Staff Report
of Staff's Evaluation and
Recommendations regarding
Great Plains Energy Incorporated's (GPE)
Proposed Acquisition of
Aquila, Inc. (Aquila)

Case No. EM-2007-0374

October 12, 2007

****<u>Denotes Highly Confidential Information</u>****

NP

Table of Contents

1. Executive Summary

The proposed transaction contained in the Joint Application of Great Plains Energy Incorporated (GPE), Kansas City Power & Light Company (KCPL) and Aquila, Inc. (Aquila) filed on April 4, 2007, establishing Case No. EM-2007-0374, will cause a net detriment to the public interest because the cost of service to establish rates for Missouri ratepayers of Aquila and KCPL, as a direct result, will be higher than the rates would be absent the proposed transaction. GPE does not have the financial strength to acquire Aquila and absorb Aquila's financial difficulties without seriously weakening GPE's financial condition. GPE's acquisition of Aquila will weaken KCPL's financial condition at a time when KCPL is committed to significant capital expenditures. When the GPE acquisition of Aquila was announced on February 7, 2007, Standard & Poor's placed KCPL's debt ratings on CreditWatch with negative implications. Standard & Poor's website provides the following information regarding its CreditWatch designation:

> CreditWatch highlights the potential direction of a short- or long-term rating. It focuses on identifiable events and short-term trends that cause ratings to be placed under special surveillance by Standard & Poor's analytical staff. These may include mergers, recapitalizations, voter referendums, regulatory action, or anticipated operating developments. Ratings appear on CreditWatch when such an event or a deviation from an expected trend occurs and additional information is necessary to evaluate the current rating. A listing, however, does not mean a rating change is inevitable, and whenever possible, a range of alternative ratings will be shown. CreditWatch is not intended to include all ratings under review, and rating changes may occur without the ratings having first appeared on CreditWatch. The "positive" designation means that a rating may be raised; "negative" means a rating may be lowered; and "developing" means that a rating may be raised, lowered, or affirmed.[1]

** ____

____

____

[1] Standard & Poor's website.
http://www2.standardandpoors.com/portal/site/sp/en/us/page.article/2,1,1,4,1148447709639.html#ID205.

**

[2] Direct Testimony of Michael Cline, Schedule MWC-4, pp. 1 and 2.
[3] Direct Testimony of Michael Cline, Schedule MWC-4, page 4, 2nd paragraph.

Standards & Poor's provides the following information and definitions on its website regarding a "rating outlook" and short-term debt (commercial paper) ratings:

> RATING OUTLOOK DEFINITIONS
>
> A Standard & Poor's rating outlook assesses the potential direction of a long-term credit rating over the intermediate term (typically six months to two years). In determining a rating outlook, consideration is given to any changes in the economic and/or fundamental business conditions. An outlook is not necessarily a precursor of a rating change or future CreditWatch action.
>
> - Positive means that a rating may be raised.
> - Negative means that a rating may be lowered.
> - Stable means that a rating is not likely to change.
> - Developing means a rating may be raised or lowered.
>
> Short-Term Issue Credit Ratings
>
> A-2
>
> A short-term obligation rated 'A-2' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher rating categories. However, the obligor's capacity to meet its financial commitment on the obligation is satisfactory.
>
> A-3
>
> A short-term obligation rated 'A-3' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation. [4]

The negative financial condition that GPE's transaction with Aquila will create is outside the parameters required to be addressed under the KCPL Experimental Regulatory Plan additional amortization adopted by the Missouri Public Service Commission (Commission) in Case No. EO-2005-0329 or under any other facet of the KCPL Experimental Regulatory Plan Stipulation and Agreement.[5] It should be noted that KCPL is not a party to the GPE acquisition of Aquila. The GPE acquisition of Aquila is unrelated to KCPL's Missouri regulated operations.

The reason the GPE acquisition of Aquila is unrelated to KCPL's Missouri regulated operations is that there is no related agreement between KCPL and Aquila to merge, or

---

[4] Standard & Poor's website: http://www2.standardandpoors.com/portal/site/sp/en/us/page.article/2,1,1,4,1148447709639.html#ID636.

[5] Page 22 of the Stipulation and Agreement, in Case No. EO-2005-0329, item (4) notes that KCPL will not argue for or receive increased cash flows from its Missouri regulated operations in order to meet the BBB+ credit ratio values because of "any risk associated with GPE that is unrelated to KCPL Missouri regulated operations."

consolidate any or all of their respective works or systems. Section 393.190.1, RSMo. 2000, states:

> No gas corporation, electrical corporation, water corporation or sewer corporation shall hereafter, sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works, or system, necessary or useful in the performance of its duties to the public, nor by any means, direct or indirect, merge or consolidate such works or system, or franchises, or any part thereof, with any other corporation, person, or public utility, without having first secured from the commission an order authorizing so to do. Every such sale, assignment, lease, transfer, mortgage disposition, encumbrance, merger or consolidation, made other than in accordance with the order of the commission authorizing same shall be void.

The Commission has a rule, 4 CSR 240-3.115, specifying the minimum "Filing Requirements for Electric Utility Applications for Authority to Merger or Consolidate." This rule requires the filing of "a certified copy of the resolution of the Board of Directors of each applicant authorizing the proposed merger and consolidation." There is no copy of any resolution of the Board of Directors of either KCPL or Aquila authorizing any merger and consolidation of any aspects of their operations filed in this case. Staff's audit of the meeting minutes and presentations to the Boards of Directors of KCPL and Aquila did not reveal any such resolutions authorizing a merger or consolidation of any portion of the KCPL and Aquila systems or works. GPE acknowledged that there are no agreements between KCPL and Aquila to merge any utility functions or activities, except for the previously-filed transaction documents and, to the extent that they may be deemed to be agreements, the post-transaction integration plans. These plans are disclosed in the August 8, 2007, update filing.[6] As to its Board, KCPL noted that "[t]he Board has been kept apprised of the integration planning process. The Board has not been requested to approve the integration plans."[7]

The previously filed transaction documents attached to the Joint Application are shown in the following table:

---

[6] Response to Staff Data Request No. 285.
[7] Response to Staff Data Request No. 286.

Joint Application Reference	Agreement Title	Parties to the Agreement
Exhibit 2	Asset Purchase Agreement by and among Aquila, Inc.	-Aquila, Inc. -Black Hills Corporation -Great Plains Energy Inc. -Gregory Acquisition Corp.
Exhibit 3	Partnership Interests Purchase Agreement	-Aquila, Inc. -Black Hills Corporation -Great Plains Energy Inc. -Gregory Acquisition Corp.
Exhibit 4	Agreement and Plan of Merger	-Aquila, Inc. -Black Hills Corporation -Great Plains Energy Inc. -Gregory Acquisition Corp.

While KCPL is a party to the Joint Application, KCPL is not a party to any of the Agreements that underlie the proposed transaction. There are no KCPL Board of Directors meeting minutes or resolutions attached to the Joint Application authorizing any work on KCPL's behalf to engage in negotiations or perform due diligence, relative to a merger or consolidation of the KCPL and Aquila works or systems, or otherwise transfer of the Aquila works or system to KCPL.

Staff reviewed the KCPL Board of Directors meeting minutes provided. Staff requested GPE and KCPL Board of Directors meeting minutes that have entries which are related to GPE's possible or actual acquisition of Aquila since January 1, 2005.[8] Staff reviewed all of the meeting minutes provided, which in KCPL's case ended ** __________ **. The following chart notes the dates of meetings provided and the comments in the meeting minutes regarding any potential or actual merger or consolidation of any of KCPL's system with Aquila's system.

[8] Response to Staff Data Request No. 256.

**

____

____

____

____

____

____

____

____

____

____

______ **[9]

While the KCPL Board meeting minutes did not contain references to a merger between or consolidation of KCPL's and Aquila's systems, the supplement direct testimony filed in this case contains many references to a merger or consolidation of KCPL and Aquila systems. For example:

- Mr. Kevin E. Bryant testifies:

> KCPL continues to develop a customer, marketing segmentation approach to facilitate adoption of our programs. This marketing approach has produced effective results for KCPL. KCPL will use this same marketing approach for Aquila's customers.[10] (Emphasis added.)

- Mr. Wallace P. Buran testifies that the purpose of his testimony is:

> [t]o provide insight into and an independent assessment of the proposed synergy savings estimates, cost to achieve these synergies and supply chain business processes for the Supply Chain Areas of the proposed **merged** company.[11] (Emphasis added.)

Mr. Buran further notes that the synergies that he discusses could not be achieved without merging the companies.[12]

---

[9] Responses to Staff Data Request Nos. 256 and 257.
[10] Supplemental Direct Testimony of Kevin E. Bryant, page 7, lines 18 through 20.
[11] Supplemental Direct Testimony of Wallace P. Buran, page 2, lines 13 through 16.
[12] Supplemental Direct Testimony of Wallace P. Buran, page 10, line 15 through page 12, line 2.

- Mr. William P. Herdegan testifies that the purpose of his testimony is to provide:

> ...additional details from the **integration** analysis of a **combined** distribution system and customer service operations resulting from Great Plains Energy's proposed acquisition of Aquila.[13] (Emphasis added.)

Mr. Herdegan goes on to identify that his testimony will address the Safety, Field and Technical Training, Metering, Materials and Fleet, Contract Management, Vegetation Management, Engineering Field Design, Field Operations, and Reliability areas of the "combined distribution system." (Id.) Mr. Herdegan further discusses the combination of KCPL's and Aquila's customer service functions. He testifies, "Customer service operations will be consolidated into the Raytown location with the exception of the consolidated Field Services group, which will remain at the 1331 facility."14 (Emphasis added.)

- Mr. William J. Kemp testifies that the purpose of his testimony is to:

> provide an independent review of the **merger** synergies estimates developed by KCPL[15]

- Mr. John Marshall testifies:

> Consolidating adjacent operations will enable the two companies to more efficiently cover the same area. The newly **merged** company will serve a **combined** metropolitan customer base of over 625,000 – an increase of almost 40% for KCPL today – and over 170,000 rural customers.[16]
>
> . . . .
>
> In particular, the logic of this **merger** is compelling from the perspective of facilities and supply chain. 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 party could do alone – reduces operating expenses and rate base. Facility **consolidation** is also a component of supply chain management synergies, which are significant.

[13] Supplemental Direct Testimony of William P. Herdegen, page 1, lines 4 through page 2, line 4.
[14] Supplemental Direct Testimony of William P. Herdegen, page 19, lines 9 through 11.
[15] Supplemental Direct Testimony of William J. Kemp, page 4, lines 17 through 19.
[16] Supplemental Direct Testimony of John Marshall, page 3, lines 9 through 13.

These include sourcing, materials management, fleet and contract management.[17]

. . . .

The second opportunity is driven by the Distribution Facilities Consolidation synergy project. This project **consolidates** five existing service centers into two. In addition to synergies identified in the project, the service center **consolidation** will deliver labor-based scale economies.[18] (Emphasis added.)

. . . .

The first **consolidation** will **merge** operations of existing Liberty and Platte City service centers into KCPL's Northland facility. This **consolidation** effort should be completed within the first six months post deal close. The second **consolidation** will combine 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.[19] (Emphasis added.)

. . . .

The **merged** organization will leverage legacy Aquila's technology and associated technical and process expertise to increase call center automation and deliver associated productivity efficiencies.[20] (Emphasis added.)

. . . .

The third source of synergy is from labor efficiencies generated from economies of scale achieved by **merging** similar operations of the two companies.[21] (Emphasis added.)

. . . .

To enable realization of synergy value and provide a seamless transition for the customers and employees of both companies, KCPL's IT team is working closely with the business areas and with their counterparts at Aquila to **consolidate** and **integrate** key infrastructure and business applications. **Consolidation** of customer service and billing, finance and accounting, and human resources applications are planned at or near Day 1. In addition to support and maintenance savings gained, the **consolidation** and

[17] Supplemental Direct Testimony of John Marshall, page 4, lines 7 through 13.
[18] Supplemental Direct Testimony of John Marshall, page 12, lines 4 through 7.
[19] Supplemental Direct Testimony of John Marshall, page 12, lines 14 through 18.
[20] Supplemental Direct Testimony of John Marshall, page 15, lines 20 through 22.
[21] Supplemental Direct Testimony of John Marshall, page 16, lines 20 and 21.

> **integration** will provide a consistent customer experience and sustained or improved levels of service. As the transition continues, IT will **consolidate** field and plant systems providing additional efficiencies and process improvements.[22] (Emphasis added.)
>
> . . . .
>
> Detailed descriptions of savings can be found in the testimony of Witness Chuck Tickles. These direct savings are in five 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 server, 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) the **combination** of the Aquila and KCPL IT organizations - resulting in a manpower reduction based on the separate organizations.[23] (Emphasis added.)
>
> . . . .
>
> There are two primary reasons for **consolidating** headquarters at 1201 Walnut. First, financially, keeping two office locations in the same area will be more costly than **combining** the two. The cost of keeping the Aquila headquarters open is $1.5 million per year, which can be avoided by **consolidating** into the current KCPL building at 1201 Walnut. In addition, KCPL Headquarters at 1201 Walnut is currently leased and would cost approximately $7 million to break the lease on the anticipated transaction close day.[24] (Emphasis added.)
>
> . . . .
>
> Synergies in these functions will come primarily from **consolidation** of select facilities and eliminating redundancies and duplicate functions / facilities processes. Several facilities are anticipated to be **consolidated**. These include **consolidating** Aquila and KCPL headquarters; **consolidating** engineering functions into KCPL's Front & Manchester facility; **consolidating** Customer Services into Aquila's current Raytown facility; **consolidating** Dispatch functions into KCPL's 801 Charlotte facility; closing service centers in Liberty, Platte City, Dodson (KCPL), Lee's Summit, Blue Springs, Lee's Summit Garage and

---

[22] Supplemental Direct Testimony of John Marshall, page 17, lines 5 through 13.
[23] Supplemental Direct Testimony of John Marshall, page 17, line 15 through page 18, line 1.
[24] Supplemental Direct Testimony of John Marshall, page 19, lines 11 through 16.

> adding a newly constructed service center near Lee's Summit, as previously described in my testimony.[25] (Emphasis added.)

- Mr. Charles H. Tickles testifies:

> After the initial Day 1 transaction, the **combined** KCPL / Aquila IT team will continue to work with the business units to migrate and/or **integrate** the two sets of applications and infrastructure systems together in the most logical approach for the benefit of our customers. Prior to the transaction date, teams of business unit and IT employees from the participating companies are meeting to define these plans for the Day 1, transition and long range optimal implementation states... After the initial Day 1 of the transaction, the **integration** will be transparent to the external customer and will have minimal impact on the internal users of IT services.[26] (Emphasis added.)

- Mr. Terry Bassham testifies:

> The **combination** of Great Plains and Aquila creates value for customers, the community at large and shareholders. The customers of Aquila and KCPL will benefit from the significant synergy savings that the **combination** of these two companies will produce. These synergies will generate net savings over the next five-years of $305 million. These benefits, which are created by more efficiently running two companies as one, will continue long after the initial five-year period used to calculate synergies in this case and will serve to reduce costs and help keep customer rates more affordable for years to come. Witness Robert Zabors has estimated these additional savings at $450 million over the five years following the synergy sharing period, i.e., 2013-2017. Through these savings, Great Plains can invest more capital, at a more affordable cost, to maintain and improve system reliability and customer service. Individual customers, and the community as a whole, will benefit from a larger, stronger regional utility that can be a better corporate citizen and provide low cost reliable service. The **combination** of the two companies is also anticipated to create value for Great Plains' shareholders.[27] (Emphasis added.)

While the Joint Applicants' testimony asserts significant savings that the Staff found to be overstated, and likely threatening to quality service through an aggressive virtual overnight implementation timetable, such savings are not caused by the proposed transaction. Staff limited its review to the proposed transaction contained in the Joint Application. The proposed

---

[25] Supplemental Direct Testimony of John Marshall, page 20, lines 3 through 11.
[26] Supplemental Direct Testimony of Charles H. Tickles, page 3, lines 4 through 9, and lines 11 and 12.
[27] Supplemental Direct Testimony of Terry Bassham, page 1, line 14 through page 2, line 11.

transaction has known detriments without offsetting benefits which make the transaction detrimental to the public interest. Staff notified one of its KCPL regulatory contacts in the presence of counsel of this issue on September 26, 2007, and was told someone would get back to Staff in the future. As of the time of the filing of this report, Staff has received no response.

