

*Exhibit No.:*  
*Issues:* Gas Prices/SERP  
Transition Costs  
*Witness:* Charles R. Hyneman  
*Sponsoring Party:* MoPSC Staff  
*Type of Exhibit:* Surrebuttal Testimony  
*Case No:* ER-2005-0436  
*Date Testimony Prepared:* December 13, 2005

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

**SURREBUTTAL TESTIMONY**

**OF**

**CHARLES R. HYNEMAN**

**AQUILA, INC. d/b/a AQUILA NETWORKS-MPS  
AND AQUILA NETWORKS – L&P**

**CASE NO. ER-2005-0436**

*Jefferson City, Missouri  
December 2005*

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

**NP**

**BEFORE THE PUBLIC SERVICE COMMISSION**

**OF THE STATE OF MISSOURI**

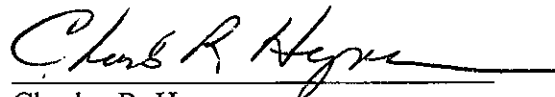
In the Matter of the Tariff Filing of Aquila, Inc.,     )  
to Implement a General Rate Increase for             )  
Retail Electric Service Provided to Customers        )  
in Its MPS and L&P Missouri Service Areas.         )

Case No. ER-2005-0436  
Tariff No. YE-2005-1045

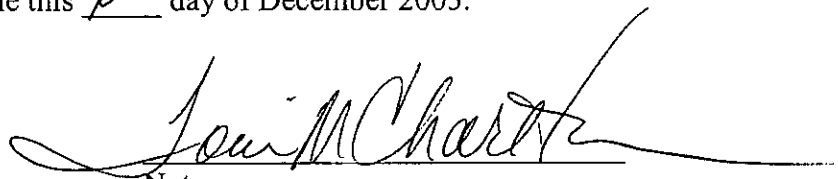
**AFFIDAVIT OF CHARLES R. HYNEMAN**

STATE OF MISSOURI     )  
                                      )  
COUNTY OF COLE     )     ss.

Charles R. Hyneman, being of lawful age, on his oath states: that he has participated in the preparation of the following Surrebuttal Testimony in question and answer form, consisting of 24 pages to be presented in the above case; that the answers in the following Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

  
Charles R. Hyneman

Subscribed and sworn to before me this 22<sup>nd</sup> day of December 2005.

  
Notary



TONI M. CHARLTON  
Notary Public - State of Missouri  
My Commission Expires December 28, 2008  
Cole County  
Commission #04474301

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**and AQUILA NETWORKS - L&P**  
**CASE NO. ER-2005-0436**

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1 the Office of Public Counsel witness Ted Robertson and AARP witness David J. Effron  
2 rebuttal testimonies on the issue of rate recovery of Aquila's merger transition costs.

3 **NATURAL GAS COSTS**

4 Q. Have you reviewed the rebuttal testimony of Aquila witness Andrew N. Korte  
5 on the subject of cost of natural gas?

6 A. Yes, I have.

7 Q. Do you agree with Mr. Korte's rebuttal comments on the issue of natural gas  
8 prices?

9 A. No. Mr. Korte argues that Staff's current method to develop natural gas  
10 prices in this case is inconsistent with the method he believes was used in Aquila's last rate  
11 case No. ER-2004-0034. He accuses the Staff of introducing bias into the production cost  
12 fuel model by using Aquila's actual prices at a historically low-cost month. Finally, he states  
13 that the Staff's selection of June 2005 as the basis for its natural gas price recommendation is  
14 arbitrary. Mr. Korte describes Aquila's NYMEX futures method in developing its natural  
15 gas prices in this case as a "comprehensive method" that provides a "more complete view of  
16 the actual marketplace."

17 Q. Do you agree that Aquila's method to determine natural gas is a  
18 "comprehensive method" that results in a "more complete view of the actual marketplace?"

19 A. No. Aquila's "NYMEX futures" method completely ignores the "actual"  
20 marketplace where it purchases its natural gas.

21 Q. What level of natural gas prices is the Staff proposing in this case?

22 A. As described in my direct testimony, the Staff is proposing an interim energy  
23 charge (IEC) with a range of natural gas prices. For the purpose of its direct filing, the Staff

1 used Aquila's actual natural gas costs incurred in June, 2005, which is approximately  
2 \*\* \_\_\_\_\_ \*\*. The individual costs for each of Aquila's natural gas burning generation  
3 units are listed on page 8 of my direct testimony.

4 The Staff has not proposed a recommended range of gas prices to include in an IEC.  
5 The Staff believed at the time it filed its direct testimony, as it still believes today, that the  
6 parties to this case will have an opportunity to negotiate an IEC in this case that will include  
7 a range of natural gas prices.

8 Q. On what type of measurement is natural gas priced?

9 A. Natural gas is often referenced on a Mcf or MMBtu basis. An Mcf measures  
10 only the volume of gas. In contrast, an MMBtu (one million British thermal units) takes into  
11 account the heating value of the gas. One MMBtu is approximately the same as one Mcf.  
12 For the remainder of this testimony, all references to natural gas prices will be on a per  
13 MMBtu basis.

14 Q. How did Staff develop its natural gas prices in this case?

15 A. Staff examined the Company's actual monthly natural gas purchases for  
16 volumes and prices, by generating unit, for the past several years. The purchases were  
17 segregated into commodity and transportation costs. The transportation costs were further  
18 broken out between the fixed and variable components.

19 In addition to analyzing Aquila's actual natural gas costs, the Staff also reviewed the  
20 actual results of Aquila's natural gas hedging program in its determination of its proposed  
21 level of natural gas prices to include in this case. As shown on Schedule 5 to this testimony,  
22 Aquila's natural gas hedging program has significantly reduced its cost of natural gas over  
23 the last few months.

1           Finally, in addition to analyzing Aquila's actual cost of natural gas and the results of  
2           its hedging program, the Staff also reviewed the comments and analysis of several industry  
3           experts on the current and projected natural gas market. The Staff reviewed some of the  
4           leading industry publications that describe conditions in the natural gas market and also  
5           predict price movements based on a variety of factors.

6           Q.     Why did Staff use the month of June to determine its natural gas prices  
7           proposed in this case?

8           A.     The last month of the update period through June 30, 2005 represented a  
9           rising natural gas market. By reflecting this latest month in its development of natural gas  
10          pricing Staff gave consideration to increased costs while at the same time maintaining  
11          consistency between all other components of Aquila's cost structure and revenue levels.

12          Since natural gas costs have risen dramatically over much of 2005, June levels were  
13          used to capture the increased costs based on actual amounts paid by Aquila.

14          Q.     How did Aquila develop its natural gas prices in this case?

15          A.     Aquila used a 30-day average of the 2006 NYMEX Strip. This 30-day period  
16          was from October 1, 2004 through December 31, 2004. This method and the list of monthly  
17          2006 futures average prices is reflected on Schedule JGB-2 to Aquila witness Jerry G.  
18          Boehm's direct testimony.

19          Q.     Is the Staff's proposed level of natural gas prices higher than the level Aquila  
20          is proposing in this case?

21          A.     Yes. Staff is proposing a \*\* \_\_ \*\* commodity cost of natural gas compared to  
22          Aquila's proposed \$6.57 commodity cost identified at page 11, line 16 of Mr. Boehm's direct  
23          testimony. However, Aquila is actually proposing a \$6.17 natural gas price in this case.

1           Q.     Why is there a difference between the \$6.57 price and the \$6.17 price you  
2 provided in the previous answer?

3           A.     In Schedule JGB-2 Mr. Boehm lists Aquila's proposed monthly gas prices for  
4 all of its natural gas burning units. These prices are based on a three-month average of the  
5 2006 NYMEX futures strip. Since NYMEX prices are based on taking delivery at the Sabine  
6 Pipeline Hub at Henry, Louisiana (Henry Hub), Aquila has to make an adjustment to the  
7 NYMEX futures prices to estimate what the cost of gas would be at the location where it  
8 purchases its natural gas. Aquila purchases most of its gas from the mid-continent region  
9 (Oklahoma and Texas). The cost of natural gas in the mid-continent region has historically  
10 been lower than the cost of natural gas at the Henry Hub.

11           This difference in cost is referred to as a location basis difference and has averaged  
12 \$.48 per MMBtu over the six months ended July 2005. With the recent hurricane activity in  
13 the Gulf region in August and September 2005, it was not unusual for this basis difference to  
14 be in the \$2 to \$3 range. Aquila is proposing a \$.40 per MMBtu location basis difference.  
15 Subtracting this \$.40 from the \$6.57 amount listed on page 11, line 16 of Mr. Boehm's direct  
16 testimony leaves Aquila's proposed net commodity cost of \$6.17.

17           Q.     Is the Staff's proposed level of natural gas prices based on actual costs of  
18 natural gas incurred by Aquila?

19           A.     Yes. The Staff did an analysis of Aquila's actual natural gas commodity cost  
20 over the last several years for each of Aquila's natural gas burning power plants. The  
21 \*\* \_\_ \*\* level being proposed by the Staff represents Aquila's actual paid cost of natural gas  
22 in June 2005, the end of the Commission-ordered updated test year in this case. While the  
23 June, 2005 actual price was used, this price was evaluated for reasonableness based on the



1 results of Aquila's gas hedging program and also based on consideration given to comments  
2 and evaluations provided by experts in the natural gas market.

3 Q. Is the Staff proposing to update its recommendation on natural gas prices to a  
4 more recent period?

5 A. Yes. As I stated at page 7 of my direct testimony, the Staff will evaluate the  
6 recent extreme volatility in the energy market and will address this issue and Aquila's post-  
7 June 2005 natural gas costs in the true-up audit of this case.

8 Q. What level of natural gas will Staff be recommending in the true-up?

9 A. Staff has not made that determination at this time. A review of Aquila's  
10 actual costs through the October 31, 2005 true-up date will be made during the Staff's true-  
11 up audit. At that time, a determination as to what the best price should be will be  
12 recommended in context of the Staff's true-up revenue requirement recommendation. The  
13 Staff will re-examine the costs, giving serious consideration to the impact of the recent  
14 hurricanes in the Gulf region on the cost of natural gas to Aquila in the months since June  
15 2005. However, as stated earlier, it is hoped that an IEC price range for natural gas will be  
16 negotiated and agreed to by the parties to this case.

