

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

In the Matter of the Application of Aquila )  
Inc., for an Accounting Authority Order )  
Regarding Accounting for Extraordinary )  
Costs Relating to Damage from the )  
December 2007 Ice Storm. )  
)

Case No. EU-2008-0233

**STAFF'S RECOMMENDATION TO GRANT ACCOUNTING AUTHORITY**

COMES NOW the Staff of the Missouri Public Service Commission (Staff) and, in response to the Missouri Public Service Commission's January 11, 2008 *Order Directing Filing*, recommends the Commission, with seven conditions, grant Aquila Inc., (Aquila) authority to defer to Uniform System of Accounts (USOA) Account 182.3, Other Regulatory Assets, the extraordinary costs Aquila's Aquila Networks L&P (L&P) division incurred due to an ice storm that occurred on December 11, 2007, as follows:

1. In its *Order Directing Filing*, the Missouri Public Service Commission (Commission) ordered the Staff to file by February 11, 2008 a pleading that is "either a recommendation or a status report informing the Commission of when Staff will file a recommendation."

2. In the attached Memorandum, which is labeled Appendix A, the Staff recommends the Commission, with seven conditions, grant Aquila an Accounting Authority Order that allows Aquila to defer to Uniform System of Accounts (USOA) Account 182.3, Other Regulatory Assets, the extraordinary costs its L&P division incurred due to an ice storm that occurred on December 11, 2007.

3. The seven conditions the Staff recommends the Commission impose are:

- a. Aquila should be authorized to defer actual incremental operation and maintenance expenses incurred for its L&P division as a direct result of the December 2007 ice storm to Account 182.3. Such expenses shall be in accordance with USOA definitions of operation and maintenance expense and shall exclude any expenditures relating to plant-in-service (i.e., capital costs). The capital costs, and any resultant retirements, would be treated like other plant investments and booked to plant-in-service and accumulated depreciation accounts.
- b. Any insurance claim proceeds or subrogation proceeds applicable to incremental storm-related operation and maintenance expenses must first be used to offset the total amount of expenses deferred under this AAO, thus reducing amounts deferred.
- c. Any gain experienced by Aquila for its L&P division that can be considered extraordinary as defined by the USOA should first be used to reduce the amount of this ice storm regulatory asset as long as the asset is recorded on Aquila's book and records.
- d. Aquila must begin ratably amortizing the ice storm regulatory asset over a five-year(60-month) period beginning in January 2008, as Aquila's application has requested.
- e. Aquila shall maintain adequate records supporting the incremental expenses deferred. Such records shall include, but not be limited to, listing of outside contractors, agreements with third parties for goods and services, controls in place to ensure all expenditures were reasonable, invoices detailing food, lodging, and labor costs, labor and material costs, procedures and verification for expense versus capitalization determinations, and determinations of incremental levels of such costs versus normal ongoing levels of costs.
- f. The Commission does not make any findings or inferences as to whether the deferred expenses are prudent and reasonable, whether other factors contributed to the damage to the system and the resulting repair/replacement costs incurred, or whether Aquila would have suffered financial harm (i.e., earnings during the period were inadequate to compensate Aquila for the costs incurred) absent deferral.
- g. The Commission reserves the right to determine the appropriate ratemaking treatment of the deferred costs in a future rate proceeding, including whether or not the deferral should be offset by any gains recognized by Aquila since the beginning of the deferral period.

5. If these seven conditions are not acceptable to Aquila, then the Commission should order a prehearing conference for the purpose of the parties proposing a procedural schedule for the filing of prepared testimony and an evidentiary hearing.

