EXHIBIT

Exhibit No.:
Issue(s): Accounting Authority Orders;
St. Joseph Light & Power Merger;
South Harper Plant Addition;
SO_2 Emission Allowances;
Witness: Ted Robertson
Type of Exhibit: Rebuttal
Sponsoring Party: Public Counsel
Case Number: ER-2005-0436
Date Testimony Prepared: Nov. 18, 2005

REBUTTAL TESTIMONY

OF

TED ROBERTSON

Submitted on Behalf of
the Office of the Public Counsel

AQUILA, INC.

Case No. ER-2005-0436

November 18, 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 rebuttal testimony consisting of pages 1 through 24.

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 18th day of November 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.

TABLE OF CONTENTS

REBUTTAL 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 REBUTTAL TESTIMONY?

A. The purpose of this testimony is to present the Public Counsel's rebuttal on the issues of accounting authority order ("AAO") costs, transaction and transition costs associated with the St. Joseph Light & Power Company merger with Aquila, Inc., South Harper construction costs and SO_2 emission allowance costs.

II. MPS AND L&P COST OF SERVICE

A. ACCOUNTING AUTHORITY ORDERS

Q. WHAT IS THE ISSUE?

A. The issue relates to the ratemaking treatment of AAO costs in the MPS rate base. First, Company, and the MPSC Staff, in their respective direct testimony, have recommended rate base treatment for the unamortized deferred balances associated with the accounting authority orders for the Sibley Rebuild and Western Coal Conversion deferrals discussed in my direct testimony. Second, Company, but not the MPSC Staff, included in rate base the unamortized deferred balance associated with the Ice Storm AAO authorized in Case No. EU-2002-1053. Third, Company also failed to appropriately track the deferred income tax balances associated with the Sibley Rebuild and Western Coal Conversion costs and did not include the deferred income taxes for either of the three AAOs as a reduction to rate base. Public Counsel opposes the inclusion of the unamortized AAO deferred cost balances in rate base and supports the reduction of rate base for the associated deferred income taxes component of all three AAOs.

Q. WHAT DO THE AAO DEFERRED COSTS REPRESENT?

A. The accounting authority orders granted MPS by the Commission allow the utility to depart from traditional methods of accounting by permitting Company to defer various costs included in one accounting period for possible rate recovery in another accounting period. By allowing the AAOs, the Commission authorized MPS to defer depreciation expense, other expenses (e.g., property taxes, ice storm repairs), and carrying costs for plant additions. In the absence of the Commission's accounting authorization, the normal

accounting practice would have been to charge the depreciation, and other costs, to expense in the period incurred, and to cease the accrual of the carrying costs (i.e., allowance for funds used during construction ("AFUDC")) at the time the plant goes into service. (The capitalization of the carrying charges is the equivalent of accruing AFUDC after the plant goes into service.)

Q. WHY DOES THE PUBLIC COUNSEL OPPOSE RATE BASE INCLUSION OF THE UNAMORTIZED AAO DEFERRED BALANCES?

A. Public Counsel believes that the AAO process has the effect of protecting Company from negative regulatory lag and that that protection should not be all encompassing for the risks it causes. In Missouri Public Service Co., Case Nos. EO-91-358 & EO-91-360, the Commission stated:

> Lessening the effect of regulatory lag by deferring costs is beneficial to a company but not particularly beneficial to ratepayers. Companies do not propose to defer profits to subsequent rate cases to lessen the effects of regulatory lag, but insist it is a benefit to defer costs. Regulatory lag is a part of the regulatory process and can be a benefit as well as a detriment. Lessening regulatory lag by deferring costs is not a reasonable goal unless the costs are associated with an extraordinary event.
>
> Maintaining the financial integrity of a utility is also a reasonable goal. The deferral of costs to maintain current financial integrity, though, is of questionable benefit. If a utility's financial integrity is threatened by high costs so that its ability to provide service is threatened, then it should seek interim rate relief. If maintaining financial integrity means sustaining a specific return on equity, this is not the purpose of regulation. It is not reasonable to defer costs to insulate shareholders from any risks. 1 Mo. P.S.C. 3d 200, 207 (1991).

