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Exhibit No.:
Issues: Merger Savings
Tracking of Merger Savings
Acquisition Adjustment
Witness: Janis E. Fischer
Sponsoring Party: MoPSC Staff
Type of Exhibit: Rebuttal Testimony
Case No.: EM-2000-292

# MISSOURI PUBLIC SERVICE COMMISSION

## UTILITY SERVICES DIVISION

# REBUTTAL TESTIMONY

# OF

# JANIS E. FISCHER

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

## CASE NO. EM-2000-292

Exhibit No. 705
Date 7/12/00 Case No. EM-2000-292
Reporter KEM

**Jefferson City, Missouri**
**May, 2000**

**NP**

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

Q. Please state your name and business address.

A. Janis E. Fischer, 3675 Noland Road, Suite 110, Independence, Missouri 64055.

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

A. I am a Regulatory Auditor with the Missouri Public Service Commission (Commission).

Q. Please describe your educational background.

A. I graduated from Peru State College, Peru, Nebraska and received a Bachelor of Science degree in Education (Basic Business) and Business Administration. In May 1985 I completed course work and earned a Bachelor of Science degree in Accounting. I passed the Uniform Certified Public Accountant examination in May 1994 and received my license to practice in March 1997. Prior to my employment at the Commission, I worked over six years as the office and accounting supervisor for the Falls City, Nebraska Utilities Department (Utilities Department).

While with the Utilities Department, I completed water and electric rate reviews developed procedures for PCB monitoring and disposal, implemented a program to verify the accuracy of remote water meters, supervised office staff and handled customer complaints. I assisted with the acquisition of Falls City's natural gas distribution system from Kansas Power and Light Company, predecessor company of Western Resources, Inc., by compiling asset records, nominating gas supplies for the municipal power plant and monitoring gas transportation customer loads. I was appointed by the Board of Public Works to the Nebraska Public Gas Agency (NPGA) Board and later elected Vice Chairperson of the Board. NPGA is comprised of members from municipal natural gas systems who collectively purchase natural gas and acquire natural gas wells to supply gas to municipal gas systems and power plants at reduced costs.

I also was employed as a staff accountant with the accounting firm of Cuneo, Lawson, Shay and Staley, PC, in Kansas City, Missouri, for approximately two years. While employed as a staff accountant, I assisted in various audits, compilations and reviews of corporations and prepared individual and corporate state and federal tax returns. I researched tax issues, assisted with compliance audits and interacted with various clients.

Q. What has been the nature of your duties with the Commission?

A. I have directed and assisted with various audits and examinations of the books and records of public utilities operating within the state of Missouri under the jurisdiction of the Commission.

Q. Have you previously filed testimony before this Commission?

A. Yes. I testified in Case No. ER-97-81, The Empire District Electric Company (Empire), Case No. GR-97-393, Union Electric Company (Union Electric);

and Case No. EM-97-515, the Western Resources, Inc. (Western)/Kansas City Power & Light Company (KCPL) merger.

Q. What was your involvement in the KCPL merger with Western Resources?

A. My area of responsibility was the review of the merger savings estimates developed by KCPL and Western. I also addressed the recovery treatment of the merger transaction costs and the "costs to achieve" the merger, also referred to as transition costs.

Q. Have you made an examination of the Application filed by UtiliCorp United Inc. (UtiliCorp or UCU) and St. Joseph Light and Power Company (St. Joseph or SJLP) (collectively Companies or Joint Applicants) in regard to Case No. EM-2000-292?

A. Yes. I performed an examination of the Application with the assistance of other Commission Staff (Staff) members.

Q. What is the purpose of your rebuttal testimony?

A. I will address certain aspects of the Company's estimated merger savings, including savings in labor costs, and the concept of calculating merger savings based on a "current dollar" basis. My testimony will also include comments on the proposed tracking of merger savings, and the use of the St. Joseph 1999 budget as the baseline for savings calculations. Testimony addressing additional savings related to employee benefits will be submitted by Staff Accounting witness Steve M. Traxler and generation/joint dispatch savings by Staff witness Dr. Michael S. Proctor of the Electric Department. I will also present information on how other state jurisdictions have addressed acquisition premiums in utility mergers/acquisitions and how the proposed merger savings regulatory plan offered by UtiliCorp contrasts with the other states. The "acquisition adjustment" issue will be addressed in more detail in the rebuttal testimony of Staff Accounting witnesses Mark L. Oligschlaeger, Cary G. Featherstone and Charles R. Hyneman, as well as in the testimony of Staff witness David P. Broadwater of the Financial Analysis Department and Dr. Proctor.

## MERGER SAVINGS

Q. Do the Joint Applicants expect any merger savings to occur because of the merger of St. Joseph into the UtiliCorp corporate structure?

A. Yes. UtiliCorp witness Vern J. Siemek identifies the estimated merger savings in his direct testimony and attached schedules. UtiliCorp claims the merger with St. Joseph will result in total estimated savings of $184.3 million over a ten-year period. UtiliCorp believes these merger savings will occur as follows:

| Year | Amount in $ |
|---|---|
| 1 | $ 12,709,000 |
| 2 | 15,348,000 |
| 3 | 16,437,000 |
| 4 | 17,894,000 |
| 5 | 18,997,000 |
| 6 | 20,594,000 |
| 7 | 19,777,000 |
| 8 | 21,079,000 |
| 9 | 20,870,000 |
| 10 | 20,561,000 |
| Total | $184,267,000 |

[Source: Response to Staff Data Request No. 1]

The Companies' response to Staff Data Request No. 1 provides the support for the calculation of estimated savings of approximately $184.3 million over ten years.

Based on Mr. Siemek's testimony and that of other Joint Applicant witnesses, UtiliCorp believes it will be able to achieve significant savings from the merger with

St. Joseph. Furthermore, UtiliCorp claims that it will be able to identify and quantify actual merger synergies to demonstrate in future rate proceedings that these savings exceed the costs relating to the merger.

Q. How is UtiliCorp proposing to treat these merger savings and merger costs in future rate cases?

A. UtiliCorp is proposing a "regulatory plan" identified in the direct testimony of Company witness John W. McKinney that the merger costs be recovered in rates from the customers of St. Joseph beginning approximately six years after the merger is completed. This is dependent upon when a planned St. Joseph rate case is filed during the last year of the moratorium. UtiliCorp proposes to retain all merger savings for the first five years through a rate moratorium. Supporting documents for the regulatory plan provided by the Company in response to Staff Data Request No. 1 show that these savings are proposed to be recovered net of the amortization of the transaction costs and costs to achieve. The Company proposes to amortize transaction costs and costs to achieve over ten years.

After the moratorium period, UtiliCorp believes it is appropriate to include the amortization of all transaction costs and costs to achieve (transition costs) in the revenue requirement for St. Joseph. UtiliCorp further expects that St. Joseph's customers will pay for one-half of the merger premium (acquisition adjustment) associated with the merger transaction in rates. UtiliCorp proposes to reflect in the revenue requirement at least an approximate $1.6 million of net merger savings in Years 6-10 following the close of the merger, even if the merger does not actually generate savings at this level.

To put this all in perspective, according to the Companies' response to Staff Data Request No. 1, the Companies' estimated savings over ten years amounts to \$184.3 million. When additional allocations to cover UtiliCorp overheads (\$99.4 million) are deducted from the savings, remaining merger savings are reduced to \$84.9 million. The total costs of the merger (100% of the acquisition premium, transaction costs and costs to achieve) are estimated to be \$107.5 million and, according to the regulatory plan proposed by UtiliCorp, St. Joseph customers in Years 6-10 will be "guaranteed" the benefit of \$7.9 million in total (\$1.577 million x 5 years). Under the regulatory plan, St. Joseph customers will be given approximately 4.28% of the total \$184.3 million projected merger savings during the first ten years following the merger's close.

Q. Has the Staff reviewed the estimated merger savings presented by the Companies?

A. Yes. The Staff has reviewed the direct testimony of Mr. Siemek and the Companies' response to Staff Data Request No. 1. This data request response contains the documents and supporting workpapers to Mr. Siemek's Schedules attached to his testimony that identify the merger savings that UtiliCorp believes will result from the merger of these two companies. The Staff also asked questions of Mr. Siemek in the March 2, 2000 transcribed interview to gather additional information concerning how the estimated savings were calculated.

Q. Has the Staff reached any conclusions about the estimated merger savings projected by the Joint Applicants?

A. Yes. The Staff contends that the estimated merger savings calculated by the Joint Applicants should not be relied upon in determining whether the Commission should approve the merger.

Q. Why does Staff believe UtiliCorp estimates of merger savings should not be relied on?

A. Estimating or projecting any future event is difficult. Predicting what the merged organization will look like and how it will operate is extremely difficult. The combining of St. Joseph and, ultimately, Empire into the UtiliCorp corporate structure will result into a completely different organization than exists today for each of these pre-merger entities. Stating with certainty what the merger impacts will have on the processes of providing utility services to post-merger customers is nearly impossible. Procedures and processes will dramatically change in these post-merger organizations, particularly at St. Joseph and Empire.

The elimination of any redundancy of the three separate entities once the mergers are completed is an important consideration of planning for the mergers but is highly speculative in nature. How much and to what level merger savings will actually materialize is guesswork. Projecting merger savings for a ten-year period is well beyond a utility's normal planning horizon. To identify and quantify merger savings for an organization that is yet to exist is beyond the practical limits of utilities and regulators to be able to use for rate purposes. The analysis of the impact of St. Joseph and Empire together combining with UtiliCorp has not even been done by UtiliCorp except on a limited basis. Mr. Richard C. Green, Jr., Chairman and CEO of UtiliCorp, has publicly stated that UtiliCorp sees a lot of potential for savings with all three of the companies together. This will be discussed in more detail later in my rebuttal testimony.

Q. Has the Commission previously allowed rates to be set based on budgets, forecasts or estimates?

A. No. The Commission generally requires that rates be set on known and measurable costs. It could be said that budgets, forecasts and estimates all have a place in planning future expected results for companies. Companies prepare budgets based on expected events and past historical data. Budgets are made for the next year and are used as a planning tool and as performance measurements. Budgets may extend out in time past one year. Forecasts may go out five years and beyond. Companies often revise budget and forecast projections annually and sometimes even monthly as circumstances change. Companies monitor budget-to-actual variances. Budgets are not infallible even though considerable effort goes into developing them. The merger estimates that UtiliCorp is asking the Commission to rely on are based on an analysis that was not as detailed as the budget process followed by UtiliCorp or St. Joseph. The Staff does not believe that the Commission should rely on projected estimates of savings to substantiate the inclusion of 50% of the acquisition premium into rate base for the customers of St. Joseph to pay for.

Q. Please describe the first attempt made by UtiliCorp to estimate the merger savings that would result from the acquisition of St. Joseph.

A. UtiliCorp developed an initial estimate of merger savings during its due diligence phase of the bidding process. This state of the merger review allows the bidder to examine public and selected internal confidential information so they can make a valuation determination of the merger candidate, in this case St. Joseph. The due diligence analysis began with review of the St. Joseph's Federal Energy Regulatory Commission (FERC) Form 1, which is the same document provided to the Missouri Commission as the Annual Report of the utility. UtiliCorp may also have used other public documents.

According to answers of Mr. Siemek given at the transcribed interview, payroll related estimates were established after review of organizational charts of St. Joseph and the FERC Form 1 (pages 354 and 355) that show the breakout of actual St. Joseph payroll expenses between various categories. On the non-payroll expense side, UtiliCorp had even less information and relied almost entirely on the FERC Form 1 for actual expenses by account and some of the outside services.

Q. Did the Joint Applicants later perform additional analysis of estimated merger savings?

A. Yes. Once UtiliCorp's offer was selected by the St. Joseph Board of Directors and a merger agreement was completed, UtiliCorp and St. Joseph started working on identifying and quantifying merger savings on a joint basis using what is known as "transition teams". Transition teams formed by the Joint Applicants "validated" the initial due diligence estimated merger savings. There were a total of seven teams formed. The teams centered on various scopes of operation: Human Resources, Finance/Accounting, Regulatory/Legislative Services, Distribution, Transmission, Supply/Generation/Steam and Information Technology. The teams began meeting in July of 1999 and continued to meet through November of 1999, when their initial validation reports were presented to the Transition Team Steering Committee. Since that time the teams have met less frequently. The transition teams' analyses led to the merger savings estimates included in Mr. Siemek's direct testimony.

The direct testimony of Company witness Vicki M. Heider, the Transition Team Leader, describes the functions of the transition teams. Ms. Heider emphasizes that the teams will assist her and the Steering Committee, which is made up of higher level management of UtiliCorp and St. Joseph, in making an orderly transition of St. Joseph into UtiliCorp. She goes on to say that use of the transition team process aids in the successful integration of the two companies with the least amount of disruption. While validating the due diligence estimated merger savings was a task of the teams, I believe their emphasis was clearly on the seamless transition of the merger from an operational standpoint. Documentation provided by the Joint Applicants in response to Staff Data Request No. 109, which consisted of transition team reports detailing the transition in work processes, also supports my belief.

Q. What do you mean when you say the transition teams validated the due diligence estimated merger savings?

A. The transition teams were to determine if the due diligence estimates were reasonable. The analyses of the transition teams were used to support the due diligence estimates and also to identify any major discrepancies, particularly if the estimated savings had been over estimated they were to notify management.

Q. Is the work of the transition teams ongoing?

A. Yes. The teams are working on final reports to the Steering Committee. According to the Companies' response to Staff Data Request No. 170, the Steering Committee will approve the final reports of the transition teams. The reports will then be used as a roadmap to ensure that expected costs and savings materialize. As of April 27, 2000, these reports have not been approved by the Steering Committee. UtiliCorp, in response to Staff Data Request No. 168 states that the integration plan is still in process and the reconciliation of the plan should be completed by August 1, 2000. Without the final approval of these reports, the Staff does not have a completed analysis from UtiliCorp/St. Joseph of the estimated savings or the integration process.

Q. Have there been any changes made to the estimated merger savings presented in the direct testimony of UtiliCorp/St. Joseph?

A. Yes. In the transcribed interview of Mr. Siemek on pages 9-11, several changes were mentioned. The distribution transition team found its departments would require additional estimated transition costs of $293,000 for staffing during the customer information system conversion. The generation transition team found that an estimated $489,000 reduction in severance costs would be realized because of anticipated personnel retirements in their departments. The finance/accounting transition team found a need for additional estimated transition costs of $172,000. These were the only changes identified by Mr. Siemek. It is possible that additional changes may occur since the projected savings are only estimates.

Q. Does the Proxy Statement of St. Joseph Light & Power Company and the Prospectus of UtiliCorp United Incorporated (Proxy/Prospectus) dated May 6, 1999 contain any information as to the accuracy of the Companies' estimated merger savings?

A. Yes, it does. On page 54 of the Proxy/Prospectus, it states:

> In this document, UtiliCorp and St. Joseph each have made forward-looking statements that are subject to risks and uncertainties. Forward-looking statements include statements concerning possible or assumed future results of operations and

> cost savings...Various risks and uncertainties may cause actual results to differ materially from the results that these statements express or imply...Please do not place undue reliance on these forward-looking statements, which speak only as of the date of this proxy statement/prospectus.

