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In the Matter of the Tariffs of Aquila, Inc., d/b/a Aquila Networks - MPS and Aquila Networks - L&P Increasing Electric Rates for the Services Provided to Customers in the Aquila Networks - MPS and Aquila Networks - L&P Service Area) Case No. ER-2007-0004

CHERLYN D. VOSS, Presiding
REGULATORY LAW JUDGE
JEFF DAVIS, Chairman,
CONNIE MURRAY,
STEVE GAW,
ROBERT M. CLAYTON, III
LINWARD "LIN" APPLING,
COMMISSIONERS

REPORTED BY: Monnie S. VanZant, CCR, CSR, RPR
Midwest Litigation Services
3432 W. Truman Boulevard, Suite 207
Jefferson City, MO 65109
(573) 636-7551

A P P E A R A N C E S

For Staff of the Missouri Public Service Commission:

Mr. Kevin A. Thompson
Mr. David Meyer
Mr. Nathan Williams
Mr. Dennis L. Frey
Public Service Commission
200 Madison Street
P.O. Box 309
Jefferson City, MO 65102
(573) 751-6514

For Office of Public Counsel:

Mr. Lewis Mills
Mr. Michael Dandino
Office of the Public Counsel
P.O. Box 2230
200 Madison Street
Jefferson City, MO 65102

For Federal Executive Agencies:

Captain Frank Hollifield
139 Barnes Drive, Suite 1
Tyndall AFB, FL 32403
(850) 283-6348
frank.hollifield@tyndall.af.mil

For AARP:

Mr. John Coffman
Attorney at Law
821 Tuxedo Boulevard
St. Louis, MO 63119
(314) 424-6779

For Department of Natural Resources:

Ms. Shelley A. Woods
Office of the Attorney General
221 W. High Street
P.O. Box 899
Jefferson City, MO 65102

For SIEUA/AGP:

Mr. David Woodsmall
Finnegan, Conrad & Peterson
428 E. Capitol, Suite 300
Jefferson City, MO 65101

Mr. Stuart W. Conrad
Finnegan, Conrad & Peterson
1209 Penntower
3100 Broadway
Kansas City, MO 64111
(816) 753-1122

For Aquila, Inc.:

Mr. Paul A. Boudreau
Mr. James C. Swearengen
Mr. L. Russell Mitten
Ms. Janet Wheeler
Brydon, Swearengen & England
312 E. Capitol Ave.
Jefferson City, MO 65102-0456
(573) 635-7166

For City of St. Joseph:

Mr. William D. Steinmeier
Ms. Mary Ann (Garr) Young
William D. Steinmeier, PC
2031 Tower Drive
Jefferson City, MO 65109
(573) 659-8672

For Kansas City, MO:

Mr. Mark W. Comley
Newman, Comley & Ruth
601 Monroe Street, Suite 301
P.O. Box 537
Jefferson City, MO 65102-0537
(573) 634-2266

P R O C E E D I N G S

JUDGE VOSS: Okay. We're going to resume on the record in Case No. ER-2007-0004. And we're going to begin today with opening statements on the fuel adjustment clause issue beginning with Aquila.

MR. MITTEN: Good morning, your Honor. If it pleases the Commission.

OPENING STATEMENT

BY MR. MITTEN:

MR. MITTEN: Automatic fuel and purchase power recovery mechanisms came into vogue about 30 years ago for one reason, and that is traditional methods of setting rates were unable to adequately deal with volatile and ever-increasing fuel and purchase power costs that affect the costs and earnings of utilities because traditional rate setting mechanisms, at least insofar as they apply to fuel and purchase power costs, have two fundamental flaws.

First is that the 12-month test period that is used to set rates is populated with expenses that are based on estimates. And no matter how thoughtful or well-intentioned, estimates are still estimates.

And in periods when fuel and purchase power costs are increasing significantly year to year, those estimates too often are too low.

The other inherent flaw in traditional

rate-making is the assumption that expense estimates for the one-year test period will recur year after year during the period rates are in effect. And even if the test period estimates are dead-on accurate for the initial year, there's no reason to believe that they will continue to be accurate four years following that initial year.

Now, although the flaws I just mentioned are real, they don't affect the majority of Aquila's operating expenses because the majority of those expenses, which are made up of things like salaries and wages and administrative and general expenses only change year to year by a small amount.

And Aquila, at least in the short-term, is able to manage around those changes so that it still has a reasonable opportunity to earn a fair rate of return. But fuel and purchase power costs are another story entirely.

The evidence in this case will show that fuel and purchase power costs constitute approximately 46 percent of Aquila's annual operations and maintenance expense.

And over the past several years, the company has seen these costs increase significantly year to year. For each of the past three years, Aquila's costs have increased between 13 and 20 percent.

And if you look at 2006 fuel and purchase power expenses, which were approximately $200 million, if the trend continues, then over the next few years, Aquila can expect to see its annual fuel and energy costs increase 30 million or more annually.

Now, I ask you to keep in mind the magnitude of those annual increases as you listen to the testimony of some of the witnesses in this case who suggest that Aquila's cost problems can be solved if the company simply manages its operations better and is more efficient.

A company Aquila's size simply can't manage around $30 million annual increases. It simply can't be done.

So that's the problem that the Commission has to confront in this case, large annual increases in Aquila's fuel and purchase power costs and no adequate way to deal with them using traditional methods of rate-making.

But that problem is not unique to Aquila, and it's not unique to Missouri. Other state regulatory Commissions have had to face that problem. And the way those Commissions have chosen to deal with it is by approving automatic fuel and purchase power cost recovery mechanisms for the electric utilities that they regulate.

Since 1979, this Commission has been prohibited from using fuel adjustment clauses. But with the passage of Senate Bill 179 and the adoption of comprehensive rules governing the filing and administration of fuel adjustment clauses, those legal impediments are now moved, and Missouri can join the regulatory mainstream.

The fuel adjustment clause that Aquila will propose in this case satisfies all of the requirements of both Senate Bill 179 and the Commission's rules, and, as such, it protects the legitimate interests of both Aquila and its customers.

If its proposed fuel adjustment clause is approved, Aquila will at long last be able to timely recover all of its prudently incurred fuel and purchase power costs. And Aquila's customers will be assured that they are neither overpaying nor underpaying for the fuel and energy costs that are necessary to provide them safe and reliable service.

The company's two primary witnesses on the proposed fuel adjustment clause are Dennis Williams and Steven Fetter.

Mr. Williams' testimony will focus on the reasons why Aquila needs a fuel adjustment clause and how that fuel adjustment clause will operate.

Mr. Fetter's testimony addresses the fuel adjustment issue from the perspective of a former state utility Commissioner because Mr. Fetter served for six years as Chairman of the Michigan Public Service Commission.

The Michigan Commission has allowed electric utilities in that state to use automatic adjustment mechanisms for many years. Aquila asked Mr. Fetter to testify in this case not just to address the many criticisms of fuel adjustment clauses, but, also, to speak to the Commission as someone who has dealt with fuel adjustment clauses in the past and has lived to tell about it.

We urge the Commissioners to use Mr. Fetter as a resource, both to answer your questions and, we hope allay your concerns about fuel adjustment clauses.

Not surprisingly, all of the other parties to this case oppose Aquila's proposal, and they will argue that fuel adjustment clauses are contrary to the public interest or that the Commission should prescribe conditions for approval of fuel adjustment clauses that, if adopted, would effectively mean that no fuel adjustment clause will ever be approved in Missouri.

Aquila's evidence in this case will show that these arguments are unfounded or, in some cases, that they already have been dealt with by the Commission.

Some of these parties will also offer what they claim are alternative fuel adjustment clauses. But as it considers these alternative proposals, Aquila asks the Commission to look past their benign facades so that you can see what the proposals really represent. Because stripped of all their euphemisms and high-sounding rationalizations, these alternative proposals have one thing in common.

They ask the Commission to approve a rate adjustment structure that will, by design, prohibit Aquila from recovering a significant portion of its fuel and purchase -- purchase power costs regardless of whether those costs are prudently incurred.

Don't be fooled when the witnesses who propose these alternatives use words like "sharing" to describe their proposals or make claims that their proposals are symmetrical and balance.

Because what the alternatives really involve is, at best, a compelled subsidy from Aquila's shareholders or, at worst, nothing short of confiscation. That's bad regulatory policy, and it's also unlawful.

Staff will propose that the Commission address Aquila's fuel cost recovery problems by imposing interim energy charge. But IECs don't work, largely, because they suffer from the same infirmities as traditional methods of regulation.

If the Commission adopts Staff's proposed interim energy charge in this case, you'll only be ensuring that the IEC's past failures will recur in the future.

With the enactment of Senate Bill 179, the legislature clearly signalled that it had reached three conclusions; first, that ever-increasing fuel and purchase power costs are a significant problem in Missouri electric utilities; second, that traditional modes of rate-making have proven inadequate to address those problems; and, third, that a properly designed fuel adjustment clause is in the public interest.

Through its proposed fuel adjustment clause, Aquila seeks to recover only its prudently incurred fuel and purchase power costs, nothing more.

The majority of state Commissions have allowed fuel cost recovery mechanisms for many years. And despite what some parties in this case may suggest, the sky hasn't fallen in any of those states.

The evidence in this case will show that because Aquila's proposal protects the legitimate interests of both the company and its customers, if the Commission approves Aquila's proposed fuel adjustment clause in this case, we believe that the sky won't fall in Missouri either. Thank you.

JUDGE VOSS: Thank you. I see Mr. Williams has come into the courtroom.

MR. WILLIAMS: Mr. Fry will be here in just a few minutes.

JUDGE VOSS: Okay. We'll move on to Public Counsel's opening on fuel adjustment clause.

MR. MILLS: Thank you, your Honor. Good morning. May it please the Commission.

OPENING STATEMENT

BY MR. MILLS:

MR. MILLS: Public Counsel opposes the granting of a fuel adjustment clause to Aquila largely because Aquila has made its own mess and is now seeking the ratepayers to bail it out of it.

Aquila is overly dependent on natural gas. It got there through its own devices, and it should not ask its ratepayers to bail it out of the mess that its gotten itself into.

Public Counsel witness Ryan Kind, in his direct testimony, sets out a number of factors that the Commission should look at in determining whether or not to use its discretion to allow a utility to receive a fuel adjustment clause.

And I think you will find that the evidence in this case shows that Aquila should not be allowed to use a fuel adjustment clause to recover its fuel and purchase power expense.

Now, with respect to Mr. Mitten's opening statement, Mr. Mitten read three things into what he believes the legislature was thinking when it passed Senate Bill 179.

I submit to you that I believe the process was probably much more simple. I think what happened was the legislature was convinced by the utility lobby that a fuel adjustment clause may have merit under some circumstances and decided to allow the Commission to use the discretion that then the Commission, in its expertise, thought fit.

By definition, allowing the Commission discretion to approve fuel adjustment clauses means that the Commission also has the discretion to turn them down. You won't hear from any utility in Missouri that they think that they don't deserve a fuel adjustment clause.

But you're going to hear from a lot of the utility's customer representatives that some of them don't. You heard it in AmerenUE. You're hearing it in Aquila. You may or may not here it in Empire if it comes up.

But at least so far as Aquila is concerned, Public Counsel urges the Commission to use its discretion and determine that Aquila does not need or warrant a fuel adjustment clause. Thank you.

JUDGE VOSS: Thank you, Mr. Mills. Staff?

MR. FREY: Thank you, your Honor. May it please the Commission.

OPENING STATEMENT

BY MR. FREY:

MR. FREY: The Staff agrees with Aquila that the non-traditional -- non-traditional mechanism is appropriate to address the company's fuel and purchase power costs in this proceeding.

The level of volatility Aquila has experienced in recent years in natural gas and energy prices calls for something other than the traditional single point approach than involving fuel and purchase power costs included in the company's revenue requirement.

Aquila proposes a fuel adjustment clause or the FAC. The staff, on the other hand, recommends and interim energy charge. Both of these mechanisms are now specifically in the newly enacted Section 386.266 of Missouri statutes. Staff witness Cary Featherstone has laid out in his testimony all of the key elements of the Staff's recommended IEC, which are along the lines of the IEC previously ordered by the Commission in Aquila Case No. ER-2004-0034.

In general, it's the same mechanism that the Commission has ordered on three past occasions. Under the

IEC, customers would be charged an amount of fuel and purchase power costs corresponding to a ceiling or a forecast price. And then amount -- an amount corresponding to a floor base price would be included in base rates.

Staff recommended that the IEC be in effect for two years following a true-up at the expiration of the IEC to determine the company's actually incurred variable fuel and purchase power costs.

If those costs fall between the base and the forecast level, Missouri customers would be entitled to a refund of the amount overpaid with interest. If the actual costs come in below the base level, customers would receive a full refund of the IEC amount with interest, and Aquila would retain the difference between the actual amount incurred and the higher base amount.

If Aquila's cost exceed the forecast level, Aquila would absorb the excess cost. Relative to Aquila's previous IEC, the Staff recommends some modifications such as the incorporation of the results of the company's hedging program and the inclusion of the relatively low CW mining contract coal costs in base rates and the higher cost of the replacement coal in the forecast rate so that after the pending lawsuit is decided, any increased costs would be subject to a prudence review.

The Staff would note that its IEC proposal with respect to the CW mining issue is consistent with the settlement of that issue reflected in the stipulation and agreement recently filed in this case.

Staff prefers the IEC over the FAC, primarily because it preserves strong incentives for Aquila to operate efficiently and to make its best efforts to minimize the costs of fuel and energy.

With the exception of Section 386.266, Staff explicitly permits the Commission to build incentive into any rate adjustment mechanism it might approve.

Because of the strong incentives built into the interim energy charge, the IEC approach is more akin to traditional rate-making than the FAC. Total pass-through of costs will have the effect of substantially reducing such incentives.

Now, Aquila is quick to point out that only prudently incurred costs will be passed through to customers following the after the fact audits and that the prudent reviews constitute a strong motivator for the company to operate efficiently and minimize fuel and purchase power costs.

Aquila points out that Missouri already has in place a natural gas utility, an analogous mechanism known as the purchase gas adjustment or PGA. In its associated process, the actual cost of adjustment is for ACA.

However, as Mr. Featherstone points out, after the fact prudent determinations present a far more daunting challenge with respect to electric utilities than they do for natural gas utilities because, in the case of an electric utility, a myriad of situations is involved such as market prices for fuel and energy generation versus purchase, fuel mix, generation mix, fuel quality, heat rates and plant outages.

In effect, with traditional rate-making, many of the prudent issues are automatically resolved in the fuel molding process that is employed during a general rate case. When the Commission adopts a particular fuel model methodology, it is, in effect, determining the prudent way to operate under normal conditions.

Using the IEC approach, the bulk of rates are set in base rates based on the fuel model. The Commission approved IEC does reflect much of this advantage of traditional rate-making in a way that the FAC does not.

Traditional rate-making is concerned with setting rates on a going forward basis. The Staff submits that when the ball game shifts from one of setting rates prospectively to one in which costs are continually at issue and after the fact audits -- and especially involving matters of complex and core operations of an electric utility, it will be extremely difficult to make imprudence determinations.

The IEC has been used in three recent cases, two involving Empire, the Empire District Electric Company, and one involving Aquila. One of the two Empire IECs was successful, and the other, arguably, was not.

Aquila complains that its experience with the IEC was not a success. However, the evidence will show that the company's high fuel and purchase power costs during the effective period of its IEC was due in large part to occurrences such as the CW Mining coal supply problem and the extended Sibley outage, both of which were totally independent of fuel and purchase power costs, but which, nevertheless, resulted in higher fuel and energy costs.

In light of these occurrences, an economist might call them dominant factors, the Staff is much less inclined to pronounce Aquila's last IEC a failure.

In the event that the Commission determines that the fuel adjustment clause is nonetheless appropriate in this proceeding, the Staff would support proposals sponsored by SIEUA and Ag. Processing witness Donald Johnstone.

The most important improvement over Aquila's proposal is the inclusion of a sharing feature by which the company and customers would share on a 50/50 basis the amount of any adjustment when it results in an overcollection or undercollection of the company's costs. Other fees key features were the inclusion of performance standards, the mechanism on fuel and energy price fluctuations and a reduction in the volatility of customers' charges being more extensive collection of recovery, period.

OPENING STATEMENT

BY MR. WOODSMALL:

MR. WOODSMALL: Good morning, your Honor, Commissioners. We have a lot of ground to cover today, so I'll be fairly brief.

Noticeably missing from Mr. Mitten's statement was any discussion regarding Aquila's need for a fuel adjustment clause. Instead, the company continues to talk about fuel volatility, the request that Missouri joins the, quote, regulatory mainstream.

Volatility alone, however, should not be enough for the Commission to depart from the time-tested practice of only changing rates based upon a review of all relevant factors.

Given the logic of the inherent and time-tested factors methodology, SIEUA and AG Processing suggest that the Commission should be -- that the company should be required to show as in a QE. A QE demonstrated by fuel cost projections, a discussion of implemented measures to minimize its fuel costs, consumer protection safeguards of the expected impact of the fuel costs of the company's bottom line. Aquila has shown none of these things.

Not surprisingly, therefore, SIEUA and AG Processing oppose the company's request and believe that the Commission should continue to rely upon the all relevant factors method for setting rates.

Despite our recommendation, if the Commission decides to grant a fuel adjustment clause, SIEUA and AG Processing have proposed an alternative fuel adjustment clause which will implement measures to minimize fuel costs and will ensure that customers are protected against unwarranted cost increases.

In its rebuttal testimony, Mr. Johnstone sets forth an alternative FAC that contains many attractive features. First, if that FAC provides the sharing mechanism, as Mr. Johnstone explains, the sharing mechanism ensures that the company has enough, quote, skin in the game to ensure that it is using its best efforts to minimize fuel costs.

In fact, because of the sharing mechanism, if the company drives down fuel costs, the company will profit for its efforts.

Second, Mr. Johnstone proposes the

implementation of certain performance standards. These standards ensure that the ratepayers are only paying for legitimate fuel and purchase power costs. Specifically, these performance standards will prevent the company from recovering replacement power associated with the unexpected failure of a base load generating facility.

Third, Mr. Johnstone proposes modifications to the company's accumulation period, recovery period, as well as the implementation of a soft cap on rate increases. This alternative FAC was a result of extensive discussion with all customer groups that relies upon extensive analysis as well as the fuel adjustment rules implemented by many other state utility Commissions.

I believe that it's infinitely superior to the alternative provided by Aquila and the Commission should consider it. I encourage you to engage in a discussion with Mr. Johnstone regarding the features of his alternative FAC and the need for those features. Thank you.

JUDGE VOSS: Okay. Thank you. Anyone from the Commercial Group? Federal Executive Agencies?

OPENING STATEMENT

BY CAPTAIN HOLLIFIELD:

CAPTAIN HOLLIFIELD: I might have to move this. It seems like a sacrilege. Your Honor, may it please the

Commission.

I want to start out with a confession. I saddled you all with the theme of responsibility and motivation based largely on this one issue alone. Now, it applies beautifully throughout this.

Those two are crucial in every decision, in every issue that's before the Commission this week and last week. But here, it applies more so than any other. Here, we are making policy.

And in making policy, we're setting the respective relationships between the parties. Here, we allocate responsibility and motivation and determine whether or not it's the right way to do it, whether or not it targets the right people and whether or not it burdens the wrong people.

Now, as an illustration, let's take a look as the system as it is now. And traditional rate-making model, you have a level set here with the rates. It's in essence, a budget. It's a limitation. How much can they do?

Now, we acknowledge what Aquila says in that they have peaks and valleys in gas prices through here. Now, whether it's alarmist, whether it's inaccurate, what have you, Aquila will have you believe that this is just unprecedented, it's something that can't be dealt with under the current system, and there are just no mechanisms to do it.

Well, ladies and gentlemen, in their own testimony, they acknowledge that they can request rate relief for these, and, conversely, although probably somewhat more improbably, they will gladly put back the values. That's, of course, contingent on them ponying up and saying well, We'll -- you know, we've overcollected, and we're going to give back or that you're going to have some group that's going to come to the Commission and then request rate relief on behalf of the ratepayers.

The effect of this budget, the effect of this rate set is a downward influence on spending. It's a downward influence. That's the motivation.

What happens if we do a fuel adjustment mechanism as they propose it, 100 percent pass-through subject to a prudence review? All of a sudden, this doesn't become a solid line. You're talking about a porous board right here.

Does this work as effectively anymore? No, it doesn't. Take it out of the picture. What is the stop gap? What stops them from not exercising optimal economic behavior? A review, the standard of which is prudence.

Well, prudence is kind of misleading. It's not a single question. It's two questions. First, what is prudence? Second is what is being reviewed prudent? It's like the reasonable man standard in civil and criminal law. And best I can recall, there's a lot of case law regarding reasonable man, and it is the subject for a lot of litigation in criminal and civil law. It's the subject it a lot of discourse.

So guess what? Every time we look at this prudence review, which is, oh, yes, by the way, an after-the-fact deal, we're going to have a shooting match over it.

And probably today is the most ironic of weeks to be discussing this because guess what's next week? Filing federal income taxes, the deadline. Think about it. How many of us just want to put the money back?

That's what we're going to ask them to do after the fact. We're going to ask them to put the money back after the fact.

As a practical matter, what's going to happen is when you have a 100 percent flow-through fuel adjustment clause, you're going to see rates bump up because we're going to have a shooting hatch every time we go back and review this.

And it ends up, at best, being a halfway split between the two, guess who gets the short end of the stick? Ratepayers. Who gets caught in the cross hairs on that? The ratepayers.

Ladies and gentlemen, I wouldn't be so foolish as to insist that the only choice that you have before you is no fuel adjustment clause. I agree with what the folks have said this morning already is that there are certain circumstances where it's appropriate. There are certain circumstances where it may even be the best course.

But this is a halfway ground, and it's a great proposal. It's a proposal which addresses motivation, that motivation which brings those who are responsible to their responsibility.

And I could never have put it as well as Mr. Johnstone has. It gives the utility skin in the game. I would ask you as not only a local user, but as a -- essentially a steward of the federal taxpayers in both the state and this country, Take a look at the halfway. Take a look at some that, yes, allows the utility to recover but that gives them that skin in the game, that keeps that motivation to optimize their economic behavior. Thank you.

JUDGE VOSS: Thank you. AARP?

OPENING STATEMENT

BY MR. COFFMAN:

MR. COFFMAN: Good morning. As I said before, AARP is extremely concerned about this issue. We believe that the -- the fuel adjustment clause presents maybe the greatest threat to ratepayers, to consumers of utility services that we've seen in -- in maybe ten years. At least since at the regulation.

And, obviously, Aquila has expended the resources, done what they wanted to do to now have an option to argue before you for these various pass-through type mechanisms.

But as you know, the legislation and the rules that are now before you don't say you have to give the company what they want or you don't have to give them everything they want.

But, of course, I guess predictably, we shouldn't be too surprised that they're here today asking for the entire enchilada. They want it all, 100 percent dumping of their business risk on the ratepayers.

And all that we're doing today is asking that you fairly balance the consumer interests of the families and the businesses that are served by this monopoly against their interests and try to find a middle ground.

If you do not see fit to consider the evidence on the record that a fuel adjustment clause is not necessarily needed at this time for Aquila, that the utility at this time has shown such spectacular bad decision-making in the past should not be let completely at the -- given a complete pass-through, we ask that in your consideration of a mechanism that you -- you find a middle ground.

The legislation says that you can accept, reject or modify, clearly implying that you can find that middle ground and, perhaps the most important provision in the SB-179 rules that you promulgated is the provision that the Commission must choose what percentage of fuel and purchase power costs flow through the mechanism.

AARP's second best alternative is that you allow 50 percent of the volatility to be pass-through, that is, a 50 percent reconcilement. Right now, under the current traditional cost of service regulation, there's zero percent reconcilement, and that is the ratepayers' best friend.

This regulatory lag that is bemoaned is actually the thing that set up the incentives that you would have in a business that really had to compete in the market place.

Consumers don't mind so much that they pay higher than costs at certain times because they know that, overall, there will be this -- this end of the game pressure to keep things down. It -- it makes specific consumer interests, such as AARP, more confident that they don't need to intervene, and they don't need to be so concerned and monitor every one of these cases and be involved in such regulatory micromanagement knowing that, going forward, if you have a set rate, those incentives are in place.

With a 100 percent pass-through, we're going to be worried about every single decision that this company makes. So the second best alternative, the 50/50, if I may use the chart here, would be something in between.

You would have a -- perhaps a softened peak and valley situation where you've recognized some of the volatility. You have mitigated the company's risk somewhat. But you have also -- you haven't completely dumped all the risk onto the ratepayers.

And as you decide for yourselves where to go between zero percent reconcilement and 100 percent reconcilement, consider which side of these scales that you're balancing here have the best means to deal with the volatility.

Is it the family who is having to balance medical and food expenses? Or is it utility that has financial resources and tools at its disposal to hedge costs as well as to make very important decisions about buying and building? These decisions, ratepayers have no control over.

We urge you that if you are going to pick a mechanism, look at one that doesn't -- that doesn't dump 100 percent of the costs that perhaps eases into this new paradigm and is -- is balanced in the way it approaches things.

The interim energy charge also has its merits, as the Staff has approached. Consumers have -- have recognized that there is some need, and the interim energy charge is an interesting balance.

There are, also, I think, very interesting and well-thought out proposals in AARP's testimony and in the testimony of the industrials, Mr. Johnstone, that also take into account without -- without removing all of the skin in the game.

And so we ask that you look closely at those and consider a middle road, if you must, in picking a new type of fuel mechanism.

AARP is going to offer tomorrow morning the testimony of Nancy Brockoway, another former Commissioner and one who has a different perspective than Mr. Fetter.

She is a Commissioner who has surveyed fuel mechanisms around many states. She served herself as Commissioner on the New Hampshire Commission as well as General Counsel for the Massachusetts Public Service Commission.

She will provide testimony from her experience about the practical limits of relying only on prudence reviews and the importance of having some skin in the game.

So with that, I will just urge you that you carefully balance this and try your best to do what's fair for consumers as well as the utility. Thank you.

JUDGE VOSS: Thank you. Mr. Coffman, I did have one question. Ms. Brockoway is not available until tomorrow?

MR. COFFMAN: That's correct.

JUDGE VOSS: Okay. Okay. Somewhere I missed that through the whole thing, so that's fine.

MR. COFFMAN: Yes. I believe -- I believe I talked to every party about that, and I thought I mentioned it last week.

JUDGE VOSS: I think it was you weren't sure, I think, and that was why I didn't finalize it.

MR. COFFMAN: I assumed that would be okay.

JUDGE VOSS: I don't believe DNR is here. Kansas City? St. Joseph? Jackson County? AmerenUE? Which brings us to our first witness, I believe. Aquila?

MR. MITTEN: Your Honor, Aquila calls as its first witness this morning Steven Fetter.

MR. MILLS: Your Honor, can we get a clarification on the order of witnesses? I show there was another witness first.

JUDGE VOSS: Yes.

MR. MITTEN: Your Honor, Mr. Fetter has a commitment later this week, and I need to get him on and off the stand today. Mr. Williams was going to be called second.

JUDGE VOSS: Are you then going to call them in order? Because I noted in your opening that you only mentioned two witnesses, and you have four.

MR. MITTEN: I only mentioned the two primary witnesses. I will call them in order when Mr. Fetter leaves the stand.

JUDGE VOSS: Does anyone have any objection to calling Mr. Fetter first?

STEVE FETTER,

being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified as follows:

DIRECT EXAMINATION

BY MR. MITTEN:

Q Good morning, Mr. Fetter.

A Good morning.

Q Please state your name and business address for the record.

A Steven M. Fetter, 1489 West Warm Springs Road, Suite 110, Tennison, Nevada, 89014.

Q Where are you currently employed, and what is your title?

A I have my own energy advisory firm called Regulations Unfettered, and I made myself the President.

MR. MITTEN: Your Honor, may I approach the witness?

JUDGE VOSS: Yes, you may.

Q (By Mr. Mitten) Mr. Fetter, I've handed you two documents which have been marked for identification as Exhibits No. 9 and 10. Let me ask you to focus first on Exhibit No. 9. Is that your pre-filed rebuttal testimony in this case?

A Yes, it is.

Q Was that testimony prepared by you?

A Yes.

Q Is the information that's contained in that testimony true and correct to the best of your knowledge and belief?

A Yes.

Q Do you have any changes or corrections you need to make to that testimony at this time?

A I believe last night I noticed one typo on page 8, line 19. The intended word was while and it was spelled in the testimony w-h-i-l-d. So that word should be while, not whild. And other than that, that's all I found at this time.

Q With that change, if I asked you the questions that are contained in your pre-filed rebuttal testimony, would your answers be the same as reflected there?

A Yes.

Q And, again, is that information true and correct to the best of your knowledge and belief?

A Yes.

Q Let me direct your attention now to the document that has been marked for identification as Exhibit 10. Is that your prefiled surrebuttal testimony in this case?

A Yes.

Q Was that prepared by you?

A Yes.

Q Do you have any changes or corrections to Exhibit 10?

A No. Not that I am aware of at this point.

Q If I asked you the questions that are contained in Exhibit 10, would your answers be the same as are reflected there?

A Yes.

Q And is that information true and correct to the best of your knowledge and belief?

A Yes, it is.

MR. MITTEN: Your Honor, I would offer into evidence Exhibits 9 and 10.

JUDGE VOSS: Are there any objections to the admission of Exhibits 9 and 10? Hearing none, they will be admitted.

