EXHIBIT

Exhibit No.:
Issue(s): Fuel Adjustment Clause
Witness/Type of Exhibit: Kind/Direct
Sponsoring Party: Public Counsel
Case No.: ER-2007-0004

DIRECT TESTIMONY

OF

RYAN KIND

Submitted on Behalf of
the Office of the Public Counsel

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Missouri Public
Service Commission

AQUILA, INC. D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P

Case No. ER-2007-0004

January 18, 2007

OPC Exhibit No. 401
Case No(s). ER-2007-0004
Date 4-11-07 Rptr KF

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Tariff Filing of Aquila, Inc., to Implement a General Rate Increase for Retail Electric Service Provided to Customers in its Aquila Networks—MPS and Aquila Networks—L&P Missouri Service Areas.	)))))	**Case No. ER-2007-0004** Tariff No. YE-2007-0001

AFFIDAVIT OF RYAN KIND

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Ryan Kind, of lawful age and being first duly sworn, deposes and states:

1. My name is Ryan Kind. I am a Chief Utility Economist for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my direct testimony.

3. I hereby swear and affirm that my statements contained in the attached affidavit are true and correct to the best of my knowledge and belief.

Ryan Kind

Ryan Kind

Subscribed and sworn to me this 18th day of January 2007.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

JERENE A. BUCKMAN
My Commission Expires
August 10, 2009
Cole County
Commission #05754036

Jerene A. Buckman

Jerene A. Buckman
Notary Public

My commission expires August 10, 2009.

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DIRECT TESTIMONY

OF

RYAN KIND

AQUILA, INC.

CASE NO. ER-2007-0004

Q. **PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.**

A. Ryan Kind, Chief Energy Economist, Office of the Public Counsel, P.O. Box 2230, Jefferson City, Missouri 65102.

Q. **PLEASE SUMMARIZE YOUR EDUCATIONAL AND EMPLOYMENT BACKGROUND.**

A. I have a B.S.B.A. in Economics and a M.A. in Economics from the University of Missouri-Columbia (UMC). While I was a graduate student at UMC, I was employed as a Teaching Assistant with the Department of Economics, and taught classes in Introductory Economics, and Money and Banking, in which I served as a Lab Instructor for Discussion Sections.

My previous work experience includes several years of employment with the Missouri Division of Transportation as a Financial Analyst. My responsibilities at the Division of Transportation included preparing transportation rate proposals and testimony for rate cases involving various segments of the trucking industry. I have been employed as an economist at the Office of the Public Counsel (Public Counsel or OPC) since 1991.

Q. **HAVE YOU TESTIFIED PREVIOUSLY BEFORE THIS COMMISSION?**

A. Yes, prior to this case I submitted written testimony in numerous gas rate cases, several electric rate design cases and rate cases, as well as other miscellaneous gas, water, electric, and telephone cases.

Q. HAVE YOU PROVIDED COMMENTS OR TESTIMONY TO OTHER REGULATORY OR LEGISLATIVE BODIES ON THE SUBJECT OF ELECTRIC UTILITY REGULATION AND RESTRUCTURING?

A. Yes. I have provided comments and testimony to the Federal Energy Regulatory Commission (FERC), the Missouri House of Representatives Utility Regulation Committee, the Missouri Senate's Commerce & Environment Committee and the Missouri Legislature's Joint Interim Committee on Telecommunications and Energy.

Q. HAVE YOU BEEN A MEMBER OF, OR PARTICIPANT IN, ANY WORK GROUPS, COMMITTEES, OR OTHER GROUPS THAT HAVE ADRESSED ELECTRIC UTILITY REGULATION AND RESTRUCTURING ISSUES?

A. Yes. I was a member of the Missouri Public Service Commission's (the Commission's) Stranded Cost Working Group and participated extensively in the Commission's Market Structure Work Group. I am currently a member of the Missouri Department of Natural Resources Weatherization Policy Advisory Committee and the National Association of State Consumer Advocates (NASUCA) Electric Committee. I have served as the small customer representative on both the Standards Authorization Committee and Operating Committee of the North American Electric Reliability Council (NERC) and as the public consumer group representative to the Midwest ISO's (MISO's) Advisory Committee. During the early 1990s, I served as a Staff Liaison to the Energy and Transportation Task Force of the President's Council on Sustainable Development.

I. INTRODUCTION AND RECOMMENDATONS

Q. PLEASE IDENTIFY THE ISSUES THAT YOU WILL BE ADDRESSING IN YOUR TESTIMONY.

A. The major issues that are addressed in this testimony include:

- Whether the Commission should approve a Fuel Adjustment Clause (FAC) for Aquila, Inc. ("Aquila" or "the Company") in this case;
- The Commission's discretion to approve, modify or reject FAC applications;
- The appropriate framework for assessing the public interest consideration in FAC applications and how these considerations apply to Aquila's situation; and
- Would permitting Aquila's FAC proposal be consistent with the Commission's rules for FACs?

Q. DOES PUBLIC COUNSEL BELIEVE THE COMMISSION SHOULD APPROVE THE ESTABLISHMENT OF A FUEL ADJUSTMENT CLAUSE FOR AQUILA IN THIS CASE?

A. No. Public Counsel believes that Commission approval of a FAC for Aquila would not be consistent with the public interest. In addition, as described later in this testimony, Aquila has not fully complied with the filing requirements set forth in section (2) of 4 CSR 240-3.161 (Electric Utility Fuel and Purchased Power Cost Recovery Mechanisms Filing and Submission Requirements) so it has not satisfied the prerequisites for receiving Commission approval of its proposed FAC in this case.

