

Exhibit No.:
Issues: Merger Savings
Witness: Vern J. Siemek
Sponsoring Party: Aquila Networks-MPS
& L&P
Case No.: ER-

Before the Public Service Commission
of the State of Missouri

Direct Testimony
of
Vern J. Siemek

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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
DIRECT TESTIMONY OF VERN J. SIEMEK
ON BEHALF OF AQUILA , INC.
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NO. ER-_____**

1 Q. Please state your name and business address.

2 A. My name is Vern J. Siemek. My business address is Aquila, Inc., 1815 Capitol Avenue,
3 Omaha, Nebraska 68102-4914.

4 Q. By whom are you employed and in what capacity?

5 A. I am currently employed by Aquila, Inc. (“Aquila” or “Company”) as Financial Manager
6 for the Nebraska Networks with responsibilities for financial management.

7 Q. Briefly describe your educational background and employment history.

8 A. I earned a Bachelor of Science degree in Business Administration with Distinction from
9 the University of Nebraska at Lincoln in 1973 and am now a Certified Public Accountant
10 in Nebraska.

11 I was named to my current position in July 2002.

12 From 1994 to 2002, I held the positions of Director and Senior Director of Business
13 Services for the utility network of Aquila in the United States and was based in Kansas
14 City, Missouri. My responsibilities included analysis of utility acquisitions, including the
15 St. Joseph Light & Power Company (“L&P”) acquisition.

16 From 1987 to 1994, I held the position of Manager of Business Development for Peoples
17 Natural Gas (“Peoples”) in Omaha, Nebraska, an Aquila division with operations in
18 Colorado, Iowa, Kansas, Nebraska and Minnesota. From 1984 to 1987, I was in charge of
19 the Regulatory Affairs group for Peoples.

1 Before joining Peoples, I was employed for eleven years in the Regulated Industries
2 division of an international accounting firm in various capacities, including five years as
3 an audit manager. As part of my responsibilities, I supervised the audits of regulated
4 companies and the reviews of annual reports to the Federal Energy Regulatory
5 Commission.

6 Q. Have you ever testified before regulatory commissions?

7 A. Yes. I have testified before the Kansas Corporation Commission, the Iowa Utilities
8 Board, the Missouri Public Service Commission (“Commission”), the Arkansas Public
9 Service Commission, and the Oklahoma Corporation Commission.

10 **PURPOSE AND SUMMARY OF TESTIMONY**

11 Q. What is the purpose of your testimony?

12 A. My testimony will summarize how the acquisition of L&P created substantial savings
13 from economies of scale for both Missouri Public Service (“MPS”) and L&P.

14 1) Economies of scale created more efficient dispatching of the combined fleet of
15 generating plants and purchase power contracts of the newly combined company.

16 2) Economies of scale also created savings for MPS by spreading Aquila’s fixed
17 support costs over the larger base of operations and customers, which reduced
18 support costs significantly for MPS.

19 3) Savings in support costs were not realized at L&P because support costs allocated
20 to L&P by Aquila replaced support costs of the standalone L&P operations.

21 My testimony will also support Aquila retaining 50% of the acquisition-related savings to
22 benefit shareholders for creating those savings, of which half would be used to establish a

1 low income assistance program. Company witness Keith Stamm will also address our
2 proposal for the low income assistance program.

3 Q. Please summarize your testimony.

4 A. My testimony can be summarized as follows:

5 1) There are considerable savings from the acquisition of L&P from joint
6 dispatching of generation plants and to MPS from spreading Aquila support costs
7 over a larger customer base.

8 2) The normal procedures for allocating Aquila costs give 100% of the merger-
9 related savings from economies of scale to MPS (both types of savings) and L&P
10 (joint dispatching only).

11 3) It is equitable for Aquila to retain 50% of those benefits both as an incentive for
12 creating the savings in lieu of recovering the costs of creating the acquisition that
13 are not now reflected in MPS or L&P costs. Retaining benefits from the savings
14 created by mergers is generally superior to recovering the costs of an acquisition
15 because it limits the impact on customers to the savings actually created by the
16 merger.

