BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Joint Application of Great Plains Energy Incorporated, Kansas City Power & Light Company, and Aquila, Inc. for Approval of the Merger of Aquila, Inc. with a Subsidiary of Great Plains Energy Incorporated and for Other Related Relief	**))))))**	**Case No. EM-2007-0374**

PRE-HEARING BRIEF OF JOINT APPLICANTS GREAT PLAINS ENERGY INC., KANSAS CITY POWER & LIGHT CO. AND AQUILA, INC.

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Joint applicants Great Plains Energy Incorporated ("Great Plains Energy"), Kansas City Power & Light Company ("KCPL"), and Aquila, Inc. ("Aquila") submit this Pre-Hearing Brief pursuant to the Commission's Order adopting procedural schedule issued June 19, 2007. The Applicants will address the issues contained in the List of Issues, Order of Witnesses, and Order of Cross-Examination filed by the Staff on November 21, 2007.

STATEMENT OF THE CASE

This case presents the Commission with a unique opportunity to build upon and expand the successes of Great Plains Energy and KCPL by bringing Aquila into their corporate family. The long-term benefits of Aquila becoming an operating subsidiary of Great Plains Energy, in coordination with KCPL, will result in greater scale operational efficiencies, and rates that over time are expected to be lower than they would be otherwise.

Great Plains Energy's acquisition of Aquila makes sense for many reasons. First, the geographical service territories of the utilities are adjacent increasing the potential for economics of scale and improved reliability. Second, Aquila and KCPL are already joint owners of the Iatan 1 generating unit and are partners in the project to build Iatan 2. Third, combining the headquarters and support functions of the two companies, which are both located in the Kansas City area, will be smooth and uneventful. Most importantly, the financial effect of Great Plains Energy's acquisition of Aquila are expected to result in immediate investment-grade credit metrics for Aquila and lower debt costs. This credit rating improvement and Great Plains Energy's financial support will permit Aquila to have greater access to capital markets on more reasonable terms. Finally, the Merger will improve the overall business risk profile of Great Plains Energy, which will benefit the ratepayers of both Aquila and KCPL.

Based on an unusually detailed analysis, the applicants conservatively estimate savings from the transaction at $755 million over ten years, with $305 million occurring during the first five years, 2008-2012. Great Plains Energy has requested that after subtracting $45 million in transition costs, these synergy savings be shared on a 50/50 basis, a standard split applied by this Commission in other cases. Even after the recovery of transaction costs of $95 million, the savings approximate $35 million. However, other parties focus not on savings and efficiencies, but rather on Great Plains Energy's request to recover Aquila's actual debt costs in future rate cases. They argue that this request demonstrates why the transaction produces no benefits in the first five years and should be disapproved. Yet, this position ignores the impact of retiring Aquila's debt and the reduced financing costs on future borrowings. It also ignores the fact that all synergies achieved after 2012 will flow to customers.

Lest the Commission "miss the forest for the trees" as it sifts through the multitude of issues raised by other parties, the joint applicants encourage the Commissioners to take a long and broad view of the benefits likely to be gained from this transaction. The prospects of Aquila and KCPL working together in a coordinated and efficient fashion, within a financially healthy holding company, will clearly bring benefits to ratepayers over the next several decades.

This Merger promises to take the best of both utilities and use their resources to the benefit of all their customers. These possibilities have already been recognized by the shareholders of Aquila and Great Plains Energy, who approved the Merger in early October. Given the positive reception which this transaction has already received, this is not the time for remorse, regrets, or second-guessing.

Rather, the joint applicants believe this is a time for looking to the future and determining that the proposed transaction will benefit customers, shareholders, and all segments of the public for many years to come. If anything, this transaction is long overdue. The Merger is more than simply "not detrimental to the public interest." It is most emphatically <u>in the public interest</u>.

I. <u>Overview of Merger</u>

The Joint Applicants request authority for Aquila to merge with a subsidiary of Great Plains Energy (the "Merger"). The Merger is conditioned on a separate but related transaction occurring first in which Black Hills Corporation ("Black Hills") will purchase Aquila's gas assets in Iowa, Nebraska, Kansas, and Colorado, as well as Aquila's electric assets in Colorado ("Black Hills Purchase"). Following the close of the Black Hills Purchase, the Merger will result in Great Plains Energy acquiring Aquila's Missouri-based utilities, Aquila Networks-MPS and Aquila Networks-L&P. Great Plains Energy will also acquire Aquila's steam operations in St. Joseph, Missouri, as well as its merchant services operations, which primarily consist of the 340 MW Crossroads generating facility in Mississippi and certain residual natural gas contracts.

The Joint Applicants do not propose to consolidate KCPL's and Aquila's service territories, nor do they propose to merge KCPL and Aquila or transfer any Aquila assets to KCPL. KCPL and Aquila will continue to operate as separate and distinct regulated Missouri utilities under their respective Commission-approved tariffs. Nonetheless, as explained more thoroughly herein, the Merger will result in significant synergy savings by bringing KCPL and Aquila under common operation.

As explained in the Direct Testimony of Terry Bassham and in the Joint Application, Black Hills will pay Aquila approximately $940 million in cash in consideration for the Black Hills Purchase. The Black Hills Purchase is controlled by the Asset Purchase Agreement ("APA") and the Partnership Interests Purchase Agreement ("PIPA"). The APA controls Black Hills' purchase of Aquila's natural gas assets in Nebraska, Kansas and Iowa. The PIPA controls Black Hills' purchase of Aquila's electric and natural gas assets in Colorado. Following the closing of the APA and PIPA transactions, Black Hills will own and operate the natural gas assets of Aquila in Nebraska, Kansas, Iowa, and Colorado. Black Hills will also own Aquila's Colorado electric assets.

The Merger will occur immediately following the consummation of the Black Hills Purchase. It will be accomplished by Gregory Acquisition Corp. ("Merger Sub"), a Delaware corporation and direct, wholly-owned subsidiary of Great Plains Energy, merging with and into Aquila, with Aquila as the surviving entity. As a result, Aquila will become a direct, wholly-owned subsidiary of Great Plains Energy, as KCPL is today.

Upon consummation of the Merger, Aquila stockholders will receive the consideration of stock and cash called for under the Agreement and Plan of Merger. Each share of Aquila's common stock will convert into the right to receive (i) 0.0856 of a share of common stock, no par value, of Great Plains Energy's common stock and (ii) a cash payment of $1.80. Based on Great Plains Energy's closing NYSE stock price of $32.05 on February 6, 2007, the Merger represents a value of $4.54 per share of Aquila common stock, for a total indicated value of approximately $1.7 billion. Great Plains Energy will also assume approximately $1 billion of Aquila's net debt and other liabilities.

The Merger and Black Hills Purchase have already received a number of approvals. Aquila's shareholders approved the transactions on October 9, 2007. The shareholders of Great Plains Energy approved the transactions on October 10, 2007. The transactions did not require the approval of Black Hills's shareholders. The Federal Energy Regulatory Commission ("FERC") approved the transactions in October. Great Plains Energy Inc., 121 FERC ¶ 61,069 (Oct. 19, 2007). In addition, on August 27, 2007, the Federal Trade Commission announced that it granted early termination of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR"). The Iowa Utilities Board and the Nebraska Public Service Commission have approved the Black Hills Purchase. In re Aquila, Inc., Docket No. SPU-07-12 (Iowa Util. Bd., Aug. 31, 2007); In re Aquila, Inc., Application No. NG-0044 (Neb. P.S.C., Oct. 16, 2007). Applications concerning the transactions are still pending before the Colorado Public Utilities Commission and the Kansas Corporation Commission.

II. Merger Synergy Savings Sharing Proposal

A. Are the estimates of savings from synergies accurate?

Yes. Great Plains Energy/KCPL's general approach to estimating synergies is consistent with industry practice, and is in fact more detailed and better supported than in most transactions. Its methodology is comprehensive, current, detailed, attributable, quality assured, and conservative. In addition, Great Plains Energy/KCPL's estimated synergies are modestly above the industry average. They appear reasonable on a stand-alone basis, and in total are in the range that would be expected on the basis of comparable transactions in the utility industry and the circumstances of KCPL and Aquila.

Based upon competent and substantial evidence that has been filed in this proceeding, the Commission should find that KCPL's estimates of the synergies from the Merger are reasonable, and the proposed treatment of the synergy savings is consistent with the practices commonly used in other jurisdictions, and should be adopted in this proceeding.

1. Could any of the synergy savings be achieved by KCPL or Aquila on a stand-alone basis absent the acquisition/ consolidation/ integration?

This is not a relevant question for consideration in this proceeding. Both "created" and "enabled" synergy savings are unlocked by the Merger, and both require management initiative and action before they can be realized. (Kemp Surrebuttal, p. 13) While the distinction between such "created" and "enabled" synergies are not clear-cut, all of these savings are a direct result of the Merger.

2. Are any of the identified synergy savings dependent on KCPL and Aquila consolidating/integrating/merging their operations?

Yes. Many of the benefits to KCPL and Aquila customers from this transaction come from integrating various KCPL and Aquila functions and activities, as described below. However, as a legal matter, the proposed Merger does not involve KCPL directly. After the Merger, KCPL and Aquila will be separate subsidiaries of Great Plains Energy. Aquila will continue to own its own power plants, its transmission and distribution facilities, and utility plant. Aquila will continue to serve its customers under its separate electricity and steam tariffs. See Giles Surrebuttal at 3. The fact that KCPL and Aquila will integrate their operations, as discussed herein, does not require any regulatory approvals not already requested in this proceeding.

B. Do the actual synergy savings exceed the sum of the transaction, transition and incremental interest costs that the Joint Applicants propose to recover over the first five (5) years following the acquisition/merger/consolidation? If not, is the proposed merger not detrimental to the public interest?

The Commission should consider the long-term benefits of the Merger in this proceeding, and not arbitrarily limit its analysis to a specific period.

The total operational synergies that will result from the proposed transaction are $305 million over the first 5-year period. However, the Merger is expected to produce substantially more savings to customers over a more extended period. The total synergies created by the proposed Merger would total $755 million, if the synergies in year five are escalated at the inflation rate through year ten. Of that amount, the customer benefit would be $603 million of the $755 million (80%) with a Net Present Value for customers of $341 million. See Zabors Supp. Direct at 8. These actual synergy savings from the Merger over the long term will substantially exceed the sum of the transaction, transition and incremental interest costs that the Joint Applicants propose to recover.

The Joint Applicants request that the Commission authorize KCPL and Aquila, collectively, to retain for a five (5) year period fifty percent (50%) of the synergy savings that result from the Merger, as quantified in the testimony of Robert Zabors. A significant portion of the savings resulting from the Merger will be used to reduce costs for Aquila's and KCPL's retail customers in future rate cases. To compensate shareholders for additional risk they bear as a result of the Merger, the Joint Applicants propose that the synergy savings be shared equally between retail customers and shareholders. See Bassham Direct at 10. After the first five years, customers will receive the benefits of all synergies. Specifically, of the $755 million in total synergies, $603 million will accrue to customers over the 10-year analysis period. See Marshall

Surrebuttal at 6 and Schedule JRM-8. Clearly, the proposed Merger is not detrimental to the public interest, and instead will promote the public interest.

The total operational synergies that will result from the proposed transaction are $305 million over the first 5-year period. However, the Merger is also expected to produce substantially more savings to customers over time. For example, the total synergies created by the proposed Merger would total $755 million, if the synergies in Year 5 are escalated at the rate of inflation through Year 10. Of that amount, the customer benefit would be $603 million of the $755 million (80%) with a net present value for customers of $341 million. See Zabors Supp. Direct at 8.

C. The Estimated Savings and Merger Synergies Are Substantial, and Will Directly Benefit the Customers.

There are a number of reasons why the acquisition of Aquila complements Great Plain's current operations. Aquila's utilities are not only adjacent to KCPL's service area, but they also fill in the gap that currently exists between KCPL's East District and the rest of its service territory. As a result, significant savings opportunities are available soon after the close of the Merger related to combined operations of many functions within KCPL and Aquila. In addition, Aquila's service areas have strong growth potential. See Downey Direct at 4.

Development of the Synergy Estimates.