Q. Was there a detailed description of the estimated merger savings included in the Proxy/Prospectus?

A. No, UtiliCorp/St. Joseph did not include any specific language or schedule to describe the estimated savings that they anticipate will occur as a result of the merger in the Proxy/Prospectus. The transition teams performed their due diligence synergy validation after the Proxy/Prospectus was issued. The due diligence estimation of merger savings was not included in the Proxy/Prospectus.

Q. Does the Proxy/Prospectus explain the rationale behind the merger?

A. Yes, the Proxy/Prospectus is directed towards the shareholders of the respective companies, UtiliCorp and St. Joseph. The reasons for the merger clearly state that the merger is for the benefit of the shareholders. Any savings resulting from the merger are anticipated to provide recovery of the acquisition premium.

Q. Have other public utility commissions raised concerns over the achieving of the merger savings?

A. Yes. Other jurisdictions in which electric utility mergers have occurred have also raised concerns about estimated merger savings. In Docket No. 98–7023, before the Public Utilities Commission of Nevada, in the Reapplication of Nevada Power Co., Sierra Pacific Power Co. and Sierra Pacific Resources for approval of agreement and plan of merger, a Compliance Order was issued:

> The joint application includes a multi-part regulatory rate plan described by the Joint Applicants as being designed to hold utility customers harmless from any adverse impact on rates associated with the costs of the merger and a proposal for an incentive mechanism through which net merger and related benefits are to be shared between customers and investors.
>
> …The Commission finds that the merger savings are estimates…*merger cost savings can neither be precisely quantified* nor accurately tracked and that the Commission should not rely upon the estimates of merger savings provided by the Joint Applicants. (Emphasis added.)

The Board of Public Utilities (BPU) for the state of New Jersey, Docket No. EM98070433, in the Orange & Rockland Utilities (RECo) merger stated their concern about estimated merger savings:

> We HEREBY DIRECT that RECo file an appropriate Cost Allocation Manual by January 1, 2000 for the Board's consideration.
>
> The primary area of controversy in this proceeding is the estimate of the net merger savings and the method and timing of the sharing of said savings with RECo's ratepayers. In deciding this issue, the Board is mindful of the similarities of the characteristics of this issue in this case and the recently concluded Conectiv merger case. Both mergers produce merger savings primarily via labor reductions and the streamlining of utility operations. The net-savings are estimated over 10-year periods in both cases and similar categories of costs to achieve the merger were identified. We are however mindful in the instant proceeding of the substantial windfall which will accrue to O&R shareholders by reason of a 38.5% appreciation in the value of their investment traceable directly to the consummation of this merger resulting in an approximate $200 million premium, which situation is unique to the instant merger vis a vis Conectiv.
> (Emphasis added)

Public utility commissions have questioned the validity of estimated merger saving because they are merely estimates and shouldn't be relied on for setting rates.

Commissions also recognize because utilities tie premium recovery to merger savings, that tracking and differentiating merger savings from non-merger savings is crucial.

Q. How does UtiliCorp propose to use these estimates in its regulatory plan?

A. UtiliCorp witness John W. McKinney in his direct testimony explains that the rate filings during the fifth year following the close of the merger will include an accounting of the synergies realized during the five-year moratorium. Mr. McKinney goes on to say, "Included in these rate filings will be the complete flow-through of all test-year operation and maintenance (O&M) synergies, adjusted to the forward average level of savings for years six through ten of the regulatory plan, net of the costs to achieve the synergies, resulting from the merger." The regulatory plan "guarantees" approximately $1.6 million in savings to St. Joseph customers in years six through ten following the merger close.

Mr. McKinney also says that the savings resulting from the merger need to be greater than the premium paid for the property so that there will be benefits for customers. UtiliCorp is depending on the amount of the estimated savings to persuade the Commission to allow the recovery of fifty percent of the acquisition premium from ratepayers.

Q. Have the personnel reductions used in calculating the estimated merger savings been determined by the Joint Applicants?

A. No. Actual personnel reductions will not begin until after closing according to timelines included in the Companies' response to Staff Data Request No. 109. Actual determinations of the number of employee reductions have not been made.

Q. Accepting the fact that the estimates are purely speculative, does the Staff have additional concerns about omissions from the Companies' analysis of projected merger savings?

A. Yes. There are two omissions that the Staff believes should have been included in order to provide essential information to the Commission. Without this information, the Commission is placed in a position of having to guess:

- What result the combined merger of UtiliCorp, St. Joseph and Empire will have on savings and

- how savings will be allocated between the electric, gas and steam operations of St. Joseph

Q. Do UtiliCorp's estimated merger savings assume a three-way combination of UtiliCorp, St. Joseph and Empire?

A. Only in relationship to generation/joint dispatch projected savings and in the allocated corporate cost scenarios. Both Mr. Siemek (pages 36-40) and Mr. Jerry D. Myers, March 1, 2000 (pages 68-69) commented in transcribed interviews with the Staff that they had not combined the three companies together for any of their merger savings calculations. Ms. Heider also commented in her initial interview with Staff on January 25, 2000 that the transition teams were distinctly separate for St. Joseph and Empire and that the teams had not done a combined three-company analysis.

Q. Does the Staff believe that an examination of merger savings for the St. Joseph transaction should include impacts from the proposed Empire merger?

A. Yes. In considering St. Joseph's merger savings, one should assume the Empire merger will also take place. Consequently, in reviewing two mergers and the impact of merger savings, an assumption must be made that both mergers will be completed. Certainly any subsequent merger of Empire will affect the degree of the merger savings of the St. Joseph merger.

Q. What influence does the Staff believe the three-way combination will have on the savings that may accrue through the merger of UtiliCorp, St. Joseph and Empire?

A. The Staff believes that there is a possibility that additional economies of scale may be generated when the three companies are merged. The separate analyses performed for UtiliCorp/St. Joseph and UtiliCorp/Empire would not capture these additional savings and therefore the estimated merger savings purported by Mr. Siemek in his direct testimony may actually be understated as they relate to St. Joseph.

Q. What types of additional savings could be realized from the three-way merger?

A. Any savings that arises from an economy of scale; for example, purchasing larger quantities, sharing project costs for Missouri specific activities, sharing personnel instead of outsourcing, etc. Without an analysis of the three-way merger, it is unknown what actual savings could be realized.

Q. How will UtiliCorp/St. Joseph separate merger savings between electric, natural gas and steam operations?

A. The Joint Applicants have not provided the Staff with any analysis that separates merger savings for electric, natural gas and steam operations. It is not known at this time how this will be done. The question was asked in the transcribed interview of UtiliCorp witness Siemek:

> Question by Staff: It's my understanding that the amounts on Schedule 1 of your St. Joseph testimony are all total company. There is no attempt to segregate electric, gas, or steam heat numbers within the schedule, correct?

> Answer by Mr. Siemek: That's correct.
>
> Question: At some point in the transition team and savings estimation process, would you expect a more formalized attempt to segregate savings, and perhaps—or certainly costs as well, between those functions of St. Joseph Light and Power?
>
> Answer: I'm not certain that I could say that would be done as part of the transition team reports.
>
> Question: And for rate purposes, at some point this number [net merger benefit to St. Joseph customers] will have to be divided into electric, gas, and steam proponents—or components? I'm sorry.
>
> Answer: Yes.
>
> Question: But you're not sure when that will be done; it may not be done, for purposes of the merger proceeding, that may be somewhere down the road?
>
> Answer: Right.

St. Joseph operating and capital budgets are developed with a clear separation of electric, natural gas and steam operations, which is necessary in determining cost of service and rates specific for each group of energy customers. The transition teams have not separated out savings or costs between electric, natural gas and steam.

Q. What is the essential information necessary to assess the merger's impact on a business function/operating unit basis, which is not included in UtiliCorp's filing?

A. The essential pieces of information are:

1. Savings by function

2. Costs by function

The financial information in UtiliCorp's direct case does not address the impact of the merger on the various operating units of the merged Company (UCU/SJPL). The business functions of the merged Company are:

- Missouri Gas Operations – SJLP & Missouri Public Service (MPS)
- Missouri Electric Operations – SJLP & MPS
- Missouri Steam Operations - SJLP

UtiliCorp's direct filing is based on the implicit assumption that if the acquisition and merger is beneficial on a total merged Company basis, then it must be beneficial to the individual operating units of the merged Company. UtiliCorp's case does not show the impacts of the acquisition and merger on the cost of service of any of the above individual operating units. Mr. McKinney discusses the Regulatory Plan and allocations for St. Joseph and MPS but does not give any indication of how the expenses will be divided between electric, gas and steam.

Q. Why do allocations need to be considered in this case?

A. Allocations are the basis for distributing the assets and expenses of a multi-operating unit utility to each business function to determine the respective business function's cost of service. Without use of allocations, one can only examine the acquisition and merger on a total company basis and not determine the merger impacts on specific operating units.

Q. Is it possible that some merger costs and savings can be directly assigned to the electric, gas and steam functions of St. Joseph and MPS?

A. Yes. There are some costs and savings specific to business functions that can be assigned separately to the electric, gas and steam operations.

Q. Is it a valid assumption that a merger that is beneficial on a total company basis, will then be beneficial to all operating units in which a company operates?

A. It is possible that a merger that is beneficial at the total company level can in fact, be detrimental to one or more of the operating units of the company. A total company analysis only purports to show that the overall benefit exceeds the overall cost. Items that appear to be insignificant on a total company basis may be significant to an operating unit, especially if the item is largely assigned or allocated to one business function. With the change of size that will occur with the mix of costs the three-way merger, if the mergers are authorized, it is possible that the resulting allocation changes will result in shifts of costs among the various operating units. A shift in allocations may create a detriment to the ratepayers of an operating unit of the merged Companies. Without a separation of the three business functions one cannot determine if there is a detriment to the public interest for customers of particular functions of St. Joseph and MPS.

Q. Does the Staff have any other concerns about the estimated merger savings?

A. Yes. The Staff will site several examples of flaws in the assumptions and calculations of the Joint Applicants' estimated merger savings. Since the merger savings presented by UtiliCorp/St. Joseph are merely estimates, it can be argued that one estimate is as good as another based on what assumptions are applied. Staff would argue that some assumptions made by UtiliCorp are in error and should be changed to better reflect merger savings that can occur after the merger is completed.

Q. Please explain your concerns related to specific areas of the estimated merger savings.

A. I will address my concerns about several areas identified in Mr. Siemek's and Mr. Myers' direct testimony in the following sections of my rebuttal testimony. Staff Accounting witnesses V. William Harris will also address Iatan fuel savings as it relates to the merger savings issue.

## BUDGET DEVELOPMENT VS. ESTIMATED SAVINGS

Q. Does UtiliCorp place importance on the development of their annual budget?

A. Yes, it does. Employees are indirectly rewarded for budget performance. In response to Staff Data Request No. 154, UtiliCorp witness Robert B. Browning explained that "Ultimately, managing the budget becomes an important step in achieving earnings per share targets." While employees are not directly rewarded for performance against budgets, all employees are rewarded for the company achieving or exceeding its earnings per share goal for each year. Mr. Browning also stated that management does not plan to establish goals for achieving expected merger savings.

Q. Do employees of UtiliCorp devote considerable time in developing budgets?

A. Yes they do. UtiliCorp's response to Staff Data Request No. 149 provided information pertaining to the budget process. The management of UtiliCorp devotes a considerable amount of time to develop budgets that are used to forecast earnings. Attaining budgeted revenues and holding expenses to budgeted amounts enhances the financial position of UtiliCorp. According to Mr. Myers transcribed interview, pages 46-49, each project manager is responsible for the coding of expenses and the outcome of the project. Managers devote time in analyzing the expense requirements and the revenue projections for their projects/departments. The process of developing the budget is time consuming and input from many individuals bring the final budget numbers together. Changes in actual activity to the budgeted estimated revenues and expenses are measured monthly.

Q. Did UtiliCorp follow the same level of detailed analysis in arriving at the estimated merger savings?

A. No. The merger savings have been approached in a different way by using a starting point of the St. Joseph 1999 budget. Employees from both St. Joseph and UtiliCorp were assigned as members of the transition teams. During the March 15, 2000 interview of Ms. Heider, Mr. Robert Browning and Ms. Kris Paper, Information Technology team member, difficulties in matching up business functions of St. Joseph to similar functions within UtiliCorp was mentioned when questions were asked about the transition team validation process. While the budget of a company becomes one single coordinated document, the transition teams have struggled to coordinate all the functions. Each company had a different approach and cost areas at St. Joseph were not all easily assignable to transition teams for inclusion into the due diligence savings validation process. Coordination of the seven transition teams has been difficult and is an ongoing process.

**MERGER SAVINGS–LABOR**

Q. Please describe the Companies' analysis of alleged merger savings related to labor.

A. The Joint Applicants provided workpapers and reports issued by the transition teams in response to Staff Data Request Nos. 1 and 109. Each of the seven transition teams was responsible for review of a portion of the St. Joseph 1999 budget during the duel diligence validation process. The analyses concentrated on the labor expenses of St Joseph. Some teams started with the St. Joseph budget and then deducted positions that they believed would duplicate existing UtiliCorp positions. Other teams took the approach of starting at zero dollars and then adding back positions that would be needed. The teams looked at St. Joseph direct labor costs associated with their specific team's department functions.

Q. Do projected labor reductions account for a large portion of the estimated merger savings?

A. Yes. A large portion of the alleged savings created by the merger come from reductions in St. Joseph personnel. Mr. Siemek describes these types of estimated savings in his direct testimony starting on page 11. Many of the reductions in direct costs to St. Joseph arise from the fact that the positions and job duties to be eliminated are duplicative of positions and job duties already being performed by personnel at UtiliCorp i.e., supervisory and management positions. St. Joseph positions that are considered as overhead will be eliminated with those job duties absorbed by UtiliCorp. In turn, the post-merger St. Joseph operating unit will be allocated a portion of UtiliCorp's corporate overheads, through the Enterprise Support Functions (ESF) and Intra-Business

Unit (IBU) allocations. In the case of the St. Joseph merger, most of the incremental support costs assigned to St. Joseph will be payroll in nature.

Q. Did the transition teams provide details to support their labor reductions?

A. Unfortunately, the transition team workpapers contain few concrete explanations to explain position reductions in the various departments. Most of the workpapers, especially in the areas of transmission and distribution, contain only the results of decisions reached regarding the numbers of positions to be reduced and no documentation of why each reduction is thought to be reasonable.

Q. Were all positions eliminated based on similar analyses?

A. No. In some cases teams were subjective in their decisions and made assumptions that tended to increase the number of positions to be eliminated. Both Mr. Myers and Mr. Siemek supported this "conservative" view. In his transcribed interview, when asked about the elimination of positions Mr. Siemek gave an example of personnel in accounts payable being able to process 10,000 invoices per person:

> So, in my case, and the example that I used, we started with, I think, 36,000 combined invoices from the two companies, which would have been three-and-a-half people at UtiliCorp. And we ended up adding three, and assuming that some of those 36,000 would go away. And I think that was generally the approach that was taken by each of the transition teams...we were fairly conservative in trying to decide what additional staff we needed to add.

Q Please explain the Staff's concerns about the projected merger savings generated from reductions in labor costs.

