

Exhibit No.:

Issues: Policy

Witness: Dennis R. Williams

Sponsoring Party: Aquila Networks-L&P

Case No.: HR-

Before the Public Service Commission
of the State of Missouri

Direct Testimony

of

Dennis R. Williams

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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
DIRECT TESTIMONY OF DENNIS R. WILLIAMS
ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-L&P
CASE NO. HR-_____**

1 Q. Please state your name and business address.

2 A. My name is Dennis R. Williams and my business address is 10700 East 350 Highway,
3 Kansas City, Missouri 64138.

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

5 A. I am employed by Aquila, Inc. (“Aquila” or “Company”) in the position of Vice
6 President – Electric Regulatory Services.

7 Q. What are your responsibilities within Aquila?

8 A. I have overall responsibility for state electric regulatory services in Missouri, Kansas and
9 Colorado.

10 Q. Please provide your educational background and work experience.

11 A. I graduated in 1974 from Central Missouri State University, receiving a Bachelor of
12 Science in Business Administration degree with majors in accounting and finance. After
13 graduation, I was licensed in Missouri as a Certified Public Accountant and employed as
14 an auditor in the regulated industries division of Arthur Andersen and Company. After
15 leaving Arthur Andersen, I was employed for a number of years with a regulatory
16 consulting firm prior to joining Aquila in 1986. At Aquila, I have served in a variety of
17 capacities prior to assuming my current responsibilities in January 2004.

PURPOSE OF TESTIMONY

Q. What is the purpose of your testimony in this case before the Missouri Public Service Commission (“Commission”)?

A. The purpose of my testimony in this proceeding is to explain, generally, why Aquila is seeking rate relief at this time; to explain options for rate mitigation, to discuss the direction of the Company including its financial plan and proposed sale of some utility properties, including the Missouri L&P steam properties; and to introduce other witnesses and the topics they will be addressing.

DESCRIPTION OF RATE REQUEST

Q. Please summarize the rate relief you are seeking in this proceeding.

A. Aquila has demonstrated in its filing the need for a \$5.029 million increase, or 44.3% above what industrial steam customers are currently paying in rates. Aquila recognizes that this is a substantial increase and I will discuss some options for mitigating the initial impact of this increase later in my testimony.

Q. What are the primary drivers of the rate request?

A. The need for the rate increase is primarily driven by higher fuel costs and elimination of an existing steam rate subsidy.

Q. What factors have increased the cost of fuel attributable to the industrial steam cost of service?

A. Industrial steam is produced from our Lake Road Generating facilities – Boilers 1 through 5. Boilers 1 through 4 are gas-fired and Boiler 5 can burn either coal or gas. Since the energy costs associated with Lake Road Boiler 5 are the lowest of the five units available for steam production, industrial steam is dispatched from that boiler whenever

1 possible. The other boilers are utilized when Boiler 5 is unavailable due to maintenance
2 or outage, or when additional steam capacity is required in excess of that available from
3 Boiler 5. As demand for steam energy escalates, the percentage of the steam load that
4 must be met through the gas-fired boilers will likewise increase. Because of the high cost
5 of gas in comparison to coal, Aquila's system average fuel costs used to produce
6 industrial steam are rising. In addition, the cost of fuel, both gas and coal, necessary to
7 operate the boilers has continued to escalate dramatically since our last rate adjustment in
8 2004.

9 Q. Please explain what you mean by elimination of an existing rate subsidy.

10 A. Prior to the acquisition of the former St. Joseph Light and Power Company by UtiliCorp
11 in 2001, a subsidy of about \$1.0 million from electric customers was built into L&P
12 steam tariffs. The theory behind this subsidy was that low steam rates attracted industrial
13 customers to the St. Joseph area and brought with them economic benefit to the
14 community. Moreover, industrial customers contributed to a higher load factor on the
15 electric system, which, in turn, helped reduce electric rates. Therefore, a subsidy from
16 electric to steam customers was deemed acceptable. Mechanically, the way this worked
17 from a ratemaking standpoint at the time of Aquila's acquisition of the L&P properties,
18 was simply by increasing electric rates by the \$1.0 million subsidy and decreasing steam
19 rates by a like amount.

