BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Tariffs of Aquila, Inc., d/b/a Aquila Networks - MPS and Aquila Networks - L&P, Increasing Electric Rates for the Services Provided to Customers in the Aquila Networks - MPS and Aquila Networks - L&P Service Areas.	))))))	Case No. ER-2007-0004

AQUILA'S APPLICATION
FOR RECONSIDERATION OR REHEARING

COMES NOW Aquila, Inc. ("Aquila" or the "Company"), by and through counsel**,** pursuant to RSMo. §386.500, 4 CSR 240-2.080, and 4 CSR 240-2.160, and respectfully applies to the Public Service Commission of the State of Missouri (the "Commission"), that it reconsider or grant rehearing of its *Report and Order* issued in the above-captioned case on May 17, 2007, to be effective May 27, 2007 (the "*Order*"). In this regard, Aquila respectfully states as follows to the Commission:

1. Portions of the *Order* are unlawful, unjust, unreasonable, arbitrary, capricious, involve an abuse of discretion, are unsupported by competent and substantial evidence upon the whole record, are in excess of statutory authority, and are unconstitutional, all in material matters of fact and law, individually or cumulatively, or both, in the particulars hereinafter stated.

Fuel Adjustment Clause

2. Although Aquila is pleased that the Commission has authorized the Company to implement a fuel adjustment clause ("FAC"), the Commission's decision that Aquila should be prohibited from recovering any more than 95 percent of the fuel and purchased power costs it incurs above the amounts included in base rates, regardless of whether those costs were prudent and were necessary to enable the Company to provide electric service to its customers, is

contrary to both the letter and the spirit of Section 386.266, RSMo. Therefore, the *Order* is unlawful in this regard.

3. Approving an FAC that allows Aquila to recover no more than 95 percent of its prudently-incurred fuel and purchased power costs above the amount included in base rates violates the letter and the spirit of §386.266(1). That statute authorizes the Commission to approve “rate schedules” or “periodic rate adjustments outside of general rate proceedings” that reflect the “increases and decreases in [a utility’s] prudently incurred fuel and purchased-power costs, including transportation.” There is nothing in the language of that statute that suggests that the General Assembly, in enacting the statute, intended that only some – and not all – of a utility’s prudently-incurred fuel and purchased power costs be passed-on to customers through an FAC. Therefore, the *Order* is unlawful in that regard.

4. It is well established as a matter of constitutional law that public utilities are entitled to rates that allow them a reasonable opportunity both to recover all of their prudently-incurred operating costs and to earn a fair return on equity. *See FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *Bluefield Waterworks and Improvement Co. v. Public Service Commission*, 262 U.S. 679, 692 (1923). The FAC authorized by the Commission in this case does neither.

5. To Aquila’s knowledge, the *Order* represents the first time the Commission has decided that a Missouri utility should be ***prohibited*** from recovering a portion of its operating costs regardless of whether those costs were prudently-incurred and were necessary to provide service to the utility’s customers. As stated above, Aquila believes such action is unlawful. But even beyond that, Aquila believes the decision constitutes bad regulatory policy. Therefore, the Company strongly urges the Commission to reconsider its decision on that basis, as well.

Return on Common Equity

6. The competent and substantial evidence in the record supports a return on common equity ("ROE") for Aquila of 10.75%, as a minimum. A minimum of 10.75% is necessary in order for Aquila's authorized ROE to comply with the standards set forth in *Federal Power Commission v. Hope Natural Gas Company*, 320 U.S. 591 (1944), and *Bluefield Waterworks v. Public Service Commission*, 262 U.S. 679 (1923). The competent and substantial evidence in the record also supports an upward adjustment to this minimum of at least 10-15 basis points and, most appropriately, 50 basis points, to account for Aquila's construction budget and corresponding risk.

7. On page 58 of the *Order*, the Commission states that the return advocated by Aquila witness Dr. Hadaway is "too high" and that it "appears as though" Dr. Hadaway designed a methodology to achieve the same return authorized in another Commission case. On page 59 of the *Order*, the Commission states that other expert witnesses "convincingly explained" that Dr. Hadaway's return on equity recommendations are "inappropriately inflated." The Commission then points to the testimony of witness Michael Gorman, and, on page 59 of the *Order*, the Commission states that it accepts as credible Mr. Gorman's testimony that Dr. Hadaway failed to acknowledge offsetting financial risks. The Commission goes on to state that Dr. Hadaway's recommendation is an "incomplete assessment" of overall risk because it "ignores other aspects of risk that make Aquila less risky than many of the comparable companies." Each of these findings, and/or conclusions and/or decisions is in error, is unlawful, unjust and unreasonable, and is not supported by competent and substantial evidence in the record.