A. The Staff has two concerns with the projected labor savings. One concern is that the structure of the combined three utilities, UtiliCorp, St. Joseph and Empire and the effect the combination will have on labor is not known. UtiliCorp has not looked at a three-way combination as it pertains to most areas of labor savings.

In addition, the Staff believes some of the labor savings included in the Companies' proposed merger savings are actually attainable by the Companies without the merger, so attributing the savings solely to the merger is misleading.

Q. Have both Companies been successful at reducing employee levels and/or labor costs in the past?

A. Yes. UtiliCorp and St. Joseph have both been able to reduce employee levels through reorganizations and downsizing. UtiliCorp's response to Staff Data Request No. 26 (see attached Schedule 1) illustrates personnel reductions related to re-engineering. The response to this Staff Data Request is discussed in further detail later in my testimony.

Q. What is the relationship between St. Joseph's and UtiliCorp's past employee reductions and this merger application?

A. The Companies allege that labor savings through employee reductions are a merger benefit and are predicated on the assumption that a merger triggers these savings. Both UtiliCorp and St. Joseph have been able to attain employee reductions on a stand-alone basis through re-engineering at UtiliCorp and on a smaller scale through reorganization at St. Joseph. The Staff believes that these reductions would continue absent the merger.

The Staff believes that both UtiliCorp and St. Joseph still have opportunities to reduce employee counts on a stand–alone basis. However, the Staff also believes that the proposed merger between St. Joseph and UtiliCorp may allow some additional labor savings that would not have occurred absent the merger. I will include examples of stand-alone labor reductions later in my testimony.

Q. Are there opportunities today for St. Joseph to reduce employee counts and/or labor costs on a stand-alone basis?

A. Yes. Opportunities for St. Joseph to downsize employee counts on a stand-alone basis exist. Part of UtiliCorp's analysis of St. Joseph, according to a statement made by Ms. Heider in her Staff interview, documented the fact that about 80 employees of St. Joseph will be eligible for early retirement within the next two years. This was later verified with UtiliCorp's response to Staff Data Request No. 200. The potential exists for St. Joseph to use early retirement as a tool to reorganize jobs at St. Joseph on a stand-alone basis.

Q. What changes in labor requirements could the analysis of the combined merger of UtiliCorp, St. Joseph and Empire have uncovered?

A. The duties that UtiliCorp personnel will assume when their counterparts at St. Joseph are terminated may be manageable. The UtiliCorp controller may be able to assume all the duties of the St. Joseph controller. The UtiliCorp supervisor of the accounts payable clerks may be able to supervise the additional staff required to process St. Joseph invoices. The termination of similar counterparts at Empire may create a workload for the Controller or the supervisor of accounts payable that requires additional employees or increased salaries for personnel that are willing to take on additional duties. It is not known at this time what effects the combined mergers may have. There could be more savings or there could be less.

Without a thorough analysis on the impact of a three-way merger, the Commission can only guess the effects the combined merger of UtiliCorp, St Joseph and Empire will have on labor savings or costs.

**MERGER SAVINGS – DISCOUNTED PRESENT VALUE**

Q. Please explain why a present value adjustment should be made to the estimated merger savings.

A. The costs to achieve the merger are largely current costs, while the estimated savings are projected to occur out into the future over the next ten years and beyond. Dollar inflows and outflows that occur at significantly different dates cannot simply be aggregated in a meaningful way; rather they must be restated at a common date to reflect the time value of money by applying the concepts of present value. Recognizing that all cost savings estimates have been "escalated" for assumed inflation for all future years, it would be appropriate to discount the estimates to a common point in time to derive a present value of estimated savings. The Company does not address the issue of present value for the savings that are projected out to the year 2010.

Q. One of the Company's merger savings assumptions is the use of a 2.5% escalation rate. Why is this assumption important to the Staff's analysis?

A. The 2.5% escalation factor is multiplied by the estimated merger savings each year with a cumulative affect. The use of an escalation factor to inflate the merger savings over the next ten-years creates a favorable comparison of merger savings to merger costs.

Q. How does the present value adjustment that the Staff is proposing compare to the escalation factors proposed by UCU/SJLP?

A. While the use of an escalation factor when projecting the estimated merger savings out into the future tends to inflate the savings, the use of a present value adjustment to bring future merger savings in line with current dollar values would discount the merger savings. To include the escalation factor, and not present value adjustments, skews merger savings estimates so that they can not be compared to current dollar merger costs.

Q. Have you completed a present value analysis of the UCU/SJLP estimated merger savings?

A. Yes. I have completed a present value analysis of the UCU/SJLP estimated merger savings that uses a weighted cost of capital interest rate and extends through the year 2010. Present value is the current value of a sum of future dollars discounted back from a specified future date to the present date at a given rate of compound interest, the weighted cost of capital.

Q. Why did you choose to use UtiliCorp's weighted cost of capital interest rate in your present value analysis?

A. The weighted cost of capital for UtiliCorp is an appropriate rate of compound interest to use in the present value computation of the value of estimated future merger savings. If savings are generated from the merger, the resulting cash flow will be available for UtiliCorp to use and will allow them possibly to avoid financing through the debt and equity markets. The weighted cost of capital represents the cost of money that UtiliCorp would be required to pay if they financed through the debt and equity markets.

Q. How did you determine the weighted cost of capital to use in your present value analysis?

A. I reviewed several sources to determine the appropriate interest rate for this analysis. The 11.37% rate is an estimate of UtiliCorp's pre-tax cost of capital as determined by UtiliCorp and provided to Staff in response to Data Request No. 1. Staff witness David Broadwater has also developed a pre-tax cost of capital for UtiliCorp as of December 31, 1999 of 11.99%. Since the purpose of my analysis is to demonstrate that the merger savings are overstated without a present value adjustment, use of the more conservative interest rate (11.37%) is adequate to demonstrate my point.

Q. What were the results of your present value analysis?

A. My calculations of net present value computed the present value of the savings at a discount rate of 11.37% for the savings each year out from 2001 through 2010. I did not apply a discount rate to 2000. The net present value of savings from 2001 through 2010 at an 11.37% discount rate is $102.3 million, compared to UtiliCorp/St. Joseph's total merger savings of $184.3. (See attached Schedule 2) In addition, Schedule 2 shows that the net present value of the total estimated savings to be provided to customers in Years 6-10 is only $3.4 million in total. This is approximately 3.34% of the total estimated savings on a net present value basis of $102.3 million.

The Staff's position is that the merger savings estimated by UCU/SJLP are overstated because they have not been discounted to current 2000 dollars. The use of a discount rate of 11.37% shows that the merger savings are overstated by at least $81.94 million.

## MERGER SAVINGS – TRACKING

Q. Has Staff reviewed the savings tracking proposal of the Joint Applicants?

A. Yes, the Staff has read the direct testimony of Company witness Myers who provides testimony to support UtiliCorp's ability to track the synergies resulting from the merger of UtiliCorp and St. Joseph. The Staff also interviewed Mr. Myers to gather additional information related to the savings tracking proposal of UtiliCorp.

Q. What is meant by tracking?

A. Tracking is a post-merger process where it is asserted that specific transactions relating to the merger can be identified, verified and the amount quantified so that a determination can be made if the merger is successful from a savings/synergies perspective. The differences between these post-merger transactions when compared to the pre-merger baseline of the stand-alone pre-merger companies are the "purported" merger savings.

Q. How does UtiliCorp propose to "track" the merger savings?

A. Under UtiliCorp's proposal, it will attempt to "track" merger savings generated by the acquisition of St. Joseph by using PeopleSoft accounting software. UtiliCorp uses PeopleSoft for its current accounting system. PeopleSoft is an accounting software application used by many utilities to capture the costs and revenues of the operations of the companies specific to the different business units and the different lines of business. UtiliCorp also uses this accounting system to tabulate incremental support costs that are allocated to the operating units through ESF and IBU allocations. In essence, PeopleSoft is nothing more than a sophisticated bookkeeping system. The PeopleSoft system will be addressed again later in this testimony.

Q. Why is it important for UtiliCorp to have the Commission believe it is possible to track merger savings?

A. UtiliCorp believes having a "tracking" mechanism in place will demonstrate to the Commission that proven merger savings will be sufficient to justify the recovery of the merger premium (acquisition adjustment) in rates. This is a very critical element to UtiliCorp's overall regulatory plan presentation as described in Mr. McKinney's direct testimony.

Q. Does UtiliCorp have an incentive to identify as much merger savings as possible under any tracking system?

A. Yes. The more merger related savings UtiliCorp can identify, the better it will be able to justify recovery of the acquisition adjustment under its own regulatory plan.

Q. Has UtiliCorp presented a detailed proposal for tracking of merger savings in its testimony?

A. No. This situation is further address in the rebuttal testimony of Staff Accounting witness Mr. Oligschlaeger.

Q. Did Mr. Myers provide additional information about UtiliCorp's tracking proposal when interviewed to explain the tracking process?

A. Yes, Mr. Myers, while not a member of a transition team, is familiar with the PeopleSoft software and its capabilities. Starting on page 44 of his transcribed interview, Mr. Myers explains his understanding of the PeopleSoft accounting system. He provided a document to the Staff during his transcribed interview that illustrates his understanding of how the merger savings will be identified by UtiliCorp (see attached Schedule 3). This schedule was apparently developed for informational purposes to discuss merger savings tracking during the transcribed interview of Mr. Myers.

Q. What was the purpose of Mr. Myers' document illustration?

A. The intent of Mr. Myers in providing the schedule was to demonstrate with the use of a simple model, how the "tracking" process would work conceptually using the PeopleSoft coding. When asked in the transcribed interview, pages 38-43, about specific details related to the schedule, such as how the process of determining the St. Joseph functions being absorbed into the incremental line of the document, Mr. Myers was less knowledgeable about how the "tracking" process would be implemented.

According to his direct testimony, transition teams will identify payroll and nonpayroll costs that will become incremental costs of UtiliCorp post-merger. Procedures will be communicated to key UtiliCorp departments regarding the proper tracking of these incremental costs. To date, these are no written procedures that have been given to Staff to support that the coding process needed for tracking merger savings has been determined. The Staff and the Commission have been asked to take UtiliCorp's word that it can be done and will be done. Without an analysis of concrete procedures that demonstrate coding and allocations of St. Joseph costs into the UtiliCorp accounting system, Staff cannot rely on what UtiliCorp has presented. UtiliCorp in actuality doesn't have a concrete tracking proposal.

Q. Please summarize the contents of Mr. Myers' tracking document, Schedule 3 of your rebuttal testimony.

A. Mr. Myers' document illustrates the line item components in the merger savings equation: the St. Joseph and UtiliCorp 1999 budget baselines, and the UtiliCorp incremental costs, all with an inflation (escalation) rate added each year out. The St. Joseph 1999 budget baseline represents the expenses that St. Joseph budgeted for 1999. The UtiliCorp 1999 budget baseline represents the expenses that UtiliCorp budgeted for 1999. The UtiliCorp incremental costs represent the St. Joseph overhead costs that will become part of UtiliCorp's ESF and IBU allocations that are distributed throughout the UtiliCorp organization.

The UtiliCorp baseline and incremental will be added together. A portion of the sum of the UtiliCorp baseline and incremental will be allocated to St. Joseph and deducted from the St. Joseph baseline. This difference represents the alleged merger savings. The UtiliCorp baseline and incremental will be coded by UtiliCorp employees using the PeopleSoft accounting system. The St. Joseph baseline will not be coded to PeopleSoft. The actual savings will not be coded either, since they represent the difference between the uncoded St. Joseph baseline and St. Joseph portion of the sum of the UtiliCorp baseline and incremental.

Q. Does Staff believe that the "tracking" method described by Mr. Myers will be able to distinguish between merger and non-merger savings?

A. No. The Staff believes that the Myers document does not support a "tracking" system that will be able to distinguish between merger and non-merger savings. Non-merger savings from what was included in the St. Joseph and UtiliCorp

1999 budgets will not be discernable from merger savings. The changes in costs as the companies move out in time from when the 1999 budgets were determined will be indistinguishable from merger savings. In essence, the Myers tracking document shows that "merger" savings will be calculated as the difference between an escalated pre-merger St. Joseph budget and post-merger costs allocated to the St. Joseph division. Changes brought about from additional acquisitions, additional technological efficiencies, and increased productivity among employees will become in effect the total costs allocated by UtiliCorp to the St. Joseph division and will be undistinguishable from merger savings according to the method outlined in the Myers document. Using this approach, UtiliCorp will be able to take "credit" for savings that were unrelated to the merger.

Q. Mr. Myers used numbers in his document for illustration only. Does he have more definitive numbers for the actual merger savings calculations?

A. No. According to Mr. Myers on pages 38 through 41 of the interview, the percentage of UtiliCorp Baseline and Incremental to be allocated to St. Joseph has not been calculated. Mr. Myers did not know if adjustments would be made to the 1999 St. Joseph Baseline to eliminate nonrecurring expenses and other elements not related to merger savings. He didn't know, when asked about the use of an inflation factor, if UtiliCorp's or St. Joseph's actual costs had ever gone down as opposed to always increasing. The following questions were posed to Mr. Myers in the transcribed interview, pages 40-41:

> Question to Mr. Myers: What I'm getting at conceptually, I don't understand why you are inflating the baseline year by year from 1999 to the year 2004. I'm just trying to understand conceptually why the company is proposing to do that.

> Answer by Mr. Myers: I will tell you my understanding. My understanding is that we're trying to take a snapshot of what the St. Joe operation would have been before the merger, without the merger taking place. Their costs would have been assumed to go up, and I picked three percent for purposes of this illustration.
>
> Question: Do costs ever go down?
>
> Answer: Yes, they do.
>
> Question: Has UtiliCorp's cost ever gone down, actual cost ever gone down?
>
> Answer: I can not answer that.
>
> Question: Do you know if St. Joe Light and Power's costs were increasing or decreasing?
>
> Answer: I don't know that.
>
> Question: Do you know if St. Joe Light and Power's costs were increasing at a three- percent inflationary factor?
>
> Answer: I don't know that.

When asked how the savings to St. Joseph could be assigned to St. Joseph specifically for financial reporting purposes, Mr. Myers on pages 69 through 73 of the interview stated that the system could do that, but that he hadn't looked at how it would be done. When asked if Mr. Myers was familiar with the terms "non-merger" and "merger related" savings, he said, "vaguely". When asked how non-merger savings would be distinguished from merger savings in the PeopleSoft system, Mr. Myers stated "...I would guess from time to time there would have to be reviews made of some of that information."

Individuals would make judgments about the adjustments that would be made to the UtiliCorp Baseline and Incremental amounts. When asked, "Will it (the PeopleSoft accounting system) be able to and is it planned to be able to track the non-merger related savings and make a distinction between those that are merger related. Has that been discussed?" Mr. Myers responded that it had not been discussed, but the system would have the capability of "tracking" those costs. In other words, if someone could make the distinction between non-merger related and merger related savings and tell PeopleSoft where to capture it, UtiliCorp's accounting system could "track" the savings. Of course, PeopleSoft will not make the distinction, UtiliCorp employees will.