(Exhibit Nos. 9 and 10 were offered and admitted into evidence.)

MR. MITTEN: And I would offer Mr. Fetter for cross-examination.

JUDGE VOSS: Going down the list of people that are present. Looks like Federal Executive Agencies is first on the list.

CAPTAIN HOLLIFIELD: Thank you, your Honor.

CROSS-EXAMINATION

BY CAPTAIN HOLLIFIELD:

Q Good morning, Mr. Fetter.

A Good morning sir.

Q Unless I misheard, the name of your firm is Regulation Unfettered; is that not correct?

A That is the name of my firm.

Q As used in the English language, would you please define "unfettered" for me?

A The word "unfettered" can be unchanged. And the intent to naming my company was that I would help to explain regulation through activities in my advisory firm.

Q Okay. Would it be fair to say that if the title of your firm were Unfettered Regulation, it would essentially be regulation that is unimpeded, unchanged?

A I guess someone could start another firm attempting to use that name. I would probably try to make them stop.

Q All right. But as it is, there's at least a pretty fair inference from the way you're advertising your firm that you're seeing -- or you want to see regulation unimpeded or that you want to see regulation being a non-impeded influence, do you not?

A No. As a former regulator and probably the biggest critic of the California restructuring experiment, I think anyone who knows my track record would not believe that I view that regulation should go away.

CAPTAIN HOLLIFIELD: No further questions.

JUDGE VOSS: Let's see. I don't believe the Commercial Group is here. Sedalia Industrial Energy Users Association?

MR. WOODSMALL: Nothing, your Honor.

JUDGE VOSS: Staff?

MR. FREY: No questions, your Honor. Thank you.

JUDGE VOSS: Public Counsel?

MR. MILLS: Yeah. I've got a few.

CROSS-EXAMINATION

BY MR. MILLS:

Q Good morning, Mr. Fetter.
A Good morning.
Q Just as a preliminary matter, can you tell me how much you're being paid for your activities in this case?
A I get paid at the rate of $480 an hour.
Q And how many hours have you put in so far?
A I can't tell you how many hours. I can tell you that I believe it's in the 30 -- 30,000s at this point.
Q Of hours or dollars?
A Dollars.
Q Okay. Now, when -- when the Missouri legislature passed Senate Bill 179, did Fitch raise the credit ratings of any Missouri utilities?
A No. I think they noted it as a positive factor, and I believe they're waiting to see if fuel adjustment clauses are actually authorized for any utilities.
Q Have -- have any of the rating agencies raised the credit ratings of any Missouri utilities at any point since Senate Bill 179 has passed?
A I can't recall at this point whether they have.
Q You don't know that they have?
A No.
Q Now, I believe you testified that Indiana is viewed as having a constructive regulatory environment.

Is that a -- is that a phrase that rating agencies use?

A Yes.

Q What does that mean?

A They carry out their decision-making on a timely basis. They issue decisions that seemed to strike a fair balance among the competing stakeholder interests.

They allow recovery of -- of costs of utilities that are shown to be prudent on a timely basis. I think those would be the major factors that would go into a constructive reputation.

Q And from -- from a rating agency's point of view, the -- the more fully, more completely costs are recovered, the better; is that correct?

A To the extent that costs are prudent, a rating agency would expect them to be recovered on a timely basis.

Q So what is the -- what is the opposite of a constructive regulatory environment? A destructive regulatory environment?

A No. It would be one where there is a lack of consistency or long delays before decisions are made or reversal of precedent without good reasons being given.

Q How is Missouri viewed?

A I'd say a few years ago, Missouri was in the bottom half of Commissions. I believe now they're viewed as in mid range. I think there's a view that processes have improved.

The legislative activity with regard to Senate Bill 179 was viewed as a positive. And so I think the major public ranker of Commissions which is Regulatory Research Associations, an information service based in New Jersey, I believe puts Missouri in the middle of the pack right now.

Q And how do Indiana's electric utility rates stack up against Missouri's?

A I haven't looked at that.

Q Would it surprise you that they are considerably higher?

A Well, each -- each state has its own particular characteristics, and so rates may be higher or lower from one part of the country to the next. And I wouldn't view that as reflecting on utility operations or on the quality of regulation.

MR. MILLS: No further questions.

JUDGE VOSS: Thank you, Mr. Mills. AARP?

MR. COFFMAN: No questions.

JUDGE VOSS: Are there questions from the Bench? I see Commissioner Murray doesn't haven't any.

COMMISSIONER GAW: Commissioner Appling has questions, I think.

JUDGE VOSS: Okay.

CROSS-EXAMINATION

BY COMMISSIONER APPLING:

Q Mr. Fetter, how are you doing?

A Hello, Commissioner. How are you?

Q It's good to see you this morning.

A Thank you very much.

Q Are you recommending the FAC for Aquila?

A I think an FAC would be a good thing for Aquila within the State of Missouri.

Q Why?

A I -- I think regulation -- the ultimate goal of regulation should be to serve as a surrogate for the -- the marketplace, which cannot exist in a monopoly environment.

And as a surrogate, regulation should seek to allow recovery of actual prudent expenditures expended in carrying out the operations of a regulated utility. And I think the goal of a fuel adjustment clause or mechanism is to give the utility recovery on a timely basis of its prudent costs, no more and no less.

Q I think I -- I think in your testimony you indicated that you kind of followed the -- 179 as it was being debated in the legislature here, right?

A Not only that, but I testified at least two times, and maybe more, discussing reasons that I viewed that enactment of such a law providing the Commission with the authority to implement an FAC would be a positive factor.

Q And in your own words this morning, tell me why you think everybody's out there saying no to this FAC that the legislature is passing.

A I believe the opponents, especially the ones who have put forward alternatives, each of those alternatives, under the best case scenario, if the utility carry out -- carried out its operations perfectly, they would not receive full recovery.

And so I think that's the major reason. They believe that the utility and its shareholders should subsidize consumer rates. And I think that's at odds with the idea of regulation, it's at odds with the idea of the marketplace, and I think it's wholly inappropriate.

Q Out of the 50 states, Mr. Fetter, how many states out there are actually engaged in or used in the FAC? Do you have any feel for that?

A Yeah. I -- I cited in my testimony a report from Regulatory Research Associates, the group I mentioned a little while ago. It -- it does date back, I believe, to October 2005.

Q Uh-huh.

A And at that point, they indicated that some kind of pass-through mechanism was used within 42 states across the United States.

Q According to page 11 in your -- I think it's your rebuttal testimony, and it talked about the state of Indiana starting on about Line Nos. 7 and 8, I believe, of that page.

A Yes, sir.

Q What experience do you have within the -- and you quote one of the orders in which a FAC was -- was authorized. Talk a little bit about Indiana and why you use them as an example in your testimony.

A Well, one reason, as I note earlier in my testimony, is that I testified within that case. I discussed what I viewed were the positive attributes of a fuel adjustment clause, and I included that quote within the -- my testimony because it -- it explains the reasoning and rationale that went into their ultimate decision with regard to fuel adjustment clauses.

Q Okay. I make the assumption that you have followed Aquila's ups and downs over the last two or three years.

A Yes. I -- I understand that they've had ups and downs.

Q Okay. With everything that you've heard this morning, has anything changed your mind that Aquila should be authorized a fuel adjustment clause?

A No. I believe to the extent that Aquila carries out its operations prudently that they deserve recovery. And, of course, the ultimate prudence decision will rest with all of you on the Bench.

COMMISSIONER APPLING: Thank you very much. Good to see you again sir.

MR. FETTER: Thank you, Commissioner.

JUDGE VOSS: Commissioner Gaw, do you have any questions?

COMMISSIONER GAW: Maybe just a few.

CROSS-EXAMINATION

BY COMMISSIONER GAW:

Q Good morning, Mr. Fetter.

A Good morning, Commissioner.

Q When were you on the Michigan Commission? Refresh my memory.

A I was there from 1987 to 1993.

Q Was that prior to retail choice in Michigan?

A Actually, I was Chairman when we started the first retail wheeling case, actually, the first retail wheeling case in the country. I had the good sense to leave before it was decided.

Q I see. I see.

A And it took it about -- it took about eight years after it was started before Michigan started their retail choice initiative. And it was, actually, I believe, the last state in the country to do so before California imploded.

Q Okay. We've had a few implosions on that since, haven't we --

A -- yes.

Q In recent -- in the recent months?

A Yeah. It has not been a very positive path for the industry.

Q Yeah. At the time you were -- that you were dealing with the Michigan Commission, was there a significant push for retail choice around the country at that point, or was it on the earlier stages?

A I'd say it was very early. The push within Michigan came from the big auto makers and steel producers. And most of them, we dealt with the special contracts.

Q Yes.

A And I believe that we could continue to deal appropriately in allocating their costs -- their burdens on the system through special contracts. But pretty much every month or two, they argued in public statements that they'd like retail choice.

And so we eventually initiated the retail wheeling case not so much to serve as a -- to carry the charge on restructuring as much to allow them to put forward their argument.

And as I mentioned, their argument didn't carry the day for eight years.

Q When -- when Michigan finally did implement former retail choice, what -- generally, what form was that?

A My understanding is it was kind of a hybrid form where people could go off the system and come back almost at will. And so it put quite a burden on the utilities because they had to continue to line up generation or purchase power in the -- in the case that customers would come back.

And I believe within the last two years, there has been a pull back and greater fairness on that issue where if a customer wants to leave, then they are more at sea than they were earlier, which I think is appropriate.

Q Was generation in Michigan forced to be sold off from the transmission and distribution system?

A No, it wasn't.

Q So the companies can still be vertically integrated?

A Yes. And, primarily, they remain integrated.

Q So it's a different model of sorts in what we have seen in some other states?

A Yeah. As I mentioned, I was -- I viewed with great fear the idea of the California utilities not being forced to divest. But, certainly, they were strongly encouraged to divest.

And, ultimately, we -- we saw what -- the negative ramifications that occurred when those who held generation outside the utility took steps to skew the marketplace.

Q What happened with the entities that wanted to compete? How did they deal with the end use customer in getting -- in getting their business?

Was there -- there was a separation some way for load-serving entities to -- to be able to serve the retail customer? How did that work in Michigan?

A The marketers came in and attempted to attract customers away. I think at the residential level there was very little success. I think at the commercial and industrial, there was more -- more success.

And so the marketing companies such as Constellation would then line up generation or supply from a third-party source and provide it. And as I said, I viewed it as a skewed model because the customer was not really taking huge risks because they could rely on

Detroit Edison or Consumers Power as, basically, a back-up without pay.

Q Okay. So in -- and during those -- during those time frames when the utilities had to -- to bear the risk, as you say, of customers leaving and coming back, how are the ROEs treated in Michigan?

A I -- my sense is that the risk that we just discussed was not flowed through into ROEs. And so the ROEs -- as compared to the authorized ROEs, the earned ROEs, it was greater volatility than one would expect to see.

Q What about the authorized ROEs?

A As far as the approximate amount, level or what?

Q Do you know whether or not the Michigan Commission took into account the volatility of customers coming and going in setting those ROEs?

A I -- I don't think it was an explicit statement. But, Commissioner, as you know, what goes on in deliberations sometimes ends up in an order without explicit citation.

Q Sure. So today in -- in Michigan, if you know, is there -- is there some degree of -- of -- or some percentage of -- of customers that are served by others other than the vertically integrated? Do you know what that number might be?

A I don't know what that number is. But there -- there are some. I think it is certainly less than hoped for when the initiative began many years ago. And my guess is it's lower than it would have been a few years ago.

Q Okay. Now, in the -- in the states around the country, you mentioned the ones that have fuel adjustment clauses -- pardon me.

Was your research -- did you do more research than just look at the information that you cited from Regulatory Research Associates? Or I believe that's who you cited.

A Yeah. I cited that October 2005 report. I also mentioned the few cases I've testified in.

Q Yes.

A But I did not do -- I did not go to the 50 states and look up the statutes. And --

Q Okay.

A -- so my --

Q Go ahead.

A I'm sorry, sir.

Q I was just going to ask you whether or not you knew specifics about those statutes to begin with.

A No. And that was what I was going to continue to say. I view that report as a trend of the type of policy judgment made at the Commission level. I would never say that this state does this, you should.

Q Yeah.

A I just recommend your consideration of the positive factors that an FAC can bring.

Q Okay. And -- and in regard to those states that have those statutes, was it -- do you know specifically which ones are required to be implemented by the Commission and which ones are options?

A I'm not sure. But I -- I would say that -- I don't know of any Commission across the country that has to do an FAC that -- well, if it doesn't want to.

Q Yes. Now, you made -- in your testimony -- and I guess that -- let me -- let me back up for a moment. In some of the retail choice states, fuel adjustment clauses aren't present, correct, because there's a bid process where there's -- there's a certain price that's set and that's how they are awarded the contract; isn't that true?

A Yes. In some retail choice states, they were not FACs. And, also, I'd say over the last ten years during the restructuring history, some utilities have agreed to go without an FAC and then have come back to an FAC.

Q Yes.

A So there's been a certain degree of volatility as the industry has felt out its way in the new environment.

Q Okay. So -- and the reason I was asking is because sometimes there's some citation in regard to those states that have -- that are not retail states and what portion of those have fuel adjustment clauses. So is that -- is that the reason why numbers are sometimes broken down that way?

A Yeah. I would guess those who pull out the integrated utilities that are not in a choice situation might offer different percentages or different numbers.

Q Okay. Now, I want you to -- you mentioned in your testimony that you thought that -- something to the effect that you thought the biggest hammer that a Commission had in regard to following up on a fuel adjustment clause was a prudence review.

A I believe that, sir.

Q All right. Now, I was -- I'm curious about if you're familiar with Missouri's prudence reviews on gas cases.

A Not in great detail.

Q Do you know how many times in the history of the purchase gas adjustment history -- provision on gas in Missouri there has been a finding of imprudence on the part of a gas utility?

A I -- I would not know, sir.
Q Okay. Are you familiar with -- you are familiar with -- with this -- with other states, I assume. Can you -- can you give me some examples of some significance prudence adjustments that have been done? Or if you know of some particulars in Michigan, that would be fine.
A Based purely on fuel or any kind of prudence?
Q Any kind of prudence dealing with a fuel adjustment clause and an electric utility.
A Well, I can give an example of -- I described in my testimony the process used in Michigan where there is a plan set and then a fuel factor, and -- and that gives guidance.
It plays out over the course of the year. To the extent that a utility takes steps different than the plan, they have to justify that after the fact. During that process, when something comes up during the year, there's usually very close communication between the utility and the Staff with regard to potential different steps so that they don't get into a situation where after the fact they're sitting in a hearing room arguing, you know, we did this and Staff will say, they did it, you know, totally out of the blue with no interaction with us.
And as I note in my testimony, I view that as a potential positive that flows out of that process that not

only will communication be focused on fuel or purchase power issues, but it creates a -- an environment where -- there's communication because there's no desire, I believe, on either side that there be an ultimate prudence disallowance.

Q Well, Mr. Fetter, that's not answering my question. My question is -- I was wanting you to give me a list of examples where there has been an imprudence finding by a Commission on an -- on a fuel adjustment clause, a list of cases and numbers about how much money was involved in those cases.

A Yeah. I -- sir, I haven't researched that. And even from my Michigan experience going back 14 years, I couldn't recall specifics.

Q Okay. Now, in regard to what a prudence review on a fuel adjustment clause might amount to, I was just wanting to think about that for a few minutes with you.

How many -- how many electric financial transactions are possible in a 24-hour period for an electric company who is buying and selling electricity on the wholesale market?

A I think most of the supply decisions are -- are beyond just daily decisions. But in the course of a day, there may be small, discreet decisions made.

Q Well, let's think about this for a minute.

Let's assume that we -- we are dealing with the possibility of accessing off-system purchases and making off-system sales. Aquila is currently not in an RTO, I believe; is that correct?

A I'm not sure, sir.

Q You haven't researched that, have you?

A I have not.

Q Let's talk about the MISO RTO for a minute. Do you know how often they settle transactions on the spot market?

A No.

Q Do you know whether or not they have resolution perhaps every five minutes?

A I don't know what the MISO does.

Q Is it -- is it possible that a sale on a -- on a short-term or a financial transaction for energy could -- could result in -- in transfers multiple times in a 24-hour period?

A I'm not sure I understand the question, Commissioner.

Q If a -- if a utility is trying to make a decision about whether it's better to use its own generation, for instance, or buy on the -- on the market, at a -- at certain points in the day, what would they have to do in order to -- to evaluate the question of whether or not it's better for them to spend their own generation or buy on the market?

A I would expect, since these decisions -- these decisions would be part of a dispatch protocol where they'd be able to assess the cost of them using their own facilities versus -- versus purchasing spot, and so I think they'd be driven by cost factors because, you know, as I mentioned in my testimony, there's no return or profit mode. So I think it would be purely based on their dispatch protocol.

Q And how would they figure that on the outside of their own generation banks? How would they factor that? What would they have to do?

A Well, hopefully, they would know their -- the cost of firing their own generation.

Q Yes.

A And then they would compare it to the -- to the ups and downs of the spot prices --

Q Yes.

A -- and make decisions based on that comparison.

Q And if those -- and those spot prices, if they -- if they were prices that -- that resolved, let's say, on an hourly basis, that would be at least -- at least 24 hours a day, correct?

A If prices changed on an hourly basis, then that would be 24 different prices.

Q If there was a day-ahead market available, there would be a question of whether or not they should or should not have purchased on that day ahead of market, correct?

A Yes, sir.

Q There would also be questions about whether they should have sold excess electricity if they had extra capacity available, correct?

A They have to make that decision.

Q There would be questions about ancillary services as well, wouldn't there, spending reserves?

A That's my understanding.

Q Whether or not to offer certain things out as a part of regulation, perhaps, or quick start capability?

A That's my understanding.

Q If -- and then there would also have to be some discussion about whether or not there might be long-term contracts that might fill a need better than some generation that they had in their own fleet, correct?

A Exactly.

Q So all of those things would have to be evaluated multiple, perhaps hundreds of thousands of transactions and possibilities, even in a year period. Wouldn't you agree?

A Yes.

Q So if -- if a Commission were to do a prudence review of all of those possible transactions, it would be quite a task, would it not, to take to evaluate that and follow through on all of those different possibilities?

A No. I don't think so.

Q Okay. How many Staff people do you think it would take to do that?

A You know, I don't know how many Staff it would take. I just know during the past 12 months, there have been multiple rate cases going on. And so I think the Staff --

Q Is already busy --

A -- has been pretty busy this year. And I can't imagine that fuel cost recovery proceedings will be any more complicated and complex than what the Staff is successfully doing now.

So I have faith in the Staff, and I have faith in you folks to have the processes work smoothly, especially since, you know, from my experience with prudence review, you look for abnormalities, and you will not often find them because there's not a profit motive. There's not a return on the utility's activities.

And so you're looking for something that's out of the ordinary, and you try to figure out why it's out of the ordinary. And that's where the prudent -- potential disallowance would flow from.

Q If there is a -- if there is an incentive, a financial incentive,a significant financial incentive for the company to make the best decision, the best prudent decision financially in regard to sales of electricity, purchase of electricity, running its own fleet, do you think the Staff pays as much -- would have to pay as much attention to those particular transactions that would take place as in an environment where there is absolutely no incentive for the company to do that, other than some post review of it?

A I mean, I view that as -- as a heavy incentive. Others in this room disagree with me.

Q Yes.

A But I don't think a financial incentive where a utility that operates perfectly cannot, under best case scenario, get full recovery for its prudent costs.

I view that as the constructive regulation, so to speak. I view it as potentially not Constitutional, as I mentioned in any testimony. It isn't --

Q Let me stop for you a minute. You believe that it's unconstitutional to not have a fuel adjustment clause?

A No, sir.

Q Okay. I just wanted to doublecheck. Now, with regard to the issue of -- of recovery, without a fuel adjustment clause, if -- it is also possible for a utility to actually make more profit, I suppose, if they do a -- a very good job of -- of their -- running their fleet, buying and selling their -- their -- buying -- excuse me -- buying other generation and selling their own generation in -- into the market. That's possible, too, isn't it?

A Or if the Commission were to set a wrong number, that -- that could also help.

Q Could you answer -- first, answer my question. I guess -- I know you did in your mind. But wouldn't you agree with me? I figured you'd already passed that and were onto your answer. I'd have to have the reporter read it back.

A Yeah. That would probably help. I'm sorry, Commissioner. I was trying to listen to you.

COMMISSIONER GAW: If you could do that, ma'am, I would appreciate it.

(The previous question was read back.)

A Yes.

Q (By Commissioner Gaw) Okay. Thank you. And the court reporter did a beautiful job of reading that very bad question back. Okay. So I guess from the --

from the standpoint of -- of this -- of this particular company, I was -- I was wanting to know whether you had done any research into seeing whether or not the generation fleet of this company was well-matched to their load.

A I have not.

COMMISSIONER GAW: Okay. That's all I have. Thank you.

MR. FETTER: Thank you, sir.

JUDGE VOSS: Commissioner Appling, I believe you had an additional question?

CROSS-EXAMINATION

BY COMMISSIONER APPLING:

Q I'd just like to run the final question, if you don't mind, sir.

A Okay, Commissioner.

Q This morning, I think we have heard several representations on Aquila and what they should receive and what they should not receive. It was said that -- the majority has said -- recommended no FAC.

I think we'll hear testimony this morning from Mr. Featherstone about an IEC. Give me your thoughts on FAC versus IEC in this case, not -- I don't want to know the world. I want to know as far as Aquila is concerned, give me your thought on that.

A As I say in my testimony, when this Commission was really barred from doing FAC, an IEC was -- was better than just putting a number in base rates.

But at the same time, an IEC has its weaknesses. My understanding from Aquila management is that during a 20-month period in 2004 and 2005, while they were under an IEC, they under-recovered fuel costs 34 million during that 20-month period, which I view as very significant.

I had a small involvement in the Empire District case, which was decided in December. And I believe in the order issued, it indicated that there was under-recovery of fuel of $27 million.

And so I think an IEC in the absence of the ability to provide an FAC was a better step than a base rate number. But I -- I think it -- it significantly pales in comparison to the idea of attempting to get actual fuel cost recovery on a daily basis of prudent costs.

COMMISSIONER APPLING: Thank you very much, sir. Judge, I have no further questions.

MR. FETTER: Thank you.

JUDGE VOSS: Do you have any more questions, Commissioner Gaw?

COMMISSIONER GAW: No, thanks.

JUDGE VOSS: I just had one. Or a little

series.

CROSS-EXAMINATION

BY JUDGE VOSS:

Q Fuel adjustment clauses are sort of a new creature to the Missouri Public Service Commission due to the recent statute changes. When you were the Chairman of the Michigan Public Service Commission, were there fuel adjustment clauses that were in place at that time?

A Yes.

Q And then I guess when they went to the retail wheeling choice, they moved away from the fuel adjustment clauses?

A My understanding is both Consumers Power and Detroit Edison, I believe, agreed to forgo a fuel adjustment clause back at the early point of restructuring.

I believe they're -- they're back under a fuel adjustment clause now. Not a hundred percent sure, but I think there has been a switch back.

JUDGE VOSS: Thank you.

MR. FETTER: Thank you.

JUDGE VOSS: Okay. I think that's all the questions I have. I want to take a quick break before we do recross based on questions from the Bench. Come back at 10:10.

(Break in proceedings.)

JUDGE VOSS: Thank you. Okay. We're going to go back on the record. Due to some witness availability issues, I want to ask all the parties, would anyone object to the first witness Wednesday morning, regardless of where we are in the witness list -- witness list, being the AARP's witness? Does anyone object to that? She will be the first witness on Wednesday morning.

And for everyone here, the stipulation presentation will be at 9:00 on Thursday morning. I will notify all the other parties directly.

All right. Seeing no more Commission questions, let's begin with recross based on questions from the Bench. Federal Executive Agency?

CAPTAIN HOLLIFIELD: No questions, your Honor.

JUDGE VOSS: Sedalia Energy Users Association?

MR. WOODSMALL: Thank you, your Honor. Very, very briefly.

RECROSS EXAMINATION

BY MR. WOODSMALL:

Q Mr. Fetter, you were asked some questions by Commissioner Appling regarding the IEC. Do you recall that?

A Yes, I do.

Q And you testified at that time that you didn't believe an IEC would work. And you noted some figures of under-recovery that Aquila management had told you, you said?

A Yes.

Q Okay. Did you make any independent analysis as to why they may have under-recovered their fuel and purchase power during that IEC period?

A No.

Q Okay. You didn't check to see if all their generating units were available during that period?

A No, I did not.

Q Okay. So you have no independent knowledge except what you were told by Aquila's management?

A That's correct.

Q Okay. You also mentioned a figure in the Empire case regarding under-recovery during the IEC period. Do you recall that?

A Yes.

Q Do you have any independent knowledge as to that under-recovery?

A Other than reviewing the order. No.

Q Okay. All you got was from Empire's management or from the order?

A No. I looked through the order.

Q Okay. You didn't look to see if Empire's units were available at that time or perhaps under performing or had some other problem?

A I did not look.

MR. WOODSMALL: Okay. Thank you, sir.

MR. FETTER: Thank you.

JUDGE VOSS: Staff?

MR. FREY: Just briefly, your Honor. Thank you.

RECROSS EXAMINATION

BY MR. FREY:

Q Mr. Fetter, I believe you indicated in response to a question from Commissioner Appling that regulation is a substitute for the market place,

JUDGE VOSS: Just a second. Is your mic on? I'm not sure it is.

MR. FREY: Yes.

JUDGE VOSS: Okay. Thank you.

Q (By Mr. Frey) I believe you indicated in response to a question from Commissioner Appling that regulation acts as a substitute for the marketplace. Do you recall that?

A I think I said surrogate, but pretty much the same idea.

Q And I think in your answer you went on to indicate that the utility should be allowed to recover all of their prudently incurred fuel and purchase power expense; is that correct?

A That's my view.

Q Do you view the allowance of full recovery from a company's costs to be one of the functions of the marketplace in a non-regulated environment?

A Could you ask the question again, sir?

Q Do you view allowance of full recovery of a company's costs in this case, fuel and purchase power, to be one of the functions of the marketplace in a non-regulated environment?

A In a non-regulated environment, a company could choose to go in and out of providing a product. And, thus, when costs went through the roof, they could choose to withdraw from the marketplace and wait until costs got within a range where they could sell product. And so I don't think the comparison is -- is aft.

Q So the answer to my question would be no; is that correct?

A The question was recovery of full costs in the unregulated marketplace?

Q Right.

A That would be different by the market, and -- and I believe a marketplace participant, their aim would be to recover full costs, and that's why they would go in and out of the marketplace as -- as costs undulated.

Q So it's not one of the functions of the marketplace to assure full recovery of costs; is that correct?
A It's -- it's the goal of marketplace participant, but the market is what it is.
Q So the answer to my question is yes; is that correct?
A The answer to the question of -- I think I better hear the question from somebody.
Q It's not one of the functions of the marketplace to ensure full recovery of costs of its participants?
A It's not a function. I would say yes.
MR. FREY: Thank you. No further questions.
JUDGE VOSS: Public Counsel?
MR. MILLS: No questions.
JUDGE VOSS: AARP?

RECROSS EXAMINATION

BY MR. COFFMAN:
Q Hi, Mr. Fetter.
A Hello, sir.
Q I was relieved to hear in your answer to Commissioner Gaw that you don't believe that traditional cost of service regulation is unconstitutional. And I'm assuming that that means that if the Public Service Commission sets rates at a certain level that -- that

provides a reasonable opportunity to earn a fair return that that is constitutional law, in your opinion?

A I believe, just to be precise, he asked me whether the absence of an FAC was unconstitutional.

Q Okay.

A And I said no, I do not believe the absence of an FAC is unconstitutional.

Q Great. And you do have a legal background, correct?

A I'm a lawyer.

Q Right. Now, and I assume that you also don't believe that a 100 percent pass-through fuel adjustment clause is -- is unconstitutional either?

A The phrase 100 percent pass-through. You're saying without any -- any prudence review or --

Q Let me ask -- yeah. Yeah. Let me ask -- the Aquila proposal in this case for a fuel adjustment clause, you believe that that's constitutionally sound, correct?

A My understanding of it with its -- with its modifications based on give and take with the parties in this room, I believe it's constitutional.

Q Right. Right. But is it your belief that some middle ground between the Aquila proposal and traditional cost of service would be confiscatory or unconstitutional?

A The alternatives I've seen under which Aquila is barred from recovering all of its prudently incurred costs, I would view as unconstitutional.

Q And -- and by barring prudently incurred costs, you mean the same way that traditional cost of service bars costs when rates are lower than costs in a particular time?

A No. The difference between what you're proposing and traditional cost of service regulation is that the Commission does its best to set rates to allow full recovery of prudent costs and an opportunity to earn a return on investment as opposed to putting in place a structure that, by its very structure, ensures that full recovery is impossible.

Q In your mind, is there any middle ground between 100 percent pass through and zero percent pass-through under traditional cost of service that could be lawful and reasonable?

A I mean, I haven't explored the issue. But anything that -- that, by its very nature, prohibits full recovery of prudent costs of providing cost of service, I -- I can't see as constitutional.

Q So is that a yes or a no? Is there any middle ground?

A I -- I have not found any.

MR. COFFMAN: Okay. That's all I have.

JUDGE VOSS: We'll see if someone is coming with questions. I was just about to go to redirect. Do you have any additional questions?

