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Issues: Synergies
Witness: Vern J. Siemek
Sponsoring Party: Aquila Networks-MPS & L&P
Case No.: ER-2004-0034 & HR-2004-0024 (Consolidated)

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Before the Public Service Commission of the State of Missouri

Rebuttal Testimony

of

Vern J. Siemek

Exhibit No. 92
Case No(s). ER-2004-0034
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TABLE OF CONTENTS OF
REBUTTAL TESTIMONY OF
VERN J. SIEMEK
AQUILA, INC. D/B/A AQUILA NETWORKS-MPS
AND AQUILA NETWORKS-L&P
CASE NOS. ER-2004-0034 AND HR-2004-0024
(CONSOLIDATED)

PURPOSE AND SUMMARY OF REBUTTAL TESTIMONY........................1

MERGER SYNERGIES TO BE SHARED........................2

OPPOSITION TO SHARING........................2

REBUTTAL IN GENERAL........................4

DETAILED RESPONSES........................5

STAFF'S CONSISTENT 'PRINCIPLES' (AND THEIR RESULTS)........................10

THE EQUITY OF SHARING SYNERGIES........................11

THE CONSEQUENCES OF NOT SHARING........................14

THE CONSEQUENCES OF SHARING SYNERGIES........................15

SUMMARY........................16

CONCLUSION........................17

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
REBUTTAL TESTIMONY OF VERN J. SIEMEK
ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NOS. ER-2004-0034 AND HR-2004-0024 (CONSOLIDATED)

1 Q. Please state your name and business address.

2 A. My name is Vern J. Siemek. My business address is Aquila, Inc., 1815 Capitol Avenue,
3 Omaha, Nebraska, 68102-4914.

4 Q. Are you the same Vern J. Siemek who sponsored direct testimony in this case on behalf
5 of Aquila, Inc. ("Aquila") before the Missouri Public Service Commission
6 ("Commission")?

7 A. Yes.

8 **I. PURPOSE AND SUMMARY OF REBUTTAL TESTIMONY**

9 Q. What is the purpose of your rebuttal testimony?

10 A. My rebuttal testimony will respond to the various witnesses who urge rejecting ANY
11 sharing of the continuing synergies resulting from the UtiliCorp (now Aquila)/St. Joseph
12 Light & Power ("L&P") merger. Those witnesses include Mark Oligschlager of
13 Commission Staff ("Staff"), Ted Robertson of the Office of the Public Counsel ("OPC"),
14 and Robert Stephens of Brubaker & Associates. All take the position that the continuing
15 and essentially undisputed synergies created by the L&P merger should be assigned 100%
16 to customers. They apparently believe that customers should realize 100% of the
17 continuing benefits despite the fact that Aquila is responsible for both the merger and the
18 synergies, and that customers have contributed little to the costs to accomplish either of
19 these.

1 **II. MERGER SYNERGIES TO BE SHARED**

2 Q. Please review the source of the synergies to be shared which gives rise to this issue.

3 A. Economies of scale from the Aquila/L&P merger created more efficient dispatching of
4 the combined fleet of generating plants and purchase power contracts of the newly
5 combined company. Economies of scale also created savings for Aquila's MPS operating
6 division by spreading Aquila's fixed support costs over the larger base of operations and
7 customers, which reduced support costs significantly for MPS.

8 **III. OPPOSITION TO SHARING**

9 Q. What is your understanding of the basis for these witnesses refusal to propose a sharing of
10 ANY of the synergies between Aquila and its customers?

11 A. First of all, their positions are not based on the details of the merger savings calculations
12 or the Company's rationale. Despite months of investigation, none of the witnesses who
13 actually reviewed the calculations objected to or expressed serious concerns based on the
14 details or the rationale of calculating the synergies.

15 Q. What then is the basis of their objection to sharing?

16 A. The witnesses list various concerns. NONE, however, are legitimate grounds for denying
17 the shareholders of Aquila a share in the continuing synergies created by the merger.
18 Many of their concerns are simply "generic" complaints they would have about any
19 merger and do not relate to Aquila's proposal in this case.

20 Q. Can you summarize the reasons offered by the Staff, OPC and the intervenors in opposing
21 ANY sharing the synergies from the merger?

22 A. Yes. Having been involved with this issue since the merger filing in 1999, it is clear
23 that, despite testimony to the contrary in the merger case, there is basically no situation

1 under which Staff or OPC could ever support sharing continuing synergies (much less
2 cost recovery) in any meaningful sense. Despite Staff's claimed 'adherence' to their
3 'principles', they have ignored their own positions from the merger case both in the last
4 MPS rate case and this rate proceeding.

5 Q. What is the basis for your impression of Staff's actions on the L&P merger synergies?

6 A. Aquila has modified its proposals to share in the synergies several times in the course of
7 the merger case and the last two MPS rate cases. Aquila has modified its proposals in
8 response to issues raised by the Staff in order to attempt to craft a proposal that meets
9 Staff's criteria. Every time Aquila modifies its proposals, Staff finds new objections on
10 top of the original ones. The impression is that Staff indicates that if Aquila does one
11 thing more, our proposal will be acceptable. When we do that one thing more, or
12 eliminate the cause of the Staff's issue, Staff develops a new issue that then prevents their
13 acceptance of our newly revised proposal. In other words, Aquila moves closer to Staff,
14 but Staff moves further away. It is clear that Staff will not be satisfied no matter how
15 many modifications Aquila makes to its proposals to share synergies except to drop them
16 entirely.

17 Q. Can you provide details of the evolution of Aquila's proposal's to accommodate Staff's
18 concerns?

19 A. Yes. Schedule Rebuttal VJS-1 lists the history of the Staff's objections to Aquila's
20 evolving proposal on sharing merger synergies from the merger case to this rate
21 proceeding. A quick review indicates where Aquila has eliminated various elements
22 raised by Staff to attempt to craft an equitable sharing proposal that Staff could accept.
23 Each time, Staff has either reneged on prior parameters (in the last rate proceeding) or

1 raised new issues to prevent any compromise (in this rate proceeding). It is not possible
2 to reach a compromise with a party that moves away during attempts to compromise.

3 **IV. REBUTTAL IN GENERAL**

4 Q. How do you respond generally to the various issues raised?

5 A. There are several responses I will use in my rebuttal testimony.

6 1. Simply summarizing the Staff and intervenor's positions highlights the inequity of
7 their 'principles'. The summary above exposes Staff's position so that the
8 Commission can make a reasoned decision based on the true facts and equitable
9 treatment.

10 2. I will also illustrate Staff's inconsistency from Aquila case to Aquila case. Staff has
11 regressed from a position of encouraging a synergies sharing proposal for three to ten
12 years if appropriate (in the merger case) to wanting to claim 100% of the synergies
13 after year one (in the last MPS electric case) to now wanting to claim 100% of the
14 continuing synergies in what the Staff would call year four.

15 Even in the merger case, Staff recognized that unrelated cost increases may
16 hamper the realization of synergies and would need to be considered even under their
17 alternative proposal that relied on inadequate regulatory lag.

