Exhibit No.:
Issues: Capacity/Turbines
Witness: H. Davis Rooney
Sponsoring Party: Aquila Networks-MPS & L&P
Case No.: ER-2007-0004

Before the Public Service Commission
of the State of Missouri

Rebuttal Testimony

of

H. Davis Rooney

<u>Denotes Highly Confidential Information**</u>**

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ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
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**BEFORE THE PUBLIC SERVICE COMMISSION
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REBUTTAL TESTIMONY OF H. DAVIS ROONEY
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D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NO. ER-2007-0004**

Q. Please state your name and business address.

A. My name is Davis Rooney. My business address is 10750 E. 350 Highway, Kansas City, MO 64138.

Q. Are you the same Davis Rooney who previously filed direct testimony in this case?

A. Yes.

Q. How is your rebuttal testimony organized?

A. My rebuttal testimony is organized as follows:

I. Fuel and Purchased Power
II. C. W. Mining Coal Contract
III. Phantom Turbines
IV. Hedging

EXECUTIVE SUMMARY

Q. Please provide a brief summary of your testimony.

A. In **Section I**, I provide rebuttal testimony regarding fuel and purchased power prices and discuss Aquila's updated resources.

In **Section II**, I address why it is inappropriate to include in this rate case estimates for the C. W. Mining coal contract, which was terminated in early 2005.

In **Section III**, I address why it is inappropriate to include non-existent generation units (phantom turbines) in this rate case.

In **Section IV**, I address the omission of the Aquila-MPS hedging program from base rates in Staff's direct case.

I. FUEL AND PURCHASED POWER

Q. What is the purpose of this section of your rebuttal testimony?

A. I am providing rebuttal testimony to the fuel and purchased power position taken by Maurice Brubaker, representing the Federal Executive Agencies, Sedalia Industrial Energy Users' Association and the St. Joe Industrial Group.

Q. What recommendations does Mr. Brubaker make recommendations regarding gas prices?

A. On page 10 of his direct testimony he recommends that Aquila's gas prices should be updated.

Q. Have you updated your direct testimony schedules?

A. Yes. In accordance with the update period ordered by the Commission, I have updated my calculations. The schedules reflecting the updated calculations have been provided to Staff and the other parties. Aquila has updated its dispatch model to reflect changes in loads, fuel prices, purchased power prices, and available resources to reflect appropriate changes through December 31, 2006.

Q. What resource changes are reflected in the updated dispatch model?

A. The 600 MW capacity solution, reflected in the direct filing, has been replaced with two actual capacity contracts totaling 300 MW of firm capacity, executed prior to year end. The two actual capacity contracts are a **__________________

**

Q. Do you agree with Mr. Brubaker's suggestion that the "into Entergy" prices should be used for the purchased power price curve?

A. No. Mr. Brubaker suggested the "into Entergy" prices because SPP-North prices are not readily available to him. Aquila, however, has updated its SPP-North prices to reflect prices through December 31, 2006.

Q. Are you addressing other fuel issues?

A. Yes. I address the C. W. Mining coal contract in the next section. Aquila witness Abby Herl also addresses the C. W. Mining coal contract in her testimony.

II. C. W. MINING COAL CONTRACT

Q. What is the purpose of this section of your rebuttal testimony?

A. I am providing rebuttal testimony in response to Staff witnesses Mr. Graham Vesely and Mr. Cary Featherstone, as well as intervener witness Brubaker.

Q. Why does Aquila exclude the C. W. Mining coal costs?

A. C. W. Mining terminated its contract with Aquila during 2005, and therefore, Aquila is no longer receiving coal under this contract. Thus, the estimates and projections provided by Staff and interveners do not represent the actual and historical, known and measurable, costs of Aquila's coal. Further, no evidence suggests that C. W. Mining will deliver coal in the future. Accordingly, Aquila has properly reflected its actual costs of coal.

Q. What is the background on the C. W. Mining contract?

A. Abby Herl discusses the specifics of the coal contract in her testimony.

Q. Why do Staff and interveners want to include the coal from C. W. Mining?

A. Coal prices increased significantly beginning in 2004, the first year of the coal contract. Replacement coal in 2004 was already 60% higher than the C. W. Mining contract price. As stated by SIEUA witness Maurice Brubaker, “These prices are substantially lower than the cost of replacement coal.” (Brubaker Direct page 8 line 9). Staff witness Featherstone also cites the higher costs, “...because the price of coal has been rising so there were significantly greater costs to the Company.” (Featherstone Direct page 37 line 11). Staff witness Vesely testified that the C. W. Mining coal “price is considerably lower than current market prices for coal of similar properties.” (Vesely Direct page 4 lines 13-14).

