Exhibit No.:	
Issue:	Synergy Savings
Witness:	Vern J. Siemek
Sponsoring Party:	UtiliCorp United Inc.
Case No.:	EM-2000-369
Date Prepared:	August 23, 2000

MISSOURI PUBLIC SERVICE COMMISSION
Case No. EM-2000-369

Surrebuttal Testimony

of

Vern J. Siemek

Jefferson City, Missouri

SURREBUTTAL TESTIMONY
VERN J. SIEMEK

UTILICORP UNITED INC.
CASE NO. EM-2000-369

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BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
SURREBUTTAL TESTIMONY OF VERN J. SIEMEK
ON BEHALF OF UTILICORP UNITED INC.

CASE NO. EM-2000-369

Q. Please state your name.

A. My name is Vern J. Siemek.

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

A. I am employed by UtiliCorp United Inc. ("UtiliCorp" or "UCU") as Director of Business Services for UtiliCorp Energy Delivery.

Q. Are you the same Vern J. Siemek that has previously filed direct testimony with the Missouri Public Service Commission ("Commission") in this case?

A. Yes.

Q. How does your surrebuttal testimony in this case involving The Empire District Electric Company ("Empire") compare to the testimony you filed concerning the UtiliCorp and St. Joseph Light & Power Co. ("SJLP") merger, Case No. EM-2000-292?

A. My surrebuttal testimony in this case is considerably different because of different issues and different amounts associated with the issues. However, the following sections of my testimony are conceptually similar to that filed in Case EM-2000-292, except for the amounts:

Section I: Corrections to Staff summary – the testimony dealing with Costs of corporate allocations Response to Miscellaneous Staff Synergy issues – the testimony dealing with

Cost of UtiliCorp general plant, Three-way merger synergies (except for the last question and answer), and Net present value of synergies

Section III: Tracking costs and recovery of Certain Costs to Achieve – testimony on tracking costs

Q. What is the purpose of your surrebuttal testimony?

A. My surrebuttal testimony will:

1. Respond to Missouri Public Service Commission Staff ("Staff") rebuttal testimony with respect to merger savings/projected synergies;
2. Respond to Staff rebuttal testimony on the impact of projected synergy issues under the proposed Regulatory Plan:
3. Respond to Staff rebuttal testimony with respect to the Costs to Achieve the Synergies;
4. Respond to Staff's concerns with the proper starting point for calculating the synergies and explain why Staff's proposed starting point is inappropriate.

My testimony will also respond to certain matters raised by the rebuttal testimony of Office of the Public Counsel ("OPC") witnesses.

I. MERGER SAVINGS\PROJECTED SYNERGIES:

Q. How do you respond to the Staff's claim that estimated merger savings\synergies in connection with the UtiliCorp-Empire merger do not exceed estimated merger costs?

A. Based on my own work, and my knowledge of the work performed by the transition teams and UtiliCorp witnesses Browning and Holzwarth, I firmly believe that both the estimated and actual merger savings/synergies will exceed the estimated and actual merger costs. In any event, UtiliCorp will bear the burden of proof in the Post Moratorium Rate Case following the merger to demonstrate to the Commission that merger savings/synergies exceed the costs to the extent that UtiliCorp seeks rate recovery of those costs. In other words, the risk is with UtiliCorp.

Corrections to Staff Summary of Synergies

Q. Various Staff witnesses have contributed to a summary of the synergies of this transaction on Page 42 of witness Traxler's testimony. Do you agree with Staff's summary?

A. No. The Staff summary has several mischaracterizations and errors that need to be corrected.

Q. Please detail the corrections needed to the Staff summary and explain the rationale for each.

A. My testimony will review and explain each correction individually and then summarize the impact on Staff's summary of synergies.

Q. Staff witness Steve Traxler at page 41, line 15 and pages 42-43, lines 29-30 and 1-5, of his rebuttal testimony, says that UtiliCorp and Empire expect a significant increase to Empire's cost of service as a result of consolidating existing Empire functions and allocating UCU Corporate Overhead costs to Empire. Do you agree?

A. That is simply not true. UtiliCorp does <u>not</u> expect a significant increase. In reaching their conclusion, Staff has apparently misinterpreted and then misused Section IV of Schedule VJS-1 of my direct testimony.

Q. Please explain.

A. The schedule VJS-1does not purport to represent comparable costs between the costs transferred to UtiliCorp and the costs allocated to Empire. For example, the General and Administrative savings in line I-2 of Schedule VJS-1 of my direct testimony include savings from eliminating the finance and treasury functions at Empire. Because those functions are eliminated, no Empire Direct Costs were transferred to UCU on lines IV-1 or IV–2. However, the Allocation to Empire on line IV-3 includes allocations of finance and treasury costs from UtiliCorp. There are numerous other similar costs that impact the comparability within Section IV. Thus, it is not appropriate for Staff to characterize the net allocation on Line IV-4 as a significant increase in Empire's cost of service.

Q. Staff witness Traxler at page 43, lines 3-5 of his testimony, indicates that UtiliCorp projects a cost increase to Empire customers of $23.6 million during years 6-10, while the Staff projects cost increases to Empire customers of $46.4 million during the same period. How do you respond?

A. Mr. Traxler's claim that UCU projects cost increases of $23.6 million is wrong.

Q. Why?

A. The Staff has only extracted a partial picture from our analysis of the transaction and as a consequence, the Staff has drawn incorrect conclusions. Staff analysis does not even incorporate all the comparable costs and synergies. At a minimum the Staff should include the benefits synergies related to the cost reductions included in the Staff's analysis. Benefits are included in the cost allocations from UCU to Empire.

Q. Are adjustments needed to correct the Staff's analysis?

A. Yes. The Staff's analysis needs to be corrected to reflect the $28.4 million of benefits synergies over years 6-10 as reflected on Schedule VJS-1 to my direct testimony. That correction results in approximately $4.8 million of synergies for Empire, as opposed to Mr. Traxler's alleged cost of $23.6 million.

Q. Why is the $4.8 million of synergies an "approximate" number?

A. The $4.8 million is approximate since the individual lines or elements of our filing were not intended to be regrouped as Mr. Traxler has attempted to do. However, the $4.8 million of synergies is certainly much more accurate than Staff's miscalculated number and shows that we expect a decrease in costs, not an increase.

Q. Staff witness Traxler at page 48, line 2 of his testimony, proposes that the cost escalation impact for UCU corporate allocations be increased from 2.5% to 5%. If UtiliCorp's allocated costs increase by more that 2.5%, what is the impact on customers under the proposed Regulatory Plan?

A. The actual increases in UtiliCorp costs would be reflected in the post moratorium rate case through the operation of the Regulatory Plan and result in lower premium costs.

Q. Even though projected UtiliCorp costs will automatically be adjusted in the future, do you agree with Staff's proposed 5% increase in the cost of UCU corporate allocations?

A. No. Staff's erroneous conclusions about "normal" cost increases were based on historical events that are not likely to recur and definitely should not be used to establish a pattern for future costs.

Q. What are those historical events?

A. In 1995, UtiliCorp centralized many Enterprise Support Functions ("ESF") from operating divisions that were previously autonomous. This centralization resulted in significant cost transfers from direct operating costs into new ESF and Intra Business Units ("IBU"). In 1997, the distribution functions of UtiliCorp were reorganized from geographical units to a functionalized basis that resulted in additional costs being transferred from direct operating costs to IBU units. During 1997, 1998 and 1999, various reengineering initiatives began to be implemented. (See Traxler rebuttal testimony, page 28 for a listing and page 31 for in-service dates of the various initiatives) As these initiatives became operational, support and communications costs increased. UtiliCorp is nearing the end of these major initiatives, however, so it is not appropriate to base future cost patterns on these events. Stated another way, these unusual events distorted the cost pattern used by Staff.

