

Exhibit No.:

Issues: Chapter 100,
L&P Transition Costs
And South Harper

Witness: H. Davis Rooney

Sponsoring Party: Aquila Networks-MPS
And L&P

Case No.: ER-2005-0436

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Before the Public Service Commission
of the State of Missouri

Rebuttal Testimony

of

H. Davis Rooney

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AQUILA, INC. D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NO. ER-2005-0436**

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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
REBUTTAL TESTIMONY OF H. DAVIS ROONEY
ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NO. ER-2005-0436**

1 Q. Please state your name and business address.

2 A. My name is Davis Rooney. My business address is 10750 E. 350 Highway, Raytown,
3 MO 64138.

4 Q. Are you the same Davis Rooney that has previously filed testimony in this case before the
5 Missouri Public Service Commission ("Commission")?

6 A. Yes.

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

8 A. The purpose of my testimony is to respond to the direct testimony of Commission Staff
9 ("Staff") and Office of Public Counsel ("OPC") witnesses as to the ratemaking treatment
10 of the Chapter 100 arrangement; the ratemaking treatment of certain costs associated with
11 the integration and assimilation of St. Joseph Light and Power Company ("SJLP" or
12 "L&P") into Aquila; the ratemaking treatment of certain costs associated with the
13 construction of South Harper; the ratemaking treatment related to accounting authority
14 orders; and Staff's use of two in-service criteria.

15 **RATEMAKING TREATMENT OF THE CHAPTER 100**

16 Q. What issue does this section of your testimony discuss?

1 A. This section discusses Aquila, Inc.'s ("Aquila" or "Company") rebuttal as to the
2 ratemaking treatment of the Chapter 100 arrangement. Specifically, this testimony is
3 directed at the rate base treatment of the upfront fees of \$927,000, as of June 30, 2005,
4 for the Chapter 100 and the recovery of the amortization of those fees.

5 Q. What treatment should be allowed?

6 A. Company proposed to recover the upfront fees on a 30 year amortization in the amount of
7 \$30,900 per year. To compensate the Company for such a long amortization, Company
8 also proposed that the un-amortized upfront fees be included in rate base. Because the
9 Company incurred costs to obtain cost reduction benefits for the rate payer that will
10 continue for the next 30 years, the Company should be allowed to recover all its costs,
11 including its cost of capital on the upfront fees. All of these costs were necessary to
12 achieve the savings.

13 Q. Is cost of capital a legitimate cost and component of cost of service in utility rate making?

14 A. Yes.

15 Q. What is the purpose of including cost of capital in utility cost of service?

16 A. Its purpose is to compensate the utility's investors (both debt and equity investors) for the
17 time value use of their money. This is necessary in order to allow the investors an
18 opportunity to earn a return when they supply funds that will not be repaid for a period of
19 time.

20 Q. What is the impact of disallowing recovery of Aquila's cost of capital?

21 A. The cost of capital on the up front fees will be carried by Aquila's investors for the next
22 30 years, while the benefits of the Chapter 100 will be enjoyed by the rate payer for each

1 of those same 30 years. A net present value calculation is often employed to express
2 what a stream of future payments is worth today. If Aquila is required to wait 30 years to
3 fully recover the amortization of the up front costs without any cost of capital, Aquila will
4 really only be collecting the current equivalent of about \$360,000 out of the \$927,000 it
5 spent.

6 Q. Has Aquila invested money in this Chapter 100 with the reasonable expectation that its
7 ratepayers will benefit by substantially more than the amount invested?

8 A. Yes. The expected tax abatement is \$25 million over 30 years in return for a cost of less
9 than \$1 million up front and \$7.3 million over 30 years.

10 Q. What treatment did OPC offer for these upfront costs?

11 A. OPC witness Ted Robertson recommended disallowance of the upfront costs to obtain the
12 Chapter 100. He recommended disallowance both from rate base and from cost of
13 service (Robertson Direct, Page 32, Lines 11-15).

14 Q. What treatment did Staff offer for these upfront costs?

15 A. After discussing these costs, Staff agreed to include the up-front fees in rate base as a cost
16 of the plant.

17 Q. Do the rate payers benefit from the Chapter 100 arrangement?

18 A. Yes.

19 Q. How do the rate payers benefit?

20 A. Primarily, the Chapter 100 arrangement provides a mechanism to abate property taxes on
21 the project. The reduced property taxes have been reflected in the cost of service for this
22 rate filing.

1 Q. Do OPC and Staff acknowledge that cost of service will be reduced by the Chapter 100?

2 A. Yes. OPC admits that it expects that property taxes will not be incurred on the South
3 Harper project (Robertson Direct, Page 32, Line 2). Staff has also testified that the
4 Chapter 100 will result in tax abatement (Case No. EO-2005-0156, Kiebel Rebuttal, Page
5 6, Line 4).

6 Q. How much is the tax abatement expected to be?

7 A. In Case No. EO-2005-0156 on Data Request MPSC-0013, the Company estimated that
8 more than \$25 million in property taxes would be abated over the 30-year term of the
9 Chapter 100 arrangement.

10 Q. Have any property taxes on the South Harper plant been included in any of the costs of
11 service provided by the Company, Staff, or OPC in the case?

12 A. No, although both included the PILOT payments.

13 Q. If the Chapter 100 is not approved in Case No. EO-2005-0156 what adjustment did Staff
14 propose?

15 A. Staff proposed to exclude the PILOT payments.

16 Q. What adjustment should Staff have proposed?

17 A. Staff should not merely exclude the PILOT payments, but should replace the PILOT
18 payment with an estimate of the property taxes that would occur in the absence of the
19 Chapter 100.

