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 MPS and L&P Missouri Service Areas.	))))	Case No. ER-2005-0436
In the Matter of the Tariff Filing of Aquila, Inc., to Implement a General Rate Increase for Retail Steam Heat Service Provided to Customers in its L&P Missouri Service Area.	))))	Case No. HR-2005-0450

STAFF'S STATEMENT OF POSITIONS

Comes now the Staff of the Missouri Public Service Commission ("Staff") and states:

1. On May 24, 2005 Aquila, Inc. filed with the Commission tariff sheets designed to implement a general electric rate increase for service it provides to its Missouri customers in and about Kansas City and St. Joseph, Missouri under the names Aquila Networks—MPS and Aquila Networks—L&P, respectively. The Commission opened Case No. ER-2005-0436 to address that filing.

2. On May 27, 2004 Aquila, Inc. filed with the Commission tariff sheets designed to implement a general steam heat rate increase for service it provide to its Missouri customers in and about St. Joseph, Missouri under the name Aquila Networks—L&P. The Commission opened Case No. HR-2005-0450 to address that filing.

3. On July 21, 2005 the Commission issued orders in each of these cases in which it stated the parties in each are to agree on a list of issues to be filed by the Staff and that "[a]ny issue not included in the issues list will be presumed to not require determination by the Commission."

4. The Staff filed a single list of issues for both cases. The Staff believes the list includes all contested issues in both cases and properly identifies the issues in each case. Following the list of issues, Staff's position on each issue follows:

REVENUE REQUIREMENT

Rate of Return

1. Return on Common Equity (Electric and Steam): What return on common equity should be used for determining Aquila's rate of return?

Staff Position: A cost of common equity of 8.50 percent to 9.50 percent would produce a fair and reasonable rate of return of 7.90 percent to 8.32 percent for the Missouri jurisdictional electric utility rate base for MPS and L&P and steam utility rate base for L&P.

2. Capital Structure (Electric and Steam): What capital structure should be used for determining Aquila's rate of return?

Staff Position: The capital structure should reflect Aquila's actual capital structure on October 31, 2005 (the true-up date). Aquila's common equity ratio is 42.43 percent and its long-term debt ratio is 57.57 percent.

3. Cost of Debt (Electric and Steam): What cost of debt should be used for determining Aquila's rate of return?

Staff Position: Aquila's embedded cost of long-term debt should be 7.445 percent.

Rate Base Issues

4. Generation Resources (Electric): What are the prudent types and amounts of generation resources to include in Aquila Networks-MPS's rate base?

Staff Position: Five combustion turbines capable of generating at least 500 MW of electricity should be included in Aquila Networks-MPS's rate base in place of the 500

MW which Aquila has included through its South Harper facility (about 315 MW) and a purchased power agreement with Calpine (

5. <u>South Harper (Electric):</u> What costs related to the South Harper facility, if any, should be included in Aquila Networks-MPS's rate base?

Staff Position: None. However, in lieu of including the South Harper facility costs in rate base, costs based on the actual costs of the South Harper facility should be included in rate base.

a. When should allowances for funds used during construction be treated as beginning and ending, and what is the appropriate AFUDC rate?

Staff Position: South Harper began generating electricity to meet system load requirements for Unit 1 on July 12, 2005, Unit 2 July 1, 2005 and Unit 3 on June 30, 2005. The units where considered for commercial operation on these dates and these should be the dates Aquila transfers the units to plant-in-service and discontinues calculating allowance for funds used during construction.

b. What cost for test power should be treated as being included in Aquila Networks-MPS's rate base?

Staff Position: The test power costs should coincide with the commercial operation date. All power generated by Unit 1 before July 12, 2005, for Unit 2 before July 1, 2005 and Unit 3 before June 30, 2005 should be test power and treated as part of the construction costs of South Harper. Test power values will be determined in the true-up audit of this case.

c. Should the costs of fee and professional services payments Aquila made to or for the benefit of the City of Peculiar for Aquila to enter into a Chapter 100 financing arrangement with the City of Peculiar be included in Aquila Networks-MPS's rate base?

