Exhibit No.:
Issues: *Cash Working Capital; Chapter 100 Ratemaking Treatment; South Harper Construction Costs; South Harper AFUDC; Accounting Authority Orders (AAOs)*
Witness: *Phillip K. Williams, CPA, CIA*
Sponsoring Party: *MoPSC Staff*
Type of Exhibit: *Surrebuttal Testimony*
Case No.: *ER-2005-0436*
Date Testimony Prepared: *December 13, 2005*

MISSOURI PUBLIC SERVICE COMMISSION
UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

PHILLIP K. WILLIAMS, CPA, CIA

AQUILA, INC.

D/B/A AQUILA NETWORKS MPS – ELECTRIC
AND AQUILA NETWORKS – L & P

CASE NO. ER-2005-0436

Jefferson City, Missouri
December 2005

BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Tariff Filing of Aquila, Inc., to Implement a General Rate Increase for Retail Electric Service Provided to Customers in Its MPS and L&P Missouri Service Areas.	))))	Case No. ER-2005-0436 Tariff No. YE-2005-1045

AFFIDAVIT OF PHILLIP K. WILLIAMS, CPA

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Phillip K. Williams, being of lawful age, on his oath states: that he has participated in the preparation of the following Surrebuttal Testimony in question and answer form, consisting of 29 pages to be presented in the above case; that the answers in the following Surrebuttal Testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.

Phillip K. Williams

Phillip K. Williams

Subscribed and sworn to before me this 12th day of December 2005.

Toni M Charlton

Notary

TONI M. CHARLTON
Notary Public - State of Missouri
My Commission Expires December 28, 2008
Cole County
Commission #04474301

TONI M. CHARLTON NOTARY SEAL NOTARY PUBLIC STATE OF MISSOURI

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AQUILA, INC.
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AQUILA NETWORKS-L&P-ELECTRIC

CASE NO. ER-2005-0436

SURREBUTTAL TESTIMONY

OF

PHILLIP K. WILLIAMS, CPA, CIA

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

CASE NO. ER-2005-0436

Q. Please state your name and business address.

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

Q. Did you prefile direct and rebuttal testimony in this proceeding?

A. Yes.

Q. What is the purpose of your surrebuttal testimony?

A. I respond to the rebuttal testimonies of Aquila, Inc. (Aquila or company) d/b/a Aquila Networks-MPS (MPS) witness Dennis R. Williams on the issue of Cash Working Capital (CWC), Aquila witness H. Davis Rooney on the issues of Chapter 100 financing of the South Harper Generating Facility, construction costs of the plant, South Harper Allowance for Funds Used During Construction costs, and Office of the Public Counsel witness Ted Robertson on the issue of inclusion of the unamortized portion of Accounting Authority Orders (AAO's) in rate base.

EXECUTIVE SUMMARY

Q. Please provide a brief summary of your surrebuttal testimony.

A. My surrebuttal testimony responds to criticism from the Company and Office of the Public Counsel's rebuttal testimony. The issues are Cash Working Capital, ratemaking treatment of Chapter 100 financing for South Harper, South Harper construction costs, South Harper allowance for funds used during construction and accounting authority orders.

The issue concerning Cash Working Capital is the Staff's use of a shortened collection lag of 4.38 days. Staff has used the 4.38 day collection lag in an attempt to insulate the customers from the Company's financial problems that resulted in the cancellation of the accounts receivable sales program the Company had participated in since the mid 1980's until 2002 when the program was cancelled by the Company who purchased the accounts receivables. The Company believes that because the program was cancelled and is no longer available in the previous format that the customers should pick up any additional costs. The Company in an attempt to pass the additional cost of the cancellation of the accounts receivable sales program on to the customers has used a collection lag of 20.51 days. The increase in the collection lag in effect will raise the cost to the ratepayers thereby passing on to the customer an added cost which is a direct result of the Company's financial problems brought about by failure of their unregulated activities.

Staff believes that Aquila should be held to prior commitments by their own senior executives who stated in prior cases before this Commission that the Company would insulate the customers from any adverse affects of their financial problems.

The Company believes that Staff's rate making treatment of the Chapter 100 financing costs should change if the Commission finds the Chapter 100 financing to be invalid or unlawful. The Company and Staff are in agreement as to the benefits of the Chapter 100 financing as a way of mitigating the property taxes associated with the South Harper plant. Staff believes that Company and Staff had an agreement as to the amount of start-up costs associated with the Chapter 100 financing arrangement and the annual Pilot payments to be included in the cost of service. However company's rebuttal testimony states there is an issue should the Commission decide that the Chapter 100 financing is invalid or unlawful and should not be approved.

Staff believes that the Company could have filed for Chapter 100 financing earlier and the current problems could have been mitigated. Staff further believes that the Chapter 100 financing is the least cost alternative for the ratepayer and the company and therefore the costs associated with Chapter 100 financing is the costs that should be included in the cost of service irrespective of the Commissions decision in Case No. EO-2005-0156. Staff further believes that the property taxes associated with South Harper would not be included in the current cost of service under Staff's traditional calculation of property taxes that has been decided by this Commission in past rate cases.

