

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI**

In the matter of Aquila, Inc. d/b/a)	
Aquila Networks-L&P, for authority)	
to file tariffs increasing steam)	HR-2005-0450
rates for the service provided to)	
customers in the Aquila Networks-)	
L&P area.)	

**PREHEARING BRIEF OF
AG PROCESSING INC**

COMES NOW Ag Processing Inc (AGP) pursuant to the ordered schedule herein and submits its prehearing brief on selected issues. We will follow the numbering of the issue statement that was used in our December 23, 2005 Position Statement but will only list those issues on which we have submitted testimony. Because AGP is also an electric customer in Aquila's L&P Division, we incorporate by reference those points expressed in a separate prehearing brief that is being submitted in Case No. ER-2005-0436. This prehearing brief will address the limited number of steam-specific issues that are believed to require address at this time. Please note that the exhibits referenced in the ER-2005-0436 case filing correspond to exhibits in that case. Reference should be made to the corresponding witnesses' testimonies in the HR-2005-0450 case.

16. Coal Prices: On what prices should Aquila's coal fuel expense be based in setting rates?

Aquila entered into a contract with C. W. Mining to secure a supply of high Btu coal for its Sibley and Lake Road generating facilities. Unfortunately, it has not received the contracted deliveries from C.W. Mining. As a result, it has replaced those supplies with higher cost supplies acquired in the market. Subsequently, Aquila has replaced this contract with higher cost coal supplies. However, we believe that the lower cost of the C. W. Mining supplies should be reflected in fuel calculations and ratepayers should only be required to pay the contracted for price with C. W. Mining plus rail delivery charges.^{1/}

There are several reasons for this recommendation, but chief among them is Aquila entered into the contract with C. W. Mining based on its own evaluations and analyses. Aquila is the one that was responsible for contracting for the coal, including the selection of the specific suppliers to perform this role. In addition, AGP understands that Aquila has taken legal action to assert its rights under the contract. Until the litigation process is complete, and until there is a full airing of Aquila's actions surrounding the execution of the contract, its management of the contract, and the legal proceedings, customers should not

^{1/} Brubaker, Direct Testimony, Ex. 89, p. 10.

be required to pay anything more than the initial contracted price.^{2/}

In addition, allowing direct passthrough of the costs of the replacement contract may well impair Aquila's ability to obtain relief in damages against C. W. Mining. At a minimum, it will certainly diminish any incentive that Aquila has to aggressively pursue the litigation.

17. Natural Gas Prices: On what prices should Aquila's natural gas expense be based in setting rates?

Natural gas prices are a contentious issue in this case, both because they are exceptionally difficult to predict and because of Aquila's high level of dependence on natural gas. Accordingly, using appropriate pricing for this critical component of fuel supply is very important.

The natural gas price that should be used in calculations in this case is the price of Aquila's gas hedged at NYMEX, adjusted for the basis differential to the market area where Aquila buys gas.

As expressed in the testimony of Aquila witness Boehm, and shown on Schedule JGB-2, Aquila used the average of 2006 NYMEX futures prices, measured over the period October through

^{2/} Brubaker, Direct Testimony, Ex. 89, p. 10-11.

December 2004. On an annual basis, the price proposed is \$6.57 per MMBtu.

Mr. Brubaker reviewed these prices. In the short term they have been driven dramatically higher by the effects of hurricanes Katrina and Rita.^{3/} But these high prices are a short-term phenomenon.

Subsequently, Mr. Brubaker updated his gas price estimates with more current information through November 30, 2005. He observed that his analysis indicated declining prices.^{4/}

But there is another factor to be considered, because the NYMEX price must be adjusted for the significantly lower cost that Aquila pays at its pipeline connections with Southern Star Central Gas Pipeline and on Panhandle Eastern Pipe Line Company - the interstate pipelines serving Aquila's Missouri locations.

Mr. Brubaker explained:

Aquila typically would be able to purchase natural gas at a price less than the NYMEX price. Aquila transports its gas on Southern Star Central Gas Pipeline (Southern Star) and on Panhandle Eastern Pipeline Company (Panhandle). The typical pricing point for gas that Aquila purchases for transport on these pipelines runs at a discount to the Henry Hub/NYMEX prices. The magnitude of the negative basis depends upon the overall level of gas prices and conditions in the market. Schedule 5SR is a graphical presentation of this basis differential over the period January 2004 through November 2005. Page 1 shows the gas price data, by month,

^{3/} Brubaker, Direct Testimony, Ex. 1038.

^{4/} See, Brubaker, Surrebuttal Testimony, ER-2005-0436, Ex. 91, p. 12.

at each of the three pricing points. Page 2 of this Schedule shows the differential over the same period of time. Note that during the early portion of this time period, the basis was in the range of -\$0.50 per MMBtu to Henry Hub. More recently, with the substantially elevated market gas prices, the basis has been significantly more negative, ranging to over \$4.00 per MMBtu, below the Henry Hub price.^{5/}

Furthermore, to make an accurate estimate for ratemaking purposes, the analyst must also take into account the extent to which Aquila has hedged its natural gas purchases. In confidential testimony in Case No. ER-2005-0436, Mr. Brubaker discussed the specifics of this concern at pages 13 through 15 of his Surrebuttal Testimony, Exhibit 91 (Case ER-2005-0436). It would not be reasonable to assume that Aquila's entire gas purchasing portfolio was not hedged and failing to take this into account would be highly detrimental to the ratepayers because it would deny them the benefit of the very hedging programs that are supposedly implemented for their benefit.

