Exhibit No.:	650
Issues:	Capacity Expense; Off-System Sales Margins
Witness:	Kevin C. Higgins
Sponsoring Party:	The Commercial Group
Type of Exhibit:	Direct Testimony
Case No.:	ER-2007-0004
Date Testimony Prepared:	January 18, 2007

BEFORE
THE MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. ER-2007-0004

Direct Testimony of Kevin C. Higgins

on behalf of

The Commercial Group

January 18, 2007

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DIRECT TESTIMONY OF KEVIN C. HIGGINS

<u>Introduction</u>

Q. Please state your name and business address.

A. Kevin C. Higgins, 215 South State Street, Suite 200, Salt Lake City, Utah, 84111.

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

A. I am a Principal in the firm of Energy Strategies, LLC. Energy Strategies is a private consulting firm specializing in economic and policy analysis applicable to energy production, transportation, and consumption.

Q. On whose behalf are you testifying in this proceeding?

A. My testimony is being sponsored by The Commercial Group. The Commercial Group is comprised of the Missouri locations of Lowe's Home Centers, Inc.; Wal-Mart Stores East LP; and J.C. Penney Corporation, Inc. Collectively, the members of The Commercial Group purchase more than 98 million kWh annually from the Aquila Networks ("Aquila") service territories in Missouri, primarily on the Large General Service and Large Power Service rate schedules. Approximately 80 percent of The Commercial Group's load is in the Missouri Public Service ("MPS") division and the balance is in the St. Joseph Light & Power ("L&P) division.

Q. Please describe your professional experience and qualifications.

A. My academic background is in economics, and I have completed all coursework and field examinations toward a Ph.D. in Economics at the University of Utah. In addition, I have served on the adjunct faculties of both the University of Utah and Westminster College, where I taught undergraduate and graduate courses in economics. I joined Energy Strategies in 1995, where I assist private and public sector clients in the areas of energy-related economic and policy analysis, including evaluation of electric and gas utility rate matters.

Prior to joining Energy Strategies, I held policy positions in state and local government. From 1983 to 1990, I was economist, then assistant director, for the Utah Energy Office, where I helped develop and implement state energy policy. From 1991 to 1994, I was chief of staff to the chairman of the Salt Lake County Commission, where I was responsible for development and implementation of a broad spectrum of public policy at the local government level.

Q. Have you previously filed testimony before this Commission?

A. Yes. I filed testimony in the AmerenUE general rate proceeding, Case No. ER-2007-0002.

Q. Have you testified previously before any other state utility regulatory commissions?

A. Yes. I have testified in over sixty proceedings on the subjects of utility rates and regulatory policy before state utility regulators in Alaska, Arizona, Colorado, Georgia, Idaho, Illinois, Indiana, Kansas, Kentucky, Michigan, Minnesota, Nevada, New York, Ohio, Oregon, Pennsylvania, South Carolina, Utah, Virginia, Washington, West Virginia, and Wyoming.

A more detailed description of my qualifications is contained in Attachment "A" to this testimony.

Overview and Conclusions

Q. What is the purpose of your testimony in this phase of the proceeding?

A. My testimony addresses: (1) The appropriate treatment of purchased capacity expense in the Aquila Networks – MPS ("MPS") territory and (2) the appropriate treatment of off-system sales margins.

As part of my testimony, I offer recommendations to the Commission on these issues in support of a just and reasonable outcome.

Q. Do you have any initial comments on the presentation of your direct testimony in this proceeding?

A. Yes. Aquila filed its direct case in this proceeding on July 3, 2006, and based its revenue requirement on a 2005 test period. As part of its filing, the Company made adjustments for known and measurable events through June 30, 2006, and proposed to make further true-ups through December 31, 2006. It is my understanding that on August 17, 2006, parties to the case reached agreement on the use of a 2005 test period, updated for known and measurable events through December 31, 2006. Pursuant to this agreement, Aquila provided preliminary data to the parties for the update period on January 16, 2007, just prior to the filing date of this testimony on January 18. Because of the obvious time constraint, this installment of my direct testimony does not take account information found in the Company's update.

It is my further understanding that, pursuant to this agreement and the Procedural Order issued August 22, 2006, Staff and intervenors may file supplemental direct testimony on February 27, 2007 that addresses quantification of certain rate base, capital structure, and income statement items. In addition, if Aquila enters into an agreement effective January 2, 2007 to purchase power instead of owning generation to supply that power, Aquila is to present evidence on that issue in its rebuttal testimony, and other parties may respond to this in surrebuttal testimony on March 20, 2007.

Consistent with this format, my direct testimony here responds to the initial filing made by the Company. On February 27, 2007, I will file supplemental direct testimony addressing the quantification of the issues raised in the testimony below. To the extent that Aquila presents evidence relating to a new power purchase agreement in its rebuttal, I will respond to that evidence in my surrebuttal testimony.