South Harper Construction Costs were brought up in the rebuttal testimony of Company witness H. Davis Rooney, however, Staff is of the belief that the issue concerning the construction cost of South Harper had been settled in the prehearing.

The calculation of the South Harper Allowance for Funds Used During Construction (AFUDC) was brought to Staff attention for the first time during when rebuttal testimony was filed by the Company. Company stated that Staff, in making a disallowance for AFUDC, was incorrect as the balances used included cost for other loadings. These other loadings included costs for payroll loadings, compensated absence loadings, payroll tax loadings, materials loadings, employee benefits loadings and etc. Staff has had a chance to review the Company's updated information and agrees that they incorrectly included these loadings in their disallowance for AFUDC in error. Staff believes that Company and Staff are now in agreement concerning the need to include the loadings in the calculation of the plant balances during the true-up. Staff and Company's only remaining issue concerning the AFUDC is when it should be stopped as a result of when the plant is declared in service. Please refer to Mr. Featherstone's surrebuttal testimony for a discussion of the in service issue.

The inclusion in rate base of the unamortized balance of the Accounting Authority Orders is once again an issue brought forth by the Office of the Public Counsel. Staff and Company have included the unamortized balance of the AAOs in rate base following the treatment prescribed by the Commission when the AAOs were originally set up in the early 1990's. The Commission authorized these deferrals in Case Nos. ER-90-101 and ER-93-37. Public Counsel believes that the AAO treatment has evolved over time and as such the unamortized balances should not be included in rate base. Staff believes that the AAOs were set-up and authorized by this Commission in previous rate case and that to revisit the treatment of these AAOs is unwarranted.

<u>CASH WORKING CAPITAL</u>

Q. Have you reviewed Aquila witness Mr. Dennis R Williams' rebuttal testimony concerning Staff's calculation of Cash Working Capital?

A. Yes, I have.

Q. What issues does Mr. Dennis Williams have with Staff's calculation of Cash Working Capital?

A. Mr. Dennis Williams disagrees with the Staff's including the impacts of an accounts receivable sales program (program) in the calculation of the collection lag portion of the revenue lag.

Q. Does Aquila have an accounts receivable program?

A. Yes, but it is not the program the Staff used. The Staff included the impacts of the accounts receivable sales program that Aquila had from the mid-1980s until 2002. Mr. Dennis Williams states on page 3 of his rebuttal testimony that:

> Due to changes in the banking industry, the type of accounts receivable sales program that was in place in 2001 is no longer available to any company. Aquila has replaced its original accounts receivable sales program with an alternative receivable financing program so that associated short-term financings can be made if necessary; however, there has been no need during or subsequent to the test year to draw upon this short term credit mechanism.

Q. Does Staff agree that there has been no need to draw upon the short-term borrowings?

A. No. If Aquila was investment grade, it could have financed some of its construction costs for the South Harper Generating Station (South Harper) typical of many other investment grade utilities instead of using high cost equity financing. The allowance for funds used during construction (AFUDC) for South Harper was high in relation to what it would have been if short-term debt would have been used. The short-term debt rates might be as low as 2% to 3% as opposed to the overall AFUDC rate on the South Harper project of 8.61% that Aquila used.

Q. If Aquila does not have the program that the Staff used, why did the Staff include the accounts receivable program it used in its Cash Working Capital analysis?

A. Staff has included the program Aquila had until 2002 to insulate Aquila's regulated customers from costs Aquila incurred as a result of its financial problems caused by its non-regulated activities.

Q. On page 3 of Mr. Dennis Williams' rebuttal testimony he states that Staff has "effectively assumed that Aquila has an accounts receivable sales program in place and that it was utilized for financing purposes during the test year. Both of these assumptions are incorrect." Do you have any comments on these statements?

A. Yes. Staff is aware that Aquila does not participate in an accounts receivable sales program that is in any way similar to the program in effect until 2002. However, Staff made the adjustment to the collection lag in an effort to hold Aquila's regulated customers harmless and insulate them from actions that occurred on the non-regulated side of Aquila's business that, left unchecked, would produce higher costs to these customers. The elimination of the Accounts Receivables Sales Program was directly attributable to the financial problems incurred by Aquila as a result of its non-regulated activities and a direct result of its non-regulated business ventures. As a result of the non-regulated failures, the consequences of those failed business decisions should be eliminated when calculating the cost of service for the regulated entity. The Company's failure to use the program in calculating the collection lag for CWC has the direct affect of increasing the revenue lag thereby increasing the Cash Working Capital requirement of the Company. By increasing the Cash Working Capital requirement, the rate base upon which the Company earns a return is also increased. The increase in the rate base corresponds to an increase in the revenue requirement, thereby increasing the cost to the ratepayer.

Q. Do you have any further explanation for why the Staff used the accounts receivable sales program Aquila had in place until 2002 rather than its current program for purposes of determining Cash Working Capital?