18 Regulatory lag itself is NOT an equitable method to share savings when the
19 synergies created are ongoing. This inequity is because those continuing synergies are
20 passed on 100% to customers periodically and thus are no longer shared. Sharing
21 synergies through the regulatory lag process as suggested by the Staff in that manner
22 is clearly one-sided.

1 3. Aquila's proposal is an evenhanded and equitable method to reasonably share in the
2 continuing synergies Aquila is creating. It requires NO elaborate tracking models. It
3 does NOT require any review of nor ask for ANY recovery of the costs to achieve the
4 merger. The economies of scale are a straightforward calculation that has been
5 described in other jurisdictions as too simple to be disputed. Even after calculating
6 only some of the synergies, Aquila proposed to retain only 50% of those acquisition-
7 related savings to benefit shareholders for creating those savings. And HALF of that
8 would be used to establish a low income assistance program!

9 **V. DETAILED RESPONSES**

10 Q. Please describe the positions that the Staff, OPC and intervenors have stated to
11 confuse the issue and give your detailed response to each.

12 ***Position No 1:*** **REGULATORY LAG IS THE CURE-ALL**

13 Staff, OPC and the intervenor's claim regulatory lag is a meaningful way for Aquila to
14 share in the continuing synergies Aquila created, especially since it has been three years
15 since the merger. (Staff witness Oligschlager, pages 21 lines 1 to 21, and page 24 lines
16 13-17; Brubaker witness Stephens, page 3, lines 31-33)

17 ***Response to No 1:*** Regulatory lag is a wholly inadequate method to achieve any
18 meaningful sharing in merger savings particularly when the synergies are long-term and
19 will continue for years. When rates are established in each rate case, which give 100% of
20 the synergies to the customers, any "sharing" goes away. However, neither the synergies
21 not the related costs disappear anywhere nearly as quickly as the regulatory lag 'sharing'.
22 Compare this to including the costs of a generating facility in rates. Both the merger
23 synergies and the costs of the facility occur for an extended period of time. No one would

1 seriously advocate eliminating the cost recovery of a generating plant because three years
2 had elapsed – how could three years be an adequate period for sharing merger synergies
3 that create long-term and continuing savings?

4 Even disregarding the inherent shortfalls in this application of regulatory lag, there
5 are even more compelling reasons to reject it in this case. That is the fact that Aquila has
6 not realized any significant positive synergies to date. Two of the three years since the
7 merger have been test periods because of increased costs to serve Missouri customers.
8 The third year was not a test period mainly because of unrelated financial stress and
9 changes that prevented the comprehensive type of rate filing required in Missouri. Staff,
10 in the merger case, acknowledge that these types of extenuating circumstances should be
11 considered in designing equitable sharing plans, even plans based on regulatory lag. A
12 quick review of the surveillance reports on MPS electric operations filed monthly with
13 this Commission indicates that at no time since 2000 has the MPS division earned at a
14 level approaching even the inadequate return on equity proposed by the Staff in this case.

15 ***Position No 2:*** **SYNERGIES ARE JUST TOO HARD TO CALCULATE**

16 Staff, OPC and intervenor claimed generically that it is too difficult to estimate the total
17 synergies, and so the synergies MIGHT be overstated. (Staff witness Oligschlager, page
18 22, lines 1 thru 12; OPC witness Robertson, page 23, lines 7-8; Brubaker witness
19 Stephens, page 3, lines 23-40 and page 14 line 12 to page 15 line 3.)

20 ***Response to No 2*:** Aquila did NOT propose 50% of TOTAL synergies – instead,
21 Aquila's proposal involves just those that are clear economies of scale for support costs
22 and joint dispatching efficiencies. Aquila proposes to share only 50% of these identified
23 synergies, and half of those will benefit low-income customers. Even if synergies from

1 the straightforward calculations were overstated by 100%, customers would still benefit
2 because the other synergies would still result in rates lower than rates absent the merger.
3 Once again, no one has actually challenged the details of the identified synergies in this
4 case.

5 Aquila has not attempted to identify and claim half of the TOTAL synergies,
6 because of the similar concerns voiced in the past. Instead, Aquila has limited the
7 synergies to those that are clear from economies of scale and that were validated by Staff
8 calculations in the prior MPS rate case. The remaining synergies accrue 100% to the
9 benefit of the customers.

10 It is interesting that Staff now makes the generic claim that it is too difficult to
11 estimate the synergies using this method, since Staff calculated the synergies in a similar
12 manner in the last MPS rate case in attempting to claim 100% of the merger synergies in
13 that case.

14 It is also interesting that witness Stephens is concerned about projecting synergies
15 based on actual amounts, but is much less concerned about projecting gas costs which are
16 much more volatile. Witness Stephens was also apparently not concerned enough about
17 the calculations to make any data requests or request any meetings with any of the Aquila
18 personnel knowledgeable about the calculations and their support, which should prejudice
19 seriously any weight afforded to his testimony.

20 ***Position No 3:* ACQUISITION COSTS SHOULD NEVER BE PAID**

21 Staff and OPC propose that acquisition costs should not be recoverable because
22 acquisition costs are never allowed in rates, were too high because Aquila should have
23 used pooling accounting, and because Aquila should have assigned costs to nonregulated

1 businesses. (Staff witness Oligschlager page 20 lines 8-10, page 22 lines 18-23, and page
2 23, lines 1-13; OPC witness Robertson pages 20 to 23; pooling- Staff witness
3 Oligschlager page 23 line 14 to page 24 line 2; nonregulated – Staff witness Oligschlager
4 page 24 lines 3 to 12, OPC witness Robertson page 23 lines 1-5)

5 ***Response to No 3:***

6 1. Aquila has NOT asked for cost recovery of acquisition costs – Aquila has asked
7 only to share in the synergies Aquila created by the merger.

8 2. Pooling was not available to Aquila, and in fact was banned by the US
9 accounting rulemakers within a year of the acquisition as not reflective of the economic
10 realities of business combination. Accounting experts in the merger case testified that the
11 economic substance of pooling is essentially the same as purchase accounting. [See
12 attached Schedule VJS-2.]

13 3. Nonregulated businesses were either insignificant or the benefits from the
14 value of generation are already reflected in the synergies created by joint dispatching
15 which are proposed to be shared.

16 ***Position No 4:*** **ACTUAL COSTS OF SERVICE ARE THE HOLY GRAIL**

17 Staff states that only ACTUAL costs of service can be reflected in rates, not synergies.
18 (Staff witness Oligschlager page 24, lines 20-22)

19 ***Response to No 4:*** Staff has frequently deviated from the actual costs of service when
20 the results aligned with Staff 'principles'. The deviations are caused by such mechanisms
21 as averaging costs over various periods (such as three years, five years, three years and
22 nine months, five years and three months), switching from cash to accrual to cash for

1 pension expense, altering income tax calculations, etc. Such an elastic view of 'actual'
2 cost of service can be adjusted to achieve a desired result.

