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Witness: *Mark L. Oligschlaeger*
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

UNION ELECTRIC COMPANY

CASE NO. EM-96-149

Jefferson City, Missouri
May 1996

Exhibit No. 9
Date 9-5-96 Case No. EM-96-149
Reporter KF

REBUTTAL TESTIMONY

OF

MARK L. OLIGSCHLAEGER

UNION ELECTRIC COMPANY

CASE NO. EM-96-149

Q. Please state your name and business address.

A. Mark L. Oligschlaeger, 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. Please describe your educational background and work experience.

A. I attended Rockhurst College in Kansas City, MO, and received a Bachelor of Science degree in Business Administration, with a major in Accounting, in August 1981. I began my employment with the Commission in September 1981 within the Accounting Department. In November 1981, I passed the Uniform Certified Public Accountant (CPA) examination and, since February 1989, I have been licensed in the state of Missouri as a CPA.

Q. Have you previously filed testimony before this Commission?

A. Yes. A listing of cases in which I have previously filed testimony before this Commission is given in Schedule 1, attached to this rebuttal testimony.

Q. Have you made an examination of the books and records of Union Electric Company (UE or Company) in relation to Case No. EM-96-149?

A. Yes, in conjunction with other members of the Missouri Public Service Commission Staff (Staff).

Q. What is the purpose of your rebuttal testimony in this proceeding?

A. The purpose of my testimony in this proceeding is to address UE's proposed ratemaking treatment of the costs and savings associated with its proposed merger with CIPSCO Incorporated (CIPSCO). CIPSCO is the parent company of Central Illinois Public Service Company (CIPS), an electric and natural gas utility operating in the state of Illinois. My testimony will also briefly address certain transmission access and pricing policy issues as they relate to the Company's Application. In addition, I will discuss certain "conditions" that the Staff recommends be placed upon this proposed merger by the Commission before the Application is approved.

OVERVIEW/BACKGROUND

Q. Please describe the events which led up to the Company's Application to merge with CIPSCO.

A. On August 11, 1995, UE and CIPSCO (the Companies) entered into an agreement to merge the two utilities, previously independent of each other, into one registered public utility holding company, later to be named Ameren Corporation (Ameren). Ameren is to be 50% owned by UE and 50% owned by CIPSCO, with UE and CIPS to continue their separate existence as operating companies under the holding company structure. This agreement was publicly announced on August 14, 1995. The Company's Application for approval of the merger was filed with the Commission on November 7, 1995.

Q. How did the Staff conduct its audit and investigation of the Company's Application in this proceeding?

A. To obtain more data and information from which to better make recommendations to the Commission in this proceeding, we submitted data requests to both UE and CIPSCO and also conducted interviews of both Companies' personnel. In certain cases, the interviews conducted were transcribed by court reporters. When this procedure was followed, the UE/CIPSCO employees had the opportunity to revise the transcript to make corrections and expand upon the responses given in the interview, if desired.

Q. In general, what are the amounts of the savings and costs that UE asserts in its direct testimony will result from its proposed merger with CIPSCO?

A. In testimony, UE estimates that a total of $590 million of savings will result from this transaction in the first ten years of the merger. (Unless otherwise noted, all numbers referenced in this testimony are applicable to the combined company, encompassing both UE and CIPS, and are not Missouri jurisdictional.) The Company also estimates that it and CIPS will incur $22 million of "transaction costs" and $19 million of "costs to achieve" (transition costs) in bringing about the transaction and implementing the merger, respectively. These costs will be addressed in the rebuttal testimony of Staff Accounting witness Thomas M. Imhoff. In addition, UE alleges that a "merger premium" of $232 million was paid by UE stockholders to CIPSCO stockholders in order to undertake the proposed merger.

Q. In what areas are savings expected to result because of the merger, and in what amounts?

A. On page 11 of the direct testimony of Company witness Gary L. Rainwater, savings are indicated as being expected in the following categories at the following amounts, applicable for the period 1997-2006:

- $204 million in administrative and general expenses
- $196 million in staffing reductions
- $84 million in electric production savings
- $69 million in purchasing economies
- $37 million in natural gas economies

Q. What is UE's proposal for reflecting merger savings and costs in its rates over the first ten years of the merger?

A. UE's proposal can be found on pages 17-26 of Mr. Rainwater's direct testimony. In essence, UE is proposing a two-step process for treating the merger for ratemaking purposes: 1) the Company would be allowed dollar-for-dollar recovery of the "merger premium" and other merger related costs, and 2) UE would "share" on a 50/50 basis with customers the residual amount of merger savings which remain after the merger costs are recovered. This residual amount of merger savings, after the "merger premium" and other costs are deducted, will be referred to hereafter as "net savings".

Q. Is UE's rate proposal in Missouri identical to the rate proposal sponsored by UE and CIPSCO before the Illinois Commerce Commission (ICC)?

A. At least in concept, the approaches sponsored in the two jurisdictions appear to be substantially the same.

Q. Are the merger costs and savings proposed to be passed on to current UE and CIPS customers?

A. Yes. The Companies' proposals call for a portion of the merger savings to be flowed to both current UE and CIPS customers, and would also have both sets of customers bear a proportionate share of the "merger premium" and other merger costs.

Q. Does the Company propose to use actual savings and cost amounts resulting from the merger on which to base future ratemaking treatment of the merger?

A. No. UE's recommendation is to use its current estimates of merger savings and costs (as of November 1995) for ratemaking purposes over the first ten years of the transaction (i.e., 1997-2006).

Q. How does the Company propose to reflect the sharing of estimated net savings levels with customers in future rates?

A. As discussed on pages 19-20 of Mr. Rainwater's direct testimony, UE proposes to adjust its actual cost of service in any future rate proceedings in the next ten years to reflect its retention of half the estimated net savings plus to charge its customers the appropriate amount of what it contends is the "merger premium" and other merger related costs. UE's proposal is to allocate the purported "merger premium" and other merger costs to cost of service over the ten year period in relation to the flow of expected savings from the transaction over the period 1997-2006. The estimated savings from the merger by year for that period can be found in Schedule 8 of Company witness Rainwater's direct testimony.

Q. Based on the Companies' proposals, how much of the total gross merger savings of $590 million would be assigned to shareholders and customers, respectively?

A. The Companies' proposal in concept would first assign approximately $273 million of merger savings to the shareholders, in order to compensate them for the asserted "merger premium" and other merger related costs. Then, the remaining $317 million of merger savings (i.e., the "net savings") would be split equally between shareholders and ratepayers, leaving $158.5 million of the savings to accrue to customers. This amount represents approximately 27% of the total gross merger savings with 73% of the savings going to shareholders. Schedule 2 to this testimony contains calculations of the intended flow of savings to customers and retention of savings by the Companies under their ratemaking proposal, showing how the saving percentages cited above were derived. This Schedule assumes that "traditional" ratemaking mechanisms will be used to provide merger benefits to customers.

Q. Are customers certain to receive 27% of the gross merger savings under UE's proposal?

A. No. The percentages given in Schedule 2 necessarily assume that a ratemaking mechanism would exist to ensure that the merger savings and costs are passed on to ratepayers in the indicated manner for each of the first ten years of the merger. To the extent there is not such a mechanism, the effect of "regulatory lag" would change the quantifications of the relative split of savings between shareholders and customers discussed above. (Regulatory lag is the difference between the time a change in a utility's cost of service occurs and the time when that change is reflected in the utility's rates charged to customers.) In general, the effect of any regulatory lag during the period 1997-2006 would be to increase the relative share of gross merger savings retained by shareholders compared to the share to be flowed to customers.

In addition, UE's specific proposal for handling merger savings and costs in the context of the current Missouri "Experimental Alternative Regulation Plan" (Incentive Plan) for that Company would also, in all probability, lead to customers receiving considerably less than 27% of the gross merger benefits for the duration of the Incentive Plan. This will be discussed in more detail later in this testimony.

Q. Does UE currently operate under a unique ratemaking procedure in Missouri?

A. Yes. A Stipulation And Agreement was filed with the Commission by UE, the Staff, the Office of Public Counsel and other parties on June 12, 1995 creating docket No. ER-95-411 which, among other things, called for implementation of an "Experimental Alternative Regulation Plan" for UE. The Commission approved the Stipulation And Agreement in its Report and Order in Case No. ER-95-411 on July 21, 1995. The Incentive Plan provides for rate credits to be issued to customers in the years 1995-98 in the amount of 50% of any UE earnings between 12.61% and 14.00% return on common equity (ROE), if the Company earns above the 12.61% level. Under the Incentive Plan, any earnings above a 14.00% ROE are returned 100% to customers through the bill credits. Any credits will be based on UE's earnings results for the twelve month periods July 1, 1995 through June 30, 1996; July 1, 1996 through June 30, 1997; and July 1, 1997 through June 30, 1998. Therefore, merger savings will impact the financial results of the second and third years of the Incentive Plan, assuming the merger is consummated in 1996 or the first half of 1997.

Q. Has UE made a proposal to incorporate the financial impact of the merger in the existing Incentive Plan?

A. Yes. UE has proposed to adjust its earning calculations under the Incentive Plan to bring above-the-line (include in cost of service) the applicable amount of the purported "merger premium" as a cost to UE, and treat above-the-line the other assorted merger costs for that financial period, as well as add to cost of service half of the net merger savings estimated for that period, in order for the shareholders to retain a portion of the savings. This proposed treatment is specified on page 25 of Mr. Rainwater's direct testimony, and pages 8-9 of Company witness Warner L. Baxter's direct testimony.

Q. Will all of UE's estimated merger savings potentially be handled through the current Incentive Plan?

A. No. The current Incentive Plan is intended to reflect the results of UE's electric operations only, not its Missouri gas operations. As previously noted, the Companies are projecting that $37 million of gas cost savings will be attributable to the merger for the years 1997-2006. Although the numbers found on Schedule 8 to Mr. Rainwater's direct testimony assume that gas cost savings can be shared 50/50 between shareholders and customers in the same manner as electric savings, there is currently no ratemaking mechanism in Missouri that will accomplish this sharing for gas savings. If these savings occur, and are eligible for recovery through the current Purchased Gas Adjustment/Actual Cost Audit (PGA/ACA) process, these savings will be passed on to customers in entirety. If a portion of the savings are not eligible for PGA/ACA treatment, they will be retained by UE in total until a gas rate proceeding is initiated. This matter is also discussed in the rebuttal testimoy of Staff witness Michael J. Wallis of the Commission's Procurement Analysis Department.

Q. What is the Staff's position on UE's ratemaking proposal for treating the savings and costs associated with its proposed merger with CIPSCO?

A. The Staff is opposed to UE's ratemaking proposals in this Application, and recommends that the Commission reject them as being unjust, unreasonable and detrimental to the public interest. The Staff believes the Company's proposal is unacceptable for the following reasons:

1) UE's proposal is premised upon use of estimated savings and costs to set rate levels in the future. These estimated amounts are not known and measurable and cannot be determined with sufficient accuracy to justify use in the setting of rates for up to ten years in the future.

2) The ultimate result of the Company's proposal is to guarantee to shareholders recovery of well over half the total savings benefits related to the proposed merger, leaving the ratepayers entirely at risk for attaining their inequitable share of merger benefits under UE's proposal.

3) The Company's proposal is inequitable in that it will lead to the assignment of the vast majority of merger benefits to shareholders. The Company's proposal for handling merger impacts in the current Incentive Plan is especially skewed towards the shareholders, in that in most circumstances over 85% of the merger benefits would be retained by shareholders under the Incentive Plan.

