

Exhibit No.: 1074

Issues: Proposed Payroll
Increase; Payroll Tax
Expense Adjustment

Witness: Dana E. Eaves

Sponsoring Party: MoPSC Staff

Type of Exhibit: Surrebuttal Testimony

Case No.: ER-2004-0034

Date Testimony Prepared: February 13, 2004 as modified February 27, 2004

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

SURREBUTTAL TESTIMONY

OF

DANA E. EAVES

FILED

FEB 27 2004

Missouri Public
Service Commission

AQUILA, INC. d/b/a AQUILA NETWORKS-MPS (Electric)

CASE NO. ER-2004-0034

*Jefferson City, Missouri
February 2004*

****Denotes Highly Confidential Information****

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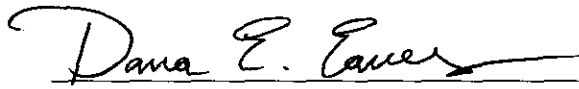
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Aquila, Inc. d/b/a Aquila Networks)
L&P and Aquila Networks MPS to implement a) Case No. ER-2004-0034
general rate increase in electricity.)

AFFIDAVIT OF DANA E. EAVES

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Dana E. Eaves, of lawful age, on his oath states: that he has participated in the preparation of the following surrebuttal testimony as modified on February 27, 2004, in question and answer form, consisting of 10 pages to be presented in the above case; that the answers in the following surrebuttal testimony as modified on February 27, 2004, 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.



Dana E. Eaves

Subscribed and sworn to before me this 27th day of February 2004.





TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

1
2
3
4
5
6
7
8
9
10
11

TABLE OF CONTENTS
SURREBUTTAL TESTIMONY OF
DANA E. EAVES
AQUILA, INC. d/b/a AQUILA NETWORKS-MPS - ELECTRIC

CASE NO. ER-2004-0034

PROPOSED PAYROLL INCREASE 2
PAYROLL TAX EXPENSE ADJUSTMENT 10
PAYROLL ISSUES NO LONGER BEING CONTESTED 10

1 **SURREBUTTAL TESTIMONY**

2 **OF**

3 **DANA E. EAVES**

4 **AQUILA, INC.**

5 **d/b/a AQUILA NETWORKS-MPS - (ELECTRIC)**

6
7 **CASE NO. ER-2004-0034**

8
9 Q. Please state your name and business address.

10 A. Dana E. Eaves, PO Box 360, Suite 440, Jefferson City, MO 65102.

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

12 A. I am a Utility Regulatory Auditor for the Missouri Public Service Commission
13 (Commission or PSC).

14 Q. Are you the same Dana E. Eaves who has previously filed direct and rebuttal
15 testimony in these cases?

16 A. Yes, I am.

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

18 A. The purpose of my surrebuttal testimony is to address the rebuttal testimony
19 of Company witness Ronald A. Klote who sponsors the inclusion of an April 1, 2004, union
20 salary increase adjustment in the Company's case. In particular, I will address the following
21 points:

- 22
- The Staff's current position on the 3% union increase on April 1, 2004.

- 1 • Staff's prior treatment of pay increases outside the test year update period
2 from the prior Missouri Public Service-MPS (formerly UtiliCorp d/b/a MPS)
3 case, Case No. ER-2001-672.

4 **PROPOSED PAYROLL INCREASE**

5 Q. Did you address the Staff's position on the 3% MPS union salary increase
6 scheduled for April 1, 2004, in your direct testimony filed in this proceeding?

7 A. No, I did not. I addressed this issue at length in my filed rebuttal testimony.

8 Q. Can you briefly describe your opposition to the inclusion of the April 1, 2004,
9 union salary increase in your annualization?

10 A. Yes. The proposed salary increase occurs a full six months past the end of the
11 update period in this case, September 30, 2003. The Staff maintains that the Company is
12 proposing an isolated adjustment, which disturbs an appropriate match of the period
13 revenues, expenses and rate base.

14 Q. Has the Commission addressed the rate treatment of isolated payroll
15 adjustments in prior cases?

16 A. The Commission has issued report and orders disallowing isolated payroll
17 adjustments in the following cases: [Re: Union Electric, 29 Mo. P.S.C (N.S.) 325, 326
18 (1987); Missouri Cities Water, 1 Mo P.S.C. (N.S.) 135,136 (1991); St. Joseph Light & Power
19 Company, 24 Mo. P.S.C. (N.S) 356, 357 (1981); and Southwestern Bell Telephone,
20 2 Mo P.S.C. (N.S.) 544-545 (1993). In the Southwestern Bell Telephone case the
21 Commission stated, "For an isolated adjustment to be appropriate, it must meet the
22 requirements that the proposed adjustment must have occurred, must be measurable, and
23 must be documented.... In addition, an isolated adjustment must also be consistent with

1 regard to the matching of revenue, expense and rate base. Uncertainty about whether an
2 adjustment is measurable adds to the difficulty of establishing proper matching.”