3 ***Position No 5:*** **Speculation**

4 Staff alleges that synergy sharing MIGHT result in some revenues that could offset some
5 of the Acquisition Premium and Transaction costs. (Staff witness Oligschlager, page 24
6 line 22 to page 25 line 2)

7 ***Response to No 5:*** Sharing synergies is sharing synergies- end of story! If that sharing
8 results in upsides that COULD offset some of the many downsides built into the
9 regulatory process, Staff's concern is still irrelevant. SOME of the sharing MIGHT pay
10 for gas and purchased power costs not recovered in rates, or MIGHT pay for cost
11 increases due to inflation, or MIGHT pay a return on future investments.

12 Staff doesn't seem as concerned that five year averaging in other Staff
13 adjustments MIGHT result in legitimate current levels of cost NOT being recovered or
14 charged to customers.

15 ***Position No 6:*** **FORECASTS SHOULD ALWAYS BE CORRECT**

16 Brubaker witness Stephens suspects that current calculations might be incorrect
17 because the merger case (filed in 1999) forecast different synergies for 2002.

18 ***Response to No. 6*** Stephens, however, had just supposedly analyzed gas costs that
19 have been extremely volatile since 2001 and which are a major component of joint
20 dispatching synergies. That same volatility significantly impacted the synergies projected
21 in 1999 and cannot reasonably serve as a basis for rejecting the current calculation of the
22 synergies.

1 **VI. STAFF'S CONSISTENT 'PRINCIPLES' (AND THEIR RESULTS)**

2 Q. Is continued adherence to the same 'principles' always a good thing?

3 A. No, blind adherence to the same principles is not necessarily a good thing- it just means
4 that one ignores new facts and circumstances. For example, treating illnesses by bleeding
5 was a consistent application of medical principles in the 18th century. In the Civil War, it
6 took four years and countless lives to prove that charging entrenched positions was
7 suicidal, even though it was consistent with military principles of the day. The principle
8 that the earth is flat is another good example of a principle that finally gave way to actual
9 circumstances.

10 Q. Has the application of Staff's 'principles' remained constant as they relate to this merger?

11 A. No, not from my vantage point.

12 Q. What were Staff's 'principles' in the merger case?

13 In the merger case, Staff indicated that it would be receptive to a plan to share synergies
14 over three to ten years, although the Staff preferred regulatory lag as a method to share
15 synergies.

16 Staff witness Oligschlaeger, in rebuttal testimony in the Merger Case, page 32-33,
17 lines 21-22 and lines 1-6, "Q. How would the Staff define a fair percentage of
18 merger savings to be passed on to customers of merged utilities? A. In past merger
19 applications, the Staff has expressed the opinion that at least **50%** of total merger
20 benefits should be reflected in customer rates over the long term if a specific
21 "regulatory plan " for a merger is to be adopted. The Staff also has stated that **if**
22 **utilities propose to assign less than half** of total merger savings to customers
23 through a regulatory plan, then the company should state compelling reason why the
24 public interest would justify that result."
25
26 That quote indicates that retention of 50% of the synergies is the standard (over the long
27 term).

1 Staff witness Proctor's example on page 17, line 4 in rebuttal testimony in the
2 Merger Case cites "...*that there will be a* **50%** *sharing between shareholders and*
3 ratepayers...."
4
5 Staff witness Proctor in rebuttal testimony in the Merger Case, page 49, line 11
6 repeats, "The **50%** of these synergies going to ratepayers can then be allocated..."
7
8 Staff witness Proctor in rebuttal testimony in the Merger Case. Page 13, lines 7-8,
9 "...*that there will be a* **50%** sharing between shareholders and ratepayers ..."
10
11 Staff witness Oligschlaeger in rebuttal testimony in the Merger Case, page 33, line
12 20-22, " ...the Staff would recommend that any "guarantee" should encompass
13 **50% of the estimated merger savings** claimed by the Joint Applicants for the first
14 ten years of the conclusion of the merger."
15
16 Clearly, at the merger, Staff felt that sharing 50% of the merger savings was the
17 appropriate standard.

18 Q. Did Staff address the situation where straight application of regulatory lag did not result
19 in a fair sharing of merger savings to a utility?

20 A. Yes. Staff witness Oligschlager, in rebuttal testimony in the Merger Case, page 48, lines
21 14 to 21 specifically addressed that situation.

22 "Q. Are there instances in which regulatory lag may not provide for a fair sharing of
23 merger savings to a utility?
24 A. That is possible. In particular, when a company undergoing a merger faces
25 increasing revenue requirements even when estimated net merger savings are
26 factored in, rate increase cases may serve to pass on achieved merger savings to
27 *customers without a chance for the utilities to retain a share of merger savings*
28 for a reasonable period. In these instances, the Staff would not be opposed in
29 concept to proposals by utilities to 'share' merger savings in the context of a rate
30 proceeding."
31
32 Q. Did Staff lay out any general guidelines about a shared synergies approach in that
33 situation?

34 A. Yes. Staff witness Oligschlager, in rebuttal testimony in the Merger Case, page 48, line
35 22 to page 49, line 9 indicates:

1 "Q. How would the Staff view such proposals if they were made by UCU [now
2 Aquila] in future rate proceedings?
3 A. The Staff's position on such proposal would depend upon the specific facts and
4 circumstances surrounding the request at that time. Any future Staff
5 consideration of merger savings sharing proposals would be tied to production
6 of evidence demonstrating incremental net customer benefits that can clearly be
7 tied to the SJLP [L&P] merger, and that would not have been possible without
8 the merger occurring. The amount of any savings retained by the utility should
9 not be tied to the amount of the consideration paid by UCU [Aquila] for the
10 SJLP [L&P] properties (i.e., the acquisition adjustment). Finally, the Staff
11 would evaluate the past ability of UCU [Aquila] to retain merger savings
12 through means of regulatory lag before considering any proposals to share
13 merger savings in rate cases."
14
15 Q. Does Aquila's current proposal reflect this guidance from the Staff?

16 A. Yes. Aquila's current proposal is clearly based on these guidelines proposed by the Staff:

17 1. Aquila did have increasing revenue requirements despite estimated net
18 merger savings, so had no chance to retain a share of merger savings for
19 a reasonable period. (evidenced by the Aquila rate case activity)

20 2. It is clear that the customer benefits are tied to the merger, and would not
21 have been possible without the merger.

22 3. The savings are not based on the consideration paid by Aquila.

23 4. Aquila's past ability to retain merger savings through regulatory lag has
24 been minimal.

25 Q. What were Staff's 'principles' in the last MPS rate case?

26 A. In the MPS rate case based on 2001 (and updated to September 30, 2002) Staff claimed
27 100% of the synergies from the merger from economies of scale. The merger had closed
28 January 1, 2001 and operations were not even fully integrated at the time of the mid-2001
29 MPS filing. In other words, despite the clear lack of any reasonable opportunity to realize
30 many of the synergies, the 'principle' of achieving lowest rates regardless of the inequity

1 cost was actually used. This violation of Staff's regulatory lag 'principle' was justified by
2 referring to the merger synergies as cost reallocations and avoiding any direct reference to
3 the merger. This was despite testimony in the Merger Case (Staff witness Featherstone
4 rebuttal, page 37, lines 11-14) that

5 "... the addition of a new division, such as *SJLP*, will cause a re-allocation of the total
6 corporate costs among the divisions of UCU, with existing divisions such as MPS
7 benefiting at some level of pre-existing corporate costs are allocated to SJLP after the
8 merger."
9
10 Q. What is Staff's position in this rate case?