A. Yes. Staff agrees that Aquila is currently participating in a financing program that is different than the accounts receivable sales program Aquila participated in previously. However, Staff is not penalizing the Company because the program is different as Mr. Dennis

Williams suggests. Staff's approach to including the old sales program is to ensure that the ratepayers are not penalized by the increase in costs resulting from the cancellation of the previous financing arrangement, as Mr. Williams prefers to characterize the Accounts Receivables Sales Program that the Company previously participated in.

Staff's use of the collection lag resulting from the sale of the Accounts Receivables was made to ensure that the ratepayers are not providing any recovery to Aquila for the financial woes that resulted because of the problems with the non-regulated side of their businesses in early 2002.

Q. Has Aquila made statements in the past that are consistent with the approach Staff is taking in this case?

A. Yes. Staff's position concerning the use of the 4.38 day collection lag is supported by the testimony, in Case No. EF-2003-0465, of Mr. Richard Dodson, Aquila's Senior Vice President and Chief Financial Officer, in a statement to this Commission. Mr. Dobson stated that the "Company would attempt to isolate the impact of Aquila's financial condition." Company's Accounts Receivable Sales Program was originally canceled as a result of the Company's financial problems which were a direct result of Aquila's non-regulated activities. Mr. Dobson further discussed on page 2 of his direct testimony in Case No. EF-2003-0465, "In the mid-1980's, Aquila, then UtiliCorp United, Inc. ("UtiliCorp") began its growth strategy by acquiring domestic utility properties." It was during this same time period that the accounts receivable program was implemented at the corporate level, while the focus was still on domestic utility operations and acquisitions. While the Program may be a non-traditional form of financing to other companies, it is traditional to Aquila because it has been used for not only a long period of time, but also when Aquila's strategy was on domestic utility operations.

Aquila is still in the process of selling assets, including many of their regulated assets, in an attempt to get out from under those problems.

Q. Mr. Dennis Williams' states on page 3 of his rebuttal testimony that Citibank no longer offers this one-step structure irrespective of the seller's credit rating. If true, would this fact affect how Staff would calculate the collection lag?

A. No. Neither Staff nor the Company can say with certainty that the accounts receivable sales program Aquila had in place until 2002 would still be available to Aquila if it had not suffered the devastating financial problems that occurred as a result of its non-regulated activities. Aquila had participated in the program that was canceled during 2002, since the mid 1980's and as such cannot say with any degree of certainty that Citicorp would have cancelled that program with Aquila, had the Company not suffered from financial problems. In fact, Mr. Williams states on page 4 of his rebuttal testimony that "Aquila experienced a severe decline in its credit rating to non-investment grade. Ciesco was no longer able to fund the Program because of the inability to issue commercial paper."

Q. Does Staff believe that since the Company has entered into a different form of Accounts Receivable Sales Program that the Commission should allow Aquila to eliminate the affect of the previous sales program as it relates to the CWC calculation?

A. No. Staff believes that the collection lag used by Staff is appropriate to eliminate the adverse effects that are an indirect result of the cancellation of the previous Accounts Receivables Sales Program. This is necessary to hold Aquila's regulated customers harmless to the devastating effects of the financial condition.

Q. What is the impact of not including the effects of the accounts receivable sales program?

A. The cancellation of the program, if taken into account in the calculation of the CWC and the elimination of the cost associated with the imputation of such a program would result in an increase in rates to the Missouri ratepayers of approximately $1.373 million for Aquila Networks – MPS, and approximately $417,000 for the L&P customers.

Q. Company witness Dennis Williams states on page 3 of his rebuttal -testimony "it appears that Staff witness [Phillip] Williams believes that the loss of the accounts receivable sales program has resulted in a detriment to Aquila and its customers." Does Staff believe that the loss of the accounts receivable sales program results in a detriment to Aquila and its customers?

A. Yes. Staff has stated earlier in this testimony, the loss of the accounts receivable sales program that existed during the late 1980's through early 2002 when it was cancelled by the lender, has the effect of increasing the CWC requirement of the Company, thereby increasing the revenue requirement to the regulated customers.

Q. Company witness Dennis Williams asserts on page 6 of his rebuttal testimony that the Staff adjustment "has the effect of ascribing the accounts receivable sales program as a permanent source of financing." Does Staff agree with this statement?

A. No. Staff's adjustment deals only with the effect that the accounts receivable sales program had on the CWC requirement and the expenses to administer that program. Staff has made no determination as to the need of or the lack of need for any form of accounts receivable sales as an appropriate form of financing. Staff has attempted to isolate costs associated with the financial condition arising from Aquila's non-regulated ventures.

Q. Has Aquila made commitments to isolate its regulated customers from any adverse impacts of the non-regulated failures?

