Exhibit No.:	
Issues:	**Transaction & Transaction Costs**
Witness:	**James M. Russo**
Sponsoring Party:	**MoPSC Staff**
Type of Exhibit:	**Rebuttal Testimony**
Case No.:	**EM-2000-292**

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

JAMES M. RUSSO

FILED

MAY 2 2000

Missouri Public
Service Commission

UTILICORP UNITED INC.
AND
ST. JOSEPH LIGHT & POWER

CASE NO. EM-2000-292

Jefferson City, Missouri
May 2000

****Denotes Highly Confidential Information****

NP

Exhibit No. 717

Date 7/ /00 Case No. EM-2000-292

Reporter ACR

REBUTTAL TESTIMONY

OF

JAMES M. RUSSO

UTILICORP UNITED INC.

AND

ST. JOSEPH LIGHT & POWER COMPANY

CASE NO. EM-2000-292

Q. Please state your name and business address.

A. James M. Russo, P. O. Box 360, Jefferson City, Missouri 65102.

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

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

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 have testified in Case No. GR-97-393, Union Electric Company; Case No. EC-98-573, St Joseph Light & Power Company; and Case Nos. HR-99-245, GR-99-246 and ER-99-247, St. Joseph Light & Power Company.

NP

Q. Have you made an examination of the Application filed by Utilicorp United Inc. (UCU) and St. Joseph Light & Power Company (SJLP) (collectively Companies or Joint Applicants) in regard to case No. EM-00-292?

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. The purpose of my rebuttal testimony is to present the Staff's recommendation concerning treatment of the transaction costs and "costs to achieve" (also known as transition costs) that are related to the merger.

TRANSACTION COSTS

Q. Please define transaction costs as they relate to the merger case.

A. Transaction costs are costs incurred by both the acquiring company and the acquired company for the purpose of consummating the merger. Examples of these costs are fees paid for legal, banking and consulting services necessary to close the transaction. The majority of transaction costs will be incurred prior to the merger closing.

Q. How should transaction costs be accounted for?

A. Since these costs are directly associated with the acquisition, they should be included with the acquisition adjustment. The costs identified as transaction costs by the Companies mirror those listed in Accounting Principle Board (APB) Opinion No. 16 which defines costs of a business combination accounted for by the "purchase" method as direct costs of the acquisition (paragraph 76 of APB 16). APB Opinion 16 also states that costs of registering and issuing equity securities are a reduction of the otherwise

NP

determinable fair value of the securities. Indirect and general expenses related to acquisitions are deducted as incurred in determining net income. APB Opinion 16 is the authoritative source for business combinations. Under the "purchase" method of accounting for a business combination, direct out-of-pocket and incremental costs of the combination, including finders' fees and fees paid to outside consultants for accounting, legal, engineering investigations and appraisals, are considered direct costs of the acquisition. The proposed merger of UCU and SJLP will be accounted for under the "purchase" method.

Q. To what Federal Energy Regulatory Commission (FERC) Uniform System of Account (USOA) does Staff propose that transaction costs be charged?

A. The Staff proposes that the transaction costs be posted to Account 425, Miscellaneous Amortization:

> This account shall include amortization charges not includible in other accounts, which are properly deductible in determining the income of the utility before interest charges. Charges includible herein, if significant in amount, must be in accordance with an orderly and systematic amortization program...Items-1 <u>Amortization of utility plant acquisition adjustments, or of intangibles included in utility plant in service when not authorized to be included in utility operating expenses by the Commission.</u> (Emphasis added.)

Account 425 is a non-operating "below-the-line" account and accordingly will not be included in UCU/SJLP cost of service to customers.

Q. How have UCU and SJLP accounted for actual transition costs for the merger to date?

NP

A. UCU and SJLP have accounted for transaction costs by booking them to Account 186.2, Miscellaneous Deferred Debits, which is defined in the FERC USOA as follows:

> To include all debits not elsewhere provided for, such as miscellaneous work in progress, and unusual or extraordinary expenses, not included in other accounts, which are in process of amortization and items the proper final disposition of which is uncertain.

Q. How do the Joint Applicants propose to treat for rate purposes transaction costs associated with the merger?

A. The Companies propose to defer and amortize the transaction costs over 10 years for financial reporting and rate purposes. The Joint Applicants' response to Staff Data Request No. 45 states:

> . . . Briefly, all transaction and transition costs should be offset and amortized over ten years. The synergies created from the merger should be offset by that amortization before any rate reductions are made. Carrying costs on that investment by UCU are not being requested. Effectively, the synergies help pay for the transition and transaction costs.

