

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
SURREBUTTAL TESTIMONY OF DENNIS R. WILLIAMS
ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NOS. ER-2004-0034 AND HR-2004-0024 (CONSOLIDATED)**

1 Q. Please state your name and business address.

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

4 Q. Are you the same Dennis Williams who previously filed rebuttal testimony in this
5 proceeding before the Missouri Public Service Commission (“Commission”) on behalf of
6 Aquila, Inc (“Aquila” or “Company”)?

7 A. Yes, I am.

8 Q. What is the purpose of your surrebuttal testimony?

9 A. I will respond to the rebuttal testimony of Commission Staff (“Staff”) witness Trisha
10 Miller and Office of Public Counsel (“Public Counsel”) OPC witness Ted Robertson
11 pertaining to accounting authority orders; to Staff witness Amanda McMellen’s rebuttal
12 testimony regarding uncollectible accounts expense; and to Public Counsel witness
13 Robertson’s manufactured gas plant testimony.

14 **MPS ACCOUNTING AUTHORITY ORDERS**

15 Q. Please explain your understanding of Staff witness Trisha Miller’s rebuttal testimony
16 with regards to the Aquila Networks-MPS (“MPS”) Ice Storm Accounting Authority
17 Order (“AAO”)?

18 A. Staff has included a total of \$1,648,979 per year in extraordinary maintenance costs
19 related to the ice storm, representing one fifth of MPS’s total incremental costs as

1 authorized by the Commission in Case No. EU-2002-1053 (see page 2 lines 16-20 of Ms.
2 Miller's rebuttal testimony). Staff's ratemaking treatment allows MPS' electric
3 operations to earn a "return of" a portion of the extraordinary expenditures incurred to
4 restore service to its electric customers as a result of the ice storm that occurred in
5 January 2002. However, Staff has excluded from rate base the unamortized AAO
6 balance at September 30, 2003 related to the ice storm.

7 Q. What is your understanding of Staff's position regarding the disallowance of rate base
8 treatment of the unamortized AAO balance?

9 A. Ms. Miller discusses in her rebuttal testimony the Commission's past treatment of AAO's
10 resulting from extraordinary events. Staff contends that extraordinary expenditures
11 associated with "acts of God" have been shared between shareholders and ratepayers and
12 that this is achieved by allowing the amortization in the Company's cost of service but
13 denying rate base treatment for the unamortized deferred AAO balance.

14 Q. What is your response?

15 A. MPS believes that a utility's request for an AAO varies depending on the nature of events
16 or circumstances surrounding the request and therefore the Commission should evaluate
17 the corresponding ratemaking treatment on a case-by-case basis. The ice storm, in MPS'
18 case, was an extraordinary event resulting in significant and material expenditures
19 incurred by the Company to repair its electric system and restore service to its normal
20 operating conditions. These expenditures are legitimate costs incurred specifically to
21 serve customers by restoring service. Customers received the benefit of these
22 expenditures and investors should not have to bear the costs legitimately incurred to serve
23 the customer.

1 Q. Why do you believe that customers should bear the cost of events such as an ice storm?

2 A. Simply stated, it is because customers have received the benefit of the costs expended to
3 restore service. More explicitly, the regulatory process acts as a surrogate for a
4 competitive marketplace. A competitive business is able to reserve for “acts of God” and
5 build the expense associated with establishing that reserve into its prices. While Missouri
6 regulatory precedent does not allow for recovery of establishing a reserve in advance of a
7 natural disaster, the Accounting Authority Order process was established as a mechanism
8 to allow utility companies an opportunity to recover in their prices the impacts of natural
9 disasters. The process should allow for the recovery of legitimate costs to restore service
10 to the customer as well as provide an opportunity for the investor to earn a return on the
11 funds they have advanced as a result of the natural disaster. A utility company has no
12 control over “acts of God” and, to me, it makes no more sense to establish a sharing
13 mechanism for these types of prudently incurred costs than it does for any other prudently
14 incurred cost.

15 Q. Has the Commission ever approved a rate recovery mechanism that shares the cost of
16 natural disasters between investors and customers?