COMMISSIONER APPLING: No additional questions.

JUDGE VOSS: Redirect?

MR. MITTEN: Thank you, your Honor.

REDIRECT EXAMINATION

BY MR. MITTEN:

Q Mr. Fetter, I just have a couple of questions, and I want to focus on an area that you and Commissioner Gaw discussed. And that has to do with the comparative risk of fully integrated utilities in Michigan compared to transmission and distribution utilities. Do you recall that conversation?

A I recall my conversation with Mr. Gaw, with Commissioner Gaw.

Q Do you have an opinion as to whether or not transmission and distribution utilities are more or less risky than fully integrated electric utilities?

MR. WOODSMALL: Your Honor, I'm going to object. I think what we're getting into is areas of risk, possibly ROE. Mr. Fetter is not an expert on that matter. The company's witness talked about that. He's here to talk about FAC, and we're far afield from that.

JUDGE VOSS: Could you restate your question again?

MR. MITTEN: My question, again, pertains to an area that Mr. Fetter discussed with Commissioner Gaw, and it is whether or not he has an opinion as to whether or not transmission and distribution electric utilities are more or less risky than fully integrated electric utilities.

JUDGE VOSS: To the extent that Commissioner Gaw already touched on the subject, I'll allow the witness to answer the question with the understanding that he's not an ROE expert, just giving his opinion as a --

A As a nice guy.

JUDGE VOSS: -- former commissioner?

A In most cases, a transmission and distribution utility would be -- would operate at a lower risk level. But as we've seen in states like Illinois and Maryland, even that issue can be in play where full recovery of prudently incurred commodity costs are not ensured.

So in the normal scheme of things, T&D would be less risky. But each utility has to be viewed on its own circumstance.

MR. MITTEN: I don't have any further questions. Thank you, your Honor.

JUDGE VOSS: Mr. Fetter, you're excused.

MR. FETTER: Thank you very much. Thank you, Commissioner.

MR. MITTEN: Your Honor, Mr. Fetter has to give testimony in Maryland later this week, and I would ask that he be fully excused so that he could leave at the end of the day.

JUDGE VOSS: No one has indicated to me that he wasn't fully excused.

MR. MITTEN: Aquila calls as its next witness Dennis Williams.

JUDGE VOSS: I don't believe the court reporter got his exhibits, Mr. Fetter's.

MR. FETTER: I left them up there.

JUDGE VOSS: Okay. Thank you. Do you have everything you need?

THE COURT REPORTER: Yes.

DENNIS WILLIAMS,

being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified as follows:

DIRECT EXAMINATION

BY MR. MITTEN:

MR. MITTEN: Your Honor, Mr. Williams' exhibits have previously been identified when he was on the stand earlier in the hearing. And at this point, I would move for the acceptance into evidence of Exhibit Nos. 32 --

JUDGE VOSS: 33 and 34?

MR. MITTEN: 33 and 34.

JUDGE VOSS: Are there any objections to the admission of those exhibits? And it was my understanding that the earlier objection to a portion of one of those exhibits has been withdrawn; is that correct?

MR. WOODSMALL: Yes, your Honor.

JUDGE VOSS: Then the exhibits are admitted.

(Exhibit Nos. 32, 33 and 34 were offered and admitted into evidence.)

MR. MITTEN: Then Mr. Williams is available for cross-examination on the fuel adjustment clause issue.

A I have just a couple of corrections to my testimony.

Q (By Mr. Mitten) I apologize. Could you please give those corrections?

A Thank you. On my direct testimony, at page 10, line 10, the word "do" should be changed to "does." In my rebuttal testimony at page 6, on line 2 -- actually, line 3, the words "customer of" should be changed to "of customer."

MR. FREY: What line was that, Mr. Williams?

A That was line 3 on page 6. And it says "has conducted a number customer of," and it should say "has conducted a number of customer demand site studies."

And, finally, at my surrebuttal testimony, on schedule DRW-1 at page 3 when I typed this, I left off a factor. And it is -- I left it off in two places. At line 1 where it says "total energy costs," in parentheses, it should say F, P, E, X and I. And that same change would be on line one under the MPS.

Also, on lines 4 of both L&P and MPS, we should add the words "and applicable interests."

JUDGE VOSS: Was that an I or Y after the X?

A I.

JUDGE VOSS: I thought so. The second time, I thought you said Y, so --

A Sorry.

JUDGE VOSS: That's all right. And what was the next correction?

A Both -- lines 4, both MPS and L&P, it should add after prior periods at "and applicable interest." That will conform the calculation with the description included in the tariff. That's all the changes I have.

MR. MITTEN: With those changes I would offer Mr. Williams for cross-examination.

JUDGE VOSS: All right. With those changes, they're admitted.

(Exhibit Nos. 32, 33 and 34 were offered and admitted into evidence.)

JUDGE VOSS: And first up for cross is the

Federal Executive Agencies.

CAPTAIN HOLLIFIELD: Thank you, your Honor.

CROSS-EXAMINATION

BY CAPTAIN HOLLIFIELD:

Q Good morning, Mr. Williams.

A Good morning.

Q Could I get you to turn to page 5 of your direct testimony?

A All right.

Q Okay. My question of you is going to be a bit laborious, and I apologize. But if you could read lines 10 through 20, which is an answer to the question, Why is that, just in case our pages are a little off. I think I may have an early version. It starts with, Traditionally.

JUDGE VOSS: Can you identify the start? I'm sorry. Of the direct or --

A Traditionally, rates have been set based upon actual costs incurred during the test year, even though true-up adjustments are sometimes made to incorporate fuel costs being experienced closer to the time that rates go into effect.

By the time customers begin paying those new rates, the underlying fuel costs may have increased or decreased dramatically. As a result, the utility can quickly suffer financial deterioration and need to file for immediate rate relief.

Or on the other hand, the utility can over-recover costs by a substantial margin resulting in the need to file a request to reduce rates or a complaint filing by another party.

The FAC will reduce an over-abundance of rate filing to free up time for the utility and Staff personnel to pursue other necessary tasks, and, most importantly, make sure the customers are reimbursing Aquila only for prudent energy costs actually incurred.

Q I wanted to make sure that I was clear on a couple of things. First off, under the current system, when you set a rate, you're basically setting, for all intents and purposes, a ceiling that you're going to have to consider as you're budgeting your -- your energy costs, demands cost, the whole thing; is that correct?

A You're setting an amount that you -- if you're talking about a -- an expense item, and I assume that's your question, in regard to fuel costs, you are setting a level at which you expect costs to be incurred in the coming periods, and that -- that's a fixed amount. So I assume that's both a base and a floor.

Q Okay.

A Or a ceiling and a floor.

Q Okay. And I wanted to confirm whether or not a

-- according to your testimony, if you have costs that do spike above that, you do have an opportunity for interim rate relief; is that not correct?

I believe the -- it's the sentence stating, As a result, the utility can quickly suffer financial deterioration and need to file for immediate rate relief, or on the other hand, a utility can over-recover courses by a substantial margin in generally the same way; is that not correct?

A When you say interim rate relief, I'm not sure if -- if we do. I'm not aware of this Commission authorizing interim rate relief.

Q Oh, I'm afraid I misread. It's immediate rate relief.

A Yes.

Q Okay.

A And -- and that refers to the fact that we could file for immediate rate relief or immediately could file for rate relief. But the assumption is it would still take the 11-month process before that rate relief were actually received.

Q So we're not talking about an inability to collect. We're talking about a regulatory lag; is that not correct?

A Regulatory lag prevents us from collecting.

That is correct.

Q You mean you never get the money or you'd never get it at the time?

A We would never get the money.

Q So you're telling me that since around 1917 on and off that you have been operating at a deficit because, under Missouri state law, you never get the money even when you request the immediate rate relief?

A Well, not since 1917 because during periods of time, there have been fuel adjustment clauses in effect.

Q But under the current regulatory regime --

A Under the current regulatory regime, that is correct. Where we incur our fuel costs and they -- to the extent they are higher than what is included in base rates, we would be precluded from recovering -- recovering that cost. And that is a major reason why our MPS current earned returns are below 4 percent and we're at a loss with St. Joe.

Q You must be incurring incredible deficits if you're not able to recover.

A Our fuel costs are increasing 20 million or more a year.

Q And you're never getting this back. I -- I see. The fixed amount that you've talked about that you have to operate under, that's pretty much analogous to a budget, is it not?

In other words, you're given a set amount of money, whether it be floor or ceiling, and you have to operate within that, especially since you never recover any spikes over that -- that allocated amount?

A Well, I don't think it's analogous to a -- a budget. A budget -- we put together our fuel budget, for example, what we expect to incur in the next year, which is likely to be far different from what is set in base rates.

You could argue that they should be the same. But, typically, that gets back to that regulatory lag. A lot of times costs in a rate case are set based upon historical costs and using those as an estimate of what will happen in the future.

Those may not correspond to what we budget and is really one of the main reasons for the need of an FAC.

Q But, nevertheless, you have acknowledged that this is a ceiling and that you do have to be cognizant of that ceiling; is that not correct?

A Under the -- under the current scheme, it's both the ceiling and the floor. Yes. It's one fixed amount.

Q Okay. On pages 7 through 8, I wanted to look at your comments on prudence reviews. Your comments say something to the effect of an annual prudence audit conducted by the Commission Staff should be adequate to ensure that only prudently incurred costs are included for recovery. Is that a pretty fair --

A That is a fair interpretation of my testimony.

Q Okay. And, further, if Staff or other parties believe that evidence supported a prudent adjustment, they would have the opportunity to bring that proposal to the Commission for an evidentiary hearing and decision. Is that a fair de --

A That's correct.

Q Okay. Could you define prudence for me?

A Prudence, in my view, is making appropriate decisions given the set of circumstances with which one is faced.

Q Okay. So, in other words, given what you're saying, all of us or our proxies are either going to be in this room or another room in this building, you know, maybe on an annual basis, and we're going to be looking at this decision again; is that not correct?

A If the parties choose to do -- do that, that -- that would be correct.

Q And given your definition of prudence and given the fact that your testimony states that there is at least an opportunity for an evidentiary hearing and decision, we're looking at going to blows over whether or not decisions were prudent, are we not?

A I believe that's what we do right now. I -- I'm not -- I -- what my testimony is is basically that the fuel adjustment clause, if anything, will not add any additional work.

Right now, the parties look at the prudence of fuel costs in connection with base rate reviews. And we -- we're in for rate cases almost every year. So --

Q But it's not going to take away, is it, either? Since we're going to be talking about prudence at least every year and you acknowledge that there's at least a possibility we're looking at an evidentiary hearing decision, we're going to be talking about prudence, which is a subjective standard?

A I -- I don't believe that the fuel adjustment clause will take away work. It may spread the work load some. But I don't think it -- it does or was intended to -- to eliminate work.

Q I had mentioned in my opening, probably -- you may or may not agree with the analogy. But next Monday or Tuesday is the federal income tax deadline. And, you know, I am, as I would assume a typical American, kind of loathe to give money back. Do you relish the notion of giving the federal government money back at the end of the year?

A I'm looking forward to getting out of these hearings so I can do my tax return and find out whether I have to give them money back.

Q Well, I think we all know that none of us like to pay. But is there anything that you can, you know, enlighten us with that would make it seem like a corporation being made up of human beings and being a human institution is going to think or act differently, that is, be -- not be loathe to give money back once it's been given?

A I don't think any -- anyone likes to spend money. And we all like to get what -- what we can, bargains. We like to spend as little as we can for what we receive.

At the same time, I think it's appropriate that I pay at least the cost that my supplier is incurring, at least reimbursing him dollar for dollar for what he incurs. And that's what the fuel adjustment clause does.

Q But the fact still remains, it's not a very palatable thing on behalf of the corporation to put money back subject to this prudence review, is it?

A I don't think the company really wants to recover more for its fuel expense than it actually incurs. And that's -- that's our proposal. The fuel adjustment clause goes both ways. We have proposed to pay -- in times that the fuel costs may decline, we have proposed to refund monies to the customer.

Q Okay. Tell me, does a fuel adjustment clause increase or decrease the risk for the corporation?

A I --

Q Keeping in mind Dr. Hadaway's testimony.

A I prefer that -- to leave that to the experts like Dr. Hadaway.

Q You refer to Dr. Hadaway's testimony. You have to at least be cognizant of it.

A I am aware of what he said. I believe he indicated -- I was in the room. And I think he did indicate that there was a slight mitigation of risk.

And he quantified that and said he had considered it in his return on equity. I don't recall how many basis points he said that was.

Q All right. With that in mind, let's look at the three basic parties we have in this transaction. We have the utility. We have the ratepayers. And somewhere out there, we have this third party who is the supplier of the -- of natural gas or the coal.

Now, we've got a risk that has admittedly been shifted from the utility. And I would venture to guess that the coal and gas company is going to get paid the amount of water. Aquila's not going to stay in business.

So where is that risk going to go? Who is that third party left over?

A Are you talking about price risk or the total risk of fuel cost or --

Q I'm talking about the risk that we are facing on this fuel clause, proposed by the fuel cause. Now, we're proposing a regime, at least according to Aquila's proposal, where they can wipe the sweat off their brow because they're getting a 100 percent pass-through.

Aquila admittedly has decreased risks. The suppliers are not going to be incurring any risk because if they incur risk, then Aquila's not going to be in business. And that leaves one party. Who is that party who is going to assume that risk?

A I think risk is shared between the customers and the utility. And when you say that the utility can wipe the sweat off its brow, the utility still has a number of risks, even associated with fuel.

Q I'm not talking about the other risks.

A Well, even associated with fuel. I mean, there are operational risks --

Q Who -- who assumes the risk that Aquila has now shed? It's the ratepayer, is it not?

A The ratepayer -- the ratepayer certainly has additional prices --

Q The ratepayers now --

MR. MITTEN: Your Honor, can counsel please allow the witness to answer his question before he asks the next one?

CAPTAIN HOLLIFIELD: That's fine.

Q (By Captain Hollifield) My apologies. Please go ahead, Mr. Williams.

A The ratepayer certainly has additional price risk, which he can control to a certain level. He controls that through his consumption of electricity, and we help the consumer control the volatility risk through billing practices, opportunities such as fixed bill or budget billing. The utility still maintains recovery risk through the prudence review.

Q So, in essence, what you're telling me is, the ratepayer who, at least in this circumstance, can't vote with his or her feet and had the dubious opportunity to make a complaint, you know, just John Q. Citizen, they are assuming some more risk, are you not?

A I think what the ratepayer is really doing is now assuming the responsibility or more likely to assume the responsibility for paying the actual costs of the fuel that the company incurs.

And to the extent that this price risk is shifted from the company, I suppose that does increase their risk somewhat, which Dr. Hadaway pointed out. And it -- it goes back to the regulatory that we were talking about before where the company has had no opportunity to recover the 20 to $30 million annual increase per years. The customers are more likely to pay for what the company is actually incurring now.

CAPTAIN HOLLIFIELD: No further questions.

JUDGE VOSS: Sedalia Industrial Energy Users Association?

MR. WOODSMALL: Thank you, your Honor.

CROSS-EXAMINATION

BY MR. WOODSMALL:

Q Very briefly, to touch on a couple matters -- or one issue that was in Mr. Imson's testimony, and I believe he's not going to be called today, I was wondering if -- in his testimony at page 1, he states that electric utility operations in Kansas should be sold during the third quarter of 2006. Do you know if that's been closed?

A That was closed April 1st.

Q Okay. Thank you. Now, moving to your testimony. Thank you for indulging me there. A couple of, first, just administrative matters, I guess.

In Mr. Johnstone's testimony, he suggested a -- are you familiar with the term "accumulation period?"

A Yes, I am.

Q And how -- how do you use that term?
A The accumulation period is the period where your -- I'm trying to think of a different word than accumulating, but you're -- you're tracking the costs and accounting for those to be summed and passed on to the customer at some future period in time.
Q And when --
A During the recovery period.
Q Okay. And I was just going to ask you, would you define recovery period for me?
A The recovery period is the period over which you actually collect the fuel costs that would be part of an FAC.
Q Okay. In Mr. Johnstone's testimony, he proposes a change to the company's recovery period changing it to a 12-month period. Can you tell me your request perspective on that?
A I can. I have no argument with a 12-month accumulation period. I had proposed a different approach in my direct testimony.
Q Real quick, you used the word accumulation period, 12-month accumulation period. Did you mean recovery period there?
A I did mean recovery period.
Q Okay. Continue.

A I'm sorry. In my direct testimony, I proposed a different approach. But I have no qualms with Mr. Johnstone's.

Q Okay. And on the issue of lime losses, it's my understanding that the company has agreed to the lime losses contained in Mr. Brubaker's testimony; is that correct?

A That is correct. I -- I believe Mr. Johnstone also referred to those, but the factors were -- were reflected in Mr. Brubaker's testimony.

Q Okay. And that lime loss study was conducted in a 2002 rate design case; is that correct?

A I -- I believe that's correct. It's the latest rate design case we have. That's where it came from.

Q And it was the latest lime loss study conducted; is that correct?

A Yes. That's correct.

Q Okay. Thank you. Now, moving on, I want you to take a hypothetical for me. Assume you have a utility company with several different generating facilities, base load, intermediate, peaking, and they have a fuel adjustment clause.

Isn't it true that that company will recover the use -- the amount of gas costs incurred for those generating facilities?

A Well, it would depend -- under the company's proposal, that is correct.

Q Okay. Now, assume for me that one of those generating facilities goes down. There's an explosion, a collapse at a damn, what have you. What would happen with fuel costs?

A It's likely that the -- that the -- since the generation is no longer available from that plant that the company would have to go out on the market and either -- it would either generate more from its other facilities, or it could go out on the market and purchase power.

Q Okay. And if the company went out on the market and purchased power under the company's current proposal, would that purchase power flow through the fuel adjustment clause?

A That's correct. The -- the operational risk of the event that you're describing would remain with the company. The cost of the fuel would be included in the fuel adjustment clause for pass-through to the customer.

Q You said fuel. Would the purchase power, the replacement purchase power, be included in the fuel adjustment clause?

A Purchase power is one of the accounts that's included in our proposal for inclusion in the fuel adjustment clause.

Q Okay. Does your -- does the company's current FAC proposal attempt to provide any recognition of negligence for the generating units being taken out of service?

A Yes.

Q Does it do it prior to the replacement purchase power being flowed through in rates?

A No. It would be subject to the -- the prudence review that we've -- we've discussed.

Q Okay. And that prudence review would happen after collection of increased rates; is that true?

A It -- it would take place after -- after the fact and would be refunded. If there was a finding of imprudence, it would be refunded to the customer after the fact with interest.

Q And in the current Aquila FAC, that could be as long as four years; is that true?

A I don't believe so. I believe it would be on an annual basis.

Q You believe that prudency review is done annually?

A That's our proposal. Yes.

MR. WOODSMALL: Okay. No further questions. Thank you.

JUDGE VOSS: Staff?

MR. FREY: Yes. Thank you, your Honor.

CROSS-EXAMINATION

BY MR. FREY:

Q Good morning, Mr. Williams.

A Good morning, Mr. Frey.

Q Following up just a little bit on a point that the good Captain touched on in his cross-examination, I think you answered in response to one of his questions that you don't think the company wants to recover more costs than it actually incurs. Do you recall stating that?

A I do. The -- the fuel adjustment clause that the company has proposed would insure that the company recurred only its cost of actually prudently incurred fuel costs.

Q Okay. As I recall, you mentioned -- you only referred to the cost that it actually incurred. You didn't use the word prudent. So my question was going to be, do you think the company would be interested in earning more than its prudently incurred costs?

A And the answer would be no.

Q And, once again, touching on a matter raised in the Captain's cross-examination, will you agree that in a typical general rate increase case, the result is normally an increase in rates for the utility?

A Normally, a rate increase case would result in a rate increase. I have seen times when companies have filed for rate increases, and during the ensuing periods, the Staff or other parties have filed the complaint case.

Q Well, is it correct that those would be a relatively small percentage of the -- of the rate increase cases that are filed?

A I think that's reflective of the fact that, in general, costs are increased, have increased.

Q So the answer is --

A So the answer is yes.

Q Thank you. With that in mind, do you see a difference between a prudence disallowance in a general rate increase case and one that occurs after the fact in the context of a fuel adjustment clause audit in which the disallowance might very well result in the removal of money from the money's pocket?

A I -- I make no great distinction. I believe both of them would remove money from the company's pocket. If -- let's say, for example, the prudence issue in a rate case were associated with payroll. And there -- so there was an adjustment made by the Staff to reduce payroll costs, even though the company was going to incur those payroll costs in the future or a rate of return penalty or anything like that.

The money would still be taken out of the company's pocket. It would be done in a different manner.

Q But if -- if the rates overall increase, then more money is going into the company's pocket for a general rate case, is it not, in the future?

A That would be true.

Q Thank you. Could you turn to your rebuttal testimony? Do you have it with you?

A I do.

Q And turn to page 6, line 17.

A I have it.

Q Okay. And there, I believe, you indicate your agreement with Public Counsel witness Ryan Kind that the Commission has some discretion in whether or not to authorize a fuel adjustment clause; is that correct?

A I agree that the Commission has some discretion. I think you went a little far when you said that I agreed with Mr. Kind because I believe the level of discretion may be different.

Q Okay. And that's what I wanted to ask you about. You go on to state that the Commission doesn't have as much discretion as Mr. Kind contends, do you not?

A I do.

Q Can you -- can you explain that?

A It's -- it's my view that Mr. Kind has some circular reasoning here that would result in a fuel adjustment clause never being allowed to be approved.

And if that's the case, then I say then why would the legislature have ever passed the statute in the first place? So that's kind of the basis for my dis -- disagreement perhaps with Mr. Kind.

Q Is it your testimony, then, that if the Commission on a case by case basis is denied fuel adjustment clauses, it doesn't have the discretion to do that?

A I think it would depend upon -- we're getting closely into legal matters. And I am not an attorney, but I think it would depend upon the rationale that the Commission used for not approving any of those fuel adjustment clauses.

Q So if it used what you considered to be an appropriate rationale and it happened to result in the denial of a fuel adjustment clause in all of the cases, let's say, over a certain period of time, two or three years, that you -- you do not think -- or you do think that that would be within the Commission's discretion; is that correct?

A It most likely would be.

Q I believe this question was asked of Mr. Fetter, and I will ask you. Are you aware of any states that have mandatory fuel adjustment clauses that the Commission is required to order them?

A I haven't a done study to tell me whether they -- it's mandatory or not.

Q So the answer is no, you're -- you're not aware of any; is that correct?

A I am not -- I am not aware of whether they are or not.

Q You mentioned in your rebuttal testimony, I believe at page 77, that Missouri already has a PGA ACA fuel cost recovery mechanism in place for natural gas and distribution companies, did you not?

A I did.

Q Are you familiar with the PGA/ACA process?

A I'm aware of it on the periphery.

Q And under that process, there is the true-up to actual costs, so-called ACA or Actual Cost Adjustment phase; is that correct?

A That is correct.

Q And the ACA phase includes a pru -- a prudence review, does it not?

A It does.

Q Would you agree that a prudence audit of fuel costs for an electric utility would be more complicated than one that occurs in the ACA for a gas utility?

A Could you repeat the question?
Q Would you -- would you agree that the prudence audit, fuel costs for an electric utility, an FAC context would be more complicated than one in an ACA case?
A Not necessarily. I -- they're -- they're different, no doubt. I mean, on the gas side, you're going to have such a thing as imbalances and multiple suppliers and things that you won't have on the electric side.
On the electric side, you're going to have some of the things that was talked about while Mr. Fetter was on the stand. I'm not sure that one or the other is more complicated.
Q When you -- when you say multiple suppliers, are you saying that an electric utility doesn't have multiple suppliers, let's say, for example, multiple suppliers of fuel?
A It does.
Q Or, indeed, multiple suppliers of coal?
A Multiple suppliers of coal are typically controlled by contract. And you get into, of course, on the coal side, you might have adders and you may or may not have adders on the gas side.
So, again, I agree that they're different, but I can't say that one is more complicated.

Q Are you aware of how long it takes to process an ACA case?
A It varies.
Q Between what and what?
A It -- it's -- it's largely driven by how long the Commission allows it to take. I know I -- I spent years -- that was one of my primary functions when I was with the consulting firm was working on -- on prudence reviews for electric and gas companies.
And -- you know, you ask kind of a general question. In some states, those were processed within a month. And at other times, I know that ACAs have dragged on for years. So that's what I mean by -- when I say it varies.
Q How about in this state?
A It varies in this state, too. There have been issues -- there have been times when cases have been allowed to drag on for years.
Q So can you provide a range for the state of Missouri?
A No, I -- I can't. Not a specific range.
Q You understand the -- the concept of regulatory lag, correct?
A I did.
Q Do you agree that the prospect of being able to

take advantage of regulatory lag constitutes a powerful incentive for the utility?

A I -- I believe regulatory lag does provide an incentive to the utility, yes.

Q Would you say it's a strong incentive?

A It -- it would depend on your definition of strong, I suppose, because I -- I like to think that the company has an incentive control costs with or without regulatory lag.

Certainly, regulatory lag adds to that, but classifying it as strong or weak or middlin, I can't do.

Q So --

A It doesn't have a lot of incentive to me. I think I would operate the same with or without regulatory lag.

Q How about the -- how about Aquila? Would -- would you classify it as a strong incentive for Aquila by your definition of strong?

A No. I would classify it as an incentive, but not a strong incentive.

Q If Aquila's authorized to implement its proposed fuel adjustment clause, won't the potential to take advantage of regulatory lag disappear as it pertains to purchase fuel and purchase power?

A There will still be some -- some regulatory lag just through the -- the mechanism. It will certainly be shortened, and there will certainly be interest at least included in the company's proposal, which would essentially deal with regulatory lag.

Q Would it be fair to say that the amount of regulatory lag would be greatly diminished?

A I would agree with that.

Q And if that were to happen?

A Whatever the incentives are, however you characterize the incentive to take advantage of regulatory lag, those, then, would also be greatly diminished; is that correct?

A They would be diminished to the -- to the same level and replaced by prudence reviews.

Q Do you agree that Aquila's incentives are not the same under an FAC?

A The level of incentive under a regime without an FAC is probably different. I do not believe that actions taken by the utility with or without an FAC would be different.

Q So you don't believe that the -- the incentives, although they're different, you don't believe that they're diminished?

A That's correct.

Q Could you turn to the bottom of page 3 of your direct testimony, please?

A All right.

Q And there you state, Aquila's original proposal for the treatment of off system sales margins; is that correct?

A That is correct.

Q And that treatment would be to share between the company and customers the amount of any under-based costs, any amount of prudent -- by which prudently incurred costs are over or under base costs. Do I have that right?

A That's certainly correct.

Q Can you read -- read the sentence providing Aquila's rationale for that proposal into the record? I believe it begins at line -- page -- line 21 of page 3.

A Sure. Starting middle of line 21, The sharing mechanism between customers and shareholders recognizes that the off-system sales market is largely outside the control of Aquila but provides incentive to Aquila to take on the additional risk of pursuing sales outside of its core markets.

Q Would it be fair that -- that the statement you just read indicates that a sharing mechanism might be appropriate in cases where the cost of revenue is at issue and are largely beyond a utility's control?

A Well, I think I expand on this -- can you restate the question? Because I want to address your question.

Q Would it be fair to say that this statement indicates that a sharing mechanism might be appropriate in cases where the costs or revenues at issue are largely beyond a utility's control?

A Yes. With the additional caveat that it would also be where those endeavors are outside of its normal business.

Q You would agree, would you not, that a sharing mechanism would provide an incentive for the utility to increase its off-system sales where previously there have been no sharing of off-system sales? Margins, I'm speaking of. I'm sorry.

A Yes. I took it that you were speaking of margins. And yes. I think incentives to have Aquila expand into a -- a business or pursue a business aggressively that we're not currently pursuing, then incentives would be affected.

Q And, likewise, if a sharing mechanism is associated with prudently incurred fuel and energy costs, it would provide the company with an incentive to lower those costs as compared to a scheme that calls for a full pass-through of those costs?

A I wouldn't agree with that necessarily. I think that gets back into the discussion we were having where the incentives might be different, but not -- not necessarily have an impact on the company's actions.

Q Well, what's -- what's the difference here between the off-system sales situation and the -- and the fuel and purchase power for, let's say, native load?

A Well, I view off-system sales as something that we're not currently pursuing as a -- as a business. We do take advantage minimally where we have the opportunity to do so to the benefit of our customers. But we're not pursuing the merchant function, which is what a separate business would be in some of the -- I know some of the other electric utilities in the state do that.

If -- when we're talking about a fuel adjustment clause, that applies to our core business. And that's why I'm saying -- I think we would run our core business just as we always have. But if -- if someone wants to encourage us to move outside of our core business into a new line of business, then perhaps an incentive would be appropriate.

Q So incentives are only useful when we're talking about getting the company into businesses other than its core business?

A I think -- I think incentives are appropriate when you're trying to change the current actions of the utility. And -- and -- but, you know -- by that, I mean, you know, major -- by that, I mean when you're -- you're talking about a fuel adjustment clause, an incentive is not, in my mind, going to change the actions of the company because we've already, I think, been doing as effective a job as we can.

Q Doesn't the company -- isn't the company -- doesn't the company often change what its -- its method of operation with respect to its core business in an effort to improve its operations?

A I think we're always looking to improve our effectiveness without sending us to any specific incentives to require us or encourage us to do so.