The Joint Applicants' data indicate that the proposed transaction is detrimental to the public interest.[28] Since the proposed transaction is a net detriment to the public interest, Staff recommends the Commission reject the Joint Application. While no express standard is stated in the applicable statue governing proposed acquisitions, section 393.190.1, RSMo. 2000, in the past the Commission has used the standard of "not detrimental to the public interest" based on long standing case law. Staff has used the standard in evaluating the transaction that is the subject of the Joint Application. The detriments to the public interest in this transaction are 1) the higher rates that must be paid by Aquila and KCPL ratepayers as a result of, and in order to address, the weakened financial condition of GPE and its affiliates/subsidiaries caused by an affiliation with the financially impaired Aquila from which KCPL will have no effective financial isolation, and 2) a weakening of KCPL's financial condition caused by an affiliation with Aquila during a period of significant construction program expenditures by KCPL. To the uninformed observer it may not be clear how Aquila's Missouri ratepayers would experience an increase in rates by being affiliated with the financially very much stronger GPE and KCPL. The proposed transaction will result in Aquila's Missouri ratepayers paying higher rates as GPE shifts costs to Aquila's ratepayers, which are now being absorbed by Aquila's shareholders under Aquila's prior, publicly-stated commitment that Aquila's Missouri ratepayers will not be charged costs caused by Aquila's failed non-utility operations.

Aquila, as a Joint Applicant to the proposed transaction, has failed to fulfill its commitment to its Missouri ratepayers that they will not to pay any costs caused by Aquila's non-utility missteps. The proposed transaction contained in the Joint Application is designed to place GPE, as the new owner of Aquila, in a better position than Aquila's current stockholders. The improvement in GPE's position as owner is created at the expense of Aquila's Missouri

---

[28] $6.6 million annual savings shown on Schedule TMR-3 attached to the Supplemental Direct Testimony of Tim M. Rush, less the $24.4 million of additional interest costs identified in the Supplemental Direct Testimony of Michael W. Cline, page 11, lines 21 through 23, which are not included in Schedule TMR-3 as per the GPE responses to Praxair Data Request Nos. 33 and 35.

ratepayers. Aquila is aware of these consequences, and yet still supports the proposed transaction.

Currently Aquila's shareholders bear the consequences of Aquila's prior non-utility missteps, which among other things resulted in Aquila's loss of its investment grade debt rating and consequent higher interest and borrowing costs. GPE is requesting in this proceeding that the Commission commit itself to charge these costs to Missouri ratepayers, not that GPE will absorb these costs as Aquila's shareholders presently do. This fact is obscured by the assertion made in the Joint Application, and related direct testimony and supplemental direct testimony, of the millions of dollars of savings that will result from a merger, transfer, or consolidation of portions of Aquila's operations with KCPL. Staff's examination in this case has revealed that these levels of savings will not result from the transaction proposed in the Joint Application, and related direct testimony and supplemental direct testimony. No merger, transfer, or consolidation of portions of Aquila's operations with KCPL is presented to the Commission for approval. Thus, only the transaction costs (i.e., the costs sought to be recovered by those who put together and effectuate the proposed transaction, attorneys, financial advisors, etc.) and costs from Aquila's past non-utility missteps (i.e., much higher interest rates/debt costs, additional amortization or higher returns on equity to restore Aquila's investment grade debt rating, guaranteed cost of service additions for savings that will not materialize) will actually result from the proposed transaction. The Joint Applicants are proposing recovery of all these costs from Aquila's current Missouri ratepayers and KCPL's Missouri and Kansas ratepayers.

The Joint Application seeks approval for a proposed transaction that has the following overarching detriments to the public interest which are not outweighed by any realistic benefits from the proposed transaction:

I. Transaction Costs;

II. High Interest Costs;

III. Amortization Expense to Provide Investment Grade Ratings to Aquila after the GPE acquisition of Aquila;

IV. Customer/Ratepayer payments for Merger Savings that will not occur; and

V. GPE waiver from the Commission's affiliate transaction rules, without any safeguards to prevent affiliate abuse of Aquila's current fuel adjustment clause.

More specifically, the proposed transaction is detrimental to the public interest in that approval of the Joint Application will result in Aquila's Missouri customers:

- Paying higher rates to recover the higher debt costs related to Aquila's non-jurisdictional operations;

- Subsidizing Aquila's non-Missouri jurisdictional activities through the obligation to pay higher rates to fund an "additional amortization" required to restore Aquila's investment grade debt rating lost through Aquila's failed non-utility endeavors as well as support the building of generation that Staff has asserted should have been already been built and put into service;

- Paying higher rates for a fifty percent saving retention based on synergy estimates that will not occur at the level or within timeframe alleged in the direct or supplemental direct testimony of GPE/KCPL witnesses filed in this case; and

- Paying higher rates to recover the GPE's and Aquila's transaction costs.

And the proposed transaction is detrimental to the public interest in that approval of the Joint Application in this case will result in KCPL's Missouri customers:

- Paying higher rates caused by the inclusion of the transaction cost portion of GPE's acquisition adjustment in the Missouri cost of service; and

- Paying higher rates for a fifty percent (50%) saving retention based on synergy estimates that will not occur at the level or within timeframe alleged in the direct or supplemental direct testimony of GPE/KCPL witnesses filed in this case.

Staff has found that the Joint Applicants use the term "merger" inconsistently in their Application and the direct testimony and supplemental direct testimony of their witnesses. At times the Joint Applicants discuss the planned merger of Aquila with and into a GPE direct, wholly-owned subsidiary, Gregory Acquisition Corp (Gregory), a Delaware corporation, with Aquila being the surviving entity. The Gregory/Aquila merger is a merger component of the transaction contained in the Joint Application necessary to effectuate GPE's acquisition of

Aquila. At other times, the Joint Applicants discuss a merger of KCPL and Aquila. A KCPL/Aquila merger is not contained in the transaction described in the Joint Application. While not contained in the proposed transaction, nearly all of the benefits required to offset the aforementioned cost detriments contained in the proposed transaction are alleged to occur from a merger or consolidation of portions of KCPL and Aquila's respective systems.

It has already been noted that there is no Aquila or KCPL Board approval of any plan of merger, consolidation, asset transfer or asset purchase agreement between Aquila and KCPL to support the extensive merger synergy estimates presented in the direct and supplemental direct testimony of the GPE/KCPL witnesses. In other words, GPE has incurred significant third party costs to develop a conceptual estimate of the dollar value of synergies related to a possible merger or consolidation of KCPL and Aquila, but apparently has failed to negotiate and formalize such a concept into an actual merger, or consolidation agreement for presentation to the KCPL and Aquila Boards of Directors as well as this Commission for approval.

GPE, KCPL, and Aquila abandoned the regulatory process that created KCPL's Experimental Regulatory Plan adopted by the Commission in Case No. EO-2005-0329 when developing the regulatory plan proposed in the Joint Application in this case. GPE/KCPL did not meet with anyone to discuss a framework of a regulatory plan related to the Joint Application in this case in any manner.[29] The GPE/Aquila approach in this case has been a reversion to the regulatory practice KCPL used prior to adopting its Comprehensive Energy Plan.

KCPL utilizes the term Comprehensive Energy Plan to collectively reference the projects resulting from the comprehensive strategic planning process begun in 2004. These collective projects are included in the Stipulation and Agreement (S&A) filed with the Commission on March 28, 2005 in Case No. EO-2005-0329 that embodies KCPL's Experimental Regulatory Plan. The Commission issued its Report and Order approving the S&A with an effective date of August 7, 2005. The Commission issued a subsequent order with an effective date of August 23, 2007, approving amendments to the S&A. There is not a Comprehensive Energy Plan document.[30]

Before initiating the Comprehensive Energy Plan, KCPL decided on major modifications in its operations independent of regulatory input or notice. Discussions between representatives

[29] Response to Staff Data Request No. 319.
[30] Response to Staff Data Request No. 260.

of GPE, KCPL and Aquila, with representatives of the Missouri Public Service Commission and Kansas Corporation Commission regarding the specifics of the plans to consolidate KCPL and Aquila might have resulted in an understanding of the appropriate scope of the proposed transaction that should be included in any such application. No specific meetings were held with the Missouri Public Service Commission or Kansas Corporation Commission to discuss methodology, approach, measurement or details regarding the cost and synergies of the proposed merger of Aquila and KCPL. [31]

In paragraph 34 of the Joint Application, the Joint Applicants state that GPE anticipates "the Merger will result in significant synergies, economies of scale, and efficiencies from the elimination of duplicate corporate and administrative services, all of which ultimately result in a lower cost of operations." These synergies will not result from a GPE acquisition of Aquila. These synergies are expected from a future merger, or consolidation of portions of the Aquila operations with KCPL operations. A merger or consolidation of KCPL and Aquila is not an element of the proposed transaction contained in the Joint Application.

In paragraph 32 of the Joint Application, the Joint Applicants state that "[a]s a consequence, existing Aquila customers will continue to experience quality day-to-day service at just and reasonable rates without incident or interruption." Such a statement regarding the probability of no incident or interruption of service is probable for the Gregory/Aquila merger needed to effectuate GPE's acquisition of Aquila. The statement is not likely to be true if, within the same time frame the conceptual KCPL/Aquila merger or consolidation designed to include such activities as the transfer of all permanent Aquila employees to KCPL[32], move all Aquila 20 West 9th corporate employees into the same space presently occupied by KCPL employees under KCPL's 1201 Walnut St. lease[33], and integration and enhancement of information technology of systems is effectuated.[34]

Staff found no merger, or consolidation agreement between KCPL and Aquila authorized by their respective Boards of Directors contained in the Joint Application for Commission approval authorizing Aquila to merge or consolidate any or all of Aquila's system or operations with those of KCPL. The overall transaction contained in the Joint Application relies heavily on

---

[31] Response to Staff Data Request No. 318.

[32] Response to Staff Data Request No. 44. Direct Testimony of Lori Wright, page 7, lines 14 and 15.

[33] Direct Testimony of William H. Downey, page 4, lines 1 through 3; Responses to Staff Data Request Nos. 362 and 363.

[34] Supplemental Direct Testimony of Charles H. Tickles, page 3, lines 4 through 17 and page 5, lines 1 through 6.

alleged synergies or savings resulting from the merger or consolidation of portions of Aquila's system or operations with those of KCPL to offset the detrimental aspects of the transaction for KCPL's and Aquila's customers. Staff found that the Gregory/Aquila merger needed to effectuate the GPE acquisition of Aquila proposed in this case will not result in significant synergies or savings to offset the detrimental aspects (i.e., costs and ratepayer subsidization support) of the proposed transaction.

In the proposed transaction, Aquila ratepayers are being requested to subsidize Aquila's non-utility operations through the payment of higher utility rates due to costs Aquila is incurring solely due to its non-utility affiliate financial failures through a proposed additional amortization or higher returns on equity to restore the investment grade debt rating lost by Aquila's non-utility results.

Currently, GPE assumes management role in relation to KCPL outside of an independent corporate governance process. Staff found evidence of GPE's influence over KCPL outside the parameters of independent corporate governance during in this case. There are several examples of KCPL providing services to GPE outside the parameters expected as the normal bounds of conduct from separate and distinct regulated corporate entities. The treatment of KCPL in this case is one example of GPE's operation outside the parameters of independent corporate governance. While KCPL is mentioned predominately throughout the direct testimony of the Applicants, KCPL is not a signatory to any of the agreements underlying the proposed transaction. Staff could find no KCPL contract or agreement with GPE authorizing KCPL employees to provide services to GPE to assist GPE in its efforts to acquire Aquila. KCPL may not have complied with the Commission's affiliate transaction rule 4 CSR-240-20-015. At this time specific concerns include: 1) KCPL reporting of its performance of merger support to GPE in its 2006 Cost Allocation Manual (CAM), 2) KCPL's failure to report the provision of services to GPE without a contract, 3) KCPL's provision of specific customer information to GPE, 4) KCPL's provision of preferential service, information, or treatment to GPE over another party, except as necessary to provide corporate support functions, and 5) KCPL's provision of services to GPE at the higher of cost or market. These are matters that will need to be addressed in an investigation outside of this case.

Further, KCPL is not a party to the Transition Services Agreement for services to Black Hills Corporation (Black Hills), nor does KCPL have an agreement with Aquila, the surviving entity of the merger with Gregory, Gregory, or GPE to fulfill Transition Services Agreement obligations to Black Hills.

There is no agreement specifying that KCPL will provide transition support services to Black Hills after Aquila sells its non-Missouri utility operations to Black Hills.[35] The Transition Services Agreement dated February 6, 2007, is among Black Hills Corporation, Great Plains Energy Incorporated and Gregory Acquisition Corp., and Section 1.1 of that agreement defines the service provider to include GPE's affiliates.[36] While the Agreement allows for GPE or Gregory to fulfill their obligations to Black Hills through a GPE affiliate, GPE or Gregory would still need an agreement with that affiliate (i.e., KCPL) to provide services on its behalf. Since the Joint Applicants represent that all the permanent Aquila employees will become KCPL employees,[37] KCPL is the entity that will provide support to Black Hills on behalf of GPE and Aquila. KCPL is to provide such services on GPE's behalf without any presently existing written agreement designating the compensation that KCPL will receive for satisfying GPE's obligation to Black Hills. The scope of services to be provided to Black Hills is extensive. The following table lists the service types covered by the Transition Services Agreement:

1) Customer Support Services;
2) Information Technology Services;
3) Accounting Services;
4) Data; and
5) Access to Service Providers.

There are further examples of KCPL acting outside of the normal bounds of conduct by separate and distinct regulated corporate entities. There is no agreement between KCPL and GPE defining the compensation KCPL receives for the services KCPL employees provide to GPE for GPE's efforts to acquire Aquila. There is no agreement specifying the priority that KCPL employees are to give to the services they provide to GPE relative to their duties in provisioning utility service to KCPL's customers in Missouri and Kansas. There is no agreement specifying that KCPL is to receive compensation from GPE consistent with the Missouri Commission's affiliate transaction rules (i.e., the greater of market or cost).

[35] Response to Staff Data Request No. 288.
[36] Response to Staff Data Request No. 287.
[37] Response to Staff Data Request No. 44; Direct Testimony of Lori Wright, page 7, lines 14 and 15.

The potential of GPE extending its practice of having KCPL act outside of the normal bounds of conduct expected of separate and distinct regulated corporate entities to Aquila is another detriment of the transaction proposed by GPE and Aquila.

The proposed GPE acquisition of Aquila through a merger of Aquila with the GPE affiliate/subsidiary Gregory is detrimental to the public interest in that GPE is seeking to improve its situation as a shareholder of Aquila over the current Aquila shareholders at the expense of Aquila's ratepayers. GPE is seeking to improve its financial status as Aquila's shareholder relative to Aquila's current shareholders by shifting the responsibility for existing liabilities from Aquila's shareholders to Aquila's ratepayers. These liabilities resulted from Aquila's activities that are not regulated by this Commission. For example, as a result of Aquila's non-utility financial reverses Aquila has higher debt costs than would be the case if Aquila had operated solely as a regulated gas and electric utility. These excess interest costs are being absorbed by Aquila's current shareholders. One of the conditions of GPE's acquisition of Aquila is that Aquila's Missouri rates be based upon Aquila's actual financing costs.[38] Currently those rates are based on imputed debt rates that are lower than the actual debt rates.

This condition to which Aquila has agreed, revokes Aquila's current long-standing commitment to not seek recovery through rates of costs it incurs in excess of those that it would have incurred if it had not engaged in energy marketing and other non-utility activities. Aquila has lost its investment-grade debt ratings as a result of its non-utility missteps. The loss of these investment-grade debt ratings has resulted in some of Aquila's current increased debt costs and also causes continuing higher borrowing rates and costs. Presently, these excess costs are being absorbed by Aquila's shareholders, not its rate paying customers. Aquila has a standing commitment not to seek recovery of these costs from its Missouri ratepayers, but by entering into this agreement with GPE, Aquila is abandoning that commitment to the detriment of its Missouri rate paying customers.

In addition to recovery of these higher debt rates and costs from Aquila's customers, GPE seeks Commission approval to require an "additional amortization" from Aquila's ratepayers to provide debt rating agencies the level of assurance these agencies have indicated that they require to restore Aquila to an investment grade debt rating. The Staff entered into separate experimental regulatory plans with KCPL and The Empire District Electric Company (Empire)

[38] Supplemental Direct Testimony of Terry Bassham, page 5, lines 1 through 9.

that each contained an "additional amortization" component designed to assist those two utilities in maintaining their investment grade debt ratings during a period of time when they are making significant capital investment in a new generating plant. Since Aquila's debt was already non-investment grade, i.e., junk bond status, Staff did not enter into an experimental regulatory plan with Aquila, with or without "an additional amortization" component. Aquila currently has no additional amortization mechanism. GPE is proposing for the Commission to impose such a condition so that GPE can acquire Aquila without additional reductions in GPE's and KCPL's debt ratings.

GPE is seeking from Aquila customers "an additional amortization" as a backstop from Aquila's ratepayers to restore Aquila's investment grade debt rating lost by Aquila as a result of Aquila's non-utility operations. This condition of the merger amounts to Aquila ratepayers subsidizing Aquila's non-utility operations. The fact that Aquila's ratepayers would be required to subsidize Aquila's non-utility operations under the terms of the Joint Application is another detriment to the public interest causing Staff to recommend the Commission reject the Joint Application.

