

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 04S-035E

RE: THE INVESTIGATION AND SUSPENSION OF TARIFF SHEETS FILED BY AQUILA, INC., DOING BUSINESS AS AQUILA NETWORKS-WPC, WITH ADVICE NO. 588.

ORDER GRANTING SETTLEMENT

Mailed Date: August 25, 2004
Adopted Date: August 17, 2004

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I. BY THE COMMISSION

A. Procedural History

1. On December 29, 2003, Aquila, Inc., doing business as Aquila Networks–WPC (Aquila or Company), filed Advice Letter No. 588. This filing was accompanied by the direct testimony and exhibits of the following Aquila witnesses: W. Scott Keith, Lisa M. Sterba,

Michael R. Apprill, Richard O. Clayburn, Rhonda J. Schmidlein, Randall D. Erickson, and Daniel K. Tyrrell.

2. The subject filing was made pursuant to a settlement agreement reached in Aquila's last rate case (*see* Decision No. C03-0697, Docket No. 02S-594E). The purpose of the filing was to implement a General Rate Schedule Adjustment (GRSA) rider of 9.60 percent to all base rates for all customers receiving electric power and energy under the Company's tariff. The proposed GRSA rider would generate an annual revenue increase of \$11,358,847. Aquila requested that the tariffs accompanying Advice Letter No. 588 become effective on 30 days' statutory notice or, in this instance, on January 29, 2004.

3. By Decision No. C04-0082, the Commission set the tariffs for hearing and suspended their effective date for 120 days or until May 28, 2004.

4. By Decision No. R04-0207-I, a prehearing conference was scheduled for March 3, 2004.

5. Timely Notices of Intervention were filed in this proceeding by the Staff of the Commission (Staff) and the Colorado Office of Consumer Counsel (OCC). Timely Petitions for Leave to Intervene were also filed by the Fountain Valley Authority, the Board of Water Works of Pueblo, Colorado, the City of Canon City, (collectively, Public Intervenors); Cripple Creek & Victor Gold Mining Company, Holcim (U.S.) Inc. (Holcim), and the Trane Company (collectively, CCHT).

6. At the March 3, 2004 prehearing conference, interventions were granted and a procedural schedule proposed by the parties was considered. Decision No. R04-0227-I adopted the following procedural schedule: Answer testimony filed on April 12, 2004, Rebuttal and

Cross-Answer testimony filed on May 3, 2004, hearing dates of May 24 through 28, 2004, and Statements of Position filed within ten days after the last hearing date.

7. On March 9, 2004, Staff filed its Unopposed Motion to Vacate Hearing Dates, Adopt Proposed Procedural Schedule, Waive Response Time, and Request for Initial Commission Decision. Under the parties' proposed procedural schedule, the dates for filing Answer testimony would change from April 12, 2004, to April 30, 2004, and the dates for the filing of Rebuttal and Cross Answer testimony would change from May 3, 2004, to June 21, 2004. It would also change the hearing dates from May 24 through 28, 2004, to July 26 through 30, 2004. Finally, it would change the date for Statements of Position from ten days after the last hearing date to August 10, 2004.

8. By Decision No. C04-0291, the Commission agreed to issue an initial Commission decision and, except with regard to a change in the deadline for filing Statements of Position, adopted the parties' proposed procedural schedule.

9. Decision No. R04-0341-I adopted the procedural schedule approved by the Commission in Decision No. C04-0291 and modified certain other procedures consistent with the initial decision process. It also reaffirmed that the Commission would hold a public comment hearing in Pueblo, Colorado, and that a technical conference on the financial models submitted in the case might be necessary. The interim decision established July 14, 2004, is the date for the technical conference.

10. On April 30, 2004, Answer testimony and exhibits were filed by Sandra-Johnson Jones, Bridget McGee-Stiles, Randy Garrouette, Karlton Kunzie, Larry Y. Shiao, and John P. Trogonoski on behalf of Staff; Basil L. Copeland, Jr. and P.B. Schechter on behalf of the OCC;

Richard A. Baudino and Stephen J. Baron on behalf of CCHT; and Martin J. Blake on behalf of the Public Intervenors.¹

11. By Decision No. C04-0497, the Commission further suspended the effective date of the tariffs filed with Advice Letter No. 588 an additional 90 days or until August 26, 2004.