17 4) Aquila has not yet realized any of the benefits of the savings from the merger.
18 Cost increases and industry conditions unrelated to the merger have thus far
19 prevented Aquila from realizing those benefits.

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

22 Q. Have you attached any schedules to your testimony?

23 A. Yes.

1 Schedule VJS-1 is an illustration of how the savings in support costs to MPS customers
2 are created by merger-created economies of scale.

3 Schedule VJS-2 is an illustration of the calculation of the support savings created for
4 MPS customers in the test period.

5 **SAVINGS CREATED BY THE MERGER FROM JOINT DISPATCHING**

6 Q. What was the first major type of saving from the merger?

7 A. The first major type of saving created by the merger is the joint dispatch of generating
8 plants and purchased power, which resulted in more efficient and cost-effective
9 generation. The testimony of Company witness Jerry Boehm describes these savings in
10 more detail. Company witness Lisa Starkebaum calculated the merger-related savings to
11 MPS by comparing the standalone dispatch model to the combined dispatch model.
12 Company witness Starkebaum also calculated the merger-related savings to L&P by
13 comparing the L&P standalone dispatch model to the combined dispatch model.

14 **ADJUSTMENTS FOR MERGER SAVINGS FOR JOINT DISPATCHING**

15 Q. What is the adjustment from the joint dispatching of generating plant and purchase power
16 contracts?

17 A. A pro forma adjustment is necessary because 100% of the savings are already reflected in
18 the test period. The separate pro forma adjustments allocating the savings for MPS and
19 L&P are calculated by Company witness Lisa Starkebaum as adjustment FPP-30. The
20 proforma adjustment starts from the total merger-related savings calculated above from
21 joint dispatching for each of MPS and L&P. Aquila's share of the savings is 50%, of
22 which half is directed to the low income assistance program. The total pro forma
23 adjustment for each of MPS and L&P is thus 50% of the total merger-created savings.

1 The Aquila share of 25% is supported later in this testimony. The 25% assigned to the
2 low income assistance program is supported by Company witness Keith Stamm. The last
3 50% of the savings remains in the test period to the benefit of all customers.

4 **SAVINGS CREATED BY THE MERGER IN OPERATING SUPPORT COSTS**

5 Q. How are the savings from economies of scale in operating costs realized by MPS
6 customers?

7 A. MPS customers realize these savings by the reduced cost allocations (including returns
8 and depreciation on common plant) from Aquila support departments. The post-merger
9 support costs of Aquila are smaller than the pre-merger support costs of the two
10 standalone entities. The larger post-merger organization generally can provide needed
11 support for both organizations that is more efficient than either organization by itself.
12 For MPS, the specific savings result from allocating Aquila support departments to the
13 new L&P business unit. New allocation drivers reduce the costs to be allocated to MPS.
14 Schedule VJS-1 illustrates this later in this testimony.

15 Q. Can you explain how this economy of scale operates in more detail?

16 A. Yes. Within economy of scale, there are two major reasons that the combined support
17 costs are more cost-efficient. The first major reason is that Aquila was able to eliminate
18 activities from L&P as a stand-alone entity that are no longer needed separately with
19 L&P operating as a division of Aquila. As a result, the combined Aquila support costs
20 for those activities are virtually the same as previously. Examples of this type of
21 economy of scale synergy are:

22 -External financial reporting (financial officers, audit fees and L&P-specific annual
23 and quarterly reports)

- 1 -Treasury functions like raising capital and L&P-specific shareholder
- 2 communications,
- 3 -Human Resources functions like developing and managing L&P-specific benefits
- 4 plans, and
- 5 -Information Systems for billing, financial reporting and managing operations.

6 The second major area is from reduced management and supervision costs needed for a
7 standalone function at L&P. Aquila needed to add only the personnel needed to actually
8 process L&P-related work, and could eliminate the layers of management and
9 supervision needed at L&P. Existing Aquila management and supervision were capable
10 of overseeing the relatively minor additional L&P functions. Some examples of these
11 areas are:

- 12 -Disbursements
- 13 -Payroll processing
- 14 -Benefits administration
- 15 -Engineering standards

16 In other words, because of the existing support structure at Aquila, Aquila's support
17 organization was able to handle the increased workload from L&P with the addition of
18 only minor incremental costs.

