

ADMINISTRATIVE PROCEEDING
FILE NO. 3-2547

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

In the Matter of :
UNION ELECTRIC COMPANY :
(70-4899) :
(Public Utility Holding Company Act :
of 1935) :
:

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SECURITIES & EXCHANGE COMMISSION

INITIAL DECISION

Washington, D.C.
September 19, 1972

Warren E. Blair
Chief Administrative Law Judge

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(Public Utility Holding Company :
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APPEARANCES: Carl H. Hendrickson and Stewart W. Smith, Jr., of
Union Electric Company, for Union Electric
Company.

Charles F. Wheatley, William T. Miller, and Grace P.
Monaco, of Washington, D.C., and Howard C. Wright,
Jr., of Cape Girardeau, Missouri, for the City of
Cape Girardeau, Missouri.

Jeremiah D. Finnegan and William F. Liliensick, of
Jefferson City, Missouri, for the Public Service
Commission of the State of Missouri.

Aaron Levy, R. Moshe Simon, A. Barry Morewitz, Thomas N.
McHugh, Jr., Fred J. Franklin, for the Division of
Corporate Regulation of the Commission.

BEFORE: Warren E. Blair, Chief Administrative Law Judge

Union Electric Company ("UE"), an exempt holding company and an electric and gas public utility company, filed an application pursuant to Sections 9(a) and 10 of the Public Utility Holding Company Act ("1935 Act") regarding its proposed offer to exchange shares of its common stock for the outstanding shares of the common stock of Missouri Utilities Company ("MU"), a nonassociate public utility company. UE also requests an order either granting it a new exemption pursuant to Section 3(a)(2) of the 1935 Act when the exchange offer becomes effective, or an order continuing its present exemption, and states that unless UE acquires all of the outstanding stock of MU pursuant to the exchange offer, UE will register as a holding company under Section 5(a) of the 1935 Act and will file a plan pursuant to Section 11(e) of the 1935 Act to eliminate the publicly-held minority interest in the common stock of MU. The further request of UE is for an order to the effect that when any publicly-held minority interest in the common stock of MU is eliminated pursuant to a Section 11(e) plan, UE will be exempt from all of the provisions of the 1935 Act other than Section 9(a)(2).

After making a preliminary examination of the application, the Division of Corporate Regulation ("Division") raised questions about:

(1) Whether the proposed acquisition by UE of 83.3% or more of the outstanding shares of common stock of MU meets the standards of Section 10 of the 1935 Act, and particularly the requirements of Sections 10(b) and 10(c).

(2) Whether, if the proposed acquisition is approved as having the tendency required by Section 10(c)(2) of the 1935

Act with respect to the electric utility assets of UE and MU, the Commission should condition such approval by requiring the divestment of the retail gas properties of the two companies and of the water service properties of MU.

(3) Whether UE should be granted an unconditional exemption under Section 3(a)(2) of the 1935 Act upon acquisition of the common stock of MU and upon the elimination of any minority interest in the common stock of MU.

(4) Whether the accounting entries to be made in connection with the proposed transactions are proper and in accord with sound accounting principles.

(5) Whether the fees, commission, and other expenses to be incurred are for necessary services and reasonable in amount.

(6) What terms or conditions, if any, the Commission's order should contain.

(7) Generally, whether the proposed transactions are in all respects compatible with the provisions and standards of the applicable sections of the 1935 Act and of the rules promulgated thereunder.

Pursuant to notice and order for hearing dated August 20, 1970, a hearing was held on the application and the issues raised by the Division. At the outset of the hearing, a further issue relating to the divestiture of UE's gas properties was raised and considered. The ruling thereon was that the issue was within the ambit of these proceedings.

The Missouri Public Service Commission and City of Cape Girardeau, Missouri ("City") appeared and were made parties to the proceedings, but the Missouri Public Service Commission did not actively participate in the hearing. UE, the Division, and the intervenor City were represented by counsel who were present throughout the hearing.

As part of the post-hearing procedures, successive filings of proposed findings, conclusions, and supporting briefs were specified. Timely filings thereof were made by UE, the Division, and City, but none was made by the Missouri Public Service Commission. The findings herein are based upon the record and upon observation of the witnesses.

Background of Involved Utility Companies

Union Electric Company

UE, a Missouri corporation, is engaged in the generation, transmission, distribution, and sale of electricity in Missouri, Illinois, and Iowa, the distribution and sale of natural gas in Illinois, and furnishes steam heat to a section of St. Louis, Missouri. ^{1/} UE's subsidiaries are Missouri Power & Light Company ("MP & L"), Missouri Edison Company ("ME"), and Electric Energy, Inc., which are engaged in electric and gas utility operations, and Union Colliery Company, an inactive Missouri corporation owning coal reserves and industrial property in Illinois. ^{2/} In 1962, UE was exempted by the Commission from the provisions of the 1935 Act except Section 9(a)(2) thereof. ^{3/}

As of December 31, 1970 the UE System, comprised of UE, MP & L, and ME, had an electric service area of approximately 19,200 square miles having an estimated population of 2,500,000. Natural gas

^{1/} UE's steam heating facilities have been found by the Commission to be retainable as incidental other business under Section 11(b)(1). North American Company, 11 S.E.C. 194, 225 (1942).

^{2/} Retention of Union Colliery Company was also allowed as reasonably incidental to other business. Id., at 226.

^{3/} Union Electric Company, 40 S.E.C. 1072 (1962).

was distributed by UE in Alton, Illinois and that city's environs, and by MP & L and ME, respectively, in 39 and 20 Missouri communities. Based upon net assets as of December 31, 1969, the UE System ranked eighteenth among all predominantly electric utilities in the United States, and was twenty-third when the ranking is related to revenues.

Missouri Utilities Company

MU, a Missouri corporation, is engaged in the generation, transmission, distribution and sale of electricity, distribution and sale of natural gas at retail in that State, and the supplying of water service to residents of Cape Girardeau, Missouri. MU has three geographically separate electric service areas, with the bulk of its business being concentrated in six counties that are about 40 miles north of the service area located at the southern extremity of Missouri. The third service area is located in central Missouri. Gas service is provided by MU in the central area and in the six-county area which includes Cape Girardeau. On December 31, 1970 MU was providing electric service to 60 communities, and gas service to 25 communities in Missouri. Based on total assets as of December 31, 1970, MU is slightly more than 3% of the size of the UE System, and for the year ended December 31, 1970 had revenues that amounted to 6% of those generated by the UE System in the same period.

MU is not a holding company, nor an affiliate, associate company, or a subsidiary of a holding company. It is not presently subject to the provisions of the 1935 Act.

