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Witness:	Vern J. Siemek
Type of Exhibit:	Direct Testimony
Sponsoring Party:	Aquila
Case No:	
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MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. __________

DIRECT TESTIMONY

OF

VERN J. SIEMEK

ON BEHALF OF

AQUILA, INC.
d/b/a
AQUILA NETWORKS – MPS
and
AQUILA NETWORKS – L&P

Omaha, Nebraska
August, 2003

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 gas rates for the service provided to customers in the Aquila Networks-MPS and Aquila Networks-L&P area	))))))	Case No. GR-________

County of Douglas)
) ss
State of Nebraska)

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
Vern J. Siemek

Subscribed and sworn to before me this 9th day of July, 2003.

Richard Petersen
Richard Petersen, Notary Public

My Commission expires:

7/4/05

RICHARD G PETERSEN
GENERAL NOTARIAL
SEAL
STATE OF NEBRASKA
COMMISSION EXPIRES
JULY 4, 2005

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DIRECT TESTIMONY OF VERN J. SIEMEK

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

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

Q. BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EMPLOYMENT HISTORY.

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

I was named to my current position in July 2002.

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

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

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

Q. HAVE YOU EVER TESTIFIED BEFORE REGULATORY COMMISSIONS?

A. Yes. I have testified before the Kansas Corporation Commission, the Iowa Utilities Board, the Missouri Public Service Commission ("Commission"), the Arkansas Public Service Commission, and the Oklahoma Corporation Commission.

PURPOSE AND SUMMARY OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony will summarize how the acquisition of L&P created substantial savings from economies of scale for Missouri Public Service ("MPS"). Economies of scale created savings for MPS by spreading Aquila's fixed support costs over the larger base of operations and customers, which reduced support costs significantly for MPS. Savings in support costs were not realized at L&P because support costs allocated to L&P by Aquila replaced support costs of the standalone L&P operations.

My testimony will also support Aquila retaining 50% of the acquisition-related savings to benefit shareholders for creating those savings, of which half would be used to establish a low income assistance program. I will also address our proposal for the low income assistance program.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. My testimony can be summarized as follows:

1) There are considerable savings to MPS from spreading Aquila support costs over a larger customer base.
2) The normal procedures for allocating Aquila costs give 100% of the MPS portion of those merger-related savings from economies of scale to MPS customers.
3) It is equitable for Aquila to retain 50% of those benefits both as an incentive for creating the savings and in lieu of recovering the costs of creating the acquisition that are not now reflected in MPS or L&P costs. Retaining benefits from the savings created by mergers is generally superior to recovering the costs of an acquisition because it limits the impact on customers to the savings actually created by the merger.
4) Aquila has not yet realized any of the benefits of the savings from the merger. Cost increases and industry conditions unrelated to the merger have thus far prevented Aquila from realizing those benefits.
5) Sharing in the savings created by the merger provides an incentive for companies to create such savings for customers by encouraging future mergers.

Q. HAVE YOU ATTACHED ANY SCHEDULES TO YOUR TESTIMONY?

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

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

SAVINGS CREATED BY THE MERGER IN OPERATING SUPPORT COSTS

Q. HOW ARE THE SAVINGS FROM ECONOMIES OF SCALE IN OPERATING COSTS REALIZED BY MPS CUSTOMERS?

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

Q. CAN YOU EXPLAIN IN MORE DETAIL HOW THIS ECONOMY OF SCALE OPERATES?

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

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

-Treasury functions like raising capital and L&P-specific shareholder communications;

-Human Resources functions like developing and managing L&P-specific benefits plans; and

-Information Systems for billing, financial reporting and managing operations.

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

-Disbursements;

-Payroll processing;

-Benefits administration; and

-Engineering standards.

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

ILLUSTRATIVE EXAMPLE OF MERGER SAVINGS IN SUPPORT COSTS

Q. CAN YOU ILLUSTRATE HOW MPS CUSTOMERS BENEFIT FROM THE MERGER BY AQUILA'S ABILITY TO SUPPORT L&P'S NEEDS WITH ONLY MINOR INCREMENTAL COSTS?

A Yes. Schedule VJS-1 illustrates conceptually how MPS customers benefit from the economies of scale produced by the L&P merger. This example has been simplified to MPS and L&P only in order to more readily illustrate the impact on these two operating units.

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

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

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

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

Both MPS and L&P benefit from this ability to leverage existing Aquila support functions. Even after factoring in the incremental support costs for L&P, support costs allocated to MPS are clearly reduced by the new allocation drivers that include L&P. This saves MPS significant support costs. At the same time, support costs allocated to L&P are somewhat less than the premerger level. This illustration indicates how the L&P standalone costs are essentially replaced entirely by the allocated support costs, resulting in small savings to L&P. Most of the savings are realized by the existing Aquila divisions like MPS whose costs are lowered from pre-merger levels since the L&P costs were replaced by support costs formerly allocated to divisions like MPS.

