

REBUTTAL TESTIMONY

OF

CHARLES R. HYNEMAN

UTILICORP UNITED INC.

d/b/a MISSOURI PUBLIC SERVICE

AND

ST. JOSEPH LIGHT AND POWER

CASE NO. GO-2002-175

FILED

MAR 23 2005

Missouri Public
Service Commission

Q. Please state your name and business address.

A. Charles R. Hyneman, 3675 Noland Road, Suite 110, Independence,
Missouri 64055.

Q. By whom are you employed and in what capacity?

A. I am a Regulatory Auditor with the Missouri Public Service Commission
(Commission).

Q. Please describe your educational background and work experience.

A. I graduated from Indiana State University in May 1985 with a Bachelor of
Science degree in Accounting. I earned a Masters of Business Administration degree
from the University of Missouri-Columbia in December of 1988. I am a Certified Public
Accountant holding certification in the state of Missouri.

In May 1985, I was commissioned as an officer in the United States Air Force. I
left the Air Force in December 1992 and joined the Commission in April of 1993.

Q. Have you previously filed testimony before the Commission?

1 A. Yes. Schedule 1, attached to this testimony, lists the cases in which I have
2 filed testimony before the Commission. My testimony addressed Accounting Authority
3 Order (AAO) issues in Case Nos. GR-96-285, GR-98-140 and GO-99-258, Missouri Gas
4 Energy; and GR-97-272, Associated Natural Gas Company. I have filed Staff
5 recommendations to the Commission on AAO Applications in Case Nos. GO-97-301 and
6 GO-2000-624, Missouri Gas Energy; and EO-97-224, Kansas City Power & Light
7 Company.

8 Q. With respect to Case No. GO-2002-175, have you made an examination of
9 the books and records of Missouri Public Service (MPS) and St. Joseph Light & Power
10 (SJLP), both operating divisions of UtiliCorp United Inc. (UtiliCorp or Company)?

11 A. Yes, with the assistance of other members of the Commission Staff
12 (Staff).

13 Q. What is the purpose of this rebuttal testimony?

14 A. The purpose of this testimony is to respond to UtiliCorp's First Amended
15 Application and the direct testimony of UtiliCorp witness Robert J. Amdor filed with the
16 Commission on March 13, 2002.

17 Q. Please summarize the history of this case.

18 A. On October 9, 2001, Laclede Gas Company, Missouri Gas Energy, Atmos
19 Energy Corporation d/b/a United Cities Gas Company and Greeley Gas Company, and
20 MPS and SJLP (all collectively referred to as Applicants) filed an Application before the
21 Commission seeking special recognition of uncollectibles expense (bad debt expense),
22 docketed as Case No. GO-2002-175. The purpose of that filing was described on page 1
23 of the Application:

... to propose changes to the tariffs of the applicants and other accounting treatment that will allow the applicants to initiate service for as many natural gas customers as possible in the upcoming heating season while addressing the financial impact the extraordinary events of last winter have had and continue to have on both customers and applicants.

Q. What relief did the Applicants seek in this docket in their October 2001 filing?

A. The Applicants requested that the Commission approve new tariff sheets that amend the current Purchased Gas Adjustment (PGA)/Actual Cost Adjustment (ACA) process to allow recovery of higher levels of bad debt expense, and/or approve an open-ended AAO to defer levels of bad debt expense that vary from what is included in current gas distribution rates..

Q. How did the Applicants describe the "extraordinary" events that led to this October 2001 filing?

A. The "extraordinary" events are described in paragraph 7 of the Application:

The winter months of November and December of 2000-2001 were among the coldest in recorded history across the United States. The winter of 2000-2001 was also marked by nationwide increases in wholesale natural gas prices that were higher than at any previous time in this country. This cold weather and high-priced natural gas posed a significant financial hardship on both gas customers and gas utilities throughout the country, Missouri included, during the winter of 2000-2001.

All of the parties to this case have subsequently withdrew from the Application, except UtiliCorp. On March 13, 2002, UtiliCorp amended its Application and filed direct testimony in support of its case. In its First Amended Application, UtiliCorp stated that it is seeking an AAO in response to the "extraordinary financial impact resulting from the extraordinary events of last winter."

1 Q. Subsequent to the Applicant's October filing, did the Commission take
2 any actions concerning gas utilities' bad debt collection practices?

3 A. Yes. In November 2001, the Commission issued an "Emergency
4 Amendment" to its Cold Weather Rule (4 CSR 240-13.055 (13)). As part of the
5 Emergency Amendment, the Commission indicated it would grant recovery of
6 incremental revenue and expenses associated with the Emergency Amendment through
7 issuance of AAOs.

8 Q. Did UtiliCorp seek an AAO pursuant to 4 CSR 240-13.055(13)?

9 A. Yes. The Commission authorized this AAO in its Order in Case No.
10 GA-2002-285 in January 2002. Because the AAO issued in Case No. GA-2002-285 only
11 applies to revenues and expenses incurred by UtiliCorp since the issuance of
12 4 CSR 240-13.055(13) (November 2001), that AAO has no bearing on the amounts
13 requested by UtiliCorp for deferral in the instant case. The amounts requested by
14 UtiliCorp in this AAO Case No. GO-2002-175, pertain to bad debt expense incurred prior
15 to November 2001.

