

Exhibit No.:

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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Missouri Public
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Surrebuttal Testimony

of

Vern J. Siemek

Exhibit No. 93
Case No(s) ER-2004-0034
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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)**

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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
SURREBUTTAL 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 and rebuttal testimony in this
5 case on behalf of Aquila, Inc. ("Aquila") before the Missouri Public Service Commission
6 ("Commission")?

7 A. Yes.

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

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

10 A. My surrebuttal testimony will respond to the various rebuttal witnesses opposed to
11 sharing ANY of the continuing synergies from the L&P merger. My surrebuttal will:

- 12 1. Crystallize the relevant questions for the Commission to consider,
- 13 2. Correct calculations and assumptions by Staff and intervenors that have led to
14 erroneous conclusions,
- 15 3. Clarify the obvious misunderstandings of other rebuttal witnesses, and
- 16 4. Respond to issues that were again raised in rebuttal.

17 Q. What witnesses have opposed sharing ANY of the continuing synergies in rebuttal
18 testimony?

1 A. Those rebuttal witnesses opposing ANY sharing of the continuing synergies now include
2 Mark Oligschlager, Cary Featherstone, Janis Fischer and Steve Traxler of Commission
3 Staff ("Staff"), Ryan Kind of the Office of the Public Counsel ("OPC"), and James
4 Dittmer on behalf of the OPC. Without exception, all urge or support rejecting ANY
5 sharing of the continuing synergies resulting from the UtiliCorp (now Aquila)/St. Joseph
6 Light & Power ("L&P") merger.

7 All take the position that the continuing and essentially undisputed synergies
8 created by the L&P merger should be assigned 100% to customers. They apparently
9 believe that it is equitable for customers who have contributed little to benefit by 100% of
10 the continuing synergies when Aquila is responsible for and paid for both the merger and
11 the synergies.

12 As I projected in my rebuttal testimony, Staff and OPC have reiterated old issues
13 that were addressed in the formulation of the Aquila proposal and attempted to raise new
14 issues. These issues ensure that Aquila's major movements towards Staff positions
15 continue to be frustrated by Staff's receding target. I have updated my Rebuttal Schedule
16 VJS-1 to Surrebuttal Schedule VJS-1 to incorporate the latest examples where Staff
17 moves farther away as Aquila tries to accommodate their concerns. I was disappointed to
18 see that staff witness Traxler (rebuttal page 3 lines 7 to 12) even criticizes Aquila for
19 evolving its current proposal to address previous Staff concerns with the merger case rate
20 plan. As you can see from Surrebuttal Schedule VJS-1, Aquinas's proposal has
21 eliminated many of Staff's issues and is based on a simple, straightforward method
22 similar to Staff's approach to capture the merger-related synergies. Developing a

1 proposed sharing is a challenge since Staff generally doesn't agree among themselves
2 other than that NONE of the continuing synergies should be shared going forward.

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

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

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

10 **III. RELEVANT QUESTIONS ON SHARING FOR THE COMMISSION:**

11 Q. What are the relevant questions at issue here that the Commission should consider?

12 A. There are really only two basic questions for the Commission to consider on this issue:

13 **1. Are the benefits/synergies created by the merger real and continuing?**

14 The answer is clearly **YES**. Otherwise, there would be no dispute over who gets
15 how much!

16 **2. Should those responsible for creating these synergies continue to share in the**
17 **synergies?**

18 Equity by itself says **YES!** In addition, the potential for additional future
19 synergies that would similarly benefit Missouri customers is also impacted.

20 Staff and intervenors in rebuttal repeat and reiterate various issues that Aquila has
21 already addressed in its proposal or our testimony, but the basic questions are really quite
22 simple and essentially unchallenged.

1 If the Commission answers the two basic questions above affirmatively, most of
2 the Staff and intervenors issues are either moot or irrelevant.

3 The calculations of the synergies are based on Staff methods from the last rate
4 case. Only one witness (Mr. Traxler) has questioned any part of the synergies. His
5 calculation was fatally flawed and his question answered upon closer review of the facts.

6 Equity is never really addressed seriously. Staff 'principles' and confusion about
7 recovering unrecoverable costs are put forth instead. Regulatory lag, despite its well-
8 documented failure in these circumstances, is dogmatically substituted for any
9 consideration of equity. Staff proposed regulatory lag as the answer, despite its clear
10 failure over the last three years. Staff claimed that \$36.4 million of synergies were
11 achieved by Aquila. However, the actual facts show that, even with all these synergies,
12 Aquila returns on equity in Missouri were substantially substandard. Returns at MPS
13 average around 4.24% for the last three calendar years.

