

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO**

DOCKET NO. 02S-594E

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RE: THE INVESTIGATION AND SUSPENSION OF TARIFF SHEETS FILED BY AQUILA, INC., DOING BUSINESS AS AQUILA NETWORKS-WPC, WITH ADVICE NO. 579.

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**ORDER APPROVING SETTLEMENT**

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**TABLE OF CONTENTS**

I. BY THE COMMISSION .....	2
A. Statement .....	2
II. <u>PROCEDURAL HISTORY</u> .....	4
III. <u>SETTLEMENT</u> .....	8
A. Incentive Cost Adjustment (ICA).....	8
B. B.A. ICA - Resetting the Base Energy Cost and the “Roll- In” of the New ICA Base ..	11
C. Return On Equity.....	12
D. Capital Structure.....	13
E. Average Versus Year-End Rate Base.....	14
F. Capacity Cost Adjustment.....	15
G. Construction Work in Progress and Allowance for Funds Used During Construction Adjustment .....	17
H. Limited Rate Case .....	18
I. Cost Allocations and Fully Distributed Cost Studies .....	20
J. Performance Based Regulation .....	23
K. Other Provisions .....	25
L. Overall Settlement Decision.....	25
IV ATTACHMENT .....	25
IV. ORDER.....	25
A. The Commission Orders That: .....	25

B. ADOPTED IN COMMISSIONERS' DELIBERATION MEETING June 12, 2003 .....27

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I. **BY THE COMMISSION**

A. **Statement**

1. This is the first rate case for Aquila, Inc., doing business as Aquila Networks – WPC (Aquila or Company) operations in nearly 20 years.<sup>1</sup> On October 15, 2002, Aquila filed its Advice Letter No. 579 and accompanying tariffs proposing a general increase in rates affecting all classes of service. On that same date, Aquila filed its supporting Direct Testimony and Exhibits. The combined effect of the proposed General Rate Schedule Adjustment rider and the energy cost “roll-in” would have resulted in an approximately \$23 million dollar revenue increase, which is almost a 22 percent rate increase. The revenue requirement as filed would have enabled Aquila the opportunity to earn a rate of return on equity of 13.25 percent and an overall return on rate base of 10.19 percent.

2. On February 18, 2003, Staff of the Colorado Public Utilities Commission (Staff), the Colorado Office of Consumer Counsel (OCC), the Fountain Valley Authority, the Board of Water Works of Pueblo, the City of Canon City, and the Cripple Creek & Victor Gold Mining Company (CC&V) (collectively, Parties or Intervenors) filed answer testimony and accompanying Exhibits. The Parties generally opposed the Company's \$23 million dollar

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<sup>1</sup> Aquila provides electrical service to over 21 communities (Pueblo, Canon City, Rocky Ford, and Florence are its larger communities). As of June 30 2002, it had over 75,000 residential customers and over 10,000 commercial, public, and industrial customers.

proposed revenue increase and recommended a range of revenue increases starting as low as \$9,834,378 (OCC), and a rate of return on equity starting as low as 9.78 percent (OCC).

3. On April 18, 2003 the Parties filed a comprehensive Settlement. The Settlement provides for an overall revenue increase of \$16 million dollars and results in a uniform 15.6 percent rate increase for each customer class. It also reflects a rate of return on equity of 10.75 percent and employs an average rate base versus the Company's proposed year-end rate base filing. Furthermore, the Settlement includes a change in the Incentive Cost Adjustment (ICA) sharing from a 50/50 sharing mechanism to a 75 percent customers/25 percent Aquila sharing mechanism. It also contains an agreement to work on a Quality of Service Plan for Aquila's electric operations and to file that plan by January of 2004. Finally, the Company agrees to file another "limited rate case" no later than December 31, 2003.

4. On May 14, 2003, the Commission held a hearing on the Settlement. At that hearing, witnesses for the parties defended the Settlement as just and reasonable and in the public interest, and recommended the Commission approve it without modification. Company witness Mr. Keith explained that the major drivers in the case were several purchased power contract capacity escalations and some major plant additions. According to Mr. Keith, another driver was the escalating cost of energy the Company is facing combined with the fact that Aquila's fuel-adjustment clause only allowed it to recover 50 percent of the cost escalation. He explained the remainder of the case was principally the result of plant additions and other operation changes that have taken place in the 20 years since the last rate case. He testified that by agreeing to file a subsequent limited rate case, the Company intended to capture the 2003 capacity costs that had been included in its initial filing. He explained this would enable the Company to recover its costs in a series of two filings rather than all at once.

5. The Commission believes that in order to assess whether a settlement should be approved, it must examine each provision both individually and as part of an overall negotiated agreement. In deciding whether the Settlement is just and reasonable and in the public interest, the Commission has reviewed all of the pre-filed testimony, the public comment hearing transcript, customer letters, and the testimony provided at the hearing.

6. Now being duly advised in the matter, the Commission approves the Settlement without modification.

## **II. PROCEDURAL HISTORY**

7. On October 15, 2002, Aquila filed Advice Letter No. 579. Aquila stated that the purpose of the filing is to increase the base energy charges in its existing tariffs by an amount equal to the proposed increase in the base energy cost in the ICA tariff, and to place into effect a General Rate Schedule Adjustment, which increases electric rates by 21.8 percent. Aquila requested that the tariffs accompanying Advice Letter No. 579 become effective on 30 days' statutory notice, or in this instance, on November 15, 2002.

8. The effect of allowing Aquila's Advice Letter No. 579 to go into affect by operation of law would have increased the electric rates for service provided to all customers by 21.8 percent, resulting in an increase in annual revenues to Aquila of \$23,402,694 for its electric network operations in Colorado. Under Aquila's proposal, the average residential customer's electric bill would increase by approximately \$112.52 annually, or about \$9.38 per month. An average small business customer's electric bill would increase by approximately \$841.92 annually, or about \$70.16 per month.

9. According to Aquila, the proposed rate increase was to recover the increased costs of providing electric service to Colorado customers, including, but not limited to, power supply contracts, and investments in new facilities designed to enhance the reliability of its electric delivery system in Colorado, and normal system operations and maintenance. Aquila represented that this filing would be the first general increase in electric base rates for its Colorado customers since February 1984.

10. By Commission Decision No. C02-1268, pursuant to § 40-6-111(1), C.R.S., we set the proposed tariffs for hearing and suspended their effective date until March 15, 2003, to determine whether the rates, terms, or conditions contained in the tariffs were proper.

11. As indicated earlier, Staff and OCC entered their appearances in this matter. Motions for interventions were filed by CC&V, the City of Cañon City, Colorado, Fountain Valley Authority, and The Board of Water Works of Pueblo, Colorado. All interventions were granted by Commission Decision.

12. On January 30, 2003, we issued Decision No. C03-0119, granting a joint motion filed by Staff and OCC requesting that the Commission issue an initial decision in this proceeding and adopt the parties' proposed schedule, and setting new evidentiary hearing dates of April 15 through 18, 22, and 23, 2003.

13. On March 7, 2003, by Decision No. C03-0241, we further suspended for 90 days, until June 13, 2003, the effective date of the tariff sheets filed by Aquila under Advice Letter No. 579.

14. By Decision No. R03-0115-I, an administrative law judge (ALJ) set a public hearing to receive public testimony and/or comments concerning Advice Letter No. 579. The

public hearing was scheduled for March 18, 2003; however, due to inclement weather, that hearing was cancelled and rescheduled for April 4, 2003 by Decision No. R03-0284-I, issued March 21, 2003.

15. On April 11, 2003, Aquila filed a joint motion to vacate the evidentiary hearing set for April 15 through 18, and 21 through 23, 2003, as well as all remaining procedural dates in the schedule. According to the motion, Aquila and the Parties had reached a settlement in principle, resolving all contested issues in this Phase I docket. The motion further indicated that the Parties would expeditiously prepare and file a written Settlement Agreement (Settlement) with the Commission along with a request that the Settlement be approved by the Commission. Therefore, the Parties requested that the evidentiary hearings and all remaining procedural dates be vacated.

16. On April 18, 2003, Aquila and the Parties filed a Joint Motion to Approve the Settlement Agreement and Vacate the Remaining Hearing and Procedural Dates. In Decision No. R03-0414-I, the ALJ granted the Parties' motion to vacate the remaining hearing and procedural dates and referred the Joint Motion to Approve the Settlement Agreement to the Commission for an initial decision pursuant to § 40-6-109(6), C.R.S., as required by Decision No. C03-0119.

