14 as an economist at the Office of the Public Counsel (Public Counsel or OPC) since April
15 1991.

1 **Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE THIS COMMISSION?**

2 A. Yes, prior to this case I submitted written testimony in numerous gas rate cases, several
3 electric rate design cases and rate cases, as well as other miscellaneous gas, water,
4 electric, and telephone cases.

5 **Q. HAVE YOU PROVIDED COMMENTS OR TESTIMONY TO OTHER REGULATORY OR LEGISLATIVE**
6 **BODIES ON THE SUBJECT OF ELECTRIC UTILITY RESTRUCTURING?**

7 A. Yes, I have provided comments and testimony to both the Federal Energy Regulatory
8 Commission (FERC), the Missouri House of Representatives Utility Regulation
9 Committee and the Missouri Legislature's Joint Interim Committee on
10 Telecommunications and Energy.

11 **Q. HAVE YOU BEEN A MEMBER OF, OR PARTICIPANT IN, ANY WORK GROUPS, COMMITTEES, OR**
12 **OTHER GROUPS THAT HAVE ADRESSED ELECTRIC UTILITY RESTRUCTURING ISSUES?**

13 A. Yes. I was a member of the Missouri Public Service Commissions (the Commission's)
14 Stranded Cost Working Group and participated extensively in the Commission's Market
15 Structure Work Group. I am currently a member of the Missouri Department of Natural
16 Resources Weatherization Policy Advisory Committee, the National Association of State
17 Consumer Advocates (NASUCA) Electricity Committee, and serve as the public
18 consumer group representative to the Midwest ISO's Advisory Committee. Several years
19 ago, I served as a Staff Liaison to the Energy and Transportation Task Force of the
20 President's Council on Sustainable Development.

21 **I. SUMMARY**

22 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

Rebuttal Testimony of
Ryan Kind

1 A. My testimony will summarize Public Counsel's recommendations regarding the merger
2 application for UtiliCorp United, Inc. (UtiliCorp or UCU) and Empire District Electric
3 Company (Empire or EDE) that is the subject of this docket. The testimony of OPC
4 witness Russell Trippensee contains OPC's overall recommendation regarding the
5 merger application. My testimony contains recommendations in the area of market
6 power, the regulatory plan, and affiliate transactions. This testimony also provides
7 analytical and factual support for Public Counsel's recommendations in each of these
8 areas.

9 Q. WHAT IS THE STANDARD THAT THE COMMISSION APPLIES IN DETERMINING WHETHER OR NOT
10 MERGER APPLICATIONS SHOULD BE APPROVED?

11 A. The Commission will approve merger applications so long as the merger is not expected
12 to be detrimental to the public interest.

13 Q. HOW DOES PUBLIC COUNSEL BELIEVE THIS STANDARD SHOULD BE APPLIED?

14 A. The Commission will need to perform a comprehensive assessment of the impacts that
15 the merger is expected to have on the public interest. The net effect of all of these
16 impacts will have to be determined in order for the Commission to decide whether the
17 merger as proposed (or as modified by recommendations made by other parties or the
18 Commission itself) is detrimental to the public interest.

19 The Joint Applicants have the burden of proof for demonstrating that their merger
20 proposal is not detrimental to the public interest. The Commission should analyze the
21 merger as proposed in the Application and testimony of the Joint Applicants. Public
22 Counsel does not believe that it or any other party have a responsibility to "help" the
23 Joint Applicants by suggesting ways that the merger proposal, as presented in the

1 testimony and Application of the Joint Applicants, can be modified so that it will pass the
2 "not detrimental to the public interest" standard.

3 **Q. IN APPLYING THE "NOT DETRIMENTAL TO THE PUBLIC INTEREST" STANDARD, SHOULD THE**
4 **COMMISSION TAKE INTO ACCOUNT THE EFFECT THAT THE PROPOSED MERGER WOULD HAVE**
5 **ON THE PUBLIC INTEREST IF THE ELECTRIC INDUSTRY IS RESTRUCTURED TO ALLOW DIRECT**
6 **ACCESS?**

7 A. Yes, most definitely. There is a general consensus that electric restructuring has a good
8 chance of coming to Missouri in the not too distant future. Empire and UCU (the Joint
9 Applicants) are in agreement with this consensus. Empire's 1999 Annual Report states
10 on page 10 that "we anticipate Missouri and Kansas to move more slowly, probably
11 beginning restructuring within the 2002 - 2005 time frame." Public Counsel believes
12 that achieving some public benefit from electric restructuring is only possible if the
13 conditions are right for the development of effective competition. Mergers, such as the
14 Empire/UCU merger, which are motivated by the merger applicant's desire to better
15 position their companies for anticipated competition must be examined critically to
16 determine if the improved competitive position of the merged companies is consistent
17 with the need to create conditions in a restructured electric industry that are likely to lead
18 to effective competition.

19 **Q. PLEASE SUMMARIZE THE MARKET POWER RECOMMENDATIONS THAT PUBLIC COUNSEL IS**
20 **MAKING TO THE COMMISSION REGARDING THIS APPLICATION.**

21 A. Public Counsel believes that the market power impacts of this merger will be detrimental
22 to the public interest unless the Commission's merger approval is conditioned upon the
23 willingness of the Joint Applicants to accept the same market power conditions agreed to

1 by KCPL and Western Resources in Case No. EM-97-515. This conclusion is based on
2 the following reasons:

- 3 • The proposed merger would significantly enhance the market power of UtiliCorp
4 relative to the amount of market power that it has absent the merger. The
5 increased market power associated with UCU's acquisition of additional
6 generation and transmission assets could be addressed by divesting a significant
7 portion of the merged entity's generation assets and divesting or transferring
8 control of the merged entity's transmission assets. In addition, customers will be
9 harmed by the increased retail market power that would result from the increased
10 retail market power in the sale of energy, energy-related services, and information
11 services that would result from the proposed merger.
- 12 • The Joint applicants have failed to propose any significant market power remedies
13 that would ensure that the potential benefits of retail competition are not
14 suppressed by the additional amount of market power that will result from this
15 merger and/or UtiliCorp's proposed merger with St. Joseph Light & Power
16 Company (SJLP).

17 **Q. IF THE COMMISSION DECIDES TO APPROVE THE PROPOSED MERGER, DESPITE PUBLIC**
18 **COUNSEL'S RECOMMENDATIONS TO THE CONTRARY (SEE REBUTTAL TESTIMONY OF OPC**
19 **WITNESS TRIPPENSEE), WHAT CONDITIONS SHOULD THE COMMISSION REQUIRE THE JOINT**
20 **APPLICANTS TO ACCEPT IN ORDER TO PROCEED WITH THE MERGER?**

21 **A.** The Joint Applicants should only be allowed to proceed with the proposed merger if they
22 are willing to accept the following conditions:

- 23 1) The Joint Applicants must agree to: (1) withdraw their request that the
24 Commission approve their proposed Regulatory Plan, (2) accept the same

1 traditional ratemaking to which UtiliCorp is currently subject, and (3) facilitate
2 the traditional ratemaking process by filing a complete rate case for all of
3 UtiliCorp's Missouri jurisdictional electric operations one year after the final
4 determination of the merger proposed in this case and the merger proposed
5 between UtiliCorp and SJLP, whichever is later. The details of this condition are
6 specified in the Rebuttal testimony of Mr. Trippensee.

7 2) If the Commission approves UtiliCorp's proposed regulatory plan, despite OPC's
8 recommendation to the contrary, then the Commission should condition its
9 approval of the merger on UtiliCorp's willingness to agree that it will commit to
10 offer generation services to its customers at cost based (rather than market based)
11 rates for the next 30 years.

12 3) Joint Applicants must agree that if electric restructuring occurs such that the price
13 of retail electric generation service in Missouri is deregulated (possibly following
14 a brief transition period where some amount of rate regulation continues), then
15 they will be subject to the same market power provisions that were contained in
16 the Stipulation and Agreement that was approved by the Commission in Case No.
17 EM-97-515. Attachment 1 of this testimony contains a modified version of the
18 portion of the Stipulation and Agreement from Case No. EM-97-515 that pertains
19 to market power issues. I have modified the original version of the Stipulation
20 and Agreement that was approved by the Commission in Case No. EM-97-515 so
21 that it references UtiliCorp and Empire in the appropriate places instead of
22 referencing Western Resources and KCPL.

23 4) UtiliCorp must be willing to join a Regional Transmission Operator (RTO) under
24 conditions that are set forth in the Vertical Market Power section of Attachment 1.

1 5) The Joint Applicants must agree to provide both Public Counsel and the Staff with
2 access to the books, records, employees and officers of all entities that are
3 affiliated with UCU or its wholly owned subsidiaries upon reasonable notice. This
4 access should include all corporate entities for which UCU or its wholly owned
5 subsidiaries have an ownership interest of 10 percent or more.

6 6) Because of the important role that Affiliate Rules and Codes of Conduct have in:
7 (1) mitigating some of the detriment associated with market power in the retail
8 merchant function and (2) reducing possible cross-subsidies between regulated
9 and non-regulated operations, the Commission should commit to close scrutiny of
10 UtiliCorp's compliance with the terms of its Affiliate Transaction Rules.

11 7) UtiliCorp must agree that it will never propose to charge its Empire division
12 customers for access to the Empire fiber optic system that Empire claims is part of
13 its non-regulated operations, because Empire's non-regulated operations have
14 never provided any compensation whatsoever to the regulated operations of
15 Empire for the use of its right of ways, poles, ducts, and underground conduit.

16 **Q. DOES PUBLIC COUNSEL HAVE ANY OTHER GENERAL RECOMMENDATIONS REGARDING THIS**
17 **MERGER APPLICATION?**

18 A. Yes. Public Counsel has become aware of significant changes that will occur in the
19 retirement and health benefits of Empire employees and retirees if the proposed merger is
20 approved by the Commission. The majority of the cost of health care premiums are
21 currently paid by Empire for its employees and retirees that have been with the Company
22 for a long time. The UtiliCorp/Empire merger Agreement calls for these costs to be
23 borne entirely by employees and retirees in the future. Some of Empire's employees that
24 have already retired or will soon retire could find themselves each paying thousands of

1 dollars more per year to maintain their health care coverage as a result of this change. In
2 addition, additional taxpayer funds (that wouldn't have been spent if the Empire health
3 care plan for retirees remained in effect) may be used to fund health care expenses for
4 those retirees once they reach age 65. Public Counsel believes that the Commission
5 should take these impacts upon Empire's current and former employees and upon
6 taxpayer funds into consideration when it makes its determination regarding whether the
7 proposed merger is detrimental to the public interest. Additional information on this
8 topic is provided later in this testimony.

9 **Q. PLEASE OUTLINE THE MAJOR TOPICS THAT ARE COVERED IN YOUR TESTIMONY.**

10 A. My testimony focuses primarily on three major areas associated with the proposed
11 merger. First, this testimony examines the major factors that have motivated the joint
12 applicants to merge. These factors include:

- 13 • The desire of Empire's senior management and Board of Directors to be acquired
14 by a larger utility so that: (1) it would be part of an entity that would be better
15 positioned to compete in deregulated electric markets and (2) it could further its
16 fiduciary responsibility to take advantage of an opportunity to enhance the value
17 of investments in Empire by its shareholders.
- 18 • The desire of UtiliCorp's senior management and Board of Directors to enhance
19 the value of its shareholder's investment by furthering its strategic objectives of:
20 (1) expanding its mid-continent footprint, (2) acquiring low cost generation assets
21 and purchase power contracts that can either be spun off and sold for a profit
22 (monetized) or used to support Aquila's power marketing activities in the future,
23 and (3) acquiring assets that can be used or leveraged to support
24 telecommunications ventures.

1 Second, this testimony addresses the reasonableness of the alternative regulatory plan
2 proposed by the joint applicants. Within this area, my testimony discusses and provides
3 support for the following points:

- 4 • The fairly high acquisition premium being paid for the assets of Empire is
5 primarily due to the future non-regulated earnings potential of Empire's
6 generation assets due to its negative stranded costs.
- 7 • A large portion of the synergies are in the area of generation and almost any
8 conceivable restructuring legislation in Missouri will transfer the benefits from all
9 of these synergies to UtiliCorp. Because of this, there is definitely no need for a
10 regulatory plan that is designed to tie the hands of this Commission by having it
11 commit today that it will allow UtiliCorp to earn a "return on" and a "return of" a
12 major portion of the acquisition premium associated with this merger deal.
- 13 • When generation becomes deregulated at the retail level, UtiliCorp could achieve
14 synergies that accrue solely to the benefit of shareholders by selling the output
15 from Empire's supply portfolio at market prices that exceed its cost of production
16 and keeping 100% of this profit margin for its shareholders. Alternatively,
17 UtiliCorp could sell these assets for a price that vastly exceeds their book value
18 and keep 100% of the gains for its shareholders. In its testimony, UtiliCorp is
19 silent about the prospect for future non-regulated earnings in this area and this
20 silence greatly understates the non-regulated earnings potential that UtiliCorp's
21 shareholders will have as a result of the mergers with SJLP and Empire.
- 22 • UtiliCorp also expects substantial non-regulated synergies from planned future
23 telephony and cable projects which will benefit from synergies between the
24 telephony assets and utility right of ways of Empire and UtiliCorp. While
25 UtiliCorp consistently touts these expected synergies in its presentations to the

1 investment community, its testimony is notably silent about the prospect for future
2 non-regulated earnings in this area. This silence is apparently intended to
3 encourage the Commission to ignore the enormous non-regulated earnings
4 potential that UtiliCorp's shareholders will have as a result of the mergers with
5 SJLP and Empire when the Commission considers the reasonableness of the Joint
6 Applicants' proposed regulatory plan.

- 7 • UtiliCorp expects other significant benefits in the area of its non-regulated
8 operations due to the following Empire attributes: (1) Empire's healthy balance
9 sheets and strong cash flows, (2) valuable brand equity and customer base, and (3)
10 a service territory which is in close proximity to UtiliCorp's other Missouri
11 service territories (providing transmission and off-system sales synergies). These
12 benefits should also be considered when the Commission considers the
13 reasonableness of the Joint Applicants' proposed regulatory plan.

14
15 Market Power issues are the third major area covered by my testimony. Within this area,
16 I address both horizontal and vertical market power issues. My testimony will discuss (1)
17 market power in generation markets (2) market power issues related to retail marketing
18 of energy and other value added services that are likely to be bundled with energy and (3)
19 vertical market power issues related to the joint ownership of transmission and generation
20 assets.

II. FACTORS DRIVING THE PROPOSED MERGER

A. INDUSTRY TRENDS

Q. IS THE PROPOSED MERGER PART OF A TREND THAT HAS BEEN TAKING PLACE IN THE ENERGY UTILITY INDUSTRY OVER THE LAST FEW YEARS?

A. Yes. The American utility industry has seen dozens of mergers proposed in the last few years. The energy sector of the utility industry has been a major part of this trend. Most mergers in the energy sector have been between neighboring electric utilities but some have been between energy and gas utilities and others have been between utilities and gas or electric marketers.

Q. WHAT ARE THE MAJOR REASONS FOR THIS RECENT TREND?

A. Utilities are changing the way they do business so they will be ready to take advantage of the major changes that are occurring in the energy utility industry. Increases in the amount of wholesale and retail competition in the utility industry have led utilities to take bold steps like mergers in order to position themselves for this new environment. In the new competitive environment, the financial success of utilities will be much more dependant upon how well they perform in competitive markets and much less dependant upon the traditional regulatory process.

Q. DOES THE ENHANCED COMPETITIVE POSITION OF UTILITIES THAT CAN RESULT FROM MERGERS COINCIDE WITH THE INTERESTS OF CONSUMERS?

1 A. Not necessarily. Consumers will benefit from competitive markets to the extent that
2 these markets cause utilities to decrease their costs and pass these cost decreases on to
3 consumers. If the profits of utilities are no longer regulated, then a strong incentive will
4 exist for utilities to lower their costs by becoming more efficient. However, since prices
5 will no longer be regulated in competitive markets, consumer benefits from these markets
6 will be dependant on the development of effective and sustained competition that forces
7 utilities to pass lower costs onto consumers.

8 Mergers can interfere with the development of the kind of effective and sustained
9 competition that is necessary to ensure that consumers benefit from competitive markets.
10 Mergers that result in an excessive concentration of generation assets, increased vertical
11 market power, the elimination of potential effective competitors, or super-regional
12 utilities with significant amounts of retail market power can be harmful to consumers.

13 **B. MOTIVATING FACTORS FOR EMPIRE AND UTILICORP**

14 **Q. WHAT DOES PUBLIC COUNSEL BELEVE ARE THE PRINCIPAL FACTORS THAT ARE DRIVING THIS**
15 **PROPOSED MERGER?**

16 A. This merger appears to be driven by the following factors:

- 17 • Empire's desire to be acquired by a larger utility so that its shareholders can
18 receive the acquisition premium windfall that the acquiring utility is expected to
19 pay for the privilege of taking control of the formerly independent utility's
20 operations and assets. The Empire management appears to have recognized that
21 the UtiliCorp merger proposal offered a good opportunity for it to try and capture
22 for its shareholders the stranded benefits (negative stranded costs) associated with
23 its energy supply generation portfolio in the form of an large merger premium.

Rebuttal Testimony of
Ryan Kind

- UtiliCorp's desire to further its mid-continent network strategy by increasing the size of its distribution service territory footprint, acquiring low cost generation assets, and acquiring telecommunications infrastructure and right of ways. The newly acquired generating assets can either be used to create a significant stream of earnings over time, since it can be used to generate power at a cost that is well below market prices, or the assets can be sold (monetized) over time to bring earnings to the UtiliCorp bottom line as needed to satisfy investor expectations.
- UtiliCorp's desire to further its merchant strategy by acquiring low cost generation assets that can be used to support Aquila's power marketing or sold to raise capital that can be used to acquire useful generating assets.
- UtiliCorp's desire to prevent its neighboring utilities (Kansas City Power & Light, Western Resources, Inc. and others) from expanding their mid-continent footprint in UtiliCorp's backyard by acquiring SJLP or Empire.
- UtiliCorp's desire to further its telecom services strategy by acquiring assets and right of ways that can be utilized or leveraged to support this strategy.
- UtiliCorp's desire to better position itself for retail and wholesale competition in the mid-continent region.

Q. HOW IS THIS PROPOSED MERGER LIKELY TO BETTER POSITION UTILICORP FOR COMPETITION?

A. The proposed merger will better position UtiliCorp for competition by:

- Reducing the prospect of cut-throat competition in regional energy markets by keeping low cost generation assets out of the hands of its local competitors.
- Lowering the cost structure of UtiliCorp and its affiliates.

- Increasing the number of customers to which UtiliCorp has access for selling electricity, natural gas, home security services, telephony, cable TV, internet, and other unregulated services.
- Increasing the amount of market power that UCU has in the retail merchant function and in retail and wholesale generation markets.

