REBUTTAL TESTIMONY

OF

RYAN KIND

AQUILA, INC.

CASE NO. GR-2004-0072

Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. Ryan Kind, Chief Energy Economist, Office of the Public Counsel, P.O. Box 2230, Jefferson City, Missouri 65102.

Q. PLEASE SUMMARIZE YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND.

A. I have a B.S.B.A. in Economics and a M.A. in Economics from the University of Missouri-Columbia (UMC). While I was a graduate student at UMC, I was employed as a Teaching Assistant with the Department of Economics, and taught classes in Introductory Economics, and Money and Banking, in which I served as a Lab Instructor for Discussion Sections.

My previous work experience includes three and one-half years of employment with the Missouri Division of Transportation as a Financial Analyst. My responsibilities at the Division of Transportation included preparing transportation rate proposals and testimony for rate cases involving various segments of the trucking industry. I have been employed as an economist at the Office of the Public Counsel (Public Counsel or OPC) since April 1991.

Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE THIS COMMISSION?

A. Yes, prior to this case I submitted written testimony in numerous gas rate cases, several electric rate design cases and rate cases, as well as other miscellaneous gas, water, electric, and telephone cases.

Q. HAVE YOU PROVIDED COMMENTS OR TESTIMONY TO OTHER REGULATORY OR LEGISLATIVE BODIES ON THE SUBJECT OF UTILITY REGULATION AND RESTRUCTURING?

A. Yes, I have provided comments and testimony to the Federal Energy Regulatory Commission (FERC), the Missouri House of Representatives Utility Regulation Committee, the Missouri Senate's Commerce & Environment Committee and the Missouri Legislature's Joint Interim Committee on Telecommunications and Energy.

Q. HAVE YOU BEEN A MEMBER OF, OR PARTICIPANT IN, ANY WORK GROUPS, COMMITTEES, OR OTHER GROUPS THAT HAVE ADRESSED ELECTRIC UTILITY REGULATION AND RESTRUCTURING ISSUES?

A. Yes. I was a member of the Missouri Public Service Commission's (the Commission's) Stranded Cost Working Group and participated extensively in the Commission's Market Structure Work Group. I am currently a member of the Missouri Department of Natural Resources Weatherization Policy Advisory Committee, the National Association of State Consumer Advocates (NASUCA) Electric Committee, and both the Operating Committee and the Standards Authorization Committee of the North American Electric Reliability Council (NERC). I have served as the public consumer group representative to the Midwest ISO's (MISO's) Advisory Committee. During the early 1990s, I served as a Staff Liaison to the Energy and Transportation Task Force of the President's Council on Sustainable Development.

I. INTRODUCTION

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony will address the proposal of Aquila, Inc. (Aquila or the Company) for the indirect recovery of St. Joseph Light & Power (SJLP) merger costs in its cost of service by including imaginary costs that the Company refers to as merger savings retention costs.

Q. IS AQUILA SEEKING TO HAVE THIS COMMISSION APPROVE A REVENUE REQUIREMENT FOR RATEMAKING PURPOSES THAT EXCEEDS THE ACTUAL LEVEL OF COSTS INCURRED IN THE TEST YEAR?

A. Yes. In his direct testimony, Aquila witness Vern Siemek states at line 1 on page 3 that his testimony is intended to "support Aquila retaining 50% of the acquisition-related savings to benefit shareholders for creating those savings." The mechanism for "retaining savings" that the Company is proposing is for this Commission to include some level of "imaginary" or "make believe" costs in the future rates of MPS gas customers. These "retained savings" are costs that do not actually exist but the Aquila is nonetheless requesting that the Commission pretend that they are real when determining the revenue requirement in this case.

Q. PLEASE EXPLAIN WHY PUBLIC COUNSEL BELIEVES THAT THE VAST MAJORITY OF THE SJLP MERGER COSTS, INCLUDING THE MERGER ACQUISITION PREMIUM, SHOULD BE CONSIDERED COSTS THAT WERE INCURRED TO SUPPORT AQUILA'S NON-REGULATED OPERATIONS.

A. Public Counsel believes that Aquila's decision to merge with SJLP was entirely driven by the Company's expectation that the merger would benefit shareholders by providing additional opportunities for non-regulated earnings. In the testimony that follows, I will show what motivated Aquila's business decisions, including the decision to merge with SJLP, and demonstrate how SJLP fit into Aquila's plans for enhancing its non-regulated earnings.

Q. PLEASE OUTLINE THE MAJOR TOPICS THAT YOU COVER WHICH ARE RELATED TO AQUILA'S REQUEST FOR INDIRECT RECOVERY OF THE SJLP MERGER COSTS.

A. My testimony focuses primarily on two major areas associated with Aquila's request for recovery of the SJLP merger costs via its merger savings retention proposal. First, this testimony examines the major factors that have motivated Aquila to acquire SJLP. These factors included the desire of Aquila's senior management and Board of Directors to enhance the value of its shareholder's investment by furthering its strategic objectives of: (1) expanding its mid-continent footprint, (2) acquiring low cost generation assets and purchase power contracts that can either be spun off and sold for a profit (monetized) or used to support Aquila's power marketing activities in the future, and (3) acquiring assets that can be used or leveraged to support telecommunications ventures.

Second, this testimony addresses the reasonableness of Aquila's request to recover the SJLP merger costs from ratepayers. Within this area, my testimony discusses and provides support for the following points:

- The fairly high acquisition premium that Aquila paid for the assets of SJLP was primarily due to the future non-regulated earnings potential of SJLP's generation assets due to the negative stranded costs associated with these assets.

- A large portion of the synergies that Aquila identified at the time of the merger were in the area of generation and almost any conceivable restructuring legislation in Missouri was expected to transfer the benefits from all of these synergies to

Aquila. Restructuring was still considered likely in Missouri at the time of the merger since the California energy crisis had not yet reached its peak and because the Enron bankruptcy had not yet occurred.

- If generation became deregulated at the retail level (as was expected at the time of the merger), Aquila could achieve synergies that accrued solely to the benefit of shareholders by selling the output from SJLP's supply portfolio at market prices that exceed its cost of production and keeping 100% of this profit margin for its shareholders. Alternatively, Aquila could sell these assets for a price that vastly exceeds their book value and keep 100% of the gains for its shareholders. In its merger testimony in Case No. EM-2000-292, Aquila was silent about the prospect for future non-regulated earnings in this area and this silence greatly understated the non-regulated earnings potential that Aquila's management expected to result from the SJLP merger.

- Aquila also expected substantial non-regulated synergies from planned future telephony and cable projects which would benefit from synergies between the telephony assets and utility right of ways of SJLP and Aquila. In its merger testimony, Aquila was also silent about the prospect for future non-regulated earnings in this area and this silence also greatly understated the non-regulated earnings potential that Aquila's management expected to result from the SJLP merger.