The Commission has recognized that lessening the effect of regulatory lag by deferring costs is beneficial to a utility but not particularly beneficial to ratepayers. Companies do not propose to defer profits to subsequent rate cases to lessen the effects of regulatory lag, but insist it is a benefit to defer costs. Regulatory lag is a part of the regulatory process and can be a benefit as well as a detriment.

Q. DOES THE PUBLIC COUNSEL KNOW THE CORRECT AMOUNT OF DEFERRED INCOME TAXES, ASSOCIATED WITH THE DEFERRED AAO COSTS, THAT SHOULD BE SUBTRACTED FROM RATE BASE?

A. No. Company's failure to maintain the proper financial records has been a factor in the tracking of these particular costs at least as far back as its 1993 electric rate case.

Q. WHAT DOES THE PUBLIC COUNSEL PROPOSE REGARDING THE AMOUNT OF AAO DEFERRED INCOME TAXES THAT SHOULD BE SUBTRACTED FROM RATE BASE??

A. Public Counsel recommends that the amounts I identified in my direct testimony for the deferred income taxes associated with the AAO unamortized deferred balances should be updated through June 30, 2005 and subtracted from rate base.

Q. WHY DID THE MPSC STAFF INCLUDE THE UNAMORTIZED AAO DEFERRED BALANCES IN RATE BASE?

A. On page 19, lines 19-23, of Staff witness, Mr. Phillip K. Williams, direct testimony, he states:

> Unamortized AAO balances at June 30, 20005, were included in rate base, to reflect a return on the unamortized balance of the AAO deferrals authorized by the Commission in Case Nos. ER-90-101, EO-91-247 and ER-93-37. These AAO deferrals are the MPS Sibley Rebuild project, Case No. ER-90-101, and the MPS Sibley Western Coal Conversion, Case No. ER-93-37.

Q. DOES THE PUBLIC COUNSEL BELIEVE THAT COMMISSION CASE NOS. ER-90-101, EO-91-247 AND ER-93-37 ARE VALID WITH REGARD TO THE APPROPRIATENESS OF RATE BASE TREATMENT FOR THE UNAMORTIZED AAO DEFERRED COSTS?

A. No. The cases Mr. Williams cites occurred early in the Commission's process of developing, or adopting, what commonly became known as accounting authority orders. In a later case, the Commission recognized that allowing a utility to earn a return on the deferred AAO costs is not an appropriate regulatory policy.

Q. IN WHICH CASE DID THE COMMISSION PREVIOUSLY DENY AUTHORIZATION FOR A "RETURN ON" AN UNAMORTIZED AAO DEFERRED BALANCE?

A. The cost recovery was denied in Missouri Gas Energy ("MGE"), Case No. GR-98-140. In its Report and Order, beginning on page 19, the Commission stated its reasoning for **denying** the utility a "return on" the unamortized deferred safety line replacement costs ("SLRP") it had booked. The Report and Order 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.**
>
> (Emphasis added by OPC.)

Q. WHY IS THE POSITION THE COMMISSION ADOPTED IN MGE CASE NO. GR-98-140 IMPORTANT?

A. Public Counsel believes that the Commission, in its decision in MGE Case No. GR-98-140, recognized that the sole purpose of accounting authority orders and their deferred cost recovery is to mitigate or lessen the effect of regulatory lag, not to eliminate it nor to protect the Company completely from risk. The Commission decided that a sharing of the risk for the extraordinary costs between shareholders and ratepayers is appropriate. Therefore, the Commission's decision in MGE GR-98-140 is especially relevant to the rate treatment of the AAO deferred costs of the instant case because its decision in that case recognized that even though the SLRP costs were determined to be extraordinary (MGE deferred SLRP costs pursuant to Commission's authorization in AAO Case Nos., GO-92-185, GO-94-234 and GO-97-301 and it is my understanding that in each of those cases the Commission determined that the costs were extraordinary), MGE's shareholders must share in the risks associated with the negative regulatory lag from which the costs emerged.