16 Q. Please describe UtiliCorp's corporate structure and operations.

17 A. UtiliCorp is an international energy and risk management company based
18 in Kansas City, Missouri. Since its formation in 1985 from the former Missouri Public
19 Service Company, UtiliCorp has grown through regulated and non-regulated energy
20 acquisitions and investments. At December 31, 2001, the Company had total assets of
21 \$12 billion and 12-month sales of \$40.4 billion. UtiliCorp recently changed its name to
22 Aquila, Inc.

1 UtiliCorp's Aquila Merchant Services subsidiary is one of the largest providers of
2 risk management and wholesale energy in North America. Its asset portfolio includes
3 electric generation plants, natural gas gathering, storage, pipeline and processing assets.
4 Aquila Merchant Services also markets and trades a diverse portfolio of commodities
5 including natural gas, power, global liquids and weather derivatives.

6 UtiliCorp's operating divisions in the U.S. serve 349,000 electric distribution
7 customers in three states: Missouri, Kansas and Colorado; and 831,000 natural gas
8 distribution customers in seven states: Missouri, Kansas, Colorado, Nebraska, Iowa,
9 Michigan and Minnesota. Its seven domestic utility divisions are Missouri Public
10 Service, St. Joseph Light & Power, Kansas Public Service, Peoples Natural Gas,
11 WestPlains Energy, Northern Minnesota Utilities and Michigan Gas Utilities. UtiliCorp
12 also operates electric and gas utility networks in Australia, New Zealand, and Canada.

13 MPS provides both electric and gas utility service to customers in the Kansas City
14 metropolitan area. SJLP also provides electric and gas utility service to customers in an
15 around St. Joseph, Missouri. This AAO application applies only to MPS's and SJLP's
16 gas operations.

17 Q. What is an AAO?

18 A. An AAO is a Commission order granting a utility the authority to depart
19 from normal accounting treatment by deferring recognition of expenses associated with
20 an extraordinary event. Normal accounting treatment requires recognition in the period
21 the expenses are incurred resulting in a reduction in the current year's net income.
22 Deferring the recognition of an expense results in the creation of a regulatory asset on the
23 utility's balance sheet for both regulatory and financial reporting purposes. The Financial

Accounting Standards Board (FASB) allows the deferral of expenses and creation of a regulatory asset if certain conditions are met. These conditions are explained in Statement of Financial Accounting Standards No. 71, *Accounting for the Effects of Certain Types of Regulation* (FAS 71). The FASB's prime consideration in allowing a utility to record a regulatory asset is that it be "probable" that the future revenue in an amount equal to the regulatory asset will be included in allowable costs for ratemaking purposes (FAS 71, para. 9a.).

Q. Please describe the Commission's standards for granting utility requests for AAOs.

A. The Commission expressed its general view on and its standards for deferral of costs incurred outside a rate case test year in its Report And Order in Case Nos. EO-91-358 and EO-91-360, applications filed by MPS. In this Report And Order, the Commission expressed its view that costs incurred outside of a rate case test year should be allowed only on a limited basis. The Commission stated:

The deferral of costs from one period to another period for the development of a revenue requirement violates the traditional method of setting rates. Under historical test year ratemaking, costs are rarely considered from earlier than the test year to determine what is a reasonable revenue requirement for the future. Deferral of costs from one period to a subsequent rate case should be allowed only on a limited basis.

In the "Standards For Deferral" section of this Report And Order, the Commission described the limited basis on which AAOs should be allowed by specifying the following standards to govern its review of allowing utility companies to defer costs incurred outside of a rate case test year as a regulatory asset. A summary of these standards is listed below:

- 1 1. Primary focus in on whether or not the event was
2 extraordinary, defined as unusual and unique, and not
3 recurring;
- 4 2. The FERC's 5 percent of income materiality standard is
5 relevant to whether the event is extraordinary, although not
6 case dispositive;
- 7 3. The determination of whether or not a cost is extraordinary
8 will be made on a case by case basis.

9 Since issuing its Report And Order in Case Nos. EO-91-358 and EO-91-360, the
10 Commission has consistently referred to this Report And Order as the basis for its
11 decision on granting or rejecting AAO applications.

12 HISTORY OF EXTRAORDINARY ITEMS

13 Q. Before addressing whether or not the event driving UtiliCorp's
14 Application in this case has met these standards, please provide a brief summary of the
15 accounting industry pronouncements that have addressed the concept of extraordinary
16 items.

17 A. As will be described later, the Commission's standards on extraordinary
18 events are derived from the Federal Energy Regulatory Commission's (FERC) definition
19 of Extraordinary items found in the Uniform System of Accounts (USOA) for electric
20 and gas utilities. This Commission has adopted the FERC USOAs for the purpose of
21 establishing accounting practices for utilities under its jurisdiction. The basis for the
22 FERC's definition can be found in accounting industry pronouncements dating back to at
23 least 1947.