Staff's review of the GPE/KCPL/Aquila Joint Application and supporting testimony shows that, if closed, the proposed transaction would result in an annual net detriment to Missouri customers in excess of $60 million dollars. The following table provides the details of this quantification:

Description $ Millions (Costs)/Benefit	KCPL – Mo.	KCPL-Ks.	MPS[39]-Retail	L & P[40]-Electric	L & P Steam	Combined Company
50% Synergy Adder	($8.7)	($6.8)	($10.7)	($2.5)	($0.2)	($28.9)
Transaction Costs	($5.4)	($4.3)	($ 6.7)	($1.6)	($.2)	($18.2)
Merger Impact before Consideration of Interest Costs	($14.1)	($11.1)	($17.4)	($4.1)	($0.4)	($47.1)
Aquila Interest Costs			**($18.3)**	**($6.1)**		**($24.4)**[41]
Merger Impact	($14.1)	($11.1)	($35.7)	($10.2)	($.4)	($71.5)
Additional Amortization						

[39] Aquila, Inc. d/b/a Aquila Networks-MPS (service area in and about Kansas City, Missouri).
[40] Aquila, Inc. d/b/a Aquila Networks-L&P (service area in and about St. Joseph, Missouri).
[41] Supplemental Direct Testimony of Michael W. Cline, page 11, line 22 amount of $24.4 multiplied by 75% for MPS and 25% for L&P from Table A.2

The table above was developed from the information taken from Schedule TMR-3 attached to the Supplemental Direct Testimony of Tim M. Rush. The amounts for synergies realized and transition costs were removed since a merger or consolidation of the KCPL and Aquila systems is not a component of the proposed transaction in this case, as previously discussed. GPE is seeking recovery of Aquila actual debt costs which exceeds the level of debt costs Aquila has represented is related to the provision of electric service to Missouri customers. The above table reflects the amount of additional interest costs that GPE is seeking from Aquila's customers contained in Michael W. Cline supplemental direct testimony. Staff does not agree that this amount represents of additional interest costs that GPE is seeking from Aquila's customers. Staff's quantification of this matter is addressed later in this Report.

The additional amortization is shown above because it is probable to be additional cost charged to ratepayers. The additional amortization is shown as zero in the above table because it is likely to vary significantly. In some years it may be zero. Due to the lack of synergy savings in the proposed transaction, the amortization will vary from zero to $41 million dollars. The section of the Report addressing additional amortization provides further information regarding the estimates of the range for the additional amortization.

Aquila currently does not pay a dividend to its shareholders. GPE expects to continue its annual common stock dividend of $1.66 per share if GPE acquires Aquila. If the Aquila shareholders become GPE shareholders, at that time GPE annual dividend payments will increase by over $53 million.[42] What is now the Aquila Missouri electric operations, the KCPL Missouri and Kansas operations, or both, will need to produce additional cash and earnings of $53 million over and above the current stand alone (i.e., no GPE acquisition of Aquila) scenario, or GPE will be pressured to maintain its existing dividend.

It should not be presumed that practically all proposed mergers and acquisitions become successful transactions. GPE noted just after the Aquila acquisition was announced that "[o]nly about half of electric utility mergers are successful, and of those approved but not ultimately successful, the post-merger integration process is seen as the greatest cause of failure."[43] Even the study attached to Mr. William J. Kemp's supplemental direct testimony contains examples,

---

[42] Response to Staff Data Request No. 67, "Great Plains Energy expects to continue its annual common stock dividend of $1.66 per share. Assuming that all 32,188,797 shares covered by the registration statement are issued, the annual dividend payments would be $53,433,403."
[43] GPE Response to Staff Data Request No. 59, Integration Planning Team Leader Kickoff Meeting, February 12, 2007 – Slide: Key success factors for GPE/Aquila.

of utility mergers that resulted in increased costs.[44] Mr. Kemp's study will be addressed later in this Report.

In its investigation in the case, Staff specifically sought the specific information that the Joint Applicants could supply to address the issue of rate impacts of the proposed transaction on Missouri customers. The questions and responses from Staff Data Requests Nos. 96 and 97 are as follows:

> <u>Question No.</u>: 0096
> Please provide copies of each and every document that shows the rates Aquila Networks-MPS and Aquila Networks-L&P customers pay will be lower under the merger conditions proposed by the joint applicants in this case than under the rates would be in effect for Aquila Networks-MPS and Aquila Networks-L&P on a standalone basis.
>
> <u>Response</u>:
> No documents have been put together that specifically demonstrate this point. However, in the initial application and supporting testimony, it was demonstrated that a net benefit would result from the merger and that customers would receive the benefit as outlined in the application. From the facts presented in the filing, an overall benefit and thus reduced rates would result to both customers of Aquila and KCPL. Further work is being performed to validate the synergies analysis, as well as allocations between jurisdictions and utilities which will be provided in August.
>
> <u>Question No.</u>: 0097
> Please provide copies of each and every document that shows the rates KCPL customers pay will be lower under the merger conditions proposed by the joint applicants in this case than under the rates would be in effect for KCPL on a standalone basis.
>
> <u>Response</u>:
> This can be seen by applying the synergy savings against the cost with the overall result being a lower cost for customers of both Aquila and KCPL. The August filing by the Company of the updated synergies should further demonstrate this fact. No specific document has been prepared that specifically shows that rates KCPL customers pay will be lower under the merger conditions.

KCPL and Aquila are unable to provide a quantification of any beneficial impact of their proposed transaction on their customer rates, yet GPE/KCPL assert they are able to quantify merger synergies for five (5) to ten (10) years into the future.[45]

---

[44] Schedule WJK-5 attached to the Supplement Direct Testimony of William J. Kemp.

The following chart is from the information Staff received in August 2007 as referenced in the Response to Staff Data Request No. 96 mentioned above:

$ Millions	KCPL – Mo.	KCPL- Ks.	MPS- Retail	L & P- Electric	L & P Steam	Combined Company
Non-Fuel Operations & Maintenance (NFOM)						
NFOM prior to Merger	$221.8	$184.7	$119.3	$43.6	$2.8	$572.2
Merger-related Annual Effects						
Synergies Realized	$(17.3)	$(13.7)	$(21.4)	$(5.1)	$(0.5)	$(58.0)
Adjustments to Cost of Service						
50% of Synergies	$8.7	$6.8	$10.7	$2.5	$0.2	$29.0
50% of transition costs	$1.3	$1.0	$1.6	$0.4	$0.0	$ 4.3
Transaction Costs	$5.4	$4.3	$ 6.7	$1.6	$.2	$18.1
Net Merger related effects	($2.0)	($1.5)	($2.4)	($.6)	($0.1)	($6.6)
NFOM after merger	$219.8	$183.2	$116.9	$43.0	$2.7	$656.6
( ) = reduction in costs						

Source: Schedule TMR-3 attached to the Supplemental Direct Testimony of Tim R. Rush.

The above table shows that the Joint Applicants portray the proposed transaction as producing marginal benefits. It shows that the Joint Applicants expect a one percent (1%) reduction in their non-fuel operations and maintenance expense from the proposed transaction after recognition of the elements of their required regulatory plan.[46] The above chart ignores operational reductions that KCPL and Aquila can achieve independent of the proposed transaction. For example, ** ______________________________

[45] Schedule RTZ-8 and RTZ-12 attached to the Supplemental Direct Testimony of Robert T. Zabors.
[46] Result from dividing $6.6 million by $572.2 million.

NP

**[47]

The above chart is dependent on a KCPL/Aquila merger and consolidation that is outside the scope of the proposed transaction contained in the Joint Application. The proposed transaction is a net detriment without the KCPL/Aquila alleged synergies. The above chart omits the additional interest costs that Aquila customers will have to pay under the conditions the Joint Applicants attach to the proposed transaction. The additional interest costs alone make the proposed transaction a net detriment, even if one accepts the KCPL/Aquila synergies levels and timetable. Mr. Bassham acknowledges that Aquila's interest costs recovered in rates are lower than its actual interest costs,[48] yet the additional costs from the GPE/Aquila proposal to recover actual interest costs is not reflected in the calculation of the impact of the proposed transaction. Mr. Cline acknowledges that GPE is seeking to recover $24.4 annually in additional interest costs from Aquila's customers not reflected in the above table, which alone shows the proposed transaction is detrimental to Aquila's rate paying customers.[49] In addition to these problems, the costs from the additional amortization have not been considered. Quantification of this detriment is addressed later in this Report. Any one of these issues shows the proposed transaction to be detrimental to the public interest through utility customers paying higher rates solely due to GPE's acquisition of Aquila.

2. Scope of Staff's Review

Staff has reviewed the GPE, KCPL and Aquila Joint Application and the filed direct and supplemental direct testimony. This review was designed to identify the elements of the Joint Application necessary to determine the scope of Staff's work and the applicable legal standard(s). The review compared elements of the Joint Application to items normally requested in prior "merger" applications and approved by prior Commissions. If a merger application only requests items that have been traditionally requested and approved in prior mergers, consolidations or transfers, or otherwise follows Commission precedent, then generally the work scope and discovery needs are less than those required to evaluate a merger containing requests

[47] Response to Staff Data Request Number 256, ** **

[48] Supplemental Direct Testimony of Terry Bassham, page 4, line 18.

[49] Supplemental Direct Testimony of Michael W. Cline, page 11, lines 12 through 23.

for Commission approval of unique items or items that have been rejected by the Commission in prior merger, consolidation or transfer cases. The Staff's review of this Joint Application has identified both novel items as well as items rejected previously by the Commission. These items, which are found on page 21 in the "Wherefore" clause of the Joint Application, are:

1) Item (e) Approving the Regulatory Plan, including Aquila's use of the Additional Amortizations mechanism in its next general rate case after achieving the financial metrics necessary to support an investment-grade rating.
2) Item (f) Authorizing KCPL and Aquila to establish a regulatory asset and amortize into cost of service costs associated with the Merger, including both transaction and transition-related costs, as properly allocated to KCPL's and Aquila's Missouri-regulated operations and excluding the non-incremental labor costs of the integration team, over a five (5) year period beginning on January 1, 2008, or the month immediately following consummation of the Merger, whichever occurs later;
3) Item (g) Authorizing 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 properly allocated to their Missouri-regulated operations.
4) Item (j) Granting KCPL and Aquila a waiver from the affiliate transaction rule to the extent deemed necessary.

These items raise issues and questions in a most significant manner after the Missouri Supreme Court's decision in *State ex rel. A.G. Processing v. Public Serv. Comm'n*, 120 S.W.3d 732 (Mo. banc 2003). Examples of theses issues and questions are: 1) in what manner can the Report and Order in this case bind future commissions in future rate cases; 2) if it can do so, what is the applicable standard for deciding future ratemaking requests respecting costs directly related to the findings of the Commission in this case, when the merger standard is "not detrimental to the public interest" the A.G. Processing decision says the Commission in a merger case should determine whether an acquisition premium is reasonable, and the rate case standard for rates is "just and reasonable"; and 3) can the Commission adopt now an additional amortization to be applied in future rate cases to support the economics of an acquiring company offer to buy another utility. The specific conditions of the Joint Application increased the complexity of the required review while calling into question the probability that the proposed merger transaction is sustainable without customers paying higher rates to support the amounts of monies and stock GPE is paying to Aquila shareholders while reducing the negative consequences to GPE's own credit rating caused by its acquisition of Aquila.

Staff attempted to prioritize these items through early data requests to GPE requesting whether the Gregory/Aquila merger needed to effectuate GPE's acquisition of Aquila would occur absent either of the four conditions (i.e., additional amortization, full recovery of transaction and transition costs over a five (5) year period, fifty percent (50%) sharing of net merger savings, and affiliate transaction rule waiver that comprise the majority of the regulatory conditions attached to the proposed transaction contained in the Joint Application. Staff intended to use these initial responses to focus its efforts on the conditions essential to completion of the merger while addressing the other conditions as time allowed. The GPE response to Staff Data Requests was:

> GPE/KCPL will review the regulatory conditions, if any, and disapproval of any portions of its request, as a total package prior to determination of its ability to close the merger.

The Staff Data Requests contain questions regarding whether the proposed transaction would be completed "if the Commission does not approve GPE/KCPL's request to establish a regulatory asset and amortize into cost of service associated with the Merger allocated transaction and transition costs over a five (5) year period beginning January 1, 2008, or the month immediately following the consummation of the Merger, whichever occurs later" or if the Commission does not approve "GPE/KCPL's request to retain fifty percent (50%) of its estimated 'synergy savings' for five (5) years through future KCPL and Aquila rates."[50]

The above response indicates that the regulatory conditions attached to the proposed transaction were part of a total package, and did not provide any guidance regarding the relative importance of each of the four conditions. Staff was not aware of, nor has experience with, a merger request consisting of all four (4) conditions bundled into a total package. Since all these conditions are apparently equally important to completion of the Gregory/Aquila merger to effectuate GPE's acquisition of Aquila and they contain detrimental aspects for KCPL and Aquila customers, the probability that the proposed transaction is detrimental to the public interest was significantly increased early in the initial stages of Staff's review of the Joint Application in this case.

---

[50] Response to Staff Data Requests Nos. 1 and 7.

These facts were known by the ** **[51]

While GPE indicates that need for such discussions, GPE/KCPL indicated in response to a Staff Data Request that they did not meet with anyone to discuss a framework for a regulatory plan related to the Joint Application in this case in any manner.[52] Further GPE/KCPL indicated in response to another Staff Data Request that no specific meetings were held with the Missouri Public Service Commission or Kansas Corporation Commission to discuss methodology, approach, measurement or details regarding the cost and synergies of the proposed merger of Aquila and KCPL.[53]

[51] Response to Staff Data Request No. 257.
[52] Response to Staff Data Request No. 319.
[53] Response to Staff Data Request No. 318.

Another matter of great concern that Staff examined was the question of whether Aquila structured the proposed transaction in a manner to circumvent its commitment not to charge its customers for the costs of its non-regulated activities. This matter is the Regulatory Plan condition requiring Aquila customers to pay higher rates necessary for Aquila to recover amounts designed to restore its investment-grade status lost through its previous non-utility activities. At a minimum, Aquila acquiesced to the proposed transaction being structured in this manner and voluntarily entered into the proposed transaction with this proposed impact on its customers.

While this condition will be discussed in greater detail later in the Staff's Report, the "additional amortization" condition is unprecedented in a merger case. There has not been a merger case in Missouri where the Commission was requested to obligate Missouri customers to restore a utility's investment grade financial condition for the benefit of the new owner. This request is further without precedent as utility customers are being requested to subsidize the residual impacts of past non-utility operations that continue to weaken Aquila's overall financial condition today. The detriment of the imposition of an additional amortization is enhanced by the fact that Missouri customers and other stakeholders have not been afforded the opportunity to attempt to structure an overall regulatory plan through a collaborative process to see if any acquisition transaction is possible that meets all parties' requirements, as was done to construct the KCPL Experimental Regulatory Plan approved by the Commission in Case No. EO-2005-0329. The Commission is requested to make Aquila customers responsible for higher debt costs caused by Aquila's non-utility missteps. There is no indication that Aquila customers would pay these higher costs absent consummation of the proposed GPE acquisition of Aquila pending before the Commission. Although each merger, consolidation or transfer case is novel, the GPE/KCPL/Aquila Joint Application is truly unique and, as a consequence, these novel components expanded the Staff's review of the proposed transaction, since Staff has never encountered such conditions in prior Missouri merger cases.

Staff used the "not detrimental to the public interest" standard for its review of the Joint Application for this Report. There are no comprehensive, all inclusive criteria specifying all possible detriments that can arise from a merger. However, Staff has traditionally examined mergers premised on the basis that a detriment exists if a merger will cause customers rates to be higher than they would be absent the merger. The Gregory/Aquila merger to effectuate GPE's acquisition of Aquila with its new and historically rejected regulatory conditions that would be imposed on KCPL's and Aquila's Missouri ratepayers caused Staff's review to include an investigation of the likelihood that Aquila's successor and/or KCPL's rates would be higher than they would be absent the Gregory/Aquila merger. While prior Missouri merger requests have dealt with requests for merger savings sharing proposals with transaction costs and acquisition premium recovery, as those terms are used in this case, the Staff has not seen before a case seeking elements of those issues plus requests for an "additional amortization" and actual interest cost to address the financial damage caused by the non-regulated activities of the utility.

There are no conclusive sources defining the population of interests that comprise the "public interest." Staff has traditionally examined merger applications in a manner that treated the consuming public that relies upon the utility for service as the principal component of the "public interest." KCPL and Aquila are both providing comparable customer service levels at this time. Customer service is another area Staff commonly examines in merger application cases.[54] Customer service levels provided by KCPL and Aquila are addressed later in this Report.

