

# EXHIBIT

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## REBUTTAL TESTIMONY

OF

RYAN KIND

Submitted on Behalf of  
the Office of the Public Counsel

UTILICORP UNITED INC.  
AND  
ST. JOSEPH LIGHT & POWER COMPANY MERGER

Case No. EM-2000-292

Exhibit No. 201  
Date 7/12/00 EM-2000-292  
Reporter KRM

May 2, 2000

NP

**BEFORE THE PUBLIC SERVICE COMMISSION  
OF THE STATE OF MISSOURI**

In The Matter Of The Joint Application Of )  
UtiliCorp United Inc. and St. Joseph Light )  
& Power Company for Authority to Merge )  
St. Joseph Light & Power Company with )  
and into UtiliCorp United Inc., and, in )  
Connection Therewith, Certain Other )  
Related Transactions. )

Case No. EM-2000-292

**AFFIDAVIT OF RYAN KIND**

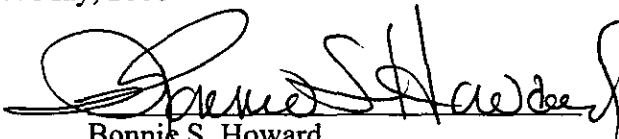
STATE OF MISSOURI     )  
                                      ) ss  
COUNTY OF COLE     )

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 54 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 2nd day of May, 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**

**ST. JOSEPH LIGHT & POWER COMPANY**

**CASE NO. EM-2000-292**

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**  
6 **LEGISLATIVE 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,**  
12 **COMMITTEES, OR OTHER GROUPS THAT HAVE ADRESSED ELECTRIC UTILITY**  
13 **RESTRUCTURING ISSUES?**

14 A. Yes. I was a member of the Missouri Public Service Commissions (the Commission's)  
15 Stranded Cost Working Group and participated extensively in the Commission's Market  
16 Structure Work Group. I am currently a member of the Missouri Department of Natural  
17 Resources Weatherization Policy Advisory Committee and serve as the public consumer  
18 group representative to the Midwest ISO's Advisory Committee. Several years ago, I  
19 served as a Staff Liaison to the Energy and Transportation Task Force of the President's  
20 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 St. Joseph Light & Power  
3 (SJLP) that is the subject of this docket. The testimony of OPC witness Russell  
4 Trippensee contains OPC's overall recommendation regarding the merger application.  
5 My testimony contains recommendations in the area of market power. This testimony  
6 also provides analytical and factual support for the regulatory plan recommendations that  
7 Public Counsel is making with respect to this application.

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

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

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

13 A. The Commission will need to perform a comprehensive assessment of the impacts that  
14 the merger is expected to have on the public interest. The net effect of all of these  
15 impacts will have to be determined in order to decide whether the merger as proposed (or  
16 as modified by recommendations made by other parties or the Commission itself) is  
17 detrimental to the public interest. While consideration of the net impacts is important,  
18 OPC witness Mark Burdette demonstrates in his testimony that certain aspects of a  
19 merger proposal can, on their own, be sufficient to cause a merger to be detrimental to the  
20 public interest.

21 **Q. IN APPLYING THE "NOT DETRIMENTAL TO THE PUBLIC INTEREST" STANDARD,**  
22 **SHOULD THE COMMISSION TAKE INTO ACCOUNT THE EFFECT THAT THE**

**PROPOSED MERGER WOULD HAVE ON THE PUBLIC INTEREST IF THE ELECTRIC  
INDUSTRY IS RESTRUCTURED TO ALLOW DIRECT ACCESS?**

A. Yes, most definitely. There is a general consensus that electric restructuring will have a good chance of coming to Missouri in the not too distant future. SJLP and UCU (the joint applicants) are in agreement with this consensus. \*\* \_\_\_\_\_

\_\_\_\_\_ \*\* Public Counsel believes that achieving some public benefit from electric restructuring is only possible if the conditions are right for the development of effective competition. Mergers, such as the SJLP/UCU merger, which are motivated by the merger applicant's desire to better position their companies for anticipated competition must be examined critically to determine if the improved competitive position of the merged companies is consistent with the need to create conditions in a restructured electric industry that are likely to lead to effective competition.

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

A. Public Counsel believes that the market power impacts of this merger will be detrimental to the public interest unless the Commission's merger approval is conditioned upon the willingness of the Joint Applicants to accept the same market power conditions agreed to by KCPL and Western Resources in Case No. EM-97-515. This conclusion is based on the following reasons:

- The proposed merger would significantly enhance the market power of UtiliCorp relative to the amount of market power that is has absent the merger. The increased market power associated with generation and transmission assets could be addressed by divesting a significant portion of the merged entity's generation



1 assets and divesting or transferring control of the merged entity's transmission  
2 assets. In addition, customers will be harmed by the increased retail market  
3 power that would result from the increased retail market power in the sale of  
4 energy, energy-related services, and information services that would result from  
5 the proposed merger.

- 6 • The Joint applicants have failed to propose any significant market power remedies  
7 that would ensure that the potential benefits of retail competition are not  
8 suppressed by the additional amount of market power that will result from this  
9 merger and UtiliCorp's proposed merger with Empire District Electric Company  
10 (Empire).

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

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

- 18 • The Joint Applicants must agree to: (1) withdraw their request that the  
19 Commission approve their proposed Regulatory Plan, (2) accept the same  
20 traditional ratemaking to which UtiliCorp is currently subject, and (3) facilitate  
21 the traditional ratemaking process by filing a complete rate case for all of  
22 UtiliCorp's Missouri jurisdictional operations one year after the close of the  
23 merger. The details of this condition are specified in the Rebuttal testimony of Mr.  
24 Trippensee.

