

Exhibit No.: 1135  
Issues: Aries Purchased  
Power Agreement

Witness: Michael S. Proctor  
Sponsoring Party: MO PSC Staff  
Type of Exhibit: Surrebuttal Testimony  
Case No.: ER-2004-0034

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**MISSOURI PUBLIC SERVICE COMMISSION  
UTILITY OPERATIONS DIVISION**

**SURREBUTTAL TESTIMONY**

**OF**

**MICHAEL S. PROCTOR**

**AQUILA, INC. D/B/A AQUILA NETWORKS-MPS**

**FILED**<sup>3</sup>

MAY 10 2004

Missouri Public  
Service Commission

**CASE NO. ER-2004-0034**

Jefferson City, Missouri  
February 2004

Exhibit No. 1135  
Case No(s). ER-2004-0034  
Date 3-1-04 Rptr TL

**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 ) Case No. ER-2004-0034  
Electricity )

**AFFIDAVIT OF MICHAEL S. PROCTOR**

**STATE OF MISSOURI**    )  
  ) ss  
**COUNTY OF COLE**        )

Michael S. Proctor, of lawful age, on his oath states: that he has participated in the preparation of the following written testimony, as modified, in question and answer form, consisting of 13 pages of testimony to be presented in the above case, that the answers in the attached written testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true to the best of his knowledge and belief.

*Michael S Proctor*  
\_\_\_\_\_  
Michael S. Proctor

Subscribed and sworn to before me this 27th day of February 2004.

**DAWN L. HAKE**  
Notary Public – State of Missouri  
County of Cole  
*Dawn L. Hake*  
\_\_\_\_\_  
Notary Public

My commission expires \_\_\_\_\_  
My Commission Expires Jan 9, 2005

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1 **SURREBUTTAL TESTIMONY**

2 **OF**

3 **MICHAEL S. PROCTOR**

4 **AQUILA, INC.**

5 **D/B/A AQUILA NETWORKS-MPS**

6  
7 **CASE NO. ER-2004-0034**

8  
9 **Q. What is your name and business address?**

10 A. My name is Michael S. Proctor. My business address is 1845 Borman  
11 Court, Suite 101, St. Louis, MO 63146-4138.

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

13 A. I am employed by the Missouri Public Service Commission (Commission)  
14 as Chief Regulatory Economist in the Energy Department.

15 **Q. What is your education background and work experience?**

16 A. I have Bachelor and Master of Arts Degrees in Economics from the  
17 University of Missouri at Columbia, and a Ph.D. degree in Economics from Texas A&M  
18 University. Prior to coming to work for the Commission, I was an Assistant Professor of  
19 Economics at Purdue University and at the University of Missouri at Columbia. Since  
20 June 1, 1977, I have been on the Staff of the Commission and have presented testimony  
21 on various issues related to weather normalized energy usage and rate design for both  
22 electric and natural gas utilities. With respect to electric issues, I have worked in the  
23 areas of load forecasting, resource planning and transmission pricing. In 1997 and 1998,

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1 I served as the Staff Vice Chair of the Market Structure and Market Power Working  
2 Group of the Commission's Task Force on Retail Competition. From December of 2000  
3 to August of 2001, I served as chairman of the Forward Congestion Markets Subgroup of  
4 the Southwest Power Pool's (SPP's) Congestion Management Systems Working Group.  
5 I am also serving as the chairman of the Organization of Midwest ISO States (OMS)  
6 working group on congestion management and financial transmission rights allocations.

7 **Q. What are your current duties in the Energy Department as Chief**  
8 **Regulatory Economist?**

9 **A.** I have the responsibility of being actively involved with the development  
10 and structure of Regional Transmission Organizations (RTOs) for the purpose of  
11 increasing efficiency and reliability in the competitive supply of electricity at wholesale.  
12 From time-to-time, the Commission Staff (Staff) will request that I testify before the  
13 Commission respecting issues on which I may have specific knowledge. This surrebuttal  
14 testimony is an instance of where I have specific knowledge regarding the electric  
15 resource planning process and the power supply agreement/purchased power agreement  
16 (PSA/PPA) entered into between what is now called Aquila Networks-MPS (MPS or  
17 Company) and an affiliate. At the time the PSA/PPA was entered into, the affiliate,  
18 Missouri Energy Partners-Pleasant Hill, LLC (MEPPH), was offering capacity and  
19 energy from a combined cycle generation facility, now known as the Aries Plant.