Proposed Transaction

UE proposes to offer to MU's stockholders, subject to certain conditions, 1.1 shares of its common stock for each outstanding share of the common stock of MU. No fractional shares will be issued under the exchange offer, but any exchanging stockholder who otherwise would be entitled to a fractional share will be afforded an opportunity to sell his fractional interest for cash or to purchase an additional interest sufficient to entitle him to a full share.

The exchange offer, to become effective, requires acceptance thereof by the holders of not less than 83.3% of the outstanding shares of common stock of MU. The requirement that such percentage be tendered is necessary in order that UE will acquire ownership of stock possessing at least 80% of the combined voting power of all classes of voting stock (including the voting preferred stock which will be neither called for redemption nor exchanged) so that the transaction will qualify as a tax-free exchange under the Federal income tax laws. The exchange offer will be made over an initial period of approximately 45 days from the day the material soliciting acceptances is first mailed, subject to extension for an additional period or periods by UE, but not beyond 180 days from the initial date of the exchange offer, unless further extended upon approval by the Commission. Shareholders of MU who tender their shares may revoke such tender at any time before 83.3% of the outstanding shares of common stock of MU have been tendered.

Applicable Statutory Standards

Section 10(c)(2)

Under the provisions of Section 10(c)(2) of the 1935 Act, approval cannot be given for "the acquisition of securities or utility assets of a public-utility or holding company unless the Commission finds that such acquisition will serve the public interest by tending towards the economical and efficient development of an integrated public-utility system." As defined in Section 2(a)(29)(A), an "integrated public-utility system" as applied to electric utility companies means:

[A] system consisting of one or more units of generating plants and/or transmission lines and/or distributing facilities, whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation.

As earlier noted, the UE System's electric service area is extensive and covers well-populated portions of Missouri. As at December 31, 1970 it owned nearly 5,000 circuit miles of electric transmission lines, 522 substations with transformer capacity of approximately 22,500,000 kilovolt-amperes, and related distribution facilities. During 1970, the UE System had electric sales totaling over 17,500,000 kilowatt hours and at year-end had more than 800,000 customers for electricity. The UE System's gross electric

property and plant at year-end 1970 was valued at approximately \$1,650,000,000 and its gross operating revenues derived from electric service amounted to \$302,687,155.

On a comparable basis, MU owned approximately 530 miles of transmission lines, 126 substations with a rated capacity of about 769,000 kilovolt-amperes, and related distribution facilities. During 1970, MU's electric sales totaled slightly more than 544,500,000 kilowatt hours and at year-end it had about 47,000 customers for electricity. MU's gross electric property and plant at year-end 1970 aggregated approximately \$34,000,000 and its gross operating revenues derived from electric service were \$11,612,657.

MU's electric facilities are connected with those of the UE System at five points in Missouri, but MU's service area ("Senath") at the southern extremity of that State is not physically connected with the electric properties of the UE System nor with either of MU's other two electric service areas. Further, it appears that MU's Senath electric properties, which are 40 miles from the nearest other MU service area, are presently interconnected with the Arkansas-Missouri Power Company, a non-affiliated system, and that interconnection with UE, although technologically possible, would be economically unfeasible for the foreseeable future. Nonetheless, UE is the principal supplier of electric energy to MU, having sold to MU during the five year period 1966 through 1970 an amount of electric energy equivalent to 72.3%, 82.2%, 63.6%,

78.1%, and 77.4%, respectively, of the total energy delivered to MU's distribution system each year.

If the proposed acquisition is consummated, it appears that economies and efficiencies may be reasonably anticipated from the combined electrical operation. As testified to by UE's executive vice-president, W.E. Cornelius, the proposed affiliation will expand the area served by the UE System, thereby providing access to additional power plant sites within the service area. In turn, construction of power plants in MU's service area would have a favorable influence upon the economy in the area, now primarily agricultural, by expanding the labor market and attracting new workers to the area. Additionally, it is UE's intention, if MU becomes a subsidiary, to assist MU in attracting new industry to the area by making UE's area development staff available for that purpose. New manufacturing facilities in MU's service area would provide a means by which per capita and total personal income in the area could be increased.

In its present operations, it appears that MU finds it uneconomical to build additional peak-load generating units into its system and relies instead upon purchased power. This situation, according to the record, would be changed were MU to become part of the UE System through UE's building peaking capacities into MU's system, thereby eliminating the need for complete reliance upon transmission facilities. Further, there is credible testimony

that as part of the UE System, MU's management and employees would have the advantage of assistance from MU's administrative and technical staff in the solution of complex problems and that such services would be available on a more economical basis than MU, standing alone, could provide or obtain.

In connection with financial aspects of MU's operations, acceptable evidence is in the record to support a finding that the cost of borrowing long-term or short-term funds, the cost of future sales of MU's common stock, and the expenses attributable to relationships with existing MU stockholders can all be reduced through affiliation with UE and its much greater financial strength. Along those lines, the president of MU testified that the expenses of MU's last common stock financing in 1969 were about 22¢ per share in contrast with the 4¢ per share experienced by UE on common stock financing in 1970, and the executive vice-president of UE pointed to the more recent respective bond financings of UE and MU which resulted in UE paying 7.55% interest while MU was required to offer a yield of 8 $\frac{1}{4}$ %.

The Division contends that UE has failed to show that economies and efficiencies will be achieved by the proposed acquisition and has also failed to show that the properties to be acquired, together with those already held by the UE System, can be more efficiently and economically operated as a part of a holding company system than if MU were to remain independent or to be integrated with other neighboring utilities. The first of

the contentions cannot be accepted, and the second is rejected as irrelevant under the circumstances here under consideration.

The Division's basic complaint regarding the economy and efficiency aspects of applicant's presentation appears to be that applicant is not specific enough. It argues that UE's assertion "there will be many opportunities to achieve substantial economies through coordination of planning, construction and maintenance," is unacceptable in the absence of detailed planning sufficient to demonstrate the requisite economies. But that argument presupposes that detailed planning is the only acceptable method of placing in the record the evidence needed to satisfy statutory requirements. While such detailed evidence would be most helpful, and provide a more solid foundation for the findings herein, there appears to be no authority, and none is cited by the Division, that precludes a finding that the standards of Section 10(c)(2) have been met where such finding is based upon evidence other than specific or detailed plans. In the present context of a proposed acquisition of a relatively small utility company, it does not appear inappropriate to credit the testimony of applicant's witnesses that substantial economies and efficiencies will result from an affiliation and to conclude that economies of scale will flow from the acquisition if consummated.