4) The UE proposal is also premised on recovery of an alleged " merger premium" that in fact will not appear anywhere on Ameren's financial statements, due to the accounting treatment applicable to this particular transaction. Therefore, UE is inappropriately seeking rate recovery of a non-existent financial cost.

Staff Accounting witnesses Cary G. Featherstone and Charles R. Hyneman are addressing the issue of the "merger premium" in their rebuttal testimony. Mr. Featherstone also addresses the question of the appropriate definition of "not detrimental to the public interest". All of the other points listed above will be explained in more detail in this testimony.

USE OF SAVINGS ESTIMATES

Q. How does the Staff define the term "known and measurable", and what is its significance?

A. A "known and measurable" expense is defined by the Staff as: 1) "known," meaning that the amount is an actually incurred cost; and 2) "measurable," meaning that the rate impact of the change can be calculated with a high degree of accuracy. The significance of this term is that historically the Commission has only reflected in rates those revenue requirement changes that were known and measurable at the time the rate decision was made.

Q. Please describe the process by which the estimate of $590 million in gross savings from the merger contained in UE's direct testimony was developed.

A. As discussed in Company witness Thomas J. Flaherty's direct testimony, the firm of Deloitte & Touche Consulting Group (Deloitte & Touche) was hired by the Companies before a merger agreement had been reached to assist them in developing an expected level of merger savings or "synergies" to result from the transaction. The direct testimony of Mr. Flaherty describes in general terms the work performed and the assumptions used by Deloitte & Touche and the Companies in developing the savings estimates.

Q. What was the intent behind the preparation of the Deloitte & Touche merger synergies estimate?

A. The engagement letter between Deloitte & Touche and the Companies dated July 17, 1995, (provided in response to Staff Data Request No. 19) called for Deloitte & Touche to produce a "definitive estimate" of potential merger savings attributable to the transaction. In his interview of April 1, 1996, Mr. Flaherty indicated that, in the context of the engagement letter, "definitive estimate" referred to an estimate reflecting "what we would have called a board ready or board quality level of information sufficient to support board decision" [Flaherty interview, Transcript page 10].

Q. Has the Staff reviewed the Deloitte and Touche merger synergies estimates?

A. Yes. I have reviewed Mr. Flaherty's testimony and the supporting workpapers for all merger savings areas except electric production cost and gas cost savings. (The workpapers were provided in response to Staff Data Request No. 1.) Electric production costs are addressed in the rebuttal testimony of Staff witnesses Thomas Y. Lin and David W. Elliott of the Engineering Section of the Commission's Energy Department. Natural gas cost savings are addressed in the rebuttal testimony of Staff witness Wallis.

Q. As a result of your review, what conclusion has the Staff reached as to the applicability of the Deloitte & Touche savings estimate to the ratemaking process?

A. In the Staff's opinion, these estimates are not an adequate basis for the setting of rates in the near term, much less for a ten year period. From the documentation that we reviewed, it is clear to the Staff that Deloitte & Touche's and the Companies' work was by necessity "broad brush" in nature, and not designed to produce a detailed, supported estimation of merger savings. In the Staff's opinion, the Deloitte & Touche savings estimates are not known and measurable.

Q. Please provide examples of how the Deloitte & Touche savings estimates are not detailed or supported.

A. Deloitte & Touche's projections of savings are based on the following estimation techniques, as outlined in Mr. Flaherty's direct testimony, page 9: "direct analysis" (use of actual costs and changes to these costs based on planned consolidation activities); "estimation" (determination based upon more limited analysis of actual data); and "comparison to other transactions" (utilization of expectations in other proposed utility mergers as a proxy for the UE and CIPS impacts). Not surprisingly, based particularly on use of the last two estimating techniques, many of the projected cost savings are stated very generally. For example, Deloitte and Touche's workpapers frequently reflect an expectation that savings for a given category of costs would be 10% of the combined companies' costs, or 25% of the smaller company's stand-alone level of costs, or some other percentage of one or both utilities' costs. The Deloitte & Touche workpapers provide no back-up or support whatsoever for how these percentages were derived. When challenged in the pending ICC

UE/CIPS merger docket as to the supportability of these estimates, Mr. Flaherty responded in rebuttal testimony that "management" believed that the estimated percentage savings of the type cited above were "reasonable". He provided no further documentary support for the estimated savings beyond what was contained in Deloitte & Touche's workpapers. UE/CIPS managements' perception of what savings levels are "reasonable" in a given area is, to put it simply, insufficient analysis and support on which to base ratemaking treatment of savings for any period, let alone an extended period.

Q. Over what period of time was the Deloitte & Touche work performed on behalf of the Companies?

A. According to the documentation reviewed by the Staff, and verified by Mr. Flaherty in his interview of April 1, 1996, Deloitte & Touche's work on merger synergy estimates was generally performed between July 10-August 8, 1995 (Flaherty Transcript p. 5). Mr. Flaherty himself estimated that he spent just above 20% of his time during that period on UE/CIPSCO synergy work, with minimal field work. Four Deloitte & Touche subordinates worked full or part-time on this project during this period, according to Mr. Flaherty (Flaherty Transcript pp. 5, 76).

Q. Has Mr. Flaherty and Deloitte & Touche previously performed work on estimating merger synergies for other merger transactions that have included the Missouri jurisdiction?

A. Yes. Mr. Flaherty was hired by Kansas Power and Light Company (KPL), now Western Resources, Inc., in relation to its planned acquisition and merger of Kansas Gas and Electric Company (KGE) that was before this Commission in 1991 in Case

No. EM-91-213. Mr. Flaherty assisted KPL in developing estimates of KPL-KGE merger synergies relating to the first five years of that merger transaction.

Q. How much time did Mr. Flaherty and Deloitte & Touche spend on the merger synergy estimation process for KPL/KGE?

A. In his interview, Mr. Flaherty indicated that he and other Deloitte & Touche employees spent over two months working on the KPL/KGE merger synergy estimates, with Mr. Flaherty himself spending an average of four days a week on-site at KPL (Flaherty Transcript p. 76). Deloitte & Touche's work for UE and CIPSCO was clearly performed in a much more compressed time frame than its similar work for KPL/KGE.

Q. What are you suggesting respecting Deloitte & Touche's synergy study?

A. The Staff is not alleging that the nature and timing of Deloitte & Touche's work for UE and CIPSCO was inappropriate for the purpose of developing a general merger saving estimate for planning purposes in advance of the merger agreement. The Staff is though disagreeing with UE that such an analysis is appropriate to use in setting rates for an extended period of time and noting items of relevance respecting the work performed by Deloitte & Touche.

Q. Are UE and CIPSCO continuing to rely on the Deloitte & Touche estimate of savings of $590 million in planning for the merger implementation process?

A. No. After the merger agreement was signed in August 1995, UE and CIPSCO entered into a joint "Transition Management Task Force" process (Transition Process) to develop an approach for implementing the merger. The Transition Process is described on page 8 of Mr. Rainwater's direct testimony. One of the purposes of the Transition Process was to develop more detailed savings estimates of the synergies to be expected from this combination. Eighteen task forces were created to examine the operational issues of combining the two companies, and to develop new savings estimates for labor and non-labor costs in each of the functional areas covered by each task force.

Q. Can you provide any additional information regarding the Transition Process?

A. Schedule 3 is the Company's response to Staff Data Request No. 179. This response contains a description of the different stages of the Transition Process, the documents that are associated with each stage, the expected due dates for each stage and the date each stage was actually completed. While page 8 of Mr. Rainwater's direct testimony reflects that the Companies planned originally for the transition planning work to be completed by the end of March 1996, Schedule 3 shows that the Company pushed the completion date for the Transition Process back to mid-April 1996. It was also the Staff's understanding that the new savings estimates would be available when the so-called "final Should Be" reports referenced in Schedule 3 were completed in March 1996; later we learned that the new estimates would not be available until the "Implementation Reports" were to be issued in April 1996. The Staff did not receive complete information concerning the new Transition Process savings estimates until April 20, 1996. Accordingly, the Staff has not had an adequate amount of time to review the new synergy estimates even for the limited value that the Staff believes they have. Since the Staff does not believe that the new synergy estimates are of more than very limited value, the Staff does not believe that a delay in these proceedings is necessary to provide the parties more time to review these new estimates. In any case, the Staff does not believe the Transition Process savings estimates are known and measurable.

Q. Please compare and contrast the timing and the level of effort employed in the Deloitte & Touche and Transition Process savings estimation processes.

A. As previously discussed, Deloitte & Touche and the Companies spent approximately one month putting together the initial synergies estimates. In contrast, the Transition Process process started in August-September 1995 and is not entirely complete as of the date of filing this testimony. The different nature of the Deloitte & Touche and Transition Process estimating processes is illustrated by the following statement in Company witness Gary Rainwater's rebuttal testimony in Illinois:

> Our original merger savings estimate required hundreds of man-hours of effort between UE, CIPS, and Deloitte and Touche. A more detailed savings estimate, which we are currently engaged in as part of our merger implementation planning process, has required thousands of man-hours.

Q. How do the Transition Process savings estimates compare to the Deloitte & Touche estimates sponsored in UE's direct testimony?

A. Gross merger savings as estimated in the Transition Process are $717 million, compared to the Deloitte & Touche estimate of $590 million. Labor savings under the new estimates are $255 million compared to $196 million estimated in the Deloitte & Touche analysis. For non-labor savings, the Transition Process amount is $462 million compared to the Deloitte & Touche estimate of $394 million. "Costs to achieve", however, increased from $19 million in the Deloitte & Touche analysis to $73 million in the new savings study. This leaves approximately $644 million in merger savings calculated in the Transition Process analysis, net of "costs to achieve".

Q. Given the new estimates of savings and costs, is the Staff still opposed to the use of estimated net merger savings to set future rates?

A. Yes. Even if the new savings estimates developed by the Companies turn out to be better supported and more detailed than the earlier Deloitte & Touche estimates, we still believe the appropriate policy is to base future rate levels on actual savings results from the merger rather than rely on estimates. No matter how well supported merger savings estimates may be, such estimates are based on too many unknown factors and speculative assumptions on which to base rates. In particular, this is true when considering a ten year period, as the Company proposes. Use of estimates to set rates also will inherently expose either the Company's shareholders or customers to the risk that actual merger savings and costs will be materially different from the estimates on which the rates would be based.

Q. Can you give an example of a "speculative assumption" that is used in the Companies' synergy estimates?

A. Yes. Both the Deloitte & Touche savings study and the subsequent Transition Process savings analysis develop first year savings estimates attributable to the merger, and then generally escalated the first year savings by 3.5% per year to determine the full ten year savings. (Estimated electric production savings are not escalated in this manner). The use of an escalation factor reflects the belief that first year savings should become greater in amount in succeeding years due to the impact of inflation. While this belief has some general plausibility, attempting to estimate an inflation rate applicable to UE expenses for the next ten years is so inherently highly speculative that it is mere guess work. Even though a 3.5% escalation assumption may be a reasonable estimation under the circumstances, so might 3%, 2.5%, or 4%. The approach of escalating first year expenses for nine additional years also reflects an implicit assumption that UE would be unable to take any steps absent the merger to reduce or eliminate these particular expenses and this level of expenses for the next ten years. This assumption does not seem reasonable.