20 **PURPOSE AND SUMMARY OF SURREBUTTAL TESTIMONY**

21 **Q. What is the purpose of your surrebuttal testimony?**

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1           A.     My surrebuttal testimony addresses issues raised in the rebuttal testimony  
2 of Mr. Jon R. Empson and Mr. Frank A. DeBacker regarding the Company's reasons for  
3 entering into a PSA with an affiliate.

4           **Q.     What is the summary of your surrebuttal testimony?**

5           A.     First, contrary to assertions made by Mr. Empson in his rebuttal testimony,  
6 my surrebuttal is that, entering a PSA/PPA with an affiliate does not diminish the risk of  
7 stranded cost for the Company. Second, contrary to assertions made by Mr. DeBacker in  
8 his rebuttal testimony, in the Commission's Order in Case No. EO-98-316, the  
9 Commission did not order the Company to use short-term capacity markets to acquire  
10 new supply-side resources through a competitive bidding process, and that such an  
11 interpretation of the Commission's Order is contrary to the Commission's policy of not  
12 pre-approving resources acquired by a regulated utility, and further is inconsistent with  
13 the Staff's recommendation and the Commission's order granting certain determinations  
14 regarding the PSA/PPA made in accordance with section 32(k) of the Public Utility  
15 Holding Company Act of 1935 as amended by the Energy Policy Act of 1992 [PUHCA].

16 **SURREBUTTAL OF MR. JON R. EMPSON**

17           **Q.     What rebuttal testimony of Aquila witness Mr. Jon R. Empson are**  
18 **you responding to?**

19           A.     At pages 2-5 of his rebuttal testimony, Mr. Empson rebuts Staff witnesses  
20 Cary G. Featherstone and Mark L. Oligschlaeger on the Staff's position regarding the  
21 Aries Plant. This rebuttal testimony characterizes the Staff's position as follows: "MPS,  
22 one of Aquila's Missouri utility operating divisions, should have built the Aries Plant

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1 rather than entering into the competitively bid, low cost Purchased Power Agreement  
2 ('PPA') with Aquila's affiliate

3 Mr. Empson cites four quotes from a report filed by the Staff on June 12, 1998  
4 entitled, "Electric Restructuring Plan for the Competitive Supply of Generation in  
5 Missouri," as evidence supporting the Company's decision to enter into a PSA/PPA  
6 rather than to build a power plant. My rebuttal testimony is intended to put the Staff  
7 report in proper context, and show why this report does not support the Company's  
8 decision to build the Aries Plant as non-regulated, Exempt Wholesale Generator (EWG)  
9 rather than as a regulated generation asset.

10 **Q. What was the purpose of the Staff report entitled, "Electric**  
11 **Restructuring Plan for the Competitive Supply of Generation in Missouri?"**

12 A. At the time, the Staff believed there was the possibility of legislation being  
13 passed in Missouri that would give open access to retail electricity customers of  
14 regulated, investor-owned utilities. The purpose of the report was to inform the  
15 Commission of the Staff's perspectives on several issues related to this potential  
16 deregulation of retail electricity supply in Missouri. In essence, the report was not a  
17 recommendation to implement retail competition, rather a proactive set of  
18 recommendations on how best to respond to this possibility. Thus, any recommendations  
19 in this report were contingent on the decision of the state legislature to implement retail  
20 competition.

21 **Q. As indicated by Mr. Empson, was stranded cost a major concern?**

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1           A.     Recovery of stranded cost was one of the major concerns for the utilities.  
2     The Commission set up several working groups to address various issues, and  
3     specifically set up a working group to address stranded cost.

4           **Q.     Mr. Empson testifies that, because of concerns about stranded cost, he**  
5     **advised the Company to be concerned about commitments to build new generation.**  
6     **What is your response to Mr. Empson's rebuttal testimony on this matter?**

7           A.     I have a difficult time following the logic of Mr. Empson's rebuttal  
8     testimony. Moreover, the issue of stranded cost is one related to cost recovery from a  
9     regulated generation asset versus profitability from a non-regulated generation asset. If  
10    deregulation of generation supply to retail customers were to occur, then the generation  
11    assets formally serving retail customers under regulated rates would have to bid to serve  
12    customers under non-regulated (market-based) prices. Assuming market-based prices are  
13    lower than regulated rates, the utilities would earn less on their generation assets under  
14    deregulation. On this concept, I believe Mr. Empson and I are in agreement.

15           However, if the Company builds generation as an EWG under PUHCA, then it  
16    faces all the market risks of recovery as a non-regulated generation asset. Thus, the  
17    decision to build a new generation asset within the Company, but as an EWG, does not  
18    change the Company's risk profile with respect to recovery of its costs.

