

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: AQUILA, INC., d/b/a AQUILA NETWORKS	DOCKET NOS. RPU-05-2 WRU-06-16-225
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ORDER DENYING MOTION TO DISMISS AND ADDRESSING WAIVER REQUEST

(Issued June 1, 2006)

On March 1, 2006, the Utilities Board (Board) issued a final order in this docket approving a general rate increase for Aquila, Inc., d/b/a Aquila Networks (Aquila), and rejecting a proposed settlement that would have established a capital additions tracker (CAT) surcharge. On March 17, 2006, Aquila filed an application for rehearing of the rejection of the CAT settlement. On April 5, 2006, the Board issued an order granting rehearing and establishing a procedural schedule.

On May 3, 2006, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed a motion to dismiss the rehearing on the basis that Aquila had not complied with the statutory notice requirements and the Board therefore lacked jurisdiction to consider the CAT surcharge. On May 12, 2006, Aquila filed a resistance to Consumer Advocate's motion and on May 16, 2006, Consumer Advocate filed a reply to Aquila's resistance. On May 23, 2006, Aquila filed a response to Consumer Advocate's reply.

On May 8, 2006, Aquila filed a request for waiver of 199 IAC 26.4(1) that limits recovery of rate case expense to the expenses incurred as of the date of a company's reply brief. Aquila requests that it be allowed to recover rate case expense through the date of the Board's order on rehearing and to include the expense in the CAT calculation or have it recovered in the next rate case. On May 10, 2006, Consumer Advocate filed a response opposing the waiver and on May 19, 2006, Aquila filed a reply to Consumer Advocate's response.

MOTION TO DISMISS

Consumer Advocate contends that the notice sent by Aquila on May 2, 2005 informed customers of the proposed general rate increase but did not inform customers of the proposal to further increase rates over and above the amount in the general rate increase through the adoption of a CAT. Consumer Advocate states that the notice also did not inform customers of the amount of the additional increase in rates that would occur if the CAT were approved by the Board.

Consumer Advocate argues that Iowa Code § 476.6(2) provides that all rate regulated public utilities shall give written notice of a proposed increase of any rate or charge to all affected customers served by the utility no more than 62 days prior to the time the application is filed with the Board. Consumer Advocate argues that the Iowa Supreme Court has held that the required notice is jurisdictional. Office of Consumer Advocate v. Utilities Board, 452 N.W.2d 588, 592 (Iowa 1990). In that decision, the Court stated that the notice required by statute is the initial step in

seeking a rate increase and unless the notice is given, the Board has no jurisdiction to permit rates proposed by the utility to be put into effect. Id.

Consumer Advocate argues that the notice sent by Aquila to customers did not reveal the essential attributes of the proposed rate increase since the notice did not reveal the proposed CAT and the associated rate increase. Because the notice is deficient, Consumer Advocate contends that the Board does not have jurisdiction to permit the proposed CAT to go into effect and the hearing should be cancelled and this proceeding on rehearing should be dismissed.

Aquila responded to the motion to dismiss and argues that the notice meets the requirements in Iowa Code § 476.6(2) and 199 IAC 26.5(1)"d"(5). Aquila argues that subparagraph 26.5(1)"d"(5) provides that a utility may establish an automatic adjustment mechanism by the filing of a schedule showing the automatic adjustment and the notice requirements for a general rate case filing are not applicable. Aquila contends that the CAT is an automatic recovery adjustment mechanism. Aquila points out that it modeled the CAT after the Cooper Tracker approved by the Board in MidAmerican Energy Company, Docket Nos. APP-96-1, RPU-96-8, issued September 27, 2004. Aquila then cites 199 IAC 26.5(1)"d"(5), which states that a public utility may establish an automatic adjustment of rates and charges for service, provided a schedule showing such automatic adjustment is first filed with the Board. This language is similar to the language in Iowa Code § 476.6(8) that authorizes the Board to approve automatic adjustment mechanisms.