Q. SOME OF YOUR ATTACHMENTS HAVE REFERENCES TO UTILICORP UNITED, INC. PLEASE EXPLAIN THE RELATIONSHIP OF AQUILA TO UTILICORP UNITED, INC.

A. UtiliCorp United, Inc. is the former name of the corporation now known as Aquila, Inc. Aquila changed its name from UtiliCorp United, Inc. to Aquila subsequent to the Company's merger with SJLP.

II. AQUILA'S REQUEST FOR THE INDIRECT RECOVERY OF MERGER COSTS.

Q. HAS AQUILA REQUESTED EITHER DIRECT OR INDIRECT RECOVERY OF ITS SJLP MERGER COSTS IN THIS CASE?

A. Yes. The indirect recovery of the SJLP merger costs has been requested in the testimony of Aquila witness Vern Siemek. The Company is seeking to indirectly recover its SJLP merger costs through its merger-related savings retention proposal. On page 3 of his testimony at line 1, Mr. Siemek states that "my testimony will also support Aquila retaining 50% of the acquisition-related savings to benefit shareholders for creating those savings."

Q. WHAT HAS THE COMPANY PRESENTED AS ITS RATIONALE FOR INCLUDING NON-EXISTANT OR IMAGINARY COSTS IN THE RATES THAT CUSTOMERS PAY FOR ELECTRIC SERVICE?

A. The rationale in the Company's testimony to support its recommendation for including imaginary costs in its future rates is spelled out in the following statements that Mr. Siemek made on page 3 of his direct testimony:

> My testimony will also support Aquila retaining 50% of the acquisition-related savings to benefit shareholders for creating those savings.
>
> …
>
> It is equitable for Aquila to retain 50% of those benefits both as an incentive for creating the savings in lieu of recovering the costs of creating the acquisition that are not now reflected in MPS or L&P costs.

…

> Sharing in the savings created by the merger provides an incentive for companies to create such savings for customers by encouraging future mergers.

Q. PLEASE ADDRESS THE THIRD STATEMENT THAT YOU LISTED ABOVE. DO YOU BELIEVE IT IS APPROPRIATE FOR THIS COMMISSION TO PROVIDE INCENTIVES FOR MISSOURI UTILITIES TO MERGE WITH OTHER COMPANIES?

A. Definitely not. The Commission should be neutral in this area. If a merger makes sense to a utility's management based on its overall financial and strategic objectives and on the savings that it may be able to retain through regulatory lag, then a utility should seek to consummate a merger. If a utility wants some type of extraordinary ratemaking treatment, like the merger savings retention proposal that appears in this rate case, then the utility should seek to negotiate some kind of arrangement (e.g. a temporary rate moratorium) with other parties at the time it is seeking approval of its merger.

Q. WHAT DO YOU THINK MR. SIEMEK IS REFERRING TO IN THE SECOND STATEMENT LISTED ABOVE WHEN HE REFERS TO ALLOWING AQUILA TO RETAIN "50% OF THE BENEFITS [SAVINGS] …IN LIEU OF RECOVERING THE COSTS OF CREATING THE ACQUISITION…"?

A. Mr. Siemek appears to be making the argument that it is appropriate to permit the Company to indirectly recover the acquisition costs associated with the MPS/SJLP merger via the savings retention mechanism that Aquila has proposed in this case.

Q. DOES PUBLIC COUNSEL BELIEVE THAT IT WOULD BE APPROPRIATE FOR THE COMMISSION TO PERMIT THE COMPANY TO INDIRECTLY RECOVER THE ACQUISITION

COSTS ASSOCIATED WITH THE MPS/SJLP MERGER VIA THE SAVINGS RETENTION MECHANISM THAT AQUILA HAS PROPOSED IN THIS CASE?

A. No. This testimony will show that the decision of Aquila's management to acquire SJLP was based on the expectation that the non-regulated synergies (both cost reductions and revenue enhancements) resulting from the merger would provide substantial financial and strategic benefits to the Company's management and shareholders. This expectation was the primary motive behind Aquila's decision to merger with SJLP.

Q. GIVEN YOUR BELIEF THAT AQUILA'S DECISION TO PURSUE THE MPS/SJLP MERGER WAS NOT BASED ON ANY BENEFITS THAT MIGHT ACCRUE TO THE REGULATED PORTION OF ITS BUSINESS, HOW DO YOU EXPLAIN THE COMPANY'S EFFORTS IN THIS CASE TO PERSUADE THE COMMISSION TO INCLUDE AN IMMAGINARY LEVEL OF COSTS IN RATES FOR THE PURPOSE OF HAVING CUSTOMERS INDIRECTLY FUND THE MERGER ACQUISITION COSTS?

A. The Company appears to see customers as a "safety net" that will protect Aquila's investors from the poor management decision that led to the merger. If the Company can rely on customers as a "safety net" for poor management decisions that are driven by the pursuit of non-regulated earnings opportunities, then there will be no incentive for the Company to avoid repeating its mistakes in the future.

Q. AT LINE 15 ON PAGE 15 OF HIS TESTIMONY, MR. SIEMEK STATES THAT "THE ACQUISITION ULTIMATELY NEEDS TO PROVIDE SHAREHOLDER BENEFITS IN ORDER TO BE SUCESSFUL." WHAT QUANTITATIVE MEASURE IS COMMONLY USED TO DETERMINE THE SUCCESS OR FAILURE OF A MERGER OR ACQUISITION FROM AN INVESTOR PERSPECTIVE?

A. Company's that are trying to persuade investors to be supportive of merger or acquisition proposals usually do so by asserting that financial projections show a merger to be accretive to earnings (or at least not dilutive) within a very short time period (generally one to three years). In other words, investors are expected to view a merger or acquisition as being successful if it is contributing to higher earnings per share (EPS) within a couple of years after the merger is consummated. In order for a merger or acquisition to be accretive, it needs to generate earnings that are sufficient to offset the negative impacts on earnings (including offsetting the amortized annual merger costs) resulting from the merger.

Of course, from the perspective of investors in the company that is being acquired, the merger is perceived to be successful once they receive the premium on the stock price of the acquired company. In the case of SJLP shareholders, those who made the mistake of retaining Aquila stock after April 2002 when it began its steep decline (from about $25/share to about $2.50/share) will probably never view the merger as being successful.

Q. PLEASE REFER AGAIN TO MR. SIEMEK'S STATEMENT THAT "THE ACQUISITION ULTIMATELY NEEDS TO PROVIDE SHAREHOLDER BENEFITS IN ORDER TO BE SUCESSFUL." IS THE SUCCESS OR FAILURE (FROM AN INVESTOR PERSPECTIVE) OF AQUILA'S DECISION TO PURSUE THE SJLP ACQUISITION AN ISSUE IN THIS CASE?

