

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

In The Matter of the Application of Aquila, )  
Inc. for Approval of its Experimental )  
Regulatory Plan and for a Certificate of )  
Convenience and Necessity Authorizing )  
it to Participate in the Construction, Ownership, )  
Operation, Maintenance, Removal, )  
Replacement, Control and Management of )  
a Steam Electric Generating Station in )  
Platte County, Missouri, or alternatively for an )  
Order specifically confirming that Aquila, Inc. )  
has the requisite authority Under its )  
Existing Certificate(s). )

Case No. \_\_\_\_\_

**APPLICATION**

COMES NOW Aquila, Inc., (hereinafter "Aquila" or "Company") pursuant to §§386.250, 393.140, 393.170, 393.230 and/or 393.240 RSMo 2000; and 4 CSR 240-2.060, 4 CSR 240-3.105 and 4 CSR 240-3.110, and, for its Application to the Missouri Public Service Commission ("Commission"), respectfully states as follows:

**OVERVIEW**

1. By this Application Aquila seeks approval from the Commission of the Company's proposed Experimental Regulatory Plan. Aquila also seeks a certificate of convenience and necessity to participate in the construction, ownership, operation, maintenance, removal, replacement, control and management of a steam electric generating station in Platte County, Missouri, or alternatively for an order specifically confirming that Aquila has the requisite authority to undertake said activities with respect to said generating station under its existing certificate(s).

## **GENERAL INFORMATION ABOUT AQUILA**

2. Aquila is a Delaware Corporation with its principal office and place of business at 20 W 9<sup>th</sup> Street, Kansas City, Missouri 64105-1711. The Company is authorized to conduct business in Missouri through its Aquila Networks-MPS and Aquila Networks-L&P operating divisions and as such is engaged in providing electrical, natural gas and industrial steam utility service in those areas of the State certificated to it by the Commission. A Certificate of Authority for a foreign corporation to do business in the State of Missouri evidencing Aquila's authority under the law to conduct business in the State of Missouri was filed with the Commission in Case No. EU-2002-1053 and said documents are incorporated herein by reference in accordance with 4 CSR 240-2.060(1)(G). Likewise, copies of the registrations of fictitious names of Aquila Networks-MPS and Aquila Networks L&P were filed with the Commission in Case No. EU-2002-1053 and said documents are incorporated herein by reference in accordance with 4 CSR 240-2.060(1)(G).

3. Aquila has pending actions or final unsatisfied judgments or decisions against it involving customer service or rates having occurred within three (3) years from the date of this Application in certain of the jurisdictions in which it provides service, but none in Missouri.

4. Aquila has no annual report or assessment fees that are overdue.

5. All pleadings, notices, orders and other communications and correspondence regarding this Application and proceeding should be directed to:

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Aquila Networks  
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P.O. Box 456  
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(573) 635-7166

### **2005 ELECTRIC RATE CASE**

6. In May 2005 Aquila will initiate a general electric rate case by filing with the Commission revised tariffs designed to increase the Company's gross annual electric revenues for its Aquila Networks - MPS and Aquila Networks - L&P divisions. While the amount of the proposed general rate increase has not been determined, the primary drivers for this request include:

- The fact that cost of fuel and purchased power embedded in existing rates is based on an underlying natural gas price of \$3.50. In connection with this, on April 21, 2006, revenues of \$18.5 million generated by Aquila's existing Interim Energy Charge ("IEC") tariff will terminate. Current market prices for natural gas remain in excess of \$6.00 per mmbtu, even though the gas price embedded with the IEC rate is \$5.14 per mmbtu. Purchased power trading, as a function of natural gas prices, remains at prices higher than reflected in the present IEC. Sulfur-dioxide credits are trading at four-times those embedded in current rates. Spot high-btu coal prices have risen dramatically during the past year. Given these

facts, the loss of the \$18.5 million in revenue now generated by the IEC will result in a significant under-recovery of Aquila's actual fuel and purchased power costs incurred to serve its Missouri electric customers.

- The construction of Aquila's South Harper 315 MW peaking facility complemented with new purchased power contracts to replace the capacity agreement for 500 MW from the Aries combined cycle unit.
- Increased costs of employee benefits, including health care and post retirement medical increases.
- General inflation.

Aquila is currently undertaking discussions with the Commission Staff ("Staff") and the Office of the Public Counsel ("Public Counsel") with respect to this proposed general rate case filing in an effort to refine and eliminate potential issues and to find ways to simplify the processing of the case.