20 Q. How much property tax was abated in 2005 and 2006?

21 A. In Case No. EO-2005-0156 on Data Request MPSC-0013, the Company estimated that,
22 of the \$25 million in tax abatement, the property tax abated for 2005 was \$1,024,000 and

1 for 2006 was approximately \$1,649,000. The large increase is the result of the 2005 taxes
2 being based on the plant at the beginning of construction and the 2006 taxes being based
3 on the plant at the end of construction.

4 Q. What did it cost to obtain the \$25 million tax abatement?

5 A. In Case No. EO-2005-0156 on Data Request MPSC-0013, the Company communicated
6 that in order to obtain the estimated \$25 million tax abatement, it agreed to pay certain
7 upfront costs and fees (\$927,000 at 06/30/2005) to the City of Peculiar and to make
8 certain payments in lieu of taxes (PILOTs) (\$7.3 million over 30 years).

9 Q. Do you believe the tax abatement could have been obtained without these costs?

10 A. No.

11 Q. Why should all of these costs be allowed in cost of service?

12 A. These are the costs incurred to achieve savings for the rate payer. To provide 100% of
13 the savings to the ratepayer and require the Aquila investors to bear 100% of the upfront
14 cost is unfair and, in my opinion, a confiscation of Aquila's resources.

15 Q. Does Aquila benefit financially from the Chapter 100 arrangement?

16 A. No.

17 Q. Can you explain why the Chapter 100 does not benefit Aquila?

18 A. **First**, the only benefits from the Chapter 100 were the property tax abatements and the
19 potential for some sale tax abatements on a portion of the construction costs. Property
20 taxes on significant new construction are not included in existing rates. Any property
21 taxes or PILOTs incurred until allowed in rates are, in general, born by the Company
22 because of regulatory lag. Regardless of whether that cost increase is small or large, it is

1 still money out of the investor's pocket, not into the investor's pocket. Consider the
2 September PILOT payment of \$241,832. Because South Harper did not exist as of our
3 last rate case, this expense is not in current rates. Because new rates that include the next
4 PILOT will not go into effect until ordered in this case, Aquila's investors pay this cost.

5 **Second**, because a rate case was filed so close to the construction of the plant, Aquila
6 expected that any property tax increase or PILOT cost savings would immediately flow
7 through the cost based rates. Both the costs of property taxes and the benefits of the
8 property tax savings would flow to the ratepayers, not to Aquila's bottom line. Therefore
9 the impact on the Aquila investor of having, or not having, the Chapter 100 would be the
10 same – essentially zero.

11 **Third**, although often referred to as "financing", this Chapter 100 was not structured to
12 provide any outside funds. Therefore Aquila did not benefit from any kind of "low cost"
13 financing arrangement.

14 Q. Have OPC and Staff allowed the PILOTs?

15 A. Yes. Both have included the cost of the PILOTs.

16 Q. Were the PILOTs any more necessary to achieving the tax abatement than the up front
17 fees?

18 A. No. Both were required to achieve the tax abatement arrangement.

19 Q. Why does OPC object to allowing recovery of the upfront fees?

20 A. OPC believes the City of Peculiar should have paid the fees out of its share of the
21 PILOTs.

22 Q. Does OPC imply that the City is the beneficiary of the PILOTs?

1 A. Yes. (Robertson Direct, Page 32, Lines 3-4).

2 Q. Does the City of Peculiar in fact receive a share of the PILOTs?

3 A. No. The distribution of the PILOTs is governed by state statute (supplied by Aquila on
4 Data Request MPSC-0085 in Case No. EO-2005-0156). The City of Peculiar does not
5 receive a share of the PILOTs. We provided the estimated distribution of the PILOTs in
6 our response to Data Request MPSC-0083 in Case No. EO-2005-0156 which shows the
7 distribution of the PILOTs does not include the City of Peculiar tax district.

8 Q. What is your recommendation to the Commission?

9 A. Aquila negotiated with the City of Peculiar to obtain a Chapter 100 arrangement that
10 produced meaningful savings for the rate payer. The rate payers will benefit for the next
11 30 years. Aquila's shareholders receive no significant benefit from the Chapter 100. Not
12 allowing recovery of all the costs, including the cost of capital, incurred to produce these
13 savings is the same as penalizing Aquila for producing savings for the rate payer. Such a
14 penalty will discourage utilities from engaging in such cost savings actions. The
15 Commission should reject this obvious attempt by OPC to penalize Aquila's shareholders
16 for producing savings that benefit the rate payer. If the Chapter 100 is denied in Case No.
17 EO-2005-0156, the Commission should order the property taxes that would have
18 occurred to be included in rates. If the Chapter 100 is approved, the Commission should
19 authorize 1) recovery of the annual PILOT payments; 2) recovery of the amortization or
20 depreciation of the upfront fees; and 3) inclusion of the unamortized upfront fees in rate
21 base.

RATEMAKING TREATMENT OF MERGER COSTS

1
2 Q. What issue does this section of your testimony discuss?

3 A. This section discusses Aquila's rebuttal as to the ratemaking treatment of the costs to
4 achieve the St. Joseph Light and Power ("SJLP") merger.

5 Q. What treatment should be allowed?

6 A. Both Staff and Company have presented testimony in prior cases, as well as in this case,
7 that ratepayers are benefiting from the merger. The largest benefit is often referred to as
8 the joint dispatch savings. Staff's direct testimony indicates that the annual savings due
9 to joint dispatch are in excess of ** _____ ** per year (Elliott Direct, Schedule 4,
10 comparison of joint dispatch to stand-alone dispatch). Company is asking for recovery in
11 this case for \$671,030 (jurisdictional) per year for approximately the next 5 years. The
12 Commission should approve recovery in rates of the costs to achieve the merger.