A. No. Whether shareholders received benefits from the decision to acquire SJLP is irrelevant to the Commission's determination in this case of the proper level of costs that should be reflected in Aquila's future rates. Aquila chose to acquire SJLP based on strategic and financial considerations related to its non-regulated business. Almost all business decisions involve some level of risk. When business opportunities don't provide expected benefits, no one should be completely surprised unless it was expected to be a risk free opportunity.

At the time Aquila decided to pursue the MPS/SJLP merger, it had shown the investment community a track record of earnings per share (EPS) growth of 8 – 10% for a couple of years and was hoping to continue that into the future. Not many investors are foolish enough to think that they can invest in a company like Aquila that was encouraging investors to believe that it could maintain this kind of earnings growth without taking on the risk that high profits could turn into high losses.

Managements are successful due to the results they obtain from a series of business decisions, not a single decision. Substantial turnover in the senior management of a Company, like that which occurred at Aquila over the last couple of years, is usually an indication that management is not seen by shareholders and investors to be prudently managing the business.

Q. BUT WOULDN'T AQUILA'S SHAREHOLDERS FEEL BETTER ABOUT THEIR INVESTMENT IF THIS COMMISSION APPROVED THE COMPANY'S PROPOSAL FOR THE INDIRECT RECOVERY OF MERGER ACQUISITION COSTS?

A. Of course that would make investors feel better about this Company and its management, but that's not a good rationale for requiring customers to "bail out" Aquila's management for making poor business decisions. If one believes that utility regulation benefits society by acting as a surrogate for competition, then the right thing for regulation to do is to let the company "pay the price" for its poor business decision, just as competitive markets punish poor business decisions. If, instead of acting as a surrogate for competition, regulation rewards or provides "safely nets" for bad business decisions, then regulation is directing society's resources towards less socially beneficial uses and failing to fulfill its role as a surrogate for competition.

Q. At line 17 on page 9 of his direct testimony in Case No. ER-2004-0034 (Aquila's pending electric rate case), Aquila witness Keith Stamm states that "Aquila's senior management accepts full responsibility for the strategic choices we made and the resultant consequences." Do you believe that Aquila's proposal in this case for the indirect recovery of merger acquisition costs is consistent with Mr. Stamm's statement that "Aquila's senior management accepts full responsibility for the strategic choices we made and the resultant consequences?"

A. No. Rather, I see Aquila's proposal in this case for the indirect recovery of merger acquisition costs as a clear indication that Aquila's senior management has not yet accepted full responsibility for the poor strategic choices that it made and the resultant consequences. As the testimony that follows will demonstrate, Aquila's decision to acquire SJLP was made to further the Company's non-regulated financial and strategic interests. The desire to provide cost reductions to customers was not the primary reason why Aquila chose to acquire SJLP. If Aquila had truly accepted "full responsibility" for the its poor "strategic choices" then it would not be pursuing its proposal for customers to "bail out" the Company by paying imaginary costs in rates for a merger that was driven by non-regulated financial and strategic considerations.

III. FACTORS THAT DROVE THE AQUILA/SJLP MERGER

A. INDUSTRY TRENDS

Q. Was the SJLP merger part of a trend that has been taking place in the energy utility industry at the time Aquila proposed the merger?

A. Yes. The American utility industry saw dozens of mergers proposed during the mid to late 1990s. The energy sector of the utility industry was a major part of this trend. Most mergers in the energy sector have been between neighboring electric utilities but some have been between energy and gas utilities and others have been between regulated utilities and gas or electric marketers.

Q. WHAT WERE THE MAJOR REASONS FOR THIS RECENT TREND?

A. Utilities were changing the way they did business so they would be ready to take advantage of the major changes that were occurring in the energy utility industry. Increases in the amount of wholesale and retail competition in the utility industry led some utilities to take bold steps like mergers in order to position themselves to take advantage of expected opportunities for increased earnings in this new environment. In the new competitive environment, some utilities expected their financial success to become more dependant upon how well they performed in competitive markets and much less dependant upon the traditional regulatory process. The perception that utilities may have opportunities for increased earnings in competitive markets has, however, been less prominent since the California energy crisis and the Enron bankruptcy. Of course, these two events were largely unforeseen at the time Aquila's management decided to proceed with the SJLP merger in order to pursue earnings opportunities in areas outside the regulated utility industry.

B. MOTIVATING FACTORS FOR SJLP AND AQUILA

Q. WHAT DOES PUBLIC COUNSEL BELIEVE THE PRINCIPAL FACTORS WERE THAT DROVE THE AQUILA/SJLP MERGER?

A. This merger appears to have been driven by the following factors:

- SJLP's desire to be acquired by a larger utility so that its shareholders could receive the acquisition premium windfall that the acquiring utility is expected to pay for the privilege of taking control of the formerly independent utility's operations and assets. The SJLP management and Board of Directors recognized that even though they are a small utility with limited growth potential, an acquirer would be willing to pay a significant premium to gain control of its low cost generating assets and purchased power contracts.

- Aquila's desire to further its mid-continent network strategy by increasing the size of its distribution service territory footprint, acquiring low cost generation assets, and acquiring telecommunications infrastructure and right of ways. This low cost generating capacity could either be used to create a significant steam of earnings over time, since it could be used to generate power at a cost that is well below market prices, or the assets could be sold (monetized) over time to bring earnings to the Aquila bottom line as needed to satisfy investor expectations for growth in EPS.

- Aquila's desire to further its merchant strategy by acquiring low cost generation assets that could be used to (1) support Aquila's power marketing or (2) sold to raise capital that could be used to acquire other generating assets closer to more lucrative markets.

- Aquila's desire to prevent its neighboring utilities (Kansas City Power & Light, Western Resources, Inc. and others) from expanding their mid-continent footprint in Aquila's backyard by acquiring SJLP or Empire.

- Aquila's desire to better position itself for competition in the mid-continent region.

Q. WHY DO YOU BELIEVE AQUILA EXPECTED THE SJLP MERGER TO BETTER POSITION THE COMPANY FOR COMPETITION?

A. The merger was expected to place Aquila in a better position for competition by:

- Reducing the prospect of cut-throat competition in regional energy markets by keeping low cost generation assets out of the hands of its local competitors.
- Lowering the cost structure of Aquila and its affiliates.
- Increasing the number of customers to which Aquila has access for selling electricity, natural gas, home security services, telephony, cable TV, internet, and other unregulated services.
- Increasing the amount of market power that Aquila has in the retail merchant function and in retail and wholesale generation markets.

C. AQUILA'S VALUE CYCLE PHILOSOPHY

Q. YOU MENTIONED AQUILA'S NETWORK AND MERCHANT STRATEGIES. COULD YOU PLEASE EXPLAIN THOSE STRATEGIES AND HOW THEY RELATED TO THE SJLP MERGER?