Q. What reasons do these witnesses provide to argue that the terminated contract prices should be included in this case?

A. Many reasons are advanced or implied including the following:

- Aquila would not pursue legal action without some external motivation, “Aquila should be expected to prudently pursue all its legal remedies...” (Vesely Direct page 4 line3). “Staff is proposing to condition recovery for the use of the higher priced replacement coal on Aquila’s pursuit of the legal remedies in the courts for damages.” (Featherstone Direct page 36 lines 4-6);
- Aquila imprudently entered into the contract “Future IEC mechanisms should identify unusual events so determination can be made for the prudence of recovery...” (Featherstone Direct page 36 lines 21-22);
- Aquila imprudently stayed in the contract “...why did Aquila continue with the agreement?” (Featherstone Direct page 38 line 5); and

- **____
____
__________________________** (Featherstone Direct page 38 lines 10-11).

Q. Staff witness Vesely expresses concerns about whether Aquila will pursue litigation of the contract (Vesely Direct page 4 line3). Are the concerns regarding litigation legitimate?

A. No. The case went to trial February 12, 2007. Again, Aquila witness Abby Herl addresses the federal litigation that resulted from the alleged improper termination of the contract?

Q. Was it imprudent for Aquila to stay in the contract?

A. No. Based on the information available at the time, it was a reasonable and prudent decision. The delay in the contract was expected to be temporary, Aquila had adequate supplies on hand for the indicated delay, and, by the end of the first delay, prices had already moved. These reasons for staying in the contract are in fact reflected in Staff's testimony. **____ ____ ____** (Vesely Direct page 11 lines 13-15). "C. W. Mining indicated to Aquila that it thought it would be able to fulfill the terms of the contract." (Featherstone Direct page 37 lines 8-9). "In May of 2004 Aquila made its first purchase of high-Btu coal to make up for the shortfalls in the C. W. Mining contract; by this time the market price had increased to the point where, as indicated in Data Request 163, Aquila generally paid **____________** per ton for coal of similar quality for the remainder of the year." (Vesely Direct page 12 lines 18-22). "By letter dated **__________________

____
____________________________________** (Vesely Direct page 11 lines 21-22). Please see Abby Herl's testimony for additional information regarding the prudence of the coal contract as well as Aquila's justifiable reasons for maintaining the integrity of the agreement.

Q. **____

A. ____
____
____
____
_____________________________**

Q. What is the ultimate impact of Staff's adjustment on Aquila?

A. In setting base rates, Staff's adjustment understates the costs of coal which Aquila knows will be substantially lower than its actual costs.

Q. If actual coal contract prices are used for setting rates in this case, what does Aquila plan to do if it receives damages from the C.W. Mining lawsuit?

A. If Aquila is permitted to implement a FAC mechanism, then it would propose that the customer be refunded a proportionate share of the replacement coal tonnage included in the FAC, less attorney's fees and litigation costs, amortized over the next five years. Absent a FAC, Aquila would propose that an appropriate refund mechanism be developed as was done in Case No. ER-82-39, involving the Peabody Coal Company lawsuit

Q. Can you summarize your testimony in this section?

A. Yes. Aquila has satisfied all of the opposing witnesses' requirements that would allow Aquila to recover its actual annualized coal costs. First, C. W. Mining was the best acceptable respondent to the coal RFP. It was the only RFP respondent that offered to meet the tonnage requirements and offered an acceptable quality coal. Next, Aquila prudently entered into the C. W. Mining contract. Further, C. W. Mining terminated the contract in early 2005 under the "force majeure" clause of the contract. Finally, Aquila is pursuing all legal remedies. Therefore, imputed coal deliveries under a terminated contract should not be included in rates. Instead, actual annualized coal costs should be reflected.

III. PHANTOM TURBINES

Q. What is the purpose of this section?

A. I offer rebuttal testimony regarding the use of five phantom (non-existent) turbines in setting rates for Aquila. These turbines are addressed in the Direct Testimony of Staff witnesses Mantle, Featherstone, and Hyneman.

Q. Why has Staff proposed five phantom turbines?

A. Staff does not accept that the three existing and operating turbines at South Harper should be considered in rate base. Additionally, Staff asserts that Aquila was imprudent in not building five turbines instead of three at South Harper. Staff believes that Aquila should be deemed imprudent for not pursuing an alternative plan presented in January 2004, which was not Aquila's Preferred Plan.

