

EXHIBIT

Exhibit No.:
Issues: Sharing of SJLP-
Related Savings
Witness: James R. Dittmer
Sponsoring Party: Office of the Public
Case No.: GR-2004-0072

FILED³

JUN 21 2004

Missouri Public
Service Commission

**Before the Public Service Commission
Of the State of Missouri**

Rebuttal Testimony

of

James R. Dittmer

February 13, 2004

Exhibit No. 65
Case No(s) GR 2004-0072
Date 3-30-04 Rptr KF

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

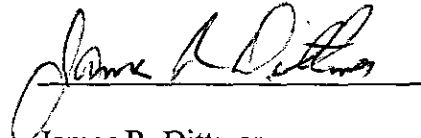
In the Matter of Aquila, Inc. d/b/a Aquila)
Networks-MPS and Aquila Networks-L&P)
For authority to file tariffs increasing natural)
Gas rates for the service provided to customers) Case No. GR-2004-0072
In the Aquila, Networks-MPS and Aquila)
Networks-L&P area)

AFFIDAVIT OF JAMES R. DITTMER

State of Missouri)
) SS
County of Jackson)

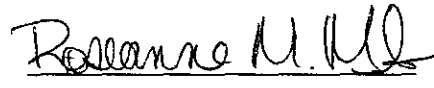
James R. Dittmer, of lawful age and being first duly sworn, deposes and states:

- 1) My name is James R. Dittmer. I am a Senior Regulatory Consultant working for the firm of Utilitech, Inc. This testimony I am presenting herein is offered on behalf of the Missouri Office of the Public Counsel
- 2) Attached hereto and made a part hereof for all purposes is my rebuttal testimony consisting of pages 1 through 25 .
- 3) I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.


James R. Dittmer

Subscribed and sworn to be this 9th day of February 2004

ROSEANNE M. MERTES
Notary Public - Notary Seal
STATE OF MISSOURI
Jackson County
My Commission Expires: Dec. 7, 2006


Notary Public

My commission expires 12-7-06

1 **REBUTTAL TESTIMONY**
2 **OF**
3 **JAMES R. DITTMER**
4 **AQUILA, INC.**
5 **d/b/a AQUILA NETWORKS – L&P and**
6 **AQUILA NETWORKS - MPS**
7 **CASE NO. GR-2004-0072**
8

9 **Q. PLEASE STATE YOUR NAME AND ADDRESS.**

10 A. My name is James R. Dittmer. My business address is 740 Northwest Blue
11 Parkway, Suite 204, Lee's Summit, Missouri 64086.

12
13 **Q. BY WHOM ARE YOU EMPLOYED?**

14 A. I am a Senior Regulatory Consultant with the firm of Utilitech, Inc., a
15 consulting firm engaged primarily in utility rate work.

16
17 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS**
18 **PROCEEDING?**

19 A. Yes. On January 6, 2004 I filed direct testimony in this case on behalf of the
20 Office of the Public Counsel for the State of Missouri (hereinafter "OPC").
21

22 **Q. ON WHOSE BEHALF ARE YOU PRESENTING REBUTTAL**
23 **TESTIMONY IN THIS CASE?**

24 A. Like my direct testimony, this testimony is being presented on behalf of the
25 OPC.
26

1 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

2 A. On behalf of Aquila, Inc. (hereinafter “Aquila” or “Company”), Mr. Vern
3 Siemek has proposed that Aquila, Inc.’s shareholders be allowed to retain a
4 portion of alleged savings arising from synergies that purportedly have resulted
5 from Aquila’s acquisition of St. Joseph Power and Light Company’s (“SJLP” or
6 “L&P”) electric, gas distribution and steam heat utility properties. The purpose
7 of this rebuttal testimony is to offer arguments in opposition to the Company’s
8 proposal to retain a portion of alleged merger-related synergy savings.

9

10 **Q. PLEASE BRIEFLY SUMMARIZE THE COMPANY’S POSITION**
11 **REGARDING THE CALCULATION AND PARTIAL RETENTION OF**
12 **ALLEGED SYNERGY SAVINGS ARISING FROM THE SJLP**
13 **ACQUISITION.**

14 A. Mr. Vern Siemek summarizes the Company’s position as follows:

15 • There are considerable savings from the acquisition of L&P from joint
16 dispatching of generation plants and to MPS from spreading Aquila
17 support costs over a larger customer base.

18 • The normal procedures for allocating Aquila costs give 100% of the
19 merger related savings from economies of scale to MPS (both types of
20 savings) and L&P (joint dispatching only).

21 • It is equitable for Aquila to retain 50% of those benefits as an incentive
22 for creating the savings in lieu of recovering the costs of creating the
23 acquisition that are not now reflected in MPS or L&P costs. Retaining

1 benefits from the savings created by mergers is generally superior to
2 recovering the costs of an acquisition because it limits the impact on
3 customers to the savings actually created by the merger

4 • Aquila has not yet realized any of the benefits of the savings from the
5 merger. Cost increases and industry conditions unrelated to the merger
6 have thus far prevented Aquila from realizing those benefits.