A. Yes. First, however, I should explain the framework in which Aquila executed its network and merchant strategies. Aquila referred to this framework as its Value Cycle Philosophy. According to this philosophy, Aquila sought to: (1) make appropriate investments, (2) optimize those investments, and (3) monetize those investments. As Attachment 1 shows, this philosophy was explained in a slide that was part of Aquila's presentation in its 1999 Year End Conference Call with investment analysts. The purpose of this framework for executing its network and merchant strategies was the creation of value for the corporation and its shareholders.

Q. PLEASE EXPLAIN HOW AQUILA'S VALUE CYCLE PHILOSOPHY WAS BROADER THAN THE MORE WIDELY RECOGNIZED UTILITY STRATEGY OF MERGING TO ACQUIRE ADDITIONAL SIZE AND COST ECONOMIES IN ORDER TO PREPARE FOR COMPETITION.

A. Aquila's Value Cycle Philosophy included this more widely recognized strategy but also considered other options for enhancing shareholder value such as disaggregating the assets/functions (e.g. generation or telecommunication assets or the retail function) of a newly-acquired vertically integrated utility and either spinning them off or combining them with the assets of other Aquila affiliates.

Q. DOES AQUILA'S TESTIMONY IN THIS CASE OR IN THE SJLP MERGER CASE DESCRIBE ITS VALUE CYCLE PHILOSOPHY AND ITS NETWORK AND MERCHANT STRATEGIES?

A. No. Aquila's testimony makes no mention of its Value Cycle Philosophy in either case. The Company's direct testimony in the merger case only described limited aspects of its network and merchant strategies. Robert Green's testimony in the merger case contained a brief description of Aquila's network and merchant strategies and Steve Pella's testimony in that case discussed the cost reduction and customer care aspects of the network strategies. For a detailed discussion of these strategies and the Value Cycle Philosophy one must review the presentations that Aquila's senior executives have made to investment analysts.

Q. WHY IS IT IMPORTANT TO LEARN MORE ABOUT AQUILA'S VALUE CYCLE PHILOSOPHY AND NETWORK AND MERCHANT STRATEGIES IN ORDER TO DETERMINE WHETHER TO APPROVE AQUILA'S PROPOSAL FOR THE INDIRECT RECOVERY OF SJLP MERGER COSTS IN THIS CASE?

A. Unless the SJLP merger is evaluated within the context of Aquila's guiding philosophy and strategies at the time it chose to merge with SJLP, it is impossible to determine the reasonableness of Aquila's proposal for the indirect recovery of SJLP merger costs in this case. Aquila's guiding philosophy and strategies and the way these strategies have been implemented in the recent past by Aquila shed a substantial amount of light on what motivated Aquila to choose to acquire SJLP.

Aquila stated in its presentations to utility analysts that it may consider selling some of the SJLP generating assets. In the late 1990s, the Company sold a power plant that was part of its West Virginia utility operations. Aquila has broken apart some of the businesses that were a part of its Australian electric utility operations. Aquila has taken advantage of the telecommunications assets that it acquired as part of its Australian electric utility operations and turned them into a profit center. These types of merger synergies and potential windfalls from the sale of low cost generation assets that Aquila anticipated at the time it chose to merger with SJLP must be taken into account when evaluating Aquila's request for the indirect recovery of SJLP merger costs in this case.

Q. YOU STATED THAT AQUILA'S TESTIMONY IN THIS CASE AND THE SJLP MERGER CASE CONTAIN ONLY A BRIEF DESCRIPTION OF ITS MERCHANT AND NETWORK STRATEGIES. WHAT WERE THE MAIN SOURCES OF INFORMATION THAT YOU FOUND ABOUT THESE STRATEGIES?

A. These strategies, along with Aquila's Value Cycle Philosophy, were described in detail in a couple of conference calls that Aquila senior executives held with financial analysts in the first quarter of 2000. On April 15, 2000, Bob Green held a "2000 Conference Call" (the 2000 Call) with Salomon Smith Barney and on February 8, 2000 Rick Green, Bob Green, and Peter Lowe (former Aquila CFO) held a "1999 Year End Conference Call" (the 1999 Call) with investment analysts. The 1999 Aquila Annual Report contains additional information on these concepts. Transcripts of the conference calls were available on Aquila's internet web site in the Presentations section of the Investor Information Area.

D. AQUILA'S NETWORK STRATEGY

Q. PLEASE RETURN TO AQUILA'S NETWORK STRATEGY AND DESCRIBE IT IN DETAIL.

A. Aquila's network strategy was to bring value to its shareholders by investing in energy networks and production assets. This strategy was implemented in Canada, the U.S., New Zealand, and Australia where Aquila has invested in energy networks. In the 2000 Call, Bob Green described recent developments in its network strategy as follows:

> First of all, our network strategy, where we essentially are taking advantage of the trend towards privatization and liberalization of energy markets around the world. We have bought utilities in Australia, New Zealand and Canada outside the U.S. **We've also acquired two distribution assets here in the U.S., St. Joe Power & Light and Empire District. We believe we can significantly enhance the value of those assets by disaggregating, breaking apart some embedded businesses, and repositioning them.** We've done that in Australia. Since 1995, our IRR in terms of that investment is over 30% and what we've done is break out the retail energy business and we will joint venture that with Shell at a value significantly above what we paid for it. **We've built a telecom business leveraging our right-of-way in the power business** and we have built a back office business that handles the settlement and billing for other power markets and generators, other participants in the marketplace. There's an analogy for that business and the telecom business; companies like Saval Systems you might have heard about and Cincinnati Bell has a subsidiary that does this. Most of the large telephone companies don't do their own billing and we believe we can outsource most of that billing to this unregulated entity which will ultimately trade at a much higher multiple. So we believe this international network strategy has the potential to create IRRs well above 20%. In Australia we've achieved 30%, and we will continue to aggressively pursue that in deregulating markets like Australia, New Zealand, Alberta, Ontario, and here domestically, as the states deregulate. (emphasis added).

E. PAST IMPLEMENTATION OF THE NETWORK STRATEGY

Q. HAVE YOU REVEWED AQUILA DOCUMENTS THAT DESCRIBE HOW THE COMPANY HAS APPLIED ITS VALUE CYCLE PHILISOPHY AS IT IMPLEMENTS ITS NETWORK STRATEGY?