A. Yes. Several Company witnesses in the previous rate case, Case No. ER-2004-0034 and in a financing case, Case No. EF-2003-0465, had also asserted that the Company would attempt to isolate the impact of Aquila's negative financial condition. This is evident in the statements of Mr. Keith G. Stamm, Aquila's Vice President and Chief Operating Officer, during Case No. ER-2004-0034 when he stated on page 2, line 19 though page 3 of his direct testimony:

> …There is likely to be a presumption on the part of some of our constituents that this is an attempt to take advantage of our customers and restore financial viability that has been threatened as a result of our investments outside of the utility sector.
>
> However, this is simply not the case. This request for rate relief stand on the merits of the need of Missouri regulated operations alone isolated and insulated from the impacts of our non-regulated activities.

Mr. Dobson, in his direct testimony in Case No. EF-2003-0465, stated on page 9 "first, we had to continue to maintain a focus on providing service to our utility customers, and ensure that the steps we take to restore Aquila's financial stability would not have any adverse impact on the utility business or its customers."

In addition to these statements, Mr. Jon R. Empson, Senior Vice President of Regulated Operations, in his rebuttal testimony for Case No. ER-2004-0034, stated the following:

> Q. When Aquila prepared the rate cases that were filed with the Commission, what guidance did you give the regulatory team?
>
> A. There were two basic principles that we made a concerted effort to apply to a review of our rate case filing.
>
> First our utility customers should no bear any of the costs associated with Aquila's exiting or winding down of our non-regulated and

> international businesses. In other words, as stated by Aquila witness Beverlee Agut in her direct testimony, our intention and desire was to insulate the customer from these activities and not include these costs in the cost of service in this case…

Mr. Empson also made similar comments in Case No. EF-2003-0465, when he stated at page 7 of his direct testimony, "However, while Aquila accepts full responsibility for its past strategy, Aquila is also taking full responsibility for restoring financial stability without adversely impacting the customer."

Mr. Empson stated in his surrebuttal testimony, at page 22, filed September 26, 2003 in that case, the following which sums up Aquila's past position regarding removing all adverse impacts from the non-regulated operations failures:

> Q. What are Aquila's corporate policies relative to this application [case EF-2003-0465]?
>
> A. Aquila has essentially declared its utility properties investment grade. In other words, while Aquila might be non-investment grade, Aquila is treating all of its utility properties as investment grade. Aquila is behaving as if an outside credit rating agency has determined that a ring fence exists and the credit risk of Aquila's utility properties had been insulated from the credit risk of the Company.

Mr. Empson further stated on page 23, lines 13 thru 16 of his surrebuttal filed in Case No. EF-2003-0465:

> Any lead-lag calculation in rate cases will be developed in a manner that normalizes or neutralizes any potential impact of prepayment for energy supplies.

Aquila made a pledge in the finance case to hold harmless the adverse effects of the Company's non-regulated operations. The adjustment to reflect the accounts receivable program in cash working capital is to ensure that this pledge made by Aquila is met so customers are not burdened with the higher rates as result of the costs that Aquila has had to incur because of its non-investment grade credit rating.

Q. How did the Company benefit from the sale the accounts receivable of the regulated utility operations?

A. Since the late 1980's Aquila sold the regulated utility accounts receivable for financial purposes and reaped the benefits of having access to the funds more rapidly than if the account receivables were collected from its customers traditionally. Because of the Company's financial troubles it has experienced, Aquila was unable to sell the accounts receivables. In essence the banks no longer wanted to do business with a company that had such a poor credit rating and poor quality of earnings potential. Now, after several years have passed since the time of the Company's financial problems which directly caused the termination of the accounts receivable sales program, Aquila now believes that the benefits of that sale should no longer be taken into account in the calculation of the Cash Working Capital. In the past, the Staff took a portion of the benefits and passed those benefits to ratepayers through the reduction to the collection lag. To allow the Company to increase the collection portion of the revenue lag would be detrimental to the ratepayers, the same ratepayers the Company witnesses have sworn would be protected from the Company's financial downturn.

Q. How did the sale of the accounts receivable work?

A. The sale of accounts receivable by the Company was a contract upon which Aquila obtained funds through the sale of its accounts receivables. The Company provided service to its regulated customers who were billed monthly. Typically, customers are billed on a monthly cycle. The meters are read once a month and the meter readings are then entered into the Company's billing system to produce a customer bill which is then mailed to the customers who are required to pay their bill within 20 days. Once the meter reading is processed and the bill is determined, an entry is made to the books of the Company to identify the amount of the bill as an accounts receivable. The accounts receivables sales program was set up by Aquila to sell the receivables two days after they were billed as a means to secure short-term borrowings. The sale of or pledging of the accounts receivables by the Company gave them the use of those receivables within two days of the billing for services rendered, therefore it did not have to wait for the customers to pay during the normal collection period, typically 20 days. The accounts receivables sales amounts were adjusted for any bad debts. Both Staff and Company in past rate cases agreed to include the benefits of this arrangement in the cost of service. In an effort to include benefits of the accounts receivable sales program in the cost of service, Company and Staff agreed to the use of a collection lag of 4.38 days in the calculation of the revenue lag and the inclusion of the costs of participating in the program as an expense. The agreement between Company and Staff in these past rate cases shortened the collection lag from approximately 20 days to the 4.38 days, which in effect reduced the Cash Working Capital needs of the Company. These funds were used primarily for mergers, acquisitions and or other corporate purposes.