WHEREFORE, in response to the Missouri Public Service Commission's January 11, 2007 *Order Directing Filing*, the Staff recommends the Commission, with the conditions set forth above and in its memorandum, grant Aquila Inc., an Accounting Authority Order that allows Aquila to defer to Uniform System of Accounts (USOA) Account 182.3, Other Regulatory Assets, the extraordinary costs Aquila's L&P division incurred due to an ice storm that occurred on December 11, 2007

Respectfully submitted,

/s/ Sarah Kliethermes  
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Missouri Bar No. 60024  
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Missouri Public Service Commission  
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#### **CERTIFICATE OF SERVICE**

I hereby certify that copies of the foregoing have been mailed, hand-delivered, or transmitted by facsimile or electronic mail to all counsel of record this 11<sup>th</sup> day of February, 2008.

/s/ Sarah Kliethermes

## MEMORANDUM

TO: Missouri Public Service Commission Official Case File,  
Case No. EU-2008-0233, Aquila, Inc.

FROM: Cary G. Featherstone – Project Coordinator, Auditing Department  
Charles R. Hyneman – Regulatory Auditor, Auditing Department

/s/ Charles R. Hyneman 02/08/08      /s/ Sara Kliethermes 02/08/08  
Project Coordinator/Date      General Counsel's Office/Date

SUBJECT: Staff Recommendation Regarding Aquila Inc.'s (Aquila) Application For An  
Accounting Authority Order For Extraordinary Costs Relating To Damage,  
From The December 2007 Ice Storm

DATE: February 8, 2008

### **Background**

On January 10, 2008, Aquila filed an application for an Accounting Authority Order (AAO). Aquila requests that the Commission issue an AAO that gives it the authority to defer, as a regulatory asset, the incremental expenses it incurred during the December 11, 2007 winter storm that occurred in both of Aquila's service areas.

The storms caused damage to Aquila's transmission and distribution facilities and disrupted electric service to thousands of Aquila's customers, primarily in its Aquila Networks L&P (L&P) division's service area in northwest Missouri, including the towns of Platte City, Maryville, and St. Joseph. The storm also affected other Missouri communities north toward the Nebraska border and west toward the Kansas state line. The damage in its Aquila Networks MPS (MPS) service area in west-central Missouri was significantly less extensive.

To repair damage caused by the storms, Aquila was required to supplement its workforce with the equivalent of several hundred additional full-time employees. The Company brought in outside repair crews from Colorado, Kansas, Indiana, Texas, Wisconsin, Ohio, and Michigan, and incurred significant costs to support these outside crews, including labor, meals, lodging, travel and equipment costs. In addition, Aquila incurred significant overtime and other related expenses for work performed by its own employees.

Aquila estimates that total costs, including capital costs will likely exceed \$13.5 million. Of this amount it expects to defer as incremental operation and maintenance expense, an estimated \$10 million for its L&P division and \$400,000 for its MPS division. As of January 24, 2007, Aquila has incurred \$6.8 million for its L&P division and \$366,680 for its MPS division. Over 80 percent of Aquila's storm restoration costs to date have been for outside repair crews and other outside services.

Aquila states that without an AAO it would be required to record all of its extraordinary expenses in the single reporting period in which those costs were incurred, calendar year 2007, which will significantly reduce the Company's earnings for that period. Aquila states that a reduction in earnings would result from this treatment that could have adverse consequences for the Company as it seeks to raise funds in the capital markets.

### **Accounting Treatment**

Aquila is asking that the Commission issue an AAO authorizing it to defer and record in the Uniform System of Accounts (USOA) Account 182.3, as a regulatory asset, the additional, incremental operating costs incurred as a result of the December 2007 ice storms. The Company further requests that the regulatory asset established by these deferrals be amortized over a five-year period commencing in January 2008.

The Staff agrees that this is the appropriate accounting treatment for any expenses deferred under this particular AAO. However, as discussed more fully below, the Staff does not recommend that Aquila be allowed to defer the total incremental costs of the ice storm incurred by both its L&P and MPS divisions. Instead, Staff recommends that an AAO be issued allowing Aquila to defer only the prudently incurred incremental costs incurred by the L&P division as a result of the ice storm.

