Exhibit No.:	
Issues:	*Merger Savings; Aries Unit*
Witness:	*Cary G. Featherstone*
Sponsoring Party:	*MoPSC Staff*
Type of Exhibit:	*Rebuttal Testimony*
Case Nos.:	*ER-2004-0034 and HR-2004-0024 (Consolidated)*
Date Testimony Prepared:	*January 26, 2004*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

CARY G. FEATHERSTONE

AQUILA, INC. d/b/a AQUILA NETWORKS-MPS (Electric)
AQUILA NETWORKS-L&P (Electric & Steam)
CASE NOS. ER-2004-0034 & HR-2004-0024
(CONSOLIDATED)

Jefferson City, Missouri
January 2004

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

NP

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Aquila, Inc. d/b/a Aquila Networks L&P and Aquila Networks MPS to implement a general rate increase in electricity.	)	Case No. ER-2004-0034
In the matter of Aquila, Inc. d/b/a Aquila Networks L&P to implement a general rate increase in Steam Rates.	)	Case No. HR-2004-0024

AFFIDAVIT OF CARY G. FEATHERSTONE

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Cary G. Featherstone, of lawful age, on his oath states: that he has participated in the preparation of the following rebuttal testimony in question and answer form, consisting of 57 pages to be presented in the above case; that the answers in the following 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.

Cary G. Featherstone
Cary G. Featherstone

Subscribed and sworn to before me this 30th day of January 2004.

Toni M Charlton

TONI M. CHARLTON
NOTARY SEAL
NOTARY PUBLIC
STATE OF MISSOURI

TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

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CARY G. FEATHERSTONE

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CARY G. FEATHERSTONE

AQUILA, INC., d/b/a AQUILA NETWORKS-MPS (Electric) and

AQUILA NETWORKS-L&P (Electric and Steam)

CASE NOS. ER-2004-0034 AND HR-2004-0024

(CONSOLIDATED)

Q. Please state your name and business address.

A. Cary G. Featherstone, 3675 Noland Road, Independence, Missouri.

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

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

Q. Are you the same Cary G. Featherstone who has previously filed direct testimony in this proceeding?

A. Yes, I am. I filed direct testimony in this case on December 9, 2003 on the areas of cost of removal / salvage and the Aries Combined Cycle generating unit.

Q. What is the purpose of this rebuttal testimony?

A. The purpose of this rebuttal testimony is to address the direct testimony filed by Aquila, Inc. (Aquila or Company; formerly known as UtiliCorp United, Inc.) Vern J. Siemek, Financial Manager for Aquila Networks--Nebraska, relating to the aspects of the merger between Aquila and St. Joseph Light & Power Company (SJLP). Specifically, Mr. Siemek states at page 2, line 21 that Aquila is seeking to retain "50% of the acquisition-related savings to benefit shareholders for creating those savings..."

In particular, I will address the following points relating to Aquila and the St. Joseph Light & Power merger (collectively the St. Joseph merger):

- The proposal by Aquila to share in the savings is to take Aquila Networks-MPS (MPS) and Aquila Networks-L&P (L&P) off of cost-based rates.
- Merger savings have benefited and been realized by Aquila's shareholders
- Rejection of the merger savings sharing proposal will not be a disincentive to Company's future merger activities.

I will address the direct testimony of Aquila witness Lisa A. Starkebaum on the issue of the Aries Purchased Power Agreement. Specifically, I will provide rebuttal testimony with regard to a cost overrun that occurred at the Aries Combined Cycle Unit (Aries) during construction. In addition, I will provide some rebuttal testimony relating to the decision to build the Aries project.

Q. Please describe how you are referring to Aquila, its divisions and affiliates in this rebuttal testimony?

A. When referring to the current Aquila corporate structure, I will be referring to Aquila Inc, the parent company of all of Aquila, Inc. including its operations regulated by this Commission: Aquila Networks-MPS and Aquila Networks Light & Power. Aquila, Inc. was formerly named UtiliCorp United, Inc. I refer to the operating division Aquila Networks-MPS as MPS and I refer to the operating division Aquila Networks-LIP as Light & Power or L&P.

In 2000 Aquila (then called UtiliCorp) and St. Joseph Light & Power Company merged. I refer to that event as the St. Joseph merger. When referring to the former St. Joseph Light & Power Company I will call it SJLP.

Q. When did the merger between Aquila and SJLP formerly merge take place?

A. The merger was completed between Aquila and SJLP on December 31, 2000.

MERGER BETWEEN AQUILA, INC. AND ST. JOSEPH LIGHT & POWER COMPANY

Q. Did you particpate in the merger case filed by Aquila (UtiliCorp), and St. Joseph Light & Power Company, in Case No. EM-2000-292?

A. Yes. I filed rebuttal testimony in that case on the areas of merger premium, acquisition adjustment and tracking of merger savings.

Q. What specific areas will your rebuttal address regarding the St. Joseph merger?

A. This rebuttal testimony will respond to the direct testimony of Aquila witness Vern J. Siemek regarding the regulatory treatment of merger savings resulting from the merger with SJLP. In this rebuttal, I will provide testimony concerning cost based rates, Aquila exclusively realizing benefits from the St. Joseph merger, a general review of the regulation of utility merger and acquisition activity in the state of Missouri and Aquila's assertion that the Commission's denial of the Company's merger savings sharing proposal will affect future merger activity in the state of Missouri. Other Staff members will be addressing the Aquila merger savings proposal as well. Staff witnesses Mark L. Oligschlaeger, Janis E. Fischer and Steve M. Traxler will provide rebuttal on this issue.

Q. How have you organized your rebuttal testimony on the merger savings sharing proposal Aquila has presented in its direct testimony filed in this case?

A. The following indicates the structure of the testimony relating to Aquila's merger saving proposal based on its merger with SJLP:

1. Mergers and Acquisition Background
2. Background of the SJLP Merger with Aquila
3. Disallowance of Merger Premiums in Rates does not Affect Mergers being Completed in Missouri
4. Merger Tracking

5. Customers are Entitled to Savings Resulting from either Merger or Nonmerger Events

6. Summary and Conclusions for Merger Savings Proposal

7. Aries Combined Cycle Unit

MERGERS AND ACQUISITIONS BACKGROUND

Q. What has been your past experience relating to other mergers and acquisitions?

A. I have been involved in Staff's review of several merger and acquisition applications filed with the Commission. Attached to this rebuttal testimony as Schedule 1 is a listing of the various merger and acquisition applications and reviews I have participated in during my employment with the Commission.

BACKGROUND OF THE ST. JOSEPH LIGHT & POWER COMPANY MERGER WITH AQUILA INC.

Q. Did SJLP provide utility services within the state of Missouri prior to its merger with Aquila?

A. Yes. SJLP provided electric, natural gas and industrial steam utility service to customers in the northwest part of the state of Missouri.

Q. Would you provide a brief history of SJLP?

A. Attached as Schedule 2 to this rebuttal testimony is a detailed background of the merger between Aquila and SJLP which includes a history of SJLP.

COST BASED RATES

Q. Does Aquila's proposal to retain half of the merger related savings as advocated by Mr. Siemek in his direct testimony take the Company off of cost based rates?

A. Yes. Mr. Siemek is supporting in his direct testimony adding adjustments, for merger savings that Aquila has identified, to the costs it is proposing to include in rates in this case. The adjustments are being made so Aquila will be able to retain, for shareholders, merger savings from the synergies occurring as a result of the St. Joseph merger.

Q. Why is this proposal necessary for Aquila?

A. If Aquila did not file a rate case, the Company's shareholders would continue to benefit exclusively from the purported merger savings, just as they have done since the closing of the merger on December 31, 2000. This situation would change with the filing of a rate case. Thus, Aquila has proposed in its rate case a sharing savings adjustment to keep some of the merger savings for its shareholders.

Since rates are based on historical costs that are normalized and annualized in a rate case, any merger savings that have occurred to date through the end of the known and measurable period, September 30, 2003, would be reflected in rates when approved by the Commission. Aquila's merger savings sharing proposal is a mechanism devised by the Company to allow retention of a portion of the merger savings for its shareholders. This "sharing" proposal, in essence, is a mechanism that allows the Company to keep the customers from fully benefiting from the St. Joseph merger. This merger savings sharing proposal takes Aquila off of rates based on actual costs.

Q. Are merger savings any different than other costs reductions that occur as result of utility decisions?

A. No. Over time, there are opportunities to reduce costs as technology brings about efficiencies. In addition, utilities engaged in employee reductions during much of the 1980s and 1990s as companies sought to cut costs, especially those that planned to avoid filing rate cases. To the extent that there were cost decreases, the companies maintained the savings for as long as their rates were not changed to reflect the reductions. Aggressive companies negotiated fuel contracts and rail freight agreements that resulted in reductions in fuel costs. These cost reductions also directly benefited shareholders as long as the company did not have its rates changed to reflect the costs declines. At the time of rate cases, or in some instances, excess revenue complaint cases, the costs savings were reflected in rates so that the company's customers could receive benefits from efficiencies and economies from technology, re-negotiated fuel, or other events and developments. These types of cost reductions generally were not identified for cost sharing, i.e., half of the savings were proposed to be "added" back to companies' cost of service calculations so the shareholders could continue to reap benefits from the costs savings.

Just as it would be inappropriate for ratepayers to "share" in costs reductions from re-negotiated fuel contracts allowing shareholders to retain the savings permanently, it is equally inappropriate to expect customers to not receive at some point the savings in costs resulting from a merger. Companies retain the savings that result from, for example, restructurings or reorganizations that result in employee reductions, until those savings are provided rate treatment through a rate case or excess revenue complaint case. Merger savings should also be reflected in rates at some point as well.

Q. Will adopting Aquila's proposal to keep half the merger savings for shareholders result in permanent savings to the Company?

A. Just as the Company has reaped 100% of any merger savings since the close of the St. Joseph merger (December 31, 2000), if the proposal identified by Mr. Siemek in his direct testimony is approved by the Commission, Aquila will be permitted to keep half of what is identified as the merger savings generated to date to at least the next rate case. If this proposal is allowed to continue, the Company will benefit by retaining half the merger savings until such time as the Commission discontinues such practice.

Q. How does the Company's proposal affect cost based rates?

A. Generally, prudent and reasonable costs are reflected in a revenue requirement calculation. When rates are determined in a rate case or excess revenue complaint case, the reasonable and prudent costs of providing utility service are included in the cost structure and the company is allowed to recover these costs in the rates it charges its customers; thus, rates are determined using actual costs that are deemed to be reasonable and prudent. While costs are normalized and annualized for a particular period, they are based on actual historical costs incurred by the utility.

Aquila's merger savings sharing proposal being sponsored by Mr. Siemek, seeks to "impute" costs savings to the cost structure. These "imputed" cost savings are not actual costs yet they are "added" back to the actual costs of the Company to determine the rates to charge its customers. While there is a basis for reflecting the recovery of actual costs in rates, there is no basis for reflecting the merger savings. Using merger savings in rates takes the Company off of cost-based ratemaking.

These merger savings can be thought of as arising from hypothetical expenses which no longer exist for purposes of rate determination. The merger savings do not represent actual costs incurred in providing utility service yet the Company proposal "adjusts" cost of service expenses by adding back a portion of these savings as an adjustment to increase expenses, thus providing a credit to the shareholders by not allowing the savings to "flow" to customers. Because the Company's cost structure will not represent actual costs if this proposal is adopted, rates to be determined in this case will not be cost based. The Company's proposal for purported merger savings increases expenses and causes rates to be higher than they otherwise would be. Apparently, Aquila's position with regard to the merger savings is that the Company is entitled to charge customers higher rates based on higher than actual costs to provide electric and steam service.

Q. Have other utilities in Missouri demonstrated experience in cost reductions?

A. Yes. Kansas City Power & Light and Union Electric have experienced cost reductions for which their shareholders reaped the benefits until rates were changed.

Q. Has the Commission approved experimental alternative regulation plans for ratemaking purposes?

A. Yes. The Commission approved in two instances experimental alternative regulation plans for Southwestern Bell Telephone Company (Southwestern Bell or SWBT) in Case No. TC-89-14 and Union Electric in Case Nos. EO-96-14 and EM-96-149. Both of these companies were in declining cost situations for their operations. At the time the Commission entered into these experimental alternative regulation plans, rates were set through an excess revenue/overearnings reviews that led to rate reductions. In both instances, there were rate moratoriums associated with the experimental alternative regulation plans.