### **AQUILA'S RESOURCE PLANNING**

7. For the last several years in connection with its Missouri electric operations, Aquila has conducted Integrated Resource Plan ("IRP") review meetings with members of the Staff, Public Counsel, and other interested entities. Since January 27, 2004, these meetings regarding Aquila's future power supply have occurred on five separate occasions. During the course of these meetings, Aquila has provided the participants with information including the following:

- Aquila's thirty-year generation and load forecasts;
- a description of Aquila's proposed transmission infrastructure programs;
- a description of all of the power supply alternatives considered by Aquila to meet its load requirements;
- Aquila's least-cost planning analysis;
- detailed presentation and subsequent discussion regarding Aquila's fuel budget cycle, fuel and purchase power plans (specifically the hedging of natural gas and on-peak purchase power);
- a description of Aquila's efficiency, affordability and demand response programs.

The next IRP review meeting is scheduled for March 31, 2005, at which time Aquila will present the latest version of its IRP.

8. Among other things, these meetings have consistently demonstrated that load growth, particularly in the Aquila Networks - MPS service territory, has given rise to the need for additional baseload generating capacity in the post-2009 time frame, supplemented by a mix of new peaking generation and purchased power contracts during the interim period to provide a reliable and cost efficient mix of new generation for Aquila's Missouri electric customers. The participants in these meetings have also discussed the need for transmission infrastructure investment, establishment of customer efficiency and affordability programs, demand-side management and environmental issues.

9. In addition, over the past year Aquila has participated in a collaborative effort with other entities (including the Staff, Public Counsel, Missouri Department of Natural Resources, City of Kansas City and Missouri Valley Community Action Agency) to develop a comprehensive Energy Efficiency Plan. Aquila will file this comprehensive plan with its March 31, 2005 IRP that will include, among other things, reviews of low income programs and demand response options. A summary of the results of the collaborative efforts and resulting program outlines is attached to this Application as Appendix 1.

#### **KCPL ACTIVITIES**

10. On May 6, 2004, Kansas City Power & Light Company ("KCPL") filed its Application To Establish Investigatory Docket And Workshop Process Regarding Kansas City Power & Light Company. In its Application, KCPL requested that the Commission issue an order opening an investigatory docket regarding the future supply and pricing of the electric service provided by KCPL and authorizing the use of the Commission's workshop process to address certain issues related to the future supply and pricing of electricity for KCPL and its customers. As a result, in June of 2004, the Commission granted the request and established an informal, investigatory case designated as Case No. EW-2004-0596. Aquila participated in this docket which, among other things, included a series of meetings and presentations that extended over seven (7) months. Subsequently, by Commission order issued February 18, 2005, this docket was closed.

11. The KCPL docket referenced above is significant for purposes of this Application in that discussions which took place in that case included issues related to KCPL's future capacity needs, capital investments related to compliance with environmental regulations, infrastructure investments, and customer programs, as well as the likely impact of these investments and programs upon KCPL's future revenue requirements. In particular, the discussions included the potential development of approximately 800-900 MW of new coal-fired, regulated baseload generation capacity located at the Iatan Electric Generating Station site near Weston ("Iatan Unit 2"). Iatan Unit 1, located at that site, is co-owned by KCPL, Aquila, and The Empire District Electric Company ("Empire"). Participation by Aquila in Iatan Unit 2 is an option which may resolve the Company's need for additional baseload generating capacity in the post-2009 timeframe.

#### **EXPERIMENTAL REGULATORY PLAN**

12. Given the facts and circumstances described above, by this Application, Aquila seeks Commission approval of an Experimental Regulatory Plan (the "Regulatory Plan"), the objective of which is, in part, to provide assurance of adequate cash flow in order to maintain investment grade metrics for the Company's Missouri operations and provide a reasonable return to shareholders during the construction period of the new base load generation that is necessary to serve Aquila's Missouri's electric customers. The Regulatory Plan addresses the comprehensive undertakings being considered by Aquila as well as the timeliness of the recovery of the costs and the financial

considerations of these extremely significant investments. The proposal for a Regulatory Plan, including the addition of new baseload generation, is consistent with the Commission's indication, on at least one occasion, that it would consider a request by a utility for the approval of additional plant if the Commission is provided with all necessary information and the facts concerning same.

By so doing, the utility would remove the contingency of obtaining a rate base determination after the plant was built, and thus the possibility that the Commission would find and conclude that the plant was not needed after monies had been expended to build the same.