Q. Do you agree with this assessment?

A. No. The company's preferred plan at the time (in approximately January 2004) was to build three turbines and pursue power agreements for additional capacity. Staff, however, proposed an alternative plan, suggesting that Aquila install 525 MW at South Harper. Aquila, acting on its Preferred Plan, has executed on 390 MW, or all but 135 MW of the amount proposed by Staff. Currently, Staff is proposing an additional 210 MW. The company, however, executed its Preferred Plan, and three turbines rather than five were installed at South Harper. Additionally, Aquila entered into a long term purchased power contract for an additional 75 MW of base load power out of a nuclear unit. The three turbines at South Harper have passed all established criteria for being considered in service and used and useful. The other two turbines proposed by Staff simply do not exist.

Q. Did this fulfill Aquila's Preferred Plan?

A. No. It is my understanding that an additional 150 MW purchased power agreement ("PPA") with another utility for system capacity and energy was not approved by that utility's regulator. This resulted in Aquila acquiring short term capacity contracts for 2005.

Q. Did Staff have comments on the Preferred Plan presented in January 2004?

A. Yes. It is my understanding that in January or February of 2004 Staff questioned the analysis that led to the Preferred Plan.

Q. Did Aquila agree to perform additional analysis?

A. In March 2004, a stipulation was reached with Staff and others in Case No. ER-2004-0034 in which Aquila agreed to prepare an expanded integrated resource plan (IRP) and file it in early 2005 -- expanded-- meaning expanded as compared to the analysis that had been performed under the existing IRP rule waiver.

Q. What did that IRP show as Aquila's Preferred Plan?

A. The Preferred Plan under that IRP called for building 150MW of base load in 2010 and entering into a PPA for 250MW.

Q. Has Aquila executed on the Preferred Plan in the 2005 IRP?

A. Yes. Aquila has an agreement to participate in the ownership of Iatan 2 for approximately 153MW of base load. Aquila issued RFPs, which resulted in an attempt to buy the Aries plant. The Aries acquisition however, was unsuccessful. Additionally, Aquila has filed a 2007 IRP as required by the Commission's rules. Aquila is in the process of issuing a new RFP to address the long term needs identified in the 2007 IRP. In the meantime, Aquila has executed short-term capacity contracts to bridge to a long-term solution.

Q. What is Staff's position in this case?

A. Staff continues to assert that an alternative plan in the pre-stipulation analysis of January 2004 should be the yard-stick of prudence for Aquila.

Q. Does Staff oppose purchase power agreements?

A. Staff witness Lena Mantle states, "Staff's view that Aquila should own its generation assets is based on the proposition that owned assets will produce the lowest long-term revenue requirement and thus the lowest overall customer rates." (Mantle Direct page 7, lines 16-18).

Q. Was Staff a party to the stipulation in Case No. ER-2004-0034?

A. Yes.

Q. Did that stipulation require Aquila to consider long-term purchase power opportunities in the stipulated IRP process?

A. Yes.

Q. Do the Commission's rules require Aquila to consider purchased power opportunities in the IRP process?

A. Yes, that requirement appears at §4 CSR 240-22.040 (1).

Q. Did Aquila pursue and enter into a purchase power contract as a result of its January 2004 Preferred Plan?

A. Yes.

Q. Did the alternate plan supported by Staff from the January 2004 analysis include any purchased power?

A. No.

Q. Did Staff remove that PPA when modeling the alternate plan?

A No.

Q. Was the expected 2005 expiration of a 500 MW (summer) contract with Aries part of the need for capacity identified in the January 2004 analysis?

A. Yes.

Q. Did this PPA help address that need?

A. Yes. Although it only provided 75 MW of capacity, it is a base load contract. In each of 2005 and 2006 it provided about 560,000 MWh of base load priced energy. This is about 70% of the approximately 800,000 MWh of intermediate priced energy Aquila took from the Aries contract in the last full calendar year of the contract (2004).

Q. How did Staff witness Lena Mantle assess this purchased power agreement?

A. Staff witness Lena Mantle stated in her direct testimony in Case No. ER-2005-0436, "Aquila found a very good 75 MW PPA with Nebraska Public Power District (NPPD), but it was still pursuing the other PPAs on which it received bids." (Case No. ER-2005-0436 Mantle Direct page 6 lines 3-4). I identified earlier in my testimony that the other PPA Aquila pursued was not approved by the other utility's regulator.

Q. Is it prudent for Aquila to pursue purchased power agreements?

A. Yes. It is both prudent and required by past stipulations and by the Commission's rules. To be sure, there are execution risks around securing a PPA, just as there are execution risks surrounding building generation, as indicated by the inability of a counter party to obtain regulatory approval for one such agreement.

Q. Were phantom turbines an issue in the last case (Case No. ER-2005-0436)?

A. Yes. As in this case, Staff proposed a generating facility with five (5) 105 MW phantom turbines for a total of 525 MW. Staff witness Lena Mantle states "In its last case the Staff modeled a site built for six (6) CTs, putting only five (5) CTs on it." (Mantle Direct page 7 lines 10-11).