Q. Do you have specific concerns with the use of a 3.5% escalation rate in the savings analysis for UE?

A. Yes. A 3.5% escalation factor may not accurately reflect UE's recent success in holding down increases in its non-fuel operation and maintenance (O & M) expenses, nor reflect the increasing emphasis UE and other electric utilities may be placing on holding down O & M expenses due to expectations of greater competitive pressure in the electric industry. A possible example of one or both of these points is that UE's O & M expense total (after deducting power production expenses) actually declined in 1995 compared to 1994 levels, according to information contained in UE's Federal Energy Regulatory Commission (FERC) Form No. 1 filed with the Missouri Commision.

Q. Are there other examples of the speculativeness of the Companies' synergy estimates?

A. Yes. Both the Deloitte & Touche and Transition Process analyses include savings related to "cost avoidance", which is defined in Company witness Flaherty's direct testimony as follows: "The total cost of service is reduced as a result of this merger from the ability to forego certain types of parallel expenditures." Most of the Companies' savings estimates relate to elements of cost that either or both companies are incurring, but which UE and CIPS project can be reduced or eliminated because of the merger. Reflection of "cost avoidance" in the estimates takes the speculation one step further: first, the Companies project that a cost not currently incurred would be incurred at some point in the future on a stand-alone basis; second, the Companies assume that the merger would eliminate the need to incur the cost at all in the future. Use of "cost avoidance" in synergy studies may have conceptual merit for some purposes, but the Staff does not agree that future rates should be based under any circumstances on this type of speculation.

Q. Does the Company intend to revise its savings sharing plan as shown on Rainwater Schedules 8 and 10 to reflect the new synergies estimate that has resulted from the Transition Process?

A. Apparently not. The response to Staff Data Request No. 55 (attached as Schedule 4 to this rebuttal testimony) indicates that UE still intends to use the Deloitte & Touche savings estimate of $590 million as the basis for its rate proposal for the next ten years.

RATE GUARANTEES

Q. You earlier mentioned that the use of merger synergy estimates to set rates would place the risk of any difference between actual savings and estimated savings on either shareholders or ratepayers. Can you explain this in more detail?

A. Yes. If estimated merger savings are used to set rates and significant differences arise between actual and estimated merger costs and savings, either a rate windfall or detriment will result, depending on the structure of the rate plan. The merger ratemaking proposal put forward by UE in this case puts the risk of actual savings being less than estimated savings squarely on its ratepayers.

Q. Please elaborate.

A. The best way to illustrate this point about the Company's plan is to use the example set forth by Company witness Rainwater in his direct testimony on pages 19-20:

> . . . consider the year 2000, the fourth year following the merger assuming it is completed at the end of 1996. We expect that the merger will reduce UE's and CIPS' combined costs in that year by $52.8 million. That is 8.96 percent of the $590 million of total savings over ten years, so we would charge 8.96 percent, or $24.5 million, of our merger investment as a pro-forma cost of service in that year. That leaves approximately $28 million in net savings, which would be split equally between stockholders and customers, i.e., $14 million would be charged as a pro-forma adjustment to UE's and CIPS' costs of service and $14 million would be made available to benefit customers.

Keeping in mind that the proposed use of up-front merger estimates to set rates means that the amount of any cost of service adjustment to effectuate a sharing of merger benefits will be fixed in advance, consider what would happen if the actual savings resulting from this merger significantly diverge from the estimates on which Mr. Rainwater's Schedule 8 are based. For example, if actual savings from the merger in the year 2000 were $20 million, the Company would still propose its cost of service adjustment to provide itself with $14 million of estimated savings, leaving only $6 million to customers. If actual savings were $35 million, UE would retain $14 million of that amount, leaving the residual of $21 million of savings to its ratepayers. And if actual savings were zero, UE's approach would still assign itself $14 million of estimated savings, leaving customers worse off by $14 million.

Q. Will it be possible to compare actual merger savings to estimated savings at any point?

A. According to the Company, it is all but impossible to "track" or monitor actual savings resulting from a merger transaction (Rainwater direct, page 24; Baxter direct, pages 10-11). The rationale of the Company for that assertion is that measurement of actual savings requires a baseline for comparison; in other words, a knowledge of what UE's and CIPS' expense levels would be on a stand-alone basis without the merger. Any such "knowledge" is equivalent to sheer guesswork or speculation, in the Company's opinion. On this belief, the Staff is in fundamental agreement with UE, as I will explain in more detail later.

Q. What is the importance of the Company's rate proposal in this Application as it relates to customer risk?

A. The Company is in effect guaranteeing itself up-front at least 73% of the estimated benefits of this transaction (based on the Company's proposal to recover the "merger premium" and other costs), leaving the customers with absolutely no guarantee that their 27% share will accrue to them. Using the ratemaking process to transfer merger risk from the Companies to its customers does not provide a reasonable level of "fairness" to customers. What UE is proposing is detrimental to the public interest.

Q. What incentives are placed upon UE to maximize merger savings under its rate proposal?

A. There is no incentive built into UE's proposal to maximize merger savings after the merger is implemented, because essentially UE would receive the benefit of the vast majority of estimated savings regardless of what the actual amount of savings will be. Moreover, even if the actual amount of savings were to exceed estimated levels, all of the excess would go to ratepayers under UE's ratemaking proposal, leaving little incentive from UE's perspective to aggressively capture savings. Under its proposal, UE will not gain from achieving greater savings than estimated, nor will it be impaired if it fails to achieve the estimated level of savings. UE's proposal is not "incentive regulation" as the term is commonly understood.

Q. Would the Staff's position potentially be different if the risk were placed on UE that actual savings may be different than estimated savings?

A. Yes, if such an approach were practical and achievable. Theoretically, the concept that a utility would be bound by and at risk for the estimated level of merger savings it put forth to justify the transaction for regulatory purposes has some attractiveness. Unfortunately, in the context of any regulatory plan to "share" merger savings, such a scheme does not appear to be practicable.

Q. Please explain your reasoning.

A. Keep in mind that conceptually a ratemaking plan using estimated savings levels as the basis for definitively sharing those savings should place the risk of achieving those savings levels on the merging companies, which is the exact opposite of the plan UE has put forward in this Application. Under this alternate approach, the customers would be guaranteed a set amount of the estimated merger savings over a period of time, with the shareholders responsible for any shortfall in achieving the estimated savings level, and also deriving the benefit if actual savings exceeded the estimated amounts. The problem arises because current ratemaking practices (either under traditional ratemaking or the Incentive Plan presently in place for UE) are designed to pass on to customers the impacts of the utility's actual financial results; i.e., any savings to a utility from a merger would be flowed to customers at the time rates are set. However, in designing an approach that puts merger ratemaking risks on the companies involved, one must be careful to make sure that customers only receive their pre-set share of estimated merger benefits, and do not also receive all or a part of the differential between actual and estimated merger savings. This necessarily assumes an ability to measure or " track" actual merger benefits, so rate adjustments can be made to ensure that customers only receive the pre-determined share of savings and shareholders alone receive the benefit or detriment from any difference between actual and estimated savings.

Q. Is such a tracking mechanism to measure actual merger savings over time feasible?

A. In the Staff's opinion, no. As noted earlier, the Staff is in essential agreement with the arguments made by Company witnesses Rainwater and Baxter that any such tracking mechanism would be in essence impossible to put in place. There is simply no intelligible way to recreate the financial results for a hypothetical entity (i.e., UE or CIPS on a stand-alone basis) one year into the future after a merger is implemented, much less ten years. The Staff has made arguments similar to UE's position in this case against merger savings tracking in Case No. EM-91-213, the KPL/KGE merger case.

Q. Does the Company's opposition to detailed merger savings tracking have any relevance to the Staff's arguments against using estimated merger savings and costs estimates to set rates?

A. In the Staff's view, yes. Mr. Rainwater states on page 24 of his direct testimony the following:

> Tracking and documenting merger savings would require comparing actual costs against hypothetical costs, costs which would have occurred without the merger, but did not occur because the merger eliminated them. Those hypothetical costs are inherently unknowable, and attempting to track them for ten years following the merger would be literally an impossible task.
>
> A Commission imposed tracking requirement would only lead to prolonged second guessing and debate about hypothetical costs, and would burden both the Commission and Company for an extended period . . .

Please note that the Companies' merger synergy estimates can be accurately defined as a comparison of "actual costs against hypothetical costs", with the amount of the savings measured by the difference between actual post-merger costs levels and "costs which would have occurred without the merger, but did not occur because the merger eliminated them". While the Company rejects a tracking mechanism on the basis that such hypothetical costs are "unknowable", this perception does not prevent the Company from proposing to use "unknowable" merger savings amounts to set customer rates for ten years. This is neither logical nor consistent.

Q. What is the implication of the Staff's opposition to tracking in regard to a sharing approach that puts merger savings risk on the Company?

A. Given the Staff's position that tracking is not feasible, the Staff does not believe that an approach to share estimated merger savings that properly puts the risk/incentive on utilities is practical to implement. If use of merger savings estimates for rate purposes cannot be effectuated without placing significant risk on customers, then reflection of actual merger savings and costs in rate calculations would be a reasonable alternative if the risk to customers from the merger is minimized by the approach used, and if customers receive a fair allocation of the actual benefits achieved. The Staff's ratemaking proposal for this merger, which involves reflection of actual merger savings and costs in rates, will be explained later in this testimony.

INEQUITABLE SHARING OF BENEFITS

Q. Under UE's ratemaking proposal, what is the maximum amount of merger savings that can flow to customers?

A. As previously described, the maximum percentage of total benefits customers can expect to receive if UE's proposal is followed is 27%. Under some circumstances, ratepayers would receive less than 27% of the total savings under the Company's plan.

Q. Is this an equitable allocation of merger benefits between shareholders and customers?

A. Not in the Staff's opinion. The Company's proposal would charge customers in full for the costs of the merger, while reserving a large majority of the savings resulting from the merger for retention by the shareholders. The Company's proposal is unfair and skewed to its own advantage, and is detrimental to the public interest.

Q. When you state your belief as to the inequity of the Company's sharing of savings proposal, are you taking into account all of the alleged merger costs that UE has claimed should be considered in that type of analysis?

A. No. The Company has asserted that there are "costs" associated with the return on its alleged merger premium "investment" and the income taxes associated with "merger premium" recovery, and that these alleged "costs" are being assumed by shareholders under UE's rate proposal. The Staff believes that neither of these items should be considered to be "costs" of the merger, nor should they be considered in an analysis of ratepayer/shareholder benefit. I will explain each of these points in turn.

Q. Please explain your position on the required "return on" the merger premium.

A. In his direct testimony on page 20, Mr. Rainwater explains that UE's proposal to recover the $232 million "merger premium" in rates over a ten year period represents recovery of that amount only, not a return on the premium. Mr. Rainwater states that UE is willing to forego direct recovery in rates of a return on the "merger premium" in hopes of making this amount up through its retention of a portion of net savings.

The reference to the need for UE to recover by some means a return on the "merger premium" relies upon an assumption that the "merger premium" is an "investment" that would normally be placed in rate base on which the Company could or should earn a return. As is explained more comprehensively in the rebuttal testimony of Staff witnesses Featherstone and Hyneman, UE will be using the "pooling of interests" method to account for the merger transaction. The pooling of interests accounting procedure is based on the theory that this combination does not represent an acquisition by one entity of another, or an acquisition of assets, but rather a combination of shareholder interests. With the pooling of interests treatment, under no circumstances will there be any write-up of assets due to this transaction, or any additional investment reflected on UE's, CIPS' or Ameren's balance sheet. Accordingly, the merger itself will not lead to any additional rate base investment. UE's attempt to assert that there is a cost associated with a return on the "merger premium" is completely contradictory to the accounting method it intends to use for the transaction.

