**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
SURREBUTTAL TESTIMONY OF JOHN C. BROWNING
ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NOS. ER-2004-0034 AND HR-2004-0024 (CONSOLIDATED)**

Q. Please state your name and business address.

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

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

A. Yes.

Q. What is the purpose of your surrebuttal testimony?

A. The purpose of my surrebuttal testimony is to address the rebuttal testimony of Missouri Public Service Commission Staff ("Staff") witness Graham Vesely.

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

A. I will address the following issues:

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

**<u>Test Year and Updated Gas Costs</u>**

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

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

Q. Why are updates used along with test years?

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

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

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

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

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

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

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

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

A. Mr. Vesely is also concerned about setting a gas cost that is too high should gas prices decline. At his recommended cost of $4/mcf, he certainly doesn't have much to worry about. As discussed in my rebuttal testimony, the real industry concern is increasing prices given the decline in productive output of existing fields, no new sources on the near-term horizon, and demand that struggles to stay within supply capability. The gas price issue is a classic economics study of supply versus demand and does not require an "extraordinary knowledge of the future" as Mr. Vesely suggests in his rebuttal testimony. Mr. Vesely's concern over falling prices sets him apart from anyone else knowledgeable in the gas industry.

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

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

**<u>Cost of Gas In Current Rates</u>**

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

A. It is true that a stipulated settlement was reached in Case No. ER-2001-672. Gas cost was not one of the issues specifically discussed in arriving at the settlement. The last known gas cost is \$2.46/mcf from Case No. ER-97-394. We do know that Staff work papers and testimony from Case No. ER-2001-672 indicates an assumed cost of about \$3/mcf. Since March 21, 2002, the effective date of Case No. ER-2001-672, gas prices have consistently increased to well over \$5/mcf. Consequently, Aquila's shareholders have shielded the ratepayers from $10 to $20 million per year in higher gas costs. It is past time to be fair to the shareholders.

**<u>Coal Prices</u>**

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

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

Q. Does this conclude your surrebuttal testimony?

A. Yes.