Q. Was there a stipulation reached in that case?

A. Yes.

Q. Was Staff a party to that stipulation?

A. Yes.

Q. Does the agreement state that the generating facility is for 525 MW?

A. No. The agreement states at Section 6 that it is for 315 MW:

> **Generating Facility Value**
>
> The rates agreed to herein support a rate base value for a 315 MW generating facility of approximately $140 million for Aquila. This amount is subject to adjustment as a result of the true-up of Aquila's South Harper Generating Station.

(Case No. ER-2005-0436 NonUnanimous Stipulation and Agreement page 5)

Q. Does the agreement address this generating facility in any other way?

A. Yes. A separate part of the agreement at Section 13 reads, in part, as follows:

> **South Harper and Prospective Generating Units**
>
> The South Harper Generating Station commercial operation dates are as follows: Unit 1-July 12, 2005; Unit 2-July 1, 2005 and Unit 3-June 30, 2005. For purposes of this case and future Aquila rate cases, test power, depreciation and allowance for funds used during construction will be calculated based on the commercial operation dates for South Harper Units 1, 2 and 3.
>
> The commercial operation date for prospective generating units will be the date the unit is first available for dispatch by the system operator. The actual commercial operation date for prospective generating units will be subject to review at the time the units are first sought to be included in rates. The actual commercial operation date for prospective generating units will be brought to the Commission for resolution in the event of an unresolved dispute.

Q. How many generating units are referred to in these two separate sections of the agreement?

A. Each section refers to only three (3) units.

Q. Why is it important whether rates in the last case included or did not include the other two phantom turbines?

A. Staff’s phantom turbine proposal not only sets an unrealistically low value on the two additional turbines, but also has a built in penalty that increases each year.

Q. Please explain the built in penalty.

A. Staff offers the hypothetical economic value of an owned facility against whatever actual costs Aquila incurs. Staff's proposal requires greater money to be given to the utility in the early years, as compared to the later years. If full value is not given in the first years, a sizeable penalty equal to the future value of the shortage is created.

Q. What is the shape of Staff's phantom turbine proposed payment stream?

A. Lena Mantle describes it as strictly declining, "However, because utility-owned generation depreciates over time—lowering the costs of that generation—over the long term the cost of utility-owned generation is lower than the cost of a series of short-term purchased power agreements." (Mantle Direct pages 8-9 lines 22-1). The payment stream proposed by Staff is highest in the first year and lowest in the last year.

Q. What is the shape of a PPA?

A. Multi-year agreements are often level. For example the annual demand (fixed) cost of the 75 MW NPPD contract remains constant for the 9-year term of the agreement.

Q. What happens if a utility is paid based on an "ownership" stream but actually incurs the economically equivalent cost based on a levelized contract?

A. The utility would appear to over-earn in the first few years, until the declining payments of the ownership stream inevitably go below the levelized stream. At that point, for the remainder of the plant life, the utility would appear to under-earn. Economically, the utility would reinvest the excess cash in the over-earning years to pay for the under-earning years.

Q. What happens if the utility is not granted its full payment in an early year and not allowed to over earn?

A. It will not have the required cash to reinvest in order to remain economically whole. A penalty is thus imposed.

Q. In the last rate case, did Aquila receive full payment for the costs of owning the five phantom turbines, including the two additional non-existent turbines?

A. The stipulation specifically mentions only three turbines at the generating facility.

Q. Were adequate amounts proposed by Staff in the last rate case for the capital and operating costs of the two additional turbines?

A. No. At the time of my writing this testimony, I have found no references in either Staff's testimony or work papers where, in the prior case, they proposed including any of the operating costs they have proposed to include in this case. I only find references to the capital related costs. In particular, I do not find any maintenance costs, property taxes, or gas reservation costs. In this case for example, gas reservation costs for the two additional phantom turbines are over **________________________**. These costs would be included in an economically equivalent purchased power contract. The invested future value, before considering taxes, of that **____**, or nearly the cost Staff has proposed for each of the two additional phantom turbines.

Q. How much has Staff proposed for the capital costs of each of the five (5) phantom turbines?

A. For the three turbines agreed to in the stipulation to the prior case, Staff continues to propose the agreed upon $140 million, adjusted for the actual costs of the three turbines actually constructed and existing at South Harper.

Q. What does Staff propose for the other two phantom turbines?

A. Staff re-proposes the much lower construction values based upon the amounts proposed by Staff witnesses Featherstone and Shallenberg in the prior Case No. ER-2005-0436 (Hyneman Direct page 25 line17).

Q. How does Staff witness Charles Hyneman characterize this value?

A. Mr. Hyneman states, "In the last case the Staff used documents containing the actual costs data from Aquila's purchase of 3 CT's at its South Harper plant as the basis for its calculations of the cost of MPS Units 4 and 5." (Hyneman Direct pages 25-26 lines 22-1).

