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Witness: *Graham A. Vesely*
Sponsoring Party: *MoPSC Staff*
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Case Nos.: *ER-2004-0034 and*
HR-2004-0024
(Consolidated)
Date Testimony Prepared: *January 26, 2004*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

FILED⁴

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Missouri Public
Service Commission

REBUTTAL TESTIMONY

OF

GRAHAM A. VESELY

**AQUILA, INC. d/b/a AQUILA NETWORKS-MPS (Electric)
and AQUILA NETWORKS-L&P (Electric And Steam)**

**CASE NOS. ER-2004-0034 and HR-2004-0024
(Consolidated)**

Jefferson City, Missouri
January 2004

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****Denotes Highly Confidential Information****

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Case No(s) ER-2004-0034
Date 2/23/04 Rptr 4F

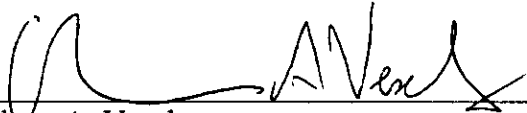
BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Aquila, Inc. d/b/a Aquila Networks)
L&P and Aquila Networks MPS to implement a) Case No. ER-2004-0034
general rate increase in electricity.)
)
)
In the matter of Aquila, Inc. d/b/a Aquila Networks)
L&P to implement a general rate increase in Steam) Case No. HR-2004-0024
Rates.)
)

AFFIDAVIT OF GRAHAM A. VESELY

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Graham A. Vesely, of lawful age, on his oath states: that he has participated in the preparation of the following rebuttal testimony in question and answer form, consisting of 13 pages to be presented in the above case; that the answers in the following rebuttal testimony were given by him; that he has knowledge of the matters set forth in such answers; and that such matters are true and correct to the best of his knowledge and belief.



Graham A. Vesely

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





TONI M. CHARLTON
NOTARY PUBLIC STATE OF MISSOURI
COUNTY OF COLE
My Commission Expires December 28, 2004

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GRAHAM A. VESELY

AQUILA, INC. d/b/a AQUILA NETWORKS-MPS (Electric)

AND AQUILA NETWORKS-L&P (Electric and Steam)

CASE NOS. ER-2004-0034 AND ER-2004-0024

(Consolidated)

Q. Please state your name and business address.

A. Graham A. Vesely, Noland Plaza Office Building, 3675 Noland Road, Suite 110, Independence, MO 64055.

Q. Are you the same Graham A. Vesely who has previously filed direct testimony in this case?

A. Yes, I am. On December 9, 2003 I filed direct testimony on the area of fuel prices.

Q. What is the purpose of your rebuttal testimony?

A. The purpose of my rebuttal testimony is to respond to the direct testimony of Aquila (Aquila or Company) witness John C. Browning related to fuel prices. Further, I will describe how the Staff's disagreement with using forecasted natural gas prices also applies to the approach taken by Office of Public Counsel witness James A. Busch, and Sedalia Industrial Energy Users Association witness Robert R. Stevens.

A. Please summarize the Staff's position regarding Mr. Browning's direct testimony.

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1 Q. The Staff believes that both the method Mr. Browning used to select the
2 price of natural gas recommended in Aquila's cases, and the result he arrived at are
3 incorrect for the following reasons:

- 4 • Rather than using only known and measurable prices,
5 Mr. Browning's estimating method also uses forecasted prices.
- 6 • His estimate includes three months of data beyond the
7 September 30, 2003 update period.
- 8 • By using exclusively 2003 natural gas prices, whether actual or
9 forecasted, Mr. Browning's recommended natural gas price does
10 not adequately take the high variability of prices into account.

11 The Staff recommends that the natural gas price should be determined using the average
12 known and measurable, historical prices Aquila paid throughout the 2002 test year and
13 the update period ended September 30, 2003. Additionally, the Staff recommends that
14 the Commission deny the Company's request to use coal prices updated beyond
15 September 30, 2003.