Staff Position: Reasonable and prudent fees and professional services payments relating to the Chapter 100 financing should be included in Aquila's Networks-MPS rate structure.

d. South Harper Exclusions – should various legal, consulting and other costs included by Aquila as costs of construction be allowed rate base treatment?

Staff Position: Aquila and Staff have reached an agreement on removing from South Harper construction costs amounts incurred in the legal, consulting and other costs relating the court and Commission cases on permitting and zoning matters.

e. If the costs related to the South Harper facility are not included in Aquila's rate base, should the cost of service reflect an alternative amount?

Staff Position: The Staff used the construction costs of the three combustion turbines at South Harper as surrogate for capacity to replace approximately 315 megawatts of capacity of the Aries purchased power agreement. If costs for South Harper are excluded from rate base, then alternative replacement capacity would have to be determined and valued in this case. Staff maintains that the recently completed South Harper unit is the best value for the costs of this capacity and should be used for the three combustion turbines, regardless of the site location or existence of the generating facility.

f. What total cost for the combustion turbines and related equipment transferred to Aquila, Inc. from Aquila Equipment, LLC and installed at Aquila's South Harper facility should be included in Aquila-Networks-MPS's rate base?

Staff Position: Based on the Commission's rejection of the Stipulation and Agreement filed in Case No. EO-2005-0156, the lower of cost or market.

6. <u>AAO's (Electric):</u> Should the unamortized balance of the accounting authority orders the Commission issued for the Rebuild and Western Coal Conversion of Aquila's Sibley generating facility be included in Aquila Networks-MPS's rate base?

Staff Position: Yes. The Commission authorized these accounting authority orders in Case Nos. ER-90-101, EO-91-247 and ER-93-37. The unamortized balances the Commission authorized in those cases should continue to be included in the rate base calculations until such time as the amortization period is complete.

7. <u>Deferred Taxes – AAO (Electric):</u> Should deferred income taxes associated with the Sibley and Ice Storm accounting authority orders be determined and applied as an offset to Aquila Network-MPS's rate base?

Staff Position: Accumulated Deferred Taxes should be included in Rate Base if the IRS tax timing difference has been normalized for ratemaking purposes. Reflecting Accumulated Deferred Taxes in Rate Base need not be consistent with the Rate Base treatment afforded any related balance sheet amounts.

8. <u>Deferred Tax Balances:</u> (Electric and Steam) Should deferred tax debit balances related to non-rate base accruals and reserves be included in the accumulated deferred income tax balances deducted from plant in service in the determination of Aquila Networks-MPS's and Aquila Networks-L&P's rate bases?

Staff Position: Accumulated Deferred Taxes should be included in Rate Base if the IRS tax timing difference has been normalized for ratemaking purposes. Reflecting Accumulated Deferred Taxes in Rate Base need not be consistent with the Rate Base treatment afforded any related balance sheet amounts.

9. Accounts Receivable Program (Electric): Should customer accounts receivable be treated as being sold for purposes of determining Aquila Network-MPS's and Aquila Networks-L&P's cash working capital included in rate base?

Staff Position: Yes. Aquila should be held to the commitment made by its senior executives in prior Commission cases that the Company would insulate its customers from any adverse affects of the Company's financial problems. Therefore, the Staff's treatment of customer accounts receivable as being sold insulates customers from the negative effects of Aquila's financial problems that resulted in the cancellation of the accounts receivable sales program.

10. 20 West 9th: (Electric and Steam) What cost should be included in Aquila Networks-MPS's and Aquila Networks-L&P's rate bases for Aquila's 20 West 9th headquarters/annex?

Staff Position: The Staff has accepted Aquila's proposal to eliminate the costs of the downtown Kansas City headquarters building that is associated with excess office space. The amount of excess office space was determined in accordance with industry standards.