Q. Is there an income tax impact related to UE's rate proposal to recover the "merger premium"?

A. Yes. Again, it should be kept in mind that under a pooling of interests form of merger there will be no booking of a "merger premium", and no amortization of a "merger premium" for financial reporting purposes. Accordingly, if the Company succeeds in collecting the "merger premium" as a purported cost in rates when there is no recognized financial cost, the financial statement impact of that collection would be increased revenues with no offsetting increases to expense, resulting in an increase to the Company's return on equity. Increases in return on equity are fully taxable, so UE would have to factor up the amount of the "merger premium" by the current income tax gross-up (approximately 62%) to make itself whole for the income taxes due on any recovery of the "merger premium".

Q. Is it the Company's position that there are additional income taxes payable due to recovery of the purported "merger premium"?

A. Yes. While this fact is not addressed in the testimony filed by UE before this Commission, rebuttal testimony filed by UE witness Jerre E. Birdsong before the ICC in the UE-CIPSCO merger docket specifically references the income tax consequences of the

Companies' rate proposal. Company witness Donald E. Brandt also agreed that there is a tax impact in his interview on March 28, 1996 (Brandt Transcript p. 23).

Q. Is the Company seeking recovery of the additional income taxes related to recovery of the purported premium from its customers?

A. No. The amounts shown on Rainwater Schedule 8 that reflect UE's proposal to charge customers for the purported "merger premium" do not reflect a factor-up of that amount for income tax purposes. Mr. Brandt confirmed in his interview that UE considers these income taxes to be a cost to the shareholder in this case (Brandt Transcript p. 25).

Q. Should any additional income taxes related to "merger premium" recovery that are the responsibility of shareholders be considered a "cost" of the merger?

A. No, they are more accurately defined as a cost of UE's ratemaking proposal. A pooling of interests merger is intended to have no tax consequences to shareholders. In fact, the Joint Proxy Statement of UE-CIPSCO and Prospectus of Ameren (provided in response to Staff Data Request No. 50) references the tax-free nature of this transaction as a specific benefit considered by the Board of Directors of both Companies in approving the merger proposal.

The only reason there would be additional taxes payable to taxing authorities as a result of this transaction is a result of UE's request for direct recovery of the "merger premium" in rates, notwithstanding the fact that no "merger premium" amount will ever be recognized for financial statement purposes. In fact, an advantage of the Staff's merger savings rate proposal (the specifics of which will be discussed later) is that the taxes associated with direct "merger premium" recovery can be avoided. UE's willingness for its shareholders to assume the tax consequences of its "merger premium" recovery proposal in no way makes that proposal more reasonable or justified.

Q. Before turning to the Staff's ratemaking proposal for this merger, are there any other problems with the Company's ratemaking approach that you wish to address?

A. Yes. UE's approach to sharing merger savings in the context of the current Incentive Plan is also objectionable.

Q. How does the Company describe its approach to sharing merger savings within the life of the Incentive Plan?

A. Mr. Rainwater describes UE's approach to sharing in the context of the existing Incentive Plan in his direct testimony on page 25:

> The amortized portion of our merger costs, including one-half of net savings as shown in Schedule 10, should be accounted for above the line as on adjustment to cost of service.

Q. What is wrong with this approach?

A. Note that UE's intent is to adjust its cost of service under the existing Incentive Plan so as to provide itself half of the estimated net savings for the applicable period. The purpose of this cost of service adjustment would be clear in a traditional rate case setting, in that such an adjustment is necessary if one desires to provide 50% of merger savings to shareholders instead of automatically passing along all savings to customers. However, the intent of the Incentive Plan is to already explicitly share 50/50 all earnings of UE between a 12.61% and 14.00% ROE in any case; there is no need to adjust cost of service under the Incentive Plan to provide half of the net savings to shareholders if the earnings effect of the merger savings causes the Company's ROE to be within the indicated 12.61%

to 14.00% band. Therefore, the Company's proposal to make an adjustment to the existing Incentive Plan earnings effectively exempts half of the net merger savings from sharing with customers at all.

Q. Please explain.

A. As previously discussed, the Incentive Plan is intended to equally share earnings between certain levels of ROE 50/50 between customers and shareholders; i.e., a 50/50 split of that part of the Company's earnings between a ROE of 12.61% and 14.00%. The Company's overall approach to treating merger savings is asserted to be a 50/50 split of savings between customers and shareholders (after covering the purported "merger premium" and the other claimed merger costs). However, within its proposal for treating merger savings in the Incentive Plan already in place, the Company would not flow 50% of net merger benefits to customers in accordance with the existing plan; instead, it would first make an "adjustment" to exempt half the net merger savings from sharing at all - that half would go entirely to the Company. Then, and only then, would the remaining half of net savings be eligible for 50/50 sharing between UE and its ratepayers. In practical terms, this additional Incentive Plan "cost of service adjustment" will likely lead to customers receiving less than the 27% of gross merger savings that has been previously identified in Schedule 2 as the probable customer share of gross savings under "traditional regulation" from the Company's proposal.

Q. Can you show by means of a Schedule what you just described?

A. Yes. Schedule 5, attached to this testimony, provides an example of how the portion of net merger savings eligible for sharing with customers will be calculated under the

Company's Incentive Plan merger rate proposal. Schedule 5 utilizes the Deloitte & Touche total UE/CIPS merger savings and costs estimates for the year 1997 that are found on Schedule 8 of Mr. Rainwater's testimony, as allocated to Missouri using the factor of 58.70% for "UE retail electric" found on Rainwater Schedule 10. Schedule 5 to this testimony shows the total UE electric merger savings estimated for 1997, the amount that would be retained by UE to compensate for the "merger premium" and other merger costs, and the half of net savings retained by UE through the "cost of service" adjustment. The residual amount in Schedule 5 represents that portion of net savings that is eligible for sharing with customers through the existing Incentive Plan grid.

Q. What percentage of merger savings will likely flow to customers under UE's proposed sharing of savings during the pendency of the current Incentive Plan?

A. UE's shareholders would first retain approximately 46% of the gross merger savings to compensate for the alleged premium and other merger costs. One half of the remaining 54% of merger benefits would be retained by the shareholders through the proposed Incentive Plan "cost of service adjustment". The remaining 27% of merger benefits would then be available for sharing on a 50/50 basis with customers. Assuming the impact of merger savings stays within the 12.61% to 14.00% ROE sharing band, under the Company's proposal only 13.5% of the total merger benefits would go to UE ratepayers, with 86.5% being kept by the Company. Under any circumstances, this is an inadequate allocation of merger benefits to ratepayers.

Q. Under the existing Incentive Plan, would customers receive only 13.50% of the merger benefits under all circumstances?

A. No. As mentioned before, earnings are only shared under the Incentive Plan between a 12.61%-14.00% ROE range. If the Company's earnings after taking merger savings into account amount to less than 12.61%, then no savings at all would be passed on to customers. If the Company's earnings are above 14.00%, then customers would receive all of the net merger savings eligible for sharing.

Q. What is Schedule 6 to your testimony?

A. Schedule 6 to this testimony is a set of calculations that show the ranges of customer benefit possible within the Incentive Plan format under the Company's proposal. Schedule 6 incorporates the amounts used in Schedule 5 relating to expected 1997 merger net savings that are eligible for sharing with customers in Missouri, and shows the amounts and percentages of the net merger savings that would be passed on to customers under various earnings scenarios. Schedule 6 shows that, out of total estimated UE electric gross savings of $22.4 million in 1997, the maximum portion that would be allocated to customers would be $6.03 million under the Incentive Plan proposal, and the minimum amount would be zero.

Q. Has the Company confirmed your understanding of their position on merger savings sharing within the Incentive Plan, as discussed above?

A. Yes. Company witness Rainwater confirmed this understanding in his March 27, 1996 interview:

> Mr. Oligschlaeger: But as it applies to the incentive agreement, as I understand your proposal, it will call for recovery of the premium and one half of the net, remaining net merger savings, before any sharing of savings is calculated for customers; is that correct?

Mr. Rainwater: That's correct. (Rainwater Transcript p. 29)

. . . . Mr. Oligschlaeger: You may have already addressed this but, just so it's clear to me, what is the purpose of the adjustment under the incentive grid to give back half of the net merger savings? From my perspective it's not necessary to. If what you wanted was a 50/50 split of net merger savings, you don't have to make that adjustment. Why should that additional increment go back to the company?

Mr. Rainwater: The short answer to your question is that we just did not consider that in our proposal. We looked at the proposal in more general terms. Because it's a long-term proposal, because there is almost no overlap between the incentive agreement and the time that we're proposing to recover the premium. So we disregarded it.

Mr. Oligschlaeger: So it's more like for purposes of your proposal you took what your overall approach would be and just applied it to the remaining term of the incentive plan without adjusting it for the incentive plan?

Mr. Rainwater: That is correct. Yes, and we've addressed that in testimony. Just to make it clear on how we are proposing that. And your interpretation is correct. But in developing our overall proposal it was my view that the overall proposal was developed independent of the incentive plan. (Rainwater Transcript pp. 31-33)

Q. Are you saying that it is possible that customers will receive none of the merger savings under some circumstances, if UE's proposal is adopted?

A. Yes.

Q. Is it possible under any circumstances for the shareholders to receive no merger benefits under the Company's proposal?

A. No. The minimum share of savings shareholders will retain under the UE proposal is 73% of gross savings, as previously noted.

Q. Is UE's proposed treatment of merger savings within the Incentive Plan consistent with the overall terms and conditions of the Incentive Plan?

A. No, not at all from the Staff's view. The Incentive Plan calls for a specific sharing between customers and shareholders within a certain ROE range. UE's proposal for handling net merger savings within the Incentive Plan effectively exempts merger savings from the 50/50 sharing specified within the Plan for merger earnings changes, to the detriment of ratepayers.

Q. Taken as a whole, will UE's ratemaking proposal for merger costs and savings be detrimental to the public interest?

A. Yes. Given the reliance in UE's proposal on the use of estimated merger savings and cost data to set rates, which by the Company's own admission cannot be verified in the future, and given that UE's proposal places the risk of failing to attain these estimated savings projections on UE's ratepayers, UE's ratemaking proposal is detrimental to the public interest. Within the current Incentive Plan, the Company is seeking guaranteed recovery of the "merger premium", other merger costs, and half of the net savings before any sharing of merger benefits with customers take place. The Commission should not approve UE's merger Application unless the Staff's ratemaking proposal offered herein is adopted in place of the Company's proposal.

STAFF RATEMAKING PROPOSAL

Q. Is it the normal practice for the Staff to make ratemaking recommendations in the context of a merger application?

A. No, it is not. Normally, the Staff would recommend that any ratemaking implications that might exist that relate to a merger application only be considered by the Commission in the next rate proceeding for the involved utility. However, the existence of the Incentive Plan complicates that approach as the potential for merger costs and savings affecting credits that UE customers might otherwise receive under that plan is very great. The merger transaction costs incurred by the Company to date will impact the first year of the Incentive Plan and, if UE's Application is approved, both merger savings and costs will have a high probability of impacting the second and third years of the Incentive Plan. In order to specify an approach for handling merger savings and costs in the overall context of the Incentive Plan, the Staff believes it must address presently in this docket ratemaking treatment for the merger for at least the duration of the Incentive Plan.

