

Exhibit No.:
Issue: Acquisition of St. Joseph
Light and Power
Company Adjustment
Witness: Mark L. Oligschlaeger
Sponsoring Party: MoPSC Staff
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

DIRECT TESTIMONY

OF

MARK L. OLIGSCHLAEGER

**AQUILA, INC. D/B/A
AQUILA NETWORKS MPS-NATURAL GAS AND
AQUILA NETWORKS L&P-NATURAL GAS**

CASE NO. GR-2004-0072

*Jefferson City, Missouri
January 2004*

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of Aquila, Inc. d/b/a Aquila)
Networks-MPS and Aquila Networks-L&P,)
Natural Gas General Rate Increase)

Case No. GR-2004-0072

AFFIDAVIT OF MARK L. OLIGSCHLAEGER

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Mark L. Oligschlaeger, being of lawful age, on his oath states: that he has participated in the preparation of the following Direct Testimony in question and answer form, consisting of 9 pages to be presented in the above case; that the answers in the following Direct 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.

Mark L. Oligschlaeger

Mark L. Oligschlaeger

Subscribed and sworn to before me this 5th day of January 2004.

Toni M. Charlton

Notary



TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

1 A. I have been employed by this Commission as a Regulatory Auditor for over 20
2 years, and have submitted testimony on ratemaking matters numerous times before the
3 Commission. I have also been responsible for the supervision of other Commission
4 employees in rate cases and other regulatory proceedings numerous times. I have received
5 training at in-house and outside seminars on technical ratemaking matters since I began my
6 employment with the Commission.

7 Q. With reference to Case No. GR-2004-0072, the Application by Aquila, Inc.
8 (Aquila/UtiliCorp or Company) d/b/a Aquila Networks - MPS (MPS) and Aquila Networks
9 L&P (L&P), to increase rates charged to their natural gas customers, have you examined the
10 books and records of Aquila/UtiliCorp pertaining to MPS and L&P?

11 A. Yes, with the assistance of other members of the Commission Staff (Staff).

12 Q. Has Aquila, Inc. been known by other corporate names?

13 A. Yes. Prior to March 2002, Aquila was known as UtiliCorp United, Inc. In this
14 testimony, to avoid confusion when referring to actions or events involving Aquila prior to or
15 after March 2002, I will refer to the Company generically throughout its entire history as
16 “Aquila/UtiliCorp.” Both MPS and L&P are divisions of Aquila/UtiliCorp.

17 Q. What is the purpose of your direct testimony?

18 A. I will address the Staff’s treatment in this rate proceeding of the cost impacts
19 of Aquila/UtiliCorp’s acquisition of St. Joseph Light & Power Company in December 2000.

20 Q. Have there been major changes to Aquila/UtiliCorp’s Missouri jurisdictional
21 operations in the last several years?

1 A. Yes. As previously referenced, Aquila/UtiliCorp closed on its acquisition of
2 St. Joseph Light & Power Company (L&P), a Missouri utility offering electric, natural gas
3 and industrial steam services, on December 31, 2000.

4 Q. Did Aquila/UtiliCorp pay a premium for acquiring L&P?

5 A. Yes. During the course of Case No. EM-2000-292, Aquila/UtiliCorp's
6 application before the Commission for approval of the L&P acquisition, Aquila/UtiliCorp
7 estimated that the premium it would pay for the L&P properties would be approximately
8 \$93 million. This is the amount of the premium that is cited in the Commission's Report And
9 Order in Case No. EM-2000-292. However, the actual premium paid for L&P by
10 Aquila/UtiliCorp in late 2000 was in fact larger, approximately \$108 million. When grossed
11 up for deferred tax revenue requirements, the total premium amount for the L&P properties is
12 \$176,494,000 (Response to Staff Data Request No. 381 in Case No. ER-2001-672). This
13 gross-up for taxes is necessary because the amount of the premium paid by Aquila/UtiliCorp
14 for the L&P properties is not tax deductible to Aquila/UtiliCorp.

15 Q. Did Aquila/UtiliCorp estimate that it would achieve certain merger savings
16 associated with the L&P transaction?

17 A. Yes. In Case No. EM-2000-292, Aquila/UtiliCorp estimated that it could
18 create approximately \$184 million in savings in operating costs over the first ten years of the
19 L&P acquisition.

20 Q. In its Report And Order in Case No. EM-2000-292, did the Commission
21 address how L&P acquisition costs and savings were to be treated for rate purposes?

1 A. No. The Commission did indicate that all rate questions concerning L&P
2 merger costs and savings were to be reserved for future rate proceedings, and would not be
3 decided by the Commission in the context of the acquisition case.