II. COMMISSION DISCRETION IN APPROVING FAC APPLICATIONS

Q. WHAT FACTORS SHOULD THE COMMISSION CONSIDER IN DECIDING WHETHER TO PERMIT AQUILA TO HAVE A FUEL ADJUSTMENT CLAUSE?

A. The factors that Public Counsel believes should be considered by the Commission include the following:

- Would permitting Aquila to use a FAC be consistent with the public interest?

- Does Aquila have a need for a FAC because it would face a substantial threat to its financial viability if it did not have a FAC in effect that would recover some or all of the increased costs of fuel and purchased power in between rate cases?
- Would permitting Aquila to use a FAC be consistent with the Commission's rules for FACs?

Q. DOES PUBLIC COUNSEL BELIEVE THE COMMISSION HAS THE DISCRETION TO DENY A FAC BASED ON ITS ASSESSMENT OF THE CONSIDERATIONS LISTED IN THE PRECEDING ANSWER?

A. Yes, both SB 179 and the Commission rules that implemented the legislation (4 CSR 240-3.161 Electric Utility Fuel and Purchased Power Cost Recovery Mechanisms Filing and Submission Requirements and 4 CSR 240-20.090 Electric Utility Fuel and Purchased Power Cost Recovery Mechanisms) make it clear that the Commission is **permitted** to approve a fuel adjustment clause but that it is **not required** to do so. There are at least two portions of 4 CSR 240-20.090 that address the Commission's discretion to approve, modify or reject applications to establish a rate adjustment mechanism (RAM).

Q. HOW IS THE TERM "RAM" DEFINED IN 4 CSR 240-20.090?

A. This term is defined in 4 CSR 240-20.090(1)(G) as follows:

> (G) Rate adjustment mechanism (RAM) refers to either a fuel adjustment clause or an interim energy charge.

Q. WHICH SECTIONS OF 4 CSR 240-20.090 GIVE THE COMMISSION THE DISCRETION TO APPROVE, MODIFY OR REJECT AN APPLICATION FOR A FAC?

A. Section (2) and subsection (2)(A) of 4 CSR 240-20.090 give the Commission the discretion to decide whether to approve, modify or reject applications to establish either a fuel adjustment clause or an interim energy charge. Section 2 states:

> (2) Applications to Establish, Continue or Modify a RAM. Pursuant to the provisions of this rule, 4 CSR 240-2.060 and section 386.266, RSMo,

> only an electric utility in a general rate proceeding may file an application with the commission to establish, continue or modify a RAM by filing tariff schedules. Any party in a general rate proceeding in which a RAM is effective or proposed may seek to continue, modify or oppose the RAM. **The commission shall approve, modify or reject such applications to establish a RAM only after providing the opportunity for a full hearing in a general rate proceeding.** The commission shall consider all relevant factors that may affect the costs or overall rates and charges of the petitioning electric utility. (Emphasis added)

This section makes it clear that the Commission must review FAC applications and determine whether such an application should be approved based on the evidence presented in a general rate proceeding. This section also requires that the Commission make its determination based upon its consideration of "all relevant factors that may affect the **costs or overall rates and charges** of the petitioning electric utility." (Emphasis added). Public Counsel's interpretation of the preceding excerpt from the rule is that if the Commission finds that the implementation of a FAC will tend to put upward pressure on costs (e.g. due to decreased incentives for the utility to acquire fuel and purchased power at the lowest cost), the Commission can reject a FAC application.

The other provision in 4 CSR 240-20.090 which makes it clear that the Commission must exercise its judgment in determining whether to approve, modify or reject applications to establish a either a FAC is subsection (2)(A) which states:

> (2)(A) The Commission **may approve** the establishment, continuation or modification of a RAM and associated rate schedules provided that it finds that the RAM it approves is reasonably designed to provide the electric utility with a sufficient opportunity to earn a fair return on equity and so long as the rate schedules that implement the RAM conform to the RAM approved by the commission. (Emphasis added)

The above quoted sub-section also makes it clear that the Commission is permitted to approve a RAM, but is not required to do so. I believe this section also makes it clear that the Commission must make a finding in its approval of a RAM that the proposed RAM is expected to result in the utility earning a "fair return." If the Commission finds that a proposed RAM is expected to result in the utility earning more than a fair return, this rule provision would make approval of such a RAM unlawful. I believe this provision also makes it clear that an approved RAM would be "reasonably designed" if it provides the utility with an "opportunity" to earn a fair return but that a RAM would not be "reasonably designed" if it went beyond providing an "opportunity" to earn a fair return by essentially guaranteeing the level of return on equity that a utility will earn.

III. THE COMMISSION'S ASSESSMENT OF PUBLIC INTEREST CONSIDERATIONS

Q. HOW DOES PUBLIC COUNSEL BELIEVE THE COMMISSION SHOULD UTILIZE THE DISCRETION THAT IS HAS, PURSUANT TO THE RULE, TO EITHER APPROVE, MODIFY OR REJECT AN APPLICATION FOR A FAC?

A. Public Counsel believes that the Commission should utilize its discretion in the same manner that it makes most of its other regulatory decisions. The basic standards that the Commission should rely on are:

- Will departing from the traditional mode of Missouri utility regulation by approving a FAC be consistent with the public interest?
- Will the rates resulting from the exercise of its discretion to approve, modify or reject applications to establish a FAC be "just and reasonable"?

Q. HOW SHOULD THE COMMISSION GO ABOUT DETERMINING WHETHER APPROVING A FAC FOR AQUILA WILL BE CONSISTENT WITH THE PUBLIC INTEREST?