16 Q. In your direct testimony you discuss the possibility of establishing a
17 mechanism for including in this case a base and ceiling level of fuel and purchased power
18 costs, subject to a true-up and refund of any over-collection. Is Staff still considering this
19 possibility?

20 A. Yes. Other parties in this case also have identified in direct testimony the
21 possibility of using a fuel mechanism to address the natural gas and purchased power
22 volatility being experienced by the utility industry in general and, more specifically, by
23 Aquila. During the week of January 12, 2003 at the prehearing conference, the majority

1 of the parties to this case met to discuss this topic and made progress towards agreeing on
2 a recommendation. However, without Commission approval of any eventual
3 recommendation, it is necessary in this rebuttal filing for the Staff to maintain its position
4 on the price of natural gas in the absence of the special mechanism mentioned above.

5 **Natural Gas Prices for Generation**

6 Forecasted data/Not known and measurable

7 Q. Please explain why Mr. Browning's use of forecasted and out-of-period
8 data in his recommended natural gas price is not consistent with the Commission's
9 ratemaking methods.

10 A. As Mr. Browning explains on page 12, lines 4 through 11, of his direct
11 testimony, he recommends using in this rate case his estimate for 2003, which he
12 obtained by averaging together the January and February 2003 actual market prices
13 (NYMEX) and the forecast for the remainder of 2003 provided by six natural gas
14 industry analysts. These analyst forecasts were published in the February-March 2003
15 period. NYMEX is the New York Mercantile Exchange.

16 Q. Did Mr. Browning update his original natural gas price recommendation
17 to known and measurable changes through September 30, 2003 as ordered by the
18 Commission?

19 A. No. Though known and measurable, historical natural gas price data for
20 the months of March through September 2003 were available after it filed its original
21 case, Aquila's position continued to be based on the forecasted values used in its
22 originally filed case. In hindsight, Mr. Browning's estimate for 2003 average natural gas

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1 prices turned out to be close to actual experience. However, the Staff believes this result
2 to be coincidental and unsuitable for setting rates.

3 Q. What are some problems with using forecasted data for ratemaking
4 purposes?

5 A. The Commission traditionally uses known and measurable, historical
6 information for setting rates. No one knows what natural gas prices will be in any future
7 period, including industry analysts. Forecasts typically attempt to project current trends
8 to future periods. In ratemaking, recognition of a cost trend, for example, affects the
9 decision of whether the most recent end of period cost likely best reflects the cost of that
10 item on a going-forward basis. However, no attempt would be properly made to build
11 into the case the result of assuming continuation of the trend beyond the update period of
12 the case.

13 According to Mr. Browning, industry analysts look at many factors that affect the
14 price of natural gas. The task of trying to discern trends in the numerous factors, and the
15 uncertainty of whether each trend is likely to continue or change, points to a subjective
16 element in producing forecasts, and probably explains the "fairly wide" range of analyst
17 forecasts provided in Mr. Browning's testimony (\$4.50 to \$6.50). This leaves ample room
18 to argue the merits of the results. Further, industry analysts update and revise their
19 forecasts with the passage of time, and every type of forecast can turn out to be very
20 different than actual experience. The Staff recommends that the Commission continue to
21 rely on known and measurable, historical data without reference to industry analyst
22 forecasts.

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1 Q. On page 7 of his direct testimony, Mr. Browning states that none of the
2 witnesses that filed in Aquila's last electric case, Case No. ER-2001-672, accurately
3 predicted the price of natural gas. Please comment on this statement.

4 A. Since a settlement of Case No. ER-2001-672 was agreed to by the parties,
5 and the settlement reflected a compromise with respect to the filed position of the parties,
6 it is not possible to speak in terms of a natural gas price that was reflected in the rates that
7 came out of that case.

8 Q. Did the Commission approve the settlement in the last Aquila rate case?

9 A. Yes. The Commission issued an Order approving the terms of the
10 Unanimous Stipulation and Agreement (Stipulation) on February 21, 2002 with rates
11 effective on March 21, 2002. The Commission authorized the Company to reduce rates
12 by \$4.25 million.