Q. Staff witness Traxler, at pages 45-46 of his testimony, questions the use of the Consumer Price Index-Urban ("CPI-U") as an approximation of post merger costs of service escalation for corporate overheads. How was the CPI-U used by UtiliCorp in this projection?

A. CPI-U was simply used as a check against assumed inflation rates.

Q. Why?

A. The CPI-U is a widely used general indicator of inflation costs on all aspects of the economy, particularly payroll. Payroll is a key component of utility cost of service. Labor costs are frequently evaluated against the CPI-U to determine whether employees have gained or lost ground via salary increases. Even some utility costs not directly impacted by CPI-U are indirectly impacted through the suppliers' payrolls. CPI-U is also widely reported by business periodicals like the Wall Street Journal and Business Week as a barometer of inflation's impact.

Q. Do you continue to believe that the CPI-U can be used to approximate inflationary impacts, even on utilities?

A. Yes. It continues to be a good general indicator of future costs and thus appropriate to use as a check against assumed inflation rates.

Q. Do you have any other comments with respect to Staff's calculation of synergies?

A. Yes. Staff has mistakenly applied its 5% inflation factor for UCU costs on the Empire synergies for A&G/Customer Services savings, Distribution savings, and Transmission savings. This results in an inappropriate and incorrect forecast of synergies.

Q. Why is this incorrect?

A. The savings/synergies being inflated reduce Empire costs, not UtiliCorp costs.

Q. What is the impact of Staff's error on the projected synergies?

A. The error actually increases the projected synergies to a level that cannot reasonably be anticipated. It is my understanding that Staff agrees with this correction and has revised testimony and schedules accordingly.

Q. Staff witness Janis Fischer, at page 25, lines 11-14 of her rebuttal testimony, has proposed reducing synergies by an adjustment purporting to represent Empire's normal, standalone job vacancy experience. How do you respond?

A. I disagree with the adjustment.

Q. Please explain why you disagree.

A. The adjustment is wrong because the Staff erred in its use of the vacancies mentioned in Mr. Robert Fancher's interview of May 22nd. In that interview, Mr. Fancher indicated that approximately 60 total positions had become vacant since the merger announcement, of which approximately 20 were related to normal attrition (non-merger). Attached as Schedule VJS-8 are pages 20-23 of that interview. The twenty positions considered non-merger-related were NOT represented by Mr. Fancher as being open for an entire year, as

Staff's adjustment assumes. In fact, Mr. Fancher specifically referred to replacing several of the positions. Maintaining 60 vacancies (or even 20) for a year from a work force of 660 people does not make sense and therefore the Staff's adjustment for vacancies to the starting point for synergies is substantially overstated.

Q. What is your understanding of how Empire normally recognizes vacancies in developing budgets?

A. It is my understanding that the cost impact of vacancies are not normally budgeted by Empire since they are relatively immaterial, but are considered as offsets to unplanned cost increases such as current gasoline price increases. Thus, budgets would still represent normal cost levels for the entire year.

Q. Assuming that an adjustment for vacancies is adopted, how should the adjustment be quantified?

A. To estimate "normal" vacancies for Empire, 1998 should be used as a representative year because it should not have any "merger-related" vacancies. A list and duration of vacancies for 1998 was developed by the Empire Human Resources department. The full time equivalency was calculated for each vacancy by dividing the vacancy duration over a year. The resulting normal vacancies were the equivalent of three positions for the entire year.

Q. How were the vacancies costed out?

A. Empire fills most vacancies by promotion and transfers from within. Of the 24 positions replaced in 1998, 21 were filled by internal candidates. That practice means that the ultimate savings from the vacancies approximates an entry-level salary. The average

1998 salary for all new hires was $21,396. The cost for three fulltime equivalents, including benefits at 20%, totals $77,026.

Q. Were there any other special situations related to vacancies?

A. Yes, three of the Empire positions that came open in 1998 were not filled as of June 30, 2000. Two of the three positions not filled (Senior Electrical Engineer, and Associate Engineer-System Planning) would be considered merger-related vacancies in reviewing 1999. Those positions are considered entry-level technical engineering positions that typically are filled by recent college graduating classes. The timing of the resignations (May 7, 1998, and October 9, 1998) was too late for 1998 college recruiting. By the time the 1999 college recruiting season was reached, the merger had been announced. As a result of the uncertainty surrounding the merger, Empire has not been able to fill the positions and therefore those two vacancies should now be considered merger-related.

Q. What is the situation with the remaining vacancy?

A. The remaining position (Construction Design Assistant) has been reorganized out of existence and could be considered a reduction of the 1999 budget. Approximate costs in the 1999 budget for this position, including benefits at 20%, are $35,200.

Q. How do the total of these non-merger vacancies compare to the Staff's estimate?

A. The corrected amount is significantly less than Staff's estimate. Staff's starting estimate of $927,940 (from Schedule 1 of Fischer's testimony) is more than eight times the corrected estimate of $112,226 ($77,026 plus $35,200). Over the ten year period, a corrected estimate for vacancy costs would be $718,732, considerably less than Staff's $11,671,530.

Q. What is the major difference with Staff's calculation?

A. Staff assumed that all vacancies (whether filled or not) were vacant for the entire year, which is not logical or supported by the facts.

Q. Can you summarize the impact of those corrections on Staff's comparison of synergies and costs for years 6-10 on page 42 of Staff witness Traxler's rebuttal testimony?

A. Yes. The two columns of Staff's summary of net Synergies (Costs) should be corrected as follows:

	UCU/Empire	Staff
Years 6-10 Net Synergies (Costs) Per Traxler page 42	($23,631)	($46,440)
Correction to reflect benefits synergies	$28,450	$28,450
Correction to 2.5% inflation on UtiliCorp allocations	NA	$33,543
Correction to 2.5% inflation on Empire synergies	NA	($17,949)
Correction for vacancies	($712)	$6,496
Corrected Years 6-10 Net Synergies (Costs)	$4,100	$4,100
Corrected Average Synergies (Costs)	**$820**	**$820**

Q. What is the net impact of correcting the errors on the STAFF column for years 6-10?

A. Correcting the errors in employee benefits synergies, inflation projections and in vacancies will result in the column labeled STAFF being changed from a Net Average Annual (Cost) of ($9,288) to a Net Average Annual **Synergy** of $820.

Responses to Miscellaneous Staff Synergy Issues

Q. Staff witnesses have raised a number of issues related to synergies that were not reflected in their summary above. Can you respond to or address Staff's concerns?

A. Yes. I will respond to Staff's issues individually in this section of my testimony.

Q. Staff witness Traxler claims that UtiliCorp general plant costs will increase the costs of general plant for Empire. How do you respond?

A. The general plant costs to be allocated by UtiliCorp to Empire are appropriate.

Q. Please explain.

A. Staff is attempting to disaggregate projected costs and synergies inappropriately, when the important issue is the overall net synergies. Those costs (for office space, furnishings and computer equipment) are no different than the payroll and other operating costs, which will be allocated to Empire customers to reflect the services now being provided by UtiliCorp. Those costs are normally allocated to business entities just as operating costs are allocated to business entities. Those support functions will be provided to Empire customers from UtiliCorp facilities for Customer Care centers, centralized engineering services, human resources, computer operations and application support, dispatching centers, information technology support, accounting and finance, treasury and management locations. These costs are incurred to provide services to Empire customers and are appropriately charged to Empire customers.

Q. What additional impact would a three-way merger of UCU, SJLP and Empire have on the synergies forecasted for Empire?

A. There would be no significant additional impact. The major area of impact from a three-way merger is on the allocation of generation synergies. Mr. Holzwarth has calculated and explained in his direct testimony the impact on generation-related synergies if both transactions are completed. The synergies calculated on Schedule VJS-1 to my direct testimony reflect that three-way impact for generation. The relatively minor differences in cost allocations of Enterprise Support Functions ("ESF") and Intra Business Unit ("IBU") departments have also already been considered.

