Exhibit No:
Issues: Allocation of Corporate Costs
Witness: Jon R. Empson
Type of Exhibit: Rebuttal Testimony
Sponsoring Party: Aquila Networks
Case No: GR-2004-0072
Date to Be Filed: February 13, 2004

MISSOURI PUBLIC SERVICE COMMISSION

CASE NO. GR-2004-0072

REBUTTAL TESTIMONY

OF

JON R. EMPSON

ON BEHALF OF

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

Omaha, Nebraska
February, 2004

AFFIDAVIT OF JON R. EMPSON

STATE OF NEBRASKA)
) ss.
COUNTY OF DOUGLAS)

Jon R. Empson, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony and schedules entitled "Rebuttal Testimony of Jon R. Empson"; that said testimony was prepared by him and/or under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information and belief.

Jon R. Empson
Jon R. Empson

SUBSCRIBED AND SWORN TO before me this 12 day of February, 2004

Teresa A Keefe

Notary Public

GENERAL NOTARY - State of Nebraska
TERESA A. KEEFE
My Comm. Exp. Oct. 31, 2005

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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
REBUTTAL TESTIMONY OF JON R. EMPSON
ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NO GR-2004-0072**

Q. WHAT IS YOUR NAME AND POSITION WITHIN AQUILA, INC. ("AQUILA" OR "COMPANY")?

A. Jon R. Empson, Senior Vice President of Regulated Operations.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. I have a B.A. in economics from Carleton College and an MBA from the University of Nebraska at Omaha.

Q. WHAT ARE YOUR RESPONSIBILITIES WITHIN AQUILA?

A. I have overall responsibility for the state utility operations in Aquila's seven state service territory as well as the regulatory, legislative and central services functions.

Q. WHEN DID YOU ASSUME THIS POSITION?

A. I assumed these responsibilities in January 2004.

Q. WHAT WAS YOUR PRIOR WORK EXPERIENCE?

A. Since 1986, I have held several officer positions in Aquila, responsible for many different functions including regulatory, legislative, legal, engineering, gas supply, human resources, accounting, measurement, and data processing. I also had a seven-year career at Northern Natural Gas/Enron in three different subsidiaries and an eight-year career at the Omaha Chamber of Commerce primarily dealing with economic development.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I will be specifically responding to direct testimony filed by various witnesses regarding the vacant office space at Aquila's headquarters and the allocation of corporate costs to Aquila's Missouri gas operations. These are essentially the same issues raised by the intervenors in Aquila's Missouri electric rate case and my rebuttal testimony is basically the same.

<u>20 West 9th</u>

Q. DO YOU AGREE WITH OFFICE OF PUBLIC COUNSEL ("OPC") WITNESS, MR. DITTMER THAT "SIGNIFICANT UNUSED AND UNNEEDED EXCESS OFFICE SPACE" (DITTMER PG. 21) ARE NOT BEING UTILIZED IN AQUILA'S HEADQUARTERS FACILITIES AT 20 WEST 9TH?

A. Yes, I do agree that at the time Mr. Dittmer toured our facility, we had space that was underutilized.

Q. IS HIS DISALLOWANCE OF RELATED COSTS APPROPRIATE?

A. No, it is not. Mr. Dittmer has calculated that 544 of the 847 workstations in the facility are currently being occupied. Therefore, he has recommended that 303/847 or 35% of the related space costs be disallowed to reflect the current vacancy rate. However, Mr. Dittmer is ignoring two important considerations. First, he did not allow any vacancy cushion to accommodate growth or redistribution of employees within the building or redesign of space utilization to improve the work environment or to accommodate the potential relocation of Aquila personnel from other Kansas City area facilities. And second, Aquila had adopted a very aggressive office space-planning program to maximize the use of the building when it was initially occupied.

Q. WHAT ASSUMPTION DID MR. DITTMER MAKE ABOUT VACANT SPACE IN AN OFFICE BUILDING?

A. Mr. Dittmer ignores the need to maintain some level of vacant space to accommodate growth in employment, redesign of usage, or special projects. It wouldn't be appropriate to assume that 100% of the space in any company's office is being occupied 100% of the time. According to an International Facility Management Association ("IFMA") Study, energy utilities average 13% vacancy cushion. This means that the 847 workstations at 100% capacity should first be reduced to 737 workstations for maximum reasonable utilization. Mr. Dittmer's calculation should first be changed to (737-544)/737 or 26% vacancy. The 26% vacancy of workstations is easily absorbed by a more reasonable assumption on space usage per employee. In fact, as the Company completes its restructuring the past density practices are being re-examined since experience has shown that it was not the most productive due to noise levels and privacy issues.

