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 Tariff No. YE-2007-0001

PREHEARING BRIEF OF THE COMMERCIAL GROUP

The Commercial Group respectfully submits its Prehearing Brief in accordance with the Commission's Order Adopting Procedural Schedule And Modifying Test Year issued August 22, 2006. Although The Commercial Group addresses only certain issues herein, it reserves the right to address any issues arising in this case including, but not limited to, other issues set out in the issues list. The Commercial Group's silence on a particular issue should not necessarily be construed as agreement with any particular party's position. The issues addressed below are in the format set forth in the List Of Issues, Order Of Issues, List Of Witnesses, Order Of Witnesses And Order Of Cross-Examination filed in this docket.

I. SUMMARY OF TESTIMONY OF KEVIN C. HIGGINS

The Commercial Group submitted the following prefiled testimony by its expert, Kevin C. Higgins:

1. Direct Testimony of Kevin C. Higgins on Capacity Expense and Off-System Sales Margins (Jan. 18, 2007).

2. Direct Testimony of Kevin C. Higgins on Revenue Apportionment and Cost of Service (Jan. 25, 2007).

3. Supplemental Direct Testimony of Kevin C. Higgins on Capacity Expense and Off-System Sales Margins (Feb. 27, 2007).

The positions advocated by Mr. Higgins on behalf of The Commercial Group are set forth below.

II. STATEMENT OF POSITIONS

4. Generation Resources: What are the prudent types and amounts of generation resources to include in Aquila Networks-MPS's rate base and for determining the fuel and purchased power expense of Aquila Networks-MPS and Aquila Networks-L&P?

Mr. Higgins recommends that MPS' purchased capacity expense be based on the prudent purchased capacity expense necessary to meet its 2006 capacity requirements rather than the amount being requested by the Company.[1]

At the time Aquila made its initial filing in this case the Company was seeking to add additional generation capacity through the acquisition of a distressed generating asset. This effort – termed the Additional Capacity Solution Project – was underway, but still unresolved, at the time of the initial filing. Accordingly, the Company's initial filing included an "initial placeholder" adjustment for purchased capacity expense.[2]

This "initial placeholder" adjustment was based on the estimated capacity cost for a long-term power purchase agreement and an assumed demand charge (including transmission and fuel transport). The amount of capacity for this hypothetical long-term power purchase agreement was nearly identical to the amount of capacity of the distressed generation asset the Company was seeking to acquire.[3]

Ultimately, Aquila was unsuccessful in acquiring the distressed generation asset. Instead the Company executed two capacity contracts prior to year-end 2006 in order to meet system capacity requirements in 2007. However, the Company's original revenue

[1] Supplemental Direct Testimony of Kevin C. Higgins (Feb. 27, 2007) at p. 6, lns. 17-20.
[2] *Id.* at p. 3, ln. 7 – p. 4, ln. 11.
[3] *Id.*

requirement filing does not appear to have been updated in the record to reflect these developments.[4]

As a result, the amount of capacity included in the Company's initial revenue requirements request exceeds its actual capacity requirements of 200 MW for a portion of 2006. While the amount capacity included in Aquila's "placeholder" adjustment may have been appropriate had the anticipated acquisition occurred, the fact is that the acquisition did not occur. Therefore, the cost of this excess capacity should not be included in rates.[5]

In addition, had the intended acquisition occurred the plant's excess capacity would have been available to make off-system sales, creating a potential benefit to customers. This potential benefit should have been recognized by the Company in its "placeholder" approach to calculating its revenue requirement. However, it was not.[6]

Therefore, not only does the Company's "placeholder" approach overstate its actual capacity needs during 2006, it also fails to recognize the customer benefits that would result from having excess capacity available.

Aquila's approach violates the well-established "matching principle" in ratemaking, which holds that rates should be based on costs and revenues that are synchronized with respect to time periods. According to the test period consensus reached by the parties (and approved by the Commission) in this case, the Company's revenue requirement is to be determined on the basis of an historic 2005 test period, with updates for known and measurable events through the end of 2006. This means

[4] *Id.* at p. 4, lns. 10-21.
[5] *Id.* at p. 5, lns. 1-20.
[6] *Id.* at p. 5, ln. 21 – p. 6, ln. 4.

that the level of retail sales used in setting rates will not extend beyond 2006. Consequently, for the sake of consistency, Aquila's capacity expense should not be based on needs beyond 2006. The Company's "placeholder" approach is based on needs beyond 2006 and, therefore, violates the "matching principle."

To correct these problems Mr. Higgins recommended an adjustment to reduce Aquila's June 30, 2006, initial revenue requirement proposal for MPS by $44,658,812. The derivation and calculation of this adjustment is set out in Schedules KCH-1 Supplemental and KCH-2 Supplemental to his February 27, 2007, Supplemental Direct Testimony.[7]

Since the filing of Mr. Higgins' February 27, 2007, filing, Aquila has submitted a "true-up" filing for December 31, 2006. Based on its true-up filing, the Company's position on the purchased power capacity expense *appears* to have changed, although it is not entirely clear that this has been fully reflected in the record of this case. *To the extent that* Aquila's position has changed to reflect its "true-up" filing, the adjustment necessary to implement Mr. Higgins' recommendation on this issue would be to reduce Aquila's December 31, 2006, revenue requirement proposal for MPS by $3,242,419.