When asked whether the Joint Applicants intend to modify their Joint Application in this case in Staff Data Request No. 344, they responded as follows:

> The joint applicants do not believe that they have materially modified any components of the joint application. However, the ratemaking treatment applicants anticipate seeking in future rate cases has changed. The joint applicants understand *AG Processing, Inc. v. Public Service Commission of the State of Missouri and Aquila, Inc.*, 120 S.W.3d 732 (Mo. 2003) to require the Commission as part of its cost analysis to consider future ratemaking issues when evaluating whether a merger is detrimental to the public. In the August 8, 2007 Supplemental Direct Testimony Pursuant to the Protective Order of Terry Bassham and Michael Cline, the joint applicants notified the Commission of certain anticipated ratemaking changes so the Commission could accurately evaluate whether the Merger is detrimental to the public. The joint applicants do not believe it is necessary to amend the joint application to reflect such changes.

The above response acknowledges that the Joint Applicants accept that a proposed merger's impact on customers' rates is a component of the required analysis in a merger case to determine

[54] *See Re UtiliCorp United, Inc.*, Case No. EM-2000-292, Report And Order, 9 Mo. P.S.C.3d 454, 472 (2000); *Re Kansas Power & Light Co.,* Case No. EM-91-213, Report And Order, 1 Mo.P.S.C.3d 150, 159 (1991); *Re Laclede Gas Co.*, Case No. 17,267, Report And Order, 16 Mo.P.S.C.(N.S.) 328, 334 (1971).

whether the transaction satisfies the “not detrimental to the public interest” standard. The Staff is unsure if it understands the changes in Messrs. Bassham’s and Cline’s supplemental direct testimony versus the Joint Application as it was filed remains unchanged. Staff will attempt to address these differences in later sections of this Report.

Aquila also acknowledges that **

**

Staff encountered difficulty in receiving the work papers from several GPE consultants who filed testimony regarding purported merger savings. Work papers were to be provided within two (2) business days following the filing of the particular testimony per the Procedural Schedule in the Commission's June 19, 2007 Order Adopting Procedural Schedule. Staff received work papers consisting of one hundred and sixteen (116) pages as late as September 24, 2007, and further information October 5, 2007. At this time, Staff decided not to pursue this

[55] Response to Staff Data Request Nos. 281 and 282.

discovery matter to its fullest extent due the fact that the merger savings contained in the direct and supplemental direct testimony relates to a merger of KCPL and Aquila that is a transaction outside the scope of the proposed transaction contained in the Joint Application. Staff notes the efforts of KCPL support staff to attempt to remedy the workpaper shortcomings issues relative to the consultants working on GPE's behalf.

3. The Status Quo

A. Aquila and its Shareholders

As noted in paragraph 3 of the Joint Application, Aquila is a Delaware corporation, with its principle office and place of business at 20 W. Ninth Street, Kansas City, Missouri. Aquila was established in 1985 and its stock is traded on the New York Stock Exchange as "ILA." Aquila is authorized to conduct business in Missouri through its Aquila Networks-MPS and Aquila Networks-L&P operating divisions and, as such, is engaged in providing electric and steam utility service in Missouri to the public in its certificated areas. Aquila is an "electrical corporation" and a "public utility" subject to the jurisdiction, supervision and control of the Commission under Chapters 386 and 393. Aquila also has regulated natural gas operations in Colorado, Iowa, Nebraska, and Kansas as well as regulated electric operations in Colorado. Aquila also has remnants of its non-regulated operations. These non-regulated remnants are related to Aquila's merchant services operations primarily consisting of the 340 megaWatt Crossroads generating facility in Mississippi and certain residual natural gas contracts. Aquila is authorized to do business in Missouri as a foreign corporation and its fictitious name registration, have been filed with the Commission in Case No. EU-2002-1053.[56]

The negative results of Aquila's non-utility operations are reflected in Aquila's overall financial condition evidenced by its elimination of a dividend to its shareholders, loss of its non-investment grade debt rating and its high debt costs. Attachment 1 to this Report is a copy of the Staff's Management Audit of Aquila, Inc. prepared in response to the Commission Order issued on June 13, 2006, in Case No. EO-2006-0356. Chapter 10 of Staff's Management Audit of Aquila, beginning on page 78 of the Audit Report, provides greater detail regarding Aquila's past decisions to invest in unregulated non-utility operations. Aquila provided Staff its comments regarding that Audit Report. Staff included Aquila's comments as a section to the Audit Report.

[56] Joint Application, page 3.

On page 11 of its comments, Aquila states, "Aquila maintains that its intent has always been clear to protect its regulated customers from the activities of its other businesses to the greatest extent possible." The Audit Report notes that Staff disagreed with Aquila regarding the adequacy of ratepayer protection from Aquila's non-utility operations. However, the proposed transaction in this case further eliminates the safeguards that existed under Aquila's management. Under the regulatory conditions attached to the proposed transaction in this case, Staff would no longer support any conclusion that Aquila's customers were not being harmed by Aquila's non-regulated activities.

Since Aquila's comments in Staff's Management Audit Report, Aquila's management has continued to abide by its commitment that Aquila's ratepayers will not pay the costs caused by Aquila's non-regulated activities, until Aquila agreed to the terms of the proposed Gregory/Aquila merger needed to effectuate GPE's acquisition of Aquila. Thus far, Aquila's non-utility costs were absorbed by Aquila's shareholders; however, if approved, the proposed transaction would shift those costs to Aquila's ratepayers. **

**[57]

At the time of the planned GPE acquisition of Aquila's shares through the Gregory/Aquila merger needed to effectuate GPE's acquisition of Aquila, a significant portion of the costs related to Aquila's non-utility missteps are reflected in the actual interest costs paid by Aquila for its debt and the loss of investment grade status for Aquila's debt. Aquila has generally only sought to recover debt costs of approximately seven percent (7%) from its Missouri regulated customers.[58] The debt costs covered by the seven percent (7%) include discount and issuance costs as well as interest costs. The excess of actual debt costs not recovered from utility customers is absorbed by Aquila's shareholders. Additional information on this subject is discussed in the Actual Debt Recovery section of this Report.

B. KCPL

As noted in the first two numbered paragraphs of the Joint Application, KCPL is a corporation duly organized and existing under the laws of the State of Missouri. KCPL is located at 1201 Walnut, Kansas City, Missouri, operating from space leased from TMP Partners L.P.[59] The 1201 Walnut lease is between KCPL and TWP Partners L.P. and was signed by KCPL in 1991.[60] KCPL is a regulated public utility. KCPL distributes and sells electric service to the public in its certificated areas in Missouri and Kansas, and is an "electrical corporation" and "public utility" subject to the jurisdiction, supervision and control of the Commission under Chapters 386 and 393 of the Revised Statutes of Missouri.

KCPL is wholly owned by GPE. GPE is located at 1201 Walnut and utilizes space governed by the KCPL lease with TMP Partners L.P. There are no agreements between GPE and KCPL for GPE to lease space from KCPL at 1201 Walnut. Costs are allocated to GPE based on the square feet occupied and used by GPE at 1201 Walnut. KCPL bills GPE Services for the usage.[61]

[57] Response to Staff Data Request No. 282 asking for access to documents provided to or received from members of Aquila's Board of Directors related to GPE's acquisition of Aquila.
[58] Supplemental Direct Testimony of Michael Cline, page 11, lines 12 through 23.
[59] Response to Staff Data Request No. 362.
[60] Response to Staff Data Request No. 362.
[61] Response to Staff Data Request No. 363.

GPE is a Missouri corporation and the holding company for KCPL and for Strategic Energy, L.L.C., a competitive end-user electricity supplier located in Pittsburgh, Pennsylvania. GPE is a public utility holding company regulated under the Public Utility Holding Company Act of 2005, which was enacted as part of the Energy Policy Act of 2005. As a holding company, GPE does not provide electric service to retail customers.

GPE and KCPL operate outside normal corporate governance parameters and written agreements. In practice, KCPL appears to be managed by GPE rather then through KCPL's own board and management. For example, KCPL employees perform services for GPE without any written contract between GPE and KCPL for such services. KCPL employees performed merger and acquisition support activities for GPE that are beyond the scope of the operations needed by KCPL to provide safe and adequate electric service to its Missouri customers. The only agreement between KCPL and GPE is related to an assignment of consolidated group corporate income tax benefits.[62] It was the Board and management of GPE, not KCPL, that routinely discussed the merger synergies anticipated from consolidation of KCPL and Aquila.

The following table identifies the **

[62] Response to Staff Data Request No. 291.

[redacted] **[63]

When this table is compared to the previous table of KCPL Board meetings relative to a merger or consolidation with Aquila, the comparison shows that KCPL has not been involved in merger activity consistent with the level expected under corporate governance parameters for a merger or consolidation of KCPL with Aquila. As previously mentioned, KCPL's Board never approved activities to consider the merger or consolidation of KCPL and Aquila. Staff's prior merger reviews indicate that common practice between entities the relative sizes of Aquila's Missouri operations and KCPL's operations, is that a Board would initially authorize officers to engage in discussions regarding a potential merger or consolidation, before any formal merger or consolidation occurred.

[63] Response to Staff Data Request No. 256.

4. The Proposed Transaction

A. Sale of Aquila's Natural Gas and Colorado Electric Operations to Black Hills Corporation (Black Hills)

The Black Hills sale is scheduled to occur slightly before the GPE transaction, but on the same day.[64] Immediately prior to closing its stock sale to GPE, Aquila will transfer its natural gas assets related to its natural gas operations in Kansas, Colorado, Iowa, and Nebraska to a Delaware limited partnership formed by Aquila referred to in the Joint Application as "Gas Opco." Gas Opco will have Aquila as the general partner and Gas Opco as the limited partner. At the same time, Aquila will transfer its electric assets related to its electric operations in Colorado to a Delaware limited partnership formed by Aquila referred to in the Joint Application as "Electric Opco." Electric Opco will have Aquila as the general partner and Electric Opco as the limited partner. Aquila, Electric Opco, and Gas Opco will then sell their partnership interests in Electric Opco and Gas Opco to Black Hills Corporation (Black Hills).

Under section 2.4 of the Transition Services Agreement among Black Hills, GPE, and Gregory, Black Hills will pay forty percent (40%) of the transitional employee severance costs. This section of the Transition Services Agreement reduces the ultimate transaction costs level that will be GPE's responsibility upon the closure of the Gregory/Aquila merger needed to effectuate the GPE's acquisition of Aquila. At the time of the sale, Black Hills will pay GPE \$20.2 million towards GPE's transaction costs liability.[65]

B. GPE acquisition of Aquila through the merger of Aquila with Gregory Acquisition Corp. (Gregory)

Staff refers in this Report to this step of the overall transaction as the "Gregory/Aquila Merger." This is the only merger addressed in the Joint Application. There is no component of the Joint Application requesting a Commission order approving a proposed merger or consolidation of any portion of the KCPL system or operations and the Aquila systems or operations. KCPL is a separate legal entity from Gregory. This matter has been addressed in greater detail elsewhere in this Report. Immediately after the completion of the Black Hills sale,

---

[64] Response to Staff Data Request No. 308.

[65] Schedule RTZ-10 from Robert T. Zabors Supplemental Direct Testimony - "People" costs of \$30.3 million divided by GPE 60% share of total "People" costs equaling \$50.5 million of total "People" transaction costs multiplied times the Black Hills share of the total, which is 40%.

Aquila will be merged into a Delaware corporation called Gregory Acquisition Corp., with Aquila as the surviving entity. This action is referred to in the Joint Application as the "Merger." Gregory Acquisition Corp. is referred to in the Joint Application as the "Merger Sub." Gregory Acquisition Corp. is a direct, wholly-owned subsidiary of GPE. Aquila will become a direct, wholly-owned subsidiary of GPE, as KCPL already is today. Aquila shareholders will then receive the consideration of stock and cash called for under the February 6, 2007, Agreement and Plan of Merger signed by Aquila, Black Hills, and GPE.

The result of the Gregory/Aquila merger would be that GPE will effectively acquire Aquila, less the operations and assets sold to Black Hills. Aquila will be comprised of its Missouri electric and steam operations, Aquila Networks-MPS and Aquila Networks-L&P, as well as its merchant services operations, primarily consisting of the 340 MW Crossroads generating facility in Mississippi, and certain residual natural gas contracts.

The Black Hills sale and the GPE acquisition of Aquila are each conditioned upon the closing of the other. This means GPE will not acquire Aquila unless the Black Hills sale is completed. GPE's acquisition of Aquila is subject to approval of both the Aquila and GPE shareholders as well as regulatory approval. On October 9 and 10, 2007, Aquila's shareholders and GPE's shareholders, respectively, approved the proposed transaction.

If the proposed transaction is consummated, KCPL and Aquila will become affiliated entities by virtue of GPE's common ownership of both of them. GPE will purchase the outstanding shares of Aquila for consideration consisting of GPE stock and cash. The purchase price that GPE will pay for Aquila was described as follows by GPE in the response to a Staff Data Request:

> As described in the joint proxy statement, the purchase price will be comprised of two components: (1) 0.0856 share of Great Plains Energy common stock for every outstanding share of Aquila common stock at the time of closing; and (2) $1.80 in cash for every outstanding share of Aquila common stock at the time of closing. It is not possible to estimate the actual purchase price at the time of closing with precision because of uncertainty related to (1) the exact number of outstanding Aquila common shares at the time of closing; (2) the timing of the closing; and (3) the value of Great Plains Energy common stock at the time of closing. Based, however, on 374.7 million outstanding Aquila common shares (as of May 4, 2007, per Aquila's First Quarter 2007 10-Q filed on May 8, 2007) and Great Plains Energy's closing share price of

$28.82 on Friday, June 22, 2007, the indicative calculation is as follows:

(1) Shares issued = 374.7 million shares of ILA * 0.0856 = 32.1 million of shares of GXP issued. Current value of those shares = 32.1 million * $28.82 = $925.1 million

(2) Cash = $1.80 per share of ILA * 374.7 million shares = $674.5 million

(3) Estimated purchase price based on current inputs = (1) + (2), or $1,599.6 million.[66]

GPE intends to purchase each of the outstanding shares of Aquila stock for $1.80 cash plus 8.56% shares of GPE stock. It is anticipated that GPE will pay approximately $1.6 billion for Aquila stock at that time. This price is based upon a market price for GPE's stock of $28.82.

At completion of the Gregory/Aquila merger, GPE will be the sole owner of Aquila with the same rights and obligations as the current Aquila shareholders. At that time GPE shareholders will be responsible for absorbing the losses resulting from Aquila's non-regulated activities as the Aquila shareholders did prior to the Gregory/Aquila merger. At that time the following issues that are being absorbed by Aquila shareholders will be transferred to GPE when GPE becomes the owner of Aquila:

- Aquila debt with a non-investment grade rating; and
- Approximately ** __________ ** of annual interest costs in excess of debt costs requested for recovery from Missouri ratepayers.[67]

GPE would be absorbing interest costs in excess of a cost of debt of seven percent (7%) which reflects discount and issuance costs in addition to interest expense on the debt levels assigned to Aquila's utility operations.[68] At this time GPE will have created the following additional liabilities as result of its acquisition of Aquila:

[66] GPE Response to Staff Data Request No. 41.
[67] ** ____ **
[68] Supplemental Direct Testimony of Michael C. Cline, page 11, lines 12 through 23.

- Approximately $53 million of additional annual dividend payments;[69] and
- Approximately $95 million of one time transaction costs.[70]

GPE and Aquila will incur transaction costs to complete the Gregory/Aquila merger. Aquila has an expected transaction costs liability of $26.4 million,[71] while GPE has an expected transaction costs liability of $89 million,[72] before reimbursement from Black Hills.

C. Aquila will be renamed.

While not a relatively significant item, the Joint Applicants also request that the Commission authorize Aquila[73] to change its name at an unspecified time to an unspecified new name. Staff recommends that the Commission reject this request and require the filing of such a request at the time Aquila knows the name it wishes to use in the future. Under the Staff's recommended approach the Commission and interested parties will have an opportunity to review the new name and parties will have the opportunity to bring forth any issues raised by the proposed new name.

5. Regulatory Plan

The effect of the Regulatory Plan is to shift the burden of the current Aquila shareholders to Aquila ratepayers, before GPE consummates the Gregory/Aquila merger needed to effectuate GPE's acquisition of Aquila. The regulatory plan has four components designed to improve GPE's status as a shareholder of Aquila relative to the status of current Aquila shareholders by placing on ratepayers: 1) increased rates to fund an "additional amortization" mechanism to maintain an investment grade rating, 2) increased rates for a regulatory asset amortized over five years to recover transaction of the proposed transaction, 3) a net synergy saving fifty percent (50%) sharing proposal that will charge customers for savings that they will not realize, and 4) increased rates by allowing Aquila to recover actual debt costs related to Aquila's non-regulated operations.