Aquila argues that the only requirement for filing a proposed automatic adjustment mechanism is that there be a filing of a schedule showing the adjustment. Aquila argues that Board precedent also warrants rejection of Consumer Advocate's motion to dismiss. No notice of the Cooper Tracker was given to customers before the Board approved its implementation. The Cooper Tracker was proposed in rebuttal testimony by a Consumer Advocate witness and no additional notice was ordered by the Board.

Aquila points out that the Consumer Advocate decision cited by Consumer Advocate involved a phase-in of rates associated with a nuclear power plant and the Court explained that substantial compliance of the statutory notice requirement requires at a minimum that the notice alert affected customers of the proposed rate increase, the right to object, and the right to request a hearing before the Board. Consumer Advocate, 452 N.W.2d at 592-93. The Court went on to state that the utility had made a good faith effort to comply with the notice requirement and no prejudice is shown by its failure to do so completely. Consumer Advocate, 452 N.W.2d at 593-94.

Aquila asserts that the notice of the general rate increase proposed in this docket met the requirements as explained by the Court in the Consumer Advocate case. Aquila also argues that Consumer Advocate should be deemed to have waived any right to object to the Board's jurisdiction since it waited until rehearing to

raise the issue and had previously joined in a settlement that included adoption of the CAT.

In its reply, Consumer Advocate argues that Board rules and Iowa Code § 476.6(2) require that notice be given of all rate increases, including rate increases to be implemented through an automatic adjustment mechanism. Consumer Advocate argues that the Cooper Tracker was proposed in rebuttal and a rate decrease was being proposed in that docket, not a rate increase. Consumer Advocate argues that the notice to customers must do more than alert the customers to some sort of rate increase. The notice must provide a meaningful disclosure of essential rate increase information, including the total amount of the proposed increase. In this case, notice was given of a proposed rate increase of \$4.1 million, but no notice was given of the CAT that could potentially result in an additional rate increase of as much as \$4.3 million.

Finally, Consumer Advocate argues that as a general rule jurisdictional objections cannot be waived and the proposed increase for the first step of the CAT is substantial. The notice did not comply with the statute or Board rules and the Board is without jurisdiction to approve the CAT.

In its response to Consumer Advocate's reply, Aquila argues that the notice meets the requirements established in the Consumer Advocate case and the total increase from the revenue requirement settlement and the first step of the CAT would be less than the \$4.1 million in the notice. Aquila also asserts that the distinctions

Consumer Advocate claims exist between the CAT and the Cooper Tracker are without merit.

Board Decision

Iowa Code § 476.6(2) requires that a rate-regulated public utility such as Aquila give written notice of a proposed increase of any rate or charge to all affected customers within a certain period. The statute requires that the notice state that a customer has a right to file a written objection to the rate increase and that the affected customer may request a hearing by the Board to determine if the proposed rate increase should be allowed. The Board is authorized to prescribe the manner and method in which the written notice shall be served.

Board rule 199 IAC 26.5 establishes requirements for the notice to customers and includes a standard notice that can be used by the utility without seeking prior approval from the Board. In this docket, Aquila filed a proposed notice for Board approval since it made some changes to the standard notice. The notice sent by Aquila states that Aquila is proposing to increase rates for natural gas service by \$4.1 million, or approximately 2.7 percent. The proposed increase shows how each customer class would be affected by the proposed increase and states that final rates may be different than those shown in the notice, that customers may file a written objection to the proposed rate increase, and customers may request the Board hold a public hearing. The notice provides a telephone number for Aquila where a customer can obtain additional information.

Consumer Advocate and Aquila have cited to the Iowa Supreme Court decision in the Consumer Advocate case to support their arguments. The Board agrees that the Consumer Advocate case provides guidance on the issue of whether the notice meets the statutory requirements. The Court in that case was faced with a similar issue involving the sufficiency of notice to customers of a proposed phase-in of a rate increase over five years. The notice indicated what a one-time increase would be and what the rate increase would be for the first year of the phase-in, but did not give the rate increases for the subsequent years or the overall effect of the phase-in on customer bills.