Q. Have utility companies in Missouri attempted to track merger savings in the past?

A. Yes, in the Kansas Power and Light Company (KPL) merger with Kansas Gas and Electric Company (KGE), Case No. EM-91-213, KPL requested that the Commission approve the merger and institute a program of sharing the merger savings between shareholders and ratepayers with each receiving 50 percent as stated in the Commission's Report and Order in that proceeding:

> 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.
>
> That the parties to this case be directed hereby to meet for the purpose of attempting to devise a merger savings tracking plan (MSTP) which will ensure that all non-merger savings can be excluded from the merger savings to be shared between ratepayers and shareholders.

Q. Was KPL successful in tracking merger savings?

A. No. The parties to the case were not able to reach an agreement on how to track the merger savings separately from the non-merger savings. The Commission directed KPL to place this issue in their next case.

Q. Did KPL, which became Western Resources, Inc., address the cost tracking system in their next rate case?

A. Yes, they did. In Western's Case No. GR-93-240, but it was concluded that the cost of maintaining the tracking system out weighed the benefits. For further discussion, please see the testimony of Staff witness Featherstone.

Q. Did the subsequent Western/KCPL Merger Stipulation and Agreement direct Western to track merger savings after the merger closing?

A. No. The Order in the Western/KCPL merger Case No. EM-97-515 states:

> The parties further agreed that it is unnecessary to develop a post-merger savings quantification tracking mechanism with respect to the instant merger and that none shall be proposed in future proceedings in Missouri.

Q. Please describe the different types of savings that can be generated from a merger.

A. In the Case No. EM-97-515, Mr. Thomas J.Flaherty, partner in the Deloitte & Touche Consulting Group LLC, filed direct testimony on behalf of Western describing three types of savings that can arise from a merger:

> 1. Created savings – These are savings that are related directly to the completion of a merger and can not be obtained absent the merger.
>
> 2. Enabled savings – These savings result from the acceleration or unlocking of certain events that can give rise to savings.

> 3. Developed savings – Reductions in cost due to management decisions that could have been made on a stand–alone basis are unrelated to the merger.

In Mr. Flaherty's Schedule TJF-2, page 36 of 75, the following was stated concerning estimated merger savings in that case:

> Potential areas of benefit, and subsequently, the resulting cost savings, are determined to be merger-related if they are not attainable by any action that management of either company could practically initiate on an independent basis. For example, management of either company could reduce labor costs by eliminating positions as part of a resource and function analysis.

Q. Do you believe that there are opportunities for UtiliCorp and St. Joseph on a stand-alone basis to create "developed" savings without the merger?

A. Yes, I do. I will provide examples of developed savings later in my testimony.

Q. Please describe the PeopleSoft system that will be used by UtiliCorp in an attempt to "track" merger savings.

A. PeopleSoft's web page provides promotional information describing the benefits and capabilities of the system. PeopleSoft has a specialized software package to aid utilities in measuring performance. The software is part of the financial system designed to enhance decision-making and organizational performance. It is also an activity based costing system, which allows companies to analyze costs, revenues and determine profitability. PeopleSoft touts itself to be an accounting system that can help utilities in a deregulated world with branding, bundling and predatory pricing. The system is designed for deregulated functions. UtiliCorp has been using PeopleSoft since

September 1997 and has incorporated its use into the Company's analysis of business unit costs and revenues for all United States domestic business operations.

Q. Does the PeopleSoft accounting system make the decision where costs should be booked and how costs are accounted for?

A. No. UtiliCorp employees make those decisions. PeopleSoft provides a means to categorize expenses to very specific cost centers. Individuals within UtiliCorp that are responsible for projects or groups of activities have the authority to code transaction expenses to specific accounts. Individuals must be relied upon to create the codes for each specific project and identify the proper coding for each invoice/source document so the flow of expenses to the proper project occurs. A review process ensures that proper codes are used.

Q. Did UtiliCorp have an accounting system before PeopleSoft?

A. Yes. An accounting system was used to tabulate expenses and revenues into an income statement, and assets and liabilities in a balance sheet. Additional reports could be generated based on the coding of transactions. Accounting systems of this type have been developed over the years as automation/computerization have improved.

Q. Have utilities always had some type of accounting systems?

A. Yes. For as long as utilities have been supplying utility services to customers they have had some type of accounting system in place to keep an accounting of revenues and expenses, and assets and liabilities. The accounting systems of the past and the accounting system of the present all have one thing in common, they all require human intervention to properly quantify and identify where costs should be booked and how these costs should be treated. PeopleSoft is no different.

Q. Is UtiliCorp attempting to portray that it has a mechanism to "track" merger related savings?

A. Yes. That is exactly how UtiliCorp is attempting to use PeopleSoft. UtiliCorp wants the Commission to believe that it has a system in place that can "track" merger savings.

Mr. Myers testified for UtiliCorp that the PeopleSoft accounting system was capable of "tracking" merger savings because the system is very complex and sophisticated. PeopleSoft may be a sophisticated accounting system but it will not be able to "track" merger savings. In fact, neither this accounting system nor any other can actually "track" merger savings. UtiliCorp personnel must tell the accounting system through the coding process what the merger savings will be and then PeopleSoft will capture the costs once personnel determine what categories and where the costs savings should be identified. It is the subjective human component of the "tracking" that will prevent the system from accurately distinguishing merger savings from non-merger savings. PeopleSoft is not the problem. The problem is inherent to the human intervention required for the coding of every possible merger and non-merger related transaction.

UtiliCorp employees will have to identify, verify and more importantly, have to quantify what the savings will be. The accounting system won't be able to do this. PeopleSoft, as an accounting system program cannot "track" merger savings, only the personnel identifying the merger savings can "track" these amounts. The only thing PeopleSoft will do is to account for the items it is "coded" to do. Without the human intervention PeopleSoft will have no way of identifying merger-related savings.

Q. Does Mr. Myers admit to this?

A. Yes. During the transcribed interview, pages 57-67, Mr. Myers stated that the coding process involved human intervention.

Q. Was there any other information concerning a savings tracking process gathered by the Staff?

A. Yes, during the transcribed interview of Mr. Siemek, the following discussion occurred:

> Question by Staff: Referring again to Mr. Myers' document (see attached Schedule 3) he gave us yesterday, the last number reflects a calculation of merger savings which is derived from the lines above it.
>
> Answer by Siemek: Yes.
>
> Question: And I guess my question to you is: Is it intended that this process will produce a number automatically that should be viewed as a merger savings amount for a particular 12 –month period, or will human judgement still have to be entered into it to say, "Is this a reasonable amount? Does this need further adjustments? This expense change has nothing to do with the merger, so let's take it out," and so on. I know that's a pretty long question.
>
> Answer: Well, I believe the intent is that the merger synergies will have to be calculated from pieces from different systems. Again, we had the three different types of costs that each would have different baseline numbers. So I believe that you would have to manually compile those or put them together to see what the resulting merger savings are. To that extent, I don't think there is one system that you can press a button and it will automatically derive. There are very few systems like that that I'm aware of, anyway. So I'm not sure that's even a possibility.

Q. Did Mr. Siemek further attempt to explain how the "tracking" of merger savings would occur?

A. Yes. The table below follows the example given by Vern Siemek in response to Staff Data Request No. 170, to explain how the synergy analysis of the transition teams will be utilized in the tracking of merger savings. The example provided by Mr. Siemek hypothetically explains how the direct labor costs currently expensed to St. Joseph on a stand-alone basis would be eliminated. The following is a quote from Staff Data Request No. 170:

> A. Assume a St. Joseph department of 10 positions at a cost of $500,000.
>
> B. The same work can be accomplished by an existing UtiliCorp department of 20 positions costing $1,000,000 by adding 4 staff at a cost of $200,000.
>
> C. The augmented UtiliCorp department of 24 positions at a cost of $1,200,000 is allocated on an established basis that allocates 33% of its costs to the St. Joseph unit at a cost of $400,000.
>
> D. The synergies in this case are $100,000 (the original St. Joseph $500,000 less the post-merger allocation of $400,000). That difference is simple to validate by retaining the original budgets for St. Joseph department (appropriately inflated) to compare to the costs then being charged to St. Joseph.

I have included the following table to demonstrate the example provided by Mr. Siemek in response to Staff Data Request No. 170:

| **SJLP Positions** | **SJLP Dollars** | **UCU Positions** | **UCU Dollars** |
|---|---|---|---|
| Pre-merger 10 | $500,000 | Pre-merger 20 | $ 1,000,000 |
| Post-merger 0 | $ 0 | Post-merger 24 | $ 1,200,000 |
| Add Allocation | $400,000 | Subtract Allocation | - $ 400,000 |
| Total Post-merger | $400,000 | Total Post-merger | $ 800,000 |
| Synergies | $100,000 | Synergies | $ 200,000 |

Q. Do you have any comments on Mr. Siemek's example?

A. Yes. I have several arguments against the example used by Mr. Siemek to explain how "tracking" will work. The additional $200,000 reduction would not be "tracked" as a merger savings because it would be distributed throughout the UtiliCorp allocation process to all divisions that are included in the allocation. I also find the example to be over simplified.

The example is very telling in that the direct costs of St. Joseph will be replaced by costs assumed from the allocation pool of UtiliCorp's ESF or IBU. In the example, the amount to be allocated back to the St. Joseph division is less than the direct costs that had previously been expensed, therefore, according to Mr. Siemek, a synergy of $100,000 can be "tracked". The actual amounts that will be "tracked" are the $400,000 of expense allocations that will flow to St. Joseph from UtiliCorp. If the savings were actually being "tracked", the $200,000 would also be a merger synergy included with the $100,000 recognized from the reduction in expenses from $500,000 to $200,000.

The critical point is that this example does not attempt to explain how non-merger savings factors will affect the savings calculation. Savings that are unrelated to the St. Joseph merger, such as other merger savings, savings generated from past and future re-engineering projects, savings from employee productivity improvements and savings from advances in technology will affect the savings calculation of Mr. Siemek; in particular, the amount of allocated UtiliCorp overhead expenses to the St. Joseph division. The calculation of merger savings will also be affected by any changes in allocations in the ESF and/or IBU, and the allocation of regulated and non-regulated business operations as well as any increases to costs or decreases to costs from economies of scale. All of these non-merger impacts would effect the calculation of merger savings under the method described in Staff Data Request No. 170.

Q. Is UtiliCorp aware of the Staff's concern regarding distinguishing merger and non-merger savings in a tracking system?

A. Yes. Mr. Siemek indicated in his transcribed interview, pages 81-85, that it was not necessary to make the distinction between merger and non-merger related savings when he said:

> The distinction between merger synergies and other synergies, or other costs, is not very important, other than that hurdle rate...I think that eliminates a lot of the contention that we've typically seen, for example, in the Western case on the KG and E synergies, where it became very critical whether a synergy was merger related or not. In our case, it doesn't make any difference as long as we meet that hurdle rate.

UtiliCorp appears not to have any intention to separate these savings from one another.

Q. Does the Staff have additional concerns about the ability of UtiliCorp to "track" merger savings?

A. Yes. The Staff has concerns with the St. Joseph 1999 budget baseline illustrated in Mr. Myers document (see attached Schedule 3). The Joint Applicants use the 1999 St. Joseph budget as the standard to which future expenses will be measured in determining if merger savings have occurred and at what amount.

Q. Has Staff done any comparisons of St. Joseph budgeted costs to actual costs?

A. Yes. The UtiliCorp/St. Joseph response to Staff Data Request No. 216 provides details of the St. Joseph major budget variances by year for 1996 through 1999. I have included the 1999 major budget variances as Schedule 4 (see attached) to my rebuttal testimony. The 1999 major budget variances demonstrate that the use of the St. Joseph 1999 budget as a baseline will allow non-merger savings to be captured as merger savings. The variances for 1999 show that the budget was over total actual O&M costs (excluding manufacturing cost of goods sold) by $3,463,000 when the unbudgeted merger related expenses were removed. This analysis shows that the pre-merger St. Joseph, on a stand-alone basis, had variances in all activity areas. If budgeted costs were measured against actuals it would appear that merger savings occurred for some activities and no savings, but additional costs, in others. Budgets are clearly no more than estimates. Using the UtiliCorp tracking format as described in Mr. Myers Schedule, any reduction in expense would appear as merger savings.

Q. Do you have any other reservations about the use of 1999 for the baseline?

A. Yes, I do. I believe that there are several reasons why the 1999 budget is not an appropriate choice for the baseline. It would appear that any nonrecurring items included in the 1999 St. Joseph budget would require review to determine if adjustments should also be made for the baseline, otherwise future years could show savings because 1999 account amounts were above a normalized level. Since the UtiliCorp baseline will also influence the savings calculation, variances from the UtiliCorp 1999 budget may also erroneously show merger savings or the absence of merger savings.

The use of any baseline used for savings tracking purposes will require a complete review by the Staff to determine what adjustments must be made to normalize expenses. In addition, any change in ESF and/or IBU allocation factors between regulated and non–regulated divisions will impact the merger savings calculation.

Q. What adjustments to account for nonrecurring events or to normalize expenses have UtiliCorp made to the St. Joseph 1999 budget?

A. UtiliCorp, in response to Staff Data Request No. 219 stated that they have adjusted the St. Joseph 1999 budget for the incorrect amortization of the 1998 rate case expense and the benefit credit from the starting point for the Human Resources budget. These are the only adjustments made to the 1999 St. Joseph budget.

Q. Do you believe that UtiliCorp has taken into consideration all adjustments that need to be made to the St. Joseph 1999 budget to normalize the amounts contained within and then project it out ten years into the future?

A. No. The Staff has become aware that costs built into the St. Joseph 1999 budget for major maintenance at Iatan which was later postponed would require an adjustment for tracking purposes. This adjustment has not been addressed by UtiliCorp.

Q. Describe the Western/KCPL merger savings "tracking" proposal and why it was proposed.

A. Western/KCPL, in their merger, Case No. EM-97-515, proposed to use the actual 1995 expenses as a baseline for purposes of "measuring" merger savings. Western proposed to index non-production O&M expenses to adjust for the impacts of inflation, customer growth and productivity. It also removed medical and dental expenses, transmission for others and net nonrecurring expenses.

For production O&M, Western factored in an inflation adjustment and removed purchased power, fuel, lease expense for LaCygne 2, net non-recurring expenses and

Wolf Creek decommissioning and outage expenses. The reason behind the proposed baseline and adjustments was to identify the savings so they could be applied to the regulatory plan proposed by Western Resources. This was essentially an incentive plan with different levels of savings depending on the higher earned return. The importance of the level of merger savings related to Western's position was that the more savings the formula "proved", the higher the retention by the Company through the incentive plan.

Q. What was the Staff's position in regard to the baseline Western/KCPL used in determining savings?

A. Even with these adjustments, the Staff opposed relying on the Western/KCPL baseline to measure against merger savings. None the less, the Western/KCPL tracking proposal was much more detailed, and was more realistic than the UtiliCorp/St. Joseph "proposed" in that Western and KCPL realized that any baseline chosen for tracking purposes must be subject to adjustment to attempt to eliminate non-merger impacts.

Q. Is the Staff aware of other attempts by utilities to "track" merger savings?

A. Yes. UtiliCorp attempted to "track" savings following their acquisition of West Plains Energy Kansas (West Plains) from Centel in 1991.