ILLUSTRATIVE CALCULATION OF ADJUSTMENT

Q. PLEASE EXPLAIN HOW THIS MERGER SAVINGS ADJUSTMENT IS CALCULATED.

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

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

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

Q. IS THAT THE AMOUNT OF THE SAVINGS YOU ARE PROPOSING IN THIS CASE?

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

ADJUSTMENT FOR MERGER SAVINGS IN OPERATING SUPPORT COSTS

Q. PLEASE EXPLAIN THE MERGER SAVINGS ADJUSTMENT.

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

SAVINGS CREATED BY THE MERGER IN RATE BASE SUPPORT COSTS

Q. ARE THERE SIMILAR SAVINGS FROM REDUCED ALLOCATIONS OF COMMON SUPPORT ASSETS (“SHARED ASSETS”)?

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

Q. WHAT ARE THOSE SHARED ASSETS?

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

MERGER SAVINGS ADJUSTMENT FOR SHARED ASSETS

Q. WHAT ARE THE SAVINGS CREATED FROM SHARED ASSETS FOR MPS?

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

Q. IS THERE A MERGER-RELATED SAVINGS ADJUSTMENT FOR SHARED ASSETS?

A. Yes. This adjustment reflects the sharing by MPS of the MPS/L&P merger related rate base synergies arising from centralized support functions. RB-70 calculates the reduction to corporate shared assets to determine the rate base savings to MPS created by the merger. The adjustment to MPS rate base, including plant and accumulated depreciation reserve, totaled $143,956, which also reflects the depreciation reserve at September 30, 2003. This adjustment adds back 50% of rate base savings from shared assets to Aquila, of which half is directed to the low income assistance program. The remaining 50% of the savings remains in the test period to benefit MPS customers.

Q. IS THERE A RELATED ADJUSTMENT TO THE RESERVE FOR DEFERRED TAXES DUE TO THE SHARED ASSETS ADJUSTMENT RB-70?

A. Yes. This adjustment (Rate Base Other Adjustment RBO-60) reflects the sharing by MPS of the MPS/L&P merger related rate base synergies, and their related reserve for deferred income tax savings. RBO-60 calculates the increase to the deferred income taxes on the corporate shared assets from adding back 50% of the merger-created savings in plant and depreciation reserves to MPS in RB-70. The adjustment to MPS for deferred income taxes is $68,917. This adjustment reflects 50% of rate base savings from the deferred taxes on the shared assets to Aquila, of which half is directed to the low-income assistance program. The remaining 50% of the savings remains in the test period to the benefit of all MPS customers.

Q. WHAT IS THE SECOND TYPE OF SAVING RELATED TO SHARED ASSETS?

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

<u>EQUITY OF RETAINING MERGER SAVINGS</u>

Q. YOU HAVE EXPLAINED IN DETAIL THE SEVERAL TYPES AND SOURCES OF SAVINGS FROM THE L&P MERGER TO MPS AND L&P COSTS. IF SOME PORTION OF THOSE SAVINGS WERE TO BE RETAINED BY AQUILA INSTEAD OF BEING PASSED ON TO BENEFIT MPS AND L&P, HOW WOULD YOU CHARACTERIZE THIS SITUATION?

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

Q. ARE THERE PRECEDENTS FOR SHARING MERGER AND ACQUISITION-RELATED SAVINGS?

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

Q. WHAT RATIO OF SAVINGS IS TYPICALLY SHARED BY THE SHAREHOLDERS?

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

Q. WHAT RATIO OF SAVINGS HAS AQUILA PROPOSED TO RETAIN?

A. Aquila proposes to retain 50% of the savings and direct half of that to the low income assistance program described later in my testimony.

Q. PLEASE DESCRIBE THE PRECEDENTS WHERE UTILITIES HAVE RETAINED A SHARE OF THE SAVINGS, WITH RELATED CITATIONS.

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

1. California Public Utilities Commission- RE GTE Corporation A.90-09-043, Decision 96-04-053, 169 PUR 4th 358 dated April 10, 1996 "We conclude that … a 50-50 sharing of the forecasted economic savings is equitable.."

2. District of Columbia Public Service Commission- Re Baltimore Gas and Electric Company –Formal Case No. 951, Order No 11075, 180 PUR 4th 393 dated October 20,1997 "We believe that the public interest … will best be served by … ratepayers to recover … 75% … of the net merger savings…"

3. Louisiana Public Service Commission –Re Entergy Corporation – Docket No. U-19904, Order No. U-19904, 146 PUR 4th 292 dated May 3, 1993 " The plan to allow shareholders to keep 60 percent of O&M cost savings allows them a reasonable opportunity to recover the premium included in their investment… without which there would be no merger savings."