Whether the properties to be acquired could be as efficiently and economically operated if MU were to remain independent or

integrated with neighboring utilities does not appear relevant. Section 10(c)(2) speaks in terms of whether an acquisition tends "toward the economical and efficient development of an integrated public-utility system," without reference to the efficiencies or economies that might result from alternative use or management of those properties. The Division puts misplaced reliance upon the Commission's decision in American Gas and Electric Co., ^{4/} as a holding that alternate available means must be evaluated. In that case the Commission, in considering the impact of Section 10(c)(2) upon the proposed acquisition there in question, held:

All we now decide is that, taking into account the state of the art and the area or region affected, the substantially enlarged group of properties that would result from the acquisition of C. & S. O. [Columbus and Southern Ohio Electric Company] by the Central System cannot be found to be "not so large as to impair . . . the advantages of localized management and the effectiveness of regulation." Consequently, we cannot find that the end product of the proposed acquisition would conform with the definition in Section 2(a)(29)(A) of an "integrated public utility system" and we cannot, because of the size of the resulting combination of properties, find that the acquisition "will serve the public interest by tending towards the economical and efficient development of an integrated public-utility system" within the meaning of Section 10(c)(2). ^{5/}

It was only after making that ruling that the Commission, as cited by the Division, observed:

In view of the emphasis which has been placed on the savings and increased efficiency which, it is asserted, would accompany the acquisition, it may not be inappropriate to note also the extent to which the

^{4/} 22 S.E.C. 808 (1946)

^{5/} Id., at 816-17.

physical benefits claimed to result from the acquisition may be achieved in other ways The capacity of independently owned utilities to coordinate their operations and interchange power through mutual operation of power pools has been amply demonstrated in the history of utility operations in this country and was made obvious during the war. 6/

Being obiter dicta, the latter quotation cannot be deemed an enunciation of a binding rule that would support the Division's position. It may be that under circumstances similar to those in the American Gas matter, availability of alternate means would be a material consideration, but that is not the present situation. Here it cannot be said of MU, as was said about Columbus and Southern Ohio Electric Company in American Gas, that MU "is not a small company, operating minor assets which have no rational existence outside the sphere of holding company domination."^{7/}

Senath Electric Properties

Other than with respect to MU's Senath electric properties, it appears that the acquisition of MU's electric properties would "tend towards the economical and efficient development of an integrated public utility system" within the meaning of that term under Section 2(a)(29)(A) and the requirements of Section 10(c)(2). The Senath electric properties must be excepted because they fail to meet the requirement of Section 2(a)(29)(A) that the facilities

6/ Id., at 817.

7/ Id.

of an "integrated electric utility system" be capable of physical interconnection and of economic operation. ^{8/}

As earlier noted the Senath electric properties are not physically interconnected with either UE or with other MU electric facilities and are geographically separated by some 40 miles from the nearest other MU service area. Additionally, it is clear from the record that regardless of the technological capacity for interconnecting the Senath electric properties with other portions of MU, it would not be economically desirable to do so. As succinctly put by UE's executive vice president in charge of operations when asked what would deter UE from making a physical interconnection to that area, "Economics; it is cheaper to buy from the supplier down there than it is to build a transmission to that area." ^{9/}

The situation with respect to the Senath electrical properties is strikingly similar to that which was involved in UE's application to acquire MP & L which led to the Commission's concluding that MP & L's electric properties at Clinton, Missouri could not be retained by UE. ^{10/} There, as here, parts of the properties UE was desirous of acquiring were geographically separated by substantial mileage, power was supplied to the small isolated area by a non-affiliated system, and company witnesses admitted that it was not economical to run a transmission line to the isolated area.

^{8/} See General Public Utilities Corp., 32 S.E.C. 807, 824-25 (1951).

^{9/} Tr. 305.

^{10/} North American Co., 32 S.E.C. 169 (1950).

The Commission's decision in Hawaiian Electric Company ^{11/} cannot aid UE in its effort to acquire MU's Senath properties in view of the fact that the retention of the physically separated facilities was permitted only after there had been given "particular weight to the unique geography of the State of Hawaii in light of the legislative history." UE has shown neither the unique geography nor the legislative history that might entitle it to have the Hawaiian Electric case considered as the controlling precedent on the question of whether the Senath properties form part of an "integrated public-utility system."

Under all of the circumstances, it is found in accordance with Section 10(c)(2) that with the exception of the electrical properties in the Senath area, the proposed acquisition of the MU electrical properties by UE will serve the public interest by tending towards the economical and efficient development of an integrated electric public utility system.

Divestiture of Water and Gas Properties

Having found that the proposed acquisition of MU's common stock was appropriate under Section 10(c)(2) with respect to the electric utility assets of MU other than those located in the Senath area, consideration must be given to the proposed acquisition of MU's gas and water properties and to the question of whether the

^{11/} Holding Company Act Release No. 16592 (1970).

UE System may be allowed to retain its present gas facilities. It is concluded that retention of MU's water and gas properties and of the present gas properties of the UE System would not meet the standards of Sections 10 and 11 of the 1935 Act, and that approval of the proposed acquisition and the granting of an exemption under Section 3(a)(2) of the Act should be conditioned upon the divest-^{12/}ment of those properties.

UE urges, as it did at the outset of the hearing, that the question of whether UE's, MP & L's, and ME's operations of gas businesses violate the standards of Sections 10 and 11 of the 1935 Act or is not in the public interest of investors or consumers is not properly before the Commission in these proceedings because those questions have all ready been answered in UE's favor. That contention is found to be devoid of merit.

UE relies upon the Commission's earlier decision in the matter of Union Electric Company^{13/} as dispositive of those issues, referring to the fact that the Commission therein released its jurisdiction theretofore reserved under Section 11(b)(1) after finding that the gas systems of UE, MP & L, and ME were retainable.^{14/}

^{12/} Under Section 10(e) of the 1935 Act an order approving the acquisition of securities may be subject to such terms and conditions as the Commission may find necessary or appropriate in the public interest or for the protection of investors or consumers.

^{13/} 40 S.E.C. 1072 (1962).

^{14/} Id., at 1079.

The weakness of UE's position is that recognition has not been given to the fact that the Commission's jurisdiction has been invoked to obtain approval for an acquisition that was not under consideration or involved in the cited matter. Whether such approval should be granted necessarily depends upon the application of statutory standards to present circumstances, not to those that existed a decade ago. Further, UE ignores the specific direction of the Commission that "particular attention be directed at said hearing" to the matters and questions raised by the Division, one of which was the divestment of UE's gas properties. Obviously, the Commission did not consider that its earlier decision precluded consideration of the question in these proceedings.

