

Exhibit No.:

Issue: Merger Savings; Aries Unit

Witness: Mark L. Oligschlaeger

Sponsoring Party: MoPSC Staff

Type of Exhibit: Rebuttal Testimony

Case Nos.: ER-2004-0034 and  
HR-200--0024  
(Consolidated)

Date Testimony Prepared: January 26, 2004

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

**REBUTTAL TESTIMONY**

**OF**

**MARK L. OLIGSCHLAEGER**

**AQUILA, INC. D/B/A**

**AQUILA NETWORKS MPS-ELECTRIC**

**AQUILA NETWORKS L&P-ELECTRIC AND STEAM**

**CASE NOS. ER-2004-0034 AND HR-2004-0024  
(Consolidated)**

*Jefferson City, Missouri  
January 2004*

**FILED**<sup>3</sup>  
APR 28 2004  
Missouri Public  
Service Commission

Exhibit No. 65  
Case No(s) ER-2004-0034  
Date 2/23/04 Rptr KF

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

In the matter of Aquila, Inc. d/b/a Aquila Networks )  
L&P and Aquila Networks MPS to implement a ) Case No. ER-2004-0034  
general rate increase in electricity. )  
)  
In the matter of Aquila, Inc. d/b/a Aquila Networks )  
L&P to implement a general rate increase in Steam ) Case No. HR-2004-0024  
Rates. )

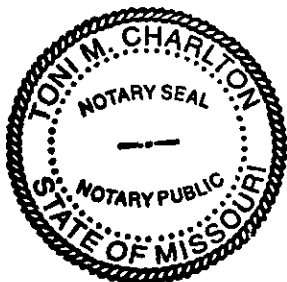
AFFIDAVIT OF MARK L. OLIGSCHLAEGER

STATE OF MISSOURI     )  
                                  )     ss.  
COUNTY OF COLE     )

Mark L. Oligschlaeger, of lawful age, on his oath states: that he has participated in the preparation of the following rebuttal testimony in question and answer form, consisting of 36 pages to be presented in the above case; that the answers in the following rebuttal testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Mark L. Oligschlaeger  
Mark L. Oligschlaeger

Subscribed and sworn to before me this 23RD day of January 2004.



Toni M. Charlton  
Notary Public

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

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12

**TABLE OF CONTENTS**  
**REBUTTAL TESTIMONY OF**  
**MARK L. OLIGSCHLAEGER**  
**AQUILA, INC.**  
**d/b/a AQUILA NETWORKS-MPS-ELECTRIC**  
**AND AQUILA NETWORKS-L&P-ELECTRIC AND STEAM**  
**CASE NOS. ER-2004-0034 AND HR-2004-0024**  
**(Consolidated)**

MERGER SAVINGS..... 2  
ARIES UNIT..... 20

1 **REBUTTAL TESTIMONY**

2 **OF**

3 **MARK L. OLIGSCHLAEGER**

4 **AQUILA, INC.**

5 **d/b/a AQUILA NETWORKS-MPS-ELECTRIC**

6 **AND AQUILA NETWORKS-L&P-ELECTRIC AND STEAM**

7 **CASE NOS. ER-2004-0034 AND HR-2004-0024**

8 **(Consolidated)**

9  
10 Q. Please state your name and business address.

11 A. Mark L. Oligschlaeger, P.O. Box 360, Suite 440, Jefferson City, MO 65102.

12 Q. Are you the same Mark L. Oligschlaeger who has previously filed direct  
13 testimony in this proceeding?

14 A. Yes, I am.

15 Q. What is the purpose of your rebuttal testimony?

16 A. The purpose of this testimony is to address the direct testimony filed by  
17 Aquila, Inc. (Aquila/UtiliCorp or Company) d/b/a Aquila Networks – MPS (MPS) and Aquila  
18 Networks L&P (L&P) witnesses Vern J. Siemek and Keith G. Stamm on the issue of Merger  
19 Savings, and to address the direct testimony of Aquila witnesses Lisa A. Starkebaum and  
20 Jerry G. Boehm on the issue of the Aries Unit Purchased Power Agreement.

21 Q. Was Mr. Siemek deposed by the Staff on the issue of merger savings?

22 A. Yes, on December 30, 2003.

1 **MERGER SAVINGS**

2 Q. What is Aquila/UtiliCorp's proposed treatment of merger savings in this case  
3 related to its merger and acquisition transaction with St. Joseph Light & Power Company in  
4 2000?

5 A. As stated in the direct testimony of Mr. Siemek, Aquila/UtiliCorp proposes to  
6 pass on to customers in rates in this proceeding the benefit of only one-half of the merger  
7 savings it has calculated from the L&P transaction, rather than reduce its requested rate  
8 increase by the full amount of these savings. Mr. Siemek provides the following reasons in  
9 his direct testimony why he believes a 50/50 sharing of merger savings between  
10 Aquila/UtiliCorp and its customers is appropriate:

11 1) *Retaining 50% of the merger savings is equitable in lieu of not*  
12 *reflecting the costs of the L&P acquisition in rates;*

13 2) *Aquila/UtiliCorp has not "realized" any of the benefits of the savings*  
14 *generated from the L&P transaction since it was entered into; and*

15 3) *Allowing Aquila/UtiliCorp to retain 50% of the merger savings will*  
16 *provide an incentive for further merger and acquisitions to take place.*

17 Q. What is the Staff's position on the proposed sharing of merger savings?

18 A. As explained previously in testimony in other cases, the Staff is not opposed to  
19 the sharing of merger savings through the vehicle of regulatory lag. However, the Staff is  
20 opposed to Aquila/UtiliCorp's proposed method for sharing merger savings in this case for  
21 the following reasons:

22 1) *Aquila/UtiliCorp has had an adequate opportunity to benefit from*  
23 *merger savings through regulatory lag since the L&P merger was entered into, and*

1 special rate measures to allow the Company further opportunity to retain merger  
2 savings are not necessary;

3 2) The Company's merger savings sharing proposal will have the effect of  
4 taking Aquila/UtiliCorp off "cost-based rates;"

5 3) Allowing sharing of merger savings in these circumstances would be  
6 allowing inappropriate indirect recovery in rates of the L&P acquisition adjustment  
7 and transaction costs;

8 4) The Commission should not be providing rate "incentives" for merger  
9 and acquisitions, either in general or for Aquila/UtiliCorp specifically; and

10 5) Contrary to Mr. Siemek's suggestion, any merger savings associated  
11 with the L&P transaction since it has been implemented have been fully realized by  
12 the Company.

13 Each of these points will be addressed in my and other Staff witnesses' rebuttal  
14 testimony on this issue.

15 Q. What other Staff witnesses are also providing rebuttal testimony on this issue?

16 A. Staff Auditing witnesses Cary G. Featherstone, Steve M. Traxler and Janis E.  
17 Fischer are also providing testimony on the issue of merger savings.

18 Q. What upfront costs can a utility incur in undertaking a merger and acquisition  
19 transaction?

20 A. Utilities frequently pay a higher price for the assets of an acquired utility than  
21 the net book value of the assets on the acquired utility's books would indicate. An  
22 "acquisition adjustment" is commonly defined as the difference between the price paid for the  
23 assets and the net book value of the assets acquired. Acquisition adjustments are also

Rebuttal Testimony of  
Mark L. Oligschlaeger

1 sometimes called "merger premiums." A utility normally will also pay certain upfront  
2 banking and legal fees related to the merger/acquisition attempt, called "transaction costs."  
3 For financial reporting purposes, it is my understanding that utilities should combine the  
4 amount of transaction costs and the amount of any payment above net book value of assets  
5 acquired into one amount, and charge it to the Acquisition Adjustment account in the Federal  
6 Energy Regulatory Commission Uniform System of Accounts. In this testimony, when I refer  
7 to the L&P "acquisition adjustment," I will be referring to both the transaction costs related to  
8 the L&P merger and the amount paid by Aquila for the L&P properties above the net book  
9 value of those properties on L&P's books.

10 Q. After a utility completes a merger/acquisition transaction, how can the  
11 company recover an acquisition adjustment in rates?

12 A. A utility can recover an acquisition adjustment directly through rates through  
13 inclusion in rate base of the acquisition adjustment and/or an amortization to expense of the  
14 acquisition adjustment, or can achieve indirect recovery of the acquisition adjustment by  
15 retaining the benefits of merger savings for a period of time.

16 Q. Has the Staff ever recommended that the Commission allow direct recovery of  
17 acquisition adjustments in rates?

18 A. No. The Staff is opposed to direct recovery of acquisition adjustments in rates  
19 for the reasons stated in my direct testimony in this proceeding.