7 • Sharing in savings created by the merger provides an incentive for
8 companies to create such savings for customers by encouraging future
9 mergers. (Mr. Vern Siemek's direct testimony, page 3)

10
11 **Q. WHERE IN AQUILA'S FILING IS THE COMPANY'S SPECIFIC**
12 **PROPOSAL?**

13 A. The Company's specific proposal to retain synergy savings is found in
14 Company Adjustment No. CS-17. Specifically, with MPS Adjustment No. CS-
15 17 the Company proposes to "add back" expenses which theoretically represent
16 support costs savings that MPS customers are realizing by virtue of Aquila's
17 acquisition of SJLP.

18
19 **Q. WHAT DO YOU MEAN WHEN YOU SAY THE COMPANY PROPOSES**
20 **TO "ADD BACK" EXPENSES?**

21 A. Aquila undertakes a calculation wherein it purports to determine the additional
22 corporate support costs that it contends the MPS division (and its ratepayers)
23 would inherit if the SJLP property had *not* been acquired. The Company's

1 implicit argument is that most of these support function costs are relatively
2 fixed in nature – regardless of the size of the entire Aquila entity. Thus, Aquila
3 undertakes a calculation which reflects the allocation of support function costs
4 assuming the SJLP division is allocated a proportionate share of such costs (as
5 is now occurring on Aquila/MPS’ books and records) and another calculation
6 which reflects the allocation of support function costs assuming SJLP was not
7 acquired (purely hypothetical). The difference in these two calculations Aquila
8 claims to be merger-related synergy savings. Specifically, Aquila proposes to
9 “add back” half of the difference in allocable corporate support function costs
10 that the Company claims the MPS division would inherit *if the SJLP property*
11 *had never been acquired*. In other words, Aquila proposes to “add back”
12 fictitious expenses that are not actually being allocated to the MPS division at
13 this point in time.

14
15 **Q. PLEASE STATE WHY YOU OPPOSE AQUILA’S PROPOSAL TO**
16 **RETAIN A PORTION OF SAVINGS PURPORTEDLY RESULTING**
17 **FROM AQUILA’S ACQUISITION OF L&P?**

18 A. My opposition to Aquila’s retention of alleged synergy savings can be
19 summarized as follows:

- 20 • There has been no real demonstration of “support cost” savings.
- 21 • Assuming there have been synergy savings, Company shareholders
22 would have experienced or “shared” in such savings as a result of
23 regulatory lag.

- 1 • The Company's claim that retention of synergy savings is necessary to
2 incent economic mergers and acquisitions is not supported by empirical
3 evidence

4
5 **Q. TURNING TO YOUR FIRST SUMMARY ARGUMENT, PLEASE**
6 **EXPAND UPON YOUR STATEMENT THAT THERE HAS BEEN NO**
7 **REAL DEMONSTRATION OF "SUPPORT COST" SAVINGS.**

8 A. Mr. Siemek provides a *hypothetical* example of how "support cost" savings are
9 allegedly inuring to MPS ratepayers. In Mr. Siemek's purely hypothetical
10 example, the sum of MPS' and SJLP's pre-merger stand-alone support costs are
11 greater than the post-merger support costs of the combined entity. Under Mr.
12 Siemek's hypothetical example, a lower amount of the combined entity's total
13 support costs are allocated to MPS than what MPS was said to be incurring on a
14 stand-alone basis prior to the merger.

15
16 In developing Company's adjustment CS-17 for the MPS division, Ms.
17 Beverlee Agut basically multiplies corporate residual support costs times two
18 allocation factors – one which does not include or consider the SJLP property
19 and one which does. The factor developed without the SJLP components in the
20 denominator obviously results in a higher MPS-responsibility percentage than
21 the factor developed with the SJLP component included in the denominator.
22 The difference in expense levels being allocated to the MPS division resulting
23 from the application of the higher (without SJLP) and lower (with SJLP) factors

1 to the corporate residual support costs Aquila assumes to be "support cost"
2 synergy savings inuring to the benefit of the MPS division.

3
4 I do not believe that the hypothetical example provided by Mr. Siemek
5 demonstrates or proves what may be happening in actuality for MPS. Further,
6 the application of two factors to a single pool of corporate support dollars
7 yielding a different allocation of dollars to the MPS division does not
8 unequivocally demonstrate or prove that the MPS division has experienced, or
9 is experiencing, the savings calculated and claimed by Aquila in this case.

10
11 **Q. ACCORDING TO MS. AGUT'S PREFILED DIRECT TESTIMONY,**
12 **THE COMPANY HAS CAPTURED AND CONSIDERED THE**
13 **INCREMENTAL COSTS INCURRED TO SUPPORT THE SJLP**
14 **ACQUISITION. IF THAT IS THE CASE, ISN'T IT A**
15 **MATHEMATICAL CERTAINTY THAT MPS RATEPAYERS HAVE**
16 **BEEN OR WILL BE BENEFITING FROM THE SJLP ACQUISITION?**

17 **A.** No. First, such savings calculation is totally dependent upon Aquila capturing
18 all incremental allocable administrative and general and other "support" costs
19 thought to be incurred to accommodate the integration of the SJLP property into
20 the Aquila Networks System. The fact that accounts and activity codes have
21 been established to record charges that might be designated as attributable to
22 accommodating the SJLP property into the system does nothing to insure that
23 all incremental costs are being recorded.