### **Requirements for Extraordinary Items**

General Instruction No. 7 to the USOA begins its definition of Extraordinary Items by stating that, with limited exceptions, net income shall reflect all items of profit and loss during the period. This expense-recognition requirement is based on the matching principle of Accounting which states that expenses should be matched with revenues of the same period.

The USOA goes on to state that extraordinary items are those items related to the effects of events and transactions which have occurred during the current period and which are of unusual nature and infrequent occurrence. Accordingly, extraordinary items will be events and transactions of significant effect which are abnormal and significantly different from the ordinary and typical activities of the company, and which would not reasonably be expected to recur in the foreseeable future.

The first thing that the USOA requires of a cost to be classified as extraordinary is that the effect of the event which gave rise to the cost must be of an "unusual nature" and of "infrequent occurrence." The USOA then adds a third test that requires the impact of the event to have "significant effect" or a material impact on current period financial results. The USOA has defined "material" in this respect, to be more than approximately five percent of net income computed as if the event had not occurred. The USOA goes on to define "unusual" as abnormal and significantly different from the ordinary and typical activities of the company. It then

defines an “infrequent” event as an event which would not reasonably be expected to recur in the foreseeable future.

The USOA definition of “extraordinary items” is modeled after generally accepted accounting principles (GAAP), and is virtually identical to the accounting standards enunciated in Accounting Principles Board Opinion No. 30, which is current GAAP on this issue.

Under GAAP rules, “extraordinary” gains or losses are material events and transactions that are both unusual in nature and infrequent in occurrence. Both of these criteria must be met for an item to be classified as extraordinary. To be considered unusual in nature, the underlying event or transaction should possess a high degree of abnormality and be clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates. To be considered infrequent in occurrence, the underlying event or transaction should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates.

### **Are Ice Storms an Extraordinary Event for Missouri Utilities?**

This AAO request is Aquila’s second AAO request for an ice storm in five years. In addition, in the last two years, every major electric utility in Missouri has either had an ice storm AAO or is currently seeking deferral accounting treatment for ice storm costs.

Given the number of recent ice storms and resultant AAOs, it is reasonable to question whether or not the occurrence of significant ice storms in Missouri can continue to meet the definition of extraordinary event as defined by the USOA.

As described below, however, the Staff has not changed its conclusion that the type of ice storm that hit Aquila’s L&P service area is an extraordinary event, thus Staff will recommend that the Commission grant Aquila deferral authority for those expenses. It should be noted also that the Commission can grant deferral authority for ice storm costs even if it determines that these events are no longer considered extraordinary under the USOA definition.

### **Materiality**

It is not solely the occurrence of an ice storm that makes it an extraordinary event. Ice storms of various degrees of severity are not unusual in winter months. It is the significance of the impact of the ice storm on current period earnings which determines whether or not an ice storm should be classified as extraordinary event and allowed exceptional accounting treatment.

Aquila’s MPS and L&P divisions are separate operating companies with separate electric utility rates. The impact of the storm on L&P’s net income will be a minimum of \$4.2 million. This amount reflects the after-tax impact on net income of Aquila L&P recognizing the actual \$6.8 million of storm costs in its income statement. This amount is clearly material to both L&P

as a separate operating company and Aquila, Inc. as a whole. However, the impact of the storm on Aquila's MPS division net income will be less than \$250,000. This amount reflects the after-tax impact of the total estimated MPS storm restoration cost of \$400,000. This amount is clearly immaterial to MPS.

## **STAFF'S CONCLUSIONS**

The Staff recommends that the Commission conditionally grant Aquila's request to defer extraordinary storm costs incurred by its Light & Power division and deny Aquila's request to defer storm-related expenses incurred by its MPS division. The Staff believes that the storm-restoration expenses incurred by Aquila's L&P division are extraordinary and meet the materiality standard under the USOA definition. Additionally, these expenses are similar to costs for which the Commission has generally granted AAOs in the past.

