

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

In the Matter of the Tariff Filing of Aquila,)	
Inc., to Implement a General Rate Increase for)	
Retail Electric Service Provided to Customers)	Case No. ER-2007-0004
in its MPS and L&P Missouri Service Areas.)	

PREHEARING BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL

The Office of the Public Counsel submits its prehearing brief. This brief only addresses in detail issues raised and supported by the testimony of Public Counsel witnesses.

ISSUE:

REVENUE REQUIREMENT

Rate of Return

1. Return on Common Equity: What return on common equity should be used for determining Aquila's rate of return?

OPC POSITION: The Office of the Public Counsel opposes a Fuel Adjustment Clause. If the PSC approves a FAC, then the reduction in the risk associated with fuel costs must be factored into the determination of the proper ROR by an appropriate and commensurate downward adjustment. In addition, any FAC must comply with SB 179 and the implementing PSC rules and reflect the proper calculations and allowable factors. Aquila's proposed FAC does not meet those basic requirements and approval would not be in the public interest

DISCUSSION: Just and reasonable rates will not be fixed if the Rate of Return does not properly reflect the risk factor for fuel costs. Public Counsel has provided Russell Trippensee's and Ryan Kind's expert testimony that provides sound regulatory reasons why it opposes

granting Aquila authority to employ a fuel adjustment clause. The FAC process singles out fuel costs, the most significant factor in the ratemaking calculus, for special treatment outside of a comprehensive rate case that results in unjust and unreasonable rates. The FAC upsets the tender balance of risk factors at work in the ratemaking process.

The underlying premise is that just and reasonable rates result when the risk factors (weather, supply shortages, volatile fuel markets, and other factors that affect prices) give the utility the incentive to mitigate these risks with efficient management to reduce fuel costs that maximize the opportunity to generate earnings (the authorized ROR) under those rates. In turn, this ratemaking process protects ratepayers from frequent adjustments, an unstable rate structure, and the shift of the entire risk of imprudent utility management and unmitigated fuel costs. (Russell W. Trippensee Direct, p. 8, line 7-18; RWT Dir.7, l 18-22)

The FAC recovers the fuel cost associated with serving the customer *in total* through a process that allows Aquila to “effectively eliminate any earnings variability related to fuel costs for those customer classes who have a FAC. . .” (RWT Direct 7, l. 20- 21) This virtually eliminates “the risk of earnings variability related to fuel costs”) and will greatly reduce it for Missouri jurisdictional operations. (RWT Dir. 7, l. 22) This reduction in the business risk resulting from a significant decline in the potential variability of earnings would result in unjust and unreasonable customer rates that compensate stockholders for a risk they no longer have. (RWT Dir. 8l, 4-6)

If the Commission adopts a FAC, then it must reflect the reduction in risk in an appropriate downward adjustment in the ROR. Any process that mitigates the impact of fuel adjustment clauses on earnings should be considered in the authorized rate of return.

Section 386.266.8 RSMo 2000 (2005 Supp) provides in pertinent part: “The commission may take into account any change in business risk to the corporation resulting from implementation of the adjustment mechanism in setting the corporation’s allowed return in any

rate proceeding, in addition to any other changes in business risk experienced by the corporation.”

“If the financial impacts of these decisions are removed via a mechanism that assures cost recovery, the incentive to operate the utility efficiently is also reduced because the risk to which management would be adverse has been reduced or eliminated.” (RWT Dir, 9, l. 11-18) The reduction in risk in rate design would also reduce the incentive to find new efficiencies. Ratepayers are not protected with the removal financial incentives for management efficiency because this leaves only after-the-fact regulatory prudence reviews as an incentive for management efficiency. (RWT Dir, 9, l. 11-18)

The PSC must consider all relevant factors which have any bearing upon setting just and reasonable rates. Section 393.270 (4), RSMo; *State ex rel. St. Louis Water Company v. Public Service Commission*, 316 Mo. 842 (Mo 1927); *State ex rel. Laclede Gas Co. v. PSC*, 535 SW 2d 561 (Mo App 1976)

Commission’s principal interest is to serve and protect ratepayers. *State of Missouri ex rel. Capital City Water Company v. P.S.C.*, 850 S.W.2d 903 (Mo. App. W.D. 1993). The protection given to the utility is merely incidental. *State of Missouri, ex rel, Crown Coach Company v. P.S.C.*, 179 S.W.2d 123 (Mo. App. 1944). The testimony of Russell Trippensee demonstrates that the FAC alters the ratemaking process to the detriment of ratepayers. If the PSC does not account for the reduced risk in a FAC, then its decision is unlawful, unreasonable, and an abuse of discretion. A “proper determination” of rates must be based upon those factors that have a material bearing on the rates and must give “due regard” a reasonable return in relation to all other facts. *State ex rel. Missouri Water Co. v. PSC*, 308 SW 2d 704 (Mo 1957)

Public Counsel’s evidence will demonstrate that the change in risk due to the FAC is a material

and relevant factor that must be given due regard and be factored into the proper ROR.

