Exhibit No.:	
Issue(s):	20 West 9th Headquarters/Annex; Accounting Authority Orders; St. Joseph Light & Power Merger; South Harper Plant Addition; Chapter 100 Fees
Witness:	Ted Robertson
Type of Exhibit:	Surrebuttal
Sponsoring Party:	Public Counsel
Case Number:	ER-2005-0436
Date Testimony Prepared:	December 13, 2005

SURREBUTTAL TESTIMONY

OF

TED ROBERTSON

Submitted on Behalf of
the Office of the Public Counsel

AQUILA, INC.

Case No. ER-2005-0436

December 13, 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

AFFIDAVIT OF TED ROBERTSON

STATE OF MISSOURI)
) ss
COUNTY OF COLE)

Ted Robertson, of lawful age and being first duly sworn, deposes and states:

1. My name is Ted Robertson. am a Public Utility Accountant for the Office of the Public Counsel.

2. Attached hereto and made a part hereof for all purposes is my surrebuttal testimony consisting of pages 1 through 45 and Schedules TJR -1.

3. I hereby swear and affirm that my statements contained in the attached testimony are true and correct to the best of my knowledge and belief.

Ted Robertson, C.P.A.
Public Utility Accountant III

Subscribed and sworn to me this 13th day of December 2005.

NOTARY PUBLIC NOTARY SEAL STATE OF MISSOURI

JERENE A. BUCKMAN
My Commission Expires
August 10, 2009
Cole County
Commission #05754036

Jerene A. Buckman
Notary Public

My commission expires August 10, 2009.

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SURREBUTTAL TESTIMONY
OF
TED ROBERTSON

AQUILA INC.
d/b/a
AQUILA NETWORKS - MPS
AND
AQUILA NETWORKS – L&P

CASE NO. ER-2005-0436

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Ted Robertson, PO Box 2230, Jefferson City, Missouri 65102-2230.

Q. ARE YOU THE SAME TED ROBERTSON THAT HAS PREVIOUSLY FILED TESTIMONY IN THIS CASE?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. The purpose of this testimony is to present the Public Counsel's response to the rebuttal testimonies of the MPSC Staff and Company on the issues of 20 West 9th headquarters/annex (HQ Complex) costs, accounting authority order (AAO) costs, transaction and transition costs associated with the St. Joseph Light & Power Company merger with Aquila, Inc., South Harper power plant construction costs, and the South Harper Chapter 100 financing arrangement fees.

II. MPS AND L&P COST OF SERVICE

A. 20 WEST 9TH HEADQUARTERS/ANNEX

Q. WHAT IS THE ISSUE?

A. In my direct testimony I provided information to the Commission that Aquila's recent restructuring activities (i.e., the exiting of its non-regulated merchant operations and other downsizing activities) have significantly reduced the employee level and utilization of the HQ Complex. The original planned capacity of the 20 West 9th headquarters/annex was 847 workstations (Jon R. Empson Rebuttal Testimony, page 2, line 10-11). The Company now has approximately 479 workstations in the entire HQ Complex (updated response to OPC DR No. 1047) serving 332 employees currently stationed at the location. My understanding of Mr. Empson's position is that the Aquila downsizing occurred for various reasons but the net effect was that it allowed Company to provide the HQ Complex employees with additional individual workspace thus it improved their working conditions and morale. Public Counsel believes his position is merely an attempt to pass on to ratepayers an increased share of the costs of the HQ Complex now that it is not being utilized as it was originally planned.

Q. HOW MANY OF THE CURRENT WORKSTATIONS ARE NOT BEING UTILIZED AT THE HQ COMPLEX?

A. Company's response to OPC Data Request No. 1047 provided copies of the schematics of the layout for each floor of the HQ Complex and those schematics show that there are currently 479 workstations. The schematics also show that of the 479 workstations there includes the following:

1.	Hotel Cubes	89
2.	Future Use	45
3.	Vacant	45
4.	Unidentified Contractor	28
5.	Non-Regulated AMS	11
6.	Unidentified Consultant	5
7.	No Identification	7
	Total	230

The response to OPC DR No. 1047 clearly shows that approximately 48.02% of the total 479 workstations are either empty, utilized by Aquila's non-regulated employees or their usage is not adequately supported. I want to emphaize that the Public Counsel's position on this issue, as I discussed in my direct testimony, is that the HQ Complex is being underutilized to the tune of 57.87%. OPC's position is based on the original planned capacity of the HQ Complex of 847 workstations. However, even under the Company identified current usage the HQ Complex underutilization approximates 48%.

Q. MR. EMPSON SEEMS TO BELIEVE THAT INCREASING THE AVERAGE SQUARE FOOT OF WORKSPACE AVAILABLE TO THE REMAINING EMPLOYEES IS RELEVANT TO THIS ISSUE; IS IT?

A. I do not believe so. On page 3, lines 16-18 of his rebuttal testimony, Mr. Empson states that the average size of a individual employee's workstation has increased from 58.5 square feet to 73.9 square feet. Though the individual workstations vary in size this represents an approximate increase from a 7.65' x 7.65' workstation to a 8.60' x 8'60' workstations: an increase of about 1 linear foot along each wall of the workstation's perimeter. I hardly think that increasing the average size of the individual workstation by such a small amount justifies the increase in HQ Complex costs Aquila desires to pass on to ratepayers. In fact, I believe, Company could have increased the size of each workstation by several more square feet and it still would not be an important factor in the decision on this issue.

Q. WHY DO YOU BELIEVE THE WORKSPACE AVAILABLE UNDER THE COMPANY'S CURRENT FLOOR LAYOUT IS NOT IMPORTANT?

A. I believe that it is not important because the size of the individual workstation and/or useable square feet available to each employee is not the issue. The issue is whether or not the HQ Complex is being utilized as it was originally intended, and it is not.

Company bought and remodeled the building and site with the intention of utilizing it as the headquarters for a large and growing multinational corporation. For a time it was just that. Aquila owned and operated many different regulated and non-regulated operations located within the United States, Canada and several other foreign countries. As such, the costs associated with the HQ Complex's investment and operation were allocated to each of these businesses. That is now not the case. Company has stated its intention to "return to its roots" as a regulated utility only. Thus, it has jettisoned all of its foreign operations and is in the process of doing the same for many of its U.S. based operations. The drastic reduction in the employee level at the HQ Complex is a direct result of the restructuring Company was forced to undertake and now the Company wants to assign to its Missouri-regulated operations an increased share of HQ Complex costs which were previously assigned to the operations that were exited. Therefore, whether Company assigns 58 square feet or 78 square feet or 100 square feet to the size of the remaining employees' individual workstations does not matter. The issue is whether the property is being fully utilized as intended, and if it is not, should the costs of its underutilization be recovered from Missouri ratepayers.

Q. IN A PREVIOUS Q&A YOU STATED COMPANY IS UTILIZING "HOTEL CUBES" IN ITS CURRENT DESIGN. WHAT IS A HOTEL CUBE?

A. On page 5, lines 19-24 of his rebuttal testimony, Mr. Empson states that companies surveyed in the IMFA Research Report #23 utilize employee workstations referred to as "hotel cubes" for periodic users. Further, he states that Aquila does the same at the HQ Complex. Although his testimony does not go into any detail as to their actual usage level, I assume that by his use of the term "periodic users" he means they are workstations available to Aquila employees (part-time or otherwise) that occasionally have to conduct business at the HQ complex.

Q. HOW MANY "HOTEL CUBE" WORKSTATIONS ARE LOCATED AT THE HQ COMPLEX?

A. My review of the Company's updated response to OPC Data Request No. 1047 shows that Company has categorized 89 (18.58%) of the total 479 workstations as "hotel cubes." Thus, approximately 19% of the workstations that I identified as being empty in my direct testimony may be accessed for occasional use by Aquila personnel and/or others.

