BEFORE THE PUBLIC SERVICE COMMISSION

OF THE STATE OF MISSOURI

In the Matter of the Application of Aquila, Inc. For Authority to Acquire, Sell and Lease Back Three Natural Gas-Fired Combustion Turbine Power Generation Units and Related Improvements To be Installed and Operated in the City of Peculiar, Missouri.	)))))))	**Case No. EO-2005-0156**

DISSENTING OPINION OF COMMISSIONERS STEVE GAW AND ROBERT M. CLAYTON III

These Commissioners dissent from the majority's Report and Order which advances Aquila's financing proposal by declining jurisdiction over the transaction. The holding of the majority relinquishes regulatory authority on such questions and sets the wrong precedent for future cases. Based on the following analysis, these Commissioners dissent.

I. INTRODUCTION

On December 6, 2004, Aquila, Inc. filed an Application with the Commission. As structured, the Application would result in the construction of the South Harper Generating Facility (the "Project"). This construction would actually be financed by the City of Peculiar through the issuance of $140 million of tax-advantaged Chapter 100 revenue bonds and ownership of the Project would be held by the City of Peculiar. Following such construction, Aquila would lease-back the completed Project for a 30-year period and, following the expiration of the lease, Aquila would assume ownership of the generating facility. Under the lease, Aquila would be responsible for the operation, maintenance and control of the generating facility.

As contained in its Application, Aquila deemed it necessary to receive an affirmative order which would specify the following authorizations:

(E) Authorizing Aquila to sell and convey to Peculiar all real estate, facilities, equipment and installation necessary to install, construct, control, manage and maintain the Project;

(F) Authorizing Aquila to lease the Project from Peculiar and operate the Project; and

(G) Authorizing Aquila to cause the Project to be pledged to the Trustee under the terms of the Indenture as security for the holders of the Bonds.

On September 1, 2005, Aquila entered into a Stipulation and Agreement with the Staff and the Office of the Public Counsel. Apparently still believing that it needed these specific authorizations from the Commission, the Stipulation would have provided Aquila the necessary Commission approvals to move forward with the project. After entering into the Stipulation, however, it became known that Aquila had not waited to receive such authorizations. Rather, Aquila had unilaterally proceeded with: (1) the sale of the turbines to the City of Peculiar; (2) the purchase of the Chapter 100 revenue bonds issued by the City of Peculiar; (3) the execution of a lease of the Project with the City of Peculiar; and (4) the execution of a Deed of Trust and Security Agreement providing Commerce Bank a security interest in the Project as security for Aquila as holder of the Chapter 100 revenue bonds. In fact, Aquila had undertaken all such transactions less than one month after filing its Application with the Commission.

Despite Aquila's numerous public proclamations from the previous 9 months that such authorizations were necessary prior to undertaking these transactions, when it was faced with the fact that it had undertaken such transactions without Commission approval and in contravention of Missouri statutes, Aquila promptly changed its position and claimed: (1) that such approvals

were not necessary; (2) that the Commission did not have jurisdiction over the transactions; and (3) that the Application should be dismissed.

The majority has adopted Aquila's most recent argument and declined jurisdiction over the transactions. The majority's rationale in this case, that these assets were not "necessary or useful" since they were not operational, sets a bad precedent for future cases in Missouri. It is one thing to accommodate Chapter 100 financing provisions, but it is far more troubling to employ a rationale that a company may dispose of any asset that is not currently deployed in the provision of service. The Commission recently approved a regulatory plan for KCP&L as well as two other regulated entities providing for special regulatory treatment to assist in the construction of the 800 MW Iatan 2 Generation Station. The cost of this plant will ultimately be in the hundreds of millions of dollars. Ratepayers will have provided early support to the companies prior to the plant generating any electricity. Yet with this decision, the majority would conclude that KCP&L could, at any time prior to the generation facility being operational, sell all or part of the new facility without approval of this Commission.

In fact, using the rationale of the majority, it is arguable that a utility could simply turn off a generator that had been operational up to that time, declare it no longer necessary, and sell it without prior authority from the Commission. It is easy to imagine how utilities could manipulate around the dictates of Section 393.190 at will. This Commission may have intended to let one dog out of the kennel, but it has left the gate open for the remainder to run out as well.

The importance of Section 393.190 should not be underestimated. Leaving review of this Commission to after-the-fact prudence reviews of asset sales is not sufficient. This Commission is assigned the responsibility to ensure that a utility has sufficient assets to serve its customers. This responsibility is a fundamental tenet behind the Commission's informal and formal

integrated resource planning. The Commission should not surrender a large portion of that responsibility in an order which has such little analysis and consideration for the precedent being set.