17. The Settlement resolved all issues between the parties to this case. Generally, the Settlement suggested that the annual revenue requirement increase in Phase I of this docket would be \$16 million. The Settlement also proposed certain regulatory principles for the \$16 million revenue requirement increase, which included, among other things, a rate of return on equity for Aquila of 10.75 percent, a divisional capital structure consisting of 47.50 percent

equity and 52.50 percent debt, a cost of debt of 7.55 percent, and an overall cost of capital or rate of return on rate base of 9.07 percent.

18. The Settlement further proposed to revise the ICA sharing mechanism from 50/50 to 75 percent customers/25 percent Aquila. The Settlement proposed to adjust actual energy costs included in the base energy rates from \$16.72 per megawatt hour (MWh) to \$21.54 per MWh.

19. The Commission issued Decision No. C03-0461 on May 5, 2003, acknowledging the ALJ's order granting the motion to vacate the hearing and referring the motion to approve the Settlement to the Commission pursuant to § 40-6-109(6), C.R.S. The Commission further rescinded the assignment of this docket to an ALJ made in Decision No. C02-1268. The Commission instead scheduled an *en banc* hearing on the proposed Settlement on May 14 and 15, 2003. As per Aquila's oral indication to the ALJ that it would amend Advice Letter No. 579 to extend the proposed effective date by an additional 14 days or until June 27, 2003, we ordered Aquila to file such amendment within five business days of the Mailed Date of the Commission order.

20. Commission Decision No. C03-0556, issued May 27, 2003, approved Aquila's Amended Advice Letter No. 579, changing the effective date of the underlying tariffs from November 15, 2002, to November 29, 2002, to allow two additional weeks from the 210-day suspension period to June 27, 2003.

21. Pursuant to the directives in Decision No. C03-0461, we conducted hearings on the Settlement on May 14 and 15, 2003. Witnesses for Aquila, the OCC, and Staff appeared to explain the Settlement and to respond to questions regarding the Settlement from the

Commission. Now, being duly advised in the matter, we approve the Settlement consistent with the discussion below.

### **III. SETTLEMENT**

#### **A. Incentive Cost Adjustment (ICA)**

22. In the Settlement the Parties agree to revise the ICA sharing mechanism prospectively to 75 percent customers and 25 percent Aquila, in order to allow Aquila to recover from or credit to customers 75 percent of the fuel and purchased energy cost changes recovered in its ICA tariff.

23. Currently the ICA tariff contains a 50/50 sharing mechanism that permits Aquila to recover from or credit to customers 50 percent of fuel and purchased energy cost changes above or below its base energy rate, based upon a historical test year of September 1 through August 31.

24. In its Direct Testimony, the Company contended that the ICA sharing mechanism should be suspended because Colorado's severe drought could drive up the Company's fuel costs if it resulted in generation being curtailed due to reduced water flow in the Arkansas River. All of the Parties opposed this proposal, arguing that it was speculative as to whether generation would in fact be curtailed, and that it was unclear what the financial impacts of such a loss would be. The Parties recommended that the Company apply for relief if and when the drought actually resulted in the curtailment of generation, and the financial impacts on the Company were clear.

25. At the Hearing, witnesses agreed the 75/25 sharing mechanism was a compromise between the Company's request to suspend sharing (100 percent pass-through) and the



Intervenors' contention in their Answer Testimony that no evidence had been presented that demonstrated the need to suspend the 50/50 sharing mechanism.

26. At the Hearing, Company witness Mr. Keith testified that one of the major drivers that led to filing the Company's rate case was the escalating cost of energy that the Company was facing and the fact that the Company's existing fuel adjustment clause only allowed Aquila to pick up 50 percent of the cost escalation. He testified that the principal advantage to the Company of the proposed sharing was that Aquila has some gas-fired generation that is susceptible to swings in the cost of fuel. In addition, Mr. Keith explained that the Company's primary contract with Public Service Company of Colorado is a "portfolio-type contract" with some gas-fired assets that expose Aquila to increased energy costs if the cost of natural gas rises. In response to a question from Commissioner Page, he also stated that the reduced risk afforded by the 75 percent pass through was one of the reasons the Company accepted a reduced revenue requirement and a lower rate of return on equity. He added that financial markets would be "happier" because it would stabilize the Company's operations financially. Mr. Keith also claimed the Company still had an incentive to get the best price on fuel and energy. He maintained that at the time the Company agreed to a 50/50 sharing mechanism, fuel prices were less volatile and at an all time low. In response to a series of questions from Commission counsel and from Chairman Sopkin, Mr. Keith stated that he expected the Company to ask for an extension of the 75/25 sharing mechanism beyond the October 31, 2004 expiration date. Mr. Keith also indicated that he thought it was a good idea to separate ICA costs from base rates and that the Company may include this proposal in its Phase II filing.

27. Staff witness Mr. Jorgenson testified that Staff was comfortable with the 75/25 sharing mechanism for energy costs. He explained that it was important to Staff that there

be a meaningful sharing percentage. He stated that at 25 percent sharing the Company still retains sufficient incentive to minimize its energy costs and negotiate the most efficient contracts it can. Mr. Jorgensen explained that the 75/25 sharing would benefit ratepayers if there were a decrease in energy costs over time because ratepayers would receive 75 percent of the reduction. He also testified that the termination of the ICA in October 2004 made it easier for Staff to accept a 75/25 sharing mechanism in the interim.

28. OCC witness Dr. Schechter testified that the 75/25 sharing mechanism was one part of the overall settlement negotiated by the parties. He explained that it appears that gas prices are increasing and the Company is legally entitled to recover fuel costs, consequently the Company's request seemed reasonable. He also maintained that the symmetrical nature of the sharing mechanism will benefit ratepayers in the event fuel prices go down in the future. Dr. Schechter explained that when fuel prices decrease, ratepayers receive 75 percent of the reduction. He stated that although the 75/25 sharing mechanism reduces the Company's incentive to economize on fuel costs, the Company still has a significant amount of money at risk. He believes the Company will act rationally to do whatever it can to reduce the amount of money spent on fuel.

29. We approve the Settlement's proposal to revise the ICA sharing mechanism prospectively to 75 percent customers and 25 percent Aquila, in order to allow Aquila to recover from, or credit to customers, 75 percent of the fuel and purchased energy cost changes recovered in its ICA tariff. As noted above, at the Hearing the parties agreed this was a compromise and part of the entire package negotiated in the Settlement. While we approve the settled compromise in this matter; we take this opportunity to encourage the Company and interested parties to explore incentive mechanisms that allow the Company to pass through non-

controllable energy costs, while subjecting energy costs the Company can control to an incentive mechanism that allows customers and the Company to share energy costs.<sup>2</sup> We also encourage the Company to propose replacement of the ICA mechanism in a time frame that allows it to become effective no later than the expiration date of October 31, 2004.

**B. B.A. ICA - Resetting the Base Energy Cost and the “Roll- In” of the New ICA Base**

30. In his Direct Testimony, Company witness Mr. Keith proposed to increase Aquila’s existing ICA base rate, currently set at \$16.72 per MWh, to recover the energy expenses incurred in the period from September 2001 to August 2002. Consistent with the Company’s October 2001 ICA filing, it seeks an increase to the ICA base to \$21.54 per MWh, which is an increase of about 29 percent. The Company intended to implement this proposed new ICA base of \$21.54 per MWh immediately. Aquila also proposed a new ICA base to be implemented after the completion of the Phase II portion of this rate case, using the test year July 2001 through June 2002. The proposed new ICA base to be implemented after the Phase II portion of this rate case is \$22.43 per MWh, an increase of about 34 percent from the current \$16.72 per MWh.

31. In their filed testimony the Parties agreed with the Company’s calculation of these new ICA base energy costs. The Parties also did not oppose the Company’s proposed two-step increase in ICA base energy costs. Page 9 of the Settlement offers a description of how the \$16 million revenue increase will be collected through a uniform revenue Phase I rate increase of 15.60 percent for all customer classes. This revenue increase includes a roll-in to account for the increase in the ICA base from \$16.72 per MWh to \$21.54 per MWh. However, it was not clear

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<sup>2</sup> Preferably on a 50/50 basis.

to the Commission whether the Settlement resulted in the same two-step increase. Consequently the Commission sought clarification of this issue at the Hearing.

32. At the Hearing, Company witness Mr. Keith explained that during the period that Phase I rates are in effect, ICA sharing will be based on \$21.54 per MWh. When the Phase II rates go into effect, ICA sharing will be based on \$22.43 per MWh. Staff witness Mr. Jorgenson testified that the two-step increase in base energy costs indeed mitigated rate shock.