A. Yes. In the 1999 Call, Rick Green described the value cycle as follows:

> The other key component of being successful with our mission and vision, on top of taking advantage of open markets, it's to constantly build value. And that is described here in the value cycle. This is a value cycle that you've heard us talk about through the year as to how we invest in opportunities, and immediately they get pushed into optimizing. Whether that means putting our operational template on them, cut costs, enhance revenues, look for emerging opportunities.
>
> Whatever that is, we do that very quickly; **and then you have the option to monetize. Grab that value and push it to the bottom line.** It consistently over time gives you another whole stream of earnings besides your existing business, your operational activities. (emphasis added)
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> This has been going on at Aquila for a number of years, starting back with our cornerstone shareholdings down in New Zealand with WEL. And we were able to position from those initial investments now to one of the larger investments in Aquila and 30% market share in New Zealand. In '95, we moved to Australia, optimizing the value there by taking the electric company, United Energy, public, and realizing that value before the regulators start to take it back away and reset returns, which will happen in January of '01.
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> And currently in '99, we continue this value cycle. The West Virginia sale, for example. We were not interested in that sale just because we got a profit on the assets. It was the strategic relationship we were able to develop with Allegheny, and the long-term gas contract that we got for Aquila, that made that a real good value proposition for us. And the Aries plant, our merchant plant that we're developing in Missouri.
>
> Here again bringing in Calpine as a partner allowed us to monetize and bring some of that value to the bottom line. So the consistent building of value is a very important measure, we think, going forward**. So when you take advantage of opening markets, and when you constantly focus on building value, it gives you a very nice earnings track record, again with the ability to move that up to 8% and even start to talk and focus on 10%.** (emphasis added)

The Aquila 1999 Annual Report also describes the value cycle and gives numerous examples of how it has followed this cycle all the way through to the monetization stage for some of its network investments. As Aquila states in its 1999 Annual Report,

> …"the Value Cycle. We invest, then optimize and monetize.
>
> This means that as we manage properties, whether acquired recently or a long time ago, we are constantly enhancing revenues, cutting costs or applying our operational model to add value. We realize that value by bringing in a partner, asking the public to invest, or developing some other strategic relationship.

Later in its 1999 Annual Report, Aquila gives the following examples of network investments that it has recently or will soon have monetized in order to "realize the appreciated value that we have created":

- Aquila realized a gain on a power plant that it sold in its West Virginia Power service territory and stated that "for us, this was another value cycle opportunity."
- Aquila says it will likely sell part of its United Networks investment in New Zealand as "the next step in the value cycle."
- In January of 2000, Aquila sold a 50% interest in its new combined cycle plant that is currently under construction at Pleasant Hill, Missouri in what it characterizes as another application of its value cycle concept.

The 1999 Call contains more details about the success Aquila has had in executing its value cycle philosophy and monetizing its investment in the Pleasant Hill (Aries) plant where Bob Green states that:

> The Aries plant is another good example. We identified an opportunity to build a 600-megawatt plant. We executed a purchase power agreement with our affiliated network business, got it approved by the Commission. We've already sold half that plant before we have a piece of steel on site, for a value of $34 million more than we'd have to put in it. So we created $34 million of value in a combined cycle plant. We expect that to grow over time. And we've already monetized half of it.

F. NETWORK STRATEGY TELECOM SYNERGIES IN AUSTRALIA

Q. DO YOU HAVE ANY FURTHER COMMENTS ABOUT AQUILA'S NETWORK STRATEGY?

A. Yes, developing telecommunications networks was a big part of Aquila's network strategy. Bob Green emphasized this in the 1999 Call where he stated "as we look at buying network assets, the telecom overlay will be a key part of the value proposition." Mr. Green also indicated in the 1999 Call that Aquila intended to implement its telecom strategy in conjunction with its purchase of the SJLP and Empire network assets.

Q. DID AQUILA EXECUTE ITS TELEPONE STRATEGY IN ANY OF THE PLACES WHERE IT OWNED ENERGY NETWORKS?

A. Yes. In the following passage from the 1999 Call, Bob Green describes the telecom business that Aquila has developed in Australia and its intention to pursue a similar

strategy in Missouri by acquiring SJLP and Empire:

> The biggest upside coming out of Australia is our telecom business, UECom. Some of you might remember a gentleman by the name of Harvey Parker, whom we hired from Telstra, to run United Energy. He left after about a year, but he had initiated a teleco strategy for United. We have refocused that strategy, and it has been quite successful.
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> Today we have about 500 miles of fiber. We're building rings around Melbourne, Sydney and Brisbane. It started out as dark fiber, providing services to the 50 data centers in the United Energy service territory. It has grown from there.
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> We expect to offer voice services this year. And it really is our biggest venture into telecom. And it is a strategy we think we can replicate. We think we can replicate it in a place like Calgary, taking advantage of our power distribution position. We think we can replicate it in Missouri. Empire has 300 miles of fiber. We think we can implement this strategy in the Empire service territory. We think we can implement it in and around Kansas City. And we're developing the business plan and identifying the right partners to make this strategy most successful in these different markets. But as we look at buying network assets, the telecom overlay will be a key part of the value proposition.

> And the business in Australia, just to give you a sense, you've got 500 miles laid; we're only using 30% of the capacity. So in terms of incremental business, there's very little capital cost associated with it, and we expect the EBIT to more than double this year. And it almost tripled in '99. So there is some talk of a potential float of that business. We haven't made any decisions. We're going to look at how we derive the best value in the long run.

In the 2000 Call, Rick Green gives further insights into Aquila's apparent successful implementation of its network and telecom strategies in Australia where he states that "in Australia…[w]e've built a telecom business leveraging our right of way in the power business."

G. AQUILA'S ENERGY MERCHANT STRATEGY

Q. LET'S TURN NOW TO A DISCUSSION OF AQUILA'S MERCHANT STRATEGY. PLEASE EXPAIN THIS STRATEGY.

A. Aquila's merchant strategy was intended to bring value to its shareholders by becoming a leading energy merchant in wholesale gas and electric markets. This strategy was primarily focused in the U.S. where Aquila became one of the leading marketers of gas and electricity and Aquila had also begun pursuing this strategy more aggressively in Europe. Aquila's 1999 Annual Report stresses the importance of Aquila's recent initiative to acquire mid-stream assets such as power plants and gas storage facilities to give it the resources that it needed to support its trading business as the wholesale energy market became more competitive. Aquila's investment in the Pleasant Hill plant fit in with this initiative. The acquisition of SJLP's low cost generating assets was also be expected to be useful in supporting this initiative in the future once the expected restructuring of Missouri electric markets took place.

Q. DID ROBERT GREEN COMMENT ON AQUILA'S MERCHANT STRATEGY IN HIS DIRECT TESTIMONY IN THE SJLP MERGER CASE?

A. Yes, on page 4 of his testimony, he stated that:

> our focus on domestic acquisitions has become basically two fold: first, we are interested in utilities that are in the mid-continent region where we currently own and operate utilities and have the platform to realize economies of scale, and second, we are interested in assets that enhance our ability to become a leading energy merchant such as the Katy Storage facility in Texas and the electric combined cycle generation plant now under construction in Cass County, Missouri by Aquila's Aquila Merchant Energy Partner business.

