

Exhibit No.:

Issues: MPS Accounting
Authority Orders and
MPS Accumulated
Deferred Income Taxes-
AAOs

Witness: Ronald A. Klote

Sponsoring Party: Aquila Networks-MPS
& L&P

Case No.: ER-2007-0004

Before the Public Service Commission
of the State of Missouri

Surrebuttal Testimony

of

Ronald A. Klote

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ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NO. ER-2007-0004

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**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
SURREBUTTAL TESTIMONY OF RONALD A. KLOTE
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D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NO. ER-2007-0004**

1 Q. Please state your name and business address.

2 A. My name is Ronald A. Klote. My business address is 20 West 9th Street, Kansas
3 City, MO, 64105.

4 Q. Are you the same Ronald A. Klote who previously filed direct testimony in this
5 case?

6 A. Yes.

7 **EXECUTIVE SUMMARY**

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

9 A. The purpose of this testimony is to address the rebuttal testimony of Public
10 Counsel witness Ted Robertson regarding Accounting Authority Orders
11 (“AAOs”) for Aquila Networks – MPS (“MPS”) and their associated
12 Accumulated Deferred Income Taxes.

13 Q. Please briefly summarize your conclusions.

14 A. In response to rate base treatment of AAOs:

- 15 • Staff’s proposal for inclusion of the unamortized portion of AAOs
16 developed in Case Nos. EO-90-114 and EO-91-358 for the Sibley Rebuild
17 Program and Sibley Western Coal Conversion Projects in rate base is
18 correct and consistent with prior Commission Orders regarding the issue.

- Public Counsel's proposal for exclusion from rate base of the two above mentioned AAOs goes against prior Commission Orders regarding the issue.

In response to Accumulated Deferred Income Taxes associated with the AAOs:

- Accumulated Deferred Income Taxes have been calculated and provided for both the Sibley Rebuild Program AAO and Sibley Western Coal Conversion Project AAO.
- Public Counsel's assertions that neither Company nor Staff provided Accumulated Deferred Income Taxes associated with the Ice Storm AAO authorized in Case No. EU-2002-1053 is not correct.

MPS ACCOUNTING AUTHORITY ORDERS

Q. What are the projects that AAOs have been granted to MPS that are covered in this section of surrebuttal testimony.

A. MPS has received AAO treatment for the following projects:

- Sibley Rebuild Program in Case No. EO-90-114
- Sibley Western Coal Conversion in Case No. EO-91-358

Q. What is MPS' proposed ratemaking treatment of the unamortized deferred AAO balances and associated amortization expense for the Sibley Rebuild Program and Western Coal Conversion Project?

A. For purposes of this rate proceeding and consistent with past rate proceedings, MPS has included the unamortized deferred AAO balances at December 31, 2006 in rate base for the Sibley Rebuild Program and Western Coal Conversion. In

1 addition, an annual amount of associated amortization expense has been included
2 in Company's cost of service.

3 Q. What has been the Commission's position regarding the treatment of the
4 unamortized balance of the Sibley related AAOs and the associated amortization
5 expense in past rate case decisions?

6 A. In previous rate cases before the Missouri Public Service Commission, specifically
7 Case Nos. ER-90-101 and ER-93-37, MPS has been granted a return on the
8 unamortized balance of the AAOs and recovery of the associated amortization
9 expense.

10 Q. Please describe the unamortized AAO balances that Staff has included in rate
11 base.

12 A. Just as Aquila has done, Staff has included in rate base the unamortized balances
13 at December 31, 2006 for the AAO deferrals associated with the Sibley Rebuild
14 Program and the Sibley Western Coal Conversion, as authorized by the
15 Commission in Case Nos. EO-90-114 and EO-91-358, respectively. This position
16 is consistent with prior Commission Orders.

17 Q. What is the position of OPC witness Ted Robertson regarding MPS' AAOs
18 associated with the Sibley Rebuild Program and Sibley Western Coal
19 Conversion?

20 A. Mr. Robertson recommends that the annual amortization costs of MPS' AAOs be
21 included in the Company's cost of service, allowing a return of the actual
22 expenses deferred from the Sibley Rebuild Program and Western Coal
23 Conversion Project. However, Mr. Robertson recommends the disallowance of

1 the unamortized deferred AAO balances from the determination of MPS' rate
2 base.

3 Q. Does Aquila agree with the recommended ratemaking treatment proposed by Mr.
4 Robertson regarding unamortized deferred AAO balances?

5 A. No.

6 Q. Please provide some history of the Sibley Rebuild and Western Coal Conversion
7 Project.

8 A. During the period of 1986 through 1993, the Sibley Rebuild and Western Coal
9 Conversion projects were initiated to extend the useful life of the Sibley
10 Generating Station by approximately 20 years and to comply with the 1990
11 Federal Clean Air Act. This project avoided building a new generation plant at
12 substantially higher costs and allowed the Sibley unit to burn low sulfur western
13 coal to meet environmental requirements.

