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Witness: *Cary G. Featherstone*
Sponsoring Party: *MoPSC Staff*
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Case Nos.: *ER-2007-0004*
Date Testimony Prepared: *February 20, 2007*

MISSOURI PUBLIC SERVICE COMMISSION

UTILITY SERVICES DIVISION

REBUTTAL TESTIMONY

OF

CARY G. FEATHERSTONE

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

AQUILA NETWORKS-L&P (Electric)

CASE NO. ER-2007-0004

Staff Exhibit No. 207
Case No(s). ER-2007-0004
Date 4-12-07 Rptr KF

Jefferson City, Missouri
February 2007

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

NP

BEFORE THE PUBLIC SERVICE COMMISSION

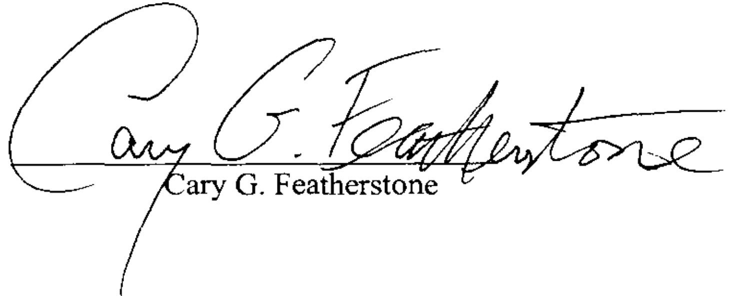
OF THE STATE OF MISSOURI

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 service area.	)))))	Case No. ER-2007-0004

AFFIDAVIT OF CARY G. FEATHERSTONE

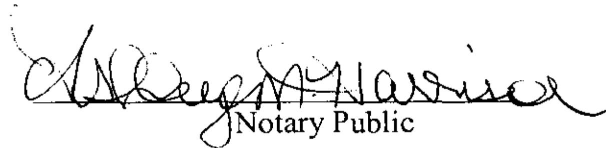
STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

Cary G. Featherstone, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Rebuttal Testimony in question and answer form, consisting of 21 pages to be presented in the above case; that the answers in the foregoing 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.



Cary G. Featherstone

Subscribed and sworn to before me this 15th day of February 2007.



Notary Public

ASHLEY M. HARRISON
My Commission Expires
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Cole County
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OF

CARY G. FEATHERSTONE

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

AQUILA NETWORKS-L&P (Electric)

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1 **REBUTTAL TESTIMONY**

2 **OF**

3 **CARY G. FEATHERSTONE**

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

5 **AQUILA NETWORKS-L&P (Electric)**

6 **CASE NO. ER-2007-0004**

7 Q. Please state your name and business address.

8 A. Cary G. Featherstone, Fletcher Daniels State Office Building, 615 East 13th

9 Street, Kansas City, Missouri.

10 Q. By whom are you employed and in what capacity?

11 A. I am a Regulatory Auditor with the Missouri Public Service Commission

12 (Commission).

13 Q. Are you the same Cary G. Featherstone who filed direct testimony in this

14 proceeding?

15 A. Yes, I am. I filed direct testimony in this case on January 18, 2007, on the

16 areas of fuel- Interim Energy Charge (IEC) and South Harper Generating Unit (South

17 Harper).

18 Q. What is the purpose of your rebuttal testimony?

19 A. The purpose of this rebuttal testimony is to address the direct testimony filed by

20 Aquila, Inc. (Aquila or Company) witness Dennis R. Williams, Vice President -- Electric

21 Regulatory Services, relating to the Company's proposal for a fuel adjustment clause (FAC).

22 Specifically, Mr. Williams states at page 2, line 15, that his direct testimony "describes the FAC

23 mechanism being proposed by Aquila and the advantages it provides to all parties in comparison

1 to other approaches utilized in the past." I address Aquila's request for the fuel cost recovery
2 mechanism that is referred to as a total pass-through fuel clause. In its proposed form, this type
3 of fuel recovery mechanism does not provide either the necessary incentives for Aquila or
4 appropriate protections for the Company's customers. Clearly, modifications would have to be
5 made to Aquila's proposed fuel clause mechanism to correct for the deficiencies inherent in the
6 approach presented in Aquila witness Williams' direct testimony.

7 I also address a "placeholder" capacity agreement that Aquila requested be included in
8 this case for a potential acquisition of a power plant by December 31, 2006. Aquila did not
9 acquire the power plant.

10 Q. Would you please describe how you are referring to Aquila, its divisions and
11 affiliates in this rebuttal testimony?