Q. Is Aquila's merger savings sharing plan similar to the Southwestern Bell or Union Electric plans?

A. Yes. However, it does not have the safeguards associated with the other plans that the Commission approved in the past. There is no mechanism in place to allow for a review of earnings so that the Company does not continue to earn above a prescribed level without a "sharing" of earnings review. While these plans, from the Staff's perspective, were intended to generally look at all of the regulated costs of the two companies, Aquila's merger savings sharing proposal only looks at what it defines as "merger savings" and seeks to treat these cost reductions in a unique manner. Aquila's proposal does not provide for a rate moratorium, unlike the experimental alternative regulation plans for Southwestern Bell and Union Electric which prevented general rate increases. While maintaining the protection of filing rate increases for its increasing costs, Aquila seeks "alternative regulation" for those isolated costs which have purportedly declined as result of the St. Joseph merger. Unlike Aquila, Southwestern Bell and Union Electric both gave up the opportunity for general rate increases through rate moratoriums in return for experimental alternative regulation. Neither Southwestern Bell nor Union Electric had any general rate increases while these plans were in effect. With the savings sharing proposal, Aquila seeks a best-of-both-worlds approach in which it retains the ability to increase rates for its generally increasing costs, but employ "alternative regulation" for its identified declining costs.

Q. Are there other differences between the experimental alternative regulation plans used by Southwestern Bell and Union Electric and Aquila's merger savings sharing proposal?

A. Yes. The Southwestern Bell and Union Electric experimental alternative regulation plans also were for specified periods of time, unlike Aquila's savings sharing proposal.

Q. Was there an oversight function attached as part of the Southwestern Bell and Union Electric plans?

A. Yes. Unlike Aquila's proposal, for each year of the experimental alternative regulation plans, the Staff and the Office of the Public Counsel monitored the earnings levels of Southwestern Bell and Union Electric to determine the amount of sharing credits, if any, which were to be credited to customers. There is no similar oversight function reflected with Aquila's savings sharing proposal.

AQUILA HAS REALIZED MERGER SAVINGS TO THE BENEFIT OF ITS SHAREHOLDERS

Q. Mr. Siemek states at page 15, line 14 of his direct testimony that "Aquila has realized little, if any, benefit from those merger savings to date." Does Staff agree with this assessment?

A. No. The St. Joseph merger was completed December 31, 2000. The integration of the two systems, now MPS and L&P, started immediately. Aquila realized merger savings from payroll and payroll-related benefits reductions, fuel and purchased power savings from joint dispatch, insurance savings along with other cost reductions. MPS benefited from the change in allocations of corporate costs that reduced its expenses.

Q. At page 16, line 2 of his direct testimony, Mr. Siemek claims that "the first year of integration resulted in relatively few savings" from the merger. On Page 15, line 15, he says that "joint dispatching was delayed until mid-year." When did joint dispatch start between the MPS and L&P systems?

A. According to the response to Date Request No. 445, joint dispatch stated August 15, 2001. The Company stated:

> In addition to the transmission path that was purchased from Associated Electric, approval to operate as a single control area was needed from SPP, MAPP, and NERC. We also had to make significant modifications to our EMS/SCADA system to complete the

> transition. August 15, 2001 was the first day for operations as a combined control area.

Thus, joint dispatch has been occurring since August 15, 2001, allowing any savings to flow directly to Aquila's shareholders for almost three years to the time rates may be changed in this case, June 2004.

Q. When did MPS start to enjoy the benefits of reduced corporate costs through the allocation process?

A. Immediately upon the close of the merger, the amount of corporate costs allocated to MPS were reduced to reflect the addition of L&P into the allocation mix.

Q. Has the Company realized significant savings from the St. Joseph merger?

A. Since the very beginning of the merger both MPS and L&P have benefited directly from merger savings. The merger closed on December 31, 2000 and since that time both of these operating division started to integrate their two businesses into one another. In fact, the integration process started prior to the close of the merger when both Companies started to plan for when the merger would become a reality.

Mr. Siemek contends that significant savings have resulted from the St. Joseph merger. He states starting at page 18, line 9 of his direct testimony that "Aquila's acquisition has created significant savings to MPS and L&P from joint dispatching and to MPS from economies of scale for support costs." Aquila has directly benefited from these "significant savings" and since Aquila is seeking to significantly increase rates, as such, it is time that the customers of these two operating divisions start to benefit from these merger savings also.

Q. When will MPS and L&P rates change?

A. Aquila filed on July 3, 2003, its cases to change electric and steam rates. The Commission suspended the tariffs filed in those cases. Absent further Commission action, this is the earliest time that customers will receive any benefit from the St. Joseph merger.

Q. Were natural gas or steam rates changed in the Company's last case?

A. No. The Company only filed to increase electric rates for its MPS division in Case No. ER-2001-672. No rate change has occurred for MPS natural gas operations since 1993, the last time Aquila filed for a rate increase for those operations in Case No. GR-93-172. Thus, no merger savings have been realized by MPS natural gas customers.

Rates have not changed for the former SJLP, now L&P electric system, since 1999 in Case Nos. ER-99-247 and EC-98-573, when the parties entered into a Stipulation And Agreement to decrease rates and the Commission approved. SJLP also filed steam and gas rate increase cases, Case Nos. HR-99-245 and GR-99-246, in 1999. Those cases settled with a small decrease in steam rates and no change in gas rates.

Q. Will merger savings continue to be created?

A. Yes. To the extent that Aquila continues to integrate the two systems together, savings will be created. Any merger savings beyond those already created will be retained by Aquila for the benefit of its shareholders until such time as rates are changed again.

THE REJECTION OF THE OF AQUILA'S MERGER SAVINGS PROPOSAL WILL NOT AFFECT MERGERS BEING COMPLETED IN MISSOURI AND ACT AS A DISINCENTIVE TO FUTURE MERGERS

Q. At page 16, line 23 of his direct testimony, Mr. Siemek states that if "shareholders do not retain some portion of merger savings, companies will be less likely to pursue mergers that could ultimately benefit customers by lowering their costs." Does Staff agree with this concern of Aquila?

A. No. Mr. Siemek further addresses this point at page 3, line 20 of his direct testimony wherein he states that "sharing in the savings created by the merger provides an incentive for companies to create such savings for customers by encouraging future mergers." Utilities have been proposing mergers for many years, and have continued to do so even if the Commission has never adopted direct recovery of merger costs and premiums or the indirect recovery of merger costs and premiums through the adoption of a merger saving sharing proposal.

Q. Will the rejection of the merger savings sharing proposal result in mergers and acquisitions not being proposed and effectuated in Missouri and actually create disincentives for utilities to acquire other utilities in Missouri?

A. No, that does not appear to be the case at all in Missouri. The experience in Missouri appears to be that if the utility considering an acquisition believes that it is in its economic as well as its business interest, it will acquire the other company regardless of any approval of any merger savings sharing proposal or direct recovery of an acquisition adjustment from ratepayers. There have been numerous mergers and acquisitions that have occurred over the years that were negotiated with merger premiums. No utility to date has received recovery in rates in Missouri of a sharing of merger savings such as the mechanism that Aquila is proposing in this case or a direct recovery of a merger premium through an acquisition adjustment, but that has not stopped mergers from being proposed or any of the mergers from being completed.

Utilities have combined with other utilities in Missouri independent of receiving recovery of the merger premium directly from customers. There have been numerous mergers announced and completed, all with the knowledge that this Commission has never adopted a merger savings proposal like the one contemplated by Aquila in this case. Nor has the Commission ever included a merger premium in rates.

Q. Did the merger between St. Joseph merger result in an acquisition adjustment?

A. Yes. Aquila will have to record on its books, for a period of 40 years, the acquisition adjustment that results from the merger premium paid to SJLP shareholders.

Q. What was the actual merger premium that Aquila incurred for the acquisition of SJLP?

A. The actual total value of the acquisition adjustment is approximately $117 million (Data Request No. 518). This amount compares to the $92.8 million amount estimated at the time of the merger application filed in Case No. EM-2000-292, referenced in Aquila's witness Siemek's direct testimony, Schedule VJS-2 in Case No. EM-2000-292 and $108.7 million in Case No. ER-2001-672 (Data Request No. 381 in Case No. ER-2001-672).

Q. What is an acquisition adjustment?

A. An acquisition adjustment results when utility property is purchased or acquired for an amount either in excess of or below net book value. Net book value relates to the value placed on utility property and recorded on the Company's books and records at the time the utility property is first placed in public service, adjusted for depreciation and amortization. This assessment of value is commonly referred to as the property's "original cost." The acquisition adjustment is made up of two components, the merger premium and the transaction costs. The transaction costs are pre-merger costs to close or complete the merger.

Q. What is "original cost?"

A. The term "original cost," as defined by the Electric Plant Instruction Section of the FERC Uniform System of Accounts (USOA), relates to:

> All amounts included in the accounts for electric plant acquired as an operating unit or system, except as otherwise provided in the texts of the intangible plant accounts, shall be stated at the cost incurred by the person who first devoted the property to utility service. (Paragraph 15,052 of USOA).

Depreciation and amortization of the utility property from the previous owner must be deducted from the original cost, which results in a net original cost figure to be recorded on the purchaser's books and records. The acquired property is valued at the same value the seller placed on it, hence the concept of "original cost when first devoted to public service," adjusted for depreciation and amortization.

Q. Is use of net original cost for valuing rate base still the predominant form of regulation?

A. Yes. In the state of Missouri, the use of original cost less depreciation and amortization, i.e., net original cost, to set rates is not only the predominant form of regulation, but to my knowledge, the only form that has been employed by this Commission.

Q. How does an acquisition adjustment result from a utility merger or acquisition?

A. Utility property is recorded on the company's books and records at net original cost. A utility must account for any difference between the acquisition cost or purchase price of property and the net original cost; i.e., the amount paid to the original owner (the seller) for utility property being first placed into service and the recorded net original cost amount. This difference in purchase price is recorded in USOA Account 114, Electric Plant Acquisition Adjustments. The amortization of the acquisition adjustment is made to Account 406, Amortization of Electric Plant Acquisition Adjustments, if authorization is granted to include the adjustment in cost of service for ratemaking purposes (above–the–line treatment). If no authorization is given to include an amortization for ratemaking purposes (i.e., below–the–line treatment occurs), then Account No. 425, Miscellaneous Amortization, must be used.

The USOA description of Account 114 states:

> A. This account shall include the difference between (1) the cost to the accounting utility of electric plant acquired as an operating unit or system by purchase, merger, consolidation, liquidation, or otherwise, and (2) the original cost, estimated, if not known, of such property, less the amount or amounts credited by the accounting utility at the time of acquisition to accumulated provisions for depreciation and amortization and contributions in aid of construction with respect to such property.
>
> . . . .
>
> C. Debit amounts recorded in this account related to plant and land acquisition may be amortized to account 425, Miscellaneous Amortization, over a period not longer than the estimated remaining life of the properties to which such amounts relate. Amounts related to the acquisition of land only may be amortized to account 425 over a period of not more than 15 years. Should a utility wish to account for debit amounts in this account in any other manner, it shall petition the Commission for authority to do so. Credit amounts recorded in this account shall be accounted for as directed by the Commission.

The USOA description of Account 406 states:

> This account shall be debited or credited, as the case may be, with amounts includible in operating expenses, pursuant to approval or order of the Commission, for the purpose of providing for the extinguishment of the amount in account 114, Electric Plant Acquisition Adjustments.

The USOA description of Account 425 states:

> This account shall include amortization charges not includible in other accounts which are properly deductible in determining the income of the utility before interest charges. Charges includible herein, if significant in amount, must be in accordance with an orderly and systematic amortization program.

ITEMS

1. Amortization of utility plant acquisition adjustments, or of intangibles included in utility plant in service when not authorized to be included in utility operating expenses by the Commission.

2. Other miscellaneous amortization charges allowed to be included in this account by the Commission.

Q. Was there an acquisition adjustment relating to the KPL merger with acquisition of KGE in Case No. EM–91–213?

A. Yes. Western Resources paid an amount for KGE in 1992 which exceeded its net book value, resulting in an acquisition adjustment identified at the time of the filing in that case of approximately $388.7 million, representing approximately a 60 percent merger premium.

