

*Exhibit No.:* 1012  
*Issues:* Accounting Authority Orders,  
Property Taxes  
*Witness:* Trisha D. Miller  
*Sponsoring Party:* MoPSC Staff  
*Type of Exhibit:* Surrebuttal Testimony  
*Case No.:* ER-2004-0034

*Date Testimony Prepared:* February 13, 2004 as modified February 27, 2004

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

**SURREBUTTAL TESTIMONY**

**OF**

**TRISHA D. MILLER**

**AQUILA, INC.**

**d/b/a AQUILA NETWORKS-MPS (Electric)**

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

*Jefferson City, Missouri*  
*February 2004*

**FILED<sup>2</sup>**

**FEB 27 2004**

**Missouri Public  
Service Commission**


**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 ) Case No. ER-2004-0034  
general rate increase in electricity. )

AFFIDAVIT OF TRISHA D. MILLER

STATE OF MISSOURI     )  
                                  )     ss.  
COUNTY OF COLE     )

Trisha D. Miller, of lawful age, on her oath states: that she has participated in the preparation of the following surrebuttal testimony as modified on February 27, 2004, in question and answer form, consisting of 25 pages to be presented in the above case; that the answers in the following surrebuttal testimony as modified on February 27, 2004, 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.

  
\_\_\_\_\_  
Trisha D. Miller

Subscribed and sworn to before me this 27<sup>th</sup> day of February 2004.



  
\_\_\_\_\_

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

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12

**TABLE OF CONTENTS**  
**SURREBUTTAL TESTIMONY**  
**TRISHA D. MILLER**  
**AQUILA, INC. d/b/a AQUILA NETWORKS-MPS (Electric)**  
  
**CASE NO. ER-2004-0034**

Ice Storm AAO Unamortized Balance .....	1
The Sibley Rebuild Project AAO and the Sibley Western Coal Conversion AAO.....	8
Property Taxes .....	16

1 **SURREBUTTAL TESTIMONY OF**

2 **TRISHA D. MILLER**

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

4  
5 **CASE NO. ER-2004-0034**

6  
7 Q. Please state your name and business address.

8 A. Trisha D. Miller, P.O. Box 360, Suite 440, Jefferson City, MO 65102.

9 Q. Are you the same Trisha D. Miller who has previously filed direct and rebuttal  
10 testimony in this proceeding?

11 A. Yes, I am.

12 Q. What is the purpose of this surrebuttal testimony?

13 A. The purpose of this testimony is to address the rebuttal testimony filed by the  
14 Aquila Networks - MPS ("MPS") electric operations  
15 witness Dennis R. Williams concerning the issues of rate base  
16 treatment for the unamortized balance of the ice storm Accounting Authority Order (AAO)  
17 and property taxes. I will also address the rebuttal testimony filed by the Office of the Public  
18 Counsel ("OPC") witness Ted Robertson concerning the issue of rate base treatment for the  
19 unamortized balances of the MPS Sibley rebuild project AAO, the MPS Sibley western coal  
20 conversion AAO.

21 **ICE STORM AAO UNAMORTIZED BALANCE**

22 Q. Please define AAOs.

Surrebuttal Testimony of  
Trisha D. Miller

1           A.     AAOs are applications made by a utility to account for specific events or  
2 items in a manner that differs from the Federal Energy Regulatory Commission's (FERC)  
3 prescribed Uniform System of Accounts (USOA) in some manner. Most often, AAOs are  
4 used to "defer" on the utility's balance sheet a cost that would otherwise be charged to  
5 expense currently on the utilities' income statement. This treatment allows a utility to seek  
6 rate recovery of the deferred item in a subsequent rate case, even if the cost in question was  
7 not incurred within the test year ordered for that rate proceeding. The Commission has  
8 usually reserved deferral treatment of expenses for "extraordinary items." Extraordinary  
9 items are defined as costs that are unusual in nature and infrequent in occurrence.

10          Q.     Can capital items be the subject of AAOs as well as expense items?

11          A.     Yes, if the capital expenditure has the nature of an extraordinary item. In that  
12 instance, depreciation expense, property tax expense and carrying charges associated with the  
13 extraordinary capital asset may be given deferral treatment through a Commission authorized  
14 AAO. The Commission has granted capital cost AAOs on several occasions, including the  
15 before-mentioned cases involving the MPS Sibley rebuild project and the MPS Sibley  
16 western coal conversion.

17          Q.     Once costs are deferred pursuant to the Commission granting an AAO, are the  
18 deferred costs subsequently allowed recovery in rates?

19          A.     Yes, if the Commission finds rate recovery to be appropriate. As a standard  
20 practice, the Commission has reserved all ratemaking questions concerning costs deferred  
21 through AAO applications to subsequent rate proceedings. If the Commission does approve  
22 recovery of deferred costs, that recovery generally takes the form of an expense amortization

Surrebuttal Testimony of  
Trisha D. Miller

1 over periods that have ranged from five to twenty years. The Commission may or may not  
2 grant rate base treatment to the unamortized balance of the AAO deferral.