13 Q. Does Aquila know what natural gas prices were used in the Company's
14 last case?

15 A. No. Since the case was a stipulation, no one is in position to know how
16 any one party valued the differences and issues in the case. While each party may file a
17 particular position supporting various elements of the revenue requirement determination,
18 it is impossible to assign a dollar value to issues within a case that is settled through
19 negotiations among the parties.

20 Under terms of the Stipulation, the parties to the case including the Company,
21 agreed to the following language under Section 18. Reservations:

22 A. The terms of this Stipulation and Agreement have resulted
23 from extensive negotiations among the Parties and are
24 interdependent. By entering into this Stipulation and Agreement,
25 none of the Parties shall be deemed to have approved or

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1 acquiesced in any ratemaking or procedural principle, or any
2 method of cost determination or cost allocation, and none of the
3 Parties shall be prejudiced or bound in any manner by the terms of
4 this Stipulation and Agreement in this or any other proceeding,
5 except as expressly specified herein. Unless the Commission
6 approves this Stipulation and Agreement in its entirety, without
7 condition or modification, this Stipulation and Agreement shall be
8 null and void, and none of the Parties shall be bound by any of the
9 terms hereof.

10 B. The Parties agree that this Stipulation and Agreement and any
11 and all discussion related hereto shall be privileged and shall not
12 be subject to discovery, admissible in evidence, or in any way
13 used, described or discussed in any proceeding, except as expressly
14 specified herein.
15 [source: Stipulation and Agreement in Case No. ER-2001-672,
16 page 8]

17 Q. For the sake of comparison, what were the filed positions of the Staff and
18 Aquila with respect to the price of natural gas for generation, and what actual prices
19 occurred in the market after the case?

20 A. Even though it is impossible to specifically identify and quantify the
21 parties' final positions in that case, as addressed above in the Stipulation, the Staff can
22 address the issue of comparison of natural gas prices strictly from what was filed in the
23 direct testimony of the parties in question.

24 The Staff filed an average value of \$ 3.13, and Aquila witness Stephen L. Ferry
25 filed an average value of \$ 7.32 in Case No. ER-2001-672. In the twelve months after
26 rates went into effect in March of 2002, the average NYMEX price turned out to be
27 \$ 3.73 per MMBtu or MCF. Admittedly, the price began rising quickly at the end of
28 2002. But considering that rates went into effect March 21, 2002, the actual price paid by
29 Aquila for much of 2002 turned out to be reasonably similar to the Staff's estimate of
30 what price should be included in Aquila's last case. The table below shows actual
31 monthly prices in \$/MCF terms paid by Aquila at the indicated generation sites. The

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1 Data are from Company invoices and reflect differing variable transportation costs to
2 each plant.

	Greenwood	Aries
3		
4	March 2002	** ___ **
5	April	** ___ **
6	May	** ___ **
7	June	** ___ **
8	July	** ___ **
9	August	** ___ **
10	September	** ___ **
11	October	** ___ **
12	November	** ___ **
13	December	** ___ **
14	January 2003	** ___ **
15	February	** ___ **

16 Q. Did the Company plan on using the NYMEX forecast price in Case No.
17 ER-2001-672?

18 A. No. Though it used such prices in its direct filing, Aquila planned on
19 updating each month's natural gas prices with actual prices as each month became
20 known. In Case No. ER-2001-672, shortly after the Company filed its rate case
21 (June 8, 2001), natural gas prices began to fall. As the case progressed much of the
22 Company's revenue requirement disappeared because of falling natural gas prices.

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1 Q. Did anyone forecasting the price of natural gas in the last case, predict
2 with certainty what the prices would be?

3 A. No. As can be seen from review of Mr. Browning's schedules attached to
4 his direct testimony and based on a review of the actual natural gas prices experienced by
5 Aquila from the end of the last case, no party, including Aquila itself, was able to predict
6 exactly what natural gas prices would do.