12 A. When referring to the current Aquila corporate structure, I will use the name
13 Aquila, the parent company, including its operations regulated by this Commission—Aquila
14 Networks-MPS and Aquila Networks Light & Power. Aquila, Inc. was formerly named
15 UtiliCorp United, Inc. I refer to the operating division Aquila Networks-MPS as MPS, and I
16 refer to the operating division Aquila Networks-L&P as Light & Power or L&P.

17 **EXECUTIVE SUMMARY**

18 Q. Please summarize your testimony.

19 A. Staff is opposed to the fuel cost recovery mechanism proposed by Aquila.
20 Aquila's proposal does not provide the necessary incentives for the Company to operate in the
21 most efficient manner that would generate least cost for fuel and purchased power. The total
22 pass-through cost recovery mechanism proposed by Aquila also does not provide the necessary
23 protection to its customers.

1 Staff presented in its direct testimony a fuel cost recovery mechanism known as an
2 interim energy charge (IEC). I detailed this mechanism and its development extensively in my
3 direct testimony filed on January 18, 2007. Staff continues to believe that the IEC would be a
4 superior cost recovery mechanism to what the Company has proposed, since it would provide
5 incentives to Aquila to operate in an efficient manner and provide the necessary protections to
6 Aquila's customers from having to experience volatility in their electric rates. An IEC uses a
7 floor and ceiling band (a base and forecast level) for fuel and energy pricing that Aquila will
8 likely experience over the period the IEC is in effect. Originally, Staff proposed a two- or three-
9 year IEC, but is now recommending a two-year IEC based on the recent announcement of the
10 proposed acquisition of Aquila by Great Plains Energy Inc., the parent of Kansas City Power &
11 Light Company (KCPL). Because of the uncertainty surrounding this acquisition, and in
12 particular, the effect the sale of Aquila to Great Plains Energy would have on the operations of
13 MPS and L&P, it is believed that two years is the maximum time an IEC mechanism should be
14 in place.

15 Another concern involves Aquila's inclusion, in its July 3, 2006, filing, of a
16 "placeholder" capacity agreement for the potential acquisition of a power plant that Aquila
17 previously owned. This facility is the Aries Combined Cycle Generating Station. Although
18 Aquila made an offer for this plant, it was not accepted by its former partner, Calpine Inc.
19 Kelson Energy successfully bid for the Aries plant and became the current owner as of January
20 2007.

21 Aquila plans to meet its capacity needs for the summer of 2007 through purchased
22 power agreements in lieu of its own generation. Staff has consistently recommended to Aquila,
23 and expected it to examine, the self-build options to meet its system load requirements. Staff

1 has taken issue with Aquila's capacity planning in the past and continues to believe that the
2 Company is deficient in making capacity planning decisions. These decisions will result in
3 higher costs in the future to the Company and its Missouri customers.

4 **FUEL COST RECOVERY MECHANISM**

5 Q. Is Aquila proposing the use of a fuel clause in this case?

6 A. Yes. Aquila witness Williams proposes the use of a fuel cost recovery
7 mechanism (fuel clause) starting at page 3 of his direct testimony. Aquila's proposal is
8 identified in Mr. Williams' direct testimony starting at page 3, line 12, wherein he addresses
9 what he refers to as "key features" of the Company's proposal:

10-12
- The FAC factor will be based upon historical differences between cost of fuel and energy built into base rates and the actual cost of fuel and energy

13-14
- Actual cost of fuel and energy for establishing the "base cost" will be the expenses recorded in FERC accounts 501, 509, 547 and 555.

15-20
- Off system sales above or below that included in base cost will be passed through the FAC at 50% of the difference. This sharing mechanism between customers and shareholders recognizes that the off system sales market is largely outside the control of Aquila, but provides incentive to Aquila to take on the additional risk of pursuing sales outside of its core markets.

21-22
- All hedge costs, settlement cost and benefits will flow through the FAC.

23-25
- Any insurance proceeds related to fuel or purchased power for generation outages ("Guaranteed Generation") will flow through the FAC.

26-28
- Purchased power capacity contracts greater than one year will be excluded. Commission approved capacity contracts which are less than one year in length will be included in the FAC.

29-30
- The FAC will be adjusted quarterly unless the adjustment factor is relatively small, as detailed later in my testimony, or for other good

1 cause shown and approved by the Commission as to why no
2 adjustment should be made.

3 • The base FAC for MPS will be established at $0.0287 per kilowatt-
4 hour sold and the base FAC for L&P will be established at $0.0215
5 per kilowatt-hour sold.

