STATE OF IOWA

DEPARTMENT OF COMMERCE

UTILITIES BOARD

IN RE: AQUILA, INC., d/b/a AQUILA NETWORKS	DOCKET NOS. TF-05-52 WRU-05-6-225

ORDER GRANTING IN PART AND DENYING IN PART REQUEST FOR WAIVER AND REJECTING PROPOSED TARIFF

(Issued June 30, 2005)

PROCEDURAL BACKGROUND

On February 18, 2005, Aquila, Inc., d/b/a Aquila Networks (Aquila), filed with the Utilities Board (Board) a request for a waiver of some of the requirements in 199 IAC 19.3(10) applicable to natural gas distribution main and service line extensions. The waiver request was identified as Docket No. WRU-05-6-225. Also on February 18, 2005, Aquila filed proposed tariff revisions that included a proposal to replace Aquila's current Iowa gas tariff sheets governing extensions of distribution mains and service lines with new facilities extension tariff sheets. The proposed tariff revisions have been identified as Docket No. TF-05-52.

On February 24, 2005, the Board issued an order docketing the waiver request and proposed tariff revisions for further review. On March 18, 2005, counsel for the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed an appearance. On May 3, 2005, the Board issued an order requesting additional information from Aquila. On May 23, 2005, Aquila filed the requested information.

WAIVER REQUEST

Aquila has requested waiver of five provisions of the Board's rules on extensions of distribution mains and service lines for natural gas service, 199 IAC 19.3(10). Aquila also requested the Board grant any other waivers it considered necessary to approve the new tariff provisions. Aquila asserts that the new tariff will (1) avoid cross-subsidization of slow-performing system expansion projects by other customers; (2) standardize Aquila's processes for analyzing and comparing capital investment projects; (3) protect Aquila's capital investment by performing more accurate pre-construction analyses using Aquila's feasibility model; (4) clarify the potential cost of expansion projects by merging the mains and service line costs into one project cost; and (5) simplify the process by using Aquila's feasibility model and related agreement. Aquila states that the new tariff provisions will match new cost causers with new cost payers to avoid any cross subsidization from existing ratepayers and create uniformity among the various states where it provides service.

Aquila states that it is not aware of any statute or other provision of law that specifically mandates the requirements of 199 IAC 19.3(10) for which Aquila is seeking a waiver. Aquila states substantially the same legal rights conferred on persons by the requirements of 199 IAC 19.3(10) that Aquila seeks to waive will be granted by the new facilities extension tariff being proposed. Aquila asserts that the new facilities tariff meets the requirements of 199 IAC 19.3(10)"e" by providing a more favorable method of extension to the customer and is not discriminatory.

Finally, Aquila asserts substantially equal protection of public health, safety, and welfare will be afforded by means other than provisions for which waiver is requested. The new extension will be reviewed and approved by the Board and will be enforced under Board rules and, as stated above, Aquila asserts that the new tariff will provide a more favorable method of extension to the customer.

In 199 IAC 1.3, the Board has adopted four criteria for considering a waiver request. The four criteria are: 1) the application of the rule would pose an undue hardship on the requesting party; 2) the waiver would not prejudice the substantial rights of any person; 3) the provisions of the rule are not specifically mandated by statute or another provision of law; and 4) substantially equal protection of public health, safety, and welfare will be afforded by a means other than that prescribed in the rule.

Having considered the waiver request and supporting information, the Board finds that there is clear and convincing evidence to support a waiver of part of the request but not all of the provisions that would need to be waived to approve the new extension tariff. The individual provisions are addressed below.

1. The requirement in 199 IAC 19.3(10)"b"(1) that a utility allow the customer or developer, at its option, to provide a non-refundable contribution-in-aid-of-construction (CIAC).

Under Aquila's proposal, this option would not be available to customers or developers. The provision being waived is the last sentence in the subparagraph set out below.

