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 REGARDING TARIFF SHEETS AND MOTION FOR CLARIFICATION OF REPORT AND ORDER AND FOR EXPEDITED TREATMENT

Aquila, Inc. ("Aquila" or "Company"), by its counsel, hereby responds to the recommendations regarding tariff sheets that was filed by the Staff on May 22, 2007. Because Staff's recommendations raise questions regarding certain aspects of the fuel adjustment clause ("FAC") that the Missouri Public Service Commission ("Commission") authorized in *Report and Order* issued in this case on May 17, 2007, Aquila also moves the Commission to issue an order clarifying that *Report and Order* with respect to three issues: SO_2 emissions allowances, off-system sales, 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:

1. On May 22, 2007, Staff filed its recommendations regarding revised tariff sheets that were filed by Aquila on May 18, 2007, in response to and in compliance with the Commission's May 17th *Report and Order*.[1] With the exception of concerns related to a "Metering Loss Adjustment" on revised tariff sheets 30 and 33, ***Staff's recommendations state that the base rate tariff sheets filed by Aquila "are designed to capture the appropriate revenues for both Aquila Networks – MPS and Aquila Networks – L&P. . .."*** As explained in Paragraph 2 of this pleading, Aquila has conferred with Staff on the "Metering Loss Adjustment" and the Company will be filing replacement revised tariff sheets that eliminate Staff's concerns.

[1] Because the revised tariff sheets filed on May 18th bore an effective date less than thirty days from the date of issuance, Aquila filed replacement sheets that bore an effective date of June 20, 2007.

But Staff's review of the tariff sheets related to the approved FAC raised questions as to how the Commission intended Aquila to deal with three issues – SO_2 emissions allowances, off-system sales, and interest on deferred fuel and energy costs. These questions caused Staff to conclude that the revised tariff sheets the Company filed to implement the FAC do not comply with the *Report and Order*.

METERING LOSS ADJUSTMENT

2. Aquila agrees with Staff that changes proposed by the Company on revised tariff sheets 30 and 33, which were intended to eliminate certain inconsistencies and ambiguities, are not appropriate. Aquila will file, for Staff's review, replacement revised tariff sheets, which eliminate the proposed changes, by the end of business on May 23, 2007,

FUEL CLAUSE SO_2 EMISSIONS ALLOWANCES

3. At paragraph 11 of its recommendations, Staff argues that the *Report and Order* does not allow Aquila to flow-through the fuel and purchase power cost recovery mechanism SO_2 emissions allowances. The sole basis for Staff's argument appears to be that SO_2 emissions allowances are identified as "Fixed and Direct charges" on Schedule 3 of the "Stipulation and Agreement as to Certain Issues" ("Stipulation"), which was approved by the Commission on April 12, 2007. But Staff's reliance on the Stipulation is unfounded. As described in Section 12 of the Stipulation, Schedule 3 merely lists and identifies, by FERC accounts and amounts, Aquila's ***base fuel costs***. The only relation that Schedule 3 has to the FAC is stated in the Stipulation as follows: "To the extent that any of the cost categories identified on Schedule 3 are permitted to be tracked in a fuel cost recovery mechanism, the amounts on Schedule 3 . . . are the fuel base amounts for purposes of calculating positive or negative fuel adjustments."

4. Although the costs listed on that schedule are grouped into two categories – "Variable and Joint" and "Fixed and Direct" – those groupings were made solely for convenience and to illustrate how costs could be directly assigned or allocated to either Aquila's MPS or L&P

divisions. “Variable and Joint” costs are simply costs that the parties to the Stipulation agreed should be allocated between the MPS and L&P Divisions. So listing SO_2 emissions allowances under the “Fixed and Direct” category meant nothing more than those costs can be directly assigned instead of allocated to one division or the other. Moreover, the fact that a particular cost is “direct” does not prevent that cost from also being variable.

5. The parties to the Stipulation never intended that the groupings on Schedule 3 would govern or control what costs the Company can or should recover through its FAC. Those issues were left for the Commission to decide in its final *Report and Order*. That intent is clear from the language of the Stipulation itself. As noted earlier in this pleading, Section 12 of the Stipulation includes the following phrase: “[t]o the extent that any of the cost categories identified in Schedule 3 are permitted to be tracked in a fuel cost recovery mechanism . . ..” This language makes clear that the parties did not intend that the Stipulation, in general, or Schedule 3, in particular, would dictate what categories of costs would or should be recovered through any FAC. Instead, those questions would be left for the Commission to decide.

6. Staff’s reliance on the language in the Commission’s *Report and Order* that states that Aquila can recover only “variable fuel and purchased power costs, including variable transportation costs” through its FAC also is misplaced. That is true because ***SO_2 emissions allowances are variable costs*** – the amounts and costs of those allowances vary 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.[2] Thus, the *Report and Order* supports Aquila’s interpretation regarding SO_2 emissions allowances, not Staff’s.

7. But Staff’s position on this issue is most surprising because, prior to the filing of its recommendations, neither Staff nor any other party to this case has ever raised any objection

[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)

to the recovery of SO_2 emissions allowances through the FAC. In fact, Staff's own witness testified that SO2 costs should be included in his proposed IEC.[3] Why Staff chose to do so at this time remains a mystery. But one thing is clear: there is no evidence on the record in this case to support the position that Staff now appears to favor.