6 • Over-recoveries and under-recoveries of costs will be recorded on
7 Aquila's books in deferred tracking accounts on which interest will
8 be calculated monthly on the balance therein using Aquila's
9 weighted average short-term cost of debt.

10 Q. When did the fuel recovery mechanism become law?

11 A. Senate Bill 179 was signed on July 14, 2005, and the law became effective
12 January 1, 2006. It is designated as Section 386.266 RSMo. This law required the Commission
13 to promulgate procedural rules before the fuel recovery mechanism would be available to
14 electric utilities.

15 Q. Has the Commission issued rules relating to the fuel recovery mechanism?

16 A. Yes. The Commission has adopted rules 4 CSR 240-3.161 and
17 4 CSR 240-20.090, which became effective January 30, 2007. These rules identify the filing
18 requirements and information that is required to implement a fuel recovery mechanism such as a
19 FAC or IEC.

20 Q. Is Staff in agreement that a fuel clause type recovery mechanism like the one
21 being proposed by Aquila should be used in this case?

22 A. No. As stated starting at page 11 of my direct testimony, Staff is proposing the
23 use of an IEC mechanism that has been used several times in past electric rate cases and is
24 similar to the forecasted fuel mechanism developed in the early 1980s and used in several cases
25 by KCPL and The Empire District Electric Company (Empire).

1 The Staff's proposal is described extensively in my direct testimony. Staff believes, in
2 light of the current energy market, that an IEC is preferable not only to Aquila's proposed FAC,
3 but also to the traditional single point price for natural gas and purchased power.

4 Q. Does Staff have a proposed level of base and forecast (ceiling) for an IEC in this
5 case?

6 A. Yes. A base for natural gas of something in the $6 per mmbtu range and $55 per
7 megawatt hour for purchased power could be a starting point. A ceiling price for natural gas
8 could be set in the order of $9 per mmbtu and upwards of $90 per megawatt hour for purchased
9 power. In addition, Staff has proposed that a dispute with one of Aquila's coal suppliers be
10 treated as part of the IEC mechanism. This would result in a base of around $21 per ton for the
11 original contract amount for the high btu blend coal used at Sibley facility and Lake Road
12 facility. The forecast amount would be approximately $40 per ton.

13 **PROBLEMS WITH AQUILA'S PROPOSED FUEL ADJUSTMENT CLAUSE**

14 Q. Why does Staff believe that the fuel clause being proposed by Aquila does not
15 provide adequate incentive for the Company to operate its system efficiently?

16 A. A total pass-through fuel clause, the type being proposed by Aquila in this case,
17 does not provide the necessary incentives to keep fuel costs as low as possible. With the
18 prospect of passing higher fuel and energy costs on to its customers on a quarterly basis as
19 proposed by Aquila, this would not provide the same incentive that the Company currently has
20 with no fuel clause or IEC mechanism in place. The existing structure provides the incentive to
21 the utility to keep fuel costs as low as possible to enable it to collect its costs in rates. When
22 rates are set higher than the Company incurs for fuel and energy costs it will be able to "keep"
23 those excess revenues. Conversely, if rates are set too low to allow the Company to properly

1 recover prudently incurred fuel and energy costs, it may under-collect costs, resulting in lower
2 earnings, assuming there are no other cost reductions or increases in revenues to offset those
3 increases.

4 Today, utilities that have no fuel clause attempt to operate their generating facilities in as
5 efficient a manner as possible in order to maximize the operating capabilities of the system.
6 Utilities place great emphasis and care in negotiating fuel supply contracts in order to get the
7 best price available. With a fuel clause that allows a total pass-through of all fuel and purchased
8 power costs, utilities simply won't have the same incentive mechanism in place to operate the
9 system as efficiently and negotiate contracts as stringently.

10 Q. Will the true-up audit for the FAC contemplated by Aquila's proposal provide
11 the necessary safeguards to ensure that only prudently incurred costs are recovered?

12 A. While the true-up audit of actual costs of the fuel clause are always touted as the
13 safeguard that will allow only prudent costs to be recovered, the reality is that it is extremely
14 difficult to impose the standard of prudence relating to plant operations and procurement of fuel
15 and energy supply. In order to make those determinations, an exhaustive review of the fuel and
16 purchased power costs would have to be undertaken to identify the type of issues relating to
17 imprudent behavior concerning plant operating and fuel supply procurement problems. It is
18 simply "easier said than done" to make adjustments for imprudence and hold the line on
19 escalating fuel and purchased power costs.

