Exhibit No.:	
Issues:	Fuel Adjustment Clause
Witness:	Donald Johnstone
Type of Exhibit:	Direct Testimony
Sponsoring Party:	Sedalia Industrial Energy Users' Association and St. Joe Industrial Group
Case Number:	ER-2007-0004
Date Testimony Prepared:	January 18, 2007

Aquila Networks-MPS and Aquila Networks-L&P

Case No. ER-2007-0004

Prepared Direct Testimony of

Donald Johnstone

On behalf of

Sedalia Industrial Energy Users' Association
and
St. Joe Industrial Group

January 2007

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 the service provided to customers in the Aquila Networks-MPS and Aquila Networks-L&P service areas	)))))))	Case No. ER-2007-2004

Affidavit of Donald Johnstone

State of Missouri)
) ss
County of Camden)

Donald Johnstone, of lawful age, on his oath states: that he has reviewed the attached written testimony in question and answer form, all 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; that such matters are true to the best of his knowledge, information and belief.

Donald Johnstone

Subscribed and sworn before me this 18th day of January, 2007

Carolyn Neporadny
Notary Public

CAROLYN NEPORADNY
Notary Public - Notary Seal
STATE OF MISSOURI
Commissioned for Camden County
My Commission Expires: August 30, 2009
Commission Number 05452654

My Commission expires:_____

Before the
Missouri Public Service Commission

Aquila Networks-MPS and Aquila Networks-L&P

Case No. ER-2007-0004

Prepared Direct Testimony of Donald Johnstone

Q PLEASE STATE YOUR NAME AND ADDRESS.

A My name is Donald Johnstone and my address is 384 Black Hawk Drive, Lake Ozark, Missouri, 65049.

Q BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A I am employed as President of Competitive Energy Dynamics, L. L. C.

Q PLEASE SUMMARIZE YOUR EDUCATION AND EXPERIENCE.

A My qualifications and experience are set forth in Appendix A.

Q WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A I have been engaged to address the appropriate design of a Fuel Adjustment Clause ("FAC") within the context of the Commission's new fuel adjustment rule. The rule addresses the possibility of rate adjustment mechanisms, which may take the form of either an interim energy charge mechanism or a fuel

adjustment mechanism. Although Aquila has put forward a specific proposal, this being the intervener opportunity for direct testimony, I will in due course respond to the Aquila proposal in the rebuttal round of testimony.

There is a grey area in which some aspects of any appropriately-designed FAC could have "revenue requirement" implications even though the bulk of the issues involved are properly addressed as "rate design." I will address issues in this testimony that appear to me to have the most direct revenue requirement implications. The balance of my specific proposal for the appropriate design of a fuel adjustment clause will appear in my testimony filed on the "rate design" date. Also, as noted above, I will reserve comment on Aquila's specific FAC proposal for the rebuttal round of testimony.

Q IN ORDER TO PROVIDE CONTEXT FOR YOUR COMMENTS, PLEASE DESCRIBE THE AQUILA FAC PROPOSAL.

A Aquila proposes a new rate schedule that is captioned "FUEL ADJUSTMENT CLAUSE ELECTRIC" The proposed rate generally provides for the collection of the Missouri jurisdictional share of Aquila's actual "fuel consumed in Company generating units, purchased power charges and emission allowance costs." The FAC rate is proposed to be adjusted quarterly. Among other things the proposed rate also provides for all hedge costs, settlement costs and benefits, emission allowance costs, and interest on the deferred amounts. The rate further provides for the costs incurred in each three-month "accumulation

period" to be collected in a subsequent three-month "recovery period". The effect is a six month lag in the collection. 100% of the variations in the tracked costs would flow through to ratepayers. Finally, the rate provides for additional collections or refunds, as the case may be, pursuant to any under or over collections and pursuant to annual prudence reviews.

Q IN YOUR OPINION, SHOULD IT BE NECESSARY FOR A UTILITY TO DEMONSTRATE A NEED FOR A FAC?

A Yes. A fuel adjustment clause more or less automatically flows through to customers the variations in costs. Retail rates are thus made volatile and, to state the obvious, volatile rates are not beneficial to customers. Rather, volatility is typically perceived as a problem for customers. Consequently, Aquila, before shifting the burden of volatility directly to customers, ought to first be required to demonstrate a need and then that need must be weighed against the negative effects of the proposed FAC. Among the negative effects are rate volatility, unpredictable utility bills, reduced incentives for the utility to achieve low and stable costs, distorted investment incentives, and the complexities of the rate administration. Any rate adjustment mechanism should be approved only if the need is acute and the negative effects are reasonably mitigated. Of course, a design that mitigated the negative effects would be preferable to one that did not do so.

Q SHOULD AN APPROPRIATELY DESIGNED FAC PASS THROUGH 100% OF THE FUEL COST VARIATIONS FACED BY THE UTILITY?

A This is a matter I will address in "rate design" testimony. Suffice to say any 100% proposal shifts a great burden to customers and regulators and my recommendation for the design will mitigate the shift in burden.

Q SHOULD A FAC EFFECT THE REVENUE REQUIREMENT AND THE LEVEL OF THE RATES THAT GO INTO EFFECT AT THE CONCLUSION OF THIS PROCEEDING?

A There are several parts to this answer. First, a FAC will reduce the risk for the utility and will therefore logically have an effect on the return on equity that will be granted by the Commission. I will leave the extent of the effect to be quantified by the return experts.