4. Nevada Public Utilities Commission –Re Nevada Power Company- Docket No. 98-7023, 191 PUR 4th 1 dated January 4, 1999. "… The commission therefore will establish a procedure that affords the shareholders a reasonable opportunity to recover these [merger] costs, upon a showing that merger savings are sufficient to justify these costs." This effectively assigned 100% of the savings to shareholders up to the level of costs incurred.

5. Massachusetts Department of Telecommunications and Energy- Re Eastern Enterprises- D.P.U./D.T.E. 98-27 –188 PUR 4th 225 – Dated September 17, 1998 "…Eastern will have an opportunity to recoup the [premium or other merger transaction] costs by seeking to capture merger related efficiencies…" This implies that 100% of the savings be assigned to shareholders up to the level of costs incurred.

6. Massachusetts Department of Telecommunications and Energy- Re Massachusetts Electric Company – D.T.E. 99-47 PUR 4th – Dated March 14, 2000 "…any recovery of … costs will depend entirely on actual cost savings achieved.." This effectively assigned 100% of the savings to shareholders up to the level of costs incurred.

7. Massachusetts Department of Telecommunications and Energy- Re Boston Edison Company- D.T.E. 99-19 195 PUR 4th 347, Dated July 27, 1999 "Following the expiration of the rate freeze, distribution rates established by the department in any base rate proceeding would account for savings gained as a result of the merger, net of the recovery of merger-related costs, including an estimated $500 million acquisition premium." This effectively assigned 100% of the savings to shareholders up to the level of costs incurred.

8. Massachusetts Department of Telecommunications and Energy- Re Colonial Gas Company – D.T.E. 98-128, 195 PUR 4th 297 Dated July 15, 1999 "…during the next 30 years, recovery of the acquisition premium must be supported by demonstrated savings."

9. Kansas Corporation Commission –UtiliCorp United, Docket No. 99-WPEE-818 RTS. "The Commission finds that the Applicant should be allowed to recover…to the extent that there are demonstrable savings created by the acquisition…" This effectively assigned 100% of the savings to shareholders.

10. Illinois Commerce Commission- Re Illinois-American Water Company – 00-0476, 210 PU4th 259 Dated May 15, 2001 "The Commission believes that a fair treatment in this case of the savings attributable solely to the Acquisition is a 50/50 sharing between shareholders and ratepayers."

11. New York Public Service Commission –Re Niagara Mohawk Holdings, Inc – Case 01-M-0075, Opinion No. 01-6 PUR 4th dated December 3, 2001 The Commission supported a plan "…which assigns to customers 50% of the additional synergies (net of cost to achieve).."

12. Kentucky Public Service Commission – RE Kentucky Utility Company- Case No. 98-474, PUR 4th, January 7, 2002 "…the sharing mechanism will be 60 percent KU and 40 percent ratepayers…"

13. Iowa Utilities Board –RE IPS Electric - Docket RPU-91-6, issued June 1, 1992. The Board awarded an incentive management award estimated at $1,000,000 annually using a 30-basis point adjustment to the equity rate of return under the Management Efficiency statutes and the Board's rule implementing that statute. The discussion relating to that finding was that the merger of Iowa Resources and Midwest Energy would result in significant tangible financial benefit to ratepayers. The incentive management award effectively gave IPS Electric a means to share in the synergies created by the merger via a higher return on equity. The Order itself references an earlier 50 basis point award to Midwest Gas for its effort in the merger. The order also allowed the recovery of those costs over a three-year period separately from the incentive

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

RECOVERY OF ACQUISITION-RELATED COSTS

Q. SEVERAL OF THE CITED ORDERS ALLOW THE RECOVERY OF ACQUISITION ADJUSTMENT COSTS. IS AQUILA SEEKING SPECIFIC RECOVERY OF ANY ACQUISITION ADJUSTMENT OR PREMIUM?

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

Q. DOES YOUR PROPOSAL REQUEST RECOVERY OF THE COSTS TO ACHIEVE THESE SAVINGS?

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

Q. DID THE ACQUISITION CREATE RELATED COSTS TO SHAREHOLDERS OF AQUILA?

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

Q. WHAT COSTS HAS AQUILA INCURRED TO ACCOMPLISH THE ACQUISITION?

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

Q. WHAT HAPPENS IF 100% OF THE MERGER-RELATED SAVINGS ARE UTILIZED TO REDUCE THE COSTS OF MPS?

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

Q. WHAT HAPPENS TO THE REMAINING SAVINGS?

A. Aquila's proposal is to assign 25% of the total savings to a low income assistance program (half of Aquila's retained 50% of the merger savings). MPS customers will realize the remaining 50% in general.