3 Q. Is the Staff recommending rate recovery of the ice storm AAO deferral?

4 A. Yes. Staff is recommending rate recovery of the deferred costs associated  
5 from the winter ice storm that occurred on the MPS system during the end of January in  
6 2002.

7 Q. Is the Staff recommending rate base treatment of the unamortized balance of  
8 the ice storm AAO?

9 A. No. The Staff disagrees with the treatment of the unamortized balance the ice  
10 storm AAO proposed by the Company witness, Mr. Williams, as set out in his rebuttal  
11 testimony.

12 Q. Please explain why the Staff disagrees with Mr. Williams' rebuttal testimony  
13 on this issue.

14 A. The Staff's disagreement with Mr. Williams' position relates to his statement  
15 on page 12, line 15 of his rebuttal testimony that "the Company is not financially made  
16 whole" if the unamortized balance of the AAO is not given rate base treatment.  
17 Mr. Williams' statement reveals his philosophy that the Company should be able to recover  
18 all of its expenses, and that in essence the shareholder should be shielded from the entire risk  
19 of owning an electrical transmission and distribution system that from time to time is  
20 subjected to winter elements and other forces of nature. It is the Staff's opinion that risk is  
21 inherent for utilities, including the risk of natural disaster or "acts of God." By providing rate  
22 base treatment for the unamortized balance of the AAO, as well as recovery of the deferred  
23 costs through amortization, the Company will be completely shielded from the financial risk

Surrebuttal Testimony of  
Trisha D. Miller

1 of a natural disaster. Events such as severe ice storms are extraordinary events that occur  
2 infrequently in the course of business, and not only the Company's customers but also the  
3 Company's shareholders should share the risk of such occurrences.

4 Q. Mr. Williams states on page 12, line 8 of his rebuttal testimony that MPS has  
5 already incurred and expended costs to repair broken lines, utility poles, electric meters and  
6 other items damaged by the ice storm in January 2002. He also states on page 12, line 6 that  
7 these costs are in the public interest of "providing safe and reliable service" and therefore  
8 should be included in rate base. Why does the Staff disagree with the Company's position  
9 that the unamortized portion of these extraordinary maintenance costs should be included in  
10 rate base?

11 A. It is the function of the Company to provide safe and adequate service to its  
12 customers as part of its obligation to serve its customers. However, this does not mean that  
13 the Company should be guaranteed total recovery of all expenses. Extraordinary expenses  
14 associated with "acts of God" by their very nature should be shared between shareholders  
15 and ratepayers. This treatment has been the consistent policy in Missouri for many years.  
16 The Staff's allowance of recovery of the cost, without rate base treatment, is still a benefit  
17 that a non-regulated firm would not receive. "Acts of God," not protected by insurance, must  
18 be borne entirely by shareholders of a non-regulated firm.

19 Q. Mr. Williams believes the shareholders would not be completely shielded  
20 from the risks of the ice storm under the Company's proposed rate base treatment. Why do  
21 you disagree?

22 A. There are three points Mr. Williams tries to make to support his belief that the  
23 shareholders have made a significant contribution to the ice storm costs and, therefore,

Surrebuttal Testimony of  
Trisha D. Miller

1 deserve rate base treatment. The first relates to the amortization of the deferral that began  
2 February 2002, several months prior to the operation-of-law date in MPS's current case, Case  
3 No. ER-2004-0034. Mr. Williams states in his rebuttal testimony on page 12, line 9: "To  
4 date, nearly two years after the effects of the ice storm, the financial impact of the ice storm  
5 is not reflected in the utility rates that MPS charges its electric customers." In response, the  
6 Staff maintains the position that it is just as likely that the Company will ultimately over-  
7 recover this item in rates as that it will under-recover this item in rates, if rates are not  
8 immediately reduced when the ice storm AAO amortization expires. In fact, it is unlikely  
9 that the expiration of an amortization amount being recovered in rates exactly matches the  
10 operation-of-law date for new rates.

11  
12  
13  
14  
15 Q. What is the second point that Mr. Williams attempts to make to justify to why  
16 the Company should receive rate base treatment for the unamortized balance for the ice storm  
17 AAO?

18 A. Mr. Williams' states his second point, on page 12, line 13 of his rebuttal  
19 testimony: "By not allowing the unamortized balance in rate base, the Company is penalized  
20 from earning a reasonable return on its plant investment, and the Company is not financially  
21 made whole." This statement is misleading. All capital expenditures made to replace plant  
22 investment due to the ice storm have been capitalized to plant in service, and will receive a  
23 reasonable return in rate base. The amounts expended for the ice storm associated with



Surrebuttal Testimony of  
Trisha D. Miller

1 repairs of lines, poles, meters, and other items are considered maintenance expenses and are  
2 included in the unamortized balance of the ice storm AAO. By denying rate base treatment  
3 for the unamortized balance for the maintenance expenses associated with the AAO, the  
4 Company is actually receiving the traditional expense recognition for maintenance expenses  
5 in rates.