4 It is my understanding that, as a result of recent court proceedings, the Commission's
5 Report And Order in Case No. EM-2000-292 relating to treatment of the acquisition premium
6 costs has been remanded back to the Commission.

7 Q. What is the Staff's position in general on appropriate rate treatment of
8 merger/acquisition costs and savings in rate proceedings?

9 A. The Staff's position on these matters, as consistently expressed over time, is as
10 follows.

11 Merger and acquisition costs, in the nature of merger premiums/acquisition
12 adjustments and transaction costs, should not be allowed in customer rates, for reasons that
13 will be addressed later in this testimony.

14 Merger and acquisition savings, to the extent they are reflected in a utility's actual test
15 year, update period or true-up period financial results, generally should be reflected in
16 customer rates. A utility's "costs to achieve," also known as transition costs, incurred to bring
17 about savings should be allowed recovery in customer rates, usually through an amortization
18 to expense. (Transition costs generally include items such as relocation and training costs for
19 employees, and costs to integrate the two former utilities' computer and telecommunications
20 systems.)

21 Q. If actual merger savings are passed on to customers in rates, doesn't that give
22 all of the cost benefits of a merger to a utility's customers, not shareholders?

1 A. No. A utility can still retain the benefit of merger and acquisition benefits for a
2 period of time through “regulatory lag.”

3 Q. What is regulatory lag?

4 A. Regulatory lag is the passage of time between when a utility’s financial results
5 change and when that change is reflected in the utility’s rates. In the Staff’s opinion,
6 regulatory lag provides utilities with significant incentives to increase their productivity and
7 achieve savings because the utilities’ shareholders will reap the benefit of the increased profits
8 that result for some time before the increased profitability can be reflected in a rate case to
9 reduce customer rates. Alternatively, regulatory lag provides utilities with significant
10 incentives to prevent decreases to earnings (e.g., expense increases) because such reduced
11 profitability will be borne by their shareholders until the point in time that a rate proceeding
12 initiated to increase customer rates can be processed by a regulatory authority.

13 Related to mergers and acquisitions, the Staff believes that the phenomenon of
14 regulatory lag can produce material benefits for the combining companies’ shareholders over
15 time if significant cost savings related to the merger/acquisition can be produced between rate
16 proceedings.

17 Q. Can Aquila/UtiliCorp gain the benefit of merger savings from the L&P
18 acquisition through regulatory lag for a period of time?

19 A. Yes. A significant amount of merger savings was projected by
20 Aquila/UtiliCorp in the merger application in Case No. EM-2000-292 to result from the L&P
21 acquisition. By the time new rates from the present rate increase case go into effect, over
22 three years will have elapsed in which Aquila/UtiliCorp will have had the opportunity to
23 benefit from merger savings through the operation of regulatory lag.

1 Q. Can the amount of L&P acquisition savings be accurately identified at this
2 time?

3 A. No. In general, it is extremely difficult, and perhaps impossible, to accurately
4 identify the amount of merger savings caused by a merger transaction after-the-fact. This
5 point has been discussed extensively in Staff testimony in many past merger and acquisition
6 applications, including Case No. EM-2000-292.

7 Q. Why is it very difficult to “track” and quantify the amount of savings resulting
8 from merger transactions?

9 A. Quantifying the amount of merger savings requires a comparison between the
10 actual costs of a company after a merger with the costs that the company would have incurred
11 if the merger or acquisition had not taken place. The latter part of the equation represents a
12 hypothetical measurement of costs under a “what if” scenario, and cannot be determined in a
13 manner that parties can likely agree is objective and that can be readily agreed to by parties to
14 a rate case.

15 Q. Why did the Staff not include in its cost of service any acquisition
16 adjustments?

17 A. There are numerous reasons for the Staff’s opposition to above-the-line
18 recovery of acquisition adjustments/merger premiums in rates. Among the major reasons are
19 the following:

- 20 1. The decision to enter into a merger or acquisition transaction is a voluntary
21 one, made by utilities (generally subject to approval by their shareholders)
22 based upon their perception of overall shareholder interests. Therefore, any

1 increase in the purchase price for utility properties that exceed the net original
2 cost of the assets in question should be the shareholders' responsibility.