Q. IS IT REASONABLE TO BELIEVE THAT THE AAO COSTS AT ISSUE ARE EXTRAORDINARY?

A. Yes. Inherent in the Commission's authorization of any AAO, to defer costs which would normally be expensed when incurred, a utility must convince the Commission that the costs for which it is requesting the specialized accounting treatment are indeed extraordinary. Though investments associated with costs deferred may vary from AAO to AAO, and from utility to utility, the rationale for receiving the abnormal regulatory accounting treatment remains the same. That is, the AAO cost deferral and recovery process is allowed in order to mitigate the effects of regulatory lag on the utility.

Q. DID THE COMPANY INCLUDE AN AMORTIZATION OF THE AAO DEFERRED COSTS IN THE CURRENT CASE OPERATING EXPENSE?

A. Yes. The Company included an expense amortization for all its AAOs in operating expense.

Q. DID THE MPSC STAFF ALSO INCLUDE AAO DEFERRED COSTS IN THE CURRENT CASE OPERATING EXPENSE?

A. Yes. Staff adopted the test year amortization for both AAO Case No. EO-90-114 (authorized recovery in MPS Case No. ER-90-101), and AAO Case No. EO-91-358 (authorized recovery in MPS Case No. ER-93-37). However, regarding the Ice Storm AAO, Aquila, Inc., Case No. EU-2002-1053, Staff adjusted the test year amortization as determined in Case No. ER-2004-0034 (see Mr. Williams' direct testimony page 20, lines 3-7).

Q. DID THE PUBLIC COUNSEL ALSO INCLUDE AN AMORTIZATION OF THE AAO DEFERRED COSTS IN THE CURRENT CASE OPERATING EXPENSE?

A. Yes.

Q. IS IT CORRECT THAT THE AAO COSTS THAT WERE DEFERRED ARE NOT ACTUALLY AN EXPENDITURE FUNDED BY THE COMPANY?

A. Yes, that is a true statement. What the Sibley AAOs deferred were the property tax and depreciation incurred after the plant was placed in service along with a carrying charge on those costs (i.e., pseudo-earnings for the utility on the deferred costs). The AAO from Case No. EO-90-114 allowed the Company to defer depreciation expenses, property taxes and carrying costs, while the AAO from Case No. EO-91-358 authorized the deferral of only depreciation expenses and carrying costs. The carrying costs and depreciation expense associated with the deferrals are not actually dollars of investment capital funded by the Company. The costs are merely accounting entries on its financial books. Neither the carrying cost nor the depreciation expense causes the Company to forego any actual outlay of cash. In fact, depreciation expense does not begin to be booked until the plant is actually placed into service. No real dollars are required for its expensing. Thus, depreciation is definitely not a capital cost. However, the dollars associated with these book entries will be recovered from ratepayers through the amortization included in the utility's cost of service.

Q. WHAT ABOUT PROPERTY TAXES?

A. During the construction of the new plant, property tax would normally be added as a cost of the construction up and until such time as the plant is placed into service then, on a going forward basis, any future property tax is treated as a normal income statement expense item. In reality, while the utility would eventually incur a real expenditure for

the payment of the property taxes, that payment would likely not occur until the year subsequent to the year the plant is put into service. In any event, neither depreciation expense, property tax expense nor carrying costs Company deferred are capital costs requiring rate base treatment according to normal accounting and ratemaking procedures. The costs deferred are nothing more than expenses and a pseudo-earnings return that the utility would not have recovered, all things being equal, during the lag period between when the new construction was finalized and placed in service and when new rates incorporating the costs associated with that new plant were authorized by the Commission.

Q. IF THE AAO DEFERRED COST BALANCES ARE INCLUDED IN RATE BASE WILL THAT PERMIT THE COMPANY TO EARN A RETURN ON AMOUNTS FOR WHICH THERE WAS NO ACTUAL INVESTMENT MADE BY THE COMPANY?

A. Yes, it would.

Q. WOULD INCLUDING THE DEFERRED COST BALANCES IN RATE BASE ALSO PERMIT THE UTILTY TO EARN A RETURN ON A RETURN?

A. Yes, it would. Allowing the Company to earn a "return on" the deferrals has the same effect of allowing it to earn a return on a return. Stated another way, the Company will recover (receive a "return of") the deferred carrying cost, depreciation expense and other expenses by way of the expense amortization included in rates, and then will earn a "return on" those same amounts. Since the carrying costs deferred represent an earnings return on the

investment for the regulatory lag period, rate base treatment would add an additional earnings return on top of those amounts.