Q. WHAT DO YOU MEAN THAT AQUILA HAD AN AGGRESSIVE OFFICE SPACE-PLANNING PROGRAM?

A. The IFMA study also indicates that the average office area per worker is 284 square feet. Aquila's average in the 20 West 9th facilities is 152 square feet per person or 53.5% of the average. A copy of a typical floor plan is attached as Schedule JRE-1 to show the density of usage. All employees, including the officers, were placed in a cubicle setting.

Q. WHAT DO YOU CONCLUDE FROM THESE STUDIES?

A. If Aquila had followed the industry standard, rather than its aggressive space utilization plan, the entire space designed for potentially 847 cubicles would now be occupied.

Q. HOW DID YOU REACH THAT CONCLUSION?

A. Using the IFMA average, the 544 employee workstations would equate to 835 workstations (544 * 1.535). It doesn't seem appropriate for Aquila to be penalized for being very aggressive in space utilitization especially as the building is being re-utilized to serve the needs of the utility. Just recently, the space on part of the 6th floor was reconfigured to provide employees with more work area and better privacy. Aquila's facility management department has plans to further enhance the work environment for all the employees at the 20 West 9th complex. Also, the office space at Raytown has become too crowded and relocation to the 20 West 9th Complex is being considered to relieve the pressure.

Corporate Cost Allocations

Q. PLEASE EXPLAIN THE ADJUSTMENT TO CORPORATE ALLOCATED COSTS PROPOSED BY STAFF WITNESS CHARLES HYNEMAN AND OPC WITNESS JAMES DITTMER.

A. Both witnesses have subjectively chosen to eliminate a portion of selected corporate department costs on the basis that these selected departments are significantly participating in Aquila's restructuring/divestiture activities and that these activities for these departments are expected to continue into the future.

Q. WHAT IS MEANT BY "AQUILA'S RESTRUCTURING/DIVESTITURE ACTIVITIES?"

A. Aquila initiated a process in mid-2002 to effectively transition the Company back to a seven-state domestic utility. The reasons for that decision are discussed in great detail in Case No. EF-2003-0465, which is pending before this Commission. In order to achieve the transition, Aquila is essentially selling all of its international utility operations and exiting the merchant business.

Q. WHAT IS THE STATUS OF THIS PROCESS?

A. Aquila has been very successful in executing this transition. The New Zealand, Australian, and United Kingdom utility properties have been sold. The sale of the Canadian utility properties is pending and should close later this spring. Aquila will have then effectively sold all of its international utility properties. The merchant business has also been substantially reduced. In December 2001, Aquila had 1,248 employees supporting its merchant business activities. By December 2003, the employment base had been reduced to 71 people and many of the assets had been sold.

Q. DO YOU CONSIDER THE TRANSITION ESSENTIALLY COMPLETE?

A. The asset sales and business restructuring activities have been substantially completed but there is still more work to be done. However, senior management's time has been and continues to be focused on the day-to-day operations of the utility business.

Q. WHEN AQUILA PREPARED THE RATE CASES THAT WERE FILED WITH THE COMMISSION, WHAT GUIDANCE DID YOU GIVE THE REGULATORY TEAM?

A. There were two basic principles that we made a concerted effort to apply to a review of our rate case filing.

First, our utility customers should not bear any of the costs associated with Aquila's exiting or winding down our non-regulated and international businesses. In other words, as stated by Aquila witness Beverlee Agut on page 7 of her direct testimony, our intention and desire was to insulate the customer from these activities and not include these costs in the cost of service in this case.

Second, we should make an initial attempt to adjust any department's cost that would not be reflective of an ongoing seven-state utility operation. (Agut Direct, page 7) It was not expected that this second principle, given the cost allocation process used by Aquila, would result in any significant adjustments but we wanted to at least use our professional judgment in making further adjustments.

Q. WHAT WAS THE RESULT OF THIS REVIEW PROCESS?

A. Aquila witness Agut provides details in her direct testimony, but the end result was that approximately $17.4 million was removed from the allocation pool. (Agut Direct, page 7) In total, six departments were removed from the allocation pool and many miscellaneous adjustments made to other allocated departments.