1 Further, I submit that there have been so many significant changes to Aquila
2 operations over the last two years that it is difficult to determine what costs or
3 savings may be attributable to any given event or set of events. Specifically,
4 following the SJLP acquisition at the beginning of 2001 Aquila continued its
5 acquisition strategy. However, as the Commission is well aware, in the second
6 quarter of 2002 Aquila fell into dire financial straits as a result of its unregulated
7 energy trading operations. Since that time Aquila has cut payroll as well as
8 other costs in response to the financial crisis brought on by its failed energy
9 trading operations. In addition to closing its energy trading operations, Aquila
10 has sold – and continues to sell – many of its properties. Additionally, Aquila
11 again reorganized its operations to transfer operations and responsibilities, that
12 in recent years had taken place on a centralized corporate basis, back to the
13 various state jurisdictions.

14
15 **Q. WHAT ARE THE IMPACTS OF THE CHANGES YOU DISCUSSED?**

16 **A.** As a result of the various noted changes, the total pool of allocable residual
17 corporate “support costs” first rose immediately following the SJLP acquisition
18 but have subsequently significantly declined. However, even though the total
19 pool of corporate allocable support costs have ultimately declined, the number
20 of Aquila properties have also significantly declined. Thus, while corporate
21 allocable costs have declined overall, MPS’ percentage share of remaining
22 residual costs have actually *increased* since SJLP has been acquired.

23

1 With its request to “add back” theoretical expenses to MPS’ cost of service
2 Aquila essentially asks this Commission to put blinders on and look at one –
3 and only one – change that has occurred with regard to the allocation of
4 corporate support costs to MPS. Specifically, Aquila would have this
5 Commission look at two different allocation factors for MPS and assume that
6 synergy savings related to the SJLP acquisition can be determined by simply
7 applying these two factors to essentially the same pool of dollars. I submit that
8 given the significant changes to Aquila’s operations over the last two years
9 discussed above, the undemanding calculation offered by Aquila simply cannot
10 reliably determine SJLP-related synergy savings for the MPS division.

11
12 **Q. DOES AQUILA CLAIM THAT THE SJLP ACQUISITION HAS**
13 **YIELDED “SUPPORT COST” SAVINGS TO SJLP?**

14 A. No. By Aquila’s own admission its acquisition of SJLP has not resulted in any
15 corporate overhead or corporate support cost savings to the SJLP division.
16 Therefore, Aquila does not propose to “add back” any phantom support cost
17 expenses to SJLP’s cost of service as it does in the case of MPS.

18
19 **Q. WHY ARE THERE NO SUPPORT COST SAVINGS FOR SJLP?**

20 A. I do not know. I find it both interesting and ironic that Aquila claims that its
21 acquisition of SJLP as well as other properties over the years have purportedly
22 resulted in economies of scale that, in turn, have resulted in savings to MPS and
23 other Aquila utility properties. Yet, with all of its size and purported

1 sophistication it cannot show any support cost savings for the relatively tiny
2 SJLP property.

3
4 **Q. DO YOU CONSIDER AQUILA’S INABILITY TO SHOW “SUPPORT**
5 **COST” SAVINGS FOR SJLP SIGNIFICANT TO AQUILA’S**
6 **ARGUMENT THAT IT SHOULD BE ABLE TO RETAIN “SUPPORT**
7 **COST” SAVINGS FOR THE MPS DIVISION?**

8 A. Very much so. In essence Aquila is asking for a “reward” or “bonus” for the
9 SJLP-related-economies-of-scale savings which it purportedly brings to MPS.
10 Yet, with all its purported size advantage Aquila cannot show a savings in
11 support costs for SJLP. It would be most ironic, and indeed, inequitable, if
12 Aquila were rewarded vis-à-vis the “add-back” of theoretical expenses that have
13 allegedly been saved by virtue of its size when – notwithstanding its size
14 advantage – it cannot demonstrate support cost savings for diminutive SJLP.

15
16 **Q: WOULD SUCH A “REWARD” BE CONSISTENT WITH THE GOALS**
17 **OF UTILITY REGULATION?**

18 A. No. It is frequently stated that regulation is intended to be the surrogate for, or
19 take the place of, competition. Regulators are charged with the task of finding
20 and eliminating from utility company’s cost of service proposals costs believed
21 to be excessive or unnecessary in the provision of safe reliable regulated utility
22 service. The “excessive” or “unnecessary” costs that regulators “disallow” are,
23 in theory, the same costs that “the market” would effectively disallow if utilities

1 were selling an unregulated good or service without the significant benefit of a
2 certificated service territory.