As contended by the Division, the Illinois Power Co.^{15/} and New England Electric System^{16/} decisions are persuasive precedents for requiring divestiture of the MU and UE gas properties.^{17/}

^{15/} Illinois Power Co., Holding Company Act Release No. 16574 (1970).

^{16/} New England Electric System, 41 S.E.C. 888 (1964), affm'd initially, SEC v. New England Electric ("NEES I"), 384 U.S. 176 (1966), rev'g 346 F.2d 399 (1st Cir. 1965), again affm'd, SEC v. New England Electric System ("NEES II"), 390 U.S. 207 (1968), rev'g 376 F.2d 107 (1st Cir. 1967).

^{17/} See also, Middle South Utilities, Inc., Holding Company Act Release No. 17116 (1971).

In the Illinois Power case, an exempt holding company with combined electric and gas services made application for approval of a proposed acquisition of common stock of an exempt electric-gas utility company which was doing business in a contiguous area in the same state, and for a continuation of the applicant's exempt status. Placing emphasis upon the Supreme Court's decision in the New England Electric case, the Commission, referring to Section 10(c)(1) and related Section 11, ^{18/} observed:

In its opinion, the Court referred, by way of background, to the Congressional objective to protect consumer interests through the elimination of "restraint of free and independent competition" and the fact that one of the abuses that had resulted from the control of utilities by holding companies was the retention in one system of both gas and electric properties and the favoring of one of these competing forms of energy over the other. The Court stated that "Congress therefore ordained separate ownership - and divestiture where necessary to reduce holdings to one system - as the 'very heart' of the Act." It also referred to a footnote in an earlier decision by it in the NEES matter stating that "by fostering competition between gas and electric utility companies, the Act promotes what has been described as 'variegated competition'." [footnote omitted]. ^{19/}

The Commission then concluded that the proposed acquisition should be conditioned on divestment of the gas properties, stating:

[T]he Supreme Court's statements in our view reflect an approach to the interpretation of the Act in the area of competition between gas and electric companies which transcends the precise issues before the Court in the NEES case. ^{20/}

^{18/} Section 10(c)(1) provides that an acquisition of securities cannot be approved if "detrimental to the carrying out of the provisions of Section 11"; the latter section limits the operations of a registered holding-company system to a "single integrated public-utility system" except that one or more additional integrated systems may be retained under certain circumstances.

^{19/} Illinois Power Co., supra, at 5.

^{20/} Id.

UE's position that Section 10(c)(2) does not require divestment of the gas properties appears well-taken in the sense that an absolute prohibition against combined gas and electric systems was not intended. But the area in which combined operations are permissible has been considerably narrowed by the views expressed by the Supreme Court in the New England Electric case some years after the numerous Commission decisions cited by UE in support of its argument. With respect to the more recent cases cited by UE, ^{21/} the Commission cannot be said to have expressed views differing from those in the New England Electric and Illinois Power cases. Where, as here, gas has obviously played a secondary ^{22/} role to electricity in the operations of MU and the UE System, the cautionary words regarding the need for separate ownership of gas and electric properties seem especially apropos. While the record may not demonstrate a deliberate neglect of gas operations in favor of electrical nor make a showing that divestiture would enhance competition, there can be no doubt that retention of the gas properties would not promote "the Congressional objective to protect consumer interests through the elimination of 'restraint of free and independent competition.'" For example, UE introduced

^{21/} Northeast Utilities, Holding Company Act Release No. 15448 (1966); Middle South Utilities, Inc., supra.

^{22/} For the year ended 1970, 3.4% of the UE System's gross revenues and 38.7% of MU's gross revenues have been derived from gas service. On a pro forma basis, assuming a consolidation of MU with UE System for the year 1970, 5.6% of the combined gross revenues would have been derived from gas service.

testimony and makes special reference in its brief regarding ME's practice of making customers aware of the fact that both natural gas and electricity are available and allowing each customer to select the type of energy best suited for his needs. ^{23/} UE also calls attention to a similar attitude, which results in MP & L's gearing its advertising and sales programs to acquainting its customers with the availability of both gas and electricity and letting them choose which form of energy to purchase, ^{24/} and states that the record discloses that UE, MP & L, ME and MU "have not favored one form of energy over the other." ^{25/} Whatever merit there may be in this even handed approach, it cannot be said that it is an equivalent of the vigorous competitive forces that Congress was intending to bring into play.

That the gas properties of UE System and MU can be integrated, as pointed out by UE in its argument for retention, seems even more reason for requiring divestiture, since no concern need be had about whether the divested gas properties can be operated as an "integrated system" offering viable competition to the electrical services of UE. The shortage of gas may well be a deterring competitive factor but, as the Division observes, that situation

^{23/} UE Exh. A, at 14.

^{24/} UE Exh. H, at 2.

^{25/} UE Brief, at 54 (March 30, 1972).

may be a temporary condition. In any event, UE admits that the effect that the current shortage may have upon the gas industry is unknown, and concedes that the difficulty may be alleviated in the future by obtaining gas from other sources. Although additional gas supplies are not expected to be available immediately, the problems caused by gas shortage do not appear to be so great as to cause despair of a new gas company's ability to operate at a satisfactory level until gas again becomes available in quantities sufficient to allow vigorous competition.

The fact that a gas shortage existing in 1950 precluded the Commission from finding that MP & L's gas properties should be divested ^{26/} is not a precedent, as claimed by UE, for similar findings now. In 1950 UE was permitted to acquire MP & L's gas properties because the Commission found that MP & L's gas department had never experienced a period of operations under normal conditions and that it was therefore not possible to balance claimed losses against the "benefits to be obtained through competition between the gas and electric businesses which might otherwise exist assuming an adequate supply of gas and a separation of control." ^{27/} A like difficulty is not to be found in the present record, the evidence indicating that the gas services of the UE System and MU have been operating under normal conditions for a number of years prior to the present gas shortage.

26/ The North American Company, 32 S.E.C. 169 (1950).

27/ Id., at 180.

While the Division does not concede the relevance of Clause (A) of Section 11(b)(1), ^{28/} it nonetheless asserts that UE has failed to sustain the burden of proving thereunder that a "loss of substantial economies" would be sustained by a severance of the gas properties. UE takes the contrary position, and further suggests that the loss of economies that would result must also be considered in connection with the public interest aspect of Section 10(c)(2).

Consideration of the cases relied upon by the parties and the applicable statutory provisions leads to the conclusion that UE is correct in its view that loss of economies is a relevant consideration under Sections 10 and 11 in determining this matter. From the standpoint of the public interest it would be improvident to sever the gas properties without considering the economic impact of that divorcement.