17 Q. Will Staff use the last month of the true-up, October 2005, to determine the  
18 appropriate natural gas price to use in the fuel calculation as it did for the updated test year  
19 period?

20 A. A review, similar to one made for the direct case will be made and will  
21 examine the natural gas costs at the end of the true-up period and all months subsequent to  
22 the updated test year period ending June 30, 2005. Careful consideration must be given to  
23 the entire energy market because of the historic hurricane season just completed and the

1 effect that the extraordinary impacts that weather conditions had on energy prices. The Staff  
2 has not yet examined all the circumstances surrounding the prices Aquila paid for natural gas  
3 since June 2005. For example, while Aquila's natural gas costs have increased since June  
4 2005, so have its gains from its natural gas hedging operations. This is a factor that the Staff  
5 will include in its analysis when it develops its true-up recommendation for natural gas  
6 prices. In addition, the Staff will attempt to obtain all available projections by industry  
7 experts to include in its consideration as to the appropriate level of natural gas prices to  
8 recommend in the true-up audit. Finally, the Staff will need to examine the short-term  
9 impact of the recent hurricane activity on Aquila's actual gas costs subsequent to June 2005.

10 Q. You described how the Staff is proposing a level of natural gas prices that is  
11 based on Aquila's actual costs. Is Aquila's proposed level of natural gas prices related to  
12 actual dollars it pays to its natural gas suppliers to purchase natural gas?

13 A. No. Aquila's proposal only includes an average of NYMEX futures prices for  
14 2006 (NYMEX strip prices). A strip is simply an average of consecutive months' prices for a  
15 given time period. For example, a NYMEX 12-month strip price quoted on a certain day  
16 would be based on the previous session's average closing price for twelve consecutive  
17 months of NYMEX futures contracts. There is no relationship between Aquila's NYMEX  
18 futures natural gas prices and the actual natural gas costs incurred by Aquila. This is the  
19 main reason why the Staff believes Aquila's "market driven" methodology is not appropriate  
20 for setting rates in this case.

21 Staff witness Kwang Y. Choe, also addresses this issue in his rebuttal testimony in  
22 this case and explains why NYMEX futures prices is not a reliable forecasting tool and  
23 should not be used for ratemaking purposes.

1 Q. Why doesn't Aquila use actual natural gas prices as the basis for its proposal?

2 A. It appears that the use of actual costs would not be consistent with Aquila's  
3 approach to how it develops inputs to its fuel and purchase power production cost model.

4 Q. Please explain.

5 A. Aquila explains this philosophy to some extent in its response to Staff  
6 questions 1 and 2 of Data Request No. 484:

7 Q) Has Aquila performed any analysis using Aquila's historical gas  
8 prices as an input to the MIDAS model to determine what the spot  
9 purchased power prices would be and then compared those prices to  
10 Aquila's historical spot purchased power prices? If yes, please explain  
11 the analysis done and provide the results of this analysis. If no, please  
12 explain why Aquila believes this analysis is not necessary.

13 A) No. The MIDAS Gold™ model needs to use market gas prices that  
14 would be available to all market generators across the Eastern  
15 Interconnect.

16 Substituting the cost structure of an individual company for the  
17 collective price developed in the natural gas market would lead to an  
18 incorrect result.

19 Q) Has Aquila performed any analysis comparing Aquila's historical  
20 actual spot purchased power prices to Aquila's historical actual natural  
21 gas prices? If yes, please explain the analysis done and provide the  
22 results of this analysis. If no, please explain why Aquila believes this  
23 analysis is not necessary.

24 A) No. As stated in the answer to part 1), Aquila's costs would not  
25 represent a market price that all market participants would be able to  
26 transact.

27 As Aquila states above, it believes that substituting Aquila's actual costs into its  
28 model would lead to an incorrect result, or an incorrect estimated cost of purchase power.

29 Q. Does the Staff agree that using natural gas prices determined in a commodity  
30 futures market is a reasonable basis for setting electricity utility rates in Missouri?

1           A.     No. While Aquila's theoretical model may work well in economic theory in  
2 an academic environment, for budget development and possibly even for long-term capacity  
3 planning, it does not work well for setting utility rates.

4           Q.     Please explain.

5           A.     Utility rates in Missouri have been based, to the greatest extent possible, on  
6 actual costs incurred by a utility. Aquila must be able to justify an increase in utility rates by  
7 showing that the increase is caused by actual increases in its costs. It is unreasonable to use  
8 some academic model to predict what prices will be when actual costs are available and  
9 should be used. This is exactly what Aquila is doing in its proposal to use a commodity  
10 futures prices to set rates in Missouri. The Commission should seriously question any  
11 attempt to set utility rates in Missouri on any basis or methodology that does not consider  
12 actual costs as a basis.

13          Q.     Did Aquila update its proposed level of natural gas prices in its rebuttal filing  
14 in this case?

15          A.     No, it did not. Through discussions with Company personnel the Staff was  
16 under the impression that Aquila was going to update its proposed level of natural gas prices  
17 using the same methodology it used in its direct filing but excluding the impact of the  
18 hurricanes in the Gulf region that occurred this summer. However, Aquila did not do so in  
19 its rebuttal filing. However, in response to Staff Data Request No. 495, Aquila recently  
20 provided its updated natural gas prices. In its response to this data request, Aquila stated that  
21 its updated prices are based on averaging three month of NYMEX prices ending August 31,  
22 2005 (pre-Katrina). This update reflects an increase in Aquila's natural gas price from \$6.17  
23 to \$8.02.

1 Q. Earlier you mentioned that the Staff reviewed the results of Aquila's hedging  
2 program in its consideration of its recommended level of natural gas prices. What impact has  
3 Aquila's natural gas hedging program had on its actual natural gas costs?

4 A. During the months when Aquila experienced significant increases in its  
5 natural gas costs, Aquila's natural gas hedging program has significantly reduced its cost of  
6 natural gas. For example, in response to Staff Data Request No. 269.1, Aquila provided  
7 documents that show it realized a gain of \*\* \_\_\_\_\_ \*\* from its natural gas hedges.  
8 Most of this gain was realized in the months of September through November 2005 when the  
9 prices of natural gas increased sharply primarily as a result of the unprecedented hurricane  
10 activity in the Gulf region.

11 Attached as Schedule 5 to this testimony is an analysis showing Aquila's pre-hedged  
12 and post-hedged natural gas costs. Aquila's pre-hedged natural gas costs through November  
13 2005 was \*\* \_\_\_\_\_ \*\* and its post-hedged price through November 2005 was \*\* \_\_\_\_\_ \*\*.   
14 The Staff took Aquila's post-hedged prices into consideration in its recommendation of the  
15 appropriate level of gas prices in this case.

16 Q. At page 12 of his rebuttal testimony, Mr. Korte appears to criticize the Staff  
17 for using different methods to calculate a level of natural gas prices to include in rates in  
18 Aquila's last rate case ER-2004-0034 ("2004 rate case") and in this rate case. Is Mr. Korte's  
19 criticism valid?

20 A. No. In the 2004 rate case the Staff used an average of actual incurred gas  
21 costs. In this case, the Staff is using the latest known actual natural gas costs consistent with  
22 updates made to the test year through June 30, 2005, and after consideration of other factors.  
23 The Staff has responded to changes in the natural gas market (as noted by Mr. Korte at page

1 12, lines 20-22 of this rebuttal testimony) by using a pricing methodology that, while still  
2 based on Aquila's actual costs, gives appropriate consideration to the current upward trend in  
3 natural gas prices.

4 Generally, criticism of the Staff's approach would only be appropriate if the Staff  
5 continued to use the same natural gas pricing methodology, year after year, despite  
6 significantly changed conditions in the natural gas markets. For example, given today's  
7 natural gas prices, a multi-year average of natural gas prices would not give appropriate  
8 consideration to current market prices and would not be appropriate to use to set Aquila's  
9 utility rates in this case.

10 Q. Please explain.

11 A. In past years natural gas prices have been relatively stable, with prices  
12 fluctuating up and down within a reasonable range. In this stable market, the Staff believes  
13 the use of average natural gas prices actually incurred by the utility over a period of time is  
14 the best method to use to set natural gas prices for ratemaking purposes.

15 Recently, however, natural gas prices have reflected unprecedented volatility. Given  
16 this significant change in the market for natural gas, the Staff believes it is more appropriate  
17 in this case to reflect Aquila's actual gas costs at the latest point in time consistent with the  
18 Commission's ordered June 30, 2005 updated test year period.

19 Q. Is it customary practice to use latest known actual prices or costs when it can  
20 be shown that costs are steadily increasing or decreasing?

21 A. Yes. When there is a steady and consistent pattern of a cost increasing or  
22 decreasing, the Staff prefers to use a latest known cost, consistent with the point in time used  
23 for other revenue requirement items such as revenues, expenses and investment. In general

1 terms, when there is no clear movement in costs, up or down, the Staff prefers to use some  
2 form of averaging of the actual costs over a longer time frame.

3 In addition, for costs or investments which rarely are decreasing, such as wage rates  
4 and plant investment, the Staff has consistently used the latest known and measurable costs  
5 or plant balances in its revenue requirement proposal.

6 Q. Is there an apparent contradiction in Mr. Korte's criticism of the Staff for  
7 being inconsistent in its methods for determining appropriate natural gas prices for Aquila for  
8 ratemaking purposes?

9 A. Yes. Mr. Korte accuses the Staff of being inconsistent by not using the same  
10 pricing methodology it used in a previous rate case, yet, at page 12, line 20 of his rebuttal  
11 testimony, he states that he agrees with the Staff for not using the same methodology it used  
12 in Case No. ER-2004-0034.