20 Q. Has the Commission ever allowed direct recovery of acquisition adjustments in  
21 customer rates?

22 A. No.

1 Q. As an alternative to the recovery of acquisition adjustments directly in rates,  
2 how can utilities retain the benefits of mergers and acquisitions for a period of time before  
3 passing on those benefits to customers in rates?

4 A. Generally, there are two different ways for utilities to retain merger benefits for  
5 a period of time: 1) through the phenomenon of regulatory lag; or 2) through a merger savings  
6 sharing proposal such as that proposed by Aquila/UtiliCorp in this case.

7 Q. What is "regulatory lag?"

8 A. As defined in my direct testimony, regulatory lag is the passage of time  
9 between when a utility's financial results change, and when that change is reflected in the  
10 utility's rates.

11 Q. How does regulatory lag allow for a company such as Aquila/UtiliCorp to  
12 retain merger savings for a period of time?

13 A. If this Commission approves a merger and acquisition transaction, the rates for  
14 the merging utilities will not change at that point. Therefore, if a merging utility can generate  
15 savings from the transaction, the utility derives a direct and immediate benefit from those  
16 savings because its rates will reflect a higher cost of service than it will actually experience  
17 following the merger. This situation will then persist until the utility's rates change, either as  
18 a result of a rate increase application from the company in question or as a result of a  
19 complaint application filed by the Staff or another party to reduce rates.

20 Q. Does regulatory lag allow for a sharing of merger savings between a utility's  
21 shareholders and its customers?

22 A. Yes. Due to the existence of regulatory lag, a utility can retain 100% of the  
23 benefit of any achieved merger savings until its rates change because of a regulatory



1 proceeding. After the company's rates change to reflect the lower post-merger costs, the  
2 utility's customers then will receive the benefit of 100% of the achieved merger savings to  
3 date. The longer a utility can avoid filing a rate proceeding, or being the subject of a rate  
4 complaint, the more its shareholders can benefit from merger savings through regulatory lag.  
5 Once rates are changed to reflect merger savings achieved to a point in time, any additional  
6 merger savings then created by the utility over the level reflected in rates can again be  
7 retained 100% for the benefit of shareholders until rates are changed.

8 Q. What is the Staff's position on use of regulatory lag to determine how much  
9 savings a utility is able to retain over time?

10 A. The Staff favors regulatory lag as a means of apportioning merger savings  
11 between utility customers and shareholders. Regulatory lag provides an incentive for utilities  
12 to maximize merger savings and avoid filing rate increase cases, so that a company can retain  
13 merger savings for as long as possible before the savings are passed on to customers in rates.  
14 Regulatory lag also allows for the utility the opportunity to recover some portion of its  
15 acquisition adjustment from retention of merger savings, before such savings are passed on to  
16 customers through a rate change.

17 Q. Has regulatory lag been the method used in this jurisdiction to apportion  
18 merger savings between utility shareholders and customers?

19 A. Yes. I am not aware of any time in which the Commission has ordered use of  
20 explicit merger savings proposals, such as Aquila/UtiliCorp's scheme in this case, as a means  
21 to share savings between shareholders and customers.

22 Q. What treatment of merger savings did Aquila/UtiliCorp seek in its merger  
23 application before the Commission for the L&P acquisition, Case No. EM-2000-292?

1           A.     The Company asked for a number of special ratemaking arrangements from the  
2 Commission in its application for approval of the L&P transaction.  These ratemaking  
3 arrangements included a five-year rate moratorium for its new L&P division, so that  
4 Aquila/UtiliCorp could retain the benefit of merger savings for that division for that full  
5 period of time.  For its MPS division, Aquila/UtiliCorp did not ask for a rate moratorium.  
6 Because the Company planned a rate increase application for its MPS division for shortly  
7 after completion of the L&P merger, Aquila/UtiliCorp sought another special rate  
8 arrangement that would apply to future MPS rate applications; specifically that the MPS  
9 corporate allocation factors be “frozen” for a period of time at pre-merger levels.  Since a  
10 reduction of corporate allocation factors for Aquila/UtiliCorp divisions such as MPS  
11 following a merger was held by the Company to be a source of merger savings, “freezing”  
12 such corporate allocation factors would serve to preserve those merger savings for retention  
13 by shareholders, even if Aquila/UtiliCorp initiated MPS rate proceedings after the merger.

14           There were other features of the Company’s requested post-merger treatment of L&P  
15 merger savings and costs, which were referred to in entirety as the “regulatory plan.”

16           Q.     Did the Staff oppose Aquila/UtiliCorp’s regulatory plan?

17           A.     Yes.

18           Q.     Did the Commission rule on the Company’s proposed regulatory plan for the  
19 Aquila/UtiliCorp – L&P merger in Case No. EM-2000-292, the merger application?

20           A.     Yes, the Commission rejected the proposed regulatory plan, stating that the  
21 Company could seek rate treatment of merger savings and costs in rate proceedings following  
22 the merger.

Rebuttal Testimony of  
Mark L. Oligschlaeger

1 Q. After the Commission issued its Order in Case No. EM-2000-292 approving  
2 the L&P merger, but rejecting the regulatory plan, could Aquila/UtiliCorp have sought to  
3 terminate the merger transaction if it was displeased with the terms of the Missouri  
4 Commission regulatory approval?

5 A. Yes.

6 Q. Was Aquila/UtiliCorp aware at the time of the Commission's Order in the  
7 merger application that regulatory lag was the traditional method used in this jurisdiction for  
8 sharing of merger savings between utility customers and shareholders?

9 A. Yes. This topic was examined extensively in the testimony filed by the parties  
10 in the merger proceeding in Missouri, Case No. EM-2000-292.

11 Q. Since Case No. EM-2000-292, has the Staff or any other party initiated a rate  
12 complaint proceeding against Aquila/UtiliCorp?

13 A. No. However, the Company filed for increased rates for its MPS division in  
14 Case No. ER-2001-672 approximately six months after the closing of the L&P merger  
15 transaction. As a result of its review of the Company's rate increase application, the Staff  
16 then filed a rate complaint case with the Commission against Aquila/UtiliCorp. Case No.  
17 ER-2001-672 ended with a negotiated rate reduction of \$4.25 million.

18 Of course, Aquila/Utilicorp has also filed for rate increases for the electric operations  
19 of its MPS division, and the electric and steam operations of its L&P division, in the instant  
20 rate proceeding.

21 Q. Did Aquila/UtiliCorp fully control the timing of the instant rate filing?

22 A. Yes.

23 Q. When was the L&P transaction closed?

1 A. The Aquila/UtiliCorp – L&P merger was closed on December 31, 2000.

2 Q. When was this rate proceeding filed?

3 A. Aquila/UtiliCorp filed this rate proceeding on July 3, 2003. If this rate case  
4 process takes the full eleven months allowed by law, that means that the Company will be  
5 able to retain all of its achieved merger savings for approximately 3.5 years after closing the  
6 merger, before prospectively passing them on to its customers in rates.

7 Q. Does the Staff consider potential retention of all merger savings by the  
8 Company for up to 3.5 years to be adequate retention of the savings before they are  
9 prospectively passed on in rates to the benefit of Aquila/UtiliCorp customers?

10 A. Yes. Certainly, no special rate mechanism is necessary to allow Company  
11 shareholders further opportunity to keep the benefit of these merger savings.

12 Q. What were Aquila/UtiliCorp's estimates of the merger savings it would be able  
13 to achieve during the first three years of the L&P merger?

14 A. In the Company's merger application in Case No. EM-2000-292,  
15 Aquila/UtiliCorp presented estimates of the merger savings it planned to achieve during the  
16 first ten years of the merger. Based upon the testimony of Company witness Siemek in that  
17 proceeding, the Company expected to achieve cumulative savings of \$36.4 million by the  
18 conclusion of the third year of the L&P merger.

19 A copy of one of Mr. Siemek's workpapers from Case No. EM-2000-292 showing the  
20 Company's estimated merger costs and savings for the first ten years following the merger is  
21 attached as Schedule 1 to this rebuttal testimony. To derive the \$36.4 million cumulative  
22 savings figure I reference above, add the results for line III, "Total Synergies, net of Costs to  
23 Achieve," for the years 2001, 2002 and 2003.

Rebuttal Testimony of  
Mark L. Oligschlaeger

1 Q. Does the Staff consider a savings amount of \$36.4 million to be significant and  
2 material?

3 A. Yes.

4 Q. What are the Staff's overall conclusions on the equity of the Company's  
5 proposal for merger savings sharing in this case?