33. The Commission is satisfied that the Settlement reflects the two-step process initially proposed by the Company and agreed to by the Parties in their filed testimony. We clarify that during the period that Phase I rates are in effect, ICA sharing will be based on \$21.54 per MWh. When the Phase II rates go into effect, ICA sharing will be based on \$22.43 per MWh.

### **C. Return On Equity**

34. As in most Phase I rate cases, the appropriate Return On Equity (ROE) for Aquila was one of the most contentious issues discussed in the prefiled testimony. All witnesses who addressed this issue derived their estimates of the appropriate return on equity using discounted cash flow analysis. While the calculation of an investor's expected rate of return under a discounted cash flow method is rooted in finance theory, there is quite a bit of judgment involved in selecting the comparable companies and expected growth rates. As a result, we were presented with a wide range of recommended rates of return on equity. Recommendations ranged from a high of 13.8 percent (Aquila) to a low of 9.78 percent (OCC). In the Settlement, the Parties agree to a ROE of 10.75 percent.

35. We approve the ROE agreed to in the Settlement. We find that the agreed upon value of 10.75 percent for the ROE for Aquila is within a range of reasonableness. We note that we recently approved a ROE of 10.75 percent for Public Service Company of Colorado's Electric Department.

**D. Capital Structure**

36. The parties agreed to use the capital structure recommended by Aquila and Staff comprised of 52.50 percent long-term debt and 47.50 percent equity.

37. The OCC was the only party that raised a concern about Aquila's recommended capital structure. In his Answer Testimony, OCC witness Dr. Schechter contended that the recommended capital structure was hypothetical and cited a past Commission decision directing the use of actual capital structure in calculating rates unless it is demonstrated by a substantial showing that ratepayers are materially prejudiced by the actual capital structure. The OCC recommended adoption of a consolidated capital structure of 54.7 percent long-term debt and 45.3 percent equity.

38. In his Rebuttal Testimony, Company witness Mr. Dunn re-emphasized that Aquila adjusted its books such that the actual capital structure of its Colorado electric operations for the test period was 52.50 percent long-term debt and 47.50 percent equity. According to the Company, a capital structure adjustment is always made at the end of each calendar year to adjust to targeted percentages.

39. We accept the capital structure portion of the Settlement without amendment. We note that the decision OCC cites pertains to a proposal to use a capital structure for a future test year. As Aquila points out, its recommendation is for an actual capital structure because

adjustments were made to its book amounts. Since the agreed upon capital structure represents an actual capital structure for a historic test year, the Commission is not changing its preference for use of actual capital structure in calculating rates.

**E. Average Versus Year-End Rate Base**

40. Plant investment, *i.e.*, rate base, generally increases over time (in nominal dollars). For any given weighted average of the allowed returns on debt and equity, the larger the rate base, the larger the allowed revenue. Given these relationships, it is not surprising that Aquila proposed using a year-end rate base, which has the effect of increasing allowed revenues, whereas Staff and OCC favored average-year rate base, which has the opposite effect. The Commission has generally employed average rate base for utilities in Colorado.

41. The Settlement adopts average rate base. The average rate base calculation excludes the Centel acquisition premium proposed by Aquila and the deferred taxes associated with the acquisition premium proposed by the OCC.

42. The Company submitted an end-of-period test year rate base in its filing. In his Rebuttal Testimony, Company witness Mr. Keith contended that given the overall growth in Aquila's electric investment in Colorado, including the recent investment in the Canon West substation, the use of an average rate base would result in an immediate attrition in the earnings level coming out of this proceeding and drive the need to file another rate case.

43. Staff and OCC both recommended use of average rate base in their filed testimony. They both maintained that average rate base was more appropriate because it recognizes that plant is added and removed throughout the year. They also argued that the Commission has only allowed end-of-period methods in special circumstances to combat

potential sources of attrition beyond the control of the Company, such as growth in costs in excess of revenues and inflation. They claimed such special circumstances are not presently pertinent to Aquila's Colorado electric operations.

44. At the Hearing, Staff witness Mr. Jorgenson and OCC witness Dr. Schechter reiterated these arguments and indicated average rate base was a key feature of the Settlement.

45. The Commission approves the Settlement's adoption of average rate base. Average rate base better reflects the fact that plant is continuously being added and removed throughout the year. Moreover, the factors that historically motivated the Commission to allow year-end rate base do not currently appear to be relevant for Aquila.

#### **F. Capacity Cost Adjustment**

46. In its initial filing, Aquila proposed an out-of-period capacity cost adjustment of \$9,433,516 corresponding to costs for an increase of 33 MW of capacity purchased through Aquila's contract with Public Service Company of Colorado (\$4,098,600), an increase of 12 MW (\$1,124,112 corrected to \$1,123,200 during the Hearing) of capacity purchased through Aquila's contract with Aquila Networks-WestPlains Kansas (WPK), and increased capacity costs associated with several other capacity contracts.

47. Several of the Parties raised concerns with Aquila's proposed capacity cost adjustment. They argued there was no corresponding revenue adjustment to account for an increase in sales that would require an increase in capacity purchased—a mismatch of revenues and expenses. The Parties made various recommendations for allowable capacity cost adjustments, all of which were less than the amount Aquila requested. Aquila rebutted this argument, indicating that the increases in capacity purchased from Public Service Company of

Colorado and from WPK were to replace amounts of capacity no longer purchased when its existing contracts expired with Southwestern Public Service and Basin Electric Power Cooperative. Aquila also indicated at the Hearing that some of the capacity increases replaced capacity decreases associated with the previous contract that it had with Public Service Company of Colorado.

48. The Settlement includes \$5,061,139 corresponding to out-of-period capacity costs for 33 MW of capacity purchased through Aquila's contract with Public Service Company of Colorado, and 0.6 MW of capacity purchased through Aquila's contract with WPK. The Settlement also excludes \$1,030,661 corresponding to out-of-period capacity costs for 11.4 MW of capacity purchased through Aquila's contract with WPK. At the hearing, Aquila provided Exhibit 2 and late-filed Exhibit 39 to address Advisory Staff's concern that the Settlement amounts for the capacity cost adjustment did not reconcile with amounts indicated in the prefiled testimony. According to Company witness Mr. Keith's testimony at the Hearing, some of the costs included in the adjustment are projected for the period of July 1, 2003, to December 31, 2003. He contends that these costs are known and measurable because they are firm contract costs. However, the adjustment accounts for costs that would occur more than one year beyond the test year. Mr. Keith explained that he felt this was reasonable since these costs were associated with contracts that replaced expired contracts.

49. Generally, we would not approve a *pro forma* adjustment for more than one year beyond the test year. However, given that the parties agreed to exclude \$1,030,661 of projected capacity costs and that they agreed to a limited rate case with a test period ending August 31, 2003, we accept this capacity cost adjustment as part of the total Settlement.



**G. Construction Work in Progress and Allowance for Funds Used During Construction Adjustment**

50. OCC witness Dr. Schechter took issue with Aquila's inclusion of Construction Work in Progress (CWIP) in rate base without including a corresponding offset for Allowance for Funds Used During Construction (AFUDC). In his Answer Testimony, Dr. Schechter reminds the Commission that it has historically allowed CWIP in rate base as long as it is offset by AFUDC. Consequently he recommended an AFUDC offset adjustment be made. On rebuttal Aquila did not agree that an AFUDC offset adjustment should be made. Aquila stated that if the Canon West-WAPA Substation is not allowed in CWIP, as recommended by the OCC, then the AFUDC offset amount should be less than what the OCC is recommending.

51. The Settlement provides that for future rate case filings, "Aquila agrees to exclude from rate base CWIP." However, the Settlement is silent on how CWIP is being treated for purposes of this rate case. Company witness Mr. Keith confirmed at the Hearing that Aquila would not include CWIP in rate base in future rate cases. Therefore, there would be no need to calculate an AFUDC offset. Mr. Keith also indicated that this treatment to eliminate CWIP is Aquila's preference because it would be more consistent with how other Aquila jurisdictions treat CWIP for rate-making purposes.

52. When questioned as to why a CWIP balance still remains in rate base in this case, Mr. Keith acknowledged that CWIP was not eliminated as far as this Settlement goes, but that CWIP had been taken care of to the party's satisfaction.

