

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

In the Matter of the Application of Aquila,)
Inc., for Authority to Acquire, Sell and Lease)
Back Three Natural Gas-Fired Combustion)
Turbine Power Generation Units and) Case No. EO-2005-0156
Related Improvements to be Installed and)
Operated in the City of Peculiar, Missouri)

AQUILA’S RESPONSE TO ORDER DIRECTING FILING

COMES NOW Applicant Aquila, Inc. (“Aquila”) and for its response to the Missouri Public Service Commission’s (“Commission”) September 29, 2005 Order Directing Filing, states the following:

Background

1. On September 29, 2005, the Commission issued an Order Directing Filing (the “Order”) recounting the procedural posture of this case. Those events have culminated most recently with the filing on September 22, 2005 by the Office of the Public Counsel (“Public Counsel”) of a Motion to Stay proceedings in this case (the “Motion”), the stated purpose of which would be to “further investigate” certain information related to the status of the Chapter 100 RSMo financing of the South Harper power station. Staff joined in Public Counsel’s Motion on September 23, 2005.

2. On September 28, 2005, Aquila filed its response to Public Counsel’s Motion, pointing out that the developments addressed in the Motion have been a matter of public record since as early as March 15, 2005. Aquila stated that it nevertheless had no objection to the Motion, so long as any delay in

ruling on the Chapter 100 RSMo financing was for a reasonably brief period of time. Aquila also pointed out that Public Counsel and Staff had stated no reservations about that aspect of the September 1, 2005, Stipulation and Agreement (the “Agreement”) addressing the agreed-to valuation of the combustion turbines and auxiliary equipment (collectively, the “CTs”) necessitated by the terms of the Commission’s affiliate transaction rule, 4 CSR 240-20.015.

3. The Commission’s Order issued on September 29, 2005 directed that Aquila, Staff and Public Counsel “file pleadings explaining how they would like this case to proceed.”

4. As set forth in the Agreement, on pages 1 and 2, Aquila’s Application requests (i) a determination that its acquisition for its regulated Missouri electric utility operations from an affiliated entity, Aquila Equipment, LLC, of three (3) 105-megawatt natural gas-fired combustion turbines for the purpose of constructing an electric generation station in an area near the City of Peculiar in an unincorporated area of Cass County, Missouri does not provide a financial advantage to an unregulated affiliate, and (ii) authorization to enter into a sale and lease-back arrangement with the City of Peculiar to facilitate the issuance of tax-advantaged Chapter 100 revenue bonds (the “Bonds”) to finance the construction and operation of the South Harper peaking power station.

Valuation of the CTs

5. Aquila’s recommendation to the Commission on how best to proceed in this case has not changed in any material respect from that contained

in its September 28, 2005 response to Public Counsel's Motion. Specifically, there is no reason for the Commission to delay issuing a decision approving that portion of the Agreement addressing the agreed-to valuation of the CTs. Neither Staff nor Public Counsel have expressed any reservations, objections or concerns about the terms of the Agreement addressing the issue of valuation. Consequently, the Commission should issue an order approving those matters addressed in § II of the Agreement without further proceedings or delay.

Chapter 100 RSMo Tax-Advantaged Financing

6. As to the issue of Aquila's request for approval of the Chapter 100 RSMo financing, Aquila does not oppose Public Counsel's Motion so long as any additional inquiries made by Staff and Public Counsel are done promptly and that Staff and Public Counsel are directed to state whether the positions they have agreed to in § III of the Agreement have changed and the justification for any such change. Aquila renews its request for a supplemental decision by the Commission on this topic sufficiently in advance of December 31, 2005 such that Aquila can make an informed decision concerning whether to keep the tax-advantaged financing in place.

7. The opinion of the Western District Court of Appeals ("WDCA") handed down on October 4, 2005 in its Case No. WD 65000 (the "Opinion") should not be taken by the Commission as a reason for not addressing the Chapter 100 financing approval sought by Aquila. It would appear the practical effect of the WDCA's Opinion was to declare the Bonds issued by the City of Peculiar as void for having failed to submit the matter to a vote of the residents of

the City of Peculiar. Aquila understands the Commission may be reluctant to issue a decision on this topic given the action of the WDCA. The Opinion, however, is not final and is subject to customary post-handdown motions and further orders of the WDCA and the Missouri Supreme Court. Aquila believes the reasoning in the Opinion is contrary to many years of established law and, consequently, the matter is by no means settled.¹ It is Aquila's expectation that rehearing or transfer will be sought by the City of Peculiar.

