EXHIBIT

Exhibit No.:
Issue(s): Acquisition Adjustment/ Merger Saving/ Tracking Mechanisms
Witness/Type of Exhibit: Robertson/Rebuttal
Sponsoring Party: Public Counsel
Case No.: EM-2000-292

REBUTTAL TESTIMONY

OF

TED ROBERTSON

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. 202
Date 7/12/00 Case No. EM-2000-292
Reporter KEM

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 TED ROBERTSON

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Ted Robertson, of lawful age and being first duly sworn, deposes and states:

1. My name is Ted Robertson. I am a Public Utility Accountant 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 96, Schedule TJR-1.

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.

Ted Robertson, C.P.A.
Public Utility Accountant III

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

TED ROBERTSON

UTILICORP UNITED INC.

AND

ST. JOSEPH LIGHT & POWER COMPANY

CASE NO. EM-2000-292

INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Ted Robertson, P. O. Box 7800, Jefferson City, Missouri 65102.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Office of the Public Counsel of the State of Missouri ("OPC" or "Public Counsel") as a Public Utility Accountant III.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND OTHER QUALIFICATIONS.

A. I graduated from Southwest Missouri State University in Springfield, Missouri, with a Bachelor of Science Degree in Accounting. In November, 1988, I passed the Uniform Certified Public Accountant examination, and obtained C. P. A. certification from the State of Missouri in 1989.

Q. WHAT IS THE NATURE OF YOUR CURRENT DUTIES WHILE IN THE EMPLOY OF OPC?

A. Under the direction of the OPC Chief Public Utility Accountant, Mr. Russell W. Trippensee, I am responsible for performing audits and examinations of the books and records of public utilities operating within the State of Missouri.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION?

A. Yes, I have submitted both written and oral testimony on many occasions before the Missouri Public Service Commission. Please refer to Schedule No. TJR-1, attached to this direct testimony, for a listing of cases in which I have previously submitted testimony.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the UtiliCorp United Inc., ("UCU" or "Company") and the St. Joseph Light & Power Company ("SJLP") request for Commission approval of the proposed acquisition of SJLP by UCU. I will address the issues of acquisition adjustment (premium), merger savings and the mechanisms associated with tracking the costs and alleged savings resulting from the proposed acquisition. Rebuttal testimony offered by OPC witnesses Trippensee, Burdette and Kind will address other detriments associated with the proposed acquisition.

Q. DOES THE PUBLIC COUNSEL OPPOSE THE PROPOSED ACQUISITION OF ST. JOSEPH LIGHT & POWER COMPANY BY UTILICORP UNITED INC.?

A. Yes. Public Counsel believes that the acquisition, as proposed, is detrimental to the public interest, and that it should be rejected in its entirety.

STANDARD OF PUBLIC INTEREST

Q. WHAT IS THE ISSUE BEFORE THIS COMMISSION?

A. The principal issue before the Commission is whether or not the proposed sale of St. Joseph Light & Power Company to UtiliCorp United Inc. is detrimental to the public interest.

Q. WHAT IS THE STANDARD OPC UTILIZED TO DEVELOP ITS RECOMMENDATION CONCERNING THE PROPOSED ACQUISITION?

A. OPC utilized the "not detrimental to public interest" standard when analyzing this transaction. The " not detrimental to public interest" standard was first articulated in State ex rel. City of St. Louis v. Public Service Commission, 73 S.W.2d 393, 400 (Mo. banc 1934). The Court in City of St. Louis stated:

> To prevent injury to the public, in the clashing of private interest with the public good in the operation of public utilities, is one of the most important functions of Public Service Commissions. It is not their province to insist that the public shall be *benefited*, as a condition to

> change of ownership, but their duty is to see that no such change shall be made as would work to the public *detriment*. In the public interest, in such cases, can reasonably mean no more than "not detrimental to the public."

The controlling statute is Section 393.190 RSMo. 1994.

Q. HOW DOES THE PUBLIC COUNSEL DEFINE "PUBLIC INTEREST?'

A. OPC generally views the members of the public that are to be protected as those consumers taking and receiving service, in this instance, from the UCU and SJLP operations. Therefore, Public Counsel would define the "public interest" as referring to the level of impact or effect that the proposed transaction will have on the Missouri customers of the two companies.

The fundamental concern in the regulation of public utilities is that the public being served will not be adversely impacted or harmed by those responsible for providing the monopoly services. Thus, the public interest generically addresses utilities customers because of the theory of regulation. Regulation acts as a substitute for competition in a monopoly environment; therefore, utilities are required to pass a public interest test because customer service options are limited by the fact that they generally do not have a choice in the supplier of their utility services.

Q. HAS THIS COMMISSION EVER INDICATED HOW IT VIEWS THE TERM "PUBLIC" WITH REGARD TO SECTION 393.190(2) RSMo 1994?

A. Yes, it has. In KPL/KGE, Case No. EM-91-213, this Commission identified the "Public" as Missouri ratepayers. At page 13 of its Order, the Commission stated the following:

> Based upon these findings and determinations, the Commission concludes that **Missouri ratepayers** will be shielded from any potential ill effects from the proposed merger and will suffer no detriment as a result. Therefore, the Commission concludes that, in the absence of a finding of detriment to the public interest, it may not withhold its approval of the proposed merger and will authorize KPL to acquire and merge with KGE.
>
> (Emphasis added by OPC)

Q. WILL IT BE NECESSARY FOR UCU TO OBTAIN REGULATORY APPROVALS FROM OTHER GOVERNMENTAL AGENCIES IN ORDER TO CONSUMMATE THE PROPOSED SALE?

A. Yes. It's my understanding that in addition to this Commission, the sale will require filings with state utility regulators in Iowa, Colorado, Minnesota and West Virginia, and with the Federal Energy Regulatory Commission ("FERC"), the Securities and Exchange Commission ("SEC") and the Federal Trade Commission ("FTC").

ACQUISITION PROPOSAL

Q. WHAT ARE THE COMPANIES REQUESTING?

A. On or about October 19, 1999, UCU and SJLP filed a Joint Application with this Commission for authorization to merge St. Joseph Light & Power Company with and into UtiliCorp United Inc. and, in connection therewith, certain other related transactions. The Joint Application was a result of an Agreement and Plan of Merger ("the Merger Agreement") executed on March 4, 1999, by UtiliCorp and SJLP. Pursuant to the Merger Agreement, SJLP shareholders will receive a fixed value of $23.00 per share for their SJLP common stock which will be converted into shares of UtiliCorp common stock when the merger is closed. UtiliCorp will also assume SJLP's existing debt obligations in the approximate amount of $80 million.

The Application stated that as of December 31, 1998, SJLP had approximately 8.1 million weighted average common shares outstanding and UtiliCorp had approximately 80 million weighted average common shares outstanding. Based upon this number of shares outstanding, the amount of equity that UtiliCorp will issue in order to exchange shares of its common stock for SJLP's stock is estimated to be $190 million. This taken together with the indebtedness of SJLP to be assumed by UtiliCorp, brings the total cost of the Merger to approximately $270 million.

This information is corroborated by the Company's response to MPSC Staff Data Request No. 90 which states that the merger is structured to be a tax free merger in which the shareholders of SJLP will exchange their stock for UCU stock. UCU will assume the tax basis of all the assets and liabilities of SJLP and will then treat the SJLP operations as a separate division operating under its corporate umbrella.

Q. WHAT DOES IT MEAN WHEN YOU SAY UCU WILL TREAT THE SJLP OPERATIONS AS A SEPARATE DIVISION OPERATING UNDER ITS CORPORATE UMBRELLA?

A. As an operating division of UCU, SJLP will cease to exist as a stand-alone company with its own separate legal entity status. SJLP essentially becomes just another revenue/cost center owned and operated under the corporate tent of UCU. It loses the distinction of being a company managed and operated by its own employees. For example, UCU's upper management will now be SJLP's upper management and UCU's Board of Directors will now be SJLP's Board of Directors, and UCU managers or agents will likely make all the important decisions regarding SJLP's future operations, and so on. One way to view the divisional structure is to visualize UCU as a single corporation that produces many similar yet different products. The services provided to the ratepayers in the franchised area SJLP currently serves are just one of the products UCU would produce.

Q. WHAT IS THE EXPECTED AMOUNT OF THE ACQUISITION PREMIUM ASSOCIATED WITH THE PROPOSED ACQUISITION?

A. UCU expects to incur a total acquisition cost of approximately $270 million (including the assumption of debt and other liabilities). This amount includes an acquisition premium, or an amount in excess of net book value, of approximately $92 million.

According to the direct testimony of Company's witness, Mr. Dan J. Streek, page 4, lines 5-15, and Schedule DJS-3, the acquisition premium, as of December 31, 1998, is calculated as follows:

1.	SJLP Assets	$243,111,979
2.	SJLP Liabilities/Credits	$147,306,653
3.	Net Book Value	$ 95,805,326
4.	Acquisition Price	$188,600,000
5.	Acquisition Premium	$ 92,794,674

Incidentally, the $23.00 per share of common stock acquisition price represents an approximate increase of 36% above the market value of the SJLP stock price prior to announcement of the proposed transaction.

Q. HOW WAS THE ACQUISITION PRICE DETERMINED?

A. The purchase terms and price were developed via a secret bidding process whereby several prospective purchasers were contacted and requested to make preliminary offers.

The preliminary offers were subsequently modified after a period of time during which the remaining bidders and SJLP performed "due diligence" investigations on each other.

Q. IS THE COMPANY REQUESTING ANY RATEMAKING TREATMENT OF THE ACQUISITION PREMIUM?

A. Yes, it is. According to the direct testimony of UCU witness, Mr. John W. McKinney, pp. 4-8, the Company is requesting that, in addition to approving the purchase and merger of SJLP with UCU, the Commission should authorize UCU to operate under the auspices of a new regulatory plan. (For the purposes of my testimony, OPC will term the Company proposed regulatory plan as an alternative regulatory plan ("ARP").)

In addition to authorizing the merger between UCU and SJLP, the Company proposed ARP, if approved, would allow UCU to operate according to the following Company-defined agreements:

1. A rate moratorium for the SJLP operating unit for a period of five year after the closing of the merger.

2. During the fifth year UCU would file a general rate case for the SJLP operation with an operational law date that would coincide with the conclusion of the five year rate moratorium.

3. The rate filing would include accounting of the alleged synergies realized during the moratorium and the balance of the unamortized acquisition premium yet to be recovered.

4. Net synergies for years six through ten of the plan would be included in the rate filing.

5. 50% of the unamortized balance of the acquisition premium would be included in SJLP's rate base and allowed a return based on a capital structure of 60% debt and 40% equity. Also, the annual amortization of the acquisition premium would be included in expenses allowed for recovery.

6. The balance of the SJLP's operations rate base would be allowed a return based on a capital structure of 47% debt and 53% equity (a structure based on SJLP's last rate case ER-99-247).

7. The allocation of corporate and intra-business unit costs to MPS shall exclude the SJLP factors from the methodology for the ten years that the plan is to exist.

A rate moratorium for five years, for all the SJLP operations, is a major requirement of the new ARP. The purpose of the proposed moratorium is to provide UCU with the opportunity and time to recover costs associated with the negotiations and purchase of SJLP. Mr. McKinney in his direct testimony, page five, beginning on line 15, states:

> During this moratorium customers will be allowed to enjoy stable low rates and **UtiliCorp will be allowed to recover part of the costs of the transaction.**
>
> (Emphasis added by OPC)

The Company is proposing that SJLP's electric, natural gas and industrial steam prices be frozen at the current level for five years from the date of closing. During the rate freeze,

UCU proposes to retain the financial benefits from the merger to offset costs of the transaction (primarily the acquisition premium and the transaction and transition costs). Coincident with the sixth year of the ARP, SJLP's rates would be reset, with the ongoing alleged net benefits from the acquisition and merger being shared with SJLP customers under a guarantee that their cost of service will be reduced by at least $1.6 million.

ACQUISITION ADJUSTMENT

Q. PLEASE EXPLAIN WHAT IS MEANT BY THE ACCOUNTING TERM "ACQUISITION ADJUSTMENT."

A. In traditional accounting, fixed assets, such as plant, are usually recorded at "original cost". Original cost, as applied to utility plant, means the cost of property to the utility devoting it to public service. An acquisition adjustment results when utility property is purchased or acquired for an amount either in excess of or below book value. Book value relates to the value placed on utility property and recorded on the Company's financial books and records at the time the utility property is first placed in public service.

If the utility property is purchased by another utility, the purchaser must record the acquisition in the appropriate "plant and property" accounts at the selling utility's original cost; similarly, the purchaser records the seller's accumulated depreciation, amortization, and contributions in aid of construction ("CIAC") in the appropriate account(s). Any

difference between the original cost and the actual price paid by a subsequent purchaser is recorded as the acquisition adjustment. An acquisition adjustment does not represent a contribution of capital (i.e., neither cash or new investment) to the public service. It merely represents a purchase of the legal interests in the properties that were possessed by the seller.

The term "original cost", as defined by the Federal Energy Regulatory Commission ("FERC") Uniform System of Accounts ("USOA"), is:

> *Original cost*, as applied to electric plant, means the cost of such property to the persons first devoting it to public service. (18 CFR Ch. 1, Subsection C, Part 101)

The deduction of depreciation, amortization, and CIAC from the original cost results in a net original cost recorded on the seller's financial books and records. Thus, any property acquired is valued on the books and records of the purchaser at the same value that the seller placed on it. This principle is referred to as the "original cost first devoted to public service concept."