II. WERE THE ASSETS "NECESSARY"?

Up to this point in time, the case law regarding the transfer of assets has been fairly clear-cut and has not required any real definition to the statutory terms of "necessary" or "useful" as contained in Section 393.190. Despite the lack of definition interpreting Section 393.190, there are other judicial decisions which provide guidance as to the definition of "necessary".

In State ex rel. Union Electric Company v. University City, the St. Louis Court of Appeals addressed a city's ability to deny a conditional use permit to an electric utility seeking to erect an electric substation at a specified site.[1] The court noted that one consideration for the city council is whether the electric substation is "necessary for public convenience at the location." In that decision, the court discussed whether alternative locations would suffice for the placement of the electric substation. Ultimately, the court determined that "necessary" did not require "absolute necessity". Rather, the court found that "necessary" means "suitable, proper and convenient to the ends sought."[2] In its pending rate case, Aquila argues that these turbines are needed in order for Aquila to meet its obligation of delivering electricity to its current Missouri customers. Clearly, given this definition of necessary, the combustion turbines owned by Aquila and ultimately transferred to the City of Peculiar were necessary according to Aquila in that they were "suitable, proper and convenient to the ends sought."

[1] 449 S.W.2d 894 (Mo. App. 1970).
[2] *Id.* at 901.

Aquila's own application in the pending proceeding argues that these combustion turbines were necessary. In its Application, Aquila discusses its need for the purchase of the three combustion turbines. Aquila notes:

> Aquila, on behalf of its Aquila Networks operating divisions in Missouri, issued several requests for proposals and conducted multiple independent solicitations seeking in excess of 500 MW of power supply beginning in 2005; 500 MW replacing an existing purchase power agreement from a combined cycle facility interconnected with the Aquila Networks-Missouri transmission system and approximately 25 MW to 100 MW necessitated by system load growth. Aquila Networks' evaluation of the comprehensive list of responses/solicitations determined that a portfolio of alternatives rather than one single response provided the least-cost supply option. Specifically, Aquila Networks determined the least-cost supply option combination to be comprised by the application of three (3) combustion turbine generators with a combined nominal rating of 318 MW and two (2) power supply agreements of 75 MW (eight-year duration) and 150 MW (five-year duration), respectively.[3]

This admission by Aquila clearly indicates that, while the three combustion turbines may not have been an absolute necessity to Aquila's network, these combustion turbines were clearly "suitable, proper and convenient to the ends sought." Given these combustion turbines were necessary, any transfer would require the approval of the Commission or would otherwise be void.

III. "NECESSARY" IS NOT DETERMINED BY A RATE BASE DETERMINATION

In its Report and Order, the majority appears to confuse the standard for the exercise of Commission jurisdiction over transfer of assets, Section 393.190, with the standard for the inclusion of an asset in a utility's rate base, Section 393.135. Specifically, the majority makes the following conclusions:

> 8. Because the facilities were not necessary or useful in the performance of Aquila's duties at the time of the transaction, Aquila did not need Commission approval before the transaction.

[3] See, Application of Aquila, Inc., Case No. EO-2005-0156, filed December 6, 2004, at page 5. (emphasis added).

9. An asset must be used and useful before an electrical corporation can charge for operating or financing it.

It is unclear the basis for the majority including the reference to the "used and useful" rate base standard in an unrelated discussion regarding the transfer of a necessary asset.[4]

The General Assembly was very clear in its use of standards for the exercise of the differing Commission authority. As previously discussed, exercise of Commission jurisdiction under Section 393.190 is predicated on a finding that the asset is "necessary or useful" in the performance of the utility's duties to the public. On the other hand, Section 393.135 requires a finding by the Commission that an asset is "fully operational and used for service" prior to allowing any electric corporation to assess any charge associated with the asset.

These standards are noticeably different. By using disparate standards, it is clearly contemplated that the Commission's jurisdiction over the transfer of assets could encompass assets that were not yet included in the electric utility's rate base. That is to say, an electric utility could possess an asset that is necessary, and is therefore regulated under Section 393.190, but is not yet "fully operational and used for service" and includable in rate base under Section 393.135. The Commission's offhanded reference to the "used and useful" standard is not only an inaccurate recitation of the Commission's rate base standard, it only serves to confuse the exercise of the jurisdiction called into question by the current application.

[4] While the "used and useful" standard is often used in generic ratemaking discussions, this standard is not contained in the Missouri statutory provision regarding the opportunity to earn on an asset. Instead, Proposition One required an electrical asset to be "fully operational and used for service" prior to the Commission including the asset in rate base. As such, the "used and useful" standard is not an accurate recitation of Missouri law and is not relevant to the pending discussion.