6 For example, if the Company performs maintenance on the distribution system or  
7 repairs on a transmission line in the normal course of maintaining its electrical system, the  
8 costs are typically expensed with no rate base treatment of the expenditures. Only the  
9 amounts relating to capital expenditures for replacement of facilities such as the replacement  
10 of an electric pole receive rate base treatment. Thus, the position of including capitalized  
11 amounts in rate base relating to the ice storm restoration and expensing those costs that are  
12 not considered capitalized in nature is consistent with denying rate base treatment for the  
13 unamortized balance of the AAO.

14 It is important to note that the AAO unamortized balance consists of only  
15 extraordinary maintenance expenses, not expenditures that were capitalized. To include the  
16 unamortized balance of the AAO in rate base would inappropriately allow expense items to  
17 receive the same treatment of capitalized expenditures.

18 Q. Please continue.

19 A. Mr. Williams' third contention on how the Company shareholders will not be  
20 made totally whole under his proposed rate base treatment can be found on page 10, line 9 of  
21 his rebuttal testimony. There, Mr. Williams states that the Company has gone nearly two  
22 years after the effects of the ice storm without an increase in rates. However, in  
23 recommending an AAO for MPS's ice storm costs, it was not the Staff's intent to cure

Surrebuttal Testimony of  
Trisha D. Miller

1 regulatory lag. Rather, the AAO is intended as a vehicle to give some rate recognition to  
2 these extraordinary costs. As previously mentioned, AAOs are often used to “defer” on the  
3 utility’s balance sheet a cost that would otherwise be charged to expense currently on the  
4 utility’s income statement. It is totally up to the Company’s discretion as when to file a rate  
5 case. Therefore, it is totally up to the Company when costs from an AAO amortization can  
6 be included in rates.

7 Q. Please summarize the reasons for the Staff’s position of not including the  
8 unamortized portion of the ice storm AAO in rate base.

9 A. AAO recovery for extraordinary events allows the return of expended dollars  
10 that the Company incurred to restore the utility system back to service. By not allowing the  
11 unamortized balance in rate base for these expenditures, the Company is not provided a  
12 return on the costs, or in other words is not allowed a carrying charge for those costs. By  
13 allowing rate base treatment of the unamortized balance of the ice storm AAO the Company  
14 is provided recovery of the actual expenses incurred to restore the utility system, but is  
15 denied recovery of carrying costs. In essence, this treatment allows a sharing of costs  
16 between the ratepayers and the Company.

17 Q. Mr. Williams states at page 14, line 12 that “all of the data requests mentioned  
18 in Ms. Miller’s direct testimony were answered and received by Staff prior to filing its direct  
19 testimony on December 9, 2003.” Is additional information still needed by the Staff to  
20 further analyze the recovery of the costs associated with the ice storm AAO?

21 A. No. Certain data requests pertaining to the ice storm were received four days  
22 prior to filing. Due to internal deadlines for the direct filing, there was not sufficient time to  
23 analyze and verify all of the information provided in Staff Data Request Nos. 544 and 564

Surrebuttal Testimony of  
Trisha D. Miller

1 prior to the filing of my direct testimony. Since the direct filing, the Staff has been able to  
2 determine the level of Company's normal operating costs based on the responses to these  
3 data requests. The Staff is now satisfied with the supporting documentation and is in  
4 agreement with the Company's quantification of the level of incremental expenses caused by  
5 the ice storm that are reflected in the ice storm AAO deferral.

6 **THE SIBLEY REBUILD PROJECT AAO AND THE SIBLEY WESTERN COAL**  
7 **CONVERSION AAO**

8 Q. What is the past history of rate base treatment for the Sibley rebuild project  
9 AAO and the Sibley western coal conversion AAO deferrals for MPS?

10 A. The Commission has consistently allowed MPS both a return "of" and return  
11 "on" the MPS Sibley rebuild project AAO and the MPS Sibley western coal conversion  
12 project AAO. The unamortized balances of these deferrals have been given rate base  
13 treatment in each of MPS' rate cases filed by the Company since the Commission first  
14 authorized recovery of these deferrals in Case No. ER-90-101. The subsequent rate cases  
15 were Case Nos. ER-93-37, ER-97-394 and ER-2001-672.

16 Q. Please describe OPC witness Robertson's position on the treatment of the  
17 unamortized balances of the Sibley rebuild project and the Sibley western coal conversion  
18 AAOs.

19 A. OPC is recommending that the unamortized balances of the Sibley rebuild  
20 project AAO and the Sibley western coal conversion AAO be excluded from rate base.

21 Q. Does the Staff agree with OPC's position?

Surrebuttal Testimony of  
Trisha D. Miller

1           A.     No. The Staff's position in this case is to continue to include in rate base the  
2 unamortized balances associated with the MPS Sibley rebuild project AAO and the MPS  
3 Sibley western coal conversion AAO consistent with the original treatment authorized by the  
4 Commission in 1990.

5           Q.     Please state OPC's reasoning for excluding the unamortized balances  
6 associated with the MPS Sibley rebuild project and the MPS Sibley western coal conversion.