From Mr. Green's statement, its apparent that SJLP's low cost generating assets could easily become a part of Aquila's merchant strategy, if retail generation markets are deregulated in Missouri. Of course, the expectations of whether and when retail generation markets may be deregulated in Missouri have changed substantially since the time that Aquila decided to acquire SJLP.

H. AQUILA'S GROWTH STRATEGY

Q. HAVE YOU REVIEWED OTHER DOCUMENTS THAT SHOW AQUILA'S FORMER STRATEGIES FOR GROWING ITS EARNINGS AS THE ENERGY INDUSTRY IN THE U.S. AND WORLD WIDE CONTINUED TO EVOLVE?

A. Yes. There is one other document that I would like to describe and comment on before turning to a discussion of how Aquila's growth and "value cycle" strategies apply to its acquisition of SJLP. The other document that I will discuss is attached to this testimony as Attachment 2. This document was introduced as Exhibit 204 HC in the Aquila/Empire merger hearing (Case. No. EM-00-369). This document is entitled UtiliCorp United Strategic Plan, 1996 – 2000, Corporate Development (UtiliCorp 1996 – 2000 Strategic Plan). I believe this document is important to bring to the Commission's attention because it covers the time frame of the SJLP merger and because it acknowledges that **____

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Q. PLEASE REVIEW THOSE ASPECTS OF UTILICORP 1996 – 2000 STRATEGIC PLAN THAT ARE RELEVANT TO AQUILA'S REQUEST FOR INDIRECT RECOVERY OF SJLP MERGER COSTS.

A. **

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IV. RELATIONSHIP BETWEEN FORMER AQUILA CORPORATE STRATEGIES, THE SJLP ACQUISITION, AND MERGER COST RECOVERY IN RATES

A. OVERVIEW

Q. PLEASE EXPLAIN WHY YOU BELIEVE IT IS VERY IMPORTANT FOR THE COMMISSION TO CONSIDER AQUILA'S CORPORATE STRATEGIES AND THE SPECIFIC CHARACTERISTICS OF SJLP WHEN DECIDING WHETHER TO APPROVE AQUILA'S PROPOSAL FOR THE INDIRECT RECOVERY OF ITS SJLP MERGER COSTS.

A. When the Commission considers the Aquila proposal for the indirect recovery of its SJLP merger costs, it should be cognizant of potential shareholder benefits that Aquila expected would be brought about by the opportunities that this merger would give to Aquila for bringing non-regulated earnings directly to its bottom line. At the time Aquila decided to proceed with the SJLP merger, the Company believed these opportunities existed in many areas, almost none of which were acknowledged by Aquila in its merger application. The closest that Aquila came to acknowledging these shareholder benefits in any of its filings in the merger case was the statement on page six of its application that "the merger will strengthen the competitive position of Aquila, including its MPS and SJLP operations, not only in Missouri, but also in the surrounding region in the Midwest."

Aquila chose to merge with SJLP for a number of factors. Many of these factors are related to Aquila's value cycle philosophy, network strategy, and merchant strategy that were described earlier in this testimony. SJLP had characteristics that made it an attractive candidate for use in the pursuit of these strategies. These characteristics included, its proximity to Aquila's other Missouri service territories (providing transmission and off-system sales synergies), its low cost generating supplies, and its telecommunications assets.

B. SJLP'S LOW COST GENERATING PORTFOLIO

Q. WHAT MATERIALS HAVE YOU REVIEWED THAT ILLUSTRATE AQUILA'S APPRECIATION OF THE VALUE OF THE LOW COST GENERATING ASSETS THAT SJLP EITHER OWNED OR TO WHICH IT HAD ACCESS?

A. Aquila has acknowledged the value in the SJLP low cost generation assets that it obtained through the merger in: its 1999 Annual Report, in presentations to investment analysts, and internal documents that analyzed the benefits of a potential acquisition of SJLP. In its 1999 Annual Report, Aquila stated that:

> Empire District and Light and Power, among the longest operating [sic] in Missouri, also bring low cost generation assets and cost-effective distribution operations.

In the "1999 Year End Conference Call" (the 1999 Call) with investment analysts, Bob Green stated:

> But take a look at the mid-continent footprint that we're building on the network side of the business. With the St. Joe and the Empire acquisition, we've brought together some very attractive low-cost generation assets, and we have added some contiguous distribution networks that afford us a significant opportunity for synergies and efficiencies. 75% of those benefits are going to come from the supply side.

Presentations at two Aquila Board of Directors (BOD) meetings that took place shortly before Aquila presented its final bid to SJLP included comments about SJLP's generating assets. The presentation at the 2/3/99 BOD meeting noted that SJLP is **____**

Q. HAVE YOU REVIEWED ANY MATERIALS THAT HAVE QUANTIFIED THE VALUE OF SJLP'S LOW COST GENERATING SUPPLIES EITHER IN TERMS OF MARKET VALUE, OR IN TERMS OF ITS POTENTIAL CONTRIBUTION TO NON-REGULATED EARNINGS STREAMS, IF GENERATION IS DEREGULATED AT THE RETAIL LEVEL IN MISSOURI?

A. **____

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Attachment 3).

Q. IS THERE A GENERALLY ACCEPTED APPROACH TO DETERMINING THE MARKET VALUE OF GENERATION ASSETS?

A. Yes. The market value is generally determined by calculating the contribution to annual earnings that each generating plant is expected to make over the life of the plant and then discounting this stream of future annual earnings to determine the present value of the earnings stream. **______________________________ *

Q. PLEASE DISCUSS IN MORE DETAIL THE **______________________________ ANALYSIS AND THE CONCLUSIONS THAT WERE DRAWN, BASED ON THAT ANALYSIS.**

A. **______________________________

- ______________________________
- ______________________________

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- ______________________________
- ______________________________
- ______________________________
- ______________________________**

C. GENERATIION SUPPLY SYNERGIES

Q. DID AQUILA'S MISSOURI PSC SJLP MERGER FILING DESCRIBE THE VALUE THAT THE COMPANY EXPECTED ITS SHAREHOLDERS TO RECEIVE IN THE FUTURE FROM ACQUIRING SJLP'S LOW COST GENERATION ASSETS?

A. No. The Company did, however, **______________________________**

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D. AQUILA'S EXPECTED OPTIONS TO DERIVE NON-REGULATED EARNINGS FROM SJLP'S LOW COST GENERATING PORTFOLIO

Q. DID AQUILA'S TESTIMONY IN THE SJLP MERGER CASE OR ITS RESPONSES TO DATA REQUESTS IN THAT CASE DESCRIBE ITS POTENTIAL TO ACHIVE SYNERGIES THAT WOULD ACCRUE SOLEY TO THE BENEFIT OF ITS SHAREHOLDERS?