19 **ILLUSTRATIVE EXAMPLE OF MERGER SAVINGS IN SUPPORT COSTS**

20 Q. Can you illustrate how MPS customers benefit from the merger by Aquila's ability to
21 support L&P's needs with only minor incremental costs?

22 A Yes. Schedule VJS-1 illustrates conceptually how MPS customers benefit from the
23 economies of scale produced by the L&P merger. This example has been simplified to

1 MPS and L&P only in order to more readily illustrate the impact on these two operating
2 units.

3 **Column A and Bar A** show the pre-merger support costs of MPS and L&P that total \$60
4 million.

5 **Column C and Bar C** each show the costs after the Merger and Allocations. The
6 combined cost of MPS and L&P are reduced from the combined cost of \$60 million to
7 \$52 million solely because there is very little incremental cost to Aquila to support L&P.
8 That economy of scale results in total cost savings of \$8 million from the \$60 million
9 pre-merger costs.

10 **Column E and Bar E** illustrate how the lower combined costs are now allocated based
11 on the allocation drivers within Aquila. MPS is now allocated costs of \$42.12 million
12 and L&P is allocated costs of \$9.88 from the new total costs of \$52 million.

13 **Column F and Bar F** calculate the savings in support costs realized by each of the units.
14 The pre-merger costs in Column A are compared to the post-merger support costs in
15 Column E for each division. Economies of scale created savings for L&P of \$.12 million
16 (\$10.0 million less post-merger costs of \$9.88 million). MPS realized savings of \$7.88
17 million (\$50.0 million less post-merger \$42.12 million).

18 Both MPS and L&P benefit from this ability to leverage existing Aquila support
19 functions. Even after factoring in the incremental support costs for L&P, support costs
20 allocated to MPS are clearly reduced by the new allocation drivers that include L&P.

21 This saves MPS significant support costs. At the same time, support costs allocated to
22 L&P are somewhat less than the premerger level. This illustration indicates how the
23 L&P standalone costs are essentially replaced entirely by the allocated support costs,

1 resulting in small savings to L&P. Most of the savings are realized by the existing
2 Aquila divisions like MPS whose costs are lowered from pre-merger levels since the
3 L&P costs were replaced by support costs formerly allocated to divisions like MPS.

4 **ILLUSTRATIVE CALCULATION OF ADJUSTMENT**

5 Q. Please explain how this Merger Savings adjustment is calculated.

6 A. Schedule VJS-2 illustrates the calculation of the adjustment. Schedule VJS-2 is based on
7 the same conceptual framework as Schedule VJS-1. Schedule VJS-2 illustrates the steps
8 to calculate the merger-related savings within the context of this rate proceeding:

- 9 1) Determine the allocated support costs after all proposed adjustments, including
10 the allocation of cost to MPS with L&P included in the allocations. (The \$52
11 million on Line 1)
- 12 2) Reduce support costs by the incremental costs to support L&P to determine pre-
13 merger support costs had the merger not occurred. (The \$2 million on Line 2)
- 14 3) Remove the L&P drivers from the allocation process so that none of the pre-
15 merger support costs are being allocated to or absorbed by L&P. (Under the MPS
16 % on Line 4)
- 17 4) Recalculate the support cost allocations to MPS with L&P eliminated. (Under the
18 MPS column of Line 4)
- 19 5) Compare the original allocated cost to MPS to the recalculated support cost with
20 L&P eliminated. (Line 5) The difference is the savings that MPS receives from
21 the merger.

22 In the illustrative example on Schedule VJS-2, the synergies to MPS are calculated as the
23 same \$7,880,000 as calculated in Schedule VJS-1.

1 Q. Is that the amount of the savings you are proposing in this case?

2 A. No, Schedule VJS-2 simply illustrates how the savings are calculated in an example that
3 includes only MPS and L&P. The actual calculation is much more complicated due to
4 the number of Aquila operating divisions. Company witness Beverlee Agut has
5 quantified the actual savings.