3 Q. Did Mr. Klote make a statement in his rebuttal testimony regarding the Staff's
4 past treatment of a future payroll increase that occurred beyond the end of the test year
5 update period in Case No. ER-2001-672, the Company's last electric rate proceeding?

6 A. Yes. On page 4, lines 17-23 thru page 5, lines 1-2 of his rebuttal testimony;
7 Mr. Klote poses the question and answer:

8 Q. Has the Staff historically recommended including historical
9 pay increases outside the known and measurable update period?

10 A. Yes. In the last MPS rate case, Case No. ER-2001-672, Staff
11 used a test year ending December 31, 2000 with known and
12 measurable changes through June 30, 2001. In direct testimony in
13 Case No. ER-2001-672, Staff witness Graham Vesely describes, on
14 page 3 of his testimony, that a union pay increase of 3.98% for ESF
15 departments effective January 1, 2002 were included in the payroll
16 annualization amounts. Both of these recommended wage increases
17 were outside the known and measurable period in the case.

18 Q. Do you have a response to this statement?

19 A. Yes. Mr. Klote failed to include the next question and answer of Staff witness

20 Mr. Vesely's direct testimony:

21 Q. Why has the Staff included an estimate for payroll increases
22 through January 31, 2002 in cost of service?

23 A. The Company requested a true-up audit in order to capture
24 significant new items through January 31, 2002. The Commission
25 authorized a true-up in this case, as discussed in the direct testimony of
26 Staff witness Williams. The estimated wage increases included in
27 Staff's direct filing will be updated to reflect MPS's actual wage
28 increases with actual employees through January 31, 2002 during the
29 true-up audit.

30 Q. After accurately stating Mr. Vesely's testimony, does Mr. Vesely's testimony
31 from the prior case support a claim that the Staff has historically recommended including pay
32 increases beyond the end of the test year update period?

1 A. No, they have not. The Staff proposed to use a true-up mechanism to reflect
2 MPS's actual wage increases with actual employees through January 31, 2002. By utilizing a
3 true-up, all significant cost of service components can be measured as of the true-up date in
4 order to maintain an appropriate matching of revenues, expenses, rate base investment and
5 cost of capital.

6 Q. Was a true-up audit actually performed in Case No. ER-2001-672?

7 A. No. While the Commission authorized a true-up, the Company's last general
8 rate increase case ended in a total dollar settlement between the parties. The Commission
9 approved the Unanimous Stipulation and Agreement on February 21, 2002, with rates
10 effective on March 21, 2002, resulting in a reduction of \$4.25 million.

11 Since this was a total dollar settlement, no ratemaking for the individual issues was
12 identified except as specifically noted in the Stipulation and Agreement. In the General
13 Provisions section of the Stipulation and Agreement under subsection "Reservations," the
14 following appears:

15 a. The terms of this Stipulation and Agreement have resulted
16 from extensive negotiations among the Parties and are interdependent.
17 By entering into this Stipulation and Agreement, none of the Parties
18 shall be deemed to have approved or acquiesced in any ratemaking or
19 procedural principle, or any method of cost determination or cost
20 allocation, and none of the Parties shall be prejudiced or bound in any
21 manner by the terms of this Stipulation and Agreement in its entirety,
22 without condition or modification, this Stipulation and Agreement
23 shall be null and void, and none of the Parties shall be bound by any of
24 the terms hereof.

25 b. The Parties agree that this Stipulation and Agreement and any
26 and all discussion related hereto shall be privileged and shall not be
27 subject to discovery, admissible in evidence, or in any way used,
28 described or discussed in any proceeding, except as expressly specified
29 herein.

30 [Source: page 8 of the February 5, 2002, Unanimous Stipulation and
31 Agreement]

1 Q. Can Aquila, Inc. (Aquila) or any other party to Case No. ER-2001-672,
2 accurately state that Staff included the payroll increases beyond the June 30, 2001 test year
3 update period?

4 A. No. Aquila has no basis for making the statement that appears at page 4 of
5 Mr. Klote's rebuttal testimony regarding the payroll increases that occurred outside of the
6 test year update period in that case.

