

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

In the Matter of the Tariff Filing of Aquila, Inc., to)
Implement a General Rate Increase for Retail)
Electric Service Provided to Customers in its)
Aquila Networks—MPS and Aquila Networks—)
L&P Missouri Service Areas.)

Case No. ER-2007-0004
Tariff No. YE-2007-0001

**STAFF’S RECOMMENDATION REGARDING AQUILA’S
TARIFF SHEETS AND STAFF’S POSITION ON HEDGING COSTS**

COMES NOW the Staff of the Missouri Public Service Commission (Staff) and, in response to both the Commission’s *Order Directing Filing and Shortening Time in Which to Respond* and to Aquila’s *Motion to Clarify Report and Order*, states the following:

SUMMARY

1. The Staff believes that some of the tariff sheets Aquila, Inc. filed on Friday, May 18, 2007, as revised on Monday May 21, 2007, do not conform to the Commission’s *Report and Order* and are otherwise deficient in the particular respects addressed below.

2. The Staff agrees with how the Commission has clarified the treatment of hedging costs in its May 22, 2007 *Order Clarifying Report and Order*, since the Staff had anticipated the Commission’s *Report and Order* would allow the recovery of hedging costs in any fuel adjustment clause or other fuel cost recovery mechanism the Commission might order.

3. In ordered paragraph 2 of its *Order Directing Filing and Shortening Time in Which to Respond* and to Aquila’s *Motion to Clarify Report and Order*, the Commission ordered Staff as follows: “The Staff of the Commission shall file a recommendation regarding Aquila, Inc. d/b/a Aquila Networks – MPS and Aquila Networks – L&P’s revised tariff filing by noon on May 22, 2007.”

4. Although with its motion accompanying its tariff sheets filed shortly after 4:00 p.m. on Friday, May 18, 2007, Aquila stated, “Aquila has been working with the Commission’s Staff in developing the revised tariff sheets, and believes that the Staff should be able to file its recommendation to approve the revised tariff sheets on May 24, 2007,” in fact, Aquila had virtually no contact with the Staff regarding compliance tariff provisions following the Commission’s issuance of its *Report and Order* in this case shortly after 4:00 p.m. on Thursday, May 17, 2007. The contact the Staff did have with Aquila personnel was with regard to base rate values, not fuel adjustment mechanism provisions.

5. Aquila filed on Friday, May 18, 2007 and then on Monday May 21, 2007 proposed tariff sheets it asserts comply with the Commission’s *Report and Order*. The Staff has reviewed those proposed tariff sheets and made inquiries of Aquila regarding them.

REVENUE REQUIREMENT CALCULATIONS

6. At page 63 of its *Report and Order* the Commission states, “Based upon a 10.25% return on equity, Aquila’s revenue requirement increase will be approximately \$13.6 million and \$45.1 million for its L&P and MPS Operating Divisions, respectively.”

7. The Staff calculated revenue requirements for both of the operating divisions for purposes of the *Stipulation and Agreement as to Certain Issues* {“partial stipulation and agreement”) using different assumptions than those the Commission later ordered. The Staff calculated new revenue requirements based on the Commission’s *Report and Order* in two ways. First, the Staff input the Commission’s decisions into the model the Staff had created and used to generate the additional revenue requirements for MPS and L&P shown in paragraph 2 of the

partial stipulation and agreement.¹ The Staff provided Aquila with the resulting revenue requirements and Aquila used them to calculate the rates shown on the tariff sheets it filed.

8. Second, the Staff calculated the differences between the inputs the Staff had used to generate the revenue requirements reflected in the partial stipulation and agreement and the way the Commission resolved the disputed issues, and used those differences to calculate the resulting incremental changes in revenue requirements. The Staff then added the incremental changes in revenue requirements to the revenue requirements contained in the partial stipulation and agreement to result in the ordered revenue requirements.

9. While the two approaches the Staff used are mathematically equivalent, due to precision used in the calculations, the results are not. The revenue requirement results using the first method—the method Aquila relied on for generating rates—are slightly less than those using the second method. The Staff believes the rates Aquila has in its tariff sheets are designed to capture the appropriate revenues for both Aquila Networks – MPS and Aquila Networks – L&P; however, Aquila has apparently included an unauthorized rate design change related to the “Metering Loss Adjustment.”

10. In its Report *and Order* the Commission states at pages 43-44:

The Commission finds a reasonable fuel adjustment clause should be straightforward and simple to administer, retain some incentive for company efficiency, and be readily auditable and verifiable through expedited regulatory review. The Commission can find no probative evidence in the record to support a finding that hedging costs or demand charges related to purchased power contracts with terms of one year or less should be recovered in a different manner than purchased power contracts with longer terms. The Commission agrees with Staff, and finds that demand charges are fixed costs to reserve capacity, and as such are more like plant investment cost than fuel or purchased power cost. This is the case irrespective of the length of the purchased power contract. Further, if demand charges on short term contracts are allowed to flow

¹ The Staff calculated and used \$918,480,038 as the rate base for MPS and \$186,501,110 as the rate base for L&P for the partial stipulation and agreement and Commission ordered revenue requirements. (Page 9 of the partial stipulation and agreement has a typographical error and incorrectly shows the rate base for L&P as \$186,801,110). The correct amounts are shown on Schedule 4 to the partial stipulation and agreement.

through the fuel adjustment clause, Aquila would be encouraged to forgo entering long term contracts in favor of short term contracts.

