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August 4, 2004

FILED⁴

AUG 04 2004

Missouri Public
Service Commission

Mr. Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge
Missouri Public Service Commission
P.O. Box 360
Jefferson City, Missouri 65102

RE: *In the Matter of the Application of Aquila, Inc. for an Accounting Authority Order
Concerning Fuel Purchases*

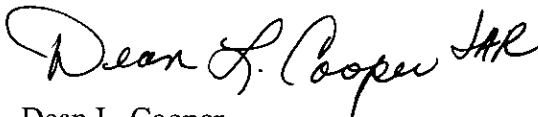
Mr. Roberts:

Enclosed for filing in the above-referenced matter are the original and eight (8) copies of Aquila's Application for an Accounting Authority Order. A copy of the foregoing document has been hand-delivered or mailed this date to all parties of record.

If you have any questions, then please do not hesitate to contact me. Thank you for your attention to this matter.

Sincerely,

BRYDON, SWEARENGEN & ENGLAND P.C.

By: 
Dean L. Cooper

DLC/jar

Enclosures

cc: Nathan Williams
John Coffman

FILED⁴

AUG 04 2004

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

Missouri Public
Service Commission

In the Matter of the Application of Aquila, Inc.)
for an Accounting Authority Order Concerning) Case No. _____
Fuel Purchases.)

**APPLICATION FOR AN
ACCOUNTING AUTHORITY ORDER**

Comes now Aquila Inc. ("Aquila" or "Company"), and for its application for an accounting authority order ("AAO"), respectfully states as follows to the Missouri Public Service Commission ("Commission"):

SUMMARY

This application requests an order which authorizes deferred accounting treatment for certain fuel costs incurred by Aquila in providing electrical service to its customers in Missouri during the period from April 22, 2004, through April 21, 2006.

APPLICANT

1. Aquila is a Delaware corporation with its principal office and place of business at 20 West Ninth Street, Kansas City, Missouri 64105. Aquila is authorized to conduct business in Missouri and, as such, is engaged in providing electrical, natural gas and heating company utility service in Missouri in those areas certificated to it by the Commission. A certified copy of Aquila's Amended Certificate of Authority to do business in this state as a foreign corporation 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 name of Aquila Networks - MPS and Aquila Networks - L&P were filed in Case No. EU-2002-1053 and a copy of the registration of the fictitious name Aquila

Networks was filed in Case No. ER-2004-0034. Said documents are incorporated herein by reference in accordance with 4 CSR 240-2.060(1)(G).

2. Aquila is an “electrical corporation,” a “gas corporation,” a “heating company” and a “public utility” as those terms are defined in Section 386.020 R.S.Mo. 2000. Consequently, it is subject to the jurisdiction and supervision of the Commission as provided by law.

3. Aquila has no pending action or final unsatisfied judgments or decisions against it from a state or federal agency or court which involve customer service or rates, which action, judgment or decision has occurred within three (3) years of the date of this Application.

4. Aquila has no overdue Commission annual reports or assessment fees.

5. All correspondence, communications, notices, order and decisions of the Commission with respect to this matter should be sent to the undersigned counsel, and to:

Gary Clemens
Director, Regulatory Services
Aquila, Inc.
10700 East 350 Highway
Kansas City, Missouri 64138
Tel: (816)-737-7934
Fax: (816)-737-7505
Email: gary.clemens@aquila.com

BACKGROUND

6. On April 13, 2004, the Commission issued its Order Approving Stipulation and Agreement wherein, among other things, the Commission approved an Interim Energy Charge (“IEC”) for Aquila Networks - MPS electric and for Aquila Networks - L&P electric. The IEC was designed to include a specific, permanent annual amount for the Missouri jurisdictional

electric costs of fuel and purchased power. Additionally the IEC included a variable amount for fuel and purchased power costs on an interim basis, subject to true-up and refund.

7. The specifics of the IEC were spelled out in the Unanimous Stipulation and Agreement between the parties. Aquila further agreed to not seek a general rate increase within 13 months after the effective date of the tariffs in Case No. ER-2004-0034 (April 22, 2004), and further agreed that no increase in rates shall become effective prior to the termination of the IEC (April 21, 2006).