Based upon operational data of the gas properties for 1969, UE has presented evidence indicating that annual gas operating costs resulting from a separation of the gas properties will aggregate \$697,800 if divestiture takes the form of one corporation operating four gas districts, or reach a total of \$892,895 in the event that each of the **four** gas operations in question is taken over by a separate corporation. It appears that the proper approach,

28/ Under Section 11(b)(1)(A) the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that -- "(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system."

since there is no question that the gas operations of MU and the UE System can make up an integrated gas utility system ^{29/} within the meaning of Section 2(a)(29)(B), ^{30/} is to consider loss of economies on the basis of a divestiture envisaging operation of the gas properties as a system by one corporation. ^{31/}

A break-down of the \$697,800, which UE claims to be the loss on a combined basis reflects the following:

Buildings	\$ 231,763
Personnel	495,640
Transportation Equipment	19,019
Office Equipment	22,402
Communication Equipment	4,082
Office Supplies & Expenses	19,854
Payroll Taxes, Pensions & Benefits	76,924
Billing-Accounting Equipment	21,541
Added Fuel Expenses	(193,425)
Total Additional Annual Costs	<u>\$ 697,800</u>

Ratios relating to loss of economies of \$697,800 to pertinent 1969

^{29/} UE and the Division agree that the gas properties can be integrated. UE Brief, at 52 (March 20, 1972); Division Brief, at 21 (June 30, 1972).

^{30/} Section 2(a)(29)(B) defines an integrated gas utility system as follows:

As applied to gas utility companies, a system consisting of one or more gas utility companies which are so located and related that substantial economies may be effectuated by being operated as a single coordinated system confined in its operations to a single area or region, in one or more States, not so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation: Provided, That gas utility companies deriving natural gas from a common source of supply may be deemed to be included in a single area or region.

^{31/} Cf. New England Electric System, 41 S.E.C. 888, 893-94 n. 13 (1964).

operational data as proposed by UE are set forth below in Table I.

Table I

	Combined Gas <u>Companies</u>	Percent of Estimated Loss of <u>Economies to:</u>
Operating Revenues	\$ 15,763,348	4.43
Operating Revenue Deductions (before Federal Income Taxes)	13,561,475	5.15
Net Operating Revenues (before Federal Income Taxes)	2,201,873	31.69
Estimated Loss of Economies Claimed	697,800	

UE further insists that it is necessary to increase the estimated loss of economies by including additional financing costs of \$1,051,894 which it believes would be experienced if the gas and electric operations were divested on a combined basis, arguing that the expense of financing a business is no less an operating cost than wages and salaries. Table II below, using the operational figures shown in Table I, reflects the result of taking those costs into consideration.

Table II

	Combined Gas <u>Companies</u>	Percent of Estimated Loss of <u>Economies to:</u>
Operating Revenues	\$15,763,348	11.10
Operating Revenue Deductions (before Federal Income Taxes)	13,561,475	12.90
Net Operating Revenues (before Federal Income Taxes)	2,201,873	79.46
Estimated Loss of Economies	1,749,694	

On the other hand, the Division takes the position that the 1969 operational data used by UE does not reflect the increased revenues granted the various gas utilities during 1970 based upon 1969 cost figures, and argues that to the extent that a fair rate of return for an investor was not being earned in 1969, the revenues for 1969 should be adjusted upward to correct that inequity. Table III below reflects the ratios resulting from comparing a \$697,800 loss of economies to pertinent 1969 operational data that have been adjusted by increasing operating revenues by \$1,215,169, the amount suggested by the Division, which equals the total of the gas rate increases actually received by the UE System and MU in 1970.

Table III

	<u>Combined Gas Companies</u>	<u>Percent of Estimated Loss of Economies to:</u>
Operating Revenues	\$16,978,517	4.11
Operating Revenue Deductions (before Federal Income Taxes)	13,561,475	5.15
Net Operating Revenues (before Federal Income Taxes)	3,417,042	20.42
Estimated Loss of Economies Claimed	\$ 697,800	

Neither the additional financing costs suggested by UE nor the operating revenues it proposes appears acceptable in determining the degree of loss of economies to be anticipated. While agreeing with UE that the Supreme Court's decision in New England Electric ^{32/}

^{32/} 390 U.S. 207 (1968).

does not rule out consideration of financing costs in loss of economies studies and concluding that such costs may be taken into account if adequately shown, ^{33/} the record does not provide sufficient basis for accepting the claimed \$1,051,894 increase in financing cost as valid.

As testified by UE's Director of Corporate Planning, H.C. Allen, the additional cost of financing was reached after assuming that a severance would result in a small gas operation with no history of earnings, or, if the companies were combined, a history of inadequate earnings. Other factors were the questionable growth in the business because of potential gas shortage and the general level of interest rates. ^{34/} But the premises on which the financing costs were predicated are much too general to permit analysis and the record does not provide the specifics to support the end result reached by Mr. Allen.

That a present gas shortage exists cannot be extrapolated without more to reach the conclusion that a permanent shortage must be anticipated. UE, however, has not submitted evidence as to the likely period over which such shortage will continue, nor data as to the effect of the shortage upon the operations of the combined companies and the concomitant effect that any change in the operations of the severed gas companies would have upon their financing costs. Similarly, there is an absence of data from which

33/ Cf. General Public Utilities Corporation, supra at 831.

34/ Tr. 615.

it may be independently determined whether the assumed 9% interest rate for debt and 10% for preferred stock are acceptable. In this connection it is noted that Mr. Allen based the assumed rates upon his tabulation of 16 gas systems that raised money by private placement during 1970, but there appears to have been no effort made to update that tabulation to find out whether applicable rates may have declined as other interest rates have since 1970.

Nor does consideration appear to have been given to variance in costs depending upon whether a municipality or an investor-owned system were the purchaser beyond the point of viewing true costs as being the same under the "opportunity cost theory."^{35/} Under the "opportunity cost theory", according to Mr. Allen, affording an income-tax exemption to municipal bonds artificially lowers the interest rate. This in turn, as further explained by Mr. Allen, results in a lower cost of gas in this instance and a misallocation of resources that would otherwise be spent in "some productive resource."^{36/} Without debating its validity, the theory cannot be accepted in support of UE's proposed financing costs. The theory postulates that an artificial advantage to gas will be offset by an equal disadvantage elsewhere in the general economy. But the concern here is not whether there is a balancing of the advantage that gas may obtain, rather the extent that gas operations would

^{35/} UE Brief, at 49 (August 2, 1972).