Furthermore, UCU witness Vern J. Siemek states on line 4, page 8 of his direct testimony:

> "The Costs to Achieve were amortized over the first ten years of the combined operations."

In addition, Mr. Siemek states in his definition of "costs to achieve," on lines 11 through 13, page 6, of his direct testimony that:

> ". . . Cost to achieve also include the legal costs and banker fees to accomplish the transaction. All of these costs are necessary to realize the synergies from the transaction."

NP

The Staff disagrees that legal costs and banker fees should be considered "costs to achieve," but instead believes they should be considered transaction costs.

Q. What is the estimated level of transaction costs for this merger?

A. The Companies' response to Staff Data Request No. 96 refers to Schedule VJS-2 and Appendix VSJ-A of the testimony of Mr. Siemek. Schedule VJS-2 lists transaction costs of $2,575,000 for banker fees and $2,000,000 for other costs. The total of transaction costs for Schedule VJS-2 is $4,575,000.

Schedule VJS-A summarizes transition costs (costs to achieve) and will be discussed later in my testimony.

Q. What amount of transaction costs have actually been recorded by UCU/SJLP?

A. In response to Staff Data Request No. 44, the Joint Applicants state through August 31, 1999 UCU has deferred $698,466 in transaction costs and SJLP, $2,378,126. The following table separates the actual transaction costs that have been incurred by UCU/SJLP through August 31, 1999 into descriptive categories:

Transaction Costs Through August 31, 1999

Type	**UCU TOTAL**	**SJLP TOTAL**
Investment Banker	$ 0	$1,698,696
Consulting Fees	153,030	0
Legal	346,302	571,404
Labor	187,996	0
Special Meetings	0	94,977
Travel & Miscellaneous	11,138	13,049
Total Transaction Costs	$ 698,466	$2,378,126

Q. What is the Staff's general position on transaction costs incurred by UCU/SJLP?

NP

A. The Staff believes that, in general, transaction costs of UCU/SJLP are direct costs of the acquisition and should therefore be treated in the same manner as the acquisition premium. Absent the merger, these transaction costs would not have been incurred. As explained in other Staff testimony, the Staff further believes that the acquisition adjustment is not the responsibility of the ratepayers to pay under the premise of making the "shareholders whole." Likewise, the recovery of transaction costs, as stated in APB Opinion 16, is associated with the amortization of the acquisition premium in purchase transactions and therefore should not be the responsibility of the ratepayers. The Staff believes that the shareholders should absorb the transaction costs since they are seeking the merger as a way to increase the value of their investment. The risks that arise as a result of the merger should be taken by the shareholders since they are the parties responsible for the merger, and the transaction costs represent known costs associated with the risks of the merger. The Staff would also propose as a condition of the merger that the Commission require UCU to continue to track transaction costs so that they may be excluded in future rate cases.

Q. In the event the Commission should decide in this docket to allow the recovery of UCU/SJLP's merger transaction costs, does the Staff have any additional recommendations to make?

A. Yes. The Staff would have the following recommendations for the Commission if the Companies' position for rate recovery of transaction costs is accepted:

- Require that the transaction costs be amortized over 40 years, thus corresponding to the amortization of the acquisition adjustment.

- Allocate a portion of amortized costs to non-regulated companies.

NP

Q. What recovery period would the Staff recommend if the Commission accepts the proposal of the Joint Applicants to amortize transaction costs for rate purposes?

A. If the Commission decides to allow UCU/SJLP to recover the transition costs from ratepayers, the Staff would recommend that the recovery be made over an extended period. For purposes of this case, the Staff proposes that the recovery period for transaction costs be 40 years. The Joint Applicants propose to amortize the acquisition adjustment over 40 years. Since the transaction costs are considered direct costs of the acquisition, it is appropriate for them to be amortized over the same period as the acquisition adjustment. If the transaction costs are amortized and recovered from ratepayers, a portion of the costs should be allocated to the non-regulated operations of UCU and SJLP. The Staff would recommend that 50% of these costs be allocated to non-regulated operations, on the basis that the Joint Applicants have not provided to the Staff any information concerning a reasonable allocation of the acquisition adjustment to non-regulated operations. Finally, the Staff would also recommend that the transaction costs not be included in rate base to the extent that the Commission would allow these cost to be amortized.

COSTS TO ACHIEVE

Q. What are "costs to achieve?"

A. "Costs to achieve" are costs that the Companies will have to incur in order to combine the systems and processes of SJLP into UtiliCorp after a merger is approved. Accounting systems will have to be combined; computers will have to be reprogrammed; procedures and practices will have to be consolidated; call centers will be integrated; and

NP

Human Resources will have to redesign benefit packages for consistency. These changes all have costs associated with their implementation.