8. Part of the justification for the IEC is the large role natural gas plays in the generation of the electricity utilized by Aquila. Given Aquila's low load factor (i.e. dependence on weather sensitive residential usage) and the need to develop generation to meet the weather-sensitive demand, Aquila has added gas-fired generation to its portfolio. Aquila's total system capacity includes 981 MW of gas-fired generation (summer) which represents 50% of the total installed capacity for serving native load and 20% of total energy generated. (Exh.¹ 107, Browning Dir., p. 5).

9. In recent years, the natural gas market has been extremely volatile creating great price risk for Aquila, and other similarly situated electric utilities. Without an IEC, Aquila would be subject to the full risk of these markets and either profit or suffer losses depending upon how those markets related to the fuel costs utilized by the Commission in setting Aquila's rates.

10. At the time the parties agreed to the IEC, the average natural gas price for 2003 was \$5.388/mcf. (Exh. 109, Browning Sur., p. 3). The U.S. Energy Information Administration ("EIA") forecast for 2004 was \$5.14/mcf. (*Id.*). The parties in the case had taken positions

¹ All exhibit ("Exh.") cites are to Commission Case No. ER-2004-0034.

indicating that the Commission should utilize a natural gas price ranging from \$3.99/mcf on the low end to \$5.64/mcf on the high end in determining Aquila's fuel costs.

11. The Office of the Public Counsel took the position that the appropriate natural gas price to include in ratemaking calculation of fuel costs for Aquila in Case No. ER-2004-0034 was \$3.99/mcf, which was derived utilizing a blend of historical prices with futures prices. (Office of Public Counsel Revised Statement of Positions, Case No. ER-2004-0034, February 13, 2004; Exh. 110, O'Donnell Reb., p. 15 (recommendation would be \$4.169/mcf, if basis removed)).

12. Aquila suggested that the Commission should use a natural gas cost of \$5.14/mcf in determining overall fuel costs and, in addition, suggested that a \$.50 adder to the cost of natural gas be used, subject to refund ($\$5.14 + \$.50 = \$5.64/\text{mcf}$). (Aquila's Statement of Positions on the Issues, Case No. ER-2004-0034, February 13, 2004).

13. Staff first took the position that an IEC "is the best mechanism for insulating both Aquila and its retail customers from the effects of widely fluctuating gas costs." (Staff's Statement of Positions, Addition To Witness List, and Reconciliation, Case No. ER-2004-0034, February 13, 2004). In the absence of an IEC, Staff proposed that the Commission use a natural gas cost of \$4.00/mcf. This amount was derived by a review of actual known and measurable prices paid by Aquila through the end of the update period of the case (September 30, 2003). (*Id.*).

14. The Sedalia Industrial Energy Users Association ("SIEUA") and AG Processing, Inc. ("AGP") took the position that adopting Aquila's proposal regarding fuel and natural gas costs would place "ratepayers at severe risk of overcharge should fuel costs be reduced, either

through market forces or through the purchasing practices of the utility.” (Statement of Position of SIEUA and AGP On Selected Issues, Case No. ER-2004-0034, February 13, 2004). SIEUA and AGP’s specific recommendation as to fuel prices was \$4.35/mcf. (Exh. 110, O’Donnell Reb., p. 16).

15. The IEC ultimately agreed to by the parties contemplated a natural gas price ceiling of \$5.14/mcf.

16. In any given month, Aquila’s IEC collections differ from its fuel costs. The IEC agreed to by the parties and approved by the Commission does not address how Aquila should record any under collections. Currently, Aquila has been required to record as expense on a monthly basis the amount by which its fuel costs exceed the IEC collections. However, this treatment results in dramatic earnings fluctuations. Not only do monthly IEC under/over recovery impacts vary in concert with the fluctuations of natural gas and other fuel prices, the impacts are even more significant in summer months when peak usage causes higher cost generation sources to be brought on line. The current required accounting mechanism does not allow for “smoothing” the impact of the under/over recovery of fuel costs created by this seasonal usage and thus defeats one of the purposes of implementing a two-year IEC period. In essence, the summer peaking months typically cause a large under recovery, while the other seasons’ generation mix typically causes over recovery.

