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

RESPONSE TO STAFF'S RECOMMENDATION TO REJECT TARIFF SHEETS, MOTION FOR CLARIFICATION OF REPORT AND ORDER, AND MOTION FOR EXPEDITED TREATMENT

Aquila, Inc. ("Aquila" or "Company"), by its counsel, hereby responds to "Staff's Recommendation to Reject Tariff Sheets" that was filed on May 29, 2007. The Company asks the Missouri Public Service Commission ("Commission") to reject Staff's recommendation and to accept the four tariff sheets filed by Aquila on May 25, 2007, that relate to the fuel adjustment clause ("FAC") that was approved in the Commission's *Report and Order*. In the alternative, because Staff's recommendation again raises questions regarding certain aspects of the FAC authorized by the Commission, the Company also renews its motion that the Commission to issue an order clarifying its *Report and Order* with respect to the two issues raised by Staff in its most recent recommendation: SO_2 emissions allowances and interest on deferred fuel and energy costs.

For its response to Staff's recommendations and in support of its motion, Aquila states as follows:

GENERAL OBSERVATIONS REGARDING STAFF'S RECOMMENDATION

1. Aquila is both concerned and frustrated by Staff's response. The Company is concerned because raising the issues discussed in Staff's recommendation shortly before the operation of law date in this case jeopardizes Aquila's ability to put in place a FAC that will accomplish the purposes for which it is designed and approved. Under the Commission's rules, the Company cannot start the deferral of either the under-collection or over-collection of fuel and

purchase power costs until the Commission has specifically approved the tariffs designed to implement the FAC.[1] And the Company is frustrated because, as will be explained later in this pleading, Staff has raised for the first time in its filings questions regarding whether SO_2 emissions allowances should be recovered through the FAC and whether Aquila should be allowed to accrue and collect interest on deferred fuel and energy costs. No party – including Staff – raised any issue related to SO_2 emissions allowances or interest on deferred costs in any filed testimony, during the hearing, or in the briefs filed in this case. It would appear that the Staff at the last minute is attempting to raise matters that were uncontested during the processing of this case. It was, therefore, reasonable for both the Company and the Commission to assume that no questions would be raised at this time just because the *Report and Order* did not specifically address those issues. Aquila fears that these issues are being raised at this time not because there is a legitimate question as to whether the Company's proposed compliance tariff sheets are consistent with the *Report and Order* but, instead, because Staff, which opposed the FAC, is attempting to frustrate the intent of the Commission as expressed in the *Report and Order* and financially penalize the Company by delaying the implementation beyond the start of the summer cooling months.

FUEL CLAUSE SO_2 EMISSIONS ALLOWANCES

2. In its recommendation, Staff argues that the *Report and Order* does not allow Aquila to recover SO_2 emissions allowances through its FAC. But Aquila believes that Staff's reliance on the language in the Commission's *Report and Order* that limits recovery through the FAC to "variable fuel and purchased power costs, including variable transportation costs" is misplaced. That is true because ***SO_2 emissions allowances are variable costs*** – the need for allowances varies as the volume of coal the Company burns to produce electricity increases or decreases and the cost of the allowances varies based on the market prices of the allowances

[1] 4 CSR 240-2.080(16).

that are acquired.[2] Because the costs of SO_2 emissions allowances clearly are variable, the language in the *Report and Order* supports recovering those allowances through the FAC, as the Company proposes, not eliminating them, as recommended by Staff.

3. Staff's argument that because SO_2 allowances do not vary directly with Aquila's kWh sales of electricity they are not variable also is unfounded: first, because it ignores the fact that other costs that will be flowed-through the FAC – such as transportation costs – also are not directly related to kWh sales; and second, because there is no evidence on the record in this case to support Staff's contention. Indeed, Staff makes this argument for the first time in this case in its recommendation.

4. The sole basis for Staff's recommendation that SO_2 emissions allowances be excluded from Aquila's FAC is because the *Report and Order* does not specifically authorize the recovery of those allowances. However the Staff ignores the Commission's discussion on page 42 of the *Report and Order* as to what costs should be recoverable through the fuel adjustment clause. The Order specifically recites Aquila's position that FERC accounts 501, 509, 547, and 555 should be included. FERC account 509 is the account for environmental costs, specifically SO2 emissions credits. Aquila conceded that certain fuel related costs which were activities within the specified accounts (such as unit train lease, depreciation and maintenance, freeze/dust suppression, fuel handling, fly-ash removal, gas reservation and demand charges on long term purchase power agreements) should be excluded. Notably, that concession did not include FERC account 509 or SO_2 emissions credits, and no party argued that it should. This left for the Commission to decide a single contested issue: the inclusion or exclusion of demand charges related to purchase power contracts less than a year in duration. Aquila believes the *Report and Order* is silent on emissions allowances because: 1) the Commission