7           A.     Mr. Robertson states on page 9, line 15 of his rebuttal testimony that "the  
8 cases Ms. Miller cites occurred early in the Commission's process of developing, or  
9 adopting, what commonly became known as accounting authority orders. In later cases, the  
10 Commission recognized that allowing a utility to earn a return on the deferred costs was not  
11 an appropriate regulatory policy."

12          Q.     Please describe the "later cases" Mr. Robertson is referring to above.

13          A.     Mr. Robertson is referring to the Missouri Gas Energy (MGE) natural gas rate  
14 case, No. GR-98-140. Prior to this case the Commission had allowed MGE as well as its  
15 predecessor company Western Resources, Inc. (WRI), both a return "of" and return "on" its  
16 Service Line Replacement Program (SLRP) deferrals in rates over 20 years. In the MGE  
17 case, the Commission determined that rate base treatment of the unamortized balance of  
18 SLRP deferrals was no longer appropriate, since it was accelerating the amortization period  
19 from the original 20-year period to 10 years. The Commission stated in its Report and Order,  
20 at page 20: "Given that the Company will recover the amortized amount of the SLRP  
21 deferral at the AFUDC rate in ten years, instead of the previous 20 years' amortization  
22 period, it is proper for the ratepayers and shareholders to share the effect of regulatory lag by

Surrebuttal Testimony of  
Trisha D. Miller

1 allowing the Company to earn a return of the SLRP deferred balance but not a return on the  
2 SLRP deferred balance.”

3 Q. Did the Company (MGE) propose less than a 20-year amortization period in  
4 Case No. GR-98-140?

5 A. Yes. MGE proposed a ten-year amortization period for the SLRP deferrals.  
6 In the previous MGE rate case, Case No. GR-96-285, MGE proposed a three-year  
7 amortization period for the unrecovered amortization relating to the SLRP deferrals.

8 Q. Is MPS proposing a different amortization period than ordered in prior rate  
9 cases for the Sibley rebuild project AAO and the Sibley western coal conversion AAO?

10 A. No. The Company is proposing the same amortization period of twenty years  
11 for the Sibley rebuild project AAO and the Sibley western coal conversion AAO as first  
12 determined in MPS’ rate case, Case No. ER-90-101, and then continued in subsequent rate  
13 cases.

14 Q. Please summarize the Staff’s position relating to OPC’s regarding rate base  
15 treatment for the Sibley rebuild project AAO and the Sibley western coal conversion AAO.

16 A. Staff is proposing the traditional amortization period and rate base treatment  
17 for the unamortized balances as set in past MPS proceedings before the  
18 Commission. By this time, the Sibley rebuild project AAO and the Sibley western coal  
19 conversion AAO have both been amortized over more than half of their designated  
20 amortization period of 20 years. In the case of the Sibley rebuild project AAO, the deferral  
21 has been amortized for almost 14 years, with six years remaining. In the case of the Sibley  
22 western coal conversion AAO, recovery in rates started in mid 1993. Therefore, over 10  
23 years of rate recovery have occurred to this point with another 10 years remaining. These

Surrebuttal Testimony of  
Trisha D. Miller

1 projects represent major capital additions to plant in service, as opposed to extraordinary  
2 maintenance expenditures resulting from an extraordinary occurrence such as the ice storm.

3 Q. Does the Staff agree with OPC's position that the unamortized balance of the  
4 ice storm AAO should not be included in rate base?

5 A. Yes, for the reasons previously discussed.

6 Q. Please describe the Staff's reasoning for denying rate base treatment to the  
7 unamortized balance of the ice storm AAO, but allowing rate base treatment for the  
8 unamortized balances of the Sibley Rebuild Project AAO and the Sibley western coal  
9 conversion AAO.

10 A. The amounts included in the ice storm AAO were considered extraordinary  
11 repair and maintenance expenditures. These extraordinary costs were incurred to restore  
12 service under emergency conditions to normal operating conditions. In contrast, the amounts  
13 included in the Sibley rebuild project AAO and the Sibley western coal conversion AAO  
14 were costs associated with the capital expenditures made to extend the life of three  
15 generating units and resulted in closer compliance with the Clean Air Act standards.

16 Q. Did the Staff originally oppose the AAOs relating to the Sibley rebuild  
17 program and the Sibley western coal conversion?

18 A. Yes. A review of the Report and Order in Case No. ER-90-101 indicates that  
19 the Staff opposed the AAO treatment for the Sibley projects. However, in recognition of the  
20 possibility that the Commission might authorize rate treatment for the AAO's, the Staff  
21 identified the process that should be used to quantify any such recovery. This quantification  
22 method related to what is referred to as "construction accounting." This treatment was  
23 identified in detail in Case No. ER-90-101 to ensure that proper accounting and ratemaking

Surrebuttal Testimony of  
Trisha D. Miller

1 processes would be used should the Commission approve the AAO recovery, as MPS was  
2 advocating in that case.