Rebuttal Testimony of  
Ryan Kind

- 1 • Joint Applicants must agree that if electric restructuring occurs such that the price  
2 of electric generation service in Missouri is deregulated, then they will be subject  
3 to the same market power provisions that were contained in the Stipulation and  
4 Agreement that was approved by the Commission in Case No. EM-97-515.  
5 Attachment 1 of this testimony contains a modified version of the portion of the  
6 Stipulation and Agreement from Case No. EM-97-515 that pertains to market  
7 power issues. I have modified the original version of the Stipulation and  
8 Agreement that was approved by the Commission in Case No. EM-97-515 so that  
9 it references UtiliCorp and SJLP in the appropriate places instead of referencing  
10 Western Resources and KCPL.
- 11 • UtiliCorp must be willing to join a Regional Transmission Operator (RTO) under  
12 conditions that are set forth in the Vertical Market Power section of Attachment 1.
- 13 • The Joint Applicants must be agree to provide both Public Counsel and the Staff  
14 with access to the books, records, employees and officers of all entities that are  
15 affiliated with UCU or its wholly owned subsidiaries upon reasonable notice. This  
16 access should include all corporate entities for which UCU or its wholly owned  
17 subsidiaries have an ownership interest of 10 percent or more.
- 18 • Because of the important role that Affiliate Rules and Codes of Conduct have in  
19 mitigating some of the detriment associated with (1) market power in the retail  
20 merchant function and (1) possible cross-subsidies between regulated and non-  
21 regulated operations, UtiliCorp must agree to comply with the Commission's  
22 Affiliate Transaction Rules regardless of any Commission decision regarding  
23 UtiliCorp's request for a waiver from these same rules.

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

Rebuttal Testimony of  
Ryan Kind

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

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

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

- 19 • The fairly high acquisition premium being paid for the assets of SJLP is primarily  
20 due to the future non-regulated earnings potential of SJLP's generation assets due  
21 to its negative stranded costs.
- 22 • A large portion of the synergies are in the area of generation and almost any  
23 conceivable restructuring legislation in Missouri will transfer the benefits from all  
24 of these synergies to UtiliCorp. There is definitely no need for a regulatory plan

1           that ties the hands of this Commission by having it commit today that it will allow  
2           UtiliCorp to earn a return on and of a major portion of the acquisition premium  
3           associated with this merger deal.

- 4           • When generation becomes deregulated at the retail level, UtiliCorp could achieve  
5           synergies that accrue solely to the benefit of shareholders by selling the output  
6           from SJLP's supply portfolio at market prices that exceed its cost of production  
7           and keeping 100% of this profit margin for its shareholders. Alternatively,  
8           UtiliCorp could sell these assets for a price that vastly exceeds their book value  
9           and keep 100% of the gains for its shareholders. In its testimony, UtiliCorp is  
10          silent about the prospect for future non-regulated earnings in this area and this  
11          silence greatly understates the non-regulated earnings potential that UtiliCorp's  
12          shareholders will have as a result of the mergers with SJLP and Empire.

- 13          • UtiliCorp also expects substantial non-regulated synergies from planned future  
14          telephony and cable projects which will benefit from synergies between the  
15          telephony assets and utility right of ways of SJLP and UtiliCorp. In its testimony,  
16          UtiliCorp is silent about the prospect for future non-regulated earnings in this area  
17          and this silence greatly understates the non-regulated earnings potential that  
18          UtiliCorp's shareholders will have as a result of the mergers with SJLP and  
19          Empire.

20          Market Power issues are the third major area covered by my testimony. Within this area,  
21          I address both horizontal and vertical market power issues. My testimony will discuss (1)  
22          market power issues related to retail marketing of energy and other value added services  
23          that are likely to be bundled with energy and (2) vertical market power issues related to  
24          the joint ownership of transmission and generation 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?**

A. Not necessarily. Consumers will benefit from competitive markets to the extent that these markets cause utilities to decrease their costs and pass these cost decreases on to consumers. If the profits of utilities are no longer regulated, then a strong incentive will

1 exist for utilities to lower their costs by becoming more efficient. However, since prices  
2 will no longer be regulated in competitive markets, consumer benefits from these markets  
3 will be dependant on the development of effective and sustained competition that forces  
4 utilities to pass lower costs onto consumers.

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

10 **B. MOTIVATING FACTORS FOR SJLP AND UTILICORP**

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

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

- 14 • SJLP's desire to be acquired by a larger utility so that its shareholders can receive  
15 the acquisition premium windfall that the acquiring utility is expected to pay for  
16 the privilege of taking control of the formerly independent utility's operations and  
17 assets. The SJLP management and Board of Directors recognized that even  
18 though they are a small utility with limited growth potential, an acquirer would be  
19 willing to pay a significant premium to gain control of its low cost generating  
20 assets and purchased power contracts.
- 21 • UtiliCorp's desire to further its mid-continent network strategy by increasing the  
22 size of its distribution service territory footprint, acquiring low cost generation  
23 assets, and acquiring telecommunications infrastructure and right of ways. This

1 low cost generating capacity can either be used to create a significant stream of  
2 earnings over time, since it can be used to generate power at a cost that is well  
3 below market prices, or the assets can be sold (monetized) over time to bring  
4 earnings to the UtiliCorp bottom line as needed to satisfy investor expectations.

- 5 • UtiliCorp's desire to further its merchant strategy by acquiring low cost  
6 generation assets that can be used to support Aquila's power marketing or sold to  
7 raise capital that can be used to acquire useful generating assets.
- 8 • UtiliCorp's desire to prevent its neighboring utilities (Kansas City Power & Light,  
9 Western Resources, Inc. and others) from expanding their mid-continent footprint  
10 in UtiliCorp's backyard by acquiring SJLP or Empire.
- 11 • UtiliCorp's desire to better position itself for competition in the mid-continent  
12 region.