Rate Base Issues

6. Accounting Authority Orders: Should the unamortized balance of the accounting authority orders the Commission issued for the Rebuild and Western Coal Conversion of Aquila's Sibley generating facility be included in Aquila Networks-MPS's rate base?

OPC POSITION: No. OPC opposes rate base treatment for the unamortized deferred balances and associated deferred income tax of the accounting authority orders.

DISCUSSION: Cost recovery was denied by the PSC in MGE case No. GR-98-140 because it recognized that the sole purpose of an AAO and its deferred cost recovery is to mitigate or lessen the effect of regulatory lag not to eliminate it or to protect the Company total from the risk. (Robertson Reb. 6-8) The sharing of the risk of extraordinary costs is just and reasonable while rate base treatment would be inconsistent with the purpose of the AAO and would be detrimental to the ratepayer. (Robertson Reb. 4-17)

By including the AAO amortization in expense and excluding the AAO unamortized balance from rate base (and including the associated deferred tax as a rate base offset) shareholders and ratepayers both will share in the negative regulatory lag experienced by Company. In Case No. GR-98-140, the Commission stated that the purpose of an AAO was to mitigate the effects of negative regulatory lag and that shareholders and ratepayers should share its cost:

The Commission finds that the unamortized balance of SLRP deferrals should not be included in the rate base for MGE. The AAOs issued by the Commission authorize the Company to book and defer the amount requested but do not approve any ratemaking treatment of amounts from the deferred and booked balances. AAOs are not intended to eliminate regulatory lag but are intended to mitigate the cost incurred by the Company because of regulatory lag.

Staff and Company's position fails to consider that the AAO deferred balances arise from the adoption of an abnormal regulatory accounting process. Recent Missouri Commission decisions have recognized this fact and understood that the management of the utilities exercise a great deal of control over the construction projects that their companies undertake. Management has great control over the timing of the construction of plant and complete discretion over the filing of general rate increase requests to recover the costs associated with new plant, thus at least to some extent, any negative regulatory lag experienced by Company is of its own making.

On the treatment of deferred income taxes associated with the Sibley and Ice Storm accounting authority orders be determined and applied as an offset to Aquila Network-MPS's rate base, the Commission has never authorized the Company to utilize flow-through tax treatment for the Sibley AAOs deferred expenses. Flow-through tax treatment implies that no tax timing difference (i.e., deferred income tax) is created due the AAO expense amounts be treated the same for ratemaking and income tax purposes In Case No. ER-90-101, the PSC found:

The Commission finds that the deferred income tax related to the AAO deferral which is included in deferred tax reserves should be used to reduce rate base a part of the process of setting rates in this case...

The Commission has not changed its position on this issue in subsequent cases, nor has it authorized the Company to use flow-through tax treatment for any AAO costs.

DEMAND SIDE MANAGEMENT

13. Should the Demand Side Management programs Aquila proposes be approved? If so, who should bear the costs of the programs?

OPC POSITION: No. While public counsel supports the implementation of properly designed cost effective DSM programs, it is not appropriate for the Commission to authorize Aquila to proceed with implementing DSM programs proposed by Aquila. (Kind rebuttal. 3)

DISCUSSION: A key defect in the four step process outlined in Aquila witness Daunis's testimony is that none of them have been properly analyzed for cost-effectiveness and many of them have not yet even been developed. (Kind Reb. 2-3) Aquila has not performed the integrated modeling necessary to show that demand side resources in its resource plan would be cost effective. There must be evidence of the cost effectiveness; the mere inclusion of DSM programs does not immediately translate into a finding that they are cost effective. The DSM plans have never been presented or reviewed by OPC. (Kind Reb. 2) Without a showing that Aquila's DSM proposals are properly designed and are cost effective Aquila's proposal lacks credibility. (Kind Reb.3-4) The inclusion would not be supported by competent and substantial evidence that there is a benefit to the public and to ratepayers. Public Counsel supports Staff witness Lena Mantle's DSM cost recovery proposal. (Kind Reb. 4-5)