24 The concept of extraordinary costs and revenues is addressed in the following
25 accounting pronouncements:

1. Accounting Research Bulletin No. 32, (ARB 32), *Income and Earned Surplus*;
2. Accounting Principles Board Opinion No. 9 (APB 9), *Reporting the Results of Operations*;
3. Accounting Principles Board Opinion No. 30 (APB 30), *Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*.

Probably the earliest discussion of extraordinary costs in accounting literature was in ARB 32 issued in 1947. (ARB 32 was reissued in June 1953 as Chapter 8 of Accounting Research Bulletin No. 43.) ARB 32 was issued by the Committee on Accounting Procedure (predecessor of the Accounting Principles Board), and described the Committee's view of extraordinary items:

... it is the opinion of the committee that there should be a general presumption that all items of profit and loss recognized during the period are to be used in determining the figure reported as net income. The only possible exception to this presumption in any case would be with respect to items which in the aggregate are materially significant in relation to the company's net income and are clearly not identifiable with or do not result from the usual or typical business operations of the period. Thus, only extraordinary items such as the following may be excluded from the determination of net income for the year, and they should be excluded when their inclusion would impair the significance of net income so that misleading inferences might be drawn therefrom...

The important concepts that were included in ARB 32 and later adopted by the FERC and this Commission are:

1. A general presumption that net income shall reflect all items of profit or loss during the period.
2. To be classified as an extraordinary expense, the item must be materially significant to net income (of significant effect).

1 3. The events which caused the extraordinary cost are
2 significantly different from the ordinary and typical
3 activities of the company.

4 In 1966, the Accounting Principles Board (Board) issued APB 9. APB 9
5 discusses, in part, the nature of events and transactions which might be considered
6 "extraordinary" and establishes related criteria which the Board feels are reasonable and
7 practicable. In its criteria for extraordinary items, the Board stated:

8 The segregation in the income statement of the effects of events
9 and transactions which have occurred during the current period,
10 which are of an extraordinary nature and whose effects are material
11 requires the exercise of judgment...Such events and transactions
12 are identified primarily by the nature of the underlying occurrence.
13 They will be of a character significantly different from the typical
14 or customary business activities of the entity. Accordingly, they
15 will be events and transactions of material effect which would not
16 be expected to recur frequently and which would not be considered
17 as recurring factors in any evaluation of the ordinary operating
18 processes of the business.

19 APB 9 retained the materiality requirement and the requirement that the
20 underlying event be significantly different from normal or customary business activities.
21 It also added the requirements that the event not be expected to recur frequently and
22 clearly be classified as nonrecurring. These two requirements are clearly listed in the
23 FERC's revised definition of extraordinary items, which has been adopted by this
24 Commission and used as a basis for defining an extraordinary event for many years.

25 Finally, the Board issued APB 30 in 1973 to provide more definitive criteria for
26 extraordinary items. In this pronouncement, the Board concluded that an event or
27 transaction should be presumed to be an ordinary and usual activity unless the evidence
28 clearly supports its classification as an extraordinary item. The Board defined
29 extraordinary items as events and transactions that are distinguished by their unusual
30 nature and by the infrequency of their occurrence. Thus, both criteria should be met to

1 classify an event or transaction as an extraordinary item. The Board described the terms
2 unusual nature and infrequency of occurrence as:

3 *Unusual nature* – the underlying event or transaction should possess
4 a high degree of abnormality and be of a type clearly unrelated to, or
5 only incidentally related to, the ordinary and typical activities of the
6 entity, taking into account the environment in which the entity
7 operates. Unusual nature is not established by the fact that an event
8 or transaction is beyond the control of management.

9 *Infrequency of occurrence* – the underlying event or transaction
10 should be of a type that would not reasonably be expected to recur in
11 the foreseeable future, taking into account the environment in which
12 the entity operates. By definition, extraordinary items occur
13 infrequently. However, mere infrequency of occurrence of a
14 particular event or transaction does not alone imply that its effects
15 should be classified as extraordinary. An event or transaction of a
16 type that occurs frequently in the environment in which the entity
17 operates cannot, by definition, be considered as extraordinary,
18 regardless of its financial effect.

19 Also, the Board determined that an extraordinary event is only relevant if it is
20 material in relation to income before extraordinary items or to the trend of annual
21 earnings before extraordinary items, or is material by other appropriate criteria. The
22 Board consistently made materiality a condition to be met before the classification of an
23 event as extraordinary was even considered.

24 APB 30 is important because it provides a more extensive description of the terms
25 “unusual nature” and “infrequent occurrence.” These terms are included verbatim in the
26 FERC’s definition of extraordinary items.

27 **FERC’S DEFINITION OF EXTRAORDINARY ITEMS**

28 The FERC describes “extraordinary items” in General Instruction No. 7 to the
29 USOA for natural gas companies. The significant components of this definition are
30 provided below:

7. Extraordinary Items.

It is the intent that net income shall reflect all items of profit or loss during the period.

Those items related to the effects of events and transactions which have occurred during the current period and which are of unusual nature and infrequent occurrence shall be considered extraordinary items.

Accordingly, they will be events and transactions of significant effect which are abnormal and significantly different from the ordinary and typical activities of the company, and which would not reasonably be expected to recur in the foreseeable future.