13 In addition, Aquila is proposing a completely different method of determining its  
14 recommended level of natural gas prices in this case from the method it proposed in Case No.  
15 ER-2004-0034. As I discussed in some detail in my rebuttal testimony, Aquila's proposed  
16 level of natural gas prices in ER-2004-0034 was based on an average of natural gas price  
17 estimates made by experts in the natural gas industry. Aquila completely abandoned that  
18 approach in this case when it switched to the 30-day NYMEX futures strip average. While  
19 the Staff has been consistent in using Aquila's actual natural gas costs as the basis for its  
20 recommendation, Aquila completely changed its methodology without adequate explanation.

21 Q. Is the Staff's use of an average natural gas cost in Case No. ER-2004-0034  
22 consistent, in theory, with the June 2005 price it is proposing in this case?

1           A.     Yes. The averaging of costs and the end of period (last month) methods are  
2 both attempts to develop a level of revenues, expenses and investment that will fairly  
3 represent the levels that will exist when the new rates from this case are in effect. As such, it  
4 is important to understand that the use of averaging methodology or the determination that a  
5 last known amount is appropriate are completely consistent methods. These methods are  
6 consistent as long as the actual costs to the utility are used as the basis for the proposal.

7           However, Aquila has taken a completely different approach in how it developed its  
8 proposed natural gas prices in this case compared to how those prices were determined in the  
9 Company's last rate case. In its last two rate cases, the two methods used by Aquila to  
10 determine natural gas prices are at the opposite ends of the spectrum, with not even a hint of  
11 consistency.

12           In the 2004 rate case Aquila believed that an averaging of industry expert price  
13 predictions was the best method to use to determine the level of natural gas prices for  
14 ratemaking purposes. As I explained in my rebuttal testimony, Aquila even went into great  
15 detail to explain to the Commission how the use of NYMEX futures prices is not appropriate  
16 for ratemaking purposes. Yet, just two years later, Aquila is now advising this Commission  
17 that the use of NYMEX futures to predict Aquila's natural gas prices is a "comprehensive  
18 method" that "incorporates a more complete view of the actual marketplace."

19           Q.     Earlier you said that the Staff considered projections of natural gas industry  
20 experts in the formulation of its recommended natural gas prices. Did you review the  
21 projections of the same industry experts that Aquila used as the basis for its natural gas  
22 recommendation in Case No. ER-2004-0034.



1           A.     Yes.   Aquila spends thousands of dollars each year to subscribe to  
2 publications produced by experts in the natural gas industry. The Staff reviewed these  
3 publications as well as the projections of other entities.

4           Q.     Do the projections made by these industry experts generally support the  
5 Staff's natural gas price recommendation in this case?

6           A.     Yes. For example, one of the publications subscribed to by Aquila produced a  
7 Spot Natural Gas Price Outlook report in its October 19, 2005 edition. While the projected  
8 prices in the first half of 2006 are high and exceed \$10, prices start to moderate in July 2006.  
9 In September through December 2006 these projected prices, after a basis adjustment, are all  
10 below \$7. These projections were made by one of the top industry experts in the field.

11          Q.     On Page 12, line 6 Mr. Korte states that Staff has "arbitrarily chosen the  
12 month of June 2005 as the accurate month to determine natural gas prices." Do you agree?

13          A.     No. There was nothing arbitrary about the Staff's use of June, 2005 as the  
14 basis for its natural gas price recommendation. The selection of this month's natural gas  
15 prices was a deliberate decision based on the information available for the Staff to examine  
16 consistent with the end of the updated test year in this case. Since Aquila's natural gas prices  
17 were trending up, the use of the last known prices gives appropriate consideration to this  
18 general price increase. While the Staff looked at averaged natural gas prices over several  
19 different periods, it determined that these results did not give appropriate weight to the  
20 general trend of increasing prices.

21          Additionally, the Staff will look at the data again in the true-up portion of this  
22 proceeding and determine if averaging or use of end of period is appropriate for the  
23 circumstances of the most current natural gas market. Regardless of the actual gas prices

1 used, the Staff will be consistent with the methodology it proposed in its direct filing to use  
2 Aquila's actual gas costs that reflect the current market conditions adjusted for known  
3 extraordinary conditions, such as the unprecedented impact on natural gas prices of the recent  
4 hurricane activity in the Gulf region of the United States.

5 Q. Should Mr. Korte be aware of the significance of the June 30, 2005 date as it  
6 relates to this case?

7 A. Yes. It is Aquila's proposal that was adopted by the Commission in its Order  
8 Concerning Test Year and True Up, and Adopting Procedural Schedule.

9 Q. At page 12, lines 12-17 of his rebuttal testimony Mr. Korte states that natural  
10 gas prices in the month of June have historically been among the lowest. He refers to June as  
11 a "historically low priced natural gas month." He goes on to say that using June natural gas  
12 prices in the production cost model introduces a bias that would have the effect of lowering  
13 estimated costs for operating the company's electric service business. Please comment on  
14 these statements.

15 A. Mr. Korte's statement that June is a low-priced natural gas month is factually  
16 wrong in today's natural gas market. This is true whether you compare Aquila's actual  
17 natural gas costs by month or whether you natural gas prices at the Henry Hub.

18 In response to Staff Data Request No. 158, Aquila provided its actual costs to  
19 purchase natural gas from 2001 through the most current month. A summary of these costs  
20 is shown on Schedule 1 to this testimony. Schedule 1 shows that in 2001, Aquila's cost of  
21 natural gas in June was the 6<sup>th</sup> highest of the year, in 2002, the 7<sup>th</sup> highest, in 2003, the 3<sup>rd</sup>  
22 highest and in 2004 the fourth highest. Aquila's cost of natural gas in June exceeded the  
23 price in January (presumably a high cost month) in 2002, 2003, 2004 and 2005.

1           Q.     In addition to comparing Aquila's actual June natural gas costs with the rest of  
2 the months in the year's gas costs, did you also do a similar analysis of Henry Hub natural  
3 gas prices?

4           A.     Yes. I used the actual NYMEX settlement prices which reflect the actual  
5 price of natural gas at the Henry Hub at the end of each month. Schedule 2 to this testimony  
6 shows that for the year 2002, the June price of natural gas was the fifth highest of the year.  
7 In 2003, the price of natural gas in June was the second highest of the year, and in 2004, the  
8 price in June was the third highest of the year.

9           Q.     Because it used June 2005 actual natural gas prices, Mr. Korte in his rebuttal  
10 testimony at page 12 accuses the Staff of introducing "bias into the results of the production  
11 cost model." Please comment.

12          A.     Using a known and actual amount incurred by Aquila at the end of its updated  
13 test year does not "bias" or distort Aquila's true cost of natural gas. To the contrary, actual  
14 costs represent the very best information on which to base utility rates and are a reasonable  
15 indication of what future costs will be. Use of actual Aquila-specific information is superior  
16 to the use of prices in the NYMEX market where Aquila doesn't even buy any of its natural  
17 gas.

18          Aquila is not only relying on a market where it does not buy its natural gas – the  
19 Henry Hub, it is relying on prices in a commodities futures market for gas to be delivered up  
20 to two years in the future (Aquila's proposal is based on NYMEX futures prices through  
21 December 2006 as they existed during the period October through December 2004).

22          As explained previously, Aquila buys no natural gas from the Henry Hub, yet it is  
23 basing its entire recommendation for natural gas costs on a market in which it makes no

1 transactions. Aquila buys most of its natural in the mid-continent region. As noted above,  
2 Aquila, once it determines NYMEX futures prices, it must make arbitrary adjustments to its  
3 estimate of natural gas prices just to estimate its actual cost in the market where it buys its  
4 natural gas.

5 Q. Please summarize your comments on Mr. Korte's rebuttal testimony as it  
6 relates to natural gas prices.

7 A. Mr. Korte said the Staff's proposal to use Aquila's June 2005 actual incurred  
8 natural gas prices is arbitrary. This is incorrect. As described above, June 30, 2005 is the  
9 well-established cutoff date for revenues, expenses and rate base component. June 2005 was  
10 the end of Aquila's updated test year recommendation, and was the end of the updated test  
11 year ordered by the Commission. Mr. Korte's assertion indicates that he was unaware of his  
12 own Company's updated test year recommendation and the Commission's ordered updated  
13 test year in this case.

14 Mr. Korte also refers to the month of June as a historically low-priced natural gas  
15 month and the Staff uses this month's prices to bias its recommendation in favor of low  
16 natural gas prices. Actually, the opposite is true. In the years 2002-2004, natural gas prices  
17 in the month of June have been among the highest of the calendar year. If any bias is  
18 introduced by the Staff in using the month of June, it is a bias in favor of higher natural gas  
19 prices. Just the opposite of what Mr. Korte asserts.

20 Finally, Aquila's approach is to rely on the NYMEX natural gas futures market as the  
21 basis for its natural gas price proposal in this case. This market is completely unrelated to the  
22 market where Aquila actually makes its buying decisions. This reliance on future predicted

1 | prices in a foreign market introduces a whole new set of complications in any attempt to  
2 | reflect Aquila's true actual natural gas prices.

3 | **SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN (SERP)**

4 |       Q.     At page 3, lines 14 through 17 of his rebuttal testimony Aquila witness Philip  
5 | Beyer provides a very general definition of a "change in control." Is this the definition of  
6 | change in control used by Aquila in its SERP?

7 |       A.     No. Aquila's SERP is attached at Schedule 3 to this testimony. In paragraph  
8 | 1.04 of the SERP Aquila describes its definition of change in control. This provision serves  
9 | no other purpose but to protect the financial interests of Aquila's senior executives,  
10 | especially its Chief Executive Officer, Mr. Richard C. Green. Under Aquila's definition, a  
11 | change in control also occurs when there is a change in Aquila's board of directors or if there  
12 | is a merger and Mr. Richard Green does not continue as a member of the board of directors.

13 |       Q.     Could the change in control provisions in Aquila's SERP prove to be a  
14 | detriment to Aquila's ratepayers?

15 |       A.     Yes, it can.

16 |       Q.     Please explain.