Q. Were there other effects on cash working capital as result of Aquila being downgraded to non-investment credit?

A. Yes. Aquila was required to prepay (pay in advance) many of the larger accounts with vendors who supplied natural gas, coal and purchased power. In some instances, the Company had to secure cash accounts with vendors before they would do business with Aquila. Some vendors required Aquila to pay early some of the payable balances with creditors. In each of these circumstances, Staff has removed the negative effects on cash working capital.

Q. Is the imputation of the accounts receivable sales program the same as the removing the effects of the prepayments?

A. Yes. Making these adjustments results in the removal of any adverse effects of the non-investment credit rating of Aquila.

Q. Has Aquila made the same adjustments in its calculation of cash working capital?

A. Yes. Aquila has removed all the effects of the prepayments and early payments from its cash working capital amount. But it has not been consistent in its approach to maintaining the accounts receivable sales program to the pre-financial collapse days. Aquila has recognized the need to compute the expense lags in a manner that does not reflect the advance payments that occurred exclusively as result to the misfortunes of the non-regulated operations. But it is perplexing why the Company believes that it is its customers' responsibility to pay higher rates just because of Aquila's negative credit ratings. Importantly, the Company is requesting that its customers pay higher rates, rates that are already among the highest in the state, because of the loss of the accounts receivable sales program while customers will feel the pressure of higher rates for higher energy costs and higher investment costs.

Q. Aquila witness Dennis Williams states on pages 7 and 8 of his rebuttal testimony that the Staff has never imputed an accounts receivable sales program for the other utilities in Missouri. Can you explain why the Staff has never imputed an accounts receivable sales program for other Missouri utilities?

A. Yes. Staff has never imputed a sales program for any other regulated utility because no other utility has participated in such a program to the Staff's knowledge. None of the other utilities had such a program nor did these other companies request cash working capital treatment in their rate cases. In fact, only Empire District Electric Company (Empire) has consistently filed rate increase cases during the time Aquila had the Sales Program. Neither AmerenUE nor Kansas City Power & Light (KCPL) has had rate cases where this issue would have come up for review. Consequently, Staff's examination has been focused on Aquila and its activities, not other regulated utilities in Missouri. Mr. Williams acknowledges in his rebuttal testimony that AmerenUE and Empire do not have accounts receivable sales programs. Staff is unaware of either company ever having had a program where they sold their accounts receivables; therefore, it would be unreasonable to assume that Staff should impute a program for either Company. Since KCPL has not had a formal rate case since the late 1980's, there have been no formal issues with KCPL in which a CWC analysis has been used. Staff has examined KCPL's earnings periodically and has recently discovered that it has a sales program. Staff will review this program and determine what appropriate approach will be used with KCPL when it files it rate case in 2006 as result of the Regulatory Plan approved by the Commission in Case No. EO-2005--0329.

RATEMAKING TREATMENT OF CHAPTER 100

Q. In his rebuttal testimony, Aquila witness H. Davis Rooney criticizes Staff concerning its ratemaking treatment of the fees associated with the Chapter 100 financing arrangement. What is his criticism?

A. Mr. Rooney disagrees with the Staff's position on the treatment of Chapter 100 financing fees for South Harper if the Chapter 100 financing arrangement Aquila closed with the City of Peculiar on December 30, 2004 is void. Staff thought there was no issue between Aquila and Staff concerning the Chapter 100 fees in this rate case until Mr. Rooney filed his rebuttal testimony. South Harper costs have been used as a proxy for 315 MW of capacity needed to replace the Aries purchased power agreement that expired on May 31, 2005. Staff is recommending that a total of 500 MW of combustion turbine generation be included in this case. Staff has taken the position that Aquila should have built the total amount of capacity to replace the Aries purchased power agreement. Staff has included the amount in cost of service on a jurisdictional basis, the amount which represents the annual payments-in-lieu of taxes (PILOT payments).

Q. Mr. Rooney states in his rebuttal testimony, starting on page 4, line 13, that if Chapter 100 financing is not approved by the Commission, then "Staff proposed to exclude the PILOT Payments." Please explain Staff's position if the Chapter 100 financing arrangement Aquila closed with the City of Peculiar on December 30, 2004 is void.

A. Staff believes a Chapter 100 financing arrangement is the most cost effective alternative for Aquila, and ultimately for ratepayers. Staff, therefore, believes Aquila should have entered into an agreement for Chapter 100 financing and taken the steps necessary to effectuate the financing as soon as it could have done so. Staff further believes that had Aquila and the City of Peculiar acted in a timely fashion and met all legal requirements to accomplish the transaction there would have been no adverse consequences to either Aquila and/or the City of Peculiar. Therefore, Staff believes that, in lieu property taxes for the South Harper facility, the costs of the Chapter 100 financing should remain in the rate case as the reasonable and prudent costs.