53. During the Hearing, OCC witness Dr. Schechter confirmed that the Settlement does not address why CWIP is still reflected in rate base without a corresponding appropriate amount of AFUDC, even though it was an issue for the OCC. Dr. Schechter stated that the

principle that the Parties agreed to for future rate cases was not applied here because the Parties agreed on an overall dollar amount of revenue increase in the settlement. In other words, to achieve the \$16 million amount for the Settlement meant that \$2.513 million of CWIP remained in rate base. He further confirmed that the Parties did agree that CWIP would be eliminated from rate base for future rate cases.

54. We are generally loathe to accept a revenue requirement where CWIP is included in rate base without a corresponding AFUDC offset. Given the Parties' representations that for settlement purposes a CWIP amount was left in rate base to achieve the bottom line agreed to revenue requirement, and that the Parties agreed to an appropriate treatment of CWIP for future rate cases, we accept the treatment of CWIP and AFUDC negotiated for this case as part of the total Settlement without amendment.

#### H. **Limited Rate Case**

55. In the Settlement, Aquila agreed to file a limited rate case no later than December 31, 2003, using a test period of the 12 months ending no earlier than August 31, 2003. Aquila agreed that when such a rate case is filed, it will not request any departure from the regulatory principles set forth in Paragraph II.2 of the Settlement.

56. At the Hearing, the Commission posed a series of questions to gain a better understanding of the purpose of this filing and its benefit to the Company, the Parties, and the ratepayers.

57. At the Hearing, the Parties vigorously supported the compromise that resulted in the agreement to file such a limited rate case. Generally the parties contended that the primary purpose of the limited rate case was to avoid a bitter litigation over the propriety of certain out of

period adjustments the Company advocated in the present rate case. According to witnesses for the Parties, the filing of a limited rate case with an updated test year is intended to create a better match between future increased capacity costs and the expected increased sales revenue from such increased capacity. The Company believes the limited rate case will result in the capture of capacity costs and rate base not included in the Settlement, and thus may result in another revenue increase. Conversely, OCC and Staff want to assure themselves that the Company is not overearning. OCC witness Dr. Schechter testified that another advantage is the additional time afforded to investigate cost allocation issues.

58. The Parties pointed out that the Company has the lawful right to file a rate case at any time. They argued that the express statement in the Settlement representing that Aquila will file a limited rate case, combined with a lack of limitations on the issues intervenors and Staff can address, will serve the public interest. The limitations on Aquila include an updated test year and an agreement not to depart from the regulatory principles set forth in Paragraph II.2 of the Settlement. This paragraph includes agreements concerning rate of return, capital structure, and use of average rate base.

59. We approve the filing of a limited rate case as described in the Settlement. We recognize that the Settlement binds Aquila to certain regulatory principles, while simultaneously allowing other parties the right to argue, present, and support positions on any issue, including regulatory principles. However, part of the purpose of the limited rate case is to avoid protracted litigation, thus we put the Parties on notice that in the absence of good cause we are not enthusiastic about any proposal that results in a departure from the regulatory principles reached in this settlement.

**I. Cost Allocations and Fully Distributed Cost Studies**

60. Within a Phase I proceeding, the Commission must determine whether the utility has complied with certain Commission rules regarding cost allocations (see 4 *Code of Colorado Regulations* (CCR) 723-47), and whether the utility has complied with the statutory requirement that no ratepayer funds have been used to subsidize a utility's nonregulated activities. § 40-3-114, C.R.S.

61. Included in the Company's direct case was the prefiled testimony and exhibits of Mr. Tyrrell. The purpose of his testimony was to describe Aquila's process for allocating corporate costs, how the process affected its WestPlains Colorado operations, and to describe the contents of his exhibits.

62. As described in Mr. Tyrrell's testimony, Aquila's preference is to directly assign costs wherever possible. However, for those costs that cannot be directly assigned, they are allocated using predetermined cost drivers. For those corporate departments where a causative driver is not found to be reasonable, and if common costs cannot be directly charged to a division, the Massachusetts Formula is utilized.<sup>3</sup> According to Mr. Tyrrell's testimony, using the 2002 budgeted corporate costs as a guideline, approximately 75 percent of the dollars are allocated via a specific cost driver, while the remaining 25 percent are assigned using the Massachusetts Formula.

63. Aquila has two general types of corporate allocations. Allocations for the Enterprise Support Functions (ESF) and allocations for the Intra-Business Unit (IBU) functions. ESF allocations encompass elements such as the Human Resource or Accounting functions, and

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<sup>3</sup> The Massachusetts Formula is a weighted average allocator based on net plant, gross margin, and payroll expense.

the IBU allocations encompass elements such as Marketing or Engineering. For the 12-month test year ending June 2002, WestPlains Colorado was allocated \$6.8 million dollars of ESF costs and \$8.6 million of IBU costs.

64. Because the test year for the rate case spanned two calendar years, the Company included cost allocation information for both 2001 and 2002. This greatly increased the number of exhibits which were included with Mr. Tyrrell's testimony.

65. In order to determine whether the Company is in compliance with our Cost Allocation Rules, we looked to the testimony and exhibits of Mr. Tyrrell. Included in Mr. Tyrrell's exhibits were: Schedule 1 - the Company's Corporate Cost Allocation Manual; Schedule 2 - the Financial Allocation Process; Schedule 8 - the Change Log for 2001; and Schedule 9 - the Change Log for 2002. Taken together, these exhibits represent the portion of Aquila's Cost Allocation Manual (CAM) which we must approve pursuant to 4 CCR 723-47-6.3.

66. Also included in Mr. Tyrrell's exhibits were: Schedule 3 - ESF Cost Allocation July 1, 2001 thru December 31, 2001; Schedule 4 - ESF Cost Allocation January 1, 2002 thru June 30, 2002; Schedule 5 - IBU Cost Allocation July 1, 2001 thru December 31, 2001; Schedule 6 - IBU Cost Allocation January 1, 2002 thru June 30, 2002; Schedule 7 - Product Allocations July 1, 2001 thru June 30, 2002; Schedule 10 - Summary of Total Charges Test Year Ended June 30, 2002; Schedule 11 - Summary of Direct Charges Test Year Ended June 30, 2002; Schedule 12 - Summary of Allocated Charges Test Year Ended June 30, 2002; Schedule 13 - ESF Allocated Charges by Dept and Resource Test Year Ended June 30, 2002; Schedule 14 - IBU Allocated Charges by Dept and Resource Test Year Ended June 30, 2002; Schedule 15 - Summary of Actual Charges Test Year Ended June 30, 2002; Schedule 16 - Summary of Direct

Charges Test Year Ended June 30, 2002; Schedule 17 - Summary of ESF Charges Test Year Ended June 30, 2002; Schedule 18 - Summary of IBU Charges Test Year Ended June 30, 2002; and Schedule 19 - Summary of Allocations to All Business Units ESF & IBU Test Year Ended June 30, 2002. Taken together, these exhibits represent Aquila's Fully Distributed Cost (FDC) Study, which it is required to file in this case pursuant to 4 CCR 723-47-3.1.1.

67. The Commission's Cost Allocation Rules, at 4 CCR 723-47-3.3, provide that when the utility performs a FDC study, the utility shall have the burden of demonstrating that the cost allocation document filed in support of the FDC study was prepared in a manner consistent with both the cost principles in 4 CCR 723-47-4 and 4 CCR 723-47-5 and the allocation methodologies approved in the utility's CAM.

68. There was no discussion in Mr. Tyrrell's prefiled direct testimony, nor in Staff's or OCC's answer testimony, whether the CAM or the FDC study comply with the Commission's Cost Allocation Rules. Furthermore, the Settlement is silent on the issues of cost allocations and FDC studies. As a result, the Commission, through its Advisory Staff, solicited questions to the Parties in Decision No. C03-0494, in advance of the Hearing. The purpose of these questions was to provide a basis for us to determine whether Aquila's CAM and FDC study complied with Commission rules and applicable statutes.

69. At the Hearing, Company witness Mr. Keith represented that Aquila's FDC was prepared in a manner consistent with Aquila's CAM and that Aquila's FDC is in compliance with the Commission's cost allocation rules. He also represented that Mr. Tyrrell's exhibits demonstrate that no ratepayer funds were used to subsidize any nonregulated activities of Aquila.

70. Staff witness Jorgensen acknowledged that Staff had investigated both the FDC and cost allocation issues. According to Mr. Jorgensen, Staff's review did not identify a basis to make adjustments to the Company's exhibits in regard to cost allocations or the FDC. As such, he recommended that the Commission approve the changes to the Company's CAM and FDC in this proceeding.