---

[69] Response to Staff Data Request No. 67. "Great Plains Energy expects to continue its annual common stock dividend of $1.66 per share. Assuming that all 32,188,797 shares covered by the registration statement are issued, the annual dividend payments would be $53,433,403."
[70] Schedule RTZ-10 attached to the Supplemental Direct Testimony of Robert T. Zabors.
[71] Schedule RTZ-10 in Supplemental Direct Testimony of Robert T. Zabors, line titled "Transaction Costs- Aquila."
[72] Schedule RTZ-10 in Supplemental Direct Testimony of Robert T. Zabors, $95.2 less Aquila Costs of $26.4 million plus Black Hills share of "People Costs" of $20.2 million.
[73] Page 21, Item (i) in the "Wherefore" clause of the Joint Application.

A. Synergy Savings Sharing Proposal

Staff recommends that the Commission reject the Joint Applicants' request in their Joint Application at Item (g) on page 21 in the "Wherefore" clause to issue an Order Authorizing 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 properly allocated to their Missouri-regulated operations. Staff recommends that the Commission reject this request for five reasons.

Staff understands that the direct testimonies of Mr. Terry Bassham and Ms. Lori Wright, as modified by the supplemental direct testimony of Mr. Bassham, frame the specifics of this issue. Mr. Bassham, beginning on page 10 of his direct testimony states:

> 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. To work, the Merger needs to address the interests of all three groups of stakeholders, i.e., retail customers, creditors and shareholders. 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 reward shareholders for any additional risk they bear as a result of the Merger and to ensure that the impact on Great Plains Energy's earnings per share is accretive in the near future, Joint Applicants propose that the synergy savings be shared equally between retail customers and shareholders. The proposed methodology for accounting for Merger-related synergies and costs to achieve is addressed in the direct testimony of Lori Wright.[74]

Ms. Wright provides these additional details in her direct testimony:

> ● "Synergy savings" is a term that refers to reductions in costs as a result of combining Great Plains Energy and Aquila as compared to the combined costs of the entities standing alone;
>
> ● Examples of synergy savings include benefits of scale and improved efficiency in support functions, economies of scale in purchasing, savings in customer service and field operations enabled by serving the same geographic area, etc. Greater detail is provided in the direct testimonies of John Marshall and Robert Zabors.
>
> ● Joint Applicants propose that KCPL and Aquila be permitted, collectively, to retain fifty percent (50%) of Merger-related synergy savings for five (5) years, beginning on January 1, 2008, or the month immediately following the

[74] Direct Testimony of Terry Bassham, page 10, lines 2 through 13.

consummation of the merger, whichever occurs last. These synergy savings would be based on the synergy savings identified and quantified in the direct testimony of Robert Zabors;

● Great Plains Energy does not recommend that synergy savings be tracked. Instead, Great Plains Energy recommends using the synergy savings identified in the Joint Application and the pre-filed testimony in support thereof. Tracking synergy savings with any degree of accuracy is problematic at best as business operations are not conducted in a static environment, but rather under constant change, including customer growth, technological improvements, etc. Tracking will become more difficult each successive year after the Merger.

● If the Commission should decide that synergy tracking is necessary, then Ms Wright suggests a simple, very basic approach, given that accuracy is not likely to improve appreciably no matter the level of complexity. Ms Wright suggests establishing base period costs and then each year subsequent to the Merger comparing that year's actual costs to the base year costs, as adjusted for inflation. The net decrease in expense would be considered synergy savings.

● Consideration for known and measurable changes should be reflected in the computation, including cost escalations, such as wage increases and the effects of inflation among others.

● Calendar year 2006 should serve as the base year because that year represents the last full year of operations unaffected by the Merger. It is also the test period for Aquila's current rate case, Case No. ER-2007-0004, and reflects a test period in which the Commission, its staff and other parties of the case are familiar. 2006 is also the test period of the current KCPL rate case, Case No. ER-2007-0291. 2006 provides a good test period for both Aquila and KCPL to evaluate synergy savings to be accomplished as a result of the Merger.

Mr. Bassham in his supplemental direct testimony provides the following modification to the synergy proposal:

> Yes, however, we propose to offset the synergies by the transition-related costs prior to sharing 50/50. Consequently, customers will retain more synergies than in our original proposal and we believe this request is more consistent with past commission practice. Total non-fuel operating synergies were $305 million. After subtracting transition-related costs of $45 million and using the 50/50 synergy sharing ratio, synergy sharing is $130 million over five years.[75]

[75] Supplemental Direct Testimony of Terry Bassham, page 8, lines 4 through 11.

Staff understands that the request in the Joint Application as modified by Mr. Bassham's supplemental direct testimony reflects the position the Joint Applicants are currently pursuing in this case. Mr. Bassham's supplemental direct testimony requires that the Commission find that fifty percent (50%) of the synergy estimates, less transition costs contained in the Joint Applicants' supplemental direct testimony, be pre-approved by this Commission such that these amounts be used as a cost of service adder to be included in KCPL's and Aquila's test years for the five years following GPE's acquisition of Aquila. The cumulative cost of service adder would be the $305 million of synergies shown on Mr. Zabors' supplemental direct testimony Schedule RTZ-8 reduced by the transition costs of $45.3 million shown on Mr. Zabors' Schedule RTZ -11 multiplied by fifty percent (50%).

Staff recommends the Commission find that there are no merger synergies to be realized or transition costs to be incurred from the proposed transaction contained in the Joint Application, since the direct testimony in the case only alleges savings from a merger or consolidation of KCPL and Aquila, which is a transaction outside of the proposed transaction before the Commission in this case. The primary element of the sharing proposal shifts the risks of the realization of any synergies to KCPL and Aquila ratepayers to the extent that ratepayers will be charged fifty percent (50%) of predetermined net synergy estimates, regardless of whether any synergies are actually realized. The Joint Applicants currently propose that customers' rates be increased by the allocated share of the following amounts:

Millions $	2007	2008	2009	2010	2011	2011	Cumulative
Proposed Synergies[76]	$0	$30	$56	$62	$75	$82	$305
Proposed Transition Costs[77]	$8	$28.8	$7.8	$.5	$.2		$45.3
Net Synergies or (Costs)	$(8)	$1.2	$48.2	$61.5	$74.8	$82	$259.7
50% Net Synergies	$(4)	$.6	$24.1	$30.75	$37.2	$41	$129.85

Their proposal is unrealistic, since KCPL and Aquila have no pending request to merge or consolidate KCPL and Aquila under GPE ownership. "It is not expected that any change will

[76] Schedule RTZ-8 attached to the Supplemental Direct Testimony of Robert T. Zabors.
[77] Schedule RTZ-11 attached to the Supplemental Direct Testimony of Robert T. Zabors.

occur in future rate cases except that the Company will include 50% of the "synergy savings" in cost of service allocated to each jurisdiction."[78]

Under GPE/KCPL's and Aquila's "synergy savings" proposal, the amount of "synergy savings" charged to ratepayers will not be modified if future projections differ from actual results. Under GPE/KCPL's and Aquila's current proposal, a tracking mechanism has not been proposed, thus no modification has been proposed. GPE/KCPL is not averse to modifying synergy savings under an appropriate tracking mechanism.[79]

**

**

In the direct testimony of Ms Lori A. Wright an alternative approach of using a 2006 base year adjusted for inflation was mentioned. This approach is inappropriate because it will overstate merger synergies due to failures to recognize productivity improvements that will occur at KCPL and Aquila, absent any merger. KCPL already has a current obligation for continuous productivity improvements.[81] The approach suggested by Ms. Wright is contrary to KCPL's Comprehensive Energy Plan and the KCPL Experimental Regulatory Plan the Commission

[78] Response to Staff Data Request No. 11.
[79] Response to Staff Data Request No. 38.
[80] Response to Staff Data Request No. 55, presentation to Moody's found in file titled "Q005_Moody's.ppt."
[81] Stipulation and Agreement approved by in Commission in Case No. EO-2005-0329 at, page 19 states that "KCPL recognizes its obligation to continue to prudently manage costs, continuously improve productivity, and maintain service quality during the Regulatory Plan."

approved in Case No. EO-2006-0329, in that the method she proposes for tracking fails to recognize KCPL's obligation to prudently manage its costs and continuously improve productivity. Ms. Wright's method only increases the base by some factor to represent inflation. There is no offset in Ms. Wright's proposal against her inflation factor to recognize the required productivity effort. Ms. Wright's method has been suggested before as a merger savings tracking device, but never utilized because the method measures normal productivity as merger savings, thus overstating the result from her approach. To Ms. Wright's credit, she notes these deficiencies in her testimony as follows:

> I would suggest a simple, very basic approach, given that accuracy is not likely to improve appreciably no matter the level of complexity.[82]

Her method would treat the productivity improvements Aquila achieves through its current Six Sigma productivity improvement efforts as merger savings. Her method would often produce savings result, even if no merger occurs, due to the inaccuracy of the inflation factor and the failure to consider productivity offsets.

The same failings identifed in Ms. Wright's alternative proposal also are in the synergy savings methodology GPE/KCPL propose in the supplemental direct testimony of their witnesses. This methodology represents the third methodology, known to Staff, used by GPE/KCPL to measure synergies. The first two methods are described in the following GPE response to a question from a debt rating agency:

**

[82] Direct Testimony of Lori Wright, page 5, lines 20 and 21.

NP

**

Of the three approaches, the current method is the least accurate and the most likely to overstate synergies, given that any method by its nature will be inaccurate.

Mr. Bassham, Mr. Kemp, and Ms. Wright suggest in their direct or supplemental direct testimonies that Staff supports their approach or it has precedence in Missouri. The Staff testimony cited is used out of context. The Staff has held to the view that merger savings cannot be accurately measured. Ms Wright's direct testimony acknowledges this fact. There has not been a merger tracking system accepted by the Commission. There can be no effective savings sharing system without an effective savings tracking system. It has been the Staff's position that merger savings be shared through a rate moratorium, where the utility is allowed to retain one-hundred percent (100%) of any savings it achieves until the time when the utility's rates are subjected to change, after the end of the moratorium period. Staff has agreed to forego any complaint case against utilities for a certain time period to provide certainty regarding the period the utility has the opportunity to retain all the purported savings benefits from its merger.

The Staff testimony cited by the GPE/KCPL witnesses is where the Staff took the position that if the Commission chose to adopt the savings sharing proposal made in the case in question, the Commission should adopt a design that allowed ratepayers to receive at least fifty percent (50%) of the alleged savings.

Mr. Bassham, Ms. Wright, and Mr. Kemp refer to Staff testimony in an Aquila case to support their synergy sharing proposal. While their direct and supplemental direct testimonies cite prior Staff testimony as providing some precedent for their proposed synergy saving sharing proposal, GPE/KCPL provided a different answer in discovery. Staff noted that GPE/KCPL did not rely upon any precedent. Their request to retain fifty percent (50%) of

[83] Response to Staff Data Request No. 55, ** **

estimated "synergy savings" for five (5) years is based on the overall plan to make the merger work for all stakeholders, where benefits are provided to ratepayers and costs of the merger are recovered.[84] This response further contradicts the statements on ** ____________________

______________________ **[85]

GPE/KCPL witness Mr. Terry Bassham alleges in his direct testimony in this case that the Staff recommended a sharing mechanism in the Aquila/St. Joseph Light & Power Company (SJLP) merger application case, Case No. EM-2000-292 that would have allowed Aquila to retain fifty percent (50%) of merger savings, and includes a quote from Staff witness Mr. Mark L. Oligschlaeger's testimony in that case, stating that regulatory plans should flow through to customers a minimum of fifty percent (50%) of total merger savings. GPE/KCPL witness Ms. Lori Wright also refers to Staff witness Mr. Oligschlaeger's testimony (and Staff witness Steve M. Traxler's testimony) in the same Aquila/SJLP merger case to support GPE/KCPL's regulatory plan at issue in this case. These GPE/KCPL witnesses are misstating the Staff's position in the Aquila/SJLP and earlier, merger case, and are also taking the quote from Mr. Oligschlaeger's testimony in that merger case out of context. In the Aquila/SJLP case, as well as in even earlier KCPL/Western Resources merger applications, the Staff recommended that existing and non-extraordinary regulatory means be used to flow merger savings and merger costs (not including acquisition adjustments) into customer rates. More specifically, the Staff advocated allowing utilities to retain net merger savings through the phenomenon of "regulatory lag," or the period between when the savings are incurred and when rates are changed to reflect new cost levels. In these cases, the Staff opposed adoption of merger "regulatory plans" that are premised upon allowing utilities to retain a certain percentage of estimated, or actual, merger savings. That is because merger savings estimates are unreliable and not "known and measurable," and because proposals to monitor and quantify ("track") actual merger savings over time are inherently speculative, because they would have to be based upon

[84] Response to Staff Data Request No. 9.
[85] Response to Staff Data Request No. 257.

hypothetical "what-if" scenarios and because there is no accurate way to separately quantify merger savings as opposed to non-merger savings after a merger is approved.

The Aquila/SJLP regulatory plan was based upon a prospective effort by the applicants to actually track merger savings, and the Staff estimated that the plan would have passed on to customers at best only 3% to 4% of projected total merger savings over the first ten years immediately after the merger. The Staff opposed this plan due to its reliance on merger tracking efforts, but also suggested, in the alternative, that if the Commission were to adopt this type of plan over the Staff's opposition, that the Commission should require an assignment of merger savings to customers of at least fifty percent (50%). That is the context of the quoted statement of Mr. Oligschlaeger cited in the testimony of GPE/KCPL witnesses Bassham and Wright. Mr. Oligschlaeger and other Staff witnesses never affirmatively supported in Case No. EM-2000-292, or in any other case, that the Commission approve a regulatory plan that assigned fifty percent (50%) of merger savings to a utility, or any such stated percentage of savings. Staff would not propose such a position, because Staff does not believe that merger savings can be accurately tracked. Ms. Wright acknowledges this when she testifies:

> Great Plains Energy does not recommend that synergy savings be tracked. Instead, Great Plains Energy recommends using the synergy savings identified in the Joint Application and the pre-filed testimony in support thereof. Tracking synergy savings with any degree of accuracy is problematic at best as business operations are not conducted in a static environment, but rather under constant change, including customer growth, technological improvements, etc. Tracking will become more difficult each successive year after the Merger.[86]

Mr. Oligschlaeger also recommended that the Commission make no ratemaking findings of any type in the Aquila/SJLP merger case, and that it wait until subsequent Aquila and SJLP rate cases to decide on rate treatment of merger savings and costs.

The Staff's recommendations in the Aquila/SJLP merger case concerning rate treatment of merger savings and costs were summarized at pages 47-53 of Mr. Oligschlaeger’s rebuttal testimony admitted into evidence in Case No. EM-2000-292.

---

[86] Direct Testimony of Lori A. Wright, page 5, lines 11 through 17.

B. Transaction Costs Recovery

GPE seeks Commission Approval to charge KCPL customers for the transaction costs portion of GPE's acquisition adjustment. In this Report, Staff refers to this element of the proposed transaction as "Transaction Costs Recovery."

The Joint Applicants request in their Joint Application in Item (f) on page 21 in the "Wherefore" clause that the Commission issue an Order Authorizing KCPL and Aquila to establish a regulatory asset and amortize into cost of service costs associated with the Merger, including both transaction and transition-related costs, as properly allocated to KCPL's and Aquila's Missouri-regulated operations and excluding the non-incremental labor costs of the integration team, over a five (5) year period beginning on January 1, 2008, or the month immediately following consummation of the Merger, whichever occurs later.

In paragraph 42 of the Joint Application, the Joint Applicants state that they do not request authorization to recover any acquisition premium associated with the "Merger." As previously discussed, the "Merger" is the Gregory/Aquila merger needed to effectuate GPE's acquisition of Aquila. The term "acquisition premium" is defined as "[t]he difference between the actual cost for acquiring a target firm versus the estimate made of its value before the acquisition."[87] The term "acquisition adjustment" is used by the Joint Applicants to have a different meaning than the term "acquisition premium."