Q. Mr. Rooney states in his rebuttal testimony on page 5 that "in Case No. EO-2005-0156 on Data Request MPSC-0013, the Company communicated that in order to obtain the estimated $25 million tax abatement, it agreed to pay certain upfront costs and fees

($927,000 at 06/30/2005) to the City of Peculiar and to make certain payments in lieu of taxes (PILOTs) ($7.3 million over 30 years)." How has Staff treated these costs in this rate case?

A. Staff has included both the up front costs to obtain the Chapter 100 financing and the ongoing PILOT payments in the cost of the plant to be included in rate base in this case. Staff continues to support the inclusion of both the upfront costs of obtaining the Chapter 100 financing and the ongoing PILOT payments in Aquila's cost of service in this case.

Q. Will including the costs of obtaining the Chapter 100 financing in the costs to construct South Harper allow Aquila to recover those upfront costs?

A. Yes. Like all other costs necessary to construct the South Harper facility, the payments made to establish the Chapter 100 financing will be recovered over the life of the facility itself through depreciation.

Q. Mr. Rooney in his rebuttal testimony starting on page 4 line 17 states, "Staff should not merely exclude the PILOT payments, but should <u>replace</u> the PILOT payment with an estimate of the property taxes that would occur in the absence of the Chapter 100." Does Staff agree?

A. No. Staff in its annualization of property taxes does not include plant under construction in its calculation of annualized property taxes. Staff calculated property taxes based upon the actual property taxes paid as a ratio of the plant-in-service as of December 31, 2004, the end of the Staff's test year. This calculation of annualized property taxes is based on the value of the property owned as of January 1, 2005, which is the date property is assessed for taxing purposes. This relationship reflects how tax payments are actually determined by the taxing authorities. Any property taxes paid on Construction Work In Progress (CWIP) would be capitalized as part of the construction cost to build the plant. Staff's annualization of property taxes does not recognize the additional plant and or retirements that occur after January 1 of the current year in the calculation of property taxes.

Any property taxes on newly constructed plant will not be assessed as plant in service until January 1 following the year of completion. The taxing authority will assess the value as January 1 the actual taxes will not be paid until December 31 of that year, well over a year after the plant is completed. Staff believes that to include the additions and retirements in the calculation of the property taxes is unreasonable, as they are not known and measurable at the current time.

Additionally Staff believes that if property taxes were incurred for 2004 and 2005 that they should not be allowed. Staff believes that Company could have obtained the proper Chapter 100 financing approval during 2004, thereby insuring the least cost alternative.

Q. When will Aquila pay property taxes on the South Harper facility as plant in service if it does not take advantage of Chapter 100 financing?

A. Any property taxes on South Harper facility which was placed in service during July 2005 and classified as plant in service will not have to be paid until December 31, 2006, a year and half after the plant became fully operational. South Harper, as plant in service, will be assessed as real property by taxing authorities on January 1, 2006 if it does not have exemption from Chapter 100 financing status.

Q. Has the issue of when to include property taxes as expense in the case been presented to the Commission in the past?

A. Yes. The Commission has excluded property taxes on newly constructed plant previously in rate cases because they were not part of that year's assessment for property tax payments. The Commission has consistently made the distinction between plant in service assessed at January 1 of a given year and plant that was classified as construction of that same year. The Commission has treated property taxes paid on construction plant as capitalized in the year of construction. The next year, when the newly completed asset is plant in service, it is assessed on January 1 with the taxes paid December 31.

The Commission took this position on Empire's State Line Combined Cycle Unit in Case No. ER-2001-0299. The Commission also ordered this treatment in the 1996 Missouri Gas Energy rate case, Case No. GR-96-285 and St. Louis County Water Company rate case, Case No. WR-2000- 0844.

The Commission, in Case No. ER-2001-299, stated in its Report and Order on page 26:

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

Q. What is Staff's position concerning the property taxes versus Chapter 100 financing costs if is unable to obtain new Chapter 100 financing?

A. Staff believes that the current costs included in the current rate case which includes the upfront costs/fees and the PILOT payments should remain in the case.

Q. If Aquila enters into Chapter 100 financing arrangement that has not yet closed and incurs additional costs in doing so, what is the Staff's position regarding those costs?

A. Any additional costs Aquila incurs would be imprudent and should not be included in the cost of service in this or in any future rate case.

Q. Why does Staff take the position that any additional costs for Chapter 100 financing should be excluded from cost of service as imprudent?

A. The Company has every opportunity to finalize the Chapter 100 financing in a timely matter prior to this case being filed. Aquila could have sought approval from this Commission well in advance of the closing and transfer of the turbine equipment costs that occurred December 31, 2004. Staff believes that Aquila put itself in the position it is in and the customers should be expected to pay additional costs to effectuate Chapter 100 financing.

SOUTH HARPER CONSTRUCTION COSTS

Q. In his rebuttal testimony Aquila witness R. Davis Rooney discusses South Harper plant construction costs. Does Staff and Aquila have any differences remaining between them concerning these costs?

A. Staff believes that there is a settlement between Staff and Company concerning the South Harper construction costs disallowances and the subsequent valuation of the plant and, therefore, they no longer have any disputes on these costs.