Q. Are there additional personnel-related economies of scale that could be realized from a three-way merger?

A. No. We are essentially joining two small companies, SJLP and Empire, with a much larger entity, UtiliCorp. As a result, the additional General and Administrative personnel needed at the larger company to support the two smaller companies are primarily incremental transaction processing personnel such as accounts payable clerks. Existing supervision and management levels at UtiliCorp were determined to be adequate for the additional supervision needed. Reducing supervisors and management of the smaller merged companies and eliminations of duplicate positions such as reporting and financing are typical examples of economies of scale. Those economies have all been extracted from the approaches used by the transition teams. We have effectively eliminated over 70% of the general and administrative positions of the two smaller companies and the few positions remaining are primarily processing positions.

Q. What happens if any additional synergies, merger or non-merger, are developed for any reason?

A. Assuming that all other projected synergies are achieved and proven, the customers of Empire will receive the additional reductions in revenue requirements from any additional synergies in years 6-10.

Q. Did you calculate net present values of the proposed synergies and related guaranteed revenue requirement reductions?

A. No.

Q. Why not?

A. Calculating Net Present Value was unnecessary to determine an appropriate result. It is generally recognized that a dollar received in years six through ten is not the same value as a dollar received today. On the other hand, if NO merger takes place, then NO dollar will be received in years six through ten and therefore there will be NO value to the Empire customers. That is the situation absent the merger-related synergies – customers will see none of those merger-related benefits.

Q. What is the impact of using discounting?

A. The apparent values of the benefits to the customers are less.

Q. Why?

A. Because the bulk of the synergies are implemented in the early years in exchange for a significant capital investment. The synergies generally grow at 2.5%, the inflation factor for most operating costs. Any discount rate in excess of 2.5% will reduce the future value of the dollars. However, it is important to remember that any benefit from future revenue requirement reductions is an improvement over the existing standalone situation. Another distinction between UtiliCorp and the customers is that UtiliCorp is attempting to recoup an investment, whereas customers will receive a benefit without having made an investment.

Q. Does discounting change the $3.0 million net synergy amount in years 6-10?

A. No. It is simply an alternate view of the same dollars of synergies. The point remains that discounting NO synergies (the case absent a merger) is definitely worth less to Empire customers than discounting the $3.0 million of synergies net of the Costs to Achieve the Synergies and some premium recovery.

Q. Staff witness Oligschlaeger at page 19 of his rebuttal testimony, and OPC witness Robertson claim that merger synergies related to nonregulated operations were not quantified and therefore more of the premium should be allocated to nonregulated operations. How do you respond?

A. I disagree. First, the nonregulated operations of Empire (per Data Request 2) are projected to be approximately 1% of Empire's 1998 actual net income, which means that 99% of net income is from regulated operations. Synergies on such small nonregulated operations would be immaterial. The Regulatory Plan already assigns only 50% of the premium to regulated operations, which is substantially less than the 99% of operations that are regulated. Finally, as explained in Section II of this testimony, premiums and synergies related to potential generation EWGs or spinouts will already be treated properly in the proposed Regulatory Plan.

Q. OPC witness Trippensee, at pages 8 and 9 of his testimony, claims that the Empire merger shouldn't be approved because the synergies are dependent on the SJLP merger being approved. How do you respond?

A. I disagree. In the event that the Empire transaction is closed and the SJLP transaction is not, the Post Moratorium rate case will reflect that situation.

Q. Staff witness Hyneman, at pages 42 to 52 of his testimony, describes at length the acquisition premium calculation and why he believes UtiliCorp would be willing to pay an acquisition premium. Do you agree with his conclusions?

A. Not entirely. Witness Hyneman has overlooked one significant source of benefits to UtiliCorp that would justify an acquisition premium--the merger-related synergies to be achieved by the merged companies.

Q. How do those merger-related synergies justify premium?

A. If commissions recognize that the merger-related synergies are created solely by the merger, it would be logical that those synergies be retained by the acquiring company and allowed to offset the premium costs. That retention would support an acquisition premium to the extent that synergies are projected.

Major Elements of Synergies

Q. Staff witness Fischer, at pages 45-48 of her rebuttal testimony, cites an UtiliCorp case that dealt with merger related synergies. What conclusions do you draw from that case?

A. The findings in that case amply demonstrate the risk to UtiliCorp of not defining and receiving approval for the types of synergies that will be considered merger-related up front. By approving this Regulatory Plan, the Commission will be setting the ground rules for all parties as to what types of costs will be considered merger-related in subsequent rate cases to avoid exactly the type of controversy generated in that case.

Q. What types of synergies are proposed in the Regulatory Plan as being merger-related?

A. The major types (and the UtiliCorp witness sponsoring each synergy) can be summarized as follows:

1. Generation –related synergies for onsystem energy, capacity, and off-system sales (Robert Holzwarth and Frank Debacker),
2. Payroll for position reductions of existing Empire staffing levels (Vern Siemek)
3. Non-payroll costs such as insurance and other out-of-pocket costs (Vern Siemek)
4. Benefits savings from reduced positions and from plan changes (Robert Browning)
5. Net transfers and allocations between the merging companies (Vern Siemek)

Q. Should the Commission rely upon UCU/Empire estimates of merger savings/synergies and merger costs in its findings regarding the proposed merger?

A. Yes. These estimates were carefully prepared by experienced personnel and are reasonable estimates of the synergies to be achieved. For additional comfort, the actual synergies and costs will be considered and reviewed by the Commission during the Post Moratorium Rate Case, five years after the closing of the merger. At that time the Commission will have the opportunity to determine the actual synergies and costs of the merger.

II. SYNERGIES IMPACTS UNDER REGULATORY PLAN

Generation Valuation

Q. Staff witnesses cite UtiliCorp's February 3, 1999 Board presentation in connection with the SJLP transaction concerning deregulating generating plants as of January 1, 2001 as 'evidence" that UtiliCorp valued Empire generating plants separately in the Empire transaction. Staff then claims that UtiliCorp believes deregulation will occur soon and this was incorporated in UtiliCorp's valuation of both SJLP and Empire. How do you respond?

A. I disagree.

Q. Why?

A. The single example of projections cited by Staff incorporated SJLP's banker-assisted projections unchanged into the base for a preliminary UtiliCorp Board presentation. The corrected view of SJLP operations, after all elements of preliminary due diligence were completed, eliminated the projected January 1, 2001 deregulation as a basis to develop any financial scenario for the value of SJLP.

Q. Why would UtiliCorp have used SJLP's banker-assisted projections as the basis for a presentation to UtiliCorp's Board concerning the SJLP transaction?

A. At the point in time of the Board presentation, the complete due diligence analysis was not available. The SJLP projections were the only base information readily available. Due diligence efforts to that point had focused on cost reductions and sales opportunities, not the underlying deregulation assumptions of the base SJLP projections. Clearly, UtiliCorp's management did not rely upon SJLP's projections or UtiliCorp's Board since the offer price authorized was considerably below the level such a projection would support. The projection of March 15, 1999, upon which the offer was based, excluded any such projection of deregulated generation.

Q. If generation is sold or spun off to nonregulated operations, would Empire customers continue to pay for the level of premium recovery in UtiliCorp's Regulatory Plan?

A. No. First, an appropriate amount of the premium would be transferred out along with the generation assets. Second, the synergies projected under the Plan would be significantly reduced by eliminating increased Off System Sales and other generation-related synergies. The impact of that synergy reduction would be to decrease the premium allowed in rate base below 50% so that customers would still see a net reduction in revenue requirements from the merger (guaranteed by the $3 million element of the regulatory plan).