Q. Was UtiliCorp successful in its attempt at "tracking" merger savings?

A. No. UtiliCorp did not successfully track these savings. When the issue of documenting the actual merger savings was brought before the Kansas Corporation Commission (KCC), UtiliCorp attempted to included a multitude of cost savings that the KCC ultimately decided were not merger related.

Q. Please summarize the details of the West Plains acquisition.

A. On September 27, 1991, in Docket No. 175,456-U, the KCC allowed UtiliCorp to acquire the electric assets of Centel subject to stipulated conditions. Centel's assets were transferred to UtiliCorp at or about net book value. However, Centel's eight percent ownership interest in Jeffrey Energy Center was transferred to Wilminton Trust and leased back to UtiliCorp. The stipulation enforced a two-year rate moratorium, a reduction in UtiliCorp's initial rate tariffs, a refund to retail ratepayers within the West Plains service territory and prohibited UtiliCorp from seeking rate recovery of any acquisition premium beyond the level of savings generated by the acquisition. UtiliCorp did not propose a method for identifying and quantify savings in the initial acquisition case. UtiliCorp presented little evidence of cost savings apart from general and administrative cost reductions in its prefiled testimony. The determination of any acquisition premium, the recovery of such costs and the issue of an appropriate measuring mechanism for the merger savings were deferred until the Applicant's next rate case.

Q. What were the merger savings issues in the subsequent KCC rate case, Docket No. 99-WPEE-818-RTS?

A. The following excerpts from the KCC Order on Application specifically address the merger savings issues in the West Plains case:

> Page 7, 17. The Applicant identified seven areas of claimed savings to support the recovery of the acquisition premium and submitted that the savings greatly exceeded any acquisition premium paid to Centel. Staff and CURB examined each area of claimed savings and contended that the Applicant failed to show a nexus between the claimed savings and the Centel acquisition...
>
> Page 8, 18. The largest claimed savings is based upon the position that the Applicant was entirely responsible for the reduced coal costs at the Jeffrey Energy Center... It appears that the primary

> reason for coal cost savings is Western's motivation to lower its coal costs and that the Applicant benefited from Western's efforts...Moreover, the Applicant failed to carry its burden of proof with respect to these claimed savings and failed to establish that the coal cost savings would not have been created but for the Centel acquisition.
>
> Page 9, 20. ...The third source of claimed savings is a Power Plant Matrix Agreement, which resulted in staff reductions and increasing plant capacity factors... The evidence does not show that these savings would not have been realized but for the Centel acquisition or that the savings related to a sharing of personnel with West Plains... It appears that this type of employee reduction was in line with prudent utility management.
>
> Page 9, 21. The fourth source of claimed merger savings is power plant savings from efficiency programs recently implemented by the Applicant in 1998. Similarly, the Applicant claimed savings in a general work force reduction implemented by the Applicant four years after the Centel assets were acquired. It appears from the evidence that these types of claimed savings are the result of good utility management and consistent with industry standards. The evidence does not establish that these recent corporate changes and restructuring efforts were related to the Centel acquisition.
>
> Page 11, 24. The final claimed cost savings is a general work force reduction implemented by the Applicant starting in 1995. This reduction is said to involve 60 positions and is claimed to reduce costs by over $4.6 million... It appears that the workforce reductions were the result of general economic changes in the electric industry that were forcing all electric utilities to make such work force reductions.
>
> Page 11, 25. ...In addition, the Commission notes that West Plains initially failed to provide adequate evidence and testimony to document their claimed savings and this failure unfortunately complicated and prolonged these proceedings.
> (Emphasis added)

Q. What conclusions did you draw from the West Plains merger savings issues in the KCC cases?

A. UtiliCorp did not provide more than general merger savings information in its initial West Plains acquisition case. At the time of the 1999 rate case, UtiliCorp attempted to claim merger related savings for coal contracts and labor savings that the KCC did not accept as merger-related.

Q. How do the rulings by the KCC in the West Plains case relate to the UtiliCorp/St. Joseph merger case?

A. I believe that UtiliCorp will attempt to mix non-merger savings with merger savings in the St. Joseph merger case also. An incentive will exist for UtiliCorp to include non-merger savings with merger savings.

Q. What do you base this opinion on?

A. My opinion is based on the response of Mr. Siemek in the transcribed interview, pages 81-83:

> Question of Mr. Siemek: With that kind of adjustments, say, to throw out a cost that would be deemed to be uncontrollable, is that something that should be or would be considered by UtiliCorp and other parties in looking at the bottom-line numbers?
>
> Answer by Mr. Siemek: Well, actually, I think that type of distinction is less important under the regulatory plan that we've proposed. In other proposals that I've seen, it becomes very significant exactly what the merger synergies are, because it sets a return on equity level or determines how much of the premium you can collect or net against the synergies.
>
> In our plan, we've tried to avoid that complexity. And so really the only reason, I think, that we need to quantify the merger, the specific merger-related savings, is to make sure that we reach the threshold or hurdle rate of $1,577,000 in years six through ten. And then it's only important because if we don't reach that hurdle rate, we've guaranteed that—there will be that much of an impact on the customers.
>
> The distinction between merger synergies and other synergies, or other costs, is not very important, other than that hurdle rate. Because under the scenario and regulatory plan that we've proposed, those synergies or costs get passed through to the customer in that year six through ten, anyway. So if we get out to the year seven and the medical costs are lower than what the

> projections are, then there are additional synergies, and we've already met the threshold, then the revenue requirements for the customers of St. Joe will be less as a consequence, whether it's merger related or not.
>
> Question: Okay.
>
> Answer: So I think that eliminates a lot of the contention that we've typically seen, for example, in the Western case on the KG and E synergies, where it became very critical whether a synergy was merger related or not. In our case, it doesn't make any difference as long as we meet.
>
> Question: That hurdle--
>
> Answer: --that hurdle rate. And even that makes no difference, to customers because we're already committing to having that guaranteed reduction in the revenue requirements.

Mr. Siemek clearly does not see a need to separate merger savings from non-merger savings. This is contrary to the policy the Commission has stated in the past.

Q. Will accurate tracking of merger savings be important under the Joint Applicants' regulatory plan to determine if the "hurdle rate" (the $1.6 million minimum savings "guarantee") is met?

A. Yes.

Q. Why does it matter that merger savings are separated from non-merger savings?

A. Ratepayers typically get the benefits of non-merger savings through cost of service reductions that ultimately reduce rates. Applying savings towards the regulatory plan proposed by UtiliCorp without separating merger savings from non-merger savings would jeopardize the flow of non-merger savings which, regardless of the merger, should all flow through to the ratepayers. At some point customers are entitled to the savings provided by prudent utility management. While, generally the utility keeps the savings for a period of time through regulatory lag, customers will eventually enjoy the benefit of those cost reductions. When a merger occurs, it is extremely important to separate the cost reductions relating to the merger and those that would have occurred absent the merger. Customers expect to benefit from the actions of a prudent management operating the utility on an on-going basis. When costs increase, customers are generally asked to pay for those increased costs through increased rates. It is equally expected when cost decrease for customers to receive those reductions in reduced rates. Simply put, customers are entitled to non-merger related savings so they must be separated from merger related savings.

Q. Is it important to distinguish between merger and non-merger related savings if recovery of an acquisition adjustment is being requested?

A. Yes. It is even more critical to identify, verify and quantify the merger related savings from the non-merger related savings to make a decision on recovery of the acquisition adjustment. This can be thought of as a cost/benefit type of analysis where the costs of the merger, in this example, the acquisition adjustment, must be compared to the benefits, in this example, the merger savings. If all savings are included in the analysis you would likely get unrealistic and unsubstantiated results.

Q. How does the business strategy of UtiliCorp contribute to the inability to separate savings related to the merger from non-merger savings?

A. As stated in UtiliCorp's 1993 Annual Report "...the company actively seeks expansion opportunities in both the regulated and non-regulated segments of the industry." UtiliCorp is a merger and acquisition company. It has had a growth through acquisitions strategy for almost two decades. The constant influx of change within UtiliCorp contributes to the complexity of the organization and the difficulty in attributing changes in expense levels to one factor (i.e., the St. Joseph merger) as opposed to other factors.

For example, suppose UtiliCorp were to acquire another major domestic utility through a merger transaction this year. This hypothetical merger would impact the financial results of UtiliCorp significantly. It would be very difficult, if not impossible, to attribute the amount of the earnings impact from this additional merger separately from the St. Joseph merger, and from other possible influences.

Q. Is the Staff convinced that the savings identified by the Companies are only attainable through the merger?

A. No. An example of non-merger savings, the recent UtiliCorp re-engineering effort, Project BTU, will be discussed in the next section of my testimony. There are also opportunities in the future after the merger is consummated for savings to be generated that are non-merger related. UtiliCorp could and has attained some of these on a stand-alone basis. St. Joseph also attained non-merger savings in their reorganization through employee reductions.

Q. Can the Staff cite examples of non-merger savings that UtiliCorp anticipates in the next few years?

A. UtiliCorp, in response to Staff Data Request No. 82, provided **________

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NP

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__________ ** The explanation as to how UtiliCorp plans to attain this improved efficiency is not provided, but it is clear that this is an example of a non-merger savings that can be generated by UtiliCorp on a stand-alone basis.

Q. Will the use of PeopleSoft for Human Resources (HR) application by UtiliCorp result in cost savings?

A. Yes, I believe it will. I asked UtiliCorp in Staff Data Request No. 198, to identify any expected/anticipated savings to be realized through the implementation of PeopleWorks Phase III. This is a software package to enhance PeopleSoft applications through additional options. Although UtiliCorp's response stated that PeopleSoft HR was implemented in January 1999, it also stated that no savings would be realized from the implementation of PeopleWorks so no savings would to be segregated from either merger.

This contradicts PeopleSoft's own data from their web page promotional documents. PeopleSoft illustrates examples of ways cost savings can be generated through efficiencies created by the implementation of its software. For example:

> A Duke Energy PeopleSoft Profile, states that the use of PeopleSoft in its HR function has allowed them to need fewer people creating economies of scale and productivity.
>
> As an other example: Entergy stated in another PeopleSoft Profile that HR allowed them to cut their human resource staffing by 30%.

These savings will be available to UtiliCorp when the Employee Service Station is implemented. The self-service functionality of the HR software allows employees access to their personnel data through a HR home page.

Even though UtiliCorp stated in response to Staff Data Request No. 198 that the basis for approval of the PeopleWorks Phase III wasn't cost savings, when these savings occur, they will flow through the allocations associated with Human Resources functions and be distributed to all divisions of UtiliCorp that received allocations from HR. St. Joseph will receive an allocation from HR. These non-merger UtiliCorp savings will be passed through to St. Joseph with the allocation process and become merger savings to St. Joseph. St. Joseph on a stand-alone basis could have implemented the same HR software and attained a non-merger savings for the same technology benefits that will now be counted as merger related savings.

Q. Has the Staff identified any additional potential stand–alone savings for St. Joseph?

A. Yes. Automated meter reading (AMR) is a savings area that St. Joseph could realize on a stand-alone basis. A Project Status Report, October 1, 1999, from the Information Technology Transition Team in response to Staff Data Request No. 107, listed the upgrade of the ITRON meter reading system that St. Joseph anticipated on a stand-alone basis. Future technological advances would allow St. Joseph opportunities to generate savings with AMR systems in the future on a stand-alone basis, just like any other utility would experience.

St. Joseph's response to Staff Data Request No. 82 provided an excerpt from page 9:

** **

Clearly, it appears that St. Joseph would be able to generate savings through the implementation of an Internet bill paying system. In addition, St. Joseph could have used this Internet system to enhance non-regulated business activities.

Another example of a cost savings that St. Joseph could implement on a stand-alone basis would be to convert their fleet replacement policy to a five-year/125,000 mile plan. This is an operational requirement of the UCU/SJLP distribution transition team, to be implemented on "Day One" of the merger. This may be intended to be included in merger related savings, while St. Joseph could have realized this as a non-merger savings if it had implemented this fleet replacement policy on its own.

## MERGER SAVINGS – RE-ENGINEERING PROJECTS/NON-MERGER SAVINGS

Q. Do UtiliCorp's projections of savings resulting from reorganization/re-engineering mimic those of the merger?

A. Yes, in some cases they do. UtiliCorp provided information about its reorganization and strategic planning effort in response to Staff Data Request Nos. 26 and 192. Several excerpts from the response to Staff Data Request No. 26 demonstrate that re-engineering savings were approached in much the same way as merger savings:

> The focus in this area was on reduction of redundancy and in gaining of efficiencies.

> Based on the findings of the "Recommended State" study, significant savings could be expected. O&M savings (exclusive) of transition costs would be $35-40 million or roughly 20%. Much of these savings would result from a decrease in personnel, which is estimated to be approximately 840 employees.

UtiliCorp recognized that there are opportunities within the UtiliCorp organization on a stand-alone basis to create savings absent the merger.

Q. Can you cite examples from Project BTU of non-merger savings?

A. Yes, I can. The Companies' response to Staff Data Request No. 192 included a copy of Project BTU, Building Tomorrow's UtiliCorp, Business Case, August 26, 1996. The following savings were referenced with the report:

- Improve efficiency of UtiliCorp's labor and material resources in design, construction and maintenance of the distribution network, allowing for lower operating costs
- The initiative of Project BTU will significantly reduce costs of operations
- BTU will reduce the time it takes to execute basic business activities
- Line and service crew productivity will increase through enhanced planning and scheduling capabilities
- The business focus of the Customer Service Center is to create the most efficient and standardized customer service/sales call center environment in the industry.
- In 1995, the estimated cost per call for call centers in Michigan and Missouri was $1.85. The improvements in the system are expected to contribute to meeting the future team goal of $1.18. This would represent a 36% decrease.

It will be difficult or nearly impossible to differentiate these types of non-merger savings from merger savings as they extend out in time. Efficiencies developed through the Project BTU re-engineering effort will be amplified through the St. Joseph and Empire mergers. Where re-engineering non-merger savings end and merger savings begin will be nearly impossible to separate, let alone "track".

Q. Does UtiliCorp continue to benefit through cost savings today as a result of the re-engineering which began in 1994?

A. Yes. Most of the benefits didn't occur until late 1997. Some of the re-engineering projects have only recently been implemented. The Missouri Customer Information System (CIS) has just been put into place within the last few months. The benefits from changes in CIS will contribute to non-merger savings for years to come. The direct testimony of Staff witness Steve Traxler in the Case No. ER-97-394 discusses the details of the re-engineering plan.

Q. Does UtiliCorp have plans to continue to strive for efficiencies and ways to reduce costs that would be classified as non-merger related?

A. Yes, UtiliCorp, in response to Staff Data Request No. 192 provided summaries of benefits of Project BTU, the re-engineering program implemented by UtiliCorp beginning in 1996. Cost savings are and will continue to be generated from Project BTU.

Q. Why are re-engineering programs implemented and how do they generate savings?

A. Re-engineering programs are implemented for a variety of reasons. Some of the reasons are improvements in coordination, systems reliability, performance standards and reductions in costs are just a few. Re–engineering is a process in which an organization reanalyzes their operations to determine where efficiencies can be created. The organization reviews benchmarks and sets goals to incorporate changes to improve its competitive position within the industry. Costs savings are often realized from re-engineering programs.