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

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

- 16 • Reducing the prospect of cut-throat competition in regional energy markets by  
17 keeping low cost generation assets out of the hands of its local competitors.
- 18 • Lowering the cost structure of UtiliCorp and its affiliates.
- 19 • Increasing the number of customers to which UtiliCorp has access for selling  
20 electricity, natural gas, home security services, telephony, cable TV, internet, and  
21 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 explained 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 newly-acquired vertically integrated utility and either spinning them off or combining them with the assets of other UtiliCorp affiliates.



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

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

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

A. Unless the merger is evaluated within the context of UtiliCorp's guiding philosophy and strategies, it is impossible to determine the reasonableness of the proposed regulatory plan. UtiliCorp's guiding philosophy and strategies and the way these strategies have been implemented in the recent past by UtiliCorp shed some light on what the future will likely hold if the proposed merger is approved.

UtiliCorp has stated in its presentations to utility analysts that it may consider selling some of the SJLP and Empire generating assets. It recently sold a power plant that was part of its West Virginia utility operations. UtiliCorp has broken apart some of the businesses that were a part of its Australian electric utility operations. UtiliCorp has taken advantage of the telecommunications assets that it acquired as part of its Australian electric utility operations and is turning them into a huge profit center. These types of

1 merger synergies and potential windfalls from the sale of low cost generation assets must  
2 be taken into account when evaluating UtiliCorp's proposed regulatory plan. If they are  
3 not, a regulatory plan could be approved which: (1) commits ratepayers to long term  
4 funding of utility assets that are no longer used in the provision of regulated utility  
5 service or (2) causes ratepayers to pay a significant portion of an acquisition premium for  
6 assets that have tremendous potential to produce non-regulated earnings for UtiliCorp's  
7 shareholders.

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

12 A. These strategies along with UtiliCorp's Value Cycle Philosophy were described in detail  
13 in a couple of conference calls that UtiliCorp senior executives held with financial  
14 analysts in the first quarter of this year. On April 15, 2000 Bob Green held a "2000  
15 Conference Call" (the 2000 Call) with Salomon Smith Barney and on February 8, 2000  
16 Rick Green, Bob Green, and Peter Lowe (UtiliCorp CFO) held a "1999 Year End  
17 Conference Call" (the 1999 Call) with investment analysts. The 1999 UtiliCorp Annual  
18 Report contains additional information on these concepts. Transcripts of the conference  
19 calls are available on UtiliCorp's internet web site (<http://www.utilicorp.com/>) in the  
20 Presentations section of the Investor Information Area.

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

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

1 A. UtiliCorp's network strategy is to bring value to its shareholders by investing in energy  
2 networks and production assets. This strategy has been implemented in Canada, the U.S.,  
3 New Zealand, and Australia where UtiliCorp has invested in energy networks. In the  
4 2000 Call, Bob Green described recent developments in its network strategy as follows:

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

30 **E. PAST IMPLEMENTATION OF THE NETWORK STRATEGY**

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

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

35 The other key component of being successful with our mission and  
36 vision, on top of taking advantage of open markets, it's to constantly  
37 build value. And that is described here in the value cycle. This is a value

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1 cycle that you've heard us talk about through the year as to how we  
2 invest in opportunities, and immediately they get pushed into optimizing.  
3 Whether that means putting our operational template on them, cut costs,  
4 enhance revenues, look for emerging opportunities.

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

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

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

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

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

33 ..."the Value Cycle. We invest, then optimize and monetize.

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

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

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

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

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

## 21 **F. NETWORK STRATEGY TELECOM SYNERGIES IN AUSTRALIA**

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

24 **A.** Yes, developing telecommunications networks has become a big part of UtiliCorp's  
25 network strategy. Bob Green emphasized this in the 1999 Call where he stated "as we

1 look at buying network assets, the telecom overlay will be a key part of the value  
2 proposition." Mr. Green also indicated in the 1999 Call that UtiliCorp intends to  
3 implement its telecom strategy in conjunction with its purchase of the SJLP and Empire  
4 network assets.

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

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

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

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

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

29 And the business in Australia, just to give you a sense, you've got 500  
30 miles laid; we're only using 30% of the capacity. So in terms of  
31 incremental business, there's very little capital cost associated with it, and  
32 we expect the EBIT to more than double this year. And it almost tripled  
33 in '99. So there is some talk of a potential float of that business. We  
34 haven't made any decisions. We're going to look at how we derive the  
35 best value in the long run.

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

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

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

8 A. UtiliCorp's merchant strategy is to bring value to its shareholders by becoming a leading  
9 energy merchant in wholesale gas and electric markets. This strategy has been primarily  
10 been focused in the U.S. where Aquila has become one of the leading marketers of gas  
11 and electricity and UtiliCorp has recently begun pursuing this strategy more aggressively  
12 in Europe. UtiliCorp's 1999 Annual Report stresses the importance of Aquila's recent  
13 initiative to acquire mid-stream assets such as power plants and gas storage facilities to  
14 give it the resources that it needs to support its trading business as the wholesale energy  
15 market becomes more competitive. Aquila's investment in the Pleasant Hill plant fits in  
16 with this initiative. The acquisition of the low cost generating assets of SJLP and Empire  
17 could also be used to support this initiative in the future as Missouri electric markets are  
18 restructured.

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

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

22 our focus on domestic acquisitions has become basically two fold: first,  
23 we are interested in utilities that are in the mid-continent region where  
24 we currently own and operate utilities and have the platform to realize  
25 economies of scale, and second, we are interested in assets that enhance

our ability to become a leading energy merchant such as the Katy Storage facility in Texas and the electric combined cycle generation plant now under construction in Cass County, Missouri by UtiliCorp's Aquila Merchant Energy Partner business.