8. On page 62 of the *Order*, the Commission found as follows: “The 11.25% rate of return advocated by the expert who testified for Aquila, Dr. Hadaway, is too high.” On page 62 of the *Order*, the Commission also found as follows: “Dr. Hadaway’s failure to acknowledge or account for financial risks faced by the comparable companies, that are either not faced by Aquila, or faced to a lessor degree, resulted in an improper inflation of his rate of return recommendation.” On page 63 of the *Order*, the Commission found that “10.25% is a fair and reasonable return on equity for Aquila that will allow it to compete in the capital market for the funds needed to maintain its financial health.” On page 64 of the *Order*, the Commission concluded that “a ROE of 10.25% satisfies the *Hope* and *Bluefield* standards and is a fair and reasonable return on equity for Aquila.” Each of these findings, and/or conclusions and/or decisions is in error, is unlawful, unjust and unreasonable, and is not supported by competent and substantial evidence in the record.

9. The Commission recognized the national average allowed ROE for electric utilities to be 10.36% and used this figure as a basis for its ultimate decision. In so doing, however, the Commission failed to recognize and take into account that many of the electric companies which make up the 10.36% ROE average for 2006 **are not more risky “fully integrated” electric utilities such as Aquila, but instead are less risky transmission only and/or transmission and distribution (“T&D”) companies**. The competent and substantial evidence in the record demonstrates that the ROE average of 10.36 was lowered by the inclusion of the rate decisions involving the T&D companies, as ROEs for T&Ds are traditionally not as high as authorized ROEs for fully integrated utilities such as Aquila. The lower risk distribution only and T&D companies had authorized ROEs ranging from 9.55 to 10.20 percent, with an average of 9.91 percent, while the more risky vertically integrated utilities like Aquila had

authorized ROEs ranging from 10.0 to 11.25 percent, with an average of 10.65 percent. Proper recognition of the above would result in a ROE award for Aquila higher than the 10.25% authorized in this proceeding.

10. Aquila agrees with Commissioner Appling that in reaching its decision in this case, the Commission must exercise its judgment based on the evidence about Aquila. When it comes to the rate of return issues, however, a utility such as Aquila must be afforded the opportunity to earn a fair and reasonable return and, to be fair and reasonable, **that return must be commensurate with returns being made at the same time and in the same general part of the country on investments in other businesses with corresponding risks and uncertainties**. *Hope*, 320 U.S. at 603; *Bluefield*, 262 U.S. at 692. The *Order* is contrary to these Supreme Court mandates, as the Commission failed to recognize and take into account that, in December of 2006, an ROE of 11.25% was authorized by this Commission for Kansas City Power & Light Company (KCPL), on a capital structure of 53.69% equity, and a 10.9% ROE was authorized for The Empire District Electric Company (Empire), on a capital structure of 49.74% equity.[1]

11. Clearly, Aquila must compete in the same capital market as KCPL and Empire, electric utilities in the same general part of the Country with corresponding risks and uncertainties. These two companies both have higher authorized returns and also more "equity thick" capital structures than does Aquila, which has only 48.17% equity in its capital structure. Aquila is not suggesting that its authorized return must necessarily "mirror" the KCPL or Empire

[1] *In re Kansas City Power & Light Company*, Case No. ER-2006-0314, Report and Order issued December 21, 2006; *In re The Empire District Electric Company*, Case No. ER-2006-0315, Report and Order issued December 21, 2006.

awards. Proper recognition of these factors, however, would result in a ROE award higher than 10.25% for Aquila in this proceeding.

12. Guided by the fair rate of return principles established by the United States Supreme Court, Aquila witness Dr. Hadaway used several methods to determine the appropriate ROE and overall rates of return for Aquila's two Missouri operating divisions. Dr. Hadaway applied these methods and the underlying economic models to an investment grade company reference group of other similarly situated electric utilities. There is no evidence in the record to support the Commission's conclusion that Dr. Hadaway designed a methodology to achieve the same return authorized in another Commission case and/or that his recommendations are inappropriately inflated.