Q. Has St. Joseph completed any reorganizations?

A. St. Joseph responded to Staff Data Request No. 193: "There has been no formal reengineering of the Company since 1994. Changes in the organization have occurred in the ordinary course of business. Specific documentation of these changes and their impact are not available." In response to Staff Data Request No. 16, St. Joseph states, in relation to employee attrition: "In 1996, our restructuring resulted in eight positions being eliminated and three new positions were added resulting in five positions being eliminated." This demonstrated that the Company has reduced costs in the past with the elimination of labor positions. This type of savings is also possible in the future.

Q. Does the Staff believe that merger savings can be segregated from savings generated from re–engineering or other cost saving methods employed by the companies on a stand–alone basis?

A. No. The Staff believes that there is no mechanism available to truly separate these savings. The UCU/SJLP merger savings tracking "proposal" cannot be relied upon because the estimates contain savings generated from re-engineering and other cost saving methods.

A commitment to achieve the levels of savings does not mean that the level of savings, if achieved, are totally merger-related. The impact of the merger will be constant to the extent that the merger impacts are less than the reported savings levels, as Staff believes to be the case. It is possible that management can engage in other activities to achieve the same level of savings by using non-merger-related decisions. It is conceptually possible that UtiliCorp can use additional work management techniques such as activity-standardization and technology substitution that are available to it on a stand-alone basis. Such savings are not merger-related.

Q. Does the Staff understand that either the Myers tracking (Schedule 3 to this testimony) or Mr. Siemek's response to Staff Data Request No. 170, both previously discussed, constitute a formal proposal for a savings tracking methodology?

A. No. In the absence of such a formal proposal, the Staff is forced to respond in this rebuttal testimony to what little information is available as to UtiliCorp's intentions in this area.

## ACQUISITION ADJUSTMENTS

Q. Have you read the direct testimony of Joint Applicant witness John W. McKinney?

A. Yes, I have.

Q. Do you have any comments to make in reference to his testimony?

A. Yes, I do. Mr. McKinney has included as "Figure 2", on page 22 of his direct testimony, a map attributed to the NAWC Sourcebook, Updated 6/23/97. This map shows the United States with the states shaded where commissions purportedly have approved acquisition adjustments. In actuality, the Staff believes the map presented by Mr. McKinney represents states where acquisition adjustments were approved for water utilities.

The original map in the June 23, 1997 NAWC Sourcebook is included in my testimony as Schedule 5. The appearance of the map is somewhat different from the one presented by Mr. McKinney. The NAWC Sourcebook map is shaded black for states that have approved acquisition adjustments for water mergers/acquisitions and shaded gray for states that allow a limited acquisition adjustment for water mergers/acquisitions. Of the twenty-six states shaded, fifteen have only allowed acquisition adjustments on a limited basis.

Q. What was the purpose of the NAWC Sourcebook update?

A. The purpose of the sourcebook for which the full title is <u>Sourcebook of Regulatory Techniques for Water Utilities</u>, is explained by Ms. Janice A. Beecher, Ph.D. Indiana University, who compiled the update for the Rates and Revenue Committee of the National Association of Water Companies. In the introduction to the sourcebook, Ms. Beecher states:

> The purpose of this Sourcebook of Regulatory Techniques for Water Utilities is to provide water industry and regulatory professionals with a comprehensive and current compilation of regulatory policies and practices. The Sourcebook describes each approach and its use. The purpose of the Sourcebook is not to emphasize or advocate any particular approach, but to provide information resources. The Sourcebook is designed to aid research and promote dialog on a wide range of alternative regulatory techniques.

Q. What sources of information did Ms Beecher rely on for the compilation?

A. In the introduction Ms. Beecher stated the following regarding her sources:

> The Sourcebook relies extensively on a 1996 survey of commission staff members...The survey includes all forty-five commissions that regulate water utilities... The survey data should be used for general information purposes only. In keeping with the goal of comprehensiveness, the survey is broad in scope but not highly detailed. Commission staff members provided a very general impression of regulatory policy in their respective states based on a very simple survey instrument. Within specific areas of policy, many variations in interpretation are likely. While much effort was devoted to ensuring the accuracy of the survey, the

> results should not be taken as a definitive statement of commission policy.

The survey used to compile the Sourcebook data had very general questions and state regulators that responded were given latitude to convey as much or as little information as they chose.

Q. Did you review the Missouri response to the NAWC survey?

A. Yes. It was answered from a water regulatory perspective only.

Q. Were there further details that accompanied the Sourcebook map that were not included with the "figure 2" map in Mr. McKinney's testimony?

A. Yes. There were survey notes that described in greater detail the circumstances in which acquisition adjustments were allowed for water utility merger cases. The survey notes included specific information to the states survey responses (see attached Schedule 6).

Q. What additional information did the Staff gain from the NAWC Sourcebook?

A. Some jurisdictions have treated acquisition adjustments for water and wastewater merger/acquisitions somewhat differently than those resulting from electric and natural gas mergers. Pennsylvania and New York are two states that have enacted policies to allow acquisition adjustments, both positive and negative, for small water utilities. These policies have been implemented because the quality of water and the financial viability of small utilities is a concern to state regulators. These concerns, along with needs for customer service improvements have spurred the approval of acquisition adjustments for certain water utilities in these jurisdictions.

While some states have realized the need to allow acquisition adjustments for troubled water systems and in some cases for wastewater systems also, the circumstances that lead to the mergers and acquisition of electric and natural gas utilities are obviously quite different.

Q. Does the Staff believe the NAWC survey's relevant to the issue of recovery of electric acquisition adjustments?

A. The NAWC survey results are not relevant to the acquisition adjustment issue as it relates to electric utility mergers.

Q. What has generated the increase in merger activity between electric utilities in recent years?

A. I believe that there are several contributing factors to the increase in merger activity in the electric industry. The restructuring of the electric industry has led to the increased merger activity. An article describing electric restructuring activities in Florida taken from the Florida Public Service Commission web page, States' Electric Restructuring Activities Update-Florida Public Service Commission , summarizes some of the main reasons why restructuring is occurring and in turn, why increased merger activity is occurring:

> A number of states are exploring retail restructuring as a way of achieving lower rates and greater customer satisfaction. Higher than average electric rates appear to be the primary driver in these states. Electric restructuring generally describes a movement from regulated monopoly electric utility services to market-based competitive electric services. A lot of different terms are being used to describe what is happening at the federal level and in other states in the transition to electric competition. Phrases such as restructuring, deregulation, competition, retail wheeling, retail access, and customer choice have all been used to describe a broad-based, national movement away from traditional

> rate base regulation of vertically integrated, monopoly public utilities.
>
> California, New Hampshire, New York and Massachusetts were among the first states to move toward retail access. The average residential rate in these states is approximately 12 cents per kilowatt-hour. Because of these high rates, economic development appears to have suffered with the loss of jobs and the relocation of industry. In many high-cost states, large commercial and industrial customers have been the most active in encouraging a move toward competition. At present, a total of twenty-two states have enacted legislation or implemented regulations requiring retail restructuring, although the legal basis is being challenged in several states... Small-use residential and commercial customers are less likely to have meaningful alternative generation supply choices in a competitive market and may be left paying higher costs.

Q. Why have state regulators become more likely to pass on acquisition adjustments in electric and natural gas utility mergers to ratepayers in recent years?

A. The pressure continues to be exerted upon regulators in states where utility costs are considered to be significantly above the national average to promote activities, whether mergers, divestitures of generation assets or deregulation initiatives, to lower utility rates. On the federal level, the philosophy of the Federal Energy Regulatory Commission (FERC) supports mergers that purport to enhance economic development, build stronger/larger companies that can survive deregulation/restructuring and cut costs through economies of scale.

It is yet to be seen if deregulation/restructuring will reduce rates for the majority of Americans. It is unlikely that the customers in low cost energy states, like Missouri, would want their state regulators to endorse the exact same philosophy as those of the high cost energy states.

Q. Have you read the direct testimony of UtiliCorp witness Robert K. Green?

A. Yes, I have.

Q. Do you have any comments about his testimony?

A. Yes, I do. On page 15, he cites Massachusetts as an example of a public service commission that has addressed acquisition premium recovery:

> After years of denying the cost of acquisition premiums, in 1994 the Massachusetts Department of Telecommunications and Energy changed its long-standing policy and now will allow recovery of the premium on a case by case basis when denying recovery of that premium would prevent consummation of a merger that would otherwise be in the public interest.

I don't believe Mr. Green went far enough in explaining the Massachusetts Department of Telecommunications and Energy (DTE) view on acquisition premiums. I will provide some excerpts from the Massachusetts Department of Public Utilities (DPU) (the predecessor to the DTE) Guidelines and Standards for Acquisitions and Mergers of Utilities (Guidelines) dated August 3, 1994 and then comment on why Massachusetts changed its policy to allow utilities the opportunity to recover acquisition adjustments:

> ...In light of concerns over high utility rates which in part may be the result of duplicative facilities, functions, and services among Massachusetts utilities, the Department has sought to reexamine its current policy towards mergers or acquisitions and determine whether the public interest may better be served by specific policy changes that enhance efficient delivery of utility services in Massachusetts.
>
> ...The Department believes that cost-effective mergers are one of several means by which utilities may be able to reduce their cost of service, improve service reliability, and enhance their financial strength.
> (Emphasis added)

Massachusetts is a high cost per kilowatt-hour state. I believe high cost states may be compelled to modify prior policy to reduce rates and improve economic development opportunities in their states. These excerpts from the Massachusetts Guidelines support my position. In his testimony, Mr. Green did not explain what led to the policy change or why Massachusetts is not necessarily comparable to Missouri.

Q. Did the Massachusetts DPU provide reasons in the 1994 Guidelines for its change in policy?

A. The following excerpts from the Guidelines explain why the DPU had not felt compelled prior to 1994 to allow acquisition adjustments:

> ...Most mergers or acquisitions that have occurred in Massachusetts have involved affiliated companies where assets and liabilities were combined into a single entity. In these cases, consolidations were achieved either by a sale of assets at a price equal to book value or by exchange of stock. Because these transactions did not result in a difference between purchase price and original book value, no acquisition premium was realized.
>
> ...A merger or consolidation may also occur through a pooling of interests by two or more utilities...some involved an acquisition price that differed from the net book value of the assets of the acquired utility, thus producing an acquisition premium...however, <u>in each of these cases, the acquiring company specifically pledged that it would not include the premium in rate base, and would not propose cost of service treatment for amortization.</u>
> (Emphasis added)

Again, Mr. Green in his direct testimony did not provide an explanation to why acquisition premiums were not approved in Massachusetts prior to 1994. It is clear through the explanation included in the guidelines that historically, acquisition premiums had not been an issue. The guideline cites at least twenty cases where premiums were not an issue in prior acquisitions.

Q. Did Mr. McKinney also reference the Massachusetts DPU?

A. Yes, he did. McKinney states:

> The Massachusetts Department of Public Utilities ("Department") set forth generic guidelines and standards for acquisitions and mergers of utilities. Prior to the generic investigation, the Department maintained a policy of disallowing acquisition adjustments. After the generic hearings, the Department determined that where potential benefits for customers exist, it is not in the interest of the customers, the shareholders, or the state to maintain a barrier against mergers.

Q. Do you have any comments about his testimony?

A. Yes. I don't believe Mr. McKinney went far enough in explaining the Massachusetts DTE's present view on acquisition premiums in the above statement, either. I would like to emphasize the requirements set out in the Guidelines that the Massachusetts DTE would consider various factors in order to determine if the merger is consistent with the public interest.

These factors were set forth in the guidelines:

(1) effect on rates
(2) effect on the quality of service
(3) resulting net savings
(4) effect on competition
(5) financial integrity of the post-merger entity
(6) fairness of the distribution of resulting benefits between shareholders and ratepayers
(7) societal costs, such as job loss
(8) effect on economic development, and
(9) alternatives to the merger or acquisition

The DTE stated, "This list is illustrative and not 'exhaustive,' and the Department may consider other factors when evaluating a ϶96 proposal." (Section 96 permits companies subject to Chapter 164 to engage in merger or acquisition under the preconditions there stated.)

The Massachusetts DTE, when allowing acquisition premiums, must be satisfied that companies demonstrated more than "potential benefits for customers exist," which is what Mr. McKinney states in his testimony. A paragraph in the Guidelines points this out explicitly:

> On the other hand, the Department will not automatically allow recovery of all premiums associated with each and every merger. Rather, we are requiring parties to demonstrate that the recovery of acquisition premiums is allowable as part of the general reckoning of cost and benefit under the G.L. c. 164, ∋96 consistency standard. Adoption of a presumptive rule in favor of acquisition premiums might mislead shareholders to expect guaranteed recovery of merger-related costs, regardless of the existence of countervailing advantages. Moreover, a blanket policy favoring recovery of acquisition premiums might have the unintended consequence of preventing market forces from acting as a restraint against what may otherwise be considered unwarranted premium levels. Therefore, based on the foregoing, the Department finds that in the future it will on a case-by-case basis consider individual merger or acquisition proposals that seek recovery of an acquisition premium. Additionally, the Department will consider the appropriate level of a recoverable acquisition premium on a case-by-case basis.

While the Massachusetts DTE may allow premiums, they have much latitude in determining how to approach mergers so that no harm comes to ratepayers or the public interest.

Q. Has the Massachusetts DTE used its guidelines in merger cases?

A. Yes. Massachusetts used its guidelines in two natural gas utility mergers. In the Eastern Enterprises (Eastern) pooling of interests acquisition of Essex County Gas Company (Essex) the applicants estimated a $47.1 million acquisition premium from earnings dilution that would be experienced by Eastern shareholders. Staff witness Mr.

Hyneman addresses issues related to the differences in accounting treatment (pooling of interest versus purchase) of mergers in his rebuttal testimony.

Q. What led the DTE to approve an acquisition premium in this merger case?

A. The DTE considered the factors in the Guidelines. Essex is a small gas local distribution company at the end of an interstate pipeline system. The DTE stated in its analysis and findings that Essex would be increasingly challenged to respond to a competitive market dominated by larger utilities and that ultimately the ratepayers would be losers if the merger did not take place. With respect to effect on rates, the DTE stated:

> The resulting net savings, and alternatives to the merger, the Department found that approval of a 10-years freeze of base rates will yield benefits to Essex's ratepayers and results in just and reasonable rates. Further, the Department recognized that the proposed merger would provide Essex's ratepayers with guaranteed savings in gas costs that would be unavailable absent the merger. Based on our evaluation of the Rate Plan, the Department also concludes that the five percent rate reduction and 10-year rate freeze, in conjunction with the opportunity for Eastern's shareholders to recover the costs associated with the merger, represents a fair allocation of the benefits between shareholders and ratepayers.

A condition of the approval was finding the Eastern/Essex transaction to be "consistent with the public interest" or a "no net harm" standard. Under the Guidelines, the extent to which recovery of the acquisition premium is permitted depends on the "no net harm" analysis.

