

Exhibit No.:

Issues: Fuel Adjustment Clause

Witness: Steven M. Fetter

Sponsoring Party: Aquila Networks-MPS
& L&P

Case No.: ER-2007-0004

Before the Public Service Commission
of the State of Missouri

Surrebuttal Testimony

of

Steven M. Fetter

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ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
SURREBUTTAL TESTIMONY OF STEVEN M. FETTER
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D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
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1 **I. INTRODUCTION AND BACKGROUND**

2 Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

3 A. My name is Steven M. Fetter. I am President of Regulation UnFettered. My
4 business address is 1489 W. Warm Springs Rd., Suite 110, Henderson, NV
5 89014.

6 Q. DOES THIS SURREBUTTAL TESTIMONY FOLLOW UPON REBUTTAL
7 TESTIMONY YOU FILED IN THIS CASE?

8 A. Yes, this surrebuttal testimony filed on behalf of Aquila, Inc. (“Aquila” or the
9 “Company”) follows upon rebuttal testimony I filed in this docket.

10 **II. EXECUTIVE SUMMARY**

11 Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

12 A. I have reviewed the rebuttal testimony of Mr. Donald Johnstone, testifying on
13 behalf of Sedalia Industrial Energy Users’ Association and Ag Processing Inc.,
14 and I disagree with him in three regards:

15 a) First, Mr. Johnstone seems to have formulated his own standard – “acute need”
16 -- that he states Aquila must meet in order to justify action by the Missouri Public
17 Service Commission (“MPSC” or “Commission”) to institute a fuel adjustment
18 mechanism (“FAC”) within this rate case. I do not see that standard in law or by
19 rule, and indeed, as I will explain, the Commission has already explicitly rejected

1 this position in its consideration of rules implementing Senate Bill 179
2 ("SB179");

3 b) Second, Mr. Johnstone presents an alternative framework for an FAC that
4 incorporates a base rate component coupled with a 50-50 "sharing" mechanism.
5 Since, under Mr. Johnstone's formulation, it would appear that Aquila would not
6 ever be able to receive recovery of all of its prudently-incurred costs related to
7 fuel and purchased power expenditures, in actuality it should not be called
8 "sharing." Rather it is a subsidy from Aquila's shareholders for a portion of the
9 prudent costs the Company expends to provide reliable quality of service to
10 customers. Accordingly, the Johnstone "sharing" alternative represents neither
11 good public policy nor would it be permissible under U.S. Supreme Court
12 precedent;

13 c) Finally, Mr. Johnstone focuses upon the importance of consumer protections,
14 but rejects the notion that a prudence review by the MPSC of Aquila's activities
15 related to fuel and purchased power procurement can be effective. As someone
16 who has served as chairman of a state utility commission utilizing an FAC, I
17 believe that Mr. Johnstone does not give sufficient credit to the benefits that can
18 accrue to both customers and investors from use of a properly-structured FAC that
19 includes a prudence review. In addition to serving as an appropriate after-the-fact
20 check on utility management decision-making, a prudence review encourages
21 ongoing communication between the regulated and the regulator in a way that can
22 avoid disputes related not only to fuel choices, but also as to any other potential
23 point of difference. Moreover, under the Johnstone proposal, customers also
24 would seem to face an inequitable situation, since at times when fuel and

1 purchased power costs are lower than the amount included in base rates, there
2 does not appear to be a mechanism for refunding that difference to customers.

3 **III. CRITIQUE OF MR. JOHNSTONE’S ALTERNATIVE FAC**

4 Q. WHAT STANDARD DOES MR. JOHNSTONE BELIEVE WOULD HAVE TO
5 BE MET FOR AQUILA TO JUSTIFY THE COMMISSION ORDERING AN
6 FAC?

7 A. Mr. Johnstone proposes a standard of “acute need,” meaning that “a substantial
8 financial need must be shown by the utility.” (Johnstone at p. 9) He then
9 proceeds to say that, while he is not a lawyer, he believes his “acute need”
10 standard is consistent with SB179.

11 Q. YOU ARE A LAWYER, AND INDEED A FORMER LEGISLATIVE
12 GENERAL COUNSEL. DO YOU AGREE WITH MR. JOHNSTONE’S
13 ASSESSMENT?