When utility property is purchased from another utility, the buyer is allowed to capitalize only the cost of the property when it was originally dedicated to utility service. This means that the excess paid over original cost for the property cannot be recorded in the

USOA Account No. 101, Utility Plant In Service. The difference (the premium amount) is recorded in the balance sheet plant USOA Account No. 114, Utility Plant Acquisition Adjustments, and any amortization of the balance is booked to the balance sheet plant reserve USOA Account No. 115, Accumulated Provision For Amortization Of Acquisition Adjustments.

If the Commission determines that the costs should be recovered from the buyer's customers, the regulatory authority may allow an offsetting amortization (expense) entry which books the costs to the utility's income statement operating income via USOA Account No. 406, Amortization Of Acquisition Adjustments thus, including the premium above the line for regulatory ratemaking. If the Commission decides that ratepayers should not be held responsible for the cost, the premium is amortized (expensed) to the non-operating income USOA Account No. 425, Miscellaneous Amortization.

Simply put, an acquisition adjustment results when utility property is purchased or acquired for an amount either in excess of or below book value. Book value relates to the value placed on utility property as recorded in a company's financial books and records. It consists of the property's "original cost" less depreciation, amortization, and CIAC. If the purchase price exceeds book cost, a "premium" has been paid to the seller. If the purchase price is less than book cost, a "discount" has been paid to the seller. The

premium or discount is classified and booked on the purchasing company's financial records as an acquisition adjustment.

Q. SHOULD THIS COMMISSION ENDORSE THE "ORIGINAL COST" CONCEPT?

A. Yes, we believe that it should endorse the concept. This Commission has the duty to ascertain the reasonable value of all property of any regulated public utility within its jurisdiction whenever such value becomes necessary to ascertain fair and reasonable rates. The rate base of a public utility represents the reasonable value of all property which is in service and devoted to the public use. Because the value of a utility's property remains unchanged as its stock is bought and sold, the transfer of stock, the indicia of ownership in a corporate entity whose stockholders are separate and distinct from the entity itself, does not affect the value of its property in service and devoted to the public use. Thus, no recalculation of the utility's property, or rate base, is appropriate.

Q. IS UCU REQUESTING A "RETURN ON" RATE BASE TREATMENT OF THE ACQUISITION PREMIUM?

A. Yes, it is.

Q. DOES PUBLIC COUNSEL BELIEVE THAT RATE BASE TREATMENT OF AN ACQUISITION PREMIUM IS APPROPRIATE?

A. No. The current rate base of SJLP is derived from the original cost of the property when it was first dedicated to public use. The purchase or trading of SJLP's stock does not affect the property's original cost. That is, a substitution of stockholders does not establish a new utility company. The transfer of stock between the sellers and buyers is little more than a simple financial transaction. In a stock transfer, most if not all of the assets transferred will continue to be used to provide the same services to the same ratepayers and those assets will remain subject to the same ratemaking jurisdiction of the same regulators. This continuity makes a recalculation of SJLP's rate base unnecessary and inappropriate.

Q. IS USE OF NET "ORIGINAL COST" FOR VALUING RATE BASE THE PREDOMINANT FORM OF REGULATION IN THE STATE OF MISSOURI?

A. Yes, it is. The use of "original cost" to set rates is not only the predominant form of regulation, but the only form which has been employed by the Missouri Public Service Commission. I know of no other time that this Commission has deviated from the concept of using net "original cost" in setting rates.

Q. IS THE USE OF ORIGINAL COST FOR VALUING RATE BASE CONSISTENT WITH GENERALLY ACCEPTED ACCOUNTING PRINCIPLES ("GAAP"?)

A. Yes, it is. The accounting profession's "cost principle" specifies that cash-equivalent cost is the most useful basis for initial accounting recognition of the elements recorded in the

accounts and reported on the financial statements. It is important to note that the cost principle applies to the initial recording of transactions and events. Financial Accounting Standards Board Concepts Statement 5, paragraph 67, explains that the initial cost is commonly adjusted for depreciation, amortization or other allocations. The "accounting constant" is the starting point, which is the historical (i.e., original) cost of the property being purchased.

Q. WHAT IS THE HISTORICAL BACKGROUND FOR THE POSITION THAT NET ORIGINAL COST SHOULD BE THE BASIS FOR SETTING RATES?

A. As briefly discussed in Mr. McKinney's direct testimony, abuses occurred in the 1920's and 1930's that created the need to adopt the original cost method for valuing rate base and setting rates. Utilities were acquiring other utility properties for amounts in excess of net book value. The valuation and transfer of properties in excess of their book value (i.e., positive acquisition adjustment) created inflated rate bases which resulted in higher rates to existing customers. The customers were paying higher rates based on services provided by the exact same property that had been providing them utility service prior to the acquisition, when, in fact, nothing had changed except for the valuation of the properties transferred. Regulators and legislators determined it was unreasonable to charge customers higher rates for the utilization of same utility property simply because the utility providing the service was acquired by another company. Thus, the concept of using the original cost of the property when first devoted to public service came to be

widely accepted. This principle has served to protect ratepayers from utilities who would buy properties at inflated prices and then seek revaluation of the properties at higher levels in order to produce greater profits. Absent this protection, the potential for abuse through acquisitions and mergers **is the same today** as it was prior to implementation of the original cost concept.

Q. DOES AN ACQUISITION PREMIUM PROVIDE ANY ADDITIONAL BENEFITS TO MISSOURI RATEPAYERS?

A. No. The acquisition premium consists of nothing more than a financial transaction that values the excess purchase cost over and above the net original cost of the SJLP properties. In and of itself, the acquisition premium provides no additional benefit to Missouri ratepayers; therefore, to allow the Company recovery through a rate base return or cost of service treatment unjustly penalizes consumers.

Q. WHAT DOES THE ACQUISITION PREMIUM REPRESENT?

A. The acquisition premium merely represents a financial transaction among shareholders, a large portion of the acquisition premium actually represents the procurement of additional shareholder value that exceeds the current market value (prior to the purchase announcement) of SJLP's stock price. From the perspective of the current SJLP shareholders the acquisition premium merely represents nothing more than a financial gain on their investment. That financial gain has nothing to do with the determination of

the value of the actual plant and service investments utilized in the operation and provision of services to utility customers. As far as those investments are concerned the purchase transaction itself changes nothing and they will remain fixed until the new owners implement any changes.

Q. DOES THE PUBLIC COUNSEL BELIEVE THAT THE ACQUISITION PREMIUM ASSOCIATED WITH THIS SALE A PUBLIC DETRIMENT?

A. As I stated earlier, yes, we do believe the acquisition premium to be a public detriment. To the extent any recovery of the acquisition premium is recovered through rates and would increase costs to Missouri customers the acquisition premium is a significant public detriment. It would have a detrimental affect on the public because their service costs would then be higher than if the sale had not occurred.

Q. IS THE POTENTIAL IMPROVEMENT OF CUSTOMER SERVICE OR LOWER RATES MOTIVATING THE PROPOSED SALE OF SJLP TO UCU?

A. No, it does not appear to be so. The stated impetus for the acquisition and merger is the fear of future competition and the procurement and/or protection of shareholder value, not lower rates or better service to customers. SJLP's managers determined that it was less risky (for shareholders) to sell now thus, preserving the increase in shareholder value created by the terms of the proposed acquisition. The alternative would be risking a uncertain future, from the perspective of the shareholder, in a potentially deregulated

electric energy market. This position is reiterated in the handwritten notes of the SJLP Special Board of Director's meeting held on February 19, 1999. On page 7 of the Board of Director's meeting notes, provided in response to MPSC Staff Data Request No. 259, it states:

**

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(Emphasis added by OPC)

TFS are the initials of Terry F. Steinbecker, President and Chief Executive Officer of SJLP. Jim Carolus is SJLP Board Member James P. Carolus.

Q. WHAT DO YOU MEAN BY FEAR OF FURTHER COMPETITION?

A. Currently, wholesale electricity markets are deregulated so prices are allowed to float. Retail rates to a utility's customers; however, are still regulated, and no date has been set in Missouri to change that. When deregulation happens in Missouri, if it happens,

utilities will lose their monopoly status and may be allowed to compete for customers in each other's service territories. Accordingly, current thought among the industry is that the size of a utility will become a very important factor in the competitive arena. Even though, in a deregulated market, electricity would still flow through the same lines and gas would still flow through the same pipes to consumers, the potential of lower margins in a competitive industry creates the threat that the shareholders equity interest in SJLP may be perceived as worth less than that which is achievable now.

Q. WAS THE SALE EFFECTUATED TO HELP SJLP CUSTOMERS?

A. No. The proposed sale of SJLP was not effectuated in order to place SJLP's customers in a better operating position than that which they currently occupy, for the most part that will not change. The sale of SJLP was enacted in order to allow the shareholders of the SJLP to acquire an increase in the shareholder value of their stock above that which existed if SJLP remained a stand-alone utility company. It appears to the Public Counsel that the concerns of the customers of SJLP in the decision-making process ran a distant second place race to the persons responsible for the sale. Yet it is the customers who are being asked to bear the heavy load associated with UCU's proposed recovery of the acquisition premium -- an acquisition premium that may never have existed if the management of SJLP, and its Board of Directors, had instead chosen to guide SJLP into the competitive arena, if and when deregulation becomes a reality.

Q. ARE YOU AWARE OF SJLP MANAGEMENT STATEMENTS AND DOCUMENTS THAT SUPPORT THESE POSITIONS?

A. Yes, I am.

For example, the following SJLP management quotes help to illustrate our position on the shareholder value issue:

> St. Joseph Light & Power has **struggled to increase shareholder earnings** for several years according to Terry Steinbecker, president, who said the company has studied the idea of a merger for five years or more and has **attempted to bolster earnings** by buying and investing with other companies. **A merger was the only way to improve shareholders earnings and make the shares easiest to buy. "We had no ability within our core business to do that."** (Source: St. Joseph, Mo., News-Press, March 6, 1999)
>
> Terry F. Steinbecker, Light & Power president and chief executive officer, said **the alliance would position the St. Joseph company well for competition as the retail electric industry is gradually deregulated.** (Source: Park Hills, Mo., Daily Journal, March 8, 1999)
>
> Terry F. Steinbecker, SJLP president and CEO said, "**As deregulation of our industry continued to unfold**, our management and board of directors, in conjunction with outside advisors, reevaluated our strategies to provide **shareholder value** and reliable service at competitive prices to our customers. As a result, we proceeded to seek a merger with an industry leader with the financial strength, the size and the commitment to growth to better achieve those objectives." (Source: Atchison County Mail, March 11, 1999)
>
> Mr. Steinbecker also stated, "**We see this as an excellent opportunity to enhance our shareholder's investment** as well as provide a reliable energy supply for out customers in a competitive market in the future." (Source Oregon Times Observer, March 11, 1999)

(Emphasis added by OPC)

Q. WILL SJLP'S EXECUTIVE MANAGEMENT BENEFIT FROM THE PROPOSED SALE?

A. Yes. In the Company's supplemental response to MPSC Staff Data Request No. 17, it states:

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Q. **

A.

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Q. **

A. **

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(Emphasis added by OPC)

Q. ** **

A. **

Q. **

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Q. **

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Q. **

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A. **

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Q. IS UCU REQUESTING RECOVERY OF THE COSTS ASSOCIATED WITH THE SJLP'S OFFICERS SEVERANCE, RETENTION AND SUPPLEMENTAL RETIREMENT PLAN?

A. Yes, it is. Referencing Schedule VJS-2 attached to the direct testimony of the UCU witness, Mr. Vern J. Siemek, UCU has classified these costs, officer and non-officer, as a transition costs which it seeks to recover over ten years.

Q. **

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A. **

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Q. IS UCU ALSO REQUESTING RECOVERY OF THE ARTHUR ANDERSON CHARGES?

A. UCU is requesting recovery of a portion of the Arthur Anderson charges. The Company's response to MPSC Data Request No. 1, Schedule VJS-2 6, lists the charges as a transaction cost.

Q. SHOULD RATEPAYERS BE REQUIRED TO REIMBURSE UCU FOR THE COMPENSATION CONSULTANTS CHARGES?

A. No. SJLP incurred the costs for activities unrelated to the operation and provision of utility services to ratepayers.

Q. WHY IS THE OPC ADDRESSING RATEMAKING MATTERS IN THIS CASE?

A. OPC believes that now is the appropriate time for the Commission to reaffirm its policy of not reflecting acquisition adjustments in rates. It is important for the Commission to understand the real risks of consummating this sale with regard to any recovery of the acquisition premium. If UCU is allowed to acquire the SJLP properties, it should do so knowing in advance that it is not going to receive recovery of the acquisition premium in rates. This places the financial risk of the transaction where it belongs, on the shareholders of UCU and SJLP.

Q. ONE OF THE STANDARDS THAT SOMETIMES HAS BEEN USED TO DETERMINE THE RATEMAKING TREATMENT OF ACQUISITION ADJUSTMENTS IS WHETHER THE PURCHASE OF THE PROPERTY WAS AN "ARM'S LENGTH" TRANSACTION. IF THE PURCHASE OF THE UTILITY PROPERTY WAS AN ARM'S LENGTH TRANSACTION, WOULD IT GUARANTEE THE LOWEST PURCHASE PRICE?

A. No. Simply because an acquisition of utility property would be considered an arm's length transaction (e.g., no affiliation or tie between the negotiating parties), this criterion alone would not guarantee the lowest possible purchase price. This is particularly true if the purchasing utility management believed that the ratepayers could be required to pay for any premium above net book value. In that circumstance, there certainly would be no guarantee that the purchasing utility would have negotiated the best possible terms.