Q. IS THE PURPOSE OF AN AAO TO MAKE THE UTILITY FINANCIALLY WHOLE WITH REGARD TO A POTENTIAL EARNINGS LEVEL?

A. No. Had the utility not received authorization for the AAOs, for the Sibley Rebuild and Western Coal Conversion projects, or even the Ice Storm AAO, it is likely it would not have recovered from ratepayers any of the costs it has deferred and now seeks recovery of in this rate case. Unless the utility had filed for a general rate increase that coincided with the in-service dates of the new plant, and/or included a test year wherein the other expenses were incurred, regulatory lag would naturally have occurred preventing it from recovering in rates any of the AAO costs it now requests. Thus, the true purpose of the Sibley Rebuild and Western Coal Conversion AAOs, and the Ice Storm AAO, is to insulate the utility and its shareholders from the risks associated with the negative regulatory lag that occurs when various costs are incurred, and/or construction projects are completed and placed in service, before the operation law date of a general rate increase case. But, that does not mean that the AAOs exist to make the utility "financially whole."

Q. IF AN AAO IS NOT TO MAKE A UTILITY "FINANCIALLY WHOLE" WHAT PURPOSE DOES IT SERVE?

A. The purpose of an AAO is to assist the utility in the **mitigation** of negative regulatory lag associated with extraordinary costs. However, it is interesting to me that no such

mechanism has been instituted in the state of Missouri for when a utility enjoys an excess earnings situation - a positive regulatory lag period. Such an important mechanism could have played an important part in MPS Case Nos. ER-97-394 and Case No. ER-2001-672. The result of those two rate cases was Commission recognition that the Company was over-earning significantly during the accounting periods reviewed. The overall rate decreases resulting from the Commission's orders in those cases approximated $16.9 million annually for MPS Case No. ER-97-394, and $4.25 million annually for MPS Case No. ER-2001-672. What I find most interesting is that Company did not request an AAO to defer its excessive earnings for future refund to ratepayers prior to the Commission ordering the rate reductions. My point being that regulatory lag works both ways for the utility; depending on the circumstances, it can result in either a positive or negative impact to the utility and its shareholders.

Q. PLEASE EXPLAIN THE CONCEPT OF REGULATORY LAG.

A. The concept of regulatory lag is based on a difference in the timing of a decision by management, and the Commission's recognition of that decision, and its effect on the rate base/rate of return relationship in the determination of a utility's revenue requirement. Management decisions that reduce or increase the cost of service without changing rates result in a change in the rate base/rate of return relationship. This change either increases or decreases the profitability of the utility in the short-run until such time as the Commission reestablishes rates to properly match the new level of service cost. Utilities are allowed to retain cost savings (i.e., excess profits during the lag period between rate cases) and are forced to absorb cost increases. When faced with escalating costs,

regulatory lag places pressure on management to minimize the change in the relationship because it cannot be recognized in a rate increase until the Commission approves such in a general rate proceeding.

Q. DOES THE COMPANY RECOGNIZE THAT ITS SHAREHOLDERS ARE BEING INSULATED FROM REGULATORY LAG?

A. When the AAOs at issue were first initiated it did. In the Commission's Report and Order, MPS, Case No. EO-91-358, page 9, its states:

> **MPS presented four considerations it believes are the benefits of allowing deferral of the costs requested**. These are rate stability, avoidance of rate case expense, **lessening the effect of regulatory lag**, and maintaining the financial integrity of the utility.
>
> (Emphasis added by OPC.)

It would appear, from reading the language in the Report and Order, that the MPS witnesses who fought to have the AAO authorized in the first place believed the insulation of shareholders from regulatory lag was an important benefit.

