FEDERAL ENERGY REGULATORY COMMISSION
WASHINGTON, D.C. 20426

In Reply Refer To:
Office of Enforcement
Docket No. PA08-5-000
September 5, 2008

Aquila, Inc.
Attention: Mr. David Douglass
Transmission Regulatory Compliance Manager
750 N.W. Missouri Road
Lee's Summit, MO 64086-5720

Dear Mr. Douglass:

1. The Division of Audits within the Office of Enforcement (OE) has completed the audit of Aquila, Inc. (Aquila) for the period of January 1, 2005 through December 31, 2007. The enclosed audit report explains our audit findings and recommendations.

2. On August 21, 2008, you notified us that Aquila will not contest our audit findings and agrees to implement our recommendations. A copy of your response is attached to this report. I hereby approve the recommended corrective actions. Aquila should make quarterly filings describing how and when it plans to comply with the corrective actions, including dates it has completed each corrective action. The filings should be made no later than 30 days after the end of each calendar quarter, beginning with the first quarter after this audit report is issued, and continuing until all the corrective actions are completed.

3. The Commission delegated the authority to act on this matter to the Director of OE under 18 C.F.R. § 375.314 (2008). This letter order constitutes final agency action. You may file a request for rehearing with the Commission within 30 days of the date of this order under 18 C.F.R. § 385.713 (2008).

4. This letter order is without prejudice to the Commission's right to require hereafter any adjustments it may consider proper from additional information that may come to its attention. In addition, any instance of non-compliance not addressed herein or that may occur in the future may also be subject to investigation and appropriate remedies.

5. I appreciate the courtesies extended to the auditors. If you have any questions, please contact Mr. Bryan K. Craig, Director, Division of Audits at (202) 502-8741.

Sincerely,

Susan J. Court
Director
Office of Enforcement

Enclosure

Federal Energy Regulatory Commission

Audit of Market-based Rate Authority & Electric Quarterly Report Filing Requirements at Aquila, Inc.

Docket No. PA08-5-000
September 5, 2008

Office of Enforcement
Division of Audits

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I. Executive Summary

A. Overview

The Division of Audits within the Office of Enforcement (OE) has completed an audit of Aquila, Inc. (Aquila). The audit was initiated to evaluate Aquila's compliance with the: (1) requirements of its market-based rate (MBR) authorization and (2) Electric Quarterly Report (EQR) filing requirements under 18 C.F.R. § 35.10b (2007). The audit covered the period from January 1, 2005 through December 31, 2007.

B. Aquila, Inc.

Aquila is a Kansas City, Missouri, based electric and natural gas distribution company that serves approximately 900,000 customers in five Midwestern states. Currently, it provides electricity to customers in Colorado and Missouri and natural gas service to customers in Colorado, Iowa, Kansas, and Nebraska. Aquila gas utility divisions do not own or operate interstate natural gas pipelines, but the electric utilities located in Colorado and Missouri do participate in the transmission of electricity in interstate commerce. Prior to April 2007, Aquila also supplied electricity to customers in Kansas. The Aquila Kansas utility operations were sold to Mid-Kansas Electric Company, a coalition of six consumer-owned cooperatives that also own Sunflower Electric Power Corporation, a regional generation and transmission service provider.

In February 2007, Aquila announced the merger of its Missouri electric operations with Great Plains Energy (the holding company of Kansas City Power & Light Company (KCP&L)), and the sale of its Colorado electric operations and its natural gas operation in Colorado, Iowa, Kansas, and Nebraska to Black Hills Corp. Aquila, along with other parties involved, submitted the application for these acquisitions to the Federal Energy Regulatory Commission (Commission) in June 2007. The Commission authorized the disposition and acquisition of jurisdictional facilities on October 19, 2007.[1]

The assets of Aquila's Missouri electric operations merged with Gregory Acquisition, Corp., a wholly-owned subsidiary specifically formed for this acquisition. Aquila became a wholly-owned subsidiary of Great Plains Energy, operating as a single company with a single brand "KCP&L." KCP&L and Aquila operate separate control areas and each company's respective generation facilities are dispatched separately. However, KCP&L absorbed most of Aquila's Missouri electric operations employees and a large amount of Aquila's corporate-support or central services (accounting, call center,

[1] *Aquila, Inc.*, 121 FERC ¶ 61,069, at 61,376 (2007).

etc) employees who will continue to operate Aquila's facilities. This transaction was completed in July 2008.