17 |       A.     Aquila's Missouri ratepayers could benefit if a more efficiently-run utility  
18 | acquires Aquila's Missouri utility assets and provides safe and reliable utility service at a  
19 | lower cost to its customers. The change in control provisions in Aquila's SERP seeks to  
20 | prevent any such acquisition by a potentially better-run utility.

21 |       Q.     If Aquila removed the change in control provisions, would you then  
22 | recommend recovery of the costs of Aquila's SERP?

1           A.     No. The change in control provisions are only one of the reasons why the  
2 Staff opposes rate recovery of Aquila's SERP. Another significant reason for the Staff's  
3 opposition is that Aquila is seeking recovery of SERP costs that include executive bonuses  
4 that were awarded, and are currently being awarded, to Aquila's executives' work on  
5 nonregulated activities.

6           Q.     Does this mean that Aquila is seeking recovery from its regulated customers  
7 of SERP expenses that are based on executive bonuses awarded for nonregulated activities?

8           A.     Yes. For example, in Aquila's Form DEF 14A filed with the Securities and  
9 Exchange Commission (SEC) on April 15, 2003, Aquila lists the base salaries and bonus  
10 payments to Aquila's eight highest-compensated employees. For 2001 these executives  
11 received an average base salary of \$437,000, and an average bonus payment of \$2.3 million.  
12 The SERP expenses sought by Aquila in this case are based on these executives' base salary  
13 and bonus payments.

14          Q.     Do the employees in Aquila's regular pension plan receive pension benefits  
15 that are based on salary and bonuses?

16          A.     No. Employees in Aquila's regular pension plan accrue pension benefits  
17 based on salary, not bonus payments.

18          Q.     At page 5, lines 9 through 11 of his rebuttal testimony, Mr. Beyer states that  
19 Aquila's SERP is unfunded. Does this fact create additional problems with Aquila's SERP?

20          A.     Yes. Aquila accounts for its SERP under the same accounting standard it  
21 accounts for its regular pension plan. This standard is Statement No. 87, *Employers'*  
22 *Accounting for Pensions*. Because Aquila makes contributions to its regular pension plan  
23 from pension costs charged in rates, the financial return on these contributions serve to

1 reduce the total amount of pension expense charged to ratepayers. Here, ratepayer-supplied  
2 funds are used to reduce future pension expense because the funds have been segregated and  
3 placed in a fund where Aquila is not allowed to withdraw the funds other than to pay  
4 retirement benefits.

5 However, Aquila does not fund its SERP. If Aquila is allowed to recover these costs  
6 in rates, these dollars (the amount collected under FAS 87 over the actual SERP payments  
7 made) would represent cost-free funds to Aquila to use for whatever purposes it chooses.  
8 Aquila can take these funds, invest them in financial securities and retain the return on these  
9 funds as nonregulated income.

10 Q. At page 5 lines 9 through 11 of his rebuttal testimony Mr. Beyer states that  
11 Aquila does not guarantee SERP benefits to its executives. Is this also a concern?

12 A. Yes, it is. Aquila is proposing to recover from its customers funds that it gets  
13 to use cost-free for a period of time with no guarantee that it will even make the SERP  
14 payments to its retired executives. Since Aquila does not fund its SERP, any amounts  
15 collected in rates can be invested in any manner Aquila chooses.

16 Q. Has the Staff previously recommended rate recovery of SERP expenses?

17 A. Yes. The Staff believes that the only purpose of a SERP is to restore the same  
18 proportionate level of pension benefits to highly-compensated employees that are afforded to  
19 all employees in the regular pension plan. Mr. Beyer describes the limits on highly-  
20 compensated employees imposed by the Internal Revenue Service in his rebuttal testimony.

21 Such a plan should not be too costly for a utility's ratepayers. In past rate cases the  
22 Staff has allowed recovery of SERP expenses that were reasonable in amount, based solely to  
23 restore regular pension benefits and were actually paid to retired executives.

**MERGER TRANSITION COSTS**

Q. At page 11 of his rebuttal testimony AARP witness David Effron states that merger transition costs should not be included in Aquila's cost of service unless it can be shown that the merger resulted in savings at least as great as the costs recovered in rates. Does the Staff agree with this statement?

A. Yes, it does. The Staff has filed extensive testimony over the years, typically in merger application cases as well as rate cases presenting this very point of view.

Q. Also on page 11 Mr. Effron states that he has seen nothing in the record in this case that shows that the merger savings are greater than the costs, that savings are directly related to the merger and that the savings could not have been achieved absent the merger. Is there evidence in this case which meets the requirements listed by Mr. Effron?

A. Yes, there is. Schedule 4 to Staff witness David Elliott's direct testimony in this case shows the fuel and purchase power costs of both of Aquila's Missouri divisions, MPS and L&P. This schedule shows the fuel and purchased power costs of both divisions on a stand-alone basis compared to fuel costs on a joint dispatch basis. There is a savings much greater than the level of transition costs proposed by either Aquila or the Staff in this case. Also, it is evident that the joint dispatch savings are related to the merger and could not have been obtained otherwise.

Q. What level of transition costs is the Staff proposing to include in this case?

A. In my direct testimony at page 36 I state that I have identified approximately \$2 million in merger transition costs that the Staff finds should be recovered in rates. Since that filing Aquila has produced extensive documentation on Aquila's merger-related costs. This material was presented to interested parties at the prehearing conference. I reviewed each document and have adjusted my proposed level of transition costs to be recovered to



1 approximately \$4.6 million. This amount includes \$2.3 million in non-executive severance  
2 costs and payroll taxes, \$1.5 million in FAS 106 OPEB curtailment, and \$.8 million in  
3 consulting costs incurred to integrate L&P into Aquila's corporate structure. The Staff is still  
4 requesting additional documentation on costs of which both the Staff and Aquila agree  
5 should be classified as merger transition costs. The Staff does not anticipate that the total  
6 amount to be recovered will exceed \$4.9 million.

7 Q. How would you classify the other documents provided by Aquila?

8 A. A significant portion of the documents were invoices by attorneys and  
9 consulting firms for work done to complete the merger. This includes getting the merger  
10 approved by this Commission, the Federal Energy Regulatory Commission (FERC), and  
11 other regulatory agencies. These costs were also related to required filings before the SEC.

12 Q. Why didn't you include these regulatory approval costs as transition costs to  
13 be recovered by Aquila in this case?

14 A. As I explained in my direct testimony at pages 35 and 36, these types of costs  
15 are classified as transaction costs. While I provide a more detailed description of the  
16 differences between merger transaction costs and merger transition costs, the main distinction  
17 is that transaction costs are incurred to get the transaction completed. Transition costs are  
18 costs to integrate the combining companies.

19 Q. Did you read the rebuttal testimony of OPC witness Ted Robertson where he  
20 maintains that the Commission's Report and Order and Second Report and Order in Case No.  
21 EM-2002-292 prevents Aquila from recovering merger transition costs?

22 A. Yes, I did. I have also read both of the Commission's Report and Orders in  
23 that case.

1 Q. What is your opinion of Mr. Robertson's assertion?

2 A. I do not agree. There is no statement in either of the Commission's Orders  
3 that would prevent Aquila from seeking recovery of the transition costs it incurred in the  
4 integration of L&P operations into Aquila's corporate structure. The only prohibition on rate  
5 recovery that can be found is in Ordered Paragraph No. 2 in the Second Report and Order,  
6 issued in 2004, where the Commission stated that Aquila shall not be allowed to recover  
7 from its ratepayers the acquisition premium arising from the merger.

8 Q. Are transition costs part of the acquisition premium?

9 A. No. At page 4 line 18 of my rebuttal testimony in Case No. EM-2002-292 I  
10 defined the term "merger premium" as follows:

11 The term "merger premium" as commonly used, can mean either the  
12 purchase price in excess of the book value or the purchase price in  
13 excess of the market value of the net assets acquired. Unless  
14 otherwise indicated, when used in the Staff's testimony in this  
15 proceeding, the term merger premium means the purchase price in  
16 excess of the book value of the net assets acquired. Both the merger  
17 premium and merger transaction costs make up the acquisition  
18 adjustment.

19 Q. Did you also define the terms merger transaction costs and transition costs in  
20 other testimony filed before this Commission?

21 A. Yes. I described these terms at pages 30 through 34 of my rebuttal testimony  
22 in Case No. ER-2001-672. These pages are attached as Schedule 4 to this testimony.

23 Q. Mr. Robertson also makes the point in his rebuttal testimony that Aquila did  
24 not have Commission authority to defer transition costs for future recovery. Do you agree?

25 A. No. In this Report and Order the Commission did reject Aquila's specific  
26 regulatory plan. However, it made no ruling on the future treatment of merger transition  
27 costs. In fact, in Ordered paragraphs 13 and 14, the Commission stated that nothing in this

1 order shall be considered a finding by the Commission of the value for ratemaking purposes  
2 of the transactions herein involved. The Commission also reserved the right to consider  
3 ratemaking treatment to be afforded the transactions herein involved in a later proceeding.

4 It stands to reason that if Aquila did not defer these merger transition costs on its  
5 books and records, it would not have the opportunity in a later rate case to seek whole or  
6 partial recovery of the transition costs. Therefore, the Staff believes that the Commission, in  
7 this Report and Order, gave Aquila the authority to defer its merger transition costs on its  
8 books and records.