[2] As described in the direct testimony of Block Andrews, the cost of SO_2 emissions allowances increased from an average of approximately $200/ton in the mid-1990s to approximately $1,650/ton at the end of December 2005. And industry analysts have predicted increases to approximately $3,200/ton in the near-term future. (Exh. 2, p. 4)

did not consider it to be an issue of controversy among the parties;[3] and 2) emission allowances were specifically included in the definition provided by Aquila. The *Report and Order* also does not specifically list the other accounts that are included such as 501, 547, and 555. However, it is obvious from reading the *Report and Order* that the Commission intended to adopt Aquila's proposal, as later modified by the Company's concession on specific activities.

5. As noted in its previous motion, Aquila is most surprised by Staff's position on this issue because prior to the filing of its recommendations on May 22nd neither Staff nor any other party to this case ever raised any objection to the recovery of SO_2 emissions allowances through the FAC. In fact, Staff's own witness testified that SO_2 costs should be included in Staff's proposed IEC.[4] Aquila submits that it makes no sense that SO_2 emissions allowances would be recoverable through one type of fuel and purchased power cost recovery mechanism but not through another, yet that is precisely the proposition the Commission would have to accept if it chooses to adopt Staff's recommendation on this issue. One thing is clear, however: there is no evidence on the record in this case from any party that supports the position that Staff now appears to favor.

6. To clarify this issue and to avoid any future confusion, ***the Company believes, as in the case of hedging costs, it may be prudent for the Commission to clarify the Report and Order. That clarification should clearly and unambiguously state that FERC Account 509 is to be included in the calculation of the fuel adjustment clause.***

INTEREST ON DEFERRED FUEL AND ENERGY COSTS

6. Under the FAC approved by the Commission, Aquila will not fully recover all of its prudently-incurred fuel and purchased power costs for more than 18 months. That is true for two reasons: first, fuel costs subject to recovery are accumulated over a 6-month

[3] Aquila notes that SO_2 emissions allowances is not listed as an issue in the submissions of any of the parties to this case. *See* "List of Issues, Order of Issues, List of Witnesses, Order of Witnesses and Order of Cross Examination," filed on March 22, 2007.

[4] *See* surrebuttal testimony Cary Featherstone, who stated: "Also, Staff would recommend that other fuel-related costs such as prudent SO_2 and hedging costs be included in an IEC." (Exh. 208-HC, p. 13)

Accumulation Period; and second, the Recovery Period for collecting those accumulated costs from customers – after they have been verified – is the 12 months immediately following the Accumulation Period. Throughout this proceeding, Aquila has proposed to accrue interest on the deferred balance of prudently-incurred but unrecovered fuel and energy costs during both the Accumulation and Recovery Periods.[5] Aquila proposed the accrual and collection of interest charges for one primary reason: to make both the Company and the customer whole by allowing each to recover the time value of money on the deferred amounts. Aquila would then have a "sufficient opportunity to earn a fair return on equity," as required by Section 386.266(4)(1). But customers also benefit from interest accruals and refunds on over-collections to the same extent, and for the same reasons, as Aquila does for under-collections. Indeed, subsection (4)(2) of the statute recognizes the importance of an interest allowance for both utilities and customers, and specifically provides for the collection and payment of interest, at a utility's short-term borrowing rate, through subsequent rate increases or refunds flowed-through any fuel and energy cost recovery mechanism that is approved by the Commission.

8. Staff's recommendation argues that calculation of interest on deferred electric energy costs would result in the payment of interest on interest (compounded interest), but this is simply not the way the proposed tariff sheets operate. For the reasons stated above, interest is computed on a monthly basis on over-collections or under-collections of fuel costs on the deferred fuel cost balance only, not on any interest previously accrued on the deferred fuel charges or credits.

9. Staff's recommendation also argues that because interest charges are not specifically authorized, the accrual of interest on the unrecovered balance of the Company's prudently-incurred fuel and purchased power costs is contrary to the FAC approved by the

[5] Aquila's position on this issue was clearly stated in both the direct and surrebuttal testimonies of Dennis Williams (Exh. 32, p. 4, and Exh. 34, p. 7) as well as in the exemplar FAC tariff sheets that accompanied Mr. Williams' testimonies (see Sched. DRW-1, p. 2, of both Mr. Williams' direct and surrebuttal testimonies).