Q. WHAT RISKS HAVE AQUILA SHAREHOLDERS ASSUMED AS A RESULT OF THIS ACQUISITION?

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

SAVINGS REALIZED SINCE THE MERGER

Q. HASN'T AQUILA BENEFITED FROM THESE SAVINGS SINCE THE MERGER WAS CONSUMMATED ON JANUARY 1, 2001?

A. No. Aquila has realized little, if any, benefit from those merger savings to date. The first year of integration was 2001. The full integration of L&P into Aquila required methodical conversions of Information Systems technology such as billing to provide a seamless transition to L&P customers. Some internal applications had to be modified to provide the proper information. Integration also required completing year-end report preparation for both Commission and Securities and Exchange reporting. The new Aquila personnel taking over responsibility for L&P customers also needed to be familiarized with the L&P records and procedures. Tariffs had to be adopted or modifications requested to accommodate differences between the approved tariffs of the two companies. The first year of integration resulted in relatively few savings.

Q. BECAUSE NO MPS RATE CASE WAS FILED IN 2001 OR 2002, DOES THAT MEAN AQUILA WAS ABLE TO REALIZE ANY MERGER-RELATED SAVINGS THAT YEAR?

A. No. Earnings were inadequate in MPS for several years. However, rapid changes in personnel and cost levels precluded the significant effort and level of accuracy of costs needed to pursue rate relief. Now that those changes have been implemented and are in place, it is very clear that current costs in Missouri have prevented any effective realization by Aquila of the merger savings.

PROVIDING BENEFITS TO CUSTOMERS

Q. HOW DO CUSTOMERS BENEFIT IF THE SHAREHOLDERS RETAIN ANY ACQUISITION SAVINGS?

A. Currently, under the Company proposal, all customers will benefit from the 50% of total merger-related savings still reflected in the test period. The customers helped by the low income assistance program will also benefit from the 25% of the savings assigned to that program. The customers share in those savings despite not contributing to their creation. If the shareholders do not retain some portion of merger savings, companies will be less likely to pursue mergers that could ultimately benefit customers by lowering their costs. Customers receive no such savings if no mergers occur, so allowing the shareholders to retain a portion of the savings is a reasonable and equitable method to lower costs to customers.

Q. HAS THE COMMISSION OR COMMISSION STAFF ENUNCIATED ANY CRITERIA IN DETERMINING WHETHER SHAREHOLDERS SHOULD RETAIN MERGER-RELATED SYNERGIES?

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

Q. HOW DOES THIS PROPOSAL CONFORM TO A REGULATORY LAG APPROACH?

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

1. Are the savings merger related? The Company's testimony clearly lays out the direct connection of the savings to the merger, so that answer is YES.
2. Has there been a reasonable time for Aquila to realize and retain those savings? That answer is clearly no. MPS results in recent years have made it abundantly clear that few savings from the merger have been realized to date for reasons unrelated to the merger.

Q WHAT IS THE LIKELY IMPACT IF THE COMMISSION ADOPTS AQUILA'S POSITION?

A. MPS customers, including customers helped by the low income assistance program, will realize a significant share of the savings created by this merger. Companies will be encouraged to pursue merger transactions that will ultimately provide additional economic benefits to customers, knowing that shareholders will also share in the economic benefits. Shareholders will be much more likely to accept the costs and risks of merger transactions if it is clear that the savings have an economic value to the shareholders as well as the customers. Adopting Aquila's proposal sends a clear signal to utilities currently operating in Missouri that mergers that make economic sense will not be prevented or made less economic by regulatory actions.

LOW INCOME ASSISTANCE PROPOSAL

Q. PLEASE DESCRIBE THE PROPOSAL TO BENEFIT LOW INCOME CUSTOMERS.

A. Aquila is proposing a 50/50 sharing of the merger synergies with our customers. The customer portion of these synergy savings would be immediately flowed back to all customers through a reduction in revenue requirements in the current case. In addition, one-half of the Company's share of these savings would be set aside to establish a low-income assistance program. This program would be administered by an outside third party for the payment of past due and at risk accounts of both low-income electric and gas customers.

Q. WHAT CONTROL WOULD AQUILA RETAIN OVER ADMINISTRATION OF THIS PROGRAM?

A. Essentially none. Aquila would continue to set aside funds for the low income-sharing program as long as the synergy savings from the acquisition are embedded in rates. An outside agency, such as the United Way or other organizations that have administered LIHEAP programs, would be selected to establish criteria for identification of low-income customers, determine the level of need and administer credits to their accounts.

CONCLUSION

Q. WHAT IS YOUR CONCLUSION?

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

Q DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.