The Court found the notice was in substantial compliance with the statute and Board rules since it adequately informed customers that a rate increase request was before the Board which might lead to a rate increase affecting the customer, informed customers that they could file written objections, and that customers could request a public hearing before the Board. Consumer Advocate, 452 N.W.2d at 593. The Court stated that the notice revealed the essential attributes of the proposed rate increase, the utility had made a good faith effort to give notice, and the Board found there was no prejudice to ratepayers.

In this instance, Aquila gave notice of a proposed rate increase and the potential effect it would have on customers. The notice was approved by the Board and was substantially similar to the standard notice provided in the Board rules at 199 IAC 26.5(1)"c." The notice does not indicate that Aquila is also seeking a capital

additions tracker that could result in a total rate increase greater than that indicated in the notice.

The Board finds that the notice given customers by Aquila in this case meets the minimum standard established by the Court in the Consumer Advocate case. The Court held that a minimum notice established by statute must alert the affected customers of the proposed rate increase, the right to object, and the right to request a hearing before the Board. Id. The notice sent by Aquila gave customers notice that a general rate increase was being proposed and informed them of the right to object and the right to request a hearing.

The Board finds that the notice was a good faith effort by Aquila to comply with the notice requirements in the statute and Board rules and no prejudice to customers has resulted from the failure of Aquila to include the proposed CAT in the notice. This is not an endorsement for Aquila's notice; it was only minimally adequate and could have been better. Still, it was adequate. In addition, even though jurisdictional issues generally cannot be waived in the original case, the Board cannot ignore the fact that Consumer Advocate joined in a proposed settlement of the CAT issue with Aquila. If Consumer Advocate believed that the notice did not meet statutory requirements, it could have raised that issue at any time in the original proceeding and before it joined in the settlement. An objection to the notice at this time of the proceeding, especially since Consumer Advocate joined the CAT settlement, raises serious equity concerns. If Consumer Advocate had raised the jurisdictional issue in

the original proceedings, it could have been addressed to allow Aquila to correct any deficiency the Board might have found by means of a supplemental notice. Even if the jurisdictional issue had merit, judicial efficiency and equity would weigh against ordering that a new notice be sent at this time and requiring Aquila to begin the proceeding again. A new notice would only delay the Board's review of the CAT and increase rate case expense.

Since the Board has determined that the notice sent by Aquila in this case meets the minimum standards of the statute and Board rules, the Board has determined that it does not need to address whether the CAT is an automatic adjustment mechanism that is subject to the notice provisions of subparagraph 26.5(1)"d"(5).

WAIVER REQUEST

Aquila points out that although 199 IAC 26.4(1) establishes a cut-off date for recovery of rate case expense as of the date of the reply briefs, the Board as early as 1989 found that the rule improperly identified the cut-off date and rate case expense is to be computed up to the date of the Board's final decision. In re: Iowa Power and Light Company, Docket No. RPU-88-10, "Order Denying Rehearing in Part, Granting Rehearing in Part and Approving Stipulation," (issued July 19, 1989). Aquila contends that the Board's order in Docket No. RPU-88-10 endorses the principle that reasonable rate case expense actually incurred by the utility, the Board, and Consumer Advocate for activities related to litigation and resolution of the case at all

times prior to the date on which the case is actually concluded should be recoverable.

Since this case will not be concluded until the Board issues an order on rehearing, Aquila states that rate case expense will continue to be incurred until that date. Aquila states that expenses associated with the rehearing will not be insubstantial, especially since all of the issues concerning the CAT are to be addressed. Accordingly, Aquila is requesting that the Board waive 199 IAC 26.4(1) to the extent necessary to allow the recovery of rate case expenses incurred by Aquila, the Board, and Consumer Advocate through such date as the Board issues an order on rehearing in this case.

Aquila states that it would be an undue hardship if Aquila is unable to recover rate case expenses that it actually incurred for activities directly related to the litigation and resolution of this case through the time the case comes to a conclusion. Aquila states the cut-off date in paragraph 26.4(1) is not mandated by statute and the granting of the waiver will not prejudice the substantial legal rights of any person. Also, substantially equal protection of public health, safety, and welfare will be afforded by means other than those prescribed in the paragraph sought to be waived.