Commission's in its *Report and Order*. As was the case with SO_2 emissions allowances, Aquila believes the lack of a specific reference to interest charges is more likely attributable to the Commission's belief that interest charges was not an issue of controversy among the parties. As noted in its previous motion, ***no party opposed the Company's proposal to accrue and collect interest through the FAC***.[6] Staff's recommendation, therefore, is not supported by any record evidence; so not only would it be fundamentally unfair for the Commission to limit the FAC in the manner Staff recommends it also would be unlawful to do so. Requiring Aquila to defer the collection of prudently-incurred fuel and purchased power costs for 18 months or more while, at the same time, prohibiting it from accruing and collecting interest on the deferred balance is tantamount to denying the Company property without due process of law. For the same reasons, Staff's proposal is equally unfair to the Company's customers in the event of an over-collection of fuel and purchased power costs. And finally, as noted previously, a FAC that prohibits the collection of interest would be contrary to both the letter and spirit of Section 386.266(4)(1) because it would not be "reasonably designed to provide [Aquila] with a sufficient opportunity to earn a fair return on equity."

10. When it approved a FAC based on the record evidence in this case, the Company believes the Commission intended both that Aquila should be allowed to accrue interest on fuel and energy costs that were deferred for collection through the FAC and that those interest costs would be collected from, or refunded to, customers. However, to clarify this issue and to avoid any future confusion, ***the Company believes it would be prudent for the Commission to grant Aquila's motion to clarify the Report and Order. That clarification should clearly and unambiguously state that it is appropriate for Aquila to both: 1) accrue interest on the deferred balance of prudently-incurred fuel and purchased power costs; and 2) that those interest costs are to be flowed-through the Company's FAC.***

[6] *See Report and Order*, p. 48 (which quotes Mr. Williams as saying there would be carrying charges associated with delayed recovery); p. 49 (which acknowledges that Mr. Johnstone stated that "any amount of the soft cap would be recovered with interest).

WHEREFORE, for all of the previously stated reasons, Aquila asks the Commission to reject Staff's recommendation regarding SO2 emissions allowances and interest on deferred fuel and energy costs and accept and authorize the implementation of the tariff sheets filed on May 25, 2007, which relate to the FAC approved by the Commission in its *Report and Order*.

In the alternative, should the Commission believe that the Report and Order should be clarified regarding either or both of the issues raised by Staff in its recommendation, Aquila prays the Commission grant the Company's Motion for Clarification and that it consider that motion on an expedited basis, pursuant to and in accordance with 4 CSR 240-2.080(16). In support of its Motion for Expedited Treatment, Aquila states as follows:

a. Expedited treatment of the Motion for Clarification is necessary because the operation of law date in this case is May 31, 2007;

b. If the Commission fails to approve tariff sheets that authorize Aquila to implement its FAC on or before June 1, 2007, the Company will be prohibited from accumulating and eventually collecting from customers fuel and purchased power costs incurred to provide service to customers for the entire month of June and continuing thereafter until such times as tariff sheets implementing the FAC are approved;[7]

c. Because June and the immediately succeeding months are within the normal air-conditioning season for customers in the Company's Missouri service area, denying Aquila the right to recover prudently-incurred fuel and purchased power costs above the amount included in base rates likely will prevent the Company from having a reasonable opportunity to recover its cost of service and earn a fair rate of return;

d. Parties who wish to respond to the Motion for Clarification should be able to do so by 12:00 noon, on May 31, 2007, because the issues raised in the motion have been known

[7] *See* 4 CSR 240-2.161(1)(G), which defines "true-up year" as "the twelve (12)-month period beginning on the first day of the first calendar month following the effective date of the commission order approving a RAM unless the effective date is on the first day of the calendar month. If the effective date of the commission order approving a rate mechanism is on the first day of a calendar month, then the true-up year begins on the effective date of the commission order."

to the parties since the Company's original Motion for Clarification, which was filed on May 23, 2007; and

e. This "Response to Staff's Recommendation to Reject Tariff Sheets, Motion for Clarification, and Motion for Expedited Treatment," was filed as soon as possible after Aquila's receipt of Staff's recommendations, which were filed after 5:00 p.m. (EST) on May 29, 2007.

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 delivered by first class mail, electronic mail or hand delivery, on the 30th day of May, 2007, to the following:

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