3
4 In the instant case Aquila effectively wants a reward for saving MPS ratepayers
5 “support costs” that it claims it has achieved, *and are only made possible by*, its
6 purchase of the SJLP property. However, the Company cannot show or claim
7 similar “support cost” savings for the smaller SJLP property. This outcome is
8 not expected. If “larger size” leads to economies of scale and sophistication in
9 business processes – as is implicit in Aquila’s argument for retention of
10 “support cost” synergy savings – one would fully expect the much smaller SJLP
11 system to experience the greatest “support cost” savings.

12
13 **Q. DOES AQUILA’S FAILURE TO ESTABLISH ANY SUPPORT COST**
14 **SAVINGS FOR SJLP INDICATE THAT SJLP WAS MORE EFFICIENT**
15 **PRIOR TO THE MERGER WITH AQUILA?**

16 A. Yes, the current scenario indicates that, for whatever reasons, prior to the
17 merger the relatively diminutive SJLP Company had been more efficient – at
18 least with regard to the provision of “support” functions – than the much larger
19 Aquila organization. Perhaps SJLP had more accountability for incurring costs.
20 Perhaps Aquila had or has difficult-to-identify-and-quantify excess capacity in
21 its “support cost” systems. Perhaps there was or are “diseconomies of scale”
22 incorporated within Aquila’s various “support cost” systems caused or created
23 by Aquila’s extensive forays into unregulated and/or international operations.

1 Perhaps some of Aquila "support cost" personnel were or are somewhat
2 overpaid. But for whatever reasons, diminutive SJLP was not, and is not, able
3 to achieve any savings in "support costs" by virtue of its affiliation with the
4 larger Aquila entity.

5
6 **Q. ISN'T IT ENOUGH THAT THE ACQUISITION OF SJLP MAYBE**
7 **YIELDING SOME ECONOMIES OF SCALE TO THE MPS DIVISION**
8 **TO SUPPORT AQUILA'S SUPPORT COST SAVINGS CLAIM?**

9 A. No. The acquisition of the SJLP system *may* be yielding some economies of
10 scale resulting in support cost savings to the MPS division relative to what the
11 MPS division would experience without Aquila's ownership of SJLP.
12 However, the fact that Aquila cannot facilitate support cost saving for the
13 relatively diminutive SJLP system indicates that similar savings should also be
14 achievable for the MPS division – in some manner or through some other means
15 – without the economies of scale theoretically brought about with the SJLP
16 acquisition.

17
18 To summarize on this latter point, Aquila is essentially asking for a reward for
19 the savings it has brought to the MPS division that it effectively claims are *only*
20 possible as a result of the economies of scale made possible by its acquisition of
21 the SJLP system. Aquila's inability to demonstrate similar economies-of-scale-
22 type support cost savings to diminutive SJLP would suggest this is not the case.
23 If pre-merger, stand-alone SJLP could carry out the various "support" functions

1 at costs equivalent to that which it is being charged vis-à-vis an allocation of
2 Aquila support costs, it stands to reason that the much larger Aquila operations
3 are not carrying out these functions as inexpensively or efficiently as SJLP.
4 Accordingly, Aquila's request to share economies-of-scale support cost savings
5 on the MPS division should be rejected.

6
7 **Q. TURNING TO YOUR SECOND ARGUMENT SUMMARIZED**
8 **EARLIER, PLEASE EXPAND UPON HOW - TO THE EXTENT**
9 **SYNERGY SAVINGS MAY HAVE ACTUALLY MATERIALIZED -**
10 **COMPANY SHAREHOLDERS WOULD HAVE ALREADY "SHARED"**
11 **IN SUCH SAVINGS AS A RESULT OF REGULATORY LAG.**

12 A. Assuming *arguendo* that support costs savings (for MPS only) have been
13 experienced, and are being experienced, as portrayed by Aquila in Adjustment
14 No. CS-17, Aquila shareholders would have retained at least a portion of such
15 savings since the acquisition. Because neither MPS' or SJLP's rates were
16 concurrently adjusted at the time of the acquisition to capture such purported
17 savings, Aquila shareholders would have retained any such savings achieved on
18 the MPS division at least from the time of the acquisition up through the time
19 that MPS rates were adjusted in early 2002. Further, since SJLP rates have not
20 been adjusted since the acquisition, any savings for the SJLP division (which
21 would only be joint dispatch since the Company cannot demonstrate "support
22 cost" savings for the SJLP division) would have inured exclusively to Aquila
23 shareholders.

1 Q. ACCORDING TO MR. SIEMEK'S DIRECT TESTIMONY, "AQUILA
2 HAS REALIZED LITTLE, IF ANY BENEFIT FROM THOSE MERGER
3 SAVINGS TO DATE." WHAT DOES MR. SIEMEK MEAN WHEN HE
4 SAYS AQUILA HAS NOT "REALIZED" ANY BENEFIT FROM THE
5 MERGER SAVINGS?