Q. Did the Commission ever include any amount of the KGE acquisition adjustment in rates?

A. No. No amount of the KGE acquisition adjustment was ever recovered in rates from Missouri ratepayers even though some of the merger savings related to KPL's Missouri natural gas operations. While the Commission authorized KPL to acquire KGE in Case No. EM-91-213, it did not allow recovery of the acquisition adjustment from KPL's customers. The Commission also did not adopt a merger savings "tracking" proposal presented by KPL that KPL claimed would have identified, verified and quantified purported merger savings and shared those savings equally between shareholders and customers. No part of the KGE acquisition adjustment was ever recovered by KPL from Missouri customers.

Q. Was Staff opposed to the recovery in rates of the acquisition adjustment relating to the KCPL and Western Resources merger in Case No. EM-97-515?

A. Yes. Western Resources initially sought recovery of the acquisition adjustment in rates in both Missouri and Kansas through an "incentive regulatory plan." To the extent Western Resources attempted to recover from Missouri customers the acquisition adjustment resulting from the proposed KCPL merger, Staff took the position that should be considered a detriment from the proposed merger.

Q. Did Western Resources later agree not to include the acquisition adjustment in rates?

A. Yes. In Case No. EM-97-515, Western Resources and KCPL agreed that the acquisition adjustment would not be recovered in rates. The Stipulation And Agreement in that case stated the following regarding the recovery of the merger premium:

> **2. MERGER PREMIUM**
>
> The **amount of any asserted merger premium** (*i.e.*, the amount of the purchase price above net book value) paid by Western Resources for KCPL **shall be treated below the line for ratemaking purposes in Missouri and not recovered in rates**. The Joint Applicants, including Westar, shall not seek to recover the amount of any asserted acquisition premium resulting from this transaction in rates in any Missouri proceeding and the Joint Application shall be considered as amended in this regard. The Joint Applicants have currently estimated this amount as approximately $870 million. In addition, Westar shall not seek to recover in Missouri the amount of any asserted acquisition premium in this transaction as being a "stranded cost" regardless of the terms of any legislation permitting the recovery of stranded costs from ratepayers.
>
> [Stipulation And Agreement in Case No. EM-97-515; emphasis added]

Q. Did the Commission approve the Stipulation And Agreement for the KCPL merger with Western Resources?

A. Yes. On September 2, 1999, the Commission approved the merger along with the Stipulation and Agreement that contained the "no acquisition adjustment recovery" language.

Q. Has there been a more recent merger case involving other utilities where the merging utilities have agreed to merge without recovery of an acquisition adjustment?

A. Recently, April 20, 2000, in Case No. GM-2000-312, the Commission approved the Stipulation And Agreement requesting the acquisition of the natural gas assets located in Missouri of Associated Natural Gas Company (Associated), wholly owned by Arkansas Western Gas Company (Arkansas Western), by Atmos Energy Corporation (Atmos). Atmos agreed not to seek recovery of the acquisition adjustment from Missouri customers. Previously, Arkansas Western's acquisition of Associated was approved by the Commission in Case No. GM-88-100 on May 13, 1988, at a premium but without recovery of the acquisition adjustment, and Arkansas Western recently sold the property to Atmos for a premium. The language in the recent Atmos acquisition – Arkansas Western Stipulation and Agreement, is almost identical to the language in the Western Resources-KCPL Stipulation and Agreement. The Unanimous Stipulation and Agreement states, as follows:

> **3. <u>Acquisition Premium</u>**
>
> The amount of any asserted acquisition premium (i.e., the amount of the total purchase price above net book value), including transaction costs, paid by Atmos for ANG [Associated Natural Gas] properties or incurred as a result of the acquisition **shall be treated below the line for ratemaking purposes in Missouri and not recovered in rates**. Atmos shall not seek either direct or indirect rate recovery or recognition of the acquisition premium, including any and all transaction costs (e.g., legal fees, consulting fees and accounting fees), in any future ratemaking proceeding in Missouri. However, Atmos reserves the right to present evidence regarding any purported Sale-related savings in any rate complaint proceeding initiated by Staff or Public Counsel. [emphasis added]

Q. Have other utilities committed to not seek recovery of acquisition premiums in rates related to property acquired in Missouri?

A. Yes. In an application of Union Electric to merge with CIPSCO filed on November 7, 1995, Union Electric entered into a Stipulation and Agreement that contained language that it would not seek recovery of a purported merger premium. The Commission on February 21, 1997, approved the merger, along with the Stipulation and Agreement. As part of the Stipulation and Agreement was the language that, "UE shall not seek to recover the amount of any asserted merger premium in rates in any Missouri proceeding. UE has identified this amount as $232 million." In addition, alleged merger benefits were discussed in the Stipulation and Agreement:

> UE shall retain the right to state, in future proceedings, alleged benefits of the merger but UE **commits to forego any additional specific adjustments to cost of service related to the merger savings or any claim to merger savings** other than the adjustments to cost of service and claims to merger savings resulting from the Commission's approval of this document or the benefits and savings which would occur through regular ratemaking treatment or the current Experimental Alternative Regulation Plan ("ARP") or the new Experimental Alternative Regulation Plan ("the New Plan") effective July 1, 1998 pursuant to this document. [emphasis added]

In the application to acquire Arkansas Power & Light's (APL's) Missouri properties, Union Electric also agreed to not seek recovery of the acquisition premium. The parties to this Joint Application, designated as Case No. EM-91-29, signed a Stipulation and Agreement on January 25, 1991. As part of the Stipulation and Agreement, Union Electric agreed not to seek recovery of the acquisition premium in any rate case in the future:

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

The Staff performed an earnings audit in Case No. EM-91-29, and in Case No. EO-87-175, concurrent with the Stipulation And Agreement in Case No. EM-91-29, Union Electric agreed

A. Yes. In an application of Union Electric to merge with CIPSCO filed on November 7, 1995, Union Electric entered into a Stipulation and Agreement that contained language that it would not seek recovery of a purported merger premium. The Commission on February 21, 1997, approved the merger, along with the Stipulation and Agreement. As part of the Stipulation and Agreement was the language that, "UE shall not seek to recover the amount of any asserted merger premium in rates in any Missouri proceeding. UE has identified this amount as $232 million." In addition, alleged merger benefits were discussed in the Stipulation and Agreement:

> UE shall retain the right to state, in future proceedings, alleged benefits of the merger but UE **commits to forego any additional specific adjustments to cost of service related to the merger savings or any claim to merger savings** other than the adjustments to cost of service and claims to merger savings resulting from the Commission's approval of this document or the benefits and savings which would occur through regular ratemaking treatment or the current Experimental Alternative Regulation Plan ("ARP") or the new Experimental Alternative Regulation Plan ("the New Plan") effective July 1, 1998 pursuant to this document. [emphasis added]

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The Staff performed an earnings audit in Case No. EM-91-29, and in Case No. EO-87-175, concurrent with the Stipulation And Agreement in Case No. EM-91-29, Union Electric agreed to absorb a $30 million decrease in revenue requirement allocated to the Small General Service, Large General Service and Primary Service customer classes. Re: Union Electric Co., Case Nos. EM-91-29, et al., Report and Order, 1 Mo.P.S.C. 3d 96, 108 (1991) and Re: Union Electric Co., Case No. EO-87-175, Report and Order, 30 Mo.P.S.C.(N.S.) 406, 410 (1990).

Also, Southern Union, parent of Missouri Gas Energy, agreed in 1993 to not recover the acquisition premium relating to its purchase of the Missouri properties of Western Resources. On August 5, 1993, Western Resources and Southern Union filed an application with the Commission seeking authority from the Commission to make this purchase transaction in Case No. GM-94-40. The Stipulation and Agreement states as follows:

> The amount of any acquisition premium (i.e., the amount of the purchase price above net book value) paid by Southern Union to Western Resources for the gas properties of Western Resources shall be treated below the line for ratemaking purposes in Missouri and neither amortization nor inclusion of the premium in rate base shall be sought to be recovered by Southern Union in rates in any Missouri proceeding.

The Commission approved the Stipulation And Agreement on December 29, 1993.

In a case involving the Missouri-American Water Company (Case No. WR-95-205), the Commission did not allow recovery of the acquisition adjustment from Missouri-American's customers. The Commission stated in its Report and Order that "[t]he Commission finds in this case that the Company has failed to justify an allowance for the acquisition adjustment." Re: Missouri-American Water Company, Case Nos. WR-95-205 and SR-95-206, Report and Order, 4 Mo.P.S.C. 3d 205, 217 (1995).

Utilities operating in this State know the position taken by various usual parties relating to merger sharing proposals and the recovery of merger premiums/acquisition adjustments in rates, and the Commission's consistent position of not allowing rate recovery of such proposals. Yet, despite no utility having been permitted to date either indirect recovery through a merger savings sharing proposal or direct recovery of a merger premium/acquisition adjustment in rates, mergers continue to be pursued and consummated respecting public utilities operating in Missouri. Other examples of this situation exist.

Staff does not believe the Commission's prior decisions on the subject of merger savings sharing proposals or acquisition adjustments articulated in the above cases in any way served to "discourage companies from actions which produce economies of scale and savings which can benefit ratepayers and shareholders alike." Re: Missouri-American Water Company, 4 Mo.P.S.C.3d at 216.

Q. Are there other cases decided by the Commission where a utility presented evidence of savings as result of an acquisition, and attempted to justify special rate treatment of the alleged merger savings?

A. Yes. In the MGE 1996 rate increase case, (Case No. GR-96-285), the Commission rejected a proposal by MGE to allow MGE to retain purported savings from Southern Union's acquisition of the Missouri properties of Western Resources in 1994. As part of the Stipulation And Agreement in Case No. GM-94-40, MGE could present to the Commission in its rate case purported evidence of savings resulting from the acquisition. The Commission's Report and Order in Case No. GR-96-285 states in part as follows:

> MGE contends that the stipulation and agreement allows MGE to request recovery of the benefits resulting from the acquisition. MGE contends that an equal sharing of these ongoing savings between customers and shareholders is a reasonable ratemaking approach and is consistent with the terms of the stipulation and agreement.
>
> . . . .
>
> ...Staff recommends that the Commission reject MGE's proposal because it does not represent appropriate or proper ratemaking policy because the alleged savings are not adequately quantified by MGE; the proposal is not fair and equitable; utilities other than MGE have also downsized without expecting any sharing of related savings; the

> alleged cost reductions benefited MGE at least up until any rate changes resulting from this proceeding; the proposal represents the equivalent of an incentive plan without any safeguards; the proposal shifts risks of MGE's cutbacks and related cost reductions to its customers; the proposal represents an attempted recovery of the acquisition premium from Case No. GM-94-40; and the proposal would take MGE off of cost of service ratemaking (cost-based rates). (Ex. 72, pp. 4-5) The Staff further argues that adoption of MGE's proposal would reward the Company for providing a lower quality of service while at the same time requesting ratepayers to pay higher than cost-based rates.
>
> The Commission finds that MGE's **acquisition savings adjustment should be rejected** in total because adoption of this adjustment would be contrary to the provision of natural gas service based on the costs of providing such service and because MGE's experimental gas cost incentive mechanism already rewards MGE's shareholders for making financially sound gas procurement decisions.
>
> [Re: Missouri Gas Energy, Case No. GR-96-285, Report and Order, 4 Mo.P.S.C. 3d 437, 460-461 (1997)]

The Commission decided a merger savings sharing proposal in an even more recent case involving St. Louis County Water Company. This water company does business in the state of Missouri as Missouri-American Water Company (Missouri-American). On May 3, 2001, the Commission issued a Report And Order rejecting a proposal to share purported merger savings between customers and shareholders in Case No. WR-2000-844. This proposal by Missouri-American was exactly the same proposal that Aquila is advocating in this case.