17 A. Yes. Ms. Miller is correct in her description of the rate order in Case No. WR-95-145
18 wherein the Commission determined that a sharing was appropriate and could be
19 achieved by allowing a return of the cost incurred without a return on those costs.
20 However, Ms. Miller did not identify a difference in that sharing mechanism compared to
21 the sharing mechanism already embedded in the MPS Ice Storm AAO.

22 Q. Please explain how a sharing mechanism is already embedded within the MPS Ice Storm
23 AAO.

1 A. In MPS Case No. EU-2002-1053, the Commission accepted the Staff's position that the
2 Company should begin amortization of the incremental deferred expenses beginning in
3 February 2002, the date of the storm. Beginning in February 2002 MPS began recording
4 expenses of over \$137,000 per month as it amortized the \$8.2 million dollars expended to
5 restore service after the ice storm. By the time any recovery of this monthly amortization
6 occurs through new rates established in this case, almost \$4 million of expense will have
7 been amortized without any opportunity for recovery. Moreover, Aquila in its direct
8 filing, requested recovery of a return on only the unamortized balance or about half of the
9 dollars originally expended. MPS investors provided the cash to restore service in
10 February 2002 and under the Company's proposal have already absorbed about 50% of
11 those costs with no opportunity for recovery. Staff's approach goes even further and
12 suggests that not only should the investor absorb the first 50% of the costs incurred to
13 restore service; they should also receive no return on the remaining unamortized
14 expenses. The result is that investors will absorb nearly two-thirds of the deferred costs
15 associated with the 2002 ice storm.

16 Q. How is this sharing mechanism different from the 1995 rate case that Ms. Miller referred
17 to in her testimony?

18 A. Ms. Miller referenced an AAO pertaining to a severe flooding incident that occurred in
19 1993 and to a subsequent rate case in 1995. She correctly pointed out that the 1995 rate
20 order approved recovery by the utility of the amortization of costs incurred, but did not
21 allow for a return by the utility's investors of a return on their investment. However, it
22 should be noted that the utility was not required to start amortizing the deferral at the time

1 the flood occurred in 1993. Amortization did not begin until the following year thereby
2 reducing the sharing of costs absorbed by the Company to below 50 percent.

3 Q. Please summarize your understanding of the rebuttal testimony submitted by Public
4 Counsel witness Mr. Ted Robertson.

5 A. With regards to Mr. Robertson's rebuttal testimony, there are three areas that the
6 Company wishes to address. These issues are as follows: 1) his proposal to exclude the
7 unamortized deferred AAO balances from rate base; 2) his suggestion that the
8 Company's accounting records may not support the incremental costs incurred; and 3) his
9 statements that the Company failed to properly maintain its accounting records to track
10 the deferred income taxes associated with the AAO's.

11 Q. What explanation does Mr. Robertson give to support Public Counsel's position
12 regarding rate base treatment of the unamortized deferred AAO balances?

13 A. Public Counsel believes that AAO's have the effect of protecting the Company from
14 regulatory lag (see page 9, lines 22-23 of Mr. Robertson's rebuttal testimony) and while
15 this may benefit the utility it is not necessarily beneficial to ratepayers (page 10, lines 1-
16 2).

17 Q. How does the Company respond?

18 A. MPS' application for an AAO and the Commission's subsequent Order in Case No. EU-
19 2002-1053 authorizing the deferral of incremental ice storm expenses has not lessened
20 the effect of regulatory lag for the Company. As stated in my rebuttal testimony, MPS
21 made the necessary expenditures to restore electric service to thousands of its customers
22 affected by the ice storm in the quickest manner possible. The cash was expended in
23 January and February 2002, and the Company was required to start amortizing these

1 expenses over a period of 60 months beginning in February 2002 as stated in the Order
2 granted by the Commission. Therefore, the unamortized AAO balance that the Company
3 has proposed to be included in rate base has already been reduced by 24 months of
4 amortization. The Company's investors have already experienced two years of regulatory
5 lag, receiving no "return on" or "return of" their plant investment, and this regulatory lag
6 will continue until new rates are established in the current rate proceeding before the
7 Commission.