MBR Authority

The Commission approved MBR authority for Aquila on December 14, 1998.[2] The Commission granted MBR authority to three divisions – Aquila Networks-Missouri Public Service (MPS (including St. Josephs Light & Power Company (St. Joseph)[3])), Aquila Networks-West Plains Energy-Kansas (WPK), and Aquila Networks-West Plains Energy-Colorado (WPC). The Commission accepted Aquila's MBR application with no additional restrictions other than directing Aquila to conform to the Commission's filing requirements and submit an updated market analysis every three years.

In December 2004, Aquila[4] submitted its second three-year market analysis. The Commission determined that Aquila passed the pivotal supplier screens in its control areas; however, it failed the wholesale market share screen for each of the four seasons in its Missouri (Aquila Networks-MPS) and Kansas (Aquila Networks-WPK) control areas. The failed wholesale market share screen led to a proceeding under section 206 of the Federal Power Act[5] to determine whether Aquila may continue to charge market-based rates. The order establishing a proceeding under section 206 also established a refund effective date.[6] During this proceeding the Commission prohibited Aquila from making MBR sales within its Missouri and Kansas control areas. Aquila opted to adopt the Commission's cost-based rate default formula and incorporated cost-based rates in its Missouri and Kansas control area tariffs that were conditionally approved on September 19, 2005.[7] The Commission terminated the section 206 proceeding on March 17, 2006.[8]

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[2] *UtiliCorp United, Inc.*, 85 FERC ¶ 61,343, at 62,329 (1998). Effective March 15, 2002, UtiliCorp United, Inc. changed its name to Aquila, Inc.

[3] *UtiliCorp United, Inc. and St. Joseph Light & Power Company*, 95 FERC ¶ 61,345 (2001). On June 4, 2001, the Commission authorized the commencement of the integrated operations of UtiliCorp and St. Joseph.

[4] "Aquila" in this paragraph collectively refers to Aquila, Inc.; Aquila Long Term, Inc.; Aquila Merchant Services, Inc.; Aquila Piatt County Power, L.L.C.; MEP Clarksdale Power, LLC; MEP Flora Power, LLC; MEP Investments, LLC; MEP Pleasant Hill Operating, LLC; and Pleasant Hill Marketing, LLC.

[5] 16 U.S.C. § 824e (2000).

[6] *Aquila, Inc.*, 111 FERC ¶ 61,030, at 61,073 (2005).

[7] *Aquila, Inc.*, 112 FERC ¶ 61,307, at 62,368 (2005).

Affiliates

During the audit period, all Aquila affiliates that had MBR authority have been dissolved and their respective MBR authorities have been terminated as follows:

- Aquila Long Term, Inc.; terminated May 17, 2007[9]
- Aquila Merchant Services, Inc. (AMS); terminated June 12, 2007[10]
- Aquila Piatt County Power, LLC; terminated June 15, 2006[11]
- MEP Clarksdale Power, LLC; terminated June 1, 2007[12]
- MEP Flora Power, LLC; terminated June 15, 2006[13]
- MEP Investments, LLC; terminated November 7, 2005[14]
- MEP Pleasant Hill Operating, LLC; terminated November 7, 2005[15]
- Pleasant Hill Marketing, LLC; terminated November 7, 2005[16]

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[8] *Aquila, Inc.*, 114 FERC ¶ 61,281, at 61,921 (2006).

[9] *Aquila Long Term, Inc.*, Docket No. ER07-739-000 (May 17, 2007) (unpublished letter order).

[10] *Aquila Merchant Services, Inc.*, Docket No. ER07-860-000 (June 12, 2007) (unpublished letter order).

[11] *Aquila Piatt County Power, LLC*, Docket No. ER06-975 (June 15, 2006) (unpublished letter order).