20 Q. Does the IEC mechanism provide incentives to the Company?

21 A. Yes. While some level of prudency review is always part of any determination
22 of fuel and purchased power costs, an IEC style fuel mechanism provides opportunities for the
23 utility to "keep" any amount under the base level. This provides incentives for a company like

1 Aquila to push fuel prices down and operate the generating fleet in the most cost effective
2 manner. At the same time in a volatile energy market, because of the use of an IEC band up to a
3 forecast (ceiling) price, the risk of rising energy prices would not be entirely placed on Aquila.
4 Within the band range, both Aquila and customers are protected as to increases and decreases to
5 fuel and energy costs. If those costs increase, the Company will recover up to the forecast
6 amount. If those costs fall, the customers will receive refunds for any amounts over-collected.

7 Q. Aquila proposes to exclude purchased power capacity contracts greater than one
8 year but include those less than one year in length. Does Staff agree that capacity agreements
9 should be excluded from a fuel recovery mechanism?

10 A. Regardless of the type of recovery mechanism the Commission authorizes in this
11 case, Staff believes the demand charge component of capacity agreements should not be
12 included in the fuel recovery process. Demand charges are fixed costs to reserve capacity of
13 another company's production facilities. These fixed costs are more like plant investment costs
14 and should not be included in any fuel recovery mechanism. The more recent IEC's have not
15 included any fixed fuel or purchased power costs and Staff continues to believe these costs are
16 not what typical fuel recovery mechanisms are intended to collect. Staff believes these
17 mechanisms are intended to recover variable fuel and purchased power costs that have been
18 shown to be difficult to forecast for ratemaking purposes.

19 Staff would recommend not including demand charges for capacity agreements of less
20 than one year duration for the same reasons as those agreements that are greater than one year.

21 Q. Will Aquila's proposed FAC cause different results than the normalized fuel and
22 purchased power costs typically determined in a rate case?

1 A. Yes. Aquila's total pass-through FAC does not recognize the inherent
2 efficiencies built into the ratemaking process. Determining fuel and purchased power costs in a
3 rate case requires analyses to be performed to identify the proper inputs to the various
4 components needed for the fuel model. These include weather normalized and annualized
5 system load requirements; fuel and freight prices; energy prices for purchased power costs;
6 normalized generation levels reflecting normal maintenance outage schedules for each
7 production facility; normal purchased power levels; normal heat rates for production facilities.
8 The fuel model process removes, or normalizes, abnormal events such as extended outages.
9 Those would be "averaged" over a period of several years. The effects of above or below
10 normal weather would also be normalized so the kwh sales included in the fuel model would not
11 be overstated or understated.

12 Aquila's proposed total pass-through FAC does not contemplate these factors. This
13 proposal is intended to pass actual total fuel and purchased power costs through the FAC,
14 ignoring the normalization and annualization process of a rate case. As an example, the higher
15 fuel costs relating to increased kwh sales through increased customer levels and usage will be
16 passed through Aquila's FAC, but the off-setting increased revenue will be ignored. Those
17 increased revenues would directly pass-through to Aquila's earnings while it will recover the
18 related higher fuel and purchased power costs through the FAC.

19 **OFF-SYSTEM SALES IN FUEL CLAUSE**

20 Q. Aquila is proposing to "share" the off-system sales above a base level as part of
21 its fuel clause proposal. Does Staff agree with this position?

22 A. No. Aquila witness Williams indicates in his direct testimony (page 3) that "this
23 sharing mechanism between customers and shareholders recognizes that the off-system sales

1 market is largely outside the control of Aquila, but provides incentive to Aquila to take on the
2 additional risk of pursuing sales outside of its core markets." Currently, the Company "keeps"
3 100% of the off-system sales above the level included in a rate case. This provides even more
4 incentive for the Company to pursue off-system sale transactions. Staff believes this is
5 appropriate until the time a rate case is filed when the base of off-system sales is re-determined.

6 Q. What are off-system sales?

7 A. Off-system sales relate to sales of electricity made at times when utilities have
8 met all obligations to serve their native load customers and have excess energy to sell to
9 other utilities. The off-system sale transactions occur between utilities resulting in profits
10 (net margin) to the selling entity, in this case, Aquila.

11 Q. What is Staff's main concern with respect to Aquila's 50% off system sales
12 sharing proposal?

13 A. The off-system sales revenues represent a very important part of an electric
14 utility's business, especially over the past several years. Staff is concerned that the sharing of
15 off-system sales concept proposed by Aquila in its FAC not be used as a basis in the future to
16 justify the "sharing" of all off-system sales.

17 It is important to make a distinction between the base level of off-system sales that
18 Aquila is not proposing to "share" and the amount above the base level that Aquila is proposing
19 to share on a 50% basis. In the past, Aquila has taken the position that all off-system sales
20 should be split on a 50% basis between customers and shareholders. Staff is very much
21 opposed to such treatment.