6 A. According to Mr. Siemek, Aquila can only "realize" a savings from the merger
7 if those savings fall to the bottom line for shareholders.

8
9 Q. HOW DOES MR. SIEMEK CONCLUDE THAT AQUILA REALIZED
10 LITTLE, IF ANY BENEFIT FROM MERGER SAVINGS TO DATE?

11 A. Mr. Siemek claims in direct testimony, and expands upon in his deposition held
12 on December 30, 2003, how he believes that unrelated cost increases –
13 particularly fuel and purchased power – have prohibited Aquila from realizing
14 any synergy savings for its shareholders. Specifically, in his deposition held on
15 December 30, 2003 Mr. Siemek responded to the following questions:

16 Q. (By Mr. Steven Dottheim) Are you saying that the St.
17 Joseph Light and Power merger has not created actual
18 savings to MPS and SJLP?

19 A. No. I'm saying that those synergies have been
20 overshadowed or overcome by other cost increases in the
21 case of 2001, certainly, and in delays in actually fully
22 integrating the joint dispatching so that the synergies didn't
23 occur for a substantial portion of 2001 because there are
24 transitional periods involved

25
26 As in my example, a substantial amount of the synergies
27 are actually assigned or allocated to MPS and the MPS
28 division was earning at less than an allowed rate of return,
29 certainly, in several of those years, which is what created
30 the rate case application that, as a result, the synergies have
31 been overcome by other costs.

1
2 Q. The cost increases that you were just referring to, are those
3 merger-related costs or are they related to other events,
4 factors?

5 A. Generally to other events. (Mr. Vern Siemek's Deposition
6 Transcript dated December 30, 2003, page 42)
7

8 **Q. DO YOU AGREE WITH MR. SIEMEK THAT MERGER SAVINGS ARE**
9 **ONLY REALIZED IF COMPLETELY TAKEN TO AQUILA'S**
10 **BOTTOM LINE?**

11 A. No, Mr. Siemek apparently believes that shareholders have not and will not
12 enjoy any synergy savings until, and if, the MPS and SJLP divisions *earn in*
13 *excess of their authorized or expected rates of return.* I disagree with Mr.
14 Siemek's rigid conclusion that the noted divisions must earn in excess of their
15 authorized returns before it can be concluded that Aquila shareholders have
16 participated in merger-related synergy savings.
17

18 **Q. PLEASE EXPLAIN.**

19 A. Many cost of service components change immediately following the passage of
20 a test year or the issuance of a rate order which determines some ongoing level
21 of cost of service components. Revenue levels, investment levels, financing
22 costs, fuel costs, wage costs as well as other operations and maintenance
23 expenses can be expected to change following a rate case – and sometimes
24 significantly. Sometimes the changes combine to cause an over earnings
25 situation, and at other times, they combine to result in under earnings.
26

1 Apparently the mix of changes in cost of service components following the
2 2001 rate case caused the MPS division to under earn – or at least earn below
3 the expectations of Aquila management. The fact that Aquila has earned less
4 than management's or even this Commission's expectation does not mean that
5 shareholders have not benefited from merger-related synergy savings
6 (assuming they have actually materialized as Aquila calculates in this case). In
7 actuality, if the synergy savings have materialized as Aquila claims and
8 calculates in this case, shareholders have benefited by achieving a higher return
9 *than they would have absent the realization of the synergy savings.* The actual
10 returns earned may still be below the shareholder's long term expectation, but
11 they would nonetheless still be greater than would have been realized *absent the*
12 *achievement of synergy savings.*

13
14 **Q. PLEASE PROVIDE AN EXAMPLE OF WHAT YOU MEAN.**

15 A. For example, if Aquila expects to earn ten percent (10.0%) on its book equity,
16 but only earns five percent (5.0%), its shareholders may not be pleased. But if
17 we assume Aquila would have only earned four percent (4.0%) on book equity
18 but for synergy savings realized, I submit that Aquila shareholders have
19 benefited from the merger. In short and in sum on this point, so long as the
20 shareholders have achieved a higher return than they would have *absent the*
21 *realization of synergy savings,* they have definitely benefited from the merger.
22 Accordingly, *if* synergy savings have occurred as quantified by Aquila in this

1 case, I urge this Commission to reject Mr. Siemek's conclusion that
2 shareholders have benefited little, if any, from the merger to date.

