Exhibit No.:
Issues: *Revenues; Uncollectible (Bad Debt) Expense*
Witness: *Amanda C. McMellen*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Surrebuttal Testimony*
Case Nos.: *ER-2004-0034 and HR-2004-0024 (Consolidated)*
Date Testimony Prepared: *February 13, 2004*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

FILED

APR 2 8 2004

SURREBUTTAL TESTIMONY

OF

AMANDA C. MCMELLEN

AQUILA, INC. d/b/a AQUILA NETWORKS-MPS (Electric)

AND AQUILA NETWORKS-L&P (Electric and Steam)

CASE NOS. ER-2004-0034 AND ER-2004-0024

Jefferson City, Missouri
February 2004

Exhibit No. 27
Case No(s). ER-2004-0034
Date 2/23/04 Rptr XF

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT OF AMANDA C. MCMELLEN

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Amanda C. McMellen, of lawful age, on her oath states: that she has participated in the preparation of the following surrebuttal testimony in question and answer form, consisting of 9 pages to be presented in the above case; that the answers in the following surrebuttal testimony were given by her; that she has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of her knowledge and belief.

Amanda C McMellen
Amanda C. McMellen

Subscribed and sworn to before me this 11th day of February 2004.

Toni M Charlton

TONI M. CHARLTON
NOTARY SEAL
NOTARY PUBLIC
STATE OF MISSOURI

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

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

(Consolidated)

Q. Please state your name and business address.

A. Amanda C. McMellen, 200 Madison Street, Suite 440, Jefferson City, MO 65102.

Q. Are you the same Amanda C. McMellen that previously filed direct and rebuttal testimony in this case?

A. Yes, I am.

Q. What is the purpose of this testimony?

A. I will address certain aspects of the Aquila Networks-MPS (MPS) and Aquila Networks-L&P (L&P), divisions of Aquila, Inc. (Aquila or Company) rebuttal filing regarding electric revenues for MPS and uncollectible (bad debts) expense for both MPS and L&P.

REVENUES

Q. Did Aquila address the issue of revenues in its rebuttal testimony?

A. Yes. Aquila witness Eric L. Watkins, on pages 2 and 3 of his rebuttal testimony, criticizes the method used by the Staff to adjust rate codes MO710 and MO711 and presents a new method the Company proposes to use to calculate the Company's adjustments to these rate codes.

Q. Why are the adjustments to rate codes MO710 and MO711 an issue?

A. Rate codes MO710 and MO711 are small commercial customers. MO710 includes those customers who do not have demand meters while MO711 includes the customers who do have demand meters. Customers are switched from MO710 to MO711 when demand meters are installed. When the two rate codes are analyzed individually, each rate code's growth calculation is misleading because these customers are likely to have an average usage that is higher than the average usage of MO710, but lower than the average usage of MO711. The Staff chose to combine these rate codes to get a more accurate result.

Q. What is the method Aquila used to calculate the adjustments to rate codes MO710 and MO711, that is described in Mr. Watkins' rebuttal testimony on pages 2 and 3?

A. The Company proposes to use the kWh usage and revenue per customer per month from rate code MO710 to calculate growth for both MO710 and MO711. In other words, Aquila assumed that the average usage per customer for rate code MO710 is the same for all new customers in rate code MO711. Then, Aquila added the results of the two growth calculations for MO710 and MO711 together for the total Company adjustment of $1,059,073.

Q. Does the Staff have concerns with Aquila's method?

A. Yes. First, use of the kWh usage and revenue from MO710 for new customers and for the customers switching to MO711 from MO710 certainly understates revenues. There was no information provided to the Staff to justify an assumption that the customers that switched from MO710 to MO711 would have the exact same normalized usage and revenues as the average customer in MO710. The actual usage for customers in the MO711 rate code was ignored in the calculation proposed by Mr. Watkins. Also, a significant number of new customers in MO711 were added in the period analyzed (test year ending December 31, 2002 and update period through September 30, 2003) that were not customers switching from MO710. Even if all the customers that left MO710 did switch to MO711, there is still customer growth of around 1,500 customers in MO711.