22 Q. When did the Company propose this treatment?

1 A. Aquila proposed to split all the off-system sales profits with customers in its
2 1997 general rate case, Case No. ER-97-394. It also made this same proposal before the Kansas
3 Corporation Commission (Kansas Commission).

4 Q. How did the Commission decide how off-system sales should be treated for
5 ratemaking purposes?

6 A. In Aquila's (then called UtiliCorp United Inc) 1997 general rate case, the
7 Commission included off-system sales in the calculation of the rate level ordered in that case.
8 The Commission stated, in part, as follows:

> 9 The Commission finds the Staff provided competent and substantial
> 10 evidence that all of the off-system sales revenue should be reflected in
> 11 the test year revenue for the purposes of setting rates. The Staff is
> 12 correct in stating that, since all of the costs of producing the off-system
> 13 sales revenue were borne by the ratepayers, and since UtiliCorp has
> 14 benefited from regulatory lag, the total amount of this revenue should
> 15 be included in rates.
>
> 16 The Commission adopts the adjustment proposed by the Staff.

17 Q. How did the Kansas Commission treat off-system sales in rates?

18 A. In Aquila's rate application filed in Kansas on December 8, 2000, its West
19 Plains Energy Kansas (West Plains) division proposed the same 50/50 "sharing" mechanism for
20 off-system sales before the Kansas Commission in Docket No. 01-WPEE-473-RTS. The
21 Kansas Commission rejected this proposal stating:

> 22 **F. Sharing of Off-System Sales Margins**
>
> 23 30. West Plains asks the Commission to reconsider its decision in
> 24 Docket No. 99-WPEE-818-RTS to not allow West Plains to share in off-
> 25 system sales margins. The [Kansas] Commission's decision was
> 26 affirmed by the Kansas Court of Appeals in *UtiliCorp United, Inc. d/b/a*
> 27 *West Plains Energy Kansas v. KCC,* slip op.85,716 (Kan.App.December
> 28 15, 2000). As discussed in Order Nos. 10 and 13 in Docket No.
> 29 99-WPEE-818-RTS, **the cost of off-system sales are borne entirely by**
> 30 **the ratepayers, while the Applicant has enjoyed all of the benefits of**
> 31 **the increased revenue.** If all of the costs are borne by the ratepayers,

1 then **all of the benefits of increased revenues should be enjoyed by**
2 **the ratepayers. The full measure of revenues and costs related to**
3 **these sales should be reflected in the cost of service at test year levels.**

4 31. West Plains again asserts its proposed sharing mechanism
5 provides incentive for West Plains to engage in off-system sales and
6 compete in the marketplace. [Keith, Rebuttal at 17]. West Plains
7 submits its proposed sharing mechanism is similar to the sharing
8 mechanism allowed in another Commission proceeding, Docket No.
9 190,061-U. [Keith, Rebuttal at 17]. These arguments are the same
10 arguments made by West Plains in Docket No. 99-WPEE-818-RTS.
11 Consistent with the decision in Docket No. 99-WPEE-818-RTS, Staff
12 made an adjustment to add back 50 percent of the sales margins that had
13 been removed in the schedules filed by West Plains with its rate
14 application.

15 32. The **Commission remains concerned about any sharing**
16 **mechanism that allocates the sales margins where 100 percent of the**
17 **costs are borne by the customers.** The Commission has not accepted a
18 sharing mechanism, as proposed by West Plains, for any other electric
19 public utility. The **Applicant has an incentive to continue making off-**
20 **system sales because the Applicant would retain all profits exceeding**
21 **the normalized level reflected in the Applicant's overall revenue**
22 **requirement. The Commission finds no compelling argument has**
23 **been advanced by the Applicant to justify the Commission's**
24 **departure from the prior decision and adoption of a new policy**
25 **regarding off-system sales. Staff's adjustment to off-system sales**
26 **revenues is accepted.**

27 [August 15, 2001 Order of KCC in Docket No. 01-WPEE-473-RTS,
28 page 13-14; emphasis added]

29 Thus, Aquila proposed this 50/50 "sharing" mechanism in Kansas on two occasions and
30 the Kansas Commission rejected the proposal in both instances.

31 Q. Have off-system sales been included in rates in the past?

32 A. Yes. Staff has consistently included off-system sales in all of the electric
33 cases that I am aware of, dating back to at least the early 1980s.