8 Q. At pages 9 - 10 of his rebuttal testimony, Mr. Robertson discusses regulatory lag and
9 indicates that it can be a benefit. Do you understand this concept?

10 A. Yes. I have heard witnesses in a number of proceedings point to regulatory lag as a
11 benefit because utility companies are given an incentive to control costs.

12 Q. Should a Commission emphasize the benefits of regulatory lag in the context of a natural
13 disaster such as the ice storm that occurred in early 2002?

14 A. No. Cost containment efforts should not be the focus in an emergency situation. MPS
15 could have reduced the regulatory lag it has experienced as a result of the ice storm, I
16 suppose, by containing costs associated with restoring service. Aquila could have limited
17 overtime; it could have limited the number of crews brought in from outlying states; and
18 the Company could have limited the number of outside contractors we used to restore
19 service. Costs would have been contained, but the time to restore service would have
20 been greatly extended. If our focus had been on regulatory lag, that is an approach
21 Aquila would have taken. However, I doubt that Aquila's customers want the Company
22 or the Commission to be focusing on cost containment, or reducing regulatory lag, when
23 they are without power and it is freezing outside.

1 Q. Please explain the Company's response to the "documentation dispute" that the Public
2 Counsel has referred to.

3 A. Mr. Robertson's rebuttal testimony (page 8, lines 10-11), makes reference to an on-going
4 documentation availability dispute that Staff has with the Company. I am aware of no
5 documentation dispute and believe that Mr. Robertson's comment relates to Ms. Miller's
6 direct testimony where she states that Staff's ice storm AAO adjustment was "subject to
7 change" pending necessary documentation to support the costs incurred (see page 9, lines
8 9-12). After Staff's further review of the responses and related documentation provided
9 in answer to data requests MPSC-0543, MPSC-0544 and MPSC-0564 which I discussed
10 in my rebuttal testimony (see pages 12-14), Staff has accepted the Company's level of
11 incremental expenses associated with the ice storm totaling \$8,244,893, (see page 2, lines
12 16-20 of Ms. Miller's rebuttal testimony). Therefore, I do not believe there is any
13 documentation dispute.

14 Q. Public Counsel notes on page 10, lines 15-17 of its rebuttal testimony that "the utility will
15 still recover the amounts booked and deferred, including the cost of carrying the deferred
16 balances". What is your response?

17 A. I do not understand this statement at all. Carrying costs are computed and included in
18 rates by multiplying the cost of money times rate base. By definition, exclusion of the
19 AAO account from rate base precludes the Company from recovering carrying costs on
20 that balance. Moreover, no property taxes or depreciation expense is included in the
21 \$8,244,893 in incremental expenses for which the Company has requested amortization
22 over five years.

1 Q. What is the Company's response to the remarks made by Public Counsel involving the
2 "Company's failure to maintain the proper financial records" associated with the deferred
3 income taxes on the MPS deferred AAO balances?

4 A. Mr. Robertson points to the Company's response to OPC data request number 1031 to
5 support his statement. I have attached that response as Surrebuttal Schedule DRW-1 to
6 this testimony. This response simply indicates that from a ratemaking perspective, no
7 deferred taxes related to the 1990 or 1992 MPS AAOs. This is because the tax benefits
8 relating to those AAOs were flowed through to customers. Thus, provision of deferred
9 taxes would not be appropriate. I simply do not understand the allegation that our
10 accounting records have been improperly maintained.

11 Q. What is Public Counsel's proposal with regards to the amount of deferred income taxes
12 associated with the deferred AAO costs that should be subtracted from rate base?

13 A. On page 11, lines 17-20 of Mr. Robertson's rebuttal testimony, Public Counsel
14 recommends that the Commission include deferred income taxes associated with the
15 accounting authority orders as a rate base offset.

16 Q. Does the Company agree with Public Counsel's proposal?

17 A. No it does not. Mr. Robertson has suggested retaining the rate base offset associated with
18 deferred taxes while never having included the related AAO in rate base. His result
19 would be to reflect a negative investment as a result of our having incurred substantial
20 costs to restore service to our customers.