20 Q. Since acquiring the L&P properties, has Aquila proposed a similar subsidy mechanism?

21 A. Yes. In a 2003 rate filing, Aquila proposed a \$1.8 million subsidy allowance by reducing
22 the request for steam revenues, and similarly adding \$1.8 million to the electric rate
23 request.

1 Q. Was Aquila's proposal accepted?

2 A. No. No other party endorsed a steam rate subsidy proposal. Thus, the \$1.8 million
3 subsidy proposal was not added to electric rates.

4 Q. Does that mean that there was no subsidization of the steam rates as a result of the 2003
5 rate filing?

6 A. No. Aquila had reduced its initially filed steam tariff proposal reflecting the \$1.8 million
7 subsidy, and the amount of steam rate relief was limited to its initial filing. That does not
8 mean that the subsidy was eliminated. It simply means that instead of the subsidy being
9 borne by electric customers, it has been borne over the past year by Aquila shareholders.

10 Q. Is Aquila proposing a similar subsidy in this rate proposal?

11 A. No. Aquila has no supporting evidence that can justify the specific value to other
12 electric customers of the attraction of industrial load to the L&P system. However, it is
13 also not appropriate for shareholders to continue to subsidize the steam system.

14 Therefore, we have proposed that the subsidy be discontinued. It is the elimination of
15 this prior subsidy that accounts for a large percentage of Aquila's request for rate relief.

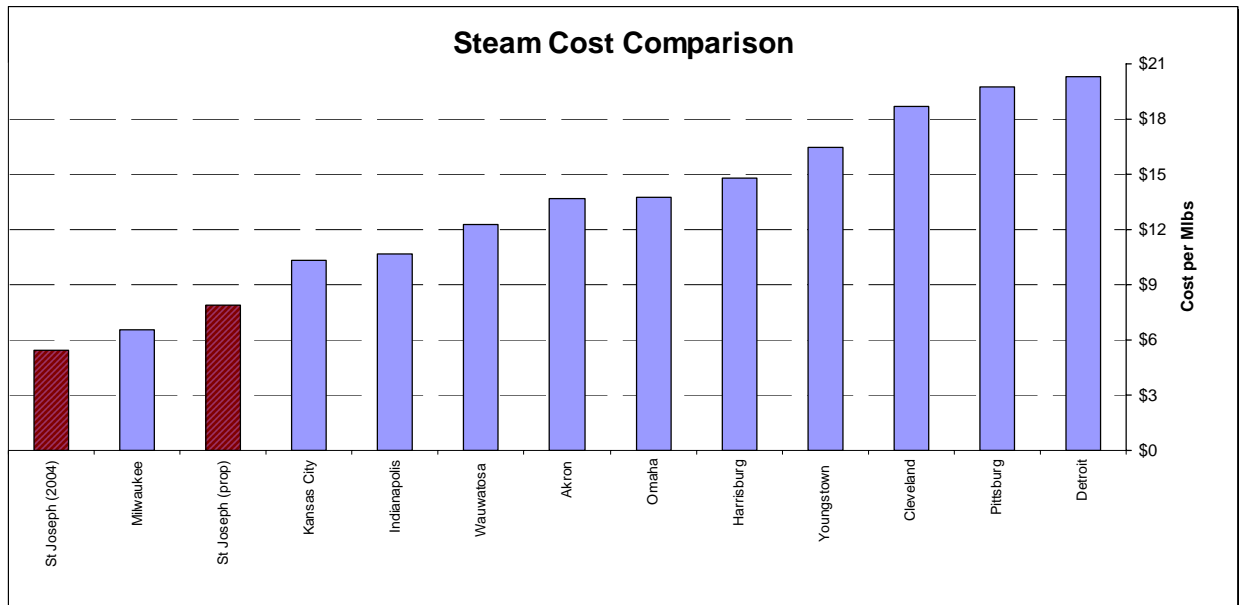
16 Q. By eliminating the subsidy will steam rates be so high as to be non-competitive?