A reconciliation of Mr. Higgins' proposed adjustments to Aquila's direct filing (6/30/06) and its true-up filing (12/31/06) is attached hereto as Exhibit "A." Mr. Higgins' recommendation has not changed. However the amount of the adjustment needed may change, depending upon the Company's current position.

[7] *Id.* at p. 6, ln. 15 – p. 7, ln. 5.

Accordingly, for all the above and foregoing reasons, The Commercial Group respectfully urges the Commission to reject Aquila's "placeholder" approach to calculating MPS' capacity expense and to adopt Mr. Higgins' recommended adjustment.

11. <u>Off-System Sales Margins</u>: How should off-system sales margins be determined? What amount of off-system sales margin should be included in expenses?

Originally Aquila proposed that off-system sales margins be based on a three-year average from 2003 through 2005. Mr. Higgins' recommended rejecting this approach. Instead he recommended that the off-system sales margins be based on actual 2006 results in order to be consistent with test-year being utilized in this case. To implement his recommendation Mr. Higgins proposed a $2,050,350 reduction in the filed MPS revenue requirement and a $1,004,627 in the filed L&P revenue requirement.[8]

Subsequently, the Company submitted its 12/31/06 true-up filing. As with the purchased power capacity expense issue discussed above, the Company's position on off-system sales margins *appears* to have changed, although this is not entirely clear from the filings in the case. *If* the Company's position on the issue has changed, the adjustments necessary to implement Mr. Higgins' recommendation would also change.

A $1,520,836 *increase* in the 12/31/06 MPS revenue requirement would be required, as would a $1,666,609 reduction in the 12/31/06 L&P revenue requirement. A reconciliation of Mr. Higgins' proposed adjustments to Aquila's direct filing (6/30/06) and its true-up filing (12/31/06) is attached hereto as Exhibit "A."

[8] *Id.* at p. 7, ln. 7 – p. 8, ln 15.

In addition, it is the understanding of The Commercial Group that Aquila has agreed to the MPSC Staff's off-system sales margin two-year average calculation of approximately $12,211,685 for the total Company. Staff's calculation differs only nominally from that of Mr. Higgins and is acceptable to The Commercial Group.

Accordingly, for the above and foregoing reasons, The Commercial Group respectfully urges the Commission to accept Staff's two-year average calculation as the appropriate level of Aquila's off-system sales margins.

III. CONCLUSION

WHEREFORE, for all the above and foregoing reasons, The Commercial Group respectfully requests that the Commission adopt the positions set forth herein.

Dated this 29th day of March, 2007.

Respectfully submitted,

Rick D. Chamberlain

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CERTIFICATE OF SERVICE

The undersigned certifies that on March 29th, 2007, a true and correct copy of the foregoing Prehearing Brief Of The Commercial Group was served by U.S. mail, postage prepaid, or by electronic mail addressed to all parties by their attorneys of record as provided by the Secretary of the Commission.

Rick D. Chamberlain

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Reconciliation of CG Proposed Adjustments to Aquila Direct Filing (6/30/2006) and True Up Update (12/31/2006)

CG Proposed Adjustments to Aquila Direct Filing (6/30/2006)

Issue	Explanation		MPS	SJL&P	Total
Weighted Cost of Capital	The CG did not address cost of capital issues		NA	NA	NA

			MPS	SJL&P	Total
Purchased Power Capacity Expense	Purchased power capacity should only reflect the actual amount incurred by Aquila for		$ (44,658,812)	$ -	$ (44,658,812)

Off-System Sales Margins	Off-system sales margins in rates should reflect 2006 actuals	Rev. Acct 447	$ 43,642,648	$ 16,158,609	$ 59,801,257
		Exp. Acct 501 & 547	$ 842,816	$ 215,083	$ 1,057,899
		Exp Acct 555	$ 37,524,220	$ 14,142,241	$ 51,666,461
		Exp. Acct 565	$ 3,225,262	$ 796,658	$ 4,021,920
		OSS Margin Adj.	$ 2,050,350	$ 1,004,627	$ 3,054,976

CG Proposed Adjustments to Aquila True-Up Information (12/31/2006)

Issue	Explanation		MPS	SJL&P	Total
Weighted Cost of Capital	The CG did not address cost of capital issues		NA	NA	NA

			MPS	SJL&P	Total
Purchased Power Capacity Expense	Purchased power capacity should only reflect the actual amount incurred by Aquila for		$ (3,242,419)	$ -	$ (3,242,419)

Off-System Sales Margins	Off-system sales margins in rates should reflect 2006 actuals	Rev. Acct 447	$ 8,714,418	$ 17,724,750	$ 26,439,168
		Exp. Acct 501 & 547	$ 459,546	$ 373,379	$ 832,925
		Exp Acct 555	$ 8,653,171	$ 14,812,727	$ 23,465,897
		Exp. Acct 565	$ 1,122,538	$ 872,035	$ 1,994,573
		OSS Margin Adj.	$ (1,520,836)	$ 1,666,609	$ 145,773

Note:

It is the CG's understanding that Aquila has agreed to Staff's OSS margin two-year average calculation of approximately $12,211,685 for the total company. The CG 2006 OSS margin is $12, 349, 585 for the total company. Thus, there is a difference of $137, 900 on a total company basis. After application of the MPS jurisdictional factor (99.485%) to MPS's allocated share of the OSS margin, the resulting total jurisdictional adjustment is $145,773, which is shown in the table above.

EXHIBIT

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