Q. Please describe the "costs to achieve" that UCU/SJLP are proposing to recover.

A. More then half of the "costs to achieve" that UCU/SJLP are seeking to recover are associated with workforce transition costs. According to the testimony of Company witness Siemek, page 6, these costs include estimated relocation costs, severance costs and retention payments. Mr. Siemek lists two additional items on lines 4 and 5 of Schedule VJS-2 as "costs to achieve." The first is "Paid Advisory Board-Three Years" in the amount of $432,000 (line 4). The second is "Fund Supplemental Exec Retirement Plan" for $1,620,000 (line 5).

Q. Does the Company identify additional "costs to achieve?"

A. Yes. Mr. Siemek states in his direct testimony, page 6, lines 8 thru 12:

> . . . Costs to achieve also include conversion costs for computer systems to new computer systems, as well as the costs of facilities needed to realize generation synergies. Cost to achieve also includes the legal costs of the Companies and banker fees of SJLP to accomplish the transaction. All of these costs are necessary to realize the synergies from the transaction.

Q. Does the Staff agree with the above statement in Mr. Siemek's direct testimony?

A. No. As stated previously, the Staff believes that the legal costs of the Companies and the banker fees of SJLP are transaction costs and not "costs to achieve." Please refer to my earlier testimony for the Staff's proposed treatment of transaction costs.

NP

Q. What is UCU and SJLP'S estimated level of "costs to achieve" for this merger as stated in Mr. Siemek's direct testimony?

A. UCU's and SJLP's estimate of "costs to achieve" for this merger is approximately $10,507,971 according to Siemek Schedule VJS-2. The following chart identifies the UCU/SJLP estimated costs by category:

Summary of Costs to Achieve Synergies

Distribution Severance	$ 876,739
Officers Severance/retention	3,232,913
Transmission Severance	392,148
Paid Advisory Board-3 Years	432,000
Fund Supplemental Exec. Retirement Plan	1,620,000
Retention Payments for Non-Officers	566,000
Gen Admin Subgroups-Fin Acctg	185,832
Human Resources-Severance	204,000
Information Technology-Severance	476,104
Regulatory/Legislative Severance/relocation	28,500
Generation Severances	489,000
Pricing Marketing Severances	142,735
Total Transition Costs	$ 8,672,971
IT Transition Costs	1,835,000
Total Costs to Achieve Synergies	$10,507,971

Q. What is UCU/SJLP's position on the accounting and rate recovery of "costs to achieve?"

A. Mr. Siemek indicates on page 8 of his direct testimony that UCU will amortize the costs to achieve over the first 10 years of combined operations. This is the same treatment proposed by the Company for what the Staff considers to be transaction costs.

Q. What is the Staff's position as it relates to the accounting treatment and recovery of these "costs to achieve?"

NP

A. The Staff believes in general that prudent actual "costs to achieve" incurred by the Company should be allowed recovery in rates, as the Company will incur these costs in order to create the opportunity for savings if the Commission approves the merger. The Staff recommends that these costs be expensed in the period in which they occur, thereby offsetting any merger savings that are actually realized during the same time period. The direct expensing of the "costs to achieve" also eliminates any problems that could develop later while trying to segregate "costs to achieve" from normal operating expenses. The Company can request recovery of these amounts incurred in future test years in rate proceedings, if desired. The Staff will make rate recommendations concerning the amount of normalized expense recovery of prudently incurred "costs to achieve" at that time.

Q. Why is Staff's position to allow recovery of "costs to achieve" different from its position not to allow recovery of transaction costs?

A. Transaction costs are directly associated with acquisition adjustment and pertain to costs incurred prior to the merger actually taking place. They should be paid by the shareholders since the merger is taking place primarily for the benefit of the shareholders and, absent the merger, these costs would not be incurred. "Costs to achieve," on the other hand, are costs that will occur after the merger is approved. There is a direct correlation between the "costs to achieve" which facilitate the joining of the UCU and SJLP organizations and the merger savings that are estimated to arise following the completion of the integration process. At that point, the customers will hopefully share in the savings that are generated from the merger, and therefore, should also share in the prudent "costs to achieve" merger savings.

NP

Q. What is the Staff's view concerning possible amortization of "costs to achieve?"

A. While the Staff believes that its position to expense "costs to achieve" in the period they occur is most appropriate, the Staff realizes that amortization of "costs to achieve" is another option that the Commission will review. If the Commission orders amortization of these costs, the Staff would recommend a 10-year amortization period. Ten years appears to be reasonable in light of the magnitude of these costs ($10.5 million) and UCU/SJLP's assertion of merger benefits occurring over this period. However, the Staff believes that if UCU/SJLP is allowed to amortize "costs to achieve," they should be carefully defined prior to any accounting deferrals.

