

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

In the Matter of the Application of Aquila,)
Inc., for an Order Authorizing Aquila,)
Inc., (if and to the Extent the Transaction)
Described Herein Would Impose a)
Mortgage or Encumbrance under Section)
393.190, RSMo.) to Execute, Deliver and)
Perform the Agreements and Instruments)
Necessary to Assume a Lease and Related)
Documents Pertaining to the Aries)
Combustion Turbine Generator Facility)
Owned by a Subsidiary of Calpine Corp.)
and Cass County, Which Was Constructed)
as Part of a Revenue Bond Project under)
Chapter 100 RSMo.)

Case No. EO-2007-0172

**STAFF RECOMMENDATION TO APPROVE
AQUILA'S APPLICATION SUBJECT TO CONDITIONS**

COMES NOW the Staff of the Missouri Public Service Commission (Staff) and for its recommendation to conditionally authorize Aquila, Inc. to execute, deliver and perform the agreements and instruments necessary to assume a lease and related documents pertaining to the Aries combined cycle facility owned by Cass County, Missouri, which was originally built jointly by Aquila, Inc. and Calpine Corporation in about 2000 as part of a revenue bond project under Chapter 100 of the Revised Statutes of Missouri, states:

1. In the attached Memorandum, which is labeled Appendix A, the Staff recommends the Missouri Public Service Commission conditionally approve the Application of Aquila, Inc. for an Order authorizing it to execute, deliver and perform the agreements and instruments necessary to assume a lease and related documents pertaining to the Aries combined cycle facility owned by Cass County, Missouri.

2. The Aries combined cycle facility consists of two natural gas-fired combustion turbine generating units coupled with a heat recovery steam generating unit that have a combined nameplate capacity of 580 MW, and associated real and personal property. MEP Pleasant Hill, LLC is leasing the facility from Cass County as part of a Chapter 100 arrangement, and MEP Pleasant Hill, LLC holds the bond Cass County issued in connection with the Chapter 100 arrangement. Essentially MEP Pleasant Hill, LLC has all of the ownership incidents of the facility, except legal title. By not having legal title to the facility, MEP Pleasant Hill, LLC avoids property taxes, making payments-in-lieu-of-taxes instead. MEP Pleasant Hill, LLC is a wholly-owned subsidiary of Calpine Corporation.

3. Aquila, Inc. is proposing to replace MEP Pleasant Hill, LLC as the lessee and bondholder in the existing Chapter 100 arrangement.¹

4. In its application, Aquila, Inc. states that, if the Commission determines it necessary, Aquila, Inc. seeks Commission authorization for the proposed transaction pursuant to Sections 393.190, RSMo 2000, and Commission Rules 4 CSR 240-2.060 and 240-3.110. The Staff notes Sections 393.180 and 393.200, RSMo 2000, address Commission jurisdiction over transfers by utilities of equity, debt and debt interests in property. None of these statutory provisions expressly provide a standard of review for this transaction; however, the courts in this state have used the standard of “not detrimental to the public interest” in connection with Section 393.190, RSMo 2000² and the Staff used the same standard in evaluating similar requests under

¹ The Staff notes these facts are very similar to those Union Electric Company d/b/a AmerenUE brought before the Commission through its application in Case No. EF-2006-0278.

² See *State ex rel. City of St. Louis v. Public Serv. Comm’n*, 73 S.W.2d 393 (Mo. banc 1934) and *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466 (Mo. App. 1980).

Sections 393.180 and 393.200, RSMo 2000.³ Further, similarly to how the parties requested the Commission to act in Case Nos. EA-2006-0499 and EA-2006-0500 regarding certificates of convenience and necessity for substations, the Staff notes that, even if the Commission does not have jurisdiction over the transaction in question here, no harm will be caused by the Commission authorizing Aquila, Inc. to engage in this transaction—Staff’s conditional recommendation in this case.