11 A. That regulatory lag will yield the correct answer, in spite of the obvious lack of any
12 material realization of synergies by Aquila during the three years since the merger. A
13 quick review of the surveillance reports filed monthly by MPS during 2001 through
14 August of 2003 indicates that the ROE's achieved by the Electric Operations of MPS
15 ranged a high of 8.55% to a low of 5.39%. All of these returns are lower than the
16 inadequate return being recommended by the Staff in the current case.

17 Staff and OPC in both cases also neglected to adhere to their 'principle' that
18 transition costs should be allowed by failing to propose any adjustment to recognize those
19 costs – the need for which was created by their recommended rejection of ANY sharing
20 in synergies.

21 **VII. THE EQUITY OF SHARING SYNERGIES**

22 Q. You have explained in detail the several types and sources of savings from the L&P
23 merger to MPS and L&P costs. If some portion of those savings were to be retained by
24 Aquila instead of also being passed on to benefit MPS and L&P, how would you
25 characterize this situation?

1 A. It is equitable for Aquila to retain a portion of those savings because the shareholders of
2 Aquila created those savings by bringing about the acquisition and they should benefit
3 from those savings. Retaining 50% of the savings for Aquila is a reasonable portion of
4 the savings, especially when half of that savings is directed to the low income assistance
5 program.
6 Q. Are there precedents for sharing merger and acquisition-related savings?
7 A. Yes, there are many recent precedents for sharing the savings from mergers or
8 acquisitions cited in my direct testimony. Many are more clear than this proposal because
9 the acquisitions occurred in a single regulatory jurisdiction. All acknowledge that the
10 savings created by acquisitions are equitably shared in some ratio between the customers
11 and the shareholders that created the savings. Sharing synergies from retaining benefits
12 created by mergers is allowed in many jurisdictions. It is generally considered superior to
13 recovering the actual costs of an acquisition because customers pay only if savings are
14 actually created by the merger.

15 **VIII. THE CONSEQUENCES OF NOT SHARING**

16 Q. What happens if 100% of the merger-related savings are utilized to reduce the costs of
17 MPS and L&P?
18 A. Economically, shareholders end up absorbing the costs that produced the savings for the
19 customers. This is clearly not equitable since the parties benefiting from the cost savings
20 do not share the costs. In addition, passing on all of the savings to customers will deter
21 future acquisitions and the savings created by them.
22 Q. What risks have Aquila shareholders assumed as a result of this acquisition?

1 A. Considerable financial risk has been incurred. Aquila must convince its shareholders and
2 the financial markets that the savings resulting from the acquisition are adequate to
3 sustain the additional capital costs incurred to accomplish the merger. Failure to do so
4 injures shareholder value. It is not enough to demonstrate that the savings have been
5 created. Some of those savings must be retained by shareholders to offset the added
6 capital costs of the transaction. The savings method chosen ensures that customers will
7 not be burdened with those additional costs unless the savings are demonstrable. It also
8 provides a strong signal to management and investors to create current and future savings
9 that will benefit both customers and shareholders.

10 If the shareholders do not retain some portion of merger savings, companies will be
11 less likely to pursue mergers that could ultimately benefit customers by lowering their
12 costs. Customers receive no such savings if no mergers occur, so allowing the
13 shareholders to retain a portion of the savings is a reasonable and equitable method to
14 lower costs to customers.

15 **IX. THE CONSEQUENCES OF SHARING SYNERGIES**

16 Q. How do customers benefit if the shareholders retain the proposed share of acquisition
17 savings?

18 A. Currently, under Aquila's proposal, all customers will benefit from the 50% of total
19 merger-related savings still reflected in the test period. The customers helped by the low
20 income assistance program will also benefit from the 25% of the savings assigned to that
21 program. The customers share in those savings despite not contributing to their creation.

22 Q What is the likely impact if the Commission adopts Aquila's position?

1 A. MPS and L&P customers, including customers helped by the low income assistance
2 program, will realize a significant share of the savings created by this merger. At a
3 minimum they receive 75% of the identified synergies, and receive 100% of synergies not
4 included specifically in economies of scale of joint dispatching.

5 Companies will be encouraged to pursue merger transactions that will ultimately
6 provide additional economic benefits to customers, knowing that shareholders will also
7 share in the economic benefits. Shareholders will be much more likely to accept the costs
8 and risks of merger transactions if it is clear that the savings have an economic value to
9 the shareholders as well as the customers. Adopting Aquila's proposal sends a clear
10 signal to utilities currently operating in Missouri that mergers that make economic sense
11 will not be prevented or made less economic by regulatory actions.

12 **X. SUMMARY**

13 1 No witnesses who investigated the calculations had any specific concerns with the
14 synergies, so the synergies are real and they are long-term and continuing.
15 2 Many of the synergies disputed in other cases (gas costs, procurement efficiencies,
16 etc) are actually reflected 100% to the benefit of customers.
17 3 Regulatory lag is NOT an equitable compensation for creating and sustaining
18 continuing and long-term synergies when MPS and SJLP never earned their
19 allowed rates of return.

1 **XI. CONCLUSION:**

2 Q. What is your conclusion?

3 A. Staff and intervenors' issues are not based on facts but appear instead to be stated as a
4 means to distract the Commission from considering the equity of Aquila's reasonable and
5 evenhanded proposal to share in the synergies Aquila created.

6 The acquisition of L&P has created significant savings to MPS and L&P from joint
7 dispatching and to MPS from economies of scale for support costs. Those savings were
8 created by Aquila with considerable effort, cost and risk. It is fair and equitable that
9 Aquila retain 50% of the savings created from that acquisition to both reward and
10 compensate Aquila for creating the savings, even more so with half of those retained
11 savings directed to the low income assistance program. The retention should be
12 accomplished by reflecting MPS and L&P pro forma adjustments retaining a portion of
13 the savings.