> b. Distribution main extensions.
> (1) Plant additions. The utility will provide all gas plant at its cost and expense without requiring an advance for construction from customers or developers except in those unusual circumstances where extensive plant additions are required before the customer can be served, or where the customer will not attach within the agreed–upon attachment period after completion of construction. In such instances, the utility shall require, no more than 30 days prior to commencement of construction, the customer or developer to advance funds which are subject to refund as additional customers are attached. A contract between the utility and the customer, which requires an advance by the customer to make plant additions, shall be available for board inspection. The utility shall allow the customer or developer, at the customer's or developer's option, to provide a nonrefundable contribution in aid of construction instead of a refundable advance for construction, under subparagraphs 19.3(10)"b"(2) and (3).

The Board addressed the option of a customer or developer choosing a non-refundable CIAC payment or a refundable advance in Docket No. RMU-03-1, Executive Orders 8 and 9 Required Revisions to Chapters 19, 20, 21, 35, and 36. On October 23, 2003, the Board issued an order in that docket adopting an amendment to 199 IAC 19.3(10)"b"(1) making it clear that a utility was required to offer a customer or developer the option when requesting a distribution main extension. The Board rejected suggestions that the customer not be given the option.

Pursuant to 199 IAC 19.3(10)"c," the option is not offered to customers who have a service line extension constructed. If the service line extension is over 100 feet of polyethylene pipe or 50 feet of metal pipe, the customer must make a CIAC payment.

The Board finds its adoption of the amendment making it clear that a utility is required to offer a customer or developer the option has created a substantial legal right and the Board should not waive that right for an individual utility. If the feasibility model produces a more favorable result for customers as Aquila suggests, then the customers will most likely accept the CIAC option. However, the Board considered this same issue in Docket No. RMU-03-1 and found that the customer should be allowed to make this choice. In addition, Aquila has not demonstrated that it will suffer an undue hardship from offering this option to customers. Any amendment to or rescission of the provision should only be considered in another rule making docket. The Board will deny the waiver request for this provision.

2. The requirement in 199 IAC 19.3(10)"b"(4) that an advance be refunded to the depositor over a ten-year period.

Subparagraph 19.3(10)"b"(4) provides that when a customer chooses to make an advance for construction, requiring that refund payments be made to the customer, the refunds shall be made over a ten-year period. Aquila states under the proposed tariff the refund period will be five years.

The Board finds that Aquila has presented sufficient information to support Aquila's position that retention of the ten-year refund period is an undue hardship. Carrying the refund period out over ten years increases Aquila's administrative costs and allows developers to extend the completion of projects beyond the anticipated completion date without any risk of losing the refund. Reduction of the refund period from ten to five years should help Aquila address the problem of developers who do not meet the completion goals of a project in a timely manner.

Waiver of the ten-year provision in subparagraph 19.3(10)"b"(4) will not prejudice the substantial rights of any person. Unlike the option discussed in number 1 above, the Board did not specifically address the ten-year provision in the order adopting amendments in Docket No. RMU-03-1 and the ten-year option is not otherwise specifically mandated by statute or another provision of law. In addition, substantially equal protection of public health, safety, and welfare will be afforded by a means other than that prescribed in the rule. A five-year period for making refunds on distribution main extensions is a reasonable period and will allow developers to recover their costs if they complete their projects in a timely manner. The Board will grant a waiver of this provision and allow Aquila to implement a five-year refund period.

3. The requirement in 199 IAC 19.3(10)"b"(2) and 19.3(10)"b"(4) that a "three times the estimated base revenue" standard be employed.

These rules provide that a utility shall require an advance for construction if the estimated construction cost is greater than three times the estimated base revenue. Aquila states that under the proposed tariff, an Aquila feasibility model will perform the function this standard currently performs in the Board's rules.

As described by Aquila, the feasibility model is used to analyze all expansion projects and thus the time value of revenue from gas usage is considered relative to the initial investment. Aquila's field personnel enter the projected annual usage and estimated construction outlays for a project and the model calculates the projected return. The model also calculates the amount of construction contribution that will be needed from a customer.

The model calculates what revenue or capital is required to justify the basic service for a typical residential or commercial customer and what facilities are included in a "base construction allowance," which is currently estimated to be $700 per residential customer. The model generates the carrying costs as measured over five years and calculates a non-refundable CIAC charge. Aquila states that it believes that all projects can be reviewed with the same model to ensure consistent application of the facilities extension parameters across all customer classes.