Q. Does the Staff believe that any of the benefits that may result from the merger should be allocated to shareholders if the merger is authorized by the Commission?

A. Yes. The Staff believes that it is good policy to allow shareholders some opportunity for retention of benefits from mergers and acquisitions, as well as other actions undertaken that have the potential to increase efficiency and productivity. Such retention of a portion of benefits is possible under traditional ratemaking as well as with structures like the Incentive Plan. For example, under traditional regulation, use of "rate moratoriums" would generally allow utilities to retain merger benefits for a period of time through regulatory lag. Rate moratoriums, of course, also serve to protect customers from any short-term cost of service increases that may result from implementation of mergers and acquisitions.

Q. What is the Staff's recommendation for recognizing merger related costs and savings in the Incentive Plan?

A. The Staff recommends that actual gross merger savings be flowed through the existing earnings grid in the Incentive Plan to be split 50/50 between customers and shareholders within the ROE range of 12.61% to 14.00%. If the Company's earnings are below a 12.61% ROE after merger savings are taken into account, the Company will retain all the savings; if the Company's earnings are above a 14.00% ROE after merger savings are taken into account, the customers will gain all of the savings. No direct recovery of the alleged "merger premium" by the Company should be allowed, for the reasons given in the rebuttal testimony of Staff witnesses Featherstone and Hyneman. Transaction costs and "costs to achieve" should be amortized to cost of service over a 20 year period, as discussed in the rebuttal testimony of Staff witness Imhoff.

Q. Why does the Staff believe its approach is preferable to the Company's proposal?

A. While the Staff's proposal provides UE with the opportunity to gain from any merger synergies that are created as a result of the merger, the risk that such savings be achieved is clearly and appropriately placed upon UE. To the extent actual merger synergies are less than what the Companies have estimated, then UE will retain a lesser amount of benefits through the ratemaking process. To the extent UE actually attains a higher level of savings than currently estimated, UE will share in the incremental amount of the increase.

In addition, the Staff's proposal would treat merger related synergies no different than nonmerger related savings or efficiencies within the Incentive Plan. The Staff believes that there is no good reason to differentiate between merger related and nonmerger related savings in the ratemaking treatment afforded such savings. The Staff in particular believes that it is not appropriate to provide merger savings more favorable treatment under the Incentive Plan than other operational savings are afforded, as the Companies' proposal does.

Q. Does this approach expose customers to financial risk if the merger is ultimately uneconomic?

A. From the customers' perspective, the merger would be uneconomic if the costs of the merger passed on to them in rates exceed the benefits which are flowed through to them in rates.

The position of the Staff in this case on recovery of the purported merger premium works to significantly reduce this particular risk to customers. If the Company's proposal for ratemaking treatment were to be approved, then the benefits of this transaction must exceed $273 million ($232 for the merger premium plus $41 million for the transaction costs and "costs to achieve") over a ten year period to be economic for ratepayers. Under the Staff's proposed approach, as long as the benefits of the merger exceed the amount of transaction costs and "costs to achieve" that are passed on to ratepayers over 20 years in rates, then the ratepayers are better off from the transaction, and the sharing of savings through the Incentive Plan would not be detrimental.

Q. Are there any absolute guarantees that the merger savings will exceed the amount of the merger costs (total transaction costs and "costs to achieve") if these merger costs are given rate recovery treatment?

A. No. However, the Staff believes that this risk is minimal, for several reasons. First, achievement of at least some savings level from this transaction should certainly be attainable. While the Staff cannot concur with the Company's specific estimate of savings from the Deloitte & Touche analysis or the Transition Process estimate, the Staff believes it is reasonable to expect that prudent management should be able to produce the level of savings needed over a 20 year period to offset transaction costs and "costs to achieve".

In addition, in his interview Mr. Flaherty described areas of possible cost savings from the merger that have not been quantified, such as savings from increased participation in the interchange market and in cost of capital (Flaherty Transcript pp. 45-46). The existence of possible benefits in these unquantified areas also serves to reduce ratepayer risk.

Finally, the Staff's proposed ratemaking would provide the Company with definite incentives to maximize the merger savings produced as a result of the merger, by allowing the Company the opportunity to retain a share of the potential benefits, rather than a guarantee.

Q. Does the Company intend to perform any work to ensure that some level of savings are achieved through the merger?

A. Yes. On page 11 of his direct testimony, Company witness Baxter addresses the Company's intent to "review" savings and "monitor changes in businesses processes" to ascertain whether savings are being generated from the merger. The Company's response to Staff Data Request No. 43 provides more detail on these points:

> For the reasons cited in the testimonies of Mr. Baxter (pages 10 and 11) and Mr. Rainwater (page 24) Union Electric does not intend to track and document actual merger savings. Instead, the Company will review the savings which are expected to be achieved and monitor the changes in the business processes to see if they are consistent with the changes in processes required to achieve the projected savings. This task will essentially be a two-step process. First, the Transition Management Task Force will ensure that the transition task teams will, at a minimum, establish plans which will achieve the expected annual savings. The transition teams are currently developing these plans. These plans, as well as the Transition Management's Task Force review and approval of these plans, are expected to be completed by March 1996. Once these plans are established, Union Electric will monitor the steps proposed to be undertaken in the plans to achieve the savings. To the extent that the steps outlined in the plan to achieve the savings are not being performed on a timely basis, management will take appropriate steps to ensure that those steps, or alternative steps, are taken.

The Staff concurs with UE's intention to monitor its business processes and review savings levels prospectively, and requests that copies of all documentation used in such reviews be provided to the Staff on an annual basis for the first ten years of the merger.

Q. Would UE have an opportunity to recover the alleged premium under the ratemaking approach proposed by the Staff in this case?

A. Yes, though it should be kept in mind that the Staff's primary motivation in proposing this particular ratemaking approach is not to guarantee the recovery of an alleged merger premium. Nonetheless, it is possible that the Company can generate sufficient savings so that the amount of savings it can retain under the Incentive Plan provides a partial or total contribution towards the alleged merger premium. Sharing of savings would provide UE the opportunity to receive indirect recovery of the purported premium amount, but the burden would be on the Company to actually generate enough savings in order to allow that recovery to occur. That is fundamentally different from the Company's suggested approach, which gives UE upfront recovery of the purported merger premium regardless of the amount of actual savings created by the merger.

Q. Is this indirect approach to allowing the Company the opportunity to recover the alleged merger premium inconsistent with the expectations of the financial community?

A. No. In fact, Goldman Sachs (UE's financial advisor for the merger), in its analysis of the financial impact of the merger to UE shareholders which was produced prior to the merger agreement, appears to have assumed that UE for ratemaking purposes would receive half of the gross merger savings rather than 100% of the alleged "merger premium" and other costs, and then half of the remaining merger savings. The comments of the financial community concerning the UE merger also generally reflect an expectation that gross merger savings would be shared equally by UE and its customers. These points are explained in more detail in the rebuttal testimony of Staff witness Featherstone. A sharing of gross merger savings 50/50 between shareholders and customers (after recovery of prudently incurred transaction costs and "costs to achieve") is essentially what the Staff is suggesting as the appropriate rate treatment in this proceeding.

Q. Are shared savings through the Incentive Plan the only possible source of recovery for the Company of the alleged "merger premium"?

A. No. As previously mentioned, under the Incentive Plan sharing of earnings with the Company's customers does not start until a 12.61% ROE is attained. The difference between the first sharing point of 12.61% and the level an authorized ROE would ordinarily be set at is commonly termed the "deadband", wherein the utility is allowed to retain 100% of that level of earnings. If one considers that a "deadband" exists in the Incentive Plan, then it would logically follow that the amount of earnings that UE retains above the "actual" ROE level to the 12.61% point constitutes a contribution to its purported "merger premium".

Q. Does the Staff intend for its ratemaking recommendations in this proceeding to continue for a full ten year period, as the Company's savings sharing proposal does?

A. No. The Staff's proposal in this case is premised specifically upon the existing Incentive Plan regulatory format. The Incentive Plan as an experiment is scheduled to terminate in 1998. In the last year of the Incentive Plan the applicable parties are to consider the future course of regulation for UE given the scheduled termination of the Incentive Plan (i.e., should the Incentive Plan be extended in its present or in a revised form, or should there be a reversion to traditional ratemaking). Without knowing more details presently as to what form this Commission's regulation of UE will take beyond June 1998, the Staff believes that it is best that ratemaking treatment of the merger impacts for UE beyond June 1998 be reserved for that later time. (It should be noted that if the Incentive Plan does expire in 1998 and traditional ratemaking is again applicable for UE, then 100% of any merger benefits will flow to the Company until the point at which a rate change is implemented, either at the instigation of the Company or another entity, such as an excess earnings complaint case which the Commission might authorize the Staff to file).

Q. In its direct testimony, does UE give any indication as to its position regarding an extension of the Incentive Plan?

A. Yes, it does. On pages 20-21 of his direct testimony, Mr. Rainwater seems to express an openness to the idea of extending the term of the Incentive Plan.

Q. What are your comments on this?

A. Given that the first year of the Incentive Plan has not been completed at this time, it is premature to recommend extension of this plan without firm knowledge of how the Incentive Plan will work in practice. However, if the current Incentive Plan does prove to encourage efficiency on the part of the Company and the sharing of the benefits of those efficiencies with customers, the Staff would certainly consider an extension of the concept underlying the Incentive Plan at the appropriate time.

Q. Does the Staff recommend any modifications to the Incentive Plan to accommodate the proposed merger with CIPSCO?

A. No, not to the Incentive Plan itself. However, a modification should be made to Attachment C, "Reconciliation Procedure", to the Case No. ER-95-411 Stipulation And Agreement, allowing for above-the-line treatment of transaction costs and "costs to achieve" in the manner recommended in the rebuttal testimony of Staff witness Imhoff.

Q. Is the existing sharing grid included in the Incentive Plan still appropriate in light of the merger?

A. The Staff does have a concern that the beginning sharing point under the present Incentive Plan of 12.61% ROE may lead to UE retaining a large portion or all the merger synergies even when its overall earnings levels might be robust, as judged by traditional or conventional standards. However, this concern should be viewed in the context that UE has not had book earnings below a 13.00% ROE since 1985, and that any merger savings that are actually produced by this merger will have the effect of pushing earnings levels even higher. In fact, UE issued a press release on April 19, 1996, in which it projected a credit would be issued to Missouri electric customers related to the first year of the Incentive Plan (i.e., earnings for the period July 1995 to June 1996 are projected to be in excess of 12.61%, as calculated under the Incentive Plan.) Therefore, the Staff believes that overall the best approach in this proceeding will be to keep the negotiated results of Case No. EM-95-411 in place for the duration of the plan (with the one minor exception noted above).

Q. If the Commission is concerned about the impact of the "deadband" on sharing results with the customer under the present Incentive Plan, are there alternatives that the Commission might consider?