71. OCC witness Dr. Schechter stated that OCC did not investigate cost allocations or FDC study issues in this case because there was insufficient time due to the pending Public Service Company of Colorado general rate case. He stated that an advantage to conducting the limited rate case provided for in the Settlement is that it would allow for an investigation into these issues. Company witness Mr. Keith did confirm at the Hearing that Aquila plans to file a new FDC study with the limited rate case. Finally, Dr. Schechter made no recommendation on whether the Commission should approve the changes to the CAM or the FDC study because he had no basis upon which to make a recommendation.

72. We approve the changes to the Company's CAM as contained in Mr. Tyrrell's exhibits Schedules 8 and 9 and Aquila's CAM, which is Schedule 1, pursuant to 4 CCR 723-47-6.3.

73. We further find that no ratepayer funds were used to subsidize Aquila's nonregulated activities in accordance with § 40-3-114, C.R.S.

#### **J. Performance Based Regulation**

74. The Settlement does not contain a Performance Based Regulation Plan (PBR) for Aquila. However, in his Answer Testimony OCC witness Dr. Schechter proposed a PBR plan for the Company. He offered two reasons the OCC proposed a PBR for Aquila. First, a PBR

will capture for ratepayers some of the increasing efficiency of Aquila's operations, on a regular basis. Second, a PBR will provide Aquila with the type of incentive on its cost of service operations that Aquila's ICA currently provides for its fuel and purchased power operations. By providing more comparable incentives for the two components of Aquila's operations, there will be less incentive for Aquila to make decisions that maximize its profit but are not necessarily in the best interests of its customers. Dr. Schechter proposed a PBR that is similar to Public Service Company of Colorado with an annual earnings test and earnings that are shared in "bands" above the Commission's authorized return on equity.

75. In his Rebuttal Testimony, Company witness Mr. Keith contended the OCC's PBR recommendation was unnecessary, unreasonable, and should be rejected by the Commission.

76. In response to questioning from Chairman Sopkin at the Hearing, Company witness Mr. Keith reiterated his arguments. He stated that without knowing the complete details of a PBR it was hard to say the Company was absolutely opposed to it. However he maintained that under a PBR plan any money forthcoming to the ratepayers as a result of overearnings would probably be less than the costs of litigation.

77. In response to questions from Commission counsel, OCC witness Dr. Schechter testified he still hopes something can be worked out with the Company. He contended there are a variety of ways to deal with performance-based regulation in terms of earnings sharing that might have higher or lower litigation costs. However, for purposes of the Settlement, he supported its omission.

78. We will not modify the Settlement by requiring a PBR. However, in general, we support performance-based regulation as a possible alternative to traditional rate of return



regulation. PBR is a potential means to motivate a company to pursue cost saving actions while providing a mechanism to share whatever efficiencies are gained with ratepayers in a timely fashion. We encourage the Company and interested parties to explore crafting a PBR plan, if suitable for Aquila's Colorado electric operations.

**K. Other Provisions**

79. To the extent other provisions in the Settlement are not specifically discussed in this order, we accept those provisions without modification.

**L. Overall Settlement Decision**

80. Consistent with our discussion above, we approve the Settlement. We find the Settlement is just, reasonable, and in the public interest.

**IV ATTACHMENT**

81. Attachment A to this Order is the Settlement.

**IV. ORDER**

**A. The Commission Orders That:**

1. The Commission approves the Proposed Settlement with the clarifications and encouragement to the Company and interested parties as articulated above.

2. The Joint Motion filed by Aquila, Inc., doing business as Aquila Networks – WPC, Commission Staff, the Colorado Office of Consumer Counsel, Cripple Creek & Victor Gold Mining Company, The City of Cañon City, Colorado, Fountain Valley Authority, and the Board of Water Works of Pueblo, Colorado to Approve the Settlement Agreement is granted consistent with the discussion above.

3. Pursuant to the terms of the Settlement Agreement, Aquila, Inc., shall file Phase II of this rate case no later than October 31, 2003.

4. The tariff sheets filed by Aquila, Inc., pursuant to Advice Letter No. 579 as amended, are permanently suspended.

5. Aquila, Inc., shall file, on not less than one days' notice to the Commission, tariffs consistent with this Decision. Such tariffs shall be filed to become effective on June 27, 2003.

6. The Commission approves the changes to Aquila, Inc.'s Cost Allocation Manual contained in Mr. Tyrrell's Exhibits Schedules 8 and 9.

7. The Commission finds that no ratepayer funds were used to subsidize Aquila, Inc.'s non-regulated activities in accordance with § 40-3-114, C.R.S.

8. The 20-day period provided for in § 40-6-114, C.R.S., within which to file applications for rehearing, reargument, or reconsideration begins on the first day following the Mailed Date of this Decision.

9. This Order is effective on its Mailed Date.

**B. ADOPTED IN COMMISSIONERS' DELIBERATION MEETING  
June 12, 2003**

(SEAL)



ATTEST: A TRUE COPY

A handwritten signature in cursive script, appearing to read "Bruce N. Smith".

Bruce N. Smith  
Director

THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF COLORADO

GREGORY E. SOPKIN

POLLY PAGE

JIM DYER

Commissioners

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO**

**DOCKET NO. 02S-594E**

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**RE: THE INVESTIGATION AND SUSPENSION OF TARIFF SHEETS FILED BY  
AQUILA, INC., DOING BUSINESS AS AQUILA NETWORKS-WPC, WITH ADVICE  
LETTER NO. 579.**

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**SETTLEMENT AGREEMENT**

Aquila, Inc., doing business as Aquila Networks-WPC, (“Aquila”), the Trial Staff of the Colorado Public Utilities Commission (“Trial Staff”), the Colorado Office of Consumer Counsel (“OCC”), the Fountain Valley Authority, the Board of Water Works of Pueblo, the City of Canon City (collectively the latter three are referred to as “Public Intervenors”), and the Cripple Creek & Victor Gold Mining Company (“CC&V”) (together referred to as “Parties”), by and through their respective undersigned counsel, and for good and valuable consideration, herewith enter into this Settlement Agreement (“Settlement Agreement”) to settle all disputed issues that have arisen or could have arisen in this docket regarding Advice Letter No. 579 and accompanying tariffs (commonly referred to as “Phase I” of Aquila’s 2002 electric general rate case). The parties respectfully submit that this Settlement Agreement results in a fair disposition of the disputed issues in this docket, that the Phase I revenue requirement and rate revisions for all customer classes that result from this Settlement Agreement are just and reasonable, and that, therefore, the Settlement Agreement should be approved by the Commission.

**I. PROCEDURAL HISTORY**

1. On October 15, 2002, Aquila filed its Advice Letter No. 579 and accompanying tariffs proposing a general increase in rates affecting all classes of service. On that same date, Aquila filed its supporting Direct Testimony and Exhibits. The filing proposed a “roll-in” of actual energy costs to base energy rates and a General Rate Schedule Adjustment (“GRSA”)

rider of a positive 18.27%. The positive 18.27% rider and the “roll-in” of actual energy costs would have resulted in an annual increase in Aquila’s base electric rates of \$23,402,694, based upon the revenue requirements for the test year ending June 30, 2002 and the use of year-end rate base. The combined effect of the energy cost “roll-in” and the GRSA rider would have resulted in a 21.8% rate increase overall for Aquila and varying rate increases for the respective customer classes. The revenue increase as filed would have enabled Aquila the opportunity to earn a rate of return on equity of 13.25% and an overall rate of return on rate base of 10.194%.

2. On October 15 and 22, 2002, Aquila caused a Notice concerning the filing of these tariffs to be published in *The Denver Post* and in *The Rocky Mountain News*, newspapers of general circulation in Aquila's electric service area. On October 16 and 23, 2002, Aquila caused a Notice concerning the filing of these tariffs to be published in *The Pueblo Chieftain*, a newspaper of local circulation in Aquila's electric service area. An Affidavit of Publication of Notice was filed on December 20, 2002.

3. This docket was initiated on November 6, 2002, when the Commission issued its Order Suspending Effective Date of Tariffs and Notice of Hearing, scheduling a one-day hearing for March 7, 2003 and certain testimony filing dates. *See*, Decision No. C02-1268. By subsequent order the suspension period was extended to June 13, 2003. *See*, Decision No. C03-0241. At the request of the Parties, a new procedural schedule was adopted, including evidentiary hearings on April 15-18 and 21-23, 2003, and dates for filing rebuttal testimony and statements of position; a date for filing surrebuttal testimony was added later. *See*, Decision Nos. C03-0119, R03-0115-I, R03-0228-I and R03-0353-I. On April 1, 2003, the Commission held a hearing in Pueblo, Colorado, for the purpose of taking testimony from Aquila’s electric customers. The hearings set for April 15-18, 2003 were vacated by Decision No. R03-0383-I to allow the Parties time to prepare and to file the written Settlement Agreement.