Merger vs. Non-merger Synergies

Q. Staff witnesses Fischer, at page 48, lines 30-31 of her testimony, and Featherstone, at pages 84-85 of his testimony, claim that in your Staff interview on March 2, 2000, you indicated that merger savings do not need to be distinguished from non-merger savings. Is that an accurate representation of your position and your statements in that interview?

A. No. A careful reading of pages 47 and 48 of my interview transcript should dispel Staff's confusion. What I essentially said was that merger-related synergies are only important to identify until the hurdle rate or level that supports the $3 million guarantee is reached. After that point, there is no longer a need to distinguish every single synergy as merger or non-merger because **ALL** synergies over the hurdle level are used to reduce the revenue requirements for the customers.

Q. Why would UtiliCorp forego the opportunity to claim merger-related synergies after that hurdle level is reached?

A. We were trying to design a simple plan that avoided the detailed arguments that Staff raises about categorizing every single synergy as merger or non-merger. We believe that our approach serves to minimize the controversy over those issues and even give additional upside opportunity to the customers since all synergies over the hurdle level will accrue to the customers' benefit.

Q. Staff witness Fischer, at page 40 of her testimony, and other Staff witnesses, express concerns about exactly what savings are merger-related. Does your previous explanation also address that concern?

A. Yes.

Q. Do you have any other relevant response to those concerns?

A. Yes. UtiliCorp will bear the burden of proof in subsequent rate cases about what might have happened had SJLP and Empire remained on a standalone basis. The position reductions being proposed are real and can be easily proven. The generation-related synergies, including offsystem sales, are real and can be easily proven. The benefits synergies and minor nonpayroll costs are real and can also be proven relatively easily. Against these easily proven and obvious synergies are Staff's highly speculative 'could-have-beens' and 'might-have-beens'. It is fairly straightforward now to evaluate the relative likelihood of material elements of that future. As added protection for the customers, our regulatory plan does not intend to claim every single merger synergy after the hurdle level is reached – after that point, any synergy, merger or non-merger, will end up to the customers' benefit. As a result the Regulatory Plan effectively reduces the kinds of speculative, potential events that Staff raises as concerns.

Forward Average Synergies

Q. Staff witness Traxler, at page 6 of his testimony, objects to the use of forward average synergies for years 6-10 to adjust the test year in the Post Moratorium Rate Case. Why did UtiliCorp include that element in the Regulatory Plan?

A. To give customers, in the Post Moratorium Rate Case, the benefits of the forward average synergies for years 6-10 after closing of the merger. The synergies are projected to grow over years 6-10 and the use of a test period from year 4 would not benefit the customers as much because synergies in year 4 have not yet reached the levels projected for years 6-10.

Q. Is the use of forward average synergies a detriment to the customers?

A. No, it actually enhances the merger value to the customers. For example, if year 4 synergies are used as the test period in a Post Moratorium Rate Case, then the guaranteed $3 million revenue requirement reduction is triggered and the $3 million is achieved by the guarantee. However, if forward average synergies result in a greater reduction to revenue requirements, customers will benefit more by using forward average synergies.

Q. What happens to premium recovery under each of these options?

A. Synergies as used in the case reduce revenue requirements, which in turn allow premium recovery. If the synergies used are too high, premiums offset the synergies and the customers are even. If the actual synergies are then less than projected, UtiliCorp suffers the shortfall. UtiliCorp is still at risk to achieve the synergies, since revenue requirements to customers were reduced based on the projections.

If the synergies used were too low, customers would have the lower revenue requirements, the premium recovered from customers would be less, and the higher actual synergies would then help pay the premium.

The customers are actually benefited more by using synergies that are too high because UtiliCorp is then at risk. The use of the forward average synergies allows UtiliCorp to err on the high side, which is of greater benefit to the customers and leaves UtiliCorp more at risk.

Q. Could you provide an example of the impact of projecting various levels of synergies?

A. Yes, this can be illustrated as follows:

Beginning Revenue Requirement Base	$950		
Forward Average Synergies	$ 50	$25	$60
Revenue Requirement (Lowered)	($ 50)	($25)	($60)

Premium recovery allowed (max $50)	$ 50	$25	$50
Net Customer Revenue Requirement	$950	$950	$940

Customers would have received more benefits had UtiliCorp used higher synergies such as the $60 in the example. If $60 of synergies were used (with a cap on premium recovery of $50), the revenue requirement would have been $940, $10 less than the $950.

Q. You indicated that UtiliCorp, not its customers, is at risk if the synergies are not achieved. Can you explain what you mean by this?

A. Yes. Another table illustrates this point:

Assume synergies of $50, with premium recovery of that same $50.

Customer revenue requirements, including $50 of premium recovery, is $950

Synergies accomplished vs. $50 projected	**$ 50**	**$ 25**
From customers	$950	$950
From synergies	$ 50	$ 25
Net Impact on UtiliCorp	$ 0	($ 25)
Net Impact on customers	$ 0	$ 0

Clearly UtiliCorp suffers if synergies are not achieved after they were used to reduce revenue requirements. Customers, on the other hand, are not harmed because the revenues were unchanged by the shortfall of synergies.

Regulatory Lag Unsuitable For Cost Recovery

Q. Staff contends that regulatory lag is an adequate vehicle to recoup premium costs. Do you agree?

A. No, not if the Staff means "traditional" regulatory lag.

Q. Why?

A. The potential for benefits from traditional regulatory lag is clearly inadequate to recover the cost of the premium because of the mechanics of regulatory lag. That is because resetting rates every third or fourth year to the new level of actual costs would eliminate too many of the merger synergies to provide a real opportunity over the longer term to recover the premium.

Q. Can you illustrate traditional regulatory lag with the projections from this filing?

A. Yes. The impacts can be illustrated as follows:

Avg Annual Premium costs, years 1-10	$39 million
Average recovery due to regulatory lag	$6.8
Average annual Shortfall	$32.2
Percentage of premium recovered by traditional regulatory lag	**17.4%**

Q. How would you characterize a 17.4% premium recovery?

A. As grossly inadequate. Under the traditional regulatory lag mechanism, most of the merger synergies flow to the customers instead of flowing to UtiliCorp who paid for the investment that created the synergies. This calculation clearly illustrates why traditional regulatory lag should not be considered an adequate replacement for the Regulatory Plan UtiliCorp has proposed.

Q. How did you calculate the average benefit of regulatory lag?

A. The calculation is shown on Schedule VJS-6. The normal interval between rate cases was assumed to be three years. All the synergies in year 3 were reflected in the rate reset that is reflected in year 5. Reflecting the decrease in year 5 allows more than adequate time for completing the case. The new rates are then reflected in the three subsequent years. This pattern is then repeated with the year 6 synergies.

Q. Is there any scenario in which regulatory lag could be effectively used to make this transaction equitable to the shareholders and to the customers?

A. Perhaps, but it would probably require that the "lag" period after the Pre-Moratorium rate case approximate the ten years covered by the current Regulatory Plan.

Q. Would a ten-year lag period or rate moratorium simplify elements of UtiliCorp's proposed Regulatory Plan?

A. Yes, it could have several simplifying advantages over the current Regulatory Plan. For example, a ten-year lag period would not require explicit tracking of synergies, it would not require explicit rate base treatment or recovery of premium, nor would it require explicit approval of a 'frozen capital' structure. It would put even more risk on UtiliCorp to achieve the synergies since those synergies would by the main means to recover any of the premium costs or of the costs to achieve the synergies.