A. Yes. If the Commission believes that some benefits of the merger definitely should be flowed to customers under the Incentive Plan regardless of what the sharing result would be under the current grid, then an approach mandating minimum merger related credits could be utilized. Under this approach, the actual credits (if any) produced under the Incentive Plan would be compared to a minimum level of merger benefits, and the larger of the two amounts would be used as a customer credit. If this approach were used, the Staff would recommend that the minimum merger benefit be based on 25% of the expected gross merger benefits for the period currently projected by the Company in its Application, as shown on Rainwater Schedules 8 and 10. Use of this approach would require a modification to the current Incentive Plan.

TRANSMISSION ISSUES/COMPETITION

Q. What is "market power"?

A. For purposes of this testimony, I am defining "market power" as the ability of a market participant to charge prices above competitive levels for a product or service in the market being examined. In the context of electric utility regulation, market power implies an ability by the utility to earn monopoly profits in the electric marketplace. Therefore, one of the purposes of utility regulation is to restrain electric utilities' inherent market power in the provision of electric service.

Q. Is market power a concern in the review of utility mergers and acquisitions?

A. Generally, yes. The increased size of the merged company is thought to provide that entity potential advantages in whatever competitive or quasi-competitive markets it may be involved. Currently, the wholesale generating marketplace is perceived as becoming increasingly competitive for various reasons, such as the Energy Policy Act of 1992 and including the effect of regulatory initiatives at the FERC level itself. UE and CIPS currently, and Ameren prospectively as the parent corporation, are and will be active participants in the wholesale generating marketplace.

Q. Does FERC examine issues of market power in its review of merger proposals?

A. Yes. Market power is a current concern to FERC due to its regulatory initiatives to encourage competition in the wholesale generating market. FERC has expressed particular concern that continued unrestrained monopoly operation of utilities' transmission systems may impede or prevent the development of truly competitive generation markets.

Utilities, through control of transmission assets, may potentially prevent possible competitors from serving wholesale customers, or alternatively charge unreasonable prices for transmission service which would have the impact of making competitors' generation offerings less competitive. For this reason, FERC in general, and for merging companies specifically, has required certain steps be taken to restrain utilities' monopoly control of their transmission system.

Q. What steps has FERC required of merging utilities (and more recently, all electric utilities) respecting their transmission systems?

A. Primarily the filing of "open access" transmission service tariffs, as specified since March 1995 by the pro forma network service and point-to-point tariffs in the so-called "MegaNOPR", i.e., in Notice of Proposed Rulemaking Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Services by Public Utilities, Docket No. EM-95-8-000, and Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Docket No. RM94-7-001. These pro forma tariffs were intended to require electric utilities to offer to third party users fair and impartial access to their transmission facilities at prices determined through a standard formula. Issuance of the final rules by FERC occurred on April 24, 1996.

Q. Have UE and CIPS filed open access tariffs as required by FERC?

A. Yes, as part of their merger application before that regulatory body. In testimony filed before the FERC, the Companies witnesses assert that the tariffs vary only in minor ways from the specifications for such tariffs outlined in the MegaNOPR.

Q. Has the Staff made an extensive examination of market power issues in this Application before the Commission?

A. No, for several reasons. First, since any market power implications of the UE/CIPSCO transaction extend well beyond the Missouri jurisdiction, it seems appropriate for the FERC to be the primary forum for the examination of these issues. Second, the actions taken by UE and CIPS as they relate to transmission policy and pricing matters alleviate, at least in part, some concerns that the Staff otherwise would have had relating to market power.

Q. What concerns has the Commission expressed in the past in regard to market power and transmission policy?

A. The Commission, in comments to FERC in past proceedings including the MegaNOPR, has expressed general support for the concept of competitive wholesale generating markets. Among the impediments the Commission has identified to formation of such competitive markets are certain transmission pricing practices generally referred to as "pancaking" which is the ratemaking practice of each transmission provider between the third party generation supplier and the generation customers charging transmission users a fully embedded price based on a "contract path" methodology. The effect of pancaking is to make transmission service inordinately expensive for potential generation supplier competitors and loads located in particular in different control areas, thus impeding potential generation competition. This Commission has recommended that regional transmission pricing methodologies be investigated to better facilitate wholesale generation competition.

The Commission's perspective on the transmission rate pancaking issue is described in more detail in its pleading entitled "Notice of Intervention, Request for Hearing and Motion to Consolidate" filed in FERC Docket Nos. EC96-7-000 and ER96-679-000, respecting Union Electric Co. And Central Illinois Public Service Co. The pleading reads, in part, as follows:

> The MoPSC, along with the State commissions of Arkansas and Kansas, has argued for the creation of regional, multiutility transmission rates to reduce the inefficiencies caused by pancaking. A growing number of parties have made similar arguments.
>
> The present pattern of inter-regional transmission charges conflicts with the goal of an efficient regional market. Transmission owners located within a "contract path," drawn on the map between the contractual generation source and the contractual load, frequently assert a right to charge for transmission service associated with the transaction. This assertion is based on the incorrect notion that electrons flow serially from the contractual source to the contractual load. The result of these separate charges is a "pancaking" of transmission charges exceeding actual costs.
>
> The combination of these independent charges can force a transmission customer to buy more transmission capacity that the physical transaction requires. Pancaking thus inflates the cost of delivered bulk power, distorts the efficient pricing of generating resources and violates the principle of comparability. It forces cost-effective bulk power options out of the market. At the same time, transmission owners whose facilities are not located on the "contract path", but yet are affected by flows caused by the contractual transaction, may not be compensated. (Pages 5-6)

Q. Do UE's and CIPS' transmission pricing proposals, as reflected in their filed FERC open access transmission service tariffs, serve to mitigate anti-competitive pancaking practices?

A. Yes, to a degree. UE's and CIPS' tariffs offer transmission service to third party users at a rate reflecting the combined transmission costs of both Companies, which eliminates any pancaking effect. By allowing competitors more economical access to Ameren's transmission facilities, the tariff tends to reduce Ameren's potential market power. However, the Missouri Commission has argued before FERC in a number of dockets that regional transmission pricing, involving all or most of the utilities in a given area, is required to mitigate potential market power that results from use of pancaked transmission pricing.

Q. Have either UE or CIPS become involved in any regional transmission pricing initiatives?

A. Yes. Schedule 7 to this testimony is UE's response to Staff Data Request No. 186, which contains UE's concurrence in a Memorandum of Understanding respecting the "Midwest Independent System Operator (ISO) Initiative". ISO refers to a structure in which utilities' transmission systems would be operated by an independent third party with the intent of denying the owning utilities' the ability to operate their systems in a manner designed to maintain competitive generation advantages for themselves. The Midwest ISO initiative was recently announced by CINergy Corporation and American Electric Power Company and involves other utilities generally in the Midwestern area of the United States. Formation of ISOs would be a further step beyond the open access transmission tariffs themselves in restraining potential market power by electric utility companies.

Q. What are UE's current plans in regard to participation in the Midwest ISO Initiative?

A. Company witness Maureen A. Borkowski described the status of UE's participation in the Midwest ISO Initiative in her March 20, 1996 interview:

> Q. [Mr. Oligschlaeger]: Reading the trade press, there has been a proposal or an initiative to set up an independent system operator for, I guess, a transmission network involving American Electric Power and CINergy and some other utilities generally to the east of UE and CIPS. You're aware of that?
>
> A. [Ms. Borkowski]: Yes. We submitted our letter last week, I believe, to begin participation in that group.
>
> Q. Begin participation. To become part of the ISO group or to investigate becoming part of it?
>
> A. The Midwest ISO group as it's currently structured is a group that has at this point agreed to endorse certain principles regarding the use of the transmission system and those parties have agreed to begin working toward the development of a Midwest ISO that would be an aggregation of transmission users in the Midwest area. Their initial region that they would encompass would be MAIN [Mid-America Interconnected Network] and ECAR [East Central Area Reliability Council]. ECAR is the reliability council to the east of us. That includes Indiana, Ohio, some of Kentucky, Michigan, basically those states. We have agreed to participate in the working groups that will begin trying to put some detailed substance to what would constitute this ISO with the objective of by the end of 1996 having a filing prepared that would describe that ISO in detail.
>
> Q. Is this initiative the same one I mentioned earlier involving AEP and CINergy?
>
> A. Yes. The Midwest ISO is what it's called.
>
> Q. So my understanding is clear, is this an endorsement of the ISO concept or are you more just investigating the concept to determine whether it will ultimately be something UE or CIPS can join into?

A. There are lists of thirteen principles and in order to participate in the development process you must indicate that you generally endorse those principles, although they do understand that some people may have specific reservations with certain aspects and that the detailed development would determine whether or not you can ultimately endorse and actually desire to become a member of the ISO. So, at this point in time it's a participation process that says we share a common interest as described in these principles and will work toward a detailed development. Every party is free at any point during the development of the proposal or even once the proposal is developed if they internally feel they can't support that, that it's not in the best interest of their customers to withdraw.

Q. I would presume perhaps that UE's interest in exploring this concept is to some degree tied into FERC's interest in exploring this concept?

A. No. I would say that's not a correct characterization at all. In fact, our primary interest is that the industry is changing and we want to participate within that change but within the conditions that we want to make sure the stakeholders who Union Electric and Ameren represent that their interests are protected. I do believe that other participants in the ISO share our concerns that transmission revenue requirement is expected to be recovered in whatever sorts of grid wide tariffs, if any, the ISO would decide to pursue and that there's a fair and equitable procedure, policy, tariff in place to balance these interests among the native load customers and other third-party users and to have price and priority of use be equitably balanced.

Q. The involvement with the Midwest initiative, I assume CIPS is involved as well at this point or will be involved?

A. At this point in time CIPS attended the initial introductory meeting which we were all invited to. [CINergy] is actually the company who chairs the Midwest ISO group at this point. As I mentioned, they invited all of the MAIN and ECAR transmission owning utilities to attend. CIPS attended the initial meeting. They have not to my knowledge at this point submitted a letter stating that they are intending to

> participate. They are still discussing that in-house. (Borkowski Transcript pp. 21-24).

Q. Does the Midwest ISO initiative involve investigation of the use of regional transmission pricing?

A. It would appear that the answer is "Yes." The Memorandum of Understanding states in part:

> The ISO will develop implement and administer a regional transmission tariff and an equitable revenue distribution procedure which will seek to satisfy each members' transmission revenue requirements.

I would note that Mr. Rainwater stated at his March 27, 1996 interview that UE's position on regional transmission pricing is wariness and skepticism:

> Mr. Oligschlaeger: Does UE, CIPS, Ameren have a current position on the establishment of regional transmission rates that would have the effect of eliminating of the so-called pancaking effect of multiple transmission rates?
>
> Mr. Rainwater: We joined the Midwest ISO group. And a position on regional rates was one of the principles that that group subscribed to. Our view on that is that if regional transmission rates can be developed which are fair and compensate all of the members of the regions for the use of their transmission, then we would support that. The difficulty of doing that is in a voluntary kind of setting, arriving at an agreement among twenty different companies on how that can be done, and was it fair to everybody.
>
> Most everyone in the industry would agree that there is -- I am choosing my words very carefully here. There is no consensus on the correct way to set transmission rates which is truly cost based and fully compensatory for any company that owns transmission. There is a wide range of theories on that.