Q. IF THE COMMISSION WERE TO DETERMINE THAT ACQUISITION ADJUSTMENTS SHOULD BE INCLUDED IN THE RATEMAKING PROCESS, WOULD THERE BE A NEED FOR THE COMMISSION TO DETERMINE THE APPROPRIATE PRICE AT WHICH UTILITIES SHOULD ACQUIRE OTHER UTILITIES?

A. Yes, if the Commission were to adopt a position of including acquisition adjustments in rates, this would place the burden of determining the appropriate purchase price of acquired utilities on the Commission. Clearly, it is a difficult process to determine what

the "least cost" or otherwise appropriate price should be for an acquired utility. In order to make that determination, the Commission would have to place itself ,or its agents, in the negotiation process to ascertain if a utility property was being or had been acquired at the lowest possible price. If this were not done, then the Commission could in no way ensure that the public would not be harmed (i.e., that the transaction was not detrimental to the public interest).

By maintaining its current position of not authorizing direct or indirect recognition of either positive or negative acquisition adjustments in rates, the Commission can avoid making a determination that the utility property in question was acquired at the lowest possible or otherwise appropriate price. The practical effect of authorizing acquisition adjustments in the ratemaking process is to shift the burden of proof from the Company to the Commission in making determinations regarding the purchase price of acquired utility properties.

Q. ARE THERE OTHER PROBLEMS WITH ALLOWING RECOVERY OF A POSITIVE ACQUISITION ADJUSTMENT?

A. Yes. Allowing recovery of positive acquisition adjustments in rates does not provide sufficient incentive for the acquiring utility to negotiate the best possible price for the acquired firm. If a utility were allowed recovery of acquisition premiums, it could negotiate less than favorable terms in acquiring a property with the knowledge that the

ratepayers would provide recovery through rates. Allowing acquisition premiums in rates sends signals to buyers of utility property that recovery is guaranteed regardless of the purchase price which may be an inflated amount above the value of the utility property. If the acquisition premium is allowed in rates, both the purchaser and the seller of said property can benefit from inflating the rate base, while the ratepayer foots the bill.

In addition, the adoption of positive acquisition adjustments for ratemaking purposes removes from purchasing utilities an incentive to negotiate a lower price or terminate negotiations when a seller requests an unreasonable price for the property in question. A policy of giving ratemaking treatment to positive acquisition adjustments would place Missouri regulated utilities at a competitive advantage over unregulated entities, since Missouri jurisdictional utilities then would have in essence a "blank check" for recovery of their acquisition expenditures from ratepayers. This situation does not exist for unregulated entities. Thus, if utility executives knew that there was a very good chance of recovery from ratepayers of an acquisition premium resulting from the purchase of utility property for an amount in excess of net book value (i.e., "original cost" less depreciation) this would pose the potential for tainting the negotiation process between the buyer and the seller.

Q. IS THE COMPANY REQUESTING THAT THE COMMISSION MAKE A DETERMINATION THAT THE ACQUISITION PREMIUM AND TRANSITION COSTS ASSOCIATED WITH THE PURCHASE ARE REASONABLE?

A. Yes, it is. On page 12, lines 16 - 19, of Mr. McKinney's direct testimony, he states:

> We are requesting that the Commission first examine our proposal and determine that significant merger benefits are or will be create as a consequence of this combination. **Next, it is appropriate to determine the transaction (premium) and transition costs associated with the benefits are reasonable.**
>
> (Emphasis added by OPC)

Q. SHOULD THE COMMISSION BE REQUIRED TO DETERMINE THE REASONABLENESS OF THE OUTLAY FOR THE ACQUISITION PREMIUM AND THE TRANSITION COSTS?

A. No, it should not. The Commission was not an active participant to the negotiations and it does not have complete access to the universe of events, materials and rationales surrounding the negotiation procedures or processes occurring prior to the sale being consummated. To make the determination requested by Company, under these circumstances, the Commission would be put in the position of endorsing or sanctioning the terms of an event of which it has only a limited or superficial knowledge. To make such a decision based only upon the information at-hand would at best be unreasonable and ill-advised.

Q. HOW DO SELLERS OF UTILITY PROPERTY BENEFIT FROM SELLING ABOVE NET BOOK VALUE?

A. The sale of utility property above net book value benefits the selling party because the gain that is created is generally treated below-the-line to the sole benefit of shareholders. The higher the price that the utility property is sold at, the larger the gain for the seller. Clearly, if the buyer believes there will be a recovery of the acquisition adjustment, there would be a greater potential for an inflated rate base, which in turn would result in higher utility rates for customers as well as a larger gain to the seller.

Based on past Commission practice, utilities expect, even demand, that any gain on the sale of company assets go to benefit the selling utility's shareholders, not ratepayers. To my knowledge, no utility has ever come forward proposing any form of sharing gains from the sale of properties with ratepayers. It is inconsistent and extremely unfair to expect utility customers to pay for the acquisition premium through rates, and then when the company disposes of the property purchased, to allow only the shareholders to reap the benefits of any gains.

Q. WOULD UTILITIES BENEFIT FROM THIS COMMISSION NOT DEVIATING FROM THE PRACTICE OF NOT ALLOWING RECOVERY OF AN ACQUISITION ADJUSTMENT IN RATES?

A. Yes, they would. Based on the ratemaking treatment afforded utilities in the past, if there is an asset acquired at less than net book value, utility shareholders reap any benefits associated with the acquisition of that asset. This occurs because the buyer records the asset on its financial books at net book value (i.e., that is the asset's "original cost" instead of the below book purchase price).

Q. DO UTILITIES BENEFIT FROM CONSISTENT TREATMENT OF ACQUISITION ADJUSTMENTS?

A. Yes, they do. Utilities that purchase property below book value resulting in negative acquisition adjustments benefit because those same utilities receive a return on property valued at its net "original cost," not the purchase price. Since these utilities would be receiving a return on the net "original cost" rate base, their return component would be computed on a rate base greater than that which these utilities actually had invested. If the Commission then decides to allow utilities to recover positive acquisition premiums it creates a situation whereby utilities are put in the position of arguing for net "original cost" ratemaking whenever a negative acquisition premium occurs, while at the same time advocating that positive acquisition premiums be treated above net "original cost." Under either scenario, the utility would benefit to the detriment of the ratepayers.

Q. ARE YOU AWARE OF ANY CASE IN MISSOURI WHEREBY A NEGATIVE ACQUISITION ADJUSTMENT WAS AFFORDED "ORIGINAL COST" RATE TREATMENT?

A. Yes, I am. In the U.S. Water/Lexington, Missouri ("U.S. Water") general rate case, Case No. WR-88-255, the Commission rejected a negative acquisition adjustment which was proposed by this Office. The negative acquisition adjustment was not used by the Commission to reduce U.S. Water's rate base, or to reflect a negative amortization to the cost of service. This Commission determined that the reasonable value of property purchased from other utilities was not its purchase price but rather the higher original cost to the first entity which devoted the property to public.

The Missouri Commission did not recognize the negative acquisition adjustment associated with the purchase nor, did it "write down" the value of the assets transferred; therefore, it would be inconsistent to "write up" the assets, by whatever means, either through the recovery of an acquisition premium or acceptance of any sharing of merger savings. Acceptance of a positive acquisition adjustment would be a reversal of the Commission precedent set in the U.S. Water rate case.

Q. DOES USING NET "ORIGINAL COST" VALUATION FOR RATEMAKING PURPOSES GIVE CONSISTENT TREATMENT TO UTILITIES?

A. Yes, it does. Using net "original cost" to determine rate base valuation for ratemaking purposes provides utilities consistency in establishing their rates. It also provides utilities with the incentive to acquire utility properties termed "troubled utilities" where it would be in the public interest for these troubled utilities to be acquired by another utility. For example, if the Commission was confronted with a troubled property and there was a buyer willing to purchase that troubled property for less than original cost, the difference between the original cost and the lower purchase price would be part of the incentive for the buyer to consummate the transaction. Without the incentive associated with this opportunity, the property may never change hands and improvements wouldn't even have been contemplated.

Q. HOW HAVE GAINS ON SALE OF UTILITY PROPERTY BEEN TREATED FOR RATEMAKING PURPOSES?

A. To my knowledge, the Commission has never allowed ratepayers to share in any gains resulting from the sale of a utility's property. The selling utility's shareholders have always realized the entire benefit of any gains received.

The Commission's position on this issue is illustrated by its decision in Kansas City Power & Light, Case No., ER-77-1 18. On page 42 of its Report and Order, the Commission stated:

> It is the Commission's position that ratepayers do not acquire any right, title and interest to Company's property simply by paying their electric bills. It should be pointed out that Company investors finance Company while Company's ratepayers pay the cost of financing and do not thereby acquire an ownership position. Therefore, the Commission finds that the disposal of Company property at a gain does not entitle its ratepayers to benefit from that gain nor does the disposal of Company property at a loss require that Company's ratepayers absorb that loss.

Furthermore, in decisions reached by the Commission in rate cases involving Missouri Cities Water Company, Case No. WR-83-14, and Kansas City Power & Light, Case No. EO-85-185, the Commission found that gains of utility property sold by those utilities would be treated "below-the-line."

The Commission has consistently followed this practice of not allowing any gains resulting from sales of utility property to flow to ratepayers. It would be inequitable for the shareholders of a seller of utility property to receive the benefit of any gain, while at the same time, the buyer of utility property is be permitted to recover from its ratepayers any "premium" above net book value. It would also be unfair to ratepayers if the seller's gain were be taken below-the-line while the buyer's premium is provided recovery above-the-line.

Q. HAS THE COMMISSION BEEN CONSISTENT IN ITS TREATMENT OF ACQUISITION PREMIUMS AND GAINS ON SALE OF UTILITY PROPERTY?

A. Yes, it has. To my knowledge, this Commission has accorded acquisition premiums and gains on sale of utility property consistent treatment in the ratemaking process. It has consistently valued utilities rate bases utilizing net "original cost" valuation methods, and it has consistently ignored the positive as well as the negative acquisition adjustments that have resulted from utility acquisitions and mergers under its jurisdiction. It has also disregarded the concept of flowing any gains derived from the sale of utility property to ratepayers. It has taken the position, as noted previously, that gains from the disposal of utility property belong to the utility's shareholders.

Q. WOULD THE CONTINUED DISALLOWANCE OF THE RECOVERY OF ANY ACQUISITION ADJUSTMENTS IN RATES CREATE A DISINCENTIVE FOR UTILITIES TO ACQUIRE OTHER UTILITIES?

A. No. If the utility considering an acquisition believes that it is in its economic as well as its business interest, it would still acquire the other company regardless of any recovery of an acquisition adjustment from ratepayers. The prudent thing to do would be for the utility to pursue the acquisition if it is considered to be in the utility's best interest.

Q DOES THE PROPOSED ACQUISITION IN THIS CASE REPRESENT AN ESSENTIAL INTEGRATION OF FACILITIES PROGRAM DEVOTED TO SERVING THE PUBLIC BETTER?

A. Not necessarily. The primary reason that this sale occurred is because the management of SJLP was seeking a less-risky way to increase shareholder value (the price of its stock). It was not implemented in order to simply integrate SJLP into a larger and more efficient system. The SJLP system is of the highest quality already. It's costs and prices are within the lowest of the utilities in the nation. The excess purchase price to be paid for SJLP, in and of itself, does not represent or forebode an improvement of service to be provided to customers and it certainly does not represent the possibility of lower rates.

Q. ISN'T IT TRUE THAT SJLP ALREADY HAS THE DISTINCTION OF BEING A QUALITY PROVIDER OF RELIABLE LOW-COST ENERGY SERVICE?

A. Yes, I believe that is a true statement. For example, on page three, lines 6-9, of the direct testimony of Mr. John W. McKinney, he provides a comparison of the existing electric rates of UtiliCorp and SJLP. For every category of customer listed, the annual average $/Kwh to service that customer category is less for SJLP than it is for UtiliCorp.

Mr. McKinney's assessment is corroborated by a UCU-originated news release provided in response to MPSC Staff Data Request No. 143. In the news release, Mr. Terry F. Steinbecker, SJLP President and Chief executive Officer is quoted as saying:

> Light & Power has achieved the distinction as a low-cost provider of quality, reliable energy services in its 3,300-square mile service area in northwest Missouri. Its rates are among the lowest in the state.

The Company's response to MPSC Staff Data Request No. 265 states that as of November 1999, SJLP's Annual Average $/Kwh in the customer classes residential, commercial and industrial was less than KCPL-MO, UE, Empire, UCU and IPL. The trending of SJLP's low rate structure is further corroborate by the Company's response to MPSC Staff Data Request No. 272 which states that in 1998 the SJLP Average Revenue Per KWH (Cents) was 5.30 when the State of Missouri Average was 6.08 and the U.S. Average was 6.74.

Q. IS THE ACQUISITION ANALOGOUS TO COST REDUCTION INITIATIVES OFTEN UNDERTAKEN BY UTILITIES?

A. No, it is not. This transaction did not occur in order to make the SJLP operations more efficient, it transpired because the management and shareholders of SJLP were searching for ways to increase the value of their common stock holdings. The decision to sell SJLP to UCU was, in my opinion, based primarily on the management and owners desire to increase the shareholder value of their respective ownership interests in the operations. However, the question may achieve some level of validity from UCU's point of view as the purchaser of SJLP, but their actions up-to-date are somewhat suspect.