C. UTILICORP'S VALUE CYCLE PHILOSOPHY

Q. YOU MENTIONED UTILICORP'S NETWORK AND MERCHANT STRATEGIES. COULD YOU PLEASE EXPLAIN THOSE STRATEGIES AND HOW THEY RELATE TO THE PROPOSED MERGER?

A. Yes. First, however, I should explain the framework in which UtiliCorp executes its network and merchant strategies. UtiliCorp refers to this framework as its Value Cycle Philosophy. According to this philosophy, UtiliCorp seeks to: (1) make appropriate investments, (2) optimize those investments, and (3) monetize those investments. As Attachment 2 shows, this philosophy was illustrated in a slide that was part of UtiliCorp's presentation in its "1999 Year End Conference Call" with investment analysts. The purpose of this framework for executing its network and merchant strategies is the creation of value for the corporation and its shareholders.

Q. PLEASE EXPLAIN HOW UTILICORP'S VALUE CYCLE PHILOSOPHY IS BROADER THAN THE MORE WIDELY RECOGNIZED UTILITY STRATEGY OF MERGING TO ACQUIRE ADDITIONAL SIZE AND COST ECONOMIES IN ORDER TO PREPARE FOR COMPETITION.

A. UtiliCorp's Value Cycle Philosophy includes this more widely recognized strategy but also considers other options for enhancing shareholder value such as disaggregating the assets/functions (e.g. generation or telecommunication assets or the retail function) of a

1 newly-acquired vertically integrated utility and either spinning them off (monetizing) or
2 combining them with the assets of other UtiliCorp affiliates.

3 **Q. DOES UTILICORP'S TESTIMONY IN THIS CASE DESCRIBE ITS VALUE CYCLE PHILOSOPHY AND**
4 **ITS NETWORK AND MERCHANT STRATEGIES?**

5 A. UtiliCorp's testimony makes no mention of its Value Cycle Philosophy. The Company's
6 direct testimony only describes limited aspects of its network and merchant strategies.
7 Robert Green's testimony contains a brief description of UtiliCorp's network and
8 merchant strategies and Steve Pella's testimony discusses the cost reduction and
9 customer care aspects of the network strategies. For a detailed discussion of these
10 strategies and the Value Cycle Philosophy one must review the presentations that
11 UtiliCorp's senior executives have made recently to investment analysts.

12 **Q. WHY IS IT IMPORTANT TO LEARN MORE ABOUT UTILICORP'S VALUE CYCLE PHILOSOPHY AND**
13 **NETWORK AND MERCHANT STRATEGIES WHEN THE PROPOSED MERGER AND PROPOSED**
14 **REGULATORY PLAN ARE EVALUATED TO DETERMINE WHETHER THEY ARE DETRIMENTAL TO THE**
15 **PUBLIC INTEREST?**

16 A. Unless the merger is evaluated within the context of UtiliCorp's guiding philosophy and
17 strategies, it is impossible to determine the reasonableness of the proposed regulatory
18 plan. UtiliCorp's guiding philosophy and strategies and the way these strategies have
19 been implemented in the recent past by UtiliCorp shed some light on what the future will
20 likely hold if the proposed merger is approved. UtiliCorp's contention that extraordinary
21 ratemaking treatment (i.e. its proposed regulatory plan for having ratepayers fund a
22 significant portion of its acquisition premium) is necessary to make the merger attractive
23 to shareholders becomes totally unreasonable in light of the unregulated synergies that
24 UtiliCorp expects to achieve from the proposed merger.

1 UtiliCorp has stated in its presentations to utility analysts that it may consider selling
2 some of the SJLP and Empire generating assets. It recently sold a power plant that was
3 part of its West Virginia utility operations. UtiliCorp has broken apart some of the
4 businesses that were a part of its Australian electric utility operations. UtiliCorp has
5 taken advantage of the telecommunications assets that it acquired as part of its Australian
6 electric utility operations and is turning them into a huge profit center. These types of
7 merger synergies and potential windfalls from the sale of low cost generation assets must
8 be taken into account when evaluating UtiliCorp's proposed regulatory plan. If they are
9 not, a regulatory plan could be approved which: (1) commits ratepayers to long term
10 funding of utility assets that are no longer used in the provision of regulated utility
11 service or (2) causes ratepayers to pay a significant portion of an acquisition premium for
12 assets that have tremendous potential to produce non-regulated earnings for UtiliCorp's
13 shareholders.

14 **Q. YOU STATED THAT UTILICORP'S TESTIMONY IN THIS CASE CONTAINS ONLY A BRIEF**
15 **DESCRIPTION OF ITS MERCHANT AND NETWORK STRATEGIES. WHAT WERE THE MAIN**
16 **SOURCES OF INFORMATION THAT YOU FOUND ABOUT THESE STRATEGIES?**

17 **A.** These strategies, along with UtiliCorp's Value Cycle Philosophy, were described in detail
18 in a couple of conference calls that UtiliCorp senior executives held with financial
19 analysts in the first quarter of this year and in the UtiliCorp "mini road shows" that were
20 put on by the UtiliCorp's senior executives this spring. On April 15, 2000 Bob Green
21 held a "2000 Conference Call" (the 2000 Call) with Salomon Smith Barney and on
22 February 8, 2000 Rick Green, Bob Green, and Peter Lowe (UtiliCorp CFO) held a "1999
23 Year End Conference Call" (the 1999 Call) with investment analysts. This Spring, the
24 Green brothers put on their "mini road shows" on the East and West coasts of the U.S.
25 The 1999 UtiliCorp Annual Report contains additional information on these concepts.

1 Transcripts of the conference calls and the May 9, 2000 "mini road show" (the New York
2 road show) that was put on for New York Analysts are available on UtiliCorp's internet
3 web site (<http://www.utilicorp.com/>) in the Presentations section of the Investor
4 Information Area.

5 **D. UTILICORP'S NETWORK STRATEGY**

6 **Q. PLEASE RETURN TO UTILICORP'S NETWORK STRATEGY AND DESCRIBE IT IN DETAIL.**

7 **A.** UtiliCorp's network strategy is to bring value to its shareholders by investing in energy
8 networks and production assets. This strategy has been implemented in Canada, the U.S.,
9 New Zealand, and Australia where UtiliCorp has invested in energy networks. In the
10 2000 Call, Bob Green described recent developments in its network strategy as follows:

11 First of all, our network strategy, where we essentially are taking
12 advantage of the trend towards privatization and liberalization of energy
13 markets around the world. We have bought utilities in Australia, New
14 Zealand and Canada outside the U.S. **We've also acquired two**
15 **distribution assets here in the U.S., St. Joe Power & Light and**
16 **Empire District. We believe we can significantly enhance the value of**
17 **those assets by disaggregating, breaking apart some embedded**
18 **businesses, and repositioning them.** We've done that in Australia. Since
19 1995, our IRR in terms of that investment is over 30% and what we've
20 done is break out the retail energy business and we will joint venture that
21 with Shell at a value significantly above what we paid for it. **We've built**
22 **a telecom business leveraging our right-of-way in the power business**
23 and we have built a back office business that handles the settlement and
24 billing for other power markets and generators, other participants in the
25 marketplace. There's an analogy for that business and the telecom
26 business; companies like Saval Systems you might have heard about and
27 Cincinnati Bell has a subsidiary that does this. Most of the large
28 telephone companies don't do their own billing and we believe we can
29 outsource most of that billing to this unregulated entity which will
30 ultimately trade at a much higher multiple. So we believe this
31 international network strategy has the potential to create IRRs well above
32 20%. In Australia we've achieved 30%, and we will continue to
33 aggressively pursue that in deregulating markets like Australia, New
34 Zealand, Alberta, Ontario, and here domestically, as the states
35 deregulate. (emphasis added).

E. PAST IMPLEMENTATION OF THE NETWORK STRATEGY

**Q. HAVE YOU REVIEWED UTILICORP DOCUMENTS THAT DESCRIBE HOW THE COMPANY HAS
APPLIED ITS VALUE CYCLE PHILISOPHY AS IT IMPLEMENTS ITS NETWORK STRATEGY?**

A. Yes. In the 1999 Call, Rick Green described the value cycle as follows:

The other key component of being successful with our mission and vision, on top of taking advantage of open markets, it's to constantly build value. And that is described here in the value cycle. This is a value cycle that you've heard us talk about through the year as to how we invest in opportunities, and immediately they get pushed into optimizing. Whether that means putting our operational template on them, cut costs, enhance revenues, look for emerging opportunities.

Whatever that is, we do that very quickly; and **then you have the option to monetize. Grab that value and push it to the bottom line.** It consistently over time gives you another whole stream of earnings besides your existing business, your operational activities. (emphasis added)

This has been going on at UtiliCorp for a number of years, starting back with our cornerstone shareholdings down in New Zealand with WEL. And we were able to position from those initial investments now to one of the larger investments in UtiliCorp and 30% market share in New Zealand. In '95, we moved to Australia, optimizing the value there by taking the electric company, United Energy, public, and realizing that value before the regulators start to take it back away and reset returns, which will happen in January of '01.

And currently in '99, we continue this value cycle. The West Virginia sale, for example. We were not interested in that sale just because we got a profit on the assets. It was the strategic relationship we were able to develop with Allegheny, and the long-term gas contract that we got for Aquila, that made that a real good value proposition for us. And the Aries plant, our merchant plant that we're developing in Missouri.

Here again bringing in Calpine as a partner allowed us to monetize and bring some of that value to the bottom line. So the consistent building of value is a very important measure, we think, going forward. So when you take advantage of opening markets, and when you constantly focus on building value, it gives you a very nice earnings track record, again with the ability to move that up to 8% and even start to talk and focus on 10%.

1 At the New York road show, Rick Green stated that:

2 One thing that's been very true about UtiliCorp over the years has been
3 our belief in the value cycle. What this says is that if we really start to
4 build value, then we ought to realize it, not just point to it on paper.
5 **When you invest and you optimize, you ought to find a way to**
6 **monetize the investment.** This is the way we've approached our
7 investments in Australia and you'll see continuing value cycle examples
8 in many of our other businesses. We see this as really another earnings
9 stream, if you will, that's over and above the organic earnings growth
10 that we consistently have achieved. It's a solid upside as we continue to
11 capture the value that is sitting in our different investments, in our
12 different markets around the world. (emphasis added)

13 During this same road show, Rick Green talked about the earnings opportunities that arise
14 for "old utility business" networks as markets start to change and become more
15 "progressive." He made the following remarks on this subject:

16 It is really these markets that have been showing us strategic
17 opportunities and pulling our strategies as the markets start to change and
18 reshape our industry. Clearly, in our two original strategies, world-class
19 manager of energy assets and global energy merchant, we've seen huge
20 opportunities and ways that one can benefit from operating in multiple
21 markets. This is especially true in operating a network or old utility
22 business in more progressive markets like New Zealand and Australia,
23 and soon in Alberta where we have recently purchased TransAlta.
24 **Opportunities such as pulling retail away from the networks, pulling**
25 **generation and transmission out, pulling out the maintenance and**
26 **construction of the pipes and wires, and creating a back room business**
27 **for energy delivery.** (emphasis added)

28 All of these are different businesses embedded within the utility — and
29 when you look at what it takes to perform each of those businesses, they
30 clearly are different businesses. We think the pieces have a value that's
31 far greater than the value of a vertically integrated network business. We
32 are starting to optimize those different businesses and you will see more
33 of that optimization going forward.

34 The UtiliCorp 1999 Annual Report also describes the value cycle and gives numerous
35 examples of how it has followed this cycle all the way through to the monetization stage
36 for some of its network investments. As UtiliCorp states in its 1999 Annual Report,

37 ...the Value Cycle. We invest, then optimize and monetize.

1 This means that as we manage properties, whether acquired recently or a
2 long time ago, we are constantly enhancing revenues, cutting costs or
3 applying our operational model to add value. We realize that value by
4 bringing in a partner, asking the public to invest, or developing some
5 other strategic relationship.

6 Later in its 1999 Annual Report, UtiliCorp gives the following examples of network
7 investments that it has recently or will soon have monetized in order to "realize the
8 appreciated value that we have created":

- 9 • UtiliCorp realized a gain on a power plant that it sold in its West Virginia Power
10 service territory and stated that "for us, this was another value cycle opportunity."
- 11 • UtiliCorp says it will likely sell part of its United Networks investment in New
12 Zealand as "the next step in the value cycle."
- 13 • In January of this year, UtiliCorp sold a 50% interest in its new combined cycle
14 plant that is currently under construction at Pleasant Hill, Missouri in what it
15 characterizes as another application of its value cycle concept.

16 The 1999 Call contains more details about the success UtiliCorp has had in executing its
17 value cycle philosophy and monetizing its investment in the Pleasant Hill (Aries) plant
18 where Bob Green states that:

19 The Aries plant is another good example. We identified an opportunity to
20 build a 600-megawatt plant. We executed a purchase power agreement
21 with our affiliated network business, got it approved by the Commission.
22 We've already sold half that plant before we have a piece of steel on site,
23 for a value of \$34 million more than we'd have to put in it. So we created
24 \$34 million of value in a combined cycle plant. We expect that to grow
25 over time. And we've already monetized half of it.

26 **F. NETWORK STRATEGY TELECOM SYNERGIES IN AUSTRALIA**

27 **Q. DO YOU HAVE ANY FURTHER COMMENTS ABOUT UTILICORP'S NETWORK STRATEGY?**

1 A. Yes, developing telecommunications networks has become a big part of UtiliCorp's
2 network strategy. Bob Green emphasized this in the 1999 Call where he stated "as we
3 look at buying network assets, the telecom overlay will be a key part of the value
4 proposition." Mr. Green also indicated in the 1999 Call that UtiliCorp intends to
5 implement its telecom strategy in conjunction with its purchase of the SJLP and Empire
6 network assets.

7 Q. HAS UTILICORP ALREADY BEGUN TO EXECUTE ITS TELEPHONE STRATEGY IN ANY OF THE PLACES
8 WHERE IT OWNS ENERGY NETWORKS?

9 A. Yes. In the following passage from the 1999 Call, Bob Green describes the telecom
10 business that UtiliCorp has developed in Australia and its intention to pursue a similar
11 strategy in Missouri by acquiring SJLP and Empire:

12 The biggest upside coming out of Australia is our telecom business,
13 UECOM. Some of you might remember a gentleman by the name of
14 Harvey Parker, whom we hired from Telstra, to run United Energy. He
15 left after about a year, but he had initiated a teleco strategy for United.
16 We have refocused that strategy, and it has been quite successful.

17 Today we have about 500 miles of fiber. We're building rings around
18 Melbourne, Sydney and Brisbane. It started out as dark fiber, providing
19 services to the 50 data centers in the United Energy service territory. It
20 has grown from there.

21 We expect to offer voice services this year. And it really is our biggest
22 venture into telecom. **And it is a strategy we think we can replicate.**
23 **We think we can replicate it in a place like Calgary, taking**
24 **advantage of our power distribution position. We think we can**
25 **replicate it in Missouri. Empire has 300 miles of fiber. We think we**
26 **can implement this strategy in the Empire service territory. We think**
27 **we can implement it in and around Kansas City. And we're developing**
28 **the business plan and identifying the right partners to make this strategy**
29 **most successful in these different markets. But as we look at buying**
30 **network assets, the telecom overlay will be a key part of the value**
31 **proposition. (emphasis added)**

32 And the business in Australia, just to give you a sense, you've got 500
33 miles laid; we're only using 30% of the capacity. So in terms of
34 incremental business, there's very little capital cost associated with it, and

1 we expect the EBIT to more than double this year. And it almost tripled
2 in '99. So there is some talk of a potential float of that business. We
3 haven't made any decisions. We're going to look at how we derive the
4 best value in the long run.

5 In the 2000 Call, Rick Green gives further insights into UtiliCorp's apparent successful
6 implementation of its network and telecom strategies in Australia where he states that "in
7 Australia...[w]e've built a telecom business leveraging our right of way in the power
8 business."

9 In his remarks at the New York road show, UtiliCorp's CFO, Peter Lowe made the
10 following comments about the implementation of UtiliCorp's network and telecom
11 strategies in Australia:

12 If we go to the next slide, the best example of that breakout in Australia
13 has been the telecommunications business. **That business originally**
14 **started as Rick mentioned, in 1997 purely stringing fiber on our**
15 **poles in our geographic area. We knew we had the skills to string**
16 **fiber. We had the right of way, and the third thing we noticed was**
17 **that we had a lot of data centers in our geographic area that needed**
18 **to be linked, and ultimately linked back to the head office. This**
19 **business purely started as stringing fiber leveraging off those core**
20 **competencies that we had in our network business. (emphasis added)**

21 As we were stringing that fiber, we noticed there was an opportunity to
22 go further. We moved out of our geographic area into the CBD (central
23 business district) of Melbourne. At that point in time, we were very
24 lucky. We approached Telstra, who was a major telecommunications
25 carrier in Australia, and we got the last access to ducts in the Melbourne
26 CBD. The reason they gave them to us is because they didn't see us as a
27 competitor. Having got them now, it put us in a very strong position.

28 Since that time we've moved into Sydney and we've moved into
29 Brisbane, and we are now working with people who provide the
30 hardware, and we're also getting into Internet service provider status. **So**
31 **it's a business that's grown from absolutely nothing in 1997 to a**
32 **business that today is worth somewhere between \$800 million and**
33 **\$1.3 billion Australian. (emphasis added)**

34 If you go to the next slide you can see what this has done to the United
35 Energy share price since we launched it. **Back in January we really**
36 **weren't saying much about the telecommunications business, and**
37 **people really didn't understand the hidden value that was trapped in**
38 **that business. Nobody realized that it was worth \$1 billion.**
39 **(emphasis added)**

1 Since we announced it in late February the share price has gone up as
2 high as \$3.65, and it's currently trading around \$3.15. Nothing else has
3 happened in the business to any great extent. That increased value has
4 come because people realized embedded in that network business is an
5 asset that has real value. We've talked about the possibility of doing an
6 IPO with that business to capture some of that value, and that's when the
7 share price really started to move.

8 Just using United Energy as an example again, and showing the sort of
9 value that can be created once you break up this animal called the
10 network business, originally the United Energy business was bought for
11 \$1.15 billion US, and the equity contribution from UtiliCorp at that point
12 was \$258 million. Since that time, we've IPO'd the business and
13 UtiliCorp's interest in United Energy has dropped to 34%, but we took a
14 \$45 million gain out at that point in time and we obviously have received
15 dividends each year we've owned it.

