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| *Exhibit No.:* | |
| *Issue:* | *Accounting Authority Orders* |
| *Witness:* | *Phillip K. Williams, CPA CIA* |
| *Sponsoring Party:* | *MoPSC Staff* |
| *Type of Exhibit:* | *Rebuttal Testimony* |
| *Case No.:* | *ER-2007-0004* |
| *Date Testimony Prepared:* | *February 20, 2007* |

**MISSOURI PUBLIC SERVICE COMMISSION**

**UTILITY SERVICES DIVISION**

# REBUTTAL TESTIMONY

**OF**

**PHILLIP K. WILLIAMS**

**AQUILA, INC.**
**d/b/a AQUILA NETWORKS – MPS ELECTRIC**
**and AQUILA NETWORKS-L&P—ELECTRIC**

**CASE NO. ER-2007-0004**

*Jefferson City, Missouri*
*February 2007*

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**D/B/A AQUILA NETWORKS – MPS**

**AND AQUILA NETWORKS – L & P**

**CASE NO. ER-2007-0004**

Q. Please state your name and business address.

A. My name is Phillip K. Williams. My business address is Missouri Public Service Commission, Fletcher Daniels State Office Building, Room G8, 615 East 13th Street, Kansas City, MO 64106.

Q. Are you the same Phillip K. Williams who filed direct testimony in this proceeding?

A. Yes, I am.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of this testimony is to address the direct testimony filed by Office of Public Counsel witness Ted Robertson on the issue of the inclusion of the unamortized portion of Accounting Authority Orders (AAOs) in rate base.

## <u>ACCOUNTING AUTHORITY ORDERS</u>

Q. What are Accounting Authority Orders?

A. Accounting Authority Orders (AAOs) are Commission authorizations for a utility to defer approved costs on the utility's books for potential recovery in a future rate case.

Q. What AAOs are involved in this case?

A. There are three AAOs in this case. The first two AAOs were granted to authorize the company to defer depreciation expenses, property taxes and carrying costs associated with the Capacity Life Extension (Sibley Rebuild Project) and Western Coal Conversion projects at its Sibley generating station. The approvals to defer and recover those costs were made pursuant to the Commission's AAOs in Case Nos. EO-90-114 and EO-91-358, and the Commission subsequently allowed recovery of these deferred costs to begin in Case Nos. ER-90-101 and ER-93-37. The Commission also granted Aquila authority to defer and amortize costs incurred due to an ice storm in its Missouri Public Service (MPS) service area in January 2002. The Commission granted that authority in Case No. EU-2002-1053. It is my understanding that the AAO associated with the ice storm is no longer an issue between Aquila and Staff.

Q. What is the current issue concerning the AAOs?

A. The current issue in this case is whether the unamortized balance of the AAOs associated with the Sibley Rebuild Program and the Western Coal Conversion Program should be included in rate base.

Q. Is there any issue concerning the expense amortization of the AAOs?

A. No.

Q. Who has raised the AAO issue in this case regarding the unamortized balance of the AAOs for the Sibley Rebuild Program and the Western Coal Conversion?

A. The Office of the Public Counsel (Public Counsel) witness Robertson states at page 3, line 11, of his direct testimony that it opposes "allowing the Company to earn a return on the remaining unamortized AAO deferral cost balances via their inclusion in rate base."

Q. Does the Staff agree with Public Counsel's position concerning the rate base treatment for the unamortized balance of the Sibley AAOs?

A. No. Staff believes that the unamortized deferred balances of the AAOs for the Sibley Rebuild Program and the Western Coal Conversion Program authorized in Case Nos. ER-90-101 and ER-93-37 should be included as an addition in the determination of rate base. Staff has consistently applied this methodology for each Aquila, Inc. rate case and the rate cases of its predecessor company since Case No. ER-90-101. The Sibley Rebuild Program AAO and the Sibley Western Coal Conversion AAO were ordered by the Commission to be amortized over a 20-year period consistent with the life extension of the generating units. The 20-year amortization period was developed based on the expected remaining life of the Sibley plant at the time of the life extension program. The capital expenditures and the related AAO authorized by the Commission for the life extension of Sibley can be thought of in the same way as any other capital expenditure in that they are given rate base treatment (return on the investment) as well as a recovery of the related costs through depreciation/amortization expense recovery. The Commission allowed the Company to include the unamortized balances in rate base in the Commission's Report and Order in Case No. ER-90-101. The Report and Order in Case No. ER-90-101 provided:

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

> be reflected in rate base. This is the usual practice when capital costs are amortized.

Q. What is Staff's understanding of why Public Counsel believes that the unamortized balances associated with the AAOs should not be allowed in rate base?

A. Mr. Robertson states "The Public Counsel's position on this issue is based on our belief that MPS is being given what essentially amounts to a guaranteed 'return of' the deferrals associated with the SCLE/WC projects and ice storm; therefore it should not be also provided with a 'return on' those same amounts." (Robertson Direct, p. 7, line 8).

Q. Why does Staff disagree with Public Counsel's rationale?

A. The Commission already made a ratemaking decision on this issue. To now accept the Public Counsel's arguments would negate the Commission's orders from Case Nos. ER-90-101 and ER-93-37. The AAOs granted in those cases were the result of life extension projects and, as such, should be treated in the same way as normal capital expenditures (which are classified as plant in service and not as routine maintenance costs). Companies are routinely allowed to earn a return on amounts that are capitalized. These amounts were included in the AAOs to provide the Company an opportunity to recover the depreciation, property taxes and carrying costs associated with the rebuilds that occurred between the completion of the projects and the Company's next rate case. Absent AAO treatment, these amounts would have been lost as a result of booking these costs directly to expense following completion of the projects.

Q. Would you define what you mean by "return of" and "return on" on investment?

A. "Return of" investment provides the Company the opportunity to recover its investment through depreciation/amortization expense. "Return on" investment occurs when an asset is placed in service, and subsequently receives rate base treatment in a rate case. Through this approach, shareholders are given an opportunity to earn a return on their investment.

Q. Is this deferred cost treatment, under an AAO, and resulting rate base treatment limited to major construction additions?

A. Yes. With the exception of major capital additions, Aquila, as well as other electric utilities, are expected to follow the Federal Energy Regulatory Commission (FERC) accounting procedures which require a discontinuation of construction accounting (capitalizing property taxes and carrying costs) when the construction project has been completed.

Because of the significant cost of major construction projects, like the Sibley Rebuild and Western Coal Conversion, the resulting expensing of depreciation, property taxes and carrying cost (interest expense), related to these projects, have a significant impact on the Company's earnings until these additional expenses can be reflected in the next rate case. Without AAO treatment, the additional expenses, which occur prior to the effective date of rates in the Company's next rate case, which could potentially result in a reduction in earnings, if other costs components are not declining.

Q. Please summarize the Staff's position on this issue.

A. The Sibley Rebuild Program and the Sibley Western Coal Conversion Project were extraordinary construction projects undertaken by the Company to provide a continuation of adequate service. These projects represent major capital additions to plant in service as opposed to extraordinary maintenance expenditures resulting from an extraordinary occurrence like an ice storm. The deferred costs included in the AAO authorized by the

Commission for the life extension of Sibley should be treated the same way as the other capital costs for these projects and afforded rate base treatment. Allowing a continuation of construction accounting under an AAO, for major capital projects, and including the AAO costs in rate base provides an incentive for the utility to commit significant capital investment on a timely basis.

Q. Does this conclude your rebuttal testimony?

A. Yes, it does.