Q. WHY DO YOU BELIEVE UCU'S ACTIONS REGARDING COST REDUCTION INITIATIVES TO BE SUSPECT?

A. One reason is that, as a term of the proposed ARP, the Company is recommending to exclude the SJLP factors from its total Company cost allocation process.

Q. WHY IS THE COMPANY'S PROPOSING TO EXCLUDE THE SJLP FACTORS FROM ITS ALLOCATION PROCESS SUSPECT?

A. According to Mr. McKinney's direct testimony, page 29, line 3 - 10, excluding SJLP factors from the Missouri Public Service ("MPS") allocation calculations will eliminate the artificial shifting of the SJLP overhead savings to MPS customers. MPS customers should continue to be allocated their existing level of corporate costs. The corporate and intra-business unit allocations to MPS will not increase if the SJLP factors are excluded.

Under the pretext of not passing any of the SJLP merger-related savings or costs to other UitliCorp operations, Mr. McKinny's testimony on this issue seems to be in direct conflict with many of the reasons that one company buys another company. To be fair to Mr. McKinney, he appears concerned with the possible inappropriate allocation of some of the merger-related savings to MPS. That would be a no-no given that UCU is trying to portray its individual operating divisions as essentially separate entities so that may enhance its chances at recovery of the SJLP acquisition premium.

However, I would argue that one of the major reasons for merging with any company would be to take advantage of the economies of scale (or synergies) that would be created

by the combination on the entire entity (purchaser and seller), not just the cost reductions that would occur in the operations of the company being sold. Whether the economies of scale are represented by employee costs saved, reduced operation & maintenance expenses, lower fuel costs, lower plant costs or whatever savings management can squeeze from the operations, the combined companies should have a lower cost structure than that of the individual companies on a stand-alone basis.

Q. ARE THERE OTHER REASONS YOU BELIEVE THE COST REDUCTIONS INITIATIVE ARE SUSPECT?

A. Yes. Public Counsel believes that it is possible, under the Company's proposal, that it may over-recover corporate overhead and intra-business unit cost allocations on a total entity basis. For example, if the SJLP factors relating to the development of corporate allocation rates are excluded from the total Company allocation process it is possible that the allocations to MPS would be artificially high. That would occur due to the fact that if the SJLP factors were included in the total Company allocation process, the base of operations to which the costs would be allocated becomes larger, thus MPS would likely receive a lower level of the allocated costs than that proposed under the Company's plan.

Q. PLEASE PROVIDE A SIMPLE ILLUSTRATION OF HOW COST ALLOCATIONS TO MPS COULD BE ARTIFICIALLY HIGH.

A. Let's suppose that UtiliCorp currently has $100 of corporate costs that it allocates out to its separate divisions, including MPS, and that that $100 level will remain the same for the next ten years (absent the SJLP factors). Assume now that MPS receives $30 of the $100 as its share of the corporate costs and that the remaining $70 goes to the other operating divisions of UCU based on the utilization of an allocation factor such as the number of employees in each separate operation or division. For simplicity's sake, assume UCU has 100 employees. MPS has 30 employees and the other operation divisions have 70 employees.

Under the Company's ARP proposal, MPS would continue to receive the $30 allocation for each of the ten years of the plan. If we then merge the SJLP corporate operation with the UCU corporate operation and assume an incremental cost of say $10, the total corporate costs now increases to $110. Assume also that SJLP has a total of 30 employees. Based on the Company's proposal SJLP would receive a corporate cost allocation of $30, MPS would still receive $30 and the other operation division would still receive $70 of the allocated costs for a total of $130. The Company would over-recover $20 ($130 less the $110).

In creating the fiction that SJLP factors would not be utilized in allocating corporate costs, the Company would actually be taking some of the cost savings relating to the

UCU/SJLP merger and recovering them by "back-dooring" them into the MPS operation for each of the ten years proposed by its ARP.

Q. DOES THE PUBLIC COUNSEL BELIEVE THAT THE COMMISSION SHOULD APPROVE OF A PLAN THAT SEEKS TO RECOVER MERGER-RELATED ECONOMIES OF SCALE IN SUCH A MANNER?

A. No, we do not. The economies of scale developed by this combination should be analyzed, developed and identified in a forthright manner. It does not appear to me that the Company's proposal does that. If economies of scale are achieved by UCU because of the merger they should be factored into the Company's operations as a whole. Once SJLP is merged with UCU it will cease to exist as a stand-alone company. SJLP will be operated as a division of UCU, and as a division of UCU its operations and identity will be completely integrated with that of UCU. It seems a little odd to me that Mr. McKinney and UCU would propose to somehow isolate the SJLP operations and allocate the costs of the merger to only SJLP's customers as if SJLP still existed as a stand-alone company. Any economies of scale created by the merger were purchased to benefit the entire UCU regulated operation, not just the SJLP operations. Apparently, the management of UCU believes this to be true, otherwise why would they have stated that the acquisition and merger was initiated in order to strengthen UCU's position going into the deregulated market.

Q. PLEASE POINT TO UCU STATEMENTS THAT SUBSTANTIATE YOUR CLAIM THAT UCU SOUGHT TO ACQUIRE SJLP TO STRENGTHEN ITS POSITION GOING INTO A DEREGULATED MARKET.

A. In a UtiliCorp-originated news release (dated March 5, 1999) provided in response to MPSC Staff Data Request No. 143, Richard C. Green Jr., UtilitCorp Chairman and Chief Executive Officer is quoted as saying:

> This agreement brings together two companies with compatible views about the importance of customers, the value of employees and the future direction of the industry. **The merger strengthens our competitive position in our home state and in the Midwest.**
>
> (Emphasis added by OPC)

And:

> As we pursue our growth strategies, UtiliCorp seeks to achieve a balance between investments in regulated and unregulated energy activities, and between domestic and international operations. **This transaction contributes to that goal and will benefit UtiliCorp's customers and shareholders.**
>
> (Emphasis added by OPC)

Q. IS IT POSSIBLE THAT THE COMPANY WOULD, WHEN AND IF DEREGULATION OCCURS, BE ABLE TO SELL THE SJLP GENERATION ASSETS FOR AN AMOUNT GREATER THAN THEIR CURRENT NET BOOK COST?

A. Yes, that is a distinct possibility. **

**

(Emphasis added by OPC)

The market value of SJLP's generation assets was corroborated in the Company's response to MPSC Staff Data Request No. 225. The response states that, **

**

Q. HAS UCU INDICATED THAT IT MIGHT SPIN-OFF OR SELL THE SJLP GENERATION ASSETS?

A. Yes, it has. On a February 8, 2000, conference call to utility analysts discussing UCU's 1999 financial results, Mr. Robert K. Green, UCU President and Chief Operating Officer, is quoted as stating:

> 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.
>
> And again, this just highlights the service territories that we've acquired with St. Joe and Empire.
>
> (Emphasis added by OPC)

Q. WOULD IT BE REASONABLE TO ASSUME THAT, IF OR WHEN, DEREGULATION COMES TO MISSOURI THAT UCU WILL SPIN-OFF OR EVEN SELL THE SJLP GENERATION ASSETS?

A. Yes, that is a distinct possibility. It's my understanding that, most if not all, of the electric utilities within the State are looking at various ways to decouple their generating assets from the their regulated operations.

Q. IF UCU IS ABLE TO EFFECTUATE THE DEREGULATION OF THE SJLP GENERATING ASSETS, IS IT A FAIR STATEMENT THAT THE MARKET VALUE OF THOSE ASSETS ALONE, MINUS THEIR NET BOOK, MAY EXCEED THE VALUE OF THE ACQUISITION PREMIUM UCU IS PAYING TO ACQUIRE SJLP?

A. **

**

Q. COULD THE MARKET VALUE OF THE SJLP GENERATING ASSETS HAVE BEEN CONSIDERED IN UCU'S ANALYSIS AND EVALUATION OF ITS BID FOR SJLP?

A. Yes, I believe that it could have. Although I do not have specific knowledge of all the factors UCU utilized in its evaluation of SJLP, I think it is reasonable to assume that

UCU did take the value of the SJLP generating assets into consideration when making its bid. Such a fact was noted by Mr. Green in his comments to the utility analysts I discussed in a prior Q&A. If it did, and it came to the same or similar conclusion that the consultants, Scott Madden & Associates Inc., did, it surely would have impacted its decision process regarding the amount of the premium it would offer to the SJLP shareholders for their common stock. In effect they may have realized that as long as the premium they offered did not exceed the excess market value of the generating assets, the purchase would provide them with an immediate increase in their own shareholder value.

If the Commission grants the Company's request to recover the acquisition premium from the SJLP ratepayers, it's probable that UCU's shareholders will reap a significant unearned windfall. That is, the acquisition premium itself plus the possible large gain from the future sale or transfer of the SJLP generation assets.

Q. IF UCU ULTIMATELY SELLS OFF CERTAIN GENERATING ASSETS DO YOU THINK THE COMPANY WOULD PROPOSE SHARING THE GAIN ON THE SALE WITH RATEPAYERS?

A. No. As I discussed earlier in this testimony, consistent with past Commission precedent, gains on the sale of utility assets are typically treated below-the-line to the sole benefit of shareholders.

Q. WHAT IS YOU EXPERIENCE WITH ALTERNATIVE REGULATORY PLANS IN THE STATE OF MISSOURI?

A. I have quite a bit of personal experience with these types of plans. I was the person within the Office of the Public Counsel that was given the primary responsibility of monitoring and auditing each of the two comprehensive alternative regulatory plans ever approved in the State of Missouri by this Commission. I have worked on both the Southwestern Bell Telephone Company ("SWBT") alternative regulatory plan, and I am currently responsible for monitoring and auditing the alternative regulatory plan that Ameren/UE Electric Company ("Ameren") is currently operating.

Q. GENERALLY, DO YOU HAVE ANY BELIEFS REGARDING THE APPROPRIATENESS AND EFFECTIVENESS OF UTILITIES OPERATING UNDER ALTERNATIVE REGULATORY PLAN?

A. Yes, I do. In a general sense, I believe that alternative regulatory plans such as those utilized by SWBT, Ameren and quite possibly the one proposed by UCU often do not work as intended. By that I mean, the alternative regulatory plans quite often create many more problems than they are intended to eliminate.

Q. WHAT DO YOU MEAN WHEN YOU SAY THE PLANS CREATE MANY MORE PROBLEMS THAN THEY ARE INTENDED TO ELIMINATE?

A. The Ameren/UE ARP is a prime example of an ARP that has gone awry. During the third and final year of the ARP approved in Case No. EO-96-14, controversies arose that attacked the fundamental basis of the ARP's founders intentions and meanings. Differences of opinion regarding all aspects of the very terms written into the ARP documents were expressed and debated, often acrimoniously and without much success towards settlement.

Public Counsel often experienced great difficulties in obtaining information from Ameren with regard to its responsibilities to monitor the ARP. Often the information requested was not provided, and on many occasions the data that was provided was unresponsive, incomplete and/or totally inaccurate. Ameren often argued that the information requested was not provided because it was not relevant to the monitoring of the Company pursuant to the ARP. Ameren essentially stated that the ARP did not allow OPC to audit the Company thus, it did not have to provide the information requested. To obtain the information OPC filed a complaint with the Commission. The Commission ultimately responded in OPC's favor, but at a cost. That cost was time. Ameren, in my opinion, successfully halted our investigation of its operations for a period of time that was crucially needed in order to accurately verify its claimed earnings sharing amount. Public Counsel foresees the same types of problems occurring with UCU's proposed ARP.

Another problem with the Ameren ARP was the differences that occurred in the individual parties interpretation of the terms of the ARP document. Consensus as to what the terms of the ARP really were or meant was an oft fought battleground. The parties interpretation often did not coincide at all. More often than not, there was total disagreement. Fundamentally, OPC, and I believe the MPSC Staff, believed that the ARP allowed our regulatory agencies to identify and take to the Commission issues which could not be resolved with Ameren. Ameren often challenged this belief as inconsistent with the terms of the ARP. Amazingly, these controversies occurred in relation to an ARP that was only in effect for three years. UCU's ARP proposal is for a duration of ten years. Public Counsel can only guess at the number of controversies and conflicts that will occur between the parties, and the Commission, if the Commission adopts UCU's proposal. In my opinion, the disagreements would be numerous and time-consuming. Therefore, it's my firm belief that the normal cost-of-service regulatory hearing process is the only appropriate way in which UCU should be regulated in Missouri.

ACQUISITION STANDARDS

Q. WHAT ARE THE ACQUISITION STANDARDS?

A. In Case No. EM-91-290, in the matter of UtiliCorp United, Inc., United and Colorado Transfer Company, the Commission created a supplemental set of standards for acquisitions and mergers, those being:

a. All documentation generated relative to the analysis of the merger and acquisition in question must be maintained.

b. The Company must present an estimate of the impact of the merger on its Missouri jurisdictional operations.

c. The Company must provide an assessment of the relative risk regarding items that impact its Missouri operations.

d. The Company must propose assurances or conditions that will address the overall merger components that pose the risk of being detrimental to the Missouri public interest.

Q. HAVE THESE STANDARDS BEEN UTILIZED IN ANY CASE PRIOR TO CASE NO. EM-91-290?

A. Yes. It's my understanding that the four standards were established in the Kansas Power and Light Company's proposed acquisition of and merger with Kansas Gas and Electric Company, docketed as Case No. EM-91-213. It's also my understanding that most of the

standards had been addressed for a number of years by companies approaching the Commission for authorization for acquisitions.