A. There are a large number of relevant factors that must be considered in making this determination. These factors include:

- The impact that the new mode of regulation will have on Aquila's incentives to minimize (subject to risk considerations) its fuel and purchase power costs.

- The impact that the new mode of regulation will have on Aquila's incentives to make reasonable resource planning decisions, including the optimization of generation asset investment and generation maintenance costs.
- Whether the proposed FAC is reasonably designed so it does not (1) guarantee that Aquila will achieve at least some given return on equity or (2) provide the utility with an opportunity to earn excessive returns above the level that is reasonable.
- Whether the projected combined impact of all of the provisions in the proposed FAC and the rate schedules that implement it are consistent with the public interest.
- Does it make sense to transfer the risk and costs of fuel and purchased power price fluctuations from the utility to customers when the utility's capability to manage this risk far exceeds the customers capability to manage it?

Q. DO YOU BELIEVE THAT COMMISSION APPROVAL OF A FAC FOR AQUILA WOULD HAVE AN ADVERSE IMPACT ON ITS INCENTIVES TO MINIMIZE (SUBJECT TO RISK CONSIDERATIONS) ITS FUEL AND PURCHASE POWER COSTS?

A. Yes. The change in incentives that occurs when a utility uses a fuel adjustment clause has even been acknowledged by Charles Mueller, the former President and CEO of Missouri's largest regulated electric utility, Union Electric Company. In Mr. Mueller's "Chairman's Letter" that was part of Ameren's 1998 Annual Report to Shareholder's, Mr. Mueller stated:

> We continue to reduce costs by increasing operating efficiency through the effective use of technology. These initiatives range from installation of remote sensing devices on our distribution lines to expansion of our automated meter system — now the world's largest. **We are also focused on lowering fuel costs. In 1998 in Illinois, we chose to eliminate the fuel adjustment clauses, which called for offering credits if certain fuel costs dropped or increasing customer bills if they rose. That decision, coupled with the fact that we have operated**

> **for several years without a fuel adjustment clause in Missouri, has given us additional incentive to continue to manage our fuel costs effectively.** Our four AmerenUE coal-fired power plants continue to use substantial quantities of lower cost, low-sulfur Western coal, reducing production costs and emissions. In 1998, AmerenCIPS' Newton Plant began using Western coal. We will continue to aggressively explore these and other options to reduce our fuel costs. (Emphasis added)

Mr. Mueller's statement about the "additional incentive" for Ameren to manage its fuel cost that occurred when the Company eliminated its fuel clause in 1998 for Ameren's regulated utility operations in Illinois demonstrates the strong impact that the presence or absence of a fuel clause can have on the financial incentives to manage fuel costs The paragraph that is quoted above starts at the bottom of the first page of the "Chairman's Letter" (see page 2 of Attachment 1).

Q. HAVE YOU REVIEWED INFORMATION ABOUT THE STEPS THAT AQUILA HAS TAKEN TO MANAGE ITS FUEL PRICE VOLITILITY RISK IN MISSOURI?

A. Yes. Aquila's SEC 10-K for the year ending 12/31/05 has a section on page 71 entitled "Market Risk – Utility Operations" where it summarizes the actions that it has taken to "mitigate the commodity price risk exposure" in its "Missouri electric operations." In the 4th paragraph of the section entitled "Market Risk – Utility Operations" Aquila states:

> **We have taken several measures to mitigate the commodity price risk exposure in our Missouri electric operations.** One of these measures is contracting for a diverse supply of coal to meet 99.8% of our native load fuel requirements of coal-fired generation in 2006 and 94.0% in 2007, respectively. We are currently receiving reduced volumes on one of these coal contracts because of a declared partial force majeure that occurred in 2001. The price risk associated with our natural gas and on-peak spot market purchased power requirements is also mitigated through a dollar-cost averaging hedging plan using NYMEX futures contracts and options. This is a multi-year hedging plan. As of December 31, 2005, we had financial contracts in place to hedge approximately 57% of our expected on-peak natural gas and natural gas equivalent purchase power exposure for 2006. (Emphasis added)

Aquila noted in the second paragraph in the "Market Risk – Utility Operations" section of its 10-K that the other two states [Kansas and Colorado] where it had electric operations during 2005 both had "ECAs that serve a purpose similar to the PGA's for our gas utilities" but that its Missouri electric operations did not have a similar "fuel adjustment mechanism." There was no mention in this section of Aquila's 10-K of any steps that the Company took to manage fuel price risk exposure at its electric operations in Kansas and Colorado so it appears that Aquila does not place a similar emphasis on managing its price risk exposure in states where it has a fuel adjustment mechanism that transfers this exposure from the utility to consumers. The Commission should take into account the reduced attention that Aquila will likely give to hedging at its Missouri electric operations when determining whether approving Aquila's proposed FAC would be consistent with the public interest.

Q. THE COMMISSION OFTEN NEEDS TO ASSESS THE UNIQUE SITUATION OF EACH UTILITY AND THE BUSINESS ENVIRONMENT IN WHICH IT OPERATES AS IT MAKES DECISIONS ABOUT HOW A UTILTY SHOULD BE REGULATED, THE RETURN ON EQUITY THAT IT SHOULD HAVE AN OPPORTUNITY TO EARN, AND THE LEVEL OF RATES THAT IT SHOULD BE PERMITTED TO CHARGE ITS CUSTOMERS. IS THAT TYPE OF ASSESSMENT REQUIRED IN THE COMMISSION'S EXERCISE OF ITS DISCRETIION TO APPROVE, MODIFY OR REJECT A UTILITY'S FAC APPLICATION?

