

Exhibit No.: 1136
Issues: Interim Energy
Charge

Witness: James C. Watkins
Sponsoring Party: MO PSC Staff
Type of Exhibit: Surrebuttal Testimony
Case No.: ER-2004-0034

Date Testimony Prepared: February 20, 2004 as modified February 27, 2004

**MISSOURI PUBLIC SERVICE COMMISSION
UTILITY OPERATIONS DIVISION**

SURREBUTTAL TESTIMONY

OF

JAMES C. WATKINS

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

CASE NO. ER-2004-0034

**Jefferson City, Missouri
February 2004**

FILED³
MAY 10 2004
Missouri Public
Service Commission

Exhibit No. 1136
Case No(s). ER-2004-0034
Date 3-1-04 Rptr gn

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24

SURREBUTTAL TESTIMONY

OF

JAMES C. WATKINS

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

CASE NO. ER-2004-0034

Q. Please state your name and business address.

A. My name is James C. Watkins and my business address is Missouri Public Service Commission, 200 Madison Street, P. O. Box 360, Jefferson City, Missouri 65102.

Q. What is your present position with the Missouri Public Service Commission (Commission)?

A. I am a Regulatory Economist in the Energy Department of the Operations Division.

Q. Please review your educational background and work experience.

A. I have a Bachelor of Arts Degree in Economics from William Jewell College, a year of graduate study at the University of California at Los Angeles in the Masters Degree Program, and have completed all requirements except my dissertation for a Ph.D. in Economics from the University of Missouri-Columbia. My previous work experience has been as an Instructor of Economics at Columbia College, the University of Missouri-Rolla, and William Jewell College. I have been on the Staff of the Missouri Public Service Commission (Staff) since August 1, 1982. A list of the major cases in which I have filed testimony before the Commission is shown on Schedule 1.

Surrebuttal Testimony of
James C. Watkins

1 Q. Are you one of the Case Coordinators for this case?

2 A. Yes. I am primarily responsible for coordination within the Operations
3 Division.

4 Q. What is the purpose of your Surrebuttal Testimony?

5 A. The purpose of my Surrebuttal Testimony is to present the Staff's position
6 regarding the Company's recovery of fuel and purchased power costs in response to the
7 rebuttal of Company witnesses John Browning in the area of natural gas pricing and
8 Jerry Boehm in the area of purchased power pricing, and to demonstrate that the
9 Commission's approval of the Staff's recommendation would also result in just and
10 reasonable rates. I will also present the details of the Staff's recommended Interim Energy
11 Charge (IEC).

12 Q. What is shown on Schedule 2?

13 A. The results of the Staff's fuel run for various natural gas price and purchased
14 power price scenarios are attached to my testimony for convenience as Schedule 2. The
15 information was developed by Staff witness David W. Elliott and is described in his
16 Surrebuttal Testimony on the IEC.

17 Q. What is shown on Schedule 3?

18 A. The calculation of the percentage amounts of the IEC surcharges and the
19 impact on customers served on each of Aquila's rate codes are attached to my testimony for
20 convenience as Schedule 3. The information was developed by Staff witness Janice Pyatte
21 and is described in her Surrebuttal Testimony on the IEC.

22 Q. What is shown on Schedule 4?

23 A. An illustrative tariff sheet to implement the IEC is shown on Schedule 4.

Surrebuttal Testimony of
James C. Watkins

1 Q. Do you have any prior experience with the mechanisms involved in the Staff's
2 recommendation?

3 A. Yes. During the mid-80's, one of my responsibilities was to forecast fuel
4 prices and determine an appropriate "allowance for forecasted fuel expense" to be included
5 in the revenue requirement of electric utilities, subject to true-up and refund. I was also
6 involved in setting up the mechanics of this process, participating in the true-up audits and
7 monitoring any required refunds.

8 More recently, I played a key role in developing an IEC for The Empire District
9 Electric Company (Empire) in Case No. ER-2001-299.

10 Q. Does the Staff's recommendation in this case provide for a process similar to
11 Empire's IEC?

12 A. Yes. The Staff's recommendation is based on Empire's IEC; however, the
13 Staff's recommendation for Aquila has been refined to include only variable fuel and
14 purchased power costs.

15 Q. Why does the Staff believe that it would be reasonable for the Commission to
16 approve an Interim Energy Charge in this case?