14 Q. What was different about the construction schedule for this project as compared
15 to other construction projects?

16 A. Very simply, the work did not follow a normal construction schedule. The work
17 was performed in off-peak periods. During normal construction projects the work
18 is completed continuously until the project is complete. Yet, for the Sibley
19 Rebuild and Western Coal Conversion Projects, the work was only completed in
20 the off-peak periods in order for the Sibley plant to be available for use during the
21 peaking season. This avoided the need of acquiring other generation or purchase
22 power resources to meet the peaking season demand. This approach provided for

1 a substantial savings to the customer, but created problems for the utility in
2 obtaining a proper return on its investment.

3 Q. Please explain the problem this created.

4 A. In order for the utility to obtain a proper return on its investment in the Sibley
5 Rebuild and Western Coal Conversion Project, a series of rate cases year over
6 year would have been required to capture the plant additions in rate base. This
7 was not a situation that the Commission, the Company or its customers wanted.
8 Yet, the Company put plant construction when completed into plant in service
9 immediately and begin depreciating the asset as each phase of the project was
10 complete. Through the use of the AAO process, the carrying costs and
11 depreciation were deferred in order to be considered in a future rate case. This
12 allowed the Company an opportunity to be provided a return on their investment.

13 Q. What is Mr. Robertson's main objection with rate base treatment of the AAOs
14 associated with the Sibley Rebuild and Western Coal Conversion Projects?

15 A. Mr. Robertson believes that a Commission ruling in a subsequent rate case to
16 when the Sibley Rebuild and Western Coal Conversion Projects were approved
17 which involved a different utility super cedes the ratemaking treatment granted
18 MPS at that time.

19 Q. What is Mr. Robertson's response to the fact that the Commission has already
20 ruled on the ratemaking treatment of the AAOs associated with the Sibley
21 Rebuild and Western Coal Conversion Projects?

22 A. Mr. Robertson states that the approval was granted early in the Commission's
23 process of adopting AAOs. This statement comes even though the AAO

1 ratemaking treatment was granted approval in the 1990 and 1993 rate cases for
2 MPS. In addition, in the 1997 rate case, there was no disallowance of the
3 deferred costs. Although seven years is not an eternity, approvals over three
4 separate rate cases and seven years should not be simply dismissed as being early
5 in the ratemaking process. This argument by Mr. Robertson is simply not
6 persuasive.

7 Q. What is Mr. Robertson's contention regarding the ratemaking treatment granted
8 Missouri Gas Energy ("MGE") in Case No. GR-98-140?

9 A. In this case, MGE was granted recovery of deferred costs associated with Safety
10 Line Replacement Program ("SLRP") costs. MGE was not provided rate base
11 treatment in this case. Mr. Robertson contends that this Commission ruling
12 should reverse the ratemaking treatment granted MPS associated with their
13 deferred AAO costs.

14 Q. Do you agree with this theory?

15 A. No.

16 Q. Why not?

17 A. The Order in Case Nos. EO-91-358 and EO-91-360 include a detailed six page
18 analysis under the heading of Standards for Deferral in which it begins with the
19 following statement:

20 "The Commission in past instances has granted AAOs on a case by case
21 basis after reviewing a company's request and Staff's and/or Public
22 Counsel's recommendations."
23

1 As is stated above, the AAO applications are reviewed by the Commission on a
2 case by case basis in which the circumstances involving each application are
3 thoroughly reviewed and discussed.

4 Q. Is there any language in the MGE Case No. GR-98-140 which would lead you to
5 believe that the Commission has abandoned this case by case standard?

6 A. There is nothing I can find in the MGE Order that would lead me to believe that
7 the Commission has abandoned their case by case analysis. In fact, there appears
8 to be some unique circumstances in this case that may have lead the Commission
9 to only allowing a return of the SLRP deferral balance.

10 Q. What are these circumstances?

11 A. It appears that the deferred SLRP costs were allowed recovery over an expedited
12 ten year period as opposed to a twenty year recovery period. The Order states:

13 "Given that the Company will recover the amortized amount of the SLRP
14 deferral at the AFUDC rate in ten years, instead of the previous 20 years'
15 amortization period, it is proper for the ratepayers and shareholders to
16 share the effect of regulatory lag by allowing the Company to earn a return
17 of the SLRP deferred balance but not a return on the SLRP deferred
18 balance."
19

20 As can be seen in this case, the Commission reviewed the AAO deferred balances
21 on its own merits and granted recovery as they deemed appropriate. Similarly,
22 the Commission has reviewed the facts of the Sibley Rebuild and Western Coal
23 Conversion Projects on their merits and granted recovery as they deemed
24 appropriate.

25 Q. What other issues do you have with Mr. Robertson's testimony?

1 A. Mr. Robertson states in his rebuttal testimony that neither the carrying cost nor
2 the depreciation expense causes the Company to forego any actual cash outlay.