John Marshall, KCPL's Senior Vice President for Delivery, and Robert T. Zabors, a partner in Bridge Strategy Group, LLC, discuss the process used to identify and quantify the non-fuel synergy savings and costs to achieve in detail in their testimony. See Marshall Direct at 1-8; Marshall Supp. Direct at 1-22; Marshall Surrebuttal at 1-11; Zabors Direct at 2-15; Zabors Supp. Direct at 1-15.

Estimation of the synergies began in July, 2006 following Great Plain's agreement to participate in Aquila's auction process. Since the Merger was publicly announced in February 2007, integration planning efforts expanded to include more than 20 teams and 150 employees of both KCPL and Aquila. See Marshall Surrebuttal at 3. Prior to the public announcement of the Merger, Bridge Strategy Group facilitated the identification of opportunities to reduce non-fuel operating and maintenance ("NFOM") expenses. Great Plains Energy already had substantial knowledge of Aquila's operations when it began this process since KCPL employees have participated alongside Aquila employees in various Missouri industry and regulatory activities, and KCPL and Aquila are partners in the Iatan 1 and 2 Units. KCPL had been involved in merger activities with Aquila's predecessor company, UtiliCorp United in the mid-1990s.

Managers from Great Plains Energy and KCPL have developed detailed estimates of the resources, expenses, and capital that Great Plains Energy will require to operate Aquila and KCPL. Participants represented the full scope of functions that will be required in a post-Merger environment, and were able to construct a comprehensive view of how the organization will run after the Merger is complete. Executives and key managers developed an overall approach to managing the combined organization, and identified transition steps to achieve the expected synergy savings. Non-fuel expense and personnel costs were allocated between Aquila (post-

Merger) and Black Hills. Follow-up discussions with Aquila enabled an even greater degree of precision to be achieved in the estimates of the synergies and savings.

Since the announcement of the Merger, there has also been extensive involvement from both Aquila and KCPL management and employees in integration planning. More than 150 people were involved on integration planning teams and subteams. The various teams worked together to determine the incremental resources (expenses, capital, and employee positions) required to operate the companies after the Merger closes. The incremental resources were compared to the baseline Aquila resources to determine the estimated amount of synergies. The synergies from each team were then combined to determine the total estimated synergies resulting from the transaction. See Zabors Supp. Direct at 5-6; Marshall Surrebuttal at 3-4.

The teams determined the synergies over a five-year period, beginning on January 1, 2008, although the expected close of the Merger will be later in the first quarter of 2008. Since the majority of the synergies will continue beyond the first five-year period, the synergies were escalated by 3.1% which is the 3-year average of the CPI-U, the consumer price index.

The major components of the expected synergies are in the following areas:

1. Reductions in operating forecasts of departments ($87 million).

The majority of these savings come from labor and non-labor cost reductions. Labor reductions are the result of actual reductions in payroll that are attributable to position reductions. The non-labor synergies result from economies of scale and the impacts of position reductions.

2. Reductions in major projects that reduce non-fuel operations and maintenance expenses ($33 million).

Facilities consolidation, the closure of Aquila's headquarters building, and the implementation of automated meter reading ("AMR") infrastructure for Aquila customers make up this synergy estimate. KCPL will close overlapping service centers and consolidate operations in a new facility and on existing KCPL Northland facility. The net benefit of this opportunity will be $6.8 million. See Zabors Supp. Direct at p. 11. The efficiencies gained from consolidating into one headquarters building will create $5.8 million in value from reductions in operating costs and increased efficiencies at Great Plains Energy's headquarters. The value of selling the Aquila headquarters building will be $16.2 million over the four years following the sale at the end of 2008. KCPL also will leverage its experience with AMR and upgrade the Aquila customer base to this level of service with a savings of $4.7 million over five years.

3. Supply Chain Synergies ($131 million).

The total savings from the supply chain is $131 million, with strategic sourcing/procurement for over half of the total savings. This consists of $97.7 million in O&M savings and $33.3 million in avoided costs of capital savings, which is generated from $95.5 million in avoided capital expenditures. See Buran Supp. Direct at 3. The integration will lead to procurement savings from greater scale and scope, and more effective use of contracted services in operations. It will also enable cost-effective investments in centralization of physical storage and better management of inventory. These savings include opportunities to leverage increased purchasing scale, best practices, and increased scope, i.e. sharing of material, equipment, and labor, where appropriate. See Buran Supp. Direct at 2-27.

4. Specific integration projects that reduce purchased power expense or increase revenue ($54 million over five years).

Optimizing the operation of Aquila's Sibley Unit 3 by utilizing KCPL's combustion expertise and outage management experience is expected to deliver 30 MW of capacity that will reduce purchased power expenses by $17 million over five years. Utilizing the economies of scale in the gas fleet and Aquila expertise to improve combustion turbine operations will capture

$3.1 million in synergies. KCPL will use its experience with boiler tube failure improvement to deliver improved performance resulting in $5.6 million in value. KCPL's experience and infrastructure in energy efficiency will add incremental value in the Aquila customer base returning $13 million over five years. Teams will leverage KCPL combustion and outage experience to improve operations at Sibley Units 1 and 2, with a savings of $1.6 million. KCPL's experience, processes, and tools will also be used to improve heat rates, saving $0.6 million. Aquila's skills, intellectual property, and processes to enhance billing processes will capture $12.8 million. The net impact of these projects is to reduce purchased power or increase revenue by approximately $54 million over the first five years. See Zabors Supp. Direct at 9-12.

D. Transition Cost Recovery.

Transition costs are estimated to be $45 million. Transition-related costs are comprised of the costs incurred to integrate Aquila and Great Plains Energy. Without incurring these costs, the companies cold not achieve the synergies while maintaining or improving system reliability for Aquila's and KCPL's customers. See Bassham Surrebuttal at 3. These costs include third party costs to support the integration from legal, Human Resources, Information Technology and process integration perspectives.

These transition costs should be recovered over a five year period, as described above.

E. Operational and Organization Benefits.

Fundamentally, the Merger will result in public utilities that are better prepared to meet the near and longer-term energy needs and challenges of the Kansas City metropolitan area and the region. It is a Merger that will provide long-term benefits to customers, communities and the environment. See Marshall Supp. Direct at 3.

From a transmission and distribution perspective, consolidating adjacent operations will enable the two companies to more efficiently cover the same area. KCPL and Aquila will serve a combined metropolitan customer base of over 625,000, an increase of almost 40% above KCPL's existing customer based today. Applying KCPL's expertise in managing urban areas and Aquila's expertise in managing rural areas will contribute to improved long-term performance. Id.

From an energy-supply perspective, the Merger will provide greater scale and enable both companies to benefit from the processes and skills of each other. Increasing efficiency and availability of generation assets delivers significant financial and environmental benefits and reduces customers' exposure to the volatility of the regional power market. KCPL and Aquila are currently joint owners of Iatan 1 and 2, and the combination will simplify the structure and operation of the units. Id.

From a workforce perspective, it is important to note that no union employees will lose their jobs. While positions will be reduced in management, it is expected that many talented Aquila employees will find opportunities with Black Hills or with KCPL in positions created due to attrition. See Marshall Supp. Direct at 3.

From a facilities and supply chain perspective, the logic of the Merger is also compelling. Facility consolidation and rationalization across the service area reduces costs for customers and supports integrated response. The reduction of duplicate facilities—including headquarters and data center operations that neither KCPL nor Aquila could do alone—reduces operating expenses and rate base. Facility consolidation is also an important component of achieving supply chain management synergies. These include sourcing, materials management, fleet and contract management. See Marshall Supp. Direct at 4.

F. Synergies Identified In Operating Functions.

1. Delivery.

Delivery functions consist of Distribution, Transmission, Energy Solutions, Customer Service and Information Technology. In these areas, the synergies come from (1) synergies in Distribution operating expenses generated from the economies of scale of combining two similar operations in adjacent service territories, and (2) synergies from consolidation of five existing service centers into two locations. See Marshall Supp. Direct at 12.

The greater Kansas City metropolitan area of the post-merged organization will be managed as a single district. The operations of the existing Liberty and Platte City service centers will be consolidated into KCPL's Northland facility. A second consolidation will combine the existing service center operations in Lee's Summit, Blue Springs, and Dodson into a new facility to be built in/or near Lee's Summit along the I-470 corridor. The necessary capital investments to achieve this result will be offset by the elimination and sale of replaced facilities. See Marshall Supp. Direct at 12. This effort over the 2008-2012 timeframe will deliver operating synergies of $6.8 million, 45% of which is generated from low facility O&M costs. The remaining 55% is expected to accrue from a reduction in contractor needs on facilities being eliminated. Perhaps more importantly, the companies believe that these changes will continue to improve customer satisfaction, reliability, safety and cost related to the Distribution function.

Transmission synergies will come from: (1) combining similar operations in adjacent service areas and (2) a potential combined Regional Transmission Organization ("RTO") membership. Scale economies will allow the post-merged organizations to reduce one five-man contract service crew. In addition, subject to regulatory approvals, KCPL and Aquila may be in the same RTO at some point in the future. See Marshall Supp. Direct at 13.

Energy Solutions offers the potential for cost reductions, but more importantly will be the function leading key integration projects that expand KCPL's capabilities and practices in energy efficiency, eServices and other areas to Aquila's customers. These programs will improve customer interaction with Aquila and provide customers with ways to better manage and monitor their energy use. For example, KCPL will offer 21 of its existing 29 programs to Aquila's customers and utilize its resources to provide the necessary funding. See Marshall Supp. Direct at 14. In addition, KCPL will leverage its existing AMR experience to develop an infrastructure with the Aquila service territory. KCPL will also use its eServices infrastructure to accelerate Aquila's move to a more accurate, more responsive customer experience. See Marshall Supp. Direct at 15; Bryant Supp. Direct at 1-9.

Customer service, a critical function for both companies, will also recognize synergies in the following areas: (1) As Aquila has more automation than is currently in place at KCPL in the customer service area, the merged organization will leverage Aquila's technology and associated process expertise to increase call center automation and deliver associated productivity efficiencies; (2) The Energy Solutions eServices initiative will leverage existing KCPL technology and process expertise to general Non-Fuel Operations & Maintenance expense savings in the Customer Service area by decreasing call volumes and associated labor needs as Aquila customer migrate to more convenient electronic self-service alternatives via the Internet; (3) Labor efficiencies generated from economies of scale will be achieved by merging similar operations of the two companies. See Marshall Supp. Direct at 16.

Information Technology ("IT") will achieve synergies in the following areas: (1) Application portfolio rationalization; (2) Consolidation of the telecom and data networks, and moving to KCPL's privately owned network model; (3) Consolidation of the production and disaster recovery Data Center facilities of the combined companies, including service, disk storage and core networking infrastructure; (4) Combining the Aquila and KCPL Energy Management Systems ("EMS") into the new KCPL EMS that will be implemented in 2008; and (5) Combining the Aquila and KCPL IT organizations, resulting in a manpower reduction based on the separate organizations. See Marshall Supp. Direct at 16-17; Tickles Supp. Direct at 2-6.

2. Supply (Plant Operations and Energy Resource Management).

The Supply function has two major functions—plant operations and energy resource management. Synergies in this area will be achieved by optimizing: (1) the operations of Sibley Unit 3 by utilizing KCPL combustion expertise and outage management; (2) economies of scale in the gas fleet and Aquila's expertise to improve combined combustion turbine operations; (3) KCPL experience, process and tools to develop a holistic program for improving heat rate; (4) KCPL experience with boiler tube failures and outage experience to improve operations and Sibley Units 1 and 2, reducing outage requirements; and (5) additional identified opportunities to reduce Non-fuel Operations and Maintenance expenses. See Marshall Supp. Direct at 18.

3. Support (Facilities, Finance and Accounting, and Human Resources).

Integration of facilities will improve effectiveness of the operations, reduce costs and promote a common, winning culture. The companies will have a single headquarters building at 1201 Walnut, and Raytown will be the customer service campus with call center, billing and related functions. Processes and systems will also be standardized with best practices and technologies adopted. See Marshall Supp. Direct at 20.

In the Finance and Accounting functions, synergies will be achieved primarily from eliminating redundancies and duplicate functions and processes. For example, redundant external audit fees will be substantially reduced. It is anticipated that of the 113 accounting and finance positions currently at Aquila, 55 positions will be needed in 2009. Id. at 21.