Q. If the Commission wishes to make a ratemaking determination concerning "costs to achieve" in this docket, does the Staff believe that all "costs to achieve" identified by UCU/SJLP should be allowed recovery in rates (other than transaction costs)?

A. No. The Staff proposes that costs associated with the Paid Advisory Board, funding of the Supplemental Executive Retirement Plan, and the officers severance/retention plan be excluded from being recovered from ratepayers.

Q. What is the Paid Advisory Board?

A. The Paid Advisory Board will be an advisory board comprised of the former board members of SJLP's Board of Directors.

Q. Why does the Staff propose the exclusion of $432,000 for the Paid Advisory Board from being recovered from ratepayers?

NP

A The Staff has not seen any documentation that would indicate this advisory board will be providing any benefit to the ratepayers.

On page 25 of the transcript of the March 23, 2000, informal interview of Terry F. Steinbecker, CEO of SJLP, Mr. Steinbecker states that the role of the advisory board has not been specifically sorted out. He further states:

> ** ____
> ____
> ____
> ____
> ________________________________ **

Furthermore, the Merger Agreement (Schedule 1 to UCU witness Robert K. Green's testimony) further indicates that the Advisory Board will be involved in advising UCU on such matters as charitable contributions and economic development activities in the St. Joseph, Missouri area. This type of activity on the Advisory Board's part further argues for below-the-line treatment of the Advisory Board fees. Charitable contributions have traditionally never been allowed in customer rates by this Commission, and economic development expenses are subject to a cost/benefit test before inclusion in rates.

Q. Why does Staff propose the exclusion of $1,620,000 for the additional funding of the Supplemental Executive Retirement Plan (SERP)?

A. The Staff believes SERP expenses should not be recovered as a transition cost, because costs to fully fund the SERP for St. Joseph officers appear to be generally of the same nature as executive severance "golden parachutes." Also, when the Staff requested an explanation from the Company in Data Request No. 205, as to why SERP costs were included in "cost to achieve," UCU failed to provide any explanation in its response for SERPs inclusion.

Q. Please provide some of the details of the SJLP Severance Agreements and the UCU Change in Control Agreement (i.e., agreements governing executive separation costs).

A. In the case of SJLP's Severance Agreements, the President and Chief Executive Officer, Vice President-Energy Supply, Vice President-Finance Treasurer and Assistant Secretary, Vice President-General Counsel and Secretary, and Vice President-Customer Services of the Company are included. The agreements provide the executives with approximately three times their annual salary if a change in control occurs. UCU supplied the estimated severance and retention cost by officer for SJLP in Schedule VJS-2.2 in response to Staff Data Request No. 1. A copy of SJLP's employment contract for officers was provided to Staff in response to Staff Data Request No. 17, and a copy of SJLP's amended and restated contract was provided in response to Staff Data Request No. 231.

Q. Have there been any changes made to the executive separation program?

A. Yes. The firm Arthur Andersen was hired to review the existing severance program at SJLP. They issued a report in November of 1998 entitled, "Review of Change-in-Control Compensation Provisions." ** ______________________

____

____

____

______________________________ **

Q. Please explain why the Staff believes that executive separation costs of $3,232,913 should not be recovered in rates.

A. Executive severance packages within an organization are compensation packages that typically guarantee payments to top executives and key employees on the occasion of a takeover, merger or some other related situation to ensure officers' neutrality. The industry refers to these severance packages as "golden parachutes." Payment of such "golden parachutes" does not have any direct correlation or benefit to ratepayers. Instead, these are the costs that benefit only a very few employees, and are primarily created for their personal protection. Staff further believes these costs are shareholder costs, because these severance packages are also designed to ensure the officers' neutrality in considering potential takeovers, sales and acquisitions. The Staff's position, therefore, is that no recovery of these costs from ratepayers is warranted.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

NP

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Joint Application of UtiliCorp United Inc. and St. Joseph Light & Power Company for Authority to Merge St. Joseph Light & Power Company With and Into UtiliCorp United Inc. and, In Connection Therewith, Certain Other Related Transactions.)	Case No. EM-2000-292

AFFIDAVIT OF JAMES M. RUSSO

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

James M. Russo, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 14 pages to be presented in the above case; that the answers in the foregoing Rebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

James M. Russo

Subscribed and sworn to before me this 8 day of May 2000.

TONI M. WILLMENO
NOTARY SEAL
NOTARY PUBLIC
STATE OF MISSOURI

Toni M. Willmeno
Notary Public, State of Missouri
County of Callaway
My Commission Expires June 24, 2000