6 A. The Staff's overall conclusion is that Aquila/UtiliCorp, by its proposal to share  
7 merger savings, is attempting to convince the Commission to adopt an inappropriate approach  
8 to treatment of merger savings in rates and abandon its long-standing traditional approach to  
9 the treatment of merger savings in rates (regulatory lag). This is after Aquila/UtiliCorp will  
10 have benefited for over three years by that traditional approach. Aquila/UtiliCorp has  
11 retained any and all merger savings that have been achieved from the L&P acquisition in  
12 entirety for over three years. Now, having made the decision to file a rate increase  
13 application, the Company is requesting that the Commission allow it to abandon traditional  
14 regulatory practices and to retain certain merger savings for an unlimited period. This  
15 proposal is unfair and inequitable to Aquila/UtiliCorp's customers, who deserve the full  
16 reflection of Aquila's L&P merger savings in the rates they will pay as a result of the instant  
17 rate proceeding. This is particularly true in the context of Aquila/UtiliCorp's current request  
18 to significantly increase electric rates for its MPS and L&P customers.

19 Q. What are "cost-based" rates?

20 A. The cost-based rate methodology means that a utility's rates are based on the  
21 utility's actual costs, including operating expenses, depreciation, taxes and a return on rate  
22 base. The utility's actual costs may be adjusted for various reasons before being reflected in  
23 rates, but cost-based ratemaking means the utility's actual costs are the starting point of the

1 analysis. Setting rates on a hypothetical cost level, as the Company is proposing in this  
2 proceeding, does not conform to cost-based ratemaking.

3 Q. How does the Company's merger savings sharing proposal violate cost-based  
4 ratemaking principles?

5 A. Aquila/UtiliCorp has asked the Commission to ignore, for rate purposes, the  
6 existence of 50% of certain purported merger-related savings. Acceptance of this proposal  
7 would mean that the Company's MPS and L&P divisions' rates would be based upon a level  
8 of expenses that are inflated above these divisions' actual cost levels.

9 Q. Has this Commission ever approved rates for utility companies that are not  
10 consistent with cost-based ratemaking?

11 A. Yes, in unusual circumstances. The Commission has approved the use of  
12 experimental alternative regulation sharing plans for Southwestern Bell Telephone Company  
13 (SWBT) and Union Electric Company d/b/a AmerenUE (AmerenUE), which allowed for a  
14 portion of any of these utilities' earnings above certain return on equity levels to be paid out  
15 to customers in the form of annual credits, as opposed to being reflected in a permanent rate  
16 reduction. This treatment resulted in customers potentially receiving some benefit from  
17 ongoing expense reductions made by utilities, while avoiding the need for time-consuming  
18 and expensive excess revenue complaint proceedings. Both the SWBT and the AmerenUE  
19 experimental alternative regulation sharing plans are no longer in effect. At the conclusion of  
20 both these plans, the Staff filed major excess revenues complaint cases, and significant rate  
21 reductions ultimately occurred (one by a last minute settlement and one after evidentiary  
22 hearings). The AmerenUE experimental alternative regulation plan proved to be particularly

1 contentious. The determination of the sharing credits for the year July 1, 1997 to June 30,  
2 1998 is on appeal to the Missouri Court of Appeals Western District.

3 A number of gas local distribution companies (LDCs) in Missouri have also operated  
4 under sharing mechanisms in relation to their gas cost expense.

5 Q. Is Aquila/UtiliCorp's current proposal for merger savings sharing in any way  
6 analogous to the sharing mechanisms previously approved for SWBT and AmerenUE?

7 A. No. Both of these utilities had a history of overearning from the Staff's  
8 perspective at the time their incentive sharing mechanisms were put in place by the  
9 Commission. Therefore, the effect of these incentive sharing plans was to trade off the  
10 opportunity for annual rate credits for customers of these utilities in place of some amount of  
11 permanent rate reductions. In contrast, Aquila/UtiliCorp is asking that the amount of  
12 permanent rate increases for its customers be increased to allow it to recover a hypothetical  
13 level of expenses that is greater than Aquila/UtiliCorp's actual costs of providing utility  
14 service in Missouri. There is no apparent customer benefit that would be related to the  
15 immediate benefits this scheme would create for Company shareholders. Aquila/UtiliCorp's  
16 requested use of a hypothetical expense level to increase rates in Missouri is unprecedented.  
17 It is also unfair and inequitable.

18 Q. Are other Staff witnesses addressing the matter of cost-based ratemaking?

19 A. Yes. Staff witness Featherstone is also addressing this subject matter in his  
20 rebuttal testimony.

21 Q. Did Aquila/UtiliCorp pay an acquisition adjustment for the L&P properties?

22 A. Yes. I referenced in my direct testimony in this proceeding the Company's  
23 response to Staff Data Request No. 381 from Case No. ER-2001-672, that stated that

1 Aquila/UtiliCorp paid an acquisition adjustment of approximately \$108 million for the L&P  
2 properties at the time of the merger closing. I have since become aware that the Company has  
3 adjusted the value of the L&P acquisition adjustment since the last MPS rate proceeding, and  
4 the value of the acquisition adjustment is now approximately \$117 million (Response to Staff  
5 Data Request No. 518 in Case No. ER-2004-0034).

6 Q. Has the Commission ever allowed recovery of acquisition adjustments in  
7 rates?

8 A. No.

9 Q. Is the Staff opposed to acquisition adjustment recovery in rates?

10 A. Yes, for the reasons stated in my direct testimony.

11 Q. Is the Company seeking explicit rate recognition of the L&P acquisition  
12 adjustment in this case?

13 A. No. However, if the Commission accepts Aquila/UtiliCorp's merger savings  
14 proposal, the result will be indirect recovery of at least a portion of Aquila/UtiliCorp's  
15 acquisition adjustment.

16 Q. Why will a proposal to share certain merger savings result in indirect recovery  
17 of a portion of the Company's acquisition adjustment?

18 A. As previously discussed, the Company's merger savings sharing proposal will  
19 result in rates based on a higher level of expense than that actually incurred by  
20 Aquila/UtiliCorp. For financial reporting purposes, the increment of expense reflected in  
21 rates higher than the Company's actual cost levels will be reflected as additional profit, and  
22 will effectively result in a return of and return on a portion of the Company's acquisition  
23 adjustment for the L&P properties.



1 Q. Will the amount of merger savings retained by Aquila/UtiliCorp under its  
2 proposal allow the Company to fully recover the costs of the acquisition adjustment?

3 A. The Staff does not know. However, the Staff believes that acceptance of the  
4 Company's merger savings sharing proposal will result in a recovery of a significant portion  
5 of the acquisition adjustment.

6 Q. Please explain.

7 A. Under current financial reporting rules, Aquila/UtiliCorp is not required to  
8 amortize its acquisition adjustment to expense unless its merger investment is judged to be  
9 impaired in some fashion. Therefore, absent evidence of impairment, the cost of the  
10 acquisition adjustment to the Company is the return on this investment.

11 In this case, the Staff's recommended pre-tax rate of return is 10.09%, based upon the  
12 mid-range return on equity (ROE) recommendation of 9.14% made by Staff witness David F.  
13 Murray of the Financial Analysis Department, with that ROE grossed up for taxes by a factor  
14 of 1.60. Applied to the acquisition adjustment amount of \$117 million, this results in an  
15 annual overall return requirement for the L&P acquisition adjustment of \$11.8 million. This  
16 amount should be compared to the amount of savings Aquila/UtiliCorp is proposing it be  
17 allowed to retain in this case of approximately \$5.75 million.

18 Q. Would indirect recovery of the acquisition adjustment through a merger  
19 savings sharing proposal be applicable to Missouri operations only?

20 A. The Company's position is that all domestic divisions of Aquila/UtiliCorp  
21 should allow sharing of L&P merger savings to account for the alleged benefits received by  
22 these divisions in the reduction in post-merger corporate allocation factors applied to each

1 division. In fact, the Company requested authorization of a merger savings sharing scheme  
2 related to the L&P merger from the Iowa Utilities Board (IUB) in a rate proceeding in 2002.

3 Q. What was the IUB's response to this merger savings sharing request?

4 A. Aquila/UtiliCorp's rate application in Iowa was settled, with no reference to  
5 Aquila/UtiliCorp's merger savings sharing proposal in the order from the Commission that  
6 accepted the settlement.

7 Q. What is the significance of the Company's request in Iowa for L&P merger  
8 savings sharing?

9 A. The significance of this request in Iowa is that Aquila/UtiliCorp is implicitly  
10 admitting that its position is that indirect cost responsibility for L&P merger costs should not  
11 be isolated solely to Missouri. This should be taken into account when comparing the  
12 Missouri only amount of requested merger savings noted above (\$5.75 million) with the  
13 Staff's calculation of the total Company amount of return on the L&P acquisition adjustment  
14 (\$11.8 million).