12. On June 9, 2004, Decision No. R04-0618-I was issued which set a public hearing in Pueblo, Colorado for July 20, 2004. A public hearing was held on that date.

13. On June 16, 2004, Decision No. R04-0642-I was issued which set a technical conference in Denver, Colorado for July 14, 2004. This decision also provided a series of questions regarding the parties' financial models. On July 7, 2004, Aquila informally requested that its witness be allowed to participate in the technical conference by telephone. Aquila also advised that it had revised its financial model to more clearly demonstrate its responses to the questions posed in Decision No. R04-0642-I. The Administrative Law Judge granted the request on the condition that Aquila would electronically send a copy to the Advisory Staff and all other parties for their review. Aquila timely submitted the electronic copy to Advisory Staff and counsel for the parties. The technical conference was held as scheduled.

14. On June 21, 2004, the following Aquila witnesses filed Rebuttal testimony and exhibits: W. Scott Keith, Michael R. Apprill, Ronald A. Klote, Beth A. Armstrong, Daniel K. Tyrrell, Ronald D. Adkins, and Donald A. Murry, Ph.D.² Cross-Answer testimony was also filed by Public Intervenors' witness Martin J. Blake on that date.

¹ Corrections to Ms. Jones' and Mr. Blakes's Answer testimony and exhibits were filed on June 14 and 21, 2004, respectively. On June 3, 2004, Dr. Schechter filed Appendix B to his Answer testimony.

² Mr. Keith filed Revised Rebuttal testimony on July 19, 2004. Portions of Dr. Murry's Rebuttal testimony were stricken by Decision No. R04-0834-I.

15. On June 22, 2004, Aquila filed a Motion in Limine to exclude certain pre-filed Answer testimony and exhibits. Aquila contended that such testimony/exhibits exceeded and/or conflicted with the regulatory principles established in Decision No. C03-0697. Responses to the motion were filed by: Staff, the Public Intervenors, CCHT, and the OCC. The OCC also filed a Motion to Strike the Aquila Motion in Limine. On July 9, 2004, Aquila filed a motion for leave to reply to responses and a reply to OCC's Motion to Strike.

16. On July 12, 2004, Staff filed a Motion in Limine to exclude certain pre-filed Rebuttal testimony and exhibits. Staff contended that such testimony/exhibits exceeded and/or conflicted with the regulatory principles established in Decision No. C03-0697.

17. On July 21, 2004, Decision No R04-0831-I was issued denying Aquila's Motion in Limine. On the same date, Decision No. R04-0834-I was issued granting Staff's Motion in Limine.

18. On July 27, 2004, the parties submitted a Settlement Agreement and Motion for Approval of Settlement Agreement (Settlement). According to the parties, the Settlement resolves all disputed issues that have arisen or could have arisen in this docket. The parties indicate in the Settlement that the agreed upon revenue increase is just and reasonable.

19. A hearing was held in connection with the Settlement on July 30, 2004. Aquila, Staff, and OCC witnesses presented testimony in support of the Settlement. The parties' Settlement Agreement, as well as all pre-filed testimony submitted by the parties, was admitted

into evidence. *See* Exhibits 1 and 4 through 35. In addition, the Aquila witness sponsored Exhibits 2 and 3, which also were admitted into evidence.³

B. Findings of Fact

20. The genesis of this case can be traced back to the Settlement Agreement approved by the Commission in Aquila's last rate case (*see* Decision No. C03-0697, Docket No. 02S-594E). Under that agreement, Aquila agreed to file a "limited" rate case on or before December 31, 2003, using a test year ending August 31, 2003. As part of the settlement, Aquila also agreed to be bound to certain regulatory principles adopted in the settlement, namely: 1) a return on equity of 10.75 percent; 2) a divisional capital structure of 47.5 percent equity and 52.5 percent debt; 3) a cost of debt at 7.55 percent; 4) use of an average rate base; 5) the disallowance of the Centel acquisition adjustment; 6) annualization of Holcim's revenue; 7) disallowance of St. Joseph Light & Power acquisition savings adjustment; 8) a 60-year depreciation life for the Canon West substation; 9) no changes in depreciation rates; 10) no annualization of property taxes; and 11) only actual expenditures for homeland security measures.