Q. HOW DID OPC WITNESS MR. DITTMER REACT TO THE COMPANY INITIATED EFFORT?

A. On page 16, lines 14-19 of his Direct Testimony, he stated that "while the Company may be commended for voluntarily removing the cost of certain ESFs deemed to be exclusively or most significantly involved in the divestiture process, I simply do not believe it has captured the time and expense of other senior management that must necessarily be devoting great resources to further divestiture and/or attempting to maintain the solvency of the Company." Mr. Hyneman for the Staff essentially reached the same conclusion. Both witnesses, without any factual basis, arbitrarily disallowed significant costs from several corporate departments.

Q. DO YOU AGREE THAT FURTHER ADJUSTMENTS, AS RECOMMENDED BY WITNESSES DITTMER AND HYNEMAN, ARE NEEDED TO MEET THE

OBJECTIVE OF INSULATING THE CUSTOMERS FROM THE COSTS OF RESTRUCTURING AQUILA?

A. No, I do not.

Q. HOW DID AQUILA ACCOUNT FOR ITS DIVESTITURE/RESTRUCTURING ACTIVITIES?

A. Aquila set up numerous activity codes to capture costs related to its divestiture activities. These activities were either direct charged to the Merchant business or retained at a corporate level and not allocated to any of Aquila's domestic networks divisions. Aquila Witness Agut addresses this process in more detail on page 8 of her direct testimony. For the period ended November 30, 2003, approximately $33 million ($8 million for 2002 and $25 million through November 2003) was spent on divestiture and restructuring activities and retained at the corporate level.

Q. ON PAGE 26 OF THE DIRECT TESTIMONY OF MR. CHARLES HYNEMAN, HE STATED THAT "IF AQUILA WAS SERIOUS ABOUT CAPTURING COSTS RELATED TO ITS RESTRUCTURING OPERATIONS IT SHOULD HAVE SET UP A RESTRUCTURING ACCOUNT TO CAPTURE THESE COSTS... ." DID AQUILA CAPTURE BOTH PAYROLL AND NON-PAYROLL RELATED RESTRUCTURING COSTS IN THE ACTIVITIES YOU MENTIONED ABOVE?

A. Aquila captured all non-payroll related incremental costs in the afore-mentioned restructuring activities. During 2002, most direct payroll related costs were incurred either within the Merchant business or within departments whose allocated costs were eliminated by Aquila before it filed its rate increase application. The charges for departments responsible for day-to-day restructuring/divestiture activities were eliminated in Aquila's application. These departments were as follows:

4032 Strategic Initiatives

4100 Capital Structure and Analysis (previously Corporate Development)

In 2003, payroll for other employees participating in these projects on an incidental basis was not captured in these activities because these were deemed one-time, non-recurring events.

Q. WHY ARE THESE ACTIVITIES SEEN AS NON-RECURRING IN THE FUTURE BY AQUILA?

A. On December 15, 2003, Mr. Richard C. Green, Chairman and Chief Executive Officer, issued a "Shareholder Update" which outlined our focus in the coming months, to "remain on completing pending asset sales; pursuing regulatory approval to pledge Aquila's utility assets as collateral for working capital requirements of our utility operations; and obtaining rate relief to reflect our actual costs of providing safe, reliable service to customers." He also stated our strategy for the coming months as two-fold. "We are restructuring the company by exiting the wholesale energy business and selling foreign and non-core assets, and we are strengthening the ongoing regulated utility business and working to improve processes to service these critical customers better." The final pending asset sales are anticipated to be completed in the 2nd quarter of 2004. Therefore, by the time rates go into effect in this case, almost our entire focus will be on the regulated utility business.

Q. IF THERE IS STILL A FOCUS, ALBEIT A MUCH SMALLER FOCUS, ON THE NON-REGULATED SERVICES BUSINESS, WOULDN'T IT STILL BE APPROPRIATE TO ELIMINATE A PORTION OF THE CORPORATE

COSTS?

A. An elimination of corporate costs pertaining to the non-regulated business occurred during the test year and will continue to occur through Aquila's normal corporate cost allocation methodology. Of the 54 remaining "ESF" departments, 42 continue to be allocated to the non-regulated Merchant/Capacity services business. Contained within the 42 departments allocation to the non-regulated business are all of the departments listed by the Staff and OPC as departments deserving of additional cost eliminations.

Q. **SPECIFICALLY, PLEASE OUTLINE THE DEPARTMENTS WHERE ADJUSTMENTS ARE PROPOSED.**

A. Below is a table containing a listing of departments whereby an additional adjustment for restructuring/divestiture activities is proposed by either the Staff or OPC with a comparison to the adjustment included in Aquila's filing.