14 **IV. ARE SYNERGIES REAL AND CONTINUING?**

15 Q. Have any witnesses questioned that the synergies are real and continuing?

16 A. Only witness Traxler of the Staff (at rebuttal page 3, lines 12 to 18) has raised a question
17 on the actual synergies. Witness Traxler questions whether the allocation of Aquila's
18 corporate general plant has been considered adequately in the Aquila proposal. Unless
19 adequate consideration has been shown, witness Traxler would eliminate the L&P joint
20 dispatch synergies.

21 Q. Did Aquila consider the allocated costs of the corporate general plant in its sharing
22 proposal?

1 A. Yes. First, however, witness Traxler overstated the impact of the plant allocations by
2 failing to include the related allocation of deferred tax reserves of \$6,710,208. These
3 reserves reduce witness Traxler's synergy reduction of \$3.8 million by the revenue
4 requirement on the reserves of by \$887, 089. That is the impact of the reserve credit
5 balance of \$6,710,208 times witness Traxler's return of 13.22%.

6 More importantly, witness Traxler also implicitly assumed that support costs from
7 Aquila were equal to the prior SJLP support costs and thus provided no offset to the costs
8 of the Aquila corporate general plant. That assumption is erroneous. The level of
9 support costs allocated to SJLP in 2002 in the 900 series of FERC accounts was
10 \$8,276,839 from L&P's annual reports to the Commission. The same accounts in 1999
11 totaled \$12,741,186. Support costs decreased over \$4.4 million dollars.

12 Q. What is the net impact of these two corrections?

13 A. These two corrections total \$5.3 million, which exceeds Mr. Traxler's original calculation
14 of \$3.8 million in question. The revised calculation actually reflects additional net
15 savings to L&P of \$1.5 million that accrue 100% to L&P customers under Aquila's
16 proposal. His calculation would be pushed even further into a deficit if the Commission
17 determines depreciation and return issues at different levels than proposed by Aquila or if
18 the impact of inflation on L&P's 1999 costs were factored in.

19 Q. Did Aquila propose to share in these synergies also?

20 A. No. As I mentioned in rebuttal testimony, Aquila has tried to eliminate contentious issues
21 in developing the sharing proposal in this case.

22 Q. Did any other witness question whether synergies were real and continuing?

1 A. No. In fact, witness Oligschlaeger (page 9 lines 19-23 of his rebuttal) relied on Company
2 projections from the merger case that indicated that the synergies would continue at least
3 for the ten years projected in the Merger Case. Witness Dittmer (page 9, lines 13-17 of
4 rebuttal) mistakenly claimed that Aquila must not be efficient because Aquila did not
5 request any sharing of support cost merger synergies at L&P.

6 Q. What was the mistake in witness Dittmer's claim?

7 A. Witness Dittmer's claim was mistaken because he assumed that there were no merger
8 synergies at L&P. A simple comparison of the 900 series of FERC accounts from the
9 commission reports show that L&P support costs have actually DECREASED from
10 \$12,741,186 in 1999 to \$8,276,839 in 2002, a decrease of \$4,464,347 (over 50%), even
11 before considering any inflation allowance on 1999's costs. Aquila chose not to ask for a
12 share of these synergies as I explained in correcting witness Traxler. Correcting Mr.
13 Dittmer's conclusions for the facts reveal that the economies of scale in support costs
14 have been realized even by L&P. These L&P savings are even more impressive because
15 Staff (Witness Featherstone's merger case rebuttal testimony on page 16, lines 9-11) had
16 previously claimed that L&P would experience an increase in support cost from the
17 standalone L&P. Aquila's ability to lower support costs even to a low cost provider like
18 L&P is further evidence that the economies of scale claimed are real and continuing.

19 **V. THE EQUITY OF SHARING**

20 Q. Do any witnesses directly address the equity of sharing the continuing synergies?

21 A. No. The issues raised either sow confusion about recovery of costs (which Aquila did
22 NOT request) or tout regulatory lag as the basis for now claiming 100% of the synergies.
23 The failure of regulatory lag is readily evident by a review of returns on the MPS and

1 L&P equity investments since the merger. Those returns averaged 4.24% at MPS and a
2 negative 1.23% at L&P over the last three calendar years.