Staff inquired regarding the precedent, if any, GPE/KCPL relied upon to support GPE/KCPL's request to establish a regulatory asset and amortize into cost of service associated with Merger allocated transaction and transition costs over a five (5) year period beginning January 1, 2008, or the month immediately following the consummation of the Merger, whichever occurs later.[88] Mr. Bassham modified this request in his supplemental direct testimony to include 100% of the transaction costs and 50% of the transition-related costs.[89]

GPE/KCPL responded, "The request for establishing a regulatory asset is based on the model approved in the Experimental Regulatory Plan in Case No. EO-2005-0329. The request for recovery of the transaction and transition cost over a five (5) year period is based on the overall plan to make the merger work for all stakeholders where benefits are provided to

[87] http://www.investopedia.com/terms/a/acquisitionpremium.asp.
[88] Staff Data Request No. 2.
[89] Supplemental Direct Testimony of Terry Bassham, page 8, lines 12 through 17.

ratepayers and cost of the merger are recovered."[90] Staff cannot find anything in the Experimental Regulatory Plan in Case No. EO-2005-0329 that serves as a precedent for transaction cost recovery. As a Stipulation and Agreement, the Experimental Regulatory Plan in Case No. EO-2005-0329 has no precedential value. ** ________________________________

____

____

____

________________ **[91] Missouri precedent is not to allow ratepayer recovery of acquisition adjustments. Ms. Wright in her direct testimony states,

> The Joint Applicants do not request authorization to recover the acquisition premium component of goodwill associated with the Merger. The Joint Applicants are requesting recovery of the transaction cost component of goodwill over a five (5) year period, as I discuss later in this testimony.[92]

The acquisition adjustment that GPE anticipates it will book if the Merger closes is $135.9 million. The amounts used to determine this adjustment were based on the fair value of Aquila's assets and liabilities at March 31, 2007. The total estimated purchase price of the merger is based on the average closing price of GPE's common stock for the period beginning two trading days before and ending two trading days after the announcement of the Merger and also includes estimated transaction-related costs. The range of dates for GPE's common stock price was between February 5, 2007, and February 9, 2007. The amount of the adjustment is preliminary and will be revised to reflect actual fair values of the related assets and liabilities as of the date the Merger is completed and final transaction-related costs.[93]

GPE/KCPL state that the term "acquisition adjustment" is essentially synonymous with the term "goodwill" as used within their testimony and refers to the excess of purchase price, including transaction costs over the fair market value of net identifiable assets acquired.[94]

Further GPE/KCPL note that the difference between the terms "merger premium" and "acquisition adjustment" as used by GPE/KCPL and Aquila in this case relates to transaction costs. As discussed in the their response to Staff Data Request No. 39, the term "acquisition

---

[90] Response to Staff Data Request No. 2.
[91] Response to Staff Data Request No. 257.
[92] Direct Testimony of Lori Wright, page 3, line 11 through 16.
[93] Response to Staff Data Request No. 43.
[94] Response to Staff Data Request No. 39.

adjustment" is synonymous with the term "goodwill" and refers to the excess of purchase price, including transaction costs, over the fair market value of net identifiable assets acquired. The term "merger premium" refers to the excess of purchase price, excluding transaction costs, over the fair market value of net identifiable assets acquired.[95]

Transaction costs do not meet the normal criteria for traditional expenses used to establish rates. These costs are not used or useful nor necessary for the provision of safe and adequate service. These costs are investor costs incurred in the buying and selling of their stock. These costs are the fees stockholders incurred when buying or selling stock. These are the costs of a non-regulated holding company. GPE and its Board decided to incur these costs. KCPL and its Board made no decision to be involved in this transaction as already discussed. Recovery of these transaction costs would result in regulated utilities subsidizing their non-regulated parent companies.

Aquila has made other commitments that it is breaking in this case. Examples of relevant commitments made by Richard Green on behalf of UtiliCorp United, Inc., Aquila before it last changed its name, follow. The Commission in its Report and Order in Case No. ER-90-101, et al, 30 Mo.P.S.C.(N.S.) 320, 350 ((1990)(emphasis added) stated:

> The evidence indicates that Company has removed from its A&G costs most of the known expenses associated with M&A activities. **The Commission believes that UtiliCorp's expenses for M&A activities should be removed from the expenses reflected in MPS' rates. When UtiliCorp was formed Company assured the Commission that the ratepayers would suffer no detriment from UtiliCorp's activities but would experience the benefits associated with UtiliCorp's activities. The Commission believes that it is inconsistent with this pledge to include M&A costs in the expenses reflected in MPS' rates. The Commission is of the opinion that it is inappropriate for MPS' ratepayers to pay for these activities which have little to do with MPS' goal of providing safe and adequate electric service in Missouri.** Therefore, the Commission finds that the $70,280 of additional costs for M&A activities should be excluded from the cost of service. Finally, the Commission is concerned that Company has not been accounting for these costs separately. Accordingly, the Commission will direct Company to account for M&A costs separately so that they can be readily excluded in future rate cases from A&G costs reflected in MPS' rates.

[95] Response to Staff Data Request No. 40.

In Case No. EM-2000-292, 9 Mo.P.S.C.3d 454 (2000), UtiliCorp United, Inc. sought to merge with SJLP (*In the Matter of the Joint Application of UtiliCorp United Inc. and St. Joseph Light & Power Company with and into UtiliCorp United Inc. and in Connection Therewith, Certain Other Related Transactions*). In its Report and Order in that case, the Commission notes that UtiliCorp asked the Commission to determine that UtiliCorp be allowed to recover transaction costs and costs to achieve associated with the merger. The Commission declined to rule on the matter on the basis that it would not make a ratemaking determination outside the context of a rate case. 9 Mo.P.S.C.3d at 476. UtiliCorp's shareholders agreed to pay a 36% acquisition premium, i.e., a purchase price 36% above the trading value of SJLP's stock just before the merger was announced. UtiliCorp requested that the Commission authorize it to recover in rates from SJLP's ratepayers the acquisition premium to the extent that ratepayers would benefit from savings arising from the merger. The Commission ruled that the matter of the recovery of an acquisition premium was a rate case matter, and not a matter properly before the Commission outside of the context of a rate case. Therefore, the Commission declined to rule on this matter also. *Id*. at 477.

A.G. Processing sought judicial review of the Commission's Report and Order and the Missouri Supreme Court reversed the Commission on the basis that the Commission erred when determining whether to approve the merger, because the Commission failed to consider and decide whether the acquisition premium was reasonable as part of its cost analysis when evaluating whether the proposed merger would be detrimental to the public. *State ex rel. A.G. Processing v. Public Serv. Comm'n*, 120 S.W.3d 737, 736 (Mo. banc 2003). The Missouri Supreme Court stated that the circuit court should remand the case to the Commission to decide the issue of the recoupment of the acquisition premium in conjunction with the other issues raised by the parties in evaluating the reasonableness of a decision to approve a merger. *Id*. at 737. On remand by the Circuit Court, Aquila, filed on February 25, 2004, in Case No. ER-2000-292 Aquila Inc.'s *Statement of Position with respect to Recoupment of Acquisition Premium and Merger Savings* stating it would not seek to recoup or otherwise recover the through rates the acquisition premium, the merger savings or the merger synergies in connection with the merger transaction. On February 26, 2004, the Commission issued its Second Report and Order in Case No. EM-2000-292, 12 Mo.P.S.C.3d 388, and could have based its decision on

Aquila's February 25, 2007, Statement Of Position. Instead, the Commission issued a decision on the merits and declined to vary from the net original cost standard to value utility plant:

> The Commission has consistently applied the net original cost standard when placing a value on assets for purposes of establishing a utility's rates. No party has cited a single instance in which the Commission has allowed a utility to directly recover an acquisition premium through its rates. In support of its request for recovery of the acquisition premium, UtiliCorp cites two Commission cases for the proposition that this Commission is not unalterably opposed to a utility's recovery of an acquisition premium. In both cited cases, In re Missouri-American Water Company, 4 Mo.P.S.C.3d 205 (1995), and In re Kansas Power & Light Company, 1 Mo.P.S.C.3d 150 (1991), the Commission did make statements suggesting that it was not unalterably opposed to the recovery of an acquisition premium in an appropriate case. However, in both cases, the Commission refused to allow the requesting utility to recover the premium in question.
>
> . . . .
>
> For many years, the Commission has used a net original cost standard to place a value on utility plant after a merger. That standard has proven to be fair to utilities as well as to ratepayers. There is no reason to vary from that standard in this case. The Commission concludes that UtiliCorp should not be allowed to recover any of the acquisition premium in its rates.
>
> The Supreme Court's decision remanding this case to the Commission also states that the Commission should determine whether the acquisition premium was "reasonable". . . . since today's decision makes it clear that it is the responsibility of UtiliCorp's shareholders to pay any acquisition premium, there is no need for the Commission to determine whether the price that UtiliCorp chose to pay for SJLP is reasonable.

12 Mo.P.S.C.3d at 390-92.

It is not clear in this order where the Commission is using the Joint Applicants definition of acquisition premium or whether the Commission is using acquisition premium to mean the same as acquisition adjustment. Staff supports the position that transaction costs are related to an acquisition premium and should be likewise absorbed by a utility's owners.

C. Actual Debt Costs Recovery

The manifestation of the abrogation of Aquila's commitment to insulate its Missouri ratepayers from the effect of its non-regulated activities can be seen in the GPE response to Staff Data Request No. 324 which asked the following question:

> What is KCPL's current estimate of the difference between the interest costs Aquila will be seeking from its Missouri customers annually for the period 2008 through 2012 if the transaction proposed by GPE/KCPL and Aquila in this case closes minus the amount Aquila would seek from these customers over the same time period if the transaction does not close?

Staff received a response from GPE indicating the amounts of annual interest costs GPE anticipates Missouri ratepayers to pay assuming acquisition and no acquisition of Aquila by GPE. GPE Table A indicates that GPE expects Missouri ratepayers to be liable for a total interest expense of ** ____________ ** for 2008 through 2012 assuming the acquisition of Aquila by GPE.

**

**

In its most recent general rate increase case, Case No. ER-2007-004, through the direct testimony of its Senior Vice President, Regulated Operations, Jon R. Empson, filed July 3, 2006, at pages six (6) through fifteen (15), Aquila presented the commitments it has made to this Commission, as well as to all of the state regulatory bodies with jurisdiction over its utility operations, to protect the customers of its regulated utility operations from financial impacts of its other operations by taking steps to insulate and separate each of its utility divisions from Aquila's other activities. As part of its insulation and separation of each of its utility divisions from Aquila's other activities, Aquila has charged its regulated utility customers rates based on long and short-term debt costs that reflect representative costs for comparable utilities with a BBB investment grade rating. As Mr. Empson explained in his direct testimony, "Aquila has essentially declared its utility properties investment grade. In other words, while Aquila as a corporation might be non-investment grade, it is treating all of its utility properties as if they were investment grade. Aquila is behaving as if an outside credit rating agency has determined that a ring-fence exists and the credit risk of Aquila's utility properties had been insulated from the credit risk of the Company."[96] In that same direct testimony, Mr. Empson also testified, "Q. How do you characterize Aquila's commitments to the business principles? A. Very important."[97]

Vice President Empson's closing Q&A in the commitments to regulators section of his direct testimony is:

> Q. Do you have any final comments concerning the Company's commitment to financially and operationally protect its regulated customers?
>
> A. Yes I do. Aquila understands and appreciates the sensitivity the Commission has about the potential repositioning impact on Missouri utility customers. Aquila has accepted full responsibility for its past strategy and is also taking full responsibility for restoring financial stability while insulating the impacts on its customers. Aquila believes that the guiding principles we outlined in the original financial plan and restated in my testimony today provide the appropriate protection.

Id. at p. 15.

---

[96] Case No. ER-2007-0004, Empson Direct, Ex. 8, p. 10.
[97] *Id*. at p. 11.

By joining with GPE and KCPL in the Joint Application in this case, Aquila is now seeking to shirk that full responsibility for its past strategy by stripping from the customers of its regulated operations the insulation it put in place in the past and requiring those customers to bear the financial brunt of Aquila's past missteps and financial reversals of its non-regulated operations.

Staff does not agree that Missouri ratepayers should be liable for the total annual interest expense of ** ____________ ** for 2008 through 2012. Aquila filed testimony in Case No. ER-2007-0004 from two witnesses that asked the Commission to approve certain allocated debt issuances and interest costs for its two Missouri operating divisions, Aquila Networks-MPS and Aquila Networks-L&P as Aquila was and still is below investment grade because of its non-regulated investments.

It was the representatives of Aquila shareholders, their officers and Board, that made the decisions to enter into non-regulated business endeavors that resulted in the level and cost of debt with non-investment grade debt rating that GPE, as a prospective buyer of Aquila, does not want to assume the responsibility that Aquila shareholders and their management have accepted for these costs and agreed that ratepayers will not pay for them. Normally, the answer to this situation is either to agree to continue to absorb these costs and reflect this liability in the price you pay for Aquila's stock or not buy Aquila. Instead, GPE requests an alternative normally rejected universally in utility regulation. GPE requests utility ratepayers to pay higher rates to absorb these costs and to commit to pay higher rates through an additional amortization to restore the debt rating lost through non-regulated activities. GPE's solution to Aquila's debt issues is for Missouri utility customers to pay higher rates until all the debt issues are resolved and Aquila's investment-grade debt rating restored. GPE's solution is for Missouri ratepayers to pay for something that GPE is not to willing to absorb. The Staff suggests that the better solution to this issue is for GPE to walk away from this transaction when it is not willing to assume the liabilities borne by current owners. Ratepayers should not have to pay higher rates to make Aquila's situation sufficiently attractive for GPE to acquire Aquila.

In Case No. ER-2007-0004, Aquila witness Dr. Samuel C. Hadaway testified in his direct testimony, on page 8, lines 8 through 11, "All of the debt issues assigned to either division have been assigned at "investment grade" rates per the Company's ongoing policy to protect its ratepayers from the activities of its non-regulated businesses through its capital assignment process." In that same case, Aquila witness Richard J. Winterman, filed Rebuttal Testimony and attached Schedule RJW-1 that indicated the Company's policy of assigned debt issuances and its related costs for each Missouri division. Staff believes that the no detriment standard would require Aquila to continue apply the same company policy after the merger of GPE and Aquila, and that Missouri ratepayers should not bear the costs associated from the activities of Aquila's non-regulated investments.

Staff has included in this Report GPE's response to Staff Data Request No. 324 where Mr. Winterman assigned debt issuances and their costs from his Schedule RJW-1 in Case No. ER-2007-0004. After adjustments were made due to the retirement of certain debt issuances, Staff indicates in Staff Table A.1 that, for the period 2008 through 2012 Aquila's MPS division will have total debt assigned of ** ___________ ** and an annual interest amount of ** __________ ** with a weighted average cost of debt of ** _____ ** percent. After adjustments were made due to the ** ______________________________ ** Staff indicates in Staff Table A.2 that, for the period 2008 through 2012, Aquila's L&P division will have a total debt assigned of ** ___________ ** and an annual interest amount of ** __________ ** with a weighted average cost of debt of ** _____ ** percent. For the period of 2008 through 2012, the total amount of debt assigned to Missouri is anticipated to be ** ___________ ** and the total interest cost is anticipated to be ** ___________ **. The total weighted average cost of debt for Aquila's Missouri operations, MPS and L&P, for the period 2008 through 2012 is anticipated to be ** _____ ** percent as shown below Staff Table A.2.

**

NP

**

**

**

GPE Table B indicates that Aquila expects Missouri ratepayers to be liable for a total interest expense of ** ______ ** million for 2008-2012, assuming there is no acquisition of Aquila by GPE.

In summary, the difference between GPE Table A's cost of debt of ** ____________ ** and Staff's cost of debt of ** ____________ ** is ** ____________ ** of additional interest costs GPE expects Missouri ratepayers to be liable for, if the proposed transaction closes. The difference between GPE Table B's cost of debt of ** __________ ** and Staff's cost of debt of ** __________ ** is ** __________ ** of additional interest costs GPE expects Missouri ratepayers to be liable for, even if the proposed transaction does not close. Staff notes that none of the tables include expenses that will be associated with the issuance of the GPE's hybrid securities.

**

**

D. Additional Amortization Mechanism

Staff refers in this Report to what GPE/KCPL/Aquila refer to as the additional amortizations mechanism in the Joint application as "Additional Amortization Mechanism." The additional amortization mechanism is noted as follows as Item (e) on page 21 in the "Wherefore" clause of the Joint Application:

> Item (e) Approving the Regulatory Plan, including Aquila's use of the additional amortizations mechanism in its next general rate case after achieving the financial metrics necessary to support an investment-grade rating.

When Staff asked GPE/KCPL to quantify the amount of additional amortization GPE/KCPL expects will be added to Aquila's Missouri rates, if any, in Aquila's next general rate case if the Commission approves GPE/KPCL's request for use of the additional amortizations mechanism in Aquila's future rate cases, GPE responded,

> In the Project Asteroid material prepared by Credit Suisse and presented to the Board of Directors on February 6, 2007, the Asteroid [Aquila] rate increase assumptions indicate that no regulatory amortization is needed to achieve a 21% FFO/Debt ratio.[98]

** ____

____

____

______________________________________ **[99] Schedule MWC-4 attached to Michael W. Cline's direct testimony shows ** ____

______________________________________ **

The additional amortization provision requested in this case should be rejected by the Commission. There are four reasons upon which this Commission should base its rejection of the Joint Applicants' requested additional amortization provision.