IV. THE COMMISSION'S FINDING REGARDING "CONTROL OF ASSETS" IS NOT AN ACCURATE DETERMINATION AND IS OTHERWISE IRRELEVANT TO THE EXERCISE OF COMMISSION JURISDICTION

In its Report and Order, the majority reaches the conclusion that:

> 7. Aquila's December 30, 2004 sale and lease-back of the facilities was not the type of transaction that Section 393.190 was meant to govern, because Aquila maintained complete control over the assets.

As the previous discussion regarding the relevant statutory provision (i.e., whether the asset is necessary or useful") indicates, the fact that a utility retains "control" of an asset, is not relevant to the question of whether Commission jurisdiction is invoked. Section 393.190 provides in pertinent part that:

> No . . . electrical corporation . . . shall hereafter sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public, . . . without having first secured from the commission an order authorizing it so to do.

Thus, while certain of the prohibited actions are characterized by a change in the control of the asset (i.e., sell, assign, lease or transfer), other actions are prohibited under the statute regardless of whether the utility maintains control of the asset (i.e., mortgage or otherwise encumber).

As such, while the majority's focus on the control of the asset may be relevant to a decision whether the combustion turbine was sold, assigned, leased or transferred, the control of the asset will not be determinative of whether the asset is mortgaged or otherwise encumbered. In fact, the very nature of a mortgage, one of the prohibited acts, is to place a lien on the property without incurring a transfer of control. Black's Law Dictionary notes that a mortgage "is regarded as a mere lien, and not as creating a title or estate." Similarly, an encumbrance, also prohibited by the statute, is defined as a "claim, lien, charge, or liability attached to and binding

real property." Given the nature of these two prohibited acts (a mortgage or encumbrance), the majority's focus on the control of the asset is misplaced.

Nevertheless, it is clear, given the documents executed by Aquila and the City of Peculiar that a sale of an asset has occurred despite the majority's insistence that Aquila "maintained complete control over the assets". Specifically, Aquila, Inc., executed on behalf of its Missouri operating division a Bill of Sale. That Bill of Sale explicitly provides that Aquila "does now **GRANT** and **CONVEY**, unto Buyer and its successors and assigns, all of its right, title, and interest, if any, in and to all machinery, equipment and other personal property whether or not installed or kept on the Project Site, and constituting the "Project Equipment", as such terms are defined in the Lease Agreement."[5] The fact that the same parties subsequently provided for the lease-back of the same Project Equipment in no ways negates the fact that the assets were indeed sold, an action in direct contravention of Section 393.190.[6]

The sale of the asset from Aquila to the City of Peculiar is further demonstrated by the City's subsequent action of executing a Deed of Trust and Security Agreement on behalf of Commerce Bank. This document provides that "the City does hereby **GRANT, BARGAIN AND SELL, CONVEY AND CONFIRM**, unto the Mortgage Trustee, and unto his successors and assigns forever, in trust, and assigns and grants to the Trustee for the benefit of the legal owner from time to time of the Bonds a security interest in, all of the hereinafter described properties whether now owned or hereafter acquired situated in City of Peculiar, Missouri (the "Property")." The "Property" is subsequently defined to include all rights, title and interest in

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[5] See, Bill of Sale, Case No. EO-2005-0156.

[6] In a separate Economic Development Agreement, the occurrence of a sale is also made clear. "Aquila and the City expect that the Project, the Property, and the Turbines will be conveyed to and legal title held by the City (and Aquila hereby agrees to timely take such actions and execute such documents as may be required to convey title to the Project and the Property to the City consistent with this Section)". Furthermore, in its Application, Aquila notes that the Project "involves a transfer of legal title of the CTs, associated equipment and the real estate upon which the Project shall be located to Peculiar".

the electricity generation, transmission and distribution facilities contained in the South Harper Peaking Facility as well as the Peculiar 345 kV Substation. Given the City's subsequent execution of a Deed of Trust and Security Agreement, it is difficult to maintain that a sale of the assets from Aquila to the City never occurred merely because Aquila maintained some operational control under a lease.