Q. Does the Company have concerns with the Staff's method?

A. Yes. In Mr. Watkins' rebuttal testimony on page 2, he states:

> If the actual average kWh usage and revenue are used for the customers that are switching to Mo711 is dramatically different than the average kWh usage computed with Ms. McMellen's approach, then revenues will be overstated or understated.

Q. How do you respond?

A. Mr. Watkins' criticism applies equally to both the method the Staff used and the method the Company used to annualize growth for these rate codes. If the combination of the MO710 and MO711 kWh usage and revenue are different than the actual average, then the Staff's revenues will be overstated or understated. However, the Company's method of using the average kWh usage and revenue from MO710 to calculate growth for MO711 is definitely more likely to understate revenues because the actual average should be more than the MO710 average but less than the MO711 average. By considering the actual usage per customer for both rate codes, the Staff's method is based upon more factual data than Mr. Watkins' method, which ignores all usage data for rate code MO711.

Q. Why wasn't the actual average used for the customers that switched from MO710 to MO711?

A. The actual average for the customers that switched is unknown at this time. If the actual average was known, the Staff would have used it in this case. In order to calculate the actual average, the Staff needed all the monthly data (customer, usage, revenue, etc.) for each customer that switched. Although this information has been provided recently, there has not been enough time to do an analysis for purposes of this testimony filing. The Staff reserves the right to alter this adjustment if the new information warrants a change.

Q. What is the Staff's recommendation?

A. The Staff believes combining rate codes MO710 and MO711 is still the most accurate method available at this time because it reflects all the customers in both rate codes.

UNCOLLECTIBLE (BAD DEBT) EXPENSE

Q. Did Aquila address the issue of uncollectible (bad debt) expense in its rebuttal testimony?

A. Yes. Aquila witness Dennis R. Williams, in his rebuttal testimony, critiques the method the Staff used to calculate the Company's adjustments to uncollectible (bad debt) expense for MPS and L&P.

Q. What was the Staff's method?

A. The Staff used a three-year and nine-month average for MPS and a five-year and nine-month average for L&P of actual net write-off rates, multiplied by the Staff's normalized revenue, to calculate bad debt expense.

Q. What is Aquila's concern with the Staff's method?

A. In Mr. Williams' rebuttal testimony on page 21, he states:

> By including only the first 9 months in 2003 in the average uncollectible rate calculation, Staff has arbitrarily excluded the Company's net write-offs recorded during the fourth quarter of 2003. Historically, in the past two years, fourth quarter net write-offs have been higher than the first three quarters. The exclusion of fourth quarter write-offs results in an understatement of the total net write-offs for 2003 by approximately 50 percent for both MPS and L&P. As such, it is not reasonable to disregard fourth quarter net write-offs because this will significantly skew the average uncollectible rate.

Q. How do you respond?

A. The Staff has decided to update the uncollectible (bad debt) expense adjustment. Now the Staff is using the most current three-year period of October 2000 through September 2003 for MPS and the most current five-year period of October 1998 through September 2003 for L&P. By updating the averages to include the most current three- and five-year periods, the Staff has addressed the Company's concern of the exclusion of fourth quarter net write-offs, without going outside the test year update period. There are now three full years (MPS) and five full years (L&P) of data for bad debts expense reflected in the Staff's adjustment. The Company proposed using the period of September 30, 2003 as the test year update period in this case and the Commission ordered such a period. Also, the data used by Mr. Williams for the last three months of 2003 is just the net write-offs, which is only one piece of the puzzle. The net write-offs should be compared to revenues to calculate the average effective uncollectible rate used to make the adjustment to uncollectible (bad debt) expense.

Q. Does the Staff plan to update its adjustment through to December 31, 2003?

A. No. December 31, 2003 falls outside of the Commission ordered test year and update period, January 1, 2002 through September 30, 2003. Updating just the uncollectible (bad debt) expense should be considered an isolated "out of period" adjustment.