15 Q. What are the Staff's overall conclusions regarding the relationship of the  
16 Company's merger savings sharing proposal to the acquisition adjustment and other merger  
17 costs?

18 A. The Staff believes that Aquila/UtiliCorp's merger savings sharing proposal  
19 would allow it to earn a significant indirect return on the L&P acquisition adjustment. Given  
20 the past traditional practice of this Commission to deny direct recovery of acquisition  
21 adjustments, the Staff believes the Commission should consider this fact in assessing the  
22 Company's extraordinary proposal to share merger savings in this proceeding.

1 Q. Is the Staff's position on Aquila/UtiliCorp's merger savings sharing proposal  
2 dependent solely on that proposal's impact of allowing indirect acquisition recovery?

3 A. No. The Staff would be opposed to the Company's merger savings proposal  
4 even if no acquisition adjustment existed for the L&P transaction, for the additional reasons  
5 stated in my and other Staff witnesses' testimony on this issue.

6 Q. At page 3 of his direct testimony, Mr. Siemek states "sharing in the savings  
7 created by the merger provides an incentive for companies to create such savings for  
8 customers by encouraging future mergers." Should this Commission be providing  
9 "incentives" for merger and acquisition transactions?

10 A. In the Staff's opinion, no. There are two reasons for this position:  
11 1) Aquila/UtiliCorp is effectively out of the merger and acquisition business at this time, so  
12 there is no reason to reward Aquila/UtiliCorp to engage in an activity that it has indicated it  
13 will not engage in; and 2) more generally, the Staff believes that the Commission should  
14 neither encourage or discourage merger and acquisition transactions for Missouri utility  
15 companies.

16 Q. Why is the Company not involved in merger and acquisition activities at this  
17 time?

18 A. Over the last 15 years or more, Aquila/UtiliCorp has been engaged in an  
19 aggressive merger and acquisition program, both in the U.S. and internationally. However,  
20 due to the Company's recent financial difficulties, it is the Staff's understanding that  
21 Aquila/UtiliCorp has suspended any merger and acquisition activity for the time being.  
22 (Deposition of Vern J. Siemek, pages 21-22). Given this, there are no merger and acquisition  
23 activities on the horizon for Aquila/UtiliCorp to be "incented" to enter into.

1 Q. If the Company were still involved in merger and acquisition activities, would  
2 the Staff's view on this matter change?

3 A. No. The Staff believes the Commission should neither encourage nor  
4 discourage mergers and acquisitions. Companies engage in these activities primarily in  
5 support of shareholder interests, and it is my understanding that the Commission is required to  
6 approve such transactions unless a finding of "public detriment" is made by it. There is no  
7 requirement that the Commission encourage transactions that may benefit shareholders but are  
8 a detriment to ratepayers. It is the Staff's position that acquisition adjustments are a public  
9 detriment.

10 In addition, even merger and acquisition transactions that may ultimately result in  
11 lower cost of service and do not involve the recovery of an acquisition adjustment from  
12 ratepayers can have negative impacts in other areas, such as schemes based on non-cost based  
13 rate regulation. Further examples of this are, it is common for utility employee levels to  
14 decline after a merger, and mergers may result in transfer of some existing Missouri utility  
15 operations to other jurisdictions. For these reasons, the Staff recommends that the  
16 Commission adopt an attitude of overall neutrality toward merger and acquisition transactions  
17 rather than to seek to either encourage or discourage merger and acquisition transactions.

18 Q. At pages 15-16 of his direct testimony, Mr. Siemek cites as support for the  
19 merger savings sharing proposal a belief that the Company has "realized" very little or none  
20 of the alleged L&P merger savings over the last three years. Is this true?

21 A. No. To the extent the Company has achieved a level of savings from the L&P  
22 transaction over the last three years, Aquila/UtiliCorp has fully "realized" the savings,  
23 because shareholders have been the sole beneficiaries of the savings so far. Mr. Siemek is

1 making a claim that if non-merger factors prevent an overall increase in Company earnings  
2 even while merger savings occur, then the merger savings were not “realized.” This is a truly  
3 unique position. Aquila/UtiliCorp would have the Commission in effect “guarantee” a certain  
4 level of income to a utility after a merger/acquisition, or in the alternative order extraordinary  
5 ratemaking schemes for the benefit of the utility shareholders, such as merger savings sharing.  
6 Even the SWBT and AmerenUE experimental alternative regulation plans were not  
7 guarantees of certain earnings levels to SWBT and AmerenUE.

8 Q. What factors allegedly caused Aquila/UtiliCorp to fail to “realize” L&P  
9 merger savings?

10 A. On page 3 of his direct testimony, Mr. Siemek states “[c]ost increases and  
11 industry conditions unrelated to the merger have thus far prevented Aquila from realizing  
12 those benefits.” More specifically, at pages 15-16 of his direct testimony, Mr. Siemek cites  
13 delays in achieving merger savings compared to the Company’s original estimates of when  
14 savings could be achieved. He also states that Aquila/UtiliCorp’s financial problems in 2002  
15 caused a decision not to file for increased rates for its Missouri divisions at that time, thus  
16 leaving the Company’s earnings at a depressed level.

17 Q. Are these relevant considerations to the Commission in reviewing the  
18 Company’s merger savings sharing proposal?

19 A. Not at all. Neither the Company’s failure to achieve merger savings as fast as  
20 it had projected, or Aquila/UtiliCorp’s recent financial difficulties (entirely related to its non-  
21 regulated operations), are in any way the Commission’s or the Company’s customers’  
22 obligation to solve. Proposing an extraordinary sharing of merger savings on account of

1 factors such as these would place an inappropriate burden on the back of the Company's  
2 captive customer base.

3 Q. At page 27 of his direct testimony, Company witness Stamm sponsors a  
4 proposal to devote half of the L&P merger savings to be retained by Aquila/UtiliCorp under  
5 its merger savings sharing proposal to a low-income customer assistance program. Does the  
6 Staff have a position on this proposal?

7 A. Yes. While the Staff encourages utilities to consider the needs of low-income  
8 customers in their policies and donation practices, the Staff cannot support a proposal to  
9 increase general customer rates by imputing hypothetical expenses into cost of service,  
10 regardless of claimed benefits to low-income customers.

11 Q. Mr. Stamm and Mr. Siemek appear to portray the Company's merger savings  
12 sharing proposal as actually benefiting customers on a 75/25 basis, taking into account the  
13 half of Aquila/UtiliCorp's share of merger savings that will be devoted to low-income  
14 customer programs. Is this view accurate?

15 A. No. If the Company's merger savings sharing proposal were adopted, any  
16 additional monies devoted by Aquila/UtiliCorp to low-income customer resources would  
17 logically have an impact of reducing the Company's bad debt expense. If this occurs, and the  
18 Company's actual bad debt expense is then lower than the rate allowance for that item, the  
19 Company's earnings levels will increase (all other factors held equal).

20 Q. Does this conclude your rebuttal testimony on merger savings sharing?

21 A. Yes, it does.

1 **ARIES UNIT**

2 Q. Has the Company made an adjustment to annualize the capacity charges  
3 associated with MPS' purchase of power from the Aries Generating Unit?

4 A. Yes, it has. Company witness Starkebaum sponsors Aquila/UtiliCorp's  
5 adjustment to annualize capacity charges associated with MPS purchased power agreements  
6 (PPAs) at page 12 of her direct testimony. She states that the Company's adjustment includes  
7 an annualization of Aries capacity charges.

8 A general description of the Aries PPA can be found on pages 7-8 of Company  
9 witness Boehm's direct testimony.

10 Q. What level of capacity charges associated with the Aries unit has  
11 Aquila/UtiliCorp included in its case?

12 A. The Company has reflected an annualized level of \$27.66 million.

13 Q. Does the Staff agree that \$27.66 million is an appropriate level to include in  
14 rates for Aries capacity charges?

15 Q. No. Because MPS is purchasing power from the Aries unit through an  
16 affiliated entity (Merchant Energy Partners – Pleasant Hill, or MEPPH), the Staff believes it is  
17 appropriate to price the capacity from the Aries unit on a "lower of cost or market" basis.  
18 Because the cost of the Aries capacity to MPS's affiliated supplier is less than the market  
19 value paid by MPS for that power, MPS's rates should reflect only the cost to Aquila of the  
20 Aries unit capacity. The quantification of this adjustment, and a more detailed explanation for  
21 its rationale, can be found in my direct testimony in this proceeding.

22 Q. Why did Aquila/UtiliCorp make the decision for its MPS division to obtain  
23 power through a purchased power agreement (PPA) with an affiliated entity?

1           A.     The Staff believes this decision was made because the Company believed it  
2 could earn higher profits by having a non-regulated affiliated entity construct a power plant  
3 and sell power to MPS through a PPA, than having MPS construct the power plant for itself.