16 But more importantly, if you look at the value up at the top of this
17 graphic, even though we sold down to 34%, that \$258 million has grown
18 to \$525 million. The interesting aspect of that valuation, if you look at
19 the distribution business it is basically valued at what UtiliCorp paid for
20 it 1995, the other pieces that have been developed and split away from
21 the network business and operate now in their own right as unregulated
22 businesses, and they have their own customer bases. They're growing as
23 well as have a major customer -- the network business and they now
24 have other customers that are enabling them to grow and have got
25 significant value being generated.

26 **G. UTILICORP'S ENERGY MERCHANT STRATEGY**

27 **Q. LET'S TURN NOW TO A DISCUSSION OF UTILICORP'S MERCHANT STRATEGY. PLEASE EXPLAIN**
28 **THIS STRATEGY.**

29 **A.** UtiliCorp's merchant strategy is to bring value to its shareholders by becoming a leading
30 energy merchant in wholesale gas and electric markets. This strategy has been primarily
31 been focused in the U.S. where Aquila has become one of the leading marketers of gas
32 and electricity and UtiliCorp has recently begun pursuing this strategy more aggressively
33 in Europe. UtiliCorp's 1999 Annual Report stresses the importance of Aquila's recent
34 initiative to acquire mid-stream assets such as power plants and gas storage facilities to
35 give it the resources that it needs to support its trading business as the wholesale energy

1 market becomes more competitive. Aquila's investment in the Pleasant Hill plant fits in
2 with this initiative. The acquisition of the low cost generating assets of SJLP and Empire
3 could also be used to support this initiative in the future as Missouri electric markets are
4 restructured.

5 **Q. DOES ROBERT GREEN COMMENT ON UTILICORP'S MERCHANT STRATEGY IN HIS DIRECT**
6 **TESTIMONY?**

7 **A.** Yes, on page 4 of his testimony, he states that:

8 our focus on domestic acquisitions has become basically two fold: first,
9 we are interested in utilities that are in the mid-continent region where
10 we currently own and operate utilities and have the platform to realize
11 economies of scale, and second, we are interested in assets that enhance
12 our ability to become a leading energy merchant such as the Katy
13 Storage facility in Texas and the electric combined cycle generation plant
14 now under construction in Cass County, Missouri by UtiliCorp's Aquila
15 Merchant Energy Partner business.

16 From Mr. Green's statement, its apparent that the low cost generating assets of SJLP and
17 Empire could easily become a part of UtiliCorp's merchant strategy, once deregulation of
18 retail generation markets occurs in Missouri.

19 **III. THE PROPOSED MERGER ALTERNATIVE REGULATION PLAN**

20 **Q. WHICH PUBLIC COUNSEL WITNESSES WILL BE ADDRESSING ISSUES RELATED TO THE PROPOSED**
21 **MERGER ALTERNATIVE REGULATION PLAN?**

22 **A.** This plan will be addressed by Mark Burdette, Russell Trippensee, Ted Robertson and
23 myself.

1 **A. OVERVIEW OF THE PROPOSED REGULATORY PLAN**

2 **Q. PLEASE BRIEFLY DESCRIBE THE BASIC ELEMENTS OF THE REGULATORY PLAN THAT HAS BEEN**
3 **PROPOSED BY THE JOINT APPLICANTS.**

4 **A.** The plan is fairly complex and I will just touch on most of the major elements of it here.
5 A more detailed description of the proposed plan can be found in Mr. Trippensee's and
6 Mr. Robertson's testimony. The proposed regulatory plan includes:

- 7 • Separate rate cases and separate revenue requirement treatment for SJLP, Empire,
8 and UtiliCorp, even though the Joint Applicants in this case and the Empire case
9 are proposing that all three utilities be operated by a single corporate entity.
- 10 • A five year rate freeze for Empire with certain exceptions, including the
11 introduction of retail wheeling in Missouri.
- 12 • A "pre-moratorium rate case" where UtiliCorp is allowed to raise rates for its
13 Empire operating division without evaluating the overall earnings situation of
14 UtiliCorp's Missouri electric operations. UtiliCorp wants the Commission to
15 make a commitment in this case that it will allow a future rate case for UtiliCorp's
16 Empire operating division which **includes** cost increases (the State Line
17 Combined Cycle Plant) that have occurred subsequent to the merger but **excludes**
18 cost decreases (e.g. reductions in personnel at UtiliCorp's Empire operating
19 division) that have occurred subsequent to the merger.
- 20 • A commitment by the Missouri Commission to allow UtiliCorp to book a
21 significant portion of the acquisition premium associated with the Empire merger
22 on the books of its Empire operating division five years after the close of the

1 proposed merger and to allow UtiliCorp to receive a return on and of this
2 acquisition premium for 35 years.

3 **B. OPC'S RESPONSE TO THE PROPOSED REGULATORY PLAN**

4 **Q. HAS PUBLIC COUNSEL RECOMMENDED ANY SPECIFIC RATEMAKING TREATMENT FOR THE**
5 **PROPOSED MERGER?**

6 A. Yes. While OPC's overall recommendation is that the merger should not be approved
7 because of the detriments it will cause, Mr. Trippensee has proposed that the Commission
8 should commit to traditional ratemaking for the merged entity, should the Commission
9 decide to approve the proposed merger. This proposal would require the Joint Applicants
10 to agree to: (1) withdraw their request that the Commission approve their proposed
11 Regulatory Plan, (2) accept the same traditional ratemaking to which it is currently
12 subjected, and (3) facilitate the traditional ratemaking process by filing a complete rate
13 case for all of UtiliCorp's Missouri jurisdictional electric operations one year after the
14 close of the proposed merger and/or the close of the proposed UtiliCorp/SJLP merger,
15 whichever is later. Additional details regarding this proposed ratemaking treatment are
16 provided in Mr. Trippensee's testimony.

17 **Q. IS ANY TYPE OF SPECIAL RATEMAKING TREATMENT NECESSARY TO ENSURE THAT THE**
18 **PROPOSED MERGER WOULD RESULT IN ALLOWING SHAREHOLDERS TO RECOVER SOME OR ALL**
19 **OF THE ACQUISITION PREMIUM?**

20 A. No. UtiliCorp freely chose to enter a merger agreement with Empire. Consumers were
21 never consulted about their views on this merger. The merger applicants are less than
22 forthcoming in their testimony where they describe the synergies resulting from the
23 merger. A large portion of the synergies are in the area of generation and almost any

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1 conceivable restructuring legislation in Missouri will transfer the benefits from all of
2 these synergies to UtiliCorp. There is definitely no need for a regulatory plan that ties the
3 hands of this Commission by having it commit today that it will allow UtiliCorp to earn a
4 return on and return of a major portion of the acquisition premium associated with this
5 merger deal. First of all, it must be pointed out that the merger agreement already
6 handsomely rewards the shareholders of Empire with a sizeable control premium.
7 Secondly, the management and Board of Directors of UtiliCorp have chosen to merge
8 with Empire because of a broad range of other benefits that are expected to result from
9 the merger. These other benefits include:

- 10 • Reducing the prospect of cut-throat competition in regional energy markets by
11 keeping low cost generation assets out of the hands of its local competitors.
- 12 • Obtaining a lower cost structure for the generation portion of UtiliCorp's
13 regulated operation. All benefits of these reduced costs will flow through to
14 shareholders once retail wheeling is allowed and generation prices are no longer
15 regulated in Kansas and Missouri.
- 16 • Increased market power in wholesale and retail generation market will enhance
17 UtiliCorp's future earnings.
- 18 • Revenue enhancements resulting from synergies between the unregulated
19 operations of Empire and UCU and between the unregulated and regulated
20 operations of Empire and UCU. UtiliCorp's recent investments in Missouri
21 telecommunications firms is an attempt to facilitate achieving these synergies.
- 22 • Cost reductions resulting from synergies between the unregulated and regulated
23 operations of Empire and UCU.

1 **Q. ARE YOU SUPPORTING ANY SPECIFIC RECOMMENDATIONS WITH RESPECT TO THE**
2 **REGULATORY PLAN?**

3 **A. Yes. My testimony supports the following recommendations:**

4 1) I recommend that the Commission not use the synergies estimates that have been
5 developed by the Joint applicants as the basis for deciding: (1) whether the merger is
6 detrimental to the public interest or (2) whether the proposed regulatory plan is just
7 and reasonable since the Joint Applicants synergy analysis fails to quantify or even
8 mention the substantial synergies that UtiliCorp intends to achieve in the non-
9 regulated areas of: (1) deregulated retail generation service, (2) possible sales of
10 generating assets with market values greatly in excess of book values, (3) power
11 marketing synergies, and (4) telecom synergies.

12 2) I recommend that the Commission reject the Joint Applicant's proposed regulatory
13 plan or any other plan that calls for extraordinary ratemaking treatment and is
14 intended to give UtiliCorp a better opportunity to recover the acquisition premium
15 than it would receive from the traditional ratemaking process. This recommendation
16 is based on the potential harm to ratepayers that could come from approval of any
17 plan for extraordinary ratemaking treatment in light of the potential windfalls that
18 would accrue primarily to the benefit of UtiliCorp and Empire shareholders due
19 primarily to the non-regulated synergies that the Joint Applicants highlight for the
20 investment community but fail to acknowledge in their testimony. It would be a
21 great injustice to commit ratepayers to funding a significant portion of the premium
22 when the Empire and UtiliCorp shareholders are likely to be the primary
23 beneficiaries of this merger.

24 3) I recommend that if the Commission approves UtiliCorp's proposed regulatory plan,
25 despite OPC's recommendation to the contrary, then the Commission should

1 condition its approval of the merger on UtiliCorp's willingness to agree that it will
2 commit to: (a) not sell or otherwise dispose of its interest in any of Empire's
3 generation assets for the next 30 years and (b) offer generation services to its
4 customers at cost based (rather than market based) rates for the next 30 years.

5 **Q. PLEASE EXPLAIN WHY PUBLIC COUNSEL BELIEVES THAT IF THE COMMISSION APPROVES**
6 **UTILICORP'S PROPOSED REGULATORY PLAN, THEN THE COMMISSION SHOULD CONDITION**
7 **ITS APPROVAL OF THE MERGER ON UTILICORP'S WILLINGNESS TO AGREE THAT IT WILL**
8 **COMMIT: (A) NOT SELL OR OTHERWISE DISPOSE OF ITS INTEREST IN ANY OF EMPIRE'S**
9 **GENERATION ASSETS FOR THE NEXT 30 YEARS AND (B) OFFER GENERATION SERVICES TO ITS**
10 **CUSTOMERS AT COST BASED (RATHER THAN MARKET BASED) RATES FOR THE NEXT 30 YEARS.**

11 **A.** UtiliCorp argues that its proposed plan is reasonable because customers will be receiving
12 significant synergies from the proposed merger that will keep rates below the level which
13 would exist absent the merger. UtiliCorp claims that it would not be to equitable force
14 shareholders to pay all or most of the acquisition premium while ratepayers are receiving
15 significant benefits from the merger. OPC's recommendation is designed to insure that
16 the opposite of this does not occur. UtiliCorp's witness John McKinney made the
17 following statements on this subject in his direct testimony:

18 We believe customers should be a principal beneficiary if a utility
19 devises a more efficient way of providing service. (page 11, line 5)

20 Sharing [of benefits] is proposed because it is clearly fair to all
21 concerned. (page 12, line 19)

22 We know of no economic system or model where it is considered fair or
23 reasonable to assign all the costs to one party or stakeholder in a
24 transaction and give all of the benefits to another. (page 13, line 7)

25 Finally, our filing demonstrates that benefits will continue to flow after
26 the transaction (premium) and transaction costs have been covered. Any
27 other outcome could only be considered unfair and unreasonable. (page
28 13, line 19)

1 Therefore, the premium deserves rate making recognition if savings are
2 passed on to ratepayers. (page 19, line 17)

3 If the Commission accepts UtiliCorp's argument that sharing merger benefits means
4 customers should pay a significant portion of the acquisition premium through
5 UtiliCorp's proposed regulatory plan or a similar plan, then the Commission should
6 ensure that those benefits are actually there for customers to enjoy. Unless OPC's cost-
7 based generation merger condition is accepted by the Commission (and agreed to by the
8 Company), those benefits will no longer be there for ratepayers to enjoy once the
9 Missouri legislature decides to deregulate retail generation service in Missouri. Empire,
10 UtiliCorp, and Public Counsel all expect this to happen fairly soon.

11 On February 8, 2000 Bob Green participated in a conference call with utility analysts
12 where he stated that:

13 with the St. Joe and the Empire acquisition, we've brought together some
14 very attractive low-cost generation assets, and we have added some
15 contiguous distribution networks that afford us a significant opportunity
16 for synergies and efficiencies. 75% of those benefits are going to come
17 from the supply side.

18 Since UtiliCorp believes that 75% of the merger benefits "are going to come from the
19 supply side" the Company should be willing to commit to ensuring that ratepayers will
20 continue to receive those benefits over an extended period of time (i.e. the remaining life
21 of the low cost generating assets that are being acquired from Empire) by agreeing to the
22 cost based generation merger condition that OPC has proposed. If UtiliCorp will not
23 agree to such a condition, it then becomes obvious that they are simply asking ratepayers
24 to help the Company fund its investments in soon-to-be-deregulated low cost generation
25 assets which will have no benefit for consumers.

26 Q. PLEASE EXPLAIN WHY UTILICORP'S ACQUISITION OF LOW COST GENERATING ASSETS WILL
27 HAVE NO BENEFITS FOR CONSUMERS IF THE COMMISSION APPROVES UTILICORP'S

1 REGULATORY PLAN WITHOUT ALSO REQUIRING THE COST BASED GENERATION MERGER
2 CONDITION THAT OPC HAS PROPOSED.

3 A. Consumers will receive no benefits from generation supply synergies because the only
4 period of time when these assets are likely to still be used to provide regulated cost-based
5 generation service to UtiliCorp's customers is during the first five years after the close of
6 the merger. Of course, UtiliCorp's proposed regulatory plan provides that its rates will
7 be frozen for the first five years. After that time, generation service will likely be sold at
8 market-based rates or frozen at rate levels that existed at the time the restructuring
9 legislation is passed for a short transition period.

10 It should be noted that Public Counsel's discussion of potential energy supply synergies
11 and our proposed cost based generation service rates merger condition **should not** be
12 interpreted to mean that OPC believes that:

- 13 • The supply side synergies resulting from this merger (even if conditions are
14 imposed to ensure that ratepayers receive these mergers benefits over an extended
15 period of time) will make up for the harm caused by increased concentration of
16 ownership in generation markets that would be caused by this merger; or
- 17 • It is appropriate to approve a regulatory plan similar to the one that UtiliCorp has
18 proposed. Such a plan would be entirely inappropriate in light of the enormous
19 synergies in non-regulated operations that will accrue solely to shareholders as a
20 result of the following Empire attributes: (1) extensive telecommunications assets,
21 (2) Empire's healthy balance sheets and strong cash flows, (3) valuable brand
22 equity, and (4) a customer base and service territory which is in close proximity
23 to UtiliCorp's other Missouri service territories (providing transmission and off-
24 system sales synergies).

1 Q. WOULD OPC'S PROPOSAL FOR THE COMMISSION TO CONDITION ITS APPROVAL OF THE
2 MERGER ON UTILICORP'S WILLINGNESS TO AGREE THAT IT WILL COMMIT TO OFFER
3 GENERATION SERVICES TO ITS CUSTOMERS AT COST BASED RATES FOR THE NEXT 30 YEARS IN
4 ANY WAY INTERFERE WITH THE LEGISLATURE'S WORK ON DEREGULATING THE ELECTRIC
5 INDUSTRY IN MISSOURI?

6 A. No. This recommendation would in no way limit the options that the legislature has for
7 restructuring the Missouri electric industry. If the Legislature decides that it wants to
8 open up the retail generation market in Missouri so that consumers are free to choose
9 among alternative providers, OPC's recommended merger condition would just ensure
10 that UtiliCorp's customers have a least one attractive choice over an extended period of
11 time. Under OPC's proposed cost based generation merger condition, no consumers
12 would be forced to take cost-based generation service from UtiliCorp and all would be
13 free to choose another generation service supplier.

14 Q. HOW WOULD UTILICORP PROVIDE GENERATION SERVICE AT COST BASED RATES IF THE LOAD
15 THAT IT NEEDS TO SERVE EXCEEDS THE CAPACITY OF THE GENERATION ASSETS THAT IT
16 CURRENTLY OWNS OR HAS ACCESS TO?

17 A. Any capacity deficits could be managed in the same way that UtiliCorp is managing such
18 deficits today. UtiliCorp satisfied its most recent capacity needs by putting the capacity
19 needs out for bid. An unregulated affiliate of UtiliCorp won this bidding process and is
20 building a plant in Missouri that will provide capacity and energy to UtiliCorp's
21 customers under a five year contract.

22 Q. WHY DID PUBLIC COUNSEL CHOOSE TO PROPOSE THAT THIS COST BASED GENERATION
23 OPTION BE MADE AVAILABLE TO UTILICORP'S CUSTOMERS FOR THIRTY YEARS, INSTEAD OF A
24 SHORTER PERIOD, LIKE TEN YEARS?

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1 A. OPC believes that the low cost generation assets that are being acquired have a remaining
2 life that is close to thirty years and will therefore be able to provide benefits to either
3 shareholders or ratepayers for this same length of time. Later in this testimony, I describe

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18 Q. ON PAGES 19 AND 20 OF HIS TESTIMONY, UTILICORP WITNESS JOHN MCKINNEY
19 ADDRESSES THE ISSUE OF WHETHER "UNREGULATED COMPANIES ARE PLACED AT A
20 DISADVANTAGE WHEN COMPARED TO REGULATED COMPANIES IF PREMIUM RECOVERY IS
21 ALLOWED IN RATES." MR. MCKINNEY ARGUES THAT UNREGULATED FIRMS ARE NOT PLACED
22 AT A DISADVANTAGE SINCE "THE UNREGULATED FIRM RETAINS THE COST SAVINGS FROM
23 SYNERGIES CREATED THROUGH THE MERGER" BECAUSE "IN THE CASE OF THE UNREGULATED
24 FIRM, THERE IS NOT A REGULATORY COMMISSION REQUIRING MERGER SAVINGS TO BE

1 FLOWED TO CUSTOMERS" SO THAT " THE UNREGULATED FIRM RECOVERS THE PREMIUM
2 THROUGH THE MERGER SAVINGS." DO YOU AGREE WITH THIS REASONING?