A. Yes, definitely.

Q. WHAT ARE SOME OF THE ASPECTS OF A UTILITY'S SITUATION THAT SHOULD BE ASSESSED BY THE COMMISSION AS IT MAKES DETERMINATIONS ABOUT FAC APPLICATIONS IN RATE CASES?

A. Public Counsel believes that the unique circumstances that should be assessed include the following:

- Is the utility's power supply cost structure vulnerable to changes in fuel and purchased power costs and if so, is this vulnerability due to factors that are beyond the utility's control?

- If the utility's power supply cost structure is vulnerable to changes in fuel and purchased power costs, is this vulnerability, combined with the present status of the utility's financial health (assuming any poor financial health is due to factors beyond the utility's control), so great that the financial viability of the utility could be threatened by addressing future increases in the cost of fuel and purchased power with the traditional ratemaking process used in Missouri where there is no FAC?

- If the utility's power supply cost structure is vulnerable to changes in fuel and purchased power costs, was this vulnerability caused by the utility management's actions or its failure to take appropriate actions?

- If the present status of the utility's financial health is questionable, was this caused by the utility management's actions or its failure to take appropriate actions?

- Has the utility taken prudent actions to hedge its vulnerability to increases in fuel and purchased power costs through (1) appropriate planning and acquisition of supply and demand-side resources and (2) appropriate hedging of generation fuel costs?

- Has the utility made a commitment to, and provided an adequate plan for, taking prudent actions to hedge its vulnerability to increases in fuel and purchased power costs through (1) appropriate planning and acquisition of supply and demand-side resources and (2) appropriate hedging of generation fuel costs over the 4-year period when the proposed FAC would be in effect?

- If the utility is seeking to pass the costs of SO2 and NOX allowance costs through its proposed FAC, has the utility developed and implemented a reasonable environmental compliance plan?

Q. DOES PUBLIC COUNSEL BELIEVE THAT AQUILA'S CIRCUMSTANCES WITH RESPECT TO THE FACTORS LISTED ABOVE SHOULD LEAD THE COMMISSION TO CONCLUDE THAT APPROVING AQUILA'S FAC APPLICATION IS CONSISTENT WITH THE PUBLIC INTEREST?

A. No. The Commission has approved updating Aquila's cost through December 31, 2006 so the Company's coal and natural gas costs will already be set at a level that will reflect Aquila's fuel costs through December 31, 2006. Aquila has a program for hedging its gas costs and it has **not** shown that its vulnerability to changes in gas costs are great enough to merit moving to a different mode of regulation with a FAC where the public would lose the protection that it currently receives from existing incentives for Aquila to manage its fuel costs wisely.

Q. TO WHAT DEGREE IS AQUILA'S EXPOSURE TO FUEL AND PURCHASED POWER COST VOLATILITY THE RESULT OF ITS OWN POOR RESOURCE PLANNING AND DECISION-MAKING?

A. Most of the fuel and purchased power cost volatility that Aquila faces at this time is the result of poor resource planning decisions that go at least as far back as Aquila's (Aquila's name was UtiliCorp United, Inc. at the time) decision to build the Aries plant as a merchant plant in order to have more generating capacity to meet its native load. At that time, Aquila saw meeting the resource needs of its regulated Missouri customers as an opportunity to generate profits for its non-regulated operations. Aquila's resource planning process and the decisions that resulted from it have continued to flounder since that time. Aquila was required to submit a resource plan to Staff and OPC in 2005 and the plan that was submitted was not a credible effort. It was seriously lacking in several areas including the range of resources that were considered, the demand-side analysis, the range of alternative plans considered and the risk and integrated analysis that was performed. Aquila has an opportunity to show that it can do a more credible job at resource planning when it files a new resource plan with the Commission next month but at this time I have no reason to be confident that the many shortcomings of its 2005 resource plan will be fully addressed.

Q. TO WHAT DEGREE IS AQUILA'S LACK OF A STRONG FINANCIAL POSITION AT THIS TIME THE RESULT OF DECISIONS MADE BY AQUILA'S MANAGEMENT IN AREAS OF THE COMPANY'S OPERATIONS OTHER THAN ITS MISSOURI REGULATED UTILITY OPERATIONS?

A. If Aquila's Missouri utility operations were ring-fenced from the rest of the Company, I do not believe that these operations would have ever suffered the credit downgrades that Aquila has received. Aquila's problems with its financial stability over the last few years are primarily a result of poor investment and operational decisions that were made by Aquila's management in an effort to achieve high rates of earnings growth from its non-regulated power marketing and merchant generation activities.

Q. HAS AQUILA BEEN PROVIDING INFORMATION TO THE INVESTMENT COMMUNITY WHICH INDICATES THAT IT HAS MOSTLY RECOVERED FROM THE POOR FINANCIAL HEALTH THAT IT WAS EXPERIENCING SEVERAL YEARS AGO?

A. Yes. The PowerPoint presentation (Attachment 2 contains 6 pages from this 28 page presentation) that Aquila put together for its November 2, 2006 investor conference call indicates that Aquila has reached the "last chapter" (See page 3 of Attachment 2) of its "repositioning" efforts. On page 2 of Attachment 2, Aquila presented graphs showing the dramatic progress (with respect to equity ratio and "debt and other obligations") that the Company has made to mitigate the damage to its capital structure that resulted from its non-regulated initiatives. Page 4 of Attachment 2 lists the 14 "repositioning" tasks that Aquila had completed as of November 2, 2006 and the 2 efforts that are still underway.