9 Q. Does this conclude your surrebuttal testimony?

10 A. Yes, it does.

Schedule 1

Deemed

Highly Confidential

In Its Entirety

## Historical NYMEX Expiration Prices

	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
2000	\$ 2.344	\$ 2.610	\$ 2.603	\$ 2.900	\$ 3.089	\$ 4.406	\$ 4.369	\$ 3.820	\$ 4.618	\$ 5.312	\$ 4.541	\$ 6.016
2001	\$ 9.978	\$ 6.293	\$ 4.998	\$ 5.384	\$ 4.891	\$ 3.738	\$ 3.182	\$ 3.167	\$ 2.295	\$ 1.830	\$ 3.202	\$ 2.316
2002	\$ 2.555	\$ 2.006	\$ 2.388	\$ 3.472	\$ 3.319	\$ 3.420	\$ 3.278	\$ 2.976	\$ 3.288	\$ 3.686	\$ 4.126	\$ 4.140
2003	\$ 4.988	\$ 5.660	\$ 9.133	\$ 5.146	\$ 5.123	\$ 5.945	\$ 5.291	\$ 4.693	\$ 4.927	\$ 4.430	\$ 4.459	\$ 4.860
2004	\$ 6.150	\$ 5.775	\$ 5.150	\$ 5.365	\$ 5.935	\$ 6.680	\$ 6.141	\$ 6.048	\$ 5.082	\$ 5.723	\$ 7.626	\$ 7.976
2005	\$ 6.213	\$ 6.288	\$ 6.304	\$ 7.323	\$ 6.748	\$ 6.123	\$ 6.976	\$ 7.647	\$ 10.847	\$ 13.908	\$ 13.832	\$ -

**UTILICORP UNITED INC.  
SUPPLEMENTAL EXECUTIVE RETIREMENT PLAN**

*(Amended and Restated Effective January 1, 2001)*

**HISTORY AND PURPOSE**

The purpose of this Plan is to provide specified benefits to a select group of management and highly compensated employees of UtiliCorp United Inc., a Delaware corporation, and its subsidiaries, if any, that sponsor this Plan. This Plan shall be unfunded for tax purposes and for purposes of Title I of ERISA.

The Plan was originally adopted effective as of July 1, 1986, and was thereafter amended and restated in its entirety effective as of May 1, 1991, and later effective as of January 1, 1998. The January 1, 1998 restatement was thereafter amended by two amendments dated August 4, 1998 and November 29, 2000, respectively. This amended and restated Plan document is effective as of January 1, 2001.

Participants who terminated employment prior to January 1, 2001, will be governed by the terms of the Plan document in effect at the time of their termination of employment.

**ARTICLE I - DEFINITIONS**

Except as specifically provided herein, all capitalized terms used in this Plan shall have the meaning assigned to them under the UtiliCorp United Inc. Restated Retirement Income Plan, as amended from time to time.

- 1.01 **"Basic SERP Benefit"** shall mean the benefit determined under Section 4.01 payable to a Participant under the Plan.
- 1.02 **"Bonus SERP Benefit"** shall mean the benefit determined under Section 4.02 payable to a Participant under the Plan.
- 1.03 **"Board"** shall mean the board of directors of the Company.
- 1.04 **"Change in Control"** shall mean the first to occur of any of the following events:
  - (1) any Person is or becomes the Beneficial Owner, directly or indirectly, of securities of the Company (not including in the securities beneficially owned by such Person any securities acquired directly from the Company or its affiliates, other than in connection with the acquisition by the Company or its affiliates of a business) representing 20% or more of either the then outstanding shares of common stock of the Company or the combined voting power of the Company's then outstanding securities; or
  - (2) the following individuals cease for any reason to constitute at least two-thirds (2/3) of the number of directors then serving: individuals who, on August 4, 1998, constituted the Board and any new director (other than a director whose initial assumption of office is in connection with an actual or threatened election contest, including but not limited to a consent solicitation, relating to the election of directors of the Company (as such terms are used in Rule 14A-11 of Regulation 14A under the Exchange Act)) whose appointment or election by the Board or nomination or election by

the Company's shareholders was approved by a vote of at least two-thirds (2/3) of the directors then still in office who either were directors on August 4, 1998, or whose appointment, election or nomination for election was previously approved; or

(3) the consummation of a merger or consolidation of the Company with any other entity, other than (i) a merger or consolidation which would result in (A) the voting securities of the Company outstanding immediately prior to such merger or consolidation continuing to represent (either by remaining outstanding or by being converted into voting securities of the surviving entity or any parent thereof), in combination with the ownership of any trustee or other fiduciary holding securities under an employee benefit plan of the Company, greater than 50% of the combined voting power of the voting securities of the Company or such surviving entity or any parent thereof outstanding immediately after such merger or consolidation, (B) such of Richard C. Green, Jr. and Robert K. Green continuing as members of the board of directors of the surviving entity or ultimate parent thereof as were members of the Board of the Company immediately prior to such transaction, and (C) individuals described in paragraph (2) above constitute more than one-half of the members of the board of directors of the surviving entity or ultimate parent thereof, or (ii) a merger or consolidation effected to implement a recapitalization of the Company (or similar transaction) in which no Person is or becomes the Beneficial Owner, directly or indirectly, of securities of the Company (not including in the securities Beneficially Owned by such Person any securities acquired directly from the Company or its affiliates, other than in connection with the acquisition by the Company or its affiliates of a business) representing 20% or more of either the then outstanding shares of common stock of the Company or the combined voting power of the Company's then outstanding securities; or

(4) the stockholders of the Company approve a plan of complete liquidation or dissolution of the Company or an agreement for the sale or disposition by the Company of all or substantially all of the Company's assets, other than a sale or disposition by the Company of all or substantially all of the Company's assets to an entity, greater than 50% of the combined voting power of the voting securities of which is owned by Persons in substantially the same proportions as their ownership of the Company immediately prior to such sale.

Notwithstanding the foregoing, no "Change in Control" shall be deemed to have occurred if there is consummated any transaction or series of integrated transactions immediately following which the record holders of the common stock of the Company immediately prior to such transaction or series of transactions continue to have substantially the same proportionate ownership in an entity which owns all or substantially all of the assets of the Company immediately following such transaction or series of transactions.

For purposes of this Section 1.02, the following definitions shall apply:

(a) **"Beneficial Owner"** shall have the meaning set forth in Rule 13d-3 under the Exchange Act.

(b) **"Exchange Act"** shall mean the Securities Exchange Act of 1934, as amended.

(c) **"Person"** shall have the meaning given in Section 3(a)(9) of the Exchange Act, as modified and used in Sections 13(d) and 14(d) thereof, except that such term shall not include (i) the Company or any of its affiliates (as defined in Rule 12b-2 promulgated

under the Exchange Act), (ii) a trustee or other fiduciary holding securities under an employee benefit plan of the Company or any of its affiliates, (iii) an underwriter temporarily holding securities pursuant to an offering of such securities, or (iv) a corporation owned, directly or indirectly, by the shareholders of the Company in substantially the same proportions as their ownership of stock of the Company.

- 1.03 **"Claimant"** shall have the meaning set forth in Section 8.01.
- 1.04 **"Code"** shall mean the Internal Revenue Code of 1986, as amended from time to time.
- 1.05 **"Committee"** shall mean the Committee described in Article VII.
- 1.06 **"Company"** shall mean UtiliCorp United Inc., a Delaware corporation.
- 1.07 **"Employer"** shall mean the Company and any subsidiaries of the Company that have been selected by the Board to participate in the Plan.
- 1.08 **"Participant"** shall mean any employee employed in pay bands I through V who is a participant in the Retirement Income Plan and who is selected to participate in the Plan by the Committee.
- 1.09 **"Plan"** shall mean this restated Supplemental Executive Retirement Plan (formerly known as the "UtiliCorp United Inc. Excess Benefit Plan").
- 1.10 **"Projected Credited Service"** shall mean, for purposes of computing a Participant's Supplemental SERP Benefit, the total projected years of Credited Service such Participant would have under the Retirement Income Plan if he were to continue employment with the Employer through age 62, or if such Participant has already attained age 62, his actual years of Credited Service under the Retirement Income Plan.
- 1.11 **"Retirement Income Plan"** shall mean the qualified defined benefit pension plan, as amended from time to time, maintained by the Company and known as the "UtiliCorp United Inc. Restated Retirement Income Plan."
- 1.12 **"Supplemental SERP Benefit"** shall mean the benefit determined under Section 4.03 payable exclusively to Participants employed in pay bands I through IVa.
- 1.13 **"Supplemental SERP Earnings"** shall mean, for purposes of computing a Participant's Supplemental SERP Benefit, the excess (if any) between (1) the Participant's Average Monthly Earnings determined under the Retirement Income Plan as if (a) the maximum benefit limit under Section 415(b)(1)(A) of the Code and the annual compensation limit under Section 401(a)(17) of the Code were not applicable, (b) Monthly Earnings included the Participant's annual base compensation deferred during a Plan Year under any nonqualified deferred compensation plan maintained by the Participant's Employer, and (c) Monthly Earnings included the Participant's annual bonus payable under the Employer's annual incentive plan or policy; and (2) the monthly average annual compensation limit under Section 401(a)(17) of the Code for the year during which the Participant terminates employment.
- 1.14 **"Total SERP Benefit"** means, to the extent applicable, the sum of a Participant's Basic SERP Benefit, Bonus SERP Benefit and Supplemental SERP Benefit.



## ARTICLE II - ELIGIBILITY

- 2.01 **Selection by Committee.** Participation in the Plan shall be limited to executives employed in pay bands I-V, all of whom are part of a select group of management or highly compensated employees. From that group, the Committee, in its sole discretion, shall designate the individuals eligible to receive a benefit under this Plan.

## ARTICLE III - VESTING

- 3.01 **Vesting.**
- (a) **Basic SERP Benefit.** Each Participant shall be entitled to 100% of his Basic SERP Benefit upon the completion of five (5) years of service, or upon termination of employment on or after attaining age 55. If a Participant separates from service prior to completing five (5) years of service and prior to attaining age 55, he shall not be entitled to any portion of his Basic SERP Benefit.
  - (b) **Bonus SERP Benefit.** Each Participant shall be entitled to 100% of his Bonus SERP Benefit if he retires from employment on or after attaining age 55 or terminates employment after completing ten (10) or more years of service. If a Participant separates from service for any reason prior to attaining age 55 and prior to completing ten (10) or more years of service, he shall not be entitled to any portion of his Bonus SERP Benefit
  - (c) **Supplemental SERP Benefit.** Each Participant employed in pay band I through IVa shall be entitled to 100% of his Supplemental SERP Benefit if he retires from employment on or after attaining age 55 or terminates employment after completing ten (10) or more years of service. If a Participant separates from service for any reason prior to attaining age 55 and prior to completing ten (10) or more years of service, he shall not be entitled to any portion of his Supplemental SERP Benefit.
- 3.02 **Change in Control.** Notwithstanding Section 3.01 or any other provision in this Plan, a Participant's Total SERP Benefit shall become 100% vested (if it is not already vested in accordance Section 3.01 above) in the event of a Change in Control.