11. SO_2 Emissions Costs (Electric): What level of SO_2 emissions costs should be included in rate base?

Staff Position: The level the Staff included in its direct testimony. Although it included a greater amount in its direct testimony, Aquila now agrees with the Staff's level.

Expense Issues

12. SO_2 Emissions Costs (Electric): What level of SO_2 emissions costs should be included in expense?

Staff Position: The level the Staff included in its direct testimony. Although it included a greater amount in its direct testimony, Aquila now agrees with the Staff's level.

13. Generation Resources (Electric): What are the prudent types and amounts of generation resources for determining fuel and purchased power expense for Aquila Networks-MPS and Aquila Networks-L&P?

Staff Position: The prudent type of generation resource to use is five combustion turbines.

14. Spot Market (Electric and Steam): How should prices for power Aquila purchases on the spot market be determined?

Staff Position: Aquila's actual historical costs during the test-year, updated through June 30, 2005; and further updated through October 31, 2005 after the true-up.

15. Purchased Power (Electric and Steam): How should prices for power based on purchased power contracts be determined?

Staff Position: Rates should be set on the cost of Aquila-owned generation, not purchased power contracts Aquila entered into in lieu of building its own regulated generation facilities.

16. Coal Prices: (Electric and Steam) On what prices should Aquila's coal fuel expense be based in setting rates?

Staff Position: Considerable uncertainty still exists as to what Aquila's actual, effective, cost of high-Btu coal will be at its Sibley and Lake Road plants. This is because of the pending litigation with its former supplier, CW Mining, over the latter's discontinuation of **the** coal supply contract that was to be in effect at least through 2006, with an option at Aquila's discretion to extend supply through 2008. With this significant matter still unresolved, it is Staff's view that it would be premature in the current rate case to charge Aquila's customers permanently for the cost of the more expensive coal with which

Aquila has replaced the CW Mining coal. Rather, this considerably more expensive replacement coal should only be used in computing the Interim Energy Charge (IEC), thus allowing at IEC expiration a prudence review in which any outcome of the litigation process may be taken into consideration.

17. Natural Gas Prices: (Electric and Steam) On what prices should Aquila's natural gas expense be based in setting rates?

Staff Position: Natural Gas Prices - Due to the recent high level of volatility in the natural gas market, the Staff believes a range of natural gas prices should be included in an Interim Energy Charge (IEC) similar to Aquila's current IEC. This range of natural gas prices should be negotiated among the parties to this case. If an IEC is not ordered in this case then a single-point natural gas price must be used to set Aquila's rates. The Staff believes that the best method to use to determine natural gas prices for ratemaking pusposes is to base the prices on Aquila's actual cost of natural gas, given appropriate consideration to the impact of recent events in the market, the opinion of experts in the industry, and the results of Aquila's natural gas hedging program.

18. Fuel Oil Prices: (Electric and Steam) On what price should Aquila's fuel-oil-in-inventory expense be based in setting rates?

Staff Position: The Staff's value for fuel oil should be relied on since it represents a price that Aquila actually paid in its most recent purchase. Alternatively, an actual average inventory cost could be used since that also represents prices actually paid by Aquila. A market price on an arbitrarily selected date, and at which Aquila has made no actual fuel oil purchases, should not be used, as it does not reflect the actual cost to Aquila of using fuel oil in its operations. The fuel oil inventories Aquila has are sufficient to last at least two years at the normal rate of usage, therefore the cost of the inventory is very likely representative of what fuel oil will cost Aquila during the period that rates issued in this rate case will be in effect.

19. 20 West 9th: (Electric and Steam) What expense for Aquila's 20 West 9th headquarters/annex should be used in setting Aquila Networks-MPS's and Aquila Networks-L&P's rates?

Staff Position: The Staff has accepted Aquila's proposal to eliminate the costs of the downtown Kansas City headquarters building that is associated with excess office space. The excess office space was determined in accordance with industry standards.

20. SERP: (Electric and Steam) Are the costs of Aquila's supplemental employee retirement plan (SERP) an expense Aquila should recover from Aquila Networks-MPS and Aquila Networks-L&P ratepayers?