Q. WHAT ARE SOME OF THE CHARACTERISTICS OF A UTILITY'S OPERATING ENVIRONMENT THAT SHOULD BE ASSESSED BY THE COMMISSION AS IT MAKES DETERMINATIONS ABOUT FAC APPLICATIONS IN RATE CASES?

A. Public Counsel believes that the characteristics of a utility's operating environment that should be assessed include the following:

- Are the prices of some or all of the fossil fuels that the utility burns in its generating units expected to have substantial volatility over the next few years?
- Are the wholesale electric markets from which the utility obtains energy and capacity expected to have substantial volatility over the next few years?

Q. DOES PUBLIC COUNSEL BELIEVE THAT THE CHARACTERISTICS OF AQUILA'S OPERATING ENVIRONMENT WITH RESPECT TO THE FACTORS LISTED ABOVE SHOULD LEAD THE COMMISSION TO CONCLUDE THAT APPROVING AQUILA'S FAC APPLICATION IS CONSISTENT WITH THE PUBLIC INTEREST?

A. No. While Aquila has a portfolio of generation resources that gives it a fair amount of exposure to fluctuations in the price of natural gas and purchased power, this exposure is due to decisions made by Aquila's management during a time that it was focusing on making risky investments outside of Missouri. Aquila's Missouri customers should not be burdened with a FAC because Aquila failed to make prudent investments in its Missouri infrastructure during a time when the Company's management was fixated on trying to make the kind of returns that Enron was making prior to its collapse.

Q. THE COMMISSION OFTEN NEEDS TO ASSESS THE COMBINED IMPACT OF A NUMBER OF FACTORS TO DETERMINE THE LIKELY NET IMPACT THAT ITS DECISIONS WILL HAVE ON THE INTERESTS OF THE PUBLIC. IS THAT TYPE OF ASSESSMENT REQUIRED IN THE COMMISSION'S EXERCISE OF ITS DISCRETIION TO APPROVE, MODIFY OR REJECT A FAC APPLICATION?

A. Yes, the impacts of implementing a major change in the way an electric utility is regulated, such as the changes accompanying a FAC clause, are numerous and complex. In order to estimate the net impact on consumers of approving an FAC application, the Commission would need to look at the net impact of a number of factors, including:

- The decreased ROE, if any, that will be reflected in the approved revenue requirement and customers' rates due to transfer of risk from shareholders to ratepayers.
- The increased costs and volatility that will likely be passed through to consumers as a result of the decreased incentive for a utility to minimize and hedge its fuel and purchased power costs.
- The increased costs that may be passed through to consumers if the Commission's resource planning oversight is not able to counteract the perverse incentives that utilities with an FAC have for relying more heavily on natural gas generating resources and purchased power due to: (1) the FAC mechanism for passing through changes in gas prices and purchased power costs when they fluctuate, (2) the absence of capital costs associated with short-term power purchases and (3) the lower capital costs associated with gas-fired generation compared to coal and nuclear generation.
- The increased costs that may be passed through to consumers if the utility reduces spending on generation efficiency improvements and maintenance costs as a result of the new incentive structure caused by the differing ratemaking treatment of FAC costs and costs that are still addressed in rate cases through the traditional ratemaking process.
- In the Commission's order of rulemaking in Case No. EX-2006-0472 (page 9), the Commission appeared to acknowledge the risk that some aspects of the new rule may not work out as expected where it stated that "in light of the fact that these

rules are highly complex, establish an entirely new procedure and are likely to contain provisions that will need to be altered, added or deleted, the Commission finds it appropriate to leave in the date certain by which the rules will be reviewed."

IV. AQUILA'S FAC PROPOSAL COMPLIANCE WITH COMMISSION FAC RULES

Q. DID AQUILA INCLUDE ALL OF THE INFORMATION REQUIRED BY THE RULE ADOPTED BY THE COMMISSION ENTILTLED "ELECTRIC UTILITY RULE AND PURCHASED POWER ADJUSTMENT CHARGES AND INTERIM ENERGY CHARGE MECHANISMS FILING AND SUBMISSION REQUIREMENTS" (4 CSR 240-3.161) AS PART OF, OR IN ADDITON TO ITS TESTIMONY?

A. I do not believe so. I have not been able to locate all of the required information in Aquila's testimony and the attachments thereto. Some of the required information that I have not been able to locate is information that is responsive to section (2) of 4 CSR 240-3.161 including subsections (H), (L), (O), (P), (Q), (R) and (S).

Q. IS A UTILITY REQUIRED TO MEET THE FILING REQUIREMENTS IN 4 CSR 240-3.161 BEFORE THE COMMISSION CAN GRANT A UTILITY'S REQUEST FOR A FAC?

A. Yes. Subsection (2)(G) of 4 CSR 240-20.090 states:

> (G) The electric utility shall meet the filing requirements in 4 CSR 240-3.161(2) in conjunction with an application to establish a RAM and 4 CSR 240-3.161(3) in conjunction with an application to continue or modify a RAM.

Q. DID AQUILA MAKE A GOOD FAITH EFFORT TO COMPLY WITH ALL OF THE RELEVANT FILING REQUIREMENTS IN 4 CSR 240-3.161?

A. No. It would have been quite simple for the Company to include some kind of roadmap in either its testimony or an attachment to guide readers to the information that was responsive to each of the pertinent filing requirements but it made no attempt to do so. Instead, the reader was required to skip from witness to witness and try to guess at which filing requirement each witness was trying to address. I have not been able to locate a single reference in Aquila's testimony to the rule adopted by the Commission entitled "Electric Utility Rule and Purchased Power Adjustment Charges and Interim Energy Charge Mechanisms Filing and Submission Requirements" (4 CSR 240-3.161).