(See Re: Union Electric Company, Case No. EA-79-119, Report and Order issued October 20, 1980, 24 MoPSC (N.S.) 72, 78).

13. It is intended that the Regulatory Plan, outlined in more detail herein, will commence on May 1, 2006 after the conclusion of the Company's 2005 general electric rate case referenced above.

14. Aquila's present power supply circumstances coupled with the preliminary results from the Company's to-be-filed March 2005 IRP for its Missouri electric operations indicate a need for an additional 150 MW of additional baseload capacity in the post-2009 timeframe. This need may be satisfied by Aquila's participation in latan Unit 2.

15. In this regard, there is generally a five to seven year lead time between a decision to proceed with a coal fired generating project and the completion of development, permitting, construction, performance testing and ultimate placement in service of the unit. Financing such large capital expenditures presents a challenge to the credit metrics of a utility such as Aquila under any circumstance because of the long permitting and construction cycle



and the regulatory uncertainty surrounding the “return on and return of” costs associated with the investment in rates over the life of the plant. The impact of national environmental policy also creates uncertainties regarding the ultimate cost of such a project. These uncertainties, however, may be addressed adequately by the establishment of certain regulatory principles to be applied to the undertakings prior to commencement of the project, and this is the situation in which Aquila now finds itself.

16. In particular, pre-establishing certain regulatory principles for Aquila’s proposed undertakings will:

- Facilitate cost effective construction financing so that competitive baseload generation will be built in Missouri. . . for Missouri customers. Lower interest rates benefit customers by reducing the carrying costs during the design, development, and construction of the plant and ultimately reducing the cost of service for the plant once it is in operation and permanently financed;
- Move the new energy facilities from engineering studies to financed projects, thereby creating construction jobs as well as permanent jobs in Missouri;
- Enhance economic development within the State; and
- Generate additional property tax dollars for state and local agencies.

17. In connection with its Regulatory Plan, Aquila agrees to make the capital investments as more fully described in Highly Confidential Appendix 2 to

this Application which will be late-filed when the Commission issues a Protective Order in this docket. The largest investments anticipated are:

- Approximately \$250 million for a 150 MW ownership in a new coal-fired generation facility planned for construction by KCPL in Platte County, Missouri, (Iatan Unit 2). This unit will be used to serve the growing base load needs of the Company's Aquila Networks – MPS customers.
- A potential investment of \$40 - \$50 million for pollution control upgrades to the existing Iatan Unit 1. This would represent Aquila's 18% ownership interest in these upgrades.
- Jeffrey Energy Center capital expenditures approximating \$20 - \$30 million.
- Sibley Generating Station environmental upgrades or alternative actions approximating \$30 - \$40 million.

18. To finance Aquila's participation in Iatan Unit 2, investors (debt and equity) will require the Company to maintain adequate cash flows to service the debt and provide a reasonable return to the shareholder. The Company must also maintain investment grade metrics at the Missouri utility level as defined by Standard & Poor's ("S&P") during the construction period. In order to meet these financing requirements the Company will require:

- A finding by the Commission that Aquila's participation in a coal generation baseload facility in the 2010-11 timeframe is

necessary, timely and prudent to serve the Missouri electric customers.

- A finding by the Commission that Aquila's 18% participation in air pollution control upgrades for Iatan Unit 1 are necessary, timely and prudent to serve the Company's Aquila Networks – L&P electric customers.
- A finding by the Commission that the capital expenditures, including capitalized carrying costs, incurred for the construction of Aquila's interest in the new coal generating facility (Iatan Unit 2) and pollution control upgrades will be recovered in rates over 40 years.
- Authorization by the Commission for Aquila to use its Missouri electric properties as collateral to support the debt required to finance additional capital investment and working capital needs.
- A finding by the Commission that Aquila's depreciation expense and carrying cost associated with its ownership interest in any pollution control upgrades or any generating asset construction placed in service during the period covered by the Regulatory Plan will be deferred as a regulatory asset until such costs can be recovered in the next rate case.
- Annual electric rate increases as needed during the period of the Regulatory Plan period to support investment grade metrics (BBB) as defined by S&P at the Missouri operating utility level

during the construction period. Should these ratios change or be modified during the period of the Regulatory Plan, appropriate ratios and targets as utilized by S&P at the time of the next rate case should be utilized. The credit metrics are as follows (also see Appendix 3 to this Application for more detailed definitions):