4           Q.     Generally, what are an electric utility's options for obtaining additional power  
5 to meet load growth or to replace existing power sources?

6           A.     Generally, electric utilities have the option of either building their own  
7 generating units to provide power for their customers or purchasing a portion of the output of  
8 a generating unit owned by another electric provider.

9           Historically, when an electric utility builds its own generating unit, it typically intends  
10 to use most of the power generated by that unit for the utility's native load customers. Some  
11 of the unit's output may be sold to neighboring utilities to meet their power needs, and excess  
12 energy during non-peak periods may also be sold to utilities in the interchange market. For  
13 ratemaking purposes, this Commission has placed in rate base the net original cost of  
14 constructing utility-owned units, and allowed a return on that amount in setting rates for those  
15 utilities. Depreciation expense is booked to charge the cost of the units to expense on the  
16 utility's income statement ratably over time. This allows the utility to earn a return "on" its  
17 investment in rate base, and to recover a return "of" the investment through depreciation.

18           Alternatively, if a utility does not wish to construct and own generating units, it may  
19 choose to either purchase capacity from a portion of the power produced by a generating unit  
20 owned by another entity, or acquire power from a utility which has purchased power from  
21 another entity – a "purchase for resale" transaction. In this case, the utility buying the power  
22 is charged a price for that power reflecting both the capital costs of the unit producing the  
23 power (the capacity or demand charge), and the incremental price of generating that power



1 (the energy charge). However, the entire amount paid by the purchasing utility for its share of  
2 power is typically charged to purchased power expense on its books.

3 Another potential difference between ownership of a power plant, and purchasing  
4 power from an outside entity is the term of the commitment. When a utility builds a power  
5 plant, normally it intends to have the plant provide power for native load customers over the  
6 useful life of the plant (generally 35-40 years or more). In contrast, agreements to purchase  
7 power may be either short-term (i.e., one to five years) or long-term (20 years or more).

8 Q. When a utility builds generation to serve native load customers, is utility  
9 ownership of that plant the only option available for that utility?

10 A. No. A utility choosing to build generation has the option of constructing the  
11 unit, selling it to a third party, and then leasing the unit back from the new owner. The lease  
12 payments charged by the new owner would again be based on the capital costs of the leased  
13 unit, as well as the incremental cost of producing energy from the plant. The utility taking  
14 power from the leased unit would charge the lease payments to lease expense on its books.

15 Q. When a utility takes power from a leased plant, as opposed to owning the  
16 plant, how would the amount of the lease payments compare to the amount of rate recovery  
17 the utility would receive from placing the unit in question in rate base?

18 A. Conceptually, the amounts should be similar, as both rate recovery of lease  
19 expense and rate recovery of amounts associated with placing generating plants in rate base  
20 are premised upon recovery of the capital and expense components of producing power,  
21 which will be identical whether the unit is owned or leased. However, there usually are some  
22 differences between the method by which lease payments are calculated for rate purposes and  
23 how revenue requirement is calculated for generating plants included in rate base. Because

1 the return on rate base component of power plant costs is calculated on the undepreciated  
2 component of the plant costs at a point in time, this results in declining cost recovery over  
3 time as the undepreciated amount of plant costs declines over time. In contrast, lease  
4 payments are normally calculated on a levelized basis; that is, calculating the total return on  
5 and of capital costs over a unit's life and spreading that amount equally over the life of the  
6 lease. In addition, a lease term may not be the same as the expected life of the generating unit  
7 put into rate base and, therefore, the capital cost recovery component of the lease payment  
8 may not be the same as the revenue requirement for the unit that would be reflected in rates if  
9 the unit were afforded rate base treatment.

10 Q. Does Aquila/UtiliCorp own or lease the Aries unit?

11 A. Yes. Aquila/UtiliCorp leases the Aries unit. As discussed in my direct  
12 testimony, Aquila/UtiliCorp has chosen to provide the title to the Aries unit to Cass County,  
13 Missouri, and then lease the plant from Cass County.

14 Q. Has MPS obtained power in the past through leasing of generating units?

15 A. Yes. MPS, while it has constructed generating units at its Greenwood and  
16 Ralph Green locations in the past, chose to sell those units to third parties and then obtain  
17 power from the plants through long-term lease arrangements.

18 Q. Why would a utility choose to lease a generating unit rather than own it  
19 directly?

20 A. In the mid to late-1970s, when MPS chose to lease the Greenwood and Ralph  
21 Green generating units, it is the Staff's understanding that MPS took that course of action  
22 because it was experiencing financial difficulties at that time, and did not want to reflect  
23 additional debt on its balance sheet associated with ownership of these units. Today, a utility

1 may choose to enter into a leasing arrangement because it expects to achieve a higher return  
2 associated with its generating plant investment through leasing the plant rather than having  
3 the cost of the unit reflected in rate base. In that case, a utility may believe that it could  
4 achieve greater profits from the unit if it was unregulated rather than be held to the regulated  
5 rates of return authorized by public utility commissions. As will be discussed later in this  
6 testimony, the desire for higher returns is the rationale for Aquila/UtiliCorp's decision to lease  
7 the new Aries unit and this arrangement is an abuse of affiliate relationships.

8 Q. Has Aquila/UtiliCorp provided any information to justify its choice to  
9 purchase generating capacity through a PPA with an affiliated entity rather than building its  
10 own generating unit?

11 A. Yes. Case No. EM-99-369 was Aquila/UtiliCorp's application for the  
12 Commission to make certain determinations required under the Public Utilities Holding  
13 Company Act of 1935 respecting the contract between MPS and MEPPH for supply of power  
14 from the Aries unit. In that proceeding, Aquila/UtiliCorp provided the Staff an analysis that  
15 purports to demonstrate that the costs to MPS of entering into a five-year lease to obtain  
16 power is less expensive than MPS owning the unit and rate basing it, over the five-year term  
17 of the lease.

18 Q. From MPS's perspective, why might obtaining power through a PPA be more  
19 economical than including the unit in rate base?

20 A. There are two basic reasons why a PPA might show a cost advantage. First, as  
21 previously discussed, lease payments are typically based on levelized recovery of capital  
22 costs, as opposed to the front-loaded recovery of the return component of the generating unit  
23 caused by rate base treatment. This is also typical for the capacity cost recovery in a PPA.

1 Second, the purchased power agreement MPS entered into calls for the Company to pay for  
2 500 MW of power during peak periods, but a reduced amount of power during non-peak  
3 periods. Rate base treatment would result in MPS customers being responsible for the entire  
4 cost of the plant.

5 Q. Because of these factors, wouldn't the MPS PPA inherently be less expensive  
6 than rate basing the Aries unit?

7 A. Not necessarily.

8 In regard to levelized cost recovery of capital costs under a PPA, the levelized cost  
9 should be calculated in such a way that customers would be indifferent between paying rates  
10 based on the traditional declining cost rate base methodology, or rates based on levelized PPA  
11 cost recovery, over the life of the unit in question.

12 Concerning the point that rate base treatment would mean the full cost of the Aries  
13 unit would be reflected in customer rates, that cost would be offset under the normal  
14 ratemaking process by the proceeds of interchange sales made from the Aries unit during off-  
15 peak periods (i.e., MPS's ability to sell power during off-peak periods due to its reduced need  
16 for power during that time). One would have to know the amount of projected interchange  
17 sales, and the estimated proceeds from those sales before reaching a firm conclusion on  
18 whether rate basing or leasing the unit would be more economical from a ratepayer viewpoint.

19 Q. Is the five-year period of the PPA an appropriate time frame in which to assess  
20 the benefits of the PPA versus owning the Aries unit?

21 A. No. Because ownership of the unit has long-term consequences, with most  
22 units having an expected useful life of 30 years or more, an evaluation of whether it is  
23 economically better to own a unit or purchase power from it should extend far beyond an

1 initial five-year lease period. In fact, use of this five-year period to justify the decision to  
2 purchase power from the Aries unit is inherently biased against the ownership option; again,  
3 because of the levelized capital cost recovery feature of PPA cost recovery.

4 Q. In the Staff's view, has MPS done an adequate job of justifying its decision to  
5 purchase power from the Aries unit, as opposed to MPS owning the unit?

6 A. No.

7 Q. Did the Company seriously give consideration to the option of having MPS  
8 build a generating unit to meet its need for power beginning in 2001?