6 **ADJUSTMENT FOR MERGER SAVINGS IN OPERATING SUPPORT COSTS**

7 Q. Please explain the Merger Savings adjustment.

8 A. A pro forma adjustment is necessary to remove the savings that would otherwise be
9 reflected 100% in the test period. Company witness Beverlee Agut calculated the
10 savings to MPS costs. Company witness Agut also calculated the pro forma adjustment
11 (CS-17). The calculation assigns 50% of the merger-related savings to Aquila, of which
12 half is directed to the low income assistance program. The remaining 50% of the savings
13 remains in the test period to benefit all MPS customers.

14 **SAVINGS CREATED BY THE MERGER IN RATE BASE SUPPORT COSTS**

15 Q. Are there similar savings from reduced allocations of common support assets (“Shared
16 Assets”)?

17 A. Yes, those savings arise from spreading the costs of Shared Assets over a larger customer
18 base as a result of the merger.

19 Q. What are those Shared Assets?

20 A. Shared Assets include general plant investments for call center equipment and for
21 software development costs for computer applications such as Customer Information
22 Systems (billing) and automated mapping.

23

1 **MERGER SAVINGS ADJUSTMENT FOR SHARED ASSETS**

2 Q. What are the savings created from Shared Assets for MPS?

3 A. There are actually two related types of savings. The first is the reduced allocation of the
4 total Shared Assets to MPS. This includes plant, net of accumulated depreciation and
5 related accumulated deferred taxes. That saving to MPS rate base should be treated
6 similarly as the operational savings.

7 Q. Is there a merger-related savings adjustment for Shared Assets?

8 A. Yes. Company witness Stephanie Murphy calculated the reduction due to Shared Assets
9 to determine the rate base savings to MPS created by the merger. The two pro forma
10 adjustments to MPS rate base, (RB-70 for plant and accumulated reserve for depreciation
11 and RBO-60 for the related reserve for deferred income taxes), reflect 50% of rate base
12 savings from Shared Assets to Aquila, of which half is directed to the low income
13 assistance program. The remaining 50% of the savings remains in the test period to
14 benefit of all MPS customers.

15 Q. What is the second type of saving related to Shared Assets?

16 A. The second type of saving is from the depreciation expense on the common assets
17 calculated above. That saving has already been reflected in the pro forma adjustment for
18 operating support cost, so no additional adjustment is required.

19 **EQUITY OF RETAINING MERGER SAVINGS**

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

1 A. It would be equitable for Aquila to retain at least a portion of those savings because the
2 shareholders of Aquila created those savings by bringing about the acquisition and they
3 should benefit from those savings.

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

5 A. Yes, there are many recent precedents for sharing the savings from mergers or
6 acquisitions. Many are simpler than this proposal because the acquisitions occurred in a
7 single regulatory jurisdiction. All acknowledge that the savings created by acquisitions
8 are equitably shared in some ratio between the customers and the shareholders that
9 created the savings.

10 Q. What ratio of shared savings is typically shared by the shareholders?

11 A. The sharing for shareholders varies from 25% to 100%.

12 Q. What ratio of shared savings has Aquila proposed to retain?

13 A. Aquila proposes to retain 50% of the savings and direct half of that to the low income
14 assistance program described by Company witness Keith Stamm.

15 Q. Please describe the precedents that support Aquila retaining a share of the savings, with
16 related citations:

17 A. Certainly. Some of the precedents where commissions have allowed the sharing of
18 acquisition-related savings to offset merger-related costs are as follows:

- 19 1. California Public Utilities Commission- RE GTE Corporation A.90-09-043,
20 Decision 96-04-053, 169 PUR 4th 358 dated April 10, 1996 “We conclude that ...
21 a 50-50 sharing of the forecasted economic savings is equitable..”
22
- 23 2. District of Columbia Public Service Commission- Re Baltimore Gas and Electric
24 Company –Formal Case No. 951, Order No 11075, 180 PUR 4th 393 dated
25 October 20,1997 “We believe that the public interest ... will best be served by
26 ... ratepayers to recover ... 75% ... of the net merger savings...”
27