3 Q. Has Staff ever testified that sharing was appropriate?

4 A. Yes. In the Aquila/L&P Merger Case, the minimum expected sharing ratio of 50% was
5 cited repeatedly. Some of those quotations are as follows:

6 Staff witness Oligschlaeger, in rebuttal testimony in the Merger Case, page 32-33,
7 lines 21-22 and lines 1-6, "Q. How would the Staff define a fair percentage of
8 merger savings to be passed on to customers of merged utilities? A. In past merger
9 applications, the Staff has expressed the opinion that at least **50%** of total merger
10 benefits should be reflected in customer rates over the long term if a specific
11 "regulatory plan " for a merger is to be adopted. The Staff also has stated that **if**
12 **utilities propose to assign less than half** of total merger savings to customers
13 through a regulatory plan, then the company should state compelling reason why the
14 public interest would justify that result."

15
16 That quote indicates that retention of synergies higher than 50% would even be
17 considered.

18
19 Staff witness Proctor's example on page 17, line 4 in rebuttal testimony in the
20 Merger Case cites "...that there will be a **50%** sharing between shareholders and
21 ratepayers...."

22
23 Staff witness Proctor in rebuttal testimony in the Merger Case, page 49, line 11
24 repeats, "The **50%** of these synergies going to ratepayers can then be allocated..."

25
26 Staff witness Proctor in rebuttal testimony in the Merger Case. Page 13, lines 7-8,
27 "...that there will be a **50%** sharing between shareholders and ratepayers ..."

28
29 Staff witness Oligschlaeger in rebuttal testimony in the Merger Case, page 33, line
30 20-22, "...the Staff would recommend that any "guarantee" should encompass
31 **50% of the estimated merger savings** claimed by the Joint Applicants for the first
32 ten years of the conclusion of the merger."

33
34 Q. Were there any other references to the equity of sharing synergies?

35 A. Yes. Witness Oligschlaeger on page 14, lines 14 to 17 of rebuttal made a passing
36 reference that the \$5.75 of synergies in Missouri needed to be considered in light of the
37 synergies requested in other jurisdictions. The implication was that Missouri's share of

1 the synergies was large in comparison to the synergies in other jurisdictions. That reason
2 for the relatively large synergies in Missouri should be obvious because joint dispatching
3 is not available to any of the gas divisions.

4 **VI. REBUTTAL OF OTHER ISSUES:**

5 Q. What are the specific issues raised by the rebuttal testimony of these witnesses?

6 A. The witnesses list a variety of old and new concerns. NONE, however, are legitimate
7 grounds for denying the shareholders of Aquila a share in the real and continuing
8 synergies created by the merger. Many of their concerns are simply detailed complaints
9 based on a misinterpretation of the sharing proposal or tangential issues that do not
10 address the fundamental equity of the proposed sharing.

11 **VII. SURREBUTTAL OF COMMON ISSUES:**

12 Q. Were any of the issues raised in common between the witnesses?

13 A. Yes, several issues can be addressed in common:

14 **Position 1:** Costs are not 'actual' costs if synergies are shared. (Featherstone rebuttal,
15 page 4 line 22 to page 8 line 5, Oligschlaeger rebuttal page 10, line 20 to page 12, line 17)

16 **Response 1:** As I indicated in my rebuttal testimony on page 8 line 19 to page 9, line 2,
17 Staff appears more than willing to restate actual costs when that results in a decrease in
18 rates. It is clearly a double standard to now claim that 'actual' costs cannot be raised as
19 well as lowered to impact rates. Sharing synergies by definition results in a higher level
20 of rates than without sharing synergies- that's how the sharing is accomplished. Creating
21 'imaginary' cost levels apparently is desirable when it reduces rates (as in disallowances
22 or historical averaging), but is forbidden when it increases rates (as in sharing synergies).

23 Staff has frequently deviated from the actual costs of service when the results aligned

1 with Staff 'principles' of lowering rates. The deviations are caused by such mechanisms
2 as averaging costs over various periods (such as three years, five years, three years and
3 nine months, five years and three months), switching from cash to accrual to cash for
4 pension expense, altering income tax calculations, etc. Such an elastic view of 'actual'
5 cost of service when it serves Staff's purposes invalidates any claim that sharing
6 synergies violates 'actual' costs.