Q. Under a ten-year lag scenario, how would UtiliCorp's Missouri Public Service ("MPS") division be impacted?

A. Similarly to the current Regulatory Plan. MPS allocation factors would still need to be determined as if the merger had not occurred. The bulk of synergies like offsystem sales would still need to be allocated or assigned to SJLP and Empire. These two synergies from the merger would still need to be available to help pay the costs of the merger.

Q. How would customers receive any benefit under such a scenario?

A. The first benefit is from having ten years of fixed rates, which results in rates that are lower by more than 25% in real terms than today's rates by year 10. A possible second benefit to customers could be developed by taking the year 6-10 guarantees and spreading those reductions over the full ten years to be implemented at the start of the moratorium period. For example, SJLP's $1.6 million for five years could be $.8 million for ten years effective immediately. Empire's $3.0 million for five years could be $1.5 million for ten years effective after the Post Moratorium Rate Case.

Q. How should regulatory reporting during the ten years be modified to reflect the results of Empire and SJLP operations?

A. The premium amortization should be reported above the line, and the premium investment should be reported in plant in service to reflect the implicit treatment of those costs.

Q. With these modifications, could a plan based on a regulatory lag concept be developed that would be equitable for both customers and shareholders?

A. I believe so, but any such plan would certainly require extensions and expansions on what normal regulatory lag entails, it would need to incorporate selected elements of the proposed Regulatory Plan, and it would need to recognize the increased risk to UtiliCorp of the extended rate freeze.

Regulatory Plan Recoveries

Q. Staff witness Traxler, at page 4 lines 11-12 of his testimony, claims that customers will subsidize merger costs and premium recovery by $110 million over the 10-year period by cost allocations and other elements of the Regulatory Plan. Do you agree?

A. No. Staff's overall position seems to be that most merger-related synergies, even though due solely to the merger, should be used to reduce rates while ignoring the substantial costs incurred by UtiliCorp to create the merger needed to achieve those synergies. These merger-related synergies are the Staff's alleged 'subsidies'. The total combined costs to UtiliCorp from the premiums alone for the initial ten years exceed $550 million ($150 million from SJLP and $400 million from Empire). Retention of the merger-related synergies is one of the ways that UCU can recoup those costs with NO detriment to the customers from the rates that customers pay today.

Q. Staff indicates that some indirect premium recovery is accomplished by using allocation factors that ignore Empire cost drivers for MPS cost allocations. Do you agree?

A. Yes. Some indirect premium recovery is achieved by this critical element of UtiliCorp's Regulatory Plan. That recovery is the reason for clearly including that element in UtiliCorp's Regulatory Plan

Q. Staff claims that MPS customers suffer a detriment by that cost allocation. Do you agree?

A. No. MPS customers are in exactly the same position as if the merger (and the considerable costs incurred to accomplish that merger) had not occurred.

Q. How is that accomplished?

A. The MPS allocation element of the Regulatory Plan recognizes a synergy that, without the special provision in the Regulatory Plan, would have been realized by MPS customers who bear none of the costs of the merger. It is equitable to retain that synergy to offset the costs incurred to create that synergy.

Q. Staff claims that the "capital freeze" results in indirect recovery of premium at the expense of Empire customers. Do you agree?

A. No, for two reasons. The first relates to the initial structure of the transaction as a stock and cash transaction. Empire equity will be replaced with enough UtiliCorp stock that the equity investment in Empire's traditional rate base will not be reduced from Empire's normal levels. Thus there is no lessening of the equity investment in Empire. The second reason is that those potential capital synergies only arise because of the merger. Empire has not in the past and has no plans to reduce the equity component of its capital structure from its equity target of 47.5%. As a result, Empire customers could not reasonably expect a lower equity structure absent the merger and would not have realized any such benefit. It is equitable to retain that potential benefit from this critical element of the Regulatory Plan.

Q. Staff has implied that direct and indirect recoveries may total more than 100% of the premium. Can you summarize the impacts of the various elements of the Regulatory Plan?

A. Yes. Schedule VJS-5 list the direct and indirect recovery elements for both mergers. I have also quantified or listed if not quantifiable other possible issues that have been referenced or should be considered in relation to premium recovery. To summarize that schedule, in years 6-10, premium costs of up to 75% and 65% respectively for SJLP and Empire are potentially recoverable. Another 15% and 9% are possible if all other potential issues are considered.

If Costs Exceed Synergies

Q. Staff witness Traxler, at page 6 of his testimony, claims that synergies in years 1-5 are less than merger costs and 50% of the premium. Does this situation put customers at risk for any of those costs in excess of the synergies?

A. No. The Regulatory Plan places all of that risk during the years 1-5 on UtiliCorp because of the rate freeze in years 1-5. There is no risk to or impact on the customers.

Q. Staff witness Traxler, at page 7 of his testimony, expresses concerns about costs exceeding savings. How do you respond?

A. His concern is not well founded.

Q. Please explain.

A. The worst case under UtiliCorp's Regulatory Plan is that none of the projected synergies are accomplished and/or proven. In that event, customers would not pay for any of the premium costs or Costs to Achieve. However, customers would still receive a benefit because of UtiliCorp's guarantee of an annual $3 million revenue requirement reduction. The guarantee would total $15 million of minimum benefit over years 6-10, even if no synergies were achieved and/or proven.

Q. How does the minimum benefit of $15 million compare to Staff's projections of net costs for years 6-10?

A. Witness Traxler's testimony, at page 64, line 32, assumes all Staff adjustments are reflected and projects Staff's expectation of costs for years 6-10 of approximately $8 million. Even if all those alleged cost increases were allowed in rates, they are more than offset by the benefits of the $15 cumulative guarantee. Customers would benefit by at least the net difference of $7 million and would have paid for none of the premium. Of course, we disagree with some of the Staff's adjustments, but have reflected the worst possible scenario to illustrate that the customers would still receive benefits even in the worst possible scenario.

Synergies Under the Plan

Q. Please summarize the cost/synergies impacts including the risk/rewards of the Regulatory Plan.

A. The Regulatory Plan can be summarized as follows:

1. The initial five-year rate freeze provides strong incentives to UtiliCorp to create synergies as quickly as possible to help offset the costs of the merger, including the significant costs of the premium. UtiliCorp is at risk to achieve the synergies during the first five years and is at risk for cost increases during those five years.

2. UtiliCorp is at risk to both achieve the synergies and to prove them before any direct recovery of a portion of premium is allowed in year 6. Even assuming both direct and indirect recovery of a portion of the premium, the amount actually received by UtiliCorp would be substantially less than the total costs incurred.

3. Empire customers suffer no detriment. The initial five-year rate freeze provides protection from potential cost increases during the five years after the Pre-Moratorium rate case, and results in a 10% real cost decrease by the end of the freeze.

4. Empire customers also benefit from the guaranteed $3.0 million revenue requirement reduction in years 6-10. Empire customers do not share any of the capital structure savings since those savings are not possible without the merger.

5. MPS customers are kept whole, suffering no detriment from their costs prior to the merger. MPS customers are asked only to forego a benefit in allocated costs that they would not have experienced absent the merger.

In summary, all customers win (or suffer no detriment) while UtiliCorp incurs sizable costs and risks that will help lower future Empire rates from the current standalone levels.

III. COSTS TO ACHIEVE THE SYNERGIES:

Q. Staff witnesses Traxler, Russo and Oligschlaeger and OPC witness Robertson have questioned various aspects of the proposed recovery of Costs to Achieve, including in some cases a distinction between transition and transaction costs. How do you respond?

A. I disagree with their positions.

Q. Why?

A. All of these costs (including legal costs and Empire banker fees) are necessary to bring about the merger and thus to realize any of the synergies from the transaction. Staff witness Russo even acknowledges as much on page 7, lines 3-4 of his surrebuttal when he says, "Absent the merger, these transaction costs would not have been incurred." Failure to deduct these costs from the synergies overstates synergies that could not be accomplished without the costs to achieve.