9 A. No. In the Staff's notes of the interview of Mr. Frank DeBacker  
10 (Aquila/UtiliCorp's Vice-President of Fuel and Purchased Power in 1998-1999) and  
11 Mr. Robert Holzwarth (Aquila/UtiliCorp's Vice-President of Power Services in 1998-1999), it  
12 is stated that Mr. DeBacker and Mr. Holzwarth were knowledgeable of a clear understanding  
13 from the Company's management at the time the Aries decision was made that  
14 Aquila/UtiliCorp's regulated electric divisions were not to construct power plants; and that  
15 these divisions' power needs were to be met through short-term PPAs.

16 As mentioned in my direct testimony, Mr. DeBacker and Mr. Holzwarth were given  
17 the opportunity to review the Staff's notes of the interview and make any corrections,  
18 additions or clarifications in the response to Staff Data Request No. 548.

19 Q. Does the Staff have additional concerns with the Company's decision to lease  
20 the Aries unit?

21 A. Yes. The Staff believes the short term of the PPA (five years) exposes MPS  
22 customers to greater risks associated with future market based pricing of power than they  
23 would if MPS owned the Aries unit.

1 Q. Please explain in general terms the concept of “market-based pricing” of  
2 power.

3 A. “Market-based” pricing of power represents charging customers for power they  
4 use based upon a price determined in a competitive marketplace of buyers and sellers. This  
5 contrasts with treatment of generating units afforded under traditional regulation, in which  
6 customers are charged rates based upon the actual capital and operating costs associated with  
7 the units that are dedicated to native load customers. The market price of power at any point  
8 in time may be higher or lower than the actual “embedded” price of power charged to  
9 customers in electric rates under current regulation.

10 Q. What factors would cause the market price of power to either be higher than or  
11 lower than the embedded costs of power reflected in rates?

12 A. Because generating units are long-lived assets, customers are likely to pay the  
13 capital costs associated with any particular unit for an extended period of time (i.e., 30-40  
14 years). If the cost of generating power from newer units and power generation technologies is  
15 declining over time compared to the embedded cost of a utility’s existing generating units,  
16 then the market price of power will be less than that utility’s embedded generating costs.  
17 Alternatively, if the cost of generation from new units is increasing relative to the embedded  
18 cost of generation for a utility, then the market price of power will be greater than that  
19 utility’s embedded generation costs. Accordingly, customers are not inherently benefited or  
20 harmed by the introduction of market-based pricing of electricity. However, customers are  
21 exposed to greater risk under market-based generation pricing.

22 Q. Why is market-based pricing riskier from a customer perspective?

1           A.     It is riskier because customers will face more volatility in rates for power under  
2 market-based pricing schemes than under the traditional embedded cost regulatory pricing  
3 approach. As previously discussed, once a generating unit is operational and included in a  
4 utility's rate base, the capital cost component of that unit's cost that is reflected in rates will  
5 be highly predictable over the life of the unit. In contrast, the capital cost component of  
6 market based electricity prices will be subject to frequent fluctuation based on trends in the  
7 generation marketplace.

8           To use an example, if a utility provides electricity to its customers from one generating  
9 unit only, the capital cost portion of electricity from that unit will be largely fixed in advance  
10 over the life of the unit for 30 or 40 years, or more. Though rates charged to customers for  
11 the capital costs of that unit may change over time, due to the "declining-cost" nature of  
12 capital recovery in rates, those changes are highly predictable. In contrast, the capital cost  
13 component of that utility's generation rates might be subject to material and unanticipated  
14 changes on a frequent basis, if rates to its customers are based upon market prices for  
15 generation.

16           For this reason, utility customers inherently face more risk of unexpected pricing  
17 changes when market prices determine the rates they pay for electric service, as opposed to  
18 the embedded costs of the generating units serving them.

19           Q.     Please explain how MPS's contract to obtain power from the Aries unit is an  
20 example of market-based pricing of power.

21           A.     While the Aries unit is expected to have a lengthy life typical of a generating  
22 unit, the contract only obligates Aries' owners to provide power to MPS for a five-year  
23 period. At the end of the five years, MPS must either reach a new agreement with the Aries

1 unit's owners to obtain additional power, or replace the power it obtained from the Aries unit  
2 with another source. While the Aries owners may choose to again bid to supply power to  
3 MPS customers when the five-year term of the current agreement has expired, they are not  
4 obligated to do so. Even if power is continues to be supplied to MPS through another Aries  
5 PPA after the five-year term of the initial PPA has expired, MPS customers will still face the  
6 risk of changes in the market price of power in the new contract. If a new five-year PPA with  
7 the Aries unit is agreed to starting in 2005, then MPS' customers will face the same risks five  
8 years later in 2010.

9 Q. Has there a general trend towards greater market pricing of electric power in  
10 this country in the recent past?

11 A. Yes, though generally this trend is tied to overall electric restructuring efforts  
12 in various jurisdictions. In other words, those jurisdictions that have chosen to allow  
13 customers greater choice in the selection of their electricity provider as a necessary  
14 consequence also allow customers greater exposure to market pricing for generation service.  
15 Whether electric restructuring is a worthy goal for pursuit is, of course, a policy judgment to  
16 be made by legislatures and regulatory bodies. The Staff believes that neither the  
17 Commission nor the Missouri Legislature has established a policy encouraging either electric  
18 restructuring or greater market pricing of power to native load customers in Missouri.

19 Changes in the electric industry in recent years related to such factors as California  
20 restructuring difficulties, the Enron bankruptcy and the financial problems of electric bulk  
21 energy marketers have led to a significant slow down in electric restructuring initiatives.  
22 Accordingly, the trend towards greater use of market pricing of power has also recently  
23 decelerated as well.



1 Q. Do electric utilities benefit from market-based pricing of generation service?

2 A. Electric utilities can conceivably achieve higher profitability levels charging  
3 market-based rates compared to traditional embedded ratemaking, when the generation  
4 services are performed by non-regulated affiliates providing capacity power to the regulated  
5 entity under some form of contract arrangement, such as the case with the Aries PPA. Again,  
6 this potential benefit depends upon the long-term trend in market prices for power compared  
7 with the embedded cost of power production.

8 Q. Has Aquila/UtiliCorp undertaken a policy in the past of attempting to move  
9 toward market pricing of generation?

10 A. Yes. Several years ago, the Company had the opportunity to place its  
11 Greenwood Units 1 and 2 in rate base upon the expiration of the long-term lease arrangements  
12 it had in place for the two units in the mid- to late-1970s. However, when Aquila/UtiliCorp  
13 exercised its option to purchase these units, it chose to place them in a non-regulated  
14 subsidiary, to enter into new leasing arrangements with the affiliated entity (MPS), and to  
15 continue to obtain power from these units for MPS customers at a new, and higher, lease rate.  
16 The Staff's concerns regarding this situation with the Greenwood units were discussed in  
17 more detail in the direct testimony of Staff witness Featherstone in Case No. ER-2001-672.

18 The Staff believes Aquila/UtiliCorp has attempted to implement a policy of no longer  
19 including in rate base the generating units it constructs to provide electric power for its native  
20 load customers in its regulated divisions. For example, the Company made an attempt in Case  
21 No. EM-97-395 to have all of its existing MPS regulated generating units placed in an  
22 unregulated EWG. (The case was later withdrawn.) Aquila/UtiliCorp's proposals in Case  
23 No. EM-97-395, the recent history of the Greenwood units and the Company's decisions

1 regarding the Aries unit all demonstrate this policy of attempting to move generation  
2 resources to Aquila/UtiliCorp's non-regulated side. Such a policy raises concerns regarding  
3 affiliate abuse.

4 Q. Why has Aquila/UtiliCorp moved towards market-based pricing of power?

5 A. Based upon its response to Staff Data Request No. 365 in Case No. ER-2001-  
6 672, the Company implemented this policy to allow it to achieve greater profit levels. The  
7 response to Staff DR No.365 states, "[t]he Company believes that the current regulatory  
8 climate does not warrant the business risks associated with constructing and owning rate-  
9 based generating plants". The Staff interprets this statement to mean that Aquila/UtiliCorp  
10 perceived at the time of this response that current return on equity levels earned on rate base  
11 investments were inadequate, and that greater returns could be garnered through the lease of  
12 power plants by affiliates and the purchase of power from these affiliates at "market" rates.  
13 This policy of moving generation from the regulated utility to the non-regulated affiliate and  
14 charging the utility a higher price is an abuse of the affiliate relationship.

15 Q. All other things being equal, if the Company can earn greater returns on its  
16 generation investment by selling power to customers at market rates, what would be the  
17 impact on MPS's customers?

18 A. All other things being equal, this means Aquila/UtiliCorp's native load MPS  
19 customers over the long-term would pay higher rates related to "market-based" PPAs for  
20 purchased power than they would pay if MPS's rates were based on embedded cost  
21 ratemaking for those units.