Q. DOES THE PUBLIC COUNSEL BELIEVE IT ODD THAT WORKSTATIONS YOU IDENTIFIED AS EMPTY IN YOUR DIRECT TESTIMONY ARE NOW CLASSIFIED AS HOTEL CUBES AND/OR FOR THE USE OF OTHER CONTRACT EMPLOYEES AND CONSULTANTS?

A. Yes, I do. Beginning on page 5, line 1 of his rebuttal testimony, Mr. Empson states that the 332 employee count at the HQ complex does not include consultants, contract employees or traveling employees such as himself. He states further that a number of the total workstations available are utilized by the full-time consultants, contract employees or traveling employees such as himself. However, I find his comments bear little substance to the reality of the current utilization of the HQ Complex. During my tour of the HQ Complex, I inquired of the tour guides which if any of the empty offices/cubicles were utilized by consultants, traveling employees, etc. The guides identified that approximately 4 cubicles on one floor of the 20W9th building and one cubicle on one floor in the annex building were utilized for such purposes (at the time of the tour all except one of these workstations was completely empty and void of any appearance of activity).

Later, during my review of the schematics for HQ Complex floor layout, I counted that, in addition to several workrooms and open-area meeting sites available to employees, there are approximately **one-hundred and fifteen (115) conference rooms** of varying size located at the HQ Complex. Given that the HQ Complex has such a large number of conference rooms in which such persons can meet and work, I find it odd that the floor schematics listed the empty workstations as described by Mr. Empson. In fact, it is my understanding, that in the original design of the HQ Complex the numerous meeting/conference rooms were included as an intended aspect of its original design, management apparently believing that they would promote employee productivity by limiting employees to the amount of time actually spent at their individual workstations. If the Company does in fact have a necessity to accommodate additional contractors, consultants or traveling employees at the HQ Complex on a continuing basis, it is my belief that an empty conference room should, more often than not, adequately meet the needs of transient employees and/or the few contractors and consultants working at the site at any given time

Q. IS THE PUBLIC COUNSEL AWARE OF ANY SIGNIFICANT STAFFING LEVEL CHANGES EXPECTED TO OCCUR AT THE HQ COMPLEX IN THE NEAR TERM?

A. No. OPC Data Request No. 1020 requested information on potential transfers of Aquila employees from other locations to the HQ complex. Company's response stated, "There are currently no known transfers." The response was dated August 8, 2005.

Q. HAVE THE COMPANY AND STAFF REACHED AN AGREEMENT TO DISALLOW A PORTION OF THE COMPLEX COSTS?

A. Yes. On page 6, lines 9-11 of his rebuttal testimony, Mr. Empson acknowledges to the Commission that Company and Staff have come to an agreement wherein, for settlement purposes only, 13% of the cost of the HQ Complex will be disallowed in this rate case. Though he does not identify the actual amount of the disallowance, I presume it represents 13% of the HQ Complex's total investment and operating costs.

Q. WHAT IS THE PUBLIC COUNSEL'S POSITION ON THE DISALLOWANCE AGREEMENT REACHED BY STAFF AND COMPANY?

A. I believe the 13% disallowance Company and Staff agreed to is merely a "drop in the bucket." In my direct testimony, I identified that, based on the original planned capacity of the HQ Complex, the underutilization of the property approaches 58%. Furthermore, even under the current usage level identified by Company the underutilization of the property exceeds 48%. The difference between a 13% disallowance and a 58% disallowance, or for that matter a 48% disallowance, represents a significant amount of HQ Complex costs, previously assigned to operations exited by Aquila, that should not be assigned to the ratepayers of Aquila's Missouri-regulated operations. It is my recommendation that the Commission adopt the HQ Complex disallowance I proposed in my direct testimony.

B. ACCOUNTING AUTHORITY ORDERS

Q. WHAT IS THE ISSUE?

A. This issue pertains only to the rate base treatment of costs Company deferred pursuant to various accounting authority orders granted by the Commission.

Q. WHAT IS YOUR UNDERSTANDING OF THE MPSC STAFF'S POSITION ON THIS ISSUE?

A. The MPSC Staff witness, Mr. Phillip K. Williams, states in his rebuttal testimony that rate base treatment should be afforded only to the AAOs for the Sibley Rebuild and Western Coal Conversion projects that occurred at the Sibley generating station.

Q. DID THE COMPANY REQUEST RATE BASE TREATMENT FOR THE UNAMORTIZED ICE STORM AAO DEFERRED COSTS?

A. Yes. Company did request rate base treatment for the costs, but it is my understanding subsequent to the pre-hearing settlement conference, Aquila acquiesced to the Staff's position of no rate base treatment for the unamortized Ice Storm deferred costs in exchange for a "basket" settlement of it and several other outstanding issues.

Q. IS THE STAFF'S POSITION OF PROVIDING RATE BASE TREATMENT FOR THE SIBLEY COSTS BUT NOT THE ICE STORM COSTS CONSISTENT?

A. No. Even though the Staff's, and now the Company's, position of no rate base treatment for costs deferred pursuant to the Ice Storm AAO is consistent with the position taken by the Public Counsel, it is inconsistent with the rate base treatment both Staff and Company propose for the unamortized Sibley AAO costs.

Q. WHY DOES THE STAFF SUPPORT RATE BASE TREATMENT OF THE SIBLEY UNAMORTIZED AAO COSTS?

A. It appears to me that Staff believes the costs deferred represent some form of a **pseudo** continuation of construction accounting. Mr. Williams (Staff) agrees that both the Sibley projects and the Ice Storm were extraordinary in nature (a necessary requirement in order to obtain AAO authorization), but on page 5, lines 16-20 of his rebuttal testimony, he attempts to justify a difference in the Sibley and Ice Storm events that he proposes would allow a stratification of the ratemaking treatment of the costs deferred. He adds, on page 5, lines 20-23, that Sibley is a <u>continuation of construction accounting</u> under an AAO that should be treated the same way as the other capital costs for the projects and afforded rate base treatment as opposed to the Ice Storm deferred costs which he alleges are maintenance expenditures. It appears that he believes the Sibley projects were undertaken to provide a continuation of adequate service, but that the Ice Storm was not and thus, therein lies a difference which he believes provides support for his different ratemaking treatment of the AAO expenses. Of course, Public Counsel believes that the Ice Storm costs are definitely a continuation or restoration of service. I seriously believe that any of the customers who were without service after the Ice Storm occurred would not represent it as merely a maintenance activity.

Q. IS MR. WILLIAMS (STAFF) CORRECT IN HIS ASSERTION THAT THE AAO COSTS DEFFERED REPRESENT A CONTINUATION OF CONSTRUCTION ACCOUNTING?

A. No. Staff's attempt to differentiate the appropriate ratemaking treatment for the Sibley deferred expenses is not based on the costs themselves but rather the events which gave rise to the AAO authorizations. His assertion that the Sibley AAOs were for the continuation of service and the Ice Storm AAO was only a maintenance activity is, in my opinion, a weak attempt by Staff to rationalize its inconsistent position on the proposed ratemaking treatment of the costs. Staff's position is inconsistent because the AAO expenses authorized for deferral by the Commission should not be thought of in the same way as a capital expenditure that is afforded rate base treatment.

Q. PLEASE CONTINUE.

A. As Mr. Williams (Staff) identifies on page 2, line 5 of his rebuttal testimony, the Sibley AAOs authorized the deferral of depreciation expense, property tax expense and carrying costs on those expenses. However, the depreciation and property tax expenses at issue are not capital costs. For example, depreciation expense is <u>never</u> considered a capital cost associated with a construction project. It does not represent wood, steel, concrete, labor or any of the other multitude of costs incurred by a utility in the construction or rebuilding of plant. The recognition and booking of depreciation expense to a utility's financial records is nothing more than an accounting methodology wherein a capital asset's usefulness is recognized over its operational life. Under normal regulatory and non-regulatory accounting, depreciation expense does not begin to be recognized and booked until the asset is actually placed into service, and even then it is always an expense and not an asset upon which a return is allowed. Staff's representation to the Commission that depreciation expense can be thought of as a normal or pseudo capital cost is wrong. Depreciation is not a capital cost nor should it be treated as one.