Value to Customers

Q. Staff witness Russo asserts that all transaction costs should be borne by shareholders since the transaction is being undertaken to increase shareholder value. How do you respond?

A. The shareholders have incurred costs to bring about the merger, which will result in subsequent benefits for customers. The shareholders are entitled to recover those costs.

Q. If UtiliCorp shareholders recover the transaction costs, does that mean that customers do not benefit?

A. No. Customers benefit because the merger will result in a rate freeze under the Regulatory Plan and the merger will bring about synergies leading to the guaranteed revenue requirement reduction in years 6-10.

Q. Staff witness Hyneman at page 40, lines 22-23 indicates that transition costs are "...costs incurred ... in an attempt to run the combined utility more efficiently." How does this compare to a definition of transaction costs?

A. This is a fair characterization of what is accomplished by the transaction costs.

Q. Staff contends that customers would benefit from still lower rates if their positions are adopted AND the merger takes place. Do you agree?

A. No. The fallacy in the Staff's reasoning is that lack of approval of the Regulatory Plan would create a serious risk that the merger will not happen If there is no merger, the customers definitely will not see any merger-related benefits.

Tracking Costs and Recovery of Certain Costs to Achieve

Q. Do you agree with the condition set out in the testimony of Staff witness Russo that transaction costs be tracked to preclude recovery?

A. No. While I believe the Costs to Achieve the Synergies should indeed be tracked, the tracking is necessary to ensure that the costs are properly included in consideration of net synergies benefiting customers of Empire, not excluded.

Q. Staff and OPC witnesses have questioned recovery of certain Costs to Achieve the Synergies such as the change-in-control agreements for Empire officers, the Advisory Board, and the curtailment costs under Financial Accounting Standard 106 (retiree medical costs). How do you respond?

A. Our position is that the totality of costs should be measured against the totality of benefits. However, even using Staff's line-by-line approach, it is clearly appropriate to net those costs against the synergies.

Q. Why?

A. Let's look at each of the three items:

1) Executive base salaries are included in current cost of service for Empire as a stand-alone company. Base executive salaries have never been raised as a cost of service issue in prior Empire rate cases to my knowledge. Those executive costs will be eliminated after the merger and are included in the projected synergies.

2) The Advisory Board is a condition set out in the merger agreement and in effect replaces ten years of the costs of the Empire Board of Directors with three years of the cost of the Advisory Board.

3) The benefit of the curtailment cost extends to the entire 10-year period that is covered by UtiliCorp's Regulatory Plan. Staff recognizes (Traxler page 23, lines 9-12) that the curtailment costs are directly caused by the position reductions that create the synergies - reductions that extend for the entire ten years of the Plan.

Q. What are the benefits that customers receive in years 6-10 from these curtailment costs compared to the benefits in years 1-5?

A. The synergies are significantly higher in years 6-10 than in years 1-5. Witness Traxler's methodology (Schedule SMT-4, line 3) shows that the synergies of the benefits costs alone during the first five years total $11.5 million. Staff indicates that this is an adequate synergy to bear the entire costs of the curtailment and ignores the synergies during years 6-10. Schedule VJS-7 extends Staff's analysis to reveal that the synergies during years 6-10 are projected to be $16.5 million (line 3 under Totals for Years 6-10)

Q. What then is the impact of the Staff recommendation?

A. Staff would have UtiliCorp absorb the entire $2.7 million of curtailment costs against the benefits of $11.5 million during years 1-5 (41% of the synergies), while customers receive a benefit of $16.5 million during years 6-10 (59% of the synergies) at no cost. This is clearly inequitable.

Q. Please explain the impact of UtiliCorp's original proposal on curtailment costs.

A. That the curtailment cost be amortized evenly over 10 years, which results in an even split of the $2.7 million cost between the two 5-year periods even though the benefits to the customers in years 6-10 are much higher than during years 1-5. The original treatment is more than fair.

Q. Staff indicates that the amortization of the curtailment costs violate the Regulatory Plan. Do you agree?

A. No. Deferral and amortization over ten years of the curtailment cost is entirely consistent with the Regulatory Plan. That plan defers costs during the moratorium that will yield benefits during the entire ten years. Almost all of the Costs to Achieve (including severances, retention costs, and IT transition costs) are incurred in the moratorium period and amortized over the ten years of the plan.

Q. Staff also implies that curtailment costs are required by accounting rules to be expensed as incurred. Do you agree?

A. No. UtiliCorp's proposed treatment of curtailment costs is no different than the requested treatment of severance costs. Our treatment of both recognizes the impact of the regulatory process on accounting principles that I discuss in more detail under recovery periods.

Q. Would you summarize how customers will fare by UtiliCorp's proposed treatment of these Costs to Achieve the Synergies in comparison to Staff's recommendations?

A. Customers will realize synergies during the ten years from the elimination of the related costs of the executives, the Board of Directors and from the position reductions that create the curtailment costs for the retiree medical plan. For Staff to recommend at the same time excluding the costs of achieving those same synergies would not be fair.

Q. Does the amortization of any of the Costs to Achieve mean that all those costs will actually be recovered from customers?

A. No. Since we have already voluntarily foregone a carrying cost on those Costs to Achieve the Synergies, the value of the ten-year recovery of those specific costs is roughly only 60%. The value of the costs amortized over 40 years is only 20%. During the first five years, the synergies are inadequate to recover our costs. As a result, it is likely that customers will actually pay far less than half of the costs.

Regulated Allocation of Costs to Achieve

Q. Staff witness Russo recommends that the Cost to Achieve the Synergies needs to be explicitly allocated to nonregulated operations. Do you agree?

A. No. The regulated businesses of Empire are considerably more than the 50% share of premium recovery explicitly requested in all years. Besides requesting only 50% of the premium, UtiliCorp' proposal already implicitly reduces the allocation of the Costs to Achieve the Synergies to the regulated operations to a lower level of costs to regulated operations than could be justified.

Q. How is that accomplished?

A. The current value of incurring costs today that are recovered over ten years and forty years with no carrying costs (as UtiliCorp has proposed) yields a payback much less than 60% of the initial expenditure. That recovery is reduced further by the shortfall of synergies during the rate moratorium.

Q. How does that compare to the regulated operations of Empire?

A. A review of the projections in the due diligence analysis supplied to Staff as part of Data Request 2 clearly indicates that the regulated operations of Empire are approximately 1% of the total operations. Regulated operations provide approximately 99% of the total net income. As a consequence, the implicit assignment of Costs to Achieve to regulated operations in the UtiliCorp filing actually under allocates costs to the regulated operations.

Recovery Period

Q. What is an appropriate recovery period?

A. The periods proposed by UtiliCorp's Regulatory Plan are appropriate. Ten years is a commonly used period for projecting synergies from mergers, and is the basis for the recovery of the majority of the Costs to Achieve. Despite that long period of recovery, we did not request carrying costs on the unamortized balances of the Costs to Achieve. Schedule VJS-1 of my direct testimony clearly shows that the projected synergies during the first five years are inadequate to recover the costs amortized during those years. Certain Costs to Achieve the Synergies were also proposed to be amortized over forty years in order to yield more benefits to the customers during years 6-10. That proposal was based on the desire to better parallel the benefits in years 6-10 with those proposed for the SJLP customers, despite the significant detriment to shareholders created by that longer recovery period. As a further protection for customers, under the Regulatory Plan, UtiliCorp will bear the burden of proof in later years to substantiate that synergies are adequate to provide for the recovery of those remaining costs, or the $3.0 million revenue requirement reduction is triggered. UtiliCorp's Regulatory Plan represents an appropriate sharing of the costs.

Q. Even if any of those Costs to Achieve the Synergies are classified transaction costs, is the Commission required to amortize these costs over forty years as suggested by Staff witness Russo?