The first reason that the GPE/KCPL/Aquila proposed additional amortization should be rejected is that Missouri regulated customers should not subsidize a utility's non-regulated activities. Approval of this feature will cause Aquila's Missouri retail customers to pay costs for

---

[98] Response to Staff Data Request No. 52.
[99] Response to Staff Data Request No. 282.

Aquila's non-regulated activities that Aquila publicly has committed its customers will not be asked to pay, at least before it executed the proposed transaction:

** **[100]

Currently, Aquila shareholders have borne the costs and consequences of Aquila's non-regulated missteps. GPE/KCPL and, Aquila are now seeking to use this acquisition and proposed merger to shift these costs from Aquila shareholders to Aquila ratepayers when GPE becomes the new sole shareholder of Aquila.

The second reason the GPE-Aquila proposed additional amortization should be rejected is that it is not being used to support acknowledged prudent improvements in infrastructure. The additional amortizations in the separate KCPL and Empire regulatory plans were designed to serve this purpose. The additional amortizations in this case are being requested to support an acquisition designed with a fast track debt rating upgrade from junk bond status contingent on regulatory assurance that ratepayers will pay the rates necessary to maintain the investment grade

[100] Aquila Response to Staff Data Request No. 282 asking for access to documents provided to or received from members of Aquila's Board of Directors related to GPE's acquisition of Aquila.

rating. The additional amortization is designed to provide the supporting economics of this acquisition of Aquila and related merger of the Aquila and KCPL systems and operation by providing assurance that the rating agencies need not be concerned about that reliability of the ** ____

________________________________ **

The third reason that the additional amortization should be rejected is that there is no evidence provided by the Joint Applicants that the additional amortization is needed for Aquila to provide utility service to its Missouri customers at current safe and adequate service levels and at current just and reasonable rates. The only need for the amortization is to support the GPE acquisition and merger. The proper bases for mergers do not include causing rates to be higher than they would be absent the merger, except as the consequence of addressing some significant and impending problem. In this case, the creation of the device of these additional amortizations only means that rates to customers will be higher because of their presence as the manifestation of ratepayers being used as a financial tool, causing this proposed merger and acquisition to be detrimental to Missouri consumers and thus detrimental to the public interest.

The fourth reason that the additional amortization should be rejected is that GPE's proposal is an inappropriate use of additional amortizations. The Joint Application request in this proceeding is contrary to the agreement that underlies the KCPL Experimental Regulatory Plan, especially III. B.10.b. at page 52 where the provision following is found:

> This Agreement is based in the unique circumstances presented by KCPL to the Signatory Parties. This Agreement shall not be construed to have precedential impact in any other Commission proceeding.

The additional amortization further seeks to go beyond the conditions set out in III.B.10.d. at page 53 of the KCPL Experimental Regulatory Plan that states:

> This Agreement represents a negotiated settlement. Except as specified herein, the Signatory Parties to this Agreement shall not be prejudiced, bound by, or in any way affected by the terms of this Agreement: (a) in any future proceeding; (b) in any proceeding currently pending under a separate docket; and/or (c) in this proceeding should the Commission decide not to approve this Agreement in the instant proceeding, or in any way condition its approval of same.

The additional amortization provision presented for Commission approval by GPE, KCPL and Aquila goes beyond the limited use to which the Staff and other parties agreed in Case No. EO-2005-0329 (KCPL Experimental Regulatory Plan) and Case No. EO-2005-0263 (Empire Experimental Regulatory Plan). The GPE/KCPL/Aquila additional amortization request has a dampening impact on the possibility of reaching future settlements. Parties are reluctant to reach agreements to experiment with new regulatory approaches when they perceive that the other parties will use selected portions of the agreement against them in future proceedings. This is why the above-quoted sections appear in agreements before the Commission. Unfortunately, generally these sections appear to be of no avail.

E. Affiliate Transaction Rule Waiver

Staff refers in this Report to the request for a variance from the Commission's affiliate transaction rule as the **"Affiliate Transaction Rule Waiver**." Staff recommends the Commission reject the Joint Applicants request in Item (j) of the "Wherefore" clause at page 21 for an Order Granting KCPL and Aquila a waiver from the affiliate transaction rule for three reasons.

Staff asked GPE/KCPL to identify the specific transactions covered by GPE/KCPL's request for the Commission to grant a variance from its' affiliate transaction rule. Staff received the following response:

> Please note that the Joint Applicants' request is for a waiver from the affiliate transactions rules only for transactions between KCPL and Aquila – both public utilities. Joint Applicants are not requesting a waiver for any transactions between the public utilities, on the one hand, and their non-utility affiliates on the other hand. It is anticipated that Aquila employees will be transferred to KCPL upon completion of the merger. Thus, KCPL employees will perform all generation, transmission, distribution and utility support functions for both KCPL and Aquila. These services would be billed or allocated to each respective utility at cost. It is also our intent to purchase and sell power at market prices between utilities until and if such time production is combined and rates reflect the combined entity.[101]

[101] Response to Staff Data Request No. 50.

The merger or consolidation of KCPL and Aquila is outside the scope of the proposed transaction in this case. Thus, no waiver is necessary related to the merger or consolidation of KCPL and Aquila, until such time as such a transaction is before the Commission for approval.

Staff further inquired of GPE/KCPL regarding what safeguards or procedural commitments, if any, GPE/KCPL intend to implement to prevent affiliate abuse if the Commission grants the affiliate transaction waivers requested by the Joint Applicants. Staff received the following response:

> Please note that the requested waiver is only for transactions between KCPL and Aquila. KCPL intends to value non-power transactions between KCPL and Aquila at cost. Wholesale electricity transactions between KCPL and Aquila will be priced as authorized by FERC tariffs. Safeguards will include policy, the cost allocation manual procedures, training and other considerations to prevent affiliate abuse.[102]

The Joint Applicants have requested a waiver that cannot be effectively evaluated or administered. The requested waiver lacks any real detail and also is, in essence, all inclusive. There is no effort by GPE, KCPL or Aquila to set out with any specificity the portions of the affiliate transaction rule to which the waiver would or would not apply, if the requested waiver were granted. The Joint Application states that the portions of the affiliate transaction rule for which KCPL seeks a waiver are "the provisions of the affiliate transactions rule under, 4 CSR 240-20-015, as it might pertain to transactions between Aquila and KCPL." A merger of KCPL and Aquila is not proposed by the Joint Application and in paragraph 46, at page 19, of the Joint Application, GPE and Aquila assert incongruously that "[b]ecause Aquila and KCPL will continue to be regulated by the Commission; the affiliate transaction rule is not applicable to transactions between KCPL and Aquila." GPE/KCPL and Aquila also contend incongruously in paragraph 46, at page 19, of the Joint Application, that they "request waiver from the affiliate transaction rule in order to facilitate transactions between KCPL and Aquila." The only explanation that GPE/KCPL and Aquila offer is that 4 CSR 240-20.015 is limited to preventing regulated utilities from subsidizing their non-regulated operations. Staff does not believe that 4CSR 240-20.015 is so limited. GPE/KCPL's and Aquila's direct testimony and supplemental direct testimony addressing the Commission's Affiliate Transaction Rule is no more expansive than GPE's and Aquila's Joint Application on this matter. The Commission's Affiliate

[102] Response to Staff Data Request No. 51.

Transaction Rule is only addressed two places in all the direct testimony and supplemental direct testimony of GPE/KCPL and Aquila and, if anything, it adds further confusion. GPE/KCPL witness Ms. Wright, Controller of GPE and KCPL, testifies as follows at page 8 of her direct testimony:

> Q: The allocation methods you described above involve the billing of costs to an affiliate company. Do the affiliate transaction regulations as documented in 4 CSR§ 240-20.015 apply to these transactions?
>
> A: The Joint Applicants request that the Commission waive its affiliate transaction rule as it pertains to transactions between Aquila and KCPL to the extent the Commission deems necessary.[103]

GPE/KCPL witness Mr. Terry Bassham also testifies as follows on page 16 of his direct testimony:

> Q: Are there any other requests for relief contained in the Joint Application that you would like to discuss.
>
> A: Yes, as I explain above, the Joint Applicants expect that KCPL and Aquila will be able to achieve significant savings from sharing certain services. To help facilitate the achievement of these savings, to the extent deemed necessary by the Commission, the Joint Applicants request a waiver from the provisions of the affiliate transactions rule, as it pertains to transactions between Aquila and KCPL.[104]

Staff recommends that the Commission deny GPE's and KCPL's request for a waiver from the provisions of the affiliate transaction rule, 4 CSR 240-20.015. Further, Staff recommends that the Commission find that it is premature to grant a waiver for transactions resulting from a merger between KCPL and Aquila that is outside of the scope of the proposed transaction contained in the Joint Application. Once there is a merger plan approved and adopted by KCPL and Aquila's Board of Directors and senior management presented to this Commission for approval, the Commission will have before it the evidence that such a merger will likely occur, as well as an understanding of the magnitude and financial impact of the transactions affected by the waiver to determine whether the "good cause" standard has been satisfied. The merger plan presented to the Commission for approval in such a future case should be of

[103] Direct Testimony of Lori A, Wright, page 8, lines 13 through 18.
[104] Direct Testimony of Terry Bassham, page 16, lines 16 through 22.

sufficient detail to allow an evaluation to determine the extent of the risks posed to service quality during and after the merger transition period.

The Joint Applicants have failed to comply with the Commission requirements for a waiver request from the provisions of the Commission's rules. The Commission rules 4 CSR-240-2.060(4) identifies requirements regarding applications for a waiver from a Commission rule. An application for a waiver shall contain information as follows:

> (A) Specific indication of the statute, rule or tariff from which the variance or waiver is sought;
>
> (B) The reasons for the proposed variance or waiver and a complete justification setting out the good cause for granting the variance or waiver; and
>
> (C) The name of any public utility affected by the variance or waiver.

The Joint Applicants only complied with item(C) above.

The Joint Application fails to identify the specific portion of the Commission's affiliate transaction rule to which the Joint Applicants' waiver request applies, i.e., the Joint Applicants fail to comply with 4 CSR 240-2.060 (4) (A). As a consequence, it appears to Staff that the Joint Applicants also have not complied with 4 CSR 240-2.060 (4) (B).

In the "Request for Waiver of Affiliate Rules" contained in paragraphs 45 and 46 of the Joint Application, the Joint Applicants state, "The Joint Applicants request a waiver from provisions of the affiliate transactions rule under 4CSR 240.20.015, *as it might pertain to transactions between Aquila and KCPL*"(emphasis added). The proposed transaction contained in the Joint Application does not specify the transactions that would require any waiver let alone the nature of the behavior the Joint Applicants intend to practice in lieu of the behavior required to satisfy the Commission's affiliate transaction rule.

The proposed transaction will invoke the Commission's affiliate transaction rules relative to the purchase and sale of energy and capacity because Aquila and KCPL will become affiliates under GPE's common ownership.

6. Other Items

A. Service Quality

I. What Is Service Quality?

Regulated utilities perform many processes and practices including billing, credit and collections, meter reading, payment remittance, call center operations, service or work order processes and service disconnection and reconnection that affect service quality. Service reliability and outage prevention are also critical components of service quality. It is the Staff's opinion that regulated utilities should perform these activities with effective and efficient internal control to promote acceptable service levels for their customers. A significant point in addressing utility service quality in a regulated environment is that utility customers pay for the service they receive, including the staffing, technology, management, training, space, vehicles, equipment and other costs. The Commission has specific rules that govern service quality in a number of areas, including service disconnection and reconnection processes, payment plans during cold weather, customer billing and payment, deposits, meter reading, utility accessibility to its customers, rules regarding registered customers and others.

Service quality performance measurements or metrics are established and used by utilities to determine and monitor the service they are providing to their customers. These measurements are important in that they provide some assurance to utilities, utility customers and utility commissions that a certain level of customer service is being provided. Some aspects of service quality, however, do not lend themselves to indicators. Examples include the consistent application of credit and collection practices, detection of billing errors, the effective training of Customer Service Associates or Representatives to ensure the relaying of accurate and consistent information to customers and courteous treatment of customers by company employees performing service calls.

II. Why Is Service Quality At Risk During A Utility Merger Or Sale Transaction?

There are a number of factors that place service quality at risk during a merger or sale case. Transitions may place additional pressure on the utilities being combined due to the merging of different processes, practices, systems, procedures, cultures, organizational structures and workforces. Transitions may require that a previous focus be shared with determining how to combine two separate systems into one, often with additional pressures of expected efficiencies or synergies and cost savings. New or different ways of operating, while determined to be desirable, may disrupt or disturb stability, security of systems, operations or staffs. In addition, there is a natural human resistance to change. "When uncertainty or ambiguity about the future accompanies change, individuals and even groups will take action based on their perception of how the change will affect them."[105]

Even though both Aquila and KCPL are Missouri regulated utilities providing electric service to a similarly sized Missouri customer bases, they are different companies with different workforces, serving different customer bases through different systems, processes and procedures.

III. What Is The Commission's Service Quality History With Both Aquila, Inc. and KCPL?

a. Aquila, Inc.

The Commission Staff has filed service quality testimony in a number of Aquila cases over the past several years to address service quality concerns identified at the Company, primarily in the area of call center performance, and to request increased reporting for Staff to more carefully monitor the utility. Specifically, Staff filed service quality testimony in Case No. EM-2000-292, (Aquila's merger with St. Joseph Light & Power Company), Case No. EM-2000-369 (Aquila's proposed merger with The Empire District Electric Company), Case No EF-2003-0465 (Aquila's financing case which requested Commission permission to pledge Missouri assets), and Aquila rate Case Nos. ER-2004-0034, GR-2004-0072 and HR-2004-0024. In addition, Staff performed a comprehensive customer service review of Aquila, Inc. in October 2005 which presented approximately 50 recommendations to Aquila management for improvements in Aquila's customer service processes and practices.

In Case No. ER-2004-0034, Staff addressed declining call center performance at Aquila which occurred after the Company's decision to use temporary workers to staff its Raytown call center as a factor in Aquila's declining call center performance. In part, the Company indicated it had utilized temporary staffing as a means to reduce costs. The Company subsequently returned to recruiting, selecting and hiring its own call center staff and staffing at higher levels.

[105] AMA Management Handbook, John J. Hampton, Editor Copyright 1994, p. 9-70.

Staff and the Office of the Public Counsel presently receive monthly call center reports from Aquila, which include: calls offered (or call volume coming into the call center), call center staffing, average speed of answer or (the number of seconds a caller waits before his/her call is answered), abandoned call rate (the percentage of calls that are abandoned by customers prior to being answered by representatives) and Service Levels (a percentage of calls answered within a specified period of seconds). Reports also include estimated meter reading data as well as reliability metrics which measure system outages. Aquila's call center performance has significantly improved in recent history. Staff does not want Aquila's improvements to reverse or decline in a post-merged environment with KCPL. Mr. William Herdegen III, Vice President of Customer Operations, addressed Aquila's anticipated customer service improvements on page 20 of his August 8, 2007, supplemental direct testimony.

b. KCPL

Staff and the Office of the Public Counsel presently receive quarterly reports of monthly service quality data from KCPL, which include total calls offered to the call center, call center staffing including management personnel, average speed of answer and abandoned call rate. To the best of Staff's knowledge, and confirmed by the utilities, both Aquila and KCPL calculate average speed of answer and abandoned call rate in the same manner. At this time, Aquila's performance in the area of average speed of answer and abandoned call rate has been superior to KCPL's performance, although Staff does not currently find KCPL's call center performance problematic. Average speed of answer and abandoned call rate are addressed further later in this Report.

It is Staff's opinion that there are shortfalls in utilizing industry comparisons or comparing one Missouri utility's service quality performance against another. However, such analyses of utility service quality metrics provide some assurance that proposed sales or mergers involving utilities in Missouri service territory do not result in a detriment to an established level of service for the customer bases presently served by each utility.

IV. Regulated Utility Mergers in Missouri Have Resulted in Service Quality Deterioration

While the merger or sale experience of one Missouri utility does not necessarily predict a similar experience for future mergers within the state, it is important to recognize such merger activity that did have documented detrimental impact to Missouri customers. The Commission observed serious customer service declines after Southern Union Company (whose operating division is Missouri Gas Energy (MGE.) acquired Western Resources Inc.'s Missouri gas properties. It is Staff's observation that applications for authority to consummate sales or mergers rarely, if ever, identify the service quality risks associated with the transactions. Prior to the MGE merger, both Southern Union and Western Resources filed testimony with the Commission indicating that the transaction would not be detrimental to the public interest, and that Southern Union was an experienced gas utility and "well versed in providing efficient, safe and reliable service." (Direct testimony of William E. Brown, Western Resources, Inc., Case No. GM-94-40, p. 4 and direct testimony of Eugene N. Dubay, Southern Union Company, Case No. GM-94-40, p. 9.)