Staff Position: The costs of Aquila's SERP should not be included in rates. While a basic SERP is designed to restore the benefits on highly-compensated employees' pension benefit payments that have been reduced due to the Internal Revenue Service's compensation limits, Aquila's SERP goes way beyond this simple goal. Aquila's SERP includes executive officer "golden parachutes" type protections that seek only to prevent a change in control of the ownership of Aquila. Aquila's SERP includes benefits that are based, in part, on executive bonuses which are paid for work on nonregulated activities and are not included in rates. In addition, Aquila's SERP not only includes the basic restoration benefit, the bonus benefit, but also an additional supplemental executive officer benefit. Finally, because of the size of Aquila's SERP it accounts for the SERP under the same accounting rules as its regular all-employee pension plan. However, the dollars included in rates for the regular pension plan are invested in the pension fund and the financial return on this fund serves to reduce the cost of the pension plan to Aquila's ratepayers. Aquila's SERP is an unfunded plan. Because it is an unfunded plan, the SERP expense dollars collected from the ratepayers would not be included in a pension fund but could be used by Aquila for any reason, including the payment of additional executive bonuses. This unfunded nature of the SERP serves to increase the cost of the SERP to Aquila's ratepayers because there is not reduction in SERP expense from the financial return on the plan assets.

21. <u>L&P Transition Costs (Electric and Steam):</u> Are the transition costs of the merger of St. Joseph Light & Power Company with Aquila an expense Aquila should recover from Aquila Networks-MPS and Aquila Networks-L&P ratepayers?

Staff Position: Yes, to the extent they exceed merger savings. Aquila should be allowed to recover in rates prudently incurred and reasonable costs to transition the operations of St. Joseph Light & Power Company into Aquila; however, this case that merger savings significantly exceed the transition costs.

22. <u>FAS 106 Funding:</u> (Electric and Steam) How should Aquila's FAS 106 funding deficiency be addressed in this case?

    Alternatively,

    FAS 106 Funding: How should Aquila's FAS 106 funding deficiency, if any, be addressed in this case?

Staff Position: Staff has determined the funding deficiency to be ($2,982,099) and ($4,035,431) for the MPS and L&P divisions respectively through year-end 2005. Aquila made a contribution to its VEBA trust in this amount on December 14, 2005.. An additional annual funding requirement of $144,763 will be required starting with effective date of rates set in this case if the Staff's recommended recovery for the St.

Joseph Light & Power merger transition costs is adopted by the Commission. The transition costs, recommended for recovery, include $1,447,631, amortized over 10 years, related to a FAS 106 curtailment in 2001 for the L&P division.

23. FAS 106 Funding: (Electric and Steam) Should the computation of Aquila's FAS 106 funding deficiency include the time value of the delay in the contributions to the fund?

Alternatively,

FAS 106 Funding: Should the computation of Aquila's FAS 106 funding deficiency, if any, include the time value of the delay in the contributions to the fund?

Staff Position: Yes. The Staff has restated Aquila's 2005 FAS 106 cost to eliminate the lost investment earnings (time value of money) resulting from Aquila's failure to make all required FAS 106 annual contributions in prior years. The Staff disagrees with the "time value of money" adjustment proposed by AARP witness, David Effron. Staff views Mr. Effron's adjustment as a penalty to Aquila for failing to fund its FAS 106 obligation. Any penalty should only be addressed in the complaint docket initiated by OPC, Case No. EC–2006-0171.

24. South Harper Expenses (Electric): What expenses related to the South Harper facility should Aquila recover from Aquila Networks-MPS's ratepayers?

Staff Position: Only those expenses Aquila prudently incurred.

a. PILOTS: Should the cost of payments-in-lieu-of-taxes (PILOTs) made as part of a Chapter 100 financing arrangement in connection with the South Harper facility be included as an expense Aquila recovers from Aquila Networks-MPS's ratepayers?