13 Q. What treatment did the Office of Public Counsel ("OPC") offer for these merger costs?

14 A. OPC states that costs to achieve should be allowed if they benefit ratepayers. (Robertson
15 Direct, Page 22, Lines 1-7). Even though Aquila asked for no recovery of the premium
16 paid (in accordance with the Second Report and Order in Case No. EM-2000-292), OPC
17 reiterates its position that no portion of the premium should be recovered.

18 Q. Does OPC believe there are any benefits from the merger?

19 A. No.

20 Q. Was OPC provided with support for merger benefits?

21 A. Yes. In Data Request No. 1093, Company provided its calculation of the joint dispatch
22 savings. Company's calculation estimated the annual joint dispatch savings to be

1 approximately ** _____ ** per year. Company also referred OPC to prior
2 testimony on the merger savings.

3 Q. Are there other savings besides the joint dispatch savings?

4 A. Yes. While the prior testimony of Company witness Vern Siemek in Case No. ER-2004-
5 0034 details and quantifies several major broad categories of savings including
6 economies of scale in operating costs and savings from shared assets, I want to focus on
7 three concrete examples. These three examples are minor in comparison to all the
8 savings discussed by Mr. Siemek, but they are easy to understand. Any one of these three
9 examples produces savings that outweigh the annual costs being requested. First, the
10 executive officers were terminated. As a group they had annual salaries in excess of
11 \$800,000 per year. Second, non-officer employees terminated had annual salaries in
12 excess of \$1,500,000 per year. Third, one has only to look at the general administration
13 and support costs for SJLP to see the savings. Account 926 was excluded because a
14 change in the ratemaking treatment of pensions in our last case makes the amounts in 926
15 not comparable. Total support costs in the 900 series (excluding 926) of FERC accounts
16 were \$12.6 million in 1999 before the merger and in 2004 were \$11.4 million. This is a
17 savings of \$1.2 million. If inflation were considered, the true savings would be even
18 larger.

19 Q. How did OPC characterize these savings?

20 A. OPC attempts to dismiss the savings out of hand as "alleged" savings. OPC also claims
21 that the Company has not sufficiently identified whether the ** _____ ** of annual

1 joint dispatch savings outweigh the \$671,030 of jurisdictional annual costs Company is
2 requesting.

3 Q. How do you respond?

4 A. First, I point out that Staff has also identified in its direct testimony an ** _____ **
5 annual joint dispatch benefit in its calculation of the stand alone costs of power and the
6 joint dispatch costs of power to the regulated customers. Second, I draw attention to the
7 fact that Company's estimate of ** _____ ** in annual savings does, in fact,
8 outweigh the costs of \$671,030. Third, I would point out that OPC has taken the extreme
9 and unconventional position of flowing only the benefits, and not the costs to achieve
10 those benefits, to the ratepayers.

11 Q. What is Staff's position on recovery of these costs?

12 A. Staff in the Merger Case (Case No. EM-2000-292) and in Case No. ER-2001-672 agreed
13 that there are merger costs that deserve consideration for recovery. Even in this case Staff
14 Witness Steve Traxler has specifically identified the \$1,447,631 of costs that deserve
15 recovery (Traxler Direct, Page 12, Lines 11-22).

16 Q. What costs to achieve the merger were incurred by Aquila?

17 A. While the total costs incurred were approximately \$18 million, in this case we are seeking
18 recovery of approximately \$3,788,000. Using a 10 year amortization, this is the
19 unamortized balance at October 31, 2005, of \$7.3 million of merger costs after
20 eliminating approximately \$11 million of costs challenged by Staff in their prior reviews.

21 Q. In the course of the merger proceedings or subsequent cases, what costs did Staff
22 recommend excluding?

1 A. Staff recommended excluding transaction costs for officer severances, retentions, certain
2 SJLP supplemental executive retirement benefits, investment banker fees, transaction
3 costs incurred by SJLP and SJLP Advisory Board fees.

4 Q. Do you agree that such costs should be excluded from recovery?

5 A. No, but for purposes of this case, we have not sought recovery of these costs. The
6 transaction costs opposed by Staff total about \$11 million. These are all costs that were
7 necessary to complete the SJLP merger and create the benefits.

8 Q. How have these costs been handled in this case?

9 A. For purposes of this case, the transaction costs opposed by Staff have not been included
10 in the costs being sought for recovery. Only those types of costs not challenged by Staff
11 in its previous reviews have been included in this case.

12 Q. What Staff reaction did Company witness Vern Siemek predict in the prior case if
13 Company moved toward Staff's position?

14 A. Mr. Siemek testified that in his negotiations with Staff, each time he moved toward their
15 position, Staff moved further away in their position (Case No. ER-2004-0034, Siemek
16 Surrebuttal, Page 2, Line 14).

17 Q. Did Aquila file for recovery of costs in accordance with Staff's previous testimony?

18 A. Yes, even though Aquila believed it should be allowed recovery of the full \$18 million,
19 Aquila voluntarily adjusted its request for recoverable costs in this case to comply with
20 the position of Staff. Aquila questions the apparent position of the Staff to continually
21 change their position on recoverability in each case before the Commission.

22 Q. What has been Staff's approach in this case?

1 A. As predicted by Mr. Siemek, although we reduced our total request by the entire \$11
2 million challenged by Staff in their prior reviews, leaving about \$7.3 million, Staff has
3 taken the position in their current review that an additional \$5.3 million of the \$7.3
4 million is now unacceptable to them and should be categorized as "transaction" not
5 "transition" costs (Hyneman Direct Page 36 Line 15).