5. The Commission has expounded on the standard “not detrimental to the public interest” before. In its Report and Order issued February 24, 2004 in the case *In the Matter of the Application of Aquila, Inc. for Authority to Assign, Transfer, Mortgage or Encumber Its Utility Franchise, Works or System in Order to Secure Revised Bank Financing Arrangements*, Case No. EF-2003-0465, the Commission stated, at page six, “The Commission has already concluded that it should approve Aquila’s request if doing so would not be detrimental to the public interest.”⁴ (footnote 10 in original) The Commission, on page six of the Report and Order, further stated, “The Commission concludes a detriment to the public interest includes a risk of harm to ratepayers.” And in the context of that case the Commission concluded on page seven of the Report and Order, “The detriment to the public interest is the unreasonable risk of harm to Missouri ratepayers compared to the minimal benefit Aquila would receive.”

6. As indicated in its recommendation, the Staff reviewed information obtained from Aquila. Based on its review of that information coupled with the fact that Cass County holds legal title and the existing Chapter 100 financing arrangement has been in place for several years,

³ See Staff’s February 17, 2006 recommendation in *Application of Union Electric Company d/b/a AmerenUE for an Order Authorizing Applicant (If and to the Extent the Transaction Described Herein Would Constitute the Issuance of an Evidence of Indebtedness by Applicant under Sections 393.180 and 393.200 RSMo) to Execute, Deliver and Perform the Agreements and Instruments Necessary to Assume a Lease and Related Documents Pertaining to the NRG Audrain Combustion Turbine Generator Facility Owned By Audrain County, Missouri Which Was Constructed as Part of a Revenue Bond Project under Chapter 100, RSMo.*, Case No. EF-2006-0278.

⁴ See *Order Denying Motion for Summary Disposition* (issued October 9, 2003)(Gaw, C., concurring).

the Staff found no issues such as encumbrances on the facility (other than those in connection with the Chapter 100 financing), compliance of the facility with zoning requirements, legal challenges that would affect the legality of the facility or similar matters such as those Aquila, Inc. has encountered with respect to its South Harper combustion turbine generating facility.

7. Based on its review, the Staff recommends the Commission approve Aquila, Inc.'s application, subject to the following conditions:

- A. Aquila shall continue to record the land and improvements (combined cycle unit) that are the subject of this transaction as a regulatory asset on its books similar to other utility property it owns.
- B. Aquila shall record the investment described above in accordance with the Uniform System of Accounts as adopted by this Commission for record-keeping purposes.
- C. Aquila shall depreciate the combined cycle unit plant accounts at the following annual rates:
 - i. Account No. 341 (Structures & Improvements): 1.67% (ASL: 60 years);
 - ii. Account No. 342 (Fuel Holders, Producers & Accessories): 2.50% (ASL: 40 years);
 - iii. Account No. 343 (Prime Movers): 3.03% (ASL: 33 years);
 - iv. Account No. 344 (Generators): 3.03% (ASL: 33 years);
 - v. Account No. 345 (Accessory Electric Equipment): 2.50% (ASL: 40 years);
 - vi. Account No. 346 (Miscellaneous Power Plant Equipment): 2.86% (ASL: 35 years).

These depreciation rates are the depreciation rates Staff will propose in the current rate case, Case No. ER-2007-0004 if Aquila successfully acquires the Aries combined cycle unit. On a composite basis they approximate the 2.86% depreciation rate (35 year ASL) ordered in The Empire District Electric Case No. 2004-0570 for the combined cycle unit plant accounts.

- D. Aquila shall book each payment in lieu of tax ("PILOT") to operating expense

during the remaining term of the Chapter 100 financing arrangement, as each annual payment is made.

- E. No ratemaking determination is being made by the Commission in this proceeding and no party to this case has acquiesced to any present or future ratemaking treatment as it relates to this transaction. The ratemaking treatment of this transaction may be addressed in Aquila's next rate case or the Staff's next earnings complaint case, but no ratemaking treatment is being sought by Aquila in this proceeding.
- F. Aquila shall seek and obtain Commission approval before it transfers any of the rights it holds pursuant to the lease where such rights are necessary or useful in the provision of regulated utility service, including the right to purchase the facility at the end of the lease.
- G. Aquila shall not sell its rights to the Bond Purchase Agreement acquired through its acquisition of the Aries Facility without Commission approval.

8. The Staff has verified Aquila has filed its annual report and is not delinquent on any assessment.

9. With its application Aquila, Inc. seeks expedited treatment requesting Commission authorization by December 8, 2006, so that it may go forward with its asset purchase agreement that requires bankruptcy court approval. It further states the bankruptcy court will determine the successful bidder for the Aries combined cycle facility in early December, 2006.