^{36/} Tr. 1091.

suffer from loss of economies in case of severance. In that context, the "opportunity cost theory" is unhelpful and cannot replace the need to consider savings in financial costs that might result from a calculation of "loss of economies" which assumes that a municipality is the purchaser of the severed properties. What has been said about the proposed financing costs also disposes of UE's contention that a divestiture of the water and gas properties would present a significant financial problem because the low interest mortgages covering those properties could not be retained and would have to be replaced by debt carrying a substantially higher interest rate.

With respect to operating revenues, the proposal of the Division and not that of UE must be accepted. UE's proposed operating revenues as reflected in Table I are taken from 1969 income statement information, a year in which gas revenues suffered by reason of regulatory lags in granting rate increases. Since it must be assumed that a gas company is entitled to a fair rate of return for the investor, and since rate increases granted in a following year based upon the previous year's cost indicate the extent of the previous year's inadequacy, it seems appropriate to adjust UE's proposal in the manner suggested by the Division. ^{37/} Table III above reflects the preferable pertinent ratios for use in making

^{37/} Cf. General Public Utilities Corporation, supra, at 837-38.

comparisons with previous Commission decisions. ^{38/}

Inasmuch as the percentages of 4.11%, 5.15%, and 20.42% reflected in Table III are less than corresponding percentages in Engineer Public Service Co., The North American Co., General Public Utilities Corporation, Middle South Utilities, Inc., and New England Electric ^{39/} cases where the Commission found losses were not of such magnitude as to be considered "substantial" within the meaning of Clause A of Section 11(b)(1), ^{40/} it cannot be said that UE has established that severance of the gas properties in question would result in a "loss of substantial economies." Accordingly, the requisite findings under Clause A of Section 11(b)(1) cannot be made to permit retention

^{38/} UE's argument that an adjustment should also be made to eliminate the revenue which the separate gas properties would receive from the electric companies cannot be accepted. Unlike the proposed additional financing costs which cannot be satisfactorily calculated from information in the record, it is a simple task of arithmetic to determine the amount of revenue that the gas companies would have received from sales to the electric operations at established retail rates instead of at the lower commodity price. UE's further argument that losses to be experienced by the electric businesses upon divorcement of the gas operations should be taken into account is rejected as contrary to established principles. As stated in Philadelphia Company, 28 S.E.C. 35, 52 (1948): "[T]he losses in economies which may be considered under clause (A) are limited to those directly related to the additional system sought to be retained."

^{39/} New England Electric System, 41 S.E.C. 888, 905 (1964). The appendix appearing at page 905 also includes instances of smaller percentages than here considered, and at 898 n.22 the Commission, for reasons there stated, disclaimed comparability to ratios shown in the appendix that relate to gas properties of Jersey Central Power & Light.

^{40/} In Philadelphia Co., supra, at 47, the Commission concluded: "For the economies to be 'substantial', they must be 'important' in the sense that they are of such nature that their loss would cause a serious economic impairment to the system."

of the gas properties even if an acquisition of MU's gas properties were possible under Section 10(c)(2).

Although viewing \$697,800 as a more appropriate figure to use than UE's proposed \$1,749,694 in calculations of the ratios of estimated loss of economies to pertinent operating data, a determination cannot be made whether \$697,800 accurately reflects the "loss of economies" that will be experienced annually by reason of severance of the gas properties. This results from the fact that the study of estimated losses prepared under the supervision of Mr. Allen is found to be materially deficient.

In preparing its presentation, there is no question that UE was free to select the expert of its own choice to undertake a "loss of economies" study. But when it chose one of its own employees for that task, it put the objectivity of the resulting study in issue, a question that would not have been injected had a disinterested person been selected. However, the fact that Mr. Allen is an employee of UE does not by itself require rejection of the study. More serious are the questions of Mr. Allen's qualifications and his dependency and that of his staff upon opinions of other employees and upon UE's Organization and Salary Review group.

Without intent to raise doubt about Mr. Allen's abilities to perform his usual functions as UE's Director of Corporate Planning, it must be said that there is substantial doubt that Mr. Allen could or did perform an independent "loss of economies" study.

Mr. Allen's experience is "primarily limited to electric[ity]" ^{41/}
and prior to the study in question he had never "done anything like
this -- like separating utilities." ^{42/} Undoubtedly this inexperience
led to an excessive dependence upon the opinions of others in UE
who had even less reason than Mr. Allen to be objective regarding
the results of the study. This reluctance to undertake an independent
study is clearly illustrated by Mr. Allen's failure to review the
efficiency of UE's existing operations. In that connection, Mr.
Allen assumed that existing costs for the combined operations were
to be accepted without question, and indicated that it would be
presumptuous for him to differ with "the experience of a management
that has operated the system over many years, that management
being constantly conscious of cost." ^{43/} Mr. Allen's further testi-
mony was that there was no investigation of the operations of ME
"to determine if their management was operating in the most efficient
manner possible," ^{44/} stating also that the efficiency had been gone
into over the years although he did not know when the last check
had taken place.

Blind acceptance of management's past record and unswerving
loyalty to an employer, commendable as they may be within an organi-
zation, have no place in a presentation of a "loss of economies" study.

41/ Tr. 612.

42/ Tr. 581.

43/ Tr. 590.

44/ Tr. 636-37.

These characteristics of Mr. Allen, which are clearly evident from the record, taint the reliability of the study, much of which could be varied depending upon Mr. Allen's judgment as to what was reasonable under the circumstances. Taking this failing into account with the absence of an efficiency study into the operations of the UE System, it must be concluded that UE has not met its burden of demonstrating by "clear and convincing" evidence that substantial economies within the meaning of Clause (A) of Section 11(b)(1) would be lost were retention of the gas properties not permitted.^{45/}

The MU water properties cannot be retained by the UE System regardless of the "loss of economies" involved in the divestiture of those properties unless a functional relationship exists between the electric properties which are to be retained by UE and the MU water properties.^{46/} Under Section 11(b)(1) a holding company system may be permitted to retain an interest in such other businesses as are reasonably incidental or economically necessary or appropriate to the operations of such integrated public-utility system. The burden is upon the holding company to show that the "other businesses" meet the standards of Section 11(b)(1).^{47/} Those standards have been construed as "requiring an affirmative showing of an operating or functional relationship between the operations of the retainable

^{45/} Cf. Philadelphia Company, supra, at 53, 61.

^{46/} Id., at 75.