To be considered as extraordinary under the above guidelines, an item should be more than approximately 5 percent of income, computed before extraordinary items. Commission approval must be obtained to treat an item of less than 5 percent, as extraordinary. (See accounts 434 and 435.) (Emphasis added.)

In its description of Account 435, Extraordinary deductions, of its USOA, the FERC defines the term "of significant effect" as "losses of unusual nature and infrequent occurrence, which would significantly distort the current year's income computed before Extraordinary Items, if reported other than as extraordinary items."

It is clear that the language in ARB 32 and APBs 9 and 30 served as the basis of FERC's definition of extraordinary items. It is also clear that both the accounting profession and the FERC considered "materiality" a requirement before a cost should be considered for extraordinary treatment.

Unlike the FERC, however, the accounting profession has never specifically defined the term "material." The FERC, in its USOA, defines "material" for the purpose of an extraordinary income or expense as an income or expense "which would significantly distort the current year's income." In accordance with its definition of an extraordinary item described above, the FERC indicates this earnings distortion

1 presumptively takes place when a revenue or expense incurred as a result of an
2 extraordinary event has an impact of "more than approximately 5 percent of income,
3 computed before extraordinary items."

4 Q. In General Instruction No. 7 described above, the FERC indicates that is
5 does not specifically have to approve deferrals of more than five percent of income as
6 extraordinary. If a utility believes the costs associated with an extraordinary event are
7 greater than five percent of income, why would it seek an AAO before this Commission
8 for authority to defer these costs?

9 A. As described above, FAS 71 requires that it be "probable" that costs
10 deferred as a regulatory asset be recovered in future rates. It has been my experience in
11 working with several utility companies on AAO cases that some auditing firms who audit
12 a utility's financial statements oppose the recognition of a regulatory asset without a
13 Commission order specifically allowing the creation of such an asset.

14 Q. Why should an item or event have to be considered extraordinary before it
15 can be eligible for AAO treatment?

16 A. The ratemaking process is premised upon normality and regularity as the
17 basis for setting rates. Accounting and ratemaking rules and conventions are presumed to
18 be capable of adequately reflecting the ongoing and normal changes to revenues,
19 expenses and rate base which a utility will experience over time. Only infrequently do
20 extraordinary events occur which justify changes to normal utility accounting and
21 ratemaking practices and procedures. Only truly extraordinary items and events justify
22 extraordinary accounting and ratemaking treatment, such as the deferral and amortization
23 of items that would normally be charged to expense when they are incurred.

1 Q. Has the Commission supported this position in past orders?

2 A. Yes, on numerous occasions. The Commission in Case No.
3 WR-2000-281, Missouri-American Water Company, in its Order Concerning Non-
4 Unanimous Stipulation And Agreement, Denying Motion to Modify, stated on page 8:

5 The items deferred are booked as an asset rather than as an
6 expense, thus improving the financial picture of the utility in
7 question during the deferral period. Id. AAOs should be used
8 sparingly because they permit ratemaking consideration of items
9 from outside the test year:

10 The deferral of cost from one period to another period for the development of a
11 revenue requirement violates the traditional method of setting rates. Rates are usually
12 established based upon a historical test year which focuses on four factors: (1) the rate of
13 return the utility has an opportunity to earn; (2) the rate base upon which a return may be
14 earned; (3) the depreciation costs of plant and equipment; and (4) allowable operating
15 expenses. State ex. Rel. Union Electric Company v. PSC, 765 S.W. 2d 618, 622 (Mo.
16 App. 1988).

17 **DESCRIPTION OF UTILICORP's REQUESTED AAO**

18 Q. What event has caused UtiliCorp to file for an AAO for its MPS and SJLP
19 gas operations in this proceeding?

20 A. UtiliCorp seeks Commission authority to defer a high level of bad debt
21 expense incurred in 2001 by its MPS and SJLP operating divisions resulting from the
22 very cold winter months of November and December 2000 coupled with the high gas
23 costs in effect at that time.

24 Q. Does Mr. Amdor state a reason why MPS is seeking this deferral?

1 A. Yes. Mr. Amdor states that UtiliCorp seeks authority under this AAO to
2 defer \$1,054,000 "so the company will not need to recognize these amounts in earnings."

3 Q. How did UtiliCorp calculate the amount it is proposing to defer of
4 \$1,054,000?

5 A. On page 10 of his direct testimony, Mr. Amdor explains that the total
6 amount of MPS and SJLP bad debt write-offs for gas operations during the period April
7 2001 through October 2001 was \$1,112,765. Mr. Amdor subtracted from this an amount
8 of \$58,477, which he claims is the level of bad debts expense included in MPS's last rate
9 case in 1992, to arrive at a rounded proposed deferral amount of \$1,054,000.

10 Q. In calculating the proposed deferral of \$1,054,000, did UtiliCorp subtract
11 the level of bad debt expense it believes to be in rates from the last gas rate case for
12 SJLP?

13 A. No. In discussions with the Company, it appears that not subtracting an
14 amount for SJLP in calculating the proposed deferral amount was an oversight that will
15 be corrected.

16 Q. Assuming that MPS's argument that its high level of bad debts incurred in
17 2001 were the results of extraordinary event, does the Staff agree with the \$1,054,000
18 deferral amount quantified by UtiliCorp in this AAO Application?