		Elimination % Payroll & Non-Payroll		
Dept ID	Description	Hyneman	Dittmer	Aquila
4040	Chairman & Chief Exec Officer	75%	50%	
4030	Chief Operating Officer	50%		100% non-payroll Only
4031	General Counsel	50%	50%	
4035	Chief Financial Officer	75%		100%
4043	Board of Directors Mgmt	50%	50%	
4183	Corporate Financial Reporting	25%	50%	
4194	Tax Income Team	25%		
6131	Global Networks Group Financial Mgmt	25%		
4120	External Communications		50%	
4130	Treasury		50%	
4131	Corp Secretary & Records Mgmt		50%	
4132	Shareholder Relations		50%	

Prior to filing its rate increase applications, Aquila performed a detailed analysis of costs and activities allocated to the regulated utility business and made adjustments to these allocated costs. For example, 100% of all costs in the Chief Financial Officer and 100% of non-payroll costs in the Chief Operating Officer departments were eliminated in Aquila's initial application. The Staff and OPC percentage disallowances are subjective in nature, lacking no hard concrete support.

Q. PLEASE DISCUSS WHY YOU CONSIDER THE STAFF AND OPC DISALLOWANCES SUBJECTIVE IN NATURE.

A. Both witnesses, Messrs. Hyneman and Dittmer provided excerpts from Aquila's Cost Allocation Manual ("CAM") as basis for their subjective disallowance percentages. The CAM is intended to describe the general functions of departments over time and does not necessarily constitute the specific activities performed by each department. Mr. Dittmer regularly and arbitrarily uses 50% as a subjective basis whenever he feels an adjustment is warranted for various issues. For example, in Aquila's Iowa rate case, Mr. Dittmer "proposed to assign 50 percent of the "allocable" portion of certain "high level" Enterprise Support Function ("ESF") departments' test year costs to international properties and to Aquila's significant mergers and acquisition activities – or more recently – sell and liquidate activities." Mr. Dittmer acknowledged that his adjustment was "judgmental" On page 18, lines 11-12 of his direct testimony. Even though Aquila has essentially sold all of its international properties and has sold the majority of its merchant assets, Mr. Dittmer has still applied his arbitrary "50%" disallowance in the Missouri case. I question how an arbitrary recommended 50% disallowance, which Mr. Dittmer deemed reasonable in September 2002 in Iowa can still be considered reasonable in January 2004, when the composition of Aquila's business has changed so dramatically and is now essentially a seven-state domestic utility.

Q. IS THERE ANOTHER REASONABLENESS TEST YOU HAVE APPLIED TO BOTH MR. HYNEMAN'S AND MR. DITTMER'S DISALLOWANCES?

A. Yes. As several of the intervenor witnesses have testified, Aquila's rates should be set on costs required on an on-going basis to operate the business. This same principle has not been used in setting a reasonable level of cost to operate a seven-state domestic utility with significant operations in Missouri.

Q. PLEASE EXPLAIN.

A. Mr. Hyneman has eliminated 75% of the Chairman and CEO's expenses on the faulty premise that the primary focus of this office going forward will be the financial restructuring of Aquila. As explained earlier, the vast majority of the asset sales and business restructuring activities have been completed. In addition, Aquila has already eliminated the department that is managing this divestiture process, the "Strategic Initiatives" Department and several supporting functions. Also, Aquila did not ever allocate any of the specific incremental costs associated with the divestiture activities. The Chairman and CEO Department consists of four individuals: Mr. Richard Green, Chairman and CEO; Ms. Nancy Manion, Senior Executive Administrative Assistant; Ms. Lynn Wilson, Issues Strategist; and Ms. Lisa Heuser, Issues Coordinator. Mr. Hyneman is essentially stating that a Missouri gas utility with $65 million in revenue would have a total payroll for a four-person staff of less than $14,000 per year. Obviously, that is unreasonable and reflects the arbitrary nature of his adjustment.

Q. HOW DID MR. DITTMER TREAT THE CHAIRMAN AND CEO DEPARTMENT?

A. Mr. Dittmer has concluded that the Chairman and CEO's Department should only require $16,841 in payroll to support the four-person department. Again this is a very unreasonable position.