21. As explained in the Direct testimony of Mr. Scott Keith, there have been certain major changes in the Company's electric operations since the last rate case. These include a nearly \$20 million increase in rate base and \$6.5 million increase in annual capacity charges from

³ Exhibit 2 shows the monthly customer impact for both a typical residential and commercial customer for both the original \$11,358,847 rate increase and the \$8,200,000 rate increase proposed under the Settlement. Exhibit 3 contains the proposed tariff sheets for the new Energy Cost Adjustment (ECA) mechanism. Those tariff sheets include the cost figures, test period, filing dates, recovery periods, and calculation method for developing the ECA factor of \$0.00125.

power suppliers. When taken together, in conjunction with the August 31, 2004 test year, this results in an increase in Aquila's annual revenue requirement of \$11,358,847.

22. Prior to settlement, the OCC asserted in its case that the amount of the increase in Aquila's annual revenue requirement should be \$6,981,641. This results from the use of a 9.50 percent return on equity; debt at a cost of 7.66 percent; a \$250,000 disallowance of expenditures associated with ten megawatts (MW) of summer peaking capacity; disallowance of \$643,442 of increased transmission expense; removal of \$8,988,947 of prepayments from rate base; disallowance of the 14.78-day increase in revenue lag days for the effect of the Incentive Cost Adjustment (ICA) on Cash Working Capital (CWC); a \$133,000 disallowance of rate case expenses; a disallowance of \$325,182 of incentive compensation for plan year 2002; disallowance of \$143,120 of pension expense; and a disallowance of \$174,602 of severance costs.

23. The Public Intervenors contended that the amount of the increase in Aquila's annual revenue requirement should be \$5,244,249. This is based on a \$6,000,537 increase in revenues in order to properly reflect the increased level of transmission costs, and a disallowance of \$114,117 of transmission expense relating to the Basin power contract.

24. Based on its analysis, Staff argued that the amount of the increase in Aquila's annual revenue requirement should be \$4,961,667. This results from the use of a 9.75 percent return on equity; debt at a cost of 7.42 percent; a \$2,742,487 disallowance of expenditures associated with excess capacity; disallowance of \$114,117 of transmission expense relating to the Basin power contract; an increase in deferred taxes of \$2,780,465 to include all deferred account balances; disallowance of the 14.78-day increase in revenue lag days for the effect of the ICA on

CWC; a \$216,000 disallowance of rate case expenses; restoration of a credit balance of \$259,546 for corporate aircraft; disallowance of \$15,987 of payroll expense; and a disallowance of \$1,830,609 of cost allocations for nonregulated operations.

25. Finally, CCHT contended that the amount of the increase in Aquila's annual revenue requirement should be \$3,458,286. This is based on the use of a 9.00 percent return on equity, debt at a cost of 7.55 percent; a \$6,501,084 increase in revenue in order to properly reflect the increased level of transmission costs; and disallowance of \$114,117 of transmission expense relating to the Basin power contract.

1. The Settlement's Regulatory Principles

26. Under the Settlement agreed upon by the parties, base rates would increase by \$8.2 million while energy costs collected through a new Energy Cost Adjustment (ECA) mechanism would decrease by \$5.424 million.⁴ The net effect on ratepayers of these two changes would be an increase of \$2.776 million. The parties intend for this change in rates to take effect on or about September 1, 2004.