Q. What conclusions and recommendations do you offer to the Commission?

A. I offer the following conclusions and recommendations:

(1) In its direct filing, MPS has made a "placeholder" adjustment of $31,325,003 to its Purchased Power (Capacity) expense. This adjustment is based on an estimate of [redacted] for the cost of acquiring additional capacity, which MPS terms the "Additional Capacity Solution Project." In my opinion, the amount of additional capacity for which the Company is seeking rate recovery is excessive to its needs. Instead, the amount of capacity expense included in rates should reflect adjusted test period capacity requirements, i.e., capacity requirements for 2006. My recommended adjustment reduces the Company's initial revenue requirement proposal by $31,160,331. I may modify this

adjustment in my supplemental testimony based upon my review of the updated information in the Company's supplemental filing.

(2) In its direct filing, Aquila is proposing that off-system sales margins be based on the three-year average of these margins from 2003 through 2005. I recommend that, instead, off-system sales margins be based on the actual levels for 2006. I will present the quantification of this adjustment as part of my supplemental testimony.

<u>Purchased Capacity Expense</u>

Q. Please describe the "placeholder" adjustment that MPS has made to its Purchased Power (Capacity) expense.

A. In his direct testimony, Company witness Kevin T. Noblet states that MPS is seeking to acquire additional capacity in an effort that the Company terms the Additional Capacity Solution Project. This effort was underway and was still unresolved at the time Aquila made its filing. Consequently, as an "initial placeholder," the Company is requesting approval to recover [redacted] in purchased capacity expense associated with the Additional Capacity Solution. This amount was calculated based on an assumed demand charge (including transmission and fuel transport) of [redacted] per kW-month for [redacted] megawatts of capacity. When this expense is added to MPS's actual purchased capacity costs for 2005, and is netted against other purchased capacity adjustments, it results in a net adjustment of $31,325,003, which appears in Schedule SKB-4 (MPS) as Adjustment FPP-20.

Q. What is the basis for the values used by the Company in determining the placeholder amount?

A. According to Mr. Noblet, at the time of its initial filing, Aquila was in the process of seeking to acquire a distressed generating asset. Because it was not assured that the Company would be successful in making this acquisition, Mr. Noblet proposed that the placeholder capacity expense be derived using the estimated capacity cost for a long-term power purchase agreement, based on certain indicative prices for the demand charge. It is my understanding that the amount of capacity included in this hypothetical long-term power purchase agreement is identical to the amount of capacity the Company would have acquired if it successfully purchased the distressed generating asset.

I note here that it is also my understanding that Aquila was not successful in acquiring the distressed generating asset.

Q. What is your assessment of the Company's approach to estimating the revenue requirement for purchased capacity?

A. I recognize that the expense derived in Mr. Noblet's approach is intended to be a placeholder, yet I believe it is important to register some disagreement at this time regarding the *amount* of capacity assumed in Mr. Noblet's calculation. The [redacted] of additional capacity assumed in the long-term purchase agreement is clearly excessive to MPS's needs, which should be based on the Company's capacity requirements in 2006. Based on my review of the Company's 2006 resource requirements, I have concluded that only 200 MW of the [redacted] of additional capacity was necessary for that year. This analysis is supported in HC Schedule KCH-1.

I recognize that if Aquila had prevailed in acquiring a [redacted] generating asset, then the full amount of this capacity would have come into the Company's possession, as the acquisition of such a unit typically results in a "lumpy" addition to any utility's capacity resources. But such an acquisition has *not* been made – with the result that the Company's "placeholder" capacity expense includes a capacity purchase that is [redacted] in excess of the Company's needs. The cost of this excess purchased capacity should not be included in rates.

In any event, had the intended acquisition occurred, the plant's excess capacity would have at least been available to make off-system sales, creating a potential benefit to customers. This benefit should have been recognized by the Company in its revenue requirement calculation – even under its placeholder approach – but it was not. The Company's failure to recognize the increased off-system sales margins that would accompany the acquisition of excess capacity is an additional problem with the Company's treatment of capacity expense.

Q. Why should the revenue requirement for MPS's capacity expense be based on 2006 resource needs?

A. According to the test period consensus reached by parties in this case, the Company's revenue requirement is to be determined based on an historic 2005 test period, with updates for known and measurable events through the end of 2006. This means that the level of retail sales used in setting rates will not extend beyond 2006. Consequently, the Company's capacity expense should not be based on needs beyond 2006. To go beyond 2006 would violate the well-established "matching principle" in ratemaking, which holds that rates should be based on costs and revenues that are synchronized with respect to time periods.

Q. What alternative approach do you recommend for determining MPS' purchased capacity expense in this proceeding?

A. I recommend that MPS' purchased capacity expense be based on the prudent purchased capacity expense necessary to meet MPS' 2006 capacity requirements. I will provide a quantification of this expense and recommended revenue adjustment in my supplemental direct testimony on February 27, 2007, unless Aquila addresses this issue in its rebuttal testimony, in which case I will address it in my surrebuttal testimony.