Q. WHY IS THE UTILICORP UNITED INC., CASE NO. EM-91-290, SIGNIFICANT?

A. The UtiliCorp case is important because, it requires that UCU propose assurances or conditions that will address the overall merger components that pose the risk of being detrimental to the Missouri public interest, and like many other utilities that have paid premiums related to acquisition and/or merger activities, UCU did not propose any ratemaking recovery of the acquisition premium paid (approximately $15 million) pursuant to its request for approval of the Centel transaction.

The Company's response to MPSC Staff Data Request No. 3, Case No. EM-91-290, stated:

> No request for recovery of any of the Centel acquisition adjustments were made in Missouri.

Furthermore, the Commission's Order Approving Merger, date September 13, 1991, pp. 4-5, stated:

> 6. That nothing in this Order shall be considered as a finding by the Commission of the value for ratemaking purposes of the properties herein involved, nor as an acquiescence in the value upon said property by the

applicants. Furthermore, the Commission reserves the right to consider the ratemaking treatment to be afforded these transaction in any later proceeding.

Q. HAD IT BEEN A STATED POLICY OF UTILICORP TO FORGO SEEKING RATEMAKING RECOVERY OF ACQUISITION PREMIUMS THAT RESULT FROM ITS MERGER AND ACQUISITION ACTIVITIES?

A. Yes, it's my understanding that for many years it has been the Company's policy to not seek rate recovery of any acquisition premiums associated with it's merger and acquisition activities. Regarding the policy, the Report and Order, page 46, in Missouri Public Service Company, Case No. ER-90-101, states:

> ...when UtiliCorp was formed Company assured the Commission that the ratepayers would suffer no detriment from UtiliCorp's [merger] activities but would experience the benefits associated with UtiliCorp's [merger] activities.

This policy was later corroborated and discussed in the rebuttal testimony of MPSC Staff witness, Mr. Cary G. Featherstone, Case No. GM-94-40, pp. 41-42:

> UtiliCorp has a stated policy of not requesting recovery of any acquisition adjustments in any jurisdictions in which it operates. Mr. Richard Green, Chairman of the Board, Chief Executive Officer and President of UtiliCorp, stated in a meeting with the Commission in late 1985/early 1986 that the MPS Division's Missouri ratepayers would be insulated from all "downside risk" associated with its merger and acquisition strategy.

In the meeting with the Commission, Mr. Green pledged that at no time would Missouri ratepayers be adversely or detrimentally affected by UtiliCorp's merger and acquisition strategy. **Mr. Green further indicated that all benefits of any merger and acquisition would flow to the ratepayers, and that they would be insulated from all problems or costs associated with this strategy of UtiliCorp.** Mr. Green explained that the benefits which result from a larger, less risky, consolidated UtiliCorp corporate structure would flow to Missouri ratepayers, while these ratepayers would be insulated from any negative or detrimental impacts.

In an interview with Mr. Green on May 21, 1990 (Case No. ER-90-101), Mr. Green concurred with this summary of his meeting with the Commission in late 1985/early 1986 and reaffirmed that position. He said that he not only made that pledge but had kept it. He stated that this was supported by the fact that at no time has UtiliCorp attempted or would UtiliCorp attempt to seek recovery in rate base of premiums (i.e., acquisition costs in excess of net book value) paid for the properties acquired by UtiliCorp. He said that UtiliCorp has not requested recovery of any acquisition adjustments in any of the jurisdictions that it operates in.

(Emphasis added by OPC)

Also, the Company's response to MPSC Staff Data Request No. 253 provided an excerpt from the direct testimony of Steve Traxler in Case No. ER-97-394. His testimony on pages 38 and 39 stated:

Q. Has Mr. Green, Chairman of UCU, given assurances to this Commission in the past that UCU's strategy of diversification through mergers and acquisition would not adversely affect Missouri ratepayers?

A. Yes. In a meeting with the Commissioners and Staff members held at the Commission offices in Jefferson City in late 1985/early 1986, Mr. Green stated that MPS' Missouri ratepayers would be

> insulated from all "downside risks" associated with the corporate mergers and acquisition strategy.
>
> In that meeting, Mr. Green promised that not only would Missouri ratepayers not be adversely affected by UCU's merger and acquisition strategy, **all benefits of the corporate strategy would flow to ratepayers**.

(Emphasis added by OPC)

Q. IS IT THE PUBLIC COUNSEL'S BELIEF THAT UTILICORP HAS RENEGED ON THE NO DETRIMENT POLICY MR. GREEN ESPOUSED?

A. Yes, it is. On page 14 of his direct testimony, the President and Chief Operating Officer of UtiliCorp, Mr. Robert K. Green, states:

> Q. Does UtiliCorp's proposal to recover part of the acquisition premium in rates mark a departure form past comments by UtiliCorp not to seek such recovery?
>
> A. **Yes, but only to the extent that UtiliCorp seeks to recover part of the premium in this docket.** However, it has always been and continues to be UtiliCorp's position that Missouri ratepayers would not be adversely or detrimentally affected by our merger and acquisition strategy. That is just as true today as it was 15 years ago. Seeking premium recovery is not inconsistent with this position.

(Emphasis added by OPC)

Q. HAVE THERE BEEN OTHER UTILITIES THAT ALSO COMMITTED TO NOT SEEK RECOVERY OF ACQUISITION PREMIUMS IN RATES FOR PROPERTY ACQUIRED IN MISSOURI?

A. Yes, in a recent case involving the purchase of the Missouri operations of Associated Natural Gas Company, Atmos Energy Corporation, agreed to forgo any recovery of the acquisition premium it was to pay for the properties. On page 8 of the Unanimous Stipulation and Agreement in Case No. GM-2000-312, it states:

> The amount of any asserted acquisition premium (i.e., the amount of the total purchase price above net book value), including transaction costs, paid by Atmos for ANG properties incurred as a result of the acquisition shall be treated below the line for ratemaking purposes in Missouri and not recovered in rates. Atmos shall not seek either direct or indirect rate recovery or recognition of the acquisition premium, including any and all transaction costs (e.g., legal fees, consulting fees and accounting fees), in any future ratemaking proceeding in Missouri.

And,

> In addition, Atmos shall not seek to recover in Missouri the amount of any asserted acquisition premium in this transaction as being a "stranded cost" regardless of the terms of any legislation permitting the recovery of stranded costs from Missouri ratepayers.

The Commission issued its Order Approving Stipulation and Agreement, Case No. GM-2000-312, approving as a resolution all issues in the case on April 20, 2000, effective on May 1, 2000.

Also, in the purchase of various GTE properties, Case No. TM-2000-182, the witness for Spectra Communications Group LLC, Mr. Kenneth Matzdorf, stated that his Company would not seek ratemaking recovery of the acquisition premium it expects to pay for the GTE exchanges. On page 14 of his direct testimony, lines 10-17, he stated:

> Q. How will any acquisition premium be handled in future rate filing? (sic)
>
> A. Spectra understands some parties' concerns that the purchase premium should not be recognized in any rate filing. Spectra also understands that the Commission has traditionally recognized original historical costs in determining the rate base for the calculation of revenue requirement. As a result, Spectra is willing to commit that it will not seek recovery of any portion of the acquisition premium in future rate filings.

Q. PLEASE CONTINUE.

A. A couple of electric utilities that have also agreed to forgo recovery of an acquisition premium include Union Electric Company ("UE") in its purchase of the Illinois utility Central Illinois Power Company, Case No. EM-96-149 and in its purchase of the Arkansas Power & Light Company's Missouri properties, Case No. EM-91-29, and

Western Resources Inc. in its proposed purchase of Kansas City Power & Light, Case No. EM-97-515.

In Union Electric Company, Case No. EM-96-149, UE agreed not to seek recovery of the acquisition premium in rates. On page two of the Stipulation and Agreement signed in Case No. EM-96-149 it states:

> 2. Merger Premium
>
> UE shall not seek to recover the amount of any asserted merger premium in rates in any Missouri proceeding. UE has identified this amount as $232 million.

In its application to acquire Arkansas Power & Light Company's (APL's) Missouri properties, Union Electric Company also agreed to not seek recovery of the acquisition premium in any rate case in the future. The Stipulation and Agreement for Case No. EM-91-29 stated:

> The amount of any acquisition premium (i.e., the amount of the purchase price above net book value) paid by UE to APL for the electric properties of APL shall be treated below the line for ratemaking purposes in Missouri and shall not be sought to be recovered by UE in rates in any Missouri proceeding, and the Joint Application should be considered as amended in this regard.

While in Western Resources Inc., Case No. EM-97-515, the Company essentially agreed to the same conditions and terms that UE had in the two cases discussed above. Beginning on page one of the Stipulation and Agreement of Case No. EM-97-515 it states:

> 2. Merger Premium
>
> The amount of any asserted merger premium (i.e., the amount of the purchase price above net book value) paid by Western Resources for KCPL shall be treated below the line for ratemaking purposes in Missouri and not recovered in rates. The Joint Applicants, including Westar, shall not seek to recover the amount of any asserted acquisition premium resulting from this transaction in rates in any Missouri proceeding and the Joint Application shall be considered as amended in this regard. The Joint Applicants have currently estimated this amount as approximately $870 million. In addition, Westar shall not seek to recover in Missouri the amount of any asserted acquisition premium in this transaction as being a "stranded cost" regardless of the terms of any legislation permitting the recovery of stranded costs from ratepayers.

The most important factor recognized by all the utilities discussed above, with the exception of the instant case, is that they all agreed that the acquisition premium paid to achieve the transactions that they negotiated is not a cost that should be borne by ratepayers, it is a cost that rightfully belongs to the shareholders. Ratepayers do not receive added value to their utility service or an increase in service just because the utility's ownership changes. The fact that new owners were willing to pay a purchase price that exceeds the net original cost of the property does not affect the utility service

provided or the majority of the assets dedicated to the provision of utility service. Ratepayers should not be required to pay more in rates simply because the ownership of the utility has changed hands.

Q. ARE YOU AWARE OF ANY RECENT ORDERS IN OTHER JURISDICTIONS WHERE RECOVERY OF ACQUISITION ADJUSTMENTS HAVE BEEN DENIED?

A. Yes, I am. In the proposed merger of an energy-based holding company, SCANA Corporation, and a natural gas local distribution company, Public Service Company of North Carolina, Docket No. G-5, Sub 400 Docket No. G-43, the North Carolina Utilities Commission Order, dated December 7, 1999, stated:

> In addition, Regulatory Condition 27 prohibits any acquisition premium from being flowed through into PSNC's rates. While a number of other states did not resolve the issue in the merger proceeding of the whether an acquisition premium is recoverable or allowed it to be recovered to the extent merger savings or other benefits could shown in later proceedings, Regulatory Condition 27 resolves this issue in PSNC"s ratepayers' favor by excluding the acquisition adjustment from rates in any subsequent proceeding.
>
> Based on the foregoing, the Commission concluded that PSNC's ratepayers are protected from all direct and indirect merger costs. (Public Utilities Reports - 198 PUR4th, page 171)

And:

> (26) All costs of the merger and all direct and indirect corporate cost increases (including those that may be assigned to SCANA, a service company or any affiliate), if any, attributable to the merger, will be excluded from PSNC's utility accounts, and shall be treated for accounting and ratemaking purposes so that they do not, affect PSNC's natural gas rates and charges. For purposes of this condition, the term "corporate costs increases" is defined as costs in excess of the level that the PSNC would have incurred using prudent business judgement had the merger not occurred.
>
> (27) Any acquisition adjustment that results from the business combination of SCANA and PSNC will be excluded from PSNC's utility accounts and treated for accounting and ratemaking purposes so that it does not affect PSNC's natural gas rates and charges. (Public Utilities Reports - 198 PUR4th, pages 182-183)

Also, in Docket No. E, G-001/PA-96-184, the Minnesota Public Utilities Commission in an Order approving the merger of Interstate Power Company with WPL Holdings, Inc., and IES Industries Inc., stated:

> While requiring that the Company use the pooling method would preclude recovery of an acquisition premium, the Commission notes that the accounting method is governed by accounting standards and is not elective.
>
> The Commission will therefore modify the Department's recommendation as follows. The Commission will approve the merger upon the condition that Interstate not seek recovery of any acquisition price over book value. This preclude rate recovery of any acquisition premium, whether considered as good will or as an acquisition adjustment. (Public Utilities Reports, 177 PUR4th, pages 414-415)

And:

e. Interstate will not seek recovery of any acquisition price over book value. This will preclude rate recovery of any acquisition premium, whether considered as goodwill or as an acquisition adjustment.

Q. IN YOU OPINION, IS IT EVER APPROPRIATE TO ALLOW A UTILITY RATE RECOVERY OF AN ACQUISITION ADJUSTMENT?

A. No, it is not.

MERGER SAVINGS

Q. IS IT UTILICORP'S ASSERTION THAT IT CAN IDENTIFY SPECIFIC MERGER-RELATED SAVINGS ASSOCIATED WITH ITS PURCHASE OF SJLP?

A. Yes, it is. According to the Company, the merger is expected to result in significant synergies from generation, economies of scale and efficiencies realized from the elimination of duplicate corporate and administrative services. UtiliCorp proposes to identify and quantify savings related to the purchase and merger.