Staff Position: Staff believes that Chapter 100 financing is the least cost alternative compared to paying property **taxes** of the South Harper plant. Company and the City of Peculiar should have properly entered into an agreement for Chapter 100 financing.

Therefore Staff will continue to include the cost of Chapter 100 financing in lieu of property taxes.

b. Property Taxes: Should the cost of property taxes on the South Harper facility be included as an expense Aquila recovers from Aquila Networks-MPS's ratepayers?

Staff Position: Staff believes that Chapter 100 financing is the least cost alternative compared to paying property taxes of the South Harper plant. Company and the City of Peculiar should have properly entered into an agreement for Chapter 100 financing. Therefore Staff will continue to include the cost of Chapter 100 financing in lieu of property taxes.

c. Fees: Should the amortization of costs of fee and professional services payments Aquila made to or for the benefit of the City of Peculiar for Aquila to enter into a Chapter 100 financing arrangement with the City of Peculiar in connection with the South Harper facility be included as an expense Aquila recovers from Aquila Networks-MPS's ratepayers?

Staff Position: Reasonable and prudent fees and professional services payments relating to the Chapter 100 financing should be included in Aquila's Networks-MPS rate structure.

25. Corporate Restructuring: (Electric and Steam) Should there be a disallowance of corporate restructuring expenses for Aquila Networks-MPS and Aquila Networks-L&P and, if so, in what amount?

Staff Position: The Staff has made an adjustment to allocate a certain percentage of the costs of selected corporate overhead departments to restructuring activities. Aquila has accepted the Staff's proposed adjustment.

26. Low Income Weatherization (Electric): Should an amount for low-income customer weatherization programs be included in Aquila Networks-MPS's and

Aquila Networks-L&P's cost of service? If so, what amount should be included, how should it be funded, which programs should be included, and what kind of review should be ordered by the Commission?

Staff Position: The low-income weatherization program funding should be funded at $108,000 as proposed by DNR. The funding **should** be paid 50% by Aquila ratepayers and 50% by Aquila shareholders. Aquila should be ordered to file a report regarding this program within the parameters and time frame suggested in Ms. Mantle's testimony.

27. Demand Side Management (Electric): Should an amount for energy efficiency services to residential and commercial customers be included in Aquila Networks-MPS's and Aquila Networks-L&P's cost of service? If so, what amount should be included, how should it be funded, which programs should be included?

Staff Position: While Staff has some concerns about the funding levels for this program, Staff supports increasing the funding for the Energy Start Change a Light, Change the World from $20,000 to $40,000 with 50% from Aquila ratepayers and 50% from Aquila shareholders. Staff recommends that the Commission approve the Commercial Audit program at the $75,000 level with 50% from Aquila ratepayers and 50% from Aquila shareholders.

Staff opposes the proposed energy efficiency program due to Ms. Randolph's failure to fully justify this program and to explain why Aquila ratepayers or Aquila shareholders should pay for it when there is a real possibility that the Aquila's ratepayers would not receive all of the benefits from the program.

CLASS COST OF SERVICE/RATE DESIGN

28. Rate Design/Cost-of-Service (Electric): How should the Commission determine what, if any, shifts in class revenues for Aquila Networks-MPS and Aquila Networks-L&P should be made in this case?

Staff Position: The Commission should determine what revenue shifts, if any, are appropriate to better align class revenues with class cost of service based on the Staff's class cost-of-service model, the Staff's allocation factors and the revenues and costs for each division determined to be reasonable and prudent by the Commission in this case. The Commission should consider the margin of error in the class cost-of-service studies and the overall impact on customers of both shifts in class revenues and overall increases in revenues in determining appropriate revenue shifts.

29. Rate Design/Cost-of-Service (Electric): How should any revenue increase for Aquila Networks-MPS or Aquila Networks-L&P that results from this case be implemented in rates?

    Alternatively, to 28 and 29,

    What is the appropriate way to adjust class revenues for any revenue increase that results from this case?