3 Q. What is “construction” accounting?

4 A. The USOA has a prescribed method for accounting for construction  
5 expenditures while a plant item is being built or constructed. The USOA accounts used for  
6 construction accounting are described below, in the order that the expenditures are accounted  
7 for, as the expenditures are ultimately booked into plant in service:

8 Q. What is Construction Work In Progress (CWIP)?

9 A. These are amounts booked into Account 107 Construction Work In Progress  
10 Electric. This account includes all direct material, indirect materials, direct labor, indirect  
11 labor and property taxes associated with all items in construction, and etc. As a project is  
12 completed, placed in service and therefore used and useful, the amount of materials, labor,  
13 property taxes and etc. associated with the construction project are transferred into  
14 Account 101, Electric Plant in Service. Any expenditure associated with a project that has  
15 not been completed will remain in Account 107 until the project is completed. It is not  
16 uncommon for a company of MPS’s size to continuously have a balance in Account 107  
17 since construction projects are being started and completed on a continuous basis.

18 Q. What costs are booked in the Plant in Service Account?

19 A. Account 101, Electric Plant in Service, reflects the capitalized cost of all plant  
20 owned by the utility that is used and useful at original cost, per the costs transferred from  
21 Account 107 associated with the construction project that produced the plant in service.  
22 When costs are transferred into this account, depreciation expense begins to be accrued on  
23 the asset.

Surrebuttal Testimony of  
Trisha D. Miller

1 Q. Please give the USOA definitions for Account 101, Electric Plant in Service  
2 and Account 107, Construction Work in Progress-Electric.

3 A. Account 101 Electric Plant in Service is defined by the USOA as:

4 This account shall include the original cost of electric plant, included  
5 in accounts 301 to 399, prescribed herein, owned and used by the  
6 utility in its electric utility operations, and having an expectation of life  
7 in service of more than one year from date of installation, including  
8 such property owned by the utility but held by nominees.

9 Account 107 Construction Work in Progress--Electric is defined by USOA as:

10 This account shall include the total of the balances of work orders for  
11 electric plant in process of construction.

12 Work orders shall be cleared from this account as soon as practicable  
13 after completion of the job.

14 Q. Please describe the ratemaking issue that developed with the Sibley rebuild  
15 project and the Sibley western coal conversion.

16 A. As described above, when these projects were completed, the costs were  
17 transferred from the construction work in progress account to the plant in service account as  
18 required by the USOA, and depreciation expense began to incur on the assets when these  
19 assets went into service. MPS incurred this expense and carrying costs related to the project  
20 without the expenses being reflected in rates. The costs associated with the plant in service  
21 began to "hit" the income statement without corresponding revenues. Therefore, MPS  
22 sought to protect its earnings level after these projects went into service through the AAO  
23 mechanism. The Commission ruled in Case No. ER-90-101 that it was appropriate to allow a  
24 deferral and later recovery of the carrying costs, depreciation and property taxes relating to  
25 the interim period of time between when the plant investment is completed and placed in  
26 service and when that plant is reflected in rates. The Commission eased the gap of time



Surrebuttal Testimony of  
Trisha D. Miller

1 between when construction was completed and then placed in service, to when the Company  
2 was allowed to recover the plant costs in rates.

3 Q. How were these costs treated in Case No. ER-90-101?

4 A. The depreciation, property taxes and return component related to these  
5 completed projects formed the basis for the deferral that the Commission decided to amortize  
6 over a 20-year period.

7 Q. Did the Commission deviate from the USOA accounting in allowing these  
8 deferrals?

9 A. Yes. USOA accounting does not allow for these types of costs to be  
10 capitalized after construction is completed, thus the need for AAO accounting treatment to  
11 allow the deferral. The reasoning for the Commission's decision to deviate from the USOA  
12 is stated below as taken from the Report and Order, in Case No. ER-90-101:

13 The final matter to be addressed on this issue involves the length of  
14 time over which these deferred rates should be amortized and whether  
15 the unamortized portion of these costs should be reflected in rate base.  
16 Staff/Public Counsel contend that, if these costs are to be reflected in  
17 rates, they should be amortized over 20 years, the extended life of the  
18 Sibley Generating Station with the unamortized costs not reflected in  
19 rate base. Staff/Public Counsel support this viewpoint by stating that  
20 the Commission has afforded such costs this treatment in prior similar  
21 instances.

22 Company contends that these costs should be amortized over a three-  
23 year period which is the approximate length of time for completing  
24 these projects. Company believes this approach would match the  
25 recovery of costs with the enjoyment of benefits arising from these  
26 projects. Company maintains that the unamortized portion of these  
27 costs should be included in rate base in order that Company may be  
28 compensated for the value of the money for the time occurring  
29 between the spending of the funds and their ultimate recovery.

30 The Commission determines that these costs should be amortized over  
31 20 years which is the approximate extended life of the plant. The  
32 Commission finds that this approach matches the payments of the  
33 costs by the ratepayers for the rebuilding with their enjoyment of its  
34 benefits. The Commission further determines that the unamortized

Surrebuttal Testimony of  
Trisha D. Miller

1 costs should be reflected in rate base. This is the usual practice when  
2 capital costs are amortized. The cases cited by Staff/Public Counsel  
3 deal with extraordinary maintenance costs and therefore, are not  
4 applicable.