17 A. The Staff believes that the magnitude of the effect on Aquila and its
18 customers of guessing wrong as to the future direction of fuel and purchased power costs
19 makes it reasonable to have a mechanism in place to limit this risk. The IEC basically
20 represents the difference between a conservative forecast of fuel and purchased power costs
21 that would limit this risk for consumers and a fairly aggressive forecast of costs that would
22 limit this risk for the Company. The difference in these forecasts amounts to approximately

Surrebuttal Testimony of
James C. Watkins

1 \$21 million per year on a Missouri jurisdictional basis for MPS (electric),

2

3 If rates are set based on a conservative forecast and it turns out that actual costs are
4 at the aggressively forecasted level, Aquila's Net Operating Income could be significantly
5 affected to the extent that Aquila could suffer serious financial consequences. If, on the other
6 hand, rates are set based on aggressively forecasted costs and it turns out that actual costs are
7 actually at conservatively forecasted levels, Aquila would experience a huge windfall and its
8 customers would have been "overcharged" by a significant amount.

9 Q. Why does the Staff believe that approval of the Interim Energy Charge will
10 result in just and reasonable rates?

11 A. Approval of the Interim Energy Charge will result in rates that recover at least
12 the level of costs based on historical prices and at most the level of costs based on a more
13 aggressive upward forecast of prices. It is intended that, within this range, the IEC will
14 recover exactly Aquila's prudently incurred actual fuel and purchased power costs.
15 Furthermore, this approach shares the burden of the price risk between Aquila and its
16 customers in such a way as to benefit both Aquila and its customers.

17 Q. If the Commission approves the Staff's recommendation regarding fuel and
18 purchased power expense, will that affect the Non-Unanimous Stipulation And Agreement
19 Pertaining To Rate Design And Class Cost Of Service (Agreement)?

20 A. No. The Staff's proposal modifies Empire's IEC surcharge to be consistent
21 with the Agreement, to which the Staff is one of the signatories. Rather than propose that the
22 IEC surcharge be collected on an equal-cents-per-kilowatt-hour basis, as in Empire's IEC,

Surrebuttal Testimony of
James C. Watkins

1 the Staff is proposing that the IEC surcharge be collected on an equal-percent-of-revenues
2 basis.

3 Q. What are the details of the Staff's proposal?

4 A. The details are as follows:

5 1. In addition to the amount approved by the Commission to be included in the
6 Missouri jurisdictional cost of service and recovered in rates on a permanent basis, an IEC
7 surcharge should be authorized to be collected for a period of two years on an interim and
8 subject to true-up and refund basis. This proposal is designed to address the potential
9 volatility in natural gas and wholesale electricity prices. The IEC surcharge should be
10 reflected separately on Aquila's Missouri electric and steam rate schedules as a surcharge in
11 the form of a percentage of rate revenue.

12 2. The basis for the amounts of variable fuel and purchased power costs that
13 should be included on a permanent basis are shown on the attached Schedule 2 in the column
14 labeled "\$3.5 Aquila Gas Prices, Staff Purchased Power." The Missouri retail jurisdictional
15 amounts would be:

16 Aquila Networks-MPS (electric) $\$89,062,868 \times 0.9847\% = \$87,700,206$

17

18

19 These amounts are somewhat less than the amounts proposed by the Staff in the absence of
20 an IEC. The lower amounts are proposed in order to properly balance the risks and rewards
21 between Aquila and its customers.

22 3. The basis for the incremental amount of variable fuel and purchased power
23 costs that should be included on an interim and subject to true-up and refund basis is the

Surrebuttal Testimony of
James C. Watkins

1 difference between the amount shown on the attached Schedule 2 in the column labeled
2 "\$5.64 Aquila Gas Prices, Aquila Purchased Power" and the corresponding amount shown in
3 the column labeled "\$3.5 Aquila Gas Prices, Staff Purchased Power." The Missouri retail
4 jurisdictional amounts would be:

5 Aquila Networks-MPS (electric) $(\$110,093,468 - \$89,062,868) \times 0.9847\% = \$20,708,832$
6
7

8 4. The rate schedules to be filed by Aquila to implement the IEC should indicate
9 that the IEC surcharge itself (as opposed to the terms and conditions applying to the IEC
10 true-up and potential refund) will expire at 12:01 a.m. on the date that is two years after the
11 original effective date of the tariff sheet.