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

### III. THE PROPOSED MERGER ALTERNATIVE REGULATION PLAN

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

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

#### A. OVERVIEW OF THE PROPOSED REGULATORY PLAN

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

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

- Separate rate cases and separate revenue requirement treatment for SJLP, Empire, and UtiliCorp, even though the Joint Applicants in this case and the Empire case are proposing that all three utilities be operated by a single corporate entity.
- A five year rate freeze for SJLP with certain exceptions, including the introduction of retail wheeling in Missouri.



- A commitment by the Missouri Commission to allow UtiliCorp to book a significant portion of the acquisition premium associated with the SJLP merger on the books of its SJLP operating division five years after the close of the proposed merger and to allow UtiliCorp to receive a return on and of this acquisition premium for 35 years.

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

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

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

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

A. No. UtiliCorp freely chose to enter a merger agreement with SJLP. Consumers were never consulted about their views on this merger. The merger applicants are less than

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

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

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- Cost reductions resulting from synergies between the unregulated and regulated operations of SJLP and UCU.

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

A. Yes. My testimony supports the following recommendations:

- 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, or (2) whether the proposed regulatory plan is just and reasonable since this analysis fails to quantify or even mention the substantial synergies that UtiliCorp intends to achieve in the non-regulated areas of deregulated retail generation service, possible sales of generating assets with market values greatly in excess of book values, power marketing synergies, and telecom synergies.
- I recommend that the Commission reject the Joint Applicant's proposed regulatory plan or any other plan that calls for extraordinary ratemaking treatment and is intended to give UtiliCorp a better opportunity to recover the acquisition premium than it would receive from the traditional ratemaking process. This recommendation is based on the potential harm to ratepayers that could come from approval of any plan for extraordinary ratemaking treatment in light of the potential windfalls that could accrue primarily to the benefit of UtiliCorp and SJLP shareholders due primarily to the non-regulated synergies that the Joint Applicants highlight for the investment community but fail to acknowledge in their testimony. It would be a great injustice to commit ratepayers to funding a

1 significant portion of the premium when the SJLP and UtiliCorp shareholders are  
2 likely to be the primary beneficiaries of this merger.

3 **Q. ON PAGES 19 AND 21 OF HIS TESTIMONY, UTILICORP WITNESS JOHN**  
4 **McKINNEY ADDRESSES THE ISSUE OF WHETHER "UNREGULATED COMPANIES ARE**  
5 **PLACED AT A DISADVANTAGE WHEN COMPARED TO REGULATED COMPANIES IF**  
6 **PREMIUM RECOVERY IS ALLOWED IN RATES. MR. McKINNEY ARGUES THAT**  
7 **UNREGULATED FIRMS ARE NOT PLACED AT A DISADVANTAGE SINCE "THE**  
8 **UNREGULATED FIRM RETAINS THE COST SAVINGS FROM SYNERGIES CREATED**  
9 **THROUGH THE MERGER" BECAUSE "IN THE CASE OF THE UNREGULATED FIRM,**  
10 **THERE IS NOT A REGULATORY COMMISSION REQUIRING MERGER SAMINGS TO BE**  
11 **FLOWED TO CUSTOMERS" SO THAT " THE UNREGULATED FIRM RECOVERS THE**  
12 **PREMIUM THROUGH THE MERGER SAVINGS." DO YOU AGREE WITH THIS**  
13 **REASONING?**

14 **A.** Absolutely not. Mr. McKinney seems to be ignoring the major difference between a  
15 regulated monopolist and competitive firm. A regulated monopolist can count on  
16 receiving a given level of revenues based on prices for his service that are set by the  
17 regulator. A competitive firm, on the other hand, only receives the market price for his  
18 services and this market price may not even cover his cost of business without the cost  
19 reductions (synergies) that he might receive through merging with another entity. The  
20 market price for a competitive firm's services may be high enough to allow it to earn a  
21 return sufficient to pay all or part of any premiums that it incurs. But there is a risk that  
22 the price will not be high enough to compensate the competitive firm for any of the  
23 acquisition premium. Mr. McKinney seems to think that it is the Commission's job to  
24 insulate a regulated monopolist from the risk that he may not be able to recover the  
25 premium

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

11 **IV. RELATIONSHIP BETWEEN UCU CORPORATE STRATEGIES, SJLP**  
12 **CHARACTERISTICS, AND THE REGULATORY PLAN**

13 **A. OVERVIEW**

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

20 **A.** When the Commission considers the proposed regulatory plan, it should be cognizant of  
21 potential shareholder benefits brought about by the opportunities that this merger would  
22 give to UtiliCorp for bringing non-regulated earnings directly to its bottom line. These  
23 opportunities exist in many areas, almost none of which have been acknowledged by  
24 UtiliCorp in its application. The closest that UtiliCorp has come to acknowledging these  
25 shareholder benefits in any of its filings is the statement on page six of its application that

1 "the merger will strengthen the competitive position of UtiliCorp, including its MPS and  
2 SJLP operations, not only in Missouri, but also in the surrounding region in the  
3 Midwest."

4 UtiliCorp chose to merge with SJLP for a number of factors. Many of these factors are  
5 related to UtiliCorp's value cycle philosophy, network strategy, and merchant strategy  
6 that were described earlier in this testimony. Both SJPL and Empire have similar  
7 characteristics that make them attractive candidates for use in the pursuit of these  
8 strategies. These characteristics include, their proximity to UtiliCorp's other Missouri  
9 service territories (providing transmission and off-system sales synergies), their low cost  
10 generating assets, and their telecommunications assets.