8. Aquila is still of the view that setting the stage for successful Chapter 100 RSMo financing is the right and reasonable thing to do, and the Agreement evidences that all parties concur. Aquila's position on this topic is not one driven by the prospect of financial gain. To the contrary, Aquila is not a beneficiary of tax savings to be realized through the use of the Chapter 100 Bonds. The true beneficiaries are the local taxing authorities, primarily the local Ray-Pec School District, and Aquila's ratepayers whose rates for electric service will be lower than otherwise would be the case due to the flow-through in rates of the preferable tax treatment.

9. There is no reason for the Commission to table a decision concerning the Chapter 100 Bond financing. Ultimately, if the legal issue concerning the validity of the Bonds is decided adverse to the City of Peculiar, the financing arrangement can be unwound. As such, Aquila believes that the public interest would be served by positioning Aquila to take advantage of the tax-advantaged financing provided by for Chapter 100 RSMo if the arrangement

¹ In this regard, the WDCA on the very same day granted rehearing in Case No. WD 64985 which had the practical effect of withdrawing its June 21, 2005 opinion.

is ultimately validated by the Courts. This can be done by approving the terms of the Agreement contained in § III thereof.

10. Alternatively, the Commission could expressly decline to rule on that part of the Agreement (§III) that recommends approval of the Chapter 100 RSMo tax-advantaged financing by and between Aquila and the City of Peculiar by concluding it lacks the statutory authority to approve or disapprove it. The Commission could follow its own reasoning set forth in the January 23, 1981 Order in Case No. EO-81-216 which determined that a sale and repurchase transaction entered into to facilitate the issuance of tax-exempt pollution control bonds is not a “sale” or “transfer” of plant within the meaning of §393.190 RSMo because it does not represent the disposition of necessary or useful parts of the electric company’s franchise, works or system.² Aquila submits the legal rationale articulated by the Commission in 1981 is consistent with sound principles of statutory construction and public policy. The record in this case makes it clear the South Harper power station is being used to meet system load requirements for the Aquila Networks-MPS electric division and, in fact, is being treated the same as if it were a power generation asset owned outright by Aquila for accounting purposes. (Williams, Exh. 1, p. 9, l. 7-10) The undisputed and singular purpose of the financing is to obtain favored property tax treatment and the legal technicalities undertaken by Aquila to avail itself of its advantages have in no manner impaired service. No one has suggested that Aquila has ceded operational control of the power station to any third party. It is undisputed that

² A copy of the Commission’s order in Case No. EO-81-216 was filed as an attachment to Aquila’s September 28, 2005, response to Public Counsel’s Motion. See, EFIS doc. # 80.

the South Harper station will be operated by Aquila for the benefit of its electric customers for the term of the lease. An express declination of statutory authority would be consistent with past Commission practice and would obviate the need for the Commission to weigh in on the merits of the proposal. Additionally, the Commission could enter such an order without the need for any further delay.

Summary of Recommendation

11. To reiterate, the Commission should move ahead immediately on the approval of that aspect of the Agreement addressing the agreed-to valuation of the CTs. Further, any additional time provided to Staff and Public Counsel to make further inquiry regarding the Chapter 100 financing in the event the Commission decides to address the merits of the proposal should be very limited and, further, calculated specifically to permit a supplemental order approving the actions taken to secure the same before December 31, 2005. The WDCA's Opinion in Case No. WD 65000 is not operative or final and provides no compelling reason to keep from moving ahead toward a supplemental order approving the Agreement.

WHEREFORE, Aquila requests that the Commission take the following steps:

A. Valuation of the CTs (§ II of the Agreement)

Issue an order approving those matters addressed in § II of the Agreement (i.e., the agreed-to valuation of the CTs) without further delay.

B. Chapter 100 RSMo Tax-Advantaged Financing (§ III of the Agreement)

(1) Direct Staff and Public Counsel to file a statement by no later than October 31, 2005 whether the positions they have agreed to in the Agreement regarding the tax-advantaged financing addressed in § III of the Agreement (i.e., the Chapter 100 RSMo financing) have changed and the justification for any such change; or

(2) Issue an order expressly refusing to rule on the tax-advantaged Chapter 100 RSMo financing on the grounds that it is not of the type of transaction with respect to which the Commission may assert jurisdiction under §393.190 RSMo without further delay.

Respectfully submitted,

/s/ Paul A. Boudreau

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and foregoing document was delivered by electronic mail, first class mail or by hand delivery, on this 14th day of October, 2005 to the following:

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