- 1 3. Louisiana Public Service Commission –Re Entergy Corporation – Docket No. U-
2 19904, Order No. U-19904, 146 PUR 4th 292 dated May 3, 1993 “ The plan to
3 allow shareholders to keep 60 percent of O&M cost savings allows them a
4 reasonable opportunity to recover the premium included in their investment...
5 without which there would be no merger savings.”
6
- 7 4. Nevada Public Utilities Commission –Re Nevada Power Company- Docket No.
8 98-7023, 191 PUR 4th 1 dated January 4, 1999. “... The commission therefore
9 will establish a procedure that affords the shareholders a reasonable opportunity
10 to recover these [merger] costs, upon a showing that merger savings are sufficient
11 to justify these costs.” This effectively assigned 100% of the savings to
12 shareholders up to the level of costs incurred.
13
- 14 5. Massachusetts Department of Telecommunications and Energy- Re Eastern
15 Enterprises- D.P.U./D.T.E. 98-27 –188 PUR 4th 225 – Dated September 17, 1998
16 “...Eastern will have an opportunity to recoup the [premium or other merger
17 transaction] costs by seeking to capture merger related efficiencies...” This
18 implies that 100% of the savings be assigned to shareholders up to the level of
19 costs incurred.
20
- 21 6. Massachusetts Department of Telecommunications and Energy- Re
22 Massachusetts Electric Company – D.T.E. 99-47 PUR 4th – Dated March 14,
23 2000 “...any recovery of ... costs will depend entirely on actual cost savings
24 achieved..” This effectively assigned 100% of the savings to shareholders up to
25 the level of costs incurred.
26
- 27 7. Massachusetts Department of Telecommunications and Energy- Re Boston
28 Edison Company- D.T.E. 99-19 195 PUR 4th 347, Dated July 27, 1999
29 “Following the expiration of the rate freeze, distribution rates established by the
30 department in any base rate proceeding would account for savings gained as a
31 result of the merger, net of the recovery of merger-related costs, including an
32 estimated \$500 million acquisition premium.” This effectively assigned 100% of
33 the savings to shareholders up to the level of costs incurred.
34
- 35 8. Massachusetts Department of Telecommunications and Energy- Re Colonial Gas
36 Company – D.T.E. 98-128, 195 PUR 4th 297 Dated July 15, 1999 “...during the
37 next 30 years, recovery of the acquisition premium must be supported by
38 demonstrated savings.”
39
- 40 9. Kansas Corporation Commission –UtiliCorp United, Docket No. 99-WPEE-818
41 RTS. “The Commission finds that the Applicant should be allowed to
42 recover...to the extent that there are demonstrable savings created by the
43 acquisition...” This effectively assigned 100% of the savings to shareholders.
44
- 45 10. Illinois Commerce Commission- Re Illinois-American Water Company – 00-
46 0476, 210 PU4th 259 Dated May 15, 2001 “The Commission believes that a fair

1 treatment in this case of the savings attributable solely to the Acquisition is a
2 50/50 sharing between shareholders and ratepayers.”

- 3
4 11. New York Public Service Commission –Re Niagara Mohawk Holdings, Inc –
5 Case 01-M-0075, Opinion No. 01-6 PUR 4th dated December 3, 2001 The
6 Commission supported a plan “...which assigns to customers 50% of the
7 additional synergies (net of cost to achieve)..”
8
9 12. Kentucky Public Service Commission – RE Kentucky Utility Company- Case No.
10 98-474, PUR 4th, January 7, 2002 “...the sharing mechanism will be 60 percent
11 KU and 40 percent ratepayers...”
12
13 13. Iowa Utilities Board –RE IPS Electric - Docket RPU-91-6, issued June 1, 1992.
14 The Board awarded an incentive management award estimated at \$1,000,000
15 annually using a 30-basis point adjustment to the equity rate of return under the
16 Management Efficiency statutes and the Board’s rule implementing that statute.
17 The discussion relating to that finding was that the merger of Iowa Resources and
18 Midwest Energy would result in significant tangible financial benefit to
19 ratepayers. The incentive management award effectively gave IPS Electric a
20 means to share in the synergies created by the merger via a higher return on
21 equity. The Order itself references an earlier 50 basis point award to Midwest
22 Gas for its effort in the merger. The order also allowed the recovery of those
23 costs over a three-year period separately from the incentive
24

25 Clearly, many jurisdictions have realized the equity of sharing acquisition-related savings
26 with shareholders to reward the companies and to help offset the costs of accomplishing
27 the transactions that created the savings.