Q. Is this characterization accurate?

A. No. I find this characterization highly inaccurate. Less than 40% of the **______ ___________** proposed by Staff is in fact based on the "actual costs data from Aquila's purchase of 3 CT's".

Q. Please explain.

A. Staff's proposed **____________________** million is not based on "actual costs data from Aquila's purchase of 3 CT's", neither is **___________________ _______________________** These two items account for **________________ _______________________** of the proposed **____________** total. Additionally, critical components have been omitted from the list of costs.

Q. Where does Staff's Base Unit Price come from?

A. Staff proposes a **________________________** Mr. Hyneman states that these amounts come from the same adjustments proposed by Staff in the prior rate case. According to Mr. Shallenberg's testimony in the last case, this amount was developed by Mr. Featherstone. (Case No. ER-2005-0436 Shallenberg Surrebuttal page 5 line18). Mr. Featherstone advanced that amount in his surrebuttal testimony. His first reference to the **__________** was in the following passage:

> **____**

Clearly the **______________________________** that represents the actual per turbine amount paid by Aquila Merchant". Instead it is an amount taken from a trade publication called Gas Turbine World (GTW) and from an offer made by a turbine manufacturer.

Q. Is the turbine manufacturer offer comparable?

A. No. The offer referred to a Siemens V84.3A2. This turbine is not similar to the 105 MW Siemens 501D5A installed at South Harper. Additionally, Aquila understands that this type of turbine has greater maintenance requirements.

Operational differences such as this have not been not been considered by Mr. Featherstone.

Q. What value was actually used and agreed upon with Staff for the Base Unit Cost of the three actual units installed at South Harper?

A. Mr. Featherstone states that, "Staff has used an amount of $66,760,000 for the three turbines and related generator auxiliaries, transformers and generator breakers...." (Featherstone Direct page 44 line9). This is slightly over $22.25 million per base unit. This amount is also less than the value established by Aquila's professional appraiser.

Q. Where does Staff's transmission cost come from?

A. According to Mr. Shallenberg's testimony in the last case, this amount was developed by Mr. Featherstone. (Case No. ER-2005-0436 Shallenberg Surrebuttal page 5 line22). Mr. Featherstone advanced that amount in his surrebuttal testimony. **____

____

____

____________________** Aries was one potential site for the turbines to be installed in 2003. Therefore, this amount relates neither to the South Harper site nor to the 2005 time-frame in which South Harper was built.

Q. Has Mr. Featherstone's Base Unit Cost included all required costs?

A. No. Mr. Featherstone's number matches the GTW amount. The GTW valuation proposed by Mr. Featherstone excludes the breakers, transformers, training, transportation, technical field assistance and dry low NOx combustors which are included in the base unit costs of the actual South Harper equipment. These required adjustments were identified both in the R.W. Beck appraisal and in Mr. Featherstone's own schedules in Case No. EO-2005-0156.

Q. How do you know these items have been excluded from Mr. Featherstone's valuation?

A. In Case No. EO-2005-0156, Staff witness Mr. Featherstone considered the GTW data. GTW prefaces its pricing data with this statement, "Equipment-only for a skid mounted single fuel gas turbine, electric generator, air intake with basic filter and silencer, exhaust stack, basic starter and controls, conventional combustion system (unless designated as D or DLE for dry low emissions design). Quoted FOB the factory in 2004 US Dollars." Mr. Featherstone noted this caveat in one of his schedules. (Case No. EO-2005-0156 Page 1 of Mr. Featherstone's Schedule 3-1 HC). Additionally, GTW states that "Electrical distribution, main step-up transformers, switchgear…are not included." (Page 12 of 2004-2005 GTW). "Equipment-only" means that training and technical field assistance is excluded. "FOB the factory" means transportation from the factory to the site is excluded. "Conventional combustion system unless designated as DLE" means that dry low NOx combustion is excluded. "Electrical distribution, main step-up transformers, switchgear" means breakers and transformers are excluded.

Q. What value has been omitted by Mr. Featherstone in relying on the GTW price without making these adjustments?

A. Aquila provided responses to data requests in Case No. EO-2005-0156 (DR OPC-0014) indicating that dry low NOx adds **__________** per unit. R. W. Beck included a value of **__________** for three sets of transformers and breakers. The estimated cost of transportation is **__________** for three units according to R. W. Beck. R. W. Beck also estimated technical field assistance and training as **______________** for three units.