[12] *MEP Clarksdale Power, LLC*, Docket No. ER07-802-000 (June 1, 2007) (unpublished letter order).

[13] *MEP Flora Power, LLC*, Docket No. ER06-974-000 (June 15, 2006) (unpublished letter order).

[14] *MEP Investments, LLC*, Docket No. ER06-179-000 (November 7, 2005) (unpublished letter order).

[15] *MEP Pleasant Hill Operating, LLC*, Docket No. ER06-180-000 (November 7, 2005) (unpublished letter order).

[16] *Pleasant Hill Marketing, LLC*, Docket No. ER06-181-000 (November 7, 2005) (unpublished letter order).

C. Summary of Compliance Findings

Below is a summary of audit staff's compliance findings. A more detailed discussion of audit staff's findings is included in Section III. Audit staff found five areas of non-compliance related to Aquila's EQR reporting and distribution of employee pay and expense requirements:

- *Reporting of Bookouts and Power Sales*: Aquila did not report 584 bookouts and 4,907 bilateral physical power sale transactions sourced and delivered external to the Aquila control area in its EQR filings from January 1, 2005 through December 31, 2007. Order No. 2001[17] requires public utilities to electronically file an EQR summarizing the contractual terms and conditions in their agreements for all jurisdictional services (including market-based power sales, cost-based power sales, and transmission service) and transaction information for short-term and long-term market-based and cost-based power sales during the most recent calendar quarter, including bookouts.

- *Aquila's Cost-based Sales*: During the audit period, Aquila misreported its Kansas municipal cost-based sales as market-based and failed to report all of its Missouri and Kansas cost-based sales for resale in its EQR filings. As stated above, Order No. 2001[18] requires public utilities to electronically file an EQR summarizing the contractual terms and conditions in their agreements for all jurisdictional services (including market-based power sales, cost-based power sales, and transmission service) and transaction information for short-term and long-term market-based and cost-based power sales during the most recent calendar quarter. Additionally, Order No. 2001, Attachment C, provides a description of the contract data and transaction data fields to be filed in the EQR.

- *EQR Reporting Errors*: Aquila incorrectly reported in its first quarter 2005 through the fourth quarter 2006 EQR filings: 1) current effective contracts, 2) Data

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[17] *Revised Public Utility Filing Requirements*, Order No. 2001, FERC Stats. & Regs., Regulations Preambles, ¶ 31,127 (2002), *reh'g denied*, Order No. 2001-A, 100 FERC ¶ 61,074 (2002), *reconsideration and clarification denied*, Order No. 2001-B, 100 FERC ¶ 61,342 (2002), *order directing filings*, Order No. 2001-C, 101 FERC ¶ 61,314 (2002), *order directing filings*, Order No. 2001-D, 102 FERC ¶ 61,334 (2003), *order refining filing requirements*, Order No. 2001-E, 105 FERC ¶ 61,352 (2003), *clarification order*, Order No. 2001-F, 106 FERC ¶ 61,060 (2004), *order adopting dictionary*, Order No. 2001-G, 120 FERC ¶ 61,270 (2007), *clarification order*, Order No. 2001-H, 121 FERC ¶ 61,289 (2007).

[18] *Id*.

Universal Numbering System (DUNS) numbers, 3) contract information, and 4) affiliate identification. Order No. 2001, Attachment C, provides a description of the contract data and transaction data fields to be filed in the EQR.[19] Furthermore, Order No. 2001-H, EQR Data Dictionary, Version 1.0, provides clarity and guidance for preparing and filing the EQR.[20]

- *Form No. 714*: Aquila's hourly system lambda values reported in its Form No. 714, Annual Electric Control and Planning Area Report (Form No. 714) were incorrectly reported for filing years 2005, 2006, and 2007. Aquila reported an hourly average cost for system lambda whereas the Form No. 714, Part II – Schedule 6 instructions require the use of system lambda.

- *Cost Allocation*: Aquila did not charge its unregulated affiliate, AMS, for the actual time Aquila's VP Energy Resources spent working on unregulated affiliate tasks, nor has it conducted a time study to support an alternate method of allocation as required by 18 C.F.R. Part 101 (2007).