Q. SHOULD RATEPAYERS BE REQUIRED TO PROVIDE MPS WITH A GUARANTEED RETURN ON THE SIBLEY REBUILD AND WESTERN COAL CONVERSION EXPENDITURES JUST BECAUSE THE COMPANY'S MANAGEMENT CHOOSES NOT TO EXERCISE ITS PLANNING AND OPERATING RESPONSIBILITIES?

A. No, ratepayers should not be required to fund such a return. Planning and operation of the Company's construction projects are a fundamental responsibility of utility's management. It is the utility's management that has complete access and control of the data and resources necessary to fulfill these responsibilities, and as such, management is the only party that has the wherewithal to implement a construction program that minimizes the effects of regulatory lag on its finances.

Q. PLEASE SUMMARIZE THE PUBLIC COUNSEL'S RECOMMENDATIONS REGARDING THE AAO DEFERRED COSTS.

A. Public Counsel recommends that an annualized level of expense amortization associated with the three AAOs be allowed in the MPS cost of service. However, Public Counsel recommends that the Company's rate base be computed so that MPS will not earn a "return on" the unamortized AAO deferred balances. Public Counsel believes that guaranteeing the utility a "return of" and "return on" the unamortized AAO deferred balances is not a fair allocation of regulatory lag implications resulting from the Company's construction projects or the occurrence of natural disasters.

Public Counsel's recommendation is based on the most recent Commission decision wherein this issue was fully litigated. In that litigated case, the Commission recognized and ordered that the unamortized deferred balances associated with AAOs should not be afforded rate base treatment. The Commission has stated that the AAOs it authorizes allow a utility to book and defer certain costs but does not approve any ratemaking treatment of the deferred balances. It has also stated that the purpose of an AAO is not to eliminate regulatory lag but

instead is intended only to mitigate costs normally absorbed by the utility because of regulatory lag. In essence, the purpose of an AAO is to lessen the effect of the regulatory lag upon the utility, not to eliminate it nor to protect a utility's shareholders completely from risk.

Public Counsel understands that the purpose of the AAO authorization is to mitigate the negative implications of regulatory lag upon the utility, not to eliminate all risks encountered by a utility. By not allowing MPS a "return on" the unamortized AAO deferred balances, the utility's management and shareholders appropriately share in some of the responsibility for the risk of the costs incurred. Excluding the unamortized AAO deferred balances from rate base allows the risk associated with regulatory lag to be shared between the shareholder and the ratepayer. The utility will still recover the actual amounts it is allowed to defer, but it simply will not be allowed to earn a return on those same costs.

In addition, with regard to the Sibley Rebuild and Western Coal Conversion AAOs, Public Counsel's position is supported by the fact that the utility's management is responsible for planning and operating the activities of the Company. If the utility's management is unable to or chooses not to implement processes and procedures that would limit the effects of negative regulatory lag on its finances, the shareholders should not be protected by the Commission with a guaranteed recovery of both the costs deferred and an earnings return on those costs. The deferral and recovery of deferred costs to maintain current financial integrity or to sustain a specific return on equity is of questionable benefit and certainly not, in my opinion, appropriate. If a utility's financial integrity is

threatened by occurrence of high or unexpected costs so that its ability to provide service is endangered, then it has the ability to and should seek interim rate relief from the Commission. Shareholders should not be insulated from all risks associated with the failure of a utility's management to adequately perform its duties.

Last, the Ice Storm AAO, though unique, is only slightly different from the Sibley Rebuild and Western Coal Conversion AAOs. The deferred costs associated with this AAO relate to a natural disaster event often referenced to as an "act of God." The Commission's past treatment of the incremental costs of such events is unambiguous. In St. Louis County Water Company, Case No. WR-95-145, the Commission decided to allow a utility recovery of the deferred costs related to natural disasters as an expense item, but **did not** include the costs unamortized balance in rate base. The Report and Order in Case No. WR-95-145 stated:

> **The burden of "acts of God" should not have to be borne solely by the ratepayers. In the case of a natural disaster, the shareholders should not be shielded from the risk, but should share in the cost with the ratepayer. Allowing County Water to recover the cost through amortization, without inclusion of the unamortized balance in rate base, achieves that sharing.**
>
> (Emphasis added by OPC.)