17 A. No. Even if the full amount of our rate request is granted, the L&P steam rates will be
18 among the lowest in the Midwest.

19 Q. Please provide a comparison of existing rates to other Midwest steam providers.

20 A. "We Energies" provides on their website a [steam cost comparison](http://webapps6.we-energies.com/ratecalc/bus/cities_info_steam.cfm?Map=N) for a number of cities
21 located in the Midwest. (http://webapps6.we-energies.com/ratecalc/bus/cities_info_steam.cfm?Map=N) A
22 graphical presentation of that information compared to Aquila's L&P steam rates is
23 presented below. As noted thereon, L&P current steam costs are by far the lowest of any

1 of the twelve cities shown and even if our full request for rate relief were granted they
2 would remain the second lowest of the twelve selected Midwest cities.



3
4 Q. Even though Aquila's steam rates are comparably low, is the Company proposing any
5 mechanism to smooth the impact of this large increase?

6 A. There are a number of alternatives that could be introduced and which Aquila would
7 consider. For example, a phase-in rate mitigation plan has been used successfully in the
8 past in some jurisdictions, including Missouri.

9 Q. Please explain how a phase-in rate plan would work.

10 A. Instead of implementing the full increase at one time, a phase-in plan initially implements
11 only a portion of the granted rate relief, with the remainder phased-in, along with the
12 Company's carrying costs associated with deferring the rate relief, over some additional
13 period. For example, a three-year phase in plan of Aquila's rate request could be
14 structured to implement only a portion of the rate request in the first year, with the
15 difference being including carrying costs being reflected in the succeeding two years.
16 Instead of an immediate increase of \$5.03 million or about 44% in one year, industrial

1 steam customers would see their rates increase by lesser percentages in each of the next
2 three years.

3 Q. Are there risks associated with a phase-in plan?

4 A. The greatest risk is that events that occurred during the test year on which rates are based
5 could change materially. For example, the loss of a major customer or increase in major
6 expense could result in the need for additional rate relief at the same time that the second
7 or third year of phased-in rates was being implemented.

8 Q. Is there any way to mitigate this risk?

9 A. The underlying cost component that is subject to the greatest volatility, and is therefore
10 most likely to drive a change in industrial steam rates, is fuel. Aquila is willing to
11 consider an Interim Energy Charge ("IEC") mechanism to provide protection to both the
12 utility and customer from fluctuating fuel prices.

13 Q. How does an IEC work?

14 A. An IEC mechanism has similarities to a typical fuel adjustment clause. Base rates would
15 be increased somewhat to provide Aquila with protection from future rises in fuel costs
16 used to create steam, but would provide credit to customers if fuel costs drop. The IEC
17 mechanism would operate so as to charge customers no more than the cost of fuel
18 actually incurred. To the extent that fuel prices are below the amount established in base
19 rates, a customer credit or refund is generated.

20 Q. Why would Aquila not simply take advantage of the fuel adjustment legislation passed
21 this year by the Missouri Assembly?

22 A. Based on advice of counsel, it is my understanding that this legislation is not applicable
23 to fuel used to generate industrial steam for resale.

1 Q. Has Aquila considered any other approaches to rate mitigation?

2 A. If other parties to this proceeding supported reinstatement of a steam rate subsidy
3 reflecting a reasonable valuation of benefit to electric customers, Aquila would
4 reconsider its support for such a mechanism.

5 **COMPANY RESTRUCTURING**

6 Q. The Company announced in March, 2005 that it was considering the sale of several of its
7 existing utility operations in other states. What is the purpose of this asset divestiture
8 program?