19 A. No. Attached to his direct testimony in this case, Mr. Amdor includes
20 Exhibits RJA-4 for MPS and RJA-5 for SJLP. These exhibits show that the average
21 annual bad debt expense for MPS in 1999 and 2000 was \$671,378 and for SJLP was
22 \$20,883 for those years. The bad debt levels incurred in 2001 (which UtiliCorp claims are
23 extraordinary) should be compared to this average to determine a representative amount

1 that conceivably could be attributed, at least in part, to the cold weather in November and
2 December 2000 and the high gas prices. Using this methodology, and assuming that the
3 events that led to these costs were extraordinary, UtiliCorp should have sought recovery
4 of \$465,587 instead of \$1,054,000.

5 Q. Please explain.

6 A. Mr. Amdor's calculation of \$1,054,000 is based on actual bad debt
7 writeoffs in 2001 minus the amount Mr. Amdor claims is in rates for bad debts from
8 MPS' last gas rate case in 1992, Case No. GR-93-172. This is faulty reasoning because
9 it is improper to measure the impact of an alleged extraordinary item by tracking a single
10 ratemaking element from a rate proceeding many years in the past. For example, a
11 review of the Staff's revenue requirement accounting schedules from that rate case shows
12 that MPS had per books margin revenues (gross revenues less purchased gas costs) of
13 \$15,913,609 in the test year ended September 1992. According to MPS's Annual Report
14 to the FERC, MPS's margin revenues for its gas operations in 2000 were \$20,087,955.
15 Using the reasoning inherent in Mr. Amdor's analysis, MPS's increase in margin
16 revenues since its last rate case of \$4,174,346 (\$20,087,955 - \$15,913,609) more than
17 offsets its \$1,054,000 increase in bad debt levels in 2001 for both MPS and SJLP.

18 The problem with UtiliCorp's reasoning is that you cannot go back and isolate
19 one expense in a previous rate case and compare that expense to a level that was incurred
20 several years later. Mr. Amdor's analysis assumes that all other revenue and expense
21 items, except bad debt expense, remained constant over the past ten years. This is an
22 illogical assumption.

1 Q. Do you have an example of an expense for MPS that was significantly
2 higher for MPS in 1992 than it is today?

3 A. Yes. The rates set in MPS's most recent gas rate case, No. GR-93-172,
4 were based on a pension expense of \$0 because MPS had not made a contribution to its
5 pension fund in several years. However, subsequent to that case, the Commission has
6 consistently ordered in rate cases that the level of pension expense to be included in rates
7 should be calculated in accordance with the provisions of Statement of Financial
8 Accounting Standards No. 87, *Employers' Accounting for Pensions* (FAS 87). The level
9 of pension expense calculated under FAS 87 for MPS has been significantly negative for
10 each year since this method was adopted by the Commission. As a result, the amount of
11 pension expense included in MPS's rates for its gas operations is significantly higher than
12 its actual cost. This amount, accumulated over the years since the Commission adopted
13 the FAS 87 pension expense methodology, could well exceed the \$1,054,000 sought by
14 UtiliCorp in this case.

15 Q. On page 5 of his direct testimony, Mr. Amdor states "It should be noted
16 that if the Company filed a rate case today, the expected recovery from this issue might
17 be substantially higher than what is requested herein." Please comment on this statement.

18 A. This statement may be true, but it is not relevant to any issue in this case.
19 If an average of bad debts over the past several years is used as the basis for normalizing
20 MPS bad debt expense in a future rate case, then it is likely that the winter of 2000/2001
21 will have a positive impact on the level of bad debts expense. It is also equally likely that
22 the relatively warm 2001/2002 winter will have a negative impact on the normalized level
23 of bad debt expense that is determined to be appropriate for ratemaking purposes. As

1 discussed above, if a rate case for MPS's gas operations were held today, other costs
2 (such as pension expense), which are lower, today than they were in 1992 would be
3 included, which could also offset the impact of MPS's higher bad debt expense.

4 **PROPOSED STAFF CRITERIA FOR AAOs**

5 Q. Is the Staff recommending, in this Case No. GO-2002-175, that the
6 Commission expand its traditional criteria for the approval of deferred cost recognition
7 under an AAO?

8 A. Yes. Continuation of the policy, which requires only that expenses be
9 extraordinary for an AAO to be approved, may subject the Commission to AAO requests
10 that do not reasonably merit consideration.

11 Q. What criteria does the Staff recommend be used by the Commission in
12 considering whether to grant an AAO?

13 A. The Staff recommends requiring that the application show that the
14 following four conditions have been met before the Commission considers granting an
15 AAO:

- 16 1. The costs resulting from the event must be extraordinary and
17 material. The Staff is recommending that the costs that are subject
18 to deferral must represent at least 5% of the utility's regulated
19 Missouri net income, computed before extraordinary items. This
20 percentage should be applied to the company's most recent twelve
21 months of earnings without reflecting the alleged extraordinary
22 event. This requirement is consistent with the materiality
23 requirement for deferral of costs that is found in Account 182.3 of
24 the USOA, as defined in the seventh General Instruction,
25 "Extraordinary Items," Subchapter C, Part 101 of the Code of
26 Federal Regulations, Title 18. The USOA is the prescribed method
27 used by FERC and adopted by the Commission for bookkeeping
28 purposes pursuant to 4 CSR 240-20.030. (It should be noted,
29 however, that 4 CSR 240-20.030(4) states, in part, that "the
30 Commission does not commit itself to the approval or acceptance

1 of any item set out in any account for the purpose of fixing
2 rates...").