3 Q. Do you agree with this statement?

4 A. I believe this statement to be misleading.

5 Q. Please explain.

6 A. The depreciation expense that Mr. Robertson refers to is the result of an initial
7 investment or an initial outlay of cash. Although the depreciation expense itself is
8 an accounting entry, it does stem from an initial cash outlay for plant investment.
9 To illustrate how the company is not being afforded an opportunity to earn a
10 return on this initial cash outlay, please review the following example. An initial
11 investment cost the Company \$2 million dollars, i.e. the Sibley Rebuild Project,
12 and the approach the Company chose to take was to delay a rate case until the end
13 of the project which was spread out for several years. If this initial outlay
14 occurred in 1991 and was put into service, depreciation expense would begin to
15 accumulate. Therefore, in 1993 when a rate case was filed for MPS, 2 years
16 worth of depreciation would have accumulated and only \$1.8 million of the
17 original investment would be part of rate base and allowed recovery. Therefore,
18 \$200,000 of initial investment was a cash outlay and does represent amounts the
19 Company should be allowed to recover.

20 Q. What is your conclusion regarding the Sibley Rebuild and Western Coal
21 Conversion project AAOs?

22 A. The Sibley Rebuild and Western Coal Conversion project AAOs are costs that the
23 Commission has previously reviewed and ruled on in Rate Case Nos. ER-90-101

1 and ER-93-37. The costs were reviewed and amortization schedules were
2 developed to amortize the costs over a 20 year period. The Commission ruled
3 that rate base inclusion should be granted for the Sibley Rebuild and Western
4 Coal Conversion Projects. This position should not change 14 and 17 years later
5 involving a 20 year recovery period.

6 **MPS ACCUMULATED DEFERRED INCOME TAXES – AAOS**

7 Q. What is the company's position regarding Accumulated Deferred Income Taxes
8 associated with AAOs?

9 A. Aquila has provided Accumulated Deferred Income Taxes as a rate base offset for
10 all three AAOs that are included in this rate case filing. These include:

- 11 • Sibley Rebuild Program in Case No. EO-90-114
- 12 • Sibley Western Coal Conversion in Case No. EO-91-358
- 13 • 2002 Ice Storm in Case No. EU-2002-1053

14 Q. What is Public Counsel witness Robertson's position on Accumulated Deferred
15 Income Taxes associated with AAOs?

16 A. On page 2 of his rebuttal testimony, Mr. Robertson states that he supports a rate
17 base offset for Accumulated Deferred Income Taxes associated with all three
18 AAOs. Yet, Mr. Robertson states that neither the Company nor MPSC Staff have
19 included Accumulated Deferred Income Taxes associated with the 2002 Ice
20 Storm AAO in their rate case filings.

21 Q. Has the Company and MPSC Staff included Accumulated Deferred Income Taxes
22 associated with the 2002 Ice Storm AAO in their rate case filings?

1 A. Yes. Both Company and Staff have included Accumulated Deferred Income
2 Taxes in their rate case filings. Company adjustment RBO-30 Accumulated
3 Deferred Income Taxes includes a timing difference line item associated with the
4 2002 Ice Storm. MPSC Staff adopted this adjustment in their rate case filings.

5 Q. Are there any other differences that you have with witness Robertson's rebuttal
6 testimony concerning Accumulated Deferred Income Taxes?

7 A. Yes. Mr. Robertson has stated that the Company has failed to maintain proper
8 financial records for the AAO-related deferred income taxes. Thus, he has chosen
9 to use a surrogate deferred tax calculation to compute the rate base offset amount
10 for Accumulated Deferred Income Taxes.

11 Q. Do you agree with this approach?

12 A. No I do not. In the last rate case, this same issue was discussed. There was some
13 confusion at the time on the appropriate deferred income tax treatment associated
14 with the Sibley AAOs. I personally spent the time digging through archive
15 records for the 1990 and 1993 rate cases in which the Sibley AAOs were
16 addressed. I was able to uncover the original deferred tax calculations used in
17 those rate cases. I noted in those rate cases that deferred taxes were not provided
18 for the depreciation component of the AAO deferred costs. These amounts were
19 treated as flow through items. Thus, in the AAO deferred tax calculations for the
20 Sibley AAOs for this rate case filing, I subtracted out the depreciation amounts
21 before computing the deferred tax amounts to be consistent with the original 1990
22 and 1993 rate cases in which the rate making treatment was first decided for the
23 Sibley AAOs.

- 1 Q. Does this conclude your testimony?
- 2 A. Yes it does.

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

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Case No. ER-2007-0004

County of Jackson)
)
State of Missouri)

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AFFIDAVIT OF RONALD A. KLOTE

Ronald A. Klote, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Surrebuttal Testimony of Ronald A. Klote;" 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.

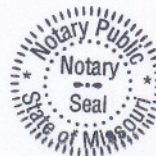
Ronald A. Klote
Ronald A. Klote

Subscribed and sworn to before me this 24th day of March, 2007.

Terry D. Lutes
Notary Public
Terry D. Lutes

My Commission expires:

8-20-2008



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