21 **L&P ACCOUNTING AUTHORITY ORDERS**

- 1 Q. What is the position of Public Counsel witness Ted Robertson regarding the AM/FM
2 Accounting Authority Order that L&P has included in its revenue requirement
3 calculation?
- 4 A. Mr. Robertson recommends the disallowance of the amortization expense that L&P has
5 included in its cost of service related to the AM/FM system, as well as the unamortized
6 AAO balance that both the Company and Staff have included in rate base. Public
7 Counsel cites that the Company has exceeded the six-year timeframe for which the
8 Commission authorized the amortization, and the unamortized deferred AAO balance is
9 nearly zero and will be fully amortized by October 2004 (see page 13, lines 11-14).
- 10 Q. Does the Company agree with Public Counsel's position?
- 11 A. No it does not. In its application requesting the accounting authority order, St. Joseph
12 Light & Power Company ("SJLP") estimated the expenses related to the AM/FM system
13 to be approximately \$1.4 million. However, the project lasted longer than expected and
14 SJLP continued to incur additional expenses related to the project. In addition, the
15 amortization schedule was not adjusted to reflect a new monthly amortization amount
16 based on the additional expenses incurred; therefore L&P is still amortizing the expenses
17 that is scheduled to be complete by October 2004.
- 18 Q. Do you agree with Mr. Robertson's statement that continued amortization of the L&P
19 AAO will result in over-recovery of deferred costs?
- 20 A. No. This contention clearly contradicts the test year concept and Public Counsel's
21 positions on one-issue rate-making.
- 22 Q. What has been the treatment of the unamortized AAO balance in past rate proceedings?

1 A. In SJLP's last rate proceeding, Case No. ER-99-247, both SJLP and Staff included the
2 unamortized AAO balance of \$679,307 in rate base in their filed case. As such, both
3 Company and Staff have recommended the same accounting treatment of the AM/FM
4 System in the current rate proceeding before the Commission, Case No. ER-2004-0034.

5 **BAD DEBT EXPENSE**

6 Q. Please explain your understanding of the method Staff used to calculate bad debt
7 expense.

8 A. Two different time periods were used to calculate bad debt expense for Aquila's Missouri
9 operations. For MPS electric operations, Staff used a three-year and nine-month average
10 of actual net write-off rates. For L&P's electric operations, Staff used a five-year and
11 nine-month average of actual net write-off rates.

12 Q. What is Staff's rationale for using a three-year and nine-month average and a five-year
13 and nine-month average of actual net write-off rates for MPS and L&P, respectively?

14 A. In MPS' case, Staff believes that the use of a three-year and nine-month average is
15 representative of ongoing levels of actual net write-offs, and that this is consistent with
16 the revenue calculation which has been updated to September 30, 2003 (see page 4, lines
17 15-18 of Ms. McMellen's rebuttal testimony). For L&P's electric operations, Staff
18 concludes that a five-year and nine-month average best reflects the Company's ongoing
19 level of bad debts based on historical data (see page 6, lines 12-13).

20 Q. Does the Company agree with Staff's position?

21 A. No it does not. Staff's use of a three-year and nine-month average for MPS and five-year
22 and nine-month average for L&P significantly distorts the average uncollectible rate in
23 that fourth quarter write-offs, which are normally higher than in other quarters, are

1 excluded causing a calculated understatement of total net write-offs for the year resulting
2 in a lower average uncollectible rate. As stated in my rebuttal testimony on page 21 lines
3 7-9, the exclusion of fourth quarter write-offs for MPS and L&P for 2003 resulted in an
4 understatement of actual net write-offs for the year of approximately 50% for both
5 divisions. Therefore, it is not reasonable for Staff to exclude fourth quarter net write-
6 offs and include only the nine months ending September 30, 2003 in its calculation of the
7 average uncollectible rate just to be consistent with the update period.