## ARTICLE IV - BENEFITS

- 4.01 **Basic SERP Benefit.** Subject to Section 3.01(a) and Section 6.02, a Participant's Basic SERP Benefit, as adjusted pursuant to Section 4.04, shall be equal to (A) minus (B), where:

(A) = the benefit that would be payable to the Participant under the Retirement Income Plan if (i) the maximum benefit limit under Section 415(b)(1)(A) of the Code and the annual compensation limit under Section 401(a)(17) of the Code were not applicable, and (ii) for Plan Years beginning after December 31, 1997, Monthly Earnings included the Participant's annual base compensation deferred during a Plan Year under any nonqualified deferred compensation plan maintained by the Participant's Employer; and

(B) = the benefit actually payable to or on behalf of such Participant under the Retirement Income Plan.

4.02 **Bonus SERP Benefit.** Subject to Section 3.01(b) and Section 6.02, a Participant's Bonus SERP Benefit, as adjusted pursuant to Section 4.04, shall be equal to (A) minus (B) minus (C), where:

(A) = the benefit that would be payable to the Participant under the Retirement Income Plan if (i) the maximum benefit limit under Section 415(b)(1)(A) of the Code and the annual compensation limit under Section 401(a)(17) of the Code were not applicable, (ii) for Plan Years beginning after December 31, 1997, Monthly Earnings included the Participant's annual base compensation deferred during a Plan Year under any nonqualified deferred compensation plan maintained by the Participant's Employer, and (iii) for Plan Years beginning after December 31, 2000, Monthly Earnings included the Participant's annual bonus (if any) payable under the Employer's annual incentive plan or policy;

(B) = the benefit actually payable to or on behalf of such Participant under the Retirement Income Plan; and

(C) = the Participant's Basic SERP Benefit payable under this Plan.

4.03 **Supplemental SERP Benefit.** Subject to Section 3.01(c) and Section 6.02, a Participant employed in pay band I-IVa shall have a Supplemental SERP Benefit, as adjusted pursuant to Section 4.04, equal to the sum of (A) plus (B) plus (C), multiplied by (D), where:

(A) = Four-tenths percent (.40%) multiplied by the Participant's Supplemental SERP Earnings multiplied by the Participant's Projected Credited Service up to a maximum of ten (10) years;

(B) = Twenty-five hundredths percent (.25%) multiplied by the Participant's Supplemental SERP Earnings multiplied by the Participant's Projected Credited Service in excess of ten (10) years but not more than twenty (20) years;

(C) = One-tenth percent (.10%) multiplied by the Participant's Supplemental SERP Earnings multiplied by the Participant's Projected Credited Service in excess of twenty (20) years but not more than thirty (30) years; and

(D) = The ratio of the Participant's actual years of Credited Service under the Retirement Income Plan to his Projected Credited Service.

4.04 **Payment of Benefits.** Subject to Section 4.05, payment of a Participant's vested Total SERP Benefit shall be made in the same manner and at the same time that benefits under the Retirement Income Plan are payable, determined in accordance with the elections made by the Participant thereunder and in accordance with the early retirement, Actuarial Equivalent, Actuarial Value, and other applicable adjustments and assumptions set forth in the Retirement Income Plan; provided that if a Participant elects to receive his benefits

in a form of payment under the Retirement Income Plan which provides death benefits to a non-spouse beneficiary, the Participant's Total SERP Benefit shall be paid in monthly installments for the life of the Participant only and shall terminate upon his death.

4.05 **Committee Discretion.** Upon the request of a Participant or beneficiary, the Committee, in its sole discretion and consistent with its established procedures and rules, may consider other forms of vested benefit payments, or the timing of vested benefit payments, as it deems necessary and prudent under the circumstances. The Committee, in its discretion, may also establish a mandatory pay-out policy pursuant to which a Participant's (or beneficiary's) Total SERP Benefit shall be automatically paid in the form of a single lump sum if the actuarial value of such benefit is less than the lump sum pay-out amount designated by the Committee from time to time in its discretion. For purposes of calculating the actuarial lump sum value of a Participant's Total SERP Benefit pursuant to the foregoing, the Plan shall use an interest rate of eight percent (8%) and the same mortality table assumptions used by the Retirement Income Plan to calculate Actuarial Value.

4.06 **Withholding and Payroll Taxes.** The Employers, to the extent required by applicable law, shall withhold from any and all benefits made under this Article IV, all federal, state and local income, employment and other taxes required to be withheld by the Employer in connection with the benefits hereunder, in amounts to be determined in the sole discretion of the Employer.

4.07 **Benefits on Death.**

(a) **Basic SERP Benefit.** If a spousal death benefit is payable under the Retirement Income Plan with respect to a Participant, a spousal death benefit shall also be payable under this Plan equal to (A) minus (B), where:

(A) = the benefit that would be payable to the Participant's spouse under the Retirement Income Plan, determined in accordance with the elections made by the Participant or spouse thereunder and in accordance with the applicable assumptions and actuarial adjustments set forth in that plan, if (i) the maximum benefit limit under Section 415(b)(1)(A) of the Code and the annual compensation limit under Section 401(a)(17) of the Code were not applicable, and (ii) for Plan Years beginning after December 31, 1997, Monthly Earnings included the Participant's annual base compensation deferred during a Plan Year under any nonqualified deferred compensation plan maintained by the Participant's Employer; and

(B) = the benefit actually payable to the Participant's spouse under the Retirement Income Plan.

(b) **Bonus SERP Benefit.** If a Participant dies after having satisfying the vesting requirements set forth in Section 3.01(b), the Participant's surviving spouse shall be entitled to a spousal death benefit equal to 50% of the Participant's Bonus SERP Benefit as of the date of his death.

(c) **Supplemental SERP Benefit.** If a Participant dies after having satisfying the vesting requirements set forth in Section 3.01(c), the Participant's surviving

spouse shall be entitled to a spousal death benefit equal to 50% of the Participant's Bonus SERP Benefit as of the date of his death.

- (d) **Payment of Benefit.** Subject to Section 4.05, any spousal death benefits payable under this Section 4.07 shall be paid in the same manner and at the same time that death benefits are paid to the Participant's spouse under the Retirement Income Plan. If a Participant has no surviving spouse, the benefits remaining under the Plan shall be forfeited.

#### ARTICLE V - TERMINATION AND AMENDMENT

- 5.01 **Termination.** The Company reserves the right to terminate the Plan at any time by action of its board of directors. The termination of the Plan shall not adversely affect any Participant or his beneficiary who has become entitled to the payment of any benefits under the Plan as of the date of termination, provided, however, that the Company shall have the right to accelerate payments by paying the Actuarial Value or Actuarial Equivalent of such payments. For all other Participants, upon the termination of the Plan, the Actuarial Value of each such Participant's vested Total SERP Benefit shall be paid out in a lump sum.
- 5.02 **Amendment.** The Company may, at any time, amend or modify the Plan in whole or in part by action of its board of directors; provided, however, that no amendment or modification shall be effective to decrease or restrict a Participant's then vested Total SERP Benefit, determined on an Actuarial Equivalent basis. The amendment or modification of the Plan shall not affect any Participant or his beneficiary who has become entitled to the payment of benefits under the Plan as of the date of the amendment or modification; provided, however, that the Employer shall have the right to accelerate installment payments by paying the Actuarial Value of such payments in a lump sum or the Actuarial Equivalent in some other accelerated form of payment.

#### ARTICLE VI - OTHER BENEFITS AND AGREEMENTS

- 6.01 **Coordination with Other Benefits.** Except as provided in Section 6.02 and except as otherwise expressly provided under any other plan or program for employees of the Employer, the benefits provided under this Plan to a Participant are in addition to the benefits available to such Participant under any other such plan or program. The Plan shall supplement and shall not supersede, modify or amend any other such plan or program except as my otherwise be expressly provided.
- 6.02 **Reduction in SERP Benefits.** Notwithstanding any provision in this Plan that may be interpreted to the contrary, the Total SERP Benefit payable to any Participant hereunder shall be reduced by the equivalent monthly lifetime benefit payable to such Participant under any other supplemental retirement agreement or plan with his Employer. If the benefit under such other retirement plan or agreement is payable in the form of a lump sum, such benefit shall be converted to a monthly lifetime benefit in accordance with the applicable Actuarial Value assumptions set forth in the Retirement Income Plan for purposes of determining the benefit offset under this Section 6.02.

#### ARTICLE VII - ADMINISTRATION OF THE PLAN

- 7.01 **Committee Duties.** This Plan shall be administered by a Committee which shall consist of the Board, or such committee as the Board shall appoint. Members of the Committee may be Participants under this Plan. The Committee shall also have the discretion and authority to (i) make, amend, interpret and enforce all appropriate rules and regulations for the administration of this Plan and (ii) decide or resolve any and all questions including interpretations of this Plan, as may arise in connection with the Plan.
- 7.02 **Agents.** In the administration of this Plan, the Committee may employ agents and delegate to them such administrative duties as it sees fit (including acting through a duly appointed representative) and may from time to time consult with counsel who may be counsel to any Employer.
- 7.03 **Binding Effect of Decisions.** The decision or action of the Committee with respect to any question arising out of or in connection with the administration, interpretation and application of the Plan and the rules and regulations promulgated hereunder shall be final and conclusive and binding upon all persons having any interest in the Plan.
- 7.04 **Indemnity of Committee.** The Employers shall indemnify and hold harmless the members of the Committee against any and all claims, losses, damages, expenses or liabilities arising from any action or failure to act with respect to this Plan, except in the case of willful misconduct by the Committee or any of its members.
- 7.05 **Employer Information.** To enable the Committee to perform its functions, each Employer shall supply full and timely information to the Committee on all matters relating to the compensation of its Participants, the date and circumstances of the retirement, disability, death or termination of employment of its Participants, and such other pertinent information as the Committee may reasonably require.