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes.

1998 ANNUAL REPORT

Strong *Fundamentals* EFFECTIVE Solutions

Ameren

Chairman's Letter

Charles W. Mueller
Chairman, President,
and Chief Executive Officer
Ameren Corporation

Our year was characterized by *efficient use of resources* AND EXPANDED SERVICE OPTIONS for all customers

To Our Owners

Over the past year, we have followed a well-defined strategy to capitalize on our generating assets, grow earnings, reduce costs and effectively manage regulatory and market uncertainties. We have enhanced the performance of our existing assets and made necessary investments to prepare for an increasingly competitive environment. That strategy has proved both durable and successful.

We continue to seek opportunities to maximize our generating assets. Ameren ranks 11th in the nation in generation capacity. 1998 was marked by several initiatives to secure and enhance this position by increasing the availability of our coal-fired plants and sustaining the already strong performance of our nuclear unit. Our Labadie and Rush Island plants set all-time generation records in 1998, while our Callaway Nuclear Plant needed only 31 days to complete its ninth refueling, tying the record set during the plant's last refueling in the fall of 1996. This record was the second shortest of any of the 27 nuclear plant refuelings conducted in the spring of 1998. Callaway continues to rank as one of the nation's best managed nuclear plants, earning recognition for operating efficiency and safety in a period of increased regulatory scrutiny.

These generation resources paid dividends in the summer of 1998 when utilities were paying unprecedented prices for power purchases. We effectively managed power costs in the face of soaring wholesale electricity prices, and these abnormally high prices had little impact on Ameren's financial results, unlike the experience of several other utilities. The year also marked further development of our energy trading and marketing affiliate. AmerenEnergy is now poised to capitalize on Ameren's strong generation assets. Finally, in 1998 we signed contracts that set the stage for the installation of combustion turbines that, by the year 2001, will add more than 700 megawatts to our generating capacity. We continue to grow earnings through core business development and investment in new products and energy-related ventures. We are developing a stream of attractive products and services that will benefit our customers and enhance our company's earnings growth. These include a number of technologically sophisticated products, from an automated bill consolidation service Ameren Ability to an energy management product Ameren Abacus that allows business or institutional customers to track energy use by process, building or facility.

Another of Ameren's major ventures involves partnerships with design and engineering firms. Foremost among these is Gateway Energy Systems, a firm that desugns, builds, finances, owns and operates utility systems for large institutional and industrial customers. In 1998, Gateway Energy sealed a 20-year contract to build a $20 steam facility for a Fortune 500 company.

We continue to reduce costs by increasing operating efficiency through the effective use of technology. These initiatives range from installation of remote sensing devices on our distribution lines to expansion of our automated meter system — now the world's largest. We are also focused on lowering fuel costs. n 1998 in Illinois, we chose to eliminate the fuel adjustment clauses, which called for offering credits if certain fuel costs dropped or increasing customer bills if they rose. That decision, coupled with the fact that we have operated for several years without a fuel adjustment clause in Missouri, has given us additional incentive to continue to manage our fuel costs effectively. Our four AmerenUE coal-fired power plants continue to use substantial quantities of lower cost, low-sulfur Western coal, reducing production costs and emissions. In 1998, AmerenCIPS' Newton Plant began using Western coal. We will continue to aggressively explore these and other options to reduce our fuel costs.

In addition, we realize that increased productivity is critical to controlling operating costs. In 1998 we eliminated more than 400 positions, essentially without layoffs, through a hiring freeze and a targeted separation plan. These reductions will yield savings of approximately $20 million to $25 million annually.

Ameren's entire work force now stands at approximately 7,450 employees — the level of employment for Union Electric alone in 1987. Compared to a decade ago, Ameren companies are serving 8% more customers — with 24% fewer employees. In 1998, Public Utility Fortnightly, a leading industry publication, recognized Ameren as one of the nation's most efficient utilities, ranking our company as the second "most improved" and 11th most efficient.

Earnings Per Share

*Excluding an extraordinary charge of $.38.

We will continue to improve our efficiency as we refine our strategies and determine the skills that are most important in meeting the challenges of a competitive environment.

Finally, we are effectively managing the market and regulatory uncertainties we face by remaining visible and active in the industry restructuring debate and on other issues. We have continually communicated to a range of government officials that we cannot support initiatives aimed at increasing competition in ways that do not adequately protect our shareholders and our customers.

On the environmental front, we are using our resources to propose alternatives to the several stringent, technically flawed regulations that federal environmental officials proposed and established in 1998. We continue to research, investigate and test technologies that offer workable and affordable alternatives.

Going forward, our strategy's operating model will increasingly be based on a business line approach. These business lines include generation; energy transmission and distribution; retail customer service; business and corporate services; and non-regulated operations. Business line teams spent 1998 planning and developing strategies that will yield added revenue and cost savings.

These efforts will keep our management and employees focused on the specific strategies that bring bottom line results in an ever-changing competitive environment. As we mark the completion of our first full year as Ameren Corporation, we can tell you that our strategy has brought results.

1998 Financial Performance In 1998, our company earned $386 million, or $2.82 per share. This compares to 1997 earnings of $335 million, or $2.44 per share, including a 1997 extraordinary charge. That charge of $52 million, net of income taxes, reduced 1997 earnings 38 cents per share. Excluding nonrecurring charges, ongoing earnings for 1998 were $2.93 per share, compared to $2.77 per share for 1997.