8 Q. Why are write-offs traditionally higher in the fourth quarter of the year?

9 A. Aquila's Missouri electric operations are largely suburban and residential, resulting in a
10 high summer peak due to air conditioning load. Customer billings are therefore highest
11 in the summer months of July through September (billing for usage during the months of
12 June through August). A ninety-day tolerance limit is generally viewed by the
13 Company's outside auditors as sufficient for collection of accounts. Bills outstanding
14 beyond that period of time are more likely to be written off. Thus write-offs are
15 substantially higher in the fourth quarter as summer billings reach the point where they
16 are considered to be uncollectible.

17 Q. Staff noted in its rebuttal testimony (page 5, lines 23-26) that the Company utilized a
18 three-year average uncollectible rate for L&P in the update, compared to the five-year
19 average uncollectible rate that was used in its direct filing. How does the Company
20 respond?

21 A. For consistency purposes, the Company changed L&P's average uncollectible rate to
22 agree with the three-year average uncollectible rate reflected in the adjustment of bad
23 debt expense prepared for MPS in both its direct and updated filing.

1 **MANUFACTURED GAS PLANT REMEDIATION COSTS**

2 Q. What is the purpose of your testimony in regards to manufactured gas plant (“MGP”)
3 remediation costs as described by Public Counsel witness Ted Robertson’s rebuttal
4 testimony?

5 A. Mr. Robertson states that MGP costs should only be charged to existing MPS gas
6 customers. He states that the electric customers should not have pay for any MGP
7 expenses.

8 Q. Do you agree with Mr. Robertson on this issue?

9 A. No.

10 Q. Why not?

11 A. It is Aquila’s position that the MGP costs are a corporate wide clean-up obligation and
12 should be a charge to all existing customers as a cost of doing business.

13 Q. Please explain what you mean by “corporate wide clean-up obligation.”

14 A. Aquila has a corporate and legal responsibility to clean up the MGP sites in its service
15 territory. In the late 1800’s and until the 1940’s gas was manufactured from coal and was
16 used to heat and light homes and businesses. These plants were abandoned all over the
17 United States with the building of natural gas pipelines. These abandoned sites are now
18 being cleaned up by various parties because of the potential contamination from coal tar
19 and other residual chemicals left in the soil. MPS has nine of these MGP sites within its
20 service territory and has an obligation to remediate these sites per the Environmental
21 Protection Agency and the Missouri Department of Natural Resources.

22 Q. Beyond the fact that these are corporate obligations, is there any other reason that electric
23 customers should share in the cost of remediation?

- 1 A. Yes, Although Mr. Robertson characterizes these sites as being disassociated from
2 electric operations, that characterization is not correct. The environmental liability
3 associated with manufactured gas plant facilities goes with the land on which the MGP
4 plant is located. As a combination electric/gas utility, MPS has a number of facilities that
5 share facilities between its gas and electric operations. A number of MGP plant sites are
6 at locations that currently house both gas and electric operations or are used exclusively
7 for electric operations. For example, the Clinton site is used for pole storage; a substation
8 resides on a site in Nevada; a warehouse is on an MGP site in Sedalia; and a power plant
9 is located at the former MGP plant site in Trenton.
- 10 Q. Has the Staff taken a position on this issue in the past?
- 11 A. Yes. In MPS Case No. ER-93-37, Staff's position was to have both electric and gas
12 customers pay for the clean-up of the MGP sites.
- 13 Q. Who was the Staff witness that filed testimony on this issue?
- 14 A. Shirley J. Norman filed direct testimony for the Staff in Case No. ER-93-37.
- 15 Q. Has MPS received any insurance payments relating to the site clean-ups?
- 16 A. Yes.
- 17 Q. Which customers received the benefit of these payments?
- 18 A. Both electric and gas customers.
- 19 Q. Please summarize Aquila's position on the MGP clean-up costs.
- 20 A. MGP site clean up is a corporate wide obligation and all costs and recovery should be
21 assigned to both electric and gas customers. Therefore, the Public Counsel adjustment
22 recommended by Ted Robertson, which requires gas customers to bear all of the costs
23 associated with MGP site clean-up, should not be accepted by the Commission.

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