4. Trial Staff, the OCC, the Public Intervenors, and the CC&V filed interventions or entries of appearance, as the case may be. During the prehearing phase of this docket, the Parties have actively engaged in prehearing investigation, including through audit requests, formal data requests, informal exchanges of information, informal discussions, and settlement negotiations.

5. On February 18, 2003, the Trial Staff, the OCC, the Public Intervenors, and the CC&V filed Answer Testimony and accompanying Exhibits. The proposals of these parties included the OCC's proposed revenue increase of \$9,834,378 and rate of return on equity of 9.78%; the Trial Staff's proposed revenue increase of \$14,189,205 and rate of return on equity of 10.8%; and the CC&V's positions that would have reduced the proposed revenue increase to about \$13,800,000 with a rate of return on equity of 10.0%. While the Public Intervenors did not present a comprehensive case on all revenue requirement issues, they did propose several downward adjustments of approximately \$7.6 million from the additional annual revenues requested by Aquila.

6. Aquila filed and served its Rebuttal Testimony and Exhibits on March 28, 2003.

7. Over the past several weeks, Aquila and the other parties have spent substantial time and efforts negotiating to settle this docket. On April 10, 2003, the Parties reached a settlement in principle resolving all contested issues in this Phase I docket. As a result of a joint motion filed by the Parties, the hearings set for April 15-18, 2003 were vacated by Decision No. R03-0383-I to allow the Parties time to prepare and to file this written Settlement Agreement. This Settlement Agreement memorializes the negotiated settlement and stipulations among the Parties. As a result of the settlement negotiations, all Parties agree, as set forth below, that all disputed issues in this Phase I docket have been resolved to the satisfaction of the Parties and that the Phase I revenue requirement and rate increases for all customer classes agreed to in this Settlement Agreement are just and reasonable.

## II. THE SETTLEMENT

1. **Revenue Requirement Increase.** As previously noted, Aquila requested \$23.4 million in additional annual revenues in this Phase I filing. As a result of the settlement, the Parties agree that the annual revenue requirement increase in Phase I of this docket will be \$16 million.

2. **Regulatory Principles Adopted in the Settlement.** For purposes of settlement, the \$16 million revenue requirement increase consists of the following specific regulatory principles and components. (Attachment A to this Settlement Agreement consists of spreadsheets that provide for the Commission's review of the details of the derivation of the \$16 million revenue requirement increase.)

- a) A fair and reasonable rate of return on equity for Aquila in this docket is 10.75%.
- b) Aquila's WPC divisional capital structure is adopted, consisting of 47.50% equity and 52.50% debt, and the Trial Staff's cost of debt of 7.55% is adopted, producing an overall cost of capital or rate of return on rate base of 9.07%. [Attachment A, Schedule 4.]
- c) Average rate base, instead of year-end rate base as proposed by Aquila, is adopted in the settlement. Under this method, the 13-month average of month-end balances is used for all rate base items. To the extent possible, *pro forma* adjustments and unusual items occurring during the test year are made using a 13-month average of month-end balances. In cases where the 13-month data is not available for *pro forma* adjustments the sum of the prior year-end balance and the test year-end balance divided by two is used. [Attachment A, Schedule 2.]

- d) The average rate base is adjusted to exclude the Centel acquisition premium proposed by Aquila and the deferred taxes associated with the acquisition premium, as proposed by the OCC. [This adjustment is shown in Attachment A, Schedule 2.]
- e) The Parties agree the \$16 million revenue requirement increase includes adjustments to Holcim revenue and capacity. [Attachment A, Schedule 3].
- f) The Parties agree that the overall \$16 million revenue requirement increase will be implemented by a uniform 15.60% Phase I increase for each customer class, as described below in Paragraph 7.
- g) The Parties further agree that the \$16 million revenue requirement increase includes the costs of certain out-of-period purchases of replacement capacity that Aquila currently has under contract. In its initial filing in this docket, Aquila requested \$6,091,800 in out-of-period capacity adjustments. For purposes of the Settlement Agreement, the Parties agree to include \$5,061,139 in out-of-period capacity costs and exclude \$1,030,661 in out-of-period capacity costs. [\$6,091,800 minus the agreed upon adjustment of \$1,030,661 in Attachment A, Schedule 3]. The excluded \$1,030,661 of costs corresponds to 11.4 MW of out-of-period capacity of the Aquila Networks-WPK displacement contract with Western Area Power Administration, and is 95% of the cost. The included \$5,061,139 corresponds to 33 MW of capacity purchased through Aquila's contract with Public Service Company of Colorado and 0.6 MW of capacity purchased through Aquila's contract with Aquila Networks-WPK.



- h) The Parties agree that the \$16 million revenue requirement increase excludes Aquila's proposed St. Joseph Light & Power acquisition savings adjustment. [Attachment A, Schedule 3.]
- i) The Parties agree that the depreciation associated with the Western Area Power Administration's Canon West Substation construction is 60 years as proposed by the Trial Staff. [Attachment A, Schedule 3.]
- j) The Parties agree that Aquila shall not be permitted to make its proposed depreciation changes. [Attachment A, Schedule 3.]
- k) The Parties agree that Aquila shall not be permitted to annualize property taxes. [Attachment A, Schedule 3.]
- l) The Parties agree that Aquila shall only use actual expenditures for any income statement adjustment related to homeland security. [Attachment A, Schedule 3.]
- m) The Parties agree that Aquila is authorized to earn on its proposed Pueblo Cooling Towers construction, less the \$105,000 reduction included in this docket. [Attachment A, Schedule 2.]

3. **Incentive Cost Adjustment ("ICA").** Currently, the ICA tariff contains a 50/50 sharing mechanism that permits Aquila to recover from or credit to customers 50% of fuel and purchased energy cost changes above or below its base energy rate, based upon a historical test year of September 1<sup>st</sup> through August 31<sup>st</sup>. The ICA tariff does not permit recovery of any purchased power demand costs. Instead purchased power demand costs are recovered through base rates. A revised ICA rider, to adjust rates to recover fuel and purchased energy costs, is filed each year on October 1<sup>st</sup> and the approved costs are recovered during the next year from November 1<sup>st</sup> through October 31<sup>st</sup>. (*See, Aquila's Colorado Electric Tariff, Sheets 89-91.*)

a) In this rate case, Aquila proposed, and the Parties agree as part of this Settlement Agreement, to adjust actual energy costs included in base energy rates from \$16.72 per MWH to \$21.54 per MWH.

b) The Parties further agree to permit Aquila to revise its ICA sharing mechanism prospectively to 75% customers/25% Aquila, in order to allow Aquila to recover from or credit to customers 75% of the fuel and purchased energy cost changes recovered in its ICA tariff. The parties agree that the 75%/25% ICA revision will be effective prospectively upon the effective date of the Commission's decision approving the rate changes stipulated in this Settlement Agreement. The Parties further agree that the ICA fuel and purchased energy costs incurred by Aquila up to the effective date of the rate changes proposed in this Settlement Agreement shall continue to be shared on a 50%/50% basis with Aquila's customers. The accounting for the prior (50%/50%) and new (75%/25%) cost sharing will be used for the appropriate time periods in the next regularly scheduled ICA reconciliation filing that Aquila submits to the Commission.

4. In all rate case filings that Aquila may make in the future, Aquila agrees to exclude from rate base construction work in progress ("CWIP") for plant that is not complete and in service at the end of the given test year.

5. As part of this Settlement Agreement, Aquila agrees to discuss collaboratively with the Trial Staff, the OCC, and any other parties that may be interested a quality of service plan for Aquila's electric operations in Colorado. The goal of this collaborative effort is to develop a quality of service plan tailored to Aquila. Aquila shall file an application with the Commission on or before January 31, 2004, for approval of its plan.

6. Aquila agrees to file a "limited rate case" using a test year subsequent to the test year in this case (i.e., no overlap of the test year). Aquila agrees that when such rate case is filed

it will not request any departure from the regulatory principles set forth in Paragraph II.2 above and the Commission's final decision in this docket. Such limited rate case filing will be pursuant to Colo. Rev. Stat. § 40-6-111 and applicable Commission rules.

(a) Subject to the foregoing, the Parties agree not to object or challenge by motion to dismiss Aquila's filing of a subsequent limited rate case on procedural or legal grounds. However, the other Parties in this docket reserve all of their rights to argue, present, and support positions on any issue, monetary amounts, data, regulatory principle, or numbers filed in or relevant to the limited rate case filing, even if different than those to which the Parties have agreed to in this Settlement Agreement.