17. Since Aquila’s IEC was implemented, natural gas prices have continued to rise above even the highest level anticipated when the IEC was designed. If prices remain at or above these levels and if no AAO authorizing alternative accounting treatment is approved, the earnings impact on Aquila will be significant. Attached hereto and marked Appendix 1, is a graph that

provides the current NYMEX strip price of natural gas through April 2006. Some of the natural gas prices shown on this graph are in the \$6.50 range. Natural gas prices are correlated to the cost of oil and global crude oil prices have recently risen to the highest levels in more than a decade. This increase in oil prices has been attributed to addition of a "fear factor" risk premium to the price of oil because of anxiety over the potential risk of disruption in Middle East oil supplies. There is no way to currently assess whether, or to what extent, this risk premium will continue to impact oil, and by correlation gas, prices over the remainder of the IEC term. Consequently, Aquila proposes herein an AAO in an attempt to smooth the current under/over recovery impact due to seasonal usage and defer consideration of the potential impact of unusually high gas prices until that impact can be fully quantified at the end of the IEC period.

18. Within this AAO Aquila is also requesting the Commission allow the NYMEX natural gas hedge settlements used to mitigate price exposure to be reflected as part of the computation of the natural gas cost used to compute the cost of fuel used for generating electricity for MPS's power plants under the IEC. The hedge settlements are normally recorded in account 417.1, Expenses of nonutility operations. This account is not considered for recovery in rate cases as it is termed below-the-line for rate recovery. This accounting and IEC computation modification will facilitate a hedging plan to protect the customer against escalating prices similar to the hedging plans used for our Missouri gas customers.

REQUEST FOR ACCOUNTING AUTHORITY ORDER

19. Because of the current market, Aquila has found itself under collected by approximately \$5.7 million since April 2004. The IEC agreed to by the parties and approved by the Commission does not address how Aquila should record these under collections. Currently,

Aquila has been required by Generally Accepted Accounting Principles (“GAAP”) and external auditing personnel to record as expense on a monthly basis the amount by which fuel costs exceed the IEC collections. However, this may not be an accurate reflection of the ultimate impact of the IEC on Aquila’s finances.

20. The IEC is designed such that calculations as to whether Aquila has under collected or over collected (and thus refunds are due) are not made until the completion of the IEC in April 2006. Thus, in theory, if market conditions change between now and April of 2006, amounts currently reflected as expense by Aquila may be eventually collected.

21. Aquila believes that the failure to address how to account for these monthly under collections or over collections during the IEC period, was an oversight by the parties that should be remedied by the Commission in this docket.

22. Additionally, because fuel costs have so greatly exceeded the costs anticipated by all parties to Case No. ER-2004-0034, Aquila believes that extraordinary circumstances exist to support the issuance of an accounting authority order. *See In re The Application of Missouri Public Service for the Issuance of an Accounting Authority Order*, 1 Mo. P.S.C. 3d 200, 205 (1991).

23. Treating these extraordinary costs as an accounting expense on a monthly basis (which will be required in the absence of an AAO as requested here), when the IEC was intended to recover fuel and purchased power costs over a two year period using a single average rate, is neither reasonable nor appropriate and can produce unnecessarily adverse effects on a utility’s financial reports.

24. Furthermore, the hedging program used by the Company to mitigate exposure to

escalating gas prices on fuel expense locks in the price for a portion of our gas volumes over some future period. This hedging technique is parallel to that which is performed to protect the Company's gas utility customers from price volatility on the gas distribution side of our business. The settlement of NYMEX natural gas contracts used to hedge this price exposure for Aquila's power plants is normally accounted for in account 417.1. These costs should instead be included in the computation of the variable fuel and purchased power cost under the IEC. Excluding the hedge settlements will preclude the use of NYMEX natural gas contracts to protect customers from escalating prices.

MECHANICS OF AAO REQUESTED

25. Aquila proposes that the requested AAO be designed to create a regulatory asset that may increase or decrease in size on a monthly basis in relation to whether or not the Company is over recovered or under recovered in a particular month.