In the Human Resources function, synergies will also come from eliminating redundancies and duplicate functions. Systems will be standardized with best practices and technologies adopted. It is anticipated that of the 32 Human Resources positions currently at Aquila, 10 positions will be needed in 2009. By 2012, however, it is anticipated that only 2 incremental positions will be part of the Human Resources organization. The decrease in personnel will be driven by migrating to a different operating model enabled by technology. Id. at 21.

4. Organizational and Management Benefits.

a. Administration and Staff.

The Merger will result in Great Plains Energy, and its affiliated companies, becoming an even stronger regional utility. Following the Merger, Great Plains Energy's footprint will be expanded into a larger contiguous service area covering over 18,000 square miles, serving nearly 800,000 customers.

Following the Merger, very little change will occur within Great Plains Energy or KCPL executive management. Michael Chesser will remain Chairman of the Board of Great Plains Energy and KCPL, as well as Chief Executive Officer of Great Plains Energy. William Downey will remain the President of Great Plains Energy and KCPL, as well as the Chief Operating Officers of Great Plains Energy and Chief Executive Officer of KCPL. Following the Merger, Mr. Downey will become President and Chief Executive Officer of Aquila. The Merger will not alter the membership of the Boards of Directors of Great Plains Energy or KCPL. Great Plains Energy corporate headquarters will remain at 1201 Walnut. Once the Merger is finalized, Aquila corporate employees will relocate to Great Plains Energy existing offices and facilities. See Downey Direct at 3-4.

Similarly, there will be little to no change in the senior management team of Great Plains Energy and KCPL as a result of the Merger. As discussed below, there will be no immediate reduction in current union employees at Aquila, but Great Plains Energy and KCPL anticipate eliminating approximately 355 overlapping positions on day 1. See Zabors Supp. Direct at p. 11.

Although Great Plains Energy and KCPL expect to retain the majority of the employees working in Aquila's Missouri operations, including all plant, transmission and distribution operations personnel, Great Plains Energy and KCPL plan to (i) eliminate duplicative, or overlapping, administrative positions, and (ii) convert the retained Aquila employees to either Great Plains Energy or KCPL employees. Great Plains Energy Services, Inc. ("GPES"), a wholly-owned subsidiary of Great Plains Energy, and KCPL will provide human resources, legal and accounting services to Aquila. See Bassham Direct at 7. Almost 900 Aquila positions will be included in the combined company. Over the first five years the number will drop to 843 positions, as transitional roles are not needed and integration projects yield results. See Marshall Supp. Direct at 9. However, as discussed above, there will be little change to KCPL's structure itself.

b. Labor.

KCPL intends to pursue negotiations that will result in the integration of the Aquila employees currently represented by IBEW 695 and 814 into KCPL's three existing bargaining units. KCPL is committed to working with the IBEW regarding Aquila's union employees, as well as with KCPL's bargaining units. Great Plains Energy believes that by combining staff and labor personnel it will have more flexibility in aligning employees with customers' needs and will provide better service. Union employees will also have expanded opportunities and options in their work locations and assignments.

G. Analysis of Synergies.

1. KCPL's Estimates and Treatment of Synergies from the Merger Are Reasonable And Consistent With Other Merger Transactions.

In an effort to ensure the reasonableness of its analysis of the synergies associated with the Merger, Great Plains Energy and KCPL requested that William J. Kemp, a Managing Director of Black & Veatch Corporation, provide an independent review of the Merger synergies estimates developed by KCPL. He assessed the soundness of KCPL's synergy estimation methodology and the reasonableness of the resulting synergy estimates in the context of the utility industry experiences in the United States. See Kemp Supp. Direct at 3-4.

Mr. Kemp has extensive experience in reviewing and analyzing public utility mergers and acquisitions, including the following transactions: PacifiCorp-Utah Power & Light; Puget Sound Power & Light-Washington Energy; Public Service Company of Colorado-Southwestern Public Service; Washington Water Power-Sierra Pacific Resources; and Exelon-PSEG Enterprises. See Kemp Supp. Direct at 3-4.

Prior to reviewing the specific synergy savings estimates, Mr. Kemp observed that the combined KCPL-Aquila organization should have significant natural advantages that will allow it to obtain synergy savings from an unusually broad range of utility operations since the companies have adjoining service areas. In addition, KCPL and Aquila are similarly sized and have complementary operating strengths, e.g., KCPL in generation and T&D, and Aquila in customer service operations. Many other transactions that Mr. Kemp has reviewed did not have these advantages, particularly the advantages of proximity. See Kemp Supp. Direct at 8-9, 21.

Based upon his extensive review of KCPL and Aquila's synergy estimates in this proceeding, he concluded:

> At least four separate lines of corroborating evidence support the conclusion that the estimates are reasonable and conservative.
>
> 1. Its synergy estimation methodology is sound. The synergy teams have drilled down to an unusually deep level of detail, and have identified and vetted reasonable levels of synergies. The sources of savings that they cited are credible.
>
> 2. KCPL's estimated total synergies (including fuel) are modestly higher than the median <u>announced</u> synergies for 26 other energy utility transactions (5% vs. 3% of total O&M, 11% vs. 9% of non-fuel O&M).
>
> 3. KCPL's estimated synergies for non-fuel O&M expense are significantly higher than the median <u>realized</u> synergies for 15 other electric utility transactions (10% vs. 2%).
>
> 4. KCPL's estimated synergies are at the upper end of the range that we have advised utility clients, based on our experience, is reasonable to expect in merger transactions (10% vs. 7-10%)
>
> KCPL's estimates tend to exceed the industry averages because KCPL and Aquila are neighboring utilities who can access an unusually broad range of synergies.

<u>See</u> Kemp Supp. Direct at 22.

Mr. Kemp also reviewed the reasonableness of the Great Plains Energy/KCPL's proposal for sharing hard synergy benefits equally between customers and shareholders. He concluded that a 50/50 split of quantifiable benefits attributable to the Merger is almost standard across the industry. "It has been a core element of the rate treatment for many utility mergers. Commissions in many jurisdictions have regarded a roughly equal split of near-term benefits as fair, reasonable, and sufficient to induce shareholders to approve the transaction in question." <u>Id.</u> at 24.

With regard to the central issues addressed in his testimony, Mr. Kemp concluded:

> 1. KCPL's general approach to estimating synergies is consistent with industry practice, and is in fact more detailed and better supported than in most transactions. Its methodology is comprehensive, current, detailed, attributable, quality assured, and conservative.
>
> 2. KCPL's estimated synergies are modestly above the industry average. They appear reasonable on a stand-alone basis, and in total are in the range that would be expected on the basis of comparable transactions in the utility industry and the circumstances of KCPL and Aquila.
>
> 3. KCPL proposes to share the medium-term synergies roughly equally between customers and shareholders. Most commissions regard this split as equitable and appropriate. Its mechanism for flowing through these benefits in rates is well-designed for the current rising unit cost environment, and leaves customers with a substantial upside for additional benefits, particularly given the companies' conservative approach to estimating the synergies.

See Kemp. Supp. Direct at 27-28.

Based upon this clear and convincing evidence, the Commission should find that Great Plains Energy's estimates of the synergies from the Merger are reasonable, and that the proposed treatment of the synergy savings is consistent with the practices commonly used in other jurisdictions and should be adopted in this proceeding.

2. The Criticisms of Other Parties Regarding KCPL's Estimates of Synergies Are Unfounded And Should Be Rejected.

Staff, Public Counsel and Praxair witnesses have made the following criticisms of KCPL's approach to the estimation and treatment of synergies: (1) Operating costs of the merged utility companies should not be adjusted for inflation by applying the Consumer Price Index [Staff Report at 77-80]; (2) Uncollectible expense should not be excluded from the costs for the Customer Service function of the merged utilities [Staff Report at 79]; (3) Mr. Kemp's workpapers were not provided on a timely basis [Staff Report at 79-80]; (4) KCPL's estimates of synergy savings from the proposed Merger are overstated or too aggressive [Dittmer Rebuttal at 36-39; Brubaker Rebuttal at 9-11]; and (5) Enabled synergies should be excluded from the total pool of synergy savings that the applicants propose for sharing between customers [Dittmer Rebuttal at 12-16].

As Mr. Kemp testified, none of these criticisms are valid or well-founded when evaluated in the light of the factual record and accepted regulatory policy principles. <u>See</u> Kemp Surrebuttal at 1-15. The use of the CPI to calculate real synergy savings is conservative for the following reasons: (1) The CPI understates the level of inflation in the non-labor portion of utility NFOM expense. If an index with greater increases than the CPI had been used to deflate the post-transaction costs of the utilities in the Kemp analysis, the decreases in real costs would have been larger; and (2) the analysis compares total costs, not unit costs. To the extent that unit sales (kwh) and numbers of customers increase in the four years between the pre-transaction cost data and the post-transaction costs, use of a different index would not capture the full gains realized by the merging utilities. <u>See</u> Kemp Surrebuttal at 7.

With regard to Staff's criticism of the exclusion of Uncollectible Accounts from the Customer Service expense figures, Mr. Kemp testified that it is proper to exclude uncollectible accounts from his analysis since: (1) Uncollectible Accounts cost is more properly characterized as a contra-revenue item, not an expense item; (2) Since the level of Uncollectible Accounts are heavily influenced by the rules of the local regulatory jurisdictions, these rules can affect the utility's revenue exposure to overdue accounts; and (3) Uncollectible Accounts costs are more closely related to the level of fuel and purchased power costs than the level of NFOM expenses. <u>Id.</u> at 9.

With regard to the Staff's criticism related to Mr. Kemp's workpapers, the workpapers he relied upon directly for his exhibits were provided with his Supplemental Direct Testimony filed in August, 2007. <u>Id.</u> at 9.

The criticisms of Mr. Dittmer and Mr. Brubaker regarding the synergy estimates are also unsupported. Mr. Dittmer's testimony makes little attempt to rebut the estimates of the synergy savings or the reasonableness of the methods for estimating synergies. Mr. Brubaker argues that the synergy estimates should be discarded merely because they are above the median of industry experience. As Mr. Kemp explains in his testimony, the synergies should be expected to be above the industry average since KCPL and Aquila are in close proximity and the potential for synergies is substantially greater than in other transactions. See Kemp Surrebuttal at 10-12.

Mr. Dittmer's assertion that the "enabled" synergy savings[1] should be removed from any analysis that attempts to evaluate the benefits of the Merger is also misplaced. As Mr. Kemp explains, both "created" and "enabled" synergy savings are unlocked by the Merger, and both require management initiative and action before they can be realized. Id. at 13. While the distinction between such synergies is not always clear-cut, all of these savings are a direct result of the Merger. On the other hand, Great Plains Energy did not address a third type of synergy identified in mergers, "developed" synergies. "Developed" synergies are reductions in cost due to management decisions that could have been made on a stand-alone basis with regard to the Merger. Id. at 7; Marshall Surrebuttal at 4-5. If the Commission accepted Mr. Dittmer's approach to synergy analysis, it would greatly reduce the incentive of any utility to pursue savings initiatives to benefit customers. See Kemp Surrebuttal at 14.

[1] Two primary types of synergies result from Mergers. The first type of synergy occurs as a direct result of combining the entities. That is, "but for" the Merger, these synergies would not exist. These are commonly called "created" synergies. The second type of synergy is "enabled" by a Merger. The Merger enables the company to apply improved practices, processes and skills from either. Synergy estimates, as explained by Mr. Zabors, included both types of synergies. See Zabors Supp. Direct at 6.

In summary, the criticisms of Staff, Public Counsel and Praxair witnesses regarding the estimation and treatment of synergy savings should be rejected. The competent and substantial evidence demonstrates that it is appropriate and conservative to adjust nominal dollar costs for inflation by the CPI, when comparing pre-transaction and post-transaction operating costs of merged utility companies. Secondly, it is appropriate to exclude Uncollectible Expense from the comparison of costs for the Customer Service function of the Merger utility companies. Third, KCPL's estimates of synergy savings from the proposed Merger are reasonable and conservative. Finally, both "created" and "enabled" synergies should be included in the total pool of synergy savings that Great Plains Energy proposes to share between shareholders and customers.