Q. ARE THERE OTHER EXAMPLES THAT FURTHER DEMONSTRATE THE UNREASONABLENESS OF THESE ADJUSTMENTS?

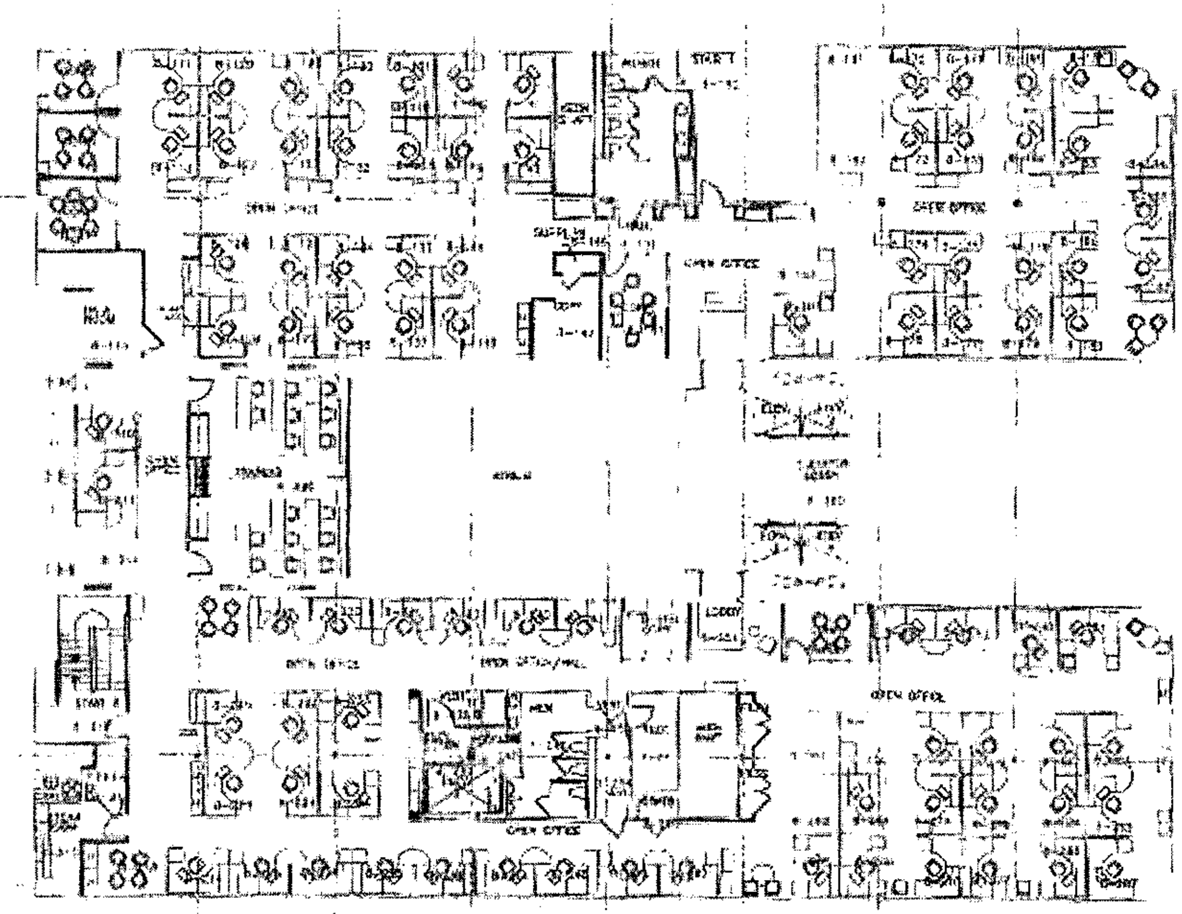
A. Yes. Virtually every adjustment recommended by Mr. Dittmer is totally unreasonable. Mr. Dittmer is recommending that for the Missouri gas operations only $4,734 in payroll expense be recovered in rates for Shareholder Relations; $1,285 for the Corporate Secretary and Records Management activities; $8,499 for the Finance Department activities; $3,502 for the General Counsel; and $8,092 in Corporate Financial Reporting. Mr. Hyneman's recommendation suffers from the same simple unreasonableness test. For the Missouri gas operations, he has recommended about $12,000 for Chief Operating Officer payroll, $15,000 for Corporate Financial Reporting, $13,000 for the Networks income tax team, and $6,000 for the Chief Financial Officer.

Q. WHAT IS YOUR CONCLUSION ABOUT THE ARBITRARY CORPORATE ALLOCATION ADJUSTMENTS BEING PROPOSED?

A. There is no basis for these arbitrary adjustments. The vast majority of the international and merchant assets have been sold and the merchant business has been reduced to a minimum. The costs for the team of people continuing to work on the final transitions have already been removed from the original rate case. Since the new rates from this case will not go into effect until June 2004, it is unreasonable to make these significant adjustments when the allocated costs are reasonable and needed to maintain operations of a seven-state domestic utility.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes it does.



(A) EIGHTH FLOOR PLAN