Aquila points out that the waiver will expire on the date the order on rehearing is issued. Aquila requests that it be allowed to recover the rate case expense by means of an appropriate adjustment to the CAT surcharge, if the CAT is approved.

In the event the CAT is not approved, Aquila requests that the rate case expense be permitted to be recovered in Aquila's next general rate case.

Consumer Advocate opposes the waiver request and points out that the Board's order in Docket No. RPU-88-10 did not hold that Iowa law permits a utility to recover expenses incurred after the Board's final order. In Docket No. RPU-88-10, the utility only sought recovery of rate case expense up to the date of the final decision.

Consumer Advocate indicates that Aquila filed compliance tariffs that incorporated its allowable rate case expenses in March 2006. The Board approved the compliance tariff on March 17, 2006, and expressly recognized that it had included updated rate case expenses. Aquila would be required to file new tariffs to increase rates and charges for additional rate case expense and Aquila would be required to give notice of the new rates and charges to customers pursuant to Iowa Code § 476.6(2).

Consumer Advocate argues that Iowa Code § 476.6(2) only provides for the inclusion of rate case expenses incurred "through the time period allowed by the Board in rendering a decision." Consumer Advocate contends that the statute provides that rate case expenses are to be recovered in the tariffs implementing the Board's final order. The statute does not contemplate recovery of rate case expenses associated with the rehearing of a final decision.

Consumer Advocate opposes the recovery of rate case expenses incurred subsequent to the final order in the next general rate case. Allowing the recovery would violate important ratemaking principles, including the test year matching principle and the prohibition against piecemeal ratemaking. Recovery of this single expense has the same flaw as the CAT, where each focuses on recovery of one item to the exclusion of all other items, especially those that could offset the need for the recovery.

Consumer Advocate also opposes inclusion of rate case expense in the CAT, if it is approved. Consumer Advocate argues that inclusion of the rate case expenses in the CAT is contrary to the stated intent of the CAT mechanism, which is to permit recovery of a return on and return of integrity capital investments. Inclusion of rate case expense in the CAT is not provided for in the proposed CAT surcharge tariff sheet and, if approved, the CAT surcharge should be used for recovery of the specific items intended.

Board Decision

Iowa Code § 476.6(5) (2005) provides that a utility shall file a report of expected expenses for litigating the case through the date of the Board's decision. The statute then provides that at the conclusion of the presentation of comments, testimony, exhibits, or briefs, the utility shall submit to the Board a listing of the utility's actual litigation expenses in the proceeding. As part of the findings in the final order, the Board is required to allow recovery of costs of the litigation expenses over

a reasonable period of time to the extent the Board deems the expenses reasonable and just.

Subrule 199 IAC 26.4(1), formerly 199 IAC 7.3(1), limits the company's rate case expense recovery in a rate case to the period from the date of the initial application through the date the utility's reply brief is filed. Subrule 199 IAC 26.4(4), formerly 199 IAC 7.3(4), limits recovery of Board staff and Consumer Advocate rate case expenses to the period stated in subrule 26.4(1) and provides that rate case expenses filed by the utility shall not include these items

On July 19, 1989, in Docket No. RPU-88-10, the Board issued an order that addressed the time period for recovery of rate case expenses. In that order, the Board stated that rate case expense is to be computed up to the date of the Board's final decision, citing Iowa Code § 476.6(8) (1989), now Iowa Code § 476.6(5) (2005).

The Board went on to state that:

"The rules [7.3(1) and 7.3(4)] identify the cut-off as the filing date of the utility's brief. The filing of the utility's reply brief is the cut-off date for allowable utility expenses. Additional recoverable Board expenses are incurred after the reply brief for review of the briefs and record in preparation of the final decision."

The Board then allowed recovery of Board and Consumer Advocate expenses incurred after the filing of the reply brief up to the date of the final order, which is what the utility had requested.

The main issue presented by Aquila in the waiver request is whether Iowa Code § 476.6(5) can reasonably be construed to include rate case expenses incurred

by the utility, Board staff, and Consumer Advocate that are associated with the rehearing of issues after the final order. The Board concludes that Iowa Code § 476.6(5) does not specifically limit the recovery of utility rate case expense to comments, testimony, exhibits, or briefs filed before the final order. The statute uses the term "decision" which is not necessarily limited to the final order but could reasonably be interpreted to include the Board's final decision in the docket, including a decision on rehearing.