6 Q. What is Staff now challenging?

7 A. Staff now is challenging non-officer severances, system conversion costs, and the costs
8 imposed on Aquila by the various regulatory agencies to which Aquila is accountable.

9 Q. Can you give examples of these regulatory costs?

10 A. Yes.

- 11 • Securities and Exchange Commission - In order to comply with the merger
12 requirements of the SEC, Aquila was required by law or regulation to make
13 certain filings, communications, and registrations and to respond to compliance
14 investigations. The time and expenses of our lawyers and accountants to comply
15 with these laws or regulations are now being disallowed by Staff as either
16 imprudently incurred or unworthy of recovery.
- 17 • Federal Trade Commission - In order to comply with the merger requirements of
18 the FTC under the Hart-Scott-Rodino Act, Aquila was required by law or
19 regulation to pay certain fees, make certain filings, and respond to compliance
20 investigations. The time and expenses of our lawyers, economists, and
21 accountants to comply with these laws or regulations are now being disallowed by
22 Staff as either imprudently incurred or unworthy of recovery.

1 • Federal Energy Regulatory Commission - In order to comply with the merger
2 requirements of the FERC, Aquila was required by law or regulation to pay
3 certain fees, make certain filings, and respond to compliance investigations. The
4 time and expenses of our lawyers, economists, and accountants to comply with
5 these laws or regulations are now being disallowed by Staff as either imprudently
6 incurred or unworthy of recovery. These filings permitted us to joint dispatch and
7 thus produce the \$11.2 million in annual joint dispatch savings.

8 • Federal Communications Commission – In order to utilize SJLP's
9 communications licenses and operate on a common communication system,
10 certain filings and license transfers had to be made with the FCC. The time and
11 expenses of our lawyers to comply with these laws or regulations are now being
12 disallowed by Staff as either imprudently incurred or unworthy of recovery.

13 • Internal Revenue Service - In order to comply with the merger requirements
14 regarding benefit plans (pensions, 401(k), OPEBs, etc.) of primarily the IRS (but
15 also the Department of Labor and the Pension Benefit Guarantee Corporation),
16 including those relating to pensions under ERISA, Aquila was required by law or
17 regulation to make certain filings, and/or respond to compliance investigations.
18 The time and expenses of our lawyers, actuaries and accountants to comply with
19 these laws or regulations are now being disallowed by Staff as either imprudently
20 incurred or unworthy of recovery.

21 • Missouri Public Service Commission - In order to comply with the merger
22 requirements of the MPSC, as well as other state regulatory commissions with

1 approval authority over the merger, Aquila was required by law or regulation to
2 make certain filings and respond to compliance investigations. The time and
3 expenses of our lawyers, actuaries and accountants to comply with these
4 requirements are now being disallowed by Staff as either imprudently incurred or
5 unworthy of recovery.

6 Q. Do you believe the costs and benefits of complying with these laws and regulations are in
7 the public interest?

8 A. Yes and I believe each agency also believes so.

9 Q. Do you believe a regulated utility should be denied recovery of the costs of complying
10 with public regulations?

11 A. Generally no. However, in the case of a utility merger, I believe it is also in the public
12 interest for the utility to demonstrate that the merger benefits outweigh the costs.

13 Q. Do you believe the utility has shown the merger benefits outweigh the costs?

14 A. Yes. I believe we have demonstrated simply and clearly that the annual benefits, from all
15 areas including the joint dispatch benefits of up to ** _____ ** annually, far exceed
16 the \$671,030 (jurisdictional) of annual costs, requested by the Company.

17 Q. What other costs are now being objected to by Staff that were not excluded in prior
18 reviews?

19 A. Whereas previously Staff has not objected to the costs of non-officer severances, Staff has
20 now excluded all or most of the non-officer severances.

21 Q. What other costs are now being objected to by Staff that were not excluded in prior
22 reviews?

1 A. Previously Staff has not objected to system conversion costs. The costs of converting St.
2 Joseph's information systems to Aquila's information system in order to eliminate
3 duplicate systems and costs are now being excluded at least in part.

4 Q. What do you recommend to the Commission?

5 A. I recommend that the Commission accept for recovery in rates the \$671,030 of annual
6 jurisdictional amortization of costs to achieve the merger proposed by Company in this
7 case.

8 **TREATMENT OF ACCOUNTING AUTHORITY ORDERS**

9 Q. What issue does this section of your testimony discuss?

10 A. This section discusses Aquila's rebuttal as to the ratemaking treatment of the deferred
11 taxes on Accounting Authority Orders.

12 Q. What treatment has Company recommended?

13 A. Company contends it has properly reflected the tax treatment as flow through or
14 normalized, depending upon the AAO. When treated as flow through for rate making
15 there are no deferred taxes for ratemaking. Additionally, Company contends that the
16 proper treatment, when normalized, of AAO deferred costs and AAO deferred income
17 taxes is to treat them consistently. The AAO deferred income taxes liability cannot exist
18 without the AAO deferred cost asset. Either they are both included in the calculation of
19 rate base or they are both excluded from the calculation of rate base.

20 Q. What position has OPC witness Ted Robertson recommended?

21 A. Mr. Robertson has recommended an inconsistent treatment. He has recommended
22 exclusion of the deferred costs that would increase rate base and he has recommended

1 inclusion of the deferred income taxes that would decrease rate base (Robertson Direct,
2 Page 16, Lines 1-12). Regardless of whether the taxes were flowed through or
3 normalized, a deferred tax reduction of rate base is incorrect if the AAO deferred cost
4 creating the deferred tax has not also been used to increase rate base.