Q. Can you summarize these adjustments?

A. See the following table, reducing these values to represent two units instead of three:

Breakers and Transformers	**___________**
Transportation	**___________**
Technical Field Assistance and training	**___________**
Dry Low NOx Combustors	**___________**
Total Omissions	**___________**

Q. Do you agree with the use of phantom turbines?

A. No. Non-existent turbines should not be used for ratemaking. Aquila was prudent in its analysis and decision making regarding the number of units to install at South Harper. The phantom turbine valuations proposed by Staff have been mischaracterized and understated. The stipulation agreement in the prior case does not support that more than three turbines were included in ratemaking. Staff's failure to adequately provide for the full costs of turbine ownership and operation in every single year places a very large long-term economic penalty on Aquila. The penalty grows larger each year. Staff's calculation of the appropriate recommendation has clearly undervalued the cost of adding 5 turbines.

IV. HEDGING PROGRAM

Q. What is the purpose of this section?

A. I offer rebuttal testimony to Staff's omission of hedging cost and settlement results in setting base rates for Aquila. Hedging costs and results are addressed in the Direct Testimony of Staff witness Featherstone.

Q. How has Staff treated hedging costs and settlement results?

A. My understanding is that Staff has not included hedging costs or settlement results in either the fuel costs or the purchased power costs used to develop base rates in their direct filing.

Q. Did Aquila incur hedging costs and results during the test year or update period?

A. Yes. According to Staff witness Phillip Williams, "The test year authorized by the Commission in its August 22, 2006, Order was the 12-month period ending December 31, 2005, with an update for known and measurable changes through December 31, 2006." (P. Williams Direct page 6 lines 9-11). During the update period, in accordance with the Non-unanimous Stipulation and Agreement in our prior rate case, Case No. ER-2005-0436, Aquila began recording its hedging costs and results above the line in regulated fuel accounts.

Q. According to the Stipulation agreement, how are hedge settlements and costs to be handled?

A. The stipulation specified that hedge settlement results would be considered part of the fuel cost and purchased power costs for ratemaking purposes.

Q. Are fuel and purchased power costs included in the items to be updated in this case?

A. Yes. According to Staff witness Williams, "Some of the major revenue requirement components which are examined that typically change from test year levels are ... fuel and purchased power expense,..." (P. Williams Direct page 6 lines 13-17).

Q. Did Staff develop its base rate proposal using fuel and purchased power costs from the update period?

A. Yes. It is my understanding that Staff's direct case gas prices and purchased power prices reflect Aquila's actual results for the test year and the update period through September 30, 2006, excluding the hedges. It is my understanding that Staff will further update these prices for the period through December 31, 2006. I believe that under Staff's historical cost of service approach, and the Stipulation, consistency requires that Staff also give recognition to the historical hedge settlements and costs in base rates.

Q. Were the hedge contracts that produced the 2006 results in place at the time the Staff agreed to the Stipulation agreement?

A. Over 70% all of the results recorded in 2006 were the result of hedge contracts that were already in place at the end of January 2006, when the stipulation was entered into. In fact, nearly 65% of the 2006 results relate to hedges that were in place at October 31, 2005, the true-up date in the prior rate case.

Q. At what gas price did the January 2006 hedge contracts settle?

A. The settle price for the January 2006 Nymex contracts was $11.43.

Q. What was the unrealized value of the Missouri hedge portfolio at the end of 2005?

A. The unrealized value was a positive $20.7 million, as reported in the Aquila 2005 annual report.

Q. Did Aquila prudently enter into these hedges?

A. Yes. Given the facts available at the time, the hedges had considerable expected value.

Q. Do you believe the high gas costs at the time and the positive hedge value contributed to the Staff's desire for Aquila to book its hedges above the line?

A. Yes.

Q. Do you agree with Staff's decision to omit the hedge settlement results and costs from base rates?

A. No. Staff's decision is contrary to the Stipulation. Staff's decision, in essence treats the 2006 hedge costs as below the line costs, contrary to the agreement. It is inconsistent with Staff's general approach to using historical results to set base rates. The majority of the hedges were in place when Staff entered into the stipulation agreement.

Q. What is Staff's position on hedging costs and results?

A. Staff proposes, "In order to accurately determine the amount of any refund owed the customers, the results of the hedging program and prudently incurred costs to implement such program should be included in the true-up IEC Audit." (Featherstone Direct page 34, line 19-21).

Q. How do you interpret this proposal?

A. I believe this proposal is contrary to the stipulation in our last rate case. Mr. Featherstone is proposing to exclude the actual results of Aquila's 2006 hedge program and wait till the end of an IEC Audit (assuming an IEC is approved at all) to review the results of our 2007 hedges. Based on discussions with Staff regarding the 2006 results of Aquila's hedge program and the current value of its hedge portfolio, Aquila believes this proposal is a disallowance of the recent results of its hedge program which has resulted in net hedge costs.