3
4 **Q. TURNING TO YOUR THIRD POINT, PLEASE EXPAND UPON YOUR**
5 **CONCLUSION THAT THE COMPANY'S CLAIM THAT RETENTION**
6 **OF SYNERGY SAVINGS IS NECESSARY TO INCENT ECONOMIC**
7 **MERGERS IS NOT SUPPORTED BY EMPIRICAL EVIDENCE.**

8 A. At the time of the SJLP acquisition, in addition to seeking authority to merge,
9 Aquila sought within its application before the MPSC authorization of a
10 "Regulatory Plan." See: Case No. EM-2000-292. The key elements of
11 Regulatory Plan included the following:

- 12 1. Five-year rate moratorium for SJLP electric, gas and steam customers
13 once the merger was approved.
- 14 2. SJLP would file electric, gas, and industrial steam heat general base rate
15 cases in the fifth and final year of the moratorium intending that new
16 rates would go into effect the sixth year after the closing of the merger.
17 The operation-of-law dates of the SJLP electric, gas and steam rate cases
18 were to coincide with the end of the five-year moratorium.
19 Commencing with the beginning of the sixth year after the closing of the
20 merger, SJLP was requesting authorization to recover in rates 50% of
21 the acquisition adjustment (both a return of 50% of the unamortized
22 portion of the acquisition adjustment as an above-the-line expense and a
23 rate base return on the 50% of the acquisition adjustment using an
24 imputed capital structure of 47% long-term debt and 53% equity) and a
25 ten-year amortization of both the transaction costs and the "costs to
26 achieve" (transition costs), without rate base treatment.
- 27 3. UtiliCorp was purporting to guarantee SJLP customers at least an
28 approximate \$1.6 million reduction in revenue requirement from net
29 merger savings in the Year 5 rate case and in any subsequent rate
30 proceedings in Years 6-10 following the closing of the merger. The
31 annual approximate \$1.6 million reduction in revenue requirement for
32 Years 6-10 was purportedly the guaranteed average estimated amount of
33 annual merger savings for Years 6-10 net of the following: a) 50%
34 recovery of the acquisition adjustment; b) recovery of other merger

1 costs; and c) the revenue requirement impact of inclusion of SJLP in
2 UtiliCorp's corporate allocation system.

- 3 4. The estimated savings amount used to determine the \$1.6 million
4 guaranteed average estimated amount of annual merger savings reducing
5 revenue requirement for Years 6-10 reflected the assignment of almost
6 the entire amount of SJLP-UtiliCorp merger savings to SJLP for
7 ratemaking purposes, as opposed to allocating more of the merger
8 savings to other divisions of UtiliCorp, such as MPS. The guaranteed
9 merger benefits to customers was to be ensured by a method of tracking
10 (quantifying) total benefits resulting from the merger.
- 11 5. For any rate proceeding in Years 6-10 following the closing of the
12 merger, a capital structure purporting to represent SJLP's pre-merger
13 capital structure of 47% long-term debt and 53% equity was to be used
14 to determine SJLP's revenue requirement.
- 15 6. In any MPS division rate case filed within ten years following the
16 closing of the merger, Aquila was proposing that the impact of the SJLP
17 acquisition be eliminated from corporate cost allocations. This last
18 element of Aquila's Regulatory Plan would be the equivalent of Aquila
19 seeking to retain 100% of alleged SJLP merger savings in A&G costs in
20 this case rather than the 50% actually being sought. In other words, this
21 element of the Regulatory Plan request would be equivalent to an "add
22 back" of approximately \$4.0 million of "allocable corporate" costs in
23 this case rather than only half – or the approximate \$2.0 million – that
24 Aquila proposes in this case.

25
26
27 As noted from the summary of the Regulatory Plan above, Aquila was seeking
28 assurances that it would retain substantial portions of any synergy savings
29 realized for a number of years. Further, some of the requested conditions also
30 had the impact of allowing Aquila to recover a portion of the premium above
31 book value that it was tendering for the SJLP property. For instance, the
32 condition that rates be established by considering SJLP's pre-merger stand-
33 alone capital structure was in effect an indirect request to "over earn" on its
34 actual capital structure – or in other words, a request to recover at least a portion
35 of the premium over book value being exchanged for the SJLP property.

36

1 **Q. WAS ADOPTION OF THE REGULATORY PLAN ESSENTIAL TO**
2 **COMPLETION OF THE MERGER?**

3 A. In its Application Aquila stated that “the Commission’s express approval of the
4 Plan is sought in the context of this Joint Application, and said approval is
5 important to this transaction.” Further, per the record from the Missouri case,
6 the Company’s witnesses indicated a preference for adoption of its proposed
7 Regulatory Plan but a willingness to accept or explore other Regulatory Plans.

8
9 **Q. DID THE MPSC ADOPT ANY ELEMENT OF AQUILA’S PROPOSED**
10 **REGULATORY PLAN?**

11 A. Ultimately, no element of Aquila’s Regulatory Plan was adopted by this
12 Commission. As the MPSC no doubt recalls, it did approve the merger, but it
13 did not promise or imply that it would adopt any ratemaking element or
14 proposal in future rate proceeding. It did state that it reserved “the right to
15 consider any ratemaking treatment to be afforded the transaction herein
16 involved in a later proceeding.” (MPSC Report and Order Case No. EM-2000-
17 292, Ordered Paragraph No. 14) Thus, the door was left open for Aquila to
18 again seek recovery of the acquisition premium in future rate proceedings – but
19 there was clearly no commitment that any portion of any such future Company
20 proposal would ever be adopted. I believe it is important to recall and
21 emphasize that nearly every element of Aquila’s claimed savings from the
22 acquisition, as well as every element of its proposed Regulatory Plan, were

1 contested by the MPSC Staff, Public Counsel and numerous intervenors to that
2 proceeding.