Q So you don't see any role for incentives in that -- in that context?

A No great role, no.

Q Now, I have a reference here, and I believe it's on -- I didn't indicate it, but I think it's on the -- page 3 of your direct testimony, page 4. Yes.

On page 4 of your direct, you refer to the additional risk of pursuing sales outside of your core market. Can you just explain what you mean by the additional risk?

A Well, if we were to pursue sales outside the core market, to do so, we'd be changing the total operation of our company. We'd be moving back more toward the merchant function that Aquila had pursued in the past.

Q Okay. Turning to your surrebuttal testimony, you announce that change in position regarding the treatment of off-system sales margins in connection with your proposed -- with the company's proposed fuel adjustment clause; is that correct?

A I'm sorry. I missed the question.

Q In your surrebuttal, you announce that the company was changing is position regarding the treatment ever off-system sales margins regarding the fuel adjustment clause?

A I don't believe we necessarily said we were changing. I think we -- we accepted some proposals or -- or -- in fact, we would be happy with the original proposal we made.

What we were doing was looking at other proposals then made by parties. And those that made sense, we said we can live with those as well. So we -- we were accepting, but not really necessarily changing. We were saying we could change and agree with those changes.

Q Okay. And did the company agree with the changes with respect to sharing of off-system sales?

A Really, it was -- it was in retrospect after read Mr. Trippensee's testimony. And he pointed out that currently Aquila wasn't aggressively pursuing off-system sales.

And he indicated it was his opinion that an incentive mechanism really didn't have a lot of impact on off-system as -- as currently pursued by -- by the company.

And -- and in retrospect, I had to agree with that.

Q Did Mr. Johnstone's rebuttal testimony play any role in the company's decision?

A Not in regard --

Q As --

A Not in regard to off-system sales.

Q In your rebuttal testimony, you criticize the proposed sharing mechanisms of Mr. Johnstone, who is the SIEUA and Ag. Processing witness as well as that of a AARP witness Ronald Benz; is that correct?

A I disagreed with what they call sharing.

Q Could you please turn to page 12, then, of your rebuttal? Do you have that there?

A Now, I have it.

Q Okay. And can you please read into the record the two sentences beginning at line 2 and ending at line 6?

A Starting in the middle of Line 2?

Q Right.

A Under both of these proposals, Aquila would never be allowed to recover 100 percent of its fuel and purchase power cost if it exceeded a prescribed label, even if those costs were determined to have been prudent incurred. Do you want me to keep going?

Q Yes. The second sentence as well?

A Conversely, customers would receive no benefit if fuel and purchase power costs were less than the base level.

Q Thank you. Can you please explain, then, why under these sharing proposals customers would receive no benefit if fuel and purchase costs were less than base level?

A I believe that's -- that's an error. The customer would receive -- would not receive 100 percent of the benefit. It -- it would correspond to the -- to the earlier statement.

Q Thank you. With respect to be sharing mechanism, I have a hypothetical for you. Suppose, if you will, that in Year 1, an electric utility with a 50/50 sharing mechanism built into a fuel adjustment clause experiences increased prudently incurred fuel and purchase power costs of $5 million above the base costs. Okay?

A In Year 1 of a fuel adjustment clause?
Q Yes.
A And is there a -- what you're calling a --
Q 50/50.
A Okay. All right.
Q Under the sharing scheme, the company only receives two and a half million of that increase; is that correct?
A If that. But no more than two and a half million, yes.
Q Well, these are the prudently incurred costs. Why did you say if that?
A Some proposals have also suggested that there be other efficiency tests and not exactly a prudence disallowance, but an efficiency disallowance.
Q Okay. But for purposes of this hypothetical and as you have set out in the fuel adjustment clause, you expect this company to receive two and a half million dollars; is that correct?
A As I have set it out --
Q Yes.
A Well, as have set it out, I wouldn't expect the company to receive the whole five million that it actually incurred.
Q Oh, I'm sorry. Right. I'm sorry. Except it

for 50/50 sharing?

A Yeah. If there were 50/50 sharing, all other things being equal, then I would accept two and a half million dollars as what the company would receive out of the 5 million that it actually incurred.

Q Okay. Now, suppose in Year 2 the company experiences prudently incurred fuel and purchase power costs that are six million below the base amount, meaning that -- that the company would be able to obtain 3 million of the decrease. Do I have that right?

A You would have that right under your hypothetical.

Q Okay. Now, under that scenario that I hypothesized, the utility would net half a million dollars, would it not?

A Under that hypothetical, they would.

Q You say then that the existence of a sharing mechanism has prevented that electric utility from recovery 100 percent of the prudently incurred fuel and purchase power costs?

A Under that hypothetical, I would say that the company would have, in that situation, been allowed to achieve even more than its prudently incurred fuel and purchase power costs.

MR. FREY: Thank you. I have no further

questions, your Honor. Thank you, Mr. Williams.

JUDGE VOSS: Public Counsel?

MR. MILLS: Thank you.

CROSS-EXAMINATION

BY MR. MILLS:

Q Good morning, Mr. Williams.

A Good morning, Mr. Mills.

Q Could I get you to turn in your surrebuttal testimony to page 14, lines 10 through 16?

A I have it.

Q Okay. Can you -- can you point to something in Mr. Trippensee's testimony that made you believe that he proposed to include hedged costs and revenues?

A I don't have his testimony to point to. But I believe at the time I read it that that was one of the items he listed.

Q Okay. You don't have a reference to that, though, from your testimony?

A I -- I do not have a reference in my testimony.

MR. MILLS: Your Honor, may I approach?

JUDGE VOSS: Yes, you may.

Q (By Mr. Mills) I've just handed you a copy of Mr. Trippensee's rebuttal testimony. Will that help refresh your recollection?

A It will, if I can have time -- a little bit of time to look at it.

JUDGE VOSS: Stop for a moment and let the court reporter change her paper.

(Break in proceedings.)

JUDGE VOSS: Okay. Please continue, Mr. Mills?

A In looking at Mr. Trippensee's testimony on page 12, it appears that I -- I probably am in error in my original understanding of his testimony.

What he -- he says -- or what the question refers to is broker costs and commissions associated with hedging rather than the -- the cost of the hedging itself.

Q (By Mr. Mills) All right. That's a significantly smaller --

A Significantly.

Q -- smaller deal, is it not?

A It's a significant -- it's significantly less likely to be a high dollar amount.

Q Okay. Do you object to the exclusion of broker fees for hedging?

A To the exclusion, yes. I would object to excluding those costs from the fuel adjustment clause.

Q Okay.

A For the -- for the same reasons I said for other insignificant costs.

Q But nonetheless, in your testimony on -- on page

14, you're referring to a misconception of what Mr. Trippensee has stated in his testimony; is that correct?

A That's correct. And with a rereading of his testimony, my testimony should -- should be changed and to include just the -- I'm sorry. I've lost it again -- but just the broker costs and commissions associated with hedging.

And I would say they would be included with the fuel adjustment clause because they are a direct cost of hedging, which is a direct cost of fuel. And if they are insignificant, then it makes no sense to include a fuel-related item from the fuel adjustment clause that's insignificant.

Q Okay. Now, just -- at a very high level, your proposal is to change rates based in changes on what you pay for fuel; is that correct?

A That's correct.

Q So if, for example, natural gas prices don't change at all but you use 10 percent more natural gas, you would propose to increase rates by that 10 percent --

A No.

Q -- all else being equal?

A No. Well --

Q No.

A If you -- the fuel adjustment clause is calculated on a kilowatt hour usage basis. So the rate in that case would likely not change.

Q If -- you're assuming, then, that rates go up by -- that usage goes up by 10 percent?

A Right. All other -- I think you said all other things being equal.

Q Yes.

A And if all other things are equal, then I would think that's the only way that -- that that would occur.

Q Okay. Well, assume with me that -- that all other things really are equal and that usage doesn't change, coal usage doesn't change. The only thing that's changed is that Aquila has turned 10 percent more natural gas over a particular period.

Would you propose increasing rates by that 10 percent through the fuel adjustment clause?

A I can't imagine why that would happen unless lime losses or something like that increased. So I can't agree with your hypothesis.

Q Okay. Make it a half a percent.

A If -- if fuel usage increased for no good reason --

Q Well, I'm not specifying a reason. I'm just saying if it does, is the effect of your proposal that rates for customers would go up?

A My proposal is that all prudently occurred fuel costs would be passed on to the customer. So if the increase was because of prudent actions for something that I can't imagine what would happen to cause that, yes.

Q So the answer to my question was yes?

A The answer to your question with the hypothesis I don't agree with is yes.

Q Okay. Now, I believe in response to some questions from Captain Hollifield, he was originally asking you about interim relief, and you said the Commission doesn't grant interim relief?

A I said I'm not aware of the Commission having granted interim relief in the number of years that I've been here in -- in Missouri.

Q And that's been since the mid '80s?

A Off and on since the mid '80s, yes.

Q Okay. But are you aware that the Commission has, in fact, granted interim relief on a number of occasions?

A They may have. I'm not aware of any times that they --

Q Okay.

A I believe it is legal for them to do so, but it is out of the norm, certainly.

Q But you believe that it is legal for them to do so and they could do so if the proper situation arose?

A It's my understanding that it is legal for them to do so.

Q Okay. Now, turning to another topic, is -- is part of your compensation based on meeting certain incentive targets?

A Yes.

Q Is one of those earnings per share targets?

A I believe there is a -- that a portion -- a small portion of all of the employees that are -- that received incentives. I think a small portion of that is -- is related to -- I'm not sure if it's earnings per share, but it's some kind of earnings factor. I -- I believe it's maybe an EBIDTA factor.

Q A what factor?

A It's Earnings Before Interest, Depreciation, Taxes and Amortization.

Q Okay. Now, is any part of your incentive compensation based on the outcome of this particular rate case?

A No.

Q Except to the extent that that may change earnings?

A That -- that would be correct.

Q Okay.
A It could depend on whether I keep a job or not. So in that regard, I guess there's some incentive.
Q Now, your rebuttal testimony, you talked about the study that you directed Mr. Davis to perform; is that correct?
A That's correct.
Q Did you direct Mr. Davis to determine an ideal resource portfolio considering demand side resources?
A I gave him really no instructions other than I wanted him to look at what an -- he considered to be an ideal portfolio.
Q And in the portfolio that he constructed, what percentage of the load is constructed through demand side resources?
A I don't -- I don't think he looked at the demand side, but that's not because I instructed him one way or another. You'd have to ask him.
Q I plan to.
A All right.
Q Do you know the answer to my question? What percentage in his ideal portfolio was met through the use of demand side resources?
A I do not.
Q Did you direct Mr. Davis to look at off-system

sales and purchase power agreements in constructing a resource -- an ideal resource portfolio?
A I gave him no instructions on what to look for in looking at the ideal.
Q Okay. Now, would you agree that at least from the customer's perspective that the prudence review is an important part of your fuel adjustment clause proposal?
A I -- I think, from the customer's standpoint, that certainly would give them comfort in -- more comfort in the fuel adjustment clause.
Q What do you propose to be the standard for establishing prudence in a prudence review?
A The same standards that exist today.
Q And what is that?
A Audits are done. Questions are raised as to whether decisions were made that were reasonable and effective given the circumstances with which the company was faced at the time decisions were made.
Q So the standard you're proposing is reasonable and effective given the information known at the time?
A I think that's as fair as -- as -- as any other. I -- my real recommendation is not to change the prudence standard from what it exists today.
Q So under that standard, there's considerable room for -- for the prudence reviewer, as we will call

him, to -- to establish that a better opportunity existed, but yet for the company's choice to not be imprudent? Would you not agree?

A Could you restate the question?

Q Isn't it possible that under the standards that you've enunciated that at the time the utility took a certain action, a better alternative could have existed than if the utility's action would be found prudent, according to your standards?

A I believe there are times when there might be two prudent choices, if that's what you meant. So there might be alternatives. So the company selects one and another party might think that another alternative should have been selected.

Both could be prudent decisions. One might be better than the other.

Q And the utility could end up choosing one that costs more to ratepayers, and yet, still by your standards be found prudent?

A Well, and I --

Q That's a yes or no question. Is that true?

A In hindsight, yes.

Q Well, I'm using your definition, which that -- that -- that you use only the information known or should have been known by the utility at the time.

A That's right. And -- and that's why I was saying you would only know using hindsight whether or not that decision actually resulted in a -- a -- more cost to the customer or less cost to the customer.

Q True. I mean, that's -- isn't that part of your proposal, that the prudence review is done after the fact?

A It would be done after the fact.

Q Is there any other way to do it?

A I don't believe there is. I think that's the way it's done today.

Q Okay. Now, in -- in your rebuttal testimony at page 10, you talk about -- and, basically, around lines 17 through 19, you talk about exposure to market price volatility; is that correct?

A That's one of the things --

Q Yes.

A -- I discuss.

Q Can hedging reduce that exposure?

A Hedging can reduce the exposure of price volatility at a cost.

Q And Aquila does, in fact, hedge many of its fuel purchases, does it not?

A Aquila has a hedging in place for its gas and purchase power transactions.

Q Okay.

A Some -- some of its gas and purchase power transactions.

Q And do you consider the way that Aquila contracts for coal purposes to be a hedging program?

A Well, Aquila's contracts, we burn about 2.3 million tons of coal annually. And I think about 2.1 million of those tons are under contract. I -- I wouldn't call that a hedge the way most people refer to hedge. But it -- it does lock in the price until those contracts expire.

Q Okay.

A And, unfortunately, those contracts are expiring within the next year.

Q Okay.

MR. MILLS: Your Honor, I'd like to have an exhibit marked.

JUDGE VOSS: You're up to 415.

MR. MILLS: Thank you.

Q (By Mr. Mills) Mr. Williams, I believe when you were on the stand earlier you said that you were familiar with the -- Aquila's 10-K filings with the Securities & Exchange Commission; is that correct?

A I'm required to review the 10-K as part of Sarbane's Oxley.

Q Okay. And a -- a portion of the 2006 10-K was admitted into evidence as Exhibit 512 in this case. Do you recall that?

A I don't know the exhibit number.

Q But you remember that -- that exhibit being admitted?

A I recall the 10-K.

Q And, in fact, portions of the 10-K were admitted. And, in fact, I believe under redirect examination, you identified that, and another page was admitted, which was page 33. Do you recall that?

A I don't recall the page number.

Q Okay. In any event, what I have just handed you which has been marked as Exhibit 415, does that appear to be page 66 from your 2006 10-K?

A It does appear to be that.

Q The heading on this page is Item 7-A, Quantitative and Qualitative Disclosures About Market Risk and the subheading apparently is Market Risk - Utility Operations; is that correct?

A That's correct.

Q And in its 2006 10-K, does Aquila not say that, quote, 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 100 percent of our native

load fuel requirements of coal-fired generation in 2007 and 62 percent in 2008 respectively. Is that correct?
A That is what it says.
Q Okay. So at least with respect to 2007, you already locked in 100 percent of your fuel -- of your coal prices?
A We do have contracts in place and -- for the 2.1 million tons which I told you, and those expire within a year.
Q I thought you said -- I thought you told me that you had contracts in place for -- for less than 100 percent for 2007.
A We burned about 2.3 million tons in 2006. We have contracts in place for 2.1 million tons.
Q Okay. So when it's -- when this document was talking about 100 percent, it's talking about 100 percent of the expected burn?
A That's likely true.
Q Okay. And as you get closer to 2008, would you expect to lock in further amounts under contracts?
A If -- if it were not for impacts of a potential merger, I would expect that.
Q Is there anything in the -- have you -- has Aquila executed a merger agreement with Great Plains Energy?

A It has.
Q And is there anything in that merger agreement that limits Aquila's ability to hedge its fuel cost going forward?
A I do not know if it's in the -- in the agreement or not. I -- I am aware that there has been discussion not to enter into new coal contracts, although there is an RFP that has been issued. So there is -- I don't think there's a firm prohibition from entering into a coal contract, but I think it would only be done so through discussions with the merchant partner --
Q Okay.
A -- and agreement with the merchant partner.
Q Now, in the past, Aquila has acted to hedge against fuel price volatility, is that correct, both coal and natural gas?
A If you're calling contracting coal as hedges, yes, coal, and, to a lesser extent, gas and power.
Q Okay. Now, in light of the possible prospective merger, is Aquila hedging future natural gas prices in the same way that it has in the past?
A It still is following its hedge program, although, as a result of the stipulation in this case, we will be looking at that hedging program.
Q Okay. Do you anticipate that in the coming

months that there will be changes to your natural gas hedging program because of the prospective merger?

A I -- I believe there will be changes in the coming months, but more as a result of the stipulation in this case.

Q And when you say more, do you mean exclusively, or do you mean some of each?

A I'm not aware of any -- I'm not aware of anything going on with the prospective merger partner or any prohibitions from the merger agreement that would -- that would keep us from entering into hedging programs.

Although, again, I'm sure, if we -- if we had major changes to our hedging programs, I'm sure we'd do it in conjunction with discussions with the merger partner. We'd inform them of what's going on.

Q Now, with respect to the merger partner, are you aware that at least the Missouri regulated affiliate, Kansas City Power & Light, has committed to not use a fuel adjustment clause for, oh, ten years beginning in 19 -- I'm sorry -- in 2005 approximately?

A I wasn't aware that it was that long a term. I was aware that they had agreed not to implement a fuel adjustment clause. I thought it was until the regulatory plan ended with the conclusion of IATAN II being put into service. But I could be wrong about that.

Q Well, I could be wrong about it, too. But at least for some period of time they've committed to not seek a fuel adjustment clause?

A That is my understanding.

Q Okay. Now, returning to Exhibit 415 -- and I read a portion of that paragraph that has to do with coal but that your 2006 10-K filed with the SEC goes on to state, The price risk associated with our natural gas and on-peak spot market purchase power requirements is also mitigated through a dollar cost averaging hedging plan using IMEX, futures contracts and options. This is a multi-year hedging plan.

As of December 31, 2006, we have financial contracts in place to hedge approximately 75 percent of our expected on-peak natural gas and natural gas equivalent purchase power price exposure for 2007. Is that correct?

A That is correct.

Q Okay. Now, do you have a copy of --

MR. MILLS: Your Honor, at this point, just so I don't forget, I'd like to offer Exhibit 415 into the record.

JUDGE VOSS: Are there any objections to that exhibit?

MR. MITTEN: I object, your Honor. I object to the introduction of a portion of the 2006 10-K. If Mr. Mills want to admit the 2006 10-K, I think he should admit the entire report because there's no way the Commission can understand the context in which the excerpt in which he's focusing on.

JUDGE VOSS: I think --

MR. MILLS: Your Honor, it's for -- perhaps Mr. Mitten wasn't here at the time. Aquila started this precedent. Aquila offered one page, I believe in addition to the 25-odd pages that the Staff originally offered in Exhibit 512. And Aquila at the time declined to produce the entire document and -- and put it into the record. And I don't believe if -- if they aren't required to that I should not be required to.

JUDGE VOSS: Yes. I believe that Aquila, although different counsel, offered Exhibit -- is it 38? Page 33 to the 2006. So I'm -- I've got to talk to co-counsel.

MR. MITTEN: I'll withdraw the objection.

MR. MILLS: Other than standing around the copier and the expense thing, I don't object to the whole exhibit going in. I just don't feel that I should be required to do it at this point. So the objection with regard to -- was 415 admitted?

JUDGE VOSS: 415 was admitted.

(Exhibit No. 415 was offered and admitted into evidence.)

MR. MILLS: Okay. Thank you.

Q (By Mr. Mills) Mr. Williams, do you have a copy of 512, which is the beginning portion of the 10-K that was admitted earlier in the case?

A No, I don't.

MR. MILLS: Your Honor, may I approach?

JUDGE VOSS: You may approach.

Q (By Mr. Mills) Mr. Williams, can I get you to turn to page 21 of your 2006 10-K? And this is a page that bears the heading Item 1-A Risk Factors?

A It does.

Q Okay. Now, the -- the bottom paragraph on that page, and I hope we're going to be in sync because I have a slightly different printing of that, states that -- and I believe this is the second to last sentence on the page.

In addition, our non-investment grade ratings generally require us to prepay our commodity purchases or post collateral to obtain trade credit; is that correct?

A That is what it says.

Q And the requirement to prepay or post collateral for fuel purchases will increase Aquila's costs to hedge fuel prices, will it not?

A I don't know.

Q Do you know whether other utilities are required to prepay on purchases or post collateral?

A I do not.

Q Is it your understanding that this description of risk factors filed with the 10-K outlines risks that are facing Aquila?

A This does talk about operating risks that Aquila faces, yes.

Q Okay. And would you expect that if the requirement to prepay commodity purchases or post collateral was an industry-wide practice that it would be reflected as a risk factor for Aquila?

A I don't know. It could be. I think there are risks that all utilities face that probably we would have to list within the 10-K. Having said that, I -- I don't know, but -- whether other utilities face the same risk or not.

Q Okay.

A I would -- I would say that it refers -- it's under a heading -- our non-investment grade credit ratings have an adverse affect on our liquidity and borrowing costs.

Q Yes.

A And none of the other utilities in the state of which I'm aware -- if you want to narrow it down to

Missouri, none of those have non-investment grade.

Q And earlier in that paragraph, there's a sentence that says, Our non-investment grade ratings have increased our borrowing costs. Is that not correct?

A That's -- that's true. And I think there was a discussion of that while Mr. Hadaway was on the stand and how that's handled in rate-making.

Q Do ratepayers have any control over or influence over the credit ratings that Aquila receives from the credit ratings agencies?

A I would say no.

Q Okay. Okay. Now, on the following page, page 22, the paragraph about two-thirds of the way down starts with the sentence that says, In our continuing regulated electric business, we generated approximately 53 percent of the power utilized by our utility customers, and we purchase the remaining 47 percent through long-term contracts or on the open market in 2006; is that correct?

A Yes. I read that.

Q And do you agree that that's an accurate statement?

A I do.

Q Do you know if any other Missouri utility relies on purchase power for almost 45 -- 47 percent for the power utilized by its customers?

A I do not know what extent other utilities in Missouri -- what percentage they use for purchase power.

Q Do you have an opinion as to whether that is an ideal resource portfolio?

A I have no opinion, but I believe the two witnesses after me might.

Q Now, with respect to -- I believe there was a hypothetical that Mr. -- Mr. Woodsmall -- now I'm going to have to stop and think and not call him Smallwood after -- after Dr. Hadaway the other day.

I believe this was in response to a hypothetical that was posed to you by Mr. Woodsmall. And I think it -- I think it had to do with a generating plant going out of service. Do you recall that?

A I do.

Q Okay. Currently, does Aquila earn a return on all of its generating plants in Missouri?

A We are authorized to earn a return on our -- on our total investment.

Q Okay. And -- and to the extent that your returns are at least positive, do you earn some return on your investment?

A That's correct. Our returns in the St. Joe area are negative. That's -- that is why I paused.

Q Right. But except for an unusual situation like that, you do earn a return on your generating facilities; is that correct?

A We -- we earn a small positive return on our MPS investment.

Q Okay.

A And we do not earn a return on our St. Joe investment.

Q Both -- both --

A If you -- if you were authorized a fuel adjustment clause, that return would be in base rates, would it not, the return on plant investment?

A The return on plant investment would remain in base rates just as it is today.

Q Okay. Now, if one of your plants goes out of service and you have to purchase more power, the increased cost of that additional power purchase would flow through the fuel adjustment clause, would it not?

A Well, you made an assumption that I can't necessarily agree with. What I will agree with is that the purchase power costs would flow through the fuel adjustment clause. But if I can give you an example, my concern with your statement, you said the increased purchase power costs. For example, we have Lake Road Units 4 through 6, which we many times in the evening -- it's a hundred megawatt plant.

We back that down to 20 megawatts. And the reason we do that is because in the evening, purchase power may be cheaper than the cost of generating, which plays into my concern about some of the efficiency rules and the like. But my concern was just assuming that purchase power is always more expensive.

Q All right. And let me -- let me clarify my question, then. Assume that you have a generating plant that unexpectedly goes out of service, that had it been running would have been cheaper than buying purchase power. In that case --

A I'm making that assumption.

Q In that case, would the increased cost of purchase power over the cost of power generated from that out of service plant flow from the fuel adjustment clause?

A The purchase power cost would flow through the fuel adjustment clause, yes.

Q Okay. And is there any provision that would remove the return in base rates -- the return on investment from that plant during that period of time?

A I wouldn't hardly think so.

MR. MILLS: Okay. That's all the questions I have. Thank you.

JUDGE VOSS: Since it's noon, did you want to take a break and do questions from the bench after lunch?

Okay. We'll break until 1:00.

(Break in proceedings.)

JUDGE VOSS: All right. We're back on the record. And we'll begin with redirect.

REDIRECT EXAMINATION

BY MR. MITTEN:

Q Mr. Williams, during Mr. Woodsmall's cross-examination of you, he posed a hypothetical. Do you recall that hypothetical?

A Not exactly.

Q I believe it was that Aquila has several different generating facilities, it has a fuel adjustment clause in place and one or more of those generating facilities goes out for some reason. Do you recall that?

A I recall that.

Q And he asked you whether or not the cost of replacement power would be flowed through the fuel adjustment clause. Do you recall that?

A I do.

Q Under what circumstances would the cost of replacement power be flowed through the fuel adjustment clause?

A Under the circumstance that it was determined that that -- that cost of power was prudently incurred.

Q And would one of the issues in this prudency review be the circumstances surrounding the outage?

A Certainly, it might be. For example, if you -- if a storm had knocked a plant out or a tornado came and -- and wiped out a portion of a generating station, that -- that might be deemed by the Commission to be outside the utility's control.

Obviously, the risk associated with repairing the plant would -- would fall to the company. But if deemed prudently incurred, the -- any replacement power that was required would flow through the fuel adjustment clause.

Q During Mr. Fray's cross-examination, he asked you a number of questions regarding regulatory lag. Do you recall those?

A I do.

Q In an era where fuel and purchase power costs can increase as much as 13 to 20 percent per year, what is the effect on Aquila under those circumstances if it does not have a fuel adjustment clause and is subject to regulatory lag?

A Well, the facts that you state are what we've been experiencing the last several years, at least the last three years. And what we would -- what we would see is continued returns that are either negative, as they are in the case of St. Joe Light & Power division, or less than 4 percent as they are in the MPS division.

The -- the assumption that if fuel costs continue on the same trend that they are increasing anywhere from 30 to 40 million dollars a year, that -- that does not allow the company to earn returns higher than -- than those that -- that I mentioned.

Fuel costs make up almost 50 percent of our total O&M. So when you've got them increasing at that level, there's just no way to manage around it and no way to maintain or earn returns that are -- that have been authorized by the Commission.

Q Now, let's assume in place of regulatory lag the sharing mechanism that Mr. Johnstone has proposed was in place. Would that significantly improve Aquila's situation?

A We -- we'd still be -- we still would not be able to earn our authorized return. We'd still be having a substantial earnings shortfall, would not be recovering our actual incurred cost of fuel.

If, at best, we could recover half of the -- the $40 million dollars, then we're still going to have a $20 million shortfall.

Q Mr. Frey also posed a hypothetical two years under a fuel adjustment mechanism. Do you recall that hypothetical?

A I do.

Q Now, the second year, he assumed a 50/50 sharing mechanism and fuel costs that were $6 million below the amount in base rates.

A Yes.

Q Now, assuming Mr. Johnstone's 50/50 sharing mechanism is in place, how realistic do you think that Year 2 hypothetical is?

A Well, that's -- that's the problem I was having with the hypothetical because, under Mr. Johnstone's testimony, as I understood it, I don't think the hypothetical is even possible.

Mr. Johnstone, in his direct testimony, says basically 50 percent of your fuel costs should be in base and 50 percent should be in the fuel adjustment clause. So if the example was that $5 million is in the fuel adjustment clause, that means 5 million is in the base. And that was the first hypothetical.

And then he says, well -- and then the second year under the hypothetical was fuel costs go 6 million below the base. Under -- under Mr. Johnstone's testimony, that would put us in a negative fuel situation, and I don't think that's possible.

Even -- even if it wasn't for that, I would say it's very unlikely that that's going to take place just because fuel costs have been shown -- although they're volatile, they've been shown to be continually increasing over time. And the expectation is that they are going to continue to increase.

Q Do you still have with you a copy of Exhibit 415, which Mr. Mills introduced into evidence earlier today?

A I do.

Q Let me direct your attention to the second paragraph of that exhibit.

A I have it.

Q The initial phrase of that paragraph is, In our continued -- continuing regulated electric business in 2006. Do you know what that means?

A Yes. That would be our regulated operations in Colorado, Kansas -- excuse me -- Colorado, Kansas and Missouri.

Q Um --

A Because we -- during '06, we still had the Kansas operations.

Q How much base load generation is there in Kansas and in Colorado that's owned by Aquila?

A There is no base load generation in Colorado. And there's relatively little base load generation in Kansas.

Q And moving down to the second line where it talks about the remaining 47 percent through long-term contracts in the open market, what do you know about that 47 percent purchase power figure?

A Well, that includes -- if -- if what you're curious about is looking at just the Missouri operations -- and this 47 percent includes two base load purchase power contracts, fairly large ones that are very attractively priced, which was part of my concern when we started talking about purchase power earlier.

And there was kind of an implication that purchase power is a bad thing. And that's certainly not -- not the case. I think using the Staff fuel run -- I'm not sure if it's the final, but in a -- in a fairly late fuel run, you look at -- the two purchase power contracts that I was referring to out of MPPD.