Furthermore, if an asset (e.g., completed construction or plant under construction) does not exist on January 1st of any given year, property tax will not exist for that asset. In the event that an asset does exist on January 1st of any given year, property tax would not be considered an allowable ratemaking expense until the year following the plant's construction and would not be included in the determination of rates until the utility's next general rate increase case. The property taxes deferred by the Sibley AAOs represent property tax expense that could not be recognized and booked as a capital asset under the Federal Energy Regulatory Commission (FERC) uniform system of accounts (USOA) prescribed for public utilities and licensees subject to the provisions of the Federal Power Act. Staff's representation to the Commission that the property tax expense deferred is a capital cost is misleading. The property tax deferred is not a capital cost. Under FERC accounting the property tax is, and would always be an expense, absent Commission authorization to treat the expense otherwise.

Q. WHAT DO THE CARRYING COSTS ON THE DEFERRED DEPRECIATION AND PROPERTY TAX EXPENSES REPRESENT?

A. The carrying costs are nothing more than interest, or a "return on," the depreciation and property tax expenses the Commission authorized Company to defer. If the depreciation and property tax are not capital costs, and they are not, then it is quite apparent to me that the carrying costs allowed on those deferred expenses are not capital in nature either.

Q. ARE THE COSTS DEFERRED PURSUANT TO THE ICE STORM AAO DISSIMILAR FROM THOSE DEFERRED IN THE SIBLEY AAOs?

A. No. Staff's attempt to distance its proposed ratemaking treatment for the Sibley AAO costs from the ratemaking treatment it proposes for the 2002 Ice Storm AAO costs is inappropriate. The Sibley projects, and the Ice Storm, were both extraordinary events which led the Company to request the authorization allowed in the accounting authority orders. The AAOs authorized the deferrals of various expenses, and denied any explicit or implicit ratemaking of the costs deferred. However, all the costs deferred are expense-related in nature.

Also, Staff slightly mischaracterizes the 2002 Ice Storm deferrals as maintenance expenditures but what was actually authorized for deferral was incremental operating expenses incurred as a result of the Ice Storm. Operating expenses include both operation and maintenance expenses. The Ice Storm AAO specifically forbade the deferral of any costs of or related to expenditures relating to plant-in-service (i.e., capital costs).

Interestingly, Staff now wants the Commission to recognize a difference between the Sibley and Ice Storm expenses deferred even though it did not recognize the proposed difference when the Ice Storm AAO was authorized. In fact, just the opposite is true. In the Ice Storm AAO, Order Granting Account Authority Order, Case No. EU-2002-1053, on page 4, it states:

> On June 17, 2002, the Staff of the Commission filed a response to Public Counsel's recommendation. **Staff stated that it agrees that the costs Aquila seeks to defer are similar to costs for which the Commission has generally issued accounting authority orders.**
>
> (Emphasis added by OPC)

Public Counsel agrees with the Staff's response in Case No. EU-2002-1053 that depreciation expense and property tax expense are similar to operating and maintenance expenses. In fact, all of the expenses deferred are normally booked to FERC USOA income statement accounts. The AAO authorizations allowed Company to transfer the costs from the income statement accounts and defer them to a regulatory asset account, but they do not in any sense represent a capital cost.

Q. WOULD THE COMPANY HAVE LOST THE OPPORTUNITY TO EVER HAVE RECOVERED THE EXPENSES ABSENT THE AAO?

A. Maybe. Mr. Williams (Staff) states on page 4, lines16-17 of his rebuttal testimony, "Absent AAO treatment, these amounts would have been lost as a result of booking these costs directly to expense following completion of the projects." That is, the sole purpose of the AAO authorization to defer the expenses is to provide the utility with the opportunity to recover the costs in a future period so as to protect shareholders from the effects of negative regulatory lag. Public Counsel believes that the AAO is simply an incentive for the Company to do the right thing. I believe it is odd that Staff and Company both now propose to include the unamortized Sibley AAOs expenses in rate base while at the same time recommending the exclusion of the unamortized Ice Storm AAO expenses from rate base. Their position is at the very least inconsistent since expenditures were actually incurred for the rebuild of the system required by the Ice Storm whereas no real expenditures were deferred pursuant to the Sibley AAOs.

Q. IS IT FAIR TO STATE THAT THE COSTS DEFERRED PURSUANT TO THE SIBLEY AAOs WERE NOT INVESTMENT-TYPE COSTS?

A. Yes. Mr. Williams (Staff) states on page 4, line 22 of his rebuttal testimony, that through his approach, "shareholders are given an opportunity to earn a return on their investment," but Staff neglects to inform the Commission that the costs deferred pursuant to the Sibley AAOs were not actually investments. They were expenses; expenses for which there was no actual expenditure or outlay of cash. Staff then attempts to support its position by bifurcating the "substance" of the events which led to the authorization of the AAOs rather than addressing the expenses that were actually deferred. Furthermore, Staff is quite aware that the costs deferred were expenses, and not investments. It states as much in the pleadings it presented to the Commission in the Ice Storm AAO, Case No. ER-2002-1053.

Q. DOES THE COMPANY RECOGNIZE THAT THE AAO PROCESS INSULATES ITS EARNINGS FROM THE EFFECTS OF NEGATIVE REGULATORY LAG?

A. Yes. On page 15, line 17, of the rebuttal testimony of Mr. Dennis R. Williams, Aquila, Inc., Vice President - Electric Regulatory Services, he states the following regarding AAO deferred expenses:

> **The deferral of expenses lessens the impact of regulatory lag**...
>
> (Emphasis added by OPC)

Q. MR. WILLIAMS (AQUILA) IMPLIES ON PAGE 18, LINES 1-2 OF HIS REBUTTAL TESTIMONY, THAT THE COSTS DEFERRED PURSUANT TO THE SIBLEY AAO ACTUALLY INVOLVED INVESTORS' MONEY. IS THAT A TRUE STATEMENT?

A. No. The expenses deferred pursuant to the Sibley AAOs did not involve the actual expenditure of any investor cash and/or other funds. They were merely accounting book entries meant only to represent expenses of a non-capital nature Company incurred in the timeframe between when the plant was placed into service and when its cost would have been included in rates.

Q. MR. WILLIAMS (AQUILA) ALSO STATES, ON PAGE 18, LINES 3-7 OF HIS REBUTTAL, THAT SHAREHOLDERS RECEIVED NO RETURN ON THE SIBLEY INVESTMENT WHILE IT WAS BEING CONSTRUCTED. IS THAT A TRUE STATEMENT?

A. No. FERC accounting rules require all costs associated with the construction of an asset to be booked to the asset's balance. During the three years that the Sibley Rebuild and Western Coal Conversion projects were being constructed, the Company would have booked all appropriate costs to a construction work in progress (CWIP) account. The costs booked to CWIP would have included an allowance for funds used during construction (AFUDC) to build the project, and the AFUDC represents both a return on investor provided capital and the cost of debt necessary to finance the project during its construction. Mr. Williams (Aquila) is apparently confused because shareholders would not have experienced three years of regulatory lag as he states. Company would have received a return on its cost of total capital during that time period by the normal addition of AFUDC to the constructed plant's cost.

Q. MR. WILLIAMS (AQUILA) ALSO STATES ON PAGE 18, LINES 9-14 OF HIS REBUTTAL, THAT THE COMMISSION HAS ALLOWED COMPANY A RECOVERY OF BOTH THE UNAMORTIZED BALANCE AND A AMORTIZATION EXPENSE IN ITS LAST FIVE RATE CASES. IS THAT CORRECT?