27. The Settlement lists the regulatory principles agreed to by the parties in this case. They include the following: a return on equity of 10.25 percent; a divisional capital structure consisting of 47.50 percent equity and 52.50 percent debt; a cost of debt of 7.42 percent (this produces an overall cost of capital, or rate of return on rate base, of 8.76 percent); an increase in income taxes of \$142,127 as a result of the effect of the interest deduction associated with the embedded cost of debt; the elimination of \$250,000 of capacity charges associated with a 2004 peaking contract; the exclusion of \$1,204,903 of the new Public Service Company of Colorado

⁴ The new ECA mechanism is intended to replace the existing ICA.

(Public Service) capacity costs and \$200,487 of the new Public Service transmission costs; the elimination of other transmission expense of \$114,167 associated with an expired Basin power contract; the reduction of Aquila's payroll annualization by \$15,987 to reflect the actual percentage wage increase granted; an increase in administrative and general expense of \$19,467 to reflect the reconciliation adjustment; the elimination from the CWC calculation of the amortization of prepayments that resides in operating and maintenance expense in this docket and in the next revenue requirement proceeding; and an increase of income taxes by \$686,075 resulting from the effect of these various adjustments.

28. The parties agree that the overall \$8.2 million annual revenue requirement increase will be collected from all customers through a new, uniform GRSA rider in such a manner that the overall percentage increase in base rates will be 6.93 percent.

2. Incentive Cost Adjustment/Electric Cost Adjustments

29. Aquila currently has an ICA mechanism which allows it to recover fuel and purchased energy costs on an expedited basis. The ICA contains an incentive aspect for Aquila to reduce energy costs below its base level. When actual energy costs are below its base energy cost level, it retains 25% of the cost reductions.⁵ The ICA rider is based upon a historical test year of September 1 through August 31. The updated ICA rider is filed each year on October 1, and the approved costs are recovered during the next year during the November 1 through October 31 time period.

⁵ Conversely, the sharing aspect of the ICA also puts Aquila at risk for absorbing 25 percent of any energy costs above its base energy levels.

30. Under the Settlement, the parties have agreed to terminate the ICA and replace it with an ECA. It proposes that the ECA become effective with the \$8.2 million rate increase that is scheduled to go into effect on or about September 1, 2004. Unlike the ICA, the ECA will allow Aquila to recover or to credit 100 percent of the fuel and purchased energy cost changes above or below its base energy cost. In contrast to the current ICA, Aquila will file for ECA changes at least twice each year, in accordance with the schedule set forth in Paragraph 3(d) of the Settlement. The ECA base cost will be set at \$22.39 per MWh effective with the new GRSA rider. The initial ECA charge is \$0.00125 per kWh. This represents a decline of \$0.00303 per kWh from the ICA charge currently in effect, and an annual decline in revenue of \$5.424 million.

31. As further justification for this change in energy cost recovery mechanisms, the Settlement states that Aquila's new purchase power contract with Public Service should result in significant energy cost savings that would not be fully realized by customers under the current sharing mechanism.

32. The Settlement also provides that, by July 1, 2006, Aquila will file an application to continue the ECA beyond 2006 or for implementation of a new ECA clause. The Parties agree that the target date for the extension of the ECA or for the implementation of a new ECA clause is April 1, 2007. During the Settlement hearing, Company witness Keith acknowledged

that Aquila has some exposure for energy costs incurred after August 2006 and the start of an “extended” ECA.⁶

3. Compliance with Cost Allocations Rules

33. Through the testimony and exhibits of Mr. Dan Tyrrell, Aquila filed a new Fully Distributed Cost (FDC) study. It also presented a Cost Allocation Manual (CAM) updated with data from the test year ending August 31, 2003, using the same methods approved in Aquila’s last Phase I Rate Case. Aquila believes that its FDC and CAM comply with the requirements of the Cost Allocation Rules, 4 *Code of Colorado Regulations*. 723-47, and § 40-3-114, C.R.S.

34. In its Answer testimony, Staff stated that it was unable to verify that the Aquila accounting system applies what is in the CAM because of a lack of an audit trail. Consequently, Staff argued that Aquila had not met its burden of proof⁷ and, therefore, the Commission should not issue a finding that the CAM complies with § 40-3-114, C.R.S.