Missouri-American sought to share merger savings it believed came about through a merger respecting American Water Works' (AWK) acquisition of National Enterprises (NEI), the former parent company of Missouri-American. The Commission stated at pages 20 and 21 of its Report and Order in the Conclusion of Law section:

> Regulation is intended to be a substitute for competition. In a competitive market, a company that achieves gains in efficiencies only

> gets to keep the benefit of those gains until its competitors implement similar efficiencies, and the company is forced to lower its prices to remain competitive. A regulated company does not get to keep the benefit of its efficiency gains indefinitely either. If the gains are large enough and not offset by increased costs elsewhere in its operations, a utility will get to keep the gains only until a complaint is brought and resolved. If the gains are offset by increased costs, the utility will only get to keep them until a rate increase case is filed and resolved. Gains in efficiency are "captured" in a rate case, and forward-looking rates are set taking the gains into account.
>
> This last situation is the one in which the Company finds itself: it claims it has achieved gains in efficiency from the merger of NEI and AWK, but nonetheless has found it necessary to request an increase in rates. The Company asks to be allowed to share (i.e., keep 50 percent) of the savings it asserts it has achieved from the AWK/NEI merger. The Commission, in keeping with regulation's role of simulating competition, will not approve the shared savings plan.
>
> The Company argues that adopting a policy of allowing utilities to retain some of the savings they achieve will encourage them to pursue mergers and acquisitions. **The Commission rejects this argument for two reasons**. First, the utility industry, including water utilities, seems to be pursuing mergers and acquisitions quite willingly without this Commission approving shared savings plans. In fact, **the Commission has never approved a sharing plan.** Second, the Commission does not need to allow utilities to keep these benefits to create an incentive to achieve efficiencies (either through successful mergers and acquisitions or otherwise); **the lag inherent in the regulatory process provides sufficient incentive.**
>
> [Case No. WR-2000-844; emphasis added]

Q. Would providing Aquila direct recovery of the acquisition adjustment relating to the St. Joseph merger be fair to all the other utilities which have agreed to not seek in Missouri direct recovery of merger premiums or which have had their merger premium recovery proposals rejected by the Commission?

A. No. Aquila is not unique in the sense that it desires to have customers of L&P and MPS subsidize its acquisition strategies. If a utility can get someone other than shareholders to pay for its merger and acquisition activity, it is likely that merger and acquisition activity (number of merger and acquisition transactions) will increase and prices paid will escalate. In prior cases, the utility, whether it was Union Electric seeking recovery of its asserted merger premium "paid" to CIPSCO shareholders or Western Resources paying KCPL's shareholders a substantial premium to merge, all took the position that the merger savings justified the recovery of the acquisition premium from their customers. As indicated above, either through Commission order, or stipulation and agreement among the parties, none of the utilities received direct recovery of the merger premium and no merger savings sharing proposals were adopted. Aquila's proposal to retain merger-related savings in this case, over and above those already recovered by the Company, would be unfair and unreasonable to all other utilities, which appropriately have had to find other means to "pay" for their growth strategies besides requiring their customers to pay for those activities.

There has been no showing that the St. Joseph merger was necessary other than from the perspective of the shareholders of the companies being "purchased" and the understandable desire to "cash-in" on the opportunity to sell their shares of stock to the highest bidder, Aquila. Customers may or may not ever directly benefit from this merger in the long term, and if there are merger benefits, they may never all be identified and quantified as all of the merger costs may never all be identified and quantified.

The St. Joseph merger benefited the shareholders of that company. Aquila wanted to acquire SJLP to supplement and promote their "midwest-continent" strategy. SJLP fit into the growth and acquisition strategy that Aquila aggressively pursued for almost two decades. Just as the Staff has consistently, in MPS rate cases, raised concerns about MPS customers subsidizing Aquila's national and international merger growth and acquisition strategies, it would be unreasonable and inappropriate for the customers of L&P and MPS to provide the incentive to any future merger plans of the Company by "funding" those mergers through costs that no longer exist to be imputed in rates as shared merger savings beyond savings Aquila has already recovered.

MERGER TRACKING

Q. Did Aquila develop a tracking mechanism to identify merger costs and savings benefits relating to the St. Joseph merger?

A. No. While the Company identified costs associated from the merger, it made no attempt to develop a cost savings and benefits tracking system.

Q. Have there been events that have occurred at the Company that have resulted in cost savings?

A. Yes. Since the St. Joseph merger closed on December 31, 2000, Aquila has experienced several events that have dramatically affected both cost increases and decreases. In addition, to the merger with SJLP, Aquila announced in November 2001 a restructuring or reorganization of its regulated utility operations from a centralized organization based on lines of business such as generation, transmission and distribution to a state-based organization.

Aquila, in 2002, experienced substantial corporate losses from its non-regulated operations, resulting in significant impacts to corporate earnings causing the Company to get out of its energy trading business as well as the selling of the majority of its non-regulated companies. This corporate financial restructuring has resulted in tremendous cuts in the work force of the Company, primarily in non-regulated operations, but also in corporate downsizing in general. Aquila announced in 2002 that it intended to exit the trading business and return to its regulated utility businesses.

The Company announced in spring 2002 the cut back of approximately 600 employees, mostly from Aquila's regulated side of the business. This was the result of the reductions from the state-based reorganization and also from the corporate financial restructuring. This restructuring continues at present.

Q. Do the reductions that Aquila has experienced from the state-based reorganization and the corporate financial restructuring have anything to do with the St. Joseph merger?

A. Certainly the corporate financial restructuring has nothing to do with the St. Joseph merger. As indicated, the adverse affect on earnings resulting from the failure of non-regulated operations caused the decision to return to Aquila regulated utility roots. The St. Joseph merger may have had some effect on the downsizing from the reorganization to state–based operations, but much of the reductions in costs related to Aquila's other previously owned regulated utility operations.

Q. How do the cost reductions from these corporate events affect the merger savings sharing proposal?

A. Regardless of the reasons for costs savings, Aquila and its shareholders have enjoyed the benefits from these reductions from the time they were made. The Company will continue to reap the rewards of these reductions until rates are changed as a result of this case, at the end of May 2004. Respecting the state-based reorganization, Aquila will have had the benefit of any cost reductions from late 2001 to June 2004, over two years. Relating to the St. Joseph merger, Aquila has enjoyed the benefit of cost reductions from the time reductions took place until rates change in June 2004. In some instances, Aquila will have these benefits for over three years.

Q. Has Aquila taken into consideration any of the cost savings it experienced from the corporate events including the merger in its merger savings sharing proposal?

A. No. Aquila has not attempted to reflect any of these known reductions in costs in its proposal to share merger savings. The cost savings from the 600 employee reductions have benefited the shareholders from the time of the cutbacks but Aquila has not reflected any of these savings in its merger savings sharing proposal. The benefits derived from joint dispatch savings since 2001 have been retained by Aquila yet none of those cost reductions have been reflected in the merger savings sharing proposal.

Q. When did the Company last have its rates changed in Missouri?

A. Aquila filed for a $49.4 million increase in MPS's annual electric rates on June 8, 2001, designated as Case No. ER-2001-672. As a result of a Stipulation And Agreement approved by the Commission in Case No. ER-2001-672, MPS's electric rates were reduced by $4.25 million on an annual basis effective March 21, 2002.

Q. What was the test year used in that case?

A. The test year proposed by the parties and ordered by the Commission in Case No. ER-2001-672 was the 12-months ended December 31, 2000, updated for known and measurable changes through June 30, 2001.

Q. Did the cost structure in Case No. ER-2001-672 reflect any changes for either of the reorganizations or restructurings occurring at Aquila?

A. No. Neither the state-based reorganization or corporate financial restructuring had occurred and, therefore, could not have been reflected in the 2001 rate case.

Q. Were cost savings that may have occurred relating to the St. Joseph merger reflected in MPS electric rates resulting from Case No. ER-2001-672?

A. Case No. ER-2001-672 resulted in a Stipulation and Agreement, thus, the reduction in rates was a "settled" amount reached by negotiations among the parties, with no party identifying how the amount of the reduction was determined by it or the other signatory parties. There was a true-up proposed in that case, but because of the settlement, no true-up was necessary and none was performed. While each party may file a particular position supporting various elements of the revenue requirement determination, it is impossible to assign dollar value to issues within a case that is settled through negotiations among the parties where those parties made no such assignment. Thus, it is impossible to say how any cost reductions from the merger, to the extent they existed, were treated in that case.

Under terms of the Stipulation, the parties to the case including the Company, agreed to the following language under Section 18. Reservations:

> A. The terms of this Stipulation and Agreement have resulted from extensive negotiations among the Parties and are interdependent. By entering into this Stipulation and Agreement, none of the Parties shall be deemed to have approved or acquiesced in any ratemaking or procedural principle, or any method of cost determination or cost allocation, and none of the Parties shall be prejudiced or bound in any manner by the terms of this Stipulation and Agreement in this or any other proceeding, except as expressly specified herein. Unless the Commission approves this Stipulation and Agreement in its entirety, without condition or modification, this Stipulation and Agreement shall be null and void, and none of the Parties shall be bound by any of the terms hereof.

[source: Stipulation and Agreement in Case No. ER-2001-672, page 8]

Q. Did Aquila and SJLP propose to track merger savings in Case No. EM-2000-292?

A. Yes. In the context of that case, the Joint Applicants proposed a regulatory plan that would have allowed the post-merger Aquila to recover the merger premium through retention of merger and non-merger related savings and through an amortization of the acquisition adjustment in a rate case for L&P after a five-year rate moratorium for L&P. Under Aquila's regulatory plan proposal in the merger case, Aquila and SJLP proposed to "track" all savings, regardless of whether they were merger-related or non-merger related.

Q. What is meant by "tracking" of merger savings?

A. "Tracking" of merger savings is the post-merger process for which it is asserted that the results of specific actions due to the merger are isolated, identified, verified and quantified. The theory is that the purported results of what would have occurred but for the merger can be and are isolated, identified, verified and quantified and compared to what has actually occurred in the aftermath of the St. Joseph merger to determine the merger savings and the amount of those savings. Tracking is the phenomenon by which post-merger costs, as a result of the St. Joseph merger, are compared with pre-merger stand-alone costs and what it is assumed those costs would be if the merger had not occurred.

Q. Can merger savings be "tracked"; i.e., isolated, identified, quantified and verified after–the–fact?

A. Tracking merger savings is extremely difficult and, in actuality, it is probably not possible. It certainly is not practical to track merger savings.

Q. Are you saying that it is difficult to prove and verify the actual savings that result from acquisitions and mergers?

A. Yes.

Q. Why is that so?

A. The difficulty in isolating, identifying, verifying and quantifying merger savings, and merger costs, relates in part to the difficulty in distinguishing between merger and non–

merger events and in part to attempting to identify and quantify what would have occurred had there not been a merger. Disputes will occur and will have to be resolved by the Commission. It is difficult to find agreement among the various parties as to what constitutes actual merger savings and, probably to a lesser extent, merger costs. Certainly, KPL, under its proposal in the KPL/KGE merger case, Case No. EM–91–213, to share all merger savings on a 50/50 basis, had real incentives to identify and quantify as much savings as being merger–related as possible, while ignoring merger costs. The practical effect of KPL's proposal was that the more merger savings and the less merger costs it identified and quantified, the more dollars it was entitled to recover by means of the merger premium.

Utilities are complex organizations with overlapping activities and functional areas. They are dynamic organizations that operate in ever–changing environments. They are constantly organizing and reorganizing functions within their corporate structure to streamline operations and obtain efficiencies where possible. Various terms have been used to characterize utility restructuring or reorganizing, such as downsizing, realigning, re-engineering and right-sizing. Most utilities attempt to achieve efficiencies through the implementation of new technologies and other productivity gains. In this environment, it is unrealistic to believe that a tracking system can be put in place to isolate, identify, quantify and verify merger and non-merger savings. It is very difficult to determine and measure the "cause and effect" relationship that may exist between taking an action and identifying and measuring the effects of that action versus not taking an action and identifying and measuring the effects of the nonaction.

Any cost savings tracking system would have to be sophisticated so that not only are necessary and appropriate categories of savings and costs established, but the necessary and appropriate documentation is established to permit an after-the-fact analysis of the decision-making and the costs and savings. Disagreements and disputes are certain in the context of an after–the–fact analysis. While one party may assert that an efficiency is the result of a merger, another may view it as nothing more than a non-merger related operating efficiency, addressing a pre–existing condition and an on-going concern that would have been addressed independent of the merger. Disputes will arise because, among other reasons, there is an incentive for the utility to identify as much of the savings as merger-related as possible and to capture as much of the savings as possible for shareholders. There will be an incentive for the utility to identify as merger-related as many workforce reductions and other cost reductions as possible. This inherent incentive will make it increasingly difficult to truly identify and quantify merger savings on a going-forward basis because it will become less possible to objectively evaluate what would have happened if the merger had not occurred. Needing to justify the inclusion of "imputed" merger savings in rates, utilities will make every effort to take credit for savings that may be nothing more than savings it would have realized absent the merger. Moreover, as the post-merger time increases, the more difficult it will be to isolate, identify, quantify and verify stand-alone versus merger costs and savings.