3 2. The utility's current rates must be inadequate to cover the event.
4 If the Commission can determine, by examining surveillance
5 reports and other information provided by the utility, that existing
6 rates appear sufficient to cover the extraordinary cost and still
7 provide the utility with a reasonable expectation of earning its
8 authorized rate of return, then the AAO request should be rejected.

9 3. The extraordinary expenses that the utility is seeking to defer
10 must result from either:

11 a. an extraordinary capital addition, such as the gas service
12 line replacement program, that is required to insure the
13 continuation of safe and adequate service, in which unique
14 conditions preclude recovery of these costs through a rate
15 case filing, or

16 b. an extraordinary event that is beyond the control of the
17 utility's management. Examples of such events include a
18 major flood or ice storm.

19 4. There must be a sufficient reason why the utility could not file a
20 rate case to recover the costs resulting from the extraordinary
21 event. Alternatively, the utility must file a rate case within 90 days
22 of the AAO approval to allow for prompt rate treatment of the
23 deferred costs. If the utility intends to seek rate recovery and defer
24 amortization of the AAO balance until the effective date of rates
25 for a future rate case, the utility should be required to file a rate
26 case soon after approval of the AAO. The Commission stated on
27 pages 8 and 9 of its Report and Order in Case No. EO-91-358:
28 "The Commission finds that a time limitation on deferrals is
29 reasonable since deferrals cannot be allowed to continue
30 indefinitely. The Commission finds that a rate case must be filed
31 within a reasonable time after the deferral period for recovery of
32 the deferral to be considered." It is the Staff's position that if the
33 impact of an extraordinary event is so significant as to require rate
34 recovery, then the only logical justification for delaying the filing
35 of the rate case would be that the extraordinary event is ongoing,
36 such as a gas service line replacement program. Normal
37 construction projects should not be afforded special AAO deferral
38 treatment.

39 (Please note that these criteria apply only to AAOs for which any
40 amortization of deferred amounts is to be delayed until the
41 effective date of rates for a future rate case. In this Application,

1 UtiliCorp is not seeking any amortization of deferred amounts until
2 a subsequent rate proceeding.)

3 Q. Does UtiliCorp's Application meet the Staff's proposed criteria?

4 A. No. As will be described below, MPS's and SJLP's high level of bad debt
5 expense in 2001 is not extraordinary. The impact of the proposed deferral amount on
6 MPS's net income is not material. Additionally, varying levels of bad debt expense is a
7 typical and recurring revenue requirement item that is appropriately handled through the
8 expense normalization process in a rate case.

9 Q. Referring to the Staff's proposed criteria No. 1 above, does the Staff
10 consider the events that led to UtiliCorp's request for this AAO to be unusual in nature?

11 A. No. As described above, to meet the Commission's longstanding
12 "unusual in nature" criteria the underlying event or transaction should possess 1) a high
13 degree of abnormality and 2) be of a type clearly unrelated to, or only incidentally related
14 to, the ordinary and typical activities of the entity, taking into account the environment in
15 which the entity operates.

16 Nothing could be more inherent in the environment of a natural gas distribution
17 company than variations in weather and gas prices. In fact, weather temperature
18 variability is so inherent to the gas distributions business that UtiliCorp, MPS's parent
19 company, offers various hedging techniques to minimize the impact of fluctuations in
20 weather to gas distribution utilities. UtiliCorp's Aquila Merchant Services offers a full
21 line of financial option products that can be used by businesses to manage the risks
22 associated with virtually any weather phenomenon. These financial option products are
23 designed to lower the negative financial impacts of adverse weather.

1 Likewise, gas utilities have gas procurement departments with employees
2 specializing in gas procurement practices who seek to minimize the cost of gas to the
3 utility in both warm and cold winters. Managing the negative impact of changes in gas
4 prices is an integral part of the work functions of these employees.

5 While it can be argued that the weather in the months of November and December
6 2000 was unusually cold, cold weather is an annual event that is clearly related to a gas
7 distribution company's ordinary and typical business activities.

8 Q. Has UtiliCorp recently indicated that it has taken steps to reduce the
9 financial impact of variations in weather?

10 A. Yes. In its February 7, 2002 press release, UtiliCorp announced that it
11 expects changes in weather to have a significantly reduced impact on future earnings:

12 The Company hedged its fuel costs for the 2002 winter season
13 (January through March) using weather products. While it is
14 impossible to hedge 100 percent of the company's weather risk,
15 UtiliCorp expects that variations in future earnings due to weather
16 will be significantly reduced.

17 Q. How are seasons with colder or warmer temperatures different
18 from other weather-related events such as the 1993 flood and the 1996 ice storm which,
19 in the past, have met the Commission's definition of "extraordinary?"