They have a cost per kilowatt hour of $13.64 compared to our base load of $13.11, our base load coal contracts. So it's a very attractive price.

And if you add those together with our coal, our total base load for Missouri comprises about 83 percent of our energy requirements. That's utilizing the Staff.

MR. MITTEN: Your Honor, I have no further questions for Mr. Williams.

JUDGE VOSS: Okay. Mr. Williams, I'm going to go ahead and excuse you for now subject to recall in the event that the Commissioners come in and have some issues.

MR. WILLIAMS: All right. Thank you.

JUDGE VOSS: Okay.

MR. MITTEN: Our next witness is Davis Rooney.

DAVIS ROONEY,

being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified as follows:

DIRECT EXAMINATION

BY MR. MITTEN:

JUDGE VOSS: You may proceed.

MR. MITTEN: Your Honor, all of Mr. Rooney's pre-filed testimony with the exception -- exception of a little over three pages of his direct testimony is going to be stipulated into the record per the stipulation that's pending before the Commission.

So my direct examination will focus only on those three-plus pages of his direct testimony that deal with fuel adjustment clause.

JUDGE VOSS: So you're going to offer --

MR. MITTEN: I can offer those pages into evidence and await the Commission's decision on the stipulation for the balance of his pre-filed testimony.

JUDGE VOSS: Okay.

Q (By Mr. Mitten) Mr. Rooney, good morn -- good afternoon. Do you have in front of you a copy of your pre-filed direct testimony which has been marked as Exhibit 24?

A I do.

Q Now, for purposes my question, I want to focus on the portion of your testimony that begins on page 26, line 22 and continues on through page 29, line 14.

A Okay.

Q Do you have that?

A Yes, I do.

Q Was that testimony prepared by you or at your direction and under your supervision?

A It was.

Q Do you have any changes or corrections to make to that portion of your testimony this afternoon?

A I -- I do not.

Q If I asked you the questions that are contained in that portion of your testimony, would your answers be the same as appears there?

A They would.

Q And is the information contained in those answers true and correct to the best of your knowledge and belief?

A It is.

Q Let me also direct your attention to Schedule

HDR-8. Was that schedule prepared by you or at your direction and under your supervision?

A It was.

Q Do you have any changes or corrections you need to make to that schedule at this time?

A I do not.

Q Is the information contained in that schedule true and correct to the best of your knowledge and belief?

A It is.

MR. MITTEN: Your Honor, I would offer into evidence Mr. Rooney's direct testimony in the portion that, again, begins on page 1 -- excuse me, page 26, line 22 and continues through page 29, line 14, and, also, Schedule HDR-8 into evidence.

JUDGE VOSS: Is there any objection to the admission of that portion of the testimony? It's admitted.

(The above-mentioned portion of Exhibit No. 24 was offered and admitted into evidence.)

MR. MITTEN: And Mr. Rooney is available for cross-examination.

JUDGE VOSS: I think Federal Executive Energy Agencies?

CAPTAIN HOLLIFIELD: No questions, your Honor.

JUDGE VOSS: Okay. Sedalia Industrial Energy

Users Association?

MR. WOODSMALL: No, thank you, your Honor.

JUDGE VOSS: Staff?

MR. FREY: No questions. Thank you, your Honor.

JUDGE VOSS: Public Counsel?

MR. MILLS: Oh, I'll ask him one just so his trip to the stand is not completely worthless.

CROSS-EXAMINATION

BY MR. MILLS:

Q Mr. Rooney, on page 29 of your direct testimony, specifically at line 11, you refer to valuable feedback to Aquila. Do you see that reference?

A Yes.

Q Can you give me an example of some valuable feedback that you got from Public Counsel and what you did in response?

A Yeah. During the IRP process that we just filed, the February 27 IRP, we had some meetings with various representatives.

As I recall, Office of Public Counsel raised some concerns about how we had modeled some DSM programs and how we had -- had grouped them together. As a result of that feedback, we went back and changed the way that we were grouping our DSM programs together.

Q And did you accept all the feedback from all the representatives throughout those meetings?

A I think we took their feedback under advisement and tried to accommodate as much of it as we thought was appropriate.

Q But you didn't accommodate all of it, did you?

A I don't recall whether there was feedback that we didn't accommodate. We tried to accommodate the feedback we got.

MR. MILLS: Okay. That's all the questions I have. Thank you.

JUDGE VOSS: AARP?

MR. COFFMAN: No questions.

JUDGE VOSS: I don't see any questions from the Bench at this time. I'm going to, again, do redirect with the potential that a Commissioner or two may come down with questions. I haven't received any indication that they are, but --

MR. MITTEN: No redirect, your Honor.

JUDGE VOSS: Okay. And I'll say the witnesses I am excusing is subject to recall, but that will just be effective through the end of the day today so that they don't have to stay tomorrow.

MR. MITTEN: We'd call as our next witness, Robert Davis.

ROBERT DAVIS,

being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified as follows:

DIRECT EXAMINATION

BY MR. MITTEN:

Q Mr. Davis, could you please state your name and business address for the record?

A Name is Robert Davis. Business address is 1000 Legent Place, Suite 1100, Orlando, Florida, 32801.

Q Mr. Davis, by whom are you employed, and what is your job title?

A I'm employed by R.W. Beck, Incorporated. We're a national consulting firm with headquarters in Seattle, Washington. My title with R.W. Beck is Senior Director.

Q Mr. Davis, do you have before you a copy of your pre-filed rebuttal testimony in this case, which has been marked for identification as Exhibit 37?

A I do.

Q Was that testimony prepared by you or at your direction and under your supervision?

A Yes.

Q Do you have any changes or corrections to your pre-filed testimony?

A A couple minor ones. On page 3, line 1, was the phrase "preferred plan plan." The second plan should be eliminated.

On page 11, line 14, the fourth word, "burden" should be past tense, "burdened."

Q Any other changes?

A No.

Q With those changes, if I ask you the questions that are contained in your pre-filed rebuttal testimony, would your answers be the same as are reflected there?

A They would.

Q And is the information in that pre-filed testimony true and correct to the best of your knowledge and belief?

A It is.

MR. MITTEN: Your Honor, I offer into evidence Exhibit 37.

JUDGE VOSS: Are there any objections to the admission of this exhibit? Hearing none, it is admitted.

(Exhibit No. 37 was offered and admitted into evidence.)

MR. MITTEN: And Mr. Davis is available for cross-examination.

JUDGE VOSS: Federal Energy Agencies?

CAPTAIN HOLLIFIELD: No questions, your Honor.

JUDGE VOSS; Sedalia --

MR. WOODSMALL: No, thank you.

JUDGE VOSS: Okay. Staff?

MR. FREY: No thanks, your Honor.
JUDGE VOSS: Public Counsel?
MR. MILLS: Sure.

CROSS-EXAMINATION

BY MR. MILLS:
Q Mr. Davis --
A Good afternoon.
Q -- my name is Lewis Mills. I represent the Public Counsel in this proceeding. When were you hired by Aquila to participate in this proceeding?
A Fall of this past year, 2006. I can't cite a specific month without reference.
Mr. MILLS: Okay. Hang on just a second. I need to check with counsel for Aquila on how much of this exhibit is going to be highly confidential.
JUDGE VOSS: No problem. While we're waiting for that, Commissioner Murray wanted me to let everyone know that she is watching on the webcast, and none of the witnesses are being held on her behalf. She has let me know that she does not have questions for the witnesses that we've been through so far. Okay?
MR. MILLS: Your Honor, I believe we just got agreement from Aquila that with respect to Davis Schedule RHD-2 attached to his rebuttal testimony, essentially, the text of that report is not highly confidential. The

tables and -- and jump in if I'm misstating this.

The tables from pages 11 of 16 through 16 of 16, they do consider to be highly confidential. Is that correct?

MR. MITTEN: That's correct, your Honor.

Q (By Mr. Mills) Okay. Now, Mr. Davis, I -- I think I'm confused here because we're -- the letter that starts on page 1 of 16 of schedule RLD-2 talks about an agreement dated October 18, 2004?

A Correct.

Q So you have a standing engagement with Aquila, and then it was expanded to cover this case in the fall of 2005?

A My company --

Q 2006?

A My company typically works under -- we sell the basic professional terms and conditions with individual clients. Many times we may be assigned a task and then not work for that client again for some -- for quite a while. So it's basically just laying out the contract terms.

The agreement you're referring to in October of 2004 was an assignment that R.W. Beck worked for Aquila on an appraisal I believe it was of the South Harper assets?

The study that we have here before us here really wasn't begun until 2006.

Q Okay. And tell me how you understood your assignment in -- in this particular aspect. What were you supposed to be doing for this case?

A Essentially, reviewing the supply mix of Aquila and coming up with an independent assessment of whether that supply mix looked reasonable or not.

Q Okay. In Mr. Williams' testimony, he said that you were to look at the optimal resource portfolio, I believe, for Aquila. Is that what you did?

A I would probably further clarify that as a theoretically optimal portfolio, theoretical being that it may not even be able to obtain the mix of assets that I analyzed within this analysis.

Q So is it your testimony that -- that an optimal resource mix contains no demand site features and no purchase power?

A When we performed the analysis, we borrowed the 2005 IRP for basic assumptions and information as well as load forecast and the DSM assumptions that were contained as part of that 2005 IRP. So this analysis and the load that was modeled within my modeling does include some impacts of DSM that were present as part of the 2005 IRP.

Q Okay. Does that include any off-system sales or any market purchases?

A It includes -- it includes purchases that Aquila had in place that -- that meet its supply mix that served the load of the retail customers. It does not include an assumption of off-system sales.

Q Okay. Can I get you to turn to page 5 of your rebuttal testimony, lines 17 through 18 where you state the analysis was performed by assuming the electric system served its entire load from its own resources?

A Uh-huh.

Q I.e., external market sales and purchases were not modeled. What does that mean?

A I qualified the term market sales and purchases, perhaps misqualified within my testimony here, but to mean spot purchases.

Q Okay.

A The purchases that we did model for Aquila were longer term type assets that I would assume to be part of any normal supply site plan of a utility.

Q Does Aquila in the real world actually rely on spot market purchases and, in fact, make spot market sales?

A To my knowledge, they do.

Q Now, with respect to the -- to your schedule RLD-2, did you assess the desirability of adding more wind to Aquila's portfolio?

A That was not examined as a resource option, no.

Q Okay. Now, was your analysis based on information and assumptions provided to you by Aquila?

A It was.

Q Did you perform an independent assessment of the information and assumptions that were provided to you?

A Most of the information we were modeling was on their existing resources. So we -- I assumed that the information provided by Aquila was accurate for the modeling of their assets.

For future expansion resources, that was also consistent with the current assumptions that Aquila's modeling in its current IRP. I did compare and contrast those to our own internal assumptions, and they were reasonable and consistent.

Q What do you mean by your own internal assumptions?

A R.W. Beck models market price forecasts. We do resource planning studies. We do all sorts of studies for clients. We have in-house a set of assumptions that we use for those purposes. And I compared and contrasted the Aquila assumptions and found them to be consistent.

Q Are your in-house assumptions geographically specified?

A In some cases.

Q And do you have in-house assumptions that cover the Kansas City area?
A Not that specific.
Q Okay.
A I would say SPP might be specific.
Q Okay. In the analysis that you undertook, are delivered prices for coal and natural gas important inputs?
A Yes.
Q Did you use the delivered prices for coal and natural gas that were supplied to you by Aquila?
A I believe so.
Q Okay. Did you do any independent assessment of the reasonableness of those assumptions?
A I did not.
Q Okay. In your Schedule RLD-2 on page 2 of 16 in the paragraph immediately above the table, you're -- you're talking there, I believe, about additional base load. And -- and in the second to last sentence, you conclude by saying, It is not clear that such opportunities existed.
Are you talking about opportunities to participate in -- in a coal-fired base load plant there? Are those the opportunities you were referring to?
A This would have been a historical view back to

2005.

Q Right.

A And I'm not certain whether Aquila had an opportunity to purchase any base load and/or intermediate capacity during this period of time.

Q But my question is, does the term "opportunities" there mean the opportunity to participate in a base load coal unit?

A I'm not aware of any coal units that were built during that period of time, so whether purchase and/or participate in a joint-owned unit, I would say that it incurs -- includes both of those.

Q I think we're talking past each other. What opportunities are you referring to in that sentence?

A Okay. The opportunity to either purchase or jointly own an asset.

Q A coal-fired base load asset? Yes or no?

A Or owned by someone else. Either.

Q Okay. And when you say it is not clear that such opportunities existed, what did you do to investigate whether or not opportunities existed?

A I've been modeling markets throughout most of the eastern United States for some time. And I'm not aware that any coal units were being built during this period of time.

Q Okay. Did you review the responses that Aquila received on the power supply RFPs that it issued over the last five years?
A No.
Q So you wouldn't know if there are any attractive opportunities that Aquila didn't pursue in those RFP responses?
A Not with regard to the RFPs, no.
Q Okay. Now, in -- in performing your model, did you not take into consideration generating unit commitment constraints and the cost of unit commitment?
A I did not.
Q Okay.
A Except for the fact that base load type assets, we did model under constraints and conditions.
Q But those constraints and commitments have to be taken into account in the real world, do they not?
A They do. You will find that most models, especially those that are attempting to find through some kind of optimization routine take various short cuts with regard to modeling the dispatch and operation of facilities. And unit commitment happens to be one of those areas that's typically eliminated or simplified.
Q And in your rebuttal testimony at page 4, you talk about generating resource dispatch and expansion

optimization model?
A Correct.
Q What model did you use?
A It was one I built myself.
Q Okay. And so the short cuts and limitations you just referred to are ones that you built into your model?
A Correct.
Q Okay.
A In order to model a unit commitment decision would have required substantially more effort and computer time than we had available.
Q Now, at page 9 of your rebuttal testimony, lines 20 to 21, you state that Mr. Kind apparently concludes that exposure to fuel or -- or power price volatility in and by itself is problematic. Where does Mr. Kind say that?
A Would you refer me to the line again in my testimony?
Q Oh, I'm sorry. In your testimony, I'm talking about page 9, lines 20 through 21.
A Uh-huh. If I could see a copy of Mr. Kind's testimony, I might be able to point you to that.
MR. MILLS: May I approach the witness, your Honor?
JUDGE VOSS: Yes, you may.

A I'd suggest that my statement here refers in general to Mr. Kind's response to his question on his reference to page 9 of his testimony, the last question on page 9 of his testimony where he describes in several locations that fuel price volatility appears to be a negative or something that a utility should attempt to avoid.

Q (By Mr. Mills) Okay. And similarly, on page 10 of your testimony, at line 20, you're paraphrasing Mr. Kind, and you use the word -- or the phrase "risky investment decisions." Did Mr. Kind ever use the phrase "risky investment decisions" in his testimony?

A My recollection is he does. Maybe not in response to that question, so I'd have to reread his entire testimony over to find the reference of which I'm referring.

Q Okay.

A Do you want me to do that?

Q If you need to in order to answer my question, then please do so.

A We read Mr. Kind's response to the referenced second question on page 10. We note that he is stating --

Q I'm sorry. My question was does Mr. Kind use the phrase "risky investment decisions?"

A He uses the term "risky investment outside of

Missouri."

Q Okay. And is that -- does that have anything to do with the creation of a portfolio -- portfolio of resources within Missouri?

A In this case, I believe it does. I think what we're referring to here is the Aries plant, which Aquila had part ownership, and then purchase power from over a period of time, including the historical portion of the evaluation that I performed and the future portion of the evaluation I performed.

So since in this case the -- the risky investments appear to apply to and incorporate the Aries plant, I'd say it does -- it is germane to the testimony.

Q Where is the Aries plant?

A I believe it's in Illinois, isn't it? No.

Q Well --

A I -- I'm sorry. I don't know its exact physical site. I believe it's interconnected through a substation, though.

Q Would it change your answer if -- if you were to assume that it's within Missouri?

A My answer is the same if it's in Missouri.

Q Okay. Now, is it -- turning -- turning back to the -- the portion of your testimony at page -- your rebuttal testimony at page 9, lines 20 to 21, is it your understanding of Mr. Kind's testimony that he believes that utilities' planning processes should be designed to eliminate volatility?

A When I read Mr. Kind's testimony, what I understand him to be saying is that volatility should be something that a utility should avoid. My -- in my evaluations, I suggest that avoiding volatility in and of itself is not necessarily good.

It depends upon what price you're going to pay to avoid that volatility. It's possible that by installing a generating unit or putting financial hedges in place that you actually spend more for that insurance or that premium to -- than the risk you're actually avoiding.

Q Okay. Well -- now, with respect to your testimony, page 10, lines 14 through 15 -- first of all, can you explain to me what you mean by if a utility is deliberately excluded from FAC cost recovery?

A I'm not -- just to qualify my answer here, I'm not a rate analyst. I'm a power supply planner. So my -- when I discuss FAC cost recovery, I'm saying it in somewhat of a generic layman's evaluation.

Q And my question is really more towards the phrase "deliberately excluded."

A If a utility is not permitted to recover its fuel costs, is probably a better way to say it, what this can -- and have a means of -- of direct pass-through, in other words, they are not in a position of having a base rate for fuel recovery, if they're allowed to have fuel costs automatically pass through, they may be more likely to make appropriate resource decisions that would result in the lowest cost to the customers.

Q So --

A If -- if I could finish. If they, however, are not allowed a fuel recovery or fuel cost adjustment, what that can cause them to do is -- is invest more heavily in base load asset, which will have a higher capital cost to the retail customer and, also, higher costs in prices through the rate of return allowed on those assets.

Because what they're attempting to do here is manage volatility on fuel prices or uncertainty on fuel prices through the purchase and utilization of base load assets.

Q Okay. Aquila has not had a fuel adjustment clause for quite some time in Missouri; is that correct?

A From what I've heard in testimony today.

Q Okay. Has the utility's plans tended toward -- I mean, Aquila's plans tended toward high fixed cost and low variable cost plants?

A I haven't seen that tendency in what I know to be in the resource mix, no.

Q In fact, their resource mix is sort of the other way around, is it not?

A I'd say it's balanced, the current resource mix.

Q Balanced in what sense?

A It's appropriately balanced. It meets appropriate levels of base intermediate peaking. That's one of the primary findings of my study.

Q It's not overloaded on high fixed cost and high variable cost plants, is it?

A No, it is not.

MR. MILLS: I believe that's all I have. Thank you.

JUDGE VOSS: AARP? John left. Any questions from the Bench for this witness?

COMMISSIONER APPLING: No questions.

CHAIRMAN DAVIS: No.

JUDGE VOSS: Redirect? I'm sorry.

CHAIRMAN DAVIS: No. I might want to re-call Mr. Denny Ray Williams when there is an opportunity.

JUDGE VOSS: I see. Following redirect?

MR. MITTEN: No redirect, your Honor.

JUDGE VOSS: You're excused.

MR. DAVIS: Thank you.

JUDGE VOSS: And I think at this time we'd like to call Mr. Williams.

MR. MITTEN: Your Honor, may I inquire about something that you said earlier about the witnesses who have testified this afternoon needing to remain to the end of the day? Does that include Mr. Fetter?

JUDGE VOSS: No. We released Mr. Fetter. The ones that I was reserving the right to recall in the event that nothing is asked of them by the end of the day, they will be released.

MR. MITTEN: Thank you.

JUDGE VOSS: Okay. And maybe sooner if I get word. Okay. I'd like to remind you, Mr. Williams, that you're still under oath.

MR. WILLIAMS: Thank you.

CROSS-EXAMINATION OF DENNIS WILLIAMS

BY CHAIRMAN DAVIS:

Q Mr. Williams --

A Yes, sir.

Q -- before we broke for lunch, there were some questions about -- I can't remember if it was the -- maybe -- maybe it was the Adjunct General. I can't remember who was asking it, but the fact that there's not any known pre-approval process for fuel purchasing; is that correct?

A There is no known pre-approval process.

Q Would you be open to a pre-approval process for

-- for -- for fuel and purchasing?

A I -- I certainly think it is something we would consider --

Q Now, would -- I mean, would you -- would you consider -- you know, I don't know who you would call here on the Staff, but maybe -- maybe Mr. Featherstone or Mr. Schallenberg and maybe we could have a -- I don't know, maybe all of the -- the -- I guess the industrial intervenors and the government, and maybe you could all have a -- have a meeting and say, well, you know, this is -- this is the deal, you know, should we take it or should we not and maybe they could put it to a vote? Do you think that would be a prudent process?

A Well, in some regards, the -- the IRP process hopefully will move somewhat in that direction. All the parties are involved in looking at the resource planning, and all have a -- a -- a voice, although the ultimate decision at this point in time remains with the company.

And I'm not aware of any parties being willing outside Aquila right now to pre-approve resources that -- the generation mix, resource plan or new -- new construction.

Q Do any of the industrial consumers ever -- ever call you up and say, Hey, you know, the price of gas is cheap, maybe you ought to go buy some, maybe you ought to go book some?

A Not to my knowledge.

Q Well, they don't -- they don't call you or anybody else at Aquila?

A Not that I've heard. No.

Q Not that you've -- no that you're -- not that you're aware of?

A No one has ever called me.

Q Do you ever call -- do you ever call them and say, Hey, should we buy, or do you think we should wait?

A I have never done that, no.

Q Would you be willing to consider it?

A We're always willing to have input, but I don't think that they should probably make the ultimate decision for Aquila.

Q Well, I -- obviously, not. And is the -- is the coal contract with, what is it, C.W. Mining. Is that still an issue in this case? Or did that --

A That was included in the --

Q That's --

A -- stipulation.

Q That's in -- that's included in the stip., so there's no longer an issue there?

A Depending on what the Commission does with the stipulation.

Q Depending on -- depending on -- okay. Well, I guess maybe you could satisfy my -- my intellectual curiosity if you know, Mr. Williams. Is force majeure (ph.), is that a standard term that's in most of the -- most of the contracts that you get from coal companies, or is that a -- and if you don't know, that's fine.

A It's a fairly standard term.

Q It is -- it is a fairly standard term?

A Yes.

Q And you're in a position to know -- I mean, you're not a lawyer, correct?

A I'm not a lawyer.

Q But you are in a position that you do look at these things, and you would know?

A I know what force majeure means, and I know that it is included in most coal contracts.

Q Okay. And then with regard to those contracts, I mean, you know, this is my -- my lay impression as an observer of some of these things, and you tell me if I'm -- I've got it wrong.

But normally, the game is when a utility like Aquila has a contract with -- with a coal company to provide coal and then all of a sudden the coal company comes back and says, you know, We've got labor problems, we're just not going to be able to, know, honor that contract at this price, but, you know, if we could get a little more money for our union guys, which means a little more money for the company, too, then we could probably make this whole thing go away, and, you know, we could -- we'd be sure that you get your coal. Have you ever heard of that happening in the industry?

A I'm aware of one instance.

Q You're aware of at least one instance?

A Yes.

Q Okay.

A And it involved Aquila, and Aquila basically said no, stick to the contract.

Q Yeah. And you didn't get any coal, did you?

A That's correct. We --

Q Do you think --

A We initially got a little coal.

Q You initially got -- you initially got a little coal, but then all of a sudden, it stopped?

A Yes.

Q Okay. Do you think a pre-approval process for fuel purchasing where the consumer advocates are brought into the mix is -- is technically feasible?

A The more parties you have making decisions, the less likely it is that you'll reach a decision. And, certainly, it's less likely you'll reach timely decisions.

And sometimes time means money. So --

Q Well, but looking at some of the testimony in this case, Mr. Williams, now, correct me if I'm wrong, but there are at least some parties alleging in this case that Aquila didn't have a real intricate gas buying strategy in terms of, you know, We'll buy so much on this date every month or something of that nature. Is that a -- that a fair characterization?

A There was an allegation that the hedging strategy that was used by Aquila was not appropriate. I don't think Aquila has ever agreed with that allegation.

Q Okay. I didn't -- I didn't ask you whether you agreed with that allegation. But that allegation is certainly out there?

A It has been made. Yes.

CHAIRMAN DAVIS: All right. No further questions, Mr. Williams. Thank you.

MR. WILLIAMS: Okay.

JUDGE VOSS: Commissioner Appling, did you have any questions for the witness?

COMMISSIONER APPLING: No questions.

JUDGE VOSS: Then you are again -- oh, actually, redirect based on questions from the Bench -- recross based on questions from the bench? That's what happens when you go out of order. I'm going to pause for a moment to make sure that was Sheryl leaving and not a Commissioner coming in. Okay. Redirect based on questions from the Bench?

MR. MITTEN: No redirect, your Honor.

JUDGE VOSS: Mr. Williams, you're again excused, at least temporarily.

MR. WILLIAMS: Thank you.

JUDGE VOSS: And we're ready for Staff's first witness. Looks like it's --

MR. FREY: Staff calls -- Staff calls Cary Featherstone, your Honor.

CARY FEATHERSTONE,

being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified as follows:

DIRECT EXAMINATION

BY MR. FREY:

JUDGE VOSS: Your witness.

MR. FREY: Thank you.

Q (By Mr. Frey) Please state your name for the record, sir.

A Cary G. Featherstone.

Q And by whom are you employed and in what capacity?

A I'm an Auditor with the Missouri Public Service Commission.

Q And did you prepare and cause to be filed what have been marked for identification purposes in this proceeding as Exhibits 206, 207, 208 and 209 HC and NP, which will be respectively Featherstone direct, rebuttal, and surrebuttal, one on gas turbines and -- excuse me -- the second one on 209 on gas turbines and 208, surrebuttal on the interim energy charge?

A I did.

Q And do you have any corrections to these documents?

A I have a couple corrections to my direct testimony. At page 11, starting on line 16, between recover and fuel, I need to insert the -- two words, "prudently incurred."

And on line 17, between cost and its I need to insert the word "for." And on the -- on the same line, division needs to be plural "divisions."

And then strike prudently incurred. So the sentence should read, Staff is proposing a mechanism to allow Aquila to recover current prudently incurred fuel and purchase power costs for its MPS and L&P divisions.

And then on page 14, of the direct testimony, line 17 where the word "relation" appears, it should be "relating." That's all I'm aware of at this point.

Q And subject to those corrections, if I asked you the questions that are contained in your testimony today, with your answers be the same?

A They would.

Q And are those answers true and accurate to the best of your knowledge, information and belief?

A They are.

MR. FREY: Your Honor, at this time, I would offer the Exhibits 2 -- 206 through 209, HC and NP, into evidence.

JUDGE VOSS: Are there any objections to those exhibits? Hearing none, they're admitted.

(Exhibit Nos. 206, 207, 208, 209 were offered and admitted into evidence.)

MR. FREY: And I tender the witness for cross-examination.

JUDGE VOSS: Okay. Public Counsel?

MR. MILLS: No questions.

JUDGE VOSS: AARP?

MR. COFFMAN: No questions.

JUDGE VOSS: Federal Executive Agencies?

CAPTAIN HOLLIFIELD: No questions, your Honor.

JUDGE VOSS: Sedalia Industrial Energy Users Association?

MR. WOODSMALL: No, thank you, your Honor.

JUDGE VOSS: Okay. Aquila.

MR. MITTEN: No questions.
JUDGE VOSS: Questions from the Bench.
CROSS-EXAMINATION
BY CHAIRMAN DAVIS:
Q Okay. Mr. Featherstone, it's your analysis that an interim energy charge is appropriate in this case and not fuel adjustment; is that correct?
A That's our preference.
Q That's your -- that's your preference?
A Yes.
Q Okay. And, basically, the difference between the interim energy charge and the -- the fuel adjustment mechanism is that there is, you know, a hard cap where if the company exceeds that cap, then they have to just absorb those costs. Is that -- is that a fair assessment?
A That is part of it.
Q That's part of it?
A At the other end of the spectrum, if -- if a rate is established for the floor, if -- if that is established correctly, that could provide an incentive to the utility to work towards beating that floor so that you are driving down the overall fuel costs.
Q Uh-huh.
A So an IEC, the acronym for Interim Energy Charge --

Q Uh-huh.
A -- kind of works in a symmetric way so that you have a floor and a ceiling that must work in tandem.
Q Has Aquila been very good about getting -- getting below the -- the floor at any time in the past?
A Well, we don't have an interim energy charge. But if you were to use the $6 floor that we're proposing, they have been, yes, at various times.
Q Okay.
A You could look at --
Q But they've had two previous interim energy charges, correct?
A They've had one.
Q They've had one. Okay. And how did -- how did they do in that one instance? Or was -- was that the one where because of the -- the problems with the coal contract that they were never really able to realize any of those benefits?
A I think you would get a lot of disagreement between them and us, Staff and the company. I think that there was no doubt, unquestionably, that they under recovered by a substantial amount. There were several factors that we think should have been considered as to why that under-recovery occurred.
The one you speak of is the -- the Sibley coal

contract. There was an outage, also, that was extended from a four-week to an eight-week outage at Sibley, which is its low cost coal-fired unit, that affected that IEC amount as well.

There was some gas pricing issue. And then, finally, there was also a -- a booking issue, how you collect the revenues and how you book the revenues. Or excuse me. The costs between the L&P and MPS divisions vision.

So those four factors, I think, caused a substantial amount of the under-recovery. It could be that we just missed a fuel forecast as well. I would have to see. But part of the under-recovery would be the fuel pricing just wasn't correct in that case.

Q And I believe -- I don't know. Is the floor and the ceiling of your IHC -- IEC proposal, that's not, that's not confidential or proprietary, is it?