14 Q Does that conclude your rebuttal testimony?

15 A. Yes.

Elimination of Staff Objections by Aquila's Evolving Synergies Sharing Proposals

	Staff Objections-Merger Case	Aquila Proposal in 2001 MPS Case	Staff Objections-2001 MPS Case	Aquila Rebuttal- 2001 MPS Case	Aquila Proposal in 2003 MPS Case	Staff Objections - 2003 MPS Case	Aquila Rebuttal- 2003 MPS Case
1	5-year freeze too long	**ELIM**	No issue	No issue	No issue	No issue	**No longer an issue by Staff**
2	Guaranteed savings too small	**ELIM**	No issue	No issue	No issue	No issue	**No longer an issue by Staff**
3	Premiums, Transaction Cost not in rates	**ELIM**	Premiums, Transaction Cost not in rates	**Note A**	ELIM	Premiums, Transaction Cost not in rates	**No issue - Not requested**
4	Some transition costs not in rates	**ELIM**	Some transition costs not in rates	**Note A**	ELIM	Some transition costs not in rates	**No issue - Not requested**
5	Pooling increased premium cost	**ELIM**	Pooling increased premium cost	**Note A**	ELIM	Pooling increased premium cost	**No issue - Not requested**
6	All savings too difficult to calculate	Didn't quantify	STAFF calculated merger synergies	Accepted revised Staff numbers!	**Staff method used- didn't ask for 100% of all synergies**	All savings too difficult to calculate	**Staff method used- didn't ask for 100% of all synergies**
7	Tracking modeling too complex	**ELIM No new model used**	No issue	No issue	No issue	Tracking modeling too complex	**Used Staff methodology!**
8	Ignores MPS cost reductions due to reallocating support costs	Filed MPS using Staff's regulatory lag approach to avoid issue	**Support reallocations to new divisions are NOW not merger-related**	Pointed out contradictions to Staff Merger Case testimony	Directly addressed allocation savings with 50% customer, 25% low-income, and 25% Aquila proposal.	**ELIM**	**No issue - synergies shared 50% customers-25% low-income customers-25% Aquila**
9	"Make-believe" costs in MPS rates	**Result of any sharing mechanism, which are acceptable to Staff**	Actual costs not reflected	**Result of any sharing mechanism, which are acceptable to Staff**	**Result of any sharing mechanism, which are acceptable to Staff**	Actual costs not reflected	**Result of any sharing mechanism, which are acceptable to Staff**
10	Sharing approach acceptable under certain conditions	Used more restrictive regulatory lag to reduce controversy	See cost reallocations	Consider alternative in rebuttal	**Basis for proposal**	Regulatory lag has now shared enough in 3 years	**Equitable sharing not realized in 3 years, as anticipated in Staff Merger Case testimony. Staff considered 10 years as acceptable.**
11						Shared synergies might result in recovering costs.	**Sharing means sharing - NOT cost recovery!**
12						Synergy forecasts from 1999 were wrong-Stephens	**Not a serious issue.**
	POSITION:	**APPROACH:**	**POSITION:**	**REBUTTAL:**	**APPROACH:**	**POSITION:**	**ANALYSIS:**
13	Prefer regulatory lag if not prevented by other costs, but sharing approach acceptable (50% minimum) for 3-10 years.	Filed under Staff's most restrictive Regulatory Lag approach to reduce controversy - 1st year not reasonable to give 100% of synergies	Claimed 100% of all synergies after one year by now rejecting allocations of costs as merger-related	Staff Inconsistent with Merger Case, so use as filed, OR reflect agreed transition costs OR Share Synergies at 70-30 or 50-50	Shared synergies on Staff calculation methodology at 50% (customers)-25% (low income customers)-25% (Aquila) starting in year 4	Sharing 3 years through regulatory lag is sufficient!	Regulatory lag as Staff proposes is inadequate. Aquila's proposal is now more favorable to customers than original Staff Sharing approach in Merger Case, but Staff continues to object and find new issues.

Note A: Aquila propsals make this objection irrelevant - not asking for recovery of any of these costs.

Exhibit No.:
Issue: Purchase Accounting & Deferred Taxes
Witness: Robert C. Kehm
Sponsoring Party: UtiliCorp United Inc.
Case No.: EM-2000-292
Date Prepared: June 26, 2000

MISSOURI PUBLIC SERVICE COMMISSION
Case No. EM-2000-292

Surrebuttal Testimony

of

Robert C. Kehm

Jefferson City, Missouri

SURREBUTTAL TESTIMONY
ROBERT C. KEHM

UTILICORP UNITED INC.
CASE NO. EM-2000-292

TABLE OF CONTENTS

PAGE

I. ECONOMICS OF BUSINESS COMBINATION ACCOUNTING................ 2

II. COULD UTILICORP HAVE USED POOLING?.................................... 6

III. INCOME TAXES.. 15

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
SURREBUTTAL TESTIMONY OF ROBERT C. KEHM
ON BEHALF OF UTILICORP UNITED INC.
CASE NO. EM-2000-292

1 Q. What is your name?

2 A. Robert C. Kehm

3 Q What is your business address?

4 A. My business address is 2301 McGee Street, Suite 400 Kansas City, Missouri 64108.

5 Q. What is your present occupation and work experience?

6 A. I am a Certified Public Accountant and a partner with Arthur Andersen LLP ("Arthur
7 Andersen"). I joined Arthur Andersen in December 1972. I became a partner in 1984. I
8 have served a number of investor-owned utilities, including UtiliCorp United Inc.
9 ("UtiliCorp") and St. Joseph Light & Power Company ("SJLP"). I am a member of the
10 American Institute of Certified Public Accountants and the state CPA societies of
11 Missouri, Kansas, and Nebraska. I am licensed to practice in the states of Missouri,
12 Kansas, Nebraska, Minnesota, and North Dakota.

13 Q. What is your educational background?

14 A. I graduated from the University of Nebraska – Lincoln with an undergraduate degree in
15 business and a Masters degree in accounting.

16 Q. Do you have experience with mergers and acquisitions?

17 A. Yes, I have worked on numerous mergers and acquisitions, including several for
18 UtiliCorp. This work has included, among other matters, due diligence assignments,

1 transaction structuring and determination of the appropriate accounting treatment for
2 business combinations.

3 Q. Are you familiar with the proposed UtiliCorp acquisition of SJLP?

4 A. Yes, I am familiar with the transaction. I previously served as the audit engagement
5 partner for UtiliCorp and SJLP when the acquisition was announced. Currently I serve as
6 the audit engagement partner for SJLP.

7 Q. What is the purpose of your surrebuttal testimony?

8 A. The purpose of my testimony is to address certain accounting matters raised by Mr.
9 Charles R. Hyneman for the Missouri Public Service Commission Staff ("Staff") in his
10 rebuttal testimony, with a specific focus on the question of "pooling" versus "purchase"
11 as it relates to the acquisition adjustment issue.

12 ECONOMICS OF BUSINESS COMBINATION ACCOUNTING

13 Q. What methods can be used by a company to account for a business combination?

14 A. Accounting Principles Board Opinion No. 16 (APB 16), entitled *Business Combinations*
15 provides two methods to account for a business combination. These are the purchase
16 method and the pooling-of-interests ("pooling") method.