5 Q. What basis does Mr. Robertson allege for this treatment?

6 A. Mr. Robertson alleges that Company did not comply with the tax normalization rules
7 (Robertson Direct, Page 15, Line 6).

8 Q. What are the rules regarding tax normalization?

9 A. With respect to items subject to normalization, the Internal Revenue Service ("IRS")
10 requires that the treatment of rate base, deferred taxes, depreciation, and tax expense for
11 ratemaking purposes all be handled consistently. In fact the IRS goes so far as to define
12 inconsistent treatment in its regulations at IRC 168(i)(9)(B).

13 Q. Is the treatment proposed by the OPC consistent for ratemaking purposes?

14 A. No.

15 Q. Does the treatment proposed by the OPC follow the principles for consistent treatment
16 used by the IRS?

17 A. No.

18 Q. In simple terms what does it mean to not be consistent?

19 A. In this case it means that the utility is giving to the rate payer a benefit, the cost for which
20 the rate payer has not paid, and will not pay.

21 Q. What is the purpose of rate base?

1 A. Rate base represents the total quantum of invested capital on which the company is
2 entitled to a reasonable rate of compensation. Its purpose is to allow compensation
3 (return on) to the utility for the time value of money advanced for utility service.

4 Q. What is the purpose of deferred taxes in rate base?

5 A. The purpose of deferred taxes in rate base is to recognize that the total cash advanced by
6 the utility investor for utility service may be reduced by its tax treatment. When
7 normalized, the rate payer should only pay return on the net cash advanced by the utility.

8 Q. In the case of a deferred cost AAO excluded from rate base, does the rate payer pay for
9 any return on the cash advanced by the utility investor?

10 A. No.

11 Q. Has the rate payer provided funds to the utility in advance of their use for this
12 expenditure?

13 A. No.

14 Q. Is the rate payer entitled to a return on funds it has not advanced or a rate-base offset to an
15 item not included in rate base?

16 A. No.

17 Q. What is the effect of providing an offset where no rate base has been allowed?

18 A. The utility is denied recovery of the cost deferred under the AAO.

19 Q. Why is this so?

20 A. While the utility will collect the amount of the AAO, through the negative rate base
21 created by the inconsistent treatment of deferred taxes, it will simultaneously refund to
22 the rate payer a portion of the AAO that it is collecting. Net, the utility will collect less

1 than the amount it was authorized to defer. This is readily apparent by considering a
2 utility that that has only a single AAO asset with associated deferred taxes. Under OPC's
3 inconsistent recommendation, rate base is negative, resulting in a rate reduction (refund)
4 for the ratepayer. Operating expense is equal to the amortization of the AAO. Added
5 together, the revenue requirement is less than the amortization. Therefore, the utility will
6 never collect through rates the full amount of the AAO deferred. In order to collect the
7 full amount it was authorized to defer, both the deferred amount and the deferred tax
8 amount must be consistently treated as either both in or both out of rate base.

9 Q. What is your recommendation to the Commission?

10 A. The Commission should permit the utility to recover the full amount of the AAOs it has
11 authorized the utility to defer. The utility is already bearing the carrying costs of the
12 AAO, reducing its ability to achieve its authorized return. The Commission should not
13 further deny the utility recovery of the full AAO through an inconsistent tax treatment
14 that unfairly penalizes the utility.

15 **RATEMAKING TREATMENT OF SOUTH HARPER COSTS**

16 Q. What issue does this section of your testimony discuss?

17 A. This section discusses Aquila's rebuttal as to the ratemaking treatment of certain costs
18 deemed imprudent by Staff and OPC.

19 Q. What treatment has Company recommended?

20 A. Company believes all its costs have been prudently incurred and should be allowed full
21 recovery.

22 Q. What costs have been excluded by OPC?

1 A OPC excluded a number of general construction and transmission construction costs
2 (Robertson Direct Schedule B-2). These costs are presented in greater detail on Schedule
3 HDR-1.

4 Q. Why have these costs been excluded?

5 A. OPC testimony provides no justification. To support his disallowances, Mr. Robertson
6 says only that these are "other costs OPC recommends be disallowed" (Robertson Direct
7 Page 29 Line 13). Frankly, I am at loss as to why OPC would exclude most of these
8 costs. Payments for crop (property) damage when accessing easements are a normal cost
9 of construction. I cannot understand why the cost of consulting engineers to ensure the
10 safety of employees and contractors assigned to a construction program would be
11 considered imprudent. Because Aquila took the role of general contractor in the
12 construction, it incurred legal fees to develop sound and clear contracts with the
13 subcontractors. The costs for construction permits, engineering and welding inspections
14 could only have been excluded as the result of a wholly random process undertaken to
15 achieve a preconceived result. As yet another example, OPC has excluded warehouse
16 costs incurred after the turbines were transferred to the regulated division in November
17 2004. OPC participated in the case to approve their transfer as of November 2004. The
18 turbines needed to be stored and that storage comes at a cost. All of these costs are
19 reasonable costs of construction.

20 Q. Could any of the engineering costs be considered turbine rehabilitation?

21 A. Yes.

1 Q. Where rehabilitation costs a consideration when determining the turbine transfer price in
2 Case No. EO-2005-0156?

3 A. Yes. The appraisal by R. W. Beck gave consideration to rehabilitation costs. OPC also
4 gave consideration to rehabilitation costs in their rebuttal testimony (Robertson Rebuttal,
5 P 55). Ultimately the proposed value in the stipulation was approximately \$4 million less
6 than the value proposed by Company's appraiser.