20 A. There are two primary differences. First, the major ice storm and the 1993
21 flood resulted only in significant increases in expenses that were not in any way related to
22 the normal and recurring operations of the utility. Secondly, unlike cold weather for a
23 natural gas utility, there are no offsetting increases in revenues from "acts of God" such
24 as floods and major ice storms.

1 Q. Is UtiliCorp's proposed \$1,054,000 incremental bad debt expense for its
2 MPS and SJLP gas operations material to MPS' s and SJLP's regulated Missouri net
3 income?

4 A. No. According to its FERC Form 1, MPS's net utility operating income
5 was \$50,948,000 for both electric and gas operations in 2000. UtiliCorp's proposed
6 deferral of \$1,054,000 represents only 2.1 percent of net income. In 2001, MPS's net
7 utility operating income as reflected in its FERC Form 1 (which has not been filed with
8 the FERC as of the date of this testimony) was \$43,321,927 reflecting a 2.4 percent
9 impact.

10 Q. Under the assumption that the Commission determines that the cold
11 weather months in November and December 2001 coupled with the high gas prices in
12 that period are an extraordinary events, does the Staff consider the \$1,054,000 deferral
13 amount proposed by UtiliCorp to be an appropriate amount for deferral?

14 A. No. As explained earlier, the \$1,054,000 amount proposed by UtiliCorp to
15 defer under this AAO is based on a faulty quantification. The Staff believes a more
16 reasonable amount would be \$465,587.

17 Q. What is the materiality impact on MPS using the more reasonable
18 \$465,587 amount?

19 A. For 2000, the impact is .09 percent and, for 2001, the impact is 1.1
20 percent.

21 Q. Your materiality analysis of UtiliCorp's proposed deferral and the more
22 reasonable staff calculation was measured against MPS's net utility income as reported in

1 the FERC Form 1. Why didn't the Staff compare the deferral amounts against net income
2 before considering the impact of the extraordinary event?

3 A. The calculation of the materiality impact excluding the impact of the
4 purported extraordinary event requires a calculation of an effective tax rate during that
5 period and the additional margin revenue that was recorded as a result of the colder than
6 normal winter months. The Staff does not possess enough information at the time of
7 filing this rebuttal testimony to make this calculation. However, the Staff's calculation
8 shown above is more conservative because it uses a lower net income amount. The
9 materiality impact, comparing the deferral amounts against net income before
10 consideration of the impact of the alleged extraordinary event, would be lower than the
11 amounts calculated above if this more correct calculation was performed.

12 Q. Other than regulatory agencies, do MPS and SJLP report earnings from its
13 gas operations to any entity outside of the Company?

14 A. No. Both MPS and SJLP, which have both electric and gas operations, are
15 divisions of UtiliCorp. No subsidiary or division of UtiliCorp reports its financial results
16 to the financial community.

17 Q. Would recognizing \$1,054,000 in earnings have a significant impact on
18 UtiliCorp's reported earnings to the financial community?

19 A. No. UtiliCorp's net income in 2001 was \$279.4 million, up from \$206.8
20 million in 2000. The after tax net income effect of an increase in expenses of \$1,054,000
21 (assuming an effective 38.3886 effective tax rate) is \$649,384. This amounts to less than
22 three-tenths of one percent of UtiliCorp's 2001 net income.

1 Q. Is it the Staff's position that the measure of the materiality of an
2 extraordinary event be measured against total company operations?

3 A. No. The Staff believes that the materiality of the financial impact of an
4 extraordinary event should be material to the Company's net income. The Staff defines
5 the word "Company" for the purpose materiality considerations in an AAO case to be the
6 regulated Missouri operations of the utility.

7 However, when determining the validity of a claimed financial detriment to
8 justify an AAO, it is also important to look at total company financial reports, not just the
9 financial performance of the Company's Missouri jurisdictional operations. It is not the
10 individual subsidiary or division financial reports, but the total Company consolidated
11 financial reports, that are provided to the financial community, including investors,
12 shareholders and investment analysts. It is these total company consolidated reports that
13 will show if a company has experienced significant financial detriment from a specific
14 transaction or event.

15 For example, in its First Amended Application, paragraph 8, UtiliCorp makes a
16 statement that cannot possibly be true. It states "absent a legitimate opportunity to
17 recover a significant portion of the extraordinarily high levels of uncollectibles expense,
18 UtiliCorp will suffer great and irreparable financial detriment." In February 2002,
19 UtiliCorp reported its 2001 earnings with great fanfare. UtiliCorp reported that its net
20 income increased over \$70 million dollars, or 35 percent over 2000 net income. The net
21 income effect of the total amount UtiliCorp is seeking under this AAO is less than three-
22 tenths of one percent of UtiliCorp's 2001 net income.

1 Q. Instead of a "great and irreparable financial detriment," how would the
2 Staff classify the impact of MPS's and SJLP's 2001 bad debt levels on UtiliCorp's 2001
3 financial results?

4 A. It would be more correct to state that the high levels of MPS's and SJLP's
5 bad debts had an immaterial and insignificant impact on UtiliCorp's financial operating
6 results in 2001. There can be no other way to describe an impact of less than three-tenths
7 of one percent.