Electric revenues were up slightly in 1998 over 1997, despite rate decreases and a $43 million credit to Missouri electric customers. These reduced earnings 6 cents and 18 cents per share, respectively. Kilowatthour sales to retail customers within our service territory were up 4%. Our annual sales growth — in a now-expanded, economically strong service area — stands at better than 2%.

Electric Industry Restructuring in Illinois Ameren continued to develop technology, organize staffs and contribute to working groups the state created to respond to the multiple requirements of 1997 legislation setting the stage for provider choice. Certain large commercial and industrial customers in Illinois can choose their energy providers in late 1999, with all business and residential customers able to choose providers by May 2002. The law also called for a 5% rate reduction that began Aug. 1, 1998, for our Illinois residential customers. That rate decrease is expected to reduce future annual revenues by approximately $14 million ($8 million over 1998).

Electric Industry Restructuring in Missouri Missouri legislators and regulators continue to analyze the issue of provider choice. As members of various restructuring task forces and committees, Ameren's managers continue to be very active in promoting the interests of its investors and customers.

In Summary Ameren Corporation is a stronger and more focused company than ever before. We are confident that our operating performance, growth initiatives and strategic direction will make Ameren a success in any competitive environment.

Service Area Kilowatthour Sales
In Billions

We are investing in the people, technology and facilities that support our core energy business. Through our merger and direct sales initiatives, we are expanding our market area and customer base. We continue to develop products that retain and attract customers, as we selectively pursue non-regulated business opportunities. While we do not underestimate the challenges, we enter the new era committed to returning value to you, our shareholders.

Going forward, we are enthusiastic about the opportunities that are open to a financially strong company, like ours. We realize that you will be best served by a company that can maintain its low-cost advantage, meet customers' total energy needs and deliver superior earnings growth.

Our thanks go to our employees and to our dedicated directors who have been actively involved in charting our course.

Sincerely,

Charles W. Mueller

Chairman, President and Chief Executive Officer

February 10, 1999

Aquila

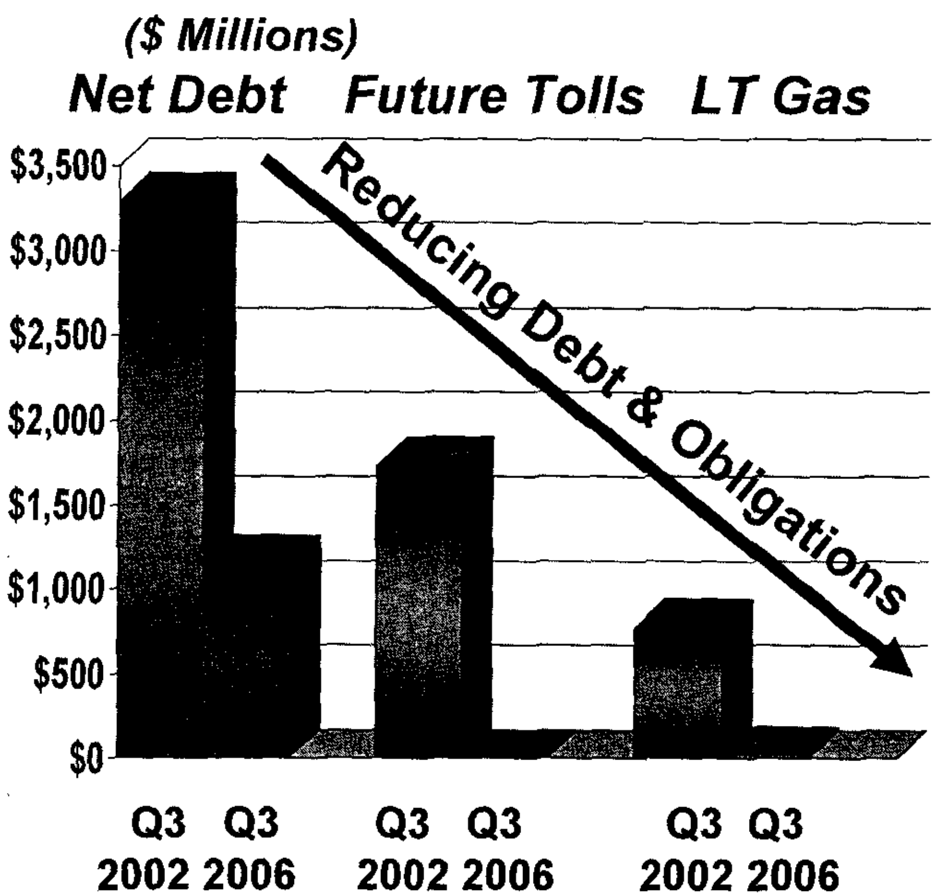
Aquila
Q3 2006 Financial Results Call
November 2, 2006