^{47/} Id.

utility system and the non-utility business sought to be retained, and an affirmative showing that retention would be in the public interest."^{48/}

While joint operation of MU's electric and water businesses may well achieve the economies claimed by UE, there has been no showing of a functional relationship between the two businesses. Without that showing, UE has not carried its burden, and it must be concluded that the water properties are not retainable under Section 11(b)(1). Middle South Utilities, Inc.,^{49/} which UE calls upon in support of its argument against divestiture, does not conflict with this conclusion. The reluctance of the Commission to order divestiture of that utility system's transit operations is attributable to the intercession of the City of New Orleans seeking to have the unified operations continued.^{50/} Here, as City cogently argues, City is the only community served by one company for water, gas, and electricity, and it takes the position that MU water and gas be divested as a condition of the acquisition.

Fairness of Exchange Offer

Under Section 10(b)(2), UE's acquisition of the common stock of MU may not be approved if it is found that the consideration, including all fees, commissions, and other remuneration to be paid

^{48/} Id.

^{49/} 35 S.E.C. 1 (1953).

^{50/} In a later proceeding, Middle South Utilities, Inc., Holding Company Act Release No. 17116 (1971), the Commission refused to consider the question of the transit operations, citing the reasons given in 1953.

is not reasonable or does not bear a fair relation to the sums invested in or the earning capacity of the underlying utility assets. Among the factors to be considered are the earnings and dividends of UE and MU and the book and market values of their respective 51/ stocks.

Table IV below reflects actual and estimated earnings, dividends, and book and market values applicable to the common stock of UE and MU for the years indicated, the results on a pro forma basis assuming the 1.1 for 1 exchange had taken place in each of the years 1967-1971, and the premium or reduction of the pro forma results as compared to actual.

Table IV

	Earnings Available For Common Stock Per Average Share Outstanding				Premium or (Reduction) by % for MU Shareholder	Dividend Per Average Share Outstanding				Premium or (Reduction) by % for MU Shareholder
	Actual		Pro-Forma			Actual		Pro-Forma		
	UE	MU	UE	MU		UE	MU	UE	MU	
1967	\$1.60	\$1.96	\$1.60	\$1.76	(10.2)	\$1.20	\$1.20	\$1.20	\$1.32	10
1968	1.59	1.60	1.58	1.74	8.8	1.20	1.20	1.20	1.32	10
1969	1.60	1.52	1.60	1.76	15.8	1.20	1.20	1.20	1.32	10
1970	1.92	1.36	1.90	2.09	53.7	1.26	1.20	1.26	1.39	15.8
1971	1.61	1.16	1.59	1.75	50.9	1.28	1.20	1.28	1.41	17.5
1972E	1.53	1.12	1.52	1.67	49.1	1.28	1.20	1.28	1.41	17.5

E - Estimates

	Book Value Per Share Outstanding (Year-End)				Premium or (Reduction) by % for MU Shareholder	Market Price <u>52/</u> Per Share			Premium (Reduction) by % for MU Shareholder
	Actual		Pro-Forma			Mean Market Price			
	UE	MU	UE	MU		UE	MU	1.1 Sh. UE	
1967	\$11.85	\$17.58	\$11.96	\$13.16	(25.1)	24-3/4	22-1/2	27-1/4	21.1
1968	13.11	17.98	13.20	14.52	(19.2)	22-1/4	21-1/2	24-1/2	14.0
1969	13.54	18.15	13.63	14.99	(17.4)	18-3/8	16-5/8	20-1/4	21.8
1970	14.41	18.31	14.47	15.92	(13.1)	--	--	--	--
1971	14.83	18.49	14.88	16.37	(11.5)	--	--	--	--

51/ Cf. Hawaiian Electric Company, Inc., supra.

52/ Market prices subsequent to announcement of the exchange offer were affected by the terms of that offer and are therefore not shown. Cf. American Electric Power Company, Inc., Holding Company Act Release No. 15800, at 8 (1967).

Because of the premiums that MU shareholders would derive from an exchange ratio of 1.1 to 1, and in particular the premiums relating to earnings and dividends, the Division objects to the fairness of the proposed offer. It suggests that a 1 to 1 ratio is the upper limit that can be found acceptable.

The Division points out that while UE has increased its dividend by 6.7% from \$1.20 to \$1.28 during the years 1967-1971 with a payout ratio of no greater than 79.5%, MU has maintained a constant dividend rate of \$1.20 in those years with the payout in 1971 equivalent to 103% of income available to stockholders. It then calls attention to the fact that if MU earnings continue the declining trend indicated in Table IV, that a reduction in MU's dividend can be anticipated. The Division also adverts to the indicated declining trend of MU's earnings as compared to the comparatively stable level enjoyed by UE, and concludes that while the proposed exchange may have been reasonable and fair through 1969, such is not the case for 1970, 1971, and as estimated for 1972.

The Division's position ignores the results of the independent studies of MU and UE by Reis & Chandler, Inc., dated May, 1970, as updated by calculations of L. Sanford Reis during November, 1971, and the testimony of senior officers of MU and UE. Reis & Chandler was engaged by UE for the purpose of determining and recommending an appropriate ratio of exchange of common shares

of UE for the common shares of MU, and on January 20, 1970 the firm advised UE that a 1.2 for 1 ratio was within the range of reason. However, UE's board determined on January 28, 1970 to approve a proposed agreement between UE and MU calling for the 1.1 to 1 ratio now in question.

At the hearing, L. Sanford Reis testified that he had updated his firm's studies to reflect results of operations through September 30, 1971, and that he was of the opinion that the 1.1 for 1 ratio is fair and equitable to the holders of common stock of MU and UE. He further testified on cross-examination that as against the premium on earnings for MU stockholders, there must be considered the element of book value, which he believed to be significant, and the element of requested rate increases by MU and UE which he assumed would give MU a much larger boost in earnings than UE. In like vein, MU's president, Ray W. Call, testified that MU had applied for a rate increase of \$1,500,000 indicating that MU's earnings would increase by 48¢ per share if the increase were granted, and W.E. Cornelius of UE voiced the opinion that MU would proportionately fare better than UE in the outcomes of their pending rate cases. If MU's rate increase had taken effect at the beginning of 1972, its estimated earnings for 1972 would be \$1.60 as compared to the \$1.53 earnings estimate for UE, and the wide disparity in earnings per share would be eliminated. ^{53/}

^{53/} Under appropriate circumstances, anticipated rate increases may be taken into consideration. Cf. Hawaiian Electric Company, Inc., supra, at 8.