3 A. Absolutely not. Mr. McKinney seems to be ignoring the major difference between a
4 regulated monopolist and competitive firm. A regulated monopolist can count on
5 receiving a given level of revenues based on prices for his service that are set by the
6 regulator. A competitive firm, on the other hand, only receives the market price for his
7 services and this market price may not even cover his cost of business without the cost
8 reductions (synergies) that he might receive through merging with another entity. The
9 market price for a competitive firm's services **may** be high enough to allow it to earn a
10 return sufficient to pay all or part of any premiums that it incurs. But there is a risk that
11 the price will not be high enough to compensate the competitive firm for **any** of the
12 acquisition premium. Mr. McKinney seems to think that it is the Commission's job to
13 insulate a regulated monopolist from the risk that it would face in competitive markets
14 where a firm may not be able to recover the premium

15 If Mr. McKinney's view of the Commission's role in reducing the risk of premium
16 recovery ever made sense, it was in a time when utilities were engaged exclusively or
17 nearly exclusively in regulated businesses. For UtiliCorp, that time has long since
18 passed. Mergers today are not prompted by a utility's desire to minimize the cost of
19 providing regulated service; if this was the motivation, they would have been proposed
20 decades ago. To the contrary, mergers today are prompted by the kind of non-regulated
21 earnings opportunities in area such as: non-regulated generation service, facilities based
22 telecommunications services, and other value added services. UtiliCorp has cited its
23 earnings potential in these non-regulated areas when it explains the motivation for the
24 merger to its shareholders and the investment community.

**IV. RELATIONSHIP BETWEEN UCU CORPORATE STRATEGIES, EMPIRE
ATTRIBUTES, AND THE REGULATORY PLAN**

A. OVERVIEW

**Q. PLEASE EXPLAIN WHY YOU BELIEVE IT IS VERY IMPORTANT FOR THE COMMISSION TO
CONSIDER UTILICORP'S CORPORATE STRATEGIES AND THE SPECIFIC ATTRIBUTES OF EMPIRE
WHEN DECIDING WHETHER TO APPROVE THE PROPOSED REGULATORY PLAN OR ANY OTHER
REGULATORY PLAN THAT IMPLICITLY OR EXPLICITLY ASSIGNS A SUBSTANTIAL PORTION OF
THE ACQUISITION PREMIUM TO RATEPAYERS.**

A. When the Commission considers the proposed regulatory plan, it should be cognizant of potential shareholder benefits brought about by the opportunities that this merger would give to UtiliCorp for bringing non-regulated earnings directly to its bottom line that are related to certain attributes of Empire. These opportunities exist in many areas, almost none of which have been acknowledged by UtiliCorp in its Application or testimony. The closest that UtiliCorp has come to acknowledging these shareholder benefits in any of its filings is the statement on page six of its Application that "the merger will strengthen the competitive position of UtiliCorp, including its MPS and Empire operations, not only in Missouri, but also in the surrounding region in the Midwest."

UtiliCorp chose to merge with Empire for a number of factors. Many of these factors are related to UtiliCorp's value cycle philosophy, network strategy, and merchant strategy that were described earlier in this testimony. Both SJPL and Empire have similar attributes that make them attractive candidates for use in the pursuit of these strategies. These attributes include their: (1) low cost generating assets, (2) telecommunications assets, (3) healthy balance sheets and cash flows, (4) brand equity and customer base and (5) service territory which is in close proximity to UtiliCorp's other Missouri service territories (providing transmission and off-system sales synergies).

1 **Q. HAS UTILICORP'S FILING AND REGULATORY PLAN REFLECTED THE BENEFITS TO ITS NON-**
2 **REGULATED OPERATIONS THAT THE COMPANY'S SHAREHOLDERS ARE LIKELY TO RECEIVE IN**
3 **THE FUTURE FROM ACQUIRING EMPIRE?**

4 A. No. UtiliCorp's proposed regulatory plan, which would require ratepayers to fund a large
5 portion of the acquisition premium, ignores the value that shareholders are likely to
6 receive in the future from acquiring Empire's: (1) low cost generating assets, (2)
7 telecommunications assets, (3) healthy balance sheets and cash flows, (4) brand equity
8 and customer base, and (5) service territory which is in close proximity to UtiliCorp's
9 other Missouri service territories (providing transmission and off-system sales synergies).
10 As stated earlier in this testimony, both Empire and UtiliCorp expect the electric industry
11 to be restructured fairly soon in Missouri. Despite this belief, UtiliCorp has stated in
12 responses to Data Requests (DRs) that it that it has not examined the market value of
13 Empire's generation assets (OPC DR Nos. 9 and 10) and that it has not analyzed any
14 synergies that might occur in the area of non-regulated operations (Staff DR Nos. 128
15 and 148). UtiliCorp made similar statements in response to OPC DR Nos. 3525, 3526,
16 and 3527 and Staff DR Nos. 152 and 228 in the SJLP merger case (Case No. EM-2000-
17 292).

18 **Q. DO YOU BELIEVE THAT UTILICORP'S DR RESPONSES INDICATING THAT IT HASN'T ANALYZED**
19 **ANY SYNERGIES IN THE AREA OF NON-REGULATED OPERATIONS REFLECT A GENERAL**
20 **DISINTEREST ON THE PART OF UTILICORP IN PURSUEING NON-REGULATED BUSINESS**
21 **OPPORTUNITIES WHERE IT CAN LEVERAGE OR DISAGGREGATE ITS TRADITIONAL UTILITY**
22 **ASSETS?**

23 A. No. This testimony contains a wealth of information regarding UtiliCorp's
24 implementation options it is considering in the non-regulated area that are guided by the
25 Company's overall strategies. UtiliCorp's response to Staff DR No. 82 contains a letter

1 to John McKinney that contains what appear to be a response to his inquiry regarding the
2 current status of Empire's non-regulated activities. (See Attachment 3.)

3 **B. EMPIRE'S LOW COST GENERATING PORTFOLIO**

4 **Q. WHAT MATERIALS HAVE YOU REVIEWED THAT ILLUSTRATE UTILICORP'S APPRECIATION OF THE**
5 **VALUE OF THE LOW COST GENERATING ASSETS THAT EMPIRE EITHER OWNS OR HAS ACCESS**
6 **TO?**

7 **A.** UtiliCorp has acknowledged the value in the Empire low cost generation assets that it
8 seeks to obtain in its 1999 Annual Report and in its presentations to investment analysts
9 In its most recent Annual Report, UtiliCorp stated that:

10 Empire District and Light and Power, among the longest operating [sic]
11 in Missouri, also bring **low cost generation assets** and cost-effective
12 distribution operations. (emphasis added)

13 In the "1999 Year End Conference Call" (the 1999 Call) with investment analysts, Bo
14 Green stated that:

15 But take a look at the mid-continent footprint that we're building on the
16 network side of the business. With the St. Joe and the Empire
17 acquisition, we've brought together some **very attractive low-cost**
18 **generation assets**, and we have added some contiguous distribution
19 networks that afford us a significant opportunity for synergies and
20 efficiencies. 75% of those benefits are going to come from the supply
21 side. (emphasis added)

22 Presentations at two UtiliCorp Board of Directors (BOD) meetings that took place in
23 February and May of 1999 included further comments about SJLP's generating assets.
24 The presentations at both of these meetings noted that SJLP has ** _____

25 _____ **

1 Q. HAVE YOU REVIEWED ANY MATERIALS THAT HAVE QUANTIFIED THE VALUE OF EMPIRE'S LOW
2 COST GENERATING SUPPLIES EITHER IN TERMS OF MARKET VALUE, OR IN TERMS OF ITS
3 POTENTIAL CONTRIBUTION TO NON-REGULATED EARNINGS STREAMS, ONCE GENERATION IS
4 DEREGULATED AT THE RETAIL LEVEL IN MISSOURI?

5 A. Yes, I have. **
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19 Q. IS THERE A GENERALLY ACCEPTED APPROACH TO DETERMINING THE MARKET VALUE OF
20 GENERATION ASSETS?

21 A. Yes. The market value is generally determined by calculating the contribution to annual
22 earnings that each generating plant is expected to make over the life of the plant and then
23 discounting this stream of future annual earnings to determine the present value of the
24 earnings stream. The present value of the earnings streams for all of a utility's generating
25 plants are then added together to arrive at the market value for its entire portfolio of

generating assets.**

Q. IS THERE A GENERALLY ACCEPTED APPROACH TO DETERMINING THE MARKET VALUE OF LONG TERM PURCHASE POWER CONTRACTS?

A. Yes, the method is very similar in concept to the method that is used for generation assets. The net present value of the stream of expected future earnings associated with each contract is calculated by taking into account the terms of each contract along with market prices to determine when (i.e. which particular hours of each year) it is beneficial to take power under each contract. The net present value of earnings streams are then summed to get the combined value for stranded costs/benefits that are associated with a utility's portfolio of purchase power contracts. **

Q. PLEASE DISCUSS IN MORE DETAIL THE ** _____ **

ANALYSIS AND THE CONCLUSIONS THAT WERE DRAWN, BASED ON THAT ANALYSIS.

A. **

Rebuttal Testimony of
Ryan Kind

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Q. YOUR DISCUSSION ABOVE INDICATED THAT THE **

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A. Empire appears to have decided that merging is the best way for it to satisfy its fiduciary responsibility to the Company's shareholders of maximizing the value of their investment in Empire. **

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1 Q. DO THE VALUE OF THE STRANDED BENEFITS ASSOCIATED WITH EMPIRE'S GENERATION
2 PORTFOLIO APPEAR TO BE REFLECTED IN THE ACQUISITION PREMIUM THAT UTILICORP IS
3 PAYING TO ACQUIRE EMPIRE?

4 A. Yes, at least some of these stranded benefits appear to be reflected in the premium that
5 UtiliCorp is paying to Empire's shareholders. The talking points that were prepared for
6 the presentation that Robert Green gave to the Missouri Commission prior to filing the
7 UtiliCorp/Empire merger application stated that:

8 For Empire the price paid was \$504 mm, about 2.2 x book, which
9 equates to a \$275 mm acquisition adjustment.

10 On May 11, 1999, Rick Green (UtiliCorp CEO) and Dan Streek (UtiliCorp Vice
11 President and Assistant Controller) held a conference call with investment analysts where
12 they discussed UtiliCorp's announcement that it intended to merger with Empire. In that
13 call, Mr. Green stated:

14 The price that we paid--\$21.25 as of the close of market yesterday--
15 represents a 39% premium. However, the more representative number is
16 a premium of 28%, which reflects a premium over the average stock
17 price that Empire has traded so far in 1999. Empire shareholders will get
18 a 15% increase in their dividend.

19 Later, in the same call, Mr. Streek stated "I'd look at our premium, which I said was
20 about \$276 million.." The \$275 million value that UCU has assigned to the merger
21 premium is **

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C. GENERATION SUPPLY SYNERGIES

Q. HAS UTILICORP'S FILING AND REGULATORY PLAN REFLECTED THE VALUE THAT ITS SHAREHOLDERS ARE LIKELY TO RECEIVE IN THE FUTURE FROM ACQUIRING EMPIRE'S LOW COST GENERATION ASSETS?

A. No. UtiliCorp's proposed regulatory plan, which would require ratepayers to fund a large portion of the acquisition premium ignores the value that shareholders are likely to receive in the future from acquiring Empire's low cost generation assets. As stated earlier in this testimony, both Empire and UtiliCorp expect the electric industry to be restructured in Missouri. Despite this belief, UtiliCorp has stated in responses to Data Requests (DRs) that it that it has not examined the market value of Empire's generation assets (OPC DR Nos. 9 and 10) and that it has not analyzed any synergies that might occur in the area of non-regulated operations (Staff DR Nos. 128 and 148). UtiliCorp made similar statements in response to OPC DR Nos. 3525, 3526, and 3527 and Staff DR Nos. 152 and 228) in the SJLP merger case (Case No. EM-2000-292)

The Company has, however, **

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Q. ISN'T IT POSSIBLE THAT THROUGH REDUCED STRANDED COST RECOVERY PAYMENTS TO UTILICORP, UTILICORP'S CURRENT RATEPAYERS MAY BENEFIT FROM THE TRANSFER OF LOW COST GENERATION ASSETS FROM Empire TO UTILICORP?

1 A. No. This would only be a possibility if the Missouri Public Service (MPS) Division of
2 UtiliCorp had a significant amount of positive stranded costs that could be offset by the
3 negative stranded cost associated with Empire's generating portfolio.

4 Q. PLEASE EXPLAIN.

5 A. Depending on the precise details of future restructuring legislation in Missouri, it could
6 be argued that if MPS currently had a substantial amount of positive stranded costs, then
7 current MPS ratepayers might benefit from UtiliCorp's acquisition of Empire's low cost
8 generating portfolio, even in an unregulated environment. This could occur if, absent the
9 acquisition of the Empire generating portfolio, MPS's generating assets had positive
10 stranded costs which would be collected from ratepayers. In this scenario, then the
11 addition of the Empire generating assets with negative stranded costs would lower or
12 eliminate the net stranded costs of the entire Missouri jurisdictional UtiliCorp generating
13 portfolio and this would cause the stranded cost charges that would have otherwise been
14 applied to MPS customers to either be reduced or eliminated.

15 Such a scenario will not come to pass, however, since even UtiliCorp acknowledges that
16 it has no stranded cost. Since UtiliCorp has no stranded cost, even without the addition
17 of low cost generating assets from SJLP and Empire, then all of the non-regulated
18 earnings associated with the addition of these low cost generating assets will accrue
19 solely to the benefit of UtiliCorp shareholders. As soon as the merger is approved,
20 Empire shareholders will have already gained a benefit from the Empire low cost
21 generating assets since the substantial premium that they will receive is based in large
22 part on allowing UtiliCorp shareholders to be the future beneficiaries of the non-regulated
23 earnings associated with the Empire generating portfolio.

1 It should be noted however, that Empire ratepayers would still be losers even if
2 UtiliCorp's stranded cost position had put its MPS ratepayers in a situation where
3 UtiliCorp's positive stranded costs could be partially or fully offset by Empire's negative
4 stranded costs. Empire ratepayers would loose in this scenario because the former utility
5 that served them, Empire, had no stranded costs. Therefore, under UtiliCorp's proposed
6 regulatory plan, they would have paid for some of the acquisition premium without
7 benefiting from any reductions in the potential stranded cost recovery that may occur
8 when the electric industry is restructured in Missouri.

9 **Q. YOU STATED THAT UTILICORP HAS NO STRANDED COST. WHAT IS THE BASIS FOR THAT**
10 **CONCLUSION?**

11 A. UtiliCorp itself has concluded that it has no stranded costs and I have no reason to doubt
12 that conclusion given the low operating costs of its supply portfolio.

13 **Q. HOW DO YOU KNOW THAT UTILICORP HOLDS THE BELIEF THAT IT HAS NO STRANDED COSTS?**

14 A. On October 19, 1999 Dwayne Hardt, UCU's Chief Financial Officer gave a presentation
15 to the Edison Electric Institute (see Attachment 8) where he displayed a slide showing
16 that UtiliCorp has "no stranded investment." Another of UtiliCorp's senior executives,
17 Max Sherman, Vice President of Project Development for Aquila's Merchant Energy
18 Partners subsidiary, testified recently on this subject before the Missouri State Senate
19 Property Tax Panel. In that testimony, Mr., Sherman stated that:

20 The existing generation fleet in Missouri, except for Callaway, can make
21 electricity at ~2 cents/kWh and make money (maybe 2.5 cents). These
22 assets are ~ 30 years old, largely depreciated, use coal (cheaper than gas),
23 and can compete with anything a developer can build. Our brand new
24 state of the art project makes electricity at ~3 cents/kWh.

Rebuttal Testimony of
Ryan Kind

1 As the above presentations indicate, two of UtiliCorp's senior executives don't believe
2 that UtiliCorp has any stranded cost. It is also interesting to note that Mr. Sherman's
3 testimony appears to imply that UtiliCorp believes that no Missouri utilities have any
4 stranded costs. It should also be noted that the newer, more expensive plant that Mr.
5 Sherman referenced in his testimony is owned by a non-regulated subsidiary of
6 UtiliCorp.

7 I have review the results of a stranded cost analysis performed by UtiliCorp a few years
8 ago. This analysis is **

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17 **Q. HAS UTILICORP PROVIDED ANY INFORMATION IN THIS CASE ABOUT ITS STRANDED COST**
18 **EXPOSURE?**

19 **A.** No. Surprisingly, UtiliCorp's response to Staff DR No. 36 regarding stranded costs
20 analysis stated that "no such study exists." Its DR response last fall to the Staff stated
21 that:

22 MPS is in the process of preparing such a study for its current generation
23 resources, however, the study has not been finalized or presented to
24 senior management for approval. A copy of the report will be provided
25 when complete.

1 This study still has not been provided to OPC so I presume it is still not "complete."

2 **E. UTILICORP'S OPTIONS TO DERIVE NON-REGULATED EARNINGS**
3 **FROM EMPIRE'S LOW COST GENERATING PORTFOLIO**

4 **Q. HAS UTILICORP'S TESTIMONY IN THIS CASE DESCRIBED ITS POTENTIAL TO ACHIEVE SYNERGIES**
5 **IN THE POWER SUPPLY AREA THAT WOULD ACCRUE SOLEY TO THE BENEFIT OF ITS**
6 **SHAREHOLDERS?**

7 **A.** No. Its testimony is completely silent with respect to this issue.

8 **Q. HAVE YOU REVIEWED ANY DOCUMENTS WHICH INDICATE THAT UTILICORP IS CONSIDERING**
9 **OPTIONS FOR DERIVIING NON-REGULATED SYNERGIES FROM EMPIRE'S LOW COST**
10 **GENERATING PORTFOLIO?**

11 **A.** Yes. The discussion earlier in this testimony where I describe UtiliCorp's Value Cycle
12 Philosophy and its Network and Merchant strategies shows how UtiliCorp's strategic
13 intent regarding investments like the Company's acquisition of Empire may be applied to
14 Empire in the future. In fact, both the 1999 Call and the 2000 Call that were discussed
15 earlier contain specific statements regarding future options that UtiliCorp may pursue
16 with its SJLP and Empire investments and explains how those options fit into the
17 Company's Value Cycle Philosophy and its Network and Merchant strategies. In
18 addition, as noted earlier in this testimony, the comments that Richard Green made at the
19 New York road show presentation expressed UtiliCorp's overall strategy for
20 disaggregating various components of the vertically integrated utilities that it acquires in
21 order to optimize and monetize those investments.

1 Q. PLEASE QUOTE THE SPECIFIC STATEMENTS THAT RICHARD GREEN MADE AT THE NEW YORK
2 ROAD SHOW PRESENTATION THAT EXPRESSED UTILICORP'S OVERALL STRATEGY FOR
3 DISSAGGREGATING VARIOUS COMPONENTS OF THE VERTICALLY INTEGRATED UTILITIES THAT IT
4 ACQUIRES IN ORDER TO OPTIMIZE AND MONETIZE THOSE INVESTMENTS.