12 5. Subsequent to the expiration of the IEC surcharge, a true-up audit will
13 commence ("the IEC true-up audit") in which the Staff, the Office of the Public Counsel
14 (Public Counsel) and other parties will have the opportunity to audit Aquila's actual fuel
15 costs for the period during which the IEC was in effect, under the same terms and conditions
16 that apply to audits in general rate cases before the Commission. If the IEC true-up audit
17 determines that all or a portion of the revenue collected by Aquila pursuant to the IEC
18 exceeds that portion of Aquila's actual and prudently incurred variable fuel and purchased
19 power costs in excess of the amount included in permanent rates on a retail Missouri
20 jurisdictional basis during the IEC period, Aquila must refund the excess, plus interest at the
21 prime rate. No refund will be made if Aquila's actual and prudently incurred costs for fuel
22 and purchased power during the IEC period equal or exceed the amount included in
23 permanent rates plus the amount collected in the IEC surcharge.

Surrebuttal Testimony of
James C. Watkins

1 6. The interest rate to be paid on the refund amount should be the same as the
2 prime rate of interest (as found in the Money Rates section of the Wall Street Journal) in
3 effect on the day the IEC expires. Interest (if there is a refund) should be applied for the
4 period from the end of the first twelve months the IEC is in effect through the end of the
5 calendar month prior to the billing month in which bill credits for the refund appear on
6 customers' bills. In other words, for the purposes of this calculation, it should be assumed
7 that the total amount of any refund accrues during the first year and that interest applies
8 thereafter.

9 7. Generally, any refund should be made as a one-time credit on the customer's
10 bill, except in cases where a customer is no longer a customer in the billing month in which
11 bill credits appear on the bills of remaining customers. In that instance, Aquila should mail
12 to the last known address of such former customer a check for the amount of the refund owed
13 that former customer. Checks should not be issued to customers for refund amounts of less
14 than \$3.00. After the bill credits have been made and checks issued, any amount of the total
15 refund plus interest which remains in Aquila's possession six months after the end of the
16 application of the bill credits, for example, due to the inability to locate a former customer,
17 shall be donated by Aquila promptly to the American Red Cross to help fund its Project
18 Help, or to a similar program.

19 8. During the period in which the IEC is in effect, Aquila should develop a
20 tracking method to identify the monthly status of the IEC in terms of the accrued refund
21 obligation and to provide the Staff and the Office of the Public Counsel with Aquila's routine
22 monthly revenue and sales reports which include the following data : (1) actual kWh sales for
23 each Missouri retail rate code by billing month and by calendar month, and (2) the revenues

Surrebuttal Testimony of
James C. Watkins

1 from kWh sales, exclusive of taxes, for each Missouri retail rate code by billing month and
2 by calendar month. The routine reports should also specifically identify the revenues
3 associated with the IEC. Aquila should submit this data in electronic format to the
4 Commission's Energy Department on a quarterly basis by no later than one month after the
5 end of each calendar quarter. Aquila should also submit the following information for the
6 duration of the IEC to the Commission's Auditing Department and to the Public Counsel:

- 7 1. monthly operating reports;
- 8 2. monthly fuel reports;
- 9 3. monthly purchase power and interchange sales report;
- 10 4. monthly outage reports including Iatan and Aries outages;
- 11 5. monthly fuel prices for a). coal and freight, b). natural gas (commodity and
12 transportation separately) and c). oil; and
- 13 6. monthly statement identifying significant changes in fuel/rail contracts,
14 capacity agreements and unusual operating conditions such as significant
15 power plant outages, unusually high purchase power prices and natural gas
16 prices, etc.