28 **RECOVERY OF ACQUISITION-RELATED COSTS**

29 Q. Several of the cited orders allow the recovery of acquisition adjustment costs. Is Aquila
30 seeking specific recovery of any acquisition adjustment or premium?

31 A. No. Aquila’s proposal seeks only to share the savings created by the acquisition, and
32 does not seek specific recovery of any of the costs, including premium.

33 Q. Does your proposal request recovery of the costs to achieve these savings?

1 A. No. Our proposal to share the savings eliminates the need to request recovery of the
2 costs. No specific costs to achieve the savings are requested, so that those costs are only
3 recoverable from the shareholder portion of the savings.

4 Q. Did the acquisition create related costs to shareholders of Aquila?

5 A. Yes, Aquila shareholders incurred costs and assumed risks in bringing about the
6 acquisition. The acquisition ultimately needs to provide shareholder benefits in order to
7 be successful.

8 Q. What costs has Aquila incurred to accomplish the acquisition?

9 A. Aquila incurred costs to transition data from old computer systems to Aquila's systems,
10 to transition acquired personnel to other positions, and to transition acquired personnel to
11 Aquila benefit plans.

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

14 A. Economically, shareholders end up absorbing the costs that produced the savings for the
15 customers. This is clearly not equitable since the parties benefiting from the cost savings
16 do not share the costs. Passing on all of the savings to customers will deter future
17 acquisitions and the savings created by them. Retaining 50% of the savings for Aquila is
18 a reasonable allocation of the savings. Half of that savings is directed to the low income
19 assistance program.

20 Q. What happens to the remaining savings?

21 A. Company witness Stamm's testimony supports Aquila's proposal to assign 25% of the
22 total savings to a low income assistance program (half of Aquila's retained 50% of the
23 merger savings). MPS and L&P customers will realize the remaining 50% in general.

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

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

11 **SAVINGS REALIZED SINCE THE MERGER**

12 Q. Hasn't Aquila benefited from these savings ever since the merger was consummated on
13 January 1, 2001?

14 A. No. Aquila has realized little, if any, benefit from those merger savings to date. The first
15 year of integration was 2001, when joint dispatching was delayed until mid-year because
16 the Federal Energy Regulatory Commission had to approve the proposed joint
17 dispatching to pass market power tests. The full integration of L&P into Aquila required
18 methodical conversions of Information Systems technology such as billing to provide a
19 seamless transition to L&P customers. Some internal applications had to be modified to
20 provide the proper information. Integration also required completing year-end report
21 preparation for both Commission and Securities and Exchange reporting. The new
22 Aquila personnel taking over responsibility for L&P customers also needed to be
23 familiarized with the L&P records and procedures. Tariffs had to be adopted or

1 modifications requested to accommodate differences between the approved tariffs of the
2 two companies. The first year of integration resulted in relatively few savings.

3 Q. Were those small savings in 2001 able to be realized by Aquila?

4 A. No. Unrelated cost increases particularly for fuel and purchased power created a revenue
5 deficiency that caused Aquila to file a rate case in 2001.

6 Q. Because no MPS rate case was filed in 2002, does that mean Aquila was able to realize
7 any merger-related savings that year?

8 A. No. At the time when a 2002 rate case (using a 2001 test period) would have been filed,
9 it was clear the massive changes in the energy industry were creating related pressures on
10 Aquila that ultimately led to the financial crisis and reorganization in early 2002.

11 Survival of the Company in total and the rapid changes in personnel and cost levels
12 precluded the significant effort and level of accuracy of costs needed to pursue rate relief.
13 Now that those changes have been implemented and are in place, it is very clear that
14 current costs in Missouri have prevented any effective realization by Aquila of the
15 merger savings. Joint dispatching savings are also impacted by fuel price volatility and
16 the last several years have been periods of significant gas price volatility.