Q. Can merger savings be tracked?

A. Realistically, it is probably impossible to accurately "track" merger savings because it requires a comparison of cost structures of the entities being merged on a pre-merger and post-merger basis. If this process is not impossible, it certainly is not practical to accurately identify merger savings. This tracking process would be extremely difficult at best and to my knowledge has never been done successfully before. The merged entities lose their identity post-merger, almost from the first day after the close of the merger. In fact, SJLP lost its pre-merger corporate identity the day the merger was announced to the public on March 5, 1999. The pre-merger SJLP entity has not existed since.

Upon the announcement of a merger, the merging companies' stock prices are immediately affected. On March 4, 1999, the day before the St. Joseph merger announcement and the date the UtiliCorp-St. Joseph merger agreement was completed, the common stock price of SJLP was $16.875 per share. On March 5, 1999, the day of the St. Joseph merger announcement, SJLP's stock price increased to $20.375 per share. On March 4, 1999, there were over 3,000 shares traded and on March 5, 1999, there were over 173,000 shares traded.

Every decision made by the merging companies after the merger is agreed to and announced is affected. Spending levels, human resources decisions, construction projects, etc. are all impacted. Every corporate decision is subject to the terms and conditions of the merger agreement; consequently, the corporate entity as it existed prior to the announcement of the merger no longer exists. While the period during the merger approval process generally results in significant changes at the entity being acquired, certainly after the completion of the merger, the acquired entity ceases to exist in every sense. To compare an ever-changing pre-merger stand-alone entity to an ever-changing post-merger announcement being acquired, presents more than a challenge; it is an incredible task that, to the Staff's knowledge, never has been truly achieved before.

Q. Why is tracking impracticable?

A. The reasons that "tracking" typically is not used to identify merger costs savings are:

- There is difficulty in establishing a proper baseline and in distinguishing merger and non-merger related impacts on earnings.

- Human intervention is required to determine subjectively how future events and transactions are isolated, identified, verified and quantified.

- Tracking has not been successfully done in Missouri.

- Aquila never developed a detailed merger savings tracking mechanism.

- St. Joseph and Aquila ceased to exist as stand-alone companies the day the merger was announced. It is impossible to identify what would have been a non-merger versus merger savings.

- The merged companies will continue to seek and achieve non-merger savings.

- The sophistication of Aquila's accounting system has not provided assurances that a merger tracking system could be successfully developed.

- Any attempt to track merger savings will be complicated by a prior history of difficulties respecting Aquila providing timely and accurate information and the lack of cooperation from Aquila in prior cases.

- Any attempt to track merger savings will be complicated by any future merger and acquisition activity of Aquila, or its current divesture of previous acquisitions and disposition of other assets.

- Any attempt to track merger savings will be complicated by future reorganizing, restructuring and re-engineering changes that every company experiences.

- Any attempt to track merger savings will be complicated by any future restructuring of the electric utility industry in the state of Missouri, to the extent that occurs.

Q. Is Staff aware of any utility using a "tracking" system to identify merger savings to set rates?

A. No. To the best of Staff's knowledge this has never been accomplished in any jurisdiction.

Q. Has Staff addressed the ability to track merger savings and non-merger savings in prior merger cases?

A. Yes. In all of the major merger applications filed with the Commission, merger savings tracking has been examined. As has been previously noted in the merger between KPL and KGE, Case No. EM-91-213, tracking of savings was a contested issue. Also, tracking was addressed in the Union Electric merger with CIPSCO, Case No. EM-96-149, and the KCPL merger with Western Resources, Case No. EM-97-515. Tracking was addressed in both of Aquila's merger cases for the St. Joseph merger, Case No. EM-2000-292 and Empire merger, Case No. EM-200-369. In all five merger cases, the difficulty to track merger savings was addressed.

Q. Did KPL request recovery of merger savings in Case No. EM–91–213, when it proposed to merge with KGE?

A. Yes. KPL expected to recover the acquisition premium in rates through a merger savings sharing proposal. In that case, KPL believed there would be sufficient merger savings that could be used to allow recovery of the acquisition adjustment.

KPL proposed, in that case, a unique approach to "share" merger–related savings. The proposal was intended to allow KPL a partial or a full recovery of the acquisition premium adjustment.

Although KPL never specifically stated that the sharing proposal would allow recovery of the acquisition premium, this in essence is what would have happened if such a proposal had been implemented. The only reason that KPL put forth such a proposal was for regulatory purposes; i.e., to make positive adjustments to test year results in future rate cases. Thus, the merger savings sharing proposal was nothing more than a ratemaking vehicle to set rates at higher levels than the actual costs incurred by KPL.

Q. Did KPL directly request any recovery of the acquisition adjustment from its Missouri ratepayers?

A. No. KPL stated that its proposed future treatment of merger costs and benefits was based on a number of considerations, including "the jurisdiction's prior treatment of both negative and positive acquisition adjustments." KPL was indicating that the reason that it was not directly proposing to recover the acquisition adjustment in Missouri was because of the Commission's decision not to recognize a negative acquisition in KPL's purchase of the Gas Service Company in 1983.

Q. Did the Commission adopt KPL's proposal to recover the acquisition premium through the sharing of the merger savings?

A. No. Although the Commission in its Report and Order in Case No. EM–91–213 initially stated its interest in the merger savings sharing concept, no part of the cost savings tracking system (CSTS) was ever implemented. The Commission stated in its Report and Order as follows:

> **. . . the Commission will not approve at this time the savings sharing proposal.** Staff has persuasively argued that KPL has a strong incentive to view savings as merger–related even if they are not and to classify them in the CSTS so as to increase the pool of savings subject to the sharing plan. **Staff demonstrated several flaws in the CSTS which could allow nonmerger savings to seep into the pool of savings to be shared.**
>
> **The Commission is not opposed to the concept of the savings sharing plan provided that only merger–related savings are shared.** The Commission does not wish to discourage companies from actions which produce economies of scale and savings which can benefit ratepayers and shareholders alike. However, **the Commission wishes to ensure that savings which would have been offset against the cost of service without the merger, benefit ratepayers one hundred percent. To avoid any detriment to ratepayers it is imperative that only savings which would not have occurred absent the merger be shared by ratepayers with shareholders.**

[Re Kansas Power & Light Co., Case No. EM-91-213, Report and Order, 1 Mo.P.S.C.3d 150, 156-57 (1991); emphasis added.]

Q. Was the cost savings tracking system ever implemented by KPL?

A. No. The Commission, in its Report and Order in Case No. EM–91–213, directed "the parties to meet for the purpose of attempting to devise a method for tracking merger–related savings." 1 Mo.P.S.C.3d at 157. The parties met but no agreement could be reached to assure the Commission that non-merger–related savings would be excluded from the cost savings tracking system. The Commission issued a follow–up Order Adopting Staff's Suggestion And Closing Docket on December 13, 1991, which placed this issue in KPL's next rate case. This Order stated in part as follows:

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

Q. Did KPL address the merits of using the cost savings tracking system to identify merger savings in its next rate case?

A. Yes. KPL's next Missouri rate case was Case No. GR–93–240. By that time, KPL had taken the name Western Resources, Inc. In that case, Western Resources' Controller, Jerry D. Courington, indicated that Western Resources discontinued the use of the cost savings tracking system because of "the level of effort necessary to measure the savings and maintain the tracking system was relatively high when compared to the expected level of merger related savings in the jurisdictions in which it would be used." (Courington direct testimony, pages 14-15). Mr. Courington recognized in his direct testimony that merger costs and savings netted each other out with the Missouri allocated costs being "virtually unaffected in total by the merger." (Courington direct testimony, page 15). Western Resources made no adjustments in its rate case to reflect in rates any recovery of the acquisition premium associated with the KGE merger.

Q. Is it difficult to "track" merger savings for the post-merger Aquila?

A. Yes. Aquila had a very aggressive growth strategy through mergers and acquisitions. Because of its recent financial difficulties, Aquila is now engaged in a divesture of many of its properties, i.e., disposition of much of its non-United States and non-public utility assets it acquired during its high growth period. The constant changes resulting from acquiring new properties, and now the disposition of those properties, makes it even more difficult to isolate, identify, verify and quantify the actual merger savings from any one transaction.

Q. Did the Commission specifically address the need to distinguish merger savings between merger and non-merger in the KPL Order?

A. Yes. The Commission in the September 24, 1991 Report and Order approving the KPL and KGE merger, clearly set out the "standard" that merger savings had to be separated from non-merger related savings. During the St. Joseph merger case, Aquila indicated this separation was not necessary. In a transcribed interview conducted in Case No. EM-2000-292, held on March 2, 2000, with Staff and Public Counsel, Aquila witness Siemek related that:

> the distinction between merger synergies and other synergies, or other costs, is not very important, other than that hurdle rate [of $1.577 in years six through ten.]....in our case, it doesn't make any difference as long as....[we make] that hurdle rate. And even that makes no difference, because we've already committed to having that guaranteed reduction in the revenue requirement.

[Source: Siemek Transcript– pages 82-83]

The "hurdle rate" Mr. Siemek was referring to meant that Aquila did not need to distinguish between merger synergies and other synergies as long as the minimum savings were achieved. Based on this discussion, Staff never believed that Aquila had any intention of attempting to track merger savings separately from non-merger savings. This is the very basis that forms the assessment as to the success or failure of the merger itself from a regulatory point of view, in particular if the company is requesting ratemaking treatment of retention of merger savings through a sharing mechanism.

Q. Why did the Commission want to ensure merger savings were separated from non-merger savings?

A. When KPL was unable to devise a "tracking" system which would separate the merger savings from the non-merger savings, the Commission issued its December 13, 1991 Order indicating that the savings sharing proposal would be rejected. The Commission's reason for requiring this separation is that it wanted to ensure that all the non-merger related savings experienced by KPL would be flowed to customers in rates. The Order stated "the Commission wishes to ensure that savings which would have been offset against the cost of service without the merger, benefit ratepayers one hundred percent."

The Commission made it very clear in the KPL/KGE merger Report and Order that savings had to be identified between merger and non-merger related savings as a condition of the initial approval of the savings tracking proposal presented by KPL in that merger request. KPL was unable to demonstrate the ability to track costs; i.e., isolate, identify, verify and quantify savings between merger and non-merger related. Because of its inability to distinguish between the types of savings, the tracking proposal presented by KPL was rejected.

Q. Are merger and non-merger related savings different?

A. Yes. While they are both "savings," they are two very different types of savings. Merger related savings are those savings that can only occur as a result of the combining of the entities that were previously operating as separate and distinct from one another. Once the combination of the entities occurs there will be savings that will exist over time from the elimination of duplication and economies of scale that are effectuated or occur through system and process improvements throughout the organization. An example of elimination of duplication would be the position of corporate president. There is a need for only one president of the company. One of the two prior positions can be, and is, eliminated once the merger takes place. System improvements may result in the combining of activities such as the consolidation of customer call centers. Instead of operating two separate call centers because both pre-merger companies had the need to operate their own call centers, the merger can result in savings from the elimination of one of the call centers that is no longer needed. Process improvements would be the automation of certain functions such as in the areas of purchasing, accounting or human resource functions that may enable savings to occur as the direct result of the merger.

Non-merger related savings are those savings that occur over time as a result of improvements in technology and efficiencies achieved by experience and a better-trained and skilled work force. An example would be savings from reorganizations and re-engineering that occur periodically such as the recently implemented state based reorganization of Aquila's regulated operations or any cost reductions occurring as result of the Company's corporate financial restructuring. These types of savings also result from negotiating improved contract terms such as those relating to fuel supply, building leases and health and medical benefits. Reductions in cost of capital and tax rates, which occurred with the Tax Reform Act of 1986, can result in savings that having nothing to do with merger and acquisition activities. System and process improvements can take place absent a merger and result in non-merger related savings. Non-merger related savings result on an on-going basis and can occur as labor becomes more efficient and productive.

These two types of savings are viewed differently and are generally afforded different treatment in merger applications. Non-merger related savings are considered as occurring regardless of the merger. There is a widely accepted view that customers are entitled to these savings. An example would be the $17 million rate reduction for Aquila's MPS division in 1997 (Case No. ER-97-394). Another example of reflecting non-merger related savings through a reduction in rates is the $15 million rate decrease passed on to KCPL's customers in 1999 (Case No. ER-99-313). In both of these cases, the companies experienced cost reductions and revenue growth over a period of time, not related to mergers. The shareholders of both companies enjoyed the benefits of these cost reductions through regulatory lag, until the rates were changed.