A. No. It is my understanding that the costs were allowed in Case Nos. ER-90-101, ER-93-237 and ER-97-394; however, these three cases preceded the Commission's decision in Missouri Gas Energy (MGE), Case No. GR-98-140. Mr. Williams (Aquila) also implies that the

Company recovered both a return of and a return on the AAO deferred costs in Case Nos. ER-2001-672 and ER-2004-0034, but his statement is not correct. Those two cases, which were subsequent to MGE Case No. GR-98-140, were "black box" settlements. No costs associated with the AAOs were specifically identified and delineated in the settlement amounts. Public Counsel could just as easily say they neither a return of nor a return on the AAO deferred costs was obtained in the those two settled cases - but that too would not be an accurate statement.

Q. STAFF STATES THAT TO ACCEPT PUBLIC COUNSEL'S POSITION WOULD NEGATE THE COMMISSION ORDERS FROM CASE NOS. ER-90-101 AND ER-93-37. IS THAT A CORRECT STATEMENT?

A. No. Mr. Williams (Staff) makes that statement on page 4, lines 8-10 of his rebuttal testimony, but it is not completely accurate either since the Commission later changed its position regarding the sharing of the AAO costs deferred. In those earlier cases, the Commission did authorize Company a return of and a return on the costs deferred; however, the Commission has stated while authorizing AAO deferrals it was not authorizing any particular ratemaking for the costs deferred. Thus, the Commission can and did change its position on the appropriate ratemaking treatment of the AAO expenses deferred. I believe that it is the Commission's responsibility to set just and reasonable rates going forward, not to correct past mistakes.

Subsequent to those two rate cases, the Commission stated that the purpose of an AAO was to mitigate the effects of negative regulatory lag; therefore, both shareholder and ratepayers alike should share its cost. On page 19 of the Commission's Report and Order, in Missouri Gas Energy, Case No. GR-98-140, it states:

> The Commission finds that the unamortized balance of SLRP deferrals should not be included in the rate base for MGE. The AAOs issued by the Commission authorize the Company to book and defer the amount requested but do not approve any ratemaking treatment of amounts from the deferred and booked balances. AAOs are not intended to eliminate regulatory lag but are intended to mitigate the cost incurred by the Company because of regulatory lag.

And, on page 20, the Commission added:

> All of the parties agree that it is the purpose of the AAO to lessen the effect of the regulatory lag, not to eliminate it nor to protect the Company completely from risk. Without the inclusion of the unamortized balance of the AAO account included in the rate base, MGE will still recover the amounts booked and deferred, including the cost of carrying these SLRP deferral costs, property taxes and depreciation expense through the true-up period ending May 31, 1998. The Commission finds that OPC's position on this issue is just and reasonable and is supported by competent and substantial evidence in the record.

Staff's testimony is misleading in that the sharing of the regulatory lag costs proposed by Public Counsel is not based upon a "whim" or a pseudo-rationalization of construction accounting. It is based upon the Commission's actual decision in the most recent case in which this issue was litigated before it. According to the Commission's MGE Report and Order, a utility should not be protected completely from risk thus, MGE was still allowed to recover the costs it deferred, but was not allowed a rate base return on those costs. Public Counsel is not challenging Aquila's recovery of the expense amortization of the costs it has deferred. The parties are basically in agreement on those amounts. However, absent the

AAO process, it is possible that the earnings associated with those expenses would not have been recovered in rates. That is something Mr. Williams (Staff) readily recognizes when he states on page 4, lines 16-17 of his rebuttal testimony:

> Absent the AAO treatment, these amounts would have been lost as a result of booking these costs direct to **expense** following completion of the projects.

And, he continues on page 5, lines 12-14:

> Without AAO treatment, the additional expenses, which occur prior to the effective date of rates in the Company's next rate case, result in a reduction in earnings that will never be reflected in rates.
>
> (Emphasis added by OPC)

Q. IS THE STAFF'S POSITION ON THIS ISSUE AT ODDS WITH THE COMMISSION'S ORDER IN THE MISSOURI GAS ENERGY CASE YOU MENTIONED EARLIER?

A. Yes. Staff, in this instance, has not followed the decision as ordered by the Commission in the MGE case. Apparently, Staff bases its recommendation on orders which originally initiated the authorization and recovery of the Sibley AAOs expenses. However, the Commission's reasoning on the appropriate rate base treatment of unamortized AAO deferred expense balances has been subsequently modified by more its recent decisions.

Q. IS THE STAFF RECOMMENDATION TO ALLOW RATE BASE TREATMENT FOR THE UNAMORTIZED SIBLEY AAO COSTS CONSISTENT WITH ITS POSITION IN OTHER RECENT CASES?

A. No. The MPSC Staff's position in this case is 180 degrees from the position it has filed in several more recent cases presented before this Commission.

Q. DID THE STAFF PROVIDE AN EXPLANATION FOR ITS INCONSISTENT POSITION ON THIS ISSUE?

A. No.

Q. PLEASE IDENTIFY AND BRIEFLY DESCRIBE THE RECENT COMMISSION CASES IN WHICH THE MPSC STAFF HAS RECOMMENDED THAT UNAMORTIZED AAO DEFERRED BALANCES BE EXCLUDED FROM RATE BASE.

A. In Laclede Gas Company, Case No. GR-99-315, the Company requested rate base treatment for unamortized deferred balances associated with an AAO on its gas pipeline safety program (just as MGE did in Case No. GR-98-140). The MPSC Staff, in its direct testimony, opposed the Company's request for rate base treatment of the deferred balances. On page nine of the direct testimony of Staff witness, Mr. Stephen M. Rackers, he stated:

> Q. How is the Staff proposing to treat the costs deferred according to the AAOs previously approved?
>
> A. The Staff is proposing the treatment recently prescribed by the Commission in its Order in Case No. GR-98-140 involving Missouri Gas Energy's safety deferrals.

Q. DID THE PUBLIC COUNSEL FILE TESTIMONY OPPOSING RATE BASE TREATMENT OF THE AAO DEFERRED BALANCES IN THE LACLEDE CASE?

A. Yes. On page 20 of my direct testimony in Laclede Gas Company, Case No. GR-99-315, I stated:

> Q. YOU STATED EARLIER THAT THE COMPANY HAS INCLUDED THE SRP DEFERRED BALANCE IN RATE BASE, IS THAT AN APPROPRIATE ADJUSTMENT?
>
> A. No, it is not. The Public Counsel recommends that the SRP deferred balance not be included in the Company's rate base. The rationale for this position is based on the view that the Company is being given a guaranteed "return of" the deferrals associated with the Safety Replacement Program; therefore, it should not be also provided with a guaranteed "return on" those same amounts.

Q. HOW DID THE COMMISSION DECIDE THE ISSUE?

A. The Commission's Order in Laclede Gas Company, Case No. GR-99-315, approved a partial stipulation and agreement entered into by the parties that provided no rate base treatment of the Company's AAO deferred balances. On page 5 of the *First Amended Partial Stipulation and Agreement* it states:

> The parties agree that they will not propose, in any manner, exclusion of such amortized amounts in Laclede's cost of service for ratemaking purposes during the aforementioned periods required to amortize such balances. <u>The parties further agree that they will not propose to include such balances in the Company's rate base</u>.
>
> (Emphasis added by OPC)

Q. PLEASE CONTINUE.

A. In St. Louis County Water Company, Case No. WR-2000-844, the Company requested rate base treatment for unamortized deferred balances associated with an AAO on infrastructure replacement deferrals. The Staff, in its direct testimony, opposed the Company's request for rate base treatment of the deferred balances. On page 10 of the direct testimony of Staff witness, Mr. Stephen M. Rackers, he recommended the following:

> ...no inclusion of the unamortized balance in rate base.

Q. DID THE PUBLIC COUNSEL FILE TESTIMONY OPPOSING RATE BASE TREATMENT OF THE AAO DEFERRED BALANCES IN THE ST. LOUIS COUNTY WATER COMPANY CASE?