A. No. Its testimony was completely silent with respect to this issue. Its responses to data requests specifically on this issue (Staff DR Nos. 152 and 228) stated that Aquila has not performed any studies of the potential for merger synergies in the non-regulated area. The Company's response to DR No. 152 even implies that Aquila has not observed any potential for merger synergies in the non-regulated area.

Q. DO YOU BELIEVE THESE DR RESPONSES WERE ACCURATE?

A. No. I don't believe Aquila's response was accurate when it stated that no analysis has been performed by or on behalf of Aquila that contains "estimates of merger savings/synergies applicable to non-regulated business operations after a combination." I also do not believe that Aquila's response to sub-part 3 of Staff DR No. 152 was accurate when it implied that Aquila has not observed any potential for merger synergies in the non-regulated area.

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Q. HAVE YOU REVIEWED ANY ANALYSIS OTHER THAN THAT CONTAINED IN THE **______ ____________________ WHICH INDICATES THAT AQUILA IS CONSIDERING OPTIONS FOR DERIVING NON-REGULATED SYNERGIES FROM SJLP'S LOW COST GENERATING PORTFILIO?**

A. Yes. The discussion earlier in this testimony where I describe Aquila's Value Cycle Philosophy and its Network and Merchant strategies shows how Aquila's strategic intent regarding investments like the Company's acquisition of SJLP may be applied to SJLP in the future. In fact, both the 1999 Call and the 2000 Call that were discussed earlier contain specific statements regarding future options that Aquila may pursue with its SJLP investment and explains how those options fit into the Company's Value Cycle Philosophy and its Network and Merchant strategies.

Q. PLEASE QUOTE THE SPECIFIC STATEMENTS REGARDING FUTURE OPTIONS THAT AQUILA MAY PURSUE WITH ITS SJLP INVESTMENT THAT WERE MADE IN THE 1999 AND 2000 CALLS AND PROVIDE ANY NECESSARY EXPLANATIONS.

A. In the 2000 Call, Bob Green makes the following statement:

> First of all, our network strategy, where we essentially are taking advantage of the trend towards privatization and liberalization of energy markets around the world. We have bought utilities in Australia, New Zealand and Canada outside the U.S. **We've also acquired two distribution assets here in the U.S., St. Joe Power & Light and Empire District. We believe we can significantly enhance the value of those assets by disaggregating, breaking apart some embedded businesses, and repositioning them.** We've done that in Australia. Since 1995, our IRR in terms of that investment is over 30% and what we've done is break out the retail energy business and we will joint venture that with Shell at a value significantly above what we paid for it. We've built

> a telecom business leveraging our right-of-way in the power business…(emphasis added)

In the 2000 Call, Bob Green makes the following statement:

> But take a look at the mid-continent footprint that we're building on the network side of the business. With the St. Joe and the Empire acquisition, we've brought together some very attractive low-cost generation assets, and we have added some contiguous distribution networks that afford us a significant opportunity for synergies and efficiencies. 75% of those benefits are going to come from the supply side.
>
> **And over time, we will look to restructure the supply-side assets and potentially take them out of rate base and provide more of an upside. It might be that the easiest path is to sell some of those assets** so we can establish a market value and avoid a stranded cost to base with the regulator; and then redeploy that capital strategically on the energy grid in other generation assets or other growth investments. (emphasis added)
>
> **And again, this just highlights the service territories that we've acquired with St. Joe and Empire.**

It seems quite clear from the above statements by the most senior Aquila witness in the SJLP merger case, that Aquila was considering the full range of options, including the sale (monetization) of some of its soon to be acquired SJLP generating assets, in order to bring significant unregulated earnings to the bottom line for its shareholders.

Q. HAVE YOU SEEN ANY INFORMATION SUBSEQUENT TO THE COMPLETION OF THE SJLP MERGER THAT INDICATES AQUILA ANTICIPATED TREATING ITS SJLP INVESTMENT JUST LIKE ANY OTHER INVESTMENT THAT IS SUBJECT TO THE VALUE CYCLE PHILOSOPHY OF AQUILA?

A. Yes, Aquila's President and Chief Operating Officer, Robert Green made the following statement in a presentation to the Edison Electric Institute (EEI) Financial Conference on October 30, 2001:

> **We have talked about the value cycle and as we invest in assets on the energy grid or energy infrastructure we don't have a buy and hold mentality like a traditional utility, we have a shareholder**

> **mentality.** We have a capability to manage, rationalize, optimize these investments. And as we do, we harvest the capital and re-deploy it. And by doing so we've been able to drive significantly higher returns, because once we've optimized the assets, the distribution asset in particular, a network asset the upside is limited. So we look to monetize the asset and invest in another asset where we see greater upside. We did that in Australia with the float of United Energy at a value significantly above what we paid for the asset, I think we bought that asset for $1.1 billion U.S. and we floated it at $2 billion. So that's the kind of upside that we try to realize. And you've probably heard about our latest investment in the U.K. in the form of Midlands, again it is the same strategy that we developed in Australia, executed in New Zealand, executed in Canada, and now will execute in the U.K. and on the continent as we find assets that we believe we can, um, a significant opportunity to optimize it and then monetize that value. (emphasis added)

The above quote from one of Aquila's senior executives shows that this Company's strategy towards making investments that can contribute to non-regulated earnings through execution of its "value cycle" strategy was still in place in late 2001, after the SJLP merger was completed. One of the slides (See Attachment 6) that accompanied Mr. Green's presentation at the EEI Financial Conference specifically identified SJLP as one of the recent investments to which Aquila is applying its "value cycle philosophy."

E. AQUILA'S EXPECTED NON-REGULATED EARNINGS IN THE TELECOM/CABLE TV AREA

Q. EARLIER IN THIS TESTIMONY, WHEN YOU WERE DISCUSSING AQUILA'S VALUE CYCLE PHILOSOPHY, NETWORK STRATEGY, AND MERCHANT STRATEGY, YOU DISCUSSED THE RELATIONSHIP BETWEEN THE COMPANY'S NETWORK STRATEGY AND ITS TELECOMMUNICATIONS AND CABLE TV INITIATIVES. HOW DID AQUILA PERCEIVE A LINK BETWEEN THE TWO?

A. Bob Green described this link in the 1999 Call where he stated "as we look at buying network assets, the telecom overlay will be a key part of the value proposition" and in the

2000 Call where he stated "we've built a telecom business leveraging our right-of-way in the power business."

Q. HAVE YOU SEEN ANY INFORMATION THAT PROVIDES AN ADDITITIONAL INDICATION THAT THE "TELECOM OVERLAY" WAS PART OF WHAT MOTIVATED AQUILA TO ACQUIRE SJLP?