11 **B. SJLP'S LOW COST GENERATING PORTFOLIO**

12 **Q. WHAT MATERIALS HAVE YOU REVIEWED THAT ILLUSTRATE UTILICORP'S**  
13 **APPRECIATION OF THE VALUE OF THE LOW COST GENERATING ASSETS THAT**  
14 **SJLP EITHER OWNS OR HAS ACCESS TO?**

15 A. UtiliCorp has acknowledged the value in the SJLP low cost generation assets that it seeks  
16 to obtain in: its 1999 Annual Report, in presentations to investment analysts, and internal  
17 documents that analyzed the benefits of a potential acquisition of SJLP. In its most  
18 recent Annual Report, UtiliCorp stated that:

19 Empire District and Light and Power, among the longest operating [sic]  
20 in Missouri, also bring low cost generation assets and cost-effective  
21 distribution operations.

22 In the "1999 Year End Conference Call" (the 1999 Call) with investment analysts, Bob  
23 Green stated that:

24 But take a look at the mid-continent footprint that we're building on the  
25 network side of the business. With the St. Joe and the Empire  
26 acquisition, we've brought together some very attractive low-cost

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1 generation assets, and we have added some contiguous distribution  
2 networks that afford us a significant opportunity for synergies and  
3 efficiencies. 75% of those benefits are going to come from the supply  
4 side.

5 Presentations at two UtiliCorp Board of Directors (BOD) meetings that took place shortly  
6 before UtiliCorp presented its final bid to SJLP included comments about SJLP's  
7 generating assets. The presentation at the 2/3/99 BOD meeting noted that SJLP is \*\*

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11 **Q. HAVE YOU REVIEWED ANY MATERIALS THAT HAVE QUANTIFIED THE VALUE OF**  
12 **SJLP'S LOW COST GENERATING SUPPLIES EITHER IN TERMS OF MARKET VALUE,**  
13 **OR IN TERMS OF ITS POTENTIAL CONTRIBUTION TO NON-REGULATED EARNINGS**  
14 **STREAMS, ONCE GENERATION IS DEREGULATED AT THE RETAIL LEVEL IN**  
15 **MISSOURI?**

16 **A. \*\***  
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24 \*\* (See  
25 Attachment 3).

1 **Q. IS THERE A GENERALLY ACCEPTED APPROACH TO DETERMINING THE MARKET**  
2 **VALUE OF GENERATION ASSETS?**

3 A. Yes. The market value is generally determined by calculating the contribution to annual  
4 earnings that each generating plant is expected to make over the life of the plant and then  
5 discounting this stream of future annual earnings to determine the present value of the  
6 earnings stream. \*\*

7 \*\*

8 **Q. PLEASE DISCUSS IN MORE DETAIL THE \*\***  
9 **\*\* ANALYSIS AND THE CONCLUSIONS THAT WERE**  
10 **DRAWN, BASED ON THAT ANALYSIS.**

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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 SJLP'S LOW COST GENERATION ASSETS?**

A. No. The Company did, however, \*\* \_\_\_\_\_  
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**D. UTILICORP'S STRANDED COST POSITION**

13 **Q. ISN'T IT POSSIBLE THAT THROUGH REDUCED STRANDED COST RECOVERY**  
14 **PAYMENTS TO UTILICORP, RATEPAYERS MAY BENEFIT FROM THE TRANSFER OF**  
15 **LOW COST GENERATION ASSETS FROM SJLP TO UTILICORP?**

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

19 **Q. PLEASE EXPLAIN.**

20 A. Depending on the precise details of future restructuring legislation in Missouri, it could  
21 be argued that if MPS currently had a substantial amount of positive stranded costs, then  
22 MPS ratepayers might benefit from UtiliCorp's acquisition of SJLP's low cost generating  
23 portfolio, even in an unregulated environment. This could occur if, absent the acquisition

1 of the SJLP generating portfolio, MPS's generating assets had positive stranded costs  
2 which would be collected from ratepayers. In this scenario, then the addition of the SJLP  
3 generating assets with negative stranded costs would lower or eliminate the net stranded  
4 costs of the entire Missouri jurisdictional UtiliCorp generating portfolio and this would  
5 cause the stranded cost charges that would have otherwise been applied to MPS  
6 customers to either be reduced or eliminated.

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

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

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

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

22 A. On October 19, 1999 Dwayne Hardt, UCU's Chief Financial Officer gave a presentation  
23 to the Edison Electric Institute (see Attachment 8) where he displayed a slide showing

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1 that UtiliCorp has "no stranded investment." Another UtiliCorp's senior executive, Max  
2 Sherman, Vice President of Project Development for Aquila's Merchant Energy Partners  
3 subsidiary testified on this subject before the Missouri State Senate Property Tax Panel.  
4 In that testimony, Mr., Sherman stated that:

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

10 As the above presentations indicate, two of UtiliCorp's senior executives don't believe  
11 that UtiliCorp has any stranded cost. In addition, Mr. Sherman's testimony appears to  
12 imply that no Missouri utilities have any stranded costs. It should be noted that the  
13 newer, more expensive plant that Mr. Sherman referenced in his testimony is owned by a  
14 non-regulated subsidiary of UtiliCorp.

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

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

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1 A. No. Surprisingly, UtiliCorp stated in its response to Staff DR No. 36 that "no such study  
2 exists." Its DR response last fall to the Staff stated that:

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

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

8 **E. UTILICORP'S OPTIONS TO DERIVE NON-REGULATED EARNINGS**  
9 **FROM SJLP'S LOW COST GENERATING PORTFOLIO**

10 **Q. HAS UTILICORP'S TESTIMONY IN THIS CASE OR ITS RESPONSES TO DATA**  
11 **REQUESTS DESCRIBED ITS POTENTIAL TO ACHIEVE SYNERGIES THAT WOULD**  
12 **ACCURE SOLEY TO THE BENEFIT OF ITS SHAREHOLDERS?**

13 A. No. Its testimony is completely silent with respect to this issue. Its responses to data  
14 requests on this issue (Staff DR Nos. 152 and 228) have stated that UtiliCorp has not  
15 performed any studies of the potential for merger synergies in the non-regulated area.  
16 The Company's response to DR No. 152 even implies that UtiliCorp has not observed  
17 any potential for merger synergies in the non-regulated area.