- Total Debt to Total Capitalization ratio;
  - Funds from Operations to Interest Coverage ratio; and
  - Funds from Operations to Total Debt ratio.
- In order to insulate the Missouri customer from the impacts of Aquila's corporate non-investment grade status, the capital structure used to determine rates and compute the above ratio's would be the assigned capital structure of 47.5% equity and 52.5% debt. All new debt assigned to the utility would reflect BBB interest cost.
  - Additional amortization as may also be required to maintain the cash flow to the utility necessary to support investment grade metrics during the construction period. Beginning with the in-service date of Iatan Unit 2, the resulting additional amortization reserve will be reversed through equal monthly accounting entries over a 40 year period.
  - A finding by the Commission authorizing cost recovery of the Energy Efficiency program costs referenced above through a

customer surcharge as these costs are amortized into cost of service.

19. In addition, as a part of the Regulatory Plan, Aquila should be authorized by the Commission to implement an interim energy charge ("IEC") or some other fuel adjustment charge ("FAC") mechanism to mitigate the volatility of changes in fuel and fuel related costs during the period covered by the Regulatory Plan. The IEC or FAC would assure timely recovery of variable fuel and purchased power energy costs as defined in the Federal Energy Regulatory Commission chart of accounts (Accounts 500, 501, 509, 547, 555 and 565) during the period of the Regulatory Plan. The IEC or FAC will be determined in the context of a general rate case in which a base level of energy cost will be determined for a test period and the IEC or FAC will be determined as the incremental difference between the "base" and the anticipated energy costs. The combination of the base and IEC or FAC amount should reasonably reflect the fuel and purchased power costs anticipated for the rates in effect during each rate case period defined in the Regulatory Plan. Consistent methodologies for fuel modeling that take into account the above-mentioned factors in determining an appropriate IEC or FAC amount should be utilized. The actual fuel and purchased power cost would be audited annually by the Staff and any over or under recovery of the actual cost compared to the IEC or FAC rate, as determined through the audit, will be reflected as an increase or decrease to the IEC or FAC rate in the next year. This over or under recovery would be recorded as a regulatory asset or liability. Because actual fuel costs can vary significantly

from year to year depending on the market conditions and the Company's hedging program, any adjustment to the IEC or FAC for the over or under-recovery is excluded from the proforma rate increases modeled in this filing. Failure to recover these costs on a timely basis could otherwise affect the Company's investment grade metrics. The allocation of the dispatched fuel and purchased power cost between Aquila Networks - MPS and Aquila Networks - L&P divisions will be agreed upon for book and rate making purposes.

20. As a part of the Regulatory Plan, Aquila will continue its three-year dollar cost averaging hedge program to mitigate price volatility for its natural gas and equivalent quantities of natural gas for hedging purchased power requirements using NYMEX financial instruments. A hedging program description is contained in Highly Confidential Appendix 4 to this Application which will be late-filed when the Commission issues a Protective Order in this docket. Further, the Company is in the process of implementing a dollar cost average hedge program designed to mitigate the effect changing highway diesel fuel prices have upon rail and/or other transportation costs ("Fuel Oil Surcharge"). As with natural gas and purchase power, the Company intends to hedge the Fuel Oil Surcharge using NYMEX financial instruments. The Company requests a finding by the Commission that the NYMEX hedge settlements used to mitigate the foregoing price exposures will be reflected as component(s) of the cost of fuel used for generating electricity for Aquila Networks - MPS power plants under the IEC or FAC in addition to the utility fuel accounts noted in the paragraph.

21. The NYMEX hedge settlements are recorded in account 417.1, Expenses of non-utility operations. An annual update on the hedging strategy will be provided to the Staff and other interested entities, and material changes agreed to by the participants, will be confirmed in writing.

22. The financial model, contained in Highly Confidential Appendix 5 to this Application which will be late-filed when the Commission issues a Protective Order in this docket, provides a proforma analysis of the annual rate increase required, using the pre-established regulatory recovery principles discussed above, to maintain the investment grade metrics during the five to seven year construction period ending as early as 2010. Modification to the model may be required as a result of:

- A change in the timing or amount of capital expenditures;
- Changes in the IRP due to execution of new purchased power contracts or the decision to add owned generating facilities to complement the capital investment included in the Regulatory Plan;
- Rate relief from the 2005 electric rate case substantially different than the amount assumed;
- A significant change in interest rates, federal or state tax laws, other governmental mandate or legislation or environmental regulations affecting utility operations;
- A change in generally accepted accounting principles;
- An act of God or terrorist.