34 Q. Why is it appropriate to include off-system sales in the current revenue
35 requirement determination?

1 A. The same generating facilities, equipment, and employee/personnel that are
2 necessary to provide service to Missouri retail electric customers are also needed to make
3 off-system sales. It is appropriate to include the off-system sales in this case because
4 Aquila's customers are paying for all costs associated with the facilities to produce electricity
5 for the firm retail customers, i.e., native load customers. To the extent that other sales can be
6 made using those facilities, the customers should benefit from these sales. The off-system
7 sales are made at a time when the generating facilities are not needed to serve the native load
8 customers. Off-system sales represent an efficient utilization of the electric system that has
9 been put in place to meet the native load customers' electricity needs. Off-system sales occur
10 at a time when the production facilities and purchases are not needed for Missouri retail
11 customers.

12 Q. Does Aquila benefit from these off-system sales?

13 A. Yes. To the extent that there are increases in off-system sales that occur after
14 rates are determined in any given proceeding, the Company will benefit from the growth and
15 increase in net margins (off-system sales less fuel costs) throughout the period until rates are
16 changed by the Commission in a general rate proceeding.

17 **INTERIM ENERGY CHARGE MECHANISM**

18 Q. Mr. Williams states at page 5, line 22, of his direct testimony that the IEC Aquila
19 had for two years was not successful. Do you agree?

20 A. There will likely be disagreement among the parties regarding the true success of
21 the IEC implemented in Aquila's 2004 rate case, Case No. ER-2004-0034 (the 2004 IEC).
22 There were several circumstances that resulted in Aquila recovering less revenue than its actual
23 fuel costs for its MPS Division. Adding to difficulty in implementing that particular IEC was a

1 problem with the way Aquila recorded fuel and purchased power expenses on its books
2 compared with the way it collected the IEC revenues. This created additional confusion,
3 administrative burden and, ultimately disagreement among the parties monitoring the IEC on
4 the effects of splitting the joint dispatch savings between MPS and L&P. While Aquila agreed
5 to refund a portion of the IEC collected for the L&P Division in a Stipulation and Agreement
6 reached between the parties in Case No. ER-2005-0436, this issue caused much concern to the
7 Company and is one of the reasons I believe Aquila views that IEC as unsuccessful.

8 Q. What were the circumstances which caused problems for the 2004 IEC?

9 A. My direct testimony, starting at page 35, identified two issues that caused
10 substantial increases in fuel and purchased power expenses that adversely affected to the 2004
11 IEC mechanism. These two events relate to a breached coal supply agreement with CW Mining
12 and the extended outage at Sibley Generating Station. Both caused significant increases above
13 the levels that the 2004 IEC anticipated, resulting in a substantial under-collection for MPS.

14 Q. What factors have caused MPS not to recover its actual fuel costs?

15 A. In the last case before the 2004 IEC was terminated, the coal dispute with CW
16 Mining alone contributed at least $8 million to the under-recovery of the IEC (page 14, line
17 10 of Aquila witness Williams rebuttal testimony in Case No. ER-2005-0436). The extended
18 Sibley outage had a significant impact since the Sibley unit is the least cost generation on the
19 MPS system. The exact impact was never quantified after the 2004 IEC ended but it was
20 likely that this outage resulted in several million dollars. Since this generating unit is the
21 Company's lowest-cost unit, any replacement power needed during the time that unit was out
22 of service would be more costly. The Sibley outage went beyond the original planned four-

1 week outage to almost eight weeks, resulting in significant increase in fuel and purchased
2 power costs.

3 **ALTERNATIVE FUEL CLAUSE PROPOSAL**

4 Q. Is Staff aware of an alternative proposal to Aquila's FAC that is being
5 discussed by some of the parties in this case?

6 A. Yes. During the prehearing conference, several of the parties started
7 discussing an alternative fuel clause proposal that was intended to address some of the
8 deficiencies of Aquila's proposed FAC. A conceptual frame work proposal was developed
9 by this group and is presently being considered as a fuel recovery mechanism that could be
10 used in this case. At this time, while Staff can not provide full support to all aspects of this
11 proposal, there is enough conceptual agreement to warrant continued further discussion and
12 refinement. If agreement can be reached among this group regarding this alternative
13 proposed fuel clause mechanism, Staff would support this approach in lieu of the proposed
14 IEC.

15 Q. Has this proposal been given to Aquila?

16 A. It is my understanding it has.

17 Q. Why would Staff support this proposal in lieu of the IEC proposal?

18 A. This alternative fuel clause proposal is being supported by some of parties in
19 this case who have been involved in the fuel clause debate during its consideration in the
20 legislative process; participated in the work shops relating to Senate Bill 179; have
21 participated in many rate cases involving Missouri utilities relating to fuel issues, including
22 development of the IEC mechanism used in several rate cases; and have examined the fuel
23 clause issue in other states. Particularly important will be the acceptance of the alternative

1 fuel clause proposal by those parties representing all the various classes of customers
2 i.e., residential, commercial and large volume industrial customers.