7 Q. Please describe the berm costs excluded by OPC.

8 A. I reviewed the change orders referenced by OPC. I also discussed the purpose of the
9 change orders with the engineers who worked on the project. First, it should be pointed
10 out that the original construction plans called for using the excavation dirt from the
11 project to build berms. The purpose of the berms is to cost effectively dispose of
12 excavation dirt and provide landscaping to reduce the intrusiveness of the plant. These
13 change orders were evaluated and authorized in early April 2005, in the midst of
14 construction. Second, the excavation work on the site produced more dirt than originally
15 planned. This additional dirt needed either to be removed from the site or used on site.
16 The engineers estimate that the cost of loading, hauling, and dumping the dirt to another
17 location offsite would have been as much as loading, hauling and dumping the dirt to
18 another location on the construction site. Third, at that point in time, it had become clear
19 that the berm, as contracted and constructed, did not live up to the conceptual design
20 presented to the public. Rather than incur the cost of removing the dirt from the site and
21 achieve no further benefit, the Company utilized the dirt on the site to improve the berms.
22 Fourth, to protect these berms from erosion, erosion blankets and grass seeding were

1 installed. Finally, trees were planted on the berm. This cost should be allowed as it is a
2 normal and reasonable and prudently incurred cost of construction.

3 Q. Are the legal and appraisal costs for the CPCN filing and the Affiliate Transaction
4 Compliance Filing also reasonable costs to include?

5 A. Yes. A portion of the legal cost was for the CPCN filing (Case No. EA-2005-0248). The
6 CPCN case was a reasonable response to clarify the CPCN status and comply with the
7 initial district court ruling requiring a CPCN ruling from the Commission. The
8 Commission, in fact, supported Aquila's position regarding the CPCN. In essence,
9 Aquila was properly defending the validity of its CPCN and the regulatory authority of
10 the Commission against a legal challenge. Therefore it should be allowed. A portion of
11 the legal cost and the appraisal costs was for the affiliate transaction filing (Case No. EO-
12 2005-0156). Aquila should also be allowed to recover its cost of compliance with the
13 rules of the Missouri Public Service Commission regarding affiliate transactions. It
14 should be noted that if Aquila had not filed for a separate review of this affiliate
15 transaction, the review would have occurred in the context of Aquila's current rate case.
16 Aquila would likely have incurred these same costs defending the affiliate transaction
17 within the context of its rate proceeding. A portion of Case No. EO-2005-0156 related to
18 approval of a Chapter 100 arrangement intended to lower costs and rates to Aquila's rate
19 payers. These are costs incurred to produce benefits for the rate payer and therefore
20 should be allowed.

21 Q. Are the legal costs for the Cass County v. Aquila case reasonable to include?

1 A. Yes. These costs are the result of defending further challenges to the validity of
2 Company's CPCN. The validity of the CPCN was supported by the Commission in Case
3 No. EA-2005-0248. The FERC plant instructions for components of construction costs
4 specifically allow for "Law expenditures" for court and legal costs directly related to
5 construction. These costs should not be excluded merely because they are legal expenses.

6 Q. Are the Chapter 100 Pilot Payments a reasonable cost of construction?

7 A. The first payment in the amount of \$214,455 was specifically designed to be paid in lieu
8 of taxes on the construction work in progress and therefore should be permitted. The
9 other \$214,456 disallowed by OPC represents accrual entries that were reversed in July
10 and will be picked up in the true-up period.

11 Q. Did OPC and Staff make any other adjustments to the South Harper construction costs?

12 A. Yes. Both Staff and OPC adjusted AFUDC. OPC developed its own AFUDC rate using
13 a methodology not in compliance with FERC rules. Staff made revisions to reflect an in-
14 service date that is before Staff's in service criteria was met. Additionally, OPC's
15 adjustments to AFUDC do not reflect certain adjustments made by Company.

16 Q. What is Company's position on these AFUDC adjustments?

17 A. Company believes OPC's rate should be rejected as it is not developed in accordance
18 with FERC guidelines and methodology and does not reflect all AFUDC entries made by
19 Aquila. Company believes AFUDC is appropriately recorded through the in-service date
20 specified by Staff's in-service criteria. The issue of Staff's in-service criteria is further
21 addressed later in my testimony.

22 Q. Are there any other South Harper adjustments Company is rebutting?

1 A. Yes. Company believes Staff has made errors in its AFUDC exclusions.

2 Q. Can you describe these errors?

3 A. Yes. Staff witness Mr. Williams deducted certain amounts presented in Schedule 3
4 attached to his direct testimony. We believe Staff has excluded certain costs it did not
5 intend to exclude. We also believe Staff's calculations incorrectly assume all
6 construction is in-service as of their proposed in-service date for the turbine generators.

7 Q. Can you describe the cost exclusions Company believes are in error?

8 A. Yes. In response to a data request, Company provided a schedule with certain cost
9 summarizations. One of the summarized costs was labeled "AFUDC/Loading". Staff
10 excluded all of the costs on this line in its efforts to exclude AFUDC after their proposed
11 in-service date. We believe that Staff did not realize that the line included other loadings
12 and costs besides AFUDC. As a result, we believe Staff has excluded several hundred
13 thousand dollars more than it intended. Among the other costs, it has excluded
14 approximately \$405,000 of test gas burned during June.

15 Q. Can you describe the construction that is not in-service as of Staff's proposed in-service
16 date?

17 A. Yes. Among other projects, the transmission line connecting the Belton South substation
18 to the north 345 kV substation could not be completed until after the summer. The final
19 connections could not be made until the summer loads were reduced. Additionally, the
20 service buildings and much of the control equipment were not in-service until August,
21 after the occupancy permits were granted. For these projects, AFUDC should continue to
22 accrue, as Company has properly done, until their in-service dates are achieved.