The Board finds that Aquila has met the four criteria in rule 1.3 for a waiver of these rules to allow use of the feasibility model. Since Aquila operates in several jurisdictions, use of different models for determining construction costs could cause confusion among Aquila construction personnel and would require cross-training if Aquila uses the same personnel in more than one jurisdiction. The waiver of the "three times base revenue" provision will not prejudice the substantial rights of any person, this provision is not specifically mandated by statute or other provision of law, and substantially equal protection of public health, safety, and welfare will be afforded by use of the feasibility model rather than the standard. The feasibility model appears to calculate a reasonable estimate of construction costs. The Board will grant a waiver of the "three times base revenue" standard and allow Aquila to use its feasibility model.

4. The definition of "estimated base revenues" in 199 IAC 19.3(10)"a" to the extent it requires the cost of purchased gas alone to be subtracted from annual revenues to calculate base revenues.

This rule provides that "estimated base revenues" shall be calculated by subtracting the cost of purchased gas from estimated annual revenues. Aquila states that under the proposed tariff, revenues from the energy efficiency cost recovery (EECR) surcharge will also be subtracted from annual revenues to calculate base revenues.

After review of this issue, the Board finds that neither the cost of purchased gas nor the EECR surcharge is to be included in calculating "estimated annual revenues," which are then used to calculate estimated base revenues. Aquila therefore does not need a waiver of any provision of 19.3(10)"a" for this purpose.

5. The definition of "estimated construction costs" in 199 IAC 19.3(10)"a" to the extent it requires the use of prior calendar year costs to compute the average cost per foot.

This rule provides, in relevant part, that "estimated construction costs" are to be calculated using prior calendar year costs. Aquila states that under the proposed tariff, construction costs will be estimated by Aquila's work management system, which relies on current updates of all cost components, rather than prior year costs.

The Board finds Aquila has met the four requirements for the waiver of the use of prior calendar year costs to compute average cost per foot of an extension. As with the feasibility model, it would be an undue hardship for Aquila to be required to use different costing models for determining the cost of construction of an extension in different states. This type of difference between jurisdictions could cause confusion among Aquila personnel and use of prior calendar year costs in Iowa could make Aquila's cost calculations inconsistent from jurisdiction to jurisdiction. In addition, the waiver of this provision will not prejudice the substantial rights of any person, this provision is not specifically mandated by statute or other provision of law, and substantially equal protection of public health, safety, and welfare will be afforded by use of the feasibility model rather than the standard.

The Board will grant a waiver of this provision as requested.

6. Waive the distinction between distribution main and service line extensions.

In the May 3, 2005, order requesting additional information, the Board questioned whether there were other provisions of the extension rules that would have to be waived if the new tariff was approved. Specifically, the Board questioned whether one or more waivers would be required for Aquila's proposal to remove the distinction between distribution main and service line extensions for calculating the cost of the extensions. Paragraphs 19.3(10)"b" and "c" provide for different calculations of costs for distribution main and service line extensions, respectively. As discussed above, the Board will grant Aquila a waiver to use the feasibility model to calculate costs, which will eliminate this distinction.

The Board finds that no additional waiver is necessary in conjunction with the waiver of the "three times base revenues" test in 199 IAC 19.3(10)"b"(2) and 19.3(10)"b"(4). The proposed tariff separates the two types of extensions as "basic extension request for general service" and "non-basic extension request for subdivision projects," which appears to maintain the distinction except for the calculation of cost. Aquila will be required to file revised tariff sheets consistent with the Board's order and the necessary distinctions from the rule should appear in those revised sheets.

Since the Board is denying the waiver of the option to choose between an advance and a CIAC payment for distribution mains, a calculation of a CIAC payment will be required for both distribution mains and service line extensions. A calculation of an advance will only be required for a distribution main extension. This distinction will remain.