17 Aquila should also provide quarterly reports to the Staff and the Public Counsel relating to
18 Aquila's analysis and record keeping for any and all natural gas capacity release and off-
19 system natural gas sales opportunities and transactions. In this report, Aquila will provide
20 information showing the amount of natural gas capacity that was available for its own use,
21 the amount used, the amount available for capacity release, the amount released, the party to
22 whom the capacity was released, the price of the release, and its duration, along with any
23 other relevant information related to the transaction. This quarterly report shall also provide

Surrebuttal Testimony of
James C. Watkins

1 information showing the amount of off-system natural gas sales, the entity to which each off-
2 system natural gas sale was made, the price of the sale, and its duration, along with any other
3 relevant information related to the transaction. This report will also include Aquila's
4 analysis as to the natural gas market conditions during the time period covered, with
5 explanations as to why Aquila did or did not make any natural gas capacity releases or off-
6 system natural gas sales during that period. Any revenues collected by Aquila due to the
7 release of unused natural gas capacity or net revenues from off-system sales of natural gas
8 during the duration of the IEC will be used to offset the calculation of the cost of fuel and
9 purchased power supplied to Aquila's ratepayers on a dollar-for-dollar basis.

10 9. At its own expense, Aquila should post bond, or otherwise provide adequate
11 assurance, to guarantee that any refund amounts due to its customers upon the expiration of
12 the IEC surcharge will remain unencumbered in the event Aquila becomes insolvent or
13 reorganizes its corporate structure.

14 Q. What is your recommendation to the Commission regarding fuel and
15 purchased power expense?

16 A. I recommend that the Commission adopt the Staff's proposal contained herein
17 regarding fuel and purchased power expense as the most reasonable resolution of the related
18 issues and as the resolution of the issues most likely to result in just and reasonable rates.

19 Q. Does this conclude your prefiled surrebuttal testimony in support of the Staff's
20 position regarding fuel and purchased power expense?

21 A. Yes.

Case List

1. The Empire District Electric Company	Case No. ER-83-42
2. Kansas City Power & Light Company	Case No. ER-83-49
3. Union Electric Company	Case No. ER-83-163
4. Arkansas Power & Light Company	Case No. ER-83-206
5. The Empire District Electric Company	Case No. ER-83-364
6. Kansas City Power & Light Company	Case No. EO-84-4
7. Union Electric Company	Case No. EO-85-17
8. Arkansas Power & Light Company	Case No. ER-85-20
9. Arkansas Power & Light Company	Case No. EO-85-146
10. Union Electric Company	Case No. ER-85-160
11. Kansas City Power & Light Company	Case Nos. ER-85-128 & EO-85-185
12. Arkansas Power & Light Company	Case Nos. ER-85-265 & ER-86-4
13. Union Electric Company	Case Nos. EC-87-114 & EC-87-115
14. St. Joseph Light & Power Company	Case No. HR-88-116
15. Union Electric Company	Case No. EO-87-175
16. Missouri Public Service	Case No. ER-90-101
17. The Empire District Electric Company	Case No. ER-90-138
18. Kansas City Power & Light Company	Case No. EM-91-16
19. St. Joseph Light & Power Company	Case No. EO-88-158
20. The Empire District Electric Company	Case No. EO-91-74
21. Missouri Public Service	Case No. EO-91-245
22. Missouri Public Service	Case No. EO-93-37
23. St. Joseph Light & Power Company	Case No. ER-93-41
24. St. Joseph Light & Power Company	Case No. EO-93-351
25. St. Joseph Light & Power Company	Case No. ER-94-163
26. The Empire District Electric Company	Case No. ER-94-117
27. Citizens' Electric Corporation	Case No. ER-97-286
28. The Empire District Electric Company	Case No. ER-97-81
29. The Empire District Electric Company	Case No. ER-97-491
30. Missouri Public Service	Case Nos. ER-97-394 & ET-98-103
31. St. Joseph Light & Power Company	Case Nos. EC-98-573 & ER-99-247
32. Citizens' Electric Corporation	Case No. ET-99-113
33. Union Electric Company	Case No. EO-96-15
34. Union Electric Company	Case No. EO-2000-580
35. The Empire District Electric Company	Case No. ER-2001-299
36. Missouri Public Service	Case No. ER-2001-672 & EC-2002-265
37. Union Electric Company	Case No. EC-2002-1
38. Citizens' Electric Corporation	Case No. ER-2002-217
39. The Empire District Electric Company	Case No. ER-2001-1074 (ER-2001-425)
40. The Empire District Electric Company	Case No. ER-2002-424