D. Summary of Recommendations

Below is a summary of audit staff's recommendations to remedy the findings in this report. Detailed recommendations are included in Section III.

- Establish written procedures to ensure that Aquila's EQR reports include bookout and power sale transactions; current effective contracts; correct DUNS numbers; accurate and complete contract and transaction information; proper identification of an affiliate, product type name, and rate description; and Missouri full requirement customers handled by Aquila's Customer Accounts Services group.[21] These procedures should include quality control procedures to review all contract and transaction information for accuracy and completeness prior to filing the EQR with the Commission.

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[19] *Revised Public Utility Filing Requirements*, Order No. 2001, 99 FERC ¶ 61,107 (2002).

[20] *Order on Rehearing and Clarification*, Order No. 2001-H, 121 FERC ¶ 61,289, at 62,563 (2007).

[21] Aquila's Kansas utility operations were sold to Mid-Kansas Electric Company, a coalition of six consumer-owned cooperatives that also own Sunflower Electric Power Corporation, in April 2007. Therefore, audit staff's recommendation to establish written procedures does not include the Kansas full and partial requirements municipal customers.

- Identify all bookout and power sale transactions that were not submitted with Aquila's EQR filings since January 1, 2003.

- File revised EQR filings from January 1, 2003, forward to correctly report all bookout and power sale transactions, current effective contracts, DUNS numbers, contract information, affiliate identification, the product type name and rate description as cost-based for Aquila's Kansas municipal contracts, and all Missouri and Kansas full and partial requirement customer contracts and transactions.

- Recalculate hourly system lambda values for each of Aquila's Kansas and Missouri control areas for reporting years 2004, 2005, 2006, and 2007 and file revised Form No. 714 filings accordingly. Additionally, include in the filings the updated economic dispatch algorithm used by Aquila to calculate system lambda values as instructed within the Form No. 714.

- Strengthen written procedures to ensure that Aquila's VP Energy Resources appropriately assigns time spent between regulated and unregulated operations. Communicate these procedures to Aquila's VP Energy Resources and provide training to ensure procedures are followed.

E. Compliance and Implementation of Recommendations

Audit staff further recommends that Aquila:

- Submit for audit staff's review Aquila's plans for implementing audit staff's recommendations. Aquila should provide these plans to audit staff within 30 days of the issuance of the Final Audit Report in this docket.

- Submit quarterly reports to audit staff describing Aquila's progress in completing each corrective action recommended in the Final Audit Report in this docket. Aquila should make the quarterly filings no later than 30 days after the end of each calendar quarter, beginning with the first quarter after the Final Audit Report in this docket is issued, and continuing until Aquila completes all the recommended corrective actions.

- Submit copies of any written policies and procedures developed in response to the recommendations in the Final Audit Report. These policies and procedures should be submitted for audit staff's review in the first quarterly filing after these products are completed by Aquila.

- Due to the number of EQR reporting errors and overarching problem of EQR

quality control, audit staff recommends Aquila conduct annual internal audits for the next two years to examine existing internal procedures used to compile and review its EQR and ensure compliance with Commission EQR rules and regulations.

II. Introduction

A. Objectives

The objectives of the audit were to determine how and whether Aquila complied with all relevant requirements associated with its MBR authorization and EQR reporting. To accomplish the objectives, audit staff reviewed data and evaluated actions taken by Aquila prior to and during the period of the audit, i.e., January 1, 2005 through December 31, 2007.

B. Scope and Methodology

The audit of Aquila included the operation of its electric utility divisions – Aquila Networks-MPS, Aquila Networks-WPC, and Aquila Networks-WPK. As mentioned above, Aquila sold its Kansas utility operations in April 2007; however audit staff did include this division's operations in its assessment for the audit period. Audit staff's review of Aquila did not include Aquila's marketing affiliate operations due to each receiving Commission approval to terminate its respective MBR authorization.