Absent special circumstances, not present here, the level of costs incurred by Aquila's MPS division for the December 2007 ice storm cannot be considered material or significant under any definition. The Staff believes that, in addition to not meeting the USOA and GAAP definitions of extraordinary, it would be bad regulatory policy to allow the deferral of insignificant and immaterial utility operating expenses under an AAO. Such costs are presumed to be recovered through existing utility rates developed through the normalized rate-setting process the utility's last rate proceeding.

## **STAFF'S RECOMMENDATIONS**

The Staff recommends that the Commission grant the Company's request subject to the following seven conditions:

1. Aquila should be authorized to defer actual incremental operation and maintenance expenses incurred for its L&P division as a direct result of the December 2007 ice storm to Account 182.3. Such expenses shall be in accordance with USOA definitions of operation and maintenance expense and shall exclude any expenditures relating to plant-in-service (i.e., capital costs). The capital costs, and any resultant retirements, would be treated like other plant investments and booked to plant-in-service and accumulated depreciation accounts.
2. Any insurance claim proceeds or subrogation proceeds applicable to incremental storm-related operation and maintenance expenses must first be used to offset the total amount of expenses deferred under this AAO, thus reducing amounts deferred.
3. Any gain experienced by Aquila for its L&P division that can be considered extraordinary as defined by the USOA should first be used to reduce the amount of this ice storm regulatory asset as long as the asset is recorded on Aquila's book and records.

4. Aquila must begin ratably amortizing the ice storm regulatory asset over a five-year (60-month) period beginning in January 2008, as Aquila's application has requested.
5. Aquila shall maintain adequate records supporting the incremental expenses deferred. Such records shall include, but not be limited to, listing of outside contractors, agreements with third parties for goods and services, controls in place to ensure all expenditures were reasonable, invoices detailing food, lodging, and labor costs, labor and material costs, procedures and verification for expense versus capitalization determinations, and determinations of incremental levels of such costs versus normal ongoing levels of costs.
6. The Commission does not make any findings or inferences as to whether the deferred expenses are prudent and reasonable, whether other factors contributed to the damage to the system and the resulting repair/replacement costs incurred, or whether Aquila would have suffered financial harm (i.e., earnings during the period were inadequate to compensate Aquila for the costs incurred) absent deferral.
7. The Commission reserves the right to determine the appropriate ratemaking treatment of the deferred costs in a future rate proceeding, including whether or not the deferral should be offset by any gains recognized by Aquila since the beginning of the deferral period.



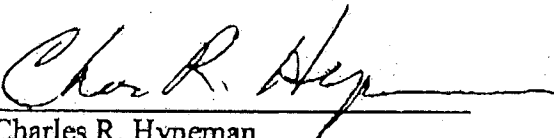
**BEFORE THE PUBLIC SERVICE COMMISSION**  
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In the Matter of the Application of Aquila, Inc.     )  
for the Issuance of An Accounting Authority     ) Case No. EU-2008-0233  
Order Relating to its Electrical Operations     )

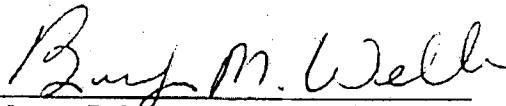
**AFFIDAVIT OF CHARLES R. HYNEMAN**

STATE OF MISSOURI     )  
                                      )     ss.  
COUNTY OF COLE     )

Charles R. Hyneman, of lawful age, on his oath states: that he has participated in the preparation of the foregoing Staff Recommendation in memorandum form, to be presented in the above case; that the information in the Staff Recommendation was developed by him; that he has knowledge of the matters set forth in such Staff Recommendation; and that such matters are true and correct to the best of his knowledge and belief.

  
\_\_\_\_\_  
Charles R. Hyneman

Subscribed and sworn to before me this 8<sup>th</sup> day of February, 2008.

  
\_\_\_\_\_  
Notary Public

BEVERLY M. WEBB  
Notary Public - Notary Seal  
STATE OF MISSOURI  
Clay County  
My Commission Expires March 17, 2008