Q. HAS UCU QUANTIFIED ANY MERGER SAVINGS PERTAINING TO NONREGULATED OPERATIONS OF THE TWO COMPANIES?

A. No. (Source MPSC Data Request No. 228)

Q. HOW DOES UTILICORP INTEND TO IDENTIFY THE MERGER-RELATED SAVINGS?

A. According to the direct testimony of Company witness, Mr. Vern J. Siemek, page 9, lines 5-16, the savings (synergies) were developed by seven transition teams that reviewed the 1999 SJLP budgets for their respective areas and estimated the costs to be retained or to be eliminated after the merger. The seven transition teams were; Electric/Steam Supply, Distribution, Transmission, Regulatory/Legislative, Finance/Accounting, Human Resources, and Information Technology. However, the Company's response to MPSC Staff Data Request No. 236 states:

> The Transition Teams have been working to verify the synergies. The Team's final report is due to be approved by management this summer. The Synergy Study will be reviewed for any necessary updates and Mr. Siemek's "Schedule VJS-1" will be updated at that time. All Transition Team reports that have been issued, (interim reports) have been reviewed by Staff. Staff will be notified when final reports are completed and approved.

Q. PLEASE DESCRIBE MR. SIEMEK'S SCHEDULE VJS-1.

A. Schedule VJS-1, attached to Mr. Siemek's direct testimony, lists the total average annual operating savings for the first five years of the proposed ARP as $16,277,000. However, this amount is then reduced by $2,653,000 for capital costs incurred in order to achieve the savings identified (included in this amount is the annual $1,509,000 amortization of the purchase transaction and transition costs), and by $9,368,000 of net UCU enterprise

support functions ("ESF") costs allocated to SJLP. The remaining net annual savings balance after subtracting the capital and ESF costs is $4,255,000. The Company's proposal is that only 50% of the acquisition premium's annual costs be recovered from ratepayers. Thus, according to the Company, only $6,758,000 ($13,516,000 multiplied by 50% equals $6,758,000) is to be recovered or offset by the $4,255,000 of savings. The Company's proposal does not identify the amount of any acquisition premium recovery that may occur if SJLP's allocation factors are not included in the total Company allocation process I discussed in the earlier Q&A.

According to Mr. Siemek, the calculations discussed above would result in the acquisition premium costs being recovered by UCU's shareholders up to the limit of the net savings identified. However, because the average net savings are less than the average premium costs during each of the first five years, the Company estimates that it will lose $2,503,000 of the acquisition premium costs each year of the five-year moratorium. Company has also indicated to OPC that it does not intend to seek recovery of the lost acquisition premium costs in any future ratemaking case. On March 2, 2000 an "Informal Interview" of Company witness, Mr. Vern Siemek, occurred. On pages 98-99 of the interview transcript it states:

EXAMINATION BY MR. ROBERTSON:

Q. On your Schedule 1 to your direct testimony, under the column average years one through five, you show a net negative synergy of 2.5 million. I guess that's on a annual basis?

A. Yes.

Q. Over five years, that would be approximately 12.5 million. Has the company made proposals to try to defer, to try to recover those costs later or what do you propose to do with those net negative synergies?

Anything?

A. Well, no, we haven't attempted to collect those latter. Those costs are all through.

Q. They are? They're gone, I guess, essentially if the five years are up, the moratorium?

A. Right.

During years six through ten of the Company's alternative regulatory plan, it estimates that the average annual net savings will increase and that the average annual premium costs will decrease. The result is the Company's estimate of an average annual $1,577,000 million positive savings balance which it has promised (or guaranteed) to pass through to ratepayers in a rate filing. According to page 6, lines 13-16, of the direct testimony of Mr. McKinney, the rate changes would be filed so that the effective law dates would coincide with the end of five-year rate moratorium.

Q. IS UCU REQUESTING RECOVERY OF THE ACQUISITION PREMIUM IT HAS AGREED TO PAY THE SHAREHOLDERS OF SJLP?

A. Yes, it is, but in the context that UCU seeks to recover the acquisition premium and other costs in rates through a "merger savings sharing proposal." UCU apparently believes that there will be sufficient merger-related savings which could be used to allow recovery of at least 50% of the acquisition premium and related costs over a ten-year period. It proposes to share equally with Missouri customers cost savings resulting from the merger. That is, for the ten years proposed, the Company will forgo 50% of the acquisition premium costs if the Commission allows UCU to recover the remaining 50% of acquisition premium costs from ratepayers by forgoing the merger-related savings that initially occur by merging the companies.

Q. HAVE ANY UTILITIES PREVIOUSLY BROUGHT THIS TYPE OF ISSUE BEFORE THE COMMISSION?

A. Yes. In the past, a number of utilities have attempted to convince regulators to permit recovery of acquisition premiums by demonstrating purported savings relating to the acquisition. This if often referred to as the "benefits test." However, actual savings that may result from an acquisition and merger are very difficult to identify, and even harder to prove. All or a portion of the savings purported to occur might have resulted from prudent management decisions other than the acquisition as part of the ongoing operations of the utility. It is a difficult, if not impossible, process to determine if the savings are related to

the acquisition or whether the savings would have eventually occurred anyway. Purported savings are by their very nature nebulous, subjective, and difficult to quantify.

Q. CAN YOU THINK OF A SITUATION WHERE IT WOULD BE APPROPRIATE TO INCLUDE ACQUISITION PREMIUM COSTS IN RATES IF COST SHARING PROPOSALS ARE DEVELOPED TO DEMONSTRATE SAVINGS?

A. No, I cannot. The Public Counsel does not believe that it is appropriate to include in rates the effects of a cost sharing proposal which would allow the recovery of an acquisition premium in rates.

Q. WHY IS IT DIFFICULT TO PROVE AND VERIFY THE ACTUAL SAVINGS WHICH ARE RELATED TO THE MERGER?

A. The difficulty in proving and verifying merger savings as well as merger costs relates to the difficulty in identifying and quantifying these savings and costs. Controversies and uncertainties may result which, of course, most likely would have to be resolved by the Commission. The controversies would occur because it is extremely difficult, if not impossible, to directly attribute savings to a given event such as an acquisition. Particularly, as the years extend past the actual date of the acquisition and merger.

It is often difficult to find agreement among the different parties as to what constitutes actual merger savings and merger costs. Certainly, UCU, under its proposal to utilize

alleged merger-related savings to recover acquisition premium costs on a 50/50 basis, has a tremendous incentive to identify and quantify as much savings as merger-related as possible. The more merger savings that UCU can identify and quantify, the more UCU attempts to justify its entitlement to recover the acquisition premium.

Q. PLEASE CONTINUE.

A. Utilities are very complex organizations with many overlapping activity and functional areas. They also are dynamic organizations that operate in an ever changing environment. Generally, utilities are constantly organizing and reorganizing functions within its corporate structure to streamline activities and obtain efficiencies where possible. Most utilities should and do attempt to achieve efficiencies through implementation of productivity measures. It is unrealistic to believe that a tracking system could be put in place to identify and quantify savings and then isolate these savings as acquisition or non-acquisition related. It is very difficult to determine and measure the "cause and effect" relationship that may exist between taking an action and identifying and measuring the effects of that action.

Any cost saving tracking system developed would have to be sophisticated enough to not only identify categories of savings and cost, but to create documentation so that an examination can be conducted many years after the fact to recreate the decision-making process surrounding the costs and savings. Obviously, a great number of controversies

and differences can develop within the context of the after-the-fact analysis. What one party may believe is the result of an acquisition, another may view as nothing more than an operating efficiency of an ongoing concern. As stated previously, there will be incentive for the utility to identify as many reductions to work force and corresponding reductions in cost as acquisition-related. With this inherent incentive, it will become more difficult going forward to truly identify and quantify acquisition as opposed to non-acquisition related cost savings.

Q. SHOULD ANY STANDARD BE ESTABLISHED TO ALLOW DIRECT OR INDIRECT RECOVERY OF ACQUISITION PREMIUM IN RATES VIA A SAVINGS/SHARING MECHANISM?

A. No, it should not. The criteria to determine the appropriateness of including an acquisition premium in rates either directly or indirectly should not be based upon a case by case analysis of costs and savings. In our opinion, the question of recovery of acquisition premiums should be treated as a consistent ratemaking policy determination by the Commission.

Q. PLEASE EXPLAIN YOUR POSITION.

A. In the past, utilities have attempted to convince regulators to permit recovery of acquisition premiums by demonstrating purported savings relating to the acquisition, often referred to as the "benefits test." However, actual savings resulting from an

acquisition and merger are very difficult to prove and verify. All or a portion of the savings which may be alleged to occur as a result of an acquisition and merger might have also resulted as part of the ongoing operations of the utility, resulting from prudent management decisions other than the acquisition and merger. Hence, it is difficult to determine if the savings relate to the acquisition and merger or whether the savings would have occurred at some point in time anyway.

Q. ARE YOU SAYING THAT NO MERGER-RELATED SAVINGS WILL OCCUR?

A. No. As I stated earlier, I'm merely informing the Commission that any merger-related savings that the Company calculates would be nebulous, subjective and difficult to quantify on an ongoing basis. By maintaining a consistent policy of treating both positive and negative acquisition adjustments below-the-line, the Commission will be able to avoid the time-consuming controversies and costly uncertainties surrounding this subject area. Utilities would also benefit by knowing what the Commission's ratemaking treatment would be for acquisition adjustments.

Q. IS THE SHARING OF ACQUISITION AND MERGER-RELATED SAVINGS CONSISTENT WITH HOW UTILITY ACQUISITIONS AND MERGERS HAVE BEEN REGULATED IN THE PAST IN MISSOURI?

A. No, it is not. I know of no precedent in the State of Missouri for the sharing of acquisition and merger-related savings. The basis of any utility's request to recover an

acquisition premium via a benefits test sharing proposal lies with its ability to track acquisition and merger impacts through a reliable accounting mechanism, the integrity of which is unreproachable and devoid of subjectivity. Even if such a system is created, and OPC doesn't think that it has been, its ability to accurately track the savings associated with the acquisition and merger is of limited life due to the dynamic nature of business. Business conditions are constantly changing and the many decisions made in support of the changing conditions would soon make its output essentially meaningless.

Q. PLEASE PROVIDE AN EXAMPLE OF HOW CHANGING BUSINESS CONDITIONS CAN AFFECT ALLEGED SAVINGS.

A. For example, would a programmers position eliminated during the merger remain vacant two years later because of decisions at the time of the merger or does it remain vacant because management is successful in its never-ending search for a higher profit margin via a lower cost structure. Of course, any analysis of the situation would tend towards the bias of the individual performing a study of the costs. Thus, subjectivity, not undisputed fact, becomes the basis for the plan offered by the Company, and without fact, this Commission should not believe that it can identify alleged merger savings and costs for one or two years much less the ten years the Company proposes.

Q. WHY IS THE COMPANY'S ARP PROPOSAL NOT REASONABLE?

A. We believe the primary purpose of the ARP is to allow the Company to obtain full recovery of the acquisition premium. That is, the merger savings sharing proposal is nothing more than a ratemaking vehicle to set rates at a higher level than the actual costs likely to be incurred by the Company.

Q. UNDER THE SCENARIO OFFERED BY THE COMPANY, WHAT WOULD BE THE VALUE OF THE ACQUISITION PREMIUM COSTS RECOVERED DURING YEARS ONE THROUGH FIVE OF THE ARP?

A. According to the Company's response to MPSC Staff Data Request No. 1, the total premium cost for years one through five of the plan is $67,582,000. This balance is the sum of the amortization of the original acquisition premium balance over 40 years, a return on the premium and costs associated with the non-tax deductibility of the premium. The individual values are as follows:

	Five-Year Cumulative	Amount
1.	Amortization	$11,510,000
2.	Return On Premium	$48,399,000
3.	Non-Tax Deductibility	$ 7,673,000
4.	Total	$67,582,000

The Company's proposal is that it recover only 50% of the total acquisition premium costs, $33,791,000 ($67,582,000 divided by 2 equals $33,791,000); however, since the net merger-related savings are only estimated to equal a total $21,276,000, the Company

would only recover the $21,276,000. It would lose recoverability of the difference of $12,515,000 ($33,791,000 less the $21,276,000 equals $12,515,000 or viewed another way the $2,503,000 per year for five years discussed earlier) for good.

Q. IF THE SJLP REVENUES INCREASED, AND COSTS REMAINED STATIC, DURING THE MORATORIUM WOULD UCU SHAREHOLDERS ALSO KEEP THAT INCREASED INCOME?

A. Yes.

Q. IF UCU IS ABLE TO REDUCE THE SJLP COST STRUCTURE EVEN FURTHER DURING THE MORATORIUM WOULD UCU SHAREHOLDERS ALSO KEEP THE INCOME GENERATED FROM THE LOWER COST STRUCTURE?

A. Yes, all other things being equal.

Q. WHAT WOULD BE THE VALUE OF THE ACQUISITION PREMIUM COSTS RECOVERED OVER THE ENTIRE TEN YEARS OF THE COMPANY'S PROPOSED ALTERNATIVE REGULATORY PLAN?

A. Assuming that the Company's numbers and calculations are correct, and that it would only recover 50% of the total acquisition premium and related costs occurring during the ten years of the ARP, the Company would recover approximately $51,796,000. Calculated as following:

	10-Year Recovery	Amount
1.	Amortization	$11,510,000
2.	Return On Premium	$45,128,000
3.	Non-Tax Deductibility	$ 7,673,000
4.	Lost During Years 1-5	($12,515,000)
5.	Total	$51,796,000

Q. WHAT IS THE VALUE OF THE UNAMORTIZED ACQUISITION PREMIUM THAT WOULD REMAIN AT THE END OF THE TEN-YEAR PLAN?

A. The Company is proposing to amortize the acquisition premium over 40 years; thus, at the end of ten years it will have amortized to expense approximately $23,020,000. The unamortized acquisition premium remaining at the end of the ten-year alternative regulatory plan would approximate **$69,060,000** ($92,080,000 less $23,020,000 equals $69,060,000).