H. Long-Term View of Benefits.

There are a number of reasons why the acquisition of Aquila complements Great Plains Energy and KCPL's current operations. First, as previously discussed, Aquila's electric utilities are adjacent to KCPL's service territory, and KCPL and Aquila are joint owners of Iatan 1 and Iatan 2. As a result, the significant savings opportunities and synergies discussed herein are available soon after the close of the Merger. See Downey Direct at 3-4.

Second, KCPL has achieved an impressive history of providing low-cost, reliable electric service to its customers and communities. It is recognized throughout the communities it serves as an innovative and high-performing utility. KCPL ranks in the top tier of performance in nearly every category typically benchmarked by utilities, including production cost, reliability, distribution cost to serve per customer. It is Great Plains Energy's objective to combine management practices and resources to achieve significant reduction in costs and further enhance reliability and customer satisfaction, with rates lower than they would have been had the Merger not occurred. See Downey Direct at 4-5. In October 2007, the PA Consulting Group awarded its highest honor, the 2007 National Reliability Excellence Award, to KCPL for "sustained leadership, innovation, and achievement in the area of electric reliability." It also named KCPL the winner of its 2007 Reliability One Award in the Plains Region. Following the closing of the transaction, KCPL and Aquila will combine the best of their respective business plans to provide customers an exemplary level of reliability and service. See Bassham Surrebuttal at 6.

Third, the financial condition of Aquila after the Merger is anticipated to satisfy the financial metrics necessary to support an investment-grade credit rating. See Downey Direct at 5. Aquila currently has an S&P credit rating of B+, which is below investment grade. Upon the public announcement of the Merger, S&P placed Aquila on positive watch. Great Plains Energy expects Aquila's credit metrics, after the Merger, combined with a guarantee by Great Plains Energy on existing Aquila debt, to be sufficient to meet the criteria established by credit rating agencies necessary for investment grade status. By achieving an investment-grade credit rating, Aquila's cost of debt will be significantly lowered. See Bassham Direct at 12-13.

Finally, the Merger is anticipated to improve the overall business risk profile of Great Plains Energy, which will own a higher percentage of regulated business than it does currently and will also spread the business risk of its nuclear assets over a broader asset and revenue base. See Downey Direct at 5. Overall, post-Merger, Great Plains Energy with KCPL and Aquila will achieve financial stability that should be reflected in the market, and that will improve their respective strategic positions and organizational strength. See Bassham Surrebuttal at 5-10; Cline Surrebuttal at 7-9.

III. Transaction Cost Recovery

A. Should transaction costs be directly charged to ratepayers through cost of service amortizations? Would the proposed merger be detrimental to the public interest if the Commission did so?

Great Plains Energy has requested that $95.2 million in transaction costs be analyzed by the Commission as it reviews the costs and benefits of this transaction, and that favorable consideration be given to their recovery in a future rate case. See Bassham Supp. Direct at 8; Zabors Supp. Direct at 14-15. Great Plains Energy is not requesting recovery of any acquisition premium or adjustment.

Although state commissions have split on whether to allow the recovery of transaction costs in rate cases, the general rule is: "The costs occurred in effecting the purchase, if ordinary, necessary, and overall not in excess of book value of the assets, should be allowed as acquisition costs." See L.S. Goodman, The Process of Ratemaking at 783 (1998). The transaction costs of $95 million clearly do not exceed the book value of Aquila's assets. See Form S-4 (Unaudited Pro-Forma Condensed Combined Balance Sheet as of 12/31/06) filed by Great Plains Energy with the Securities and Exchange Commission at p. 171.

In the past Staff has concurred with the request of merging utilities to amortize transaction and transition costs over time. In 1997 Staff agreed with Union Electric Co. in its Merger with Central Illinois Public Service Co. that "[a]ctual prudent and reasonable merger transaction and transition costs (estimated to be $71.5 million) shall be amortized over ten years beginning the date the merger closes." In re Union Elec. Co., 6 Mo. P.S.C. 3d 28, 176 P.U.R. 4th 201 (Mo. P.S.C., Feb. 21, 1997).

However, in this case Staff opposes any favorable consideration of transaction costs based upon a narrow application of accounting terminology to this case. KCPL witness Lori

Wright testified that the joint applicants did not request authorization to recover the acquisition premium of approximately $135 million, which she viewed as a "component of goodwill associated with the Merger." See Wright Direct at 3. She went on to state that the applicants "are requesting recovery of the transaction costs component of goodwill over a five-year period ...." Id. As the comptroller of KCPL and Great Plains Energy, Ms. Wright made clear that Great Plains Energy is required to use purchase accounting methods to record the Merger. She stated: "The excess of the purchase price, including transaction costs, over the fair market value of the net identifiable assets is recorded as goodwill. Examples of the transaction costs include investment banker fees and legal fees." Id. at 4. See Zabors Direct at 14; Zabors Supp. Direct at 14-15.

However, this is not the kind of "goodwill" as has been defined by the courts in reviewing regulatory cases. The Supreme Court has defined goodwill as "that element of value which inheres in the fixed and favorable consideration of customers, arising from an established and well-known and well-conducted business." Los Angeles Gas & Elec. Corp. v. Railroad Comm'n, 289 U.S. 287, 313 (1933); Des Moines Gas Co. v. Des Moines, 238 U.S. 153, 165 (1919). As a leading commentator on regulatory principles has stated: "To include goodwill in the rate base would involve circular reasoning; its value depends on a utility's earnings, which, in turn, depend on the rates established by the Commission. Its inclusion, therefore, would permit the capitalization of expected future earnings. Goodwill has not been accepted for purposes of ratemaking." See Charles F. Phillips, Jr., The Regulation of Public Utilities, 351 (1993).

Regardless of the accounting protocols, the transaction costs incurred in this proceeding are best viewed as "costs to achieve" which were necessary to ensure that a merger process was effective, synergy savings are achieved, and that the Merger is completed. See Wright Direct at 3. These costs are discussed in detail in the Direct and Supplemental Direct testimony of Robert T. Zabors, a business economist with Bridge Strategy Group LLC. See Zabors Direct at 12; Zabors Supp. Direct at 14-15 and Sched. RTZ-10. These costs are reasonable, and the Commission should give favorable consideration to their recovery in a future Aquila rate case.

Although Great Plains Energy is not requesting favorable consideration of any acquisition premium or adjustment in this case, the reasons most commonly cited for allowing rate base treatment of such elements should be noted. A leading public utility accounting treatise has stated that allowing rate-based treatment occurs "when acquisitions will present an essential or desirable part of an integration of facilities program devoted to serving the public better." See Hahne, Aliff and Deloitte & Touche, Accounting for Public Utilities, Section 4.04[2] (1998).

Favorable treatment is also considered when the acquisition is viewed as being in the public interest because operating efficiencies offset the excess price over net original costs, and where the acquisition was determined to have involved an arm's length transaction. Id. These factors are appropriate for consideration by the Commission as its takes up issues related to recovery of transaction costs in a rate case.

Therefore, while the Commission is not required to make determinations regarding transaction cost recovery in this case, it should indicate in its decision that it is willing to consider recovery of these and other ordinary and necessary merger-related costs in the future.

IV. Actual Debt Cost Recovery

A. Should the Commission require GPE/KCPL to continue protecting ratepayers from the activities and results of Aquila's non-regulated businesses by setting rates based on a “regulatory cost of debt” rather than Aquila's actual cost of debt? Would the proposed merger be not detrimental to the public interest if the Commission did not do so?

The Commission should include Aquila’s actual debt costs in its evaluation of the Merger and should conclude that consideration of the recovery of these costs in a future rate case is not a detriment. To the extent these actual debt costs are recovered in a future rate case post-Merger will ensure access to cheaper capital sources that will be used to finance the infrastructure investments being made on behalf of Aquila’s customers. See Bassham Supp. Direct at 4-8.

Great Plains Energy Treasurer Michael W. Cline gives the details of the post-Merger plan to reduce Aquila’s cost of debt and to improve its balance sheet.

Within a relatively short period following closing, Great Plains Energy expects both Moody’s and Standard & Poor’s will upgrade Aquila’s credit rating to investment grade. See Bassham Supp. Dir. At 4-6; Cline Direct at 7-9; Cline Supp. Direct at 5. This will result in an immediate coupon rate reduction of two of Aquila’s senior note issues, most prominently a $500 million issue with a maturity of July 2012 being reduced from 14.875% to 11.875%. Id. at 5. This 300 basis point coupon reduction represents $15 million in reduced pre-tax interest expense annually over the life of the issue. Id. at 11. Although Great Plains Energy estimates that Aquila’s actual annual pre-tax interest cost will be significantly higher than currently allowed in rates, Aquila customers will be benefited over the long term by the company achieving and maintaining investment-grade status as a result of the Merger. As a result, any short-term burden to Aquila’s customers in bearing actual interest costs is outweighed by the benefit of achieving a long-term objective of financial stability and rates that reflect actual cost of service. Similarly, Great Plains Energy intends to have Aquila retire a significant portion of its debt portfolio in order to achieve an investment-grade credit rating. See Cline Supp. Direct at 12-13. These debt retirement costs also represent a largely short-term expense which customers should be willing to bear in exchange for the long-term benefits provided by investment-grade status.

The debt cost issue cannot be viewed in isolation from the rest of the proposed transaction. How to address actual interest costs should be considered a short-term issue. The outstanding Aquila debt that is of greatest concern is the $500 million Senior Notes which mature in July 2012. Given that Aquila's next rate case is likely to be filed no earlier than the spring of 2008, with rates going into effect in the spring of 2009, customers would bear any additional costs for only three years. Beyond the first five years following the Merger, the benefit of Aquila's ability to raise capital at investment-grade rates will accrue entirely to ratepayers. As Mr. Cline testified, the Commission must consider the long-term benefits to ratepayers from reduced financing costs for Aquila on future borrowings. Mr. Cline's examples in highly confidential portions of his Surrebuttal Testimony give an idea of the benefits that will flow to Aquila customers in the future. See Cline Surrebuttal at 6-7. Although these benefits are difficult to quantify precisely, they will occur if Aquila is investment grade and must be a qualitative consideration of the Commission as it evaluates the impact of the Merger on Aquila and its customers. Id. at 7-8.

In analyzing Aquila's prospects for borrowing funds at reduced rates, the Commission must recognize two contemporary facts of life. First, the impact of the sub-prime mortgage crisis on global credit markets since June 2007 has reinforced the importance of access to capital that a higher credit rating brings. While creditworthy borrowers have encountered challenges in accessing long-term debt capital on attractive terms, this can be even more difficult for borrowers with non-investment grade ratings. It surely is in the best interest of ratepayers to have their utility with sufficient financial strength to borrow long-term capital on reasonable terms. Second, a higher credit rating will enable Aquila to make short-term borrowings on an unsecured basis.

In their opposition to Great Plains Energy's request that the Commission agree to consider actual debt cost recovery in a future rate case, Staff, OPC and Praxair ignore the impact of the retirement of debt costs. Staff also ignores the fact that Aquila's debt costs will increase in the future because of its Infrastructure Program. As Mr. Cline testified, Staff holds the amount of Aquila debt apportioned to its Missouri assets constant over the five-year period 2008 through 2012. See Cline Surrebuttal at 14-15. Staff has previously recognized Aquila's need to expand capacity in another case:

> Aquila's need for additional electric power generation that provides electricity continuously (base load capacity) and its desire to participate in ownership of Iatan Unit 2 are the driving forces behind its application in this case. Based on projected load growth in the service areas of both Aquila Network-MPS and Aquila Networks-L&P, Aquila needs additional generation to meet its Missouri customers' power needs. Iatan Unit 2 is planned to begin supplying such power in 2010. Aquila, like other utilities in Western Missouri, has not added any base-loan capacity since the late 1980s.

See Staff's Suggestions in Support of Stipulation and Agreement, In re Aquila, Inc., Case No. EO-2005-0293 (July 29, 2005).