WHEREFORE, the Staff recommends that the Commission issue an order that authorizes Aquila, Inc., subject to the conditions set forth above, to execute, deliver and perform the agreements and instruments necessary to assume a lease and related documents pertaining to the Aries combined cycle facility owned by Cass County, Missouri.

Respectfully submitted,

/s/ Nathan Williams

Nathan Williams

Deputy General Counsel

Missouri Bar No. 35512

Attorney for the Staff of the

Missouri Public Service Commission

P. O. Box 360

Jefferson City, MO 65102

(573) 751-8702(Telephone)

(573) 751-9285 (Fax)

nathan.williams@psc.mo.gov

Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 22nd day of November 2006.

/s/ Nathan Williams

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. EO-2007-0172

FROM: David Murray, Financial Analysis Department

/s/ David Murray/ 11/22/06
Financial Analysis Department

/s/ Nathan Williams/ 11/22/06
General Counsel's Office

SUBJECT: Staff Recommendation for **Conditional Approval** of Aquila, Inc.'s Application to execute, deliver, and perform the agreements and instruments necessary to assume a lease and related documents pertaining to the Aries combustion turbine generator facility owned by Cass County, Missouri, which was originally constructed as a joint venture by Aquila, Inc. and Calpine Corporation as part of a revenue bond project under Chapter 100 of the Revised Statutes of Missouri.

DATE: November 22, 2006

AQUILA, INC.

1. **Type of Transaction:** Lease
2. **Proposed Date of Transaction:** December 11 or third business day after the Bankruptcy Court enters the Sale Order.
3. (a) **Statement of Purpose of the Transaction:** To assume a lease and related documents from MEP Pleasant Hill, LLC, a wholly-owned subsidiary of Calpine Corporation, to take advantage of the tax benefits of an existing Chapter 100 financing arrangement with Cass County, Missouri. According to its Application, Aquila, Inc. is seeking authorization for lease of a generating facility that has a nameplate capacity of 580 MW.

(b) **The Staff deems this purpose reasonable.**
4. **Copies of original lease and associated documents are attached to the Application.**
5. **The Staff reviewed a certified copy of the resolution of the directors of Aquila, Inc. authorizing the proposed transaction.**
6. **The Commission's Fee Schedule does not apply to this transaction.**
7. **The Staff recommends the Application be approved with conditions (see below).**

HISTORY:

On October 31, 2006, Aquila, Inc., filed an Application with the Missouri Public Service Commission, seeking authority to execute, deliver, and perform the agreements and instruments necessary to assume a lease and related documents pertaining to the 580 megawatt gas-fired combined cycle electric generating facility located in Cass County, Pleasant Hill, Missouri, (hereinafter referred to as the “Aries Facility”) and owned by Cass County, Missouri. The lease agreement is part of an existing Chapter 100 financing arrangement. The Chapter 100 financing arrangement was completed pursuant to Sections 100.010 to 100.200, RSMo 2000. Aquila, Inc. filed the Application pursuant to Sections 393.190, RSMo 2000 and Commission Rule 4 CSR 240-2.060 and 4 CSR 240-3.110. In response the Commission established Case No. EO-2007-0172.

On November 1, 2006, the Commission issued its ORDER ADDING PARTY, DIRECTING NOTICE, AND DIRECTING FILING in this case. In that order the Commission directed its Data Center and Information Office to give proper notice of the case; set an intervention date of November 13, 2006; made MEP Pleasant Hill, LLC a party to the case; and directed its Staff to file a recommendation or a preliminary response no later than November 15, 2006. Staff filed its preliminary response on November 15, 2006, informing the Commission that Staff had received several data request responses on November 14, 2006, and was awaiting a response to a follow-up data request. Staff informed the Commission that it would file its recommendation by the latter of November 22, 2006, or within three days after receiving Aquila, Inc.’s response to the last outstanding data request. Staff received Aquila, Inc.’s response to the final data request on November 21, 2006.