Q. Why are isolated "out of period" adjustments not appropriate for inclusion in rates?

A. An isolated "out of period" adjustment violates the principles established in the Suspension Order and Notice issued July 22, 2003. The Commission on page 2 stated:

> The Company's proposal should also specify a complete list of accounts or items of expense, revenues, and rate base designed to

> prevent any mismatch in those areas. The Commission will not consider a true-up of isolated adjustments, but will examine only a "package" of adjustments designed to maintain the proper revenue-expense-rate base match at a proper pointing in time. [See In re Kansas City Power & Light Company, 26 Mo. P.S.C. (N.S.) 104, 110 (1983)]

Q. Did any party recommend a true-up in this case?

A. No. No party to this case, including the Company, requested a true-up.

Q. Who recommended the update period of September 30, 2003?

A. The Company recommended the update period of September 30, 2003, as explained in the Order Concerning Test Year and True-up, Resetting Evidentiary Hearings, Adopting Procedural Schedule, and Concerning Local Public Hearings, dated October 12, 2003, as follows:

> Aquila filed its test year recommendation as directed on August 5, and proposed the 12 months ending December 31, 2002. Aquila also recommended that that [sic] test year be updated for known and measurable changes through September 30, 2003.

Q. Why is there an established test year and update period?

A. Test year and update periods are established to provide a period of time for review and analysis of the utility's operations to determine the reasonableness and appropriateness of the rate filing. The test year forms the basis for any adjustments necessary to remove abnormalities that have occurred during the period and to reflect any increase or decrease to the accounts of the utility. Adjustments are made to the test year level of revenues, expenses and investment to determine the proper level of investment on which the utility is allowed to earn a return. After the recommended rate of return is determined for the utility, a review of existing rates is made to determine if any additional revenues are necessary. If the utility's earnings are deficient, rates need to be increased. In some cases, existing rates generate earnings in excess of authorized levels, which may indicate the need for rate reductions. The test year and update period are vehicles used to evaluate and determine the proper relationship between revenue, expense and investment. The relationship is essential to determine the appropriate level of earnings for the utility.

Q. What is an update period?

A. The use of a test year update period allows test year data to remain current through the update period for changes in material items that are known and measurable. Such items could include plant additions and retirements, payroll increases and changes in employee levels, customer growth, changes in fuel prices, etc. All elements that make up the revenue requirement are considered and the result may be an increase or decrease from previous levels. Test year amounts are adjusted to enable the parties to make rate recommendations on the basis of the most recent auditable information available.

Q. Has the Company's position been consistent for uncollectible (bad debt) expense for L&P in this case?

A. No. Although Aquila's position for uncollectibles for MPS is the same as it filed in direct testimony, the Company has changed its position on L&P bad debts. The Company is no longer using a five-year average, as stated in Mr. Williams' rebuttal testimony on page 20, and is now using a three-year average in its updated case for L&P.

Q. What rationale had Mr. Williams provided for the change in position?

A. Mr. Williams has not provided any rationale for the Company's change in position.

Q. What is your view regarding the Company's change in position?

A. The Staff believes the Company changed its position on L&P bad debts to use the highest effective uncollectible rate. By using a three-year average, the years 1998 and

1999 are eliminated from the five-year average. The uncollectibles for these two years are more in line with the September 30, 2003 update period, which the Staff believes is the most accurate representation of an ongoing level of expense, without going outside of the update period used for this case.

Q. Has the Company maintained consistency in its use of the update period ordered by the Commission?

A. Unfortunately, no. The September 30, 2003 update period the Company suggested and adopted by the Commission has not been adhered to by Aquila. The Company has requested consideration in rates for the following items that will occur outside the test year and update period of September 30, 2003:

- An April 1, 2004 payroll increase (see testimony of Staff witness Dana Eaves)
- A small increase in coal prices occurring on January 1, 2004 (see testimony of Staff witness Graham Vesely)
- An increase in property taxes for plant additions that won't be paid until December 31, 2004 (see testimony of Staff witness Trisha Miller)
- An increase in jurisdictional allocations for the loss of the city Odessa from wholesale customers in March or April 2004 (see testimony of Staff witness Alan Bax)

The Company has not made any effort to stay within the period of time to set rates that it originally requested from the Commission.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.