No one disputes the fact that a capacity constrained environment exists today, and that we are in an intensive period of capital construction projects. See Downey Direct at 6; In re Aquila, Inc., Case No. EO-2005-0293, Order Approving Stipulation and Agreement (Mo. P.S.C., Aug. 9, 2005) ("Aquila needs coal-fired generation to meet its energy and capacity requirements"). The Commission has also recognized that Aquila "needs to increase its baseload capacity to mitigate the effects of high natural gas prices, and as a cost-effective means of providing electric service to its Missouri jurisdictional customers." Id. at 4.

In approving KCPL's Regulatory Plan in 2005, the Commission "agree[d] with Mr. Schallenberg and Mr. Trippensee that the Stipulation contains provisions that facilitate lower rates for customers in the future that would not exist absent this Stipulation." See Report and Order, In re Kansas City Power & Light Co., Case No. EO-2005-0329 (Aug. 23, 2005) at 27. See also NERC 2007 Long-Term Reliability Assessment, 2007-2016 (Oct. 2007)(Of four key findings, the first stated: "Electric capacity margins continue to decline – action needed to avoid shortage") at 8. For the Southwest Power Pool region, the projected annual rate of growth for peak demand over the next ten years is 1.7%, while energy consumption growth is projected for the same period at a higher annual rate of 1.8%. Id. at 194.

Consequently, rates for both Aquila and KCPL ratepayers will increase in the future. The critical question in reviewing the terms of this Merger is whether these future higher rates will be lower than expected if the Merger occurs. The Commission's analysis of the Merger's costs and benefits should place in proper context Great Plains Energy's request that favorable consideration be given in a future rate case to recovery of Aquila's actual debt costs that will be incurred in the near future. If a reasonable period of analysis of ten years is employed, the Commission will be able to conclude that the potential recovery of Aquila's actual debt costs in a future rate case does not outweigh the benefits of the Merger.

V. Additional Amortizations Mechanism

A. Should the Commission allow Aquila to implement "Additional Amortization to Maintain Financial Ratios" similar to those negotiated by KCPL with stakeholders in Case No. EO-2005-0329? If not, is the proposed merger detrimental to the public interest? If yes:

1. Has Aquila proposed a plan in which the additional amortizations are balanced by provisions favorable to ratepayers and other stakeholders? If not, is the proposed additional amortization device detrimental to the public interest?

2. Will the additional amortizations shift the risks of the costs of Aquila's unregulated activities from Aquila to its ratepayers? If yes, is the proposed merger detrimental to the public interest?

3. Is the additional amortization device proposed by the Joint Applicants set out in a sufficient level of detail to be able to be understood and effectively administered?

Great Plains Energy and Aquila have asked the Commission to approve the use of an Additional Amortizations mechanism for possible use to maintain investment-grade metrics for Aquila <u>after</u> it achieves that status post-Merger. Because this mechanism will only be employed after the Merger to preserve and maintain Aquila's metrics and, indeed, may not even be necessary if Aquila's credit ratios are sufficient, there is no good reason for the Commission not to authorize Aquila to utilize this tool.

To be clear, the Additional Amortizations mechanism is not being proposed to "restore" Aquila to investment grade metrics. While Great Plains Energy has proposed that the mechanism be available to Aquila if needed to support credit metrics, the proposed debt reduction strategy results in sufficient cash flow so that currently Great Plains Energy and Aquila assume it will not be needed. <u>See</u> Cline Supp. Direct at 13. However, the availability of the Additional Amortizations is viewed by the rating agencies as both an important sign of regulatory support for credit quality and a vital means of risk mitigation for bondholders. Id. at 13-14.

Despite the clarity of Great Plains Energy's proposal to utilize Additional Amortizations only to maintain Aquila's credit ratios after it becomes investment grade post-Merger, Staff continues to portray the proposal as one to "restore" Aquila to investment grade metrics. See Staff Report at 19, 28. Staff then suggests that if the Additional Amortizations are used, they would subsidize Aquila's non-regulated activities. However, Great Plains Energy and Aquila have clearly stated that the amortizations would only be used post-Merger to maintain Aquila's investment grade credit metrics while it is engaged in the environmental retrofit project at Iatan 1 and the construction of Iatan 2. Certainly, in a future rate case where Additional Amortizations are proposed, other parties would be free to argue that under the particular facts its use would be inappropriate. However, given the commitment of Great Plains Energy and Aquila to carry out the infrastructure improvements at Iatan and at other Aquila generating facilities, such as the Sibley Generating Station, it is premature for any party to suggest that the Additional Amortizations are not being used to support prudent improvements in infrastructure.

Staff's position in this Merger case is contrary to the positions it has taken in other cases. For example, in the Empire District Electric Company's application for approval of an experimental regulatory plan related to expanding its generation plant, Staff stated:

> Historically, the ability of Missouri utility companies to remain investment grade has been a matter of concern to the Commission, particularly when the utilities are engaged in construction projects necessary to the continued provision of safe and reliable service to customers.

See Staff Suggestions in Support of Stipulation and Agreement, In re Empire Dist. Elec. Co., Case No. EO-2005-0263 (July 21, 2005) at 8.

Both Staff and OPC emphasize the fact that Aquila in its 2005 applications to the Commission in Case No. EO-2005-0293 eliminated any request for a regulatory plan that included the Additional Amortizations mechanism. See Trippensee Rebuttal at 4-5. As KCPL's Chris Giles has testified, because Aquila was below investment grade at the time it decided to invest in additional facilities at Iatan 1 and 2, there was no reason for a provision to keep Aquila at investment grade. See Giles Surrebuttal at 9.

Furthermore, the specific reason for the Additional Amortizations is to maintain Aquila at investment grade while it embarks on significant construction projects designed to maintain safe and adequate service levels at rates that are just and reasonable. Because ongoing construction projects will cause rates to be higher, the uncertainties caused by those projects should not lead to Aquila being downgraded from investment grade when it files its next rate case in the spring of 2008. The Additional Amortizations are not a financial tool that is designed to benefit only Aquila and not its consumers. Any such amortizations awarded in a future Aquila rate case will support the financial health of Aquila which, in turn, will benefit its ratepayers. Any such amortizations will also reduce Aquila's rate base and the rates charged to its customers in subsequent rate cases.

Finally, Staff and OPC object to the use of the Additional Amortizations mechanism because they have only previously been employed in the KCPL and Empire cases that were resolved in 2005 by negotiated stipulations. While that is true, this fact is no reason for the concept not to be applied in a future Aquila case. As Staff noted in supporting those stipulations, the use of the Additional Amortizations mechanism is lawful just, as the Commission's implementation of interim rate relief or its use of normalization of tax timing differences are lawful. In this regard, Staff has advised the Commission that the use of financial ratios in setting

Additional Amortizations is proper and consistent with the Court's language in State ex rel. Laclede Gas Co. v. PSC, 535 S.W.2d 561, 566-74 (Mo. W.D. 1976), regarding its ability to grant interim rate relief. See In re Empire Dist. Elec. Co.. Case No. EO-2005-0263, Staff Suggestions in Support of Stipulation and Agreement at 8 (July 21, 2005). See also State ex rel. Utility Consumers Council of Missouri, Inc. v. PSC, 606 S.W.2d 222, 226-27 (Mo. W.D. 1980).

Although the stipulations in the KCPL and Empire 2005 Regulatory Plan Stipulations contained many other provisions, with the exception of the Additional Amortizations remaining in place to serve as an offset to rate base, none of the other elements are relevant to the goal of maintaining investment-grade credit during a period of construction. See Giles Surrebuttal at 10-11. Given the fact that KCPL, Empire and Aquila are all partners in the construction of Iatan 2 and the environmental upgrades at Iatan 1, it would be counterproductive to deny Aquila the use of the Additional Amortizations once it is investment grade, while the concept is being extended to its partners.

Great Plains Energy and Aquila recommend that the Commission approve the use of the Additional Amortizations mechanism in the form in which they were approved in KCPL's 2005 Regulatory Plan Stipulation and Agreement in Case No. EO-2005-0329. The Report and Order of July 28, 2005, as amended on August 23, 2005, provides sufficient detail for use in any future Aquila rate case. In its Report and Order, the Commission found that it was "reasonable and appropriate to adopt regulatory policies, including the use of the additional amortization provision contained in the Stipulation, that are designed to give KCPL the opportunity to maintain its investment grade ratings during the term of the Experimental Regulatory Plan, based on the conditions set out in the Experimental Regulatory Plan regarding KCPL's necessary conduct." See In re Kansas City Power & Light Co., Case. No. EO-2005-0329, Report and Order at 29.

Great Plains Energy and Aquila do not object to the Commission incorporating elements of the additional amortization mechanism as set forth in the KCPL Regulatory Plan in a decision in this case that permits Aquila, once it achieves investment grade metrics, to use the Additional Amortizations mechanism in a future rate case to maintain that status.

VI. Affiliate Transaction Rule Waiver/Variance -- Hearing Day: Fri. 12/7

A. Should GEP/KCPL and Aquila be granted a waiver/variance from the provisions of the affiliate transactions rule under 4 CSR 240.015 as it might pertain to transactions between Aquila and KCPL? Will the proposed Merger be not detrimental to the public interest if the Commission does so?

B. Have GPE/KCPL and Aquila complied with the Commission's rules regarding a request for a waiver or variance from the affiliate transactions rule, such as the requirement regarding making a showing of good cause?

C. Have GPE/KCPL and Aquila provided adequate details for there to be clarity respecting what provisions of the affiliate transactions rule that GPE/KCPL and Aquila are seeking relief from?

These issues are addressed below.

The affiliate transaction rule does not apply to transactions between KCPL and Aquila.

The Commission's affiliate transaction rule, 4 CSR 240-20.015, was enacted in 2003. The "purpose" section of the rule provides:

> **This rule is intended to prevent regulated utilities from subsidizing their non-regulated operations.** In order to accomplish this objective, the rule sets forth financial standards, evidentiary standards and record-keeping requirements applicable to any Missouri Public Service Commission (commission) regulated electrical corporation whenever such corporation participates in transactions with any affiliated entity (except with regard to HVAC services as defined in section 386.754, RSMo. Supp. 1998, by the General Assembly of Missouri). **The rule and its effective enforcement will provide the public the assurance that their rates are not adversely impacted by the utilities' nonregulated activities.** (Emphasis added.)

Despite the fact that 20.015(1)(A) broadly defines “affiliate” as an entity that controls or is controlled by, or is under common control with a regulated electrical corporation , the text of the rule shows that it is only applicable to transactions between a regulated electrical corporation and an unregulated affiliate. For example, Section 2.015(1)(H) defines “preferential service” as information or treatment or actions by the regulated electrical corporation which places the affiliated entity at an unfair advantage over its competitors. Regulated electrical corporations do not have competitors. Thus, the purpose of the rule is to prevent a regulated electrical corporation from sharing information that would help an unregulated affiliate.

Similarly, Section 20.015(2)(E) and (F) both are premised on the concept that the information and marketing materials are provided by a regulated electrical corporation to an affiliate that is not regulated by the Commission. Likewise, Sections 20.015(4) and (6) concerning records and access to records require that a regulated electrical corporation keep its records separate from those of its affiliates and make those records available to the Commission. Since both Aquila and KCPL will continue to be regulated electrical corporations after approval of the transaction, each will be subject to the Commission’s recordkeeping requirements, and the Commission will have, as it does today, full access to both entities’ records. The rule was clearly designed to give the Commission access to the records of unregulated entities just as the Commission now has full access to the records of regulated electrical corporations.

In keeping with the purpose and substantive provisions of the rule, the Commission has stated that “[t]he purpose of the affiliate transaction rules is to prevent cross subsidization, in which a conglomerate including a regulated entity seeks to shift the costs of its unregulated activities to its regulated customers."[2] Because Aquila and KCPL will both be regulated electrical corporations after the transaction is completed, transactions between KCPL and Aquila do not involve cross-subsidization.