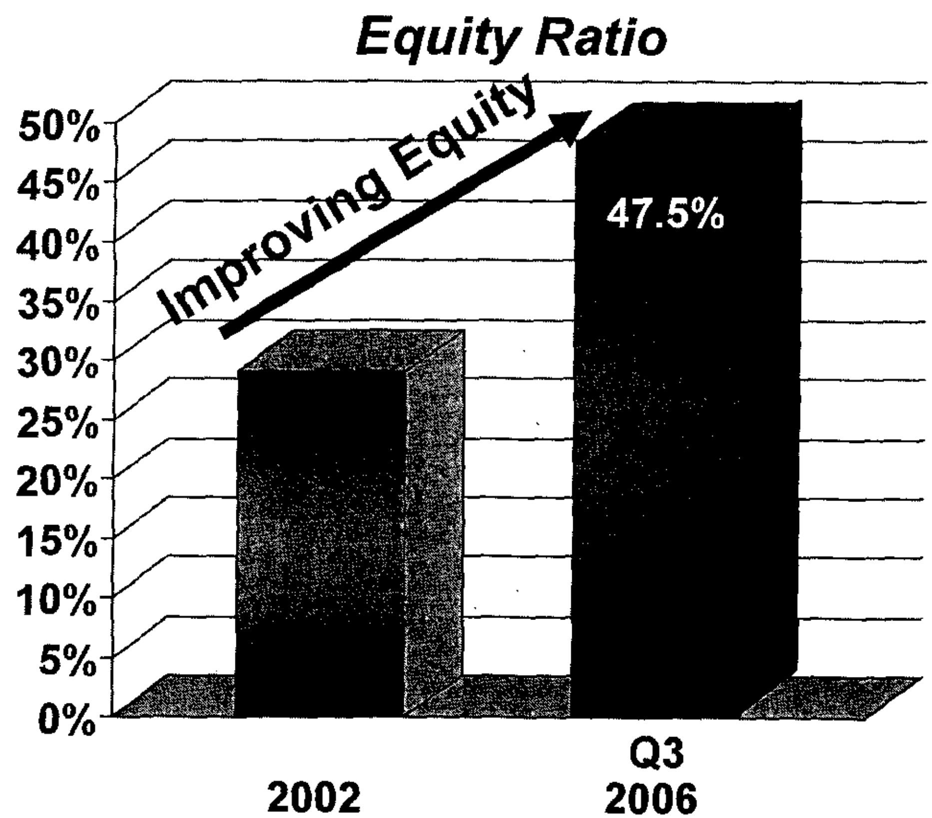
Rick Green
Chief Executive Officer

Beth Armstrong
Chief Accounting Officer

Keith Stamm
Chief Operating Officer

Strengthening Our Capital Structure





Our focus remains on reducing debt

Final Chapter of the Repositioning

Aquila

Wrapping Up Repositioning

2002 - Present —— Future Actions

Delivered Results

- ✓ Exited non-core businesses
- ✓ Contracted Sales of $4.6 billion of assets
- ✓ Terminated $1.6 billion of tolls
- ✓ Terminated 4 long-term gas contracts
- ✓ Decreased debt by over $2.1 billion; improved maturity profile
- ✓ Raised $446 million from equity markets in 2004
- ✓ Completed early exchange of PIES
- ✓ Obtained efficient working capital financing
- ✓ Closed Elwood settlement
- ✓ Closed Everest sale
- ✓ Closed Minnesota sale
- ✓ Closed Missouri sale
- ✓ Completed debt tender offer
- ✓ Prepaid term loan

Work Remaining

- Complete KS Electric asset sale
- Debt reduction & restructuring

Aquila

Deploying Asset Sale Proceeds – $ Millions

Sources:		
Merchant Peakers	March 2006	$175.0
Michigan Gas (1)	Thru Q3 2006	339.9
Missouri Gas (1)	May 2006	102.1
Everest (net)	June 2006	76.0
Minnesota Gas (1)	Thru Q3 2006	317.9
YTD Proceeds (1)		$1,010.9
Uses:		
Elwood	June 2006	$(218.0)
Debt Reduction (2)	June 2006	(382.7)
Prepaid Term Loan (2)	September 2006	(215.3)
YTD Uses		$(816.0)
Proceeds Still Available for Use		$194.9
Kansas Electric	2007	249.7
Available Proceeds – Current & Pending		$444.6

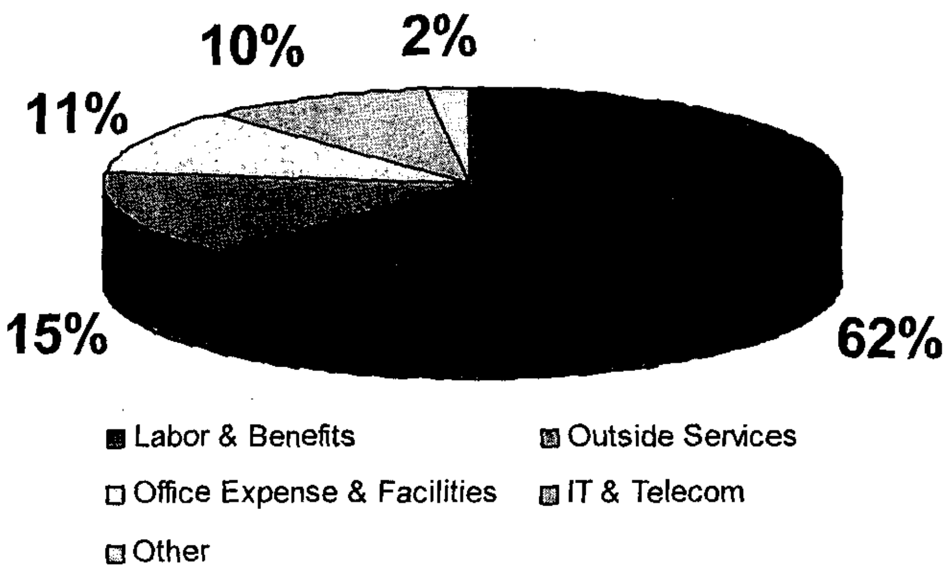
(1) - includes working capital. (2) - includes premium.

Aquila

Targeted Efficiencies Being Realized

Reduce Operating Costs

2005 $42.3 Million *



* Previously allocated to discontinued operations

Actions to Date

- Headcount reduced by 190; plan is total reduction of 220.
- Significant consolidation of facilities has occurred.
- Negotiation of new contracts for smaller Aquila going forward.