3 This group is currently developing an alternative proposal that will likely provide
4 more safeguards and protection to Aquila and its customers. In addition, this alternative
5 proposal will better address the efficiency of operating the Company's generating assets than
6 the Aquila total pass-through FAC.

7 **AQUILA CAPACITY**

8 Q. Does Staff have any response to the "placeholder" long-term ** ___ **
9 megawatt purchased power agreement Aquila has included in its direct case, as described at
10 pages 4 and 5 of the direct testimony of Aquila witness Kevin T. Noblet?

11 A. Yes. Mr. Noblet identifies in his direct testimony filed July 3 of last year that
12 Aquila might have an opportunity to purchase a "local natural gas-fired combined cycle
13 facility that is currently scheduled to be sold this year."

14 Q. Does Aquila need additional capacity?

15 A. Aquila has less firm long-term capacity than it needs to serve its MPS system
16 load requirements. Since 2001 Aquila has been seeking to replace a purchased power
17 agreement (PPA) relating to the Aries Combined Cycle Unit (Aries) that MPS entered into
18 with an Aquila affiliate, Aquila Merchant, that expired on May 31, 2005.

19 Q. What generating facility is Mr. Noblet referring to?

20 A. The Aries power plant that was previously jointly owned by Aquila and
21 Calpine, Inc. before Aquila sold its interest to Calpine in the spring of 2004. Aries is a
22 585 megawatt combined cycle unit that started commercial operation in February 2002 and is
23 located in Aquila's MPS service territory in Cass County, Missouri.

1 Q. Did Aquila acquire the Aries power plant?

2 A. No. While Aquila bid on the plant in early December 2006, the successful
3 bidder Kelson Energy acquired the plant in mid-January 2007.

4 Q. Is the "placeholder" purchased power agreement that Aquila included in its
5 direct case filed July 3, 2006, still appropriate?

6 A. No. Since Aquila did not acquire the Aries facility from Calpine, whatever
7 value the ** ___ ** megawatt "placeholder" purchased-power agreement may have had no
8 longer exists.

9 Q. Given that Aquila was unable to acquire Aries, how does it intend to meet
10 MPS' future system load requirements?

11 A. After it failed to acquire Aries, Aquila hastily entered into the two capacity
12 purchased power agreements in late December 2006. One agreement is for ** __ **
13 megawatts of capacity for the period ** ______________________________ ** and the other
14 is for ** ___ **megawatts of capacity for ** ______________________________ **. Staff
15 anticipates Aquila will rely on these two capacity purchased power agreements to meet its
16 summer of 2007 peak season needs.

17 Q. Has Aquila updated its original filing?

18 A. Yes, with the parties, but not in filings with the Commission. As ordered in
19 the procedural schedule, Aquila recently provided the parties its updates to December 31,
20 2006. Included in those updates are two capacity purchased power agreements.

21 Q. Should these capacity purchased power agreements be included in Aquila's
22 cost of service?

1 A. No. The Commission should impute Aquila-owned generation capacity to
2 Aquila Networks-MPS to satisfy Aquila's capacity needs instead of the two capacity
3 agreements. Certainly the hypothetical purchased power agreement that Aquila identified as
4 a "placeholder" that is no longer valid and cannot be executed and is for more capacity than
5 Aquila Networks-MPS needs should not used to set rates in this case.

6 Q. Would you please elaborate on your response?

7 A. Yes. First, let me point out that generally Staff disagrees with utilities filing
8 general rate increase cases that include "placeholders" for anticipated future events rather
9 than relying on actual historical data; however, in this case, recognizing Aquila hoped to
10 acquire from Calpine the Aries unit, Staff did not attempt to dissuade Aquila from including
11 the "placeholder" ** _______ ** purchased power agreement in its direct case before Aquila
12 initiated this case. While Staff did not oppose Aquila using a "placeholder" purchased power
13 agreement when it filed its direct testimony on July 3, 2006, Staff does take issue with Aquila
14 not filing supplemental direct testimony well in advance of the other parties' rebuttal filing
15 deadline of February 20, 2007, after Aquila failed to acquire the Aries facility and executed
16 in December of 2006 two capacity purchased power agreements.