(b) Aquila agrees to submit its limited rate case using as a test period the 12 months ending no earlier than August 31, 2003. Aquila will annualize the \$16 million revenue requirement increase resulting from this Settlement Agreement for the test year used in the limited rate case filing.

(c) Aquila agrees to file its limited rate case with the Commission no later than December 31, 2003. Aquila further agrees to provide each of the Parties with a complete copy of such filing, within a reasonable time after it is filed with the Commission.

7. The \$16 million revenue increase will be collected through a uniform revenue increase of 15.60% for all customer classes. The development of the uniform revenue increase is shown on Attachment B to this Settlement Agreement and is calculated in the following manner. First, the revenue increase for each class resulting from the roll-in to base energy rates of \$4.82 per MWH is determined. This roll-in corresponds to the increase in the ICA base from \$16.72 per MWH to \$21.54 per MWH and results in an increase of one-half of that amount, or \$2.41 per MWH, because the ICA presently recovers 50% of the ICA costs above the \$16.72 base. Second, the balance of the revenue increase to produce \$16 million overall to Aquila and to

produce a 15.60% Phase I increase for each customer class is determined. The GRSA factors applicable to base rates for each customer class are set forth on line 19 of Attachment B. These Phase I rate revisions are intended to be in effect only until the Phase II rates are in effect pursuant to the final Phase II decision.

8. As a result of the settlement in this case and the agreed method to allocate the revenue increase to the customer classes, typical residential electric customers using 579 KWH will see an increase of \$6.83 on their monthly bills, while typical small business electric customers using 5,520 KWH per month will see an increase of \$49.00 per month. Each of these monthly increases in the average residential and commercial bills is equal to an increase of 15.60%.

9. Aquila intends to file Phase II of this rate case by September 1, 2003, but in any event, absent Commission authorization, Aquila shall file Phase II of this rate case no later than October 31, 2003. Aquila agrees to work with the Trial Staff on the timing of the Aquila Phase II filing to minimize the burden on the Parties and counsel that will also be working on Public Service Company of Colorado's Phase II filing that is expected to be filed in October or November 2003.

10. The Parties agree that the uniform 15.60% Phase I increase for each customer class and the approval of this Settlement Agreement is just, reasonable and in the public interest.

11. If the Commission approves this Settlement Agreement, tariffs conforming to this Settlement Agreement and implementing the agreed upon Phase I rate revisions may be filed on one-day notice.

### **III. GENERAL TERMS AND CONDITIONS**

1. Through active prehearing investigation and negotiation, the Parties have reached the agreement set forth herein resolving all contested and disputed issues in this docket in a

manner which the Parties agree is just and reasonable and in the public interest. The Parties further agree that reaching agreement by means of negotiation and settlement rather than through litigation is in the public interest.

2. The Parties agree to present, to support, and to defend this Settlement Agreement before the Commission and the courts. The Parties further agree, if necessary, to present testimony and exhibits to the Commission to secure the approval of this Settlement Agreement.

3. The Parties hereby agree that all pre-filed testimony and exhibits shall be admitted into evidence in this docket without cross-examination. This Settlement Agreement reflects compromise and settlement of all issues raised or that could have been raised in this docket.

4. This Settlement Agreement shall not become effective until the issuance of a final Commission Order approving the Settlement Agreement, which Order does not contain any modification of the terms and conditions of this Settlement Agreement that is unacceptable to any of the Parties. In the event the Commission modifies this Settlement Agreement in a manner unacceptable to any Party, that Party shall have the right to withdraw from this Settlement Agreement and proceed to hearing on the issues that may be appropriately raised by that Party in this docket. The withdrawing Party shall notify the Commission and the Parties to this Settlement Agreement by e-mail within three (3) business days of the Commission modification that the Party is withdrawing from the Settlement Agreement and that the Party is ready to proceed to hearing; the e-mail notice shall designate the precise issue or issues on which the Party desires to proceed to hearing (the "Hearing Notice").

5. The withdrawal of a Party shall not automatically terminate this Settlement Agreement as to any other Party. However, within three (3) business days of the date of the Hearing Notice from the first withdrawing Party, all Parties shall confer to arrive at a

comprehensive list of issues that shall proceed to hearing and a list of issues that remain settled as a result of the first Party's withdrawal from this Settlement Agreement. Within five (5) business days of the date of the Hearing Notice, the Parties shall file with the Commission a formal notice containing the list of issues that shall proceed to hearing and those issues that remain settled. The Parties who proceed to hearing shall have and be entitled to exercise all rights with respect to the issues that are heard that they would have had in the absence of this Settlement Agreement.

6. Hearing shall be scheduled on all of the issues designated in the formal notice filed with the Commission as soon as practicable. In the event that this Settlement Agreement is not approved, or is approved with conditions that are unacceptable to any Party who subsequently withdraws, the negotiations or discussions undertaken in conjunction with the Settlement Agreement shall not be admissible into evidence in this or any other proceeding, except as may be necessary in any proceeding to enforce this Settlement Agreement.

7. Approval by the Commission of this Settlement Agreement shall constitute a determination that the Settlement Agreement represents a just, equitable and reasonable resolution of all issues that were or could have been contested among the Parties in this proceeding.

8. All Parties specifically agree and understand that this Settlement Agreement represents a negotiated settlement in the public interest with respect to the various Aquila rate matters and terms and conditions of service for the sole purpose of the settlement of the matters agreed to in this Settlement Agreement. No Party or person shall be deemed to have approved, accepted, agreed to, or consented to any concept, theory or principle underlying or supposed to underlie any of the matters provided for in this Settlement Agreement, other than as specifically provided for herein. Notwithstanding the resolution of the issues set forth in this Settlement

Agreement, none of the methods or ratemaking principles herein contained shall be deemed by the Parties to constitute a settled practice or precedent in any future proceeding, except as otherwise provided in Paragraph No. II.6. of this Settlement Agreement. Nothing in this Settlement Agreement shall preclude Aquila from seeking prospective changes in its electric rates by an appropriate filing with the Commission. Nothing in this Settlement Agreement shall preclude any other party from filing a Complaint or seeking an Order to Show Cause to obtain prospective changes in Aquila's electric rates.

9. This Settlement Agreement may be executed in counterparts and by facsimile copies of signatures, all of which when taken together shall constitute the entire Settlement Agreement with respect to the issues addressed by this Settlement Agreement.

#### **CONCLUSION**

For the reasons stated above, the Parties respectfully request that the Commission enter an order approving this Settlement Agreement with the finding that the Commission's approval of this Settlement Agreement represents a fair, just, and reasonable resolution of all disputed issues that have arisen, or which could have arisen, in this docket.

DATED this 18th day of April 2003.

AQUILA NETWORKS-WPC  
CALCULATION OF SETTLEMENT REVENUE REQUIREMENT  
12 months ending June 30, 2002

Settlement Agreement Attachment A  
Docket No. 02S-594E  
Schedule 1

Line

No.

1	Net CPUC Jurisdictional rate base	\$	109,960,901
2	Return on Rate Base		9.07%
3	Required earnings	\$	9,975,186
4	Net CPUC Jurisdiction Operating Earnings		56,785
5	Deficiency / (Excess)		9,918,400
6	Factor to Gross		1.613163413
7	Required Revenue Change	\$	16,000,000
8	Effect on Average Residential Customer ( @ 579 kWh per month)	\$	6.83
9	Effect on Average Commercial Customer ( @ 5,520 kWh per month)	\$	49.00