14 A. No I do not. Nowhere in the language of SB179 does a “substantial financial
15 need” standard appear, and, indeed, adoption of such a standard by the
16 Commission would place Missouri apart from other states that are currently
17 utilizing FACs because I know of no state that requires a utility to make a
18 threshold showing of financial need in order to qualify for an FAC. Moreover, in
19 its Final Order of Rulemaking related to FACs, the MPSC explicitly rejected a
20 requirement that an assessment of a utility’s earnings would have to be made
21 before an FAC could be utilized, thus undercutting Mr. Johnstone’s
22 recommendation that the Commission should adopt a standard of “acute
23 [substantial financial] need” here:
24

1 The Commission finds that an earnings threshold for eligibility to
2 use a [rate adjustment mechanism] is contrary to the intent of the
3 legislature, as articulated in SB179. Therefore, no such eligibility
4 criteria will be included in the rule.¹
5

6 Accordingly, whether an FAC should be permitted should be based upon an
7 assessment of the benefits it provides – rates and recovery tied to actual
8 prudently-incurred fuel and purchased power costs – and should be consistent
9 with the legislative intent behind SB179: that such mechanism be “reasonably
10 designed to provide the utility with a sufficient opportunity to earn a fair return on
11 equity” and should include “provisions for an annual true-up which shall
12 accurately and appropriately remedy any over- or under-collections ... through
13 subsequent rate adjustments or refunds.”²

14 Q. MR. JOHNSTONE ALSO RECOMMENDS THAT AN ALTERNATIVE FAC
15 BE CONSIDERED UNDER WHICH A 50-50 “SHARING” MECHANISM
16 WOULD ALLOW FOR RECOVERY OF ONLY A PORTION OF AQUILA’S
17 FUEL COSTS. HE ARGUES THAT SUCH A FRAMEWORK WOULD BE
18 NECESSARY BECAUSE ANY ATTEMPT BY THE MPSC TO CARRY OUT
19 AN AFTER-THE-FACT PRUDENCE REVIEW WOULD BE UNAVAILING.
20 DO YOU AGREE WITH HIS VIEWS?

21 A. No, not at all. First, if I understand Mr. Johnstone’s proposal correctly, even if
22 Aquila operates as efficiently as it possibly can, it will not be able to recover
23 100% of its prudently-incurred costs. This on its face would appear to violate

¹ Missouri Public Service Commission Final Order of Rulemaking, Case No. EX-2006-0472, September 21, 2006, at 14.

² Missouri Revised Statutes, Section 386.266.4(1) - (2).

1 U.S. Supreme Court precedent (dating back more than 60 years in the Bluefield³
2 and Hope⁴ cases, which defined the concept of “just and reasonable rates” as it
3 relates to fair utility rates of return). In Hope, the Court stated, “From the investor
4 or company point of view it is important that there be enough revenue not only for
5 operating expenses but also for the capital costs of the business.”⁵

6 However, legal arguments aside, just from a policy perspective I see no
7 rational purpose being served by an FAC structured so that the Company cannot
8 ever receive full recovery of its prudently-incurred fuel expenditures. I know of
9 no other state utility commission that has adopted as its official policy that a
10 utility will not be able to recover prudently-incurred costs of providing essential
11 service to customers. Such a policy here would be inconsistent with the intent of
12 SB179, and, indeed, the MPSC in its final rulemaking order explicitly rejected a
13 “sharing” arrangement like that proposed by Mr. Johnstone in his Alternative
14 FAC:

15 COMMENT: Several lay commenters verbally
16 suggested that it would only be fair for utilities to pass
17 through only 50% of fuel costs and that the utility and
18 its shareholders be required to pay the other 50%.

19 RESPONSE: These commenters may be confusing the
20 proposal by other commenters that no more than 50% of
21 fuel and purchased power costs be recovered in a [rate
22 adjustment mechanism] and that 50% remain in base
23 rates.... If not, then the Commission must disagree with
24 this comment in that it would not allow for the setting of
25 just and reasonable rates that allow the utility a reasonable
26 return.⁶

³ *Bluefield Water Works & Improvement Co. v. Public Service Commission of West Virginia*, 262 U.S. 679 (1923).

⁴ *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591 (1944).

⁵ *Id.* at 603.

⁶ Missouri Public Service Commission Final Order of Rulemaking, Case No. EX-2006-0472, September 21, 2006, at 4.

1 This comment shows that the Commission appreciates the interplay between
2 prudently-incurred fuel and purchased power expenditures and appropriate
3 recovery of those costs. Thus, Mr. Johnstone, in formulating his Alternative FAC
4 based upon a “sharing” of prudent fuel costs not only goes against the rationale of
5 a properly-structured FAC, he also simply ignores the clear policy message that
6 the MPSC provided during its promulgation of rules in support of SB179.