7. A waiver of the provision providing for the free installation of 50 feet of non-polyethylene pipe.

A second possible waiver raised by the Board in the May 3, 2005, order was the provision in 199 IAC 19.3(10)"c" that a utility must provide either 100 feet of polyethylene pipe or 50 feet of metal pipe at no cost to the customer. Aquila stated that it understood the current rules allow a customer some discretion in choosing whether to have a polyethylene pipe extension or a metal pipe extension constructed for a service line extension. Aquila proposes to remove any discretion and Aquila will provide the 100 feet of polyethylene pipe as required by paragraph 19.3(10)"c."

The Board does not interpret this paragraph as allowing a customer to choose which type of pipe the utility will install. The utility is to install pipe that meets safety and engineering standards and the utility has the discretion of which type of pipe best meets these requirements. The Board does not consider a waiver of this paragraph to be necessary.

8. A waiver that allows Aquila to add a requirement that residential and commercial customers must commit to 500 therm and 50,000 therm usage, respectively, to receive the first 100 feet of polyethylene pipe free.

Aquila proposes to add a requirement that customers must commit to minimum usage levels in order to qualify for distribution pipe at no charge. Aquila states that the 500 therm requirement was intended to be an estimate of reasonableness that roughly equals the peak day usage break point between the SV (small volume) and LV (large volume) classes. Aquila explains that LV customers are more likely to be stable, but their usage patterns make it more difficult to estimate usage, and there is often a benefit to these customers if they exaggerate their expected usage. These large users also may require more capital investment by Aquila. Aquila proposes a three-year assurance from LV customers to provide some protection for ratepayers that the estimated usage will be reasonable and the ratepayer subsidies will be minimized.

Aquila's proposed tariff on 2nd Revised Sheet No. GT-40 states that a "basic extension request" is a request for a distribution extension for which the specified facilities are provided free of charge, provided the customer commits to use natural gas for its basic space heating requirements or a minimum of 500 therms for at least one year. The proposed tariff provides that the customer will be required to pay the full non-refundable CIAC payment to initiate service if the customer does not meet these minimum thresholds.

The 500 therm commitment is not in the current rules and Aquila would need a waiver to add this additional requirement to the provision of the free service line extension. Under current rules, the utility is required to construct and finance a service line extension without requiring a CIAC payment or any payment by the customer for a service line extension of 100 feet or less of polyethylene pipe. The current rule does not require a commitment by a customer to use a certain amount of natural gas annually.

The Board understands Aquila's goal of attempting to reduce what it considers subsidization of some extensions by other ratepayers. Customers who only use natural gas for a fireplace receive a free extension just the same as those who are using much more natural gas for space heating and water heating. The current rules are designed to allow any customer to obtain a service line extension regardless of intended usage and Aquila's overall rates are established by taking this into account. Adding a minimum usage requirement is an issue that needs to be decided in a rate case, not through the waiver process. The Board will not grant a waiver to allow this provision in the proposed tariff.

9. A waiver to allow Aquila to not bill developers unless the cost is over $10,000.

Aquila proposes to waive "potentially refundable advances" that are less than $10,000 and bill developers for advances that are greater than $10,000. The waiver of construction charges that are under $10,000 is provided for in Aquila's Facilities Extension Agreement but is not reflected in the proposed tariff. Aquila states that it would be willing to put this provision in the proposed tariff.

Since the $10,000 threshold for applying a construction charge is a benefit to a customer, a waiver is not required for Aquila to implement the threshold. However, it is not clear whether the waiver of the $10,000 applies to the first $10,000 in all projects or only for those where construction costs are under $10,000. The $10,000 threshold must apply to all projects so that it is non-discriminatory and it should be described in Aquila's tariff.

PROPOSED TARIFF

Based upon the information provided by Aquila, the Board understands that the proposed tariff (1) provides for a free basic service extension, (2) recognizes two types of construction charges, non-refundable CIAC and potentially refundable advances, and (3) provides for the application of a feasibility model, which is a standard method for valuing capital investment, as well as other changes from the current tariff. Aquila proposes new tariff provisions designed to match projected incoming revenues from customers to the costs of owning, operating, and maintaining gas distribution assets and servicing customers. Aquila also is attempting to standardize its operations among the various states and indicates that a similar tariff has been approved in Missouri and Minnesota and is being considered by Nebraska.