22 Q. Is it possible at this time to determine whether this Aquila/UtiliCorp policy of  
23 not placing new generating units in rate base was in the best interest of MPS ratepayers?

1           A.     Any such conclusion cannot be reached in the absence of a study comparing  
2 the benefits and risks of direct ownership of units by MPS to obtaining power through lease  
3 arrangements and PPAs. However, there are a number of indications that Aquila/UtiliCorp  
4 expected the future price of power to increase, at least in the short-term; at the time the Aries  
5 decision was made. If the Company's expectations are correct, the decision to purchase power  
6 from the Aries unit as opposed to ownership of the unit by MPS may not be in the best  
7 interest of MPS customers.

8           Q.     What indications are you referring to?

9           A.     The above answer is based on the following points:

10           1.)    The Staff is aware of a number of power price forecasts utilized by the  
11 Company that showed an expectation of sharply higher power prices through time.

12           2.)    The market cost of replacing power obtained through a lease of the  
13 Greenwood Units 1 and 2 several years ago was in excess of the prior leased cost, as  
14 well as in excess of the cost of power from these units if these units were included in  
15 rate base.

16           3.)    The acquisition adjustment paid by Aquila/UtiliCorp to obtain the  
17 assets and property of L&P in late 2000 was based, in part, on an expectation that the  
18 market value of L&P generating units was considerably in excess of the value of those  
19 units as reflected in L&P's rate base.

20           Each of these points will be addressed in more detail below.

21           Q.     What is your basis for asserting that the Staff has reviewed Company power  
22 price forecasts that show significantly higher power prices into the future?

1           A.     In its review of the Aries PPA issue in the last MPS electric rate proceeding in  
2 Missouri (Case No. ER-2001-672), as well as the instant case, the Staff has become aware of  
3 the existence of several power price forecasts prepared by Aquila/UtiliCorp that indicated  
4 sharply higher market prices of power were expected in future years. These forecasts were  
5 prepared in the period of the late 1990s to the early years of this decade.

6           Q.     What is the significance of these power price forecasts?

7           A.     If a regulated utility expects escalating power prices into the future, it would  
8 seem to be logical for that utility to hedge against higher power prices by owning and  
9 controlling its own generating units, as opposed to relying on short-term PPAs and exposing  
10 your customers to the risk of frequent power price increases.

11          Q.     What was the situation concerning the price of power MPS is obtaining from  
12 Greenwood Units 1 and 2?

13          A.     As previously mentioned, upon the expiration of the long-term leases from  
14 which MPS formerly obtained power from these units, Aquila/UtiliCorp chose to purchase  
15 these units from the owners, place the units in an unregulated subsidiary, and then enter into a  
16 new lease for the supply of power to MPS customers. The new lease costs were:  
17 (1) substantially higher than the cost of power to MPS from these units under the recently  
18 expired lease; and (2) substantially higher than the cost of power from these units if those  
19 costs had been based upon traditional rate base treatment of those units

20          Q.     How does Aquila/UtiliCorp's acquisition of the L&P properties pertain to the  
21 expected market price of power in the future?

22          A.     As was discussed in the rebuttal testimony of Staff Auditing witness Charles  
23 R. Hyneman in Case No. EM-2000-292, Aquila/UtiliCorp's Application to acquire L&P, one

1 of the reasons why the Company chose to pay a significant premium for these properties was  
2 Aquila/UtiliCorp's perception that L&P's existing generating assets had a market value far in  
3 excess of their value in L&P's rate base. Consequently, the Company paid a price for these  
4 assets based upon an expectation that the price of power from these units in the future would  
5 exceed the price charged based upon the units' rate base value.

6 Q. Does the fact that a utility decides to place ownership of generating facilities in  
7 an unregulated affiliate necessarily mean that the unregulated affiliate must charge the  
8 affiliated regulated entity a market price for power?

9 A. No, such affiliate abuse is not necessary. This is demonstrated by the Kansas  
10 City Power & Light Company (KCPL) Application for Commission approval of its corporate  
11 restructuring, docketed as Case No. EM-2001-464. In that case, KCPL received permission to  
12 form a holding company named Great Plains Energy, Incorporated (GPE). KCPL (the  
13 regulated utility) will retain all of its existing generating assets. Under the holding company  
14 structure, GPE proposed to place its future generating needs in an unregulated affiliate  
15 company, Great Plains Power, Inc. (GPP). However, the Stipulation and Agreement in Case  
16 No. EM-2001-464 called for any power sold to KCPL from certain generating units owned by  
17 GPP in the future would be sold at cost-based rates, so that the cost of power paid by KCPL  
18 would be equivalent to the costs paid by customers under traditional cost-of-service based  
19 rates. The Commission approved this Stipulation and Agreement, using the following  
20 language:

21 In January of 2001, KCPL entered into a binding memorandum of  
22 understanding with General Electric Company under which KCPL may  
23 lease or purchase up to five combustion turbine generating units. Each  
24 of these units has a generating capacity of 77 MW. These turbines will  
25 not be completed until 2003. If the proposed reorganization is  
26 approved, KCPL anticipates seeking Commission approval to transfer

1 its rights under the memorandum of understanding to GPP. KCPL  
2 anticipates that it will need an additional 231 MW of generation  
3 capacity in the next three years, that is, the generating capacity of three  
4 of the five combustion turbines. KCPL currently purchases less than  
5 five percent of its energy needs on the open market. If the proposed  
6 reorganization is approved, KCPL may enter into a cost-based purchase  
7 supply agreement with GPP to acquire this additional capacity. Such a  
8 cost-based purchase supply agreement would provide power at a cost to  
9 ratepayers identical to costs under traditional cost-of-service based  
10 rates. The cost of power generated by a combustion turbine owned by  
11 GPP would be essentially identical to the cost of power generated by a  
12 combustion turbine owned directly by KCPL.

13 Order Approving Stipulation and Agreement and Closing Case, pp. 7-8.

14 Q. What is the Staff's overall policy recommendation in this proceeding regarding  
15 the Aries unit?

16 A. The Staff has seen no evidence that Aquila/UtiliCorp has ever performed an  
17 adequate analysis to compare the long-term cost of direct ownership of the Aries unit with the  
18 cost of obtaining power from that plant through short-term PPAs. What evidence exists at  
19 this point does indicate, however, that the Company has expected and still expects the price of  
20 power in the marketplace to increase over time. If that is true, then MPS customers may have  
21 been better off being able to utilize Aries power over its expected useful life as a Commission  
22 regulated asset, rather than periodically having to obtain higher priced power from sources  
23 elsewhere, or by paying for power from the Aries unit periodically "marked-up" to reflect  
24 current market pricing.

25 The Company is currently in the process of receiving and evaluating bids concerning  
26 its power needs subsequent to the expiration of the current Aries unit PPA. At this time, the  
27 Staff recommends that the Commission order Aquila/UtiliCorp to explicitly consider MPS's  
28 ownership of a generating unit (and, consequently, rate base treatment of the unit) as a  
29 potential source of power beyond 2005, and as an alternative to continued receipt of power

1 through affiliated lease arrangements and short-term affiliated PPAs. Such an analysis should  
2 be at least as detailed as that which is addressed in the Commission's suspended electric  
3 utility resource planning rules, 4 CSR 240-22.010-.080. The analysis should also be of a  
4 long-term nature, in order to fully and fairly assess the benefits and detriments of MPS's  
5 options for obtaining future capacity, including utility ownership of power plants. Only if  
6 Aquila/UtiliCorp is ordered to do this will the Commission be able to adequately review and  
7 evaluate in future rate proceedings the necessary evidence as to whether MPS is seeking  
8 recovery of an excessive level of expense to compensate it for power provided to its  
9 customers.

10 Q. Has the amount of the Staff's proposed adjustment for test year Aries capacity  
11 charges changed since the filing of the Staff's direct testimony?

12 A. No. The Company has provided the Staff with certain additional information  
13 regarding Aries costs during the prehearing conference to this case. The Staff is still in the  
14 process of evaluating this information. If this or other information leads the Staff to revise its  
15 Aries adjustment amount, the Commission and the parties to this proceeding will be informed  
16 of these changes promptly.