7 **Position 2:** Regulatory lag has already rewarded Aquila sufficiently (Oligschlaeger
8 rebuttal, page 5, line 7 to page 6, line 21 and page 9, line 3 to page 10, line 18,
9 Featherstone rebuttal page 10 line 11 to page 11, line 21 and Dittmer rebuttal page 12,
10 line 13 to page 13, line 7)

11 **Response 2:** My rebuttal testimony on page 13, lines 11 to 16 addressed this general
12 issue. In short, the returns earned during 2001 to 2003 were wholly inadequate even with
13 the synergies that were created during that time. Aquila's Missouri returns that averaged
14 4.24% were far short of even the clearly inadequate returns being recommended by Staff
15 in the current case.

16 One new claim introduced by witness Oligschlaeger was that the Merger case filing
17 indicated that \$36.4 million of synergies were projected for the first three full years of the
18 merger. That claim ignores several relevant facts.

- 19 1. The actual merger date was delayed 6 months from the projections in the
20 merger case, which meant that the double costs of the transition staffing,
21 and conversion reduced the first year of synergies substantially from the
22 projections.

- 1 2. Receiving FERC approval for joint dispatch in August 2001 effectively
2 reduced the first year synergies by most of the year, including the critical
3 summer cooling season.
- 4 3. The cost of producing the \$36.4 million of synergies costs was projected to
5 be \$10.5 million from the same analysis cited by witness Oligschlaeger
6 (lines IV.1 and IV.2).
- 7 4. In the last MPS electric rate case that reduced MPS rates by over \$4
8 million, Staff claimed 100% of the MPS merger synergies.
- 9 5. Finally, the actual returns achieved despite the synergies were far below
10 even the substandard returns recommended in this case by Staff and
11 intervenors. That means that even with the merger synergies, Aquila was
12 unable to earn what even the Staff supposedly considers a fair rate of
13 return. This is the most telling evidence that regulatory lag does not work
14 as Staff claims.

15 Despite Mr. Dittmer's conclusion that a 5% return is better than a 4% return, the level of
16 return at either 4% or 5% are both far below fair, and demonstrates the fallacy of
17 regulatory lag in this situation.

18 **Position 3:** Lack of equitable treatment will not discourage acquisitions that create more
19 synergies (Featherstone rebuttal page 13, line 10 to page 14, line 5, Dittmer rebuttal page
20 4, lines 6-8, Oligschlaeger rebuttal page 16 line 17 to page 17, line 17)

21 **Response 3:** This is directly contradicted by Staff and intervenor witnesses (Featherstone
22 rebuttal, page 24 line to page 25, line 2, and Dittmer himself at rebuttal page 25, lines 3-
23 8) who indicate that increased synergy sharing/cost recovery could result in higher

1 economic values to acquiring companies. It logically follows that higher economic values
2 would result in more mergers, resulting in even more synergies to be shared with
3 customers.

4 Witness Dittmer listed several transactions of Aquila and claimed that the
5 majority did not receive any sharing or cost recovery. Of the ten transactions cited:

- 6 1. The two largest and most recent (the Minnegasco Nebraska and West Plains
7 Energy acquisitions) received cost recovery in rates,
- 8 2. Three transactions did not have acquisition premiums or opportunities for
9 significant synergies by their nature, and
- 10 3. The remaining five were much smaller acquisitions that had little opportunity for
11 joint dispatching synergies or economies of scale.

12 Joint dispatching needs electric companies with generation capability with cost effective
13 interconnects. Potential savings from economies of scale were much smaller in past years
14 under the decentralized operating division model. Contrary to witness Dittmer's claim,
15 Aquila's actions seeking sharing or cost recovery in the cases above reinforce our
16 position that economics from mergers are improved when sharing occurs. Improved
17 economics will encourage future activity and create benefits to be shared with customers.
18 Given the firestorm of resistance evidenced by Staff and intervenors, the synergies need
19 to be substantial (as in this case) to justify the effort needed to share in them.

20 Witness Dittmer also made a backdoor attempt to question legitimate Aquila
21 support costs (page 11, lines 2-8). This comment completely ignored the months of Staff
22 effort spent reviewing those support costs. The comment was nothing more than a

1 transparent attempt to raise unfounded and unsupported doubt on an issue that was
2 already fully investigated.