AQUILA, INC.’S REQUEST:

On September 22, 2006, Aquila, Inc. (Aquila) entered into an Asset Purchase and Sale Agreement with MEP Pleasant Hill, LLC (MEP) by which Aquila will acquire, subject to the satisfaction of certain conditions precedent, including bankruptcy court approval, the assets, including the rights of MEP as lessee under the lease with Cass County, comprising what is generally referred to as “the Aries Facility” located in Cass County, Missouri. The Aries Facility consists of a 580 megawatt gas-fired combined cycle electric generating facility, all equipment, electrical transformers, and certain electrical interconnection facilities related thereto, and associated real property located in Pleasant Hill, Cass County, Missouri.

Aquila does not ask in its Application for Commission authorization to acquire, operate, or value the Aries Facility. Aquila’s Application is limited solely to Commission authorizations it may need to assume the existing lease between MEP and Cass County, and other documents necessary to effectuate that transaction.

ANALYSIS OF TRANSACTION:

Under the proposed transaction, Aquila will become the lessee in an existing lease with Cass County. Although Cass County will hold legal title to the Aries Facility, the lease terms allow the lessee to operate and control the Aries Facility as if it holds legal title. The lease requires the lessee to make the lease payments to Cass County, however, Cass County is obligated to make matching bond payments to the bondholder. As part of the proposed transaction Aquila will become the bondholder. The lease payments and bond payments offset each other for no net revenue impact on either Aquila or Cass County. Consequently, the Chapter 100 financing arrangement is not executed to procure additional funds and the payments that Aquila makes on the lease does not result in any cash outflow. Instead, the purpose and effect of the arrangement is to replace taxes payments the lessee would make if it held legal title with reduced payments in lieu of taxes (PILOT).

Aquila can acquire title to the Aries Facility at any time before the expiration of the lease term by paying the nominal sum of \$50,000, plus some other costs. If it does so, the economic impact to Aquila will be the loss of possible property tax savings over the remaining life of the bond, assuming the annual PILOTs are still less than estimated annual property taxes.

If Aquila were to sell its interest in the bond to a third party, Aquila could be raising additional funds for use in its operations. The cost of these funds would depend on Aquila's sale price for the remaining bond payments. If Aquila were to execute such a transaction, then this cost could be considered in Aquila's cost of capital for ratemaking purposes. Although the Staff understands Aquila does not intend to sell the bond for additional funds, the Staff believes it would be appropriate to condition approval of this transaction to ensure this does not occur without Commission approval.

Aquila has proposed to pay \$158.5 million for the Aries Facility. Exhibit 7 attached to Aquila's Application implies that Aquila plans on using currently available cash to fund the purchase of this transaction. If the transaction closes, an amount matching the acquisition cost would be recorded under Aquila's utility plant account.

Aquila asserts that ratepayers will benefit from this transaction because total PILOTs will be less than the property taxes that Aquila would have paid if it had not entered into the Chapter 100 arrangement. Aquila did not provide any estimates of property tax savings in its Application. However, in response to Staff Data Request No. 0007, Aquila estimated that the property tax savings over the remaining term of the agreement could be anywhere from approximately \$5 million to \$8.5 million.

If the Chapter 100 financing of the Aries Facility is ever held to be illegal, Aquila may simply unwind the Chapter 100 financing and forego any additional property tax savings that it may have received. To the extent that the property tax advantage is reflected in future rates, this would be realized by ratepayers. However, if it is discontinued, then this could be an additional cost of service to Aquila.

COMPARISON TO PREVIOUS CHAPTER 100 CASES:

The Staff is aware of three other instances where utilities have filed applications with this Commission seeking approval for Chapter 100 financing arrangements. They are Aquila's request to enter into a Chapter 100 financing arrangement with the City of Peculiar for its South Harper generating facility (Case No. EO-2005-0156), AmerenUE's request to enter into a Chapter 100 financing with the City of Bowling Green for a generating facility (Case No. EO-2003-0035), and AmerenUE's request to become the lessee under an existing Chapter 100 financing arrangement with the County of Audrain for an already built generating facility located in that county (Case No. EF-2006-0278). Factually, Case Nos. EO-2006-0156 and EO-2003-0035 are most dissimilar to the instant application since each involved new Chapter 100 arrangements. In contrast, Case No. EF-2006-0278 is most analogous since it also involved assumption of an existing arrangement.