Q. What did the DTE decide in the other natural gas merger case?

A. The Northern Indiana Public Service Company (NIPSCO) acquisition of Bay State Gas Company (Bay State) was treated for accounting purposes as a purchase rather than a pooling of interests. The applicants estimated a merger premium of $315 million, including estimated transaction costs of $5 million. The DTE approved a five-year rate freeze. The focus of this case was growth of NIPSCO and the anticipated merger savings benefits were not quantified. The DTE allowed Bay State to seek recovery of the acquisition premium in future rate proceedings. The recovery of the premium would be dependent upon achieving merger-related savings.

Q. Have there been other Massachusetts merger cases where the Guidelines were applied?

A. Yes. In another DTE merger case between Boston Edison Company (BEC) and Commonwealth Energy, DTE 99-19, the Massachusetts Guidelines were applied. In this case, BEC was asking for recovery of an acquisition premium of $502 million under the purchase accounting merger method. The DTE approved the merger with a four year rate freeze and allowed recovery of the premium. The DTE relied on a finding of projected merger savings of $632.5 million over the first ten years following the merger close. Costs over the same time would be $205 million in amortization of the premium and $135 million after tax transaction costs.

The Case has been appealed to the State Supreme Court by the Attorney General and a group of large volume customers who contend the rate plan is not in the public interest and the fact that merger savings estimates were relied on by the DTE, led to uncertainties about how much consumers will actually save.

Q. Did Mr. McKinney provide examples from other state public utility commissions in his direct testimony?

A. Yes, he did. Mr. McKinney listed Oklahoma Corporation Commission (OCC) "criteria" that he believes the UtiliCorp/St. Joseph transaction meets.

Q. Have you reviewed the Oklahoma Gas & Electric Company (OG&E) case referenced in Mr. McKinney's direct testimony?

A. Yes, I have. The OCC established a standard test for rate base treatment of acquisition premiums with four points for consideration. These were stated in Mr. McKinney's direct testimony at page 23. The OG&E case, Cause Nos. PUD900000898, PUD910001055, PUD900001005, Order No. 380443, 150PUR 4$^{th}$ 33, February 25, 1994, involved the rates being charged by Enogex, a wholly owned subsidiary of OG&E, in its pipeline transportation charges to OG&E. The OCC decided to pass 50% of the acquisition premium cost through the Fuel Adjustment Clause being charged by Enogex in transportation charges to OG&E. The decision was based on evidence for allocation of the transportation and processing segments of OG&E. The OCC found that in this OG&E case that the transaction substantially met the four criteria recognized in the treatise, Accounting for Public Utilities. The OCC went on to state:

> The transaction was in the public interest, the price paid was reasonable, the benefits to ratepayers were equal to or greater than the premium level which the Commission allows for rate treatment, and the transaction was conducted at arm's-length. Furthermore, the acquisition is deemed to have been the least cost alternative available to OG&E. These factors were analyzed when the purchase occurred.
>
> The parties concur that the acquisition premium amounts to a purchase price of $133,056,188 above the depreciated book value of the Mustang transportation pipeline and natural gas processing facilities.
>
> However, this amount will not be passed along to the ratepayers in its entirety. Allocation of the acquisition premium is necessary to reflect the share of the acquisition premium which fairly can be recovered from ratepayers... This allocation is shown from the record to be determined by two factors: (1) statistical and financial analysis regarding the split between the transportation and processing segments, and (2) policy considerations involving the choice to pass a portion of the benefits and burdens of the transportation segment along to the ratepayers.

Q. Should the Commission accept OCC standards in determining if the UtiliCorp/St. Joseph merger should be approved?

A. No. Each state commission should follow its own statutes, policies, standards, etc. in determining approval of mergers and rate treatment of the merger. While the OCC standards appear on the surface to be reasonable and UtiliCorp believes their St. Joseph merger transaction meets these standards, these standards are not specific to Missouri.

Q. In reference to the four OCC "standards", does the staff believe that the UtiliCorp/St. Joseph acquisition adjustment meets all four standards for recovery?

A. No. In particular, the Staff questions whether the Joint Applicants have demonstrated that total merger savings will exceed the merger premium in this case. Please see the testimony of Staff witness Oligschlaeger and Traxler on this point.

Q. Have you reviewed merger cases in other state jurisdictions besides those mentioned by Mr. McKinney and Mr. Green?

A. Yes. I have reviewed merger cases in several other jurisdictions and have found that state commissions have a variety of approaches to approving mergers. Companies don't necessarily ask for recovery of acquisition premium from ratepayers. Commissions, even when asked to allow recovery of acquisition premiums, don't always allow recovery. Commissions may postpone deciding the recovery issue until savings can be proven. The status of deregulation in the state often influences the approach the commission takes in deciding how much recovery, how long to extend rate freezes, savings sharing mechanisms, etc.

Q. Why is there a question of how acquisition adjustments should be treated?

A. There are two basic accounting/rate issues relating to acquisition adjustments. The first is the appropriate treatment of the acquisition adjustment in rate base. The second is the appropriate cost of service treatment of the amortization of the acquisition adjustment.

Q. Do you have some specific examples?

A. Yes. I reviewed the California Public Utilities Commission's (CPUC) opinion in the merger of Pacific Enterprises and Enova Corporation (Enova), D.98-03-073. California implemented electric industry restructuring in January 1998. Pacific Enterprises and Enova wanted a ten year sharing period to recover fifty-percent of an estimated $1.1 billion in savings. In the Opinion, the CPUC commented on problems with the ten-year plan in conjunction with an electric rate freeze and a PBR mechanism, which anticipated a cost of service review in 2003:

> It will be difficult and artificial to conduct this cost of service review with a merger savings overlay. If the utilities true up forecast merger savings to actual savings, they would have an incentive to change from a narrow view of merger savings now to an expansive view of merger savings later. If the utilities lock in merger savings now, any future cost-of-service review will be artificial. We will have to add non-existent costs back into the utility system to develop a cost-of-service review for stand-alone utility operations and redesign earnings sharing mechanisms.

I believe this statement points to problems in proposals to track merger savings because companies have incentives to combine merger and non-merger savings. This will also likely be a problem in the UtiliCorp/St. Joseph merger under the Joint Applicants' tracking proposal.

Q. Do you have another example of how other jurisdictions have ruled in merger cases?

A. Yes. The PacifiCorp and Scottish Power merger was completed November 30, 1999. The combined utility is now one of the top ten investor-owned U.S. electric utilities. The PacifiCorp and Scottish Power merger was approved in several states. I chose to review merger cases in the states of Wyoming and Idaho to examine the main issues in those jurisdictions. Each state has taken a position that addresses their specific situation based on current rates, customers service concerns, and the status of deregulation in that state in addition to the requirements of the laws governing the regulation of utilities in that state.

Denise K. Parrish, Supervisor of the Rates and Pricing Section of the Wyoming Public Service Commission, testified as a member of the Consumer Advocate Staff in that jurisdiction's proceedings. She advised the Wyoming Public Service Commission as follows:

> You have to look at each state on an individual basis and see where they are. For instance, the Idaho staff thinks that PacifiCorp may be over earning. We heard Mr. O'Brien indicate that they are probably under earning in Idaho. Utah has just had a rate case. Oregon has an alternative form of regulation in place where some increases are coming about on a quasi-automatic basis. So I don't think it's fair to compare Wyoming to those other states when there are different regulatory schemes in place.

Q. Did ScottishPower make concessions to the state of Wyoming as part of its regulatory plan?

A. Graham Morris, Head of Finance for Manweb (a regional electric company in England and Wales), testified for ScottishPower, in the Wyoming merger application case regarding the nature of the merger transaction:

> All transaction costs would be excluded from PacifiCorp utility accounts. He stated the result of this exclusion. We have ensured that the costs associated with the transaction will not be passed on to customers. <u>The companies are bearing these costs and the acquisition premium, which ScottishPower is paying for PacifiCorp.</u>
> (Emphasis added)

Alan V. Richardson, Executive Director and member of ScottishPower Board of Directors, testified:

> ScottishPower would share its transition plan with the Commission within six months after closing of the merger. The plan will identify how ScottishPower expects to achieve cost savings and the expected costs and benefits of these initiatives. Additionally, ScottishPower committed to submit an informational filing in June 2001 to show how planned cost savings will be promptly reflected in Wyoming results of operations.

Q. What did the Commission decide in the Wyoming ScottishPower/PacifiCorp merger?

A. On November 17, 1999 the Wyoming Commission ordered in Docket No. 20000-EA-98-141 approval of the reorganization under the terms and conditions of the Stipulation and its Amendment. Condition 4 of the stipulated case as amended states that:

> The 2001 informational filing will include a full description, calculation and dollar identification of merger savings. The filing will include in the adjusted revenue requirement calculation, any such merger savings. <u>The Wyoming allocated share of merger-related savings shall be no less than $4 million per annum, rather than the approximately $1.5 million previously discussed and agreed upon by them. If the savings are higher than $4 million, the</u>

> <u>higher figure will be used for the 2001 informational filing; and the higher figure will be reflected in the next general rate case filed on or after January 1, 2001. If the full $4 million is not demonstrated, the parties agree that it may be imputed for ratemaking purposes.</u> (Emphasis added)

ScottishPower presented a position to the Wyoming Commission that did not include substantial risk to the ratepayers. By not seeking recovery of the acquisition premium and the costs of the transaction, the company removed many of the barriers for approval of the merger. At the same time, the company also agreed to reflect merger savings in rates.

Q. How did Idaho react to the ScottishPower/PacifiCorp merger?

A. The merger of ScottishPower with PacifiCorp was opposed by Idaho citizens at public hearings. Citizens feared the loss of control of an American utility to a foreign company.

Q. What concessions did ScottishPower make in Idaho as part of its regulatory plan?

A. ScottichPower, following the conclusion of the technical hearings in Idaho, filed with the Commission a Notice of Merger Credit Commitment that was incorporated in to the Commission's Order:

> Pursuant to that offer, ScottishPower and PacifiCorp shall provide guaranteed merger-related cost of service reductions for four years through an annual merger credit on customers' bills. The amount of the credit shall be $1.6 million per year for the years 2000, 2001, 2002, and 2003. The total credit in years 2000 through 2003 will be $6.4 million. For each of the years 2002 and 2003, ScottishPower and PacifiCorp may reduce or offset the $1.6 million merger credit to the extent that cost reductions related to the merger are reflected in rates.

The Order also states in regard to transaction costs and the estimated savings:

> ScottishPower and PacifiCorp will exclude all costs of the transaction from PacifiCorp's utility accounts...ScottishPower originally guaranteed operating efficiencies of at least $10 million annually on a system basis. If the minimum $10 million annual reduction is not achieved by the end of the third year, an amount equal to the difference between the $10 million and efficiencies actually achieved must be moved below the line to be absorbed by shareholders.
>
> Annual report of efficiencies achieved must be provided to the Commission Staff to verify the savings along with an annual commission basis earnings report. ScottishPower has committed to provide these reports in a format similar to that currently used by the Company in the UK. The actual report format can be modified for additional information following the merger if the Commission so desires.
>
> Moreover, Staff will audit the annual commission basis earnings report and file an audit report with the Commission. The results of this report can be used to determine if the efficiencies have been achieved. If not, the procedure and actual adjusting entries can then be determined.

Q. What statutory standards govern mergers in the state of Idaho?

A. The Idaho Commission applies the standards which are found in Idaho Code ϶ 61-328. That statute states:

> ...If the commission shall find that the public interest will not be adversely affected, that the cost of and rates for supplying service will not be increased by reason of such transaction, and that the applicant for such acquisition or transfer has the bona fide intent and financial ability to operate and maintain said property in the public service...

Q. What does Staff want the Commission to gain from reading these excerpts for the ScottishPower merger case?

A. There are several points Staff would like to comment on. Mergers are taking place still today where acquisition adjustments are not recovered. Companies enter into mergers without threatening to cancel the merger if regulators don't allow recovery of acquisition adjustments. States approach mergers from their specific perspectives. Regulators must weigh the benefits and costs to determine the best approach for each specific merger case. Various sharing mechanisms including rate reductions, rate freezes, savings sharing and the opportunity to seek recovery in future rate case treatment of acquisition adjustments have all been implemented in mergers.

Q. Can you cite other examples from various states as to how regulatory commissions determine an acceptable treatment of acquisition adjustments?

A. In the state of Florida, generally, the Public Service Commission (PSC) looks for quantifiable merger benefits, which will offset the acquisition adjustment. In fact, the Commission allowed an acquisition adjustment associated with the consolidation of Central Florida Gas Company and Chesapeake Utilities Corporation. In FPSC Order No. 18716, the PSC reserved the right to review the actual savings in a future rate case. And, in the next rate review, the PSC noted that the savings, which were predicted to occur as a result of the acquisition, never, materialized. To the contrary, the company experienced an increase in its revenue requirements since the acquisition. With the absence of savings from which to recover the premium, the Commission removed the acquisition adjustment from rate base (FPSC Order No. 23166).

## SUMMARY/CONCLUSIONS

Q. Please summarize your conclusions and position.

A. My conclusions and position are the following:

**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 JANIS E. FISCHER

STATE OF MISSOURI )
) ss.
COUNTY OF COLE )

Janis E. Fischer, of lawful age, on her oath states: that she has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 78 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

Janis E. Fischer

Janis E. Fischer

Subscribed and sworn to before me this 3rd day of May 2000.