18 **Q. DO YOU BELIEVE THESE DR RESPONSES ARE ACCURATE?**

19 A. No. I don't believe UtiliCorp's response was accurate when it stated that no analysis has  
20 been performed by or on behalf of UtiliCorp that contains "estimates of merger  
21 savings/synergies applicable to non-regulated business operations after a combination." I  
22 also do not believe that UtiliCorp's response to sub-part 3 of Staff DR No. 152 was  
23 accurate when it implied that UtiliCorp has not observed any potential for merger  
24 synergies in the non-regulated area.

## Rebuttal Testimony of Ryan Kind

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**Q. HAVE YOU REVIEWED ANY DOCUMENTS OTHER THAN THAT CONTAINED IN THE**  
**\*\* \_\_\_\_\_ \*\* WHICH INDICATES THAT UTILICORP IS**  
**CONSIDERING OPTIONS FOR DERIVING NON-REGULATED SYNERGIES FROM**  
**SJLP'S LOW COST GENERATING PORTFOLIO?**

A. Yes. The discussion earlier in this testimony where I describe UtiliCorp's Value Cycle Philosophy and its Network and Merchant strategies shows how UtiliCorp's strategic intent regarding investments like the Company's acquisition of SJLP may be applied to SJLP in the future. In fact, both the 1999 Call and the 2000 Call that were discussed earlier contain specific statements regarding future options that UtiliCorp may pursue with its SJLP and Empire investments and explains how those options fit into the Company's Value Cycle Philosophy and its Network and Merchant strategies.

**Q. PLEASE QUOTE THE SPECIFIC STATEMENTS REGARDING FUTURE OPTIONS THAT UTILICORP MAY PURSUE WITH ITS SJLP AND EMPIRE INVESTMENTS THAT WERE**

**MADE IN THE 1999 AND 2000 CALLS AND PROVIDE ANY NECESSARY  
EXPLANATIONS.**

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

First of all, our network strategy, where we essentially are taking advantage of the trend towards privatization and liberalization of energy markets around the world. We have bought utilities in Australia, New Zealand and Canada outside the U.S. **We've also acquired two distribution assets here in the U.S., St. Joe Power & Light and Empire District. We believe we can significantly enhance the value of those assets by disaggregating, breaking apart some embedded businesses, and repositioning them.** We've done that in Australia. Since 1995, our IRR in terms of that investment is over 30% and what we've done is break out the retail energy business and we will joint venture that with Shell at a value significantly above what we paid for it. We've built a telecom business leveraging our right-of-way in the power business...(emphasis added)

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

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

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

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

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

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1 course, subject to Commission approval under the current regulatory paradigm, free to  
2 dispose of its assets as it sees fit. One has to wonder though, if UtiliCorp is willing to  
3 commit up front to sharing 50% of the gains on the sale with ratepayers since it is asking  
4 the Commission to make an up front commitment to having ratepayers fund 50% of the  
5 acquisition premium that was necessary to purchase SJLP's low cost assets? On the other  
6 hand, if UtiliCorp chooses to retain SJLP's low cost generating supplies after generation  
7 has been deregulated at the retail level, would UtiliCorp commit today to marking up the  
8 price of electric generation service only 50% of the way from the book cost to the market  
9 price since the Company is asking this Commission to commit today to having ratepayers  
10 fund 50% of the acquisition premium that was necessary to purchase SJLP's low cost  
11 assets?

12 **Q. HAVE YOU SEEN ANY OTHER INFORMATION THAT INDICATES UTILICORP**  
13 **ANTICIPATES ADDITIONAL NON-REGULATED SYNERGIES IN THE GENERATION**  
14 **SALES AND POWER MARKETING AREAS AS A RESULT OF THE PROPOSED MERGERS**  
15 **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. UTILCORP'S POTENTIAL NON-REGULATED EARNINGS IN THE**  
6 **TELECOM/CABLE TV AREA**

7 **Q. EARLIER IN THIS TESTIMONY, WHEN YOU WERE DISCUSSING UTILICORP'S VALUE**  
8 **CYCLE PHILOSOPHY, NETWORK STRATEGY, AND MERCHANT STRATEGY, YOU**  
9 **DISCUSSED THE RELATIONSHIP BETWEEN THE COMPANY'S NETWORK STRATEGY**  
10 **AND ITS TELECOMMUNICATIONS AND CABLE TV INITIATIVES. HOW DOES**  
11 **UTILICORP PERCEIVE A LINK BETWEEN THE TWO?**

12 A. Bob Green described this link in the 1999 Call where he stated "as we look at buying  
13 network assets, the telecom overlay will be a key part of the value proposition" and in the  
14 2000 Call where he stated "we've built a telecom business leveraging our right-of-way  
15 in the power business."

16 **Q. HAVE YOU SEEN ANY INFORMATION THAT INDICATES THE "TELECOM OVERLAY"**  
17 **WAS PART OF WHAT MOTIVATED UTILICORP TO ACQUIRE SJLP AND EMPIRE?**

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

22 Second, in terms of a near-term upside is our telecom business that's  
23 emerging first in Australia. We expect to float a telecom business at a  
24 valuation close to the initial investment value in United Energy, the  
25 power company we bought back in 1995. We think that should have a

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big impact on UtiliCorp's share price. **As well, we are aggressively pursuing that telecom strategy here domestically.** (Emphasis added)

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

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

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

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

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

...

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

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

...

Q: I was wondering if you could ballpark for us the level of investments you're looking at making in telecom over the next two to three years. And then also maybe you could provide us a little bit more detail on the

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1 New Zealand and Australia regulatory processes and how you see  
2 yourselves coming out.