SOUTH HARPER ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION

Q. At page 23 of his rebuttal testimony, Aquila witness R. Davis Rooney states that Staff's disallowance of AFUDC has been incorrectly calculated due to including cost associated with other loadings. Do you have a response to this assertion?

A. Yes. Staff was unaware the amount it was using to calculate AFUDC included other loadings in the monthly balances. Staff believes that a reasonable and prudent level of other loadings should be reflected in the construction costs of the South Harper plant. The amounts provided by the Company in a Weekly Cash Flow analysis included other loading in monthly amounts along with amounts of AFUDC. These additional loadings included costs for payroll loadings, payroll taxes, materials loadings, employee benefits loadings, compensated absences, etc. Staff picked up the total of these amounts in a calculation of AFUDC costs that was used as basis for disallowances made in the direct case for South Harper. Those amounts are not currently included in the amounts Staff has disallowed in its current South Harper adjustments. Staff has discussed this with Aquila and believes that this issue has been eliminated.

For the true-up in this case, Staff will ensure that proper loadings that should be included in the South Harper construction costs will be reflected in the true-up calculation.

ACCOUNTING AUTHORITY ORDERS (AAO)

Q. What Accounting Authority Orders are at issue in this case?

A. There are two Accounting Authority Orders at issue in this case. The Commission granted the first two Accounting Authority Orders to authorize Aquila to defer depreciation expenses, property taxes, and carrying costs associated with the capacity life extension and western coal conversion projects at its Sibley generating station. The Commission granted these authorizations to defer and seek recovery of these costs in its Accounting Authority Orders entered in Case Nos. EO-90-114 and EO-91-358, and they were subsequently reauthorized 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 what is now its MPS service area in January 2002. The Commission granted that authority in Case No. EU-2002-1053. The Accounting Authority Order associated with the Ice Storm is not an issue in this case.

Q. What is the current issue concerning the Accounting Authority Orders related to Aquila's Sibley generating station?

A. In his rebuttal testimony Office of the Public Counsel witness Ted Robertson raises again, as he did in his direct testimony, whether the unamortized balance of the AAO's associated with the Sibley rebuild and the western coal conversion should be included in rate base.

Q. Is there any issue concerning the expense amortization of the AAO's?

A. No. Staff believes that the issue is not with the amortization of the AAOs but that the Public Counsel's concern lies with the Commission's previous decisions in Case Nos ER-90-101, EO-91-247 and ER-93-37 to allow the unamortized balance of the Sibley Rebuild and the Sibley Western Coal Conversion AAOs in rate base.

Q. You have stated that the issue in this case is the unamortized balance of the AAOs for the Sibley Rebuild and the Western Coal Conversion, is this correct?

A. Yes. Mr. Robertson in his rebuttal testimony states, starting on page 5, line 13, that "The cases Mr. Williams cites occurred early in the Commission's process of developing, or adopting, what commonly became known as accounting authority orders. In a later case, the Commission recognized that allowing a utility to earn a return on the deferred AAO costs is not an appropriate regulatory policy."

Q. Do you know what "later case" Mr. Robertson is referring to?

A. Yes. Mr. Robertson is referring to the 1998 Missouri Gas Energy (MGE) natural gas rate case, No. GR-98-140. Prior to this case the Commission had allowed MGE as well as its predecessor company Western Resources, Inc. (WRI), both a return "of" and return "on" it Service Line Replacement Program (SLRP) deferrals in rates, amortized over a period of 20 years. In the 1998 MGE case, the Commission determined that rate base treatment of the unamortized balance of SLRP deferral was no longer appropriate, since it was accelerating the amortization period from the original 20-year period to 10 years. The Commission stated in its Report and Order, at page 20:

> Given that the Company will recover the amortized amount of the SLRP deferral at the AFUDC rate in ten years, instead of the previous 20 years' amortization period, it is proper for the ratepayers and shareholders to share the effect of regulatory lag by allowing the Company to earn a return of the SLRP deferred balance but not a return on the SLRP deferred balance.

Q. Did MGE propose less than a 20-year amortization period in Case No. GR-98-140?

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

Q. Is Aquila proposing in this case an acceleration of the amortization or a different amortization period than the Commission ordered in prior rate cases for the Sibley rebuild project AAO and the Sibley western coal conversion AAO?

A. No. Aquila is proposing the same amortization period of twenty years for the Sibley rebuild project AAO and the Sibley western coal conversion AAO as first determined in Case No. ER-90-101, and then continued in subsequent rate cases. Public Counsel is the only party seeking to change the outcome of the Commission's previous orders concerning these AAOs.

Q. Would you please summarize the Staff's position regarding rate base treatment for the Sibley rebuild project AAO and the Sibley western coal conversion AAOs?