V. APPLICABILITY OF THE ARKANSAS POWER & LIGHT PROCEEDING

In a footnote, the majority attempts to buttress its argument that this transaction does not fall within the purview of Section 393.190 because Aquila maintained control of the assets, by pointing to a prior Arkansas Power & Light (APL) decision. Ignoring the fact that prior Commission decisions are not binding on a subsequent Commission, the use of the Arkansas case in the matter is flawed. The Commission in the Arkansas case gave multiple possible reasons for not examining the transaction among them being that the company was not a Missouri entity, that the pollution control equipment in issue was located in Arkansas and that it was not clear that the assets were necessary in the performance of APL's duties to its Missouri customers. None of these reasons exist in the present case. It is understandable that the Commission in the Arkansas case would have seen little reason to intervene in a matter so removed from Missouri interest. It is not understandable with Aquila – a company headquartered in Missouri with thousands of Missouri customers in a matter involving a generating facility to be built in Missouri and used to serve Missouri customers. This Commission should not use the analysis of the Arkansas case to expand the exception to the Commission's jurisdiction over a Missouri utility with an asset intended to be used entirely for the purpose of serving Missouri customers.

In fact, since the issuance of the APL decision, this Commission has exercised its jurisdiction over Chapter 100 financings with a utility under a similar fact situation as the present case. In its Application, Aquila notes the Commission's previous decision regarding Union Electric's use of Chapter 100 financing for the purpose of constructing an electric generating facility in Bowling Green, Missouri. Given its previous acceptance of and reliance on the Union Electric decision, it is disingenuous for Aquila to now claim a lack of Commission jurisdiction based upon the 25 year old APL decision.

VI. RELATED COURT DECISIONS

The current proceeding is just the latest in a long line of proceedings, judicial and administrative, deriving from the siting, construction and financing of the South Harper Generating Facility. While none of these proceedings are final and all are still subject to various degrees of reconsideration or appeal, the current judicial determinations regarding South Harper establish the following facts:

(1) The South Harper Generation Facility could not be sited by Aquila without a specific grant of authority by the Public Service Commission;

(2) The Commission's previous grants of service area authority did not constitute the specific grant of authority necessary for the placement of a generation facility;

(3) As such, Aquila had not received specific authority from the Commission prior to beginning construction of the South Harper electric plant, in direct contravention of Section 393.170.1; and

(4) As a result of its failure to receive the approval of its citizens, the City of Peculiar did not have the authority to issue the Chapter 100 Revenue Bonds underlying the construction of the South Harper facility.

Against these numerous pending legal impediments to the siting, construction, financing and operation of the South Harper facility, these Commissioners question the wisdom of moving forward with the current proceeding. Setting aside the legal problems as stated herein, a great cloud of uncertainty hangs over this project, the utility and the opponents of the project awaiting finality. The siting case recently affirmed by the Court of Appeals does not permit the case to move forward, while the City of Peculiar's improper issuance of Chapter 100 revenue bonds places in question the whole financing transaction. Prudence would suggest a delay until all appeals are final.

CONCLUSION

It is clear from the foregoing discussion that the CTs used in the South Harper Generation Facility were considered necessary by Aquila in the performance of Aquila's duties to the public. The necessary nature of these assets is admitted by Aquila in its Application as well as in its pending rate proceeding. As such, Section 393.190 specifically prohibits any sale, assignment, lease, transfer, mortgage or other encumbrance without the prior approval of the Commission. The record indicates that Aquila executed, in December of 2004, a Bill of Sale providing for the transfer of all of Aquila's rights, title, and interest in the South Harper CTs. Recognizing that Aquila had not yet obtained the approval of the Commission, this transaction is necessarily void. No amount of accounting or legal gymnastics can correct this legal deficiency.

Finally, these Commissioners wish to note that nothing in this Order makes reference to the questionable handling of information relating to this case by Aquila. It is apparent that the Company has been less than forthright with the Commission. Specifically, we note: (1) Aquila never voluntarily disclosed to the Commission that the December 2004 transfer occurred; (2) Aquila's failure to provide executed copies of the relevant documents; (3) Aquila's use of the

future tense in its pleadings and testimony in describing a transaction that had already occurred; (4) Aquila's claims that the Commission should have been aware of the executed transaction based upon public statements by the Mayor of Peculiar in a different proceeding, despite Aquila's principal witness denying he was aware of the December 2004 transaction at the time of the September 21, 2005 hearing; and (5) Aquila's failure to address Commissioner inquiries at the hearing or to correct the Commission and the parties' belief that the transaction had not yet occurred. Explanations by counsel and Aquila's witness were not satisfactory and proved elusive, vague and questionable. Nowhere in the majority's Order is Aquila admonished for its representations or omissions. As such, it appears that such lack of candor is acceptable practice before this tribunal. Such representations and omissions deserve further inquiry from the Commission for possible future action.

For the foregoing reasons, these Commissioners dissent.

Respectfully Submitted

Steve Gaw
Commissioner

Robert M. Clayton III
Commissioner

Dated at Jefferson City, Missouri,
on this 21st day of December, 2005.