7 Out-of-period data

8 Q. Please discuss the fact that Aquila's recommended use of 2003 natural gas
9 prices contains out-of-period data.

10 A. The Commission ordered all parties filing testimony in this proceeding to
11 base their cases on a calendar year 2002 test year with adjustments for known and
12 measurable changes through September 30, 2003. Aquila's reliance on 2003 full-year
13 forecasted data includes three months beyond the end of the update period, namely
14 October, November, and December 2003.

15 Q. Having set a 2002 test year for this rate case, why has the Commission
16 ordered parties to the proceeding to update their analysis through September 30, 2003?

17 A. Within the time limits available for issuing a final order in the case, having
18 the parties update their analysis to include events through September 30, 2003 provides
19 additional perspective from which to decide the need for adjustments to the test year.
20 This is intended to produce better results at the end of the ratemaking process by using as
21 current information as possible.

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1 Q. Since the Commission ordered parties filing testimony to update their
2 cases through September 30, 2003, would it not be even better to update natural gas
3 prices through the end of 2003?

4 A. No. The Staff's entire case is based on an update of the 2002 test year for
5 material known and measurable changes through September 30, 2003. An attempt to
6 arbitrarily take natural gas prices beyond that date while leaving the other elements of the
7 case at September 30, 2003 is known as an isolated out-period adjustment, and should be
8 rejected.

9 Q. Please give an example of the Commission previously expressing itself on
10 this subject.

11 A. As long ago as in Case No. ER-83-49, a rate case involving Kansas City
12 Power & Light Company, the Commission stated:

13 The Commission has no desire to entertain isolated adjustments,
14 but seeks a "package" of adjustments designed to maintain the
15 proper revenue-expense-rate base match at a proper point in time.
16 Evidence of "picking and choosing" by a party with the intent of
17 simply raising or lowering revenue requirement will not be
18 condoned.

19 [Commission Report and Order, Case No. ER-83-49, page 8]

20 Variability of natural gas prices

21 Q. Please explain why it is the Staff's position that natural gas prices have
22 been, and continue to be highly variable?

23 A. The experience in this case provides a good illustration of such variability.
24 The average actual (settlement) price for natural gas on the NYMEX during the nine
25 months of the update period increased by 75% over the average test year NYMEX price
26 (\$ 5.65 vs. \$ 3.22). Short-term spikes brought the price even higher.

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1 Q. What difficulties does this create for those parties having a stake in the
2 ratemaking process?

3 A. With proven price variability being so great since the beginning of the test
4 year, it is not hard to see why there is concern on all sides when it comes to the question
5 of what price to use for setting rates in this case. The Staff recognizes that the Company
6 has a legitimate claim to protect its earnings. The Staff is equally concerned with the risk
7 of using a price in rates that ends up charging customers significantly more than what
8 Aquila's actual costs end up being. Actual experience after rates are set is understood to
9 vary to some extent for many items from what was designed by the ratemaking process.
10 But the risk of experience being materially different than what was foreseen, to the
11 detriment of either the Company or the customers, is higher when there is greater risk of
12 a rapid and material change in cost of an item after rates are set. Natural gas prices, given
13 their proven volatility, are likely to represent the greatest risk of actual experience turning
14 out materially different than what the ratemaking process envisioned.

15 Q. How does the Staff's selection of its natural gas price attempt to balance
16 the risk of highly variable natural gas prices equally between the Company and its
17 customers?

18 A. As described in my direct testimony, the Staff recommends using a natural
19 gas price that reflects the actual weighted average cost to the Company at each of its
20 generating plants over the period of the test year and update period. The main obvious
21 difference with Aquila's proposed method is that the Staff sees prices as being too
22 uncertain to be able to tell which monthly prices, if any, best represent the going-forward
23 at September 30, 2003. Therefore, all prices have been given equal representation, and

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1 weighted with respect to the gas quantities purchased at each price. The Staff's attempt
2 was to reflect the reality of both the lower prices seen during the test year, as well as the
3 higher prices in the update period. The Company chose to give more weight to the prices
4 experienced during the update period.