3
4 **Q. WHAT DID THE COMMISSION DO IN EM-2000-292?**

5 A. Following a contested hearing, the MPSC explicitly rejected Aquila's proposed
6 Regulatory Plan. Further, this Commission did not accept any party's claimed
7 synergy savings (or lack thereof). It, nonetheless, authorized the merger, but
8 expressly refused to give any regulatory assurance as to how it would deal with
9 claimed merger-related synergy savings in future regulatory proceedings.
10 Notwithstanding the fact that it had not received approval of even one of its key
11 elements of its proposed Regulatory Plan, Aquila elected to proceed with the
12 transaction. Given that Aquila proceeded with the SJLP transaction without an
13 approved "Regulatory Plan" or any assurance that it would retain potential
14 future synergy savings, it is difficult to accept Mr. Siemek's claim that the
15 sharing of such savings are necessary to provide an incentive for utilities to
16 undertake cost effective mergers or acquisitions.

17
18 **Q. IS IT YOUR UNDERSTANDING THAT THE MISSOURI SUPREME**
19 **COURT REVERSED AND REMANDED THE COMMISSION'S**
20 **DECISION IN EM-2000-252.**

21 A. Yes. It is my understanding that legal ramifications of that decision are being
22 addressed by a Motion to Dismiss.

1 **Q. WHEN MR. SIEMEK WAS EMPLOYED BY PEOPLE'S NATURAL**
2 **GAS COMPANY BEFORE IT WAS ACQUIRED BY AQUILA DID HE**
3 **PARTICIPATE IN ANY UTILITY ACQUISITIONS?**

4 A. Yes, at his deposition Mr. Siemek testified he participated in the acquisition of
5 Liberal Gas Company (1988), the Nebraska properties of Minnegasco (1993)
6 and gas operations in Fremont, Minnesota. (Deposition Vern Siemek p. 80-81).

7 **Q. DID PEOPLE'S NATURAL GAS RECEIVE RECOVERY OF THE**
8 **ACQUISITION PREMIUM OR ALLEGED SYNERGY SAVINGS IN**
9 **THOSE ACQUISITIONS?**

10 A. For the Liberal Gas Company and Fremont, Minnesota acquisitions Peoples did
11 not receive recovery of an acquisition premium or alleged synergy savings. (Mr.
12 Vern Siemek Deposition Transcript pp. 83, 85). According to Mr. Siemek
13 Peoples did receive recovery of some of the acquisition premium for its
14 purchase of the Minnegasco Nebraska properties. (Mr. Vern Siemek Deposition
15 Transcript p. 83).

16
17 **Q. IN THE PAST DID AQUILA HAVE A POLICY OF SEEKING OUT**
18 **UTILITY ACQUISITIONS TO ADD TO ITS EXISTING CUSTOMER**
19 **BASE?**

20 A. Yes, in his Direct Testimony before the Iowa Utilities Board in Case No. RPU-
21 02-5 Aquila, Inc. d/b/a Aquila Networks at page 5 Mr. Siemek indicates that
22 from 1984 to 2004 Aquila (under its former UtiliCorp name) had accomplished
23 many utility acquisitions during the last twenty years. Specifically Kansas

1 Public Service (1984), People's Natural Gas (1985), West Virginia (1987),
2 Northern Minnesota Utilities (1986), West Plain Energy (1991), Arkla's Kansas
3 operations (1994) and SJLP (2001).

4
5 **Q. DID AQUILA RECEIVE RECOVERY OF AN ACQUISITION**
6 **PREMIUM OR SYNERGY SAVINGS WHEN IT ACQUIRED KANSAS**
7 **PUBLIC SERVICE (1984)?**

8 A. No it did not. (Response To OPC Data Requests 5007 and 5008).

9
10 **Q. DID AQUILA RECEIVE RECOVERY OF AN ACQUISITION**
11 **PREMIUM OR SYNERGY SAVINGS WHEN IT ACQUIRED WEST**
12 **VIRGINIA GAS (1987)?**

13 A. No, it did not. (Response To OPC Data Request 5009 and 5010).

14
15 **Q. DID AQUILA RECEIVE RECOVERY OF AN ACQUISITION**
16 **PREMIUM OR SYNERGY SAVINGS WHEN IT ACQUIRED**
17 **NORTHERN MINNESOTA UTILITIES (1986)?**

18 A. No, it did not. (Response To OPC Data Request 5011).

19
20 **Q. DID AQUILA RECEIVE RECOVERY OF AN ACQUISITION**
21 **PREMIUM OR SYNERGY SAVINGS WHEN IT ACQUIRED ARKLA'S**
22 **KANSAS OPERATIONS (1994)?**

23 A. No, it did not. (Mr. Vern Siemek Deposition Transcript p. 86).

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Q. DID AQUILA RECEIVE RECOVERY OF AN ACQUISITION PREMIUM WHEN IT ACQUIRED WEST PLAIN ENERGY (1992).