5 A. During his presentation at the New York road show Richard Green talked about the
6 earnings opportunities that arise for "old utility business" networks as markets start to
7 change and become more "progressive." He made the following remarks on this subject:

8 It is really these markets that have been showing us strategic
9 opportunities and pulling our strategies as the markets start to change and
10 reshape our industry. Clearly, in our two original strategies, world-class
11 manager of energy assets and global energy merchant, we've seen huge
12 opportunities and ways that one can benefit from operating in multiple
13 markets. This is especially true in operating a network or old utility
14 business in more progressive markets like New Zealand and Australia,
15 and soon in Alberta where we have recently purchased TransAlta.
16 **Opportunities such as pulling retail away from the networks, pulling**
17 **generation and transmission out, pulling out the maintenance and**
18 **construction of the pipes and wires, and creating a back room business**
19 **for energy delivery. (emphasis added)**

20 All of these are different businesses embedded within the utility — and
21 when you look at what it takes to perform each of those businesses, they
22 clearly are different businesses. We think the pieces have a value that's
23 far greater than the value of a vertically integrated network business. We
24 are starting to optimize those different businesses and you will see more
25 of that optimization going forward.

26 Q. PLEASE QUOTE THE SPECIFIC STATEMENTS REGARDING FUTURE OPTIONS THAT UTILICORP MAY
27 PURSUE WITH ITS SJLP AND EMPIRE INVESTMENTS THAT WERE MADE IN THE 1999 AND 2000
28 CALLS AND PROVIDE ANY NECESSARY EXPLANATIONS.

29 A. In the 2000 Call, Bob Green makes the following statement:

30 First of all, our network strategy, where we essentially are taking
31 advantage of the trend towards privatization and liberalization of energy
32 markets around the world. We have bought utilities in Australia, New
33 Zealand and Canada outside the U.S. **We've also acquired two**
34 **distribution assets here in the U.S., St. Joe Power & Light and**

1 **Empire District. We believe we can significantly enhance the value of**
2 **those assets by disaggregating, breaking apart some embedded**
3 **businesses, and repositioning them.** We've done that in Australia. Since
4 1995, our IRR in terms of that investment is over 30% and what we've
5 done is break out the retail energy business and we will joint venture that
6 with Shell at a value significantly above what we paid for it. We've built
7 a telecom business leveraging our right-of-way in the power
8 business...(emphasis added)

9 In the 2000 Call, Bob Green makes the following statement:

10 But take a look at the mid-continent footprint that we're building on the
11 network side of the business. With the St. Joe and the Empire
12 acquisition, we've brought together some very attractive low-cost
13 generation assets, and we have added some contiguous distribution
14 networks that afford us a significant opportunity for synergies and
15 efficiencies. 75% of those benefits are going to come from the supply
16 side.

17 **And over time, we will look to restructure the supply-side assets and**
18 **potentially take them out of rate base and provide more of an upside.**
19 **It might be that the easiest path is to sell some of those assets** so we
20 can establish a market value and avoid a stranded cost to base with the
21 regulator; and then redeploy that capital strategically on the energy grid
22 in other generation assets or other growth investments. (emphasis added)

23 And again, this just highlights the service territories that we've acquired
24 with St. Joe and Empire.

25 It seems quite clear from the above statements by the most senior UtiliCorp witness in
26 this case, that UtiliCorp is considering the full range of options, including the sale
27 (monetization) of some of its soon to be acquired generating assets, in order to bring
28 significant unregulated earnings to the bottom line for its shareholders.

29 UtiliCorp is of course, subject to Commission approval under the current regulatory
30 paradigm, free to dispose of its assets as it sees fit. However, if UtiliCorp were to
31 exercise this option, either under the current regulatory paradigm, or in a post electric
32 restructuring paradigm, would UtiliCorp feel compelled to share the gains with ratepayers
33 after all of the rhetoric that Mr. McKinney has expressed in his testimony regarding the
34 inequity of assigning "all the costs to one party or stakeholder in a transaction and

1 [giving] all of the benefits to another?" Unfortunately, I do not believe that UtiliCorp
2 would feel compelled to act in a manner consistent with its rhetoric but would instead
3 feel compelled (due to its legal obligations) to act in a manner that satisfies its fiduciary
4 obligation to its shareholders by seeking outcomes that maximize the value of their
5 investment.

6 Q. MR. KIND, ONE OF OPC'S RECOMMENDATIONS THAT YOU SUPPORTED REGARDING
7 UTILICORP'S PROPOSED REGULATORY PLAN WAS THAT THAT IF THE COMMISSION APPROVES
8 UTILICORP'S PROPOSED REGULATORY PLAN, DESPITE OPC'S RECOMMENDATION TO THE
9 CONTRARY, THEN THE COMMISSION SHOULD CONDITION ITS APPROVAL OF THE MERGER ON
10 UTILICORP'S WILLINGNESS TO AGREE THAT IT WILL COMMIT TO: (A) NOT SELL OR OTHERWISE
11 DISPOSE OF ITS INTEREST IN ANY OF EMPIRE'S GENERATION ASSETS FOR THE NEXT 30 YEARS
12 AND (B) OFFER GENERATION SERVICES TO ITS CUSTOMERS AT COST BASED (RATHER THAN
13 MARKET BASED) RATES FOR THE NEXT 30 YEARS. PLEASE EXPLAIN HOW THIS
14 RECOMMENDATION IS RELATED TO THE TESTIMONY THAT YOU HAVE PROVIDED REGARDING
15 THE LOW COST POWER SUPPLY PORTFOLIO THAT UTILICORP WOULD ACQUIRE FROM EMPIRE
16 IF THIS MERGER IS APPROVED.

17 A. My testimony in this case, along with the testimonies of the other OPC witnesses
18 (Trippensee, Robertson, and Burdette) provide facts and analysis that we believe are more
19 than sufficient to demonstrate the UtiliCorp's proposed regulatory plan is detrimental to
20 the public interest. If, despite OPC's recommendation that the Commission not approve
21 UtiliCorp's proposed regulatory plan, the Commission proceeds to approve the proposed
22 plan or a similar plan, then OPC recommends that the Commission condition its approval
23 on UtiliCorp's willingness to agree that it will commit to: (a) not sell or otherwise
24 dispose of its interest in any of Empire's generation assets for the next 30 years and (b)
25 offer generation services to its customers at cost based (rather than market based) rates

1 for the next 30 years. I have referred to this recommended condition earlier in this
2 testimony as "OPC's cost-based generation merger condition."

3 Public Counsel believes that its cost-based generation merger condition is the only way
4 that the Commission can ensure that ratepayers are assured of getting something in return
5 for their contributions toward paying off the merger premium that UtiliCorp would pay for
6 acquiring Empire. Without this condition, the supposed benefits that ratepayers would
7 get from paying for a significant portion of the merger premium could simply "vanish
8 into thin air." This disappearing act could occur because as Robert Green has stated,
9 "75% of those [merger] benefits are going to come from the supply side." Robert Green
10 has also stated:

11 And over time, we will look to restructure the supply-side assets and
12 potentially take them out of rate base and provide more of an upside. It
13 might be that the easiest path is to sell some of those assets...

14 and

15 We've also acquired two distribution assets here in the U.S., St. Joe
16 Power & Light and Empire District. We believe we can significantly
17 enhance the value of those assets by disaggregating, breaking apart some
18 embedded businesses, and repositioning them.

19 Richard Green made similar comments at the New York road show where mentioned:

20 Opportunities such as pulling retail away from the networks, pulling
21 generation and transmission out, pulling out the maintenance and
22 construction of the pipes and wires, and creating a back room business
23 for energy delivery.

24 The "restructuring," "disaggregating," and "breaking apart" of assets that Robert Green
25 refers to and the "pulling generation and transmission out" to which Richard Green refers
26 would require Commission approval prior to the passage of electric restructuring
27 legislation in Missouri. However, after the Legislature restructures the electric industry
28 in Missouri, the Commission is likely to have very little authority over utility proposals to

1 sell or spin off their supply side assets. Also, after electric restructuring occurs in
2 Missouri, and absent a commitment by UtiliCorp to do other wise, any supply side
3 benefits from the merger are likely to vanish as incumbent utilities are allowed to charge
4 market based instead of the lower cost based rates. When UtiliCorp's' customers lose
5 their ability to obtain cost based generation service from UtiliCorp, they loose 75% of the
6 merger benefits that they were supposed to be getting in return for funding a large part of
7 the acquisition premium that UtiliCorp paid to acquire Empire. In summary, while OPC
8 opposes Commission approval of the proposed UtiliCorp regulatory plan in any form.
9 Public Counsel strongly recommends that the Commission not approve the plan and its
10 commitment for UtiliCorp ratepayers to pay off most of the acquisition premium over the
11 next 40 years without solid assurances by UtiliCorp that the supply side synergies that the
12 Company promises will actually materialize on ratepayers utility bills.

13 **Q. HAVE YOU SEEN ANY OTHER INFORMATION THAT INDICATES UTILICORP ANTICIPATES**
14 **ADDITIONAL NON-REGULATED SYNERGIES IN THE GENERATION SALES AND POWER**
15 **MARKETING AREAS AS A RESULT OF THE PROPOSED MERGERS WITH SJLP AND EDE?**

16 **A.** Yes, on page 10 of the 1999 UtiliCorp annual report in a section that discusses the
17 proposed SJLP and Empire mergers, the Company states that:

18 From an operational standpoint, combining the companies strengthens all
19 three networks by providing an important north-south link between
20 electric transmission grids in Iowa to the north and Arkansas to the
21 south. **On the generation side, the mergers will provide UtiliCorp**
22 **with a direct avenue to conduct business with more utilities in the**
23 **mid-continent region. This would greatly broaden the operational**
24 **scope and business opportunities in the electric generation business**
25 **for the company. (emphasis added)**

26 Once again the above quote illustrates the non-regulated business opportunities that
27 UtiliCorp expects to gain from this merger. Unfortunately, the Company's regulatory
28 plan seeks long term commitments from ratepayers to fund the acquisition premium that

1 made these business opportunities available to the Company. UtiliCorp seeks to obtain
2 this commitment from the Commission long before it is able to take the earnings results
3 of these non-regulated business opportunities into account when determining what
4 extraordinary ratemaking treatment, if any, might be appropriate under the circumstances.

5 **F. UTILICORP'S POTENTIAL NON-REGULATED EARNINGS IN THE**
6 **TELECOM/CABLE TV AREA**

7 **Q. HAS UTILICORP'S TESTIMONY IN THIS CASE OR ITS RESPONSES TO DATA REQUESTS DESCRIBED**
8 **ITS POTENTIAL TO ACHIEVE SYNERGIES THAT WOULD ACCRUE SOLELY TO THE BENEFIT OF ITS**
9 **SHAREHOLDERS IN THE FIBER OPTIC OR TELECOMMUNICATIONS AREA?**

10 A. No. Its testimony is completely silent with respect to this issue. Its responses to a data
11 request regarding synergies associated with non-regulated operations (Staff DR Nos. 128)
12 stated that:

13 Non Regulated operations were determined to be relatively immaterial to
14 the company. In addition, UtiliCorp did not have security or fiber optics
15 businesses.

16 This DR was answered by Vern Siemek, UtiliCorp's Director of Business Services for
17 UtiliCorp Energy Delivery. I was very surprised to learn that Mr. Siemek is not aware of
18 the substantial investments that UtiliCorp and its affiliates have been making in fiber
19 optic networks and telecommunications over the last few years. OPC received Mr.
20 Siemek's response to this data request on February 29, 2000. For some reason Mr.
21 Siemek appears to be unaware of the major investments in fiber optics and
22 telecommunications services that UtiliCorp and its affiliates have been making in both
23 Australia and Missouri.

1 Q. EARLIER IN THIS TESTIMONY, WHEN YOU WERE DISCUSSING UTILICORP'S VALUE CYCLE
2 PHILOSOPHY, NETWORK STRATEGY, AND MERCHANT STRATEGY, YOU DISCUSSED THE
3 RELATIONSHIP BETWEEN THE COMPANY'S NETWORK STRATEGY AND ITS
4 TELECOMMUNICATIONS AND CABLE TV INITIATIVES. HOW DOES UTILICORP PERCEIVE A
5 LINK BETWEEN THE TWO?

6 A. Bob Green described this link in the 1999 Call where he stated "as we look at buying
7 network assets, the telecom overlay will be a key part of the value proposition" and in the
8 2000 Call where he stated "we've built a telecom business leveraging our right-of-way
9 in the power business."

10 Q. HAVE YOU SEEN ANY INFORMATION THAT INDICATES THE "TELECOM OVERLAY" WAS PARTLY
11 WHAT MOTIVATED UTILICORP TO ACQUIRE SJLP AND EMPIRE?

12 A. Yes, a number of the statements made by UtiliCorp' senior management indicate that the
13 non-regulated synergies associated with the SJLP and Empire mergers was a major factor
14 in deciding to pay the premiums necessary to acquire these two utilities. I'll start with the
15 comments that Bob Green made in the 2000 Call where he stated that:

16 Second, in terms of a near-term upside is our telecom business that's
17 emerging first in Australia. We expect to float a telecom business at a
18 valuation close to the initial investment value in United Energy, the
19 power company we bought back in 1995. We think that should have a
20 big impact on UtiliCorp's share price. **As well, we are aggressively**
21 **pursuing that telecom strategy here domestically.** (Emphasis added)

22 In an interview that appeared in the April/June 2000 issue of *Leaders Magazine*, Robert
23 Green expounded on the potential telecom synergies that can be achieved from
24 investments in network utilities by stating that :

25 In the near future I think we're going to see telecommunications layered
26 over gas and power networks and assets, with energy companies
27 becoming significant competitors to existing telecom players in certain
28 niche markets. For instance, where we already have the right-of-way to

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1 lay fiber for that last mile, UtiliCorp could be a formidable competitor.
2 We can also leverage our distribution network to lay fiber across central
3 business districts, to be used by other carriers. Our operations in
4 Australia already provide us with a model for how that's done.

5 In his remarks at the New York road show, Richard Green made the following comments
6 about UtiliCorp's plans and strategies in the Communications business and how its
7 investments in electric utilities and telecommunications companies in Missouri fit into
8 these plans and strategies:

9 The communication business, as you heard Peter talk about, we've been
10 doing that successfully in Australia, where we have accumulated 33,000
11 fiber miles. The key that we saw last year was to take that successful
12 telecom strategy and apply it in other marketplaces where we are doing
13 business. **The opportunity in the US we have found first to be with**
14 **our acquisitions of St. Joe and Empire. St. Joe has a small fiber**
15 **company called ExOp, and Empire has 300 miles of fiber that we got**
16 **with the Empire or will get with the Empire acquisition. (emphasis**
17 **added)**

18 The first thing we have done in our own service territory is out in Pueblo,
19 Colorado, where we have begun building out a fiber network. We are
20 currently doing this simply through contract; the same way we got
21 started down in Australia. In Pueblo for example, it's a contract with the
22 city government to build a private network for their government
23 buildings around town. However, when you put in the fiber cable, I
24 believe we're using 86 fiber cable, the city is only going to use maybe
25 one or two of the fibers so rest is the dark fiber that you can begin to
26 light as you add customers to that network.

27 The whole intent here in the US is if we look at the third and fourth tier
28 communities, which essentially are the communities in our service
29 territory where we serve electric and gas, it is a market that has not been
30 pursued. I'll show you that in a minute.

31 **Once you lay the fiber the branded services that can be offer to**
32 **customers, we've found, are a good addition. Services such as**
33 **Internet access and long distance. Partnering with others that**
34 **provide those additional services, we see as a successful way to add**
35 **to the profitability. I already mentioned ExOp, where we have 35%**
36 **ownership of a CLEC and it's up and running, offering service. So, we**
37 **have a real working model that we can expand. (emphasis added)**

38 The key to making this work is to make sure that we have the
39 management resources, the depth to execute. That points to our
40 partnership with GLA International or Everest, which we announced in a
41 recent news release. It is the management group that came out of Brooks

1 Fiber when they sold to WorldCom, and they want to do it again. In
2 partnership with them, we think there is a lot of potential to lay fiber,
3 mainly in the Midwest, and make it a very profitable business.

4 This graphic is what I meant when I was talking about the third and
5 fourth tier cities, predominantly in the Midwest. If I showed you a map
6 of where the majority of the fiber build-out is currently taking place,
7 where a lot of the CLECs are building market share, you would see it on
8 either coast. There would be a void in the Midwest. We think there is a
9 clear opportunity for us to be able to get the market share that one needs
10 to be profitable. As you've probably heard from others, you need to get
11 to around the 20% market share level to reach profitability. Then there is
12 huge potential profitability as you continue to grow your market share.

13 If you look at the tier three and four cities, you are looking at the
14 possibility of getting market share to 60-70%, simply because a build-out
15 in the smaller communities hasn't occurred. **If you overlay our**
16 **capability here in the Midwest with our own fiber network that we**
17 **lease for our own utility purposes, it gives us a huge advantage for**
18 **continued expansion.** (emphasis added)

19 Based on our Midwest network presence combined with Quanta Services
20 you can easily see how we can leverage those operations to make sure
21 we get our fiber in and get it in quickly, to be able to take market share.
22 An example is the recent contract that Everest signed with Quanta for
23 \$400 million to begin to lay fiber starting in parts of the Kansas City
24 area.

25 So the competitive advantages we have in our service segment is Quanta,
26 one of the premier companies providing construction of bandwidth
27 infrastructure. The Everest connection with its management and depth of
28 management out of Brooks Fiber that has done it before and will do it
29 again. **If you layer in UtiliCorp service territory, which encompasses**
30 **the steps you have to go through to lay fiber -- get franchises,**
31 **understand regulation, understand the customer -- we are already**
32 **doing that. So that makes it an easy overlay to speed the execution**
33 **of building out this network and we're already doing it in a small**
34 **way in with our ExOp initiative in northern Missouri.** (emphasis
35 added)

36 A significant amount of additional detail about UtiliCorp's domestic telecom strategy
37 was revealed by Bob Green in the 1999 call where he made the following statements:

38 The biggest upside coming out of Australia is our telecom business,
39 Secom. Some of you might remember a gentleman by the name of
40 Harvey Parker, whom we hired from Telstra, to run United Energy. He
41 left after about a year, but he had initiated a telecom strategy for United.
42 We have refocused that strategy, and it has been quite successful.

1 Today we have about 500 miles of fiber. We're building rings around
2 Melbourne, Sydney and Brisbane. It started out as dark fiber, providing
3 services to the 50 data centers in the United Energy service territory. It
4 has grown from there.