> Most everyone agrees that the postage stamp rates that are being used now have some flaws. There is not an agreement on which way rates should go ....
>
> ... That's a decision that every company needs to look at on its own and make its own judgment in regard to is our company made whole by that change relative to where we are now.
>
> And that's a very hard to question to answer because when you change transmission arrangements, a lot of things change. Not just your transmission rate but with the power market that company participates in is also affected and that company's ability to use the power market to reduce its generation costs for its own customers is affected.
>
> And companies need to look at that from a retail customer's interest and point of view and decide whether that's a positive or a negative.
>
> We would not support a change that would be detrimental to our retail customers. That's our basic position. I gave you a long answer on where we stand on the issue. That's our basic position. We would not support a change that would be detrimental to our customer, but we are working with a group that is interested in developing that kind of rate.
>
> So we'll look at that. We'll look at the tradeoffs involved in making a judgment whether or not we can participate in that without harming our customers.
>
> • • • •
>
> [Mr. Oligschlaeger]: . . . if this merger goes into effect and Ameren Corporation, would CIPS and UE have the autonomy to decide separately whether to enter into such an agreement? Could, for example, CIPS decide not to do that while UE decided to enter into it?
>
> [Mr. Rainwater]: No. That's a kind of issue that will be determined based on a corporate-wide policy. That's not an operating company kind of issue. (Rainwater Transcript pp. 88-92)

Q. Has CIPSCO agreed to participate in the Midwest ISO initiative?

A. No, not to the Staff's knowledge.

CONDITIONS

Q. There are certain conditions to Commission approval of the UE/CIPSCO merger which the Staff believes are necessary are there not?

A. Yes. In response to detriments perceived by the Staff in regard to this Application, the Staff believes it reasonable to recommend that the Commission place conditions on any approval it makes of the Application in order to eliminate detrimental impact to Missouri customers. Other Staff witnesses will be sponsoring conditions in addition to the ones I address in this testimony. Each of these conditions relate to the statutory requirement that UE charge just and reasonable rates for safe and adequate service and the Commission is charged with seeing to it that this occurs.

Q. What is the Staff's first concern to be addressed herein?

A. The Staff believes that an assurance should be made by UE that the Staff will have access to the books and records of Ameren regulated and non-regulated affiliates as necessary to audit and review affiliated transactions affecting UE's regulated cost of service in Missouri. As previously noted, UE and CIPS will be operating companies under the holding company structure of Ameren, along with there being unregulated Ameren subsidiaries or affiliates. Ameren Services Company, a "service company", will be providing certain services to UE, CIPS and other Ameren affiliates, the costs of which will be allocated to UE and the other subsidiaries or affiliates for recovery. It is also contemplated that goods and services will be provided to UE from and from UE to regulated and nonregulated Ameren subsidiaries or affiliates after the merger is implemented. Transactions involving affiliates are not "arm's-length" in nature, and inherently raise concerns of cross-subsidization of nonregulated entities by regulated entities. To allow the Staff the ability to properly investigate affiliates' charges and service companies allocations, the Staff recommends that the following conditions be placed on the merger:

> Acknowledgment and agreement that the Commission may access and require without subpoena the production of all accounts, books, contracts, records, documents, memoranda, papers of Ameren Corporation and any affiliate or subsidiary of Ameren Corporation.
>
> (The above language should be deemed to include invoices, reports, studies, analyses, calculations, gas supply models, and electric and dispatch models.)
>
> Acknowledgment and agreement that the Commission may require answers, and/or the appearance of officers or employees of Ameren Corporation and any affiliate or subsidiary of Ameren Corporation without subpoena to provide answers to questions upon which the Commission may need information respecting Ameren Corporation and any affiliate or subsidiary of Ameren Corporation.

Q. Are there other conditions the Staff would recommend in regard to affiliated transactions and service company allocation issues?

A. Yes. As described in the rebuttal testimony of Staff Accounting witness James E. Schwieterman, UE and CIPSCO are developing procedures to govern the allocation of service company costs and the provision and pricing of inter-affiliate transactions through the so-called General Services Agreement (GSA) which, merely in shell form, is attached to the direct testimony of Mr. Rainwater as his Schedule 5. The Securities and Exchange

Commission will have some jurisdiction over the GSA, and accordingly some jurisdiction over the cost allocation and transfer pricing provisions of the GSA. Concerns with overlapping Missouri Commission/SEC jurisdiction over the GSA is discussed in the rebuttal testimony of Mr. Schwieterman and Staff witness Jay W. Moore of the Commission's Financial Analysis Department. While any specific concerns the Staff has with the details to be developed respecting the GSA, the Staff has proposed be addressed at a later time in Staff testimony in this proceeding, the Staff believes it to be appropriate to address generally allocation and transfer pricing issues through the following condition proposed by the Staff:

> Ameren and each of its subsidiaries and affiliates shall employ accounting and other procedures and controls related to cost allocations and transfer pricing to ensure and facilitate full review by the Commission, and to protect against cross-subsidization of non-UE Ameren businesses by UE's retail customers.

Q. What is the next condition?

A. The Staff is concerned that Missouri customers may lose the benefit of UE's management and operations experience and expertise if personnel are transferred to other Ameren regulated or nonregulated subsidiaries or affiliates. To alert the Staff to any potential situations along this line, the following condition should be placed upon UE:

> Ameren and UE shall avoid a diversion of management and operations talent that would adversely affect UE. Ameren and UE shall provide to the Commission an annual report identifying nonclerical personnel transferred from UE to any of Ameren's other businesses.

Q. What is the next concern of the Staff?

A. In the regulation of UE by the Commission, it will be at times necessary to have access to up-to-date allocation factors indicating the relative size of UE compared to Ameren as a whole. Accordingly, the following condition should be placed on UE:

> On a quarterly basis, Ameren and UE shall provide the Commission with a report detailing UE's proportionate share of Ameren (i) total consolidated assets; (ii) total consolidated operating revenues; (iii) total operating and maintenance expense; and (iv) total consolidated number of employees.

Q. Are there any other conditions which you are suggesting be made part of any Commission approval of this Application?

A. Yes, one other condition. The Staff is concerned that precautions be taken that the merger and the new corporate structure not negatively impact the cooperative relationship that has generally typified UE-Staff dealings in the past relating to discovery matters. Therefore, the Staff suggests the following condition:

> Ameren, UE and all Ameren subsidiaries affiliates shall cooperate with the Commission and its Staff in matters of discovery and continue the current practices of UE related to discovery, including timeliness and responsiveness of data request responses and signing and dating data request responses by those responsible for said responses.

SUMMARY/CONCLUSIONS

Q. Please summarize your testimony.

A. The Staff recommends that the Commission reject UE's ratemaking proposal for merger costs and savings for the following reasons:

1. UE's proposal is premised upon use of estimated merger savings and costs that are not currently known and measurable and cannot be verified in the future.

2. The Company's proposal effectively guarantees the shareholders' share of merger savings, while putting the risk of attaining merger savings on the Company's customers.

3. UE's proposal will lead to shareholders retaining an inordinate amount of merger savings compared to customers, particularly under UE's suggested approach for sharing merger savings under the current Incentive Plan.

In place of the Company's ratemaking proposal, the Staff recommends that the Commission adopt a ratemaking approach that calls for gross merger savings to be flowed through the existing earnings grid in the Incentive Plan to be split 50/50 between customers and shareholders within the ROE range of 12.61% TO 14.00% through June 1998 (the currently scheduled end date for the Incentive Plan).

Q. Are there any other matters you wish to address at this time?

A. Yes. As explained in the rebuttal testimony of Staff witness Schwieterman, the Staff proposes to file supplemental rebuttal testimony on the subject of the GSA cost allocation and transfer price procedures which have yet to be developed by the Companies.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the matter of the application of Union Electric Company for an order authorizing: (1) certain merger transactions involving Union Electric Company; (2) the transfer of certain assets, real estate, leased property, easements and contractual agreements to Central Illinois Public Service Company; and (3) in connection therewith, certain other related transactions.	)))))))	Case No. EM-96-149

AFFIDAVIT OF MARK L. OLIGSCHLAEGER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Mark L. Oligschlaeger, 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 57 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.

Mark L. Oligschlaeger
MARK L. OLIGSCHLAEGER

Subscribed and sworn to before me this 7th day of May, 1996.

J. Kay Niemeier
Notary Public

My Commission Expires: J KAY NIEMEIER
NOTARY PUBLIC STATE OF MISSOURI
COLE COUNTY
MY COMMISSION EXP. FEB. 26,2000

RATE CASE PROCEEDINGS

MARK L. OLIGSCHLAEGER

COMPANY	CASE NO.
Kansas City Power and Light Company	ER-82-66
Kansas City Power and Light Company	HR-82-67
Southwestern Bell Telephone Company	TR-82-199
Missouri Public Service Company	ER-83-40
Kansas City Power and Light Company	ER-83-49
Southwestern Bell Telephone Company	TR-83-253
Kansas City Power and Light Company	EO-84-4
Kansas City Power and Light Company	ER-85-128 & EO-85-185
KPL Gas Service Company	GR-86-76
Kansas City Power and Light Company	HO-86-139
Southwestern Bell Telephone Company	TC-89-14
Western Resources	GR-90-40 & GR-91-149
Missouri-American Water Company	WR-91-211
UtiliCorp United, Inc. / Missouri Public Service	EO-91-358 & EO-91-360
Generic: Expanded Calling Scopes	TO-92-306
Generic: Energy Policy Act of 1992	EO-93-218
Western Resources/Southern Union Company	GM-94-40
St. Louis County Water Company	WR-95-145

SHAREHOLDER/CUSTOMER SHARING UNDER UE RATE PROPOSAL

		AMOUNT IN MILLIONS	% OF GROSS SAVINGS
TOTAL GROSS MERGER SAVINGS		$590.0	100.0%
SHAREHOLDER PORTION OF GROSS SAVINGS:			
PORTION NECESSARY FOR REIMBURSEMENT OF "MERGER PREMIUM"	$232.0		
PORTION NECESSARY FOR REIMBURSEMENT OF TRANSACTION COSTS/"COSTS TO ACHIEVE"	$41.0		
RETENTION OF ONE-HALF OF NET SAVINGS (590 million - 273 million = 317 million net savings)	$158.5		
TOTAL SHAREHOLDER MERGER SAVINGS:		$431.5	73.1%
CUSTOMER PORTION OF GROSS SAVINGS:			
ONE-HALF OF NET SAVINGS	$158.5		
TOTAL CUSTOMER MERGER SAVINGS		$158.5	26.9%

SOURCE: SCHEDULE 8 ATTACHED TO DIRECT TESTIMONY OF UE WITNESS GARY L. RAINWATER

NOTE: RELATIVE PERCENTAGES OF MERGER BENEFITS GOING TO SHAREHOLDERS AND CUSTOMERS AS SHOWN ABOVE DO NOT REFLECT APPLICATION OF THE CURRENT INCENTIVE PLAN FOR UE, NOR ANY IMPACT OF "REGULATORY LAG"

No. 179

DATA INFORMATION REQUEST

Union Electric

CASE NO. EM-96-149

Requested From: Jim Cook

Date Requested: 03/20/96

Information Requested:

1) Please provide a description and purpose of each of the following regarding the merger of Union Electric and CIPSCO/CIPS:

a) Charters

b) "As Is" reports

c) Preliminary "Should Be" reports

d) Final "Should Be" reports

e) Detailed Implementation reports

2) Identify when these reports were estimated to be completed and when they were/will be actually completed.

Requested By: Cary Featherstone

Information Provided: See attached.

The attached information provided to the Missouri Public Service Commission Staff in response to the above data information request is accurate and complete, and contains no material misrepresentations or omissions, based upon present facts of which the undersigned has knowledge, information or belief. The undersigned agrees to immediately inform the Missouri Public Service Commission Staff if, during the pendency of Case No. EM-96-149 before the Commission, any matters are discovered which would materially affect the accuracy or completeness of the attached information.