Therefore, in order that ratepayers and shareholders both share in the financial effects of the negative regulatory lag the utility would have experienced, had the AAOs not been authorized, Public Counsel recommends that MPS be permitted to earn an annualized

"return of" the deferred costs, for all three AAOs, but not earn a "return on" any of the unamortized AAO deferred balances.

B. ST. JOSEPH LIGHT & POWER MERGER

Q. SHOULD THE COMPANY BE ALLOWED TO RECOVER FROM RATEPAYERS MERGER COSTS INCURRED IN YEARS PRIOR TO THE TEST YEAR?

A. No. Public Counsel's position is that Company had no authority to defer the costs of prior years it now requests to recover from ratepayers. The Commission did not provide Company with any order that would have allowed it to defer the costs for future recovery nor, to my knowledge, is there any authoritative accounting basis that would have allowed it to do so without the Commission's explicit authorization. Furthermore, prior to the conclusion of the legal activities surrounding the merger request in UtiliCorp United Inc. and St. Joseph Light & Power Company Case No. EM-2000-292, Company explicitly dropped its request to recover the merger costs in that case and all other future cases before the Commission.

Q. HOW DID THE COMMISSION RULE ON THE ISSUES PRESENTED IN THE UTILICORP UNITED INC. AND ST. JOSEPH LIGHT & POWER COMPANY MERGER CASE?

A. In UtiliCorp United Inc. and St. Joseph Light & Power Company Case No. EM-2000-292, Company, in addition to requesting approval of the proposed merger, Company tendered a "regulatory plan" whereby it sought Commission authority to recovery some transaction and transition costs it incurred associated with its purchase of the former St.

Joseph Light & Power Company. The Commission approved the merger, but rejected the Company's proposed regulatory plan. Regarding the transactions associated with the regulatory plan, on page 45 of the Report and Order, effective December 24, 2000, it stated:

> 7. That the Regulatory Plan proposed by UtiliCorp United Inc. is rejected.

Q. DID THE COMMISSION LEAVE OPEN THE POSSIBILITY THAT THE MERGER COSTS WOULD BE CONSIDERED IN LATER CASES?

A. Yes. On page 47 of the Report and Order the Commission stated:

> 13. That nothing in this order shall be considered a finding by the commission of the value for ratemaking purposes of the transactions herein involved.
>
> 14. That the commission reserves the right to consider any ratemaking treatment to be afforded the transactions herein involved in a later proceeding.

Q. DID LEGAL ACITIVITES LATER LEAD TO A MODIFICATION IN THE COMMISSION'S ORIGINAL REPORT AND ORDER FOR THE CASE?

A. Yes. In the subsequent Second Report and Order for Case No. EM-2000-292, effective March 7, 2004, the Commission reiterated its rejection of the Company proposed regulatory plan. On page 2 of the Second Report and Order it states:

> The Commission, however, rejected a Regulatory Plan proposed by UtiliCorp that would have predetermined various matters regarding how the

cost of the merger would be treated by the Commission in future UtiliCorp rate cases.

In addition, on page 9, the Commission added:

> 2. That UtiliCorp United Inc. shall not be allowed to recover from its ratepayers the acquisition premium arising from the transaction that is approved in this Report and Order.

Q. WHAT CAUSED THE COMMISSION TO CHANGE ITS POSITION ON THE POSSIBILITY OF CONSIDERATION OF THE MERGER COSTS IN A LATER CASE?

A. In order to reach an agreement with the parties to the case, Company agreed to forgo any future recovery of the merger transaction and transition costs. On page 3 of the Commission's Second Report and Order, Case No. EM-2000-292, it states:

> **On February 25, 2004, Aquila, Inc. f/k/a UtiliCorp filed a statement of position in which it stated that it will not seek to recoup or recover through rates the acquisition premium or the merger savings or synergies in connection with the merger transaction in its pending rate cases or in any future rate cases before the Commission.**
>
> (Emphasis added by OPC.)

Q. WHY DID THE COMPANY AGREE TO FORGO RECOVERY OF THE ALLEGED MERGER COSTS?

A. The pleading filed by Company on the 25th of February 2004 states:

1. The captioned proceeding has been remanded to the Commission by the Missouri Supreme Court to consider and decide, among other things, the recoupment of the acquisition premium which resulted in connection with the merger which is the subject of this proceeding.