A Not from my perspective. I didn't make it HC.

Q Okay. Okay. All right. Well, I just ask to make sure. And was the -- was -- the ceiling for natural gas, was that $9; is that correct?

A It was.

Q Okay. If -- let me ask you this, Mr. Featherstone: Do you think that -- do you think if the price of natural gas -- if the price of natural gas were to hit $9 or go above for an extended period of time, I don't know, say, one month or two months, do you think we should just -- well, I would assume that Aquila would be -- would automatically be filing another rate case. Do you think?

A Well, I -- regardless of what the Commission does with fuel costs or IEC, the company is going to file in the rate case.

Q Right.

A I believe that's going to be next year. I think that's a given, at least what I've been told. So that shouldn't influence you. Hopefully, it won't. I think at various times with an IEC mechanism, you will over and under-recover.

It is for a period of time. We're recommending a two-year period of time because of the Kansas City Power & Light, Great Plains merger with Aquila.

At one time, we recommended a three -- two to three years depending on what the Commission would like to see. At various times during that period, during those two years, 24 months, you may at any given month be over-recovered or under-recovered. It is at the end of the period that you look at, do the true-up, do the prudency review and analysis and determine whether it was successful or not.

Q So, Mr. Featherstone, what would you think about the approval -- pre-approval process if Mr. Williams were to call you up and say, I'm thinking about buying some natural gas at, you know, $6. How much do you think I should lock in?

A Having -- having been a participant in the integrated resource planning process, capacity planning process, we were very vocal in giving our ideas and suggestions. And very seldom were they needed. So I'm not sure that in the pre-approval process that you're describing --

Q Well, what -- what suggestions do you have for the management at Aquila, although we realize that they may -- I guess there has been a case filed which may or may not determine their length of time on this earth. But what -- what suggestions have you made in the past that have not been needed?

A I think it's -- it goes to a settled issue. But I think that if you looked at some of the testimony on capacity planning and on the turbine issue, I think you'd come away with that the Staff has been very strong advocates for the, I think you've heard the phrase --.

Q Yeah. The five turbines, two phantom turbines that are kind of out there in limbo?

A I think the phrase is, You put the steal in the ground, building versus buying. And that has been an ongoing discussion and dialogue that we have had with this company for a number of years and certainly dates back to the Aires power plant and I suspect will continue until some other company takes it over or they --

Q Until there's -- until there's a resolution. Okay. What other -- what other suggestions?

A Those are the ones that I -- that come to mind.

Q Okay. I -- that is one. What was the other one that I was missing there?

A We don't -- we don't have many other collaborative efforts where we have discussions about the running of the company's affairs. I've not been a participant in that, at least in discussions with the company in terms of its buying decisions, be it its fuel contracts which were not -- so -- so that's the only one that comes to mind from my perspective.

Q Okay. But you def -- I mean, I believe I read it -- I mean, is it -- is it your belief that both Empire and KCP&L have a much superior hedging strategy for purchasing natural gas?

A You're referring to the witness -- I'm not the witness on hedging.

Q Okay. But it's Chuck Hyneman's or Charles R. Hyneman's testimony, his surrebuttal, I think, where he gets into that and he describes the differences between Aquila's hedging policies practices and those of Empire's and Kansas City Power & Light?

A Uh-huh. And that is, as Mr. Williams has indicated this morning, or this afternoon that that is part of the stipulation. They have, I think agreed -- I don't want to get too far afield, but they have agreed to look into their hedging policy and consider changes to it.

Q Okay. Are there any considerations -- with regard to the fuel adjustment issue, there were several -- I don't know if you want to call them conditions were the right word, but conditions, I think, that Staff recommended in its testimony for -- for fuel adjustment. Which of those, in your opinion, are the most important?

A If -- if you're not interested in an IEC -- and we realize that without a collaborative effort that was going to be an uphill battle. But if you're not interested in an IEC, you, being the Commission, we have lent our support to the Sedalia Industrial Group and their proposed what is referred to as an alternative fuel cost.

One of the key features with that is -- that I think is important is the sharing mechanism. I think that has some features to it that is similar to an IEC.

There was also recommendation that there be a 3 percent limit to cap for an increase, which I think is attractive and ought to be considered. The annual recovery period, I think that's important.

From just a logistics and resource commitment, certainly, keeping in the prudency review should -- should the Commission go with a fuel cause, I think, is important, although I think it's a very daunting task to do the reviews as you do that after a purchase gas adjustment.

Those are the ones that come to mind. There may be some others in my testimony, but I don't know. They don't stand out right now.

Q Now, if this is a more appropriate question for Mr. Hyneman, please -- please feel free to -- to respond in that fashion. But, you know, based on what you know and have read, do you think that requiring Aquila as a condition in this rate case to adopt a new hedging strategy and come back to this Commission and get it approved? Do you believe that would be a prudent exercise?

A I think it's important for the company to re-examine and evaluate its hedging strategy and seek outside guidance. And we -- there's a couple of consultants that we're aware of. I think the company is aware of that -- they have indicated that they will entertain in -- in contracting their services. I guess the --

Q How long do you think it will take them to get that process underway and -- and change their ways?

A I -- I would not think -- hopefully, they've started the process already. I would not think that it would -- it would require an awful -- I don't believe -- I don't think it's going to be a along lead time.

Q Six months?

A Perhaps, or less.

Q Less than six months?

A Perhaps.

Q Okay.

A I think that the -- the things that's throwing me about your question is coming back to Commission with -- for --

Q For approval?

A -- for approval.

Q So they could definitely -- they could definitely come back and get something. The question is, can they get it -- can they get it approved?

A Yes.

Q Okay.

A And -- and, also, do you want to be in that business of approving every aspect of the company's operations kind of micromanagement question. They still have the responsibility and obligation to manage the company.

CHAIRMAN DAVIS: Okay. Judge, I have -- I have no further questions. But Commissioner Murray is here, so she might want to -- she might want to ask Mr. Featherstone some questions now.

JUDGE VOSS: Commissioner Murray?

CROSS-EXAMINATION

BY COMMISSIONER MURRAY:

Q Good afternoon, Mr. Featherstone.

A Good afternoon.

Q I have a couple of questions. And I'm trying to understand why it is that you would prefer a mechanism whereby the company would be left in a situation where even under the best case scenario -- and I'm talking about your alternative proposal, which would be the sharing mechanism -- that the company would be unable to recover entirely its fuel costs.

Why would you prefer that over a mechanism such as the fuel adjustment cause that would allow for full recovery and no -- you know, no sharing, no detriment to the ratepayers, thereby no detriment to the company thereby but just purely a flow-through of the costs?

A I don't believe that -- the 50 percent sharing proposal does not provide the opportunity to recover its

-- its full fuel costs.

Nor do I believe that -- that no fuel mechanism or IEC mechanism, which is traditional rate base, rate-making treatment, denies the company the opportunity to recover fuel costs.

Q And the IEC mechanism has been around for quite some -- quite some time, has it not?

A The first -- the first one was developed for Empire's 2001 rate case.

Q Okay. And since that time, the legislature passed Senate Bill 179 to allow the Commission to impose the fuel adjustment clause; is that correct?

A Yes. And it also permitted an IEC mechanism as part of that SB-179 Bill.

Q And the IEC mechanism -- and I know you just went over this with the Chair. Unfortunately, I was kind of running between the two places, and I didn't hear everything.

But the -- the IEC mechanism sets a cap; is that right?

A It -- it sets a floor and a cap, a range that is subject to refund. Anything within that range that has prudently incurred costs is -- is either refunded or retained by the company, depending on the circumstances.

Q And under that mechanism, isn't it possible for the ratepayers to pay -- isn't it possible for the company to lose a little or for the ratepayers to lose a little?

A Not within the range. Now, it is -- at the cap, it is a hard cap. Anything in excess is absorbed by the company. And anybody that goes below the floor is also obtained by the company.

In that sense, the customers will lose if they beat the floor, and the company will lose if they exceed the ceiling.

Q And why, in your opinion, is that preferable to the FAC, which would provide that neither the ratepayers nor the company receive more than they should?

A I think the IEC provides many of the incentives of traditional rate-making. In other words, it -- it provides a range of pricing, both in terms of the floor and the ceiling, where the parties, the customers as well as the company, know exactly what that range is, and the company can manage its fuel procurement and operational system to the -- to within that range.

And so that if they can -- if they can find a way to price fuel and operate efficiently, they have an opportunity to drive down the fuel costs, customers will certainly benefit, but so does the company.

Q Okay. And do you -- do you believe that the company does not have an incentive to operate efficiently when there is an FAC mechanism in place, including the prudence review?

A I think they have much less incentive under a fuel pass-through fuel clause. It's human nature. It takes a lot of work to operate an electric system. It takes a lot of work to negotiate contracts.

If you have a total pass-through, if you pass those on to your consumers, you may not fight with your coal supplier as much as if it's coming out of your pocket or you may not operate your plant in an insufficient manner.

Q But it's not a total pass-through, is it? Isn't it a total pass-through of currently incurred costs?

A That is what the company says. Yes.

Q Isn't that what the law says?

A It provides for prudency review. Yes.

Q So that the inefficiencies, I would assume, would be considered imprudent if they exist?

A If -- if you find them and if -- if you can discover them. And if you can present the necessary evidence, it is a -- a daunting task and a very slippery slope, particularly in prudency reviews where in very subtle ways the parties that are making the claim of imprudence, the burden shifts suddenly and sometimes in absolute terms to -- to those parties, and it becomes very difficult to present those arguments and present those circumstances and facts. And that's if you can find them.

Q Okay. This have -- have you reviewed the statute allowing the FAC?

A I have. When I say -- I've reviewed the Commission rules and the SB-179 statute.

Q And under what circumstances would you be in favor of allowing an FAC?

A Well, we're -- we're proposing a -- a fuel mechanism in this case so that we think Aquila is a -- a utility that should have some type of fuel mechanism, particularly with the -- with the energy prices being where they are today. So --

Q And the fuel mechanism that you have recommended is the one that they could have had prior to Senate Bill 179; is that correct?

A They -- they -- well, I think yes and no. But if -- if you get a -- forgive me. I'm not an attorney. But if you -- if you get a total consensus and -- particularly, if the company must agree to an IEC mechanism, it cannot be prior to 179 to not be imposed upon them as I understand it. But it had to be negotiated, and you at least had to have every party in the case take the position non-opposition.

In most of the -- in fact, all of the IECs that

I am aware of, it was done on a collaborative basis. And all of the parties who had an interest in the fuel area took part in the discussions and negotiations, and, ultimately, I believe, either did not oppose or they signed the -- the stipulation regarding the IEC.
I think that's different than the environment today.

Q Okay. So you're saying that your recommendation actually flows from Senate Bill 179?

A Yes, ma'am.

COMMISSIONER MURRAY: Okay. I think that's all I have. Thank you.

MR. FEATHERSTONE: Thank you.

JUDGE VOSS: Commissioner Gaw, do you have any questions?

COMMISSIONER GAW: Does Jeff have any more?

CHAIRMAN DAVIS: No. No. Go ahead.

CROSS-EXAMINATION

BY COMMISSIONER GAW:

Q Mr. Featherstone, in regard to a prudency review, have you ever conducted a prudency review on an electric company dealing with the issues that would come up in a fuel adjustment clause?

A I have not personally. I did not think that -- in the sense of an after-the-fact review, I assume is your question?

Q Yes, it is.

A I -- I -- there might be two individuals that are left from the days that date back to the fuel clauses. When I started, they were just finishing up those reviews, Steve Traxler and Bob Schallenberg.

I -- I do not know of anybody else -- I think maybe on -- on the Staff, there might be one or two others, perhaps Russ Trippenssee, Office of Public Counsel. But no, not personally.

Q Okay. I -- I thought I heard you answering earlier to Commissioner Murray's inquiry in regard to some concerns you had about a prudency review. You mentioned, I believe, the negotiation of contracts in an example about human nature and what it was, how hard a company would -- would work to get the lowest price that negotiable. Do you remember that general -- general answer?

A I do.

Q I'm just wondering, in -- in looking at that was type of a situation on a prudency review, how would you be able to determine how hard the company negotiated to achieve a certain price on a -- on a contract for sales or purchases?

A It's very difficult. You would have to have access to, I think, a lot of data, memorandums, studies, analyses performed by the utility, by its consultants if they've hired one. And I'm thinking of the coal contracts as an example. E-mails. Perhaps some phone conversations.

One of the -- the things that -- that the rate-making process -- and I'm kind of an old school rate-making kind of guy -- that gives you is -- I think a good example is the Sibley outage.

I think under traditional rate-making, we took the position -- we were aware of it. We -- in fact, I visited the plant, talked with the superintendent, kind of got an overview of what happened, provided some -- did some discovery and received some documents and looked at those and concluded that because the traditional rate-making process allowed for an averaging of that outage through the -- the fuel model, that we would not pursue the issue and not present the issue, we would not identify -- it would not rise up to an impact.

When you have a situation where you're doing a total pass-through of -- for fuel clauses where those higher costs of generation and purchase power is going to be passed through, you might -- you might tend to look at that in a much different light and conclude much different -- differently because you're no longer in the position where you can just simply take it and average or add out or spread out those additional costs.

Q Would it be -- would one of your concerns in regard to a prudency review being an adequate substitute for allowing financial incentives to -- to cause the company to -- to take the more prudent action be that the -- the number of transactions that Staff would have to review in any particular test year period? I guess, technically, you would have to go -- you potentially might have to go back further than that, but whatever period you want to confine it to.

A I think the -- the increase in -- in the transactions, to use your term, that you would have to exam and review and make a determination yea or nay, up or down increases dramatically.

I don't know a lot about the purchase gas adjustment process or the ACA process, Actual Cost Adjustment, to that PGA.

I have talked to those who do that, and it's a daunting task. The cases go on forever. They do not have a strong track record. I've talked to the manager who was -- who runs the -- the Commission's procurement analysis group. And he told me that --

Q Let me -- let me -- let me stop you because I don't want to make counsel start getting squeamish out there about hearsay, so I'll do it myself. But if -- if you would, just -- just give me an -- an understanding, if you have a basic understanding, of that process from being here, that's -- that's all right if you want to -- if you want to pursue that.

If you -- but if it's based entirely upon some hearsay from somebody else, if you'd avoid that issue, I'd appreciate it.

A I have not performed any of those analyses myself. I have not had that responsibility.

Q Can you imagine in regard to -- or would you have an idea in regard to electricity matters on a pure fuel adjustment without any incentives what kinds of transactions you might have to look at and the number of transactions that -- that might be -- be needed for review purposes?

A Well, certainly, you would look at all the coal contracts. You would look at all the purchase power agreements. You would look at the pricing structure mechanisms, what they pay.

You look at the plant operations. You look at the outage and forced and scheduled outage of each power plant. You look at the power plants' efficiencies and operations. You look at the -- the capital additions and budget process.

You know, there's a whole myriad of items that we look at normally in a rate case. And I think that those will continue and increase with a greater degree of scrutiny because you're having to make absolute decisions.

Q And that's, again, would you say because of the fact that you can't rely on the financial incentives presumably causing the company to do -- to do the prudent thing in regard to matters and decisions that would fall within the fuel adjustment clause realm?

A That's right. Now, the alternative fuel, if you're -- if you went into a fuel clause mechanism, one of the, I guess, beauties, if you will, is the sharing mechanism.

Q I don't want to get to that point yet.

A Okay.

Q If you want to get to that point -- I may want to do that in a minute, but right now, I just want to focus on what you would do without any incentive?

A Okay.

Q Okay. Now, you mentioned the long-term coal contracts. Would you have to look at potentially spot prices, purchases for coal?

A Sure.

Q Would you have to look at long-term natural gas contracts to serve as the combustion turbines?

A Yes.

Q Would you have to look at the short-term spot purchases in the natural gas market?

A Yes. I think you would have to look at all of the fuel, short-term, long-term spot market.

Q Let me keep going here.

A Okay.

Q What about in regard to capacity need on the natural gas transmission system and reservation of that and what was done with regard to capacity reservations to service those generators?

A Yes.

Q What about -- what about transactions that were made on the electric side in regard to -- well, let me -- let me back up. What would be in the fuel adjustment clause in regard to other issues outside of purchases and sales and fuel and purchases and sales of electricity, which I'll get into in a minute? What else would be in that fuel adjustment that would have to be examined?

A We would propose just looking at variable costs, the company's fuel mechanism wants to look at all costs.

Q Including what? I'm -- can you spell those out generally?

A They would include a fuel handling cost. They include --

Q Now, what is fuel handling? What is that?

A The -- when you're -- when you're at a -- particularly a coal-fired plant, you have a lot of labor involved and equipment involved and just moving the coal pile around from place to place.

Q Okay.

A It is a fairly labor-intensive -- it is not -- not incident to costs.

Q Are those employee costs, or are they costs that are incurred with independent contractors? Do you know?

A They are typically employees. They are typically -- they include labor costs, but much of what is in the fuel calculation itself is non-labor, the maintenance and the equipment cost to perform that activity.

Q So the cost for maintaining the equipment for moving coal around, for instance, is that proposed to be included?

A It is the unloading and the handling of the fuels.

Q You'd have to look at those -- those costs and -- if you were doing a prudency review?

A If -- if you look at the company's proposal that's --

Q I'm -- I'm fine. That's fine. Let's look at the company's proposal on these questions.

A All right.
Q What about the -- the transportation of coal, the contracts for that? Would you have to examine those as well?
A Are you talking about freight and transportation?
Q Freight.
A Absolutely.
Q All right. What else is listed from the company as being a part of the fuel adjustment that fits their proposal?
A Certainly, their hedging costs.
Q Hedging for what?
A Natural gas, primarily.
Q So would you have to examine whether or not there was a prudent hedging policy in place by the company?
A Yes.
Q In regard to the natural gas component?
A Yes.
Q And what else would you have to look at?
A Well, you would look at the efficiency of the power plants themselves.
Q I'm talking -- right now, I want to -- I want to stay focused on the company's proposal for things that

should be passed through on the fuel adjustment, if you could, and carry that through to the conclusion, and then we can get into some of these other things.

A Those would affect those costs that would be passed through.

Q Okay. All right.

A The plant heat rates would -- would affect the --

Q What would you be looking at when you're dealing with heat rates?

A Well, that's something that we typically look at in each case. You -- you examine to see if there's been a -- something that is out of the norm that causes -- that is causing the plants to operate less efficient than they have historically. Those are things that you would examine and look at.

Q Okay. So you'd have to examine whether or not there was appropriate maintenance or improvements that were done or inappropriate maintenance or improvements that were done as part of your prudency view?

A That's correct.

Q Okay. What else?

A Maybe others, but I think you've exhausted my list.

Q What about electricity sales, then? Let's talk about that. Let's say there were off-system sales that were made by the company. Would you have to review those to see whether or not those sales were prudent at the time?

A You -- yes and no. The company's original proposal was to share a 50/50 basis above base level. And they have now changed that position or have -- have said that off-system sales should just flow through in their entirety.

Q As in that?

A As in that.

Q So would you not have to examine the prudence of those sales as a part of the fuel adjustment without an incentive mechanism?

A I think you can look at the sales in terms of -- to make sure that you will have -- that -- that if that is the fuel mechanism to make sure to ensure that you've got all the sales.

Q Would you not also have to ensure that there were -- that they made the sales that they could have made in a prudent fashion, whether they were or were not made? Wouldn't you have to examine that? If they had excess capacity, for instance, to sell in the market and they had a generator that was -- that was -- had additional capacity to sell energy into -- into a market or into in some bilateral transactions, wouldn't you be examining that to see whether or not that sale had actually been made?

A Yes. We attempted to do that even in the normal rate-making process, traditional rate setting process. That's a very difficult task to look at a sale that didn't occur and to be able to examine that a generator was available. You could have tried to make a sale, and you didn't. It's -- it's a very difficult scope of work to try to get your arms around.

Q Of course, if you're dealing with no fuel adjustment clause and no IEC on the opposite end and just everything's built into base rates, there is a financial incentive to increase your off-system sales margins, is there not?

A Absolutely.

Q Okay. And then in regard to off-system purchases, would the same thing be true there, whether or not the company should or should not have made off-system purchases during the period of review?

A We -- we examine those very carefully. And as you've, I think, read some testimony in the past and taken some issue with that aspect, but you would still have to do that type of analysis. That wouldn't change under fuel cost mechanism.

Q Okay. Actually, it would be more intensified, would it not, because you lost the incentive mechanism to ensure the prudent outcome of system sales, purchases and -- and off-system sales purchases -- off-system sales and purchases? I'll get it right. Sorry.

A It would increase because -- and, in fact, there's some real examples, actual examples of off-system purchases that, you know, I don't want to -- want to be, you know, cavalier and say we didn't pay any attention to, but they were short-term in nature.

They were with an affiliate. They needed the capacity and the energy. But because they were not going to be priced in the rate case because of the short-term nature, they weren't going to be included by either the company or the Staff in the -- in the setting of rates.

We sort of pushed it aside. We were aware of it, knew it wasn't going to have an impact in the rate case, so we didn't take any attention.

With the fuel clause, those affiliate transactions would have to be examined. They would have to be looked at because they would then flow -- start to flow through on a quarterly basis.

Q And just in general, in regard to the off-system purchases, you'd have to review those to see whether or not they, first of all, got a good price, paid a good price, correct?

A Yes.

Q You also have to see whether or not they had their own generation available perhaps that was at a lower price at the time?

A Yes.

Q And -- and while, of course, there are longer-term contracts that -- that could be reviewed and reviewed in regard to the anticipated prices that would go over that longer term, I would assume that -- that would be one kind of a transaction you might be reviewing?

A That would be correct.

Q You'd also be reviewing transactions that can occur multiple times on a daily basis, wouldn't you, on the spot market or out with bilateral transactions that might be made, either purchases or sales?

A I think you would look at a -- you would try to look at it, I think, on a higher level. But if you found problems where you suspected that you would have to get into much more detail, you might very well get into daily transactions.

Q And, in essence, you're telling me you might not have the resources to do a complete check of all of those transactions, correct?

A That's possible.

Q And if you were in a position where there was an adequate financial incentive, such as what might be said to exist in traditional rate-making without a fuel adjustment clause mechanism, you wouldn't be as concerned about those individual transactions, would you?
A That's right. And, typically, we're not.
Q Okay. Now, I want to ask you about one matter that's been out there that I've seen, and you may have already talked about this. I apologize if you have.
I believe it may -- may have come -- I'm not even sure if that's the case. I've seen a -- I've seen one proposal dealing with -- with putting part of the -- of the cost of fuel and off-system sales in base rates and part of it in a mechanism like a fuel adjustment clause. Have you talked about that?
A Yes.
Q What was your -- what was your question in that kind of a proposal?
A The Sedalia Industrial Group is -- I think it's that opposer you're --
Q I'm not sure if that is. I've seen that from AARP at least in one case. It that a possibility?
A It's an alternative proposal. If the Commission's not interested in an IEC type mechanism, the Staff would support that certainly before we would support

the company's total pass-through.

Q And that would be where there was some setting of -- of amounts of off-system sales and fuel costs and -- including -- well, including the sales and purchases that were made of electricity in base rate, perhaps half of the -- and then -- and then setting that as 50 percent of those anticipated rates going forward, and then the other 50 percent allowing it to be flowed in an FAC? Is that -- is that what you're talking about?

A Yes. It's a sharing proposal of -- it's found in Mr. Johnstone's testimony. I think it first appears in his rebuttal testimony.

Q Let me stop you, because whenever you use the word sharing, it confuses me because when I hear the word sharing, it translates over to me to sharing between ratepayers and the company as an incentive mechanism which I want to make sure that we're talking about the same thing here.

And I understand the terminology isn't wrong. It's just I want to make sure I'm following you?

A In -- in my mind, the -- in this instance of sharing does not -- does not mean a sharing between customers and -- and shareholders. In this instance, the sharing is used as a -- it is really the 50 percent is in a fuel clause. And the other 50 percent would be treated in a more traditional rate setting, fashion.

So that I think it's a misnomer to think of it in terms of that 50 percent is at -- is -- is being borne by the shareholders. It's not. The company has --

Q It's just --

A -- every opportunity to recover that -- that share of the 50 percent in a more traditional way.

Q Yes. We have 100 percent of -- of that figure in -- in most of our -- well, at least several of our utilities, correct, now?

A In the last 30 years, it's been that way. And the utilities have done quite well in most of those years.

Q Okay. Now, you probably have already said this, too. Is that, in order of preference, your third preference?

A I -- I really don't have -- I guess two.

Q Okay.

A The IEC is Staff's --

Q All right.

A -- preference absent that.

Q Staff isn't advocating to put everything into base rates in this case?

A It is not.

Q Okay. Keep going.

A The IEC is the first preference. Absent that, then, we are -- we've aligned ourselves with the Sedalia Industrial Groups, what is called an alternative fuel clause.

Q Okay.

A Alternative to the company's proposal.

Q Okay. Now, if you go to that kind of mechanism, one of the questions that I need clarification about is the question of what actually is included in the fuel adjustment clause. And you mentioned some of that a while ago.

So what is Staff's position in regard to what should be in the FAC on things such as you were mentioning about dealing with moving coal around and -- and other issues that may -- or for cost of charges that may be out there?

A The fuel handling is a legitimate expense. It is an expense that can and is normally dealt with outside even the fuel model. Typically, you included test year levels and it doesn't fluctuate. In my mind, it has no business in a fuel mechanism of any sort, in an IEC mechanism or fuel cost mechanism.

There are a host of costs that have no business being in a fuel cost mechanism. I would only be interested in seeing a fuel clause that would address the variable costs, costs that typically -- I think they're the costs that, frankly, that SB-179 intended to address. And that is the variability of gas, coal, and to a lesser degree, oil.

Q Okay.

A Actual fuel pricing themselves and then the purchase power.

CHAIRMAN DAVIS: Mr. Featherstone, can I jump in there for a minute? So, basically, you're reiterating the testimony that, you know, rail car repairs and other things like that are just -- you know, I mean, that's your -- those are fixed costs that the utility -- or they're predictable -- I mean, they're more tangible depreciable assets that should just go into your base of cost of service, right?

A The rail car maintenance is not a depreciable asset. It is a repair. It is a cost.

CHAIRMAN DAVIS: Right.

A But it is an item that you can --

CHAIRMAN DAVIS: It's a measurable expense that shouldn't be --

A Sure.

CHAIRMAN DAVIS: Can you refresh for my recollection -- I apologize for butting into Commissioner Gaw here, but what were the other things in this that Aquila was seeking coverage for? Can you list those out?

A Certainly, the rail maintenance. I think they want all fuel handling.

CHAIRMAN DAVIS: What is -- what is, quote, fuel handling, just so I have a better handle on that?

A It is the cost associated with the delivery of coal, the unloading of coal and then the moving of -- and it's primarily coal. I think there's some fuel handling for -- for gas.

But it's primarily coal. It is the -- the physical movement within the power plant itself of the coal spot. It requires a lot of equipment and it --

CHAIRMAN DAVIS: So does that include like real expense, like, let's say, for instance, their rail carriers decide to -- is that transportation cost included, or -- or this is more in plant --

A This is at the plant site.

CHAIRMAN DAVIS: This is the -- okay.

A There is a rail maintenance charge that the utility is responsible for that is typically charged -- they're responsible in some cases actual maintenance of their rail lines going into the plant. There are rail car maintenance. There is the unit train leasing cost. All of these types of costs have -- they're -- they're semi-variable at best. They're simply not a direct variable charge. And they can be predicted and can be analyzed separate. They do not have to be a part of the fuel cost, and I would recommend that they not be.

There is depreciation on the unit trains. That typically has been charged to the fuel accounts. There's property taxes on rail trains, and that's -- that's charged consistent with the fuel costs.

Those are the kind of costs that should not in any way, shape or form be part of the this mechanism.

CHAIRMAN DAVIS: Okay. Thank you, Mr. Featherstone. Sorry, Commissioner.

COMMISSIONER GAW: Oh, no. No. That's helpful. I just want to clarify your last couple of points.

Q (By Commissioner Gaw) Mr. Featherstone, you say the depreciation on the rail cars should or should not be a part of the fuel adjustment clause?

A Should not be.

Q Should not be. I thought you said that. But then I thought you were also saying they have traditionally been a part of fuel cost. I didn't understand whether that's what you said or something different.

A They -- they had and still are -- they are charged to Account 501 Uniform System of Accounts per 501.

Q And, to me, that begs the question of why wouldn't you put it in the fuel adjustment clause if it's

traditionally been part of the fuel clause?
A All the costs that we've been talking about are fuel costs --
Q Yes.
A -- and are charged to the fuel accounts.
Q Okay.
A Those costs that are truly variable, we would advocate that is what the -- the spirit and the intent of the fuel mechanism should be.
Q Okay. So, again, you're back to what you just testified to, that there should be a distinguishing factor based upon those -- those elements that have a significant degree of potential variability --
A Yes.
Q -- tied directly to -- to the cost of fuel itself?
A Yes.
Q And transportation?
A And transportation. Transportation is -- is -- obviously, it's a separate charge and separate suppliers and vendors. But it is -- there are delivery charges for all of their fuels, and those are included in -- in the field accounts and should be included in part of the fuel clause.
Q Okay. Mr. Featherstone, refresh my memory. In

regard to the -- I don't know whether this matter is a settled issue and how it relates to the fuel adjustment clause, and that has to do with the -- the matter of the peaking units and the -- those that are -- that have been dealt with for Staff in a way such that those that are actually present are -- and -- and I think this is at the South Harper facility, have an additional two or three added to that number. Is that -- is that settled?