#### ARTICLE VIII - CLAIMS PROCEDURES

- 8.01 **Presentation of Claim.** Any Participant or beneficiary of a deceased Participant (such Participant or beneficiary being referred to below as a "Claimant") may deliver to the Committee a written claim for a determination with respect to the amounts distributable to such Claimant from the Plan. If such a claim relates to the contents of a notice received by the Claimant, the claim must be made within 60 days after such notice was received by the Claimant. The claim must state with particularity the determination desired by the Claimant. All other claims must be made within 180 days of the date on which the event that caused the claim to arise occurred.
- 8.02 **Notification of Decision.** The Committee shall consider a Claimant's claim within 90 days (unless special circumstances require additional time), and shall notify the Claimant in writing:
- (i) that the Claimant's requested determination has been made, and that the claim has been allowed in full; or
  - (ii) that the Committee has reached a conclusion contrary, in whole or in part, to the Claimant's requested determination, and such notice must set forth in a manner calculated to be understood by the Claimant:
    - (1) the specific reason(s) for the denial of the claim, or any part of it;

- (2) specific reference(s) to pertinent provisions of the Plan upon which such denial was based;
  - (3) a description of any additional material or information necessary for the Claimant to perfect the claim, and an explanation of why such material or information is necessary; and
  - (4) an explanation of the claim review procedure set forth in Section 8.03) below.
- 8.03 **Review of a Denied Claim.** Within 60 days after receiving a notice from the Committee that a claim has been denied, in whole or in part, a Claimant (or the Claimant's duly authorized representative) may file with the Committee a written request for a review of the denial of the claim. Thereafter, but not later than 30 days after the review procedure began, the Claimant (or the Claimant's duly authorized representative):
  - (i) may review pertinent documents;
  - (ii) may submit written comments or other documents; and/or
  - (iii) may request a hearing, which the Committee, in its sole discretion, may grant.
- 8.04 **Decision on Review.** The Committee shall render its decision on review promptly, and not later than 60 days after the filing of a written request for review of the denial, unless a hearing is held or other special circumstances require additional time, in which case the Committee's decision must be rendered within 120 days after such date. Such decision must be written in a manner calculated to be understood by the Claimant, and it must contain:
  - (i) specific reasons for the decision;
  - (ii) specific reference(s) to the pertinent Plan provisions upon which the decision was based; and
  - (iii) such other matters as the Committee deems relevant.
- 8.05 **Legal Action.** A Claimant's compliance with the foregoing provisions of this Article VIII is a mandatory prerequisite to a Claimant's right to commence any legal action with respect to any claim for benefits under this Plan.

#### ARTICLE IX - MISCELLANEOUS

- 9.01 **Unsecured General Creditor.** Participants and their Beneficiaries successors and assigns shall have no legal or equitable rights, interests or claims in any property or assets of an Employer. Any and all of an Employer's assets shall be, and remain, the general, unpledged, unrestricted assets of the Employer. An Employer's obligation under the Plan shall be merely that of an unfunded and unsecured promise to pay money in the future.
- 9.02 **Employer's Liability.** An Employer's liability for the payment of benefits shall be defined only by the Plan. An Employer shall have no obligation to a Participant under the Plan except as expressly provided in the Plan.

- 9.03 **Nonassignability.** Neither a Participant nor any other person shall have any right to commute, sell, assign, transfer, pledge, anticipate, mortgage or otherwise encumber, transfer, hypothecate or convey in advance of actual receipt, the amounts, if any, payable hereunder, or any part thereof, which are, and all rights to which are, expressly declared to be, unassignable and non-transferable. No part of the amounts payable shall, prior to actual payment, be subject to seizure or sequestration for the payment of any debts, judgments, alimony or separate maintenance owed by a Participant or any other person, nor be transferable by operation of law in the event of a Participant's or any other person's bankruptcy or insolvency.
- 9.04 **Not a Contract of Employment.** The terms and conditions of this Plan shall not be deemed to constitute a contract of employment between any Employer and the Participant. Such employment is hereby acknowledged to be an "at will" employment relationship that can be terminated at any time for any reason, with or without cause, unless expressly provided in a written employment agreement. Nothing in this Plan shall be deemed to give a Participant the right to be retained in the service of any Employer or to interfere with the right of any Employer to discipline or discharge the Participant at any time.
- 9.05 **Furnishing Information.** A Participant or his beneficiary will cooperate with the Committee by furnishing any and all information requested by the Committee and take such other actions as may be requested in order to facilitate the administration of the Plan and the payments of benefits hereunder, including but not limited to taking such physical examinations as the Committee may deem necessary.
- 9.06 **Terms.** Whenever any words are used herein in the masculine, they shall be construed as though they were in the feminine in all cases where they would so apply; and wherever any words are used herein in the singular or in the plural, they shall be construed as though they were used in the plural or the singular, as the case may be, in all cases where they would so apply.
- 9.07 **Captions.** The captions of the articles, sections and paragraphs of this Plan are for convenience only and shall not control or affect the meaning or construction of any of its provisions.
- 9.08 **Governing Law.** Subject to ERISA, the provisions of this Plan shall be construed and interpreted according to the internal laws of the State of Missouri without regard to its conflict of laws principles.
- 9.09 **Validity.** In case any provision of this Plan shall be illegal or invalid for any reason, said illegality or invalidity shall not affect the remaining parts hereof, but this Plan shall be construed and enforced as if such illegal and invalid provision had never been inserted herein.
- 9.10 **Notice.** Any notice or filing required or permitted to be given to the Committee under this Plan shall be sufficient if in writing and hand-delivered, or sent by registered or certified mail, to the address below:

UtiliCorp United Inc.  
Attn: Director of Benefits  
20 West Ninth Street

Such notice shall be deemed given as of the date of delivery or, if delivery is made by mail, as of the date shown on the postmark on the receipt for registration or certification.

Any notice or filing required or permitted to be given to a Participant under this Plan shall be sufficient if in writing and hand-delivered, or sent by mail, to the last known address of the Participant.

- 9.11 **Successors.** The provisions of this Plan shall bind and inure to the benefit of the Participant's Employer and its successors and assigns and the Participant and the Participant's beneficiary.
- 9.12 **Spouse's Interest.** The interest in the benefits hereunder of a spouse of a Participant who has predeceased the Participant shall automatically pass to the Participant and shall not be transferable by such spouse in any manner, including but not limited to such spouse's will, nor shall such interest pass under the laws of intestate succession.
- 9.13 **Incompetent.** If the Committee determines in its discretion that a benefit under this Plan is to be paid to a minor, a person declared incompetent or to a person incapable of handling the disposition of that person's property, the Committee may direct payment of such benefit to the guardian, legal representative or person having the care and custody of such minor, incompetent or incapable person. The Committee may require proof of minority, incompetency, incapacity or guardianship, as it may deem appropriate prior to distribution of the benefit. Any payment of a benefit shall be a payment for the account of the Participant and the Participant's beneficiary, as the case may be, and shall be a complete discharge of any liability under the Plan for such payment amount.
- 9.14 **Court Order.** The Committee is authorized to make any payments directed by court order in any action in which the Plan or Committee has been named as a party.
- 9.15 **Distribution in the Event of Taxation.** If, for any reason, all or any portion of a Participant's benefit under this Plan becomes taxable to the Participant prior to receipt, a Participant may petition the Committee for a distribution of that portion of his benefit that has become taxable. Upon the grant of such a petition, which grant shall not be unreasonably withheld, the Employer shall distribute to the Participant immediately available funds in an amount equal to the taxable portion of his benefit (which amount shall not exceed a Participant's unpaid vested benefit under the Plan). If the petition is granted, the tax liability distribution shall be made within 90 days of the date when the Participant's petition is granted. Such a distribution shall affect and reduce the benefits to be paid under this Plan.

## ARTICLE X - TRUST

### 10.01 **Trust.**

- (a) **Establishment.** Each Employer may transfer to the trust created pursuant that certain Executive Benefit Security Trust Agreement dated as of January 1, 1997 by and between the Company and the trustee named therein (hereinafter referred to as the "Trust"), such assets as the Employer determines, in its sole discretion, are necessary to fund the Trust in accordance with an actuarial funding method and actuarial assumptions



designed, in the reasonable judgment of an actuary appointed by the Company, to replicate the funding policy followed with respect to the Retirement Income Plan.

(b) **Contribution Following Change of Control.** Notwithstanding Section 10.01(a) above, in the event of a Change of Control, the Company shall as soon as administratively possible, but in no event later than ten (10) days following such Change of Control, make an irrevocable contribution to the Trust, in cash or other readily marketable property acceptable to the Trustee, equal to the sum of (i) an amount which, when added to the fair market value of the assets then held in the Trust which are attributable to this Plan, shall cause the fair market value of such assets to equal the actuarially determined present value of the benefits payable under the Plan as of the date of such Change of Control, and (ii) an amount equal to a reasonable estimate of the present value of the administrative, Trustee's, legal and consulting fees to be incurred during the life of the Trust on and after the Change of Control. The amount of the Company's contribution paid or payable to the Trust pursuant to the foregoing shall be determined by a benefits consultant appointed by the Company.

10.02 **Interrelationship of the Plan and the Trust.** The provisions of the Plan shall govern the rights of a Participant to receive distributions pursuant to the Plan. The provisions of the Trust shall govern the rights of the Employers, Participants and the creditors of the Employers to the assets transferred to the Trust. Each Employer shall at all times remain liable to carry out its obligations under the Plan.

10.03 **Distributions From the Trust.** Each Employer's obligations under the Plan may be satisfied with Trust assets distributed pursuant to the terms of the Trust, and any such distribution shall reduce the Employer's obligations under this Plan.

\*\*\*\*\*

**SIGNATURE PAGE**

**IN WITNESS WHEREOF**, UtiliCorp United Inc. has caused this Plan document to be executed  
this \_\_\_\_\_ day of \_\_\_\_\_, 2001.