2. In connection therewith, Aquila states that it will not seek to recoup or otherwise recover through rates the subject acquisition premium.

3. **In addition, Aquila states that it will not seek to recover through rates the merger savings or synergies in connection with the merger transaction which is the subject of this proceeding (which savings recovery the Staff has characterized as "premium recovery") either in the pending Aquila rate cases, Case No. ER-2004-0034, Case No. HR-2004-0024, and Case No. GR-2004-0072, or any subsequent Aquila rate proceeding before this Commission.**

4. WHEREFORE, having submitted its statement of position as aforesaid, Aquila respectfully requests the Commission to issue in this matter in accordance with the remand of the Missouri Supreme Court at its earliest opportunity.

(Emphasis added by OPC.)

Q. GIVEN THAT THE COMPANY VOLUNTARILY AGREED TO FORGO FUTURE RECOVERY OF THE ACQUISITION PREMIUM, MERGER SAVINGS AND SYNERGY COSTS WAS THERE ANY NEED FOR THE COMMISSION TO AUTHORIZE THE DEFERRAL OF THE COSTS ALLEGED IN THE CURRENT CASE FOR FUTURE RECOVERY?

A. No, the Commission did not provide the Company with the authorization to defer the costs for future recovery. There was no need for the authorization since the Company had agreed not to seek recovery of the merger costs in all future cases.

Q. SINCE THE COMPANY DID NOT RECEIVE COMMISSION APPROVAL TO DEFER THE COSTS FOR FUTURE RECOVERY, IS IT NOW APPROPRIATE FOR

THE COMMISSION TO ALLOW THE COSTS IN THE RATEMAKING OF THE CURRENT CASE?

A. No. Absent the Commission's authorization to defer the alleged costs, Company had no right to seek recovery of the costs in this or any other case. In fact, Public Counsel is astonished at the Company's audacity wherein in order to settle a previous case before this Commission it agrees never to seek recovery of the alleged costs in any future case - yet here it stands with its hands out requesting the Commission to force ratepayers to fork over the funds.

C. SOUTH HARPER PLANT ADDITION

Q. IN YOUR DIRECT TESTIMONY YOU RECOMMENDED A DISALLOWANCE FOR VARIOUS CONSTRUCTION COSTS PENDING CLARIFICATION OF THEIR PURPOSE AND NECESSITY. HAVE YOU COMPLETED YOUR REVIEW OF THOSE COSTS?

A. No. On page 30, lines 18 - 23, of my direct testimony, I stated that Public Counsel had several data requests outstanding for information pertaining to costs we recommended disallowed. Company has since responded to several of my requests for additional information, but some of its responses lacked complete disclosure of the information sought. I again contacted the Company seeking to obtain the information it did not provide in its initial responses. Subsequent to my contacting it, Company provided me with another packet containing some, but not all, of the information I had originally requested. This packet of information was provided to me on the Wednesday prior to the Friday filing date of this rebuttal testimony. Public Counsel is currently in the process of

reviewing that information while it awaits a complete response to all the interrogatories. As we do not yet have all the information required in order to support a thorough review of the costs in question, I will update the Commission regarding the Public Counsel's position on this issue in surrebuttal testimony.

D. SO_2 EMISSION ALLOWANCES

Q. WHAT IS THE ISSUE?

A. Public Counsel believes that the MPSC Staff's proposed cost of service for MPS and L&P, respectively, includes an excessive amount of costs associated with SO_2 emission allowances.

Q. WHAT ARE THE MPSC STAFF PROPOSED COSTS?

A. The MPSC Staff witness for this issue, Mr. Graham A. Vesely, sponsors adjustments wherein $1,090,025 and $573,845 is included in the MPS and L&P rate bases, respectively. He also sponsors an adjustment of $1,854,891 (Staff Run Adj. S-15.1) that represents the incremental cost increase necessary to achieve an annualized expense level of costs for MPS and an adjustment of $2,495,039 (Staff Run Adj. S-16.1) that represents the same for the L&P electric operations.