A. Staff is proposing the continuance of the traditional amortization period and rate base treatment for the unamortized balances as set forth in past Aquila rate case proceedings before the Commission. By this time, the Sibley rebuild project AAO and the Sibley western coal conversion AAO have both been amortized over approximately 70% of the original amortization period of 20 years. In the case of the Sibley rebuild project AAO, the deferral has been amortized for almost 16 years with a little over four years of the amortization remaining. In the case of the Sibley western coal conversion AAO, recovery in rates started in mid 1993. Therefore, over 12 years of rate recovery have occurred to this point with another 8 years remaining. These projects represented major capital additions to plant in service at the time they were completed, as opposed to extraordinary maintenance expenditures, such as the ices storm or a service line replacement program.

Q. Did Staff oppose the AAOs relating to the Sibley rebuild program and the Sibley western coal conversion when Aquila originally sought them?

A. Yes. A review of the Report and Order in Case No. ER-90-101 indicates that the Staff opposed the AAO treatment for the Sibley projects. However, in recognition of the possibility that the Commission might authorize rate treatment for the AAOs, the Staff identified a process to quantify any such recovery. This quantification method related to what is referred to as "construction accounting." This treatment was identified in detail in Case No.

ER-90-101 to ensure that proper accounting and ratemaking processes would be used if the Commission approved the AAO recovery as Aquila advocated in that case.

Q. Did the Commission agree with Staff's opposition to Aquila's AAO deferrals?

A. No. The Commission granted the Company recovery of the AAO deferrals for depreciation expenses, property taxes, and carrying costs.

Q. What was Aquila's proposal in Case No. ER-90-101?

A. Aquila proposed to recover the AAO deferral over a three year period of time. Staff opposed this recovery period and presented a position to treat the rebuild costs and coal conversion costs and nothing more than construction costs, using the same construction accounting cost principles.

Q. Did the Commission adopt Staff's position?

A. Yes. The Commission rejected Aquila's three year amortization treatment and ordered the construction accounting treatment for the Sibley rebuild and coal conversion projects.

Q. What is "construction" accounting?

A. The FERC Uniform System Of Accounts (USOA) has a prescribed method for accounting for construction expenditures while a plant item is being built or constructed. The USOA accounts used for construction accounting are described below, in the order that the expenditures are accounted for, as the expenditures are ultimately booked into plant in service.

Q. What is Construction Work In Progress?

A. All costs to construct a plant investment are booked in Account 107, Construction Work In Progress Electric (CWIP). This account includes all direct material, indirect materials, direct labor, indirect labor and property taxes associated with all items in construction, and etc. As a project is completed and placed in service, the amount of material, labor, property taxes and etc. associated with the construction project are transferred in Account 101, Electric Plant in Service. Any expenditures associated with a project that has not been completed will remain in Account 107 until the project is completed. It is not uncommon for a company of MPS' size to continuously have a balance in Account 107 since construction projects are being started and completed on a continuous basis.

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

A. Account 101, Electric Plant in Service, reflects the capitalized cost of all plant owned by the utility that is used and useful at original cost. The construction costs are transferred from Account 107 when the project is completed to plant in service. When costs are transferred into this account, depreciation expense begins to be accrued on the asset and the company no longer is permitted to accrue allowance for funds used during construction AFUDC).

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

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

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

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

> This account shall include the total of the balances of work orders for electric plant in process of construction.
>
> Work orders shall be cleared from this account as soon as practicable after completion of the job.

Q. What ratemaking issue developed with the Sibley rebuild project and the Sibley western coal conversion?

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

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

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

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

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

> The final matter to be addressed on this issue involves the length of time over which these deferred rates should be amortized and whether the unamortized portion of these costs should be reflected in rate base. Staff/Public Counsel contend that, if these costs are to be reflected in rates, they should be amortized over 20 years, the extended life of the Sibley Generating Station with the unamortized costs not reflected in rate base. Staff/Public Counsel supports this viewpoint by stating that the Commission has afforded such costs this treatment in prior similar instances.
>
> Company contends that these costs should be amortized over a three-year period which is the approximate length of time for completing these projects. Company believes this approach would match the recovery of costs with the enjoyment of benefits arising from these projects. Company maintains that the unamortized portion of these costs should be included in rate base in order that Company may be compensated for the value of the money for the time occurring between the spending of the funds and their ultimate recovery.
>
> 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 ratepayers 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. The cases cited by Staff/Public Counsel deal with extraordinary maintenance costs and therefore are not applicable.

Q. Does Staff believe that the Commission should continue the rate base treatment of the Sibley Rebuild AAO and the Western Coal Conversion AAO.

A. Yes. Staff believes that the projects associated with these AAOs provide a life extension of at least 20 years to the Sibley plant and therefore the amortization of the AAOs and the inclusion of the unamortized balances in rate base matches the period the plants life was extended. The AAO deferral treatment has the effect of treating the construction accounting in essence treating the AAO deferrals like all construction costs that are charged to CWIP and then to plant in service. This treats these costs just like construction costs in that they are included as an amortization like depreciation, recovering the investment component. The rate base treatment is to treat these costs further just like construction cost in that they are afforded a return in rate base, i.e. the recovery on the investment component.

Q. Does this conclude your surrebuttal testimony?

A. Yes, it does.