5 We expect to offer voice services this year. And it really is our biggest
6 venture into telecom. And it is a strategy we think we can replicate. We
7 think we can replicate it in a place like Calgary, taking advantage of our
8 power distribution position. **We think we can replicate it in Missouri.**
9 **Empire has 300 miles of fiber.** (Emphasis added)

10 **We think we can implement this strategy in the Empire service**
11 **territory. We think we can implement it in and around Kansas City.**
12 **And we're developing the business plan and identifying the right**
13 **partners to make this strategy most successful in these different**
14 **markets.** But as we look at buying network assets, the telecom overlay
15 will be a key part of the value proposition. (Emphasis added)

16 ...
17 We will continue to pursue this telecom strategy that has emerged out of
18 Australia. **There is significant potential with the assets we're**
19 **acquiring at Empire and St. Joe to create an Australian-like telecom**
20 **play in the mid-continent.** (Emphasis added)

21 **And as I said, we've got I think 300 miles of fiber at Empire, and a**
22 **significant business at St. Jo that we think we can build, based on**
23 **our Australian experience, into a real growth vehicle for UtiliCorp.**
24 (Emphasis added)

25 ...
26 Q: I was wondering if you could ballpark for us the level of investments
27 you're looking at making in telecom over the next two to three years.
28 And then also maybe you could provide us a little bit more detail on the
29 New Zealand and Australia regulatory processes and how you see
30 yourselves coming out.

31 B. Green In terms of telecom, just to give you an idea, in Australia,
32 Peter, I think we've invested like \$15 million? And we've got a valuation
33 of \$300 million. So it's not capital-intensive, and we're only using 30%
34 of the capacity. So as we look at what we might do in Calgary – I mean,
35 **I think that would be an example and then as we look at what we**
36 **might do with the assets we've acquired through Empire and St. Joe,**
37 **the capital expenditure is not big.** (Emphasis added)

38 **I mean, in St. Joe I think we're looking at putting \$4 million into the**
39 **business to fund their expansion.** (Emphasis added)

1 Q. THE ABOVE QUOTE DESCRIBES THE 300 MILES OF FIBER THAT UTILICORP EXPECTS TO
2 LEVERAGE IN THE EMPIRE SERVICE TERRITORY. WHAT KIND OF TELECOM ASSETS DO
3 UTILICORP AND Empire POSSESS THAT COULD BE LEVERAGED TO CREATE NON-REGULATED
4 SYNERGIES IF THE PROPOSED MERGERS ARE APPROVED?

5 A. UtiliCorp has recently invested in two telecommunications companies near Kansas City.
6 UtiliCorp of course already possesses its own right of way and fiber loops that it has
7 installed for internal communications purposes. According to the UtiliCorp 1999 Annual
8 Report, SJLP is already in the "telecommunications, data networks" business.

9 Q. UTILICORP HAS PROPOSED A REGULATORY PLAN WHERE RATEPAYERS PAY A SIGNIFICANT
10 PORTION OF THE ACQUISITION PREMIUM THAT WAS NECESSARY TO ACQUIRE THE ASSETS
11 (INCLUDING TELECOM ASSETS) OF SJLP AND EMPIRE. HAS UTILICORP OFFERED TO SHARE
12 ANY OF ITS EXPECTED FUTURE NON-REGULATED EARNINGS ASSOCIATED WITH ITS PLANNED
13 TELECOM AND CABLE TV INITIATIVES?

14 A. No.

15 Q. HAVE YOU DISCOVERED ANY OTHER INFORMATION ABOUT EMPIRE'S FIBER OPTIC NETWORK
16 THAT YOU BELIEVE WOULD BE OF INTEREST TO THIS COMMISSION?

17 A. Yes. Empire appears to believe that the fiber optic system that it installed in order to
18 serve the communications need of its regulated operations is a non-regulated asset which
19 it can use to derive below the line profits. Curiously, Empire holds this belief even
20 though Empire's regulated operations have never been compensated for the use of its
21 right of ways, poles, ducts, and underground conduit. Empire stated the following in its
22 response to OPC DR No. 55:

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1 Empire's fiber optics was intended to be used primarily by Empire. The
2 excess capacity of the lines are being leased out and this is what is being
3 recorded as non-utility revenues. The fiber optic lines are not included in
4 rate base. No payments for the use of right-of-way, poles, ducts,
5 underground conduits have been made by the non-utility operations.
6 Conversely, the regulated operations have not made any payments for the
7 use of the dark fiber.

8 **Q. HAVE YOU DISCOVERED THE AMOUNT OF REVENUES THAT THIS FIBER OPTIC SYSTEM IS**
9 **GENERATING FOR WHAT EMPIRE REFERS TO AS ITS "NON-UTILITY OPERATIONS?"**

10 **A.** Yes. As stated on the first page of Attachment 3, "the company received revenues in the
11 amount of \$1,531, 241 for fiber services from 6/1/99 to 8/12/99. Given the lucrative
12 nature of this business and the advantages that a regulated utility has in access to right-of-
13 way, poles, ducts, underground conduits, it is understandable why Empire would attempt
14 to assert that the current and future revenue from this business should benefit its
15 shareholders by going below the line. Several aspects of this arrangement are, however,
16 currently unexplained:

- 17 • How can Empire claim that all of the revenues from its fiber business should
18 solely benefit shareholders when the Company's regulated operations have never
19 been compensated for the use of its right-of-way, poles, ducts, underground
20 conduits?
- 21 • Why wouldn't these fiber optic assets be considered assets of the regulated utility
22 when, according to Empire, they were "intended to be used primarily by Empire?"
- 23 • If Empire installed fiber optic cables that were not intended to be used primarily
24 by Empire's regulated operations did Empire misuse its powers of eminent
25 domain to obtain access to right of ways for the installation of fiber optic cable?

- 1 • Were these fiber optic facilities installed by employees of the regulated utility
2 who were using equipment that is in the rate base of the regulated utility? If so,
3 did Empire keep detailed records that would allow it to allocate the costs
4 associated with these personnel and equipment to Empire's "non-regulated
5 operations" from its regulated operations?
- 6 • Are Empire's current arrangements for allocating costs and revenues associated
7 with its fiber optic system in compliance with the Commission's affiliate
8 transactions rule? If UtiliCorp acquires Empire's fiber optic system, will it
9 allocate the costs and revenues associated with its fiber optic system in a manner
10 that complies with the Commission's affiliate transactions rule?

11 Public Counsel is still waiting for DR responses from Empire that should help to answer
12 some of the above questions.

13 **G. OTHER SOURCES OF BENEFITS TO UTILICORP'S NON-REGULATED**
14 **OPERATIONS NOT REFLECTED IN THE SYNERGIES ANALYSIS AND**
15 **DESIGN OF THE REGULATORY PLAN.**

16 **Q. WILL UTILICORP'S NON-REGULATED OPERATIONS BE RECEIVING OTHER BENEFITS THAT ARE**
17 **NOT REFLECTED IN ITS SYNERGIES ANALYSIS OR THE DESIGN OF ITS REGULATORY PLAN?**

18 A. Yes. UtiliCorp non-regulated operations will receive additional benefits from the
19 proposed merger as a result of the following attributes of Empire: (1) Empire's healthy
20 balance sheets and cash flows, (2) valuable brand equity and customer base and (3)
21 service territory which is in close proximity to UtiliCorp's other Missouri service
22 territories (providing transmission and off-system sales synergies).

1 Q. WHY DO YOU BELIEVE THAT EMPIRE'S HEALTHY BALANCE SHEETS AND CASH FLOWS WILL BE
2 BENEFICIAL TO THE NON-REGULATED OPERATIONS OF UTILICORP?

3 A. **
4 _____
5 _____
6 _____
7 _____
8 _____ **

9 Q. HAVE YOU SEEN ANY EVIDENCE WHICH INDICATES THAT UTILICORP ACTUALLY RELIES ON THE
10 FINANCIAL STRENGTH (HEALTHY BALANCE SHEETS AND CASH FLOWS) OF ITS REGULATED
11 OPERATIONS TO SUPPORT ITS NON-REGULATED OPERATIONS?

12 A. Yes. A May 24, 2000 email message to Tom Wertz from Laurie Hamilton and a reply to
13 that same message from Tom Wertz to Laurie Hamilton (see Attachment 9) indicates that
14 UtiliCorp's non-regulated affiliated entity, Aquila sometimes relies on the credit backing
15 of UtiliCorp to support some of its transactions. The ability of UtiliCorp to have
16 sufficient credit to support these types of non-regulated transactions will obviously be
17 enhanced if its balance sheets and cash flow patterns become stronger as a result of the
18 proposed merger.

19 Q. PLEASE PROCEED TO DISCUSS THE NON-REGULATED BENEFITS ASSOCIATED WITH UTILICORP'S
20 ACQUISITION OF A UTILITY WITH GOOD BRAND EQUITY?

21 A. I will discuss that issue below in the retail market power section of this testimony.

H. GLARING DEFICIENCIES IN UTILCORP'S SYNERGIES ANALYSIS.

Q. DO YOU BELIEVE THAT THE SYNERGIES ANALYSIS THAT UTILICORP SUBMITTED TO THIS COMMISSION AS SUPPORT FOR ITS REGULATORY PLAN IS A POOR REFLECTION OF THE FUTURE SYNERGIES THAT UTILICORP EXPECTS TO RECEIVE FROM THIS MERGER SINCE IT FAILS TO QUANTIFY OR EVEN MENTION THE SUBSTANTIAL SYNERGIES THAT UTILICORP INTENDS TO ACHIEVE IN THE NON-REGULATED AREAS SUCH AS DEREGULATED RETAIL GENERATION SERVICE, POSSIBLE SALES OF GENERATING ASSETS WITH MARKET VALUES GREATLY IN EXCESS OF BOOK VALUES, POWER MARKETING SYNERGIES, AND TELECOM SYNERGIES?

A. Yes, I do and for that reason, I recommend that the Commission not use the synergies estimates that have been developed by the Joint Applicants as the basis for deciding: (1) whether the merger is detrimental to the public interest and (2) whether the proposed regulatory plan is just and reasonable.

V. MARKET POWER CONCEPTS APPLIED TO THE ELECTRIC INDUSTRY

Q. PLEASE DEFINE THE CONCEPTS OF HORIZONTAL AND VERTICAL MARKET POWER.

A. These concepts were defined in the Electric Restructuring Consumer Education Message Recommended by this Commission's Education Working Group on August 14, 1998. The concept definitions that were used in this report were arrived at by a diverse group of stakeholders, including utilities. I have chosen to use these definitions as a starting point for addressing market power concepts in this testimony since there is already a broad consensus among Missouri stakeholder groups that these are reasonable definitions. The Commission's Education Working Group report contained the following definitions for market power:

Market power is the ability of a firm, alone or in concert with other firms, to profitably maintain the price of a product above the competitive

1 market level for an extended period of time. Suppliers with vertical or
2 horizontal market power could charge unfair prices and realize excessive
3 profits.

4 *Vertical* market power involves the ability of a firm to control an
5 essential element in the vertical production chain and, through that
6 control, cause competitors to be at a disadvantage through either
7 restricted access or higher costs for the products or services required to
8 produce and deliver the specific product.

9 *Horizontal* market power exists when a single firm or small group of
10 firms have the ability to affect the price of a product. In the case of a
11 single firm, horizontal market power is present when a firm dominates a
12 market where entry barriers protect it from competition. In the case of a
13 small group of firms, horizontal market power can occur through explicit
14 collusive behavior or through strategies that jointly maximize the self-
15 interest of each of the firms.

16 VI. MARKET POWER IN GENERATION MARKETS

17 **Q. HAS PUBLIC COUNSEL ANALYZED THE POTENTIAL FOR THE PROPOSED MERGER TO INCREASE**
18 **THE AMOUNT OF MARKET POWER THAT THE JOINT APPLICANTS WILL HAVE IN GENERATION**
19 **MARKETS?**

20 **A.** Yes. While Public Counsel has not performed any detailed modeling of expected
21 conditions in future deregulated retail generation markets with and without the merger,
22 we have nonetheless examined the configuration and cost structure of UtiliCorp's,
23 SJLP's, and Empire's generation supply portfolios. We have also noted UtiliCorp's
24 stated intention to further expand its Mid-continent footprint as additional network
25 acquisition opportunities arise. Public Counsel believes that UtiliCorp's acquisition of
26 the low cost generation supply portfolios of SJLP (378 mw) and Empire (878 mw) are
27 likely to be just the beginning of future network and generation asset acquisitions in the
28 region surrounding Missouri and Kansas as UtiliCorp acts on its stated intention to
29 further expand its Mid-continent footprint.

1 Public Counsel believes that the acquisition of the low cost SJLP and Empire generating
2 assets alone is sufficient to increase UtiliCorp's market power in future deregulated
3 generation retail markets significantly above the level that would exist absent the merger.
4 Of course, it should also be kept in mind that UtiliCorp's new 600 megawatt Pleasant Hill
5 plant will probably some day become part of the same generating portfolio, once
6 UtiliCorp's other plants are removed from ratebase.

7 **Q. DO YOU HAVE ANY ADDITIONAL REMARKS ABOUT THE POTENTIAL FOR UTILICORP TO**
8 **EXERCISE HORIZONTAL MARKET POWER IN DEREGULATED RETAIL MARKETS?**

9 A. Yes. The Commission should only approve this merger if the Joint Applicants are willing
10 to agree to the same market power conditions that the Commission approved in the
11 KCPL/Western Resources merger case.

12 **VII. VERTICAL MARKET POWER ASSOCIATED WITH THE JOINT**
13 **OWNERSHIP OF GENERATION AND TRANSMISSION ASSETS.**

14 **Q. ARE UTILITIES ABLE TO EXERCISE VERTICAL MARKET POWER THROUGH THEIR OWNERSHIP OF**
15 **TRANSMISSION ASSETS?**

16 A. Yes. Transmission owning utilities can exert some influence on the outcome of
17 generation markets when they have complete discretion to plan, operate, and control
18 interconnection of new suppliers to transmission systems within their service territories.

19 **Q. WHAT STEPS HAS THE FERC TAKEN TO ADDRESS THIS PROBLEM?**

20 A. The FERC took some initial steps to address this problem in orders FERC Orders 888
21 and 889. The FERC, however has not decided that these initial steps were sufficient for
22 the purposes of encouraging non-discriminatory access to the transmission system. Since

1 that time the FERC has been exploring additional means of encouraging or requiring
2 utilities to join Regional Transmission Organizations (RTOs). FERC Order No 2000 is
3 the FERC's most recent effort to encourage non-discriminatory access to the transmission
4 system and enhance reliability as the number of transactions escalates rapidly.

5 **Q. WHAT STEPS HAS THE MISSOURI PSC TAKEN TO ADDRESS THIS PROBLEM?**

6 A. The Commission has participated in the recent FERC dockets that have explored RTO
7 issues by presenting comments at forums arranged by the FERC to receive input from
8 state Commissions and other interested parties. The Commission also addressed this
9 issue in the UE/CIPS merger docket (Case No. EM-96-149) by requiring UE to make
10 reasonable efforts to join an ISO (Independent System Operator). The Commission also
11 addressed this issue in Case No. EM-97-515, in which it approved a Stipulation and
12 Agreement that required Western Resources to join an RTO under certain specified
13 conditions.

14 **Q. WHY DID THE COMMISSION ORDER UE TO TAKE REASONABLE STEPS TO JOIN AN ISO IN THE**
15 **UE/CIPS MERGER CASE?**

16 A. In that case both Staff and OPC witnesses filed testimony stating that the merger was
17 likely to amplify vertical market power problems, especially if retail wheeling becomes
18 available in Missouri. On pages 15 and 16 of its Report and Order in that case, the
19 Commission stated the following:

20 The Commission finds that there are sufficient facts in evidence to be
21 concerned about the potential increase in market power from the
22 proposed merger. The merger could have a significant adverse impact on
23 the degree of competition within UE's Missouri service territory due to
24 limited transfer capability for imported power, as well as the
25 disincentives caused by pancaked transmission rates. In order to
26 eliminate pancaked transmission rates, Ameren would need to belong to
27 a regional transmission group having a region-wide transmission rate.

1 To address the vertical market power concern that Ameren could use its
2 transmission system to restrict competition from other generation, the
3 regional transmission group should be an entity that will independently
4 operate the transmission systems of the vertically integrated utilities in
5 the region.

6 In the Ordered section of its Report and Order in that case, the Commission set forth
7 specific procedures for UE to follow in joining an ISO and requesting Commission
8 approval to do so.

9 **Q. WHAT IS PUBLIC COUNSEL'S RECOMMENDATION REGARDING THE VERTICAL MARKET POWER**
10 **ISSUES ASSOCIATED WITH THE PROPOSED MERGER.**

11 **A.** OPC recommends that the Commission condition its approval of the proposed merger on
12 the applicants' willingness to join an RTO under the conditions specified in the Vertical
13 Market Power Section of Attachment 1. Attachment 1 contains that same conditions that
14 the Commission ordered in Case No. EM-97-515, in which it approved a Stipulation and
15 Agreement that required Western Resources to join an RTO under certain specified
16 conditions. By requiring UtiliCorp to join an RTO now, before retail competition arrives,
17 the Commission will be helping to foster an environment where wholesale competition
18 can develop under conditions that do not threaten the security of the transmission grid.
19 The Commission's action on this issue is also necessary to assure that all market
20 participants have access to transmission service operated by an independent entity under
21 terms and conditions that are not perceived to be discriminatory.

22 **VIII. RETAIL MARKET POWER IN THE SALE OF ENERGY AND ENERGY-**
23 **RELATED SERVICES**

24 **Q. PLEASE EXPLAIN THE CONCEPT OF RETAIL MARKET POWER IN THE SALE OF ENERGY AND**
25 **OTHER VALUE-ADDED SERVICES THAT ARE LIKELY TO BE BUNDLED WITH THE ENERGY**
26 **COMMODITY (NATURAL GAS OR ELECTRIC GENERATION SERVICE).**

1 A. Retail market power in the sale of energy and energy-related services can result from a
2 large number of factors. The public interest will not be significantly impacted by retail
3 market power in the sale of energy and energy-related services until retail wheeling
4 (direct access to competitive generation service) is permitted by law in Missouri. Once
5 retail wheeling is permitted by law in Missouri, then a period of transitioning from a
6 monopoly market (where a sole provider was allowed to serve the entire market within its
7 service territory) to a competitive market will commence. Providing the right
8 environment during this transition period where conditions are favorable for the
9 development of vigorous and sustained competition is crucial in order for consumers to
10 see some near-term benefits from deregulated markets. It is important to note that even
11 though significant harm will not result from the accumulation of retail market power in
12 the sale of energy and energy-related services until retail wheeling begins, the acquisition
13 of this type of market power prior to deregulation can amplify the harm from it that
14 occurs after deregulation.

15 Once retail generation markets are deregulated, then consumers will be depending
16 primarily on competitive forces to keep prices at reasonable levels. There is some
17 question about how quickly competitive markets will develop to take the place of cost-
18 based rate setting that has protected consumers in the regulated monopoly environment.
19 Experience has shown that effective competition is not always fast to develop in formerly
20 regulated markets where the regulated monopolist was allowed to have 100 percent of the
21 market share. As long distance telephone services were deregulated, the former
22 monopolist, AT&T, saw its market share erode very slowly and the market was, and still
23 is to some extent, characterized by tight oligopoly behavior where AT&T was a "price
24 leader" even without overt collusion between the dominant firms.