The second part of the answer goes to the remainder of the revenue requirement. In this regard, I recommend that the revenue requirement be developed under the standard Commission rules and procedures. In other words, the fuel costs ought to be a part of the determination of the revenue requirement on the same basis as if there were no FAC.

One additional consideration is the need to define the portion of the costs (revenue requirement) that is to be tracked if a fuel adjustment is approved. The FAC costs need to be defined and expressed as an amount per kWh (with due consideration of line losses). It may be that certain rate case adjustments to the fuel costs remain in base rates and it may also be that a

fixed percentage of fuel costs remains in base rates. Costs not included in the FAC tracking mechanism would continue to be a part of base rates.

Q ARE THERE REASONS WHY IT WOULD BE DESIRABLE TO TRACK SOMETHING OTHER THAN 100% OF FUEL AND PURCHASED POWER COSTS IN A RATE ADJUSTMENT MECHANISM?

A Yes. I will address the reasons in my rate design testimony.

Q SHOULD A RATE ADJUSTMENT MECHANISM NECESSARILY PROTECT AQUILA FROM THE INEVITABLE EXPENSE BUMPS THAT WILL OCCUR IN THE OPERATION OF ITS PRODUCTION FACILITIES?

A No. I do not understand that to be the goal of a FAC. However, any 100% pass through of fuel and purchased power costs under a FAC would do just that.

Every time a low cost unit goes off line or suffers reduced output due to any outage, expenses will necessarily go up due to the higher cost of replacement energy. In fact, every bump in expenses due to any and all operational problems would automatically pass through to customers. Ratepayers, in effect, become insurers of the energy replacement cost for every operational limitation and problem. That is not a good thing for customers. Nor is it sound regulatory policy.

The only prospect whatsoever for any ratepayer protection should not come after the fact, perhaps even years later at the conclusion of any

prudence review and litigation. For in the meantime, the money would be out of ratepayer pockets and in the coffers of the utility. This is a most unfortunate side effect of any fuel adjustment mechanism that passes through 100% of fuel and purchased power costs and this unfortunate result should be either mitigated or eliminated with a design that will protect customers.

Q IS IT POSSIBLE TO ESTABLISH A RATE ADJUSTMENT PROVISION THAT WOULD OFFER AQUILA SOME RELIEF FROM VOLATILE ENERGY MARKETS WHILE NOT AT THE SAME TIME AUTOMATICALLY PASSING THRU EVERY COST ASSOCIATED WITH EVERY OPERATIONAL PERTURBATION IN THE AQUILA PRODUCTION FACILITIES?

A Yes. This matter will be addressed in my rate design testimony.

Q DOES THIS CONCLUDE YOUR TESTIMONY AT THIS TIME?

A Yes it does. As I noted earlier, I will address in my rate design testimony present the criteria that I believe are important to implement in any FAC so that it is appropriate and reasonable in its operation and effect on consumers. I will reserve until the rebuttal testimony any evaluation of the specific Aquila FAC proposal and compare it to those standards.

Appendix A

Qualifications of Donald E. Johnstone

Q PLEASE STATE YOUR NAME AND ADDRESS.

A Donald E. Johnstone. My address is 384 Black Hawk Drive, Lake Ozark, MO 65049.

Q PLEASE STATE YOUR OCCUPATION.

A I am President of Competitive Energy Dynamics, L. L. C. and a consultant in the field of public utility regulation.

Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A In 1968, I received a Bachelor of Science Degree in Electrical Engineering from the University of Missouri at Rolla. After graduation, I worked in the customer engineering division of a computer manufacturer. From 1969 to 1973, I was an officer in the Air Force, where most of my work was related to the Aircraft Structural Integrity Program in the areas of data processing, data base design and economic cost analysis. Also in 1973, I received a Master of Business Administration Degree from Oklahoma City University.

From 1973 through 1981, I was employed by a large Midwestern utility and worked in the Power Operations and Corporate Planning Functions. While in the Power Operations Function, I had assignments relating to the peak demand and net output forecasts and load behavior studies which included such

factors as weather, conservation and seasonality. I also analyzed the cost of replacement energy associated with forced outages of generation facilities. In the Corporate Planning Function, my assignments included developmental work on a generation expansion planning program and work on the peak demand and sales forecasts. From 1977 through 1981, I was Supervisor of the Load Forecasting Group where my responsibilities included the Company's sales and peak demand forecasts and the weather normalization of sales.

In 1981, I began consulting, and in 2000, I created the firm Competitive Energy Dynamics, L.L.C. As a part of my twenty-five years of consulting practice, I have participated in the analysis of various electric, gas, water, and sewer utility matters, including the analysis and preparation of cost-of-service studies and rate analyses. In addition to general rate cases, I have participated in electric fuel and gas cost reviews and planning proceedings, policy proceedings, market price surveys, generation capacity evaluations, and assorted matters related to the restructuring of the electric and gas industries. I have also assisted companies in the negotiation of power contracts representing over $1 billion of electricity.

I have testified before the state regulatory commissions of Delaware, Hawaii, Illinois, Iowa, Kansas, Massachusetts, Missouri, Montana, New Hampshire, Ohio, Pennsylvania, Tennessee, Virginia and West Virginia, and the Rate Commission of the Metropolitan St. Louis Sewer District.