5 Q. The Staff's pricing method uses an average over a 21-month period, but
6 why was it not willing to use, for example, a 12-month average instead?

7 A. When the price of natural gas is so volatile, choosing a smaller window of
8 time over which to determine the average price will make a bigger difference in the
9 results, depending on which period is chosen. For example, the average NYMEX price
10 for the 2002 test year and the 12-month period ending September 30, 2003 were \$ 3.22
11 and \$5.24, respectively. If an even shorter period is selected, the outcome can vary even
12 more.

13 Q. So during a period of highly variable prices, selecting a wider window of
14 time (during that period of high volatility) over which to average the price of natural gas
15 better serves the objective of being neutral in terms of future expectations?

16 A. Yes. This is why the Staff recommends averaging natural gas prices over
17 the entire 21-month period spanning the test year and the update period. To make the
18 judgment Aquila has made, that the price of natural gas during the twelve months of 2003
19 better represents the price at September 30, 2003 on a going-forward basis, suggests
20 either extraordinary knowledge of the future, or simply a preference for the safer position
21 of recommending the higher prices of the update period. A position based on an opposite
22 preference (i.e., for the lowest prices experienced) might dictate the selection, for
23 example, of only the test year prices, to the exclusion of the higher update period prices.

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1 Q. But aren't the update period data better indicators of the natural gas price
2 on a going-forward basis, since they are more recent?

3 A. No. If the Commission finds the overall data persuasive that natural gas
4 prices have been highly volatile since the beginning of the test year, then it should agree
5 with the Staff's recommendation that all prices throughout the 21-month period should be
6 given equal weight in the absence of some pricing mechanism that includes a true-up and
7 refund provision. Reliance on most recent price alone is appropriate for costs that, unlike
8 natural gas, have shown stability.

9 Q. What portion of Office of the Public Counsel witness James A. Busch's
10 direct testimony do you wish to rebut?

11 A. Mr. Busch arrived at his recommended natural gas price by averaging
12 historical prices for the three years 2001-2003 together with the futures market forecast
13 for 2004. Without repeating reasons discussed above, the Staff recommends against
14 using a forecasted 2004 natural gas price in setting rates. Consistent with this, the
15 revenues, expenses, rate base, and capital structure used in the Staff's filing are data that
16 were known and measurable at September 30, 2003. The data were annualized and an
17 attempt was made at normalization in order to reflect the going-forward value.

18 Q. What portion of Sedalia Industrial Energy Users Association witness
19 Robert R. Stevens' direct testimony do you wish to rebut?

20 A. Mr. Stevens arrived at his recommended natural gas price by averaging the
21 futures market forecasts for the period 2004-2006. This method is also inconsistent with
22 the way rates have been set by this Commission. The Staff agrees with Mr. Stevens that
23 Aquila's recommendation gives too much weight to gas prices during "abnormally high

1 levels". However, we recommend normalizing the natural gas price built into rates by
2 analyzing prices over the historical period I have described.

3 **Coal Prices**

4 Out-of-period data

5 Q. Has Mr. Browning proposed using coal prices that went into effect after he
6 September 30, 2003 update period?

7 A. Yes. Beginning on page 13 of his testimony, he describes coal price
8 changes scheduled for 2004 at the Sibley, Lake Road, and Iatan plants. The Staff has
9 only included in its case the contractual price of all coal and freight at
10 September 30, 2003. As mentioned by Staff witness David W. Elliott in his rebuttal
11 testimony, I have, however, revised the Staff's price of coal used at the
12 Jeffrey Energy Center to reflect an October 1, 2003 increase as occurring, in substance,
13 within the update period.

14 Q. Does this conclude your rebuttal testimony?

15 A. Yes, it does.