7 Thus, when Mr. Johnstone says “sharing,” it is just a euphemism for
8 “subsidy,” reflecting the fact that he believes that the Company should not be
9 permitted to recover 100% of its prudently-incurred fuel and purchased power
10 costs, and that, apparently, customers have an entitlement to lower rates than true
11 cost of service would dictate. Such a forced subsidy (which I understand could go
12 into the tens of millions of dollars annually of negative impact on shareholders) is
13 contrary to law, inconsistent with rationale regulatory policy, and goes in the
14 opposite direction of the specific purposes for which SB179 was enacted.

15 Q. HOW DO YOU RESPOND TO MR. JOHNSTONE’S CRITICISM OF THE
16 EFFECTIVENESS OF PRUDENCE REVIEWS OF FUEL AND PURCHASED
17 POWER SUPPLY DECISIONS?

18 A. Based upon my experience as a state regulator and from what I have seen at other
19 commissions across the U.S., I do not see any impediments preventing the MPSC
20 from being able to carry out effective oversight of Aquila’s fuel and purchased
21 power supply decision-making. It is important to emphasize that, unlike with
22 other fuel recovery structures that do not even aspire for precision, with a
23 properly-structured FAC there is nothing to be gained by a utility’s trying to game

1 the system. The most that that utility can get is reimbursement for the substantial
2 funds it has put forward – it receives no return for its fuel and purchased power
3 expenditures. Under such conditions – where the spectrum of potential results
4 spans from getting reimbursed for upfront fuel expenditures (with no return nor
5 possibility of gain) at one end, to anywhere else on that spectrum representing less
6 than full recovery – I see a significant incentive for a utility to try its hardest to
7 ensure that its activities fall within a zone of reasonable prudent behavior. With a
8 properly-structured FAC, to do otherwise could only result in negative
9 consequences

10 In addition, what I found when I served as chairman of the Michigan
11 Commission, the more effective the processes a commission puts into place for
12 fuel prudence review, the more ongoing communication there will be between
13 utility management and regulatory staff in order to avoid future disallowances.
14 But the benefits from such interaction go far beyond the exchanging of thoughts
15 related to fuel procurement. Open and candid communication creates the
16 potential that disputes and disagreements between the regulated and the regulator
17 will be headed off long before the Commission has to become involved.

18 Finally, it is important to remember that a prudence review of resource
19 procurement activities taken where an FAC exists is no different than the myriad
20 prudence determinations that a regulatory body makes within the context of a
21 traditional rate case. While the topics for review under an FAC may be
22 circumscribed, a commission has total freedom to delve as deeply as it wishes into
23 any issue in dispute.

IV. CONCLUSION

Q. DO YOU HAVE CONCLUDING THOUGHTS?

A. Yes. The concept of utility regulation is to provide a surrogate for the competitive market that is not present when a company possesses monopoly or near-monopoly status with regard to an essential good, such as utility service. FACs attempt to align the costs that a utility expends for fuel and purchased power with its recovery of those costs on a timely basis.

I find it interesting that Mr. Johnstone and other opponents of an FAC for Aquila have continued to put forward concepts that would not provide Aquila with even the possibility of 100% recovery of costs related to fuel and purchased power, even when the Company's expenditures are wholly appropriate and thus prudent. Not only would this be at odds with existing legal precedent, but it is counterintuitive to what consumers within a non-regulated marketplace would feel is right. If you remove the emotion and politics that often accompany regulatory ratemaking across the U.S. and innocently ask customers if a provider should be entitled to recoup all of its prudent costs of providing a product, I have to believe the response of the overwhelming majority of fair-minded consumers would be "Yes, of course" -- and this does not even factor in that, when it comes to pass-through of fuel costs, no profit is earned since a utility company does not receive any return on funds put forward for fuel.

Thus, I continue to believe that it is wholly consistent with rational utility economics for customers to pay the actual costs of fuel and purchased power that are procured for their benefit – and that a properly-structured FAC, including a prudence review process, is the best means to effectuate that result.

1 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

2 A. Yes it does.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Aquila, Inc. d/b/a Aquila
Networks-MPS and Aquila Networks-L&P
for authority to file tariffs increasing electric
rates for service provided to customers in
the Aquila Networks-MPS and Aquila
Networks-L&P areas)
)
)
)
)
)

Case No. ER-2007-0004

County of Jefferson)
)
State of Washington) ss

AFFIDAVIT OF STEVEN M. FETTER

Steven M. Fetter, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Surrebuttal Testimony of Steven M. Fetter"; that said testimony was prepared by him or under his direction and supervision; that if inquiries were made as to the facts in said testimony he would respond as therein set forth; and that the aforesaid testimony is true and correct to the best of his knowledge, information, and belief.



Steven M. Fetter

Subscribed and sworn before me this 19th day of March, 2007



Notary Public

My commission expires:

9/24/08