. . . The Commission concludes it would be improper to allow Aquila to flow hedging costs or demand costs associated with any purchased power contract through its fuel adjustment clause. ***The Commission concludes Aquila will only be allowed to flow variable fuel and purchased power costs, including variable transportation costs, through its fuel adjustment clause.***

(Emphasis added.)

FUEL CLAUSE SO₂ EMISSION ALLOWANCES

11. In Schedule 3 of the partial stipulation and agreement, SO₂ emission allowances are listed in the “Fixed and Direct charges” category, not the “Variable and Joint” category. Based on the language of the *Report and Order* and the categorization of the partial stipulation and agreement, SO₂ emission allowances should not be included in the fuel clause provisions of Aquila’s tariff sheets. It appears to the Staff the tariff sheets Aquila filed include SO₂ emission allowance costs found in FERC Account 509 in the fuel clause provisions.

FUEL CLAUSE OFF-SYSTEM SALES

12. Like SO₂ Emission Allowances, the Commission does not include off-system sales in the fuel clause the Commission describes in its *Report and Order*. As stated above the Commission expressly states in its *Report and Order*, ***“The Commission concludes Aquila will only be allowed to flow variable fuel and purchased power costs, including variable transportation costs, through its fuel adjustment clause.”*** (Emphasis added.) While the Commission has clarified in its May 22, 2007 *Order Clarifying Report and Order* that hedging costs are to be included in the fuel clause, off-system sales are neither a variable fuel cost nor a variable purchased power cost, nor are they like hedging costs. In light of the Commission’s language in its *Report and Order*, as clarified, only variable fuel and purchased power costs Aquila incurs to serve its native load should be included in its fuel clause tariff provisions and

the highest variable costs Aquila incurs when it has off-system sales should be associated with those sales, and not with serving its native load, *i.e.*, the highest variable fuel and purchased power costs Aquila incurs when it has off-system sales should not flow through to Aquila's customers through Aquila's fuel clause. It appears to the Staff Aquila's fuel clause provisions in its tariff sheets would allow variable fuel and purchased power costs associated with off-system sales to flow through to Aquila's customers paying tariff rates.

FUEL CLAUSE INTEREST

13. Aquila has included the calculation and payment of interest in its fuel clause tariff provisions. The Staff does not find the calculation or payment to be supported by the Commission's *Report and Order* or Commission rule or statute. The Staff requests Aquila provide the following information to assist the Staff in finally determining whether Aquila's tariff sheets comply with the *Report and Order* in this regard:

FUEL CLAUSE TRUE-UP

14. Section 386.266.4(2), RSMo Supp 2006, requires a fuel adjustment clause to "include[] provisions for an annual true-up which shall accurately and appropriately remedy any over- or under-collections, including interest on the utility's short-term borrowing rate, through subsequent rate adjustments or refunds." Similarly Commission Rule 4 CSR 240-20.090(5) requires such annual true-ups. The Staff has reviewed Aquila's tariff sheets for language that tracks the statute and the rule and was unable to locate any.

FUEL CLAUSE PRUDENCY

15. Section 386.266.4(4), RSMo Supp 2006, requires a fuel adjustment clause to "include[] provisions for prudence reviews of the costs subject to the adjustment mechanism no less frequently than at eighteen-month intervals, and shall require refund of any imprudently

incurred costs plus interest at the utility's short-term borrowing rate.” Likewise, Rule 4 CSR 240-20.090(7) requires such prudence reviews. Similar to its inability to find in the proposed tariff sheets language tracking the Commission's rule provision regarding true-ups, the Staff was unable to find any provisions addressing a review of Aquila's variable fuel and purchased power costs for prudence.

INTEREST ON DEFERRED ELECTRIC ENERGY COSTS

16. Neither section 386.266, RSMo Supp 2006, nor Commission Rule 4 CSR 240-20.090, nor the Commission's *Report and Order* includes the allowance of any recovery of interest on deferred electric energy costs through a fuel adjustment clause. The Staff believes interest is only allowed on true-up amounts, not rate adjustments. Further, the Staff believes the interest piece of Aquila's fuel adjustment clause equation on Original Tariff Sheet 125 of its compliance tariff filing would result in interest being paid on interest—compound interest—something that is clearly not a variable fuel or purchased power cost.

UNVERIFIED MATTERS

17. Aquila has calculated base energy costs per kWh sold. The Staff has requested from Aquila workpapers so that Staff can verify Aquila's calculations. At this time, the Staff is unable to state the tariff sheets are correct in this regard.

18. Aquila has applied line losses in creating its tariff provisions. At this time the Staff does not know how Aquila applied those line losses. For example, the Staff does not know if Aquila applied them to metered sales or to kWhs at generation. Staff is requesting Aquila provide the Staff with the information it needs to evaluate how Aquila applied line losses for compliance with the Commission's *Report and Order*.

WHEREFORE, the Staff recommends the Commission not approve the tariff sheets Aquila filed Thursday, May 17, 2007, and allow Aquila an opportunity to provide information in response to the foregoing questions raised by the Staff and to file substitute sheets making changes to conform the submitted tariff sheets to the *Stipulation and Agreement As To Certain Issues* the requirements of Section 386.266 RSMo Supp 2006, the requirements of Commission Rule 4 CSR 240-20.090, and the Commission's *Report and Order*. Further, the Staff states that the Commission's clarification of the treatment of hedging costs in its *Order Clarifying Report and Order* carries out the Staff's intent when it entered into the *Stipulation and Agreement as to Certain Issues*.

Respectfully submitted,

/s/ Nathan Williams

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or emailed to all counsel of record this 22nd day of May 2007.

/s/ Nathan Williams