As addressed at page five in direct testimony filed by the Commission's then Manager of Consumer Services, Janet Hoerschgen, in an MGE rate case, Case No. GR-98-140, MGE acquired the Western Resources properties in February 1994 and in December of the same year, the Office of the Public Counsel, Staff and MGE filed a joint motion to open a docket to investigate the billing and customer service practices of the merged company. Nine areas were identified for review which included a number of alleged 4 CSR 240-13 rule (customer service quality) violations. The ensuing case, GO-95-177, resulted in 37 recommendations to MGE management in a report filed with the Commission on April 28, 1995. During 1996, complaints reported to the Commission's Consumer Services Department had increased by approximately 75% over those reported prior to the merger.

On July 22, 1996, Staff filed a complaint with the Commission against MGE, alleging several violations of Commission rules and MGE tariffs in Case No. GC-97-33. Subsequently, the Office of the Public Counsel filed a complaint with the Commission alleging MGE unlawfully billed certain customers and sent bills during an unauthorized billing period. This case was docketed as Case No. GC-97-497. MGE customer service problems were issues in its subsequent rate cases which included, among numerous other allegations, MGE's self-reported inaccurate billing of 110,000 residential and 11,000 small and large commercial customers.

MGE's "Customer Service Action Plan" also concluded that MGE did not meet the expectations of customers who called to resolve situations with their gas service or other related issues. The breach of internal control in one area, such as in the case of MGE's billing errors, resulted in significant call volumes to its call center that its staff could not adequately respond to in the post acquired utility. While many factors were identified as causing MGE's service problems, workforce reductions and high rates of employee turnover were attributed to some of the service declines (Wimberley, Direct Testimony, Case No. GR-98-140 p 5, Hoerschgen, Direct Testimony, Case No. GR-1996-285, p 26.) MGE's own review of its business practices during that period provides some indication of how serious the situation was shortly after the merger:

> Current business practices have resulted in a one to three call ratio to customer base. Incoming average monthly calls have increased 99 percent in the last year through May. Today four out of ten customers hang-up versus waiting to speak to a consultant to resolve their situation. Employees' morale is extremely low which has resulted in a high absentee rate and lack of customer focus. Currently, MGE does not meet the expectations of customers who call to resolve situations with their gas service or other related issues. (August 12, 1996 MGE Customer Service Action Plan, pp. 6-7)

As with many service quality processes, the decline or failure in one process can have a negative impact on other processes. MGE's inability to respond to customer calls in an acceptable manner was at least partially responsible for a significant increase in customer calls coming to the Missouri Public Service Commission's Consumer Services Department. As a result, a number of Staff went beyond their normal job duties to assist the Consumer Services Department with customer calls to handle the rise in Commission call volumes. In some cases, MGE customers related to the Staff that they had tried to contact MGE's call center for days with no success in reaching a representative. In addition, Staff spent numerous audit hours on-site at MGE facilities analyzing the utility's service quality declines that were documented in the previously mentioned cases.

V. Present KCPL and Aquila Service Quality Metrics

Staff met with representatives from KCPL and Aquila on September 21, 2007 to discuss the proposed transaction, impacts on service, plans for transitions and potential staffing reductions in the customer service area. Staff has also submitted numerous data requests to both utilities to determine how service quality may be impacted if GPE acquires Aquila. Both utilities have indicated the transaction will not be detrimental to the public interest and they anticipate a net gain of two call center employees for serving KCPL customers and what are now Aquila's Missouri electric customers.

Call centers perform a critical function in utility operations as they provide the primary means for customers to contact their utility. Customers require contact with their utilities for a wide range of issues including: reporting of emergencies and service outages; desires to begin, discontinue, transfer or restore service; questions about bills regarding usage, delinquent accounts; and the ability to make payment arrangements. During the winter months when the Commission's Cold Weather Rule[106] is in effect, call centers may actually be a "life line" for some customers who are nearing service disconnection and need to make payment arrangements. It is always imperative, but particularly so during emergencies and in times of unusually cold and hot weather, that call centers function in an effective manner. As utilities have closed business offices that once accommodated walk-in traffic and provided customers with a utility presence in their community, the role of the call center has become increasingly important as a primary point of contact for utility customers.

Page 21 of Mr. William Herdegen III's supplemental direct testimony provides key customer service metrics used to determine service quality for both Aquila and KCPL. While Aquila and KCPL's actual service quality performance appears to be very similar in the metrics identified, Aquila's performance is presently superior to that of KCPL's on those specific metrics.

Specifically referring to page 21 of Mr. Herdegen's supplemental direct testimony, Aquila's percent of calls answered within 20 seconds for 2006 is superior to KCPL's percentage of calls answered within 30 seconds. In the area of bill accuracy, Aquila has a lower percentage of estimated meter reads and its meter reading accuracy is also slightly better than KCPL's. Staff also calculated Commission complaints for calendar year 2006, and Aquila continues to be slightly better than KCPL in this area:

[106] This rule protects the health and safety of residential customers receiving heat-related utility services by placing restrictions on discontinuing and refusing to provide heat-related utility service from November 1 through March 31 due to delinquent accounts of those customers.

	Customers*	MOPSC Complaints	Complaints Per Thousand Customers
KCPL	271,000	245	.90
Aquila	304,000	242	.79

*Customer Numbers Are Approximate

As stated earlier, average speed of answer and abandoned call rate are two call center metrics that are based on the speed with which calls are answered and the percentage of abandoned calls. Abandoned calls may arise for many reasons, but frequently customer calls are abandoned because of increased wait times. Most commonly, the longer the average speed of answer or wait time for a customer call to be answered by a representative, the higher the abandoned call rate.

As also stated earlier, to the best of Staff's knowledge, and confirmed by the utilities, both Aquila and KCPL calculate average speed of answer and abandoned call rate in the same manner. Below are two tables which present the call center metrics of average speed of answer and abandoned call rates for Aquila and KCPL for 2006 through August 2007:

Abandoned Call Rate				
	Aquila		**KCPL**	
	2006	**2007**	**2006**	**2007**
January	4.80	1.10	1.95	2.62
February	3.40	1.20	2.00	3.37
March	1.60	1.20	6.23	3.61
April	1.60	1.60	5.18	4.69
May	7.20	1.50	4.60	2.72
June	3.60	1.40	3.23	2.38
July	.80		5.92	
August	1.30		3.70	
September	1.30		1.96	
October	1.50		2.29	
November	.50		3.00	
December	.70		1.31	

Average Speed of Answer				
	Aquila		KCPL	
	2006	2007	2006	2007
January	54	7	26	18
February	40	9	30	30
March	18	12	46	31
April	18	16	38	40
May	78	16	32	24
June	39	14	28	18
July	9		45	
August	14		34	
September	14		23	
October	14		21	
November	3		30	
December	5		14	

Source: Aquila and KCPL Service Quality Reports Provided to the Staff and the Office of the Public Counsel as a result of Case Nos. EO-2005-0329 and ER-2004-0034.

As can be seen from the tables, Aquila's service quality performance regarding these two call center metrics has generally been superior to KCPL's performance.

Call Center Staffing

Aquila and KCPL have indicated to Staff that there will be no net reductions in call center staff from either utility in the combined organization. The Missouri jurisdictional allocated headcounts of Aquila's present call center of approximately 49 staff and KCPL's approximate 70 head count will be combined initially. In addition, KCPL has indicated its intent to hire an additional 12 Customer Care staff (call center employees) to handle what is anticipated to be a 10 to 15% increase in call volumes after the transition.

Service Centers

Mr. Herdegen's supplemental direct testimony also identifies plans to reduce the planned Kansas City District from 11 service centers to six, with the remaining districts of the East, Southeast, South and North being operated with the same number of service centers as presently exist. While the Company points to increased efficiencies by combining service centers in the Kansas City area, as well as improved service to customers, Staff cautions that Commission rules govern the length of time for service reconnections and the reduction in service centers should not impede compliance with these rules.[107]

VI. Staff's Recommendation Should The Merger Be Approved

Staff recommends that all service quality reporting that is currently in place for both utilities be submitted to Staff and the Office of the Public Counsel on a monthly basis. Staff also recommends that KCPL, as expressed in Mr. Herdegen's testimony, conduct periodic meetings with Staff to discuss key aspects of the transition's progress, including but not limited to the area of billing, credit and collections, service order processes, call center, meter reading and payment remittance.

B. Customer Billing Data Retention

Billing data is the information that a utility uses to calculate customers' monthly bills. It includes, at a minimum, the rate used to billed the customer, the date the customer's meter is read and the measurement of the customer's electricity usage since the prior reading, e.g., energy, demand, etc. The type and amount of information collected is specific to the rate structure used to bill the customer.

Billing information is necessary for forecasting a utility's energy usage. If billing data is not available, the rate analyst does not have the utility specific information required to reasonably forecast future energy needs. Since identifying trends is an important component of forecasting, it is important to have a long-term series of data. If the rate analyst only has a limited amount of data, trends in energy usage may not be identified correctly, if they can be identified at all.

Keeping a long term series of billing data requires not only retaining the existing information but also maintaining it in a useable format. Care must be taken in retaining customer information so that customers can be grouped into homogenous classes across time. When utilities merge, it is important that the surviving utility obtain and preserve the customer billing data prior to the merger in a format suitable for use in future forecasts.

In addition to using billing information for forecasting, when changes in utility rate structures are proposed, multiple years of billing information may be utilized to determine the

[107] 4 CSR 240-13.050 (11) and 4 CSR 240-13.055 (5)(B).

impact of the proposed changes. Billing information is also used in the calculation of normalized revenues in rate cases.

C. The Kemp Study

In GPE witness William J. Kemp's supplemental direct testimony, he compares KCPL's estimated synergies with what he calls the "realized" synergies from 15 other utility merger transactions. These supposed "realized" synergies are based upon data received from a SNL Financial (Regulatory Research Associates) database which contained information from the Federal Energy Regulatory Commission (FERC) Forms 1 and 2 for each utility. For his analysis GPE witness Kemp used expenses incurred by each merging utility the year before the merger was announced and applied a factor based upon the Consumer Price Index (CPI) to the expenses to arrive at the expenses adjusted to 2006 dollars. The same calculations were performed for the expenses incurred by the merging utilities for the third year after the merger was consummated. He then compared the expenses adjusted to 2006 dollars the year before the merger and the expenses adjusted to 2006 the third year after the merger to arrive at the alleged savings due to the merger. For example, Mr. Kemp used the Union Electric Company and CIPSCO, Inc. merger that was consummated on December 31, 1997, as one of his comparable mergers. Calendar years 1997 and 2001 data were adjusted to 2006 dollars and compared. This comparison is supposed to show any merger savings, i.e., whether the 2001 expense levels are less than the 1997 expense levels.

Mr. Kemp's use of expenses adjusted to 2006 dollars is not an accurate look at the true expenses incurred for the merging utilities before and after the mergers as chosen for this comparison. If one were to compare the actual expenses before and after the mergers, without application of the CPI, only five of the 15 mergers achieved lower total non-fuel operation and maintenance (O&M) expense levels in the third year after the merger than the year before the merger.

FERC Cost Data for Mergers

% Changes in Expense Before Merger and Expense After Merger (includes Electric Cust Accts-Uncollectible Accts)

Acquiror (or Larger Entity)	Acquiree	Total Non-Fuel O&M	Gen Non-Fuel O&M	Trans O&M	Dist O&M	Cust Serv	Sales	A&G
Ameren Corp	CILCORP	-9%	-20%	-17%	24%	-12%	-53%	-14%
Ameren	Illinois Power Company	2%	-6%	-33%	37%	0%	-34%	-5%
American Electric Power Company	Central & South West Corp	6%	16%	-5%	17%	-8%	-96%	-5%
Carolina Power & Light Company	Florida Progress Corp	22%	24%	14%	0%	-18%	-31%	76%
Unicom	PECO Energy	-57%	-100%	-26%	1%	-26%	-87%	-24%
Consolidated Edison Company of NY	Orange & Rockland Utilites, Inc.	-33%	-86%	0%	14%	-11%	-9%	-52%
Delmarva Power & Light Company	Atlantic Energy, Inc.	-45%	-109%	32%	15%	135%	839%	-42%
Energy East Corp	Central Maine Power Company	-10%	-85%	16%	27%	-12%	-24%	-15%
FirstEnergy Corp	GPU, Inc.	205%	124%	207%	-5%	-29%	-92%	30%
LG&E Energy LLC	Kentucky Utilities Company	7%	-3%	33%	-15%	-21%	-97%	46%
Nevada Power Company	Sierra Pacific Power Company	117%	608%	91%	-2%	18%	-59%	9%
Northern States Power Company	New Century Energies, Inc.	27%	26%	69%	-8%	2%	-52%	61%
Ohio Edison Company	Centerior Energy	11%	12%	78%	-3%	8%	440%	-5%
Potomac Electric Power Company	Conectiv Energy, Inc.	52%	615%	19%	-1%	-16%	15%	41%
Union Electric Company	CIPSCO Inc.	10%	-9%	1%	36%	23%	-48%	17%
	Average	20%						

In *Re St. Joseph Light & Power Co.*, Case Nos. ER-93-41, et al., Report and Order, 2 Mo.P.S.C.3d 248, 259 (1993), SJLP proposed a 5-year historical maintenance expense average, adjusted for inflation by use of the CPI. The Commission adopted a 5-year historical maintenance expense average, but the Commission found no reasonable basis to, in addition, adjust the maintenance expense based on the CPI:

> . . . The Consumer Price Index only reflects certain portions of national price increases and is not related to company-specific information. The Commission does not believe maintenance expense set upon a national Consumer Price Index is reasonable. Each company is different and expense adjustments should be set on an individual company's expenses and not upon statistical extrapolation based on an index which measures a wide array of unrelated prices.

2 Mo.P.S.C.3d at 259.

The Commission stated in *Re Kansas City Power & Light Co.*, Case Nos. EO-85-185, et al., Report and Order, 28 Mo.P.S.C.(N.S.) 228, 281 (1986), "The Commission reiterates its position set out in Re: *Union Electric Company*, 27 Mo.P.S.C.(N.S.) 183 (1985). Industry comparisons do not establish a standard of prudence."

GPE witness Kemp's "realized" merger savings analysis does not include amounts recorded in the Uniform System of Accounts (USOA) Account 904 for electric operations in his calculation of the Customer Service and Total Non-Fuel O&M expense areas. Staff's comparison of actual expenses incurred one year before the merger and actual expenses incurred the third year after the merger was consummated contains the amounts recorded in USOA Account 904 for Uncollectible Accounts. A comparison of the actual amounts recorded in Account 904 reveals on average a 28 % increase from the year before the merger and the third year after the merger was final. By not including these amounts, witness Kemp's "realized" merger savings are greater than if he would have included these amounts in his analysis

<u>INCOMPLETE WORKPAPERS</u>

Mr. Kemp's initial set of workpapers were incomplete and did not allow a complete review of how Mr. Kemp arrived at his figures to show merger savings. The first set did not contain the names of all of the utilities he used in the calculations and what expense items were included in each of his functional expense areas. His initial workpapers did not provide the names of the operating divisions and/or subsidiaries that were included in each of the 15 merger examples. For example, Mr. Kemp had to combine the expenses reported for 10 separately reported divisions and/or subsidiaries to arrive at the total expenses for the American Electric Power Company, Inc. and Central and South West Corporation merger. Mr. Kemp also did not indicate what expenses were included in each of the expense categories. Mr. Kemp has subsequently provided the formulas he used. They are still being reviewed by Staff to determine the accuracy of the numbers. The formulas were provided to Staff after a second request for more information concerning Mr. Kemp's workpapers.

DESCRIPTION OF CPI (%=Relative Importance @ 12/06)

The Consumer Price Index is a measure of the average change paid by consumers for a market group of goods and services over a period of time. Witness Kemp uses the "Official CPI" which is the U.S. City Average for All Items, 1982-1984=100 (CPI-U). Over 200 goods and services are included in this index. The following is a list of some of the items included in the CPI.

Food and Beverages (*14.992%)*
Cereal, bakery products, meats, poultry, fish, eggs, dairy products, fruits, vegetables, beverages, service meals and snacks

Housing (*42.691%)*
Shelter, fuel oil, utility gas service, electricity, furniture, appliances, tools, household cleaning supplies

Apparel (*3.726%)*
Men's apparel, women's apparel, boy's apparel, girl's apparel, footwear, jewelry

Transportation (*17.249%)*
New vehicles, Gasoline, motor vehicle maintenance, motor vehicle insurance, airline fare

Medical Care (*6.281%)*
Prescription drugs, physician services, hospital services, health insurance, eyeglasses

Recreation (*5.552%)*
Television, pets, sporting goods, photography, toys, newspapers, memberships

Education and Communication (*6.034%)*
Tuition, postage, telephone service, computer software and accessories

Other Goods and Services (*3.476%)*
Tobacco, personal care products, legal services, funeral expenses, laundry and dry cleaning