AQUILA NETWORKS - WPC  
 JURISDICTIONAL STATEMENT OF OPERATIONS /  
 FOR THE YEAR ENDED JUNE 30, 2002

Settlement Agreement Attachment A  
 Docket No. 02S-594E  
 Schedule 3

**Settlement Adjustments**

LINE NO	(A) DESCRIPTION	(B) COMPANY	(C) Holcim Revenue	(D) 2003 Capacity Disallowance	(E) Canon West WAPA	(F) Depreciation	(G) Amort. Of Acq. Adj.	(H) Acquisition Benefit	(I) Property Tax	(J) Projected Security	(K) Wages & Benefits	(L) ICA Revenue (Fly Ash)	(M) Tax	(N) Subtotal	(O) As Adjusted
1	<b>OPERATING REVENUES</b>														
2	SALES OF ELECTRICITY	\$ 107,030,527	\$ (929,960)									\$ 151,907		\$ (778,053)	\$ 106,252,474
3	PROVISION FOR RATE REFUNDS	-													
4	OTHER	364,632													364,632
5	<b>TOTAL OPERATING REVENUE</b>	<b>107,395,159</b>	<b>(929,960)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>151,907</b>	<b>-</b>	<b>(778,053)</b>	<b>106,617,106</b>
6	<b>OPERATING EXPENSES</b>														
7	PRODUCTION	74,574,698	(589,373)	(1,030,661)							(37,090)			(1,657,124)	72,917,574
8	TRANSMISSION	5,636,360									(4,556)			(4,556)	5,631,804
9	DISTRIBUTION	5,918,588									(46,894)			(46,894)	5,871,694
10	CUSTOMER ACCOUNTS	2,464,720									(16,742)			(16,742)	2,447,978
11	CUSTOMER SERVICE	101,811									(1,885)			(1,885)	99,926
12	SALES	305,642									(1,163)			(1,163)	304,479
13	ADMINISTRATIVE & GENERAL	11,631,146						(546,809)		(300,000)	(63,518)			(910,327)	10,720,819
14	DEPRECIATION & AMORTIZATION	10,270,674			(100,701)	(399,534)	(1,042,549)							(1,542,784)	8,727,890
15	TAXES OTHER THAN INCOME	2,755,108							(267,641)		(10,604)			(278,245)	2,476,863
16	INCOME TAXES:													-	
17	CURRENT	(2,708,256)											1,551,246	1,551,246	(1,157,010)
18	DEFERRED	(1,481,696)												-	(1,481,696)
19	<b>TOTAL OPERATING EXPENSES</b>	<b>109,468,795</b>	<b>(589,373)</b>	<b>(1,030,661)</b>	<b>(100,701)</b>	<b>(399,534)</b>	<b>(1,042,549)</b>	<b>(546,809)</b>	<b>(267,641)</b>	<b>(300,000)</b>	<b>(182,452)</b>	<b>-</b>	<b>1,551,246</b>	<b>(2,908,474)</b>	<b>106,560,321</b>
20	<b>NET OPERATING INCOME</b>	<b>\$ (2,073,636)</b>	<b>\$ (340,587)</b>	<b>\$ 1,030,661</b>	<b>\$ 100,701</b>	<b>\$ 399,534</b>	<b>\$ 1,042,549</b>	<b>\$ 546,809</b>	<b>\$ 267,641</b>	<b>\$ 300,000</b>	<b>\$ 182,452</b>	<b>\$ 151,907</b>	<b>\$(1,551,246)</b>	<b>\$ 2,130,421</b>	<b>\$ 56,785</b>

Synopsis of Staff Adjustments

- (F) Change in amortization of Canon West - WAPA (Adj.#36) from Company proposed 19 years to Staff's proposed 60 years
  - (G) Change in Depreciation Expenses: ( disallow adjustments # 33, #34, #35)
  - (I) Change in Acquisition Benefit Sharing - reverses Company adjustment #29
  - (J) Change in Amortization of Acquisition Adjustment - reverses balance in account 406
- Additional adjustments are shown on Page 5

Holcim adjustment true up:	<u>Difference</u>
Revenue	929,960
Energy	589,373
Gross marg.	340,587

Capacity disallowance from company request: (1,030,661)

AQUILA NETWORKS - WPC  
 CAPITAL STRUCTURE and WEIGHTED AVERAGE COST OF CAPITAL  
 FOR THE YEAR ENDED JUNE 30, 2002

Settlement Agreement Attachment A  
 Docket No. 02S-594E  
 Schedule 4

<u>Description</u>	<u>6/30/2002 Per Books</u>	<u>Aquila Hypothetical</u>	<u>Settlement Recommended</u>	<u>Ratio</u>
Long Term Debt	\$ 65,234,000	\$ 62,662,268	\$ 62,662,268	52.50%
Common Equity	54,122,700	56,694,433	56,694,433	47.50%
Total	<u>\$ 119,356,700</u>	<u>\$ 119,356,701</u>	<u>\$ 119,356,701</u>	<u>100.00%</u>

	<u>Ratio</u>	<u>Cost</u>	<u>Weighted Cost</u>
Long Term Debt	52.50%	7.553%	3.97%
Common Equity	47.50%	10.75%	5.11%
Total	<u>100.00%</u>		<u>9.07%</u>

Aquila Networks - WPC  
Calculation of GRSA Factors by Rate Class  
Settlement Methodology With Roll-in of New ICA Base

		(a)	(b)	(c)	(d)	(e)	(f)		
		<u>Residential</u>	<u>Commercial</u>	<u>Industrial</u>	<u>Lighting</u>	<u>Water Pumping</u>	<u>Total</u>		
1	Unadjusted test year billed mWh	Aquila filing	522,712	746,597	222,779	22,322	31,874	1,546,284	
2	Holcim adjustment	Aquila rebuttal			181,463			181,463	
3	Adjusted test year billed mWh	line 1 + line 2	522,712	746,597	404,242	22,322	31,874	1,727,747	
4	Test year unadjusted revenue	Aquila filing	\$ 39,503,226	\$ 42,122,994	\$ 10,280,544	\$ 2,228,760	\$ 1,710,203	\$ 95,845,727	
5	Less: unadjusted ICA revenue	Response to CC&V 3-2	1,413,868	1,761,587	1,047,416	-	247,434	4,470,305	
6	Unadjusted base rate revenue	line 4 - line 5	38,089,359	40,361,407	9,233,128	2,228,760	1,462,769	91,375,422	
7	Holcim base rate adjustment	Aquila rebuttal			6,254,105			6,254,105	
8	Adjusted test year base rate revenue	line 6 + line 7	38,089,359	40,361,407	15,487,233	2,228,760	1,462,769	97,629,527	
9	ICA Revenue at TY accrual level	line 3 x \$2.85 per mWh	2.85 (1)	1,489,729	2,127,801	1,152,090	63,618	90,841	4,924,079
10	Total test year revenues	line 8 + line 9	39,579,088	42,489,208	16,639,323	2,292,378	1,553,610	102,553,606	
11	Roll-in of base ICA	line 3 x \$4.82 per mWh	4.82	2,519,472	3,598,598	1,948,447	107,592	153,633	8,327,741
12	Adjusted base rate revenue w/roll-in	line 8 + line 11	40,608,830	43,960,004	17,435,680	2,336,352	1,616,401	105,957,268	
13	ICA Revenue after roll-in & sharing change	line 3 x \$0.66 per mWh	0.66 (2)	344,990	492,754	266,800	14,733	21,037	1,140,313
14	Total test year revenues after roll-in & sharing	line 12 + line 13	40,953,820	44,452,758	17,702,480	2,351,085	1,637,438	107,097,581	
15	Net increase in total revenues	line 14 - line 10	\$ 1,374,733	\$ 1,963,550	\$ 1,063,157	\$ 58,707	\$ 83,829	\$ 4,543,975	
16	Increase at equal % on total revenues	line 10 x 15.60%	15.60% (3)	\$ 6,174,970	\$ 6,628,995	\$ 2,596,000	\$ 357,648	\$ 242,388	\$ 16,000,000
17	Less: increase from fuel roll-in	- line 15	(1,374,733)	(1,963,550)	(1,063,157)	(58,707)	(83,829)	(4,543,975)	
18	Adjusted rate increase for GRSA	line 16 + line 17	\$ 4,800,237	\$ 4,665,445	\$ 1,532,843	\$ 298,941	\$ 158,559	\$ 11,456,025	
19	GRSA factor to be applied to base rates	line 18 / line 12	11.82%	10.61%	8.79%	12.80%	9.81%	10.81%	
20	Net rate increase from roll-in & sharing	line 15	\$ 1,374,733	\$ 1,963,550	\$ 1,063,157	\$ 58,707	\$ 83,829	\$ 4,543,975	
21	Rate increase from GRSA	line 18	4,800,237	4,665,445	1,532,843	298,941	158,559	11,456,025	
22	Total rate increase	line 20 + line 21	\$ 6,174,970	\$ 6,628,995	\$ 2,596,000	\$ 357,648	\$ 242,388	\$ 16,000,000	
23	Percentage increase on total present revenue	line 22 / line 10	15.60%	15.60%	15.60%	15.60%	15.60%	15.60%	

**NOTES**

- (1) 50% of difference between test year net fuel & purchased power per mWh and existing ICA base ((22.42-16.72)\*0.50)
- (2) 75% of difference between test year net fuel & purchased power per mWh and new ICA base ((22.42 - 21.54)\*0.75)
- (3) \$16,000,000 divided by line 10, column f (Total test year revenues)