1 Q. What is your recommendation to the Commission?

2 A. Company has only included reasonable and prudent costs in the construction costs for the
3 South Harper plant. Company has appropriately capitalized AFUDC through the in-
4 service date. Staff and OPC's proposals exclude many costs that are clearly prudent or
5 have been excluded in error. Company recommends that the Commission reject these
6 exclusions.

7 **STAFF'S IN-SERVICE CRITERIA**

8 Q. What issue does this section of your testimony discuss?

9 A. This section discusses Aquila's rebuttal as to Staff's use of two different methodologies
10 to determine the one in-service date of combustion turbines.

11 Q. Why is does Company oppose the use of two different methodologies?

12 A. Company believes that the use of two methodologies arbitrarily increases regulatory lag,
13 without establishing a single meaningful in-service date.

14 Q. How does the use of two methodologies increase regulatory lag?

15 A. By making one method easy to meet and the other method relatively harder to meet,
16 Company must allow greater lead time in filing for rate cases. This is to be sure that the
17 harder criteria can be met before the cut off of the known and measurable period. This
18 forces the easier criteria to also be moved forward. Since the accounting Staff of the
19 Commission argues that the easier criteria should be used for cutting off AFUDC and
20 starting depreciation, they force an increase in regulatory lag.

21 Q. What are the two methodologies?

- 1 A. Staff's engineering department has developed and issued to Aquila in-service criteria.
2 Under this criteria, the equipment can not be declared in-service (or used and useful) until
3 all criteria are achieved. In contrast, Staff's accounting department has, in this case,
4 advanced criteria that declare each unit in-service from virtually the first date it generates
5 electricity.
- 6 Q. What day did South Harper Unit #1 first deliver test power onto the grid?
- 7 A. July 11, 2005 at 12:00 noon.
- 8 Q. What day is Mr. Featherstone recommending for the in-service date of South Harper Unit
9 #1?
- 10 A. July 11, 2005.
- 11 Q. Can these turbine/generators generate electricity for testing under load without being
12 connected to and delivering to the grid?
- 13 A. No.
- 14 Q. What does "in-service" mean?
- 15 A. In-service means it is no longer considered Construction Work in Progress. In the FERC
16 chart of accounts, there is Account 107 – Construction Work in Progress; Account 106 –
17 Completed Construction Not Classified; and Account 101 – Electric Plant in Service. For
18 all practical purposes, Account 106 and Account 101 are the same thing. They differ only
19 in that for Account 106 the accounting details on how to record in Account 101 have not
20 been finalized.
- 21 Q. What determines when construction is completed?

1 A. The field construction engineers are responsible for communicating to the accounting
2 department the in-service date. They are responsible for determining that all appropriate
3 performance criteria have been met and that no further significant construction or testing
4 remains that could interfere with its ability to be used for utility service.

5 Q. Did your engineers (Sega) advise the Company of when the engineering Staff's criteria
6 had been met?

7 A. Yes. Sega issued a report on October 17, 2005 that the in service criteria had been met on
8 August 12, 2005.

9 Q. Does the mere fact that electricity is being generated for sale qualify the plant as in-
10 service?

11 A. No. According to FERC Electric Plant Instruction 3 – Components of Construction Cost,
12 one of the components of construction cost is "earnings and expenses during
13 construction". This is defined as:

14 (a)....Where the power generated by a plant under construction is delivered to the
15 utility's electric system for distribution and sale, or is delivered to an associated
16 company, or is delivered to and used by the utility for purposed other than
17 distribution and sale (for manufacturing or industrial use, for example), the credit
18 shall be the fair value of the energy so delivered.....(b) The expenses shall consist
19 of the cost of operating the power plant, and other costs incident to the production
20 and delivery of the power for which construction is credited under paragraph (a),
21 above...(FERC Electric Plant Instruction 3A(18))
22

23 It is clear that delivering electricity for sale is not the sole criterion for in-service.

24 Q. Has Aquila capitalized earnings and expenses?

25 A. Yes. Between accounting Staff's in-service date and engineering Staff's in-service date,
26 Company capitalized net earnings, reducing capitalized construction costs by \$451,511.

27 Q. What in-service criteria did Aquila's engineers use?

1 A. Aquila complied with the criteria published by the engineering division of the Staff of the
2 Missouri Public Service Commission. Compliance with the criteria provided by Staff
3 was documented by our engineers in a report we received on October 17, 2005. This
4 report states in part:

5 Demonstration of compliance with each of the above criteria occurred over a
6 period of time from approximately June 17, 2005, the date upon which Unit 3
7 accomplished first fire, through and including August 12, 2005. On this later
8 date, Unit 3 completed its Capacity Factor Testing and Noise Compliance Testing
9 on the plant site. Therefore, the technical in-service date for the South Harper
10 Peaking Facility is presumed to be August 12, 2005. (Sega In-Service Status
11 Report Page 1.3)
12

13 Q. What is the purpose of Staff's in-service criteria?

14 A. It is my understanding that this criterion was established to ensure that all appropriate
15 performance criteria have been met and that no further significant construction or testing
16 remains that could interfere with the plants ability to be dedicated to and used for reliable
17 utility service. This is necessary to comply with state statute.

18 Q. What if the plant failed one or more of the engineering Staff's in-service criteria?

19 A. First and foremost, it could indicate that all major construction is not complete and the
20 plant is not truly ready for service. Secondly, Staff has made it clear that failure to meet
21 their criteria means that the plant cannot be considered in-service rate base (used and
22 useful) for rate-making purposes.

23 Q. Has the accounting Staff of the Commission developed and issued its criteria for in-
24 service?

25 A. No.

26 Q. What in-service criteria have the accounting Staff advanced in this case?

1 A. Staff claims that the in-service date is the Provisional Acceptance date as defined in the
2 Siemens Westinghouse Equipment Supply Agreement (Featherstone Direct, Page 52,
3 Lines 11-12).