The affiliate transaction rule, as explained in the surrebuttal testimony of KCPL's Chris Giles, has asymmetrical pricing requirements which are designed to make a regulated utility indifferent to purchasing or selling goods to an unregulated affiliate. While this might make sense if the transaction involved KCPL and an unregulated affiliate, it does not make sense when both parties are regulated electrical corporations. See Giles Surrebuttal at 7. The problem is that since KCPL would be on one side of a transaction and its affiliate (as defined under the rules). Aquila would be on the other side, it would be impossible to comply with the rule. Id. For example, if Aquila sells KCPL ten widgets, with a fair market value of $15.00 and a fully distributed cost of $10.00, under Section 20.015(2)(A) KCPL, as the buyer, would have to pay Aquila $10.00 per widget, the lower of the fair market value or the fully distributed cost. But Aquila could only sell to KCPL at $15.00 per widget, the higher of the fair market value or the fully distributed cost. Thus, the transaction would not be able to occur under the affiliate transaction rule.

Since the synergies contemplated by Great Plains Energy are premised on the ability of KCPL and Aquila to exchange goods and services at cost, the affiliate transaction rules would actually prevent benefits from accruing to Missouri ratepayers. The literal application of the affiliate transaction rule in this case simply prevents synergies from occurring between KCPL and Aquila, and actually creates detriments for their ratepayers.

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[2] In re Union Elec. Co., Case No. EO-2004-0108 at 44.

Waiver of Rule.

Should the Commission determine that the affiliate transaction rule does apply to transactions between regulated affiliates, KCPL and Aquila request a waiver of the entire rule as it pertains to transactions between KCPL and Aquila. As shown above, the asymmetrical pricing requirements of the rule would prevent Aquila and KCPL from taking advantage of the synergies between the two companies. This constitutes "good cause" for the waiver. Thus, the "Standards" and "Evaluating Standards" in Sections 2 and 3 of the rule should not apply. Moreover, since both KCPL and Aquila will continue to be subject to the Commission's recordkeeping requirements for regulated electrical corporations, Sections 4, 5, 6 and 7 of the rule which relate to recordkeeping should not apply. The prevention of duplicative regulatory requirements constitutes "good cause" for the waiver of these sections of the rule.

VII. Service Quality

A. Can service quality problems resulting from a Merger/consolidation/ acquisition of a works or system necessary or useful in the performance of duties to the public preclude the Merger/consolidation/acquisition from being not detrimental to the public interest?

B. Has GPE/KCPL taken adequate measures to ensure that its proposed post-consolidation/post-Merger/post-acquisition operations will not be detrimental to the public interest by precluding service quality issues arising from the consolidation/Merger/acquisition?

Both issues are addressed below.

In its report, Staff devotes several pages (pp. 70-72) to a 1994 gas utility merger which the Staff believes supports its position that service quality risks are rarely identified in Merger applications. KCPL submits that while service quality problems can arise, the existence of one Merger which resulted in customer service problems is not relevant to this case.

Moreover, the testimony of Great Plains Energy/KCPL witness Herdegen explains the steps that will be taken to ensure that reliability will not be adversely impacted by the Merger. KCPL and Aquila have reviewed both companies' management structure, practices, technology and the use of the field workforce to ensure that both companies can reach and maintain Tier 1 performance objectives. The strategy is to adopt the KCPL organization design to minimize change as much as possible for combining the two companies' customer service functions. Teams were formed using subject matter experts from each company based on the current KCPL functional areas in the customer service organization as the baseline. See Herdegen Supp. Direct at 17. In this way all work was accounted for at Aquila and properly mapped into the KCPL organization. As a result of this analysis, 124 incremental positions will be added to KCPL's customer service team after the transaction is complete. This number represents the sum of the allocation from Aquila's Central Service team to its Missouri electrical properties plus the direct cost areas of meter reading, customer service personnel and the customer relations team. In addition, the potential for additional customer questions for the nine months following the completion of the transaction, an additional 12 employees will be retained in the care center to respond to these expected inquiries.

KCPL and Aquila integration planning teams have initiated a full review of system, process, business rule and regulatory differences between the two companies in preparation for actual integration. The primary goal is to provide a common customer experience, regardless of the service area.

KCPL has reached an agreement with Jim Alberts to lead Customer Service operations for both companies. Mr. Alberts is a key reason for Aquila's successful and award winning customer service operations. KCPL expects that Mr. Alberts will be able to use his experience to deliver high service levels. See Marshall Surrebuttal at p. 12. The intent is to capture the best practices from each company in order to deliver even better service than before.

Great Plains Energy/KCPL's objective is to maintain the strong levels of performance demonstrated by both Aquila and KCPL. Great Plains Energy/KCPL recommends reviews of customer service performance at regular intervals with the Staff to ensure that service will continue at current levels. See Herdegen Supp. Direct at 21. Should customer service issues arise as a result of the transaction, Great Plains Energy/KCPL are committed to resolving those issues and to work with the Staff in that process.

VIII. Transmission and RTO/ISO Criteria – Hearing Day(s): Mon. 12/10, Tues. 12/11

A. Have Applicants demonstrated that the proposed transaction is not detrimental to the public interest even though they have not addressed the rate and other impacts of their intent to have Aquila participate in the Midwest ISO rather than SPP?

It is unnecessary and premature to require the applicants in this proceeding to evaluate the potential impacts of Aquila's RTO status. Aquila has an application pending before the Commission in Case No. EO-2008-0046, requesting authority to transfer functional control of its transmission facilities to MISO ("Aquila MISO Proceeding"), and the Merger will have no direct impact on KCPL's or Aquila's RTO status. KCPL is a full member of the Southwest Power Pool ("SPP"). See Spring Surrebuttal at 1. KCPL's participation in the SPP has been approved by this Commission, the Kansas Corporation Commission ("KCC"), and the Federal Energy Regulatory Commission ("FERC"). Any change to KCPL's RTO status would require the approval of those commissions. Aquila is currently a conditional member of the Midwest Independent Transmission System Operator ("MISO") whereby MISO provides specific transmission security and reliability coordination functions for Aquila. SPP provides Aquila regional transmission tariff administration, available transmission capacity ("ATC"), total transmission capacity ("TTC"), and other regional planning functions. The Commission is currently considering Aquila's RTO status in the Aquila MISO proceeding. Consequently, it would be premature and speculative to require the applicants to address the potential impacts of Aquila's RTO status in this proceeding. Moreover, the Merger will have no direct impact on KCPL's or Aquila's RTO status. KCPL will continue to be a member of SPP. Aquila's RTO status will be controlled by the outcome of the Aquila MISO Proceeding. Consequently, it is also unnecessary for the Commission to address Aquila's RTO status in this proceeding.

B. Have Applicants demonstrated that the proposed transaction is not detrimental to the public interest even though they have not addressed the rate and other impacts of potential joint dispatch of the combined companies' generation resources, including the impacts on transmission and interconnection availability?

It is unnecessary and premature to require the applicants in this proceeding to evaluate the potential impacts of joint dispatch. KCPL does not plan to jointly dispatch the combined Aquila and KCPL generation fleet. See Dana Crawford Direct Testimony at 5. KCPL plans to operate post-Merger with two control areas – one for KCPL and one for Aquila. A subsequent decision to joint dispatch would be subject to regulatory review, at which time a record would be fully developed concerning the impacts of such action. Consequently, it is unnecessary and premature to attempt to quantify the potential joint dispatch efficiencies for the proposed Merger.

In the Merger approval proceeding before FERC, Docket Nos. EC07-99-000 and EL07-75-000 ("FERC Merger Proceeding"), the City of Independence ("Independence") asked FERC to require KCPL and Aquila to quantify the impacts of joint dispatch before being permitted to merge. In its order approving the Merger FERC denied the request, reasoning that

> Independence's argument that the Commission cannot reasonably conclude that proposed transaction presents neither horizontal nor vertical market power issues without analyzing the possibility of joint dispatch of KCP&L's and Aquila's generation is misplaced. First, our analysis focuses on merger-related effects on

> competition, and there is no evidence in the record that KCP&L and Aquila plan to engage in joint economic dispatch following the merger. Second, even if KCP&L and Aquila do pursue a joint economic dispatch agreement, Applicants have shown that the merger will not adversely affect competition. Regarding horizontal market power, Applicants' analysis shows that the combination of KCP&L's and Aquila's generation will not materially increase market concentration using the AEC measure, indicating that the merger will not harm competition in the relevant market; thus, even if Applicants do engage in joint dispatch, the merger will not create or enhance the ability to exercise market power. Further, if KCP&L and Aquila do pursue a joint dispatch agreement, they will need to file an operating agreement with the Commission, at which time Independence will have the opportunity to participate in the proceeding and protect its interests. Therefore, we will not require a further analysis of the effect of joint dispatch or condition section 203 approval on Applicants not engaging in joint dispatch, as proposed by Independence.

Great Plains Energy Inc., et al., 121 FERC 61,069 at P 36 (2007).

Independence's concerns regarding transmission and interconnection availability are similarly misplaced. KCPL and Aquila provide transmission service through FERC-jurisdictional Open-Access Transmission Tariffs. KCPL and Aquila fulfill specific FERC Order 888 and more recently Order 890 obligations for offering open-access, non-discriminatory transmission service to their customers. Following the Merger, KCPL and Aquila will continue to provide transmission service through an OATT.

Independence also raised this issue before FERC, arguing that KCPL and Aquila had not adequately evaluated the impact of the Merger on transmission availability as part of their market power analysis in support of their application. FERC held as follows:

> We find that the Applicants have shown that the proposed transaction will not adversely affect competition. Regarding the horizontal combination of generation capacity, Applicants' analysis shows that for all relevant geographic markets, there are no screen failures for AEC, the relevant measure in this case, indicating that it is unlikely that the transmission will harm competition. In addition, the Black Hills Acquisition will not result in the consolidation of generating assets in any relevant market. Given that the proposed transaction does not materially increase the merged firm's market share or market concentration, we conclude that it is not likely to create or enhance Applicants' ability to exercise market power in any wholesale electricity markets. Regarding the vertical combination

> of upstream transmission and natural gas assets with downstream generating capacity, Applicants have shown that the proposed transaction will not create or enhance the ability or incentive to use control of upstream assets to harm competition in downstream wholesale electricity markets. We reach this conclusion because: (1) Applicants' transmission facilities will be operated pursuant to an OATT, thus ensuring that they cannot be used to frustrate competition in wholesale electricity markets; and (2) there is no overlap between Applicants' natural gas transportation assets and downstream electric generation capacity in any relevant wholesale market. We discuss the specific issues raised by protestors below.
>
> Independence argues that Applicants fail to show that Independence will not be affected by decreased transmission availability. However, it does not offer any evidence that less transmission will be available to it. Applicants' transmission system is subject to a Commission-approved OATT, which ensures open access to the transmission system.
>
> Regarding merger-related increases in vertical market power, we are not persuaded by Independence's argument. Applicants' transmission facilities are currently and will continue to be operated pursuant to an OATT, thus ensuring that they cannot be used to frustrate competition in wholesale electricity markets.

Great Plains Energy Inc., et al., 121 FERC 61,069 at P 34, 35 and 37 (2007) (footnotes omitted). FERC expressly considered the same arguments Independence raises in this proceeding and correctly concluded that the Merger does not create any transmission availability concerns.

C. Should Commission approval of the Joint Application be conditioned upon Aquila being required to join and operate its generation and transmission facilities under the auspices of the Southwest Power Pool (SPP) Regional Transmission Organization (RTO) with KCPL within four (4) months of approval of the merger.

No. The Commission should not condition its approval of the Merger on Aquila being required to join SPP, particularly in light of the pending Aquila MISO Proceeding. A full and thorough record is being developed in that case concerning the benefits and costs associated with Aquila's RTO status. Such evidence is critical for the Commission's evaluation of which RTO, if any, would best serve Aquila and its customers. SPP and MISO are both active participants in the Aquila MISO Proceeding, as are Independence and Dogwood. However, neither SPP, nor

MISO, is a party to this case. MISO in particular would be prejudiced if the Commission were to adopt Independence's recommendation in this proceeding.

Evidentiary hearings in the Aquila MISO Proceeding have been scheduled for early March 2008. By that time, it is possible the Merger will have closed. Not only will the Commission be able to base its decision on a much more fully developed record concerning Aquila's RTO status, but the Commission will also have much more certainty about the Merger itself. For both of these reasons, it makes sense for the Commission to defer its consideration of Aquila's RTO status to the Aquila MISO Proceeding.