17 Q. Please explain the primary differences between the two methods.

18 A. The pooling method is intended to present as a single interest two or more common
19 stockholder interests that were previously independent. A pooling is a stock-for-stock
20 transaction, meaning the acquiror must use its stock to acquire the stock of the acquiree.
21 The combined entity values the assets and liabilities of the combining enterprises at
22 historical cost. Goodwill is not recorded as an asset in business combinations accounted

1 for using this method. In order to apply the pooling method, a business combination
2 must meet a very specific and restrictive set of criteria. Business combinations that do
3 not meet all of the pooling criteria are required to use the purchase method.
4 In the purchase method, the acquiror can use cash or stock to effect the combination. The
5 assets acquired and liabilities assumed of the acquiree company are recorded at their fair
6 values, rather than historical cost. Goodwill is recorded for the difference between the
7 consideration paid and the fair value ascribed to the assets and liabilities. Similar to a
8 pooling, a purchase can be a stock-for-stock transaction.
9 Q. How does a purchase transaction differ economically from a pooling transaction?
10 A. Assuming all things are equal, with the exception of not meeting all the pooling criteria, a
11 purchase transaction will have the exact same economics as a pooling transaction. In
12 other words, it will not differ economically.
13 Q. What do you mean by the "same economics?"
14 A. The economics of a business combination equal the amount a willing buyer is willing to
15 pay a willing seller for its business. If this amount is in excess of the fair value of the net
16 assets of the business, goodwill is created. This is true in all acquisitions, whether
17 accounted for as a purchase or pooling. The fact that purchase accounting gives financial
18 statement recognition to the goodwill does not impact the economics of the transaction.
19 Similarly, the fact that pooling does not recognize goodwill does not change the
20 economics of the transaction.
21 Q. Can you illustrate this point?
22 A. Yes. To illustrate this point, I refer to the proposed acquisition of SJLP as follows:

	December 31, 1999 (Amounts in thousands, except per share amounts)	
	Pooling	Purchase
Consideration per share of SJLP	$ 23.00	$ 23.00
Shares of SJLP outstanding	8,268	8,268
Total consideration	$190,164	$190,164
Less: Estimated fair value of SJLP (1)	96,188	96,188
Estimated goodwill acquired	$ 93,976	$ 93,976

(1) Assumes the net book value and fair market value of SJLP's net assets are the same.

The above example demonstrates the following:

1. The economics of the transaction are the same: UtiliCorp is paying the same for SJLP, whether or not it is accounted for as a pooling or a purchase.
2. Goodwill is created in both a pooling and a purchase. However, if pooling is used, the goodwill is ignored in the future financial statements of UtiliCorp. This creates an optical illusion. Pooling appears to be a less expensive transaction – no goodwill is shown in the financial statements. However, as the example indicates, that is not the case. The pooling method created the same amount of goodwill as the purchase method.

Q. On page 10, lines 3-7 of Mr. Hyneman's rebuttal testimony, he concludes that the pooling-of-interests method is the preferable method of accounting for a business combination. How do you respond?

A. I do not agree.

Q. Why not?

A. I do not know what criteria Mr. Hyneman is using to conclude that pooling is "preferable." There is considerable discussion regarding whether or not pooling is even appropriate, let alone preferable. This debate is a continuation of arguments raised in

1 1970 when APB 16 was issued. In issuing APB 16, the Accounting Principles Board did
2 not conclude that pooling was "preferable". In fact, that document outlined the defects of
3 pooling. The most serious defect identified was that the pooling method did not
4 recognize the economic substance of the transaction. It also ignores the current market
5 value of the assets underlying the transaction.
6 The APB also identified the fact that the pooling method was restrictive – it limited
7 actions companies could take for the betterment of the businesses prior to or after the
8 transaction. In the current era of change, I do not believe any accounting method which
9 restricts a company's current and future flexibility to make business decisions could be
10 deemed to be "preferable".
11 Q. How does pooling restrict a company's flexibility?
12 A. The pooling criteria limit the actions a company can take for a period of two years before
13 and after the transaction. I will address this in more detail later in my testimony.
14 Q. Are the reported results of operations different if the transaction is a pooling compared to
15 a purchase transaction?
16 A. Yes. Pooling produces a more favorable book accounting answer than does a purchase
17 because it ignores the increased depreciation caused by reporting assets at their higher fair
18 value and the amortization of goodwill. Goodwill is the amount a company is willing to
19 pay to acquire another company over the fair value of its assets and liabilities. In a
20 purchase transaction, goodwill is recorded and amortized over a future period. In a
21 pooling transaction, goodwill is not recorded.

1 Conventional wisdom has held that the equity market for companies whose mergers were
2 accounted for as poolings was stronger than for those who used the purchase method. A
3 more significant analysis may conclude otherwise. For example, Mr. Hyneman
4 references an article "Say Goodbye to Pooling", *CFO Magazine*, February, 1997 in his
5 *testimony on page 13, line 12 to support the prefer ability of pooling. This same article*
6 states the following:

7 According to a growing body of academic research, however, avoiding goodwill through
8 poolings actually has no positive effect on share prices. In fact, in some cases, the
9 opposite is true. A recent paper by Michael Davis, associate professor of accounting at
10 Lehigh University, for example, points out that the stocks of companies that use purchase
11 accounting show better aggregate performance in the short term (six months) and no
12 difference in the longer term (one to three years) than companies that have combined
13 through the pooling method. In addition, the study, which was published in the *Journal*
14 *of Applied Corporate Finance,* showed that poolers frequently bend over backwards,
15 often incurring extra costs, to meet the 12 pooling conditions. *Even worse, poolers as a*
16 *group pay much larger premiums over current market valuations--in one study by Davis,*
17 *up to 200 percent higher-- than do purchase-method buyers, as the lack of goodwill*
18 *amortization and the rising value of their stock allows them to pay more for the*
19 *marginally better reported earnings per share. (emphasis added)*

20 COULD UTILICORP HAVE USED POOLING?

21 Q. What types of assistance has Arthur Andersen provided to UtiliCorp related to this
22 transaction?

23 A. I and others in my firm have had discussions with UtiliCorp personnel concerning the
24 structure of this transaction.

25 Q. Has Arthur Andersen provided any written advice to UtiliCorp specifically as it relates to
26 pooling criteria?

27 A. No. UtiliCorp did not request and we did not provide any written advice regarding the
28 application of the pooling criteria to this transaction. We did, however, review and

1 provide comments on a document prepared by Mr. Streek and shown on Schedule DJS-2
2 to his direct testimony.
3 Q. Is it unusual for a client to not request a formal pooling study when a pooling is initially
4 contemplated?
5 A. No, it is not unusual at all. Given the complexities of the pooling rules, it is time
6 consuming and expensive for a company to have a study performed. When a company
7 determines it is unlikely that one of the criteria will not be met, it is not necessarily
8 prudent to expend additional resources and time to evaluate all the criteria, since failure
9 to meet any of the criteria will preclude pooling.
10 Q. Are you familiar with the criteria required to be met in order to apply the pooling method
11 to a business combination?
12 A. Yes. I have been involved in numerous proposed transactions for a variety of companies
13 that intended to apply the pooling method. I am also familiar with the process of pre-
14 clearing pooling issues with the SEC. I have had the opportunity to pre-clear issues with
15 them and in some instances, our clients were successful with their arguments.
16 Q. Could you please provide some background regarding the complexities of the pooling
17 method?
18 A. In 1970, the Accounting Principles Board issued *APB 16: Business Combinations*. This
19 accounting standard provided two acceptable methods for accounting for a business
20 combination. In general, the pooling method was designed to address the unique "merger
21 of equals" business combination, in which theoretically the companies acquire each other.
22 If the transaction met an extensive set of criteria, they could apply the pooling method.

1 If these criteria were not met, a company would need to apply the purchase method. The
2 acceptance of two methods of accounting for business combinations was a compromise
3 solution. Both methods had their proponents and detractors. The APB goes so far as to
4 identify the "defects" of each method.