Staff Position: After adjusting each rate component on each tariff to accomplish any shift in class revenues determined appropriate by the Commission, each rate component on each tariff should be increased by the percentage required to recover each division's cost of service.

RELIABILITY ISSUES

30. <u>Service Reliability (Steam):</u> Should Aquila be directed to study any alleged recent reliability problems on its steam system, identify solutions, and report its findings to the Commission and interested parties?

Staff Position: Staff has no position on this issue at this time.

31. System Resource Study and Plan: (Steam) Should Aquila be directed to perform a study of steam production resources to include the results of the reliability review and to identify economical alternatives for the provision of steam service, and report its findings to the Commission and interested parties?

Staff Position: Staff has no position on this issue at this time.

FUEL COST RECOVERY

32. IEC (Electric and Steam): If the Commission adopts an interim energy charge, how should it be structured?

    a. What natural gas costs/prices should be included in the charge?

Staff Position: The IEC should have a range for natural gas prices of between $5 per mmbtu and $10 per mmbtu.

    b. What coal costs/prices should be included in the charge?

Staff Position: The IEC should have a range for high btu coal for Sibley and Lake Road should be between the CW Mining contract amount and the replacement coal.

    c. What purchased power costs/prices should be included in the charge?

Staff Position: The IEC should have a range for purchased power should be between $35 per mwh and $65 per MWh.

    d. What SO_2 emission credits should be included in the charge?

Staff Position: Staff has reservations of including SO2 emission credits in the IEC, but would support the inclusion in an IEC if other parties believe it appropriate.

i. Should Aquila be required to use pet coke as a fuel to reduce SO_2 emissions?

Staff Position: Staff does not have a position on this issue.

e. Should the IEC be established and trued-up on a divisional basis (for MPS and for L&P separately) or on a unified basis (MPS and L&P combined?

Staff Position: If the Commission adopts an interim energy charge, it should be established and trued-up on a divisional basis based on actual prudently incurred costs assigned to each Aquila MPS and L&P division.

f. Additional items to consider include treatment of off-system sales and hedging program cost/benefits.

Staff Position: If the Commission adopts an interim energy charge, it should not include the margin from off-system sales. The annualized level of for off-system sales (revenues and costs) should be included in permanent (or "base") rates. The hedging program benefits and reasonably incurred costs should be included in the interim energy charge.

33. <u>IEC Rate Design (Electric and Steam):</u> If the Commission adopts an interim energy charge, how should the cost of the charge be allocated to customer classes in setting rates?

Staff Position: Generally, they should be allocated to customer classes based on class contribution to annual sales.

a. How should natural gas costs be allocated to customer classes?

Staff Position: All variable fuel and purchased power costs should be allocated to customer classes based on class contribution to annual sales.

b. How should coal costs be allocated to customer classes?

Staff Position: All variable fuel and purchased power costs should be allocated to customer classes based on class contribution to annual sales.

c. How should purchased power costs be allocated to customer classes?

Staff Position: All variable fuel and purchased power costs should be allocated to customer classes based on class contribution to annual sales.

d. How should SO_2 emission credits be allocated to customer classes?

Staff Position: All variable fuel and purchased power costs should be allocated to customer classes based on class contribution to annual sales.

e. How should off-system sales and hedging program cost/benefits be allocated to customer classes?

Staff Position: Only variable fuel and purchased power costs should be included in an IEC; however, if the margin from off-system sales are included, they should be allocated to customer classes based on class contribution to annual sales. Hedging program cost/benefits should be allocated to customer classes based on class contribution to annual sales.

ANALYSIS OF FUEL OPTIONS (Steam and Electric)

34. Should Aquila have considered alternatives to high Btu Western Coal for burning at Sibley and Lake Road, including petroleum coke and various emission control options?

Staff Position: Staff does not take a position on this issue.

WHEREFORE the Staff submits the foregoing positions statements to the list of issues that set out issues for both Case Nos. ER-2005-0436 and HR-2005-0450.

Respectfully submitted,

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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 23rd day of December 2005.

/s/ Nathan Williams