Q. Did these companies voluntarily reduce rates?

A. In the case of KCPL, it did. Staff performed an earnings audit of KCPL and the parties, KCPL, OPC and Staff, reached an agreement on the dollar amount of the reduction. In the case of Aquila's MPS divisions rates, Staff had to file an excess revenues complaint case to reduce the MPS rates. After Staff filed its complaint case, designated as Case No. EC-97-362, Aquila filed a rate increase case designated as Case No. ER-97-394, which sought a $25 million increase to MPS's electric rates. Staff's initial complaint case was dismissed but Staff subsequently filed another excess revenues complaint case against MPS, Case No. EC-98-126, which was consolidated with Case No. ER-97-394. The Commission ultimately reduced MPS's electric rates by $17 million in its Report and Order dated March 6, 1998. The filing of the rate increase case by Aquila is a commonly used strategy by utilities to counter an excess revenue complaint case and keep overearning for as long as possible.

The Staff started reviewing Aquila's rates, MPS division, in the spring of 1996 as part of its examination of the merger application filed by Aquila and KCPL as Case No. EM-96-248. After the merger between KCPL and Aquila failed, Staff continued its review of Aquila's rates and filed a complaint case on March 3, 1997 to reduce rates by $23 million designated as Case No. EC-97-362. From the time Staff started its review of the electric rates of MPS to the date the rate reduction was implemented, March 6, 1988, it took two years.

SJLP employed the exact same approach in Staff's 1998 excess revenues complaint case, Case No. EC-98-573. SJLP filed a rate increase case docketed as Case No. ER-99-247. These two cases ultimately resulted in a $2.5 million rate reduction by Stipulation And Agreement in 1999. Once a utility increases rates, it generally resists any attempt to reduce rates, regardless of reductions in costs or revenue growth that may have occurred since the last rate rebasing.

Q. Has the Commission had concerns that indicated the importance of maintaining a distinction between merger-related events and non-merger-related events?

A. Yes. In the KPL merger with KGE (Case No. EM-91-213), the Commission wanted to be certain that no merger-related costs would be passed to customers. The Commission stated the following relating to the segregation of merger and non-merger costs:

> The Commission has also found that there is the potential for a detrimental effect on Missouri ratepayers from the merger through increased A&G and capital costs. Therefore, the Commission, in order to shield Missouri ratepayers from such detriment, has made it clear to KPL that such costs will be carefully scrutinized in any future, postmerger rate case to assure that no such detriment is suffered by Missouri ratepayers.
>
> [Commission Report and Order in Case No. EM-91-213, 1 Mo.P.S.C.3d at 159]
>
> . . . .
>
> The Commission will direct its Staff to carefully audit KPL in future rate cases to screen out costs caused by the merger and to suggest methods, if necessary in future rate cases, such as those recommended herein, which might be used to shield Missouri ratepayers from costs arising from the merger.
>
> The Commission will also direct KPL to keep its books so that costs associated with the merger are clearly segregated. Abnormal increases in A&G expenses will be carefully scrutinized and, unless persuasively explained as not related to the merger, will be associated with the merger.
>
> [Commission Report and Order in Case No. EM-91-213, 1 Mo.P.S.C.3d at 157]

In addition, from prior Commission decisions respecting its rate cases, Aquila is aware of the importance that the Commission has given to the distinction between merger and non-merger related activities. In Aquila's 1990 rate case, Case No. ER-90-101, involving its MPS division, the Commission issued its Report and Order stating the importance of segregating Aquila's merger and acquisition costs so those costs would be excluded from rates.

These Aquila merger and acquisition activities have been examined in each of Aquila's rate increase cases and Staff's excess revenues complaint cases, and were specifically identified as an issue in Case No. ER-90-101 where the Commission found as follows:

> The evidence indicates that the Company has removed from its A&G costs most of the known expenses associated with M&A activities. The Commission believes that UtiliCorp's expenses for M&A activities should be removed from the expenses reflected in MPS' rates. When UtiliCorp was formed, Company assured the Commission that the ratepayers would suffer no detriment from UtiliCorp's activities but would experience the benefits associated with UtiliCorp's activities. The Commission believes that it is inconsistent with this pledge to include M&A costs in the expenses reflected in MPS' rates. <u>The Commission is of the opinion that it is inappropriate for MPS' ratepayers to pay for these activities which have little to do with MPS' goal of providing safe and adequate electric service in Missouri.</u> Therefore, the Commission finds that the $70,280 of additional costs for M&A activities should be excluded from the cost of service. Finally, the Commission is concerned that Company has not been accounting for these costs separately. <u>Accordingly, the Commission will direct Company to account for M&A costs separately so that they can be readily excluded in future rate cases from A&G costs reflected in MPS' rates.</u>

[Commission Report and Order in Case No. ER-90-101, 30 Mo.P.S.C. (N.S.) 320, 350-351; emphasis added]

In addition, in Aquila's 1997 rate case (Case Nos. ER-97-394, ET-98-103 and EC-98-126) the Commission adopted the Staff's adjustments to assign costs to Aquila's three major non-regulated activities of mergers and acquisitions, international operations and new product development. The March 6, 1998 Report and Order states that "the Commission finds substantial evidence supports the position of the Staff. The Commission finds the proposed adjustment to be reasonable in light of the poor timekeeping and inadequate records offered by UtiliCorp." <u>Re: Missouri Public Service, Case No. ER-97-394, et al., Report and Order, 7 Mo.P.S.C.3d 178, 209 (1998)</u>. In this Report and Order, the Commission affirmed its prior decision to exclude from rates costs relating to the merger and acquisition strategy of Aquila.

Q. Does Staff believe that Aquila's accounting is able to "track" merger savings?

A. No. Aquila's accounting system, just like any other bookkeeping system is able to categorize costs, and identify those costs to specific accounts when the system identifies through a "coding" process where those costs should go. This same process is expected by Aquila to be used to "track" merger savings. The accounting system still will require individuals to isolate, identity, verify and quantify the savings, and separate those savings between merger and non-merger related events. Aquila personnel will have to be able to determine what the pre-merger SJLP operations were, if they are to compare these costs to the costs of the post-merger L&P operations. Those individuals making the "coding" decisions will have to make judgments and decisions about, among other things, assumptions and costs respecting how the merger affected the post-merger L&P operations. During an interview on March 1, 2000, in Case No. EM-2000-292, Mr. Jerry Myers, then UtiliCorp's Director of Corporate Accounting and Reporting, indicated that coding would have to be completed by individuals to enter into the accounting system. [Transcript, pages 19-26]. While Aquila and St. JJLP did not explained in detail how they intended to implement tracking procedures, it was apparent that Aquila was not going to distinguish between merger savings and non-merger savings to the level that was envisioned in the KPL/KGE cost savings tracking system.

Q. What is the significance of individuals making the coding decisions to the accounting system?

A. These decisions are made in an after-the-fact fashion about a company that no longer exists. The many judgments needed to identity and verify the existence of merger-related savings would undoubtedly cause much disagreement and dispute. Individuals are making the determinations as the information is entered into the accounting system. Unfortunately, the review process that takes place so that merger costs, and ultimately, merger savings, can be "carefully scrutinized," as required by the Commission in the KPL/KGE merger, takes place well after the decisions are made, i.e., coded, and information is entered into the accounting system.

CUSTOMERS ARE ENTITLED TO SAVINGS GENERATED BY UTILITIES FOR EITHER MERGER OR NONMERGER EVENTS

Q. Are utility customers entitled to cost savings that occur as a result of mergers or non-merger events?

A. Yes. Historically, customers have enjoyed the benefits of cost reductions, as well as declines in rate base and growth in revenues. As utilities experience productivity gains through technology improvements and downsizing of their work forces, cost increases have been kept in check or mitigated. Through restructuring, reorganizations and re–engineering programs, utilities have been experiencing cost decreases (or, at least, cost increases have been moderated, allowing for revenue gains to outpace them) through improvement in methods and processes which have occurred over time. This is not to say that decreasing costs are not also the result of developments other than efficiencies, such as decreasing interest rates and declining inflation rates.

Q. Why are customers entitled to benefits from cost savings?

A. Through the regulatory process, utilities generally benefit most immediately from cost reductions and growth in revenues. When significant cost reductions take place over time, public utility commission staffs or offices of public counsel may perform revenue reviews to determine the need for possible rate reductions. There are various factors that may warrant reductions in rates:

1. Reduction in capital costs is one of the most significant causes for declining revenue requirements.

2. Early retirement programs and cost efficiencies have resulted in steady reductions in employee levels.

3. Renegotiations and aggressive negotiation of fuel supply contracts and railroad freight rates have resulted in a steady decline in actual fuel costs which has contributed significantly to cost savings.

4. With reduction in construction programs from the levels of the 1970's and 1980's, utilities have experienced declining rate base, and thereby decreasing revenue requirements.

5. Shifting allocations involving multi-state utilities can, and do, cause declining jurisdictional costs and rate bases when growth occurs in other jurisdictions as a result of: (a) adding new customers, (b) usage increases and (c) adding service as a result of mergers and acquisitions.

6. Reductions in corporate income taxes have had a significant impact resulting in declining utility costs.

All of these factors can have a substantial impact on costs, causing the need to review rates periodically.

As previously noted, to the extent that merger-related savings occur, these are typically retained by the utility until a rate case. Through regulatory lag, the utility's shareholders reap all the benefits of costs reductions, either from the merger or through other non-merger-related means, until the new cost structure is reflected in rates. Customers normally wait a period of time before they experience any savings from reorganizations, restructuring, re-engineering, down-sizing or mergers and acquisitions.

Q. Has Staff included merger related savings in the present case?

A. Yes. Referring to the direct testimony of David W. Elliott, Staff ran stand alone production cost models to develop fuel and purchased power expenses used in this case for MPS and L & P cost of service. In addition, the allocations used to assign corporate overhead costs reflect the inclusion of L & P.

Q. If Staff has considered the impacts of the merger savings in this case, does this mean Aquila has been able to successfully track merger costs and savings?

A. No. The discussion on merger tracking and the need for such a mechanism relates to the ability to separate the merger costs and savings from the "normal" non-merger activities of the Company. As indicated above, the Commission has viewed this as essential in the past in considering the sharing of merger savings between the customers and shareholders.

Because two costs elements have been identified does not mean the Company has done a meaningful job of providing sufficient detail to the level expected in segregating the related merger costs and savings from non-merger events such as the state based reorganization.

The savings resulting from joint dispatch and corporate allocations are two examples of savings that were expected as result of the St. Joseph merger. There were other aspects to the merger that have not been identified or "tracked" to enable the parties to judge the success of the St. Joseph merger. Those merger costs and savings have not been segregated out from the rest of the Aquila operations as required in the previous merger savings sharing proposals.

Q. Has Aquila benefited from the savings relating to the joint dispatch and corporate allocations?

A. Yes. As noted above in my rebuttal testimony, Aquila has enjoyed the benefits from joint dispatch savings from August 2001 and enjoyed the benefits immediately upon completion of the St. Joseph merger in the area of corporate allocations. When the St. Joseph merger was complete the factors used to allocate costs to the divisions of Aquila changed by virtue of SJLP being incorporated into the allocation mix. Less corporate costs were allocated to MPS simply because the allocator changed with the inclusion of SJLP.

Q. Is it certain that merger savings have taken place for MPS and L&P?

A. While it appears that there are some merger savings, it cannot be stated with certainty that all the savings that been identified relate exclusively to the merger. As an example, in the joint dispatch area Aquila witness John Browning, Vice President Resource Operations, has indicated that the off-system sales transactions have been adversely impacted as result of the St. Joseph merger. (Data Request No. 404)

Q. Have could off-system sales transactions be affected by the St. Joseph merger?

A. An off-system sale is the exchange of power between utility entities. In the normal course of operations absent the merger, MPS would buy electricity from SJLP and MPS would sell electricity to SJLP. With the merger, those transactions now take place between these two Aquila divisions as part of the joint dispatch process. Now, the two

Aquila divisions exchange between themselves any excess or unused power to meet the energy needs of their customers on an economic basis.

Because of the decline in off-system sales, Staff inquired as to the reason for this occurrence. Mr. Browning indicated in response to a data request that the St. Joseph merger affected the off-system sales between the two entities and was one of the reasons for the decline in off-system sales.

Q. Should the off-system sales that occurred between Aquila and SJLP and are now part of joint dispatch between MPS and L&P be treated as a merger savings?