19           **Q.     Do you agree that Staff, because of stranded cost, recommended in its**  
20     **report suggesting courses of action in the event of deregulation of generation supply**  
21     **to retail customers that utilities should enter into contracts for power rather than**  
22     **build generation plants?**



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1           A.     No, I do not agree. The Staff stated in its report that “In addition to  
2 replacing existing generation capacity, all of the investor-owned utilities will need to add  
3 additional capacity to meet their growth in native load (wholesale under contract and  
4 retail). It is **anticipated** that much of this new generation capacity will be acquired  
5 through short-term purchased power contracts rather than from the addition of new  
6 generation capacity.” [Electric Restructuring Plan for the Competitive Supply of  
7 Generation in Missouri, p. 29, and emphasis added] This anticipation was not a  
8 recommendation by the Staff. In addition, this anticipation was based on the assumption  
9 that a Company would shift its risk of stranded cost by purchasing power from another  
10 supplier, rather than taking on that risk itself by having the generation built by an  
11 affiliate. Moreover, if the owner of the generator selling capacity and energy is an  
12 affiliate of the utility, then there is no resulting shift in risk for the Company.

13           **Q.     Why is there no shift in stranded cost risk of a new generation plant if**  
14 **it is built by a non-regulated affiliate of the utility?**

15           A.     First, stranded cost risk is a shareholder risk, and moving the risk from the  
16 utility company to an affiliate company, both of which are ultimately owned by the same  
17 shareholders is in essence, no shift in risk at all. Second, where deregulation of retail  
18 electricity supply has occurred, it is common for the generation assets of the utility to be  
19 placed into a non-regulated subsidiary company, leaving the utility as the distribution  
20 company. Thus, if deregulation were to occur, the distinction between regulatory  
21 generation assets and non-regulated assets would no longer exist. Thus, having  
22 generation built in a subsidiary does not mitigate stranded cost risk.

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1           **Q.    Doesn't entering into a contract for power supply shift the risk of**  
2 **stranded costs to the ratepayer?**

3           A.    No, it does not. The contract for power supply is not with the ratepayer; it  
4 is between the supplier and the utility. If deregulation occurs, the only insurance the  
5 utility has against stranded cost is the possibility that the contract price is close to current  
6 market prices, in which case there will be little or no stranded cost. On the other hand, if  
7 the utility builds the plant itself, or has it built by an affiliate, it may incur stranded cost to  
8 the extent that the cost of the plant is greater than what can be recovered from selling the  
9 electricity at market prices.

10           **Q.    Didn't actions by the Company that brought Calpine in as a partner**  
11 **in the Aries plant result in mitigation of Aquila's stranded cost risk for the Aries**  
12 **plant?**

13           A.    Yes, bringing in a partner should help to mitigate a portion of the stranded  
14 cost risk. However, the decision to bring Calpine in as a partner was made after the  
15 decision to which Mr. Empson's rebuttal testimony is referring; i.e., the decision to enter  
16 into a PSA/PPA with a non-regulated subsidiary of MPS rather than having MPS build  
17 the generation as a regulated asset.

18 **SURREBUTTAL OF MR. FRANK A. DEBACKER**

19           **Q.    What rebuttal testimony of Aquila witness Mr. Frank A. DeBacker**  
20 **are you responding to?**

21           A.    Mr. DeBacker submitted thirty-four pages of rebuttal testimony that  
22 addresses the process that MPS went through before and when it entered into the  
23 PSA/PPA with its affiliate, MEPPH on February 22, 1999. Mr. DeBacker's rebuttal

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1 testimony goes back to March 29, 1993 when the Missouri Public Service Commission  
2 issued rules for Electric Utility Resource Planning at 4 CSR 240-22. His rebuttal  
3 testimony then skips forward to early in 1998 when the Commission opened  
4 Case No. EO-98-316 regarding agreements between the Staff and Aquila (at that time,  
5 UtiliCorp) regarding allowing the utilities an alternative to making filings required by  
6 Commission Rule 4CSR 240-22. In essence, the alternative was for the Company to  
7 meet with the Staff, OPC and intervenors two times per year on resource planning and to  
8 provide briefings on changes in load forecasts, implementation plans and the Company's  
9 analyses of various risks regarding its resource plans, including contingency plans related  
10 to those risks.