5 Q. *You stated that pooling requires a company to meet an extensive set of criteria. How*
6 *many general criteria are there?*

7 A. There are twelve general criteria as defined in APB No. 16, paragraphs 46-48. The
8 twelve general criteria address three broad principles. First of all, the combining
9 companies must be independent prior to the transaction. Secondly, a pooling must be a
10 *stock-for-stock transaction. Lastly, there must be an absence of future planned*
11 transactions that would alter the character of the combining businesses. APB 16 was a
12 compromise of differing views, and, as a result, some of the requirements are arbitrary.
13 Consequently, the rules have a great deal of room for interpretation that has subsequently
14 developed through practice.

15 Q. Does the Securities and Exchange Commission ("SEC") have a role in regards to these
16 pooling criteria?

17 A. Yes. The SEC has taken upon itself the responsibility of developing interpretations to
18 these rules. SEC opinions regarding pooling matters tend to govern the application of
19 pooling rules to mergers of SEC registrants. In recent years, the SEC has continued to
20 narrow its interpretations of the pooling rules. This has resulted in a complex set of SEC
21 interpretations serving as the authoritative basis for multi-billion dollar transactions.

1 *These narrow interpretations have made the ability to pool much more difficult and*
2 constraining.
3 I believe the current SEC view on poolings is that every merger is a purchase unless
4 proven otherwise. Therefore, companies expecting to complete a pooling can expect
5 conclusions for all the criteria to be subject to significant challenge. Failure to apply the
6 pooling rules based on the SEC's interpretation could result in financial hardship if the
7 SEC ultimately rejects a company's proposed pooling and forces a subsequent
8 restatement.
9 Q. In order to qualify for pooling, how many of the criteria must be met?
10 A. All of the criteria must be met in order to apply the pooling method.
11 Q. Do some of these criteria restrict the flexibility of a company?
12 A. Many of the criteria are restrictive. As a general rule, a company that wishes to pool
13 must refrain from certain actions that may result in an alteration of equity or a disposition
14 of assets for a period of two years before initiation until two years after the
15 consummation of a pooling transaction. In essence, a company is handcuffed during this
16 time period. In the current business environment, this four-year period is a significant
17 amount of time. During this period, it is not unreasonable to conclude that a company
18 may be restricted from taking actions to improve the financial health of the organization
19 in order to preserve a pooling transaction and avoid the financial hardship of restating
20 previously issued financial statements.
21 Q. Did UtiliCorp take any action that precluded it from using the pooling-of-interests
22 method of accounting?

1 A. Yes. As Mr. Streek reported in his direct testimony (page 3 lines 21-22), UtiliCorp
2 issued stock options to employees in November, 1998. This represented an "alteration of
3 equity" under APB 16, paragraph 47, which is prohibited. Paragraph 47c states:

4 None of the combining enterprises changes the equity interest of the voting
5 common stock in contemplation of effecting the combination either within two
6 years before the plan of combination is initiated or between the dates the
7 combination is initiated and consummated; changes in contemplation of effecting
8 the combination may include distributions to stockholders and additional
9 issuances, exchanges, and retirements of securities.

10 Q. In regards to paragraph 47c above, what does "in contemplation" mean?
11 A. In the literal sense, "in contemplation" would indicate a lack of independence between
12 two or more events. One action is made with the intent of impacting another. In apb 16,
13 "in contemplation" suggests that a company might act to improve its position or the
14 relative position of its owners. This would be contrary to pooling because the concept of
15 *pooling is the combining of economic interests as though the two companies had always*
16 been together.
17 Q. Has the sec indicated its position regarding "in contemplation"?
18 A. Yes. Subjective concepts, such as "in contemplation of", naturally generate differences in
19 practice. The SEC appears to be attempting to maximize uniformity in the application of
20 the pooling rules. The SEC has indicated it spends a significant amount of time
21 addressing this issue as it relates to the alteration of equity interests. Given the subjective
22 nature of "in contemplation," the SEC relies extensively on the timing of an event
23 characterized as an alteration in equity interests. As a general rule, anything falling
24 within two years of the transaction is presumed to be "in contemplation" of the

1 transaction. It is increasingly difficult to disprove this presumption the closer the event
2 occurs to the actual transaction.

3 Q. What is your understanding of the sec staff's views regarding the impact of "in
4 contemplation" specifically as it relates to the alteration of equity interests?

5 A. It is my understanding that the SEC staff takes the position that any change in equity
6 interests that occurs within two years of initiation of a business combination is presumed
7 to have been made in contemplation of the combination. In other words, any action
8 which would result in an alteration of equity in contemplation of the combination would
9 preclude pooling.

10 Q. Has Arthur Andersen published an interpretation of this?

11 A. Yes. Arthur Andersen has issued a publication which presents an interpretation of this
12 concept. These interpretations are intended to present our understanding of current
13 practice. Interpretation 47c-18 of *Accounting for Business Combinations, ninth edition*
14 addresses the issuance of options, the key considerations of which are summarized as
15 follows:

16 1. Awards or grants made within two years are presumed to be in contemplation of a
17 combination.
18 2. The presumption (in contemplation of the combination) may be overcome if
19 awards or grants are made under pre-existing plans, and are granted under normal
20 terms of the plan and in normal amounts. In assessing this, the SEC staff
21 considers this historical pattern of awards under the plan.
22 3. In some situations, factual evidence may support a contention that an issuance
23 was not in contemplation. Such factual evidence must be clear; the closer the
24 issuance to the initiation of the combination, the more difficult for any factual
25 evidence to be persuasive.

1 4. Once an issuance is determined to be in contemplation, the change can only be
2 "cured" by rescinding the options so long as no option holder has exercised any of
3 the options issued.

4 Q. Could the UtiliCorp stock option award be presumed to be in contemplation of the
5 acquisition?

6 A. Yes. UtiliCorp issued a stock option award under its 1991 Employee Stock Option Plan
7 in November of 1998. During the week of November 9, 1998, SJLP representatives
8 contacted UtiliCorp. By the end of November, UtiliCorp had expressed its intent to make
9 a bid for SJLP. This is an extremely tight timeline between the award issuance and the
10 initiation of discussions with SJLP. Clearly, a presumption exists that this award was in
11 contemplation of the combination. UtiliCorp would bear a heavy burden in proving
12 otherwise.

13 Q. Are you aware of any other factual information, other than the timeline included in the
14 joint proxy statement/prospectus dated May 6, 1999 and the information supporting Mr.
15 Hyneman's timeline on page 25 of his testimony, that could clearly demonstrate that the
16 stock options were not issued in contemplation of the acquisition?

17 A. I am not aware of any other substantive, factual information which could clearly refute
18 the "in contemplation" presumption.

19 Q. You stated above the presumption (in contemplation of the combination) may be
20 overcome if awards or grants are made under pre-existing plans, and are granted under
21 normal terms of the plan and in normal amounts. Could you please explain what this
22 means?