UTILICORP UNITED INC.

By: \_\_\_\_\_

## **Summary of Modifications**

### **UtiliCorp United Inc. Supplemental Executive Retirement Plan**

*(As Amended and Restated Effective January 1, 2001)*

- Executives employed in pay bands I-V are eligible for the SERP.
- The SERP was amended to add a new "Bonus SERP Benefit" and "Supplemental SERP Benefit."
- The Bonus SERP Benefit is designed to provide executives an additional retirement benefit based on the executives' annual bonus pay. Bonus pay is currently excluded from consideration under UtiliCorp's qualified defined benefit pension plan. All SERP participants are eligible for the Bonus SERP Benefit. (See SERP sections 1.02 and 4.02)
- The Supplemental SERP Benefit is designed to provide executives employed in pay bands I – IVa an additional market-based retirement benefit. The maximum retirement benefit is generally equal to 7.5% of the executive's average total pay in excess of the annual Internal Revenue Code dollar limitation. (See SERP sections 1.10, 1.12, 1.13 and 4.03)
- In order to receive the Bonus SERP Benefit and Supplemental SERP Benefit, an executive must either (i) retire from employment on or after attaining age 55, or (ii) separate from service after completing ten (10) or more years of service. All SERP benefits are adjusted to take into account early retirement and other applicable actuarial adjustments. (See SERP section 3.01)
- If a married executive dies after having satisfied the vesting requirements for the Bonus SERP and Supplemental SERP Benefits, the executive's surviving spouse will receive a benefit equal to 50% of the benefit that would have been paid to the executive. There is no death benefit for unmarried executives. (See SERP section 4.07)
- The Committee has the discretion to adopt a mandatory pay-out policy pursuant to which an executive's SERP benefit would be paid in a single lump sum if the actuarial value of such benefit is less than specified dollar amount. (See SERP section 4.05)

1 Q. In this testimony are you saying that the Staff considers the pooling of  
2 interests method of accounting preferable to purchase accounting for financial accounting  
3 purposes?

4 A. No. This testimony is not concerned with which accounting method is  
5 theoretically the better method for financial accounting purposes. There are strong  
6 arguments to be made for both methods, and both methods have weaknesses. The point of  
7 this testimony is that the pooling of interests accounting method was available when  
8 UtiliCorp merged with SJLP. UtiliCorp had the option to choose the pooling method that  
9 would have eliminated the existence of an acquisition adjustment. UtiliCorp, for whatever  
10 reason(s), decided to abandon the pooling method and use the accounting method that  
11 requires the recognition of an acquisition adjustment and its attendant negative regulatory  
12 issues.

13 **MERGER COSTS**

14 Q. Please explain and differentiate the three different types of merger costs  
15 referred as the merger premium, transaction costs and transition costs.

16 A. The merger premium and transaction costs are "ownership" costs. Transition  
17 costs are not ownership costs, but are incurred during the process of merging the operations  
18 of the combining utilities into a single, more efficient utility. The term merger premium was  
19 defined earlier, transaction and transition costs are described below.

20 Transaction costs are costs incurred by both the acquiring company and the acquired  
21 company for the purpose of consummating the merger. Examples of these costs are fees paid  
22 for legal, banking and consulting services necessary to close the transaction. The majority of  
23 transaction costs will be incurred prior to merger closing. Transaction costs are referred to as

1 "direct costs of the merger" and are coupled with the merger premium to make up the amount  
2 of the acquisition adjustment to be recorded on the acquiring company's balance sheet. Both  
3 the USOA and GAAP require that transaction costs be treated the same as the merger  
4 premium.

5 Transition costs are also referred to as "cost to achieve." Transition costs are costs  
6 incurred to merge or combine the operations of the two combining utilities into one,  
7 potentially more efficient utility. Two of the more common transition costs are those related  
8 to human resources and information technology:

9 Human resources costs - Reductions in staff through streamlining and  
10 ending duplication. These include severance costs, buyout packages  
11 and unpaid sick and holiday leave, as well as the physical relocation of  
12 the work force.

13 Information technology - Moving from two to one integrated computer  
14 system may require the purchase of new computer hardware and  
15 software, the disposal of old machinery and outside consultant costs.  
16 Old files need to be converted, data needs to be transferred and  
17 employees need to be trained on new applications and work flow  
18 processes.

19 Q. Explain why the Staff is proposing different accounting and ratemaking  
20 treatment for the merger premium, transaction costs and transition costs.

21 A. The merger premium and transaction costs are types of ownership costs which  
22 are rightly absorbed by the owners of the merging companies. Generally, the merger would  
23 not take place without the shareholders of both companies approving the transaction. The  
24 decision on the amount of money to pay to acquire a company, and the amount of money to  
25 accept in selling a company is made by the board of directors in their fiduciary duty to the  
26 company shareholders. Once an agreement between the board of directors of both companies  
27 is reached, a special meeting is usually required to be held in which both shareholder groups  
28 vote to approve or reject the merger. (Because of the relatively small size of the SJLP

1 merger, a UtiliCorp shareholder vote was not required). The merger is approved, if, and only  
2 if, both owner groups believe it is in their best interests. In this merger, the SJLP shareholder  
3 group and the UtiliCorp Board of Directors (acting for the UtiliCorp shareholders) decided  
4 that the \$23 per share price for each SJLP common share was in the best interests of the  
5 respective shareholder group.

6         Ratepayer interests are not considered in the decision to buy (acquiring utility) or sell  
7 (acquired utility). Ratepayer interests are not considered because the structure of a merger  
8 agreement and the initial approval of the merger going forward is an ownership decision.  
9 Ratepayers, as nonowners, have 1) no ownership rights in utility assets, 2) no vote in the  
10 decision to be a part of a merger, and 3) no influence in the structure of the terms and  
11 conditions of a merger.

12         As described above, transaction costs are those costs necessary to complete the  
13 merger and include legal fees, regulatory approval cost and financial consulting fees. In  
14 deciding whether or not to merge with another utility, SJLP's Board of Directors paid its  
15 financial advisor, Morgan Stanley, approximately \$2.6 million (response to Staff Data  
16 Request No. 44, Case No. EM-2000-292) to provide an opinion if the \$23 per SJLP common  
17 share offer price from UtiliCorp was fair, from a financial point of view, to SJLP's  
18 shareholders. This cost is clearly not related to providing utility service more efficiently, but  
19 is only incurred to protect the financial interests of the shareholders in the merger transaction.  
20 Because the merger premium and transaction costs incurred in this merger were incurred  
21 solely to benefit both SJLP and UtiliCorp shareholders, as owners, these costs should not be  
22 directly reflected in UtiliCorp's utility rates borne by UtiliCorp's customers.

1           Unlike the merger premium and transaction costs, most transition costs are incurred  
2 after the merger in an attempt to run the combined utility more efficiently. If attained, these  
3 efficiencies should be reflected in a lower cost of providing utility service, thereby proving a  
4 potential benefit to utility customers. These costs are similar to other "reorganization" or  
5 "restructuring" costs incurred by utilities to operate more efficiently and effectively.  
6 Because these costs are incurred by a utility attempting to make its operations more efficient,  
7 transition costs, if prudent and reasonable, typically are included in a utility's cost of  
8 providing service. Transition costs that do result in merger savings benefit the shareholders  
9 though regulatory lag until these savings are reflected in rates in a rate proceeding or an  
10 earnings/revenues complaint case.

11           For these reasons, the Staff does not believe it is reasonable to exclude, in rates, the  
12 actual costs incurred to achieve the merger savings (transition costs), while simultaneously  
13 flowing through all the merger savings in rates to the ratepayers. Consistent with this belief  
14 is the Staff's position that reasonable and prudent transition costs actually incurred should be  
15 reflected in rates to be recovered from ratepayers.

16           Q.     Is there any validity to a claim that merger premiums and transaction costs are  
17 no different from other costs incurred to run a utility more efficiently, such as a renegotiation  
18 of a purchase power contract, or a corporate reorganization?

19           A.     No. Merger premiums and transaction costs are incurred only by the explicit  
20 approval of the shareholders (or board of directors acting in the fiduciary interests of the  
21 shareholders) and only after the shareholders determine that the merger is in their best  
22 "financial" interests. The merger premium and transaction costs are not associated with  
23 running the utility operations more efficiently and, therefore, are not analogous to

1 reorganizations or renegotiations of purchased power contracts, which are designed to run  
2 utility operations more efficiently. Transition costs are the only type of merger costs  
3 incurred to run the utility more efficiently and these types of costs are analogous to contract  
4 renegotiations and reorganizations.

5 **ACCOUNTING FOR THE SJLP PURCHASE**

6 Q. How much did UtiliCorp to pay to acquire SJLP?

7 A. According to the Company's response to Staff Data Request Nos. 130 and  
8 381, UtiliCorp paid \$190.2 million to acquire the 8.27 million outstanding common shares of  
9 SJLP at December 29, 2000 and incurred \$5.6 million in transaction costs, which includes  
10 the legal and banker fees necessary to complete the transaction. Adding the \$5.6 million  
11 transaction costs to the purchase price of \$190.2 million results in a total purchase price of  
12 \$195.8 million.

13 Q. Please explain why you are including transaction costs in the purchase price?

14 A. Both GAAP and the FERC USOA require that transaction costs be included  
15 along with the purchase price to determine the overall cost to acquire plant assets.

16 Q. Is the actual purchase price of \$195.8 similar to the estimated purchase price  
17 during the pendency of Case No. EM-2000-292, UtiliCorp's merger application case before  
18 this Commission?

19 A. Yes. The estimated purchase price was \$193.2 million (\$188.6 million stock  
20 cost plus an estimated \$4.6 million transaction costs.) However, while there was not much of  
21 a change from the estimated to the actual purchase price, there was a significant change in  
22 the amount of the acquisition adjustment. The estimated acquisition adjustment was  
23 \$97 million and the actual amount determined after merger closing was \$114.3 million. This



Schedule 5

Has Been Deemed

Highly Confidential

In Its Entirety