SUMMARY OF MODEL RUNS

	\$5.64 Aquila Gas Prices Aquila Purchased Power	\$5.64 Aquila Gas Prices Staff Purchased Power	\$4.00 Aquila Gas Prices Aquila Purchased Power	\$4.00 Aquila Gas Prices Staff Purchased Power	Staff Gas Prices Staff Purchased Power	\$3.5 Aquila Gas Prices Staff Purchased Power
--	--	---	--	---	---	--

**MPS DIVISION
ALLOCATED**

\$	\$110,093,468	\$102,302,002	\$94,148,294	\$95,235,293	\$94,458,823	\$89,062,868
\$/MWH	\$18.942	\$17.592	\$16.195	\$16.383	\$16.244	\$15.322

**AQUILA CASE NO. ER-2004-0034 AND HR-2004-0024 (CONSOLIDATED)
THE DISTRIBUTION OF ADDITIONAL REVENUES THAT WOULD
RESULT FROM STAFF'S PROPOSED IEC SURCHARGE**

AQUILA NETWORKS - MPS

Rate Codes		Current Rate Revenue	Add'l \$ due due to IEC Surcharge	% Change due to IEC Surcharge
MO860	Residential General Use	\$116,063,719	\$7,739,471	6.67%
MO870	Residential w/ Space Heat	\$46,414,471	\$3,095,054	6.67%
MO710,MO711	Small GS, Sec	\$47,738,011	\$3,183,311	6.67%
MO716	Small GS w/kW mtr, Pri TOD (GS) - 1 phase	\$71,837	\$4,790	6.67%
MO720	Large GS, Secondary	\$40,531,461	\$2,702,757	6.67%
MO725	Large GS, Primary	\$1,604,645	\$107,002	6.67%
MO721	RTP (721) TOD (GS) - 3 phase, Sec	\$133,186	\$8,881	6.67%
MO730	Large PS, Secondary	\$24,542,637	\$1,636,575	6.67%
MO735	Large PS, Primary	\$21,560,474	\$1,437,716	6.67%
MO731	RTP (731)	\$990,959	\$66,080	6.67%
MO737	RTP (737)	\$2,518,891	\$167,967	6.67%
MO919	Special Contract (Modine)	\$244,818	\$16,325	6.67%
MO650	Thermal Energy	\$294,133	\$19,614	6.67%
MO740	Schools & Churches, Sec	\$2,794,462	\$186,343	6.67%
MO745	Schools & Churches, Pri			
MO800	Muni Water Pumps	\$458,533	\$30,576	6.67%
MO810	Muni Park & Rec	\$187,610	\$12,510	6.67%
MO811	Muni Park & Rec, 3-phase	\$208,355	\$13,894	6.67%
MONxx	Lighting	\$5,034,628	\$335,724	6.67%
MO888	Interdepartmental	\$12,762	\$851	6.67%
MO720	Economic Development Credits	(\$51,819)	(\$3,455)	6.67%
MO730	Economic Development Credits	(\$587,212)	(\$39,157)	6.67%
MO735	Economic Development Credits	(\$209,936)	(\$13,999)	6.67%
	Total MO Rate Revenue	\$310,556,623	\$20,708,832	6.67%

Schedule 3-1

**INTERIM ENERGY CHARGE
RIDER IEC**

APPLICATION:

This Interim Energy Charge Rider is applicable to all electric service billed under any electric rate schedule, metered or unmetered, subject to the jurisdiction of the Missouri Public Service Commission (MPSC) as reflected separately on each rate schedule. The revenue from this rider will be collected on an interim and subject to true-up and refund basis under the terms ordered in Case No. ER-2004-0034.

RATE:

In addition to the charges that Aquila makes for electric service set forth in its approved and effective rate schedules, the following percentage amount will be added:

Aquila Networks MPS (electric).....6.67%

CONDITIONS:

This interim rider shall be in effect for two (2) years from the original effective date of this tariff. Subsequent to the expiration a true-up audit will determine if any portion of the revenues collected exceed Aquila's actual and prudently incurred cost for fuel and purchased power during the interim period, and refunds, if warranted will be issued. Interest will be equal to the prime rate in effect on the day the IEC expires and will be applied to any amount to be refunded. No refund will be made if Aquila's actual and prudently incurred costs for fuel and purchased power during the IEC period equal or exceed the revenues collected.

Such refunds, if any, shall be based upon the billing units of the customer to which these amounts were applied. Any refund will appear as a one-time credit on the customer's bill.