4 Q. What is Provisional Acceptance?

5 A. Provisional Acceptance is declared when Siemens Westinghouse, during a contractually
6 defined performance test, met its performance obligations to demonstrate that the
7 equipment could produce 95% or more of the guaranteed net power at 105% or less of the
8 guaranteed heat rate, as defined in the terms of the Equipment Supply Agreement. On the
9 Provisional Acceptance Date, the equipment was deemed capable of generating electricity
10 and possession and control of the unit was transferred from Siemens Westinghouse to
11 Aquila.

12 Q. What does Staff conclude regarding Provisional Acceptance?

13 A. Staff dedicates much of their testimony attempting to equate in-service with the mere
14 ability to generate electricity for sale (they use the terms "commercial" and
15 "commercially in-service").

16 Q. Does the ability to generate electricity for sale at Provisional Acceptance mean that a
17 plant is in-service?

18 A. No. As noted above in FERC Electric Plant Instruction 3, the ability to generate
19 electricity for sale does not mean the plant is "in-service". The engineering Staff also
20 requires much more proof of in-service than the mere ability to generate power for sale.
21 Even Mr. Featherstone acknowledges that "the generating units must meet the in-service
22 criteria to be considered to meet the used and useful test" (Featherstone Direct, Page 53,

1 Line 2). This confirms that plant that does not qualify as in-service (that is, Construction
2 Work in Progress) cannot be used and useful.

3 Q. Is Provisional Acceptance the same as Final Acceptance?

4 A. No. Final Acceptance requires 100% of the performance guarantees to be met, as does
5 the Staff's engineering in-service criteria.

6 Q. When did final Acceptance occur?

7 A. Final Acceptance occurred on August 12th, after the testing required by the Department of
8 Natural Resources showed that 100% of the emissions guarantees had been met.

9 Q. Does final acceptance necessarily mean that the equipment is in-service?

10 A. No. There were noise requirements beyond those specified in the Siemens Westinghouse
11 contract that also had to be met.

12 Q. When were the noise requirements met?

13 A. Measurements were taken on August 10-12, 2005. Additional measurements were later
14 taken on August 18-19, 2005. The noise study results were not official until the final
15 report was issued on October 17, 2005; however, the noise requirements were also met on
16 August 12th. Although the report concluded that the equipment noise guarantees and the
17 Cass County Noise Ordinance had been met, the report did note an opportunity to
18 investigate additional noise attenuation.

19 Q. Can you summarize Mr. Featherstone's definition of in-service?

20 A. Yes. Mr. Featherstone believes that if a plant can generate electricity for sale, it should
21 be considered in-service, even if it has not demonstrated that it can pass the tests
22 necessary to conclude that all substantial construction is complete.

1 Q. Is this definition in use by any regulatory agency?

2 A. Yes. I believe Mr. Featherstone's definition of "commercial" is similar to one used by
3 the Environmental Protection Agency ("EPA"). I believe the EPA declares a unit
4 "commercial" when it first delivers power, including test power, to the grid.

5 Q. Is the EPA's definition appropriate for use in determining in-service for accounting
6 purposes under the FERC accounting rules adopted by the Missouri Commission?

7 A. No. FERC has its own rules which do not use "commercial" as the criteria for in-service.

8 Q. What terms does FERC use to describe "in-service"?

9 A. The instruction for Account 106 – Completed Construction not Classified states "...this
10 account shall includeelectric plant which has been completed and placed in service..."

11 Q. What is the difference between "completed and placed in service" and the term "fully
12 operational and used for service" as used in Section 393.135 of the Missouri Revised
13 Statutes.

14 A. I am not aware of a difference.

15 Q. What other terms does FERC use to describe "in-service"?

16 A. The instruction for Account 107 – Construction Work in Progress states "...expenditures
17 which are common to and which will be used in the operation of the project as a whole
18 shall be included in electric plant in service upon the completion and the readiness for
19 service of the first unit."

20 Q. What is the difference between "upon completion and the readiness for service" and the
21 term "fully operational and used for service"?

22 A. I am not aware of a difference.

1 Q. What is your recommendation to the Commission?

2 A. The Company has followed the in-service criteria developed and published and provided
3 in advance to Aquila by the engineering department of Staff. It was the in-service criteria
4 provided to us and followed in good faith. Company's engineer on this project has issued
5 a report documenting the date on which the in-service criteria was met. Accounting Staff
6 provided no advance criteria. In-service is an engineering not accounting determination.
7 The in-service date should be the date that complies with engineering Staff's in-service
8 criteria.

9 Q. Does this conclude your testimony?

10 A. Yes.

Listing of OPC General Construction and Transmission Construction Exclusion

Entire Schedule is HC

Schedule HDR-1

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Aquila, Inc. d/b/a Aquila)
Networks-MPS and Aquila Networks-L&P,)
for authority to file tariffs increasing electric)
rates for the service provided to customers in)
the Aquila Networks-MPS and Aquila)
Networks-L&P area)

Case No. ER-2005-0436

County of Jackson)
) ss
State of Missouri)

AFFIDAVIT OF H. DAVIS ROONEY

H. Davis Rooney, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Rebuttal Testimony of H. Davis Rooney;" that said testimony was prepared by him and under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.

H. Davis Rooney
H. Davis Rooney

Subscribed and sworn to before me this 16th day of November, 2005.

Terry D. Lutes
Notary Public
Terry D. Lutes

My Commission expires:

8-20-2008



TERRY D. LUTES
Jackson County
My Commission Expires
August 20, 2008