A. Yes. On page 10, lines 13-14, of the direct testimony of the Public Counsel witness, Mr. Russell W. Trippensee, he stated:

> Public Counsel believes the Commission should not include any deferred amounts in rate base...

Q. HOW DID THE COMMISSION DECIDE THE ISSUE?

A. On page 24 of the Commission's Report And Order in St. Louis County Water Company, Case No. WR-2000-844, it stated that it:

> ...will not allow a return on the unamortized balance.

Q. PLEASE CONTINUE.

A. In Missouri Gas Energy, Case No. GR-2001-292, Company requested rate base treatment for unamortized deferred balances associated with an AAO on its gas pipeline safety program and an AAO for Y2K costs. The Staff, in its direct testimony, opposed the Company's request for rate base treatment of the deferred balances. On page 6, of the direct testimony of the Staff witness, Mr. Mark L. Oligschlaeger, he stated:

> Q. Has the Staff included the unamortized balances of the SLRP deferrals in rate base?
>
> A. No. Again, this treatment is consistent with the Commission's Report And Order in Case No. GR-98-140.

Also, on page 9 of Mr. Oligschlaeger's direct testimony, he added:

> Q. Is the Staff proposing to include the unamortized balance of the Y2K deferral in rate base?
>
> A. No.

Q. DID THE PUBLIC COUNSEL ALSO FILE TESTIMONY OPPOSING RATE BASE TREATMENT OF THE AAO DEFERRED BALANCES IN THE MISSOURI GAS ENERGY COMPANY CASE?

A. Yes. Beginning on page 3, line 17, of my direct testimony in Missouri Gas Energy, Case No. GR-2001-292, I stated:

> A. Public Counsel has calculated the unamortized SLRP deferral and annual amortization pursuant to the terms ordered by the Commission in the related cases. In MGE's last general rate increase

> case, Case No. GR-98-140, the Commission ordered that guaranteeing the Company a "return of" and "return on" the unamortized SLRP deferral is not a fair allocation of regulatory lag resulting from the on-going construction project. In order to comply with that Commission decision, the Public Counsel has not adjusted the Company's rate base so that it can earn a "return on" the current unamortized SLRP deferral.
>
> Public Counsel believes that the Commission's Order in Case No. GR-98-140 regarding this issue was a fair and equitable allocation of the risk and costs associated with the SLRP project. While we continue to believe that an amortization period of 20 years or longer is more appropriate, we are firmly committed to and in agreement with the Commission's decision to disallow any addition to rate base of the unamortized SLRP deferral. This view is based on the fact the OPC believes management is responsible for planning and operation the activities of the Company. If management is unable to do or chooses not to implement processes and procedures which would limit the effect of regulatory lag on its finances, the Company should not be protected by the Commission with an effective guarantee of earnings. Therefore, in order that ratepayers and shareholders both share in the effect of regulatory lag, the Public Counsel is recommending that Company be allowed to earn a "return of" the SLRP deferred balance but not a "return on" the SLRP balance.

Q. HOW DID THE COMMISSION DECIDE THE ISSUE?

A. The Commission's Order in Missouri Gas Energy, Case No. GR-2001-292, approved a Stipulation and Agreement entered into by the parties that, except for a few items, was based on a total dollar amount settlement. Thus, the Commission did not have to rule on this issue individually.

Q. PLEASE CONTINUE.

A. In Laclede Gas Company, Case No. GR-2001-629, the Company requested rate base treatment for unamortized deferred balances associated with an AAO on its safety main replacement program. The Staff, in its direct testimony, opposed the Company's request for rate base treatment of the deferred balances. On page 8, of the direct testimony of Staff witness, Mr. Doyle L. Gibbs, his proposal stated:

> ...no rate base inclusion of the unamortized balance and a rate base offset for the related deferred income taxes.

Q. DID THE PUBLIC COUNSEL ALSO FILE TESTIMONY OPPOSING RATE BASE TREATMENT OF THE AAO DEFERRED BALANCES IN THE LACLEDE CASE?

A. Yes. Beginning on page 9, line 17, of the direct testimony of the Public Counsel witness, Ms. Kimberly K. Bolin, Laclede Gas Company, Case No. GR-2001-629, she stated:

> Q. YOU STATED EARLIER THAT THE COMPANY HAS INCLUDED THE SRP DEFERRED BALANCE IN RATE BASE, IS THAT AN APPROPRIATE ADJUSTMENT?
>
> A. No. The Public Counsel recommends that the SRP deferred balance not be included in the Company's rate base. The rationale for this position is that the Company is being given an effective guaranteed "return of" the deferrals associated with the Safety Replacement Program; therefore, it should not be also provided with a guaranteed return on those same amounts.

Q. HOW DID THE COMMISSION DECIDE THE ISSUE?

A. The Commission's Order in Laclede Gas Company, Case No. GR-2001-629, approved a unanimous stipulation and agreement entered into by the parties that provided no rate base treatment of the Company's AAO deferred balances but did allow for a <u>return of</u> the deferred balances. Beginning on page 10 of the *Unanimous Stipulation And Agreement* it states:

> The parties also agree that a regulatory asset equal to the balances deferred pursuant to the Safety Replacement Program accounting authorization granted in Paragraph 5 of the Stipulation and Agreement in Case No. GR-99-315 through July 31, 2001 shall be established with a balance of $2,755,688. One tenth of this balance has been included in the cost of service recognized in this proceeding and one tenth of such balance shall continue to be amortized annually in cost of service for ratemaking consideration for the next subsequent nine years.

Q. DOES THE AAO PROCESS PROVIDE A "WINDFALL" OPPORTUNITY TO THE COMPANY?

A. Yes, it does. Unlike Mr. Williams (Aquila) rebuttal testimony which states that it does not (beginning on page 19, line 20), the costs deferred by the Sibley AAOs did not require any actual investment by the Company. The costs deferred represent non-cash expenses, not investments, Company would have incurred subsequent to the plant being placed in service and recognized in its income statement. Absent the AAO process, the Company may not have recovered in rates any of the expenses it was authorized to defer. I would certainly describe any recovery of the deferred costs as a "windfall" to Company's shareholders though I believe Mr. Williams (Aquila) prefers to use the phrase "**lessens the impact of regulatory lag**."

Q. DOES THE COMPANY STILL OPPOSE THE INCLUSION IN RATE BASE OF THE DEFERRED INCOME TAXES ASSOCIATED WITH THE AAO EXPENSE AMORTIZATIONS?

A. Yes. My understanding of the Company's original position is, 1) there are no deferred income taxes associated with the Sibley AAOs due to Company utilizing flow-though tax treatment for the amortization of the expenses, and 2) there are Ice Storm AAO deferred income taxes but they should be treated as an offset to rate base only if the unamortized AAO balance is also included in rate base (see Rebuttal Testimony of Company witness, Mr. H. Davis Rooney, page 15, lines 13-19).

Q. DID COMPANY INCLUDE THE ICE STORM AAO DEFERRED INCOME TAXES AS AN OFFSET TO RATE BASE IN ITS FILED CASE?

A. In its original filing, Company included the unamortized balance of the Ice Storm AAO deferred expenses in rate base but it **inadvertently** left out the offset of the associated deferred income taxes. I presume since it now has adopted the Staff's position of no rate base treatment for the unamortized Ice Storm AAO deferred expense balance, it is now opposed to the offset for the Ice Storm AAO deferred income taxes.

Q. DID THE COMPANY EVER RECEIVE COMMISSION AUTHORIZATION TO USE FLOW-THROUGH TAX TREATMENT FOR THE SIBLEY AAOs?

A. No, it did not. To my knowledge, the Commission has never authorized the Company to utilize flow-through tax treatment for the Sibley AAOs deferred expenses. Flow-through tax treatment implies that no tax timing difference (i.e., deferred income tax) is created due the AAO expense amounts be treated the same for ratemaking and income tax purposes. However, in MPS Case No. ER-90-101 (the original cost recovery case for the first Sibley AAO), both Staff and the OPC contended that the Company did not appropriately account for deferred income taxes associated with the AAO. Subsequently, on page 30 of the Report and Order, MPS Case No. ER-90-101, the Commission ordered the following:

> The Commission finds that the deferred income tax related to the AAO deferral which is included in deferred tax reserves should be used to reduce rate base a part of the process of setting rates in this case...