3 2. Utilities usually attempt to justify recovery of acquisition adjustments in rates
4 based upon an assertion that achieved merger savings exceed the revenue
5 requirement impact of the acquisition adjustment, and that it is only "fair" that
6 merger costs be reflected in rates as merger savings are. However, due to the
7 inherent inability to accurately track merger savings after-the-fact,
8 quantification of merger savings is much more difficult than quantification of
9 merger costs which, in comparison, are more straightforward in nature and
10 identifiable. Therefore, any regulatory body's deliberation on merger savings
11 recovery issues concerning acquisition adjustments will unavoidably center on
12 very subjective and contentious assertions about the level of merger savings
13 actually achieved, with very little objective evidence available to the regulatory
14 authority on which to assess the validity of merger savings claims.

15 3. In this instance, Aquila/UtiliCorp chose to account for the L&P transaction as a
16 "purchase" transaction for financial accounting purposes, rather than as a
17 "pooling" transaction. Acquisition adjustments at the time of the
18 Aquila/UtiliCorp-L&P merger only had to be booked for a purchase
19 transaction, not poolings, under the financial accounting rules in place when
20 the L&P acquisition was announced and closed. Aquila/UtiliCorp could have
21 chosen to structure the L&P transaction as a pooling, and could have totally
22 avoided the need to amortize an acquisition adjustment to expense on its
23 income statement (and seek recovery of the amortization in rates). However,

1 Aquila/UtiliCorp chose to structure the deal as a purchase, for reasons related
2 to its shareholders interests.

3 4. One reason Aquila/UtiliCorp chose to acquire L&P was its perception of
4 substantial benefits in non-regulated areas of Aquila/UtiliCorp's operations.
5 Among these benefits was Aquila/UtiliCorp's belief that L&P's electric
6 generating units had a much greater market value than their net book value
7 indicated, and that there was a significant possibility that electric restructuring
8 initiatives would allow for all or a portion of that additional value to flow to
9 Aquila/UtiliCorp's bottom line. For this and other reasons, a substantial
10 portion of the L&P acquisition adjustment would need to be allocated to non-
11 regulated operations before any consideration should be given to granting rate
12 recovery to the remaining (regulated) portion. In the L&P merger application
13 case, Aquila/UtiliCorp refused to propose a specific allocation of the
14 acquisition adjustment to non-regulated operations.

15 5. Regulatory lag usually will allow a utility sufficient opportunity to retain the
16 benefit of merger savings for a period of time. For example, Aquila/UtiliCorp
17 will have had the opportunity to retain merger savings from the L&P
18 acquisition for over three years by the time new rates from this proceeding go
19 into effect.

20 Q. Does the Staff recommend that Aquila/UtiliCorp be allowed to retain a portion
21 of alleged merger savings through a "sharing" of merger savings?

22 A. No. Allowing a utility to "share" a portion of merger savings, instead of
23 reflecting all incurred merger savings in customer rates, would result in rates being set by

1 means other than from the company's actual cost of service. Such sharing of merger savings
2 is best viewed as another means of recovering merger costs in rates, including the acquisition
3 adjustment, and the Staff is opposed to recovery of acquisition adjustments for the reasons
4 already stated in this testimony.

5 Q. Please summarize the Staff's position concerning the L&P acquisition as it
6 relates to this rate proceeding.

7 A. The Staff's position on reflecting the impacts of the L&P acquisition in this
8 rate proceeding is as follows:

- 9 1. The Commission should base MPS's and L&P's rates on those divisions'
10 actual cost of service, including L&P merger savings incurred to date and
11 reflected in MPS's and L&P's revenue requirements, if any.
- 12 2. The Commission should not include the L&P acquisition adjustment or
13 transaction costs in rates in this proceeding.
- 14 3. The Commission should not allow any "sharing" of L&P merger savings in
15 this proceeding, as that would allow for an indirect means of recovering the
16 L&P acquisition adjustment.

17 Q. Does this conclude your direct testimony?

18 A. Yes, it does.

MARK L. OLIGSCHLAEGER

COMPANY	CASE NO.
Kansas City Power & Light Company	ER-82-66
Kansas City Power & Light Company	HR-82-67
Southwestern Bell Telephone Company	TR-82-199
Missouri Public Service Company	ER-83-40
Kansas City Power & Light Company	ER-83-49
Southwestern Bell Telephone Company	TR-83-253
Kansas City Power & Light Company	EO-84-4
Kansas City Power & Light Company	ER-85-128 & EO-85-185
KPL Gas Service Company	GR-86-76
Kansas City Power & Light Company	HO-86-139
Southwestern Bell Telephone Company	TC-89-14
Western Resources, Inc.	GR-90-40 & GR-91-149
Missouri-American Water Company	WR-91-211
UtiliCorp United, Inc. / Missouri Public Service	EO-91-358 & EO-91-360
Generic: Expanded Calling Scopes	TO-92-306
Generic: Energy Policy Act of 1992	EO-93-218
Western Resources, Inc./Southern Union Company	GM-94-40
St. Louis County Water Company	WR-95-145
Union Electric Company	EM-96-149
St. Louis County Water Company	WR-96-263
Missouri Gas Energy	GR-96-285
The Empire District Electric Company	ER-97-82
UtiliCorp United, Inc./Missouri Public Service	ER-97-394
Western Resources, Inc./Kansas City Power & Light Company	EM-97-515
United Water Missouri, Inc.	WA-98-187