Q. What happens if an IEC or fuel adjustment clause allowing hedges is not approved?

A. The adjusted test year costs of hedging will be excluded from recovery and no hedging results or costs will be included in rates.

Q. What is the purpose of Aquila's hedge program?

A. Aquila's hedge program is primarily intended to address gas and purchased power volatility. Reducing volatility is not the same as reducing costs. Volatility means that prices go up **<u>and</u>** prices go down. In general, when prices go up relative to the contract price in the hedge, the hedge will tend to produce positive settlements (gains). When prices go down, the hedge will produce negative settlements (losses).

Q. Can you give a simple example of where volatility is reduced but costs are not?

A. Consider the analogy of fire insurance for a homeowner. The homeowner buys the insurance to avoid the risk (volatility) of the loss of his home to fire. Every year that he buys the insurance and does not have a fire, his costs are higher than if he did not buy the insurance. Many homeowners never have a fire. If they never have a fire, buying insurance did not reduce their costs. However it did reduce their volatility risk (a fire). The homeowner will experience a gain on his fire insurance only in the event he has a fire. I, for one, hope I never have a fire, and thus I hope I never have a gain on my fire insurance.

Q. How does this relate to hedging?

A. One of the ways Aquila hedges gas prices is by buying call options. Aquila pays a premium to set a cap on gas prices. If gas prices go over the cap, Aquila will have a gain on the call option. If gas prices do not go over the cap, the premium paid will be expensed. In order for the call option to have a gain, there has to be a fire, that is, prices have to go up as high as the cap. Staff's proposal, in effect, excludes the hedge costs we incurred in 2006, because prices in 20/20 hindsight did not go up.

Q. What is your understanding of the Company's historical view of hedges and regulation?

A. From my perspective, Aquila has viewed hedging as a program with high regulatory risk. The primary risk has been the expectation that hedge benefits would be flowed back to the customers and hedge costs would be disallowed.

Q. How did Aquila address this risk?

A. Aquila chose to record both hedge benefits and costs below the line, thus removing them both from rate making. Aquila held both the risk of the costs and the benefits for the shareholder. As noted by Mr. Featherstone, prior to the stipulation in Case No. ER-2005-0436, Aquila recorded both gains and losses below the line.

Q. What where the results of the hedging program during 2004 and 2005?

A. As noted in Mr. Featherstone's testimony, Aquila realized net losses for 2004 and the first half of 2005. Aquila recorded these losses of approximately **________ _______** below the line. In the second half of 2005 Aquila realized net gains of approximately **____________** which it also recorded below the line.

Q. What is Staff's opinion of Aquila's decision to record hedging gains and losses below the line?

A. Aquila was criticized for its position. "In late 2005, Aquila had significant gains in its hedging program with would have **reduced costs** if reflected in an IEC mechanism." (Featherstone Direct page 35 lines 5-7) (emphasis added). Staff contrasts it with Empire's program. "In other words, the **benefits** of Empire's hedging program would be used in the IEC mechanism to **reduce the cost impact** from higher energy markets." (Featherstone Direct page 34 lines 13-15) (emphasis added).

Q. What was the status at the end of 2005 of the hedges scheduled to settle in 2006 through 2008?

A. The hedge portfolio, based on gas prices at the time, had an unrealized market (mark-to-market) beneficial value of approximately $20.7 million (Aquila 2005 Annual Report), which Aquila had also recorded as an increase to income.

Q. When was the stipulation in Case No. ER-2005-0436 submitted to the Commission?

A. It was submitted on February 3, 2006 according the date stamp on the document.

Q. What did the stipulation require regarding hedges?

A. The agreement at Section 17, states, in part:

> The Signatory Parties agree, for accounting and ratemaking purposes, that hedge settlements, both positive and negative, and related costs (e.g. option premiums, interest on margin accounts, and carrying cost on option premiums) directly related to natural gas generation and on-peak purchased power transactions under a formal Aquila Networks-MPS hedging plan will be considered part of the fuel cost and purchased power costs recorded in FERC Account 547 or Account 555 when the hedge arrangement is settled.

(Case No. ER-2005-0436 Non-Unanimous Stipulation and Agreement)

Q. How did Aquila interpret this agreement?

A. Aquila believed that the words "for accounting **and ratemaking** purposes, that hedge settlements, **both positive and negative** ... **will be considered part of fuel cost** and purchase power costs" (emphasis added) addressed its concerns that only positive settlements would be considered for ratemaking.