7 Q. Would the Staff have included the October 1, 2001, and January 1, 2002,
8 payroll increase in its case in Case No. ER-2001-672 without a true-up?

9 A. No. As indicated above, there was a true-up planned through January 31,
10 2002, in that proceeding. Because the case ended in a total dollar settlement, no true-up
11 occurred and there would be no agreement among the parties how the total dollar settlement
12 amount was arrived.

13 Absent the true-up, the Staff would take the same position in the last case regarding
14 those payroll increases as it is taking in this case. The April 1, 2004, payroll increase is an
15 out-of-period adjustment and should not be reflected in the payroll annualization without a
16 true-up.

17 Q. Is the Staff proposing a true-up be performed in this case to capture the
18 April 1, 2004, payroll increase?

19 A. No. No party to this case, including the Company, has proposed a true-up and
20 Staff does not believe the circumstances warrant one in this case. Typically, true-ups are
21 performed when major and material items occur that cause a substantial increase or decrease
22 to the revenue requirement (example: if material changes that occur resulting in the need for

1 a true-up would be the addition of a major capital expenditure such as a power plant addition,
2 or a purchased power contract). Such was the case in Case No. ER-2001-672. Absent such
3 material events, true-ups are unnecessary. Since no material items or events were expected
4 to occur past the September 30, 2003, time period, no party requested a true-up.

5 Q. Did the Company request that the test year update period end at September 30,
6 2003, in this case?

7 A. Yes. In the Order Concerning Test Year and True-up, Resetting Evidentiary
8 Hearings, Adopting Procedural Schedule, and Concerning Local Public Hearings, dated
9 October 12, 2003, the Commission stated:

10 Aquila filed its test year recommendation as directed on August 5, and
11 proposed the 12 months ending December 31, 2002. Aquila also
12 recommended that that [sic] test year be updated for known and
13 measurable changes through September 30, 2003. Aquila further
14 stated that it does not intend to request a true-up audit and hearing. On
15 August 19, the Staff of the Missouri Public Service Commission
16 indicated that it concurred with Aquila's recommended test year but
17 recommended that the test year be updated for known and measurable
18 changes through June 30, 2003. However, after being made aware of
19 Aquila's purpose for requesting the adjustment period be through
20 September 30, Staff subsequently indicated that it would not be
21 opposed to an updated period through September 30, 2003, if Aquila
22 could provide its books and records by October 20, 2003.

23 Clearly, it was Aquila that identified the need for the test year of December 31, 2002,
24 updated for known and measurable changes through September 30, 2003. If the Company
25 believed that the April 1, 2004, payroll increase was material enough to need to be included
26 in this case, it could have postponed its filing to accommodate this change.

27 Q. Is it common for a utility to experience financial changes past the end of the
28 test year update period?

1 A. Yes. Utility companies are dynamic organizations and, accordingly,
2 experience financial changes on a consistent basis regardless of the dates set for the update
3 period and the true-up period (if applicable). Inherent to the regulatory process is the need to
4 establish a “cut-off” or deadline, so the case can move forward to be completed according to
5 the Commission’s prescribed schedule. If parties to the case continue to seek recovery of the
6 impact of every financial past established case, the case would never be finished.

7 Q. When true-up audits are performed, are payroll increases the only items
8 considered?

9 A. No, a host of items are included in the true-up. The Commission has referred
10 to these items as a “package” of events. The Commission has emphasized the importance of
11 considering all relevant factors in the context of determining utility rates and has not allowed
12 inclusion of isolated adjustments, such as the April 1, 2004, payroll increase, in rate cases.

13 In the Suspension Order issued in this case, the Commission stated the following:

14 Inasmuch as the Commission is required by law to give rate increase
15 cases preference over all other questions pending before it and to
16 decide such cases as quickly as possible, and since the burden of proof
17 that the proposed rates are just and reasonable is upon the company
18 proposing the rates, the Company shall file both its recommendation
19 concerning the proper test year to be used in these proceedings and any
20 request for a true-up no later than two weeks after the date of this
21 order. Any true-up request must include a proposed date to which the
22 Company’s financial data is to be brought forward. The Commission
23 has reserved dates for a true-up hearing. **The Company’s proposal**
24 **should also specify a complete list of accounts or items of expense,**
25 **revenues, and rate base designed to prevent any mismatch in those**
26 **areas. The Commission will not consider a true-up of isolated**
27 **adjustments, but will examine only a “package” of adjustments**
28 **designed to maintain the proper revenue-expense-rate base match**
29 **at a proper pointing in time. [See In re Kansas City Power & Light**
30 **Company, 26 Mo. P.S.C. (N.S.) 104, 110 (1983)]**

31 [Page 2 of Suspension Order; (emphasis added)]

1 Q. Would including the April 1, 2004, payroll increase in this case be considered
2 a proper “package” of adjustments?

3 A. No. Only including this isolated adjustment of April 1, 2004, payroll increase
4 would not constitute a package of adjustments at all, but rather what the Commission refers
5 to as an “isolated” adjustment. If the April 1, 2004, payroll increase was included in this
6 case, the “revenue-expense-rate base match at a proper point in time” would not be
7 maintained.