Moreover, in response to essentially identical arguments, FERC declined to condition its approval of the Merger on Aquila being required to join SPP. FERC found as follows:

> We will decline the protestors' request to condition our section 203 authorization on the Applicants joining a particular RTO. When necessary, the Commission conditions merger authorization in order to address specific, merger-related harm; but no such harm has been identified in this proceeding. Moreover, the Applicants' future RTO status is unclear at this time and therefore, there is no baseline against which to assess merger-related changes to rates.

Great Plains Energy Inc., et al., 121 FERC 61,069 at P 50 (2007). FERC expressly considered Independence's assertions concerning the different cost structures of SPP and MISO, the same issues as those raised by Independence and Dogwood in this case. FERC declined to condition the Merger on a particular RTO status for KCPL or Aquila.

D. Should Commission approval of the Joint Application be conditioned upon Aquila and KCPL being required to consolidate their balancing authority areas within six (6) months of approval of the Merger.

No. The Commission should not condition its approval of the Merger on KCPL and Aquila being required to consolidate their balancing authority areas within a specified timeframe. This Commission is presently evaluating Aquila's RTO status in a separate proceeding. Moreover, SPP is presently evaluating consolidating Balancing Authority operations within its footprint. Given the significance of these activities, which are properly beyond the scope of this

Merger application, the Commission should not direct KCPL and Aquila to consolidate their Balancing Authority operations in this case. Until these other matters are resolved, it would be premature and potentially redundant for KCPL and Aquila to pursue consolidation of their Balancing Authority operations.

IX. Municipal Franchise and Energy Audits – Hearing Day(s): Wed. 12/12, Thurs. 12/13

A. Should Commission approval of the Joint Application be conditioned upon the negotiation of a single, unitary franchise between KCPL/Aquila and the City of Kansas City within nine (9) months of the Commission's approval of the Merger?

In its Rebuttal Testimony, the City of Kansas City (the "City") has asked the Commission to abrogate the Franchise Agreement entered into by the City and KCPL as a condition of approving the Merger. The Commission not only lacks such authority under Missouri and federal law, but any such action would not be in the public interest.

1. Misuse of Regulatory Process.

The City's request that the Commission condition approval of this proposed Merger on KCPL relinquishing its franchise with the City in exchange for a franchise of a limited term is a classic case of using a regulatory process to infringe upon a counterparty's contractual rights. In 1881 the City and KCPL's predecessor-in-interest entered into a valid and binding Franchise Agreement that sets forth the respective parties' rights and obligations. For decades the City has urged KCPL to terminate the Franchise Agreement and negotiate the terms and conditions of an agreement of a limited term.

Although it has considered the City's requests, KCPL has refused to alter its rights and obligations under the Franchise Agreement because benefits and protections provided by the Franchise Agreement to KCPL customers and shareholders outweigh the inducements offered by the City.

2. The City Cannot Use Contracts to Abridge the State's Police Power.

In its Rebuttal Testimony the City sets forth its reasons why it believes it is desirable to extinguish the Franchise Agreement and negotiate a franchise agreement that has a term limit. The City suggests, inter alia, that it lacks adequate guidance in determining who pays the costs associated with relocations, line extensions and under-groundings. These issues are addressed by KCPL's Commission-approved tariffs. For example, if the City or any other municipality asks KCPL to relocate its facilities that are located in a private easement, the City pays the relocation costs. If the facilities are located on public rights of way, any changes are done at KCPL's expense. See Section 15.08, Changes and Removal, Municipal Lighting Service, KCPL General Rules and Regulations, P.S.C. Mo. No. 2 (Tariff Sheets 1.51-52) (1989). See also id., Section 10.03(e)(v), Underground Distribution System in Residential Subdivisions. Within the context of the City's laudable efforts to encourage existing businesses to expand their operations and to attract other businesses to the City, the primary purpose of these tariffs is to ensure that KCPL's customers do not subsidize the development costs of private entities and that existing rates and service levels are maintained. See May Dep't Stores Co. v. Union Elec. Light & Power Co., 107 S.W.2d 41, 49 (Mo. 1937)("May Dep't Stores").

The Missouri Supreme Court has held that establishing reasonable rates for public service falls within the police power of the state. May Dep't Stores, 107 S.W.2d at 49; State ex rel. City of Sedalia v. PSC, 204 S.W. 497, 498-99 (Mo. 1918)("Sedalia"). The Missouri Constitution commands that "[t]he exercise of the police power of the state shall never be abridged, or so construed as to permit corporations to conduct their business in such a manner as to infringe the equal rights of individual or the general well-being of the state." See Missouri Const., § 5, art. 12; Sedalia at 498. This prohibition is not limited to private corporations. The Supreme Court also has concluded that the legislature cannot "authorize a municipal corporation to make a contract abridging or limiting ... the police power." See State ex rel. Kansas City v. PSC, 524 S.W.2d 855, 859 (Mo. 1975)(police power cannot be hindered or frustrated by contracts between individuals, companies or governmental subdivisions); State ex rel. Kansas City Pub. Serv. Co. v. Latshaw, 30 S.W.2d 105, 108 (Mo. 1930)(Legislature cannot authorize municipal corporations to make contracts with utilities regarding rates that prevent the state from establishing reasonable rates); Sedalia at 497.

It appears that the City hopes to shift some of the costs of its redevelopment efforts from companies expanding or relocating their businesses to Kansas City to KCPL's customers. By asking the Commission to condition the approval of the proposed Merger on KCPL's "willingness" to negotiate contractual terms regarding who pays relocation, line extension and under-grounding costs, the City is seeking to abridge the State's police powers in connection with the establishment of just and reasonable rates for KCPL's customers in contravention of the Missouri Constitution. Missouri law requires that the Commission reject the City's request as both unlawful and contrary to the public interest.

3. The Franchise Agreement is Protected from Impairment by the Missouri and Federal Constitutions.

The Franchise Agreement does not contain a limitation on its duration. Under Missouri law, a franchise agreement that does not specify a period of duration is a grant in perpetuity. Missouri Pub. Serv. Co. v. Platte-Clay Elec. Cooperative, 407 S.W.2d 883, 889 (1966); State ex rel. McKittrick v. Missouri Pub. Serv. Corp., 174 S.W.2d 871, 879 (Mo. 1943); State ex rel. Chaney v. West Missouri Power Co., 281 S.W. 709, 714 (Mo. 1926). Perpetual franchise agreements are grants of property rights protected from impairment by the Contract Clauses of the United States and Missouri Constitutions. See U.S. Const., art. I, § 10; Missouri Const., art. I, § 13.

While it desires new terms and conditions under a franchise of a limited term, the City is well aware that it is bound by the Franchise Agreement. Provided KCPL does not forfeit the Franchise Agreement, the only way for the City to lawfully abrogate the Franchise Agreement is to demonstrate that the Franchise Agreement frustrates or hinders the City's proper exercise of its police powers. If this were the case, the City would not use this Merger proceeding to achieve its goal. It would have the authority to accomplish its goal without involving the Commission. However, the facts show the contrary. In describing the City's experience with KCPL, the City Manager himself noted that "on the whole it has been good." See Cauthen Rebuttal at 7. He commended KCPL for having "contributed significantly to the demand-side management programs and weatherization programs of the Neighborhood and Community Services Department." Id.

Despite this, the City hopes to manipulate this proceeding to achieve a result that it cannot accomplish on its own through lawful means. In the absence of a finding by the Commission that the Franchise Agreement frustrates or hinders the proper exercise of its police power, the Commission cannot grant the City's requested relief without impairing KCPL's contractual rights. XO Missouri, Inc. v. Maryland Heights, 256 F. Supp. 2d 966, 974 (E.D. Mo. 2002)("XO Missouri").

The continued operation of the Franchise Agreement in no way frustrates or hinders the Commission's ability to exercise the State's police power. In addition, the City has failed to introduce any credible evidence into the record upon which the Commission could base a decision to abrogate the Franchise Agreement, or condition the proposed Merger on KCPL's "willingness" to relinquish its rights under the Franchise Agreement. The City has merely argued that it wants a better deal. The City has failed to introduce into the record any credible evidence that the Franchise Agreement, after governing the relationship between the City and KCPL for 126 years, now threatens the Commission's ability to protect the health, safety and general welfare of the citizens of Missouri.

> Legislatures and municipalities cannot, in the exercise of assumed police powers, violate [franchise agreements], and overthrow vested rights . . . . The limit to the exercise of police power in these cases must be this: The regulations must have reference to the comfort, safety or welfare of society; they must not be in conflict with any of the provisions of the [franchise agreement]; and they must not, under pretense of regulation, take from the corporation any of the essential rights and privileges which the [franchise agreement] confers. In short, they must be police regulations in fact, and not amendments of the [franchise agreement] in curtailment of the corporate franchise. [XO Missouri, 256 F. Supp. 2d at 974, quoting State ex rel. City of St. Louis v. Laclede Gaslight Co., 14 S.W. 974, 980 (1890).]

The City is attempting to enlist the Commission to help it avoid its contractual obligations. An order conditioning approval of the proposed Merger on KCPL's "willingness" to replace its Franchise Agreement with an agreement that provides less protection to KCPL's customers would unlawfully impair KCPL's rights and be contrary to the public interest. Accordingly, the Commission should reject the City's request.

B. Should Commission approval of the Joint Application be conditioned upon requiring KCPL/Aquila to fund a comprehensive energy audit by a third party to evaluate the City of Kansas City's opportunities for lower costs, increased efficiency, consolidated purchasing and cooperative sitting or cogeneration with the utility?

No. The Commission should not condition its approval of the Merger on KCPL/Aquila funding a third-party energy audit for the City. First, it is unclear why the City should receive such a service at the expense of KCPL's and Aquila's other customers. KCPL and Aquila are obligated to serve their customers in a non-discriminatory manner. KCPL has already implemented an Energy Audit rebate program that is generally available to all its customers. See Marshall Surrebuttal at 18. The City would have the Commission condition its approval of the Merger on the City receiving a better deal than what is available to KCPL's or Aquila's other customers. The City's only justification for such favorable and discriminatory treatment is that it is served by both KCPL and Aquila at multiple locations. This fact does not make the City unique, nor does it justify the discriminatory treatment the City requests.

Second, there are numerous programs under KCPL's Comprehensive Energy Plan ("CEP") in which the City could participate. The CEP contemplates demand response, energy efficiency, and affordability programs to be considered and evaluated by the Customer Program Advisory Group ("CPAG"), a group specifically established to evaluate customer programs. Id. at 17. As the result of the collaborative CPAG process, KCPL has successfully implemented several programs and continues to evaluate others. The City has directly benefited from a number of these programs. Specifically, KCPL:

- Offered KCPL's Energy Audit rebate program to various City departments to help fund audits;
- Committed $2.25 million over a five-year period to the City's Weatherization Program beginning in 2006;
- Suggested energy efficient improvements for City buildings, such as the custom energy efficiency rebate for lighting;
- Offered Energy Optimizer and Power tariffs, key components in KCPL's suite of energy efficiency solutions, to various City departments. Id. at 18.

Third, if such an audit funding program were to be implemented, the CPAG should evaluate it. The City is a participant in the CPAG, and as described above, has directly benefited from a number of programs that resulted from CPAG's consideration. The CPAG evaluates programs that would be available to all customers, or at least all members of a particular customer class. It would appear that the City seeks to circumvent that collaborative, inclusive process to derive a benefit for a single customer, the City.

Moreover, the City's request for a KCPL/Aquila-funded audit appears to be partially premised on the City's mistaken belief that after the Merger is approved, the City will only receive electric utility bills from a single entity. In fact, Kansas City will continue to receive bills from Aquila and KCPL.

Given the measures regarding energy efficiency that are already in place and the fact that the City's request would result in it receiving a service that is not generally available to KCPL's and Aquila's other customers, the Commission should reject Kansas City's request to require KCPL or Aquila to fund a third-party energy audit.

X. Quality of Service Plan and Earnings Sharing Mechanism – Hearing Day(s): Wed. 12/12, Thurs. 12/13

A. Should Commission approval of the Joint Application be conditioned upon requiring KCPL/Aquila to file an application for a Quality of Service Plan within 90 days of the Commission's final decision in this proceeding?