A. No. First, regulatory commissions have some authority to impact accounting by the method approved for cost recovery. Examples commonly seen are accounting orders deferring extraordinary costs for later recovery; income tax benefits that are flowed-through to rates immediately rather than normalized through deferred tax entries; deferrals and amortizations of various unusual costs like storm damages that would normally be expenses of the period in which they occur; the accounting for purchased gas cost tracking mechanisms that reflect over or under recovery of actual gas costs; and pension/retiree medical benefit expenses where accounting principles are frequently altered.

Second, even if that authority were not invoked, the accounting principles on amortizing goodwill do not require amortization over forty years, but rather establish a maximum life of forty years, with shorter lives recommended depending on the circumstances. In this instance, the regulatory plan was proposed for only ten years, so that same ten-year life is appropriate to amortize the costs to achieve.

Q. Staff witness Russo recommends amortizing additional items of the Costs to Achieve over forty years, and at the same time recommends that no carrying costs be allowed. How do you respond?

A. I disagree.

Q. Why?

A. Since we have already voluntarily foregone a carrying cost on all of Costs to Achieve the Synergies, the value of the ten-year recovery is roughly only 60%. Achieving even that value ignores the fact that the amortization is not fully recovered in the first five years of the rate moratorium when synergies do not recover the costs. Lengthening the amortization to forty years reduces the value of the recovery to roughly 20%, even before the moratorium shortfall. This 20% value is actually what the company has voluntarily proposed on two of the major cost items. Further reductions would clearly be inequitable.

Q. How do you respond to Staff witness Russo's recommendation that transition costs be expensed as incurred, but allow recovery through rates if incurred during a rate review period or test period?

A. I disagree. Since almost all of the transition costs will be incurred in the first three years (all during the rate moratorium), the practical effect of that recommendation is to deny any recovery of the transition costs. Such a denial would clearly be inequitable since it would have UtiliCorp expend all the costs of implementing the synergies and then return all of the consequent synergies to the customers, who would have paid none of the costs.

IV. PROPER STARTING POINT FOR SYNERGIES:

Types of Synergies

Q. Staff witness Traxler, at page 18 of his testimony, objects to the use of the 1999 budget of Empire as the savings/tracking "baseline". How do you respond?

A. The 1999 budget was not used for all the baselines. The starting point for measurement is different for each of the three major types of synergies because of their different characteristics.

Q. What are the three major types of synergies?

A. The three major types of costs are benefits; generation-related synergies; and other operations and maintenance costs.

Q. What is the appropriate starting point to measure synergies for benefits and why?

A. The correct starting point to measure synergies in the benefits area is a year-by-year projection on the proper basis to calculate the merger-related synergies, as witness Browning set out in the schedules to his direct testimony. These year-by-year projections reflect the complex nature of the various elements of benefits costs, particularly pensions and retiree medical costs, as well as correcting estimates of future costs. Mr. Browning's surrebuttal testimony will provide more detailed explanations of the complexity that is incorporated in these calculations.

Q. What is the appropriate starting point to measure synergies for generation-related synergies and why?

A. The correct starting point for generation-related synergies is also a year-by-year projection on the proper basis to calculate the merger-related synergies, as witness Holzwarth set out in the schedules to his direct testimony. These year-by-year projections reflect the complex nature of the various elements of costs and revenues in these areas, including the interaction of fuel costs, capacity availability, purchased power contracts and growth opportunities in sales. Mr. DeBacker's surrebuttal testimony will provide more detailed explanations of the complexity that is incorporated in these calculations.

Q. What is the appropriate starting point to measure synergies for other operations and maintenance costs and why?

A. I believe the correct starting point for other operating and maintenance expense synergies is the 1999 budget of Empire as the proper basis to calculate the merger-related synergies. That starting point is reflected in the schedules to my direct testimony and consistently used by the transition teams in developing their projected synergies. As discussed in my interview by Staff, the 1999 budget was selected as the baseline because it was the most current information on expected Empire operating costs available to all the transition teams. This enabled the transition teams to have the benefit of the best and most current view of Empire operating managers of Empire costs to operate and in a form that facilitates management of those cost going forward. I continue to believe that the 1999 budget is appropriate for developing those synergies projections.

Q. Staff contends that 1999 budgeted costs are less reliable because some budgeted events do not occur. The sole example cited by Staff witness Traxler is the scheduled Iatan maintenance outage that was deferred from 1999 to early 2000. Staff witness Harris also referred to net savings from fuel expense reductions at Iatan as savings already in place that should not be considered merger-related. Staff contends that such variances reduce the ability to use the budgets as a starting point for synergies. How do you respond?

A. Budgets can be just as reliable as adjusted actuals as a starting point. Actuals cannot be used without adjustments in rate cases or in these proceedings. The Iatan situations do not even require an adjustment to UtiliCorp's synergies.

Q. Why not?

A. UCU did not rely on the 1999 Budget as the starting point to develop generation-related synergies. UCU used the year-to-year projections as discussed earlier. No synergy related to the Iatan maintenance is included in any future year synergies because the delay does not effect 2001 and later years in the year-to-year projections. Likewise, no synergy from the fuel expense reduction from lower pricing is included in the year-to-year projection since both the standalone and the combined projections used the same basis for fuel costs.

Q. Are there other reasons to use the 1999 budget as the starting point for other operation and maintenance expenses?

A Yes. Management's ability to monitor and ensure that the synergies are accomplished is much improved by using an operational budget that actually shows what a department is spending. The costs of many departments become intermixed when converted to FERC accounts. It would add an unneeded layer of complexity to start from adjusted FERC accounts and then translate back into manageable department targets. Any additional complexity that is not necessary such as attempting to translate backward from FERC accounts should be avoided.

Q. Can budgeted amounts be relied upon for purposes of establishing a savings tracking "baseline" for just the other operating and maintenance costs?

A. Yes.

Pre-Moratorium Rate Case

Q. Could Staff's proposal of using cost levels from the Pre-Moratorium Rate Case be relied upon for purposes of establishing a savings tracking "baseline" for just the other operating and maintenance costs?

A. No, because it is unknown what those levels of costs will be at this time. We do not believe it appropriate to inject additional levels of risk on UtiliCorp from a baseline to be set in the future, especially given Staff's stated intent to reflect merger-related synergies into that case. Staff has already objected to setting rules on what costs should be included in that case.

Q. Can the levels of cost in the Pre-Moratorium Rate Case be relied upon for benefits costs?

A. No. The complex nature of those costs render comparisons to single base years almost meaningless and definitely inappropriate for calculating synergies. See the surrebuttal testimony of Mr. Browning for additional discussion on this point.

Q. Can the levels of cost in the Pre-Moratorium Rate Case be relied upon for generation-related synergies, particularly fuel/purchased power?

A. Not without considerable care and definition of terms, but Mr. DeBacker is the appropriate witness to address that.

Q. Do the starting point measurements need to be resolved in this proceeding?

A. Yes. UtiliCorp needs to know the ground rules on measuring merger-related synergies now with the fewest possible uncertainties or unresolved issues in order to determine the likely financial impacts and thus the economics of the transaction prior to closing.