COMPANY**CASE NO.**

Missouri-American Water Company	WM-2000-222
UtiliCorp United, Inc. / St. Joseph Light & Power Company	EM-2000-292
UtiliCorp United, Inc. / The Empire District Electric Company	EM-2000-369
Green Hills Telephone Corporation	TT-2001-115
IAMO Telephone Company	TT-2001-116
Ozark Telephone Company	TT-2001-117
Peace Valley Telephone Company, Inc.	TT-2001-118
Holway Telephone Company	TT-2001-119
KLM Telephone Company	TT-2001-120
Missouri Gas Energy	GR-2001-292
The Empire District Electric Company	ER-2001-299
Oregon Farmers Mutual Telephone Company	TT-2001-328
Ozark Telephone Company	TC-2001-402
Gateway Pipeline Company, Inc.	GM-2001-585
Missouri Public Service	ER-2001-672
Union Electric, d/b/a AmerenUE	EC-2002-1
Laclede Gas Company	GA-2002-429
Aquila, Inc., d/b/a Aquila Networks-MPS-Electric and Aquila Networks-L&P-Electric and Steam	ER-2004-0034 and HR-2004-0024 (Consolidated)

MARK L. OLIGSCHLAEGER

Company Name	Case Number	Issues
Western Resources, Inc.	GR-90-40 and GR-91-149	Take-Or-Pay Costs
Missouri-American Water Company	WR-91-211	True-up; Known and Measurable
Missouri Public Service	EO-91-358 and EO-91-360	AAO
Generic Telephone	TO-92-306	Revenue Neutrality; Accounting Classification
Generic Electric	EO-93-218	Preapproval
Western Resources, Inc. & Southern Union Company	GM-94-40	Regulatory Asset Transfer
St. Louis County Water Company	WR-95-145	Policy
Union Electric Company	EM-96-149	Merger Savings; Transmission Policy
St. Louis County Water Company	WR-96-263	Future Plant
Missouri Gas Energy	GR-96-285	Riders; Savings Sharing
The Empire District Electric Company	ER-97-82	Policy
Missouri Public Service	ER-97-394	Stranded/Transition Costs; Regulatory Asset Amortization; Performance Based Regulation
Western Resources, Inc. & Kansas City Power & Light	EM-97-515	Regulatory Plan; Ratemaking Recommendations; Stranded Costs
United Water Missouri, Inc.	WA-98-187	FAS 106 Deferrals
Missouri-American Water Company	WM-2000-222	Conditions
UtiliCorp United, Inc. & St. Joseph Light & Power Company	EM-2000-292	Overall Recommendations

Company Name	Case Number	Issues
Utilicorp United, Inc. & The Empire District Electric Company	EM-2000-369	Overall Recommendations
Green Hills Telephone	TT-2001-115	Policy
IAMO Telephone Company	TT-2001-116	Policy
Ozark Telephone Company	TT-2001-117	Policy
Peace Valley Telephone	TT-2001-118	Policy
Holway Telephone Company	TT-2001-119	Policy
KLM Telephone Company	TT-2002-120	Policy
Missouri Gas Energy	GR-2001-292	SLRP Deferrals; Y2K Deferrals; Deferred Taxes; SLRP and Y2K CSE/GSIP
The Empire District Electric Company	ER-2001-299	Prudence/State Line Construction/Capital Costs
Ozark Telephone Company	TC-2001-402	Interim Rate Refund
Gateway Pipeline Company	GM-2001-585	Financial Statements
Missouri Public Service	ER-2001-672	Purchased Power Agreement; Merger Savings/Acquisition Adjustment
Union Electric, d/b/a AmerenUE	EC-2002-1	Merger Savings; Criticisms of Staff's Case; Injuries and Damages; Uncollectibles
Laclede Gas Company	GA-2002-429	AAO Request
Aquila, Inc., d/b/a Aquila Networks-MPS-Electric and Aquila Networks-L&P- Electric and Steam	ER-2004-0034 and HR-2004-0024 (Consolidated)	Aries Unit and Acquisition of St. Joseph Light and Power Company Adjustment