3 Witness Dittmer also cited (page 7 lines 7-19) numerous changes to the support
4 costs of Aquila, claiming that those changes called into question the level of synergies. In
5 fact, those changes are already reflected in the base cost and the impact of those changes
6 is already reflected appropriately in the cost allocations in this case. Mr. Dittmer also
7 confuses merger and non-merger impacts, a distinction that witness Featherstone (pages
8 38-39 of rebuttal) believe is a key requirement for sharing. As a result, those savings are
9 already reflected to the benefit of customers, and should not be misused to deny sharing
10 of the merger related synergies.

11 **Position 4:** Continued Staff confusion on cost recovery versus synergy sharing
12 (Oligschlaeger rebuttal page 4, line 16 to 22, Featherstone rebuttal page 14, line 1 to page
13 26, line 3, Dittmer rebuttal page 36, line 8 to page 38, line 4, and Kind rebuttal pages 25
14 to 38)

15 **Response 4:** Sharing synergies is sharing synergies. Aquila is NOT seeking cost
16 recovery even of the costs Staff 'principles' would support.

17 Witness Kind's confusion on cost recovery takes him on several tangents where
18 he speculates on the basis for the decision to merge. Most of that speculation is
19 irrelevant to a synergy sharing proposal – especially since the synergies to the customers
20 of MPS and L&P are undisputed by witness Kind or any other witness in this case!

21 Indeed, even witness Kind's speculation that generation was generally thought to
22 be imminently deregulated at the time of the merger is interesting but irrelevant in the
23 sharing situation at hand. The low-cost generation of L&P that witness Kind suggests to

1 be non-regulated is instead being used to the benefit of the MPS and L&P customers and
2 is the primary driver of the joint dispatching synergies in this case.

3 Even if any of witness Kind's concerns about other alleged nonregulated benefits
4 for the merger were correct, that does not change the very real and undisputed fact that
5 the merger created real and continuing benefits to utility customers that witness Kind
6 would have this Commission ignore. Aquila's proposal requests that only 25% (half of
7 the 50% retained after the low-income funding) of some of the synergies be retained by
8 Aquila. The remaining 75% of the synergies directed to customers and low-income
9 customers are more than ample to reflect any allocation of synergies to non-regulated
10 synergies that witness Kind alleges, if they even exist.

11 **VIII. SURREBUTTAL OF INDIVIDUAL ISSUES: CITATIONS IN FAVOR OF**
12 **SHARING SYNERGIES**

13 Q. Where any unique new valid issues raised by Staff witness Fischer in her rebuttal?

14 A. No. Staff witness Fischer apparently misunderstood the citations in my direct testimony.
15 My direct testimony cited numerous examples where other commissions have approved
16 some type of sharing of synergies as equitable and fair. It was not my intent or stated
17 purpose to claim that every situation was exactly the same as in this case, merely to point
18 out that sharing synergies was a common practice. Witness Fischer mistakenly undertook
19 a detailed study of each citation to disprove a claim never made! By immersing herself in
20 that detailed exercise, witness Fischer allowed herself to be distracted by the trees without
21 noticing the very large forest of approving the sharing of synergies.

22 Q. Is witness Fischer's opposition to sharing consistent with Staff positions on sharing
23 synergies?

1 A. No. Her position seems puzzling because Staff is on record repeatedly in the Aquila/L&P
2 merger case as indicating that a 50% sharing is appropriate! As I pointed out earlier,
3 Staff repeatedly in the merger Case used 50% as the benchmark for sharing synergies.
4 Witness Fischer's research seems misdirected at best and irrelevant to this case.

5 Q. Does witness Fischer impose a realistic standard for this Commission to make a decision
6 on sharing?

7 A. No. It appears that Ms. Fischer would require approval of a majority of other
8 commissions in exactly the same circumstances on exactly the same sharing plan. This
9 Commission can make an appropriate decision without having to resort to such an
10 impossible standard.

11 **IX. RECOMMENDING COMPLEXITY WHILE COMPLAINING ABOUT IT**

12 Q. Were any new valid recommendations raised by witness Featherstone?

13 A. No. Witness Featherstone's major recommendation was to recommend additional levels
14 of complexity to address declining cost situations as he expected in the two cases cited in
15 rebuttal testimony page 8 lines 11 to 18. This was despite persuasive evidence that
16 neither MPS or L&P are in a declining cost situation. This recommendation was then
17 followed by the Staff's negative experiences in the two cases cited. Staff's aversion to
18 more complex regulatory tracking plans was made very clear by Staff's testimony in the
19 merger case. Staff's aversion to such plans in the merger case were a major reason why
20 Aquila developed a simple approach that claims only some of the merger-related
21 synergies, an approach based on Staff's own calculations. Aquila's situation is unlike the
22 declining cost situation cited by witness Featherstone, so Aquila's simple proposal is
23 superior and effectively incorporates Staff's aversion to complexity. Incidentally, it

1 appears that the Staff's double standard is again at work here. When earnings potentially
2 are over the allowed returns, credits to customers are in order. No similar concern or
3 'principle' concerns Staff when returns are lower than allowed.