Q. IS THE COMPANY'S PROPOSAL TO GUARANTEE A REVENUE REDUCTION IN YEARS SIX THROUGH TEN FAIR TO RATEPAYERS?

A. No, it is not. During the last five years of the ARP, the alleged merger-related savings and the acquisition premium costs would also be factored into the development of new rates to the extent that UCU guarantees an average annual revenue reduction of $1.6 million per year. Over five years that revenue reduction guarantee of $1.6 million per year would approximate $8 million. Contrast that amount with the $51,796,000 the

Company would recover during the same time period. It's not exactly a fair trade. Especially, when you understand that the unamortized acquisition premium remaining at the end of the ARP would still approximate $69,060,000.

Q. IS IT THE COMPANY'S INTENTION TO REQUEST RATEMAKING RECOVERY OF THE $69,060,00 AT A LATER DATE?

A. I believe that it is.

Q. IF THE COMMISSION AGREES TO AUTHORIZE THE ALTERNATIVE REGULATION PLAN AS PROPOSED AND ALSO, AT A LATER DATE, AUTHORIZES THE RECOVERY OF THE ENTIRE UNAMORTIZED ACQUISITION PREMIUM, WHAT WOULD BE THE TOTAL MINIMUM RECOVERY AFFORDED THE COMPANY?

A. At a minimum, the Company would recover approximately **$102,856,000** ($51,796,000 plus $69,060,000 equals $102,856,000) over the ten years of the ARP. Furthermore, the $102,856,000 could potentially increase to as much as **$265,854,000**, if a return and benefits associated with the non-deductibility of the unamortized acquisition premium balance are also authorized for recovery.

Q. EARLIER YOU DISCUSSED THAT COMPANY REDUCED THE MERGER-RELATED SAVINGS BY THE TRANSACTION AND TRANSITION COSTS.

WHAT TYPE OF COSTS DO THE TRANSACTION AND TRANSITION CHARGES REPRESENT?

A. Schedule VJS-2, attached to Mr. Siemek's direct testimony, identifies transaction and transition costs of $15,082,971. The transaction costs total $4,575,000 of which $2,575,000 are for bankers fees and $2,000,000 are listed as other transaction costs. The transition costs total $10,507,971 of which $8,672,971 are primarily for severance and retention payments, executive retirement payments, and costs for a paid advisory board. The remainder of the transition cost total, $1,835,000, is for Information Technology system conversion costs.

Interestingly, most of the transaction costs were incurred by and for the benefit of SJLP by SJLP, but UCU, in its proposal, is requesting that it be allowed to recover those costs from ratepayers. The portion of the estimated $2,575,000 in bankers fees that were incurred by SJLP for SJLP is the entire $2,575,000 while the SJLP portion of the other transaction costs is $758,000 of the $2,000,000 listed (Source: MPSC DR No. 1, Schedule VJS-2-6). The irony of the Company's proposal is that UCU has the wherewithal to make such a request at all. Allegorically, it's as if UCU answered a classified advertisement offering for sale an automobile for the price of a hundred dollars. UCU buys the car and then tells its customers it needs to be reimbursed for the price of the automobile and also for the cost of the classified advertisement. UCU says, "No we didn't place or pay for the advertisement but you need to reimburse us for it anyway."

OPC believes that it is illogical for ratepayers to reimburse UCU for costs SJLP shareholders incurred to sell their common stock at a premium of approximately 36%. Those costs are directly linked to SJLP's efforts to increase shareholder value thus, they should remain with the shareholders. Just as the cost of the classified advertisement would remain the responsibility of the individual that decided to sell the automobile and placed the advertisement.

Who's to say that the selling price does not already include or compensate the SJLP shareholder's for the costs that they incurred to sell their shares to UCU. If that is true, and the Commission allows UCU to recover the requested acquisition premium and the transaction costs then it's possible that a double-recovery situation would exist. Those very same selling costs would be included in the acquisition premium and also in the transaction costs identified by the Company. Either way ratepayers should not have to reimburse UCU for costs it did not incur nor, should they be held responsible for costs incurred solely to benefit SJLP's shareholders.

TRACKING THE ALLEGED MERGER SAVINGS

Q. HAS THE COMPANY OFFERED TO IMPLEMENT A SYSTEM TO CALCULATE AND TRACK THE ALLEGED MERGER-RELATED SAVINGS?

A. Yes. The Company claims that it will be able to measure actual achieved merger-related savings on an ongoing basis once the merger is consummated to ensure that customers receive the guaranteed minimum revenue requirement reduction benefit from the merger. Its proposal to measure merger savings raises issues concerning the tracking of savings, but it does not answer the fundamental questions whether tracking savings is feasible at all, and whether the specific proposal for tracking purported savings is adequate to such a task.

Q. DOES THE PUBLIC COUNSEL BELIEVE THAT THE COMPANY CAN SUCCESSFULLY IDENTIFY AND TRACK THE ALLEGED MERGER-RELATED SAVINGS OVER THE COURSE OF TEN YEARS?

A. No, we do not. The tracking of merger-related savings over a period of time does not have a successful track record in Missouri. The process has been discussed at various times; however, there has never been a successful implementation of such a process. Public Counsel believes that an accurate tracking mechanism is virtually impossible to perform and maintain over an extended period of time.

Q. WHY DOES PUBLIC COUNSEL HOLD THIS BELIEF?

A. Upon consummation of the merger, the operational dynamics of the utilities will continue to evolve and change. Decisions are continually required to meet the demands and challenges faced by the utilities at the subsequent points in time. An accurate tracking system would require not only the measurement of decisions based on current conditions but also an analysis of what the situation would have been absent the merger. Analyzing each possible situation that would exist absent the merger and the response of two or more individual firms that no longer exist would require the use of numerous resources and reliance on many assumptions. Public Counsel believes that this Commission should not give its approval to a tracking system that by its very nature would be purely speculative.

Q. HAS THIS COMMISSION EVER BEFORE ORDERED THE ALLOWANCE OR IMPLEMENTATION OF A SAVINGS SHARING PLAN ASSOCIATED WITH A PURCHASE AND MERGER OF A UTILITY COMPANY?

A. I am not aware of any instance where this Commission has allowed such a plan to be implemented; however, the Commission stated on page 9 of its Report and Order in Kansas Power and Light, Case No. EM-91-213:

> The Commission will not approve at this time the savings sharing proposal. Staff has persuasively argued that KPL has a strong incentive to view savings as merger-related even if they are not and to classify them in the CSTS so as to increase the pool of savings subject to the sharing plan.

> Staff demonstrated several flaws in the CSTS which could allow non-merger savings to seep into the pool of savings to be shared.
>
> The Commission is not opposed to the concept of the savings sharing plan provided that only merger-related savings are shared. The Commission does not wish to discourage companies from actions which produce economies of scale and savings which can benefit ratepayers and shareholders alike. However, the Commission wishes to ensure that savings which would have been offset against the cost of service without the merger, benefit ratepayers one hundred percent. To avoid any detriment to ratepayers it is imperative that only savings which would not have occurred absent the merger be shared by ratepayers with shareholders.

Furthermore, on page 13 of the Report and Order, the Commission added:

> ...the Commission has determined that the savings sharing plan should not be approved until the Commission can be assured that no nonmerger savings can seep into the pool of merger saving which would be shared between ratepayers and shareholders.

Q. WHY WAS THE COST SAVINGS TRACKING SYSTEM NEVER IMPLEMENTED?

A. The Commission's Order, Case No. EM-91-213, directed the parties to meet and attempt to:

> ...devise a method for tracking merger-related savings.

However, agreement could not be reached among the parties to assure the Commission that non-merger-related savings would be excluded from the cost savings tracking system ("CSTS").

On December 13, 1991, the Commission issued a follow-up Order which placed this issue in Kansas Power & Light's ("KPL") next case. This Order stated in part:

> Based upon these pleadings, the Commission determines that Staffs suggestion should be adopted, to forego consideration of this issue in this docket. If KPL wishes to have the possibility of receiving a share of the merger savings it may use a system it considers appropriate for excluding non-merger savings from the pool of savings which might be shared and present that approach to the Commission in its next rate case complete with the amounts to be shared. At that time the Commission will consider whether the device employed by KPL is sufficiently foolproof to permit sharing of merger savings with shareholders.

The Commission rejected KPL's proposed merger savings tracking system in Case No. EM-91-213. Arguably, the CSTS system was the most elaborate tracking system developed to-date, yet it did not give the assurances to needed to satisfy the Commission.

Q. WAS KPL THE PREDECESSOR COMPANY OF WESTERN RESOURCES INCORPORATED?

A. Yes, it was. On May 8, 1992, KPL changed its name to Western Resources Inc. ("WRI" or "Western Resource")

Q. DID WESTERN RESOURCES ADDRESS THE MERITS OF USING THE COST TRACKING SYSTEM TO IDENTIFY THE MERGER-RELATED SAVINGS IN ITS NEXT RATE CASE?

A. Yes, it did. In Western Resources' next general rate case, Case No. GR-93-240, its Controller, Mr. Jerry D. Courington, stated that Western Resources discontinued the use of the cost tracking system because:

> ...the level of effort necessary to measure the savings and maintain the tracking system was relatively high when compared to the expected level of merger related savings in the jurisdictions in which it would be used. (Courington direct testimony, pages 14-15)

In fact, in response to MPSC Staff Data Request No. 72, Western Resources stated the following relating to the CSTS:

> The CSTS was developed for the purpose of tracking cost savings associated with the merger of KPL and KGE. At the time of its development a decision by the Kansas Corporation Commission or the Missouri Public Service Commission regarding the merger had not been reached. The Company believed such a system would be necessary for purposes of demonstrating to the commissions that savings associated with the merger had been met. Both of the commission staffs objected to the concept. In Kansas as an alternative to the CSTS, the Commission elected to use an indexing procedure. In Missouri no alternative by the Commission was put forth. However, based on the potential relatively small savings from the merger which would accrue to Missouri and the fact that the majority of the savings would be in the form of a different capital structure which could easily be identified without the use of the CSTS, it became impractical to continue its use.

Q. HAVE OTHER UTILITIES IN MISSOURI EVER ATTEMPTED TO OBTAIN RATEMAKING RECOVERY OF AN ACQUISITION PREMIUM BY ALLEGING MERGER-RELATED SAVINGS?

A. Yes, they have. In Missouri Gas Energy ("MGE"), Case No. GR-96-285, the Company proposed an adjustment that added expenses to rate base equal to 50 percent of alleged ongoing savings from Southern Union's acquisition of Missouri properties from Western Resources, Inc. MGE alleged savings of labor and associated taxes, benefit savings, purchased gas savings, MIS savings, lease cost savings (building and vehicle) and financial savings and asserted that an equal sharing of the ongoing savings between customers and shareholders is a reasonable ratemaking approach.

Q. DID THE COMMISSION APPROVE THE COMPANY'S PROPOSED SHARING PLAN?

A. No, it did not. On page 42 of the Commission's Report and Order, Case No. GR-96-285, it stated:

> The Commission finds that MGE's acquisition savings adjustment should be rejected in total because adoption of this adjustment would be contrary to the provision of natural gas service based on the costs of providing such service...

Q. WHAT IS YOU OPINION AS TO WHY THE COMMISSION REJECTED MGE'S PROPOSAL?

A. I believe that the proposal was rejected because it did not represent appropriate or proper ratemaking policy because the alleged savings were not adequately quantified; the proposal was not fair and equitable; utilities other than MGE have downsized without expecting any sharing of related savings; the alleged savings benefited MGE at least up until any rate change from the proceeding; the proposal represented the equivalent of an incentive plan without any safeguards; the proposal shifted risks of MGE's cutbacks and related cost reductions to customers; the proposal attempted recovery of an acquisition premium and the proposal would have taken MGE off of cost of service ratemaking. In summary the proposal would have rewarded MGE for providing a lower quality of service while at the same time requesting ratepayers to pay higher than cost-based rates.

Q. PLEASE CONTINUE.

A. In Case No. WM-93-255, Missouri-American Water Company ("MAWC"), was granted approval to perform a stock purchase agreement in which the Company acquired 100% of the common stock of Missouri Cities Water Company ("MCWC"). The sale was approved by the Commission and upon its consummation MAWC recorded a positive acquisition adjustment on its books of record for the amount of the premium that exceeded the book value of MCWC (i.e., $4,392,316). On December 31, 1994, after

obtaining authorization from the Commission in Case No. WM-95-150, MCWC was merged into MAWC.

In MAWC's next general rate increase filing, Case No. WR-95-205 et al, the Company attempted to convince this Commission to permit recovery of its acquisition premium by demonstrating purported savings relating to the acquisition. However, the Commission found that the Company's argument for recovery of the acquisition premium was not appropriate. In the Commission's Report and Order, Missouri-American Water Company, Case No. WR-95-205, page 19, it stated:

> The Commission finds in this case that the Company has failed to justify an allowance for the acquisition adjustment.

Continuing on to page 20 it stated:

> The Commission finds it is appropriate that the excess purchase costs over and above the net original cost of the Missouri Cities Water Company properties be booked to USOA Account 114 (Utility Plant Acquisition Adjustments) and amortized below the line over 40 years to USOA Account 425 (Miscellaneous Amortization).