Based upon the above analysis of the statute, the Board finds that § 476.6(5) authorizes the Board to allow recovery of rate case expense, including those expenses incurred by the utility, up through a decision on rehearing. This interpretation is supported by the prohibition in Iowa Code § 476.18 against recovery of legal fees and attorney fees incurred by a utility in an appeal in state or federal court of Board action (unless otherwise ordered by the Board). The Board considers the prohibition in § 476.18 to be the normal statutory cut-off date for rate case expense.

The Board recognizes that it adopted rules that limit recovery of rate case expenses to the period ending at the filing of the reply brief in the original case. The Board can waive this cut-off date where it finds that the additional expenses are reasonably incurred. In Docket No. RPU-88-10, the Board in effect waived the cut-off date and allowed recovery of Board staff and Consumer Advocate expenses incurred up until the final decision. Since the Board did not amend its rules after that order,

the cut-off date of reply briefs is still the rule and must be waived if Aquila is to be allowed to recover additional rate case expense.

Rather than make a decision prior to the hearing on rehearing, the Board will take the issue of recovery of additional rate case expense with the record on rehearing. The Board must determine whether the additional rate case expenses are reasonably incurred and to make that decision it will need additional information. To obtain the necessary information, Aquila and Consumer Advocate shall be required to file, prior to the hearing, the actual rate case expense from December 16, 2005, through the final order issued March 1, 2006, and then from that date through June 1, 2006. Aquila and Consumer Advocate shall also file an estimate of their expenses from June 1, 2006, to the filing of their reply briefs on rehearing.

Based upon consideration of the methods of recovery available to Aquila if additional rate case expense is allowed, the Board rejects Aquila's request for recovery of the additional rate case expenses through the CAT or deferral to the next rate case. It is not an appropriate method of recovery of rate case expense to allow it to be recovered in a yearly adjustment intended to include only integrity investments. Recovery of rate case expense would violate that primary rationale for approving a CAT mechanism and would amount to allowing recovery of almost any expense item outside of a rate case.

It is also not sound regulatory policy to allow rate case expense from this case to be deferred to the next general rate case. Deferral of these costs to the next rate

case would violate test year matching and would be single-issue ratemaking and retroactive ratemaking. The Board understands that the statute has exempted rate case expense from the single-issue ratemaking principle. However, the Board understands the statute to limit recovery of rate case expense to the compliance tariffs approved as a result of the docket in which those expenses were incurred. Rate case expenses are not the type of extraordinary expenses that justify deferral accounting treatment and recovery in a later general rate increase case.

Since the two methods of recovery proposed by Aquila are not acceptable, the only method the Board is aware of that is available to Aquila for recovery of any additional rate case expenses allowed in this case is through revised tariffs filed after the order on rehearing. The Board does not agree with Consumer Advocate that revised tariffs filed after the rehearing order would require a new notice. Any additional rate case expense allowed should be treated in the same manner as if an issue from the revenue requirement part of the case was being considered on rehearing. Any increase in rates ordered for revenue requirement issues would be recoverable without additional notice and additional rate case expense should receive similar treatment.

ORDERING CLAUSES

IT IS THEREFORE ORDERED:

1. The motion to dismiss filed by Consumer Advocate Division of the Department of Justice on May 3, 2006, is denied.

2. The request for waiver filed by Aquila, Inc., d/b/a Aquila Networks, on May 8, 2006, will be taken with the record in this case.

3. Aquila, Inc., d/b/a Aquila Networks, and the Consumer Advocate Division of the Department of Justice shall file on or before June 7, 2006, additional rate case expense information as described in this order.

UTILITIES BOARD

/s/ John R. Norris

/s/ Diane Munns

ATTEST:

/s/ Judi K. Cooper
Executive Secretary

/s/ Curtis W. Stamp

Dated at Des Moines, Iowa, this 1st day of June, 2006.