

Exhibit No.:

Issues: Gas Costs

Witness: John C. Browning

Sponsoring Party: Aquila Networks-MPS

Case No.: ER-2004-0034 &

Before the Public Service Commission
of the State of Missouri

Surrebuttal Testimony

of

John C. Browning

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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
SURREBUTTAL TESTIMONY OF JOHN C. BROWNING
ON BEHALF OF AQUILA, INC.**

D/B/A AQUILA NETWORKS-MPS
CASE NOS. ER-2004-0034

1 Q. Please state your name and business address.

2 A. My name is John C. Browning. My business address is 10750 East 350
3 Highway, Kansas City, Missouri 64138.

4 Q. Are you the same John C. Browning who previously filed direct and rebuttal
5 testimony in this case before the Missouri Public Service Commission
6 (“Commission”)?

7 A. Yes.

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

9 A. The purpose of my surrebuttal testimony is to address the rebuttal testimony
10 of Missouri Public Service Commission Staff (“Staff”) witness Graham
11 Vesely.

12 Q. Please summarize your issues with respect to Mr. Vesely’s testimony.

13 A. I will address the following issues:

- 14 • The use of test year and updated gas costs versus the method utilized in
15 my direct testimony
- 16 • Cost of gas in current rates
- 17 • Coal prices

18 **Test Year and Updated Gas Costs**

19 Q. Explain your understanding of the use of test years.

1 A. Test years are the time interval used to capture the many costs that must be
2 considered, along with other factors, in the calculation of revenue
3 requirements for a company to achieve an appropriate rate of return on equity.
4 By selecting a period of sufficient length, such as 12 months, most normal and
5 seasonal costs for things like payroll, travel expenses, operations and
6 maintenance, etc. will be captured in a way that levelizes ordinary
7 fluctuations. I agree that this is a useful and fair way of capturing most
8 expenses.

9 Q. Why are updates used along with test years?

10 A. Costs do vary from year to year and the changes in certain costs can be large
11 enough to significantly impact the rate calculation. In an effort to fairly set
12 rates with known and measurable costs, updates are allowed using out-of-test-
13 year information for those costs. In this case, the update period includes
14 January 1, 2003 through September 30, 2003 information.

15 Q. Why did you not use gas costs from 2002, the test year, in your testimony?

16 A. In my direct and rebuttal testimony, I have exhaustively and conclusively
17 demonstrated that 2002 is an unrepresentative or “defective” year for use in
18 setting rates if the goal is to be fair to both the customer and the shareholder. I
19 have also explained that the volatility of gas prices has made the use of the
20 traditional test year method, as recommended by Mr. Vesely, unsuitable for
21 fairly setting rates.

22 Q. Doesn't the update for gas cost correct the problems with the test year?

1 A. No. Mr. Vesely insists on including the “defective” costs from 2002 in a 21-
2 month average. By doing this, he dilutes the true impact of today’s gas prices
3 on Aquila rather than updating them. If Mr. Vesely really wanted to update
4 prices, he could use the known and measurable 12-month strip of settled
5 NYMEX prices for the period ending September 30, 2003. This price is
6 \$5.238/mcf.

7 Q. Why doesn’t Mr. Vesely use this 12 month updated strip?

8 A. In his rebuttal testimony, M. Vesely expresses concern that because of the
9 volatility in gas prices, a 21-month average is better than a more narrow 12-
10 month average. In fact, by including 2002 in the average calculation, he is
11 including more of the recent volatility than if he used the 12 month updated
12 strip. With the exception of March 2003, the price trend appears to be
13 flattening through 2003 and into 2004. The average price for all of 2003 was
14 \$5.388/mcf.

15 Q. What else concerned Mr. Vesely about the 12-month updated strip?

16 A. Mr. Vesely is also concerned about setting a gas cost that is too high should
17 gas prices decline. At his recommended cost of \$4/mcf, he certainly doesn’t
18 have much to worry about. As discussed in my rebuttal testimony, the real
19 industry concern is increasing prices given the decline in productive output of
20 existing fields, no new sources on the near-term horizon, and demand that
21 struggles to stay within supply capability. The gas price issue is a classic
22 economics study of supply versus demand and does not require an
23 “extraordinary knowledge of the future” as Mr. Vesely suggests in his rebuttal

1 testimony. Mr. Vesely's concern over falling prices sets him apart from
2 anyone else knowledgeable in the gas industry.

3 Q. Mr. Vesely has described the fact that the \$5.14/mcf recommended in your
4 direct testimony matches very closely with today's prices as "coincidental".
5 How do you respond?

6 A. "Coincidental" might be a fair description of the fact that the current EIA
7 forecast of \$5.14/mcf for 2004 exactly matches my original recommendation.
8 On the other hand, if the industry experts and Aquila carefully and objectively
9 analyze all factors affecting gas prices to arrive at an expected future price, it
10 is hardly coincidental that actual prices compare favorably to the consensus of
11 these analyses.

12 **Cost of Gas In Current Rates**

13 Q. On page 5 of his rebuttal testimony, Mr. Vesely refers to your direct
14 testimony, concerning the methods used by witnesses in Case No. ER-2001-
15 672, and makes the point that this case was settled and no one knows what is
16 actually in rates for gas cost. Please comment on his testimony.

17 A. It is true that a stipulated settlement was reached in Case No. ER-2001-672.
18 Gas cost was not one of the issues specifically discussed in arriving at the
19 settlement. The last known gas cost is \$2.46/mcf from Case No. ER-97-394.
20 We do know that Staff work papers and testimony from Case No. ER-2001-
21 672 indicates an assumed cost of about \$3/mcf. Since March 21, 2002, the
22 effective date of Case No. ER-2001-672, gas prices have consistently
23 increased to well over \$5/mcf. Consequently, Aquila's shareholders have

1 shielded the ratepayers from \$10 to \$20 million per year in higher gas costs. It
2 is past time to be fair to the shareholders.

3 **Coal Prices**

4 Q. On page 13 of Mr. Vesely's rebuttal testimony, he indicates that the Staff has
5 used coal prices for Sibley, Lake Road, and Iatan that were in effect as of
6 September 30, 2003 rather than using the new contractual prices that will be in
7 effect on January 1, 2004. Please comment.

8 A. A new agreement for high Btu blending coal at Sibley and Lake Road was
9 signed on September 10, 2003. At the time of my testimony, we were test-
10 burning high Btu blend coals as part of the selection process. In my
11 testimony, I requested that the coal costs be updated once a contract was
12 signed. With this contract, our cost from this supplier is known and
13 measurable. We will be purchasing coal under this contract as rates in this
14 case become effective. I know that this type of update has been allowed in
15 past cases, so I do not understand why Mr. Vesely has taken this position. I
16 continue to request that updated coal prices be included in rates.

17 Q. Does this conclude your surrebuttal testimony?

18 A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Aquila, Inc. d/b/a Aquila
Networks-MPS ~~_____~~,
for authority to file tariffs increasing electric
rates for the service provided to customers in
the Aquila Networks-MPS ~~_____~~
~~_____~~ area)
)
)
)
)
)

Case No. ER-2004-0034

County of Jackson)
)
State of Missouri)

ss

AFFIDAVIT OF JOHN C. BROWNING

John C. Browning, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Surrebuttal Testimony of John C. Browning;" that said testimony was prepared by him and 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.

John C. Browning
John C. Browning

Subscribed and sworn to before me this 13th day of February, 2004.

Terry D. Lutes
Notary Public
Terry D. Lutes

My Commission expires:

8-20-2004