25 As the electric deregulation experience in California and other states has shown, new
26 entrants may be slow to actively contest a newly-opened market, especially during the

1 transition when metering and billing is still performed by the incumbent and the recovery
2 of significant stranded costs leaves little margin for profits. In addition to the problems
3 associated with policies for stranded cost recovery and making metering and billing open
4 for competition, incumbent electric providers have numerous advantages that can make it
5 difficult for new entrants to pry customers away from their former monopoly providers.
6 These advantages, which tend to give incumbent providers some degree of retail market
7 power in the sale of energy and energy-related services can result from a large number of
8 factors including:

- 9 1) Customer inertia to stay with the former monopoly provider.
- 10 2) Incumbent utility brand name.
- 11 3) Customer relationships established by providing information and advice on
12 energy matters to Key Accounts and other large customers.
- 13 4) Sale of energy-related and other value-added products to customers before and
14 after direct access.
- 15 5) Ability to price extra services below cost if structural separation or strong
16 affiliate transaction rules are not in place to prevent this.
- 17 6) Privileged access to customer information (names, usage patterns, credit history,
18 tendency to buy additional products, and profiles of large customers) without
19 compensating the regulated operation for this information (if affiliate rules don't
20 prevent this from occurring).
- 21 7) Privileged access to customer communication channels such as billing inserts.
22 contacts with new customers, and customer service calls.

1 8) Special contracts that lock in large customers for some period of time after direct
2 access becomes available.

3 **Q. HOW DO THE FACTORS THAT YOU HAVE LISTED ABOVE FIT INTO THE DEFINITIONS OF**
4 **HORIZONTAL AND VERTICAL MARKET POWER THAT YOU PROVIDED EARLIER IN THIS**
5 **TESTIMONY?**

6 A. All of the above factors contribute to market power in the sale of energy and energy-
7 related services as a result of the vertically integrated nature of electric utilities. The
8 bundling of energy and energy-related services is also a horizontal market power
9 problem.

10 **Q. DO Empire AND UCU ALREADY HAVE SOME MARKET POWER RELATED TO EACH OF THE**
11 **EIGHT FACTORS THAT YOU HAVE LISTED ABOVE?**

12 A. Yes. Both utilities have market power resulting from most of the eight factors listed
13 above. For some of the factors (factors 1 and 2) this market power is largely the result of
14 being an incumbent utility that is perceived by its customers in a positive light. Other
15 factors are relevant to retail market power because of proactive steps that the utility has
16 taken to enhance its incumbent advantage.

17 While regulators need to be concerned with the retail market power associated with any
18 of these eight factors, in this docket, it is appropriate to focus on **increases** in retail
19 market power that would result from the proposed merger.

20 **Q. HOW WOULD RETAIL MARKET POWER RELATED TO THE EIGHT FACTORS INCREASE AS A RESULT**
21 **OF THE PROPOSED MERGER?**

1 A. There are two ways of looking at this. First, the market power possessed separately by
2 Empire and UCU in each of these eight areas will be additive. By additive, I mean that if
3 each of the merger partners have comparable market power in each of these areas, then
4 their market power will have increased when they are joined together. For example, if
5 both utilities have two long-term contracts with key customers that last for 5 years after
6 deregulation is expected to occur, then after the merger, a dominant regional competitor
7 will exist that has four customers who cannot be lured away by new entrants when retail
8 generation markets become open to competition.

9 Q. DID THE COMMISSION EXPRESS CONCERNS ABOUT MARKET POWER AT THE RETAIL
10 (AGGREGATOR) LEVEL IN ITS REPORT AND ORDER IN THE UE/CIPS MERGER CASE?

11 A. Yes, it did. On page 17 of its order, the Commission noted that:

12 In the retail merchant markets, Dr. Rosen believes that new aggregators
13 would find it difficult to compete with the incumbent utility because of
14 lack of name recognition.

15 ...

16 The Commission finds that there are sufficient facts in evidence for it to
17 be concerned about horizontal market power for both generation and
18 aggregation.

19 Q. LETS RETURN TO THE EIGHT FACTORS LISTED ABOVE THAT CAN LEAD TO RETAIL MARKET POWER
20 IN THE SALE OF ENERGY AND ENERGY-RELATED SERVICES. PLEASE SUMMARIZE THE STATUS
21 OF Empire AND UCU WITH RESPECT TO THESE EIGHT FACTORS.

22 A. Alright. With regard to the first factor (customer inertia to stay with the former
23 provider), all incumbent utilities can expect to benefit from this factor when direct access
24 becomes available. Utilities will often claim that 30 or 40 percent of their customers
25 would switch to a new supplier in order to receive a discount of 10 or 20 percent. Well,

1 what about the other 60 to 70 percent of customers? Why wouldn't they switch in order
2 to cut their electric bills by 10 or 20 percent? The answer, to a large extent, is customer
3 inertia. It has been shown that it takes a large incentive to get most customers to take any
4 affirmative action to leave their current supplier.

5 **Q. PLEASE PROCEED TO DISCUSS THE SECOND FACTOR, INCUMBENT UTILITY BRAND NAME.**

6 A. This factor tends to help incumbent suppliers retain customers, except in those fairly
7 unusual situations where the incumbent has developed a bad reputation with its customer
8 base. I have reviewed the results of customer surveys performed by or for Empire and
9 UCU. For both utilities, these surveys indicate that most consumers have a positive
10 perception of their current provider.

11 Empire's marketing strategy documents indicate that it believe that it possesses
12 significant brand equity in Southwest Missouri. In a November 26, 1997 document
13 entitled *Business Plan for the Empire District Electric Company, Natural Gas Marketing*
14 *Venture* (provided in response to OPC DR No. 24), Empire discusses a proposal to
15 partner with UtiliCorp to market natural gas in its service territory. UtiliCorp and Empire
16 believed that Empire could successfully enter the natural gas business due to the value of
17 the Empire brand name within its service territory. This document discussed this subject
18 on page 8 where it stated:

19 UtiliCorp provides both electricity and natural gas service to customers
20 located in the Kansas City area (as far south as Nevada) and also
21 provides various energy related products and services in at least 15 other
22 states under the brand "Energy One." **UtiliCorp and Empire both**
23 **believe the "Empire" brand name has more value in SW Missouri**
24 **than could easily or rapidly be established using the "Energy One"**
25 **brand.** (emphasis added)

26 Another Empire marketing strategy document entitled Marketing Strategy for the Empire
27 District Electric Company (provided in response to Staff DR No. 82) contains additional

1 statements from Empire about the value of its brand name. On page 3 of this document,
2 Empire states that:

3 **One of our greatest strengths is our retail service image.** Although
4 production facilities and transmission lines bring value, the retail service
5 side of the business is what has produced our favorable image. Surveys
6 have consistently proven our success in this area. Empire's excellent
7 customer service reputation is a major part of that strength. No matter
8 where the energy originates or what process it may take to get it to the
9 customer, most would prefer Empire District (the employees they know)
10 to be the business to serve them and assure customer satisfaction.
11 Customer surveys have consistently indicated high regard for Empire's
12 service and low cost. (emphasis added)

13 Later in the same document, on page 7, Empire states that:

14 **There is considerable equity in the Empire brand name.** Its is upon
15 this base that our new image and identify program will be built to carry
16 us through the end of this century and into the next with enthusiasm and
17 zeal. (emphasis added)

18 While the above quotes contain some of the usual excess enthusiasm and cheerleading
19 that is commonly found in marketing documents, I believe it also substantiates my
20 assertion that UtiliCorp is acquiring a utility with a brand name and image that can be
21 used to create barriers to new entrants in the Empire service territory and enhance the
22 profitability of UtiliCorp's current and future (e.g. deregulated retail generation service)
23 non-regulated operations in the Empire service territory.

24 **Q. PLEASE PROCEED TO DISCUSS THE THIRD FACTOR, CUSTOMER RELATIONSHIPS ESTABLISHED BY**
25 **PROVIDING INFORMATION AND ADVICE ON ENERGY MATTERS TO KEY ACCOUNTS AND**
26 **OTHER LARGE CUSTOMERS.**

27 **A.** Both of the applicants have taken advantage of this method to increase customer loyalty.

28 **Q. PLEASE PROCEED TO DISCUSS THE FOURTH FACTOR, THE SALE OF ENERGY-RELATED AND**
29 **OTHER PRODUCTS TO CUSTOMERS BEFORE AND AFTER DIRECT ACCESS.**

1 A. Both Empire and UtiliCorp has been very active in recent years, promoting optional value
2 added services such as fiber optic services, home warranties, optional lighting services.
3 home security services, and deregulated gas commodity sales.

4 Q. PLEASE PROCEED TO DISCUSS THE FIFTH FACTOR, ABILITY TO PRICE EXTRA SERVICES BELOW
5 COST IF STRUCTURAL SEPARATION OR STRONG AFFILIATE TRANSACTION RULES ARE NOT IN
6 PLACE TO PREVENT THIS.

7 A. This factor is also applicable to Empire and UCU. While the Missouri Commission
8 recently enacted an Affiliate Transaction Rule, both UtiliCorp and Empire had requested
9 waivers from the rule. I have been unable to discover any evidence that either UtiliCorp
10 or Empire have taken any actions to comply with the rule. If utilities are allowed to
11 cross-subsidize unregulated activities where non-regulated services are being offered by
12 the incumbent to its customers, either before or after direct access begins, then incumbent
13 utilities will have an additional advantage over new entrants by virtue of their ability to
14 offer a bundle of services where some services are priced below cost because they have
15 been subsidized by utility ratepayers.

16 Incumbents that are not subject to strong affiliate transaction rules may also find that it is
17 easier to give their affiliates superior access to the utilities' regulated facilities. The
18 Commission should not approve this pending merger application unless UtiliCorp agrees
19 to comply with the Commission's affiliate rules. If UtiliCorp is allowed to merge with
20 SJLP and Empire it will acquire additional unregulated business lines from each of these
21 utilities. These rules are necessary to ensure that utilities that engage in complex affiliate
22 transactions (like those that the merged entity is likely to engage in) do not harm
23 ratepayers by cross subsidizing their non-regulated activities.

1 Empire's ventures into the fiber optic business does not appear to comply with the
2 Commission's rules. As I stated earlier, Empire's regulated operations have never been
3 compensated for the use of its right of ways, poles, ducts, and underground conduit to
4 install fiber optic cable that Empire alleges are part of its "unregulated operations." The
5 Commission's rules prohibit the provision of services such as this to an affiliated entity
6 unless the affiliated entity compensates the regulated utility with payments that are equal
7 to the greater of the fully allocated cost or market value of the services provided.

8 UtiliCorp's use of the credit backing of the regulated utility to support transactions made
9 by Aquila also raises questions about compliance with the Commission's rules. Based on
10 the email message in Attachment 9, UtiliCorp does not appear to interpret the rule to
11 apply to situations where the regulated utility is providing credit backing which support
12 transactions made by its affiliated entity, Aquila. If the credit to support transactions
13 made by Aquila had not value, then it would not be needed.

14 **Q. HAS UTILICORP ENTERED INTO ANY RECENT CONTRACTUAL RELATIONSHIPS WITH ITS**
15 **AFFILIATES THAT INCREASE THE CONCERNS ASSOCIATED WITH AFFILIATE TRANSACTIONS**
16 **UNLESS THERE ARE EFFECTIVE RULES IN PLACE TO: (1) CREATE STANDARDS FOR HOW**
17 **AFFILIATED TRANSACTIONS SHOULD OCCUR AND (2) REQUIRE THAT ADEQUATE RECORDS OF**
18 **TRANSACTIONS ARE KEPT TO ALLOW FOR AUDITS TO ENSURE THAT THESE STANDARDS ARE**
19 **ADHERED TO?**

20 A. Yes. ** _____
21 _____
22 _____ ** The possibilities for
23 affiliate abuse and cross-subsidy under such an arrangement are obvious.

1 **Q. PLEASE PROCEED TO DISCUSS THE SIXTH FACTOR, PRIVILEGED ACCESS TO CUSTOMER**
2 **INFORMATION (NAMES, USAGE PATTERNS, CREDIT HISTORY, TENDENCY TO BUY ADDITIONAL**
3 **PRODUCTS, AND PROFILES OF LARGE CUSTOMERS) WITHOUT COMPENSATING THE**
4 **REGULATED OPERATION FOR THIS INFORMATION IF AFFILIATE RULES DON'T PREVENT THIS**
5 **FROM OCCURRING.**

6 A. According to the survey that OPC performed and submitted to the Commission as
7 exhibits in the Affiliated Transactions Rulemaking cases (Case Nos. EX-99-442, GX-99-
8 444, and GX-99-445), both UtiliCorp and Empire are currently taking advantage of these
9 information resources to enhance their efforts at marketing unregulated services to their
10 customers.

11 **Q. PLEASE PROCEED TO DISCUSS THE SEVENTH FACTOR, PRIVILEGED ACCESS TO CUSTOMER**
12 **COMMUNICATION CHANNELS SUCH AS BILLING INSERTS, CONTACTS WITH NEW CUSTOMERS,**
13 **AND CUSTOMER SERVICE CALLS.**

14 A. Both Empire and UCU appear to be currently taking advantage of these information
15 resources to enhance their efforts at marketing unregulated services to their customers.

16 **Q. PLEASE PROCEED TO DISCUSS THE EIGHTH FACTOR, SPECIAL CONTRACTS THAT LOCK IN**
17 **LARGE CUSTOMERS FOR SOME PERIOD OF TIME AFTER DIRECT ACCESS BECOMES AVAILABLE.**

18 A. Both Empire and UCU have entered into long-term contracts with some of their most
19 important customers.

20 **Q. HOW DOES THE BUNDLING OF ENERGY AND OTHER VALUE-ADDED SERVICES THAT ARE LIKELY**
21 **TO BE BUNDLED WITH THE ENERGY COMMODITY CREATE A HORIZONTAL MARKET POWER**
22 **PROBLEM?**

Rebuttal Testimony of
Ryan Kind

1 A. I share the belief held by many industry experts that in order to compete effectively in the
2 market for retail generation service (with the possible exception of market niches for
3 products like green power), retail generation service will probably have to be bundled
4 together with other value-added services including: natural gas, conservation and load
5 management services, distributed generation, home and business security services,
6 appliance warranty and rental services, telecommunications services, internet services,
7 and entertainment services. While this bundling may not occur immediately (with the
8 exception of natural gas for large customers) upon the opening of generation markets to
9 retail competition, it is likely to develop fairly rapidly, in part due to the emergence of
10 technologies that facilitate the joint provision of these services.

11 By either supplying customers with a bundle of services now or being prepared to offer a
12 bundle of services once direct access is permitted, utilities create barriers to entry. Once
13 markets are open, new entrants may find that profit margins on the energy commodity
14 alone are too slim to justify the marketing efforts needed to attract new customers. If the
15 incumbent is already offering, or is prepared to offer, a bundle similar to what the new
16 entrant can offer, then the new entrant will have more difficulty getting customers to
17 switch from the incumbent. While bundling services is a fairly common practice in non-
18 regulated industries, it raises special concerns in industries that are expected to soon
19 undergo a transition from regulated monopolies to competition.

20 **
21 _____
22 _____
23 _____
24 _____
25 _____
26 _____
27 _____

1
2
3
**

4 **IX. MARKET POWER RECOMMENDATIONS**

5 **Q. WHAT IS PUBLIC COUNSEL'S RECOMMENDATION FOR RESOLVING THE MARKET POWER**
6 **ISSUES IN THIS CASE?**

7 **A.** OPC recommends that the Commission condition the approval of this merger on the
8 applicant's willingness to accept the same market power provisions that were contained
9 in the Stipulation and Agreement that was approved by the Commission in Case No. EM-
10 97-515. These provisions will insure that the market power detriments that would
11 otherwise be associated with the proposed merger will be largely mitigated.

12 Attachment 1 contains a modified version of the market power provisions that were
13 contained in the Stipulation and Agreement that was approved by the Commission in
14 Case No. EM-97-515. The provisions that were included in the Stipulation and
15 Agreement for the KCPL/Western Resources merger have been modified so that they will
16 refer to the merger applicants in this case, instead of referring to KCPL and Western
17 Resources. In his direct testimony, Mr. McKinney expressed UtiliCorp's desire "for
18 similar treatment from the Commission in this proceeding" with regard to "deferring the
19 retail market power study" in a manner similar to the way it was deferred in the
20 Stipulation and Agreement that was approved by the Commission in the KCPL/Western
21 resources merger case. Therefore, the horizontal market power provisions contained in
22 Attachment 1 should be acceptable to UtiliCorp since they are identical to those in the
23 Case No. EM-97-515 Stipulation and Agreement.

**X. MODIFIED RETIREMENT AND HEALTH PLAN PROVISIONS FOR
EMPIRE'S CURRENT AND FORMER EMPLOYEES**

**Q. PLEASE SUMMARIZE THE INFORMATION THAT PUBLIC COUNSEL HAS OBTAINED REGARDING
THE MODIFIED RETIREMENT AND HEALTH PLAN PROVISIONS FOR EMPIRE'S CURRENT AND
FORMER EMPLOYEES.**

A. Public Counsel has become aware of significant changes that will occur in the retirement and health benefits of Empire employees and retirees if the proposed merger is approved by the Commission. The majority of the cost of health care premiums are currently paid by Empire for its employees and retirees that have been with the Company for a long time. The UtiliCorp/Empire merger Agreement calls for these costs to be borne entirely by employees and retirees in the future. Some of Empire's employee that have already retired or will soon retire could find themselves each paying thousands of dollars more per year to maintain their health care coverage as a result of this change. In addition, additional taxpayer funds (that wouldn't have been spent if the Empire health care plan for retirees remained in effect) may be used to fund health care expenses for those retirees once they reach age 65. Public Counsel believes that the Commission should take these impacts on Empire's current and former employees and taxpayer funds into consideration when it makes its determination regarding whether the proposed merger is detrimental to the public interest.

**Q. HAVE YOU SEEN ANY INFORMATION CREATED BY UTILICORP THAT SUMMARIZES THE
CHANGES THAT WOULD OCCUR IN THE HEALTH CARE COSTS WHICH MUST BE PAID BY
EMPIRE'S CURRENT AND FORMER EMPLOYEES?**

1 A. Yes. The Joint Applicant's response to OPC DR No. 49 contains a summary the of
2 effects of these changes in a document (see the last page of Attachment 10) entitled
3 "Premium Increase Estimates Based on 1-1/2 Year Freeze of Empire Benefits." This
4 document, which was prepared by UtiliCorp in the Spring of 1999 shows that huge
5 increases in monthly health care costs of former Empire employees that will occur if the
6 merger is approved. In the three scenarios examined by UtiliCorp, the monthly health
7 care costs would rise from \$52.50 to \$400.00, from \$87.50 to \$400, and from \$70 to
8 \$260. As the examples illustrated in this summary show, monthly health care premium
9 decline from their peak amounts to \$200 when former Empire employees turn 65 and
10 employees are able to coordinate their UtiliCorp health care benefits with Medicare.
11 While the reduction in health care expenses when former employees turn 65 is beneficial,
12 the monthly health care costs will still be much greater than they would have been if the
13 former Empire employees were still covered under the current Empire health plan. It
14 should also be noted that the reduction of monthly health care expenditures when former
15 employees turn 65 is made possible by an expenditure of taxpayer funds that would not
16 have been necessary if the current Empire health care plan had remained in effect.