In Case No. EF-2006-0278, AmerenUE was assuming a lease from NRG Generating and took over (i) the leasehold interest pursuant to the Chapter 100 Lease Agreement, (ii) the respective rights and obligations under the Chapter 100 Grant Agreement, and (iii) rights of NRG Generating under the Chapter 100 Bond. Aquila's current Application proposes to execute the assumption of the lease and the Chapter 100 financing arrangement in essentially the same fashion. The only difference between the two cases are the statutes referenced for purposes of the requested relief. In the NRG case, AmerenUE requested relief pursuant to Sections 393.180 and 393.200, RSMo, because it is a Missouri corporation. However, in the instant case Aquila did not request relief pursuant to the same statutes because it is not a Missouri corporation. Aquila requested relief pursuant to Section 393.190 RSMo, because the Commission may view this transaction as an encumbrance of Aquila's Missouri utility properties.

Although the relief Aquila requested in its Application is limited to the Chapter 100 financing arrangement, the Staff is sensitive to the recent issues that have surrounded the South Harper case. Consequently, Staff issued several data requests to determine if there are any lingering controversies associated with this property. Staff inquired about the following: (1) any requirements to rezone the project site, and (2) any knowledge of challenges or potential challenges to the original site of this facility. According to Aquila the site was rezoned to light industrial in May 1999 and there are no challenges or potential challenges to the site that would affect the Aries Facility. Additionally, the Staff believes that the mere fact that this plant has been in service since 2002 without any known controversies is noteworthy.

OTHER ISSUES:

The Staff has verified Aquila has filed its annual report and is not delinquent on any assessment. The fee schedule does not apply to this transaction because there isn't new financing associated with this transaction. Staff is not making a determination of the prudence of Aquila's acquisition of the Aries Facility for purposes of resource planning or the ultimate price Aquila pays for the facility, if it acquires the facility.

RECOMMENDED CONDITIONS:

Staff recommends the Commission approve Aquila's Application, with the following conditions:

1. Aquila shall continue to record the land and improvements (combined cycle unit) that are the subject of this transaction as a regulatory asset on its books similar to other utility property it owns.
2. Aquila shall record the investment described above in accordance with the Uniform System of Accounts as adopted by this Commission for record-keeping purposes.
3. Aquila shall depreciate the combined cycle unit plant accounts at the following annual rates:

Account No. 341 (Structures & Improvements): 1.67% (ASL: 60 years);
Account No. 342 (Fuel Holders, Producers & Accessories): 2.50% (ASL: 40 years);
Account No. 343 (Prime Movers): 3.03% (ASL: 33 years);
Account No. 344 (Generators): 3.03% (ASL: 33 years);
Account No. 345 (Accessory Electric Equipment): 2.50% (ASL: 40 years);
Account No. 346 (Miscellaneous Power Plant Equipment): 2.86% (ASL: 35 years).

These depreciation rates are the depreciation rates Staff will propose in the current rate case, Case No. ER-2007-0004 if Aquila successfully acquires the Aries combined cycle unit. On a composite basis they approximate the 2.86% depreciation rate (35 year ASL) ordered in The Empire District Electric Case No. 2004-0570 for the combined cycle unit plant accounts.

4. Aquila shall book each payment in lieu of tax ("PILOT") to operating expense during the remaining term of the Chapter 100 financing arrangement, as each annual payment is made.
5. No ratemaking determination is being made by the Commission in this proceeding and no party to this case has acquiesced to any present or future ratemaking treatment as it relates to this transaction. The ratemaking treatment of this transaction may be addressed in Aquila's next rate case or the Staff's next earnings complaint case, but no ratemaking treatment is being sought by Aquila in this proceeding.
6. Aquila shall seek and obtain Commission approval before it transfers any of the rights it holds pursuant to the lease where such rights are necessary or useful in the provision of regulated utility service, including the right to purchase the facility at the end of the lease.
7. Aquila shall not sell its rights to the Bond Purchase Agreement acquired through its acquisition of the Aries Facility without Commission approval.

The Staff concludes that, with the above conditions, approval of this Application would be in the public interest. This proposed transaction has the potential to result in both lowered rates to consumers and property tax savings to Aquila. Because it creates a benefit, although not immediately realized, to Missouri ratepayers served by Aquila, this transaction, with the conditions the Staff proposes, is in the public interest.