Mr. Brubaker noted that Aquila's proposed gas pricing was unsupported and proposed that a better index was the swap prices under Aquila's hedges for April 2006 through March 2008 but reduced to recognize the basis differential to the market area where the gas is actually purchased by Aquila.^{6/} He also

^{5/} Brubaker, Surrebuttal Testimony, ER-2005-0436, Ex. 91, p. 13.

^{6/} Brubaker, Surrebuttal Testimony, ER-2005-0436, Ex. 91, p. 16-17.

recommended using Staff's projection of purchased power prices.^{7/}

Finally, as noted in Ms. Hennings' testimony, there is a considerable question concerning the adequacy of Aquila's analysis and planning with respect to the use of solid fuels, as well as consideration of the most appropriate method to deal with regulated emissions. Particular issues include the specific emissions to be controlled, the choices among fuel sources, technology to reduce emissions, the cost of acquiring emission allowances, reliability of fuel suppliers, and the impact of different strategies on generating unit operations and maintenance requirements. The issues in this case concerning coal for Sibley and Lake Road bring all of these issues to the forefront. It is important that the Commission put Aquila on notice that an effective planning process not only is expected, but required. While always important, it must be in place before any fuel adjustment rate form that would comprehend periodic rate adjustments to pass through prudently incurred fuel and purchased power cost is considered.^{8/}

^{7/} Brubaker, Surrebuttal Testimony, ER-2005-0436, Ex. 91, p. 17.

^{8/} Brubaker, Surrebuttal Testimony, ER-2005-0436, Ex. 91, p. 19.

29. Service Reliability: Should Aquila be directed to study any alleged recent reliability problems on its steam system, identify solutions, and report its findings to the Commission and interested parties?

AGP receives steam service from Aquila through direct piping from the Lake Road generating station. Reliability of service is important to AGP because drops in pressure result in shutdown of AGP systems with resulting loss of product, production time, and in some instances employee and plant safety issues.

Mr. Donald Johnstone, an engineer, reviewed the service and the interruption history for AGP. He testified

There have been interruptions in the steam service and furthermore, any interruption in the steam service can lead to an even longer interruption in AGP production. This occurs because it often necessarily takes time to restart AGP processes when the steam interruption is of a magnitude that leads to an interruption in the AGP processes. Also, any interruptions in the steam service make it difficult for AGP to maintain the consistently high quality product that is needed.^{9/}

These interruption events were significant in number. In his highly confidential October 27, 2005 Direct, Mr. Johnstone noted the number of events that had occurred and the serious issues that these interruptions presented to AGP.^{10/} The pattern and frequency has appeared to deteriorate as compared to

^{9/} Johnstone, Direct Testimony, Ex. 1044, pp. 4-5.

^{10/} Johnstone, Direct Testimony, Ex. 1045, p. 3.

prior years which may suggest either maintenance or equipment problems.^{11/} Mr. Johnstone recommended that Aquila be ordered to perform a comprehensive study of the causes of the deterioration in reliability as compared to prior years. This study should identify solutions and should include a plan to implement the solutions in a cost effective manner. Some solutions may require a change in the steam resources at the Lake Road Plant and, if so, an additional more extensive study would be required. In any event the initial report should be completed within 90 days after the Commission's order in this proceeding and shared with AGP and the Commission at that time.^{12/}

30. System Resource Study and Plan: Should Aquila be directed to perform a study of steam production resources to include the results of the reliability review and to identify economical alternatives for the provision of steam service, and report its findings to the Commission and interested parties?

Aquila's steam system has had substantial growth in the past few years. One result of this growth is that a significant amount of steam will be produced with natural gas at a substantial cost premium as compared to the previous cost of steam

^{11/} Johnstone, Direct Testimony, Ex. 1045, p. 3.

^{12/} Johnstone, Direct Testimony, Ex. 1045, p. 4.

produced predominantly with coal. Aquila has stated that a steam resource study may be completed in six to eight months (Aquila response to data request, see Schedule 2 attached to Johnstone October 27 direct testimony). Such an important study should be a requirement of the final report and order in this proceeding so as to ensure both a proper study and a proper consideration of the results of the study. The report should be provided to the Commission and the parties at a specified date certain not later than eight months after the final report and order in the instant proceeding. Study results and any prudent improvements identified by this method must be addressed by Aquila in the report. Based on the report parties may pursue any appropriate action or remedy, if needed, by means of discussions with Aquila or an appropriate filing before the Commission, or both.^{13/}

Respectfully submitted,

FINNEGAN, CONRAD & PETERSON, L.C.



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^{13/} Johnstone, Direct Testimony, Ex. 1045, p. 4.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that I have this day served the foregoing pleading by email, facsimile or First Class United States Mail to all parties by their attorneys of record as provided by the Secretary of the Commission.



Stuart W. Conrad

Dated: January 10, 2006