8 Q. What other items would have to be considered to appropriately include the
9 April 1, 2004, increase?

10 A. Customer levels would be examined to determine if there is any impact on
11 revenues; employee levels would be reviewed to see changes that occurred since the update
12 period; plant and reserve levels are looked at; fuel and purchased power expense are typically
13 included in any true-up analyses along with a host of other cost elements. Just reflecting one
14 item alone would not establish a proper rate level that customers should be expected to pay.

15 Q. Why is it important to consider all relevant items?

16 A. Ratemaking is a process of maintaining relationship between all the elements
17 of the Company’s operations—its rate base, revenues and expenses. It is essential to
18 examine all relevant factors to establish rates at a point in time. The customer levels are
19 examined to determine revenues and the plant to serve the customers is considered at the
20 same point in time. The revenues generated are compared to the expenses that it takes to
21 provide utility service to these customer levels. In order to maintain this proper
22 “relationship,” all the parties to the rate case process should go through painstaking steps to
23 ensure that all the “relevant” factors are considered and none are left out of the calculation.

1 | When all the cost of service items are brought into sync at a point in time—the rate base to
2 | serve the customers matched with cost elements and revenues—then a proper rate
3 | determination can be made.

4 | Q. Is the April 1, 2004, payroll increase a known and measurable change?

5 | A. No. As stated in my rebuttal testimony, this payroll increase is neither
6 | “known” nor “measurable.” Unless a true-up is performed, the number of employees at
7 | April 1, 2004, is and will not be known. If the number of employees is not “known,” then
8 | the payroll increase applied to an unknown quantity will cause the payroll amount itself to be
9 | unknown.

10 | Q. Has Aquila experienced any employee reductions since the last general rate
11 | case?

12 | A. Yes. Through organizational restructuring, the Company has decreased its
13 | employees from historical levels. The Staff is also ** _____
14 | _____ ** after it’s review of the August 2003 Board of Directors. If this occurs then
15 | the Company will ** _____ **.

16 | Q. Should the Commission reject Aquila’s proposed payroll increase?

17 | A. Yes. This payroll increase will not occur until six months after the
18 | September 30, 2003, test year update period established by the Commission at the
19 | recommendation of the Company. Other events have taken place since the end of the test
20 | year update period, such as increases in revenues due to customer growth that would have to
21 | be considered before any increase to payroll could be included in cost of service calculation.

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1 **PAYROLL TAX EXPENSE ADJUSTMENT**

2 Q. Does the Staff and the Company use the same method in calculating the
3 annualized payroll tax expense level?

4 A. Yes. The Staff and the Company agree on methodology but disagree on the
5 annualized payroll expense amount discussed earlier. At page 9 of Mr. Klote's rebuttal
6 testimony he states with regard to payroll tax expense "[The difference between Aquila's and
7 Staff's payroll tax annualization expense is the result of Staff adjusting the annualized
8 payroll expense amounts as discussed earlier in my testimony. Staff's payroll annualization
9 amount has been lowered as a result of its adjustments. In addition, other differences exist
10 due to the summary approach used by Aquila, as opposed to the detailed individual approach
11 used by Staff.]" The Staff believes that the level of payroll tax expense should follow the
12 level of annualized payroll expense level. If the Commission accepts the Staff's annualized
13 level of payroll, as discussed earlier, then the Commission should also accept this adjustment
14 to payroll tax expense.

15 **PAYROLL ISSUES NO LONGER BEING CONTESTED**

16 Q. Are there payroll issues that are no longer an issue between the Company and
17 the Staff?

18 A. Yes. It is my understanding as part of a settlement package between Aquila
19 and the Staff, the 401K Benefits Matching expense and Employee Stock Option Plan (ESOP)
20 contribution expense matters, as described in Mr. Klote's rebuttal testimony, are no longer
21 issues.

22 Q. Does this conclude your surrebuttal testimony?

23 A. Yes, it does.