Aquila states there are seven basic differences between the current extension tariff and the proposed tariff. The seven as described by Aquila are as follows:

1. The proposed tariff treats service lines and mains together to eliminate the need to apply separate tests.

2. The proposed tariff subtracts the EECR from the calculation of "estimated base revenues."

3. The proposed tariff provides for a "basic extension request" where Aquila will provide specified facilities for free.

4. The proposed tariff will use Aquila's capital investment estimation process that is embedded in its automatic work management system instead of the previous calendar year costs as an estimate. Aquila states that this system is continually updated with current contractor and material prices and provides a more accurate estimate for estimating all of its work.

5. Aquila proposes: (1) not to bill developers or builders for advances unless they exceed $10,000, (2) to eliminate the customer option to

select a non-refundable CIAC or a potentially refundable advance, and (3) to change from a ten-year to a five-year open extension period. Aquila believes that customers would be better off accepting the Aquila-calculated CIAC, versus a potentially refundable charge at the beginning of a project with charges refunded over time.

6. Aquila states that the standard service connection cost from the main to the customer's house is approximately $660. A typical residential customer using natural gas for full space heating and water heating requirements would provide approximately $247 annually in margins to Aquila under current rates. On the other hand, a residential customer using natural gas only for a fireplace would generate approximately $113, assuming 12 months of customer charges are paid. Aquila asserts that the capital justification for the two residential homes is vastly different. Absent specific recognition of this difference, existing customers will subsidize the capital investment to serve limited use customers like fireplaces.

7. Aquila states the current tariff refers to a "three times revenue" factor to justify a project, but this test does not account for the build-out rate of subdivisions. Revenue earned in the earlier years is not equal to revenue earned in later years, due to the net present value of the inflows. The Aquila feasibility model recognizes this discounting of value.

In addition to the seven differences referenced above, Aquila is proposing in the new tariff to distinguish between "proven" developers and "unproven" developers. Aquila explains that the distinction will allow it to charge an "unproven" developer a potentially refundable advance as well as a CIAC payment. If a project is developed as promised, Aquila would refund the advance over five years. Aquila suggests that the construction advance ensures that Aquila will be made whole if the builder is overly optimistic in projecting housing hook-ups. Aquila states that it typically would be required to make about 50 percent of its investment to lay the mains before roads and other subdivision infrastructure is completed.

Developers that have a good track record with Aquila will not be required to provide the cash contribution up front, but will be monitored for non-performance and will be subject to back billing for not meeting the commitments executed in the facilities extension agreement. Developers with a poor record or no record, or those classified as unproven or indeterminate, will be required to provide the total cost of the project before the extension is constructed. Aquila considers an unproven developer to be (1) a new developer with no track record with Aquila or one that cannot provide a sound credit record; or (2) a developer who does not deliver on its stated intentions, for example, by not delivering the promised number of homes or indicating all homes will be heated with gas, but then using heat pumps.

The Board has addressed the seven differences described above in the waiver section of this order. A further discussion of the issue of back-charging a customer who does not meet the thresholds in the tariff is necessary. The discretion provided in the proposed tariff to treat a "proven" developer differently than an "unproven" developer also needs to be addressed.

Aquila stated in the additional information that it would not charge a customer in the event the customer's usage does not exceed an expected level of 500 therms for a single residence or 50,000 therms for a commercial development. Aquila states that it has included the 500 therm threshold to obtain information that can be included in a feasibility model to prevent subsidization of projects like new subdivisions, which can be somewhat speculative. Aquila states that it is primarily interested in whether the customer's potential usage would justify the investment to serve that customer. Aquila states that it would not attempt to disconnect a customer who did not meet the threshold usage level.

It appears that Aquila's statement that it will not charge a customer who does not meet the proposed 500 therm requirement is not consistent with the provisions in the proposed tariff or Exhibit A of the Facilities Extension Agreement. Original Sheet No. GT-42-4 provides that all applicants who make a basic extension request for general service must agree to use natural gas of at least 500 therms, for at least one year, to receive the basic facilities free of charge. The proposed tariff provides that applicants making a non-basic extension request for subdivision projects may incur construction charges for costs in excess of the basic facilities installed free. The proposed tariff then provides that "proven" projects, which are projects requested by a developer having a proven track record, will have the applicable standard construction allowance subtracted from the estimated construction costs to calculate the non-refundable CIAC charge. Potentially refundable charges would not be applied to proven projects.