No. The Commission should not condition its approval of the Merger on KCPL/Aquila filing a Quality of Service Plan. First, there is no evidence that such a plan is warranted. Second, the Commission already receives and reviews much of the information the City would have KCPL and Aquila provide. The Staff already reviews the very performance measures mentioned by it witness, Mr. Hix, as part of the Staff's Cost of Service report when a utility files a rate case. In KCPL's last rate case (ER-2007-0291), the Staff reviewed five years of data for System Average Interruption Frequency Index ("SAIFI"), System Average Interruption Duration Index ("SAIDI"), Customer Average Interruption Duration Index ("CAIDI"), and Momentary

Average Interruption Frequency Index ("MAIFI"). It found no evidence of long-term trends that should be cause for concern by the Commission. Because the Staff regularly reviews reliability data and can take action should the data indicate a problem, Mr. Hix's proposal is not relevant to the Commission's decision to approve the Merger.

B. Should Commission approval of the Joint Application be conditioned upon establishment of an Earnings Sharing Mechanism that returns to customers excess earnings of KCPL/Aquila above an authorized level.

No. The Commission should not condition its approval of the Merger on KCPL/Aquila establishing an Earnings Sharing Mechanism. It would be inappropriate to condition approval on such a mechanism. KCPL and Aquila are currently engaged in major generation construction programs. Both companies also have the continued need to raise additional capital, beyond the current construction of facilities, to meet environmental regulations. See Giles Surrebuttal at 13.

These infrastructure programs will require both Aquila and KCPL to file rate cases with the Commission requesting revenue increases in the year after the transaction closes, regardless of how the synergies are ultimately shared between customers and shareholders. See Giles Surrebuttal at 13-14. These rate increases will be needed to recover the costs of new facilities as they are placed into service, combined with increasing fuel costs and other increasing operations and maintenance expenses. Such costs will exceed the total estimated synergies of the acquisition during the next several years. Id. at 14. However, it must be recognized that the synergies resulting from the Merger will require a smaller increase in rates than would have been required absent the transaction. In other words, contrary to the premise underlying Mr. Hix's proposal, there will be no excess earnings to share. Id. The Commission will have the opportunity to consider that assertion in future rate cases. For the foregoing reasons, the Commission should reject the City's request for an Earnings Sharing Mechanism.

XI. Future Rate Case – Hearing Day: Wed. 12/12, Thurs. 12/13

A. Should Commission approval of the Joint Application be conditioned upon requiring KCPL/Aquila to file a comprehensive rate case with respect to the merged operations within three (3) years of the Commission's approval of the Merger?

No. The Commission should not condition its approval of the Merger on KCPL and Aquila filing a consolidated rate case within a specified timeframe. The City's request would require the Merger or consolidation of KCPL and Aquila, something that is not contemplated here. Great Plains Energy, the parent company of KCPL, is requesting approval to acquire Aquila and merge it into a subsidiary of Great Plains Energy. Aquila will retain and continue to operate under its Commission-approved tariffs. KCPL and Aquila will maintain separate generation, transmission, and distribution systems. Id. at 15. It is premature at this time to set a date when it might become appropriate to merge or consolidate KCPL or Aquila. As such, the Commission should reject the City's request.

XII. Miscellaneous Legal Issues

A. Have the Joint Applicants, Great Plains Energy, Incorporated, Kansas City Power & Light Company and Aquila, Inc. obtained from their Boards of Directors the authorizations necessary to effectuate actions required to merge, consolidate, combine, or integrate the systems, works and operations of KCPL and Aquila Networks -- MPS and Aquila Networks -- L&P proposed in the instant case?

B. Have the Joint Applicants, Great Plains Energy, Incorporated, Kansas City Power & Light Company and Aquila, Inc., applied to the Missouri Commission for the authorizations necessary to effectuate the Merger, consolidation, combination, or integration of the systems, works and operations of KCPL and Aquila Networks -- MPS and Aquila Networks -- L&P proposed in the instant case.

C. What is the legal effect for future Commission cases of the present Commission adopting the GPE/KCPL/Aquila proposals contained in their Joint Application filed on April 4, 2007?

D. Is the net detriment test utilized by the Joint Applicants as the not detrimental to the public interest standard, the criteria required by law for determining whether the proposed acquisition and related transactions are not detrimental to the public interest? Will the proposed Merger cause a net detriment to the public interest because the cost of service on which rates for Missouri ratepayers of Aquila and KCPL will be established will be higher as a direct result of the Merger than the cost of service would be for Aquila and KCPL absent the proposed transaction?

E. Does the Affiliate transactions Rule, 4 CSR 240-20.015, apply to transactions between regulated electrical corporations that are wholly owned by the same parent company?

Issues A-D are addressed below. Issue E is addressed in Section VI.

Applicable Legal Standard.

Great Plains Energy, the parent company of KCPL, is requesting approval under Section 393.190 to acquire Aquila and merge it into a subsidiary of Great Plains Energy. Such approval must be granted unless the Merger would be detrimental to the public interest. See 4 CSR 240-3.115(1)(D). Missouri courts have recognized that "the obvious purpose of Section 393.190 is to ensure the continuation of adequate service to the public served by the utility." State ex rel.

Fee Fee Trunk Sewer, Inc. v. Litz, 596 S.W.2d 466, 468 (Mo. App. E.D. 1980). See State ex rel. City of St. Louis v. PSC, 73 S.W.2d 393, 400 (Mo. 1934).

In Ag Processing, Inc. v. PSC, 120 S.W.3d 732 (Mo. 2003), the Supreme Court reversed a Commission decision under Section 393.190 where the acquisition of St. Joseph Light & Power Co. by Aquila's predecessor UtiliCorp United Inc. involved an acquisition premium. The Commission rejected Aquila's proposal regulatory plan under which a portion of the acquisition premium would be recovered in rates, refusing to consider the premium because it believed it was a rate case issue. The Supreme Court reversed, finding that the Commission must "consider and decide all necessary and essential issues" such as acquisition premium "as part of the cost analysis when evaluating whether the proposed Merger would be detrimental to the public." Id. at 736.

In a recent AmerenUE application seeking approval for the transfer of assets to its sister utility AmerenCIPS,[3] the Commission found that the Ag Processing case did not announce a new standard for asset transfer but rather restated the existing "not detrimental to the public" standard. The Commission determined that a cost/benefit analysis in which all the benefits and detriments in evidence are considered is required under the law. The Commission also clarified that the Ag Processing decision did not require the Commission to deny approval simply because there was a risk of future rate increases. The Commission found that it must consider this risk, together with other possible benefits and detriments to determine whether the proposed transaction is likely to be a net benefit or a net detriment to the public. The Commission also

[3] In re Union Electric Co., Case No. EO-2004-0108, Report and Order on Rehearing (Feb. 10, 2005).

found that the Ag Processing decision did not allow it to defer issues with ratemaking impact to a future rate case.

The Commission defined its role under Section 393.190:

> In considering whether or not the proposed transaction is likely to be detrimental to the public interest, the Commission notes that its duty is to ensure that UE provides safe and adequate service to its customers at just and reasonable rates. A detriment, then, is any direct or indirect effect of the transaction that tends to make the power supply less safe or less adequate, or which tends to make rates less just or less reasonable.
>
> The presence of detriments, thus defined, is not conclusive to the Commission's ultimate decision because detriments can be offset by attendant benefits. The mere fact that a proposed transaction is not the least cost alternative or will cause rates to increase is not detrimental to the public interest where the transaction will confer a benefit of equal or greater value or remedy a deficiency that threatens the safety or adequacy of the service. [In re Union Elec. Co., Case No. EO-2004-0108, Report and Order on Rehearing at 49.]

Applying this analysis, the Commission must look at the potential benefits and detriments, and then determine if the transaction results in a net detriment to the public.

§393.190 approval is only required with regard to the Aquila and Gregory Acquisition Corp. Merger.

In its filing, the Applicants have been clear that the synergies and cost savings result from the integration of the Aquila and KCPL operations. The Applicants provided a detailed synergy analysis in this regard. Public Counsel and the intervenors reviewed these synergies and presented their findings with regard to these synergies in their testimony. Staff, on the other hand, believes that it does not need to review the synergies because KCPL has not filed an application to merge or consolidate with Aquila under §393.190.

Staff's position is contrary to law and should be rejected. As recognized under Missouri corporate law, in order for a Merger or consolidation to occur two entities must combine to form one entity. KCPL and Aquila are not merging or consolidating as both will remain separate entities with separate tariffs, separate rates, and separate generation and distribution systems. "Merge" and "consolidate" are not defined in the statute so the Commission must look to other sources for guidance. Under Missouri law "any two domestic corporations may merge into one of the corporations . . . ." See § 351.410 (emphasis added). Similarly, any two domestic corporations may consolidate in a new domestic corporation . . . ." See § 357.415 (emphasis added). Thus, Missouri corporation law does not support Staff's view that KCPL and Aquila are merging or consolidating.

The Commission's rules also contemplate that a merger or consolidation involves two companies becoming one entity. 4 CSR 240-3.115, which lists the filing requirements for merger or consolidation applications, requires in subsection (1)(c) that the application contain the balance sheet and income statement of each applicant and a balance sheet and income statement of the surviving corporation. Since KCPL and Aquila will both continue to exist, there is no merger or consolidation before the Commission as contemplated by the Commission's rules.

Finally, the Staff's interpretation does not square with the purpose of §395.190 as defined by the Courts and recognized by the Commission.[4] If a utility is to be purchased or merged with an entity, the Commission needs to be assured that the new owner or entity providing service continue to provide adequate service to the public as the Commission can make sure that it has access to the new entity's or owner's books and records, and that the new entity or owner will continue to provide adequate service by looking at the new entity's or owner's track record in the

[4] The Commission recognized that the purpose of Section 393.190.1 is "to ensure the continuation of adequate service to the public served by the utility." In re Missouri-American Water Co., Case No. WM-2004-0122 (Report and Order, issued Nov. 20, 2003), quoting State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz, 596 S.W.2d 466, 468 (Mo. App. E.D. 1980).

operation of a public utility.[5] In this case, both Aquila and KCPL will remain separate entities and will continue to provide service to their respective customers. Both companies are well known to the Commission. While, KCPL and Aquila will combine much of their operations in order to achieve synergies, as detailed in KCPL's testimony, both utilities are fully subject to Commission regulation as individual entities in the same way that they are today.

Requested Authorization from Boards of Directors.

The Staff argues that KCPL and Aquila have failed to file a certified copy of resolutions of their respective board of directors authorizing the proposed Merger or consolidation of KCPL and Aquila as required under 4 CSR 240-3.115. See Staff Report at 4. As explained earlier, KCPL and Aquila are not merging or consolidating. The utilities will remain in existence and continue serving their customers under separate tariffs. In addition, the rule cited by Staff contemplates that only one entity will exist at the end of the Merger or consolidation, which is not the case here.

Legal Affect for Future Commission Cases.

In the application, Great Plains Energy requests approval to acquire Aquila. Issues regarding Merger-related rate increases have been raised by the parties. While the Commission is not able to speculate about future rate increases, it must under the Ag Processing decision determine the reasonableness of the risk of such rate increases as it assesses the costs and benefits of the Merger.

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[5] This Commission applies the following factors when considering whether a Section 393.190.1 transaction meets the "not detrimental" standard: (1) the applicant's experience in the utility industry; (2) the applicant's history of service difficulties; (3) the applicant's general financial health and ability to absorb the proposed transaction; and (4) the applicant's ability to operate the assets safely and efficiently. Missouri-American Water Co., supra, citing In the Matter of the Joint Application of Missouri Gas Energy, Report and Order, 3 Mo. P.S.C.3[d] 216, 220 (1994).

As with all of its decisions, this Commission cannot bind a future Commission. Section 386.490.3 provides that every order or decision of the Commission shall continue in force until changed or abrogated. Thus, its orders are always subject to change to meet new and different conditions, as dictated by the public interest. See State ex rel. Jackson County v. PSC, 532 S.W.2d 20, 29 (Mo. banc 1975).

Respectfully submitted,

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CERTIFICATE OF SERVICE

I do hereby certify that a true and correct copy of the foregoing document has been hand delivered, emailed or mailed, postage prepaid, this 27th day of November, 2007, to all counsel of record.

/s/ Karl Zobrist
Karl Zobrist