Had the Commission authorized the Company to utilize flow-through tax treatment for the costs, it would not have been necessary for the Commission to specifically identify that the associated deferred income taxes be used as an offset to rate base. To my knowledge, the Commission has never changed its position on this issue nor has it authorized the Company to use flow-through tax treatment for any AAO costs it has ever deferred. Thus, it is the Public Counsel's position that the Company's allegation that no deferred income taxes exist because it utilized flow-through tax treatment of the expenses is very much an inaccurate assertion unsupported by the facts in the relevant cases.

Q. IF THE COMPANY DID NOT TRACK AND BOOK THE SIBLEY DEFERRED INCOME TAXES DOES THAT MEAN THEY SHOULD NOT BE DETERMINED AND UTILIZED AS AN OFFSET TO RATE BASE IN THE INSTANT CASE?

A. No. If Company chose, of its own initiation, to not book the appropriate deferred income tax, it may have violated Internal Revenue Service (IRS) rules regarding income tax normalization requirements; however, the violating of IRS rules is not the issue in this case. The issue here is merely to determine the appropriate amount of Sibley and Ice Storm AAO deferred income taxes to use as an offset to rate base. Since the Company has failed to track and book the deferred income taxes related to the Sibley AAOs, I recommend that the Commission adopt the amounts I calculated and recommended in my direct testimony on page 15, lines 8-15, as an appropriate substitute for the offset amounts. In addition, on page 21, lines 1-19 of my direct testimony, I identified that the Company does track and book deferred income taxes associated with the Ice Storm AAO. I recommend that the updated amount, as identified by the Company in its response to OPC Data Request No. 1023, be utilized as the rate base offset for the Ice Storm AAO deferred income tax.

Q. COMPANY HAS ALSO TAKEN THE POSITION THAT A RATE BASE OFFSET OF THE AAO DEFERRED INCOME TAXES IS NOT APPROPRIATE IF THE UNAMORTIZATED AAO EXPENSE BALANCES ARE NOT INCLUDED IN RATE BASE. IS THAT AN APPROPRIATE POSITION?

A. No, it is not. Company witness for this portion of the issue, Mr. H. Davis Rooney, states, on page 15, lines 18-19 of his rebuttal testimony, "The AAO deferred income taxes liability cannot exist without the AAO deferred cost asset. Either they are both included in the calculation of rate base or they are both excluded from the calculation of rate base." He adds on page 16, lines 2-4, "Regardless of whether the taxes were flowed through or normalized, a deferred tax reduction of rate base is incorrect if the AAO deferred cost creating the deferred tax has not also been used to increase rate base." I believe that he is wrong on both assertions.

Q. PLEASE CONTINUE.

A. First, it is apparent that Mr. Rooney is proposing the Company should continue to ignore a direct order of this Commission which specifically required that Sibley AAOs deferred income taxes be utilized as an offset to rate base. That in and of itself is certainly not an appropriate recommendation. The Commission has not ordered, in any case subsequent to MPS Case No. ER-90-101, that it has changed its position on the proper ratemaking treatment of AAO deferred income taxes. The Commission in the Report and Order for that case required the ratemaking treatment of the deferred income tax as an offset to rate base, and to my knowledge that position has never changed.

Second, Mr. Rooney's assertion that deferred income tax somehow follows in tandem with rate base treatment of the AAO unamortized costs is just plain wrong. It is wrong because AAO deferred tax is caused by the timing difference between when Company takes an income tax deduction for the amortization expense and the time that the amortization expense is recognized (on the income statement) for financial reporting and regulatory accounting purposes. The existence of the deferred tax is not related in any way to the inclusion of the unamortized deferrals in rate base. They are created solely because of the timing difference in book and tax recognition, thus the deferred tax should be recognized in rate base. The amortization of the AAO deferred expenses is a regulated expense that is being recovered in the cost of service. The exclusion of the unamortized AAO deferred expense balances from rate base only affects the **return on** the deferrals, not the **return of** the deferrals.

Q. PLEASE DESCRIBE DEFERRED INCOME TAX AND WHY IT IS TREATED AS AN OFFSET TO RATE BASE.

A. Deferred tax is simply the result of timing differences between when a company deducts a certain expense on its tax return and when it deducts the expense on its financial statement records (i.e., regulated books). The deferred tax reserve represents, in effect, a prepayment of income tax by ratepayers. As an example, because Company is allowed to deduct depreciation expense on an accelerated basis for income tax purposes, depreciation expense deducted on its income tax return is greater that the depreciation expense used for ratemaking purposes. This results in the actual income tax currently owed being lower than if the tax/book amounts expensed had been synchronized. The difference is referred to as a book-tax timing difference and a deferral of future income taxes is created (i.e., the deferred tax reserve).

Q. WHAT DOES THE DEFERRED INCOME TAX REPRESENT?

A. The difference, the net credit balance in the deferred tax reserve, represents a source of cost-free funds available to Company to use free from any restrictions. It can use the funds for just about any purpose, including items such as management bonuses, management salary increases or to fund its non-regulated operations. Therefore, rate base is reduced by the deferred tax to avoid having ratepayers pay a return on funds that are cost-free to the Company.

Q. DOES DEFERRED INCOME TAX RELATE IN ANY WAY TO WHETHER OR NOT AN ASSET IS RECOGNIZED IN RATE BASE?

A. No.

Q. SHOULD THE DETERMINATION OF WHETHER OR NOT DEFERRED TAX IS INCLUDED IN RATE BASE BE CONTINGENT ON WHETHER THE RELATED UNAMORTIZED AAO DEFERRED EXPENSE IS INCLUDED IN RATE BASE?

A. No. The inclusion of deferred tax as a rate base offset and the inclusion of the unamortized AAO deferred expense balance are not connected. The only reason the deferred tax exists is because of the timing difference between the period the AAO amortization is recognized for ratemaking purposes and the period it is recognized for income tax purposes. The inclusion or exclusion of the AAO unamortized balance in rate base has no effect on whether the Company enjoys the free use of the associated deferred tax funds. Deferred tax recognized in cost of service for setting rates represents an expense recovered in rates currently for which the Company has no current outlay. Company has the use of the funds generated by these prepaid taxes (i.e., provided by ratepayers) until the funds are required for higher tax liabilities in the future. Including all deferred tax created through the ratemaking process as an offset to rate base is the proper ratemaking treatment.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE.

A. Public Counsel recommends that the Commission not approve rate base treatment of the Company's Sibley and Ice Storm AAO deferred balances. I believe that the Commission is correct in its more recent decisions that AAOs should not be used to insulate utilities from all risk associated with regulatory lag. By including the AAO amortization in expense and excluding the AAO unamortized balance from rate base (and including the associated deferred tax as a rate base offset) shareholders and ratepayers both will share in the negative regulatory lag experienced by Company.

Public Counsel is also concerned that at least a portion of the MPSC Staff continues to reject the Commission's most recent position regarding the sharing of AAO regulatory lag costs between shareholders and ratepayers. This may be occurring because the Staff is relying on outdated Commission orders to reach positions regarding the ratemaking treatment of the AAO deferred costs; however, Mr. Williams (Staff) does not explain his reasons for taking a position that is inconsistent with the MPSC Staff's position in other more recent cases nor does he adequately explain why two separate extraordinary events which resulted in AAO authorization, and have had similar expense costs deferred, should be afforded dissimilar regulatory ratemaking.