For projects defined as "unproven" or "indeterminate," the proposed tariff provides, at Aquila's sole discretion, that the customer must also pay a potentially refundable construction charge on a per dwelling basis. The applicable standard construction allowance will be subtracted from the estimated construction costs for the project in order to determine the non-refundable CIAC charge.

Exhibit A to the Facilities Extension Agreement for residential single-family construction provides "[I]n the event that the structure(s) are not built within the five (5) year period, or structure(s) are not built in accordance with this Agreement, the Customer will be required to pay the applicable Construction Charges." Exhibit A to the Facilities Extension Agreement for non-residential single-family construction provides that customers estimating usage of less than 5,000 dekatherms will be required to perform within one year and customers estimating usage of greater than 5,000 dekatherms will be required to perform for up to three years. This agreement also provides that in the event a structure or structures are not built within the requisite period or not built in accordance with the agreement, the customer will be required to pay the applicable construction charges.

The Board has addressed the 500 therm requirement for receiving the free service line extension in the waiver section of this order. The Board finds that any provision requiring a customer to commit to a minimum usage in order to receive the free construction allowance provided in 199 IAC 19.3(10)"b" and "c" is inconsistent with the intent of the rule and would allow Aquila to charge for construction where the rule contemplates that the service would be extended to the customer free of charge. The costs of providing free extensions is part of the development of rates in a general rate case and any change to this provision should be addressed in a general rate docket.

The other provisions in the proposed tariff appear to give Aquila broad discretion over whether to charge a developer a refundable charge in addition to a CIAC payment based upon Aquila's decision of whether the project has a "proven" or "unproven" track record. Since the Board is not granting the waiver of the requirement that a utility must give a customer or developer the option of a CIAC or an advance for a distribution main extension, Aquila will not have the discretion provided in the proposed tariff. Aquila will be required to offer all customers the option rather than require an advance based upon its subjective decision of whether a customer is "proven" or "unproven" and Aquila will not be allowed to require both a CIAC payment and an advance from certain developers.

Based upon the decision of the Board not to grant a waiver of all of the provisions of its extension rules requested and the discussion above, the Board will reject the proposed tariff. Aquila may file a revised proposed tariff consistent with the decisions in the order.

NOTICE OF INQUIRY

After reviewing the information provided by Aquila, the Board has determined that it should open an inquiry into its extension rules to determine if they are still relevant in the changing natural gas and electric environment. The Board will issue an order opening the inquiry.

ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. The waiver request identified as Docket No. WRU-05-6-225 filed by Aquila, Inc., d/b/a Aquila Networks, on February 18, 2005, is granted in part and denied in part as follows:

a. Waiver of the requirement in 199 IAC 19.3(10)"b"(1) that a utility allow the customer or developer, at the customer or developer's option, to provide a non-refundable contribution-in-aid-of-construction (CIAC) is denied.

b. Waiver of the requirement in 199 IAC 19.3(10)"b"(4) that an advance be refunded to the depositor over a ten-year period is granted. Aquila may establish a five-year refund period by tariff.

c. Waiver of the requirement in 199 IAC 19.3(10)"b"(2) and 19.3(10)"b"(4) that a "three times the estimated base revenue" standard be employed is granted. Aquila may use its proposed feasibility model upon filing and receiving approval of appropriate tariff language.

d. No waiver is necessary to subtract EECR costs from annual revenues to calculate base revenues. The requested waiver of 199 IAC 19.3(10)"a" is denied.

e. Waiver of the definition of "estimated construction costs" in 199 IAC 19.3(10)"a" to the extent it requires the use of prior calendar year costs to compute the average cost per foot is granted.

f. Waiver to allow establishment of a 500 therm threshold to receive free service connection is denied.

2. The proposed tariff identified as Docket No. TF-05-52 is rejected.

UTILITIES BOARD

/s/ John R. Norris

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 30th day of June, 2005.