35. As part of the Settlement, the parties agree that Aquila will discuss in a cooperative process with Staff and any other parties that may be interested (the participants) how Aquila’s CAM and its general ledger accounting system interact. Through this process, the participants will analyze cost allocation/assignments to and between Aquila’s regulated and non-regulated business activities. These discussions will occur through scheduled workshops that will utilize the new Cost Allocation Rules expected to be promulgated in Docket No. 04R-003EG

⁶ Examination of the ECA filing schedule table on pages 7 and 8 reveals that the last test period for energy costs ends in August 2006. To the extent the “extended” ECA, which is to be filed on July 1, 2006, does not take effect on August 1, 2006, the Company may not be able to recover some energy costs above its base cost of energy of \$22.39/MWH. Likewise, to the extent energy costs are lower than the base energy costs in the August 2006 time period, customers would not see any corresponding reductions.

⁷ See Answer Testimony of Sandra Johnson-Jones page 24.

(the new rules). The scheduling of the workshops will commence within 90 days of the effective date of the new rules.

36. In the workshops, the participants will start with an evaluation of the CAM and the FDC study filed in this case. The participants will then discuss the development of a new CAM and will discuss it on a department-by-department basis. The workshops will address the correlation between Aquila's accounting system and the new CAM. The parties believe that this evaluation will result in fair and reasonable cost assignments and allocations of costs to and between the Company's regulated and non-regulated business activities consistent with the requirements of § 40-3-114, C.R.S., and the new rules.

37. The Settlement provides that the participants shall have reasonable access to relevant information, subject to an appropriate non-disclosure agreement, concerning the Company's costs that could be assigned between and among regulated and non-regulated services. In the event the participants do not receive such information in a timely fashion, the participants may formally seek assistance from the Commission including, as necessary, a request to employ formal discovery processes. Finally, if the participants in the workshop process are not able to agree on an approach to accomplish a fair and reasonable allocation of costs to and between the Company's regulated and non-regulated business activities, the participants agree to notify all participants in writing, and the unresolved issue(s) shall be submitted to the Commission no later than 60 days after receipt of the written notification.

38. Once a new CAM is developed that is consistent with the new rules, Aquila will file the new CAM and a new FDC study. The target date for such filing will be 18 months after

the effective date of the new rules, which date may be extended by mutual agreement of the participants.

C. Conclusions

39. We conclude that the Settlement Agreement should be approved. We find that the regulatory principles used to develop the \$8.2 million base rate increase in conjunction with the energy cost decrease of \$5.424 million for an overall increase in customer rates of \$2.776 million or 2.23 percent are just and reasonable. Additionally, changing to a 100 percent pass-through mechanism for energy costs under an ECA, instead of the current sharing incentive contained in the ICA, is in the public interest given Aquila's current purchased power situation. Finally, the establishment of workshops to allow interested parties to better understand the interaction between Aquila's accounting systems and its CAM and FDC is reasonable given the pending cost allocation rulemaking.

II. ORDER

A. The Commission Orders That:

1. The Settlement Agreement and Motion for Approval of the Settlement Agreement filed on July 27, 2004, by Aquila, Inc., the Staff of the Colorado Public Utilities Commission, the Colorado Office of Consumer Counsel, the Fountain Valley Authority, the Board of Water Works of Pueblo, the City of Canon City, the Cripple Creek & Victor Gold Mining Company, Holcim (U.S.) Inc., and the Trane Company, is approved.

2. The tariff sheets filed by Aquila, Inc., pursuant to Advice Letter No. 588 are permanently suspended.

3. Aquila, Inc., shall file on not less than one day's notice to the Commission tariffs consistent with this Decision. Such tariffs shall become effective on September 1, 2004.

4. 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.

5. This Order is effective upon its Mailed Date.

**B. ADOPTED IN COMMISSIONERS' DELIBERATIONS MEETING
August 17, 2004.**

THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF COLORADO

Commissioners