8. 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: 1) SO_2 emissions allowances are variable costs; and 2) that SO_2 emissions allowances are to be flowed-through Aquila's FAC.***

FUEL CLAUSE OFF-SYSTEM SALES

9. Staff's position on off-system sales is equally puzzling because no party to this case has ever taken the position that off-system sales should be excluded from the calculation of the costs Aquila will pass-through its FAC. Several parties opposed the Company's initial proposal to share off-system sales margins on a 50/50 basis. But after the Company abandoned that proposal in favor of a 100 percent flow-through of off-system sales margins, no party testified or argued that off-system sales should be excluded from the FAC.

10. Although the Company believes, and has advocated throughout this case, that off-system sales margins above the level included in base rates should be flowed-through the FAC, Aquila accepts Staff's position on this issue and will file, for Staff's review, replacement revised tariff sheets, which eliminate off-system sales from the FAC by the end of business on May 24, 2007.

FUEL CLAUSE INTEREST

11. Under the FAC approved by the Commission in its *Report and Order*, Aquila will not fully recover its prudently-incurred fuel and purchased power costs for 18 months. That is

[3] *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)

true for two reasons: first, fuel costs subject to recovery are accumulated over a 6-month period; and second, those accumulated costs are then recovered over the following 12 months. Throughout this proceeding, Aquila has proposed to accrue interest throughout both the 6-month Accumulation Period and the 12-month Recovery Period on the deferred balance of prudently-incurred but unrecovered fuel and energy costs. This proposal was designed to achieve one objective: to make the Company whole and to afford it a "sufficient opportunity to earn a fair return on equity," as required by Section 386.266(4)(1). Indeed, subsection (4)(2) of the statute specifically provides for the collection of interest, at a utility's short-term borrowing rate, through subsequent rate increases or refunds flowed-through an approved fuel and energy cost recovery mechanism.

12. Paragraph 13 of Staff's recommendations argues that the accrual of interest on the unrecovered balance of the Company's prudently-incurred fuel and purchased power costs is contrary to the FAC authorized by the Commission's *Report and Order*. Again, Aquila is surprised by Staff's position because no party opposed the Company's proposal to accrue and collect interest through the FAC. Because Staff's position is not supported by any record evidence, not only would it be fundamentally unfair for the Commission to limit the FAC in the manner Staff suggests it also would be unlawful to do so. Requiring Aquila to defer – for as long as 18 months – the collection of prudently-incurred fuel and purchased power costs while, at the same time, prohibiting it from accruing and collecting interest on the deferred balance is tantamount to denying the Company property – the time value of the deferred costs – without due process of law.

13. When it approved an FAC for Aquila based on the record evidence in this case, the Company believes the Commission intended both that interest would be accrued on fuel and energy costs that were deferred for collection through the FAC and that those interest costs would be collected from customers. 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.

FUEL CLAUSE TRUE-UP

14. Aquila agrees with Staff's recommendation regarding the requirement of both Section 386.266 and the Commissions rules that the Company's FAC should include provisions for an annual true-up that will accurately and appropriately remedy any over- or under-collections through the fuel clause. Aquila will file, for Staff's review, replacement revised tariff sheets that satisfy this requirement by the end of business on May 24, 2007.

FUEL CLAUSE PRUDENCY

15. Aquila agrees with Staff's recommendation regarding the requirement of both Section 386.266 and the Commissions rules that the Company's FAC should include: 1) provisions for prudence review of the costs subject to the fuel clause no less frequently than at 18-month intervals; and 2) a requirement that refunds of any imprudently-incurred costs include interest at the Company's short-term borrowing rate. Aquila will file, for Staff's review, replacement revised tariff sheets that satisfy this requirement by the end of business on May 24, 2007.

INTEREST ON DEFERRED ELECTRIC ENERGY COSTS

16. For the reasons previously stated in the pleading under the heading "Fuel Clause Interest," Aquila believes Staff's position is in error and that the Commission should grant the Company's motion for an order of clarification as previously described.

UNVERIFIED MATTERS

17. Aquila will work with Staff to resolve all remaining issues related to: 1) the Company's calculation of base energy costs per kWh sold; and 2) how Aquila applied line losses in creating its revised tariff that relate to the FAC.

WHEREFORE, for the reasons stated above, Aquila requests that the Commission take the following action:

1. Approve all of Aquila's revised tariff sheets, except those that implement the FAC, to become effective May 31, 2007;

2. Deny Staff's recommendations relating to the issues of SO_2 emissions allowances and fuel clause interest (including interest on deferred electric energy costs). Aquila will then file replacement revised tariff sheets for its FAC that: a) eliminate off-system sales from the FAC; b) provide for a fuel clause true-up; and c) provide for periodic prudence reviews, along with a request that those replacement tariff sheets be authorized to go into effect on May 31, 2007, in accordance with the Company's May 21st "Motion for Expedited Consideration and Approval of Tariff Sheets" and;

3. If the Commission chooses not to reject Staff's recommendations regarding SO_2 emissions allowances and/or fuel clause interest (including interest on deferred electric energy costs), it should establish an expedited period for interested parties to file a response to Aquila's motion for clarification of the *Report and Order*. In support of this request and as required by 4 CSR 240-2.080(16): (i) Aquila requests that parties who oppose the motion for clarification be directed to file their responses by 5:00 p.m. (EDT) on Friday, May 25, 2007, and that the motion be decided either by delegation or by the Commission at its regular agenda meeting on May 29, 2007; (ii) the proposed expedited response schedule should not significantly disadvantage any party and should allow the Commission

time to consider and decide the motion before the operation of law date in this case; and (iii) this motion was filed within twenty-four hours of Aquila's receipt of Staff's recommendations, which was as soon as the Company could prepare and file an appropriate 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 delivered by first class mail, electronic mail or hand delivery, on the 23rd day of May, 2007, to the following:

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