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

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

12 **Q. THE ABOVE QUOTE DESCRIBES THE 300 MILES OF FIBER THAT UTILICORP**  
13 **EXPECTS TO LEVERAGE IN THE EMPIRE SERVICE TERRITORY. WHAT KIND OF**  
14 **TELECOM ASSETS DO UTILICORP AND SJLP POSSESS THAT COULD BE LEVERAGED**  
15 **TO CREATE NON-REGULATED SYNERGIES IF THE PROPOSED MERGERS ARE**  
16 **APPROVED?**

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

22 **Q. UTILICORP HAS PROPOSED A REGULATORY PLAN WHERE RATEPAYERS PAY A**  
23 **SIGNIFICANT PORTION OF THE ACQUISITION PREMIUM THAT WAS NECESSARY TO**  
24 **ACQUIRE THE ASSETS (INCLUDING TELECOM ASSETS) OF SJLP AND EMPIRE.**  
25 **HAS UTILICORP OFFERED TO SHARE ANY OF ITS EXPECTED FUTURE NON-**  
26 **REGULATED EARNINGS ASSOCAITED WITH ITS PLANNED TELECOM AND CABLE TV**  
27 **INITIATIVES?**

28 A. No.

**G. 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 OF 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.

**IV. 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:

1 Market power is the ability of a firm, alone or in concert with other  
2 firms, to profitably maintain the price of a product above the competitive  
3 market level for an extended period of time. Suppliers with vertical or  
4 horizontal market power could charge unfair prices and realize excessive  
5 profits.

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

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

18 **V. MARKET POWER IN GENERATION MARKETS**

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

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

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

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

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

**VI. VERTICAL MARKET POWER ASSOCIATED WITH THE JOINT OWNERSHIP OF GENERATION AND TRANSMISSION ASSETS.**

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

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

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

A. The FERC took some initial steps to address this problem in orders FERC Orders 888 and 889. The FERC, however has not decided that these initial steps were sufficient for

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

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

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

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

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

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

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eliminate pancaked transmission rates, Ameren would need to belong to a regional transmission group having a region-wide transmission rate. To address the vertical market power concern that Ameren could use its transmission system to restrict competition from other generation, the regional transmission group should be an entity that will independently operate the transmission systems of the vertically integrated utilities in the region.

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

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

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

**VII. RETAIL MARKET POWER IN THE SALE OF ENERGY AND ENERGY-RELATED SERVICES**

**Q. PLEASE EXPLAIN THE CONCEPT OF RETAIL MARKET POWER IN THE SALE OF ENERGY AND OTHER VALUE-ADDED SERVICES THAT ARE LIKELY TO BE BUNDLED**



**WITH THE ENERGY COMMODITY (NATURAL GAS OR ELECTRIC GENERATION SERVICE).**

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

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

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

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

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1                   7) Privileged access to customer communication channels such as billing inserts,  
2                   contacts with new customers, and customer service calls.

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

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

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

12           **Q.   DO SJLP AND UCU ALREADY HAVE SOME MARKET POWER RELATED TO EACH**  
13           **OF THE EIGHT FACTORS THAT YOU HAVE LISTED ABOVE?**

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

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

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

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

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

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

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

18 ...

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

22 **Q. LETS RETURN TO THE EIGHT FACTORS LISTED ABOVE THAT CAN LEAD TO RETAIL**  
23 **MARKET POWER IN THE SALE OF ENERGY AND ENERGY-RELATED SERVICES.**  
24 **PLEASE SUMMARIZE THE STATUS OF SJLP AND UCU WITH RESPECT TO THESE**  
25 **EIGHT FACTORS.**

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1 A. Alright. With regard to the first factor (customer inertia to stay with the former  
2 provider), all incumbent utilities can expect to benefit from this factor when direct access  
3 becomes available. Utilities will often claim that 30 or 40 percent of their customers  
4 would switch to a new supplier in order to receive a discount of 10 or 20 percent. Well,  
5 what about the other 60 to 70 percent of customers? Why wouldn't they switch in order  
6 to cut their electric bills by 10 or 20 percent? The answer, to a large extent, is customer  
7 inertia. It has been shown that it takes a large incentive to get most customers to take any  
8 affirmative action to leave their current supplier.

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

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

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

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

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

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1           A.     While I have not had the opportunity to investigate SJLP's activities in this area,  
2           UtiliCorp has been very active in recent years, promoting optional value added services  
3           such as home warranties under the Energy One brand name.

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

7           A.     This factor is also applicable to SJLP and UCU. While the Missouri Commission  
8           recently enacted an affiliate transaction rule, both UtiliCorp and SJLP have requested  
9           waivers from the rule. Without such a rule, it is very difficult to monitor the affiliate  
10          activities of utilities to insure that there is no cross-subsidization of unregulated activities.  
11          If utilities are allowed to cross-subsidize unregulated activities where non-regulated  
12          services are being offered by the incumbent to its customers, either before or after direct  
13          access begins, then incumbent utilities will have an additional advantage over new  
14          entrants by virtue of their ability to offer a bundle of services where some services are  
15          priced below cost because they have 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 **Q. HAS UTILICORP ENTERED INTO ANY RECENT CONTRACTUAL RELATIONSHIPS**  
2 **WITH ITS AFFILIATES THAT INCREASE THE CONCERNS ASSOCIATED WITH**  
3 **AFFILIATE TRANSACTIONS UNLESS THERE ARE EFFECTIVE RULES IN PLACE TO:**  
4 **(1) CREATE STANDARDS FOR HOW AFFILIATED TRANSACTIONS SHOULD OCCUR**  
5 **AND (2) REQUIRE THAT ADEQUATE RECORDS OF TRANSACTIONS ARE KEPT TO**  
6 **ALLOW FOR AUDITS TO ENSURE THAT THESE STANDARDS ARE ADHERED TO?**

7 A. Yes. \*\* \_\_\_\_\_  
8 \_\_\_\_\_  
9 \_\_\_\_\_ \*\* The possibilities for  
10 affiliate abuse and cross-subsidy under such an arrangement are obvious.