A. The Kansas Corporation Commission stated in Docket No. 99-WPEE-818-RTS:
16. The Commission finds that the Applicant should be allowed to recover the acquisition premium through cost of service requirements only to the extent that there are demonstrated savings created by the acquisition but that no acquisition premium should be recovered through rate base adjustments.

Q. EMPIRICALLY IS RECOVERY OF THE ACQUISITION ADJUSTMENT OR SYNERGY SAVINGS NECESSARY FOR AQUILA TO SEEK TO ACQUIRE OTHER UTILITY COMPANIES?

A. Obviously not. Aquila has consummated numerous acquisitions in which it did not receive recovery of any acquisition adjustment or alleged synergy savings.

Q. DID MR. SIEMEK ADMIT THAT RECOVERY OF SYNERGY SAVINGS EMPIRICALLY WERE NOT NEEDED TO INDUCE AQUILA TO GROW THROUGH ACQUISITIONS?

A. Yes. In his December 30, 2003 deposition Mr. Siemek was asked about numerous Aquila utility acquisitions that have occurred over the past 20 years. That fairly extensive line of cross-examination ended with the following exchange:

Q. (By Mr. Douglas Micheel) So out of all of those acquisitions that we talked about, there are only two that you can point to where there was either an acquisition premium recovery or a synergy savings recovery? Is that correct?

- 1 A. Only two where there were specific requests for approval
2 of a plan, that's correct.
- 3 Q. And despite that, those companies that you worked for or
4 their evolving companies continued to do mergers and
5 acquisitions? Isn't that correct?
- 6 A. Yes, that's correct.
- 7 Q. So with respect to those mergers, there was no need for this
8 incentive to share savings? Isn't that correct?
- 9 A. *I would say there was no necessity. There was no need.*
10 (Mr. Vern Siemek Deposition Transcript pages 88 and 89,
11 *emphasis added*)
12

13 **Q. DO YOU DRAW ANY CONCLUSIONS FROM THE QUOTED**
14 **EXCHANGE?**

15 A. Mr. Siemek claims at page 3 of his direct testimony that "[s]haring in the
16 savings created by the merger provides an incentive for companies to create
17 such savings for customers by encouraging future mergers." Mr. Siemek may
18 argue in a *theoretical sense* that if companies can persuade regulatory
19 commissions to share savings thought to be merger-related such actions or
20 approvals provide an incentive for utilities to acquire and merge. However,
21 specific Aquila actions over the last 20-year period, a period in which Aquila
22 acquired numerous properties largely without being explicitly allowed to retain
23 synergy savings or recover an acquisition premium paid, would suggest or
24 indicate that such incentive is not a *necessity*.

25

26 **Q. DO YOU HAVE OTHER SUPPORT FOR YOUR BELIEF THE**
27 **RECOVERY OF AN ACQUISITION PREMIUM OR SYNERGY**
28 **SAVINGS IS NOT A NECESSITY FOR COMPANIES TO MERGE?**

1 A. Yes, I believe that it is noteworthy that according to testimony submitted by Mr.
2 Robert Green on behalf of Aquila in the Missouri SJLP merger application
3 docket, Aquila was informed that six to ten other utilities were sent information
4 memorandums and that all were considered viable strategic bidders. Given the
5 noted interest in the SJLP property, it would appear probable that some larger
6 utility would likely have acquired the SJLP property if Aquila had not. And if it
7 had been acquired, synergy savings – to the extent they could realistically be
8 realized – would likely have been achieved for SJLP ratepayers as well as the
9 acquiring utility's ratepayers.

10

11 **Q. ARE YOU AWARE OF ANY CASES WHEREIN THIS COMMISSION**
12 **HAS EXPLICITLY APPROVED RECOVERY OF AN ACQUISITION**
13 **PREMIUM AND/OR THE EXPLICIT SHARING OF SAVINGS**
14 **THOUGHT TO BE MERGER RELATED?**

15 A. No. As previously noted, Mr. Siemek claims that the sharing of synergy
16 savings would provide incentives for mergers and acquisitions. Given
17 Missouri's precedent on this issue, and Mr. Siemek's claim that the sharing of
18 synergy savings is necessary – or certainly provides incentives – for mergers
19 and acquisitions, one would have expected there to be little interest in the SJLP
20 property. The noted interest by other suitors in the SJLP property would
21 suggest that Mr. Siemek's conclusion is incorrect.

22

1 Mr. Siemek argues that allowing companies to retain a portion of synergy
2 savings provides incentives for mergers. As noted, there is ample empirical
3 evidence that such sharing is not necessary. Further, I submit that regulatory
4 commissions should be mindful that allowing the recovery of acquisition
5 premiums and/or explicitly allowing calculated merger savings to be “shared”
6 for a period of time can lead to unnecessarily high premiums being paid – which
7 can in turn lead to more creative rate proposals for recovery of such acquisition
8 premiums.

9
10 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

11 **A. Yes, it does.**