Q. WHAT IS THE BASIS FOR MR. VESELY'S RATE BASE ADJUSTMENTS?

A. On page 17, lines 22-23, of his direct testimony he states that he included the unused level of emissions allowances that Aquila carried on its books at June 30, 2005, on a 13-month average basis, in rate base.

Q. WHAT IS THE BASIS FOR MR. VESELY'S MPS ANNUAL EXPENSE ADJUSTMENT?

A. On page 19 of his direct testimony, in reference to a question about computing the annualized expense of SO_2 allowances, he states that he computed the cost to Aquila MPS and L&P of purchasing the additional allowances required for the amount of sulfur emissions produced at their power plants. It's my understanding, he did the computation by accepting the Company's forecast for 2005 but backed out a 10% increase for the Sibley power plant that was based on the assumption that higher sulfur Illinois coal would continue to be used to fill in for the shortages caused by the C.W. Mining contract termination.

Q. WHY DOES THE PUBLIC COUNSEL DISAGREE WITH MR. VESELY'S RECOMMENDATION FOR THE MPS SO_2 EMISSION ALLOWANCE ANNUAL EXPENSE COST?

A. Basically, I disagree with Mr. Vesely's computation of the required number of emission allowances needed for the Sibley power plant because I believe it is based on an excessive estimate. His computation starts with the Company's 2005 forecast of 16,367 emission allowances (source: Company work paper FPP-17-2) reduced by 10%. The ensuing amount (i.e., 14,730) is further reduced by the EPA provided free allowances of 8,791 to arrive at a final annualized emission allowance level of 5,939. The difference between Staff's 5,939 and my proposed annualized emission allowance level of 3,068 is 2,871.

Q. WHAT ACCOUNTS FOR THE DIFFERENCE OF 2,871 EMISSION ALLOWANCES?

A. A large part of the difference relates to his use of an estimated increase in Sibley power plant emission allowances provided by Company in its instant case work papers. Company's estimate of Sibley's needs far exceeds the actual level of emission allowances required by the power plant in recent years. The estimate is inflated because the actual allowances required by the power plant is inflated above normal due to an unusual situation. The unusual situation being, as I described in my direct testimony, the difficulties Company has encountered with the fulfillment of the low-sulfur coal contract it had with the C. W. Mining Company.

Q. SHOULD RATEPAYERS BE REQUIRED TO FUND THE INCREASED COSTS ASSOCIATED WITH THE FAILED C. W. MINING CONTRACT?

A. No. Company has filed a lawsuit to recover the damages it has incurred relating to this issue; therefore, the increased costs associated with its need for increased SO_2 emission allowances, because it is forced to burn a higher cost higher sulfur content coal, should not be also recovered from ratepayers. Assuming ratepayers should be held responsible for the increased costs (an assumption with which we do not agree), a potential recovery from the lawsuit along with a guaranteed recovery from ratepayers creates a situation whereby double recovery of the increased costs might occur and we definitely believe that would neither be appropriate nor fair. In addition, I've been informed by the Public Counsel that recovery, from ratepayers, of the incremental costs increases associated with the necessity of Company to obtain the coal from other sources includes some risk that C. W. Mining could be relieved of the obligation to pay Aquila for the damages it may have caused.

Q. IS THE COST OF THE SO_2 EMISSION ALLOWANCES STAFF INCLUDED IN THE RATE BASES OF MPS AND L&P APPROPRIATE?

A. No. It's my understanding that Staff included a 13-month average of the unused level of emissions allowances as recorded in Aquila's financial books of record. Public Counsel believes that the recorded balances Staff utilized actually overstate the costs of the annual level of emission allowances required by the Company. The amounts recorded on the financial books of record include, in addition to excessive costs associated with the C. W. Mining contract issue, costs associated with other trading (e.g., purchases/sales/swaps, etc.) activities of SO_2 emission allowances by the Company. Furthermore, the booked prices for the emission allowances may not accurately reflect the pricing situation currently being experienced by the utility. Since the booked costs do not accurately represent an annualized level of SO_2 emission allowances going-forward, Public Counsel believes that the rate base amounts Staff is recommending are excessive.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.