If these data are voluminous, please (1) identify the relevant documents and their location (2) make arrangements with requestor to have documents available for inspection in the Union Electric office, or other location mutually agreeable. Where identification of a document is requested, briefly describe the document (e.g. book, letter, memorandum, report) and state the following information as applicable for the particular document: name, title, number, author, date of publication and publisher, addresses, date written, and the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies of data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control within your knowledge. The pronoun "you" or "your" refers to Union Electric and its employees, contractors, agents or others employed by or acting in its behalf.

Signed By: Daniel F. Cole

Date Response Received: ____________

Prepared By: Daniel F. Cole

Data Information Request
Union Electric
Case No. EM-96-149

Information Requested:

1) Please provide a description and purpose of each of the following regarding the merger of Union Electric and CIPSCO/CIPS:
   a) Charters
   b) "As Is" reports
   c) Preliminary "Should Be" reports
   d) Final "Should Be" reports
   e) Detailed Implementation reports

2) Identify when these reports were estimated to be completed and when they were/will be actually completed.

Information Provided:

1) Description and purpose of each of the following regarding the merger of Union Electric and CIPSCO/CIPS:

   a) Charters

   Charters were developed to provide teams with an overview of the merger transition effort, including the team organizational structure and identification of team leaders. Information was also provided on team targeted merger savings, as developed in the D&T study. Background information was included to provided teams with information on how the targets were developed.

   b) "As Is" reports

   Teams identified the processes to be examined, key business requirements for those processes, information and other systems that supported/enabled the process, key linkages to other processes, and the current UE and CIPS annual labor and non-labor costs for the process. Teams also identified any major differences in each process and why those major differences exist.

   c) Preliminary "Should Be" reports

   Teams were asked to analyze different alternatives for each process and recommend which alternative should be implemented to meet the requirements of the merged companies. The teams then developed estimates of the savings that would result from the recommended alternatives.

d) Final "Should Be" reports

These reports summarize the recommendations that are to be implemented for the merged companies.

e) Detailed Implementation reports

The purpose of these reports is to develop the list of activities necessary to complete the mergers, the schedule for those activities, and the associated transition costs.

2) Identify when these reports were estimated to be completed and when they were/will be actually completed.

a) Charters

Charters were to be completed and delivered to the teams on September 8, 1995. They were delivered on that date.

b) "As Is" reports

Teams were given some flexibility as to when the "As Is" reports were to be completed. However, the end of November was given as an overall deadline. Teams generally met this schedule.

c) Preliminary "Should Be" reports

Teams were at first given some flexibility as to when they would be allowed to complete the "should be's". However, the Steering Committee later directed that all preliminary "should be" reports be completed by 12/15/95. Generally, all reports were submitted by that date.

d) Final "Should Be" reports

There was no official deadline for these reports. However, it was expected that final "should be" reports would be completed in early March. They were completed in late March.

e) Detailed Implementation reports

Detailed implementation reports are expected to be available around April 15.

Prepared by Daniel F. Cole

No. 55

DATA INFORMATION REQUEST
Union Electric
CASE NO. EM-96-149

Requested From: Steven R Sullivan
Date Requested: 11/22/95
Information Requested:
Will UE update its merger filing in any manner as a result of the work of the Transaction Management Task Force? If the answer is "yes", when will that update occur?

Requested By: Mark Oligschlaeger

Information Provided: See attached.

The attached information provided to the Missouri Public Service Commission Staff in response to the above data information request is accurate and complete, and contains no material misrepresentations or omissions, based upon present facts of which the undersigned has knowledge, information or belief. The undersigned agrees to immediately inform the Missouri Public Service Commission Staff if, during the pendency of Case No. EM-96-149 before the Commission, any matters are discovered which would materially affect the accuracy or completeness of the attached information.

If these data are voluminous, please (1) identify the relevant documents and their location (2) make arrangements with requestor to have documents available for inspection in the Union Electric office, or other location mutually agreeable. Where identification of a document is requested, briefly describe the document (e.g. book, letter, memorandum, report) and state the following information as applicable for the particular document: name, title, number, author, date of publication and publisher, addresses, date written, and the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies of data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control within your knowledge. The pronoun "you" or "your" refers to Union Electric and its employees, contractors, agents or others employed by or acting in its behalf.

Signed By: GLRainwater

Date Response Received: ____________________

Prepared By: Gary L. Rainwater

No. 55

Data Information Request
Office of Public Counsel
to Union Electric
Case No. EM-96-149

Information Requested:

Will UE update its merger filing in any manner as a result of the work of the Transition Management Task Force? If the answer is "yes," when will that update occur?

Information Provided:

UE will file a revised merger savings estimate when that work is finalized. Preliminary results indicate that the actual merger savings will exceed our original estimate. However, we will not amend our original cost-recovery proposal, which was based on shareholders recovering merger costs plus one-half of the original $590 million net merger savings estimate. The revised savings estimate will mean that we now expect shareholders to receive somewhat less than one-half of actual net merger savings and customers to receive somewhat more than one-half of actual net savings.

MERGER SAVINGS ELIGIBLE FOR CUSTOMER SHARING UNDER UE RATE PROPOSAL FOR CURRENT INCENTIVE PLAN

1997 MERGER SAVINGS CALCULATION

1997 ESTIMATED MISSOURI ELECTRIC GROSS MERGER SAVINGS	$22,444,000
LESS: PREMIUM AND OTHER MERGER COSTS	10,386,000
MISSOURI ELECTRIC NET SAVINGS	12,058,000
LESS : INCENTIVE PLAN "COST OF SERVICE ADJUSTMENT"	6,029,000
SAVINGS AMOUNT ELIGIBLE FOR CUSTOMER SHARING	$6,029,000

SOURCE: SCHEDULES 8 AND 10 ATTACHED TO DIRECT TESTIMONY OF UE WITNESS GARY L. RAINWATER

INCENTIVE PLAN GRID - CUSTOMER SHARING SCENARIOS

1997 ESTIMATED TOTAL MISSOURI GROSS ELECTRIC SAVINGS: $22,444,000 (FROM SCHEDULE 5)

	SHAREHOLDER	CUSTOMER	% OF CUSTOMER SHARE TO TOTAL SAVINGS OF $22,444,000
ROE < 12.61% 100% TO SHAREHOLDER	$6,029,000	0	0.0%
ROE > 12.61%, < 14.00% 50/50 SHARING	$3,014,500	$3,014,500	13.4%
ROE > 14.00% 100% TO CUSTOMER	$0	$6,029,000	26.9%

SOURCE: AMOUNTS TAKEN FROM SCHEDULE 5 TO THIS TESTIMONY
ROE AND SHARING GRID PERCENTAGES TAKEN FROM THE COMMISSION'S REPORT AND ORDER IN CASE NO. ER-95-411

No. 186

DATA INFORMATION REQUEST
Union Electric
CASE NO. EM-96-149

Requested From: Jim Cook
Date Requested: 03/22/96
Information Requested:
RE: 3/20/96 interview with Maureen Borkowski.
Please provide copies of the Memo of Understanding relating to the Midwest "Independent System Operators" initiative, and UE's letter concerning participation in the initiative, as discussed by Ms. Borkowski.

Requested By: Mark Oligschlaeger

Information Provided: See attached.

The attached information provided to the Missouri Public Service Commission Staff in response to the above data information request is accurate and complete, and contains no material misrepresentations or omissions, based upon present facts of which the undersigned has knowledge, information or belief. The undersigned agrees to immediately inform the Missouri Public Service Commission Staff if, during the pendency of Case No. EM-96-149 before the Commission, any matters are discovered which would materially affect the accuracy or completeness of the attached information.

If these data are voluminous, please (1) identify the relevant documents and their location (2) make arrangements with requestor to have documents available for inspection in the Union Electric office, or other location mutually agreeable. Where identification of a document is requested, briefly describe the document (e.g. book, letter, memorandum, report) and state the following information as applicable for the particular document: name, title, number, author, date of publication and publisher, addresses, date written, and the name and address of the person(s) having possession of the document. As used in this data request the term "document(s)" includes publication of any format, workpapers, letters, memoranda, notes, reports, analyses, computer analyses, test results, studies of data, recordings, transcriptions and printed, typed or written materials of every kind in your possession, custody or control within your knowledge. The pronoun "you" or "your" refers to Union Electric and its employees, contractors, agents or others employed by or acting in its behalf.

Signed By: Maureen A. Borkowski

Date Response Received: ____________

Prepared By: Maureen A. Borkowski

UNION ELECTRIC

R. Alan Kelley
Vice President
Energy Supply

March 13, 1996

Mr. John Procario
Cinergy Corporation
P.O. Box 960
Cincinnati, OH 45201-0960

Dear John:

Please find attached a Union Electric Company executed copy of the Midwest ISO Principles.

As I stated at the March 4 MAIN/ECAR conference in Cincinnati, while we have some reservation regarding a few principles, we are in general agreement with the concepts which have been put forth. We look forward to working with you and the other bulk transmission owners toward their implementation.

It is our understanding that we have the right to withdraw from the Midwest ISO if Union Electric is not comfortable with its development. We hope that will not become necessary.

Sincerely,

R Alan Kelley

RAK:mmh

Attachment

bcc: G. L. Rainwater
J. H. Raybuck

MIDWEST ISO PRINCIPLES

1. A Midwest Independent System Operator (ISO) whose management is independent of transmission owners can provide eligible requesters non-discriminatory open access to the bulk transmission systems of the members and ensure system security.

2. The ISO will have functional control of the combined transmission system of the members.

3. The ISO members will retain ownership of, and the obligation to physically operate and maintain, their transmission facilities. The existing control areas will provide real-time transmission operations data to the ISO.

4. The bulk transmission system managed by the ISO includes facilities that affect transmission transfer capability and system security – generally those facilities operating above 100 kV.

5. ISO members will be electrically interconnected.

6. The ISO will determine available transmission capability and schedule transmission transactions.

7. The existing control areas will be retained to provide local generation control and economic dispatch. The control areas will continue to be responsible for maintaining the generation/load balance and the frequency of the interconnected system.

8. The ISO will be responsible for regional system security which includes bulk transmission security and power supply security. Bulk transmission security functions include approval of scheduled transmission line outages, loading relief procedures, redispatch of generation and ordering curtailment of transactions and/or load. Power supply security entails monitoring control area performance and ordering the control areas to take actions, including load curtailment and increasing/decreasing generation in situations where an imbalance between generation and load places the system in jeopardy. ISO security procedures and policies will be consistent with those of NERC and the regional councils.

9. The ISO will develop, implement, and administer a regional transmission tariff and an equitable revenue distribution procedure which will seek to satisfy each members' transmission revenue requirements.

10. The ISO will be regulated by the FERC.

11. The ISO will plan for the expansion of the regional bulk transmission system.

12. The ISO will develop a dispute resolution process.

13. The ISO will ensure the availability of ancillary services required to support transmission service.

February 5, 1996

MIDWEST ISO
MEMORANDUM OF UNDERSTANDING

The undersigned bulk transmission owners endorse the attached Midwest ISO principles, dated February 5, 1996, and will proceed to develop final documents implementing these principles to be filed with the appropriate regulatory agencies.

R Alan Kelley
Vice President - Union Electric Co.