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Witness: Phillip K. Williams, CPA CIA
Sponsoring Party: MoPSC Staff
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MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

PHILLIP K. WILLIAMS

FILED

MAY 2 2007

**Missouri Public
Service Commission**

**AQUILA, INC.
d/b/a AQUILA NETWORKS – MPS ELECTRIC
and AQUILA NETWORKS-L&P—ELECTRIC**

CASE NO. ER-2007-0004

*Jefferson City, Missouri
February 2007*

Staff Exhibit No. 236
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ACCOUNTING AUTHORITY ORDERS 2

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1 A. Accounting Authority Orders (AAOs) are Commission authorizations for a
2 utility to defer approved costs on the utility's books for potential recovery in a future rate
3 case.

4 Q. What AAOs are involved in this case?

5 A. There are three AAOs in this case. The first two AAOs were granted to
6 authorize the company to defer depreciation expenses, property taxes and carrying costs
7 associated with the Capacity Life Extension (Sibley Rebuild Project) and Western Coal
8 Conversion projects at its Sibley generating station. The approvals to defer and recover those
9 costs were made pursuant to the Commission's AAOs in Case Nos. EO-90-114 and
10 EO-91-358, and the Commission subsequently allowed recovery of these deferred costs to
11 begin in Case Nos. ER-90-101 and ER-93-37. The Commission also granted Aquila authority
12 to defer and amortize costs incurred due to an ice storm in its Missouri Public Service (MPS)
13 service area in January 2002. The Commission granted that authority in Case
14 No. EU-2002-1053. It is my understanding that the AAO associated with the ice storm is no
15 longer an issue between Aquila and Staff.

16 Q. What is the current issue concerning the AAOs?

17 A. The current issue in this case is whether the unamortized balance of the AAOs
18 associated with the Sibley Rebuild Program and the Western Coal Conversion Program
19 should be included in rate base.

20 Q. Is there any issue concerning the expense amortization of the AAOs?

21 A. No.

22 Q. Who has raised the AAO issue in this case regarding the unamortized balance
23 of the AAOs for the Sibley Rebuild Program and the Western Coal Conversion?

1 A. The Office of the Public Counsel (Public Counsel) witness Robertson states at
2 page 3, line 11, of his direct testimony that it opposes "allowing the Company to earn a return
3 on the remaining unamortized AAO deferral cost balances via their inclusion in rate base."

4 Q. Does the Staff agree with Public Counsel's position concerning the rate base
5 treatment for the unamortized balance of the Sibley AAOs?

6 A. No. Staff believes that the unamortized deferred balances of the AAOs for the
7 Sibley Rebuild Program and the Western Coal Conversion Program authorized in Case
8 Nos. ER-90-101 and ER-93-37 should be included as an addition in the determination of rate
9 base. Staff has consistently applied this methodology for each Aquila, Inc. rate case and the
10 rate cases of its predecessor company since Case No. ER-90-101. The Sibley Rebuild
11 Program AAO and the Sibley Western Coal Conversion AAO were ordered by the
12 Commission to be amortized over a 20-year period consistent with the life extension of the
13 generating units. The 20-year amortization period was developed based on the expected
14 remaining life of the Sibley plant at the time of the life extension program. The capital
15 expenditures and the related AAO authorized by the Commission for the life extension of
16 Sibley can be thought of in the same way as any other capital expenditure in that they are
17 given rate base treatment (return on the investment) as well as a recovery of the related costs
18 through depreciation/amortization expense recovery. The Commission allowed the Company
19 to include the unamortized balances in rate base in the Commission's Report and Order in
20 Case No. ER-90-101. The Report and Order in Case No. ER-90-101 provided:

21 The Commission determines that these costs should be amortized over
22 20-years which is the approximate extended life of the plant. The
23 Commission finds that this approach matches the payments of the costs
24 by the ratepayer for the rebuilding with their enjoyment of its benefits.
25 The Commission further determines that the unamortized costs should

1 be reflected in rate base. This is the usual practice when capital costs
2 are amortized.

3 Q. What is Staff's understanding of why Public Counsel believes that the
4 unamortized balances associated with the AAOs should not be allowed in rate base?

5 A. Mr. Robertson states "The Public Counsel's position on this issue is based on
6 our belief that MPS is being given what essentially amounts to a guaranteed 'return of' the
7 deferrals associated with the SCLE/WC projects and ice storm; therefore it should not be also
8 provided with a 'return on' those same amounts." (Robertson Direct, p. 7, line 8).

9 Q. Why does Staff disagree with Public Counsel's rationale?

10 A. The Commission already made a ratemaking decision on this issue. To now
11 accept the Public Counsel's arguments would negate the Commission's orders from Case
12 Nos. ER-90-101 and ER-93-37. The AAOs granted in those cases were the result of life
13 extension projects and, as such, should be treated in the same way as normal capital
14 expenditures (which are classified as plant in service and not as routine maintenance costs).
15 Companies are routinely allowed to earn a return on amounts that are capitalized. These
16 amounts were included in the AAOs to provide the Company an opportunity to recover the
17 depreciation, property taxes and carrying costs associated with the rebuilds that occurred
18 between the completion of the projects and the Company's next rate case. Absent AAO
19 treatment, these amounts would have been lost as a result of booking these costs directly to
20 expense following completion of the projects.

21 Q. Would you define what you mean by "return of" and "return on" on
22 investment?

23 A. "Return of" investment provides the Company the opportunity to recover its
24 investment through depreciation/amortization expense. "Return on" investment occurs when

1 an asset is placed in service, and subsequently receives rate base treatment in a rate case.
2 Through this approach, shareholders are given an opportunity to earn a return on their
3 investment.

4 Q. Is this deferred cost treatment, under an AAO, and resulting rate base treatment
5 limited to major construction additions?

6 A. Yes. With the exception of major capital additions, Aquila, as well as other
7 electric utilities, are expected to follow the Federal Energy Regulatory Commission (FERC)
8 accounting procedures which require a discontinuation of construction accounting
9 (capitalizing property taxes and carrying costs) when the construction project has been
10 completed.

11 Because of the significant cost of major construction projects, like the Sibley Rebuild
12 and Western Coal Conversion, the resulting expensing of depreciation, property taxes and
13 carrying cost (interest expense), related to these projects, have a significant impact on the
14 Company's earnings until these additional expenses can be reflected in the next rate case.
15 Without AAO treatment, the additional expenses, which occur prior to the effective date of
16 rates in the Company's next rate case, which could potentially result in a reduction in
17 earnings, if other costs components are not declining.

18 Q. Please summarize the Staff's position on this issue.

19 A. The Sibley Rebuild Program and the Sibley Western Coal Conversion Project
20 were extraordinary construction projects undertaken by the Company to provide a
21 continuation of adequate service. These projects represent major capital additions to plant in
22 service as opposed to extraordinary maintenance expenditures resulting from an extraordinary
23 occurrence like an ice storm. The deferred costs included in the AAO authorized by the

1 Commission for the life extension of Sibley should be treated the same way as the other
2 capital costs for these projects and afforded rate base treatment. Allowing a continuation of
3 construction accounting under an AAO, for major capital projects, and including the AAO
4 costs in rate base provides an incentive for the utility to commit significant capital investment
5 on a timely basis.

6 Q. Does this conclude your rebuttal testimony?

7 A. Yes, it does.