Q. Does this conclude your surrebuttal testimony?

A. Yes.

Summary of Direct and Indirect Recovery of Premium and Other Potential (Costs)
Empire and SJLP

		Premium Recovered SJLP				Premium Recovered Empire			
		Years 1-5		Years 6-10		Years 1-5		Years 6-10	
1 Premium costs-average annual		**$ 13,516**	100%	**$ 12,208**	100%	**$ 41,036**	100%	**$ 37,065**	100%
Direct Recovery									
2 Recovered via Projected Synergies		$ 4,255	31%	$ 6,104 Note A	50%	$ 13,733	33%	$ 18,533 Note A	50%
Indirect Recovery									
3 Allocations to MPS not reduced		$ 2,644	20%	$ 2,991	25%	$ 4,818	12%	$ 5,450	15%
4 Total recovery		**$ 6,899**	**51%**	**$ 9,095**	**75%**	**$ 18,551**	**45%**	**$ 23,983**	**65%**
Other Potential (Costs)									
5 Frozen Capital	B	$ 2,208	16%	$ 2,208	18%	$ 5,240	13%	$ 5,240	14%
6 Non-merger cost increases not recovered during freeze	C	**See Note C**		NA		**See Note C**		NA	
7 Carrying costs-costs to Achieve	D	$ (1,286)	-10%	$ (429)	-4%	$ (3,109)	-8%	$ (1,786)	-5%
8 Total other potentials		**$ 922**	**7%**	**$ 1,779**	**15%**	**$ 2,131**	**5%**	**$ 3,454**	**9%**

Note A: Assumes projected synergies developed and proven to Commission-UtiliCorp at risk to develop synergies and prove to Commission.
Note B: Not considered recovery of premium due to structuring of acquisition. Included for disclosure.
Note C: UtiliCorp at risk for these costs, including capital costs increases, during moratorium. Cost increases during the five-year freeze reduce recovery of premium.
Note D: UtiliCorp elected not to request recovery of carrying costs as part of the overall cost recovery.

Projected Recovery of Premium From Regulatory Lag - Empire

	Net synergies by year (VJS-1 Annual)	Year 4 Rate Reset Lagged 1 yr	Synergies After Yr 4 Reset	Year 7 Rate Reset Lagged 1 yr	Net Synergies After Yr 7 Reset
2001	$ 3,497		$ 3,497		$ 3,497
2002	$ 10,039		$ 10,039		$ 10,039
2003	$ 14,669		$ 14,669		$ 14,669
2004	$ 17,051	$ -	$ 17,051		$ 17,051
2005	$ 23,407	$ (14,669)	$ 8,738		$ 8,738
2006	$ 21,379	$ (14,669)	$ 6,710		$ 6,710
2007	$ 24,009	$ (14,669)	$ 9,340	$ -	$ 9,340
2008	$ 22,564	$ (14,669)	$ 7,895	$ (6,710)	$ 1,185
2009	$ 16,826	$ (14,669)	$ 2,157	$ (6,710)	$ (4,553)
2010	$ 22,728	$ (14,669)	$ 8,059	$ (6,710)	$ 1,349

Cumulative recoveries from synergies	$ 68,025
Average annual recovery from synergies	$\boxed{\$ \ 6,803}$

Extension of SMT-4
Staff Witness Traxler

Analysis of Early Retirement Impact on Employee and Retiree Benefit Costs-Empire

	Staff recommendation	Proposal per filing		
	Totals from SMT-4 for Years 1-5	Totals for Years 1-5	**Totals for Years 6-10**	**Totals for Years 1-10**
1 Reduction in Employee Benefit Costs - Headcount Reductions	$ (3,234,375) Note A	$ (3,234,375)	$ (3,590,240)	$ (6,824,615)
2 Reduction in FAS 106 costs - Conversion of Empire to UCU Benefits	$ (8,291,362) Note A	$ (8,291,362)	$ (12,866,623)	$ (21,157,985)
3 Total Savings - Benefits Conversion & Headcount Reduction	$ (11,525,737)	$ (11,525,737)	$ (16,456,863)	$ (27,982,600)
4 Increase in Accrued Fas 106 costs - Headcount Reduction	**$ 2,732,315**	$ 1,366,158	$ 1,366,158	$ 2,732,315
5 Net Savings During Moratorium - Years 1-5	$ (8,793,422)	$ (10,159,580)	$ (15,090,706)	$ (25,250,285)
6 Percentage of Total Savings by Periods (line 3 above)		41%	59%	100%

Note A: Source is Browning Schedules RBB-6 and RBB-8, EM 200-369

BY MR. FEATHERSTONE:

Q. You mentioned in your testimony that there had been positions vacancies that have occurred since the merger has been announced, and I took it, it was just a one question and answer, that related to the need to reflect those vacancies in the rate case?

A. Right.

Q. Could you kind of explain that a little bit?

A. What we didn't want to do in the rate case was to go in and leave all the vacant positions that occurred because of the merger, not include dollars for those, because in effect you've taken synergies that would be created by the merger already out, so the moratorium was to leave all those pre-merger costs as they were.

Q. What is the concept behind that?

A. Well --

Q. What's the reason for that?

A. -- the purpose for a moratorium is to allow some recovery of the premium, and if you go ahead and take synergies out that have occurred because of the merger, you're not recovering.

Q. Do you know approximately how many positions you're talking about, have you been able to identify those?

A. We're down about 60 people but I believe about 40 of those are directly merger-related at this time. That changes.

Q. 60 positions?

A. I think we're down 60 total positions, but 40 of them I believe at this time are directly related to the merger.

BY MR. OLIGSCHLAEGER:

Q. Would that, for example, mean that the other 20 would just be a normal vacancy situation?

A. Yes, and that's what we would propose in the case is that we only show those positions directly related to the merger, and we have a current list of those which we've supplied on a DR, we just have to update that at the time.

BY MR. FEATHERSTONE:

Q. What was the process that you went about on identifying what was a merger-related vacancy and a non-merger-related vacancy?

A. We know why the people left and we just went down the list of all the people that had left since the merger was filed, and identified those that left because of the merger. Some of them you have to follow through, Cary, because this person leaves and you can move another one in, you know, there may be a different position that's still vacant but it was created because that first person left.

Q. Have any of the officers of the company left?
A. No, not yet.
Q. Not yet. Are we talking about power plant workers, clerical workers, are we talking about directors, managers?
A. You're talking about all levels, but primarily related to the service type functions that, you know, have a much higher certainty that their job is not going to be here.
Q. Customer services?
A. Finance, would be one example; we've lost a lot of engineers.
Q. So it would be primarily in the administrative function, what's referred to as corporate overhead?
A. Right, it would be a higher percentage. There are a few in the operational groups that had an opportunity and said, "Well, I don't want to face the uncertainty of trying to stick around a year and see if I've still got a job." Everyone has a different nervousnes level I guess.
Q. Sure.
A. Some people don't want to face it and some will wait and see what happens.
Q. Has Empire been able to identify those individuals and have they documented that, is there some type of

report, analysis, that you prepared, I say "you," meaning Empire?

A. Yes. I mentioned earlier we have a current list of people that have left, that we've supplied that list in response to a data request.

Q. And that needs to be updated you said?

A. Well, there will be other people leave between now and when we file the rate case, so that would have to be continually updated.

Q. Would that information, I assume that Empire would be able to supply the individual by name, position?

A. Yes.

Q. Kind of rank, serial number, salary?

A. Yes.

Q. When they left and a reason on why the individual decided to leave?

A. Yes.

Q. That's all part of that package?

A. I think what we've supplied at this point is the name, job, salary, and I think we've supplied a list of everybody that's left including those that didn't leave because of the merger.

BY MR. OLIGSCHLAEGER:

Q. If you know, what is the total expected reduction in your employee levels associated with the merger once

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

County of Jackson)
)
State of Missouri)

AFFIDAVIT OF Vern J. Siemek

Vern J. Siemek, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled surrebuttal testimony; that said testimony was prepared by him; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.

Vern J. Siemek

Subscribed and sworn to before me this 14th day of August, 2000.

Sandra L. Horvat
Notary Public

My Commission expires:

8/16/2003

" NOTARY SEAL "
Sandra L. Horvat, Notary Public
Jackson County, State of Missouri
My Commission Expires 8/16/2003