17 While Staff would have supported Aquila acquiring the Aries facility, Staff does not
18 support Aquila using purchased power agreements to satisfy its need for adequate and
19 reliable long-term power. Aquila's South Harper facility has 315 megawatts of capacity.
20 Because of the legal issues surrounding that plant, which may lead to it being removed, Staff
21 did not include that electric generating facility in its direct case, instead using it as the basis
22 for the costs of a site and three of five 105 megawatt combustion turbines the Staff has
23 imputed to Aquila, and described in the direct testimony of Staff witnesses

1 Cary G. Featherstone, Philip K. Williams and Charles R. Hyneman as Aquila's MPS
2 generating facility. With Aquila's South Harper facility included in the generation mix for
3 MPS, as stated in the direct testimony of Staff witness Lena M. Mantle, MPS still had a
4 shortfall of about 200 megawatts in meeting its 2006 and continuing long-term capacity
5 needs. Rather than relying on purchased power agreements to meet those continuing
6 capacity needs, particularly a "placeholder" agreement for capacity that far exceeds that
7 capacity need, the Commission should adopt the approach advanced by the Staff and impute
8 owned generation capacity to Aquila, *i.e.*, the 525 megawatts MPS facility described in the
9 direct testimony of Staff witness Hyneman, which appropriately matches Aquila's capacity
10 needs with company-owned generation plant, albeit imputed ownership.

11 Q. How has Aquila met its system load requirements in the past?

12 A. Aquila constructed three peaking turbines at its South Harper facility, which
13 total 315 megawatts of capacity. In early 2005, Aquila-MPS entered into a long-term unit
14 participation purchased power agreement with Nebraska Public Power District (NPPD) for
15 75 megawatts of capacity from Cooper Nuclear Station. The NPPD agreement extends
16 through January 2014. Aquila also secured a purchased power agreement for wind
17 generation from Gray County Wind Energy in Gray County, Kansas. A small portion of the
18 capacity can be accredited and is specifically assigned to MPS, L&P, and an affiliate, West
19 Plains Energy Kansas. Aquila also entered into a 100 megawatt unit participation purchased
20 power agreement from two coal-fired units (50 megawatts each) with NPPD Gerald
21 Gentlemen Station through May 2011 for L & P.

22 To make up a shortfall in its capacity requirements for the summer of 2006, Aquila
23 secured additional capacity for last summer, but nothing beyond. Aquila entered into a

1 ** ____

2 __________________ ** to meet the summer of 2006 capacity needs.

3 Q. Do the two capacity purchased power agreements Aquila entered into in late

4 December 2006 meet Aquila's future capacity needs?

5 A. No. The two capacity agreements that Aquila has signed are only for ** ___

6 ___________________________ **. Aquila has the same capacity need in ** ____ ** and

7 beyond. In fact, Aquila needs even more capacity to meet the growth of the MPS and L&P

8 systems. At this time Aquila has no plans in place to meet the ** ____ ** peak capacity

9 season. Aquila has exposed itself and ultimately its customers to the energy market place

10 without adequate consideration of the option to build or acquire generating capacity. In fact,

11 it is becoming more evident that Aquila has no intention of building, or even seriously

12 examining this option in a meaningful way.

13 Q. Did Aquila examine building generating capacity to meet the summer of 2006

14 and 2007?

15 A. No. Aquila received responses from the request for proposals issued in

16 July 2005 from several different sources for the summer of 2006. None of these responses

17 included a self-build option. For the summer of 2007 capacity needs, Aquila received

18 proposals in late winter 2006 but none provided for a self-build option for next summer.

19 Q. When was the last time Aquila considered a self-build option to meet its

20 capacity requirements?

21 A. Aquila's Generation Group did submit a response to Aquila's request for

22 proposal on November 22, 2004, for capacity year 2007. However, at that time Aquila made

23 no attempt to consider meeting its capacity needs by the purchase of any turbines or even

1 getting any bids from turbine manufacturers. Aquila did not make any meaningful attempt to
2 examine meeting its system load requirements by any means other than purchasing the
3 capacity from other sources for either 2006 or 2007. For either of these peak summers,
4 Aquila did not consider several options that other utilities have pursued, such as: 1) seeking
5 offers of new turbines from turbine manufactures; 2) requesting offers of new equipment that
6 has been released before delivery that turbine manufacturers discount; 3) pursuing the gray
7 market for turbines from non-turbine manufactures; and 4) examining access to existing
8 facilities Aquila owns and that it is attempting to sell to third party non-affiliates.

9 Aquila did pursue these options in early 2006 for the summer of 2008, but it remains
10 to be seen if the Company will seriously consider building generation to meet its system load
11 requirements for that year.

12 Q. Does this conclude your rebuttal testimony?

13 A. Yes.