Toni M. Willmeno

Notary Public, State of Missouri
County of Callaway
My Commission Expires June 24, 2000

TONI M. WILLMENO
NOTARY SEAL
NOTARY PUBLIC
STATE OF MISSOURI

UCU/SJLP Merger Case EM-2000-292
Analysis of Personnel UCU Reengineering

EM-2000-292 Synergies
DR26UCUReengineering
JEF

| DR Response #26 | 6/23/94 dated materials Current Employees | Current Disco | % Dollar Change | Rec State | Rec Disco Employees | Change in Dollars | Change in Employees | New Total |
|---|---|---|---|---|---|---|---|---|
| Operations | 2,320 | $88,706 | -26.22% | $65,450 | 1,575 | ($23,256) | (745) | 2,095 |
| Engineering | 77 | $3,111 | -17.13% | $2,578 | 48 | ($533) | (29) | 60 |
| Communications | 20 | $1,684 | -28.74% | $1,200 | 11 | ($484) | (9) | 14 |
| Legal | 12 | $1,518 | -13.37% | $1,315 | 7 | ($203) | (5) | 8 |
| Regulatory/Legislative | 38 | $5,976 | -15.71% | $5,037 | 23 | ($939) | (15) | 26 |
| Human Resources | 72 | $6,078 | -32.54% | $4,100 | 47 | ($1,978) | (25) | 58 |
| Mtrls/Procurement/Fleet Facilities Management | 57 | $7,432 | -7.66% | $6,863 | 71 | ($569) | 14 | 103 |
| Internal Audit | 19 | $1,021 | -21.06% | $806 | 15 | ($215) | (4) | 18 |
| Accounting | 180 | $9,351 | -18.00% | $7,668 | 143 | ($1,683) | (37) | 179 |
| InformationSystems | 121 | $11,379 | 0.00% | $11,379 | 121 | $0 | 0 | 144 |
| Call Center | 35 | $1,050 | 128.76% | $2,402 | 77 | $1,352 | 42 | 95 |
| Marketing/Bus Dev/Econ Dev | 120 | $7,932 | 1.20% | $8,027 | 107 | $95 | (13) | 164 |
| Senior Management | 35 | $6,293 | -26.90% | $4,600 | 26 | ($1,693) | (9) | 31 |
| General Admin | | $3,815 | -26.90% | $2,789 | | ($1,026) | | |
| Benefits | | $20,420 | -26.90% | $14,927 | | ($5,493) | | |
| UCU | 20 | $10,455 | 0.00% | $10,455 | 20 | $0 | 0 | 32 |
| Risk Management | 4 | $3,680 | -17.36% | $3,041 | 3 | ($639) | (1) | 7 |
| Total (excluding operations) | 810 | 101,195 | -13.84% | $87,187 | 719 | ($14,008) | (91) | |
| Total | 3,130 | 189,901 | -19.62% | $152,637 | 2,294 | ($37,264) | (836) | 3,034 |

UtiliCorp United/St. Joe Light & Power Merger
Case No. EM-2000-292
Response to DR #1 and Schedule VJS-2
Incorporating Present Value Calculations into Savings

(Amounts in thousands)

| Savings Area | 2001 | 2002 | 2003 | 2004 | 2005 | 2001-2005 Average | 2006 | 2007 | 2008 | 2009 | 2010 | 2006-2010 Average | Total |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Operating Costs | | | | | | | | | | | | | |
| Dispatching/Generation | 3,820 | 4,358 | 5,196 | 6,021 | 6,687 | | 7,817 | 6,502 | 7,274 | 6,557 | 5,733 | | 59,965 |
| General & Administrative | 5,193 | 5,599 | 5,739 | 5,882 | 6,029 | | 6,180 | 6,334 | 6,493 | 6,655 | 6,822 | | 60,926 |
| Distribution | 1,385 | 1,821 | 1,965 | 2,014 | 2,064 | | 2,116 | 2,169 | 2,223 | 2,279 | 2,336 | | 20,372 |
| Transmission | 315 | 548 | 562 | 576 | 590 | | 605 | 620 | 636 | 652 | 668 | | 5,772 |
| Conversion to UtiliCorp Benefits | 1,996 | 3,022 | 2,976 | 3,401 | 3,626 | | 3,876 | 4,152 | 4,454 | 4,728 | 5,003 | | 37,234 |
| Savings Subtotal | 12,709 | 15,348 | 16,438 | 17,894 | 18,996 | 16,277 | 20,594 | 19,777 | 21,080 | 20,871 | 20,562 | 20,577 | 184,269 |
| **Discounted 11.37%** | **11,412** | **12,374** | **11,900** | **11,631** | **11,087** | **11,681** | **10,793** | **9,306** | **8,907** | **7,918** | **7,005** | **8,786** | **102,333** |
| Transaction/Transition Costs | | | | | | | | | | | | | |
| Severance/Change of Control | | | | | | | | | | | | | |
| Transaction Costs | | | | | | | | | | | | | |
| IT Transition Costs | | | | | | | | | | | | | |
| Total Trans/Trans Costs | (1,509) | (1,509) | (1,509) | (1,509) | (1,509) | | (1,509) | (1,509) | (1,509) | (1,509) | (1,501) | | (15,082) |
| Captial Savings (Costs) | | | | | | | | | | | | | |
| Depr-Interconnect/SCADA/T&D | (285) | (330) | (324) | (318) | (313) | | (307) | (302) | (296) | (290) | (330) | | (3,095) |
| Return on Interconnect SCADA/T&D | (896) | (897) | (841) | (786) | (731) | | (677) | (624) | (571) | (519) | (463) | | (7,005) |
| Total Synergies, net of Cost to Achieve | 10,019 | 12,612 | 13,764 | 15,281 | 16,443 | 13,624 | 18,101 | 17,342 | 18,704 | 18,553 | 18,268 | 18,194 | 159,087 |
| **Discounted 11.37%** | **8,996** | **10,168** | **9,964** | **9,933** | **9,597** | **9,732** | **9,486** | **8,161** | **7,903** | **7,039** | **6,223** | **7,762** | **87,470** |
| Enterprise Support Functions Allocated | | | | | | | | | | | | | |
| SJLP Direct Costs Transferred to ESF | 2,292 | 2,350 | 2,409 | 2,469 | 2,530 | | 2,594 | 2,659 | 2,725 | 2,793 | 2,863 | | 25,684 |
| SJLP Direct Costs Transferred to IBU | 922 | 1,212 | 1,308 | 1,341 | 1,374 | | 1,409 | 1,444 | 1,480 | 1,517 | 1,555 | | 13,562 |
| Support Functions Allocated (In) | (12,375) | (12,685) | (13,002) | (13,327) | (13,660) | | (14,002) | (14,352) | (14,710) | (15,078) | (15,455) | | (138,646) |
| Net Allocations (costs) savings to SJLP | (9,161) | (9,123) | (9,285) | (9,517) | (9,756) | (9,368) | (9,999) | (10,249) | (10,505) | (10,768) | (11,037) | (10,512) | (99,400) |
| Total Synergies, net | 858 | 3,489 | 4,479 | 5,764 | 6,687 | 4,255 | 8,102 | 7,093 | 8,199 | 7,785 | 7,231 | 7,682 | 59,687 |
| **Discounted 11.37%** | **770** | **2,813** | **3,242** | **3,747** | **3,903** | **2,895** | **4,246** | **3,338** | **3,464** | **2,954** | **2,463** | **3,293** | **30,940** |
| Premium Costs | | | | | | | | | | | | | |
| Return on Premium | (10,203) | (9,941) | (9,680) | (9,418) | (9,156) | | (8,895) | (8,633) | (8,371) | (8,110) | (7,848) | | (90,255) |
| amortization of Premium | (2,302) | (2,302) | (2,302) | (2,302) | (2,302) | | (2,302) | (2,302) | (2,302) | (2,302) | (2,302) | | (23,020) |
| Reflect non-tax Deduct of Premium | (1,535) | (1,535) | (1,535) | (1,535) | (1,535) | | (1,535) | (1,535) | (1,535) | (1,535) | (1,535) | | (15,350) |
| Total Premium Cost | (14,040) | (13,778) | (13,517) | (13,255) | (12,993) | (13,517) | (12,732) | (12,470) | (12,208) | (11,947) | (11,685) | (12,208) | (128,625) |
| SJLP Share of Premium Costs | (7,020) | (6,889) | (6,759) | (6,628) | (6,497) | (6,758) | (6,366) | (6,235) | (6,104) | (5,974) | (5,843) | (6,104) | (64,313) |
| Synergies, net of 50% of Premium | (6,162) | (3,400) | (2,280) | (864) | 191 | (2,503) | 1,736 | 858 | 2,095 | 1,812 | 1,389 | 1,578 | (4,626) |
| **Discounted 11.37%** | **(5,533)** | **(2,741)** | **(1,650)** | **(561)** | **111** | **(2,075)** | **910** | **404** | **885** | **687** | **473** | **672** | **2,075** |

| | |
|---|---|
| NPV Total Savings Years 1-10 | 102,333,106 |
| NPV Total to Customers Years 6-10 | 3,419,542 |
| Percent to Customers | 3.34% |

Schedule 2

Dept Example

| Line No. | Description | | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 |
|---|---|---|---|---|---|---|---|---|
| 1 | **SJLP Baseline** | | | | | | | |
| 2 | '99 Budget inflated by 3% | | 1,000 | 1,030 | 1,061 | 1,093 | 1,126 | 1,159 |
| 3 | **UCU Baseline** | | | | | | | |
| 4 | '99 Budget inflated by 3% | | 3000 | 3,090 | 3,183 | 3,278 | 3,377 | 3,478 |
| 5 | **UCU incremental** | | | | | | | |
| 6 | Estimate inflated by 3% | | 300 | 309 | 318 | 328 | 338 | 348 |
| 7 | *Sub Total* | | 3,300 | 3,399 | 3,501 | 3,606 | 3,714 | 3,826 |
| 8 | Portion allocated to SJLP | 25% | 825 | 850 | 875 | 901 | 929 | 956 |
| 9 | Merger Savings | | 175 | 180 | 186 | 191 | 197 | 203 |

**Schedule 3**

UtiliCorp/St Joseph Light & Power Merger
Case No. EM-2000-292
Response to DR 216

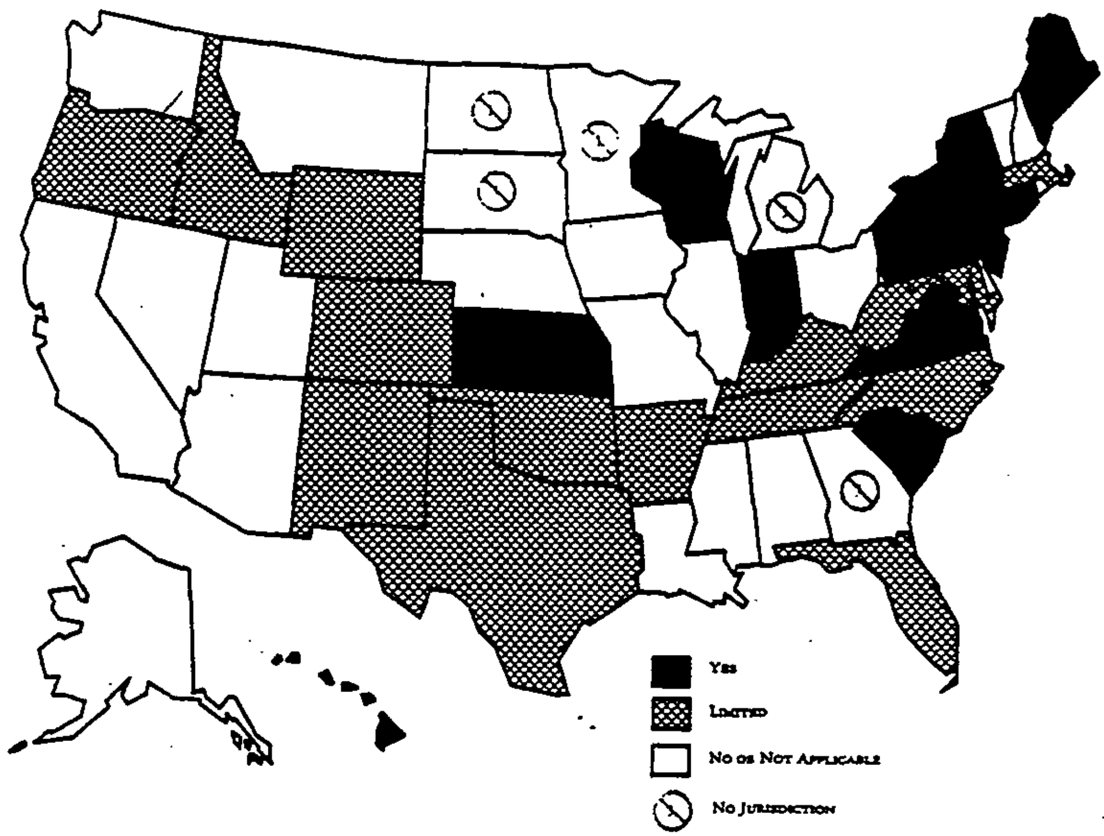
St. Joseph Light & Power Company
Major Budget Variances
Year-To-Date December 1999

| | Incr./(Decr.) thousands |
|---|---|
| OPERATING REVENUES | |
| Electric: | |
| Retail sales and other | (1,554) |
| Sales for resale | 511 |
| Gas | (670) |
| Industrial steam | 52 |
| Manufacturing, net of returns & allowances | (9,246) |
| Total Revenue | (10,907) |
| | |
| FUEL AND INTERCHANGE | |
| Fuel | 1,972 |
| Purchased power-system energy | 480 |
| Resale | (246) |
| Gas | (395) |
| Total Energy Costs | 1,811 |
| | |
| Manufacturing cost of goods sold (2) | (6,906) |
| | |
| Subtotal-Gross Margin (Percy Kent ($2,340) | (5,812) |
| | |
| OTHER OPERATIONS AND MAINTENANCE | |
| Percy Kent (2) | (694) |
| Merger related expenses | 3,141 |
| Strategic planning expenses, over budget | 100 |
| Iatan, primarily postponed scheduled maintenance | (667) |
| Distribution maintenance | (177) |
| Transmission maintenance | 129 |
| Boiler #6 | (281) |
| Turbine #4 | 150 |
| Turbine #7 | 120 |
| Sales and use tax audit | 159 |
| Rate case adjustment for pension & OPEB | (240) |
| Computer O&M, primarily loss of personnel | (226) |
| Safety programs | (133) |
| Insurance, under budget | (208) |
| Procure materials and services | (123) |
| Vacation true-up | 161 |
| Legal services, under budget | (101) |
| G&A transferred to capital items | (184) |
| SERP gain, offset in other | (112) |
| Other generation | (135) |
| Other T&D | (37) |
| Other retail services | (186) |
| Other gas and steam | (85) |
| Other support | (693) |
| Total Operations and Maintenance | (322) |
| | |
| OTHER EXPENSES | |
| General taxes | (290) |
| Depreciation | 226 |
| Total Operating Expense | (5,481) |
| | |
| OTHER EXPENSE (INCOME) | 922 |
| | |
| INTEREST EXPENSE | 718 |
| | |
| INCOME BEFORE INCOME TAXES | (7,066) |
| | |
| INCOME TAXES | (2,108) |
| MINORITY INTEREST | (690) |
| | |
| TOTAL VARIANCE | (4,268) |
| | |
| EFFECT ON EPS | (0.52) |

Schedule 4

# 1.2 Commission Policy

Commissions that have Approved Acquisition Adjustments




Arkansas ⅄
Colorado ⅄
Connecticut
Florida ⅄
Hawaii
Idaho ⅄
Indiana
Kansas
Kentucky ⅄
Maine
Maryland ⅄
Massachusetts (1994 ⅄
New Jersey
New Mexico ⅄
New York (1994)
North Carolina ⅄
Oklahoma ⅄
Oregon ⅄
Pennsylvania (1995)
South Carolina
Tennessee ⅄
Texas ⅄
Virginia
West Virginia ⅄
Wisconsin
Wyoming ⅄

( ) Approximate effective date (if available).
⅄ On a limited basis.



**Schedule 5**

**NAWC Sourcebook 6/23/97**

The survey notes included specific information to the following states survey responses:

- Colorado. When shown to benefit ratepayers.
- Delaware. Acquisitions at original cost.
- Florida. Positive, negative, and no adjustments have been made.
- Hawaii. Book purposes only.
- Indiana. Case specific.
- Maryland. If purchase is in the public interest.
- Missouri. Acquisition adjustments have never been recognized in rates.
- New York. Policy exists.
- North Carolina. On a case-by-case basis.
- Oregon. Only where a net benefit to customers is shown.
- Rhode Island. Acquisitions above book are generally disallowed.
- Tennessee. If utility can prove that excess price above net book benefits existing and new customers.
- Texas. Case-by-case (no laws or rules).
- Virginia. Adjustment no higher than purchase pricing using net book value.
- West Virginia. Debit balances not reflected in operations; credit balances must be ruled on by the Commission.
- Wisconsin. Rate recovery determined on a case-by-case basis in the utility's rate case.