4 **X. SURREBUTTAL IN GENERAL**

5 As I pointed out in my rebuttal testimony, Staff acknowledged in the merger case that
6 unrelated cost increases may hamper the realization of synergies. Those unrelated cost
7 increases would need to be considered even under regulatory lag.

8 Regulatory lag itself is NOT an equitable method to share savings when the synergies
9 created are ongoing. Regulatory lag also creates lags in recovering legitimate cost
10 increase (like inflation) and cuts more than it helps. Regulatory lag is a double-sided
11 sword and more frequently works to the detriment of the investors. This inequity on the
12 synergy side is because those continuing synergies are passed on 100% to customers
13 periodically and thus are no longer shared. Sharing synergies through the regulatory lag
14 process as suggested by the Staff in these circumstances is clearly one-sided and
15 inequitable.

16 Aquila's proposal is an evenhanded and equitable method to reasonably share in the
17 continuing synergies Aquila is creating. It requires NO elaborate tracking models. It
18 does NOT require any review of nor ask for ANY recovery of the costs to achieve the
19 merger. The economies of scale are a straightforward calculation that is based on Staff
20 methodology and that has been described in other jurisdictions as too simple to be
21 disputed. Even after capturing only some of the merger synergies, Aquila proposed to
22 retain only 50% of those acquisition-related savings to benefit shareholders for creating

1 those savings. And HALF of that would be used to establish a low income assistance
2 program!

3 **XI. THE EQUITY OF SHARING SYNERGIES**

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

8 A. It is equitable for Aquila to retain a portion of those savings because the shareholders of
9 Aquila created those savings by bringing about the acquisition and they should benefit
10 from those savings. Retaining 50% of the savings for Aquila is a reasonable portion of
11 the savings, especially when half of that savings is directed to the low income assistance
12 program.

13 Q. Are there precedents for sharing merger and acquisition-related savings?

14 A. Yes, there are many recent precedents for sharing the savings from mergers or
15 acquisitions cited in my direct testimony. Many are more clear than this proposal because
16 the acquisitions occurred in a single regulatory jurisdiction. All acknowledge that the
17 savings created by acquisitions are equitably shared in some ratio between the customers
18 and the shareholders that created the savings. Sharing synergies from retaining benefits
19 created by mergers is allowed in many jurisdictions.

20 **XII. THE CONSEQUENCES OF NOT SHARING**

21 Q. What happens if 100% of the merger-related savings are utilized to reduce the costs of
22 MPS and L&P?

1 A. First, there is a fundamental inequity created because shareholders absorb the costs that
2 produced the savings for the customers. This is clearly not equitable since the parties
3 benefiting from the cost savings do not share the costs. In addition, passing on all of the
4 savings to customers now will deter future acquisitions and the savings created by them.

5 Q. What risks have Aquila shareholders assumed as a result of this acquisition?

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

15 If the shareholders do not retain some portion of merger savings, companies will be
16 less likely to pursue mergers that could ultimately benefit customers by lowering their
17 costs. Customers receive no such savings if no mergers occur, so allowing the
18 shareholders to retain a portion of the savings is a reasonable and equitable method to
19 lower costs to customers. It is an incentive to simply be treated equitably.

20 **XIII. THE CONSEQUENCES OF SHARING SYNERGIES**

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

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

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

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

10 Companies will be encouraged to pursue economic merger transactions that are
11 equitably treated and that will ultimately provide additional economic benefits to
12 customers, knowing that shareholders will also share equitably in the continuing
13 economic benefits. Shareholders will be much more likely to accept the costs and risks of
14 merger transactions if it is clear that the continuing and long-term savings have an
15 equitable economic value to the shareholders as well as the customers. Adopting
16 Aquila's proposal sends a clear signal to utilities currently operating in Missouri that
17 mergers that make economic sense will not be prevented or made less economic by
18 inequitable regulatory actions.