To accomplish our audit objectives we performed the following procedures:

- Prior to commencement of the audit on October 17, 2007, reviewed publicly-available materials, including, Aquila's filings to the Commission (FERC Form No. 1 (Form No. 1), prior audits, compliance filings, etc); select filings to the Securities and Exchange Commission (10K and 10Q); and materials available on Aquila's Open Access Same-time Information System (OASIS).

- Reviewed Aquila's original MBR application, Commission approval and conditioning of Aquila's MBR, triennial market power updates, approval of cost-based rates, and other filings related to Aquila's MBR authorization.

- Reviewed EQR contract and transaction filings to determine if Aquila accurately reported EQR information.

- Examined market-based and cost-based sale transactions into and out of Aquila's Kansas and Missouri control areas.

- Conducted interviews, teleconferences, and held several meetings with Aquila personnel to discuss processes, procedures, operations, and preliminary and final observations.

Audit staff also performed a number of specific actions to evaluate Aquila's compliance with all relevant requirements of the two areas identified within the scope of this audit. A summary of these actions follows.

Audit staff conducted an on-site visit the week of December 10-14, 2007 to perform additional audit field work prior to the approval of the sale of Aquila to Great Plains Energy and Black Hills Corp. While on-site, audit staff evaluated physical separation, observed the procedures used by Aquila merchant function employees to develop and transact power sales, extensively discussed with Aquila personnel the use of such procedures and control processes to ensure compliance with Commission MBR requirements, discussed Aquila's and its affiliates' MBR authority and changes that have occurred since gaining Commission approval, and discussed the administration of Aquila's EQR and applicable codes of conduct.

In order to evaluate compliance with MBR requirements, audit staff reviewed Aquila's MBR tariffs on file, as well as filings and subsequent Commission orders, to determine what conditions, waivers, etc., were placed on Aquila. Audit staff reviewed Aquila's filed EQRs to distinguish market-based and cost-based sales and requested from Aquila information about generated and purchased energy, energy transfers and purchased transmission, and customer invoices to test 14 contracts and 50,112 transactions for accurate application of tariffs and approved rates. Discussions were held while on-site with Aquila's Director, Wholesale Energy; VP Energy Resources; traders; and Director, Asset Optimization to assess and compare the company's application of tariffs, document market strategy within and outside of an organized market, understand the use of transmission, comprehend optimization of generation assets, and observe the administration of Aquila's code of conduct.

With respect to EQR filing requirements, audit staff reviewed Aquila's EQR filings and identified anomalous contract and transaction data in the filings. While on-site, audit staff observed and documented filing procedures and control procedures used to ensure compliance with EQR filing requirements. Extensive discussions were held with Aquila's Sr. Contract Administrator to evaluate Aquila's quality controls, risk management tools, data flow, and the review process to verify accuracy and comprehensiveness of Aquila's EQR. Audit staff also reviewed supporting documentation for EQR data, including contracts and invoices to ensure accuracy of the contract and transaction information reported in the EQR. Audit staff randomly sampled 10 contracts and their correlating invoices from Aquila's 1st Quarter 2007 EQR filing to verify accurate reporting of contract data and transaction data in the EQR.

Sales at a Metered Boundary

Audit staff reviewed Aquila's compliance with certain provisions of Order No. 697 (effective September 18, 2007), specifically provisions applicable to a seller that had mitigated the presumption of market power through the implementation of cost-based tariffs within its control area.[22] Order No. 697 requires that sales of energy and capacity at the metered boundary between the seller's mitigated balancing authority area and a balancing authority area where the seller has been granted MBR authority (border sales) meet certain requirements. Order No. 697 requires companies making such border sales to maintain from the date of sale all information related to the sale demonstrating that the sale was made at the metered boundary, that the sale was not intended to serve load within the mitigated market, and that no affiliate of the mitigated seller would sell the same power back into the mitigated seller's mitigated market. Order No. 697-A modified these requirements on rehearing. Under the terms of Order No. 697-A, border sales of energy and capacity are permissible where the seller has been granted MBR authority provided: (i) legal title of the power sold transfers at the metered boundary of the balancing authority area where the seller has market-based rate authority; and (ii) the seller and its affiliates do not sell the same power back into the balancing authority area where the seller is mitigated. The seller must retain, for a period of five years from the date of the sale, all data and information related to the sale that demonstrates compliance with items (i) and (ii) above.[23]