13. The Commission erred in not utilizing Dr. Hadaway's recommendation of 10.75% as the starting point for determining the Company's rate of return in this proceeding. Purportedly to support its findings and conclusions regarding Dr. Hadaway's recommendations, the Commission points to pages 5-6 of witness Gorman's rebuttal testimony and pages 334-364 of the hearing transcript (footnotes 136 and 137 of the *Order*). Neither this evidence, nor any other evidence in the record, supports the Commission's finding and conclusions in this regard. The Commission correctly recognized that the discounted cash flow ("DCF") results reflect the fact that many companies in the proxy groups have fuel cost recovery mechanisms. The Commission, however, incorrectly and unreasonably failed to recognize and take into account the fact that the DCF results also reflect each company's other risk elements (nuclear activities, non-regulated businesses, etc.).

14. Although many questions were put to Dr. Hadaway on cross examination regarding how nuclear power and other specific elements of risk impact his proxy companies, the

competent and substantial evidence demonstrates that each of these elements had been fully considered and taken into account by Dr. Hadaway. Because of certain “screens” for selection of his reference group of comparable companies, regulated operations were at least 70 percent of operating revenues and were, on the average, 87% of the total revenue for each sample company, and these other elements (i.e. nuclear activities, etc.) were “non-events” in terms of risk. The evidence also shows that each of these elements are fully considered and quantified by Standard & Poor’s (“S&P”) in arriving at the business profile risk number to assign to each company. The bottom line is that there is no competent and substantial evidence to discredit Dr. Hadaway’s 10.75% starting point. The evidence further demonstrates that construction risk is not taken into account by S&P in its business profile assessment, thus justifying an independent review of these circumstances as undertaken by Dr. Hadaway.

15. The competent and substantial evidence demonstrates that an adder or adjustment for construction risk, to the starting point or minimum of 10.75, is necessary in order for Aquila’s authorized ROE to comply with the standards set forth in *Hope* and *Bluefield*, and the Commission apparently recognizes the fact that an upward adjustment is necessary. Without this upward adjustment from the DCF-indicated reference group ROE, Aquila, with construction expenditures as a percentage of net plant at 118.2 percent, will be unable to compete with other enterprises – such as Dr. Hadaway’s group of comparables, which have construction expenditures as a percentage of net plant at an average of only 60.9 percent, and Missouri utilities KCPL and Empire. The evidence demonstrates that the DCF results for the comparable companies reflect everything known about each of those companies, including their risks, but that those companies are not exposed to the same level of construction risk as is Aquila.

16. With its Report and Order of December 21, 2006 in the KCPL case, the Commission provided for an upward adjustment of 25 basis points for KCPL's construction risk. KCPL's construction budget as a percentage of net plant is significantly less than Aquila's. Further, KCPL's construction risk is partially ameliorated by the additional amortizations KCPL may book. There is no basis for a determination that the construction risk adjustment should be less for Aquila than for KCPL. The Commission correctly recognized that an upward adjustment for construction risk is necessary and appropriate (page 62 of the *Order*), but incorrectly and unreasonably determined that the adjustment in this case should be only 10-15 basis points. The substantial and competent evidence in the record supports an upward adjustment of 50 basis points, from the starting point of 10.75 percent.

Conclusion

17. For the reasons stated above, the *Order* is unlawful, unjust, unreasonable, arbitrary, capricious, involves an abuse of discretion, is unsupported by competent and substantial evidence upon the whole record, is in excess of statutory authority, and is unconstitutional, all in material matters of fact and law.

WHEREFORE, Aquila, Inc. respectfully requests that the Missouri Public Service Commission reconsider or grant rehearing with respect to its May 17, 2007 *Report and Order*, and upon reconsideration or rehearing, issue a new order setting aside its May 17 *Report and Order*, which new order is consistent with the evidence and applicable law as more fully set forth above in this pleading.

Respectfully submitted,

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Certificate of Service

I hereby certify that a true and correct copy of the above and foregoing document was sent by U.S. Mail, postage prepaid, hand-delivered, or sent by electronic transmission, on this 25th day of May, 2007, to all counsel of record.

_____/s/ Diana C. Carter__________