19 **XIV. SUMMARY**

20 1 No witnesses who investigated the calculations had any valid or specific concerns
21 with the synergies, so the synergies are clearly real, long-term and continuing.
22 Many of the synergies disputed in other cases (gas costs, procurement efficiencies,

1 and even SJLP support costs) are actually reflected 100% to the benefit of
2 customers.

3 2 Equity is not properly achieved by regulatory lag. Regulatory lag does NOT
4 provide equitable compensation for creating and sustaining continuing and long-
5 term synergies when it is clear that MPS and L&P have not earned anywhere near
6 their allowed rates of return since the merger, despite synergies created from the
7 merger.

8 **XV. CONCLUSION:**

9 Q. What is your conclusion?

10 A. The issues raised by these parties in rebuttal are not based on facts but appear instead to
11 be stated as a means to distract the Commission from considering the equity of Aquila's
12 reasonable and evenhanded proposal to share in the real and continuing synergies Aquila
13 created.

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

22 Q Does that conclude your surrebuttal testimony?

23 A. Yes.

**Elimination of 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 Guaranteed savings | ELIM | No issue | No issue | No issue | No issue | No longer an issue by Staff |
| 2 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, (4.24% avg ROE) as acknowledged in Staff Merger Case testimony. Staff considered 10 years as acceptable in merger case. |
| 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. |
| 13 | | | | | Need more complex model like Ameren, with annual cost review | See 7 above- Staff complained about complexity in merger case |
| 14 | | | | | SJLP support costs are now higher under Aquila. | Error and bad research by Staff and Intervenors. |
| 15 | | | | | Need to determine ALL synergies and categorize between merger and nonmerger | See 7 - Also Aquila proposal leaves many synergies 100% to customers to avoid contention. |
| | | | | | Citations on sharing not exactly this situation. | Look at Forest, not trees. |
| | | | | | Inequitable treatment won't discourage acquisitions. | Logic alone refutes this point. |
| | | | | | Costs of corporate assets not considered at L&P. | Were considered before proposal for sharing determined. |
| POSITION: | APPROACH: | POSITION: | REBUTTAL: | APPROACH: | POSITION: | ANALYSIS: |
| 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 proposals make this objection irrelevant - not asking for recovery of any of these costs.

Summary of Returns on Equity Achieved for 2001-2003

(Source: Monthly Surveillance Reports)

| | MPS ROE | L&P ROE |
|-----------------------|--------------|---------------|
| 2001 January | 3.64% | -3.61% |
| February | 3.19% | -2.50% |
| March | 3.19% | -3.70% |
| April | 1.77% | -4.09% |
| May | 1.25% | -3.89% |
| June | 1.12% | -3.90% |
| July | 1.68% | -4.46% |
| August | 1.49% | -5.68% |
| September | 1.45% | -7.73% |
| October | 2.25% | -7.90% |
| November | 2.19% | -8.17% |
| December | 3.17% | -0.03% |
| 2002 January | 2.65% | -0.77% |
| February | 2.19% | -2.14% |
| March | 3.61% | -0.69% |
| April | 3.98% | -1.40% |
| May | 3.81% | -0.60% |
| June | 3.57% | -0.57% |
| July | 2.47% | 0.16% |
| August | 2.79% | 0.08% |
| September | 6.36% | 0.18% |
| October | 6.20% | 0.04% |
| November | 6.49% | 0.57% |
| December | 6.40% | 0.37% |
| 2003 January | 6.97% | 0.77% |
| February | 7.59% | 1.29% |
| March | 8.02% | 1.76% |
| April | 7.63% | 1.73% |
| May | 6.44% | 0.83% |
| June | 6.52% | 0.86% |
| July | 7.25% | 1.21% |
| August | 7.31% | 1.13% |
| September | 4.48% | 1.74% |
| October | 4.50% | 1.67% |
| November | 4.36% | 0.74% |
| December | 4.75% | 2.58% |
| Simple Average | 4.24% | -1.23% |

**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 Douglas)
) ss
State of Nebraska)

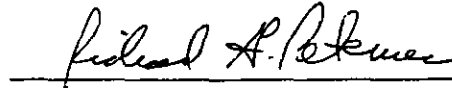
AFFIDAVIT OF VERN J. SIEMEK

Vern J. Siemek, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Surrebuttal 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 10th day of February, 2004.



Notary Public
Richard Petersen

My Commission expires:
2/10/04