Q. Do you have a "placeholder" adjustment to MPS' revenue requirement at this time?

A. Yes. Based on the information available to me at this time, I recommend an adjustment to reduce the Company's initial revenue requirement proposal for MPS by $31,160,331. This adjustment is shown in HC Schedule KCH-2, and is calculated by removing [redacted] of the [redacted] that the Company included in its Additional Capacity Solution. I will update this adjustment either in my supplemental direct testimony or surrebuttal testimony, as appropriate.

Off-System Sales Margins

Q. What approach has Aquila proposed for the treatment of off-system sales margins?

A. As noted in the direct testimony of Susan K. Braun, Aquila is proposing that off-system sales margins be based on a three-year average from 2003 through 2005. Based on this approach, the Company proposes adjustments to both the MPS and L&P off-system sales revenue and expense, as shown in Schedules SKB-4 (MPS) and SKB-4 (L&P), Adjustments R-35 and FPP-35.

Q. What is your assessment of this approach?

A. I recommend against using a three-year average to determine off-system sales margins, as it is inconsistent with the manner in which all other aspects of revenue requirements are being determined in this proceeding. As discussed above, the revenues and expenses in this proceeding are based on a 2005 historic test period with updates for known and measurable events through the end of 2006. The treatment of off-system sales margins should be consistent with this overall approach.

Q. What alternative approach do you recommend for the treatment of off-system sales margins?

A. I recommend that the off-system sales margins be based on actual 2006 results.

Q. Have you quantified your proposed adjustment to Aquila's off-system sales margin at this time?

A. No. I will quantify this adjustment in my supplemental direct testimony when updated information is available.

Q. Does this conclude your direct testimony?

A. Yes, it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

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

AFFIDAVIT OF KEVIN C. HIGGINS

STATE OF UTAH)
)
COUNTY OF SALT LAKE)

Kevin C. Higgins, being first duly sworn, deposes and states that:

1. He is a Principal with Energy Strategies, L.L.C., in Salt Lake City, Utah;

2. He is the witness who sponsors the accompanying testimony entitled "Direct Testimony of Kevin C. Higgins;"

3. Said testimony was prepared by him and under his direction and supervision;

4. If inquiries were made as to the facts and schedules in said testimony he would respond as therein set forth; and

5. The aforesaid testimony and schedules are true and correct to the best of his knowledge, information and belief.

Kevin C. Higgins

Subscribed and sworn to or affirmed before me this 16th day of January, 2007, by Kevin C. Higgins.

Margaret A. Petersen
Notary Public

My Commission No.: ___________
My Commission Expires: 02-28-08
(SEAL)

NOTARY PUBLIC
MARGARET A PETERSEN
505 EAST 200 SOUTH
SALT LAKE CITY, UT 84102
My Commission Expires 2/28/2008
STATE OF UTAH

Calculation of Excess Purchased Power Capacity in Aquila's MPS Revenue Requirement Proposal

	(a)	(b)	(c)	(d)
	Purchased Capacity to Meet MPS 2006 Capacity Needs		**Purchased Capacity Included in MPS Revenue Requirement Proposal**	
Ln #	**Contract**	**Capacity**	**Contract**	**Capacity**
1	NPPD Cooper	[redacted]	NPPD Cooper	[redacted]
2	Aries		Aries	
3	Wind - Credited		Wind - Credited	
4	Total		Total	

5 Excess Capacity Included in MPS Rev. Req't (Ln 4, Col (d) - Ln 4, Col. (b)) = [redacted]

Data Source: Aquila Response to MPSC Data Request 214 (HC).

Adjustment to Aquila's Proposed MPS Annualized Purchased Power Contract Amount to Reflect the CG's Recommended MPS Annualized Purchased Power Contract Capacity Amount

Ln No.	Description	Amount	Source
1	Aquila Annualized MPS Purchased Power Capacity Amount ($)	[redacted]	Aquila FPP-20-1 Workpaper
2	CG Recommended Annualized Purchased Power Capacity Amount ($)		See Detail Below
3	CG Adjustment Required to MPS Direct Filing ($)		= Ln 2 - Ln 1
4	Jurisdictional Factor #3 (Demand)		Aquila FPP-20-1 Workpaper
5	CG Adjustment (Elec-Juris)		= Ln 3 x Ln 4

Detail Supporting CG Recommended Annualized Purchased Power Capacity Amount

Ln No.	Description	Amount	Source
6	2006 Aries Contract Capacity (MW)	[redacted]	Aquila Response to MPSC-0212 (HC)
7	Capacity Price ($/kW-month)		Aquila FPP-20-2 Workpaper
8	Monthly Purchased Power Capacity Amount ($)		= Ln 6 x 1000 x Ln 7
9	Months in Year		
10	Annualized Purchased Power Capacity Amount ($)		= Ln 8 x Ln 9
11	Add NPPD Cooper (75MW) Purchased Power Capacity Amount		Aquila FPP-20-2 Workpaper
12	CG Recommended Annualized Purchased Power Capacity Amount		Ln 10 + Ln 11