26. Because the IEC is trued up at the end of the two-year program period, the balance that is under or over collected will not be known until April 2006. Underlying fuel costs can be volatile, resulting in significant monthly, and year to year, fluctuations. Therefore, Aquila is recommending that the monthly IEC under/over collection be charged to Other Regulatory Assets (Account 182.3), thereby reflecting the ongoing nature of the IEC. Without an accounting order authorizing alternative treatment, all fuel costs would be charged to expense as incurred. The effect would be that during the summer months Aquila will under collect fuel costs that are being charged through the IEC, (\$19.71 per Mwh and \$13.98 per Mwh for the MPS and L&P divisions, respectively) and during the fall and spring, an over collection will likely occur because fuel costs will be below amounts noted above. Not until the IEC expires in April of 2006 will Aquila

know the final, average fuel cost incurred during the IEC period.

27. Also, the NYMEX hedge settlements normally booked to account 417.2 for the period April 2004 through April 2006, which is the time the IEC is in effect, should be included in the computation of variable fuel expense in the IEC computation.

AAO

28. As a consequence of the extraordinary fuel costs being experienced by Aquila, the Company requests a Commission order granting the following AAO:

The Company is authorized to record on its books a regulatory asset which represents the expenses associated with fuel costs, including the settlement of natural gas price hedges, to the extent they exceed Aquila's recoveries under the Interim Energy Charge created by the Commission in Case No. ER-2004-0034, until April 21, 2006. During this period, Aquila will increase or decrease the regulatory asset on a monthly basis depending upon whether Aquila has under-recovered or over-recovered fuel costs in that month. Thereafter, Aquila may maintain this regulatory asset on its books until the effective date of the Report and Order in Aquila's next general rate proceeding following April 21, 2006.

CONDITION

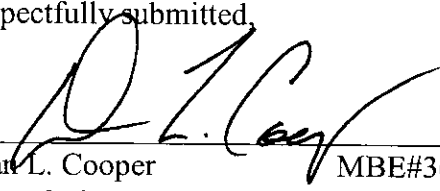
29. Aquila proposes that the Commission adopt the following condition, if the requested AAO is granted by the Commission:

The Commission makes no findings or inferences as to whether the deferred expenses are reasonable, or whether Aquila would have suffered financial harm (i.e. whether earnings during the period were adequate to compensate Aquila for the costs incurred) absent deferral. The Commission reserves the right to consider the ratemaking treatment of the costs deferred and any assertions by parties related to these issues to a future rate case.

WHEREFORE, Aquila Inc. respectfully requests that the Commission issue its Accounting Authority Order, consistent with the request made herein, and for such further orders

as the Commission should find reasonable and just.

Respectfully submitted,



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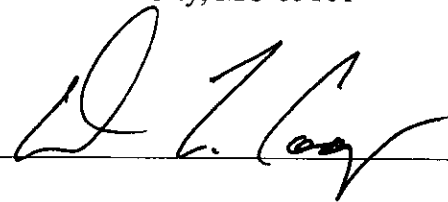
ATTORNEYS FOR AQUILA, INC.

CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing document was hand-delivered, or sent by electronic mail, on August 4th, 2004, to the following:

Nathan Williams
Office of the General Counsel
Governor Office Building, 8th Floor
Jefferson City, Mo 65101

John Coffman, Public Counsel
Office of the Public Counsel
Governor Office Building, 6th Floor
Jefferson City, MO 65101



AFFIDAVIT

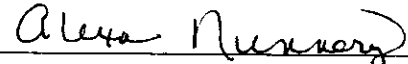
STATE OF MISSOURI)
)
COUNTY OF Jackson)

ss

I, Gary Clemens, state that I am Director of Regulatory Services for Aquila, Inc. ("Aquila"); that I have read the above and foregoing document; that the statements contained therein are true and correct to the best of my information, knowledge and belief; and, that I am authorized to make this statement on behalf of Aquila.


Gary Clemens

Subscribed and sworn to before me this 3rd day of August, 2004.


Notary Public

My Commission Expires:



Chart1