A. No. These off-system sales transactions provided a profit margin to these two companies prior to the merger, and should not be considered part of merger savings.

Q. Did the Company quantify the effects of off-system sales on merger savings?

A. No. No attempt was made to "track" from the off-system sales levels that took place between the two companies prior to the merger to the exchange of power pursuant to joint dispatch after the merger. There is no identification in Mr. Siemek's merger savings sharing proposal of the distinction between merger savings from joint dispatch and earnings from off-system sales that were not experienced because of the joint dispatch of the MPS and the former SJLP generating units.

Q. If the Company has created the savings, then why isn't it appropriate to allow Aquila to "keep" the savings?

A. The Company has been allowed to "keep" the savings from the time the savings occurred until new rates in this case will take place in June 2004. At some point, it is reasonable for customers to benefit from any cost reductions from a merger or from cost reductions achieved in the normal course of business operations.

SUMMARY AND CONCLUSIONS FOR THE MERGER SAVINGS SHARING PROPOSAL

Q. Please summarize your conclusions relating to Aquila's proposed recovery of the acquisition adjustment resulting from the St. Joseph merger.

A. Aquila chose when to file this case to adjust MPS and L&P electric and steam rates. As a result of its belief that it needed to file these rate cases, Aquila developed its merger savings sharing approach to retain a substantial portion of the merger savings it believes may have been generated to date from the St. Joseph merger. This proposal by Aquila deviates from cost-based rates by not reflecting MPS's and L&P's actual cost of service in rates. By making adjustments in its electric and steam cases to increase expenses over actual levels, the Company is not reflecting one-half of the cost savings that may have resulted from the merger to date. These imputed expenses increase the cost of service of MPS and L&P from the allocations of corporate costs and fuel cost savings from joint dispatch. Aquila's merger savings sharing proposal deviates from the standard practice of developing rates based on actual costs.

Aquila's shareholders have enjoyed the benefits of the merger since the merger was closed on December 31, 2000 and will continue to reap those benefits until the present rates are changed by the Commission—currently this is not expected before June 2004 in these cases. Thus, Aquila will have received full benefit from the merger for almost three and one-half years. Neither the customers of MPS nor the customers of L&P have received any savings benefits from the merger.

If Aquila's proposal to retain merger savings through the imputation of cost savings over actual costs is approved, this will set a precedent for future mergers and rate cases. Adopting a merger savings sharing mechanism could result in even greater pressure in the future for the extraction of even greater merger premiums than have been negotiated previously. If utilities successfully propose that their customers subsidize growth through mergers and acquisitions, then it can be expected that more and more mergers will take place at greater and greater risk to customers.

ARIES COMBINED CYCLE UNIT

Q. Has the Company made an adjustment to annualize the capacity charges associated with MPS' purchase of power from the Aries Generating Unit?

A. Yes, it has. Company witness Starkebaum sponsors Aquila's adjustment to annualize capacity charges associated with MPS purchased power agreements (PPAs, purchased sales agreements or capacity agreement) at page 12 of her direct testimony. She states that the Company's adjustment includes an annualization of Aries capacity charges.

Q. What level of capacity charges associated with the Aries unit has Aquila included in its case?

A. The Company has reflected an annualized level of $27.66 million.

Q. Does the Staff agree that $27.66 million is an appropriate level to include in rates for Aries capacity charges?

A. No. Because MPS is purchasing power from the Aries unit through an affiliated entity (Merchant Energy Partners – Pleasant Hill or MEPPH), Staff believes that the Company has overstated its capacity purchase relating to the Aries capacity agreement referred to as a "purchased power agreement" (PPA). Staff witness Mark L. Oligschlaeger will provide the rationale in his rebuttal testimony for Staff's position that the Aries contract should be treated on lower of cost or market basis.

Q. Did the PPA between MPS and the partners of the Aries Combined Cycle Unit allow the pass-through of construction cost amounts in excess over the original estimate?

A. Yes. The agreement MPS reached allowed for certain costs to be absorbed through the PPA. Some construction problems resulted in costs over the original construction estimate. Installation of the two heat recovery steam generators (HRSGs) caused some of the cost overruns. Also, the purchase and installation of the two combustion turbines caused cost overruns.

The combustion turbine cost overruns have been charged back to MPS through terms of the PPA.

Q. What amount has been charged to MPS relating to the increase in cost for the combustion turbines at Aries?

A. In a March 19, 2001 letter from Aquila Energy, MPS was notified of a cost increase for power purchased through the PPA. The letter from Aquila Energy stated that the combustion turbines cost $2.4 million more than expected and, in accordance with Section 5.1(a) of the agreement, "an increase of the capacity charge to [MPS] by $0.055 per kW-month for the first $1,000,000 of cost increase above the original estimate" would be charged to MPS.

In addition, the March 19, 2001, letter indicated that there was a $0.0297 per kW-month credit in the capacity charge. The credit offset to the increase results in an overall increase in the capacity charge of $0.0253 per kW-month.

Q. Should this increase be charged to MPS customers?

A. No. One of the purposes of purchasing capacity through a PPA is not having to absorb the "risk" of ownership, in particular, the risks associated with the construction of the generating facility. These cost overruns are clearly the responsibility of the owners, Aquila and Calpine, and not the entities acquiring short-term power or capacity. Therefore, if the Commission allows the capacity charge costs in rates as proposed by the Company, the amount of the increase of $0.0253 per kW-month for these associated overruns and underruns should not be included in rates.

Q. What is the total amount of the increase relating to these overruns and underruns?

A. The PPA provides MPS 200 megawatts for the 12 months of the year (January 1 through December 31). The PPA also provides an additional 300 megawatts of capacity for six months (April through September) of each year of the PPA starting April 1, 2002 through May 31, 2005, the date the PPA terminates. Based upon this information, the $0.0253 per kW-month cost overrun pass through amounts to $106,260 on an annual basis:

200 megawatts for 12 months (200,000 kWs) [200,000 kWs times $0.0253 per month times 12]	$ 60,720
300 megawatts for six months (300,000 kWs) [300,000 kWs times $0.0253 per month times 6]	45,540
TOTAL MPS - electric	**$106,260**

Q. Is Aquila being charged the $0.0253 per kW-month for the cost overruns?

A. Yes. A review of the Aries invoices charged MPS for capacity and energy costs shows that the Aries partners are billing the overrun amount to MPS and MPS is paying the $0.0253 per kW-month above the agreed upon contract amount shown in the PPA signed on February 22, 1999.

Q. How should the amounts identified above be considered by the Commission?

A, If the Commission adopts the Aries capacity agreement amounts identified in the direct testimony (page 12) of Company witness Lisa A. Starkebaum, the overrun adjustment determined above should reduce the amount of the costs for this capacity charge. If the Commission values the Aries capacity agreement according to the Company's position, then the contract demand charges should be used and not the inflated amount resulting from the costs overruns.

BUILDING GENERATION CAPACITY FOR MISSOURI PUBLIC SERVICE

Q. Did Aquila examine the building of generating capacity as part of its regulated operations?

A. Yes. In 1998, prior to the decision to build Aries by the non-regulated side of Aquila, the Company considered building a 500-megawatt combined cycle unit on the same land that Aries was built on by its non-regulated operations (MPS). This unit was intended to be an Exempt Wholesale Generator (EWG) with Aquila's regulated operations bidding on providing capacity to MPS.

In the summer of 1998 at the time of the initial evaluations of the request for proposals (RFP) for capacity for MPS, which were issued on May 22, 1998, the regulated operations of Aquila responded to its own RFP with a "build" proposal. This build option to supply capacity and energy to MPS from a combined cycle unit operated by the EWG was the low cost option at the time of the initial review phase of the RFP.

Q. Why didn't the regulated side of Aquila (MPS) build the combined cycle unit as a EWG?

A. The regulated operations of the UtiliCorp presented its proposal to Robert Green, then UtiliCorp President, who made the decision that the regulated side of UtiliCorp's operations would not build the Aries project. The material covered two different dates: 1) October 8, 1998-Financial Analysis of Supply Options, and 2) October 28, 1998-Updated Analysis of Supply Options. The presentation material was provided to Staff in response to Staff Data Request No. 301 and is attached to this testimony as Highly Confidential Schedules 3 and 4.

Q. How did Staff find out about the process that was used to determine who would build the Aries project?

A. This was discussed with former Aquila personnel who were involved in not only the issuance and review of the RFP, but also as one of the bidders to the RFP to supply capacity to MPS through the EWG. Staff conducted an interview with the individuals who were directly involved in the issuance and review of the RFP and also in making the decision to submit a bid to build a combined cycle unit to supply power to MPS as an EWG.

Q. How did the interview with the former Aquila personnel come about?

A. Staff indicated to Aquila that it wanted to discuss the RFP process and aspects of how MPS came to agree to purchase power from the Aries partners. Aquila contacted two individuals who were directly involved in these decisions and provided them for an interview with Staff.

Q. Is it Staff's view that UtiliCorp should have given more consideration to the building of the Aries project as a regulated unit?

A. Yes. Staff believes that the option to build the Aries project by the regulated operations of UtiliCorp and rate base the generating station in the traditional manner should have been chosen.

Q. Is there another Staff witness who is providing rebuttal testimony on the Aries issue concerning the build options?

A. Yes. Staff witness Mark L. Oligschlaeger also addresses the Aries build option in his rebuttal testimony.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.

MERGERS AND ACQUISITIONS BACKGROUND

UtiliCorp United Inc. Merger with Empire District Electric Company—Case No. EM-2000-369

I filed rebuttal testimony on the proposed merger between Empire and Aquila, then called UtiliCorp. On December 15, 1999 Aquila, with Empire, filed an application requesting approval of a merger of Aquila with Empire. The Commission approved this merger on December 28, 2000 in Case No. EM-2000-369, but Aquila chose not to complete the merger.

Kansas City Power & Light Company Merger with Western Resources, Inc.—Case No. EM-97-515

I was project coordinator for Staff's review of Kansas City Power & Light Company's (KCPL) proposed merger with Western Resources, Inc. (Western Resources). On May 30, 1997, KCPL and Western Resources filed their initial application with the Commission requesting approval of a merger between KCPL and Western Resources. This application was designated as Case No. EM–97-515. A Stipulation and Agreement was filed with the Commission on July 20, 1999 and on September 2, 1999, the Commission issued an Order Approving the Stipulation and Agreement. The merger between KCPL and Western Resources ultimately was not completed.

Union Electric Company Merger with CIPSCO, Inc.—Case No. EM-96-149

Staff witnesses Mark L. Oligschlaeger, Charles R. Hyneman and I, among others, were involved in the Staff review of the proposed merger between Union Electric Company (UE) and CIPSCO Inc. (CIPSCO). This merger was announced in August 1995 and was not completed until December 31, 1997. On November 7, 1995, UE filed an application with the Commission requesting authority to merge, designated as Case No. EM–96–149. The Commission conditionally approved this merger in a Report And Order issued on February 21, 1997.

Kansas City Power & Light Company Merger with Kansas Gas & Electric Company—Case No. EM-91-16

Along with other members of the Staff, I was involved in the review of the hostile tender offer to Kansas Gas & Electric Company (KGE) shareholders made by KCPL. On July 16, 1990, KCPL filed an application with this Commission to acquire and merge with KGE, which was docketed as Case No. EM–91–16. After KGE signed a merger agreement with Western Resources, known at the time as Kansas Power & Light Company (KPL), KCPL withdrew its tender offer on December 13, 1990.

Kansas Power & Light Company Merger with Kansas Gas & Electric Company—Case No. EM-91-213

I was also involved in the review of KPL's merger with and acquisition of KGE. On November 21, 1990, KPL filed an application with this Commission docketed as Case No. EM-91-213, requesting authority to acquire all classes of capital stock of KGE, merge with KGE, and issue stock and incur debt obligations relating thereto. That application was a result of a definitive Agreement and Plan of Merger dated October 28, 1990, which was executed by the two companies. The Commission authorized the KPL merger with KGE in a Report And Order dated September 24, 1991. The State Corporation Commission of the State of Kansas (Kansas Commission or KCC), in Consolidated Docket Nos. 172,745-U and 174,155–U, approved that same merger on November 15, 1991. After receiving the necessary regulatory approvals, KPL completed the merger with KGE on March 31, 1992.