11 **Q. Do you agree with Mr. DeBacker's characterization of what he calls**  
12 **the "main elements of the supply-side acquisition process" that Aquila was ordered**  
13 **to follow by the Commission in Case No. EO-98-316?**

14 **A. No, I do not agree with a portion of Mr. DeBacker's characterization of**  
15 **what the Commission ordered in Case No. EO-98-316. Specifically Mr. DeBacker**  
16 **mischaracterizes the Commission's Order to require MPS to "use short-term capacity**  
17 **markets to acquire new supply-side resources through a competitive bidding process."**  
18 **Instead, the Commission ordered MPS to comply with the terms of the Joint Agreement**  
19 **submitted by MPS, Staff and the Office of Public Counsel in Case No. EO-98-316. The**  
20 **terms of the Joint Agreement are clear at pages 13 and 14 where the specifics of**  
21 **immediate question regarding supply-side resource requirements were addressed. The**  
22 **Joint Agreement lists five specific elements numbered (3) through (7) in the Joint**  
23 **Agreement in bold.**

- 1           **(3) In its August 1998, briefing, MPS will provide Staff, OPC and intervenors**  
2           **with a summary report of a reoptimized supply side only plan. The report**  
3           **will include a presentation on the derivation of avoided costs that will be**  
4           **used in screening demand-side measures.**
- 5
- 6           **(4) In its August 1998 briefing MPS will provide to Staff, OPC and intervenors**  
7           **an update on the renegotiation of the leases for the combustion turbine**  
8           **generating units, including an evaluation of possible options, such as: renew**  
9           **lease on a short term basis, renew lease on a long term basis, purchase the**  
10           **units, negotiate a capacity only contract, joint ownership, or cancel the lease**  
11           **and replace the capacity with new units or capacity contracts. This**  
12           **evaluation should include the possibility of retail competition.**
- 13
- 14           **(5) In its February 1999 briefing MPS will provide to Staff, OPC and**  
15           **intervenors a summary report that evaluates the overall cost effectiveness of**  
16           **maintaining versus refurbishing versus retiring of existing generating units,**  
17           **taking into account the uncertainties associated with the following areas –**  
18           **component failure, cost of replacement power, availability for replacement**  
19           **power, peak load growth, environmental regulations, fuel costs, and retail**  
20           **competition.**
- 21
- 22           **(6) At the time MPS begins to implement a competitive bidding process to**  
23           **solicit capacity for its forecasted needs, MPS will provide to Staff and OPC**  
24           **copies of the competitive bidding RFPs at least 45 days prior to send out**  
25           **each FTRP. Staff and OPC will review said RFP and provide comments to**  
26           **MPS within 30 days of receiving the RFP.**
- 27
- 28           **(7) Thirty (30) days before awarding contracts to successful bidders, MPS will**  
29           **provide to Staff and OPC its evaluation of the proposals received in**  
30           **response to its RFP for its forecasted capacity needs. This evaluation will**  
31           **include the elements of risk analysis and plan selection as described in 4CSR**  
32           **240-22.070.**
- 33

34           Nowhere within any of these conditions is a requirement that “MPS should use  
35 short-term capacity markets to acquire new supply-side resources through a competitive  
36 bidding process.” Moreover, all of these requirements related directly to informational  
37 requirements that MPS should satisfy as an alternative to meeting the requirements of the  
38 Commission’s rules on Electric Utility Resource Planning (4 CSR 240-22).

39           At the time the Joint Agreement was entered into, the Company had made the  
40 Staff aware of its intention to issue a specific RFP for purchased capacity and energy.

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1 The last two items (6 and 7) address conditions that the Company was to fulfill if it were  
2 to pursue that course of action. Nowhere does the Joint Agreement require the Company  
3 to pursue short-term contracts for purchased capacity and energy. To do so would be  
4 totally inconsistent with the heart of the Electric Utility Resource Planning rules, which  
5 emphasize the planning process and includes no requirement for Commission pre-  
6 approval of specific resources. The Staff would never have signed a Joint Agreement in  
7 which MPS, or any utility, was told to pick one type of resource over another.  
8 Mr. DeBacker's characterization of the Joint Agreement on this issue is totally incorrect,  
9 as well as being inconsistent with the entire Electric Utility Resource Planning process.

10 **Q. At page 31, Mr. DeBacker characterizes your memorandum**  
11 **supporting the approval MPS application for the Commission to approve the PSA**  
12 **with its Affiliate under Section 32(k) of PUHCA. Do you agree with Mr. DeBacker's**  
13 **characterization of your recommendation?**

14 A. Mr. DeBacker's characterization of my recommendation is factually  
15 correct, but incomplete, leaving out a very important aspect of that recommendation – the  
16 focus of the recommendation on the process followed, not the outcome of the competitive  
17 bidding process. Moreover, the Staff was not recommending pre-approval of the  
18 PSA/PPA for ratemaking purposes, but could assure that the public interest would be  
19 protected because the ratemaking review would occur before the costs of the PSA were  
20 recovered in rates from MPS customers.