A. Yes, a number of the statements made by Aquila's senior management indicate that the non-regulated synergies associated with the SJLP merger were a major factor in deciding to pay the premiums necessary to acquire SJLP. I'll start with the comments that Bob Green made in the 2000 Call where he stated that:

> Second, in terms of a near-term upside is our telecom business that's emerging first in Australia. We expect to float a telecom business at a valuation close to the initial investment value in United Energy, the power company we bought back in 1995. We think that should have a big impact on Aquila's share price. **As well, we are aggressively pursing that telecom strategy here domestically**. (Emphasis added)

A significant amount of additional detail about Aquila's domestic telecom strategy was revealed by Bob Green in the 1999 call where he made the following statements:

> The biggest upside coming out of Australia is our telecom business, Secom. Some of you might remember a gentleman by the name of Harvey Parker, whom we hired from Telstra, to run United Energy. He left after about a year, but he had initiated a telecom strategy for United. We have refocused that strategy, and it has been quite successful.
>
> Today we have about 500 miles of fiber. We're building rings around Melbourne, Sydney and Brisbane. It started out as dark fiber, providing services to the 50 data centers in the United Energy service territory. It has grown from there.
>
> We expect to offer voice services this year. And it really is our biggest venture into telecom. And it is a strategy we think we can replicate. We think we can replicate it in a place like Calgary, taking advantage of our power distribution position. **We think we can replicate it in Missouri.** Empire has 300 miles of fiber. (Emphasis added)
>
> We think we can implement this strategy in the Empire service territory. **We think we can implement it in and around Kansas City. And**

> **we're developing the business plan and identifying the right partners to make this strategy most successful in these different markets. But as we look at buying network assets, the telecom overlay will be a key part of the value proposition.** (Emphasis added)
>
> …
>
> We will continue to pursue this telecom strategy that has emerged out of Australia. **There is significant potential with the assets we're acquiring at Empire and St. Joe to create an Australian-like telecom play in the mid-continent.** (Emphasis added)
>
> **And as I said, we've got I think 300 miles of fiber at Empire, and a significant business at St. Jo that we think we can build, based on our Australian experience, into a real growth vehicle for Aquila.** (Emphasis added)
>
> …
>
> Q: [Investment analyst] I was wondering if you could ballpark for us the level of investments you're looking at making in telecom over the next two to three years. And then also maybe you could provide us a little bit more detail on the New Zealand and Australia regulatory processes and how you see yourselves coming out.
>
> A. [Bob Green] In terms of telecom, just to give you an idea, in Australia, Peter, I think we've invested like $15 million? And we've got a valuation of $300 million. So it's not capital-intensive, and we're only using 30% of the capacity. So as we look at what we might do in Calgary – I mean, **I think that would be an example and then as we look at what we might do with the assets we've acquired through Empire and St. Joe, the capital expenditure is not big.** (Emphasis added)
>
> **I mean, in St. Joe I think we're looking at putting $4 million into the business to fund their expansion.** (Emphasis added)

Q. WHAT KIND OF TELECOM ASSETS DID AQUILA AND SJLP POSSESS AT THE TIME OF THE SJLP MERGER THAT COULD HAVE BEEN LEVERAGED TO CREATE NON-REGULATED SYNERGIES?

A. At the time of the SJLP merger, Aquila had recently invested in two telecommunications companies near Kansas City and the SJLP service territory. Of course, Aquila already possessed its own right of way and fiber loops that it had installed for internal communications purposes. In Aquila's 1999 Annual Report, the Company stated that SJLP is already in the "telecommunications, data networks" business.

V. SUMMARY OF PUBLIC COUNSEL'S POSITION REGARDING AQUILA'S REQUEST FOR THE INDIRECT RECOVERY OF SJLP MERGER COSTS VIA ITS MERGER SAVINGS RETENTION PROPOSAL

Q. PLEASE SUMMARIZE OPC'S POSITION REGARDING AQUILA'S REQUEST FOR THE INDIRECT RECOVERY OF SJLP MERGER COSTS.

A. Aquila's request that this Commission include non-existent costs in the Company's cost of service because the Company asserts that "the [SJLP] acquisition ultimately needs to provide shareholder benefits in order to be successful" should be denied. Aquila freely chose to enter into a merger agreement with SJLP. Consumers were never consulted about their views on this merger. The merger applicants were less than forthcoming in their testimony in the SJLP merger case where they failed to acknowledge the non-regulated synergies that the Company expected to result from the merger. A large portion of the expected synergies were in the generation area and, at the time of the merger, almost any conceivable restructuring legislation in Missouri was expected to transfer the benefits from all of these generation synergies to Aquila. Such legislation was widely expected by most industry observers, including Aquila officials, at the time the Company decided to pursue a merger with SJLP. The management and Board of Directors of Aquila chose to merge with SJLP because of a broad range of non-regulated benefits that were expected to result from the merger: These expected non-regulated benefits included:

- Reducing the prospect of cut-throat competition in regional energy markets by keeping low cost generation assets out of the hands of its local competitors.

- Obtaining a lower cost structure for the generation portion of Aquila's regulated operations. All benefits of these reduced costs were expected to flow through to shareholders if, as expected, retail wheeling was allowed and generation prices were no longer regulated at the retail level in Missouri.

- Increased market power in wholesale and retail generation markets would enhance Aquila's future earnings.

- Revenue enhancements resulting from synergies between the unregulated operations of SJLP and Aquila and between the unregulated and regulated operations of SJLP and Aquila. Aquila's investments in Missouri telecommunications firms is an example of an attempt to facilitate achieving this type of synergy.

- Cost reductions resulting from synergies between the unregulated and regulated operations of SJLP and Aquila.

If Aquila's proposal to include a non-existent costs in its cost of service for the purpose of indirectly recovering merger costs ever made sense, it was prior to the time when utilities began diversifying into areas beyond their regulated public utility businesses. For Aquila, that time has long since passed. Utility mergers in the 1990s were not prompted by a utility's desire to minimize the cost of providing regulated service; if this was the motivation, the mergers would have been proposed decades ago. To the contrary, these mergers were prompted by the desires of utility managers to pursue non-regulated earnings opportunities in areas such as: non-regulated generation service, facilities based telecommunications services, and other value added services. Aquila cited its earnings potential in these non-regulated areas when it explained the motivation for the merger to its shareholders. It would be an extreme injustice to see SJLP merger costs included indirectly in rates (under the guise of retaining merger savings) when

Aquila made the decision to incur merger costs (including the acquisition premium) to acquire SJLP not for the purpose of lowering costs for ratepayers, but because it believed the SJLP merger would lead to handsome returns for shareholders from non-regulated business opportunities.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. YES.

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