Southern Union Company Acquisition of Missouri Properties of Western Resources, Inc., d/b/a Gas Service—Case No. GM-94-40

I was also involved in the Staff's review of the Joint Application filed with the Commission on August 5, 1993 for the authorization to sell, transfer and assign certain assets relating to the provision of natural gas service in Missouri from Western Resources, d/b/a KPL

Gas Service to Southern Union Company (Southern Union). This case was docketed as Case No. EM–94–40. The Joint Application was a result of an Agreement for Purchase of Assets dated July 9, 1993, which was executed by the two companies. The Commission approved this purchase transaction on December 29, 1993. Southern Union continues to operate this natural gas distribution system in the western part of Missouri as Missouri Gas Energy (MGE).

I was one of the witnesses who addressed a proposal made by MGE in its 1996 rate case (Case No. GR-96-285) to share in purported savings relating to the acquisition.

Q. What other experience do you have regarding mergers and acquisitions?

A. I was involved in discussions with other Staff members who were reviewing the Union Electric acquisition of Arkansas Power & Light Company's (APL) Missouri properties, docketed as Case No. EM–91–29. This application was filed on August 2, 1990 and was approved in a Report And Order issued on September 19, 1991.

I have been involved in several other merger and acquisition applications filed with the Commission. Included among these applications was the application of United Cities Gas Company (United Cities) to acquire Monarch Gas Company, docketed as Case No. GM–96–180. This application was filed on November 29, 1995 and was approved by the Commission on March 22, 1996.

I presented testimony in Case No. GR–90–152 on the proper ratemaking treatment of the acquisition adjustment resulting from the acquisition of Associated Natural Gas Company by Arkansas Western Gas Company.

Also, I have been involved in examining the effects of the acquisition and merger activities of Aquila's Missouri Public Service (MPS) division. Specifically, I was involved in the supervision of an audit of in Case No. GR–88–194, wherein the Staff examined Aquila's

Corporate Office function, particularly the effects on cost of service of that utility's acquisition and merger strategy, in the context of a natural gas rate increase case.

In addition, I was the principal Staff witness on the Corporate Office costs issue in Aquila's 1990 electric rate increase case, Case No. ER–90–101 respecting the MPS division's electric operations.

I have reviewed several other applications filed with the Commission relating to acquisitions of utility property. Most of those other cases involved Aquila, including the acquisition of Peoples Natural Gas Company from InterNorth that was approved by the Commission in 1985 in Case No. EF-86-73, and the acquisition of the electric properties of Centel by Aquila in the early 1990s.

BACKGROUND OF THE ST. JOSEPH LIGHT & POWER COMPANY MERGER WITH AQUILA, INC.

Q. What was the history of St. Joseph prior to its merger with Aquila?

A. According to St. Joseph's 1998 Annual Report to Shareholders, St. Joseph "has been in the public utility business since 1883. It became an independent, investor-owned business in 1950." It was incorporated in the state of Missouri in 1895.

St. Joseph's corporate headquarters were located in St. Joseph, Missouri. It was an independent investor-owned electric utility that was engaged in the generation, purchase, transmission, distribution and sale of electricity to over 62,000 electric customers in 74 cities, towns and villages, and in a large rural area encompassing 3,200 square miles in northwest Missouri. In 1999 electric revenues represented about 70% of its total revenues. St. Joseph also supplied natural gas service to approximately 6,400 customers in Maryville and 14 other communities, and provided industrial steam service to six customers in St. Joseph, Missouri.

Q. When did Aquila and St. Joseph file their application to merge?

A. On October 19, 1999, Aquila filed an application with the Commission requesting approval of a merger between Aquila and St. Joseph pursuant to the "Agreement and Plan of Merger" (Merger Agreement) dated March 4, 1999. Under terms of this Merger Agreement, St. Joseph merged with and into Aquila, then called UtiliCorp. The merger was publicly announced on March 5, 1999.

Q. Did this Commission approve the merger between Aquila and St. Joseph?

A. Yes. On December 14, 2000, the Commission approved the merger in Case No. EM-2000-292. All other regulatory approvals were received by Aquila and St. Joseph, and the merger was completed by December 31, 2000.

Q. How did Aquila approach St. Joseph to bring about this merger proposal?

A. Aquila submitted a proposal to merge with St. Joseph in a bidding process to acquire all the common stock of SJLP. This bidding process was initiated by St. Joseph through its financial advisor, Morgan Stanley Dean Witter (Morgan Stanley) in late 1998.

Q. What was the purchase price offered by Aquila for St. Joseph?

A. Under the terms of the merger agreement, Aquila proposed to pay St. Joseph shareholders a fixed value of $23.00 of its common stock for each share of St. Joseph's common stock. According to the direct testimony (page 6) filed in Case No. EM-2000-292 by Aquila witness Robert K. Green, President and Chief Operating Officer, the total value of the merger transaction was to be $270 million, of which $190 million relates to the purchase of approximately 8.2 million shares of St. Joseph's common stock and the assumption of an expected $80 million in liabilities. That estimate represented a $92 million or approximately 36 percent merger premium to the book value of St. Joseph. The Aquila common stock was to be based on the average trading price for Aquila's common stock during the 20 trading days ending on the fifth trading day prior to the closing date (Proxy Statement, page 31).

Upon the completion of the merger on December 31, 2000, all the operations of St. Joseph were merged with and into the operations of, Aquila, and St. Joseph is now being operated as a division of Aquila. Aquila maintained the St. Joseph Light & Power Company name as a trade name within the existing service territory of St. Joseph. The service once provided by St. Joseph is now being provided by Aquila Networks-L&P, a division of Aquila.

Q. Did St. Joseph seek a buyer for its utility property?

A. Yes. The Proxy Statement (pages 14 through 16) identified in detail the process that the Board of Directors of St. Joseph engaged in to conduct a series of analyses relating to its future operations. Also, in the direct testimony of Mr. Terry F. Steinbecker, Chairman of the Board, President and Chief Executive Officer of St. Joseph, (Case No. EM-2000-292 direct, pages 2 through 6) there is similar detail about the merger process that St. Joseph used to determine its future corporate structure. Some of the more important events that occurred during the period of 1995 to the March 4, 1999, the date the merger agreement was executed, are as follows:

- Prior to 1995, St. Joseph's Board of Directors (Board) studied various strategies for maximizing shareholder value.

- In 1995, St. Joseph retained a consulting firm, Planmetrics, Inc., which presented to the Board an analysis in January 1996 relating to Strategic Planning of St. Joseph. This presentation was used by the Board to make decisions on St. Joseph's diversification program.

- The diversification program resulted in the acquisition of several companies by St. Joseph, including Percy Kent, who is a manufacturer of small paper bags for food, agricultural, chemical, pet food and other consumer packaging companies.

- In 1998, St. Joseph retained another consulting firm, Scott, Madden & Associates, Inc. (Scott, Madden), which issued a confidential report to the Board of Directors on Strategic Planning. Scott, Madden recommended that St. Joseph should sell the Company.

- On July 15, 1998, the Board approved the retention of Morgan Stanley as financial advisor to St. Joseph. Morgan Stanley was instructed to develop potential strategic alternatives for maximizing shareholder value, including a potential merger or strategic alliance.

- On October 14, 1998, Morgan Stanley outlined the strategic challenges facing St. Joseph and recommended that St. Joseph explore a potential business combination with a larger utility company as the best means of maximizing long-term value for St. Joseph's shareholders.

- At the October 14 meeting, the Board instructed Morgan Stanley to contact seven companies for the purpose of obtaining expressions of interest in a potential business combination.

- Between November 27 and December 2, 1998, two of the seven potential bidders informed Morgan Stanley of their interest in receiving information about St. Joseph. During a December 4 meeting with the Board, Morgan Stanley informed the Board that a third party had indicated an expression of interest.

- Between December 16 and 18, 1998, Morgan Stanley received a preliminary expression of interest from each of three potential bidders. On December 21, Morgan Stanley discussed financial and non-financial aspects of the non-binding bids that contained preliminary proposed valuations of between $19.70 and $22.25 per share of SJLP common stock.

- Between January 12 and 21, 1999, the three parties that submitted non-binding bids performed due diligence reviews of St. Joseph.

- Between January 7 and February 17, 1999, St. Joseph's management conducted a due diligence review of the three interested parties.

- On February 16, 1999, St. Joseph received final binding proposals from two of the three interested parties. Aquila's proposal was a fixed value of $22.50 per share of St. Joseph common stock. The second proposal was an all stock transaction at a value of $21.28 per share of St. Joseph common stock, with a downward price adjustment in the event of a reduction in the bidder's share price. The third interested party had informed Morgan Stanley it did not intend to submit a final binding proposal.

- On February 19, 1999 the Board met to review and compare the two binding bids. Because Aquila had the higher and a fixed bid, the Board requested Morgan Stanley to see if Aquila would increase its offer. Morgan Stanley contacted Aquila and encouraged it to increase its bid. Aquila raised its bid to $23.00 per share of St. Joseph common stock.

- Based upon the increase in price to $23.00 per share and the more favorable structure of Aquila's bid, on February 22, 1999 the Board of Directors authorized management and St. Joseph's legal advisors to negotiate a definitive merger agreement with Aquila. This occurred over the next ten days.

- Sometime after February 22, 1999 and prior to March 4, Morgan Stanley contacted the financial advisor of the other bidder, which did not augment its proposal as a result of that conversation.

- as a result of the merger, **St. Joseph's shareholders will most likely benefit from UtiliCorp's dividend rate,** which then was, and in recent years had been, higher than St. Joseph's dividend rate;

- **St. Joseph's shareholders will benefit by participating in the combined economic growth of the service territories** of UtiliCorp and St. Joseph, and from the inherent increase in scale, the market diversification and the resulting increased financial stability and strength of the combined entity;

- the merger **will result in cost savings from decreased electric production and gas supply costs, a reduction in operating and maintenance expenses** and other factors;

- the combined enterprise **can more effectively participate in the increasingly competitive market** for the generation of power;

- UtiliCorp has significant non-utility operations and, as a larger and stronger financial entity following the merger, should be able to **manage and pursue further non-utility diversification activities** more efficiently and effectively than St. Joseph as a stand-alone entity; and

- the merger and various provisions of the merger agreement **offer St. Joseph's shareholders, customers and employees** and the St. Joseph community a unique **opportunity to realize the benefits** created by combining the two companies.

[emphasis added]

The reasons cited by the Board in its communication to the shareholders regarding the merger clearly illustrates that the merger was about increasing the overall wealth of St. Joseph's shareholders. The Proxy Statement and Mr. Steinbecker's direct testimony in Case No. EM-2000-292 (pages 2 through 4), indicate that the Board made the decision to merge with Aquila based solely on "maximizing shareholder value." The payment of the merger premium to St. Joseph's shareholders and the increased dividends on an ongoing basis to former St. Joseph shareholders taking UlitiCorp stock relate directly to "maximizing shareholder value." To that end, the merger process engaged in by St. Joseph was a success. St. Joseph ensured that the interest of its shareholders was first and foremost in the merger analyses. The customers' interests were secondary in all respects.

Q. Was the basis for the SJLP merger with Aquila increasing the overall wealth of shareholders?

A. Yes. It is necessary for a proposed merger to provide opportunities to shareholders in order for management to be able to pursue the merger. If the merger cannot be presented as advantageous to shareholders, they will not vote for approval. The Proxy Statement identifies several benefits to St. Joseph's shareholders to ensure that they believe that they are being rewarded for giving up control of the company. Maximizing shareholder value is extremely important in the merger process. The board of directors has a special and unique responsibility to the shareholders and other investors of the entity to ensure that the owners of the entity are fully compensated for relinquishing their ownership interest. The payment of the merger premium to St. Joseph's shareholders is the primary benefit to them, along with any opportunity to receive an increase in dividends. Also, typically the opportunity for a smaller company like St. Joseph to access more potential shareholders by trading stock in a larger pool of investors, such as was and is the case for Aquila's stock, is considered a benefit. This allowed former St. Joseph stockholders to trade their stock in a more liquid market than was previously available to them. Other potential shareholder benefits resulting from mergers, include the opportunity to be an owner of a larger combined company with greater potential for economic growth, the opportunity as a shareholder to "keep" the preponderance of the purported merger savings, the opportunity to participate in the increasingly competitive market for power, the opportunity to engage in non-regulated and non-utility diversification and the opportunity to realize the benefits of a larger combined company in the procurement of capital, goods and services, etc. These all relate directly to enhancing shareholder value.

Featherstone

Schedules 3 and 4

Are Highly Confidential

In Their Entirety