Furthermore, Staff and Company's position fails to consider that the AAO deferred balances arise from the adoption of an abnormal regulatory accounting process. Recent Missouri Commission decisions have recognized this fact and understood that the management of the utilities exercise a great deal of control over the construction projects that their companies undertake. Management has great control over the timing of the construction of plant and complete discretion over the filing of general rate increase requests to recover the costs associated with new plant, thus at least to some extent, any negative regulatory lag experienced by Company is of its own making.

Public Counsel agrees with the Commission that fairness dictates that ratepayers should not bear the <u>entire</u> burden of the costs occurring during the regulatory lag period prior to the cost of the new plant being built into rates. Public Counsel's position is consistent with the most recent Commission orders on this matter. In addition, when weighed against the fact that utilities are not required to return, to ratepayers, excess earnings incurred during a positive regulatory lag period, it is clear that fairness dictates the result Public Counsel advocates in this case. The ratemaking treatment proposed by the MPSC Staff and Company ignores those facts and seeks instead to toss the entire AAO negative regulatory lag burden onto the backs of ratepayers.

C. ST. JOSEPH LIGHT & POWER MERGER

Q. WHAT IS THE ISSUE?

A. The issue concerns whether certain costs Company incurred in prior years to consummate its SJLP merger should be allowed recovery in the instant case.

Q. HAS THE COMPANY'S WITNESS ON THIS ISSUE CORRECTLY CHARACTERIZED THE PUBLIC COUNSEL'S POSITION?

A. No. In his rebuttal testimony, Mr. H. Davis Rooney, on page 8, lines 18-19, states that Public Counsel does not believe there were any benefits associated with the merger. His statement is not the Public Counsel's position. In fact, his interpretation of the OPC position on this issue is completely wrong.

Q. PLEASE CONTINE.

A. In my direct testimony, I wrote that merger transaction costs only exist to benefit shareholders thus, they should never be recovered from ratepayers. In addition, I stated the merger transition costs (costs to achieve) should only be recovered to the extent that the benefits of the merger exceed the costs to integrate the operations of the merging entities. I added that since the Company had not seen fit to develop and implement a system to track for comparison the various costs and benefits, there was insufficient evidence to confirm that the merger benefits have outweighed the merger costs. Therefore, the cost recovery requested by Company should be denied.

Furthermore, on the date that my direct testimony was filed, I had several data requests outstanding seeking to identify the specifics associated with the costs Company seeks to recover. Company's response to the outstanding data requests (i.e., OPC Data Request Nos. 1108, 1109 and 1110) show that the costs it seeks to recover were incurred in calendar years 1999 through 2003, with most occurring in calendar year 2001. Since each of those calendar years, 1999-2003, are outside of the test year and update period of the instant case, it would be inappropriate to allow recovery of the costs now.

Q. DID THE COMPANY OBTAIN COMMISSION AUTHORITY TO DEFER THE COSTS AT ISSUE FOR FUTURE RECOVERY IN A LATER RATE CASE?

A. No. The Commission did not grant the Company the authority to defer the costs. It did not do so because no such request was made of it. As stated in my instant case rebuttal testimony, in Case No. EM-20002-292 (the UtiliCorp/SJLP merger case), Company agreed to forego any future recover of the SJLP merger transaction and transition costs. Thus, it did not request, and the Commission did not grant, the authority for it to defer the costs at issue for actual or possible future recovery in a later general rate increase case.

Q. IF THE COMPANY DID NOT OBTAIN COMMISSION AUTHORITY TO DEFER THE COSTS INCURRED IN YEARS 1999 THROUGH 2003, SHOULD IT NOW BE ALLOWED TO RECOVER THOSE SAME EXPENSE/EXPENDITURES IN THE INSTANT OR A FUTURE GENERAL RATE INCREASE CASE?

A. No. It is my belief that if the Commission were to allow Company to recover any portion of the costs it now seeks for this issue, a violation of the prohibition on retroactive ratemaking would occur.

Q. WHAT IS MEANT BY THE CONCEPT OF RETROACTIVE RATEMAKING?

A. A simplified definition of retroactive ratemaking is to reach back into a utility's operations of prior years and selectively move costs (investment, revenues, expenses, etc.) forward into the test year of a later case which is being utilized for the development of future rates and the resulting effect on earnings. Absent Commission authority to defer the costs for possible future year recovery (e.g., an AAO), allowing recovery of the costs in the development of the utility's instant case revenue requirement would create imbalances within the regulatory model utilized for the setting of rates. That is, since the revenue requirement of the utility is based upon the instant case test year, inclusion of costs from outside the test year will tend to either overstate or understate the revenue requirement and earnings (mostly overstate since a utility would not offer to refund over-earnings of prior years).

Q. WHAT IS A TEST YEAR?

A. In the state of Missouri, one of the first steps in the development of rates for a regulated public utility consists of the setting of a 12-month test year. The test year (most often a recent fiscal or calendar year) is the beginning point wherein a utility's investment and expenses necessary to provide a specified level of service are scrutinized in order to develop the annual revenue requirement needed to provide an appropriate level of earnings (i.e., rate of return). The annual revenue requirement represents the utility's return on its current used and useful investment along with reasonable operating expenses to provide a specified level of service. The rates of individual customer classes are developed from the revenue requirement.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION?

A. It is the Public Counsel's recommendation that recovery of the SJLP merger costs requested by Company be denied. The Commission never authorized Company to defer the costs (incurred in calendar years 1999 through 2003) for possible future recovery. Thus, to allow the costs to be included in the development of the instant case rates would be a violation of the prohibition on retroactive ratemaking. In addition, it is the Public Counsel's belief that the Company did voluntarily forego recovery of these same costs in its SJLP merger case, Case No. Em-2000-292.

D. SOUTH HARPER PLANT ADDITION

Q. WHAT IS THE ISSUE?

A. In my direct testimony, I testified that Public Counsel has identified certain costs related to the South Harper power plant construction, as of June 30, 2005 (the end of the Commission ordered test year know and measurable period), that should be disallowed in the instant case. Furthermore, I also testified that the adjustments I recommended were subject to change based on, 1) the finalization of the Commission ordered true-up audit, and 2) Company responses to several OPC data requests were outstanding at the time the testimony was prepared.

Q. HAS THE TRUE-UP OF THE SOUTH HARPER POWER PLANT CONSTRUCTION BEEN FINALIZED?

A. No. The Commission's Order established a test year true-up occurring through October 31, 2005. That audit has not yet been completed; therefore, it is likely that the parties may recommend various additional adjustments to the South Harper power plant construction costs that occurred during the true-up period beginning July 1, 2005 and ending October, 31, 2005. The finalization of the true-up audit, and true-up hearing, will occur in February 2006.

Q. DID COMPANY'S RESPONSES TO THE OUTSTANDING PUBLIC COUNSEL DATA REQUESTS SHOW THAT CERTAIN COSTS YOU RECOMMENDED BE DISALLOWED SHOULD ACTUALLY BE INCLUDED IN THE DETERMINATION OF RATES FOR THIS CASE?

A. Yes. Company's responses did provide information that, in my opinion, adequately support including some of the costs in the determination of rates for this case (subject to the overall disclaimer that none of the costs should be allowed if the courts determine the power plant is to be dismantled). Attached as Schedule TJR-1, to this testimony, is a worksheet which lists various construction costs incurred, as of June 30, 2005, that I continue to recommend be disallowed. I have not updated certain other South Harper related cost adjustments (i.e., transmission costs, AFUDC or depreciation expense) I identified in my direct testimony because either the Company has not yet adequately provided the support for the costs or I expect further adjustment of the costs will occur in the final true-up audit.