5 \_\_\_\_\_

6

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16

17 **PROPERTY TAXES**

18 Q. Does the Staff agree with Mr. Williams' rebuttal testimony on page 23 where  
19 he describes his understanding of the Staff's adjustment to annualize property tax expense?

20 A. No. The Staff examined property tax payments made in 2000, 2001 and 2002  
21 to determine the trend in property taxes paid. The Staff determined that property taxes paid  
22 over the three-year period had decreased from year to year. The Staff calculated the

Surrebuttal Testimony of  
Trisha D. Miller

1 adjustment by developing a property tax rate to be applied to total electric plant in service as  
2 of December 31, 2002. The Staff developed the property tax rate by dividing the amount of  
3 total company (MPS) property taxes paid in 2002 by the total property as of  
4 December 31, 2001. This property tax rate was then applied to total plant in service at  
5 December 31, 2002, to arrive at annualized property taxes. From this amount, the amount of  
6 property taxes charged to construction (capitalized) was deducted to arrive at annualized  
7 property tax expense. The annualized property tax expense was then subtracted from test  
8 year property tax expense to arrive at the adjustment.

9 Q. At page 23 of Mr. Williams' testimony, he indicated that the Company  
10 disagrees with the Staff's amount of property tax expense included in the test year audit. Do  
11 you agree with Mr. Williams' criticism that the Staff's property tax annualization ignores  
12 property that was placed in service during the test year update, January 1 through  
13 September 30, 2003?

14 A. No. As stated earlier, the Staff calculated property taxes based upon the  
15 actual property tax payments at December 31, 2002, the end of the Staff's test year. This  
16 payment of tax is based on the value of the property owned as of December 31, 2001, which  
17 is the date property is assessed for taxing purposes. The relationship reflects how tax  
18 payments are actually determined by the taxing authorities.

19 Q. Why is the December 31/January 1 (January 1) assessment date important?

20 A. The state and local taxing authorities use January 1 as the assessment date to  
21 determine the appraised value of the property, which forms the basis of the property tax  
22 liability owed the state and political subdivisions for the calendar year. Any plant additions  
23 or property that are completed and booked to plant in service during the period of January 2

Surrebuttal Testimony of  
Trisha D. Miller

1 through December 31 of any given calendar year will not be assessed for property tax  
2 purposes until January 1 of the following year. In essence, the property tax liability  
3 associated with this plant is not due to the state and local taxing authorities until November-  
4 December of the subsequent year. Thus, unless the property was in-service on January 1, the  
5 taxes will not be owed until November-December of the following year.

6 As an example, any plant additions that MPS added to its plant in service on  
7 January 2, 2003, will not be assessed by the taxing authorities until January 1, 2004; the taxes  
8 will not be billed until November-December of the following year; and the taxes will not  
9 actually be paid until December 31, 2004.

10 Q. Mr. Williams states at page 24, lines 12 through 14 of his rebuttal testimony  
11 “Using Staff’s calculation methodology, Aquila is being denied recovery of property tax  
12 expense amounts associated with property that was placed in service during the known and  
13 measurable time frame.” Does the Staff agree?

14 A. No. Mr. Williams is attempting to persuade the Commission that the Staff’s  
15 calculation of property taxes is in some way mismatched with the Staff’s other  
16 normalizations and annualizations throughout the rest of its case. The Staff has calculated  
17 the property tax annualization based upon how the taxing authorities assess and how Aquila  
18 ultimately pays these taxes. Because of the unique nature of how property taxes are  
19 determined and ultimately paid, the typical normalization and annualization process used by  
20 both the Company and the Staff for other expense items is not appropriate for property tax  
21 expense.

22 The previous example of plant additions included in plant in service on January 2,  
23 2003, is an illustration of the unique nature of property taxes. Unlike a payroll or revenue

Surrebuttal Testimony of  
Trisha D. Miller

1 annualization, which the Staff attempts to include through an end of the test year, the end of  
2 an update to the test year period, or the end of a true-up period, the January 2, 2003, plant in  
3 service balances will not be included in the Company's booked property tax expenses until  
4 January 2004. Indeed, Aquila will not accrue a property tax expense for any of the plant  
5 additions through the end of the update period of September 30, 2003, until January of 2004.  
6 This accrual will only be an estimate because the Company will not know the actual amount  
7 of property tax payments until late in 2004, when the taxing authorities distribute the tax  
8 bills, usually in November or December of that year. The property tax amounts will not  
9 actually be paid until December 31, 2004, the due date for property taxes.

10 Q. Does the Staff's method of determining property taxes include plant  
11 investments as of September 30, 2003?

12 A. Yes. To the extent that plant investment was in service as of January 1 of  
13 2003, these plant dollars would be assessed and paid for by the end of the year 2003.  
14 Aquila's proposed calculation for property taxes includes all plant additions from the  
15 beginning of the year through September 30, 2003.

16 Q. When would Aquila have to pay the property taxes on the September 30,  
17 2003, plant additions that Mr. Williams is proposing in rates?

18 A. The plant additions that occurred through September 30, 2003, will not be  
19 assessed until January 1, 2004, and not be paid by the Company until December 31, 2004, a  
20 full 15 months past the update period in this case. In fact, these property taxes will not be  
21 paid by Aquila until six months past the operation-of-law date for this case of June 2004.