1 A. The SEC staff has developed a model for determining whether an award can be
2 considered "normal". In assessing the "normality" of a stock option award, the SEC staff
3 looks to the historical pattern of awards. This includes the following:
4 1. Who is receiving the awards.
5 2. What are the sizes of the awards by employee levels within a company.
6 3. Timing of awards.
7 4. Terms of the awards, including exercise price, vesting and exercise period.
8 Q. Did UtiliCorp conclude that the award was normal?
9 A. No, it did not.
10 Q. Do you concur with UtiliCorp's opinion?
11 A. Yes, I believe it would be very difficult to prove that the 1998 option award would meet
12 the definition of "normal". Mr. Hyneman's own testimony suggests that the award was
13 not "normal" when he states on page 27, line 25 through page 28, line 4:

14 . . . it would be reasonable for the SEC to take into consideration that, unlike most
15 companies' stock option plans, UtiliCorp's Employee Stock Plan is unusual and options
16 under this plan are not intended to be issued on a regular basis . . . irregular issuances of
17 stock options should be considered normal because this conforms to the plan's intent and
18 the plan's history.

19 I believe the SEC staff would have agreed with Mr. Hyneman: The award was unusual
20 (only one award in previous 6 years) and the issuances were irregular (no systematic
21 pattern for granting the award). Accordingly, the SEC staff would have rejected the
22 notion that the plan was "normal".
23 Q. You have stated that 1.) A presumption exists that the award was in contemplation of the
24 acquisition, 2.) The presumption cannot be overcome because of the proximity of the

1 option award date to the acquisition agreement, and 3.) It is your belief that the SEC
2 would not consider the option awarded in November, 1998 to be normal. Can this
3 problem be "cured"?

4 A. Technically, it can be cured. UtiliCorp could have rescinded the options. However, from
5 a practical business standpoint it is not curable as UtiliCorp stated in response to Staff
6 Data Request No. 167:

> 7 The only cure would have been rescinding or canceling the options. The
> 8 Company did not feel this would have been in the best interest of employee
> 9 morale and there were still uncertainties with regard to the eventual
> 10 consummation of the transaction.

11 Q. What would the impact of the share rescission have been to the employees?

12 A. If the option award had been rescinded, the employees would have forfeited the rights to
13 1,278,713 options. While they vest in one year, they do not expire until 10 years
14 following issuance. To an employee, these options have unknown future potential value.
15 UtiliCorp would have been precluded from issuing or promising (written or unwritten)
16 any additional compensation to the employees in exchange for the rescission.

17 Q. On pages 28 and 29 of Mr. Hyneman's testimony, he suggests that the reason UtiliCorp
18 may not be pursuing pooling more aggressively is its intent to sell the generation assets of
19 SJLP at some point in the future. Could this preclude pooling?

20 A. Yes, selling assets can preclude pooling. However, the relative size of SJLP to UtiliCorp,
21 makes it unlikely that a disposition of certain assets would preclude pooling. The
22 significance of a disposal is generally evaluated in terms of the assets, revenues, and
23 earnings. Significance is also evaluated in terms of the gain or loss on the disposition.
24 The disposition of SJLP generating assets would not be considered significant and would

1 not preclude pooling unless the gain or loss on the sale exceeded 10% of UtiliCorp's
2 earnings.
3 Q. On page 23, lines 25-27, Mr. Hyneman states that "UtiliCorp should have vigorously
4 presented its case to the SEC that the November 1998 stock option issuance was not done
5 "in contemplation" of the merger." Could UtiliCorp have taken this issue to the sec for
6 pre-clearance?
7 A. Yes, they could have taken this issue to the SEC for pre-clearance.
8 Q. What would have been the likely outcome of that effort?
9 A. In my opinion it is unlikely that the outcome would have been successful. Based on my
10 experience and the recent actions of the SEC, the presumption of "in contemplation"
11 caused by actions taken by a company in the six months prior to the announcement of a
12 merger are extremely difficult to overcome. UtiliCorp would not likely have been
13 successful.
14 Given the circumstances, I believe UtiliCorp acted in a prudent manner in addressing this
15 pooling concern by acknowledging the inability to use the pooling method early, rather
16 than dedicate additional resources to address all the pooling criteria, identify all the
17 potential issues requiring SEC clearance, and present its case to the SEC. This process
18 have been expensive, time-consuming, and most likely not successful.
19 INCOME TAXES
20 Q. As currently structured, the merger of UtiliCorp and SJLP is a tax-free merger under IRC
21 Section 368(a)(1)(a). On page 69 and 70 of Mr. Hyneman's testimony, he asserts that if

1 the merger is determined to be taxable the deferred taxes of SJLP may be lost. Is this
2 true?
3 A. No. UtiliCorp is acquiring the stock of SJLP. This includes all the deferred tax assets
4 and liabilities of SJLP. The ultimate determination of the transaction as being taxable or
5 non-taxable will not impact the fact that the deferred tax assets and liabilities of SJLP
6 were acquired by UtiliCorp and will survive the transaction.
7 Q. Does this conclude your surrebuttal testimony?
8 A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

County of Jackson)
)
State of Missouri)

AFFIDAVIT OF ROBERT C. KEHM

Robert C. Kehm, **being first duly sworn,** deposes and says that he is the witness who sponsors the accompanying testimony entitled surrebuttal testimony; that said testimony was prepared by him and or under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.

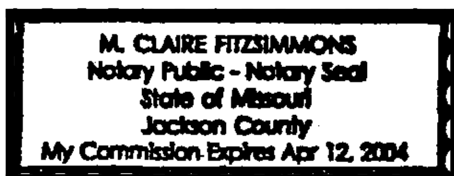
Robert C. Kehm

Robert C. Kehm

Subscribed and sworn to before me this 16th day of June, 2000.

M. Claire Fitzsimmons

Notary Public



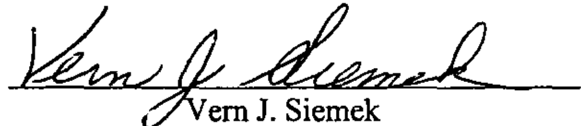
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Aquila, Inc. d/b/a Aquila Networks-MPS and Aquila Networks-L&P, for authority to file tariffs increasing electric rates for the service provided to customers in the Aquila Networks-MPS and Aquila Networks-L&P area	)	Case No. ER-2004-0034
In the matter of Aquila, Inc. d/b/a Aquila Networks-L&P, for authority to file tariffs Increasing steam rates for the service provided To customers in the Aquila Networks-L&P area	)	Case No. HR-2004-0024

County of Jackson)
) ss
State of Missouri)

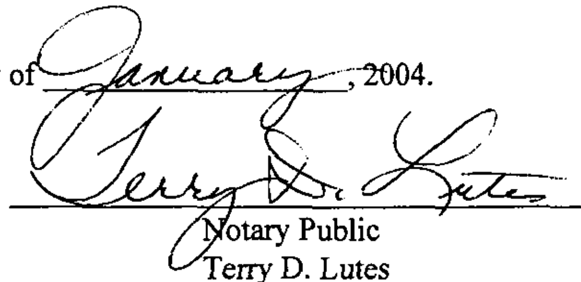
AFFIDAVIT OF VERN J. SIEMEK

Vern J. Siemek, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Rebuttal Testimony of Vern J. Siemek;" that said testimony was prepared by him and under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.



Vern J. Siemek

Subscribed and sworn to before me this 26th day of January, 2004.



Notary Public
Terry D. Lutes

My Commission expires:
8-20-2004