17 **PROVIDING BENEFITS TO CUSTOMERS**

18 Q. How do customers benefit if the shareholders retain any acquisition savings?

19 A. Currently, under the Company proposal, all customers will benefit from the 50% of total
20 merger-related savings still reflected in the test period. The customers helped by the low
21 income assistance program will also benefit from the 25% of the savings assigned to that
22 program. The customers share in those savings despite not contributing to their creation.

23 If the shareholders do not retain some portion of merger savings, companies will be less

1 likely to pursue mergers that could ultimately benefit customers by lowering their costs.
2 Customers receive no such savings if no mergers occur, so allowing the shareholders to
3 retain a portion of the savings is a reasonable and equitable method to lower costs to
4 customers.

5 Q. Has the Commission or Commission Staff enunciated any criteria in determining whether
6 shareholders should retain merger-related synergies?

7 A. Yes. In the UtiliCorp (now Aquila)/L&P merger Case No. EM-2000-292, Staff indicated
8 a strong preference for regulatory lag as the preferred approach to sharing merger-related
9 savings. Aquila's proposal in this case to retain the merger-related savings is essentially
10 a regulatory lag-based approach.

11 Q. How does this proposal conform to a regulatory lag approach?

12 A. It answers the two basic questions about the savings being retained:

13 1. Are the savings merger related? The Company's testimony clearly lays out the
14 direct connection of the savings to the merger, so that answer is YES.

15 2. Has there been a reasonable time for Aquila to realize and retain those savings?
16 That answer is clearly NO. The unrelated cost increases that led MPS to file rate
17 cases based on 2000 and 2002 results have made it abundantly clear that few
18 savings from the merger have been realized to date for reasons unrelated to the
19 merger.

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

21 A. MPS and L&P customers, including customers helped by the low income assistance
22 program, will realize a significant share of the savings created by this merger.

23 Companies will be encouraged to pursue merger transactions that will ultimately provide

1 additional economic benefits to customers, knowing that shareholders will also share in
2 the economic benefits. Shareholders will be much more likely to accept the costs and
3 risks of merger transactions if it is clear that the savings have an economic value to the
4 shareholders as well as the customers. Adopting Aquila's proposal sends a clear signal to
5 utilities currently operating in Missouri that mergers that make economic sense will not
6 be prevented or made less economic by regulatory actions.

7 **CONCLUSION:**

8 Q. What is your conclusion?

9 A. Aquila's acquisition has created significant savings to MPS and L&P from joint
10 dispatching and to MPS from economies of scale for support costs. Those savings were
11 created by Aquila with considerable effort, cost and risk. It is fair and equitable that
12 Aquila retain 50% of the savings created from that acquisition to both reward and
13 compensate Aquila for creating the savings. Half of those retained savings would be
14 directed to the low income assistance program. The retention should be accomplished by
15 reflecting MPS and L&P pro forma adjustments retaining a portion of the savings.

16 Q Does that conclude your direct testimony?

17 A. Yes.

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the matter of Aquila, Inc. d/b/a Aquila)
Networks-MPS and Aquila Networks-L&P,)
for authority to file tariffs increasing electric)
rates for the service provided to customers in)
the Aquila Networks-MPS and Aquila)
Networks-L&P area)

Case No. ER-_____

County of)
) ss
State of)

AFFIDAVIT OF VERN J. SIEMEK

Vern J. Siemek, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Direct Testimony of Vern J. Siemek;" that said testimony was prepared by him and under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.

Vern J. Siemek

Subscribed and sworn to before me this _____ day of _____, 2003.

Notary Public

My Commission expires:

Savings to MPS From L&P Merger
(Conceptual Illustration)

	Total Aquila	MPS %	MPS
1 Aquila current support costs	\$ 52,000,000	81.00%	\$ 42,120,000
2 Less Incremental costs for L&P	\$ 2,000,000		
3 Adjusted current support costs without L&P incremental costs	<u>\$ 50,000,000</u>		
4 MPS share of adjusted current support costs excluding incremental L&P costs and excluding L&P allocation drivers		100%	\$ 50,000,000
5 Savings to MPS created by the economies of scale from the merger			<u>\$ 7,880,000</u>