Q. PLEASE DESCRIBE THE CONSTRUCTION COSTS YOU CONTINUE TO RECOMMEND BE DISALLOWED.

A. By far the majority of the costs, shown on TJR-1, consist primarily of legal activities surrounding the Aquila, Inc. Case Nos. EO-2005-0156 and EA-2005-0248. Aquila, Inc., Case No. EO-2005-0156 relates to the cost of the turbines/equipment transfer to the regulated utility along with the proposed Chapter 100 financing arrangement, while Aquila, Inc., Case No. EA-2005-0248 pertains to the related certificate of convenience and necessity issue. In addition, I recommend the disallowance of certain storage and CT rehabilitation costs incurred due to Aquila storing the CTs/equipment at the Richards-Gebaur air base and Ralph Green power plant site prior to its installation at the South Harper site. The remaining costs are either relatively minuscule in value or have not, in my opinion, been adequately supported by Company or are PILOT payments Company booked to the cost of the power plant's construction.

Q. WHY DOES THE PUBLIC COUNSEL RECOMMEND THE DISALLOWANCE OF THE LEGAL COSTS IDENTIFIED?

A. It is the Public Counsel's belief that the legal activities were imprudent expenditures incurred by Company due to its mismanagement of the South Harper power plant construction. Had the Company obtained the proper regulatory authorizations to transfer the turbines/equipment, enter into the Chapter 100 financing arrangement and construct the power plant, it is more likely than not that these costs would have never been incurred. As it now stands, the Missouri Western District Court of Appeals has determined that the Company did not obtain the proper authority to construct the power plant nor did it have the proper authority to enter into the bond financing for the Chapter 100 arrangement. In addition, this Commission has heard evidence in Aquila, Inc., Case No. EO-2005-156 that the Company had actually transferred certain property related to the construction, to the City of Peculiar, prior to obtaining the Commission's approval for the transaction(s). Thus, it may be that the power plant will require dismantling and the Chapter 100 arrangement is void. Public Counsel believes that the legal costs incurred to support the Company's position on these issues should not be considered an appropriate addition to the construction cost of the of the power plant because they are not a normal expense expected to be incurred in the construction of a power plant. The legal costs did not add any value to the actual construction cost of the South Harper power plant, thus they will not provide any benefit to ratepayers even if the plant is ultimately allowed to continue operating. If the costs were not incurred to benefit ratepayers, then ratepayers should not be required to reimburse the Company for the expenditures.

Q. WHY DOES THE PUBLIC COUNSEL RECOMMEND THE DISALLOWANCE OF THE STORAGE AND REHABILIATION COSTS FOR THE CTs/EQUIPMENT?

A. These costs were incurred due to Company's failure to utilize the CTs/equipment for its original purpose. The CTs/equipment was originally intended for the Aries II power plant project, but when that plan was abandoned, Company chose to store the CTs/equipment for an extended period of time. The costs to store and later rehabilitate the CTs and equipment would never have been incurred had the Company appropriately planned to bring the CTs and equipment onsite at the time they were actually needed for the South Harper power plant construction.

Q. WHY DOES THE PUBLIC COUNSEL RECOMMEND THE DISALLOWANCE OF THE PILOT PAYMENTS THAT ARE CURRENTLY INCLUDED IN THE SOUTH HARPER CONSTRUCTION COST?

A. Prior to entering into the Chapter 100 financing arrangement, Company did not obtain Commission approval for the transaction. It transferred property to the City of Peculiar without first obtaining the Commission's authorization to enter into the transaction, thus the arrangement may be void. That is, it does not exist. If the financing arrangement does not exist, the costs for it which Company seeks to recover from ratepayers do not exist and they should not be allowed in the determination of regulated rates.

Furthermore, the Missouri Western District Court of Appeals has ruled that the bonds associated with the Chapter 100 financing arrangement are also void. Given that both the Commission, and the Appeals Court, has yet to authorize the Chapter 100 financing arrangement, it is my belief that it does not currently exist. Costs associated with a financing arrangement that does not have the proper authorization of the regulatory bodies that govern its existence are not known and measurable, and costs that are not known and measurable are not included in rates.

Q. IS IT LIKELY THAT OTHER COSTS ASSOCIATED WITH THE CHAPTER 100 FINANCING ARRANGEMENT, SUCH AS AFUDC AND THE EXPENSING OF ADDITIONAL PILOT PAYMENTS, WILL REQUIRE FURTHER ADJUSTMENT?

A. Yes. However, Public Counsel will address these issues in greater detail in the true-up once all the costs of the South Harper power plant construction have been subjected to a final audit.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE.

A. In my direct and rebuttal testimonies, I identified costs associated with the South Harper power plant construction that should be disallowed from the determination of rates in the instant case. I have attached to this testimony a worksheet that further clarifies a portion of the construction costs incurred by Company, as of June 30, 2005, that I continue to recommend be disallowed. I have not updated my total recommended disallowance for other South Harper construction-related costs, incurred prior to and after the June 30, 2005 date, because it is likely that the adjustments I propose for the costs will require further modification subsequent to the final audit of the total South Harper construction costs.

E. CHAPTER 100 FEES

Q. WHAT IS THE ISSUE?

A. The issue concerns whether certain costs incurred by Aquila to structure the financing of the South Harper Power Plant ownership should be recovered in rates. The costs in question resulted from Aquila's negotiations with the City of Peculiar to obtain a Chapter

100 arrangement for the South Harper Power Plant. Commensurate with the negotiations for the Chapter 100 arrangement, Aquila agreed to be held responsible for the payment of costs associated with services provided to the City by its bond counsel (Gilmore and Bell) and financial advisor (McLiney and Company). Company also agreed to provide the City with a one-time payment of a $700,000 issuance fee for it to enter into the Chapter 100 agreement. In the response to OPC Data Request No. 6, Aquila, Inc. Case No. EO-2005-0156, Company stated that the purpose of the issuance fee was:

> This was a negotiated amount that the City required to issue the bonds. The City is permitted to collect an issuance fee for administration of the bonds.

Q. WHAT IS THE PUBLIC COUNSEL'S POSITION ON THIS ISSUE?

A. The Public Counsel recommends that all the costs identified in the previous Q&A not be included in the determination of the Company's cost of service. Our initial opposition to Company's recovery of the costs from ratepayers was based on our belief that the benefits that the City of Peculiar, and surrounding community, would receive from the arrangement's PILOT payments should have been compensation enough for the City entering into the agreement. However, it is my belief, that recent court action has now made the Chapter 100 financing arrangement and recovery of its associated costs a moot point.

Q. PLEASE CONTINUE.

A. On 11/22/2005 the Missouri Court of Appeals Western District in Case No. WD65000 overruled a motion for rehearing and denied an application for transfer to the Missouri Supreme Court filed by the City of Peculiar on 10/19/2005. The motion for rehearing and application for transfer were in response to the Western Appellate's majority opinion issued on 10/04/2005. In the 10/04/2005 Opinion Summary, it stated:

> StopAquila.Org and individual landowners in Cass county appeal a circuit court judgment finding that the Missouri constitution did not require the city of Peculiar to submit a $140 million revenue bond issue involving an electric power plant construction project to Peculiar votes for approval. REVERSED.

It is the Public Counsel's belief that the Chapter 100 arrangement between Aquila and the City is void, and as such, any costs associated with it do not exist because no tax abatement arrangement exists. Ratepayers certainly should not be required to fund recovery of costs associated with an agreement that does not even exist.

Q. IS IT STILL POSSIBLE THAT AQUILA AND THE CITY OF PECULIAR COULD RECEIVE A FAVORABLE OPINION ON THE CHAPTER 100 ISSUE FROM A HIGHER COURT?

A. Counsel has informed me that may be possible; however, it is my understanding that such action, if it were to occur at all, would likely consummate after the instant case is finalized. Therefore, the Chapter 100 costs at issue would still lack the necessary ingredients to allow them in rates. That is, the costs would not be "known and measurable" because the Chapter 100 arrangement does not legally exist, and if they are not "known and measurable," there is significant Commission and regulatory precedent for their disallowance.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes, it does.

Schedule TJR-1

Has Been Deemed

“Highly Confidential”

in its

Entirety