Surrebuttal Testimony of  
Trisha D. Miller

1 Q. Has the Commission recognized the importance of maintaining the proper  
2 relationship between revenues, expenses and rate base in this rate proceeding and previous  
3 rate proceedings?

4 A. Yes. In the Suspension Order and Notice the Commission stated: “The  
5 Commission will not consider a true-up of isolated adjustments, but will examine only a  
6 “package” of adjustments designed to maintain the proper revenue-expense-rate base match  
7 at a proper pointing [sic] in time.” Similar language has been used in many other rate  
8 proceedings before the Commission.

9 Q. Would it be appropriate to include an accrual/estimate of property taxes to be  
10 paid in 2004 in this rate case?

11 A. No. The Staff is considering no other expense item for inclusion in this case  
12 anytime in 2004. It is important to note that the property taxes that Aquila paid on or about  
13 December 31, 2002, represents the level of plant at January 1, 2002, which is the exact time  
14 period which the Staff used to calculate its property tax annualization in this case.

15 Q. Does Aquila’s proposal to include a level of property tax expense based upon  
16 plant in service as of September 30, 2003, violate the test year concept?

17 A. Yes. Aquila’s proposed level of property tax expense violates the test year  
18 and the test year update periods in this case. This proposal is not consistent with a complete  
19 “package” of adjustments that appropriately reflects a consistent revenue-expense-rate base  
20 relationship at a point in time. Mr. Williams has only considered one item of expense out to  
21 late 2004 with his proposed property tax treatment, while not considering other items such as  
22 additional revenues from customer growth during 2004, property insurance, plant additions  
23 and retirements, depreciation reserve and possibly other items to the same point in time.

Surrebuttal Testimony of  
Trisha D. Miller

1 Q. Why is it important to maintain the proper relationship of the individual  
2 components that make up the revenue requirement?

3 A. It is very important that all elements of the revenue requirement be considered  
4 at a consistent point in time because events occur that result in constant changes in revenues,  
5 expenses and rate base that cause changes to the overall revenue requirements. Reflecting  
6 changes for only one element of the revenue requirement, in this case property taxes, without  
7 consideration of other offsetting changes in other revenue requirement components, will  
8 likely lead to setting a distorted level of rates.

9 Q. Is the Company's proposed level of property tax expense "known and  
10 measurable?"

11 A. No. Aquila's proposed level of property tax expense is not a known and  
12 measurable expense, which can or should be included in the cost of service in this  
13 proceeding.

14 Q. Please define the term "known and measurable."

15 A. A "known and measurable" expense is an expense that is 1) "known,"  
16 meaning that the amount is certain to occur, did or definitely will be an actually incurred cost  
17 and 2) "measurable," meaning that the rate impact of the change (for example, property tax  
18 expense) can be calculated with a high degree of accuracy. The significance of this term is  
19 that historically the Commission has only reflected in rates the revenue requirement changes  
20 that were known and measurable at the time the rate decision was made. Therefore, property  
21 taxes associated with the September 30, 2003, plant balance are not "known and measurable"  
22 until 2004. The January 1, 2004, assessment date is outside the test year and does not  
23 constitute a proper or appropriate inclusion into the cost of service in this case.



Surrebuttal Testimony of  
Trisha D. Miller

1 Q. If the Company does not “know” what the actual amounts of property tax  
2 expense will be until late in a given year, how does Aquila determine the level which it books  
3 to expense on a monthly basis?

4 A. Each year the Company will attempt to estimate the appropriate expense level  
5 it believes will be incurred in that given year. It may change its estimate from time to time  
6 during the course of the year but, ultimately, when the actual property tax payment amount  
7 becomes known, Aquila must book a “true up” amount to make the actual property tax  
8 payment equal the level recorded for the year on its books and records. These “true up”  
9 amounts are generally booked late in the year, usually in November or December. The actual  
10 amounts of property taxes associated with the September 30, 2003, plant levels (as well as  
11 any level of property tax on plant in service levels during 2003) will be estimated and booked  
12 as an expense beginning in January 2004 and will not actually be known until November-  
13 December of that year. The property tax “true-up” adjustment to correct the earlier property  
14 tax estimates will not be until late in 2004, as it relates to 2003 additions. Thus, Aquila’s  
15 proposal regarding property taxes in this case would result in a mismatch of the relationship  
16 between revenue, expense, and rate base.

17 Q. Is there a difference between the amounts charged to expense for property  
18 taxes for any given year and the property tax payments for that year?

19 A. Property taxes assessed on plant in service are expensed. Property taxes are  
20 also assessed on Aquila’s construction activities. The amount of property taxes associated  
21 with construction work in process (CWIP) is capitalized. The property taxes expensed are  
22 different than the total payment amounts because of the portion that is capitalized on the

Surrebuttal Testimony of  
Trisha D. Miller

1 utilities books. In other words, the amount of property taxes expensed will be lower than the  
2 total property taxes paid because of the capitalized portion of property taxes.