9 A. As part of its ongoing “repositioning” plan to further reduce debt, Aquila has announced
10 that it is considering the sales of gas utility assets in Michigan, Minnesota and Missouri
11 and electric assets in the states of Kansas, Colorado and Missouri. The Missouri electric
12 sale would also include the sale of Aquila’s industrial steam business. Although the
13 Company has listed all of the assets above for sale, no final decision has been made as to
14 which, if any, of the assets listed will ultimately be sold. As a result, the Company could
15 conceivably sell all or none of the properties listed for consideration. The decision to sell
16 will be based on an evaluation of bids received in comparison to the value Aquila can
17 provide by continuing to own and operate each of these respective properties.

18 Q. If the Aquila-L&P steam business is listed for sale, why are you asking for the
19 Commission to increase its rates as part of this proceeding?

20 A. The operations of our Aquila-L&P division are entitled to earn a fair return on investment
21 regardless of whether or not those operations are potentially sold. Also, as mentioned
22 previously, Aquila may decide to retain the L&P operations if the bids from outside
23 parties are not sufficient to justify its sale. Finally, since the debt to be retired from the

asset sales proceeds is the remaining debt from Aquila’s “non-regulated” activities, and none of this debt has been assigned to either the MPS or L&P operations, the asset sales program should have no impact on the present rate filing.

Q. Is the Company requesting that any of the costs associated with the asset sales process be recovered in rates from its Missouri ratepayers?

A. Absolutely not.

INTRODUCTION OF OTHER WITNESSES

Q. Please provide a summary of other Aquila witnesses in this proceeding and the topics that they will address.

A. While I have generally discussed the major drivers behind Aquila's request, there are a number of other topics for which testimony is presented in support of our proposal. A list of other witnesses and the topics they will address is presented below.

Witness and Issue List

Susan K. Braun
Test year & True-up
Plant and Reserve
Materials and Supplies
Fuel Inventory
Revenue
PSC Assessment
Rate Case Expense
Depreciation

Gary M. Denny
Rate Design

Samuel C. Hadaway
Cost of Capital

Ronald A. Klote
 Fuel
 Corporate Allocations
 Allocation Factors
 Injuries and Damages
 Dues & Donations
 Advertising Expense
 Income Tax Expense
 Income Taxes Offset
 Cash Working Capital

Amy S. Murray
Payroll
Incentive
Employee Benefits
Insurance
Miscellaneous Test Year Adj
Payroll Tax
Prepayments

Timothy M. Nelson
Lake Road Generating Station
Production Modeling System
Natural Gas Pricing

H. Davis Rooney
Pensions

- 1 Q. Does this conclude your prefiled direct testimony?
- 2 A. Yes, it does.

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

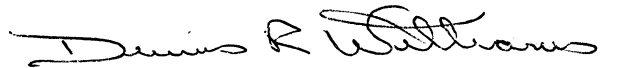
In the matter of Aquila, Inc. d/b/a Aquila)
Networks-L&P, for authority to file tariffs)
Increasing steam rates for the service provided)
To customers in the Aquila Networks-L&P area)

Case No. HR-_____

County of Jackson)
) ss
State of Missouri)

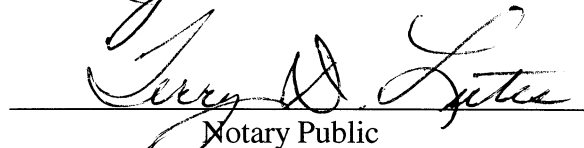
AFFIDAVIT OF DENNIS R. WILLIAMS

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



Dennis R. Williams

Subscribed and sworn to before me this 27th day of May, 2005.



Notary Public
Terry D. Lutes

My Commission expires:

8-20-2008



TERRY D. LUTES
Jackson County
My Commission Expires
August 20, 2008