A It is part of the stipulation and agreement that we'll be discussing Thursday.

Q Okay. All right. How does that play into the fuel adjustment clause, if at all --

A Well, that was -- that was --

Q -- so I can ask more detailed questions of that in the stip. hearing? So I don't want to go through a lot of that here, but --

A It -- it certainly plays into it in terms if we advocated turbines, steel underground. The company has met that capacity with the South Harper, three turbines, with two purchase power agreements. Those costs to fuel power the -- the turbines would be part of the fuel clause.

Certainly, the purchase power agreements. The energy charges would be part of a fuel clause.

Q So as it's settled, if the stip. were to be accepted by the Commission, it's clear how that would play -- either play with a fuel adjustment clause and interim energy charge or all of the fuel and off-system sales and purchases being in base rates?

A I think so.

Q Okay. All right. I'll deal with that during the stip., then. In regard to any concerns that anyone might have in regard to the -- to the generation fleet that it is currently owned by Aquila and how that compares to what -- what -- what might match their load requirements, is there any -- is there anything in this discussion on fuel adjustment clause that -- that addresses that overall resources question?

A Well, I think the Office of Public Counsel has addressed that question in terms of its -- its opposition, I think in total to a fuel clause.

Q Okay.

A And part of it is their view of -- of failed capacity planning.

Q Yes.

A That was not part of the Staff's analysis in its determination that some type of mechanism should be employed.

COMMISSIONER GAW: Okay. I think that's all I have. Thank you, Mr. Featherstone. Thank you, Judge.

JUDGE VOSS: Are there any additional questions from the Bench? Is there any recross based on questions from the Bench?
MR. WOODSMALL: Yes, your Honor.
MR. MILLS: Raised hands.
JUDGE VOSS: Let's see. Public Counsel first.

RECROSS EXAMINATION

BY MR. MILLS:
Q Okay. Mr. Featherstone, I believe in response to a question by Chairman Davis, you mentioned that the -- the Staff had been involved in Aquila's resource planning and, in fact, had been vocal in that planning process. Do you recall that answer?
A I do.
Q Is it your understanding that -- that much of the things that you have been vocal about have not been adopted by Aquila?
A When -- many is probably too strong because we focused -- that I personally have been involved in, in the discussions that -- that I have recalled and what I was referencing was primarily whether you build your own generating capacity or that you engage in the market --
Q Okay.
A -- through purchase power agreements. That's -- that's been the primary, I think, disagreement. There

have been other points, certainly, on the demand side management. There's a lot of discussion. I'm not as familiar with those. I'm not familiar with those -- with those nuances. And so I'm not -- I'm not -- I'm not addressing any of those.

Q Were you in the hearing room when Mr. Dennis Rooney was on the stand?

A I was.

Q And did you hear his testimony that he couldn't recall any input from parties that Aquila hadn't taken? Is that consistent of your recollection of the input that you've given?

A Well, I think Mr. Rooney was referring to perhaps the proper recent IRP meetings. I think he's fairly new to those discussions. I think he alluded to that there was some input that he received in terms of their -- their IRP filing that dealt with demand side management issues. That's what I recall.

Q Okay. Okay. Now, with -- with respect to -- you had some discussion with Chair Davis about incentives. Do you know whether Senate Bill 179 explicitly refers to incentives?

A I -- I don't recall right offhand --

Q Okay.

A -- whether they -- used that term or not.

Q Okay.
A I think the concepts are there.
Q Okay. Well, with respect to incentives, is it -- is it possible to have a meaningful incentive for a utility company that doesn't really involve having money at stake?
A Well, one -- one would like to think that a utility, if they're handsomely paid, would do the right thing because that's their jobs, to -- just because that's the right thing to do. But --
Q Put you out of work, wouldn't it?
A It would. However -- and it's one of the -- really, the strong concepts behind incentive compensation is we were instructed in the first part of the '80s when that came into vote that people need a certain reward. And if they think that they -- through performance and through ingenuity and initiative and hard work they could be rewarded, and they'll work a little harder and be more innovative.
And I think that same concept works in most aspects of life. It certainly does, I think, when we're talking about this -- the rate-making incentive. There are a lot of incentives built into traditional rate-making. The regulatory lag is sometimes scoffed at, but it's a powerfully incentive mechanism. And I think

that if you can capture some of that theory and some concepts in a fuel mechanism, you're much more better off than kind of throw your hands up and say, We've got to collect a hundred percent of our costs and the customers are responsible for all of this.

Q Now, you had some discussion with Chairman Davis about prudence reviews. Is it -- after a period of months or a year, is it -- is it your experience that -- that -- that the Staff is able to get all of the information it desires about particular transactions?

A No. Some of the -- some of -- some of my observation from afar in looking at the -- the ACAs as an example, just -- just in my observation of seeing different filings and pleadings and depositions and emotions to compel that the process doesn't lend itself -- it's almost an inherent incentive to drag one's feet in a prudency review.

I already have the money. I don't want to give it up. I certainly don't want to be cited with imprudence because we know what that means. It might be my job if I'm a utility guy. And I'd be caught with the adjustment, so I don't have a lot of incentive to cooperate. I'm going to do just the bare minimum. And I may not have a lot of incentive to provide the documents that are necessary to do a full review. So I think it's just the opposite.

Q And, in fact, some of the transactions, particularly short-term ones, may not even actually have a whole lot of documentation created at the time; is that correct?

A That can be the case.

Q Now, in response to some questions from Commissioner Gaw, I believe you talked about heat rate and plant efficiency. Do you recall that?

A Yes, sir.

Q If plants are not maintained properly, will it take more fuel to generate the same amount of power?

A It -- it can. And what -- what typically happens when a plant is not maintained properly is your forced outage rates will go up. And if you're a low cost generator, that means the replacement power, whether that's your own generation or that you buy on the open market is more costly.

So it has -- it will increase the total cost of fuel.

MR. MILLS: That's all I have. Thank you.

JUDGE VOSS: I think we'll take a real quick ten-minute break and then finish with the recross. So we'll come back at 3:11.

(Break in proceedings.)

JUDGE VOSS: All right. We will resume with redirect based on -- or recross based on questions from the Bench. The Sedalia Industrial Energy Users Association?

MR. WOODSMALL: Yes. Thank you, your Honor. Very briefly.

RECROSS EXAMINATION

BY MR. WOODSMALL:

Q Very early on in Chairman Davis' questions, you were asked about various aspects of a fuel adjustment clause, and you talked about an accumulation period, recovery period.

Just a point of clarification, you mentioned the 3 percent cap. Do you know whether that 3 percent cap is a soft or hard cap?

A I think it's been referred to as a soft cap.

Q And what does that mean to you?

A I'm not sure that I really know.

Q Okay. Can you tell me, does the cap provide for deferral of any amounts over that amount -- over that cap?

A I believe it does.

Q Okay. And those amounts, those deferred amounts, would be recovered later?

A They would. And I think, if I'm not mistaken, it is with interest.

Q Okay. Another aspect of the FAC that you failed to discuss and I wanted to bring up was the -- the performance standards. Are you familiar with that term as it applies to Mr. Johnstone's proposal?

A Yes.

Q Okay. Can you tell me what the performance standards are?

A He --

MR. MITTEN: Your Honor, what Commissioner asked about performance standards?

MR. WOODSMALL: He was asked questions by Chairman Davis about various aspects of the alternative FAC. He was asked about -- and he mentioned accumulation period, recovery period, soft caps. He talked a lot about sharing. I wanted to finish it out and ask -- and answer the fifth question about the performance standards.

MR. MITTEN: Well, I think Mr. Woodsmall admitted in his question that Mr. Featherstone had not mentioned it on the stand in his testimony, so I don't think this is an appropriate subject for recross.

MR. WOODSMALL: He was asked extensively about the alternative FAC, and it's a portion of the FAC.

JUDGE VOSS: I think I'm going to have to sustain that objection.

MR. WOODSMALL: Okay.

Q (By Mr. Woodsmall) Chairman Davis and Commissioner Gaw asked you a great deal of questions about various costs that might be included in a fuel adjustment clause. Do you remember those questions?

A I -- I do.

Q You mentioned fuel handling. I don't know if you discussed it or not. Can you tell me, demand costs, are those recoverable under a fuel adjustment clause?

A Well, certainly under the company's proposal, the -- the demand costs associated with long-term contracts are excluded. However, they want to include the demand cost for short-term. It would be my view that -- that those costs for short or long-term should be excluded from the fuel cost mechanism.

Q And why is that?

A While they are charged to Account 555, which is the purchase power costs, demand costs, from -- from -- from my perspective, really relates to the reservation of -- of plant assets.

They really are not fuel energy related in any sense. They are contracted as part of the purchase power agreement, and they are paid whether or not any electricity is transported to the utility.

So it is a -- it's a fixed cost. And those should be treated -- they can be identified easily from the contract. They can be quantified. And they can be treated as part of the traditional rate-making and do not have to be and should not be allowed in the fuel cost.

Q And, finally, another -- cost of replacement power, do you have an opinion as to whether those -- that should be included in a fuel adjustment clause?

A Well, in the sense of replacement power, you're talking about like an insurance policy where if a unit goes down they're going to get a reimbursement? Is that how you're using replacement --

Q Well, I wouldn't tie it in with insurance. It certainly is if a unit goes down the power -- in lieu of that unit.

A Well, the replacement power, as I'm -- as I'm understanding the question, I think, is -- is something that would typically be passed through if the Sibley unit went down for whatever reason.

You know, it can go down for a variety of reasons. It's one of the low cost generating assets of the company. So any -- any power that's purchased or any asset that is generated is going to have a higher cost than Sibley.

So if you're using the replacement power in that sense, that likely would flow through the fuel clause. But it would be subject to review.

Q Do you believe it's appropriate for that replacement power to flow through a fuel adjustment clause?

A I -- I think it's likely legitimate cost at least should throw through and that should be subject to -- to the prudency review mechanism. Yes.

MR. WOODSMALL: No further questions. Thank you.

JUDGE VOSS: Aquila?

CROSS-EXAMINATION

BY MR. MITTEN:

Q Mr. Featherstone, you had a lengthy exchange with Commissioner Gaw regarding issues that would have to be reviewed in the prudency review that Aquila has proposed as part of its fuel adjustment clause. Do you recall those questions?

A I do.

Q And I got the sense that you believed that that would be a problem to have to review all those issues.

A I guess I'm struggling -- having a problem with your use of the word "problem." It -- it is -- it is what it is. I think that a review of that type is going to be very difficult in the sense of -- of it being a problem.

If -- if the Commission authorizes a fuel mechanism IEC or fuel clause, it will be something that --

that the Staff and the parties will simply have to deal with in some fashion.

Q Now, the Staff's fall-back position if the Commission does not adopt an IEC is the sharing proposal that Mr. Johnstone has made; is that correct?

A Yes, sir.

Q And am I correct that there is a prudency review under Mr. Johnstone's proposal?

A I -- I believe there is, but with a caveat that the -- the 50/50 sharing -- and I think Ms. -- Commissioner Gaw sort of hit it right that that's probably not a correct way of looking at it in terms of sharing because that -- that denotes something that it isn't.

The -- this 50/50 sharing mechanism sort of doesn't eliminate but certainly mitigates a -- a large portion of the prudency review, after the fact review.

Q So you believe that Aquila could be less prudent under Mr. Johnstone's proposal than it would be under its own proposal? Is that what you're saying?

A No, not at all.

Q Well, then explain your last answer to me.

A What I'm saying is the -- the detailed analysis and the -- I don't want to call it second-guessing. It's -- it's sometimes referred to that generally by utilities that detailed analysis and that scrutiny perhaps some of the decision-making will -- processes will be lessened. It will not be a -- I don't believe a lesser standard.

I don't believe that Aquila, if it thinks that it can get -- through that 50 percent sharing proposal, can be less prudent. I don't believe that at all.

Q Of the lengthy list of items that you identified to Commissioner Gaw as having to be looked at in a prudency review under Aquila's proposal, which of those would you not have to look at under Mr. Johnstone's proposal, which Staff has adopted as its fall-back position?

A I think the short-term demand charges. I believe the fuel handling and a lot of what's referred to as the -- the fixed charges or you'll -- you'll see a phrase or hear a phrase called the fuel adders. I -- I don't believe that the -- Mr. Johnstone is proposing that those be included as part of the fuel clause.

Q Well, let's -- let's assume that they're in the fuel clause, whether it's under Mr. Johnstone's proposal or under the company's. You'd still have to look at them under either proposal; isn't that correct?

A If -- if they were included in both proposals? Yes. You would still look at them.

Q Now, you also mentioned during your exchange with Commissioner Gaw that you believe fly ash removal and fuel handling costs should not be included in the fuel adjustment clause; is that correct?

A I -- I don't recall that -- that Mr. Gaw asked me about fly ash removal. So to your question directly, certainly, those type of costs shouldn't be included in -- in a fuel cost.

Q Now -- excuse me. In the base fuel cost number that is in the stipulation and agreement that is pending before the Commission, fly ash removal and fuel handling costs are included in that base fuel cost number; is that correct?

A I believe they would be.

Q So if those costs are not to be recovered through the fuel adjustment clause, wouldn't you have to adjust that base fuel number?

A No. I -- I believe that the -- the base fuel cost in the stip. and agreement -- stipulation and agreement includes those fuel adders and -- which would be fly ash removal and other -- the type of costs that I was discussing with Mr. Gaw -- or Commissioner Gaw, that they would be included in terms of the base and not -- not to be recovered as part of the -- the fuel mechanism.

Q So increases or decreases in those costs would not be reflected in the fuel adjustment clause?

A I believe they ought not be. The increases and decreases -- these types of costs do not fluctuate significantly.

Q I know you said that you believe they ought not be. But what I'm asking you is if they're in the base fuel costs, would they not be -- would decreases or increases in those costs not be reflected in the fuel adjustment clause?

A I -- I believe that they would not be in the fuel adjustment clause and they should not be in the fuel adjustment clause.

Q And that's regardless of whether they're in the base fuel number that's included in the stipulation?

A I -- I believe they're in the base number.

Q But, again, in response to my question, regardless of whether they're in the base fuel number, they would not be recovered through the fuel adjustment clause as you understand it?

A That would be my understanding. Yes.

MR. MITTEN: No further questions. Thank you.

JUDGE VOSS: I tried to first direct it to all the parties that I knew had indicated they had recross. But there are a couple of parties -- does AARP have any?

MR. COFFMAN: None.

JUDGE VOSS: And Federal Executive Agencies?

CAPTAIN HOLLIFIELD: No questions, your Honor.

JUDGE VOSS: Then I believe we are ready for redirect based on questions from the Bench and the parties.

MR. FREY: Thank you, your Honor.

REDIRECT EXAMINATION

BY MR. FREY:

Q Just a couple of questions, Mr. Featherstone. Chairman Davis reviewed with you the Staff's recommendation as to coal price. I don't know if you covered both the base and the forecast coal prices. And I wonder if you could just state what they are as well as the purchase power prices that the Staff is recommending in this case.

A It was outlined in rebuttal and again in surrebuttal. Our -- our analysis shows that -- that a range of $6 for -- $6 per MMBTU for natural gas and $55 per megawatt hour for purchase power would -- would be an appropriate base or -- or ceiling.

A base, in this instance, I'm referring to as the interim energy charge base and that a $9 per MMBTU natural gas price and a $90 per megawatt hour price would be the -- the ceiling for the IEC range.

And I derived those by historical numbers. And you could -- I'd refer the Commission and the parties to the schedule that I attached to my surrebuttal Schedule 1 that would identify how those ranges were developed and just taking the last 48 months of actual costs that the company experienced for natural gas.

Q And the purchase power?

A The purchase power, I had a similar analysis. I did not include it as a schedule, but I did a similar review of the company's historical purchase power pricing to develop the $55 and $90 per megawatt hour for purchase power.

Q Okay. And that -- that remains the Staff's recommendation today?

A It does.

Q There was a considerable discussion with the Bench on the elements of fuel costs. I think you indicated they fell into the fuel accounts that should not be included in a fuel recov -- adjustment mechanism. And I was just wondering if you could state what -- what costs should be in there.

A Well, our -- our -- our proposal -- and I would -- I would say that really relates to -- presented in terms of interim energy charge. But I would certainly suggest that that be also -- if there's a fuel mechanism that's -- that's developed or authorized by the Commission, our proposal is that only variable costs of the fuel and transportation -- it's delivered fuel costs that should be included as part of an IEC or fuel mechanism. That would include the oil, the gas, the coal as well as the purchase power.

Q Okay. And one other question. Mr. Mitten asked you a question about the types of things you might not have to look at in the case of the alternative fuel adjustment mechanism that Mr. Johnstone has proposed versus in the company's proposed fuel adjustment mechanism. Do you recall that question?

A Yes.

Q Would the level of materiality of these costs play a role here as far as the Staff's effort in this regard? Let me ask you this: Would the level of materiality change between Mr. Johnstone's approach versus the proposal of the company?

A I -- I think that the company's total pass-through of all costs increases the scope of the work and increases the level of the prudency review, the details that you would have to look at and increases the work then -- then under an IEC, perhaps, certainly, under a fuel mechanism that has a 50 percent sharing type of -- of relationship.

MR. FREY: Okay. Thank you. No further questions, your Honor. Thank you.

JUDGE VOSS: I think, Mr. Featherstone, you are excused.

MR. FEATHERSTONE: Thank you.

JUDGE VOSS: Would Staff like to call their next witness?

MR. FREY: May I have a moment, your Honor?

JUDGE VOSS: Sure.

MR. FREY: Your Honor, could we go off the record for just a -- just a few minutes?

JUDGE VOSS: We can take a five-minute break.

MR. FREY: Thank you.

(Break in proceedings.)

MICHAEL TAYLOR,

being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified as follows:

DIRECT EXAMINATION

BY MR. FREY:

JUDGE VOSS: Your witness, Mr. Frey.

MR. FREY: Yes. Thank you, your Honor.

Q   (By Mr. Frey) Could you please state your name for the record, sir?

A   Michael E. Taylor.

Q   And by whom are you employed and in what capacity?

A   Missouri Public Service Commission, Utility Engineering Specialist.

Q And did you prepare and cause to be filed in this proceeding what's been marked for identification purposes as Exhibit 227, which is the rebuttal testimony of Michael E. Taylor?

A Yes.

Q And are there any corrections to that testimony at this time?

A No.

Q If I were to -- if I were to ask you the same questions as are in this testimony, would your answers be the same today?

A Yes.

Q And are those answers true and accurate to the best of your knowledge, information and belief?

A Yes.

MR. FREY: Your Honor, I would offer Exhibit 227 into the record.

JUDGE VOSS: Are there any objections to the admission of that exhibit? Hearing none, it is admitted.

(Exhibit No. 227 was offered and admitted into evidence.)

MR. FREY: I tender the witness for cross.

JUDGE VOSS: Public Counsel?

MR. MILLS: No questions.

JUDGE VOSS: AARP?

MR. COFFMAN: No questions.
JUDGE VOSS: Federal Executive Agencies?
CAPTAIN HOLLIFIELD: No questions, your Honor.
JUDGE VOSS: Sedalia Industrial Energy Users Association?

CROSS-EXAMINATION

BY MR. CONRAD:
Q Mr. Taylor, have you had any discussions with the company about this issue?
A Yes.
Q How have they been left?
A To the best of my knowledge, there is a proposed resolution that has been discussed with the company and Staff. And that is still pending, to the best of my knowledge.
Q Have there been discussions with the other parties involving that issue?
A I do not know.
Q Do you suppose there should be?
A I would --
MR. FREY: I'm going to object to that, your Honor.
JUDGE VOSS: Could you repeat the question? I'm sorry.
MR. CONRAD: I'm asking him what the position of

Staff is, whether other parties should be involved in their discussions if they're moving towards resolution of this issue with the company.

If counsel wants to answer the question, he can. But we have a data request that we've asked about that, and I can go get it if we need to.

MR. FREY: I'm not -- I'm sorry. I'm not familiar with that data request.

MR. CONRAD: Well, convenient.

MR. FREY: And true.

MR. CONRAD: Whether true or not, still convenient.

JUDGE VOSS: Mr. Taylor, will you be available tomorrow if they need to re-call you for questions?

MR. TAYLOR: Yes. Yes.

JUDGE VOSS: Will that --

MR. CONRAD: That's fine.

JUDGE VOSS: That way, we can maybe address the issue and find out what the data request is and what needs to be potentially --

MR. CONRAD: Uh-huh,

JUDGE VOSS: So just let me know if you need to re-call Mr. Taylor tomorrow. So I'll waive ruling on that objection until tomorrow when we can figure out what's going on.

MR. CONRAD: Very well.

JUDGE VOSS: Does that conclude your questions for the witness?

MR. CONRAD: Yes, at this time.

JUDGE VOSS: At this time.

MR. CONRAD: Because that might go somewhere else. We'll -- we'll see.

JUDGE VOSS: Okay. Well, we are down to Aquila already.

MR. MITTEN: No questions.

JUDGE VOSS: Questions from the Bench?

CHAIRMAN DAVIS: No. I -- I just want to be -- make sure I'm down here today when --

JUDGE VOSS: See the fireworks?

CHAIRMAN VOSS: Uh-huh. Well, I could -- I could -- I could ask one.

JUDGE VOSS: It's good to see orneriness.

CROSS-EXAMINATION

BY CHAIRMAN DAVIS:

Q Mr. Taylor, do you think it would be a good idea if, as part of this rate case, we required Aquila to call Mr. Conrad and consult with Mr. Conrad about the fuel purchasing decisions required for making any fuel purchases?

A I'm not sure I'm qualified to answer that, Chairman.

Q Who do you think would be the most qualified witness to -- to opine on that issue?

A I'm not sure I can answer that question either.

CHAIRMAN DAVIS: Okay. All right. No further questions.

JUDGE VOSS: I guess we're -- any recross based on questions from the Bench?

MR. CONRAD: I'll be happy to hold until tomorrow.

JUDGE VOSS: Okay. Redirect?

MR. FREY: No redirect. Thanks.

JUDGE VOSS: Mr. Taylor, you are excused pending potential re-call tomorrow.

MR. TAYLOR: Okay.

JUDGE VOSS: SedaliaIndustrial Energy Users Association?

MR. WOODSMALL: Call Don Johnstone, please.

DONALD JOHNSTONE,

being first duly sworn to testify the truth, the whole truth, and nothing but the truth, testified as follows:

DIRECT EXAMINATION

BY MR. WOODSMALL:

JUDGE VOSS: Your witness.

MR. WOODSMALL: Thank you, your Honor.

Q (By Mr. Woodsmall) Would you state your name for the record, please?
A Donald Johnstone.
Q And can you tell us who you're appearing on behalf of in this case?
A I'm appearing on behalf of the Sedalia Industrial Energy Users Association and the St. Joe Industrial Group.
Q Do you have in front you have what's been marked Exhibits 503, your direct testimony, revenue requirement, 504, direct testimony, rate design, 505, rebuttal, and 506, surrebuttal?
A I do.
Q Do you have any changes or corrections to make to that at this time?
A I do. In the rebuttal, Exhibit 505, page 29, line 3, the word "census" that appears on line 3 should be stricken, and in its place, the word "alternative" should be inserted.
JUDGE VOSS: What line was that?
MR. WOODSMALL: Line 3.
A Line 3. On page 29.
JUDGE VOSS: Yes. That would be my problem.
Q (By Mr. Woodsmall) Did you have any other changes to make?

A Yes. And then attached to that same testimony is Schedule 1, page 2 of 6. And at line 7 at the end of that line, there should be an insertion of three words. Those would be "average of the."

Q Where was that again, please? Line 6?

A Line 7.

Q Oh, line 7. Would you read what line 7 should say in its totality, please?

A Starting at the comma, it would read, Applied to the average of the beginning and ending monthly balance of deferred energy, electric energy cost, et cetera.

Q Thank you. Any other changes?

A That's all.

Q If I were to ask you the questions contained in your testimony, your prepared testimony here today, would your answers be substantially the same?

A Yes, they would.

Q And are those answers true and correct to the best of your knowledge and belief?

A Yes, they are.

MR. WOODSMALL: Your Honor, I'd offer into the -- into the record Exhibit 503, 504, 505, 506, and tender the witness for cross-examination.

JUDGE VOSS: Are there any objections to the admission of those exhibits? Hearing none, they're admitted.

(Exhibit Nos. 503, 504, 505, and 506 were offered and admitted into evidence.)

JUDGE VOSS: AARP?

MR. COFFMAN: No questions.

JUDGE VOSS: Public Counsel?

MR. MILLS: No questions.

JUDGE VOSS: Staff?

MR. FREY: Just a few, your Honor. Thank you.

CROSS-EXAMINATION

BY MR. FREY:

Q Mr. Johnstone, in your surrebuttal testimony, you criticize the interim energy charge recommended by the Staff, do you not?

A Yes. That's correct.

Q Could you turn to page 3 of that testimony? And I'm looking at Line 4. Do you have that?

A Yes.

Q And I quote where you state, Indeed, the costs and rates charged will not even reach prudence -- reach the prudence review if the actual costs are less than the ceiling. Have I quoted you correctly?

A Yes.

Q And can you explain the basis of -- for that assertion?

A I suspect the word "ceiling" should be floor, and that would fix that statement, sir. I think what I think of as the floor, Mr. Featherstone referred to as the base amount.

Q So the word "ceiling" should be floor there?

A Yes.

Q Okay. Mr. Johnstone, would you agree that Aquila is more heavily dependent upon gas-fired generation than some other electric utilities in Missouri?

A That's my understanding. Yes, sir.

Q Would you say that in the most recent three or four years, natural gas prices have been much more volatile than, say, ten years ago?

A Yes, sir.

Q And for a utility such as Aquila, do you believe that when these prices are highly volatile, a mechanism other than the traditional single point approach to developing an amount for fuel might be appropriate?

A My client would prefer to have no fuel adjustment mechanism or IEC. And so that's -- that's the customer perspective.

That being said, I -- I think that with some of the important protections of the alternative FAC that's attached to my rebuttal testimony, a mechanism could become much more palatable.

Q Do you believe a non-traditional mechanism would have been appropriate for any of the past, say, five to seven years for Aquila?

A Well, I understand there was one IEC. So the parties agreed at a point in time that an alternative was appropriate. And I haven't looked back on that to determine whether I'd agree or not. I don't have any basis to make a conclusion.

Q Can you describe the circumstances under which, in your opinion, such a mechanism might be called for?

A A mechanism could be called for if -- if there was a showing that under traditional regulation, that is, without a fuel adjustment or an IEC, it would be very difficult for a utility to have a reasonable opportunity to earn its allowed return.

Q Can you give an example of such a situation?

A Well, hypothetically, if Aquila had come in and shown some forecast of cost over the next several years and its ability or inability to -- to earn a reasonable return based on those projections, I think there could be some showing that there would need to be an adjustment mechanism.

So that would be a hypothetical situation under which an FAC or IEC might be deemed appropriate. I have seen no such showing in this docket.

Q So you would be looking for certain, for example, projected or actual rate of -- rate of return that the company was earning as kind of an indication of that or -- would that be the kind of thing you would be looking for?

A Well, yes, sir. I -- by definition, we set rates, and they're applied prospectively. And so while history can offer some information, what's -- what's really important, the nut we're trying to crack is to ensure that there is a reasonable opportunity for a return going forward.

And -- and in the context of these mechanisms, I don't think there's any option but to take a look forward and see what the implications of the mechanism would be for earnings in the future.

Q And do you have any kind of a level of earnings in mind which would be kind of a -- a trigger for you to say that something is -- a mechanism would be appropriate or required?

A No.

Q So then you cannot identify a level of rate of return that would qualify for what you call acute need; is that correct?

A That's correct. That would depend on all of the fact and circumstances of the case.

MR. FREY: Thank you, Mr. Johnstone. I have no -- nothing further, your Honor.

JUDGE VOSS: Aquila?

CROSS-EXAMINATION

BY MR. MITTEN:

Q Mr. Johnstone, good afternoon.

A Good afternoon.

Q At page 9 of your rebuttal testimony, you state that you believe Aquila should be required to demonstrate substantial financial need, which you term as acute need, before the Commission authorizes a fuel adjustment clause; is that correct?

A Yes, sir.

Q Now, there is no financial need standard in Senate Bill 179; is that correct?

A I'm sorry. In what sense?

Q Is there a financial need standard in Senate Bill 179?

A SB-179 -- and, of course, I'll have to point out that I'm not an attorney. But based on my understanding of this, as a layperson, it talks about the Commission's powers under paragraph 4 or Section 4 of SB-179.

What that says is, The Commission shall have the power to approve, modify or reject a fuel adjustment mechanism as under subsections 1 to 3, only after providing the opportunity for a full hearing and general rate proceeding, including a general rate proceeding initiated by complaint.

The Commission may, and I'd underscore may, approve such rate schedule after considering all relevant factors which may affect the cost or overall rates and charges of the corporation defined at the time the adjustment mechanisms is set forth in the schedules. And then there's about four items listed under that.

And so my point would be this: The Commission is obliged to consider all relevant factors, and I can't imagine anything more relevant than the financial need.

Q So you interpreted that language in Senate Bill 179 where it says, The Commission shall consider all relevant factors which may affect the costs or overall rates and charges of the corporation as meaning that Aquila or any other utility seeking a fuel adjustment clause would have to demonstrate financial need; is that correct?