8 Q. Did UtiliCorp itself provide indications that the cold winter and high gas
9 prices of the winter of 2000/2001 did not have a material impact even on its domestic
10 utility operations?

11 A. Yes. In its February 7, 2002 press release announcing its 2001 financial
12 results, UtiliCorp noted that earnings before interest and taxes (EBIT) for its domestic
13 utility operations decreased from \$219.6 million in 2000 to \$166.2 million in 2001. The
14 "key reasons" cited for this decline in the press release were:

- 15 1. The elimination of management fees paid to UtiliCorp from
16 Quanta Services, Inc.(Quanta).
- 17 2. Reduced equity earnings from Quanta stemming from a
18 downturn in the telecom sector.
- 19 3. A full-year start up costs associated with the build-out of
20 UtiliCorp's communications business in two Kansas City
21 suburbs.

22 There was no mention in this press release of any negative impact of the cold
23 2000/2001 winter and high gas prices on UtiliCorp's domestic utility operations.

1 Q. Has the Commission denied AAO requests when companies have had
2 opportunities to file a rate case to recover the costs, rather than deferring the costs?

3 A. Yes. The Commission's Report And Order in Case No. EO-2000-845,
4 St. Joseph Light and Power Company, stated:

5 However, the simple fact that an expense is extraordinary and
6 nonrecurring is not enough to justify the deferral of that expense.
7 Implicit in the Commission's previous orders regarding requests
8 for AAOs is a requirement that there must be some reason why the
9 expense to be deferred could not be immediately included for
10 recovery in a rate case. [Emphasis added.]

11 Q. Does the Staff know of any reason why MPS cannot file a rate case at this
12 time, or at the time MPS incurred its high level of bad debt expense?

13 A. No. The Staff knows of no reason why MPS and SJLP cannot file a rate
14 case in this time frame. The Staff would propose that if the costs associated with MPS's
15 and SJLP's bad debts are significant enough to justify an AAO request, then both
16 divisions of UtiliCorp should file a rate case to seek prompt recovery of these costs.

17 Q. Has MPS recently completed a rate case for its electric operations?

18 A. Yes. The Commission approved a Stipulation and Agreement among the
19 parties to Case No. ER-2001-672 in February 2002, which resulted in a rate decrease for
20 MPS's electric operations of \$4.25 million on an annual basis. On February 21, 2002,
21 UtiliCorp issued a press release stating that this rate reduction was fair both to MPS and
22 its customers.

23 Q. If the Commission wishes to continue the precedent it established in Case
24 No. EO-2000-845 of not allowing deferrals when utilities cannot justify their failure to
25 seek rate relief for the extraordinary item, what decision should it make in this
26 proceeding?

1 A. The Commission should deny MPS's AAO request.

2 SUMMARY AND CONCLUSION

3 Q. Please summarize the Staff's recommendation regarding MPS's request
4 for AAO deferral treatment in this case.

5 A. The Staff is recommending that the Commission modify its policy
6 regarding the approval of AAO deferral treatment, to incorporate the following criteria:

7 (1) The event must be extraordinary and material. The amount to be deferred
8 must be at least 5% of the utility's regulated Missouri net income for a recent
9 twelve-month period not reflecting the impact of the event.

10 (2) The utility's existing rates must be inadequate to cover the event.

11 (3) The extraordinary costs must be related to either:

12 (a) an extraordinary capital project, such as a gas service line
13 replacement program, that is required to insure the continuation of safe and
14 adequate service and that, because of unique circumstances, cannot be recovered
15 in a normal rate case filing, or

16 (b) an extraordinary event that is beyond the control of management.
17 Examples would include a major flood or ice storm.

18 (4) The utility must show sufficient reason why it cannot recover the costs
19 through the normal rate case process. Alternatively, the utility must file a rate case
20 within 90 days of the AAO approval.

21 With regard to MPS's request in this case, the Staff is recommending that the
22 AAO request be denied because MPS did not experience an extraordinary event. This

1 AAO request does not meet the criteria established by the Commission of an
2 extraordinary event.

3 Even if the Commission considers these expenses extraordinary, the costs that
4 MPS has requested to defer with the AAO are not material in relation to the net income
5 of MPS's regulated utility operations. Also, MPS has not presented the Commission with
6 any explanation of why it would not file a rate case to recover additional bad debt
7 expenses, in lieu of seeking an AAO.

8 Q. Does the Staff have any recommendations for the Commission if it
9 chooses to approve MPS's requested AAO?

10 A. Yes. If the Commission decides to approve the AAO request, the Staff
11 would recommend it impose the following conditions:

12 (1) that no ratemaking findings be included in the approval. Determination of
13 the prudence of the expenditures should be postponed until MPS's next rate case. Also, a
14 decision regarding the length of any amortization period ordered for recovery of any
15 deferral is a rate decision that ordinarily should not be made outside of a rate proceeding.

16 (2) that MPS be required to file a rate case within 90 days of the issuance of
17 the AAO. In the event such a rate case is not filed, MPS should be required to end the
18 deferral and write-off to expense any amounts deferred to that point.

19 Q. Does this conclude your rebuttal testimony?

20 A. Yes, it does.

21