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

16 A. According to the survey that OPC performed and submitted to the Commission as  
17 exhibits in the Affiliated Transactions Rulemaking cases (Case Nos. EX-99-442, GX-99-  
18 444, and GX-99-445), UCU is currently taking advantage of these information resources  
19 to enhance its efforts at marketing unregulated services to their customers.

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

Rebuttal Testimony of  
Ryan Kind

1 A. Both SJLP and UCU appear to be currently taking advantage of these information  
2 resources to enhance their efforts at marketing unregulated services to their customers.

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

6 A. Both SJLP and UCU have entered into long-term contracts with some of their most  
7 important customers.

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

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

21 By either supplying customers with a bundle of services now or being prepared to offer a  
22 bundle of services once direct access is permitted, utilities create barriers to entry. Once  
23 markets are open, new entrants may find that profit margins on the energy commodity



1 alone are too slim to justify the marketing efforts needed to attract new customers. If the  
2 incumbent is already offering, or is prepared to offer, a bundle similar to what the new  
3 entrant can offer, then the new entrant will have more difficulty getting customers to  
4 switch from the incumbent. While bundling services is a fairly common practice in non-  
5 regulated industries, it raises special concerns in industries that are expected to soon  
6 undergo a transition from regulated monopolies to competition.

7 **IX. MARKET POWER RECOMMENDATIONS**

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

10 A. OPC recommends that, the Commission condition the approval of this merger on the  
11 applicant's willingness to accept the same market power provisions that were contained  
12 in the Stipulation and Agreement that was approved by the Commission in Case No. EM-  
13 97-515. These provisions will insure that the market power detriments that would  
14 otherwise be associated with the proposed merger will be largely mitigated.

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

Rebuttal Testimony of  
Ryan Kind

1 Attachment 1 should be acceptable to UtiliCorp since they are identical to those in the  
2 Case No. EM-97-515 Stipulation and Agreement.

3 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

4 **A. YES.**  
5

## 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.l.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:

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**

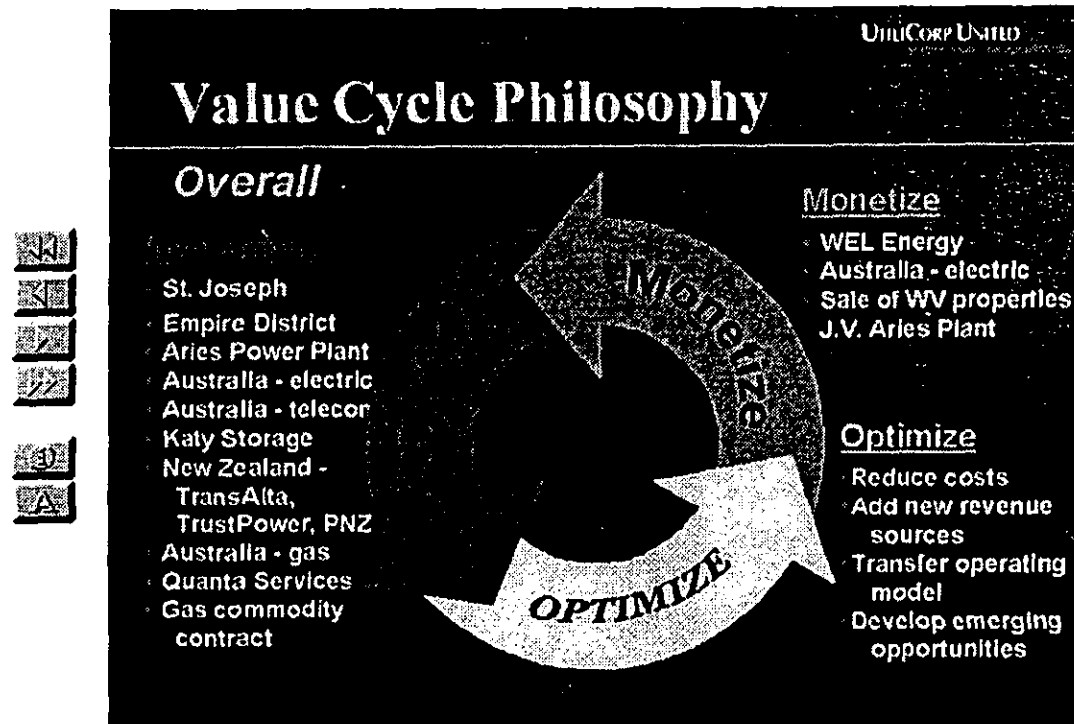
I. The SJLP division of UtiliCorp may continue using the names "SJLP" and "St. Joseph Light & Power" indefinitely for the provision of: (i) regulated electric service prior to the implementation of open access for residential and small general service customers, and (ii) unbundled distribution service 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 SJLP in SJLP'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 SJLP as of the date of this Stipulation and Agreement, or has been used

by SJLP to provide regulated products and services in SJLP'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.



ATTACHMENT 3

HAS BEEN

DEEMED HIGHLY CONFIDENTIAL

IN ITS ENTIRETY

ATTACHMENT 4

HAS BEEN

DEEMED HIGHLY CONFIDENTIAL

IN ITS ENTIRETY

ATTACHMENT 5

HAS BEEN

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ATTACHMENT 6

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ATTACHMENT 7

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UTILICORP UNITED

# Stock Valuation



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10/19/99 Presentation at EEI  
by Dwayne Hardt, UtiliCorp  
Chief Financial Officer