A That is my recommendation, sir.

Q Now, prior to preparing your rebuttal testimony in this case, did you have occasion to review the Commission's final order of rule-making for 4 CSR 240-20.090?

A I did.

Q Do you happen to have a copy of that final order with you?

A No.

MR. MITTEN: Your Honor, may I approach the witness?

JUDGE VOSS: Yes, you may.

Q (By Mr. Mitten) Mr. Johnstone, I have handed you a copy of the Commission's final order of rule-making that I referred to a moment ago.

And let me ask you to turn to page 14 of that order. At the bottom of that page after the word "response," could you please read aloud what's written there?

A The Commission finds that an earnings threshold for eligibility to use a ramp is contrary to the intent of the legislature. As articulated in SB-179, therefore, no such eligibility criteria will be included in the rule.

Q So at the time you made your suggestion there that there is an earnings test for a utility to have a fuel adjustment --

MR. WOODSMALL: Your Honor, I'd object. I believe he's mischaracterizing the witness's testimony. This witness never used an earnings test. So I -- if he wants to change his question, I won't -- I'll withdraw my objection.

JUDGE VOSS: Could you restate your question?
Q (By Mr. Mitten) Well, let me go at it this way. You had a discussion with Mr. Frey a few moments ago, didn't you?
A I answered his questions.
Q And you were talking about a rate of return that would be -- a minimum rate of return before a company could request a fuel adjustment clause. Do you recall that testimony?
A I did not answer that with the minimum rate of return.
Q That's right. You didn't. But you didn't enter into the discussion saying you didn't know what the minimum rate of return would be; is that right?
A Well, I guess whatever I said, it was something along those lines. I don't think that's precisely what I said.
Q Rate of return is earnings, isn't it, Mr. Johnstone?
A Oh, it's more than earnings. Return on equity is earnings.
Q Return on rate base is earnings, too, isn't it?
A No. Return on rate base includes the cost of debt, which is not earnings.
Q But at least part of rate of return is earnings;

is that right?
A Yes, sir.
Q So let me ask you again. Since you have determined this minimum rate of return, whatever that is, may be required in order to a utility to request a fuel adjustment clause, let me ask you if that position is not contrary to what's stated in the Commission's final order of rule-making.
A Oh, no, it is not.
Q You don't think so? Could you please explain to me why?
A The earnings tests that have been discussed in the context of rule-making had to do with whether or not there could be increases after an FAC was in effect.
In other words, once your fuel costs had gone up, you would have to come in and make a showing that there were insufficient earnings before you could go ahead and increase the rates. I understand that to be what was discussed in the Commission order. So that's something entirely different.
Q Well, let me refer you a little bit above the portion that you just read --
A Okay.
Q -- where it says, An earnings test means the utility would effectively never be able to utilize a ramp

when fuel costs are rising unless the utility established up to four times per year that it is under-earning. Does that cause you to question what you just told me?

A None whatsoever. In fact, that reinforces the point. What had been discussed was an earnings test would operate to prevent the fuel mechanism from flowing through increases after it was in effect.

That is substantially, I'd say, entirely different than what we're talking about in my testimony.

Q In your rebuttal testimony, you propose what you call an alternate fuel adjustment clause; is that right?

A Yes, sir.

Q And one of the key features of that alternate fuel adjustment proposal is what you refer to as 50/50 sharing; is that correct?

A Yes, sir.

Q Now, at page 10 of Exhibit 504, which is the second direct testimony that you filed, you state that, The simplest way to maintain an incentive is to continue base rate treatment for a portion of the fuel costs. Is that right?

A Yes, sir. That's what it says.

Q And then you go on to say that, Perhaps the most straightforward example would be a design that provides a fuel adjustment clause for 50 percent of the fuel costs

and continues rate base treatment for the other 50 percent; is that correct?
A Yes, sir.
Q Now, your testimony says fuel costs. Did you also mean purchase power costs?
A Yes, sir. It would be whatever is defined to be included under the terms of the FAC.
Q Now, under your proposal in this rate case, if it's adopted, 50 percent of Aquila's test period fuel and purchase power costs would be included in base rates; is that correct?
A Yes and no.
Q Explain yes and no.
A I'd be happy to. Fifty percent would be included, but 100 percent would be included, also.
Q You're going to have to explain that one to me.
MR. WOODSMALL: Me, too.
A The base fuel costs had been defined -- it's in the neighborhood of two cents -- a little over two cents. I understand that to be the base fuel number.
Q (By Mr. Mitten) I'm not interested in --
A That's a hundred percent.
Q Mr. Johnstone, I'm not interested in any particular fuel number. I'm simply trying to figure out, under your proposal, how much of Aquila's base fuel costs

will be included in base rates? What percentage?

A I would refer you, sir, to the alternative FAC, and the base cost is defined on Schedule 1, page 2, line 34. And I think you would find that to be all of the fuel costs as determined by the Commission in this proceeding.

And that's what's referred to as the base fuel cost.

Q So a hundred percent of base fuel costs are going to be included in base rates under your proposal?

A Well, perhaps you need to explain to me what you mean by included in base rates.

Q Which part of that question didn't you understand?

A Base rates. What do you mean when you say base rates, sir?

Q I mean the base rates that would be set by the Commission in this proceeding.

A Which rates are those?

Q The base rates. What part of base rates don't you understand?

A Well, are you distinguishing that from the FAC?

Q Yes.

A All right. And where would the fuel costs appear in base rates? I'm just trying to understand the scenario. You seem to be -- we've had this communication problem before, and I'm trying to make sure I understand your question, sir.

Q Well, I'm not sure I understand the answers any better than when we had this communication problem before. There would be no specifically identified fuel costs in base rates. It would be a base rate.

A As I understand, there is, and that base amount is what would be defined either under the company's FAC or under the alternative FAC. That is what constitutes the amount of base fuel costs.

Q Well, let's assume for purposes of my illustration that the company's base fuel costs are $200 million. What portion of that $200 million is going to be included in base rates?

A Well, the rates are set on a per kilowatt hour basis. So if we took the 200 million and we divided it by the -- by the kilowatt hour sales, we would know the fuel cost per kilowatt hour that is in base rates. It would be the base fuel costs, and that would be what's in base rates.

Q But the revenue requirement is not set on a kilowatt hour basis. So what percentage of the $200 million base fuel costs would be included in base rates?

A 100 percent.

Q 100 percent?
A Yes, sir.
Q Okay. So did you change your position from when you filed your direct testimony where you were recommending that only 50 percent be included in base rates?
A No, sir, I haven't.
Q So do you think 50 percent is the same as 100 percent?
A Well, I think the source of the confusion comes from the tracking mechanism.
Q I'm simply reading your testimony. In your direct testimony, you said 50 percent in base rates, 50 percent from the fuel adjustment clause. And now you're telling me 100 percent in base rates.
A Well, would you like to refer me to the point that you're looking at again, please?
Q Absolutely. It's page 10 of Exhibit 504. I read it to you a moment ago. Perhaps the most straightforward example is as the design provides a fuel adjustment clause for 50 percent of the fuel costs and continues base rate treatment for the other 50 percent.
A Okay. And your question?
Q That says 50 percent in base rates and 50 percent through a fuel adjustment clause, doesn't it?

A It says provides a FAC for 50 percent of the fuel costs and continues base rate treatment. It doesn't say what's in base rates. It says base rate treatment for the other 50 percent.

What that means is, to the extent that there are variations in costs up or down, 50 percent of the variations will be given tracking under the FAC and 50 percent will not, 50 percent of the variation.

That's -- that's how you achieve base rate treatment for 50 percent.

Q So if there are $200 million in base fuel costs and fuel costs increase by 20 percent within the first year, how much of that $40 million increase would be given fuel adjustment clause treatment?

A Well, it depends on the cost per kilowatt hour. That's what determines it.

Q Well --

A You've not given me that.

Q You're right. I haven't given you the cost per kilowatt hour. I'm simply asking you, under your 50/50 sharing proposal, are we talking about 50 percent of the 40 million? Are we talking about 100 percent of the 40 million? Are we talking about some other number?

A Well, without knowing the extent to which sales have changed, I can't answer that.

Q Let's assume sales haven't changed.

A Oh, okay. So the scenario is we've got exactly the same sales in the two periods.

Q Exactly.

A All right. Under that scenario, the cost per kilowatt hour would have gone up by 20 percent. And under the mechanism, 50 percent of that increase would be tracked. And so you would have a $20 million increase that would flow through to customers under the FAC.

Q Okay. Now I think we're getting somewhere. Can you read this behind you, Mr. Johnstone? We're going to have to change this slightly.

So $200 million in fuel and purchase power costs. Two hundred million would be recovered through base rates; is that correct?

A Yes. Well, that would be given -- we've got this continuing tension about what to call these things. The base fuel costs under the FAC would be based on the $200 million number. So --

Q So under what you've just told me, would you recover the whole $200 million in fuel costs under base rates, and there would be nothing to recover through the fuel adjustment clause; is that right?

A That's correct.

Q Okay. Now, let's assume for purposes of this illustration that we have a 15 percent increase Year 1 -- Year 2 over Year 1, but no change in sales.

So you've got total fuel costs of $230 million. The amount recovered through base rates would be the same $200 million that we had a moment ago; is that correct?

A That's correct.

Q The amount recovered through the fuel adjustment clause would be 30 million; is that correct?

A Yes.

Q And under your proposal, how much of that $30 million would the company get to recover? Half?

A Pursuant to the FAC, you would recover 15 million. The remainder would be recovered through the operation of base rates.

Q And how would you recover the remaining $15 million through base rates?

A Well, it's the same way that rates have operated for the last 30 years. To the extent that costs go up, you've got to manage your business in a way to -- to have earnings. And so you have to control all of your costs to be equal to your revenues.

Q So the only way that the company would recover that additional $15 million is if it reduced costs elsewhere; is that correct?

A Well, the first thing I would think they would do is --

Q Yes or no, Mr. Johnstone?

A No.

Q Would there be an be increase in base rates?

A The company could certainly apply for one.

Q Without -- without a rate case, would there be any increase in base rates?

A No.

Q So no increase in base rates. 200 million recovered through existing base rates, 15 million recovered through the fuel adjustment clause. And the other 15 million comes from where?

A The 200 million --

Q That's not my question, Mr. Johnstone. I want to know where the other $15 million comes from.

A Well, if you'd like me to explain, I'd be happy to. If you don't want me to, I won't.

Q I do want you to explain where the other 15 million comes from.

A All right. I'll try again. The base rates are set at a level that allows you to recover total revenues, not just fuel, but all of your costs, prudently incurred costs subject to the test year, no immeasurable changes, no organization adjustments with the true-up.

Q When the base --

A Once those rates are set -- I'm sorry. Did you want me to stop?

Q Yes. But the base rates allow you to recover 100 percent of your operating costs only if the assumptions that were included in the test year hold true; isn't that correct?

A No.

Q Well, you'll have -- you have a total amount of revenue to cover X amount of expenses. That's the way the revenue requirement is set, right?

A Yes.

Q And there is an assumed level of expenses; is that correct?

A Well, no. It's not an assumed level. It's the product of a rate case. There's a lot of work that goes into establishing the right level.

Q Well, you're right. But it is, at the end of the day, based upon assumptions of what costs are going to be in the future; isn't that correct?

A No, sir.

Q It's not?

A No, sir.

Q It's based upon a knowledge of what costs are going to be in the future?

A No, sir.

Q What is it based on?
A It's based on the test year with immeasurable changes.
Q But that test year is populated with assumptions of what those expense levels are going to look like during the first year the rates are going to be in effect; isn't that right?
A That's not my understanding. No, sir.
Q So in order for the company to recover this $15 million that I've been looking for, all of its expenses would have to fall within the parameters that were set in the test period; is that right?
A No, sir.
Q All right. You'll have to explain to me where the $15 million comes from.
A The rates are set pursuant to a test year. Based on that test year, we move forward, and the company, presumably, has given the intent to have a reasonable opportunity to earn a reasonably fair return.
Now, there's no reason to expect any particular cost to be what it was with any precision during the test year. That was simply the basis for designing the rates. Some costs may be higher. Some costs may be lower.
You will have a fixed amount of revenue that comes in under the rates, and then you'll have to compare

all of your costs. And, indeed, that is the source of the incentives that many of the parties have talked about in this proceeding.

You have to manage all of those costs to a controlled level in order to earn your return.

Q And if you're not able to manage the costs within the parameters of the expense levels that were included in the test period, then you're not going to earn the rate of return that you were allowed; is that correct?

A That's correct.

Q And we know for a fact in our example here that our fuel costs increased 15 percent from the end of Year 1 to the end of Year 2, is that correct, a total of $30 million?

A Yes.

Q And only 15 million of that would be recovered through the fuel adjustment clause?

A Yes. Seven and a half percent.

Q Now, let's look at Year 3. Another 15 percent increase in fuel costs. Total fuel costs are 265 million. The amount recovered through base rates would be 200 million. The amount subject to the fuel adjustment clause would be 65 million. How much of that 65 million would be collected through the fuel adjustment clause?

A Well, I heard Mr. Featherstone testify that there's going to be another rate case.

Q I'm not asking Mr. Featherstone. I'm asking you under the hypothetical scenario that I have just put forward to you, how much of the $65 million would be collected through the fuel adjustment clause?

A Well, you did give me an assumption about whether or not there would be a rate case, and I've heard testimony to the effect that there will be a rate case.

Q Well, there's not going to be a rate case. No rate case. No change in base rates. I'm just asking you, under your proposal, how much of that $65 million is the company going to be able to recover through the fuel adjustment clause?

A Okay. So the scenario is the company has made a commitment that there will be no rate case filing in the next year to change anything?

Q I'm asking you under the hypothetical that I have set out, Mr. Johnstone, what portion of the $65 million is going to be collected through your fuel adjustment clause?

A Well, you're asking me a hypothetical that's inconsistent with the testimony that I've heard. But --

Q It's a hypothetical, Mr. Johnstone. It doesn't have to be consistent with the testimony.

A Okay.

Q Please answer the question that I asked.

A Well, I'm -- I'm trying to make sure that I give a full and complete answer, sir. Under the assumption that the company chooses to not have a rate case, then we would have, subject to the FAC mechanism, this $65 million. And the tracking mechanism under the alternative FAC would provide for increases in retail rate to recover 50 percent of that, assuming that the sales did not change over this period of years.

Q So that would be 32.5 million. Not very good at arithmetic. So if that's not correct, please tell me.

A That sounds right to me.

Q Now, one of the aspects of your alternate fuel adjustment proposal is a set of outage standards to be applied to Aquila's coal-fired generation facilities; is that correct?

A Yes, sir.

Q And under your proposal, if Aquila failed to perform up to those standards during a given period, then the company would be prohibited from passing certain costs through the fuel adjustment clause. Is that also correct?

A First, let me just back up and correct it. They've been referred to as performance standards, not outage standards. Now, yes. So having made that correction, the purpose is to ensure that there is generation within the normal bounds that we would expect to see from the company. And if there is not that level of generation, some generation would be imputed.

Q And the performance standards that you're proposing would also apply to power that Aquila buys from the Nebraska Public Power District; is that right?

A Yes, sir.

Q Now, are you aware that Aquila doesn't operate the Nebraska Public Power District generating facilities?

A I think that goes by definition, sir.

Q Is that a yes?

A Yes.

Q Now, in reviewing your proposal for performance standards, I couldn't find where in your testimony you stated how much it would cost Aquila to meet those standards. Could you tell me where in your testimony that is?

A I would expect that it would cost them nothing.

Q That wasn't my answer (sic). Could you tell me where in your testimony where you discuss what it will cost Aquila to meet those standards?

A It shouldn't cost them anything.

Q Do you discuss that in your testimony?

MR. MITTEN: I want to move to strike the last two answers as not responsive. I simply asked him where it was in his testimony. I didn't ask him to augment his testimony on the stand.

MR. WOODSMALL: I have no clue how to respond, your Honor. They're talking so far past each other. He won't let him respond, and --

MR. MITTEN: Well, I asked a very specific question. Where in your testimony do you discuss what it will cost Aquila? It's either there or isn't there.

MR. WOODSMALL: And his response was it's not there because I didn't discuss it, and you won't let him answer that.

MR. MITTEN: No. That wasn't his response. His response was it will cost Aquila nothing, which was very different from it's not there because I didn't discuss it.

MR. WOODSMALL: Because it won't cost them anything.

JUDGE VOSS: I think you opened the door for that answer a little bit with the question, because if it's not there -- of course, it is also something that could be addressed on redirect.

MR. WOODSMALL: Yeah. I guess.

JUDGE VOSS: I'm -- they're going back and forth so fast. I'm going to let it stand for now because I'm certain that Mr. Woodsmall and Mr. Conrad will ask that question on redirect anyway, and I would let it in as explaining the answer.

Q (By Mr. Mitten) Mr. Johnstone, where in your testimony do you state your conclusion that the benefits to Aquila's customers of the performance standards that you have proposed equal or exceed the costs to Aquila? Do you discuss that anywhere in your testimony?

MR. WOODSMALL: Your Honor, compound question. I'm going to break this down to a very basic level. One question at a time.

MR. MITTEN: All right. I'll -- I'll withdraw the second question.

Q (By Mr. Mitten) Where in your testimony do you discuss your conclusion that the benefits to customers will equal or exceed the costs to Aquila of complying with your performance standards?

A I don't see a cost to Aquila to comply.

Q That is not responsive to my question, Mr. Johnstone. Do you discuss that or do you not discuss that in your testimony?

A Benefits and costs. Benefits to customers versus costs to Aquila?

Q That equal or exceed the cost that Aquila will incur in complying with your performance standards.

A I'm not sure that I understand your question. I have to say based on -- on what you've asked, I don't see where I would point to my testimony. The discussion of performance standards appears on page 16.

Q But I asked a very specific question. Where in your testimony do you state the conclusion that the benefit to customers equal or exceed the costs of Aquila complying with performance standards?

MR. WOODSMALL: Your Honor, I'm going to object. He's asking him -- the problem seems to be that there is a belief that he stated a conclusion.

A Right. Thank you.

MR. WOODSMALL: Mr. Johnstone never stated that conclusion. So maybe we can move from that.

JUDGE VOSS: I think the question was did you state such a conclusion. So it sounds like if that's true, then the answer would be no.

A Yes, ma'am.

JUDGE VOSS: I think that's correct. Is that what --

MR. MITTEN: Fine.

JUDGE VOSS: Does that answer your question?

MR. MITTEN: That answers my question.

Q (By Mr. Mitten) Now, you testified on the fuel adjustment clause issue in the Ameren rate case that's pending before the Commission, didn't you?

A Yes, I did.

Q And in reviewing your testimony in that case, I noticed that there were some differences between your testimony there and your testimony here.

For example, I didn't see any mention in your Ameren testimony of incentive by design. Did you mention that in your Ameren testimony?

A No.

Q You did not propose an alternative fuel adjustment clause in the Ameren case; is that correct?

A That's correct.

Q There was no 50/50 sharing proposal in your testimony in the Ameren case; is that correct?

A That's correct.

Q Your pre-filed testimony in the Ameren case didn't include any discussion regarding your beliefs as to the adequacy of prudency reviews; is that correct?

A That's correct.

Q And I also didn't see any discussion in your Ameren testimony of the prudence standards that you thought the Commission should apply to that company's fuel adjustment clause; is that right?

A That's right.

Q Now, at page 4 of Schedule 1 that is attached to your rebuttal testimony in this case, you have a whole section entitled Rebuttable Presumption of Prudence; is that correct?

A Yes.

Q Now, rebuttable presumption of prudence sounds very legalistic for someone who is not a lawyer. Did you really write that section in your proposal?

A No.

Q So do you believe you're qualified to answer questions about that section of your testimony?

A I'm not qualified to give a legal opinion. I'd be happy to give you my understanding of that.

Q Okay. And under what circumstances does the presumption of prudence shift under your proposal?

A When there's a colorable showing of inference.

Q And define that for me.

A I guess that will be fact-specific.

Q Well, as a general proposition, at what point would the presumption and the burden become the utility's instead of the person attacking the rebuttable presumption?

A If there were evidence that the company was negligent in the operation of a power plant or in the maintenance of a power plant such that it caused a serious increase, substantial increase in fuel costs and that showing was made that that would be one example, which in my mind, would be a colorable showing of -- of imprudence, which would then launch the investigation. And the company would, therefore, have the burden of proof.

Q I'm trying to understand the proposal that you've made in your testimony. So as a general proposition, you said negligence would be one example. Can you give me a general statement of when the burden would shift under your proposal?

A Yes. When there is a colorable showing of imprudence.

Q But you can't tell me any more about what would constitute a colorable showing?

MR. WOODSMALL: Your Honor, asked and answered. He said it's fact-specific. If he wants to give him a hypothetical, maybe we can get there. But he said it's a fact-specific determination.

Q (By Mr. Mitten) But that's as far as you can go, fact-specific determination?

A Yes, sir.

Q How would the reasonable person standard regarding the need to make additional inquiry work under your standard?

A I don't understand your question. Where is the reasonable man standard?

Q Reasonable person standard.

A Reasonable person. Thank you. I'd like to be politically correct.

Q Could you open your -- can you turn to page 4 of 6 of Schedule 1 that's attached to your rebuttal testimony?

A Yes.

Q Provided, however, that if the facts and information --

MR. WOODSMALL: What line are we on?

Q (By Mr. Mitten) Excuse me. Beginning on line 6. Provided, however, that if the facts and information then known to the decision-makers would have caused a reasonable person in possession of those facts and information to have made further inquiry. So you see where I'm referring to reasonable person --

A Yes.

Q -- in your standard? So could you tell me how the reasonable person standard would work under your prudence standard?

A Mr. Williams earlier testified that prudence standard would be reasonable and effective given information known at the time. That, I think, is the essence of it.

We're talking about a reasonable person making choices that are reasonable and effective given the information that was known or could have been, should have been known at the time.

Q Well, I think Mr. Williams' discussion was in terms of what the appropriate prudence standard would be, and I'm going a little bit deeper into yours as to how the reasonable person exception that you have included in your standard would work.

A Well, the exception that you're talking about, provides, however, in my mind is what triggers what should have been known. The shorthand way to say that is what should have been known.

In other words, we look at what you knew, what the utility knew. And then if a reasonable person would have said, gee, the -- the fuel prices seem to have an unusual permeation here, maybe we should make some additional inquiry, that would be the reasonable person standard.

And as I would understand and interpret that, that is going to the -- the issue of what should have been known by the utility. So not only do we have what they knew, but if a reasonable person would have looked further to learn more, then that's what we're talking about in that phrase there.

Q Is that subjective or an objective standard?

A Well, I think by definition, all of this tends to be subjective in the final analysis.

Q Do you know whether the student -- prudence standard that you have imposed, how it compares to prudence standards that the Commission has used in the past?

A Well, I think the rebuttable presumption goes well beyond what they've done in the past. And our point is that if -- if you've got this sharing mechanism which preserves some of the incentives that have been in place traditionally, then you can have the rebuttable presumption of prudence, which is, I think, very important in terms of reducing the -- the burden. It's a big difference.

Q Is it your impression that under the Commission's -- under the prudence standard that the Commission has used in the past, there's not a rebuttable presumption?

A It's my understanding that under the company's proposal, the burden of prudence would go to the Staff and any other parties that would participate in a prudence review.

Q That wasn't my question, Mr. Johnstone. I'm asking if under the prudence standard that the Commission has used in the past, is it your impression that there was not a rebuttable presumption in that standard?

A Well, I'm trying to put it in the context of the

FAC that we're talking about here. And -- and I guess the times when there was an FAC before this Commission predates me, so I -- I don't have any basis to go back and make comments about what might have been done 30 or more years ago.

Q So the prudent -- what if the Commission has used a prudence standard that was not in the context of a fuel adjustment clause? Do you know whether or not the standard that you're proposing, how that compares to that prudence standard that the Commission may have used?

A My impression would be that it's generally similar. But I can't tell you that I have gone through and tried to do any comparisons.

Q Do you know how your prudence standard compares to the prudence standard that's applied by courts in this state?

A I do not know.

Q Is it your belief that there should be one prudence standard that applies to all utilities, or will the prudence standard vary from utility to utility?

A Well, we've talked about the -- the fact that this is fact-specific and it's subjective. So I think, by definition, the applications are unique. I think, as a general matter, prudence, per se, is -- is probably universal. But -- but in every instance that I'm aware of, it ends up being a question of -- of facts and subjective judgments based on those facts.

Q I'm not sure I understood your answer in connection with my question. Is there one prudence standard that applies to all utilities?

A Let me try it again. I think at a very high level there is a single standard.

Q That's a yes or -- thank you.

A The application is specific, however.

Q Mr. Johnstone, one last question. Do the clients that you represent in this proceeding believe that they are entitled to rates that prohibit Aquila from recovering all of its prudently incurred fuel and purchase power costs?

A No.

MR. MITTEN: Thank you.

JUDGE VOSS: Before I go any further, will Mr. Johnstone be available tomorrow?

MR. WOODSMALL: Yes, he will, your Honor.

JUDGE VOSS: Because I think that we'll probably finish tomorrow with some questions from the Bench.

CROSS-EXAMINATION

BY THE COURT:

Q But I did have one question myself because this is my understanding. Under traditional rate-making -- and

I always -- I guess I had always thought like Aquila that was your best guess as to what the cost is in a rate year.

But whatever you -- whatever means you use to set your base fuel cost in traditional rate-making, isn't that the same method you would use in either a fuel adjustment clause or an FAC, and the difference is what you do with it after you set the base rate?

You use all the information you have to determine what the base rate should be. And then once that base rate is established in traditional rate-making, that's what you get.

And in an FAC, if you go over that at all, as proposed by Aquila, 100 percent of it will go through?

A Or under --

Q And under yours, if you go over at all, 50 percent of it goes through?

A Or if it goes down 50 percent.

Q Goes back.

A And it's on a per kilowatt hour basis. And I believe, in this proceeding, the only proposals would be to set the base fuel costs as determined in this proceeding from regular base rates.

I certainly have seen proposals that would go with a forecast for the first year, for example, but not in this docket.

Q But traditionally, I mean, it's what happens after the base rates are set that are different under the fuel mechanisms. Is that generally true?

A Yes, ma'am.

JUDGE VOSS: Okay. That's all I really had. We could show that I didn't get confused. But we will do questions from the Bench and recross and everything tomorrow on Mr. Johnstone if that's all right with everybody because we have some court reporter issues -- you have to get out by five, and they're going to lock doors.

MR. WOODSMALL: Just for clarification, we're starting with Ms. Brockoway tomorrow?

JUDGE VOSS: Yes. If that's all right with everyone. Yeah. Because they had agreed --

MR. WOODSMALL: And then we'll --

JUDGE VOSS: Okay.

MR. COFFMAN: Your Honor, as long as Ms. Brockoway can get out reasonably close to noon, it doesn't matter where we pick her up.

JUDGE VOSS: We can go ahead and start. And if it looks like we're getting into trouble, since we're going to completely break and start over, we might as well go with her first thing. That way nothing bad would happen with extra questions and no one can be cut short.

MR. COFFMAN: Appreciate that. Thank you.

JUDGE VOSS: We try to accommodate. With that, we are off the record. I'm sorry. Just one second.

MR. FREY: Your Honor, before we go off the record, I'd just like to note that we're missing a witness in this list of witnesses. The Staff has one more witness, Lena Mantle, who filed surrebuttal testimony against Mr. -- with respect to Mr. Davis, Mr. Davis' testimony.

And my understanding is that the -- the -- there may be some questions of Ms. Mantle, too, so we need to put her on the stand tomorrow. Mr. Taylor is going back up, too, so that maybe a good time -- if you would agree, that might be a good time to put Ms. Mantle up tomorrow.

JUDGE VOSS: Then we'll -- our plan will be for Ms. Brockoway first and to finish up with Mr. Johnstone, and then we can go back to Staff's witnesses.

MR. FREY: Okay. Thank you.

JUDGE VOSS: We'll get everybody in. We may be here late tomorrow. Hopefully not. But we'll finish tomorrow so that we're clear before the stip. presentation.

All right. Any other issues to address before we go off the record? Okay. Then we're off the record.

I N D E X

I N D E X (CONTINUED)

I N D E X (CONTINUED)

E X H I B I T S

EXHIBIT	DESCRIPTION	OFFERED	ADMITTED
9	Rebuttal Testimony of Steve Fetter	571	571
10	surrebuttal Testimony of Steve Fetter	571	571
24	Direct Testimony of Dennis Rooney	675	675
32	Testimony of Dennis Williams	608	608
33	Testimony of Dennis Williams	608	608
34	Testimony of Dennis Williams	608	608
37	Rebuttal Testimony of Robert Davis	679	679
206	Direct Testimony Of Cary Featherstone	702	702
207	Rebuttal Testimony of Cary Featherstone	702	702
208	Surrebuttal Testimony of Cary Featherstone	702	702
209	Surrebuttal Testimony of Cary Featherstone	702	702
227	Rebuttal Testimony of Michael Taylor	759	759
461	Pg. 66 of 2006 10-K	664	664
503	Direct Testimony of Donald Johnstone	766	766
504	Direct Testimony of Donald Johnstone	766	766

E X H I B I T S (CONTINUED)

EXHIBIT	DESCRIPTION	OFFERED	ADMITTED
505	Rebuttal Testimony of Donald Johnstone	766	766
506	Surrebuttal Testimony of Donald Johnstone	766	766

(Original exhibits were retained by the Public Service Commission.)