Aquila will notify the Staff, Public Counsel and other interested entities as soon as reasonably possible after the Company becomes aware of any material change (10% or greater change in capital investment assumption or impact on revenue requirement) impacting the financial model.

23. All Missouri electric off-system sales will be included above-the-line in the ratemaking process during the term of the Regulatory Plan. Aquila will include off-system sales in the revenue requirement determination in each rate case filed during the term of the Regulatory Plan.

24. Aquila agrees to work collaboratively with other entities to develop in-service test criteria for the Iatan Unit 2 and environmental investments.

25. Aquila agrees to file rate cases beyond the period of this Regulatory Plan, if necessary, in order to address the future affects of the facilities operations.

#### **CERTIFICATE OF CONVENIENCE AND NECESSITY**

26. The Commission may determine that Aquila needs a certificate of convenience and necessity to participate in Iatan Unit 2. Aquila, however, as the successor to St. Joseph Light & Power Company ("SJLP") holds a certificate issued to SJLP in Case No. 17,895 on November 14, 1973, which authorizes SJLP (now Aquila) "...to participate in the construction, ownership, operation, maintenance, removal, replacement, control and management of Iatan Steam Electric Generating Station ... as a tenant in common with undivided ownership interests in all or any portions thereof." "Iatan Steam Electric Generating Station" is defined in that Order as a "multi-unit site designed for four generating units to



be constructed and operated by KCPL.” The Order additionally recites that SJLP will have the right to elect to participate in ownership of Unit 2 to the extent of a 1/3 ownership interest therein. In addition to this authority, Aquila holds area certificates which together encompass a portion, if not all, of the site of the Iatan Steam Electric Generating Station. In view of the foregoing, Aquila submits that the certificates now held by the Company provide authority to participate in Iatan 2 as described in the Application.

27. Notwithstanding the foregoing, the granting of a new certificate, if one is deemed necessary by the Commission, will be in the public interest because the electric power to be generated by Iatan Unit 2 will be rate based capacity that will be available to serve increasing demand for electric power by Aquila’s customers in this State. There are operational and cost advantages inherent in a utility’s ownership of generating facilities. In recognition of these advantages, the Commission has stated its preference for company-owned generation instead of heavy reliance on purchased power agreements (“PPAs”) to meet Missouri load requirements and to protect Missouri customers. (See, FERC Docket EC03-53-000 and 001, Opinion 473, pages 7 and 10). This statement has been consistent with Aquila’s recent experience whereby the Staff has encouraged the Company to reduce its reliance on purchased power contracts in favor of power plant ownership when justified. The addition of Iatan Unit 2 to Aquila’s resource portfolio will improve the mix of Aquila’s dedicated assets to its contracted capacity.


28. In view of the foregoing, by this Application Aquila requests permission, approval and a certificate of public convenience and necessity to participate in the construction, ownership, operation, maintenance, removal, replacement, control and management of a steam electric generating station to be located within a proposed site area on the left bank of the Missouri River near Upper Iatan Bend in Platte County Missouri, Iatan Unit 2, or alternatively for an order specifically confirming that Aquila has the requisite authority under its existing certificate(s) for these undertakings. In the event the Commission determines that it should consider issuing a new certificate, the information required by 4 CSR 240-3.105(1)(B) will be late-filed as soon as available.

WHEREFORE, Aquila respectfully requests that this Commission issue its Order:

- A. providing public notice of this Application and establishing a deadline for intervention in this proceeding no later than April 1, 2005; and
- B. taking up, considering and approving Aquila's Experimental Regulatory Plan as described herein in a timeframe that allows the Company to participate in whatever ownership, leasehold, purchased power arrangement and/or other form by which Aquila may secure the capacity and associated energy that will serve the best interests of the Company's Missouri customers; and

- C. granting the relief requested in paragraphs 18, 19, 20, 23, 28 supra; and
- D. granting such other relief as deemed necessary and appropriate which is not inconsistent with this Application.

Respectfully submitted,



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Attorneys for Applicant Aquila, Inc.

### **CERTIFICATE OF SERVICE**

I hereby certify that a true and correct copy of the above and foregoing document was delivered by first class mail or by hand delivery, on this 2<sup>ND</sup> day of March, 2005 to the following:

General Counsel's Office  
Missouri Public Service Commission  
200 Madison Street, Suite 800  
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Governor Office Building  
200 Madison Street, Suite 650  
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