While the Division dismisses these views of Cornelius and Reis as "merely suppositions," and is critical of the absence of forecasts for MU and UE for years beyond 1972, it appears that the testimony should be credited and that the record does not require the forecasts referred to by the Division before a determination can be made as to fairness. It is true that the testimony of Cornelius and Reis in this area may include "suppositions" in the sense that they were attempting to forecast the outcome of pending rate cases, but the independence of Reis and the expertise of these witnesses compels acceptance of such "suppositions" as "expert opinion" entitled to considerable weight in evaluating the fairness of the UE offer. Assuming the validity of the opinions of Reis and Cornelius, as well as that of Call, the predicted premium on earnings for MU stockholders would not eventuate nor would MU's dividends be reduced.

Considering all relevant factors, including the fact that the terms of the proposed exchange were a result of arms-length negotiations, the proposed 1.1 to 1 exchange ratio is found to be fair and reasonable. The MU shareholders may well receive greater earnings and dividends, as well as a wider market for their stock, but this will be offset to an extent by a reduction in book value per share. UE shareholders can expect to benefit from growth in MU's service area for which they will suffer at most a slight dilution in earnings per share.

Testimony of UE's executive vice-president concerning the fees and expenses UE proposes to pay in connection with the proposed

acquisition indicates that a total of \$88,500 will be required, and the Division does not take issue with that amount. It is concluded that payment of fees and expenses in the aggregate of \$88,500 is fair and reasonable.

Other Matters

Section 3(a)(2) of the 1935 Act allows the Commission to exempt any holding company, and every subsidiary company thereof, from any provision or provisions of the 1935 Act "unless and except insofar as the Commission finds the exemption detrimental to the public interest or the interest of investors or consumers, if -- such holding company is predominantly a public utility company whose operations as such do not extend beyond the State in which it is organized and States contiguous thereto." As earlier noted, UE was exempted in 1962 from all provisions of the 1935 Act except Section 9(a)(2). Since the record establishes that UE will continue to be predominantly a public-utility company should MU become one of its subsidiaries, there appears to be no reason not to grant UE the requested exemption under Section 3(a)(2) providing that the public interest and the interest of investors and consumers are protected by a divestiture of UE's present gas properties and of the Senath electric properties and the water and gas properties to be acquired.

Without such divestiture, however, it is clear that the anti-competitive aspects involved in a continuation of UE's combined gas and electrical operations, augmented by those of MU, require a

finding that an exemption under Section 3(a)(2) would be detrimental to the public interest and to the interests of investors and consumers, and a finding that the proposed acquisition does not meet the standards of Section 10(b)(1) ^{54/} or of Section 10(c)(1).

The Public Service Commission of Missouri and the Illinois Commerce Commission, the only regulatory bodies other than this Commission having jurisdiction over the proposed acquisition, have approved of the issue of 804,095 shares of UE common stock to acquire in exchange not less than 83.3% of MU's outstanding common stock on a basis of 1.1 shares of UE common stock for each share of MU common stock. Counsel for UE has represented that neither the laws of Missouri or of Illinois prohibit a single company from providing both electric and gas service in the same territory and has also represented that upon obtaining the approval of this Commission and required authorizations pursuant to the securities laws ("blue sky") of the States having jurisdiction over the issuance of UE common stock in exchange for that of MU, all laws will have been complied with relative to the proposed transaction. It appears, therefore, that the proposed acquisition will not be unlawful under the provisions of Section 8 of the 1935 Act and that, assuming divestiture of the gas properties owned and to be acquired, the requirements of Section 10(f) have been satisfied.

^{54/} Section 10(b)(1) provides that the Commission shall approve an acquisition unless it finds that the acquisition will tend towards the concentration of control of public-utility companies, of a kind or to an extent detrimental to the public interest or the interest of investors or consumers.

UE has stated that if the proposed exchange takes place without UE thereby acquiring all of the common stock of MU, UE will submit a plan pursuant to Section 11(e) of the 1935 Act for the purpose of eliminating the publicly-held minority interest in MU. It appears that the standards of Section 10(b)(3) of the 1935 Act relating to the appropriate capital structure of the holding-company system of an applicant would be served by the elimination of any minority interest in MU resulting from the exchange in question. Such elimination will therefore also be required as a condition of the approval of the proposed acquisition.

Conclusion

Based upon the foregoing, it appears that an order should be entered approving the proposed acquisition of MU common stock by UE upon the conditions heretofore indicated and granting UE an exemption pursuant to Section 3(a)(2) as of the effective date of the proposed exchange offer on condition that the gas properties of the UE System and the ^{gas, water, and electrical} ~~water and gas~~ properties of MU are divested within a reasonable time.

Accordingly, IT IS ORDERED that the application of Union Electric Company be, and it hereby is, granted, subject to the following conditions:

1. that appropriate provision be made for the divestment

55/ All proposed findings and conclusions submitted by the parties have been considered, as have their contentions. To the extent such proposals and contentions are consistent with this initial decision, they are accepted.

of the gas properties of Union Electric Company and its present subsidiaries, and for the divestment of the gas, water, and Senath electrical properties of Missouri Utilities Company,

2. that upon consummation of the proposed acquisition, Union Electric Company submit a plan pursuant to Section 11(e) of the 1935 Act for the purpose of eliminating any resulting publicly-held minority interest in Missouri Utilities Company, and

3. that jurisdiction of the Commission is retained to enter such other and further orders and to take such further action as may be necessary or appropriate in connection with any questions involving the foregoing terms and conditions, and

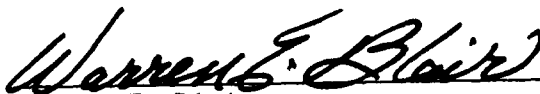
IT IS FURTHER ORDERED that an exemption pursuant to Section 3(a)(2) of the 1935 Act from all provisions of the Act, except Section 9(a)(2) thereof, is hereby granted upon condition:

1. that Union Electric Company divest the gas properties of Union Electric Company and its present subsidiaries, and the gas, water and Senath electrical properties of Missouri Utilities Company, and

2. that Union Electric Company promptly file a report with the Commission disclosing any changes that occur affecting Union Electric Company's relationship with or interest in Electric Energy, Inc., and any changes in the ownership or the securities of the latter company or in that company's contract with the Atomic Energy Commission.

This order shall become effective in accordance with and subject to the provisions of Rule 17(f) of the Rules of Practice.

Pursuant to Rule 17(f) of the Rules of Practice, this initial decision shall become the final decision of the Commission as to each party who has not, within fifteen days after service of this initial decision upon him, filed a petition for review of this initial decision pursuant to Rule 17(b), unless the Commission, pursuant to Rule 17(c), determines on its own initiative to review this initial decision as to him. If a party timely files a petition for review, or the Commission takes action to review as to a party, the initial decision shall not become final with respect to that party.



Warren E. Blair
Chief Administrative Law Judge

Washington, D.C.
September 19, 1972