Q. Have these concerns been rekindled?

A. Yes. Conversations with Staff, the wording of Staff's testimony and the complete absence of all hedging program results and costs in Staff's direct case are a cause for great concern. Aquila is highly concerned that ratemaking gains will be included without limit and losses will be greatly limited if not excluded entirely, as Staff has done in their direct case. Aquila is concerned that Staff has stepped so abruptly away from the Stipulation. Finally, Aquila is concerned that Staff has not explained in its direct testimony its reasoning for deviating from the treatment agreed to in the stipulation.

Q. What conversations have you had with Staff.

A. Aquila met with Staff representatives Cary Featherstone, Charles Hyneman, and Steve Traxler. Also present from Aquila were Gary Clemens, Susan Braun, Gary

Gottsch, Laura Templemen and me. I, for one, left with the impression that the standard of prudence for hedging is the ability to produce gains. Those conversations left me with the impression that Staff believes only positive settlements are prudent.

Q. Would it be beneficial to consistently have gains in a hedge program?

A. No, not in total. Hedges are purchased at prices that reflect the market's expectations for prices. Gains reflect that actual prices exceeded the market's expectations. Consistent gains would mean that actual prices are rising faster than the expected prices. Higher gas prices mean higher total costs to Aquila and to our customers. This is not a good thing.

Q. Do you believe it possible to always produce gains in a hedging program?

A. No. Over time I believe it is likely that gains and losses of the fixed positions will substantially offset. The only scenarios that I am able to imagine under which gains are consistently produced are either 1) market prices that always move in one direction faster than the market's expectation or 2) a trading program that has perfect foresight (or hindsight) into market prices. Neither of these scenarios exists in reality.

Q. What testimony wording concerns you?

A. Staff witness Featherstone's direct testimony (pages 33-34) is laden with phrases such as:

- "mitigate energy costs" (line12);
- "minimize the cost affects and volatility of expected raising markets" (line17);

- "Hedging is done to mitigate natural gas and energy costs" (line 18);
- "Staff believes that a well thought out, managed and prudently executed hedging program should .... minimize fuel costs" (lines 19-21); and
- "giving full credit to any reduction in natural gas pricing" (p34 line 13).

Q. How do you interpret these phrases?

A. These phrases paint a picture that gains, and hence cost reductions, can consistently be achieved. By referring to expected rising markets he implies the unrealistic scenario of consistently rising markets. He appears to be laying the groundwork for explaining why the negative hedge settlements should not be included in ratemaking, contrary to the stipulation agreement.

Q. Are you saying that hedging should not be subject to prudence reviews?

A. Prudence reviews are fine; however, in a hedging program it is particularly easy to use 20/20 hindsight to claim imprudence. For example, if prices go up, then Staff would be asking why we did not buy sooner. On the other hand, if prices go down, then Staff would ask us why we did not wait to buy.

Q. What other phrases in Mr. Featherstone's testimony concern you?

A. The following statement also concerns me:

> "In particular, energy markets like the heating season in 2000 (September through December) and 2001 (January through March), the energy markets of late 2003 and 2004 and the late 2005 energy market may

benefit by a hedging program implemented by electric and natural gas companies."

(Featherstone Direct pages 33-34 lines 22-2).

Q. How do you interpret this phrase?

A. This is an example of 20/20 hindsight. He is stating that certain past seasons "may benefit" by a hedging program.

Q. What is the amount of the 2006 hedge results and losses?

A. The hedges settled in 2006 for natural gas and purchased power totaled **______ _______** of net costs.

Q. How do you recommend the Commission should handle 2006 hedging costs?

A. If the Commission accepts Staff's energy costs in this case, the Commission should include the historical 2006 hedge costs. Staff's energy costs for gas and purchased power are based on historical costs. Staff should include the related historical hedge results and costs in accordance with the Stipulation Agreement in Case No. ER-2005-0436. If they have specific issues where they believe we were imprudent, they should remove those costs. It seems unreasonable to me that all the 2006 hedge costs, including those hedges in place at the time of the Stipulation, would now be considered imprudent without explanation.

Q. Does this conclude your testimony?

A. Yes.

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Aquila, Inc. d/b/a Aquila Networks-MPS and Aquila Networks-L&P, for authority to file tariffs increasing electric rates for the service provided to customers in the Aquila Networks-MPS and Aquila Networks-L&P area	))))))	Case No. ER-2007-0004

County of Jackson)
) ss
State of Missouri)

AFFIDAVIT OF H. DAVIS ROONEY

H. Davis Rooney, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Rebuttal Testimony of H. Davis Rooney;" 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.

H. Davis Rooney

H. Davis Rooney

Subscribed and sworn to before me this 20th day of February, 2007.

Terry D. Lutes

Notary Public
Terry D. Lutes

My Commission expires:

8-20-2008

Notary Public State of Missouri Notary Seal

TERRY D. LUTES
Jackson County
My Commission Expires
August 20, 2008