17 Q. HAS OPC RECEIVED CORRESPONDENCE FROM EMPIRE RETIREES AND RELATIVES OF
18 EMPIRE'S REGARDING THE CHANGE IN EMPIRE'S HEATH CARE AND RETIREMENT BENEFITS
19 THAT WOULD OCCUR IF THE MERGER IS APPROVED?

20 A. Yes, OPC has received several such letters. One of the letters that was received from a
21 former Empire employee and his wife is contained in Attachment 11. This couple was
22 particularly concerned with the uncertainty over how surviving spouses will be treated
23 under health care and retirement plans if the merger is approved.

24 Another letter (see Attachment 12) was written by Elizabeth Diane Baker on behalf of her
25 father and several other Empire retirees. She notes in her letter the contrast between the

1 golden parachutes that have been awarded to Empire's senior executives and the huge
2 health care cost increases that will be imposed on Empire's retirees.

3 As the second to the last page of Attachment 10 indicates, Myron McKinney appears to
4 have tried to negotiate more favorable health care benefits for his current and former
5 employees, but the senior management of UtiliCorp refused to budge on this issue. It is
6 unclear, however, whether Mr. McKinney offered to reduce the value of the golden
7 parachute that he was receiving as part of the merger in order to negotiate a better health
8 care deal for his current and former employees. Of course, it is interesting to note that
9 while UtiliCorp is adamant that its shareholders will not only not be harmed by this
10 merger, but must receive some immediate benefits in the form of near term EPS
11 accretion, the Company appears to have no problems with making current and former
12 Empire employees worse off (in terms of layoffs and reductions in health care and
13 retirement benefits) as a result of this merger.

14 **Q. IS THERE ANY OTHER INFORMATION ABOUT THE IMPACTS OF THE PROPOSED MERGER ON**
15 **EMPIRE'S EMPLOYEES THAT THE COMMISSION SHOULD TAKE INTO ACCOUNT IN ITS**
16 **ASSESSMENT OF WHETHER OR NOT THE PROPOSED MERGER IS DETRIMENTAL TO THE PUBLIC**
17 **INTEREST?**

18 **A.** Yes. The proposed merger will cause about 270 jobs to be eliminated in Empire's service
19 territory. The elimination of these jobs is likely to have an adverse impact on the
20 economy in Empire's service territory. The job reductions that accompany corporate cost
21 cutting efforts are generally thought to have a positive impact on the economy as a whole
22 due to the dynamic efficiency impacts of such cost cutting efforts. These dynamic
23 efficiency impacts are expected to occur in competitive industries as the cost cutting that
24 is brought about by competitive forces will usually lead to a more efficient allocation of
25 societies resources which enhances the well being of society as a whole in the long run.

1 (Economists are careful to point out that the predicted enhancement of society's overall
2 does not take into account any impacts that a reallocation of society's resources may have
3 on the overall distribution of wealth.)

4 However, such dynamic efficiency effects are not necessarily expected to occur when the
5 cost cutting takes place in industries like the utility industry that are dominated by
6 regulated monopolies. In these types of industries, the existence of such dynamic
7 efficiency effects is dependant on the existence of "perfect regulation" which would
8 replicate competitive market conditions and cause regulated monopolies to behave in the
9 same manner in which firms behave in competitive industries. One on the crucial
10 components of competitive markets that facilitates dynamic efficiency impacts is that
11 firms in competitive industries are "price takers" not "price makers."

12 In this case, UtiliCorp's regulatory plan is essentially an effort to make it a "price maker"
13 rather than a "price taker." UtiliCorp has proposed that its rates be fixed for five years,
14 regardless of its cost level and the Company has proposed that the Commission make a
15 commitment in this case to allow its prices to be inflated for 40 years after the close of
16 the merger by including acquisition premium costs in its prices. The inclusion of this
17 premium will offset much of the merger-related cost reductions that would otherwise be
18 included in future prices (especially if it was part of a competitive industry). Without a
19 decline in the energy prices being charged by UtiliCorp's Empire division that would
20 cause input prices to fall (and employment to increase) at firms that use a significant
21 amount of energy in their production processes, the dynamic efficiency effects that would
22 be expected to occur in a competitive industry will be lost.

23 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

24 A. Yes.

OPC's PROPOSED MARKET POWER CONDITIONS

a. Horizontal Market Power

1. The merged entity agrees that at a time and in a proceeding to be determined by the Commission, which is either required by legislation or related to the start of retail electricity competition in Missouri, the merged entity will file a retail market power study in conformance with the schedule to be determined pursuant to Subsection a.l.v. in this Stipulation and Agreement, focusing on the merged entity's horizontal market power. The market power study must meet the following conditions:

i. For purposes of determining the extent of horizontal market power, the study shall model the competitive market for retail electricity, including the following assumptions:

a. All generation is available for competitive bid. There is no native load;

b. Transmission costs include only losses, congestion pricing (embedded transmission costs are collected through non-distance sensitive reservation charges, not usage charges) and such other transmission costs which can be reasonably expected to occur in the near future;

c. Transmission lines, capacities and constraints will be consistent with regional reliability council or regional transmission organization models used to determine transmission availability within each region that is modeled; and

d. The model will determine as the base case the economic

dispatch of generation subject to transmission constraints, losses and congestion that is consistent with minimization of total generation costs through marginal cost bids from generators to meet hourly loads throughout an appropriate test year.

ii. For purposes of determining the concentration of market power, the study shall assume that the relevant geographic market is the North Southwest Power Pool ("North SPP") region plus the region served by the Associated Electric Cooperative, Inc. ("AEC") and the Southwestern Power Administration ("SPA"), unless the relevant geographic market is otherwise determined to be different based on the Department of Justice's "hypothetical monopolist test." (U.S. Department of Justice and Federal Trade Commission. Horizontal Merger Guidelines, 57 Fed. Reg. 41,552 (1992)). If the merged entity applies this "hypothetical monopolist test," it shall use a model that meets the conditions specified in Section 13.a.1.i. above.

iii For purposes of determining the merged entity's ability to exercise market power through strategic pricing of electricity, the merged entity shall perform an analysis that considers various pricing strategies (including but not limited to capacity withholding and strategic bidding on both a unilateral and multilateral basis), which generation owners in the relevant geographic market might use to increase profits above the marginal cost bidding of generation. The merged entity shall perform the pricing strategy analysis using a model that meets the conditions specified in Subsection a.1.i. above.

iv. The merged entity also agrees to perform, and include in its market power filing, transmission studies in which the share of UtiliCorp's Missouri retail market that is available to alternative providers of generation is determined. Availability of

market shares to alternative providers of generation means that an alternative provider of electricity is not restricted by the transmission system or any other barriers to entry and is therefore able to deliver electricity to its customers on a year-round basis.

The merged entity also agrees to meet with the Staff, Public Counsel, and any other interested signatory party within six (6) months after the closing of the merger to discuss, on a preliminary basis, the structure and manner of completing its retail market power study to be filed with the Commission. Following the adoption of legislation authorizing retail electricity competition in Missouri, the merged entity also agrees to file with the Commission its proposed timetable for completing the retail market power study prior to the commencement of the study. The Staff, Public Counsel and any interested signatory party reserve the right to comment upon and/or suggest alternative approaches or schedules for the completion of the retail market power study.

vi. Public Counsel agrees to withdraw from UtiliCorp's merger case now pending before the Federal Energy Regulatory Commission (FERC), Docket No. EC00-27-000.

2. If the market power study performed in accordance with Subsection a. 1. in this Stipulation and Agreement indicates the need for measures to mitigate horizontal market power or the market share analysis performed in accordance with Subsection a.i.iv. in this Stipulation and Agreement indicates that less than three-fourths of UtiliCorp's Missouri retail distribution service territory is available to alternative providers of generation, then, in its market power filing before the Commission, the merged entity will propose and support mitigation measures that meet the following conditions:

i. The proposed and supported mitigation measures will assure that, at a minimum, three-fourths of UtiliCorp's Missouri retail distribution service territory is available to alternative providers of generation services by the time retail competition is fully implemented in Missouri.

ii. Mitigation measures that will be considered by the merged entity will include, but are not limited to:

Upgrades to transmission import capabilities into UtiliCorp's Missouri retail distribution service territory;

Sales of generation outside UtiliCorp's Missouri retail distribution service territory that will increase the import capability into that geographic area;

Not building additional generation capacity in UtiliCorp's current control area;

Not building additional generation capacity in UtiliCorp's current control area to produce electricity for sale within UtiliCorp's current control area;

Wholesale sales of capacity and/or energy from the merged entity's owned generation to alternative providers at prices that mitigate the merged entity's horizontal market power, and

Divestiture of the merged entity's owned generation.

iii. For mitigation measures involving generation owned by the merged entity (*e.g.*, sales outside UtiliCorp's Missouri retail distribution service territory, wholesale sales of capacity/energy to alternative suppliers or divestiture of owned generation), the relevant generating stations are those that are assigned or allocated to serve UtiliCorp's Missouri retail customers.

iv. The Applicants agree that if the Commission, as a result of the proceeding described above, orders the divestiture of the merged entity's owned generation, the merged entity will not appeal such an order on grounds claiming that the Commission lacks the necessary jurisdictional or statutory authority to order the divestiture of generation. The merged entity retains the right to challenge any such order based upon any other grounds.

b. Vertical Market Power

1. The merged entity agrees that it will become a member of a Regional Transmission Organization ("RTO") that most closely meets the conditions set out below, to the extent that these conditions are not otherwise inconsistent with the FERC's rules, requirements or guidelines for RTOs authorized by the FERC. The merged entity will file a proposal with the Commission for authorization to join an RTO: (i) on or before the deadline specified by FERC by which utilities are required to submit RTO proposals; (ii) on or before any deadline specified by FERC requiring the merged entity to join an RTO; or (iii) on or before the time that the Commission sets for market power proceedings, whichever comes first. Until that time, the merged entity will offer all regional transmission services that are available through the SPP or other regional tariff.

2. With respect to regional transmission rates, the RTO should offer:

- i. Transmission rates for collecting embedded transmission costs that are not pancaked or distance sensitive; and
- ii. Regional transmission service for both short-term and long-term, point-to-point service, as well as network service.

3. With respect to governance, control and authority, the RTO must:
 - i. Be the Tariff Administrator having the authority to determine the availability of transmission service;
 - ii. Be the Security Coordinator having the authority to determine when and how line loading relief is implemented; and
 - iii. Have an independent board of directors.
4. With respect to transmission planning, upgrades and expansion, the RTO must:
 - i. Coordinate transmission planning throughout the region;
 - ii. Have the responsibility for transmission system impact studies being performed;
 - iii. Have in place policies that promote the timely upgrade or addition of new transmission facilities; and
 - iv. If condition iii., immediately above, is not met, then the merged entity agrees that it will make timely upgrades or additions to the transmission system as required by the RTO.

c. **Retail Market Power Provisions**

- I. The Empire division of UtiliCorp may continue using the names "Empire" and "Empire District Electric Company" and "Empire District Electric" and "Empire District" indefinitely for the provision of: (i) regulated electric service prior to the implementation of open access for residential and small general service customers, and (ii) unbundled distribution service and provider of last resort retail generation service after open

access is implemented.

2. Effective eighteen (18) months after the close of the merger and for fifteen (15) years thereafter, the Joint Applicants agree that the merged entity shall not use for unregulated products and services provided by UtiliCorp (or its successors) or the affiliates of either of those entities, names or brand logos that are the same as or similar to those used by Empire in Empire's current Missouri service territory in connection with the provision of regulated products and services as of the date of this Stipulation and Agreement. For purposes of this Stipulation and Agreement, the prohibition regarding the use of the same or similar names or brand logos for any offering of unregulated products and services shall be interpreted to include the use of names or logos that contain or could be reasonably associated with the name or logo that is used by Empire as of the date of this Stipulation and Agreement, or has been used by Empire to provide regulated products and services in Empire's current Missouri service territory. For purposes of this Stipulation and Agreement, the term "regulated products and services" shall be interpreted to include: (i) regulated electric service offered prior to open access for small general service and residential customers, or (ii) unbundled distribution service and provider of last resort retail generation service offered after open access is implemented.

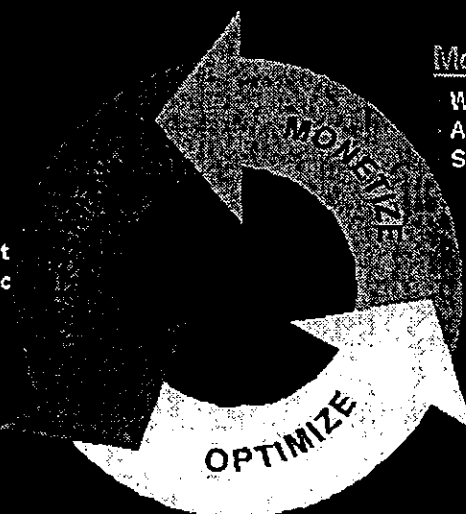
d. Market Power Legislation

1. The merged entity further agrees that it will not propose or otherwise support legislation in Missouri designed to prohibit or substantially limit the Commission from addressing market power issues in the manner set forth in these MARKET POWER CONDITIONS.

Overall

Investment

- St. Joseph
- Empire District
- Aries Power Plant
- Australia - electric
- Katy Storage
- New Zealand - TransAlta.
- TrustPower. PNZ
- Australia - gas
- Quanta Services
- Gas commodity contract - AYE



Monetize

- WEL Energy**
Australia - electric
Sale of WV properties

Optimize

- Reduce costs in network business
- Add new revenue sources
- Transfer operating model
- SMEPA contract

Slide 37 of 39

September 8, 1999

John McKinney
Regulatory Services
UtiliCorp United
20 West Ninth Street
Kansas City, MO.

Dear Mr. McKinney,

Marketing, handled through Empire's Major Account and Customer Service Support Division continues to be an exercise in evolution, with new products being added to our mix while tried and sometimes unsuccessful initiatives are being dropped. It is our intent to continue to add products and services as we find opportunities, and to continually evaluate ongoing programs and products to insure their continuing viability.

Of the marketing initiatives identified in the strategic marketing plan, several have been determined to be viable and are ongoing. Some of those are as follows:

1. Fiber Optics – Empire presently has approximately 300 miles of fiber optics cable installed. The East fiber connects the communities of Branson, Ozark and Springfield, Mo. The West fiber serves Joplin, Neosho, Webb City and Carthage, Mo. as well as communities in Southeast Kansas. The fiber is used primarily for Empire's own data and communications transfer, but fiber services are also being provided for certain commercial, industrial and institutional customers. The company received revenues in the amount of \$1,531,241 for fiber services from 6/1/99 to 8/12/99. The revenues from 1/1/99 to 8/1/99 were approximately \$384,000.
2. E-Luminate – Although lighting retrofit is still a part of this program, it hasn't proved to be as popular with commercial customers as hoped, and emphasis has been shifted to Sports field and Decorative lighting. Since this shift 1-1-99, Empire has realized gross revenues of approximately \$360,000 with an estimated net revenue of \$80,000. Empire is also cultivating a distributorship relationship with some large commercial and industrial customers by providing lighting equipment at a 15% markup with no inventory investments.(order and ship)
3. E-Watch – Empire's fledgling security company continues to grow and attract new customers. Revenues from equipment sales between 1-1-99 and 8-1-99 have amounted to \$109,000, and income from monitoring for the same period have amounted to just over \$49,000.

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4. Dual Fuel – Marketing personnel are actively marketing the use of dual-fuel heat pumps, but our concentration has shifted to retrofit primarily. It is still our belief that new construction should be sold total electric.
5. Gas Marketing - Empire continues to pursue natural gas marketing opportunities through an agency agreement with Aquila Energy. To date this has been breakeven, however the experience being gained is invaluable, and the labor cost associated with it is negligible.

Several of the initial marketing initiatives outlined Empire's Marketing Strategy have since been determined to be impractical or unprofitable at this time. They are:

1. E-Home – This program and energy management were part of Empire's old DSM projects which encouraged the development of energy efficient homes through co-op advertising and Empire certification. While EDE does still certify energy efficient homes, the co-op advertising for developers has been discontinued, due to high cost and low profitability.
2. Energy Management – This program has also been discontinued due to a lack of interest from customers and little or no profit potential for the company.
3. Financing - Financing has been determined to be unneeded given the high availability and low cost of consumer credit through more traditional brokers. There seemed to be little interest among customers, and even less potential for profit.

New Initiatives:

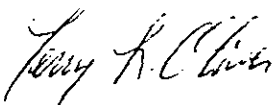
1. Meter Treater – Whole house surge suppression and point of use surge suppression is a growing market. Empire has actively marketed and leased this type of product since January, 1999. To date we have developed an ongoing revenue stream of approximately \$10,000 annually.
2. UPS - In August of 1999 Empire's Marketing team began selling UPS equipment to provide improved power quality and back up power to all classes of customers. This product has been made available with an investment of only \$8,000. Due to the quick availability of equipment through our supplier it will not be necessary to maintain a costly inventory beyond the original investment. Empire has also reached a limited distribution agreement with our supplier, thus allowing the company to act as both retailer on system and supplier to wholesale accounts served by the company.

3. Generlink – Empire is nearing agreement to lease and distribute an automatic throw over switch which will allow our customers to easily, economically and safely make use of their own home generators.
4. Generators – Negotiations are ongoing and close to agreement with a new producer of high end permanently installed generators for home and small commercial use. If successful, Empire will be both retail and wholesale supplier within our service territory.

This is a brief overview of Empire District Electric Company's marketing initiatives as they have been, are now, and look forward to becoming. Several individual documents accompany this report that will give a more detailed view of our existing marketing plans.

Should you require any additional information, please don't hesitate to contact me by phone at 417-625-4242 or E-Mail at toliver@empiredistrict.com.

Cordially,



Terry L. Oliver
Director of Major Accounts & Customer Service Support
The Empire District Electric Company

**ATTACHMENT 4
HAS BEEN DEEMED
HIGHLY CONFIDENTIAL**

**ATTACHMENT 5
HAS BEEN DEEMED
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**ATTACHMENT 6
HAS BEEN DEEMED
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**ATTACHMENT 7
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