17 Q. Does this complete your rebuttal testimony?

18 A. Yes, it does.

Summary of Synergy Benefits, net of Costs to Achieve

UtiliCorp/Saint Joseph Light and Power

(Dollars in Current 000's)

	2001					2002					2003					2004					2005					First Five Full Years		2006					2007					2008					2009					2010					Years 8-10		Ten Full Years	
	2001	2002	2003	2004	2005	Total	Average	2006	2007	2008	2009	2010	Totals	Average	Totals	Average	Totals	Average	Totals	Average	Totals	Average	Totals	Average	Totals	Average	Totals	Average	Totals	Average	Totals	Average	Totals	Average	Totals	Average																				
<b>I Operating Costs</b>	<b>Current Dollars</b>																																																							
1 Dispatching/Generation Savings <i>See I.1</i>	\$ 3,820	\$ 4,358	\$ 5,198	\$ 6,021	\$ 6,687	\$ 26,082	\$ 5,218	\$ 7,817	\$ 6,502	\$ 7,274	\$ 6,557	\$ 5,733	\$ 33,883	\$ 6,777	\$ 59,965	\$ 5,997																																								
2 General & Administrative Savings <i>See I.2</i>	\$ 5,193	\$ 5,599	\$ 5,739	\$ 5,982	\$ 6,029	\$ 28,442	\$ 6,888	\$ 6,180	\$ 6,334	\$ 6,493	\$ 6,655	\$ 6,822	\$ 32,484	\$ 6,497	\$ 60,926	\$ 6,093																																								
3 Distribution Savings	\$ 1,385	\$ 1,821	\$ 1,965	\$ 2,014	\$ 2,064	\$ 9,249	\$ 1,850	\$ 2,118	\$ 2,169	\$ 2,223	\$ 2,279	\$ 2,336	\$ 11,122	\$ 2,224	\$ 20,370	\$ 2,037																																								
4 Transmission Savings	\$ 315	\$ 548	\$ 562	\$ 678	\$ 690	\$ 2,591	\$ 518	\$ 605	\$ 620	\$ 636	\$ 652	\$ 668	\$ 3,180	\$ 636	\$ 5,772	\$ 577																																								
6 Conversion to UtiliCorp Benefits <i>See I.5</i>	\$ 1,996	\$ 3,022	\$ 2,978	\$ 3,401	\$ 3,628	\$ 15,021	\$ 3,004	\$ 3,878	\$ 4,152	\$ 4,454	\$ 4,728	\$ 5,003	\$ 22,213	\$ 4,443	\$ 37,234	\$ 3,723																																								
8 Total O&M	\$ 12,709	\$ 15,348	\$ 16,437	\$ 17,894	\$ 18,997	\$ 61,365	\$ 16,277	\$ 20,594	\$ 19,777	\$ 21,079	\$ 20,870	\$ 20,581	\$ 102,882	\$ 20,576	\$ 184,287	\$ 18,427																																								
<b>II Capital Savings (Costs):</b>																																																								
1 Depr - Interconnect/SCADA/T&D <i>See II.1</i>	\$ (285)	\$ (330)	\$ (324)	\$ (318)	\$ (313)	\$ (1,570)	\$ (314)	\$ (307)	\$ (302)	\$ (298)	\$ (290)	\$ (330)	\$ (1,525)	\$ (305)	\$ (3,095)	\$ (310)																																								
2 Amort of Transaction/Transition Costs	\$ (1,509)	\$ (1,509)	\$ (1,509)	\$ (1,509)	\$ (1,509)	\$ (7,545)	\$ (1,509)	\$ (1,509)	\$ (1,509)	\$ (1,509)	\$ (1,509)	\$ (1,501)	\$ (7,537)	\$ (1,507)	\$ (15,082)	\$ (1,508)																																								
3 Return on Interconnect SCADA/T&D	\$ (896)	\$ (897)	\$ (841)	\$ (786)	\$ (731)	\$ (4,152)	\$ (830)	\$ (677)	\$ (624)	\$ (571)	\$ (519)	\$ (463)	\$ (2,854)	\$ (571)	\$ (7,006)	\$ (701)																																								
4 Return on Transaction/Transition Costs	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -	\$ -																																								
5 Total Capital Savings (Costs)	\$ (2,690)	\$ (2,736)	\$ (2,674)	\$ (2,613)	\$ (2,553)	\$ (13,267)	\$ (2,653)	\$ (2,493)	\$ (2,435)	\$ (2,376)	\$ (2,318)	\$ (2,294)	\$ (11,916)	\$ (2,383)	\$ (25,183)	\$ (2,518)																																								
<b>III Total Synergies, net of Cost to Achieve</b>	\$ 10,019	\$ 12,612	\$ 13,763	\$ 15,281	\$ 16,443	\$ 68,118	\$ 13,624	\$ 18,101	\$ 17,342	\$ 18,703	\$ 18,552	\$ 18,267	\$ 90,966	\$ 18,193	\$ 159,084	\$ 15,908																																								
<b>IV Enterprise Support Functions Allocated (In) Current Dollars</b>																																																								
1 SJLP Direct Costs transferred to ESF <i>See I.2</i>	\$ 2,292	\$ 2,350	\$ 2,409	\$ 2,469	\$ 2,530	\$ 12,050	\$ 2,410	\$ 2,594	\$ 2,659	\$ 2,725	\$ 2,793	\$ 2,863	\$ 13,633	\$ 2,727	\$ 25,683	\$ 2,568																																								
2 SJLP Direct Costs transferred to IBU	\$ 922	\$ 1,212	\$ 1,308	\$ 1,341	\$ 1,374	\$ 6,157	\$ 1,231	\$ 1,409	\$ 1,444	\$ 1,480	\$ 1,517	\$ 1,555	\$ 7,404	\$ 1,481	\$ 13,561	\$ 1,356																																								
3 Support Functions Allocated (In)	\$ (12,378)	\$ (12,885)	\$ (13,002)	\$ (13,327)	\$ (13,660)	\$ (65,049)	\$ (13,010)	\$ (14,002)	\$ (14,352)	\$ (14,710)	\$ (15,078)	\$ (15,455)	\$ (73,597)	\$ (14,719)	\$ (136,845)	\$ (13,865)																																								
4 Net Allocations (costs) savings to SJLP	\$ (9,161)	\$ (9,123)	\$ (9,285)	\$ (9,517)	\$ (9,755)	\$ (46,842)	\$ (9,368)	\$ (9,999)	\$ (10,249)	\$ (10,505)	\$ (10,768)	\$ (11,037)	\$ (52,559)	\$ (10,512)	\$ (99,401)	\$ (9,940)																																								
<b>V Total Synergies, net of Costs to Achieve and Allocated Costs</b>	\$ 858	\$ 3,489	\$ 4,478	\$ 5,764	\$ 6,688	\$ 4,255	\$ 8,101	\$ 7,093	\$ 8,198	\$ 7,784	\$ 7,230	\$ 7,681																																												
<b>VI Premium Costs</b>																																																								
1 Return on Premium <i>See IV:1</i>	\$ (10,203)	\$ (9,941)	\$ (9,680)	\$ (9,418)	\$ (9,156)	\$ (48,399)	\$ (9,680)	\$ (8,895)	\$ (8,633)	\$ (8,371)	\$ (8,110)	\$ (7,848)	\$ (41,857)	\$ (8,371)	\$ (80,256)	\$ (9,026)																																								
2 Amortization of premium	\$ (2,302)	\$ (2,302)	\$ (2,302)	\$ (2,302)	\$ (2,302)	\$ (11,510)	\$ (2,302)	\$ (2,302)	\$ (2,302)	\$ (2,302)	\$ (2,302)	\$ (2,302)	\$ (11,510)	\$ (2,302)	\$ (23,020)	\$ (2,302)																																								
3 Reflect non-tax deductibility of premium	\$ (1,535)	\$ (1,535)	\$ (1,535)	\$ (1,535)	\$ (1,535)	\$ (7,673)	\$ (1,535)	\$ (1,535)	\$ (1,535)	\$ (1,535)	\$ (1,535)	\$ (1,535)	\$ (7,673)	\$ (1,535)	\$ (15,347)	\$ (1,535)																																								
4 Total Premium cost	\$ (14,040)	\$ (13,778)	\$ (13,518)	\$ (13,255)	\$ (12,993)	\$ (67,582)	\$ (13,516)	\$ (12,731)	\$ (12,470)	\$ (12,208)	\$ (11,946)	\$ (11,685)	\$ (61,041)	\$ (12,208)	\$ (128,623)	\$ (12,862)																																								
<b>VII SJLP share of premium costs</b>	\$ (7,020)	\$ (6,869)	\$ (6,788)	\$ (6,627)	\$ (6,497)	\$ (6,758)	\$ (6,368)	\$ (6,236)	\$ (6,104)	\$ (5,973)	\$ (5,842)	@50%	\$ (6,104)																																											
<b>VIII Synergies, net of 50% of premium</b> (Line V less VII)	\$ (6,162)	\$ (3,400)	\$ (2,280)	\$ (864)	\$ 192	\$ (2,503)	\$ 1,736	\$ 858	\$ 2,094	\$ 1,811	\$ 1,388	\$ 1,577																																												

Schedule 1

ANNUAL  
DETAIL  
VJS-1