In MAWC's next general rate increase filing, Case No. WR-97-237 et al, the Company once again attempted to convince this Commission to allow it to recover the acquisition

premium it incurred in its purchase of MCWC. MAWC alleged that, in conjunction with the purchase and merger of the Missouri Cities Water Company, it created cost savings and efficiencies which it wishes ratepayers to share equally with shareholders. Company requested that the Commission permit it to institute a program of sharing between shareholders and ratepayers (with each receiving 50 percent) of the operation and maintenance ("O&M") expense savings related to its merger with the Missouri Cities Water Company.

Q. PLEASE CONTINUE.

A. The MAWC witness, Mr. James E. Salser, asserted in his direct testimony, and his accompanying Schedule JES-1, that the Company achieved cost savings and efficiencies in its operation and maintenance expenses that were are a direct result of Missouri-American's purchase of the operations of the former Missouri Cities Water Company. Furthermore, he advanced that had the purchase and resulting merger not occurred these savings would never have occurred nor benefited ratepayers.

Q. WHAT WAS THE CONTENT OF MR. SALSER'S SCHEDULE JES-1?

A. Schedule JES-1 was a comparative analysis of the alleged annual cost savings and efficiencies related to the purchase and merger of Missouri Cities Water Company by Missouri-American. Listed on Schedule JES-1 was the Company's operation and maintenance expenses for calendar years 1993 through 1996, along with the pro-forma

instant case. The Company utilized the comparison of the yearly O&M expenses to develop a recorded average net O&M expense amount per customer which it then compared to an inflation adjusted net O&M expense amount per customer. The difference in the recorded O&M amount verses the inflation-adjusted O&M amounts was multiplied by pro forma customer levels to provide a total annual cost savings and efficiencies.

Q. DID MAWC DEVELOP A COST TRACKING SYSTEM THE PURPOSE OF WHICH WOULD BE TO SEPARATE SAVINGS WHICH WOULD HAVE OCCURRED WITHOUT THE MERGER FROM THOSE GENERATED SOLELY BY THE MERGER?

A. No, it did not. The Company's response to MPSC Staff Data Request No. 96 which requested whether Company had implemented any cost saving tracking systems since the date of the merger in January 1995 stated:

> No, except for the review of Company 168 & 169 forms, employee levels, and number of customers by year since the acquisition.

Q. ISN'T A LARGE PORTION OF THE MERGER-SAVINGS IDENTIFIED BY UCU ASSOCIATED WITH CHANGES IN EMPLOYEE LEVELS?

A. Yes, it is.

Q. HOW DID THE COMMISSION RESPOND TO MAWC'S REQUEST?

A. The issue did not go to hearing. On or about July 24, 1997, the parties to the case signed a nonunanimous Stipulation and Agreement that granted the Company a "dollar-specific" rate increase. The Commission approved the Stipulation and Agreement with its Report and Order of November 6, 1997.

Q. DO YOU BELIEVE THAT THE MERGER-RELATED SAVINGS UCU HAS IDENTIFIED WILL BE VALIDATED BY ITS PROPOSED TRACKING SYSTEM?

A. No, I do not. The merger-related savings and the tracking system, described by Mr. Siemek and Mr. Meyer, will not be not valid for several reasons. One of which is that the alleged merger-related savings and efficiencies will probably be overstated for each year after the consummation of the merger. Overstatement is likely to occur because the Company has not adjusted the 1999 budgets (which are the bases Company says it will use to identify savings on an ongoing basis) of UCU and SJLP to remove expenses and/or other costs items not allowed for regulatory purposes. It is highly likely that at least some portion of the budgeted amounts for each year would not be approved, by this Commission, for inclusion in the determination of rates. If ratepayers are not required to reimburse the Company for these expenses and other costs, it is irrelevant whether they have over time increased or decreased. The Company's tracking mechanism fails to identify and remove these unknown expenses and costs before the merger-related savings are determined.

Furthermore, without a tracking system to verify and validate the alleged cost savings and efficiencies the Company's simple comparison of the differences occurring between SJLP and UCU budgeted amounts, adjusted for inflation, are at a minimum extremely subjective, and in all likelihood faulty to the point of being useless. Because UCU's proposal, like Missouri-American Water Company's before them, does not rely on a tracking mechanism that would identify and track the specific savings that are related solely to the merger, it does not provide this Commission with competent and substantial evidence to order its implementation. It is irrelevant that merger-related savings and efficiencies may or may not have actually occurred unless such cost savings and efficiencies can be separately identified and directly traced to the purchase and merger of SJLP. It's my understanding that the Company has not developed or implemented a system to separate the alleged savings so that only ratepayers would benefit from nonmerger savings while merger savings would be split with shareholders. In my opinion, the proposal Mr. Siemek and Mr. Meyer champion does not even begin to satisfy the requirements for a savings sharing plan that the Commission expressed in its Report and Order in Kansas Power and Light Company, Case No. EM-91-213.

Q. DOES THE PUBLIC COUNSEL BELIEVE THAT THE UCU AND SJLP 1999 BUDGETS ARE THE APPROPRIATE BENCHMARK FROM WHICH MERGER RELATED-SAVING COULD BE TRACKED?

A. No, we do not. While we believe that the Company's ability to track any merger-related saving is at best short term in nature, the 1999 budgets are not the appropriate pre-acquisition base from which costs and/or savings should potentially be recognized. The appropriate benchmark, in our view, would the actual regulatory cost structure of the companies. That is, if the Commission desires a representative benchmark, it should order an audit of both companies prior to beginning the process of attempting to track alleged merger-related savings.

Q. IN THE COMPANY'S ANALYSIS OF MERGER-RELATED SAVINGS HAS IT INCLUDED COSTS THAT WOULD NOT BE ALLOWED FOR RATEMAKING PURPOSES?

A. Yes. In the Company's response to MPSC Staff Data Request No. 581 which asked what elimination, if any, was made for allocated Enterprise Support Function and Intrabusiness Unit costs which have not been allowed in rates in Missouri based upon prior Commission orders (e.g., marketing, corporate jet, governmental affairs, etc.), the Company stated:

> **No adjustments were made.**
>
> (Emphasis added by OPC)

Q WOULD THE COSTS REQUESTED IN THE PREVIOUS Q&A BE INCLUDED IN THE 1999 BASELINE BUDGETS FOR UCU AND SJLP?

A. Yes, I believe that they would.

Q. WOULD THE COSTS LIKELY TO BE DISALLOWED BY THE COMMISSION, IF INCLUDED IN THE BASELINE BUDGETS, TEND TO INFLATE THE COMPANIES COST STRUCTURE?

A. Yes. Any comparison of the companies cost structures would be inflated by the amount of any costs likely to be disallowed that reside in the baseline budgets.

Q. DO BUDGET VARIANCES OCCUR WITH REGULARITY?

A. Yes. A budget is merely management's best estimate of what the operation will do. It is a tool to be utilized in the planning and operation of a company. It is not necessarily representative of actual results. For example, in the Company's response to MPSC Staff Data Request No. 216, the 1996 - 1999 Annual Major Budget Variances Reports for SJLP were provided. The reports show that during the years 1996 - 1999 SJLP revenue increased/(decreased) from budgeted by; $2.4 million, $19.1 million, ($10.7) million and ($10.9) million, respectively. During the same timeframe operating expenses increased/(decreased) from budgeted by; $776 thousand, $17 million, ($8.5) million and ($5.5) million, respectively

Q. SHOULD THIS COMMISSION RELY ON THE UCU AND SJLP 1999 BUDGETS TO IDENTIFY AND TRACK ALLEGED MERGER-RELATED SAVINGS?

A. No. Reliance on budgeted or estimated numbers, the primary purpose of which is to be utilized only as a planning and monitoring tool, would not be in the best interest of ratepayers or the companies. The budgeted numbers are only estimates, not actual revenue/cost results, and they can be extremely volatile.

Q. DOES THE PUBLIC COUNSEL BELIEVE THAT UCU CAN ACCURATELY TRACK THE MERGER-RELATED SAVINGS FOR TEN YEARS OR MORE?

A. No, of course not. In my opinion, the Company's savings sharing plan request is nothing more than a surreptitious attempt to recover from ratepayers the excess purchase price (i.e., acquisition purchase premium) it paid over and above the booked original cost for SJLP. The Public Counsel views the savings sharing plan as nothing more than a means for UCU to recover the costs of its purchase and merger with SJLP, including the acquisition premium, at the expense of Missouri ratepayers.

Q. WHAT IS THE CORE PROBLEM WITH THE COMPANY'S METHODOLOGY FOR IDENTIFYING AND TRACKING THE SPECIFIC MERGER-RELATED SAVINGS GOING FORWARD?

A. The core problem with the system that the Company proposes to utilize is that it is not setup to allow for the specific identification and tracking of the merger-related verses the

nonmerger related savings that will occur upon and after the entities merge. As I understand it, the system will be used to develop and draw upon a comparison of the two companies cost structures during the ARP. That is, the mechanism would compare the companies' actual costs (which supposedly would reflect the merger-related savings) with benchmark costs (which reflect the individual companies prior to the merger occurring) for each year that the ARP is in existence. As I discussed earlier, the benchmark costs are based on the UCU and the SJLP 1999 budgets adjusted for an inflation factor.

Q. CAN YOU PROVIDE AN EXAMPLE OF HOW THE COMPANY INTENDS TO CALCULATE THE MERGER-RELATED SAVINGS?

A. Yes. The Company's response to MPSC Staff Data Request No. 218 provided an example of its proposed tracking methodology. The "Merger Savings Tracking Calculation" identified as Jerry Myers Interview Schedule 1 is as follows:

Dept. Example

Description	1999	2000	2001	2002	2003	2004
SJLP Baseline '99 Budget inflated by 3%	1,000	1,030	1,061	1,093	1,126	1,159
UCU Baseline '99 Budget inflated by 3%	3,000	3,090	3,183	3,278	3,377	3,478
UCU Incremental Estimate inflated by 3%	300	309	318	328	338	348
Sub Total	3,300	3,399	3,501	3,606	3,714	3,826

Allocated to SJLP (25%)	825	850	875	901	929	956
Merger Savings	175	180	186	191	197	203

In the example, merger-related savings are represented by the difference in the SJLP operating costs allocated to SJLP (i.e., 25%) from the merged utility (UCU Baseline plus Incremental) and the total costs incurred by SJLP (SJLP Baseline) absent the merger.

Q. WILL SUCH A SIMPLE COMPARISON OF THE COMPANIES COSTS TRULY ALLOW UCU TO TRACK AND SEPARATE THE SPECIFIC MERGER-RELATED SAVINGS AND THE NONMERGER SAVINGS THAT WILL OCCUR DURING THE TEN YEARS OF THE ARP?

A. In our opinion it will not. UCU's proposed tracking system does not identify cause and effect, it simply measures changes in absolute dollars in a post-merger environment as compared to a pre-merger budget.

RECOMMENDATION

Q. WHAT IS YOUR RECOMMENDATION?

A. It is my recommendation that the Commission deny the Company's request for a program of sharing alleged merger-related savings between ratepayers and shareholders. I have identified the detriments to Missouri customers resulting from the proposed sale of SJLP properties to UCU in the areas of the acquisition adjustment, merger savings and merger savings tracking and OPC continues to oppose as a policy matter allowing any recovery of positive or negative acquisition premiums in rates. Public Counsel recommends that the Commission reaffirm its policy in this proceeding of not allowing any rate recovery of acquisition premiums by denying authorization of the Company's request to consummate its purchase of St. Joseph Light & Power Company. UCU's purchase proposal should not be approved, as currently requested, because it contains provisions which are detrimental to the public interest. Finally, since UCU's position on its proposed sharing plan does not allow it to agree to forgo rate recovery of the acquisition premium, the Commission should reject its purchase and merger of SJLP in its entirety.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

CASE PARTICIPATION
OF
TED ROBERTSON

Company	Case No.
Missouri Public Service Company	GR-90-198
United Telephone Company of Missouri	TR-90-273
Choctaw Telephone Company	TR-91-86
Missouri Cities Water Company	WR-91-172
United Cities Gas Company	GR-91-249
St. Louis County Water Company	WR-91-361
Missouri Cities Water Company	WR-92-207
Imperial Utility Corporation	SR-92-290
Expanded Calling Scopes	TO-92-306
United Cities Gas Company	GR-93-47
Missouri Public Service Company	GR-93-172
Southwestern Bell Telephone Company	TO-93-192
Missouri-American Water Company	WR-93-212
Southwestern Bell Telephone Company	TC-93-224
Imperial Utility Corporation	SR-94-16
St. Joseph Light & Power Company	ER-94-163
Raytown Water Company	WR-94-211
Capital City Water Company	WR-94-297
Raytown Water Company	WR-94-300
St. Louis County Water Company	WR-95-145
United Cities Gas Company	GR-95-160
Missouri-American Water Company	WR-95-205
Laclede Gas Company	GR-96-193
Imperial Utility Corporation	SC-96-427
Missouri Gas Energy	GR-96-285
Missouri-American Water Company	WR-97-237
St. Louis County Water Company	WR-97-382
Union Electric Company	GR-97-393
Missouri Gas Energy	GR-98-140
Laclede Gas Company	GR-98-374
Union Electric Company	EO-96-14
Union Electric Company	EM-96-149
United Water Missouri Inc.	WR-99-326
Laclede Gas Company	GR-99-315
Missouri Gas Energy	GO-99-258
Missouri-American Water Company	WM-2000-222
Atmos Energy Corporation	WM-2000-312
UtiliCorp/St. Joseph Merger	EM-2000-292