The failure of Aquila to submit evidence of the cost effectiveness of its DSM proposal results in a failure of Aquila to carry its burden of proof that its proposal is just and reasonable. Without evidence of cost effectiveness, the PSC is left with a record without competent and substantial evidence that it achieves the key goal of the DSM programs and that ratepayers will benefit from the program. Assuring benefits to the ratepayers and protecting ratepayers from undue and unreasonable burdens is the PSC's duty. *State of Missouri ex rel. Capital City Water Company v. P.S.C., 850 S.W.2d 903 (Mo. App. W.D. 1993).*

FUEL COST RECOVERY

15. Should the Commission authorize Aquila to use a fuel and purchased power recovery mechanism allowed by 4 CSR 240-20.090?

- i. What standard should the Commission use in determining whether to allow Aquila to use a fuel and purchased power adjustment mechanism?
 - ii. What portion of fuel and purchased power costs should be recovered by a recovery mechanism rather than by base rates?
 - iii. Should a fuel and purchased power adjustment mechanism include recovery of any demand costs?
 - iv. Should a fuel and purchased power adjustment mechanism require definitive production standards for recovery of fuel and purchased power costs via the mechanism?
- a. FAC: If the Commission authorizes Aquila to use a fuel adjustment clause, how should it be structured?
- i. What recovery period should be used in the FAC?
 - ii. What line losses adjustment should be included in determining the fuel cost adjustment?
 - iii. How often should the fuel adjustment clause be adjusted?
 - iv. Should the fuel adjustment require a phase-in (cap) for sharp changes in fuel or purchased power costs?
 - v. What heat rate testing of generation plants should be conducted?

OPC POSITION: No. Public Counsel has proposed a thoughtful and thorough review of the policy considerations the Commission should evaluate in deciding to allow Aquila a FAC. (Kind Direct; Trippensee Rebuttal)

DISCUSSION: Public Counsel believes that the FAC proposed by Aquila would not be in the public interest. Public Counsel witness Ryan Kind has presented detailed and extensive

discussion of the policy and regulatory implications of the FAC. (Kind Dir.6-15) He has also discussed the Commission's discretion in approving FAC applications as well as the factors the Commission should consider for a FAC. (Kind, Direct 6-15)

Public Counsel has concerns Aquila's fuel adjustment clause proposal. Mr. Trippensee identified these specific areas as did Mr. Kind (Kind Dir. 15-16). In summary, Public Counsel opposes the implementation procedures and cost inclusions in the FAC proposed by Aquila for multiple reasons. The implementation procedures are not consistent with Commission rules and include costs that are not appropriate for inclusion in a FAC. Aquila's FAC is designed to effectively eliminate or at a minimum significantly impact the Commission's ability to perform prudence reviews which are the ratepayers' only remaining consumer protection if a FAC is in fact implemented. If a FAC is adopted, Public Counsel further recommends that that actual revenues be matched with actual costs and that an estimated level of sales not be used. (RWT Reb 2-21; 22)

Public Counsel contends that:

1. Aquila's proposed FAC implementation procedures are not consistent with 4 CSR 19 240-20.090. 20.
2. The short length of the recovery period increases volatility in customer rates.
3. The timing of the recovery period increases volatility for customers during periods of high use.
4. The timing of the recovery period creates a mismatch between cost causer and cost payer
5. Potential inclusion of costs that are not fuel or purchased power costs.

6. Creates four mandatory FAC filings per year and decreases regulatory oversight resources. The FAC will not result in revenues related to fuel equaling fuel costs eligible for recovery.

(RWT Reb 2-22)

As discussed in the Rate of Return discussion, all relevant factors must be considered. As set out in Mr. Kind's and Mr. Trippensee's testimony there are material and relevant factors that cannot be ignored in this rate case when deciding whether a FAC is in the public interest. , There are material and relevant factors concerning the application of the FAC factors specifically to Aquila and all aspects of its operations as identified by Mr. Kind. There are material and relevant factors concerning the compliance of Aquila's FAC proposal to SB 179, the Commission FAC rules and the FAC factors that should be applied.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been emailed to all parties this 30th day of March 2007.

/s/ Lewis R. Mills, Jr.

By:_____