3 Q. Did the Staff include property taxes on construction in its case?

4 A. No. Property taxes relating to construction that is assessed on January 1 of  
5 any given year is capitalized to construction and captured in the CWIP account or  
6 Account 107. The only portion of property taxes that should be included in expense are  
7 those property taxes relating to the plant in service balance through the January 1 date, not  
8 the plant additions made through September 30, 2003, that will be assessed on January 1,  
9 2004.

10 Q. On page 24, lines 1 through 3 of Mr. Williams' rebuttal testimony, he  
11 describes how the Company calculated the level of property tax expense that they propose.  
12 Do you agree with this calculation?

13 A. I agree that the mathematics are correct, but that calculation is not based on  
14 how property taxes are actually assessed. The December 31, 2002, or January 1, 2003, plant  
15 balances are used to assess the property, not the September 30, 2003, plant balances. The  
16 September 30, 2003, plant balances will never be used for assessment purposes since that is  
17 not how the taxing authorities assess for property taxes. The September 30, 2003, balances  
18 will be included in the January 1, 2004, balances for assessment purposes. The property tax  
19 amount will not be known until approximately November or December 2004 and the  
20 payment will not be actually due until December 31, 2004.

21 Q. Has this issue, or a similar issue, previously been tried before the  
22 Commission?

1           A.     Yes, several times.  Recently in Case No. ER-2001-299, the Empire District  
2 Electric Company (Empire) proposed a property tax balance of June 30, 2001, in the  
3 Company's property tax adjustment calculation, very similar to Aquila's request for  
4 September 30, 2003, levels in this case.  The June 30, 2001, date was associated with the  
5 true-up period of the rate case to include Empire's State Line Combined Cycle Unit in rates.  
6 The Commission stated in the Report and Order at page 22:

7                     The Commission finds that the arguments of Staff and Praxair  
8 regarding the property tax issue are persuasive.  Staff's estimate of  
9 property taxes is based upon known and measurable factors and  
10 preserves appropriate matching of all revenue requirements, and is  
11 consistent with the Commission's past practice.  Empire's position is  
12 not based upon known and measurable factors.  In addition, it would  
13 be unreasonable for the Company to start charging ratepayers in  
14 October 2001 for (estimated) costs that the Company will not start  
15 paying until January 2002.  The Commission determines that it will  
16 not increase the total company revenue requirement to account for  
17 property taxes on the additional plant in service.

18           Also, in Case No. GR-96-285, Missouri Gas Energy (MGE) contended that the most  
19 current known and measurable plant balances should be used to calculate an ongoing level of  
20 property tax expense.  Thus, MGE used a May 30, 1996, plant balance in the annualization  
21 of property tax expense.  The Staff's position was that the last actual property tax assessment  
22 should be used to determine property taxes for revenue requirement purposes.  The  
23 Commission found in favor of the Staff's position on this issue.  The Commission stated in  
24 its ruling that:

25                     MGE will not accrue a property tax expense for any of the plant  
26 additions through May 31, 1996 identified in the Rebuttal Testimony  
27 of Mr. Kelly until January of 1997.  This accrual will only be an  
28 estimate for which the Company will not know the actual amount of  
29 property tax payments until late in 1997, when the tax bills are  
30 distributed by the taxing authorities, usually in November or  
31 December of that year.  (Ex. 73, p.4)

Surrebuttal Testimony of  
Trisha D. Miller

1                   The Commission finds that MGE's proposal would require waiting  
2                   until the end of 1997 to account for an item of expense for inclusion in  
3                   this case because this would be a violation of the test year, updated test  
4                   year or true-up concepts. Staff's recommendation will be adopted.

5                   In Case No. WR-2000-844, St. Louis County Water Company also argued that its  
6                   property tax expenses should be based on the level of plant in service to be reflected in rates.

7                   The Commission in that case ruled:

8                   The Commission traditionally, and properly, allows recovery of cost  
9                   increases that are projected to occur after the end of the test year  
10                  (including any adjustment periods) only if those costs are known and  
11                  measurable. A cost increase is "known" if it is certain to occur, and it  
12                  is "measurable" if the Commission is able to determine the amount of  
13                  the increase with reasonable precision. The Company's projected  
14                  property tax increases are neither known nor measurable. While it is  
15                  probable that the Company will experience an increase in property tax  
16                  expense at the end of the year, it is by no means certain. Even more  
17                  damaging to the Company's proposal is the fact that its best estimate  
18                  of the amount of any increase is based on an assumption that finds no  
19                  support in the record. Company's proposed property tax calculation  
20                  assumes that the tax rates for 2000 will be the same as the tax rates for  
21                  1999. Because any increase the Company's property tax expense is  
22                  not known and measurable, the Commission will not adopt the  
23                  Company's proposal. Staff's proposal to use a known amount (the last  
24                  amount actually paid), while probably not a perfectly accurate  
25                  representation of the property taxes that will be paid in the future, at  
26                  least avoids the speculation inherent in Company's proposal.

27                  Q.     Does this conclude your surrebuttal testimony?

28                  A.     Yes, it does.