21 **Q. Why did the Staff focus on the process followed by MPS in soliciting**  
22 **and evaluating the competitive bids rather than on the outcome?**

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1           A.     At that time the Commission had six years prior issued rules for Electric  
2 Utility Resource Planning (4 CSR 240-22) in which the question of pre-approval versus  
3 review of the resource planning process had been at issue. The Electric Utility Resource  
4 Planning rules adopted by the Commission did not envision pre-approval, rather the  
5 purpose was to set and review minimum standards for the Electric Utility Resource  
6 Planning process. In essence, the commitment of Staff resources for pre-approval is  
7 significantly greater than those that would be required to review the planning processes  
8 being used by the electric utilities. Thus, the Staff's usual procedure for the review of  
9 resource acquisition by an electric utility was to focus on the process, not the outcome.

10           In addition, in its application for Commission approval under Section 32(k) of  
11 PUHCA, the Company recognized the fact that the Staff would not be making  
12 recommendations with respect to ratemaking. Specifically, at page 6 of the MPS  
13 application, it states:

14           15. UtiliCorp understands that an order containing the findings  
15 required by the PUHCA with respect to the PSA shall in **no way** be  
16 binding on the Commission or any party to a future rate case to contest the  
17 ratemaking treatment to be afforded the PSA. [Aquila's Application in  
18 Case No. EM-99-369, Emphasis Added]  
19

20           **Q.     What future review for purposes of ratemaking did you anticipate at**  
21 **the time you submitted your recommendation.**

22           A.     The following portion of the recommendation indicates that as a part of a  
23 future review, a detailed analysis of the two proposals and other alternatives would be  
24 required.

25           It is important to note that the Staff has not evaluated the two  
26 proposals to determine which is least cost or whether accepting either of  
27 the two proposals would be a prudent management decision. Moreover,  
28 this Commission does not pre-approve the acquisitions of resources by

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1 electric utilities. Instead, in its 1993 rulemaking on electric resource  
2 acquisitions (4 CSR 240-Chapter 22), this Commission enacted rules that  
3 focused on the process, not the outcome. [Memorandum by Michael S.  
4 Proctor, April 5, 1999, Case No. EM-99-369, p.8]

5 The first sentence in the above quote from my memorandum makes it very clear that the  
6 Staff did not make a determination that the MEPPH capacity and energy was the most  
7 cost effective supply option for MPS to meet its capacity and energy obligation, whether  
8 compared to a second alternative being evaluated by MPS or compared to other possible  
9 alternatives. Moreover, the review that I made of the PSA did not include the detailed  
10 analysis that would be required for purposes of ratemaking. This was also made explicit  
11 in my memorandum.

12 At this time, the Staff has not performed a detailed analysis of which  
13 of the two alternatives is least cost. Such an analysis should be done prior  
14 to the Commission approving the cost of the PSA in rates for Missouri  
15 Public Service customers. Subject to this condition, it is not necessary that  
16 this analysis be conducted at this time in order to determine whether or not  
17 the PSA is in the public interest. Moreover, to make such a determination  
18 at this time would put the Commission in the position of pre-approval of  
19 the prudence of MPS entering into the PSA, which is an approach that the  
20 Commission uniformly has rejected over many years. UtiliCorp in its  
21 Application recognizes and accepts the Commission's historical approach,  
22 wherein at paragraph 15, UtiliCorp states as follows:

23 15. UtiliCorp understands that an order containing the findings  
24 required by the PUHCA with respect to the PSA shall in no way be  
25 binding on the Commission or any party to a future rate case to contest the  
26 ratemaking treatment to be afforded the PSA. [Memorandum by Michael  
27 S. Proctor, April 5, 1999, Case No. EM-99-369, p.9]  
28

29 **Q. In this case, has the Staff reviewed the prudence of the purchased**  
30 **power agreement that MPS and MEPPH entered into?**

31 A. It is my understanding the Staff witnesses Mark L. Oligschlaeger and  
32 Cary G. Featherstone have made such a review and recommendations concerning the  
33 prudence of this contract.

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1           **Q.    Does this conclude your surrebuttal testimony?**

2           **A.    Yes, it does.**