During the course of the audit, Aquila was prohibited from making MBR sales within its Missouri and Kansas control areas effective June 27, 2005. Aquila sold its Kansas utility operations in April 2007 and all Aquila affiliates terminated their respective MBR authorities on or before June 12, 2007. Aquila made no purchases from affiliates, with the exception of the summer of 2005 when it purchased firm energy from AMS through a Commission approved agreement during June, July, August, and September 2005.[24] Therefore, by the time the additional record retention requirements of

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[22] *Market-based Rates for Wholesale Sales of Electric Energy, Capacity, and Ancillary Services by Public Utilities*, 119 FERC ¶ 61,295 (2007) (Order No. 697), *Order on Rehearing and Clarification*, Order No. 697-A, FERC Stats. & Regs., Regulations Preambles, ¶ 60,149 (2008) (Order No. 697-A).

[23] Order No. 697-A at P 339.

[24] *Aquila Merchant Services, Inc.*, Docket No. ER05-472-000, at P 1 (April 7, 2005) (unpublished letter order approving AMS to provide Aquila up to 225 MW of capacity with an option to purchase up to 225 MWh per hour of associated station firm energy from the Crossroads Energy Center in Clarksdale, Mississippi during June, July, August, and September 2005).

Order No. 697 became effective on September 18, 2007, Aquila had sold its Kansas utility operations and each of its marketing affiliates had terminated its MBR authority. As a result, during the audit period, the additional record retention requirements applied only to Aquila's sales within Aquila's Missouri control area and its neighboring metered boundaries.

Aquila serves full requirements customers within its Missouri control area under pre-existing cost-based agreements. During the audit period, no other wholesale sales were made by Aquila or other affiliates within Aquila's Missouri control area. All of Aquila's MBR sales occurred at one of its metered boundaries or at a specific delivery point outside of its Missouri control area with the purchase of appropriate transmission. Aquila's existing Missouri electric utility operations' metered boundaries are with Associated Electric Cooperative, Inc.; MidAmerican Energy Co.; AmerenUE; Westar Energy, Inc.; KCP&L; City of Independence Power & Light Department; and Empire District Electric Co.

Audit staff noted that Aquila does not maintain written procedures to ensure compliance with Order No. 697. However, Aquila's Director of Wholesale Energy stated in writing that all Aquila traders, operators, and schedulers were aware that MBR sales could only occur outside of Aquila's control areas. In addition, all transactions received a North American Electric Reliability Corporation (NERC) tag and discussions were held with counterparties on recorded phone lines prior to all completed sales to verify the ultimate sink location. The recordings are maintained for two years. Transmission is then requested or purchased to move all energy sales from the Aquila system to the ultimate load.

Audit staff examined Aquila's energy sale transactions made either inside or at the metered boundary of its Missouri control area for the randomly chosen month of October 2007 (a total of 1,326 transactions at a value of $6.8 million). The month of October 2007 was chosen since it fell between Order No. 697's effective date, September 18, 2007 and audit staff's field work completion date of December 31, 2007. Audit staff evaluated the point of delivery for all transactions and determined that all Missouri MBR sales were made at a metered boundary between Aquila and a neighboring control area. All other sales for resale in Missouri were to full requirements customers under pre-existing cost-based agreements. Subsequent to the effective date of Order No. 697, Aquila no longer had an affiliate with MBR authority with which it could engage in sales of energy or capacity. Audit staff found no evidence that Aquila engaged in improper sales.

III. Findings and Recommendations

1. Reporting of Bookouts and Power Sales

Aquila did not report 584 bookouts and 4,907 physical bilateral power sale transactions sourced and delivered external to the Aquila control area in its EQR filings from January 1, 2005 through December 31, 2007.

Pertinent Guidance

18 C.F.R. § 35.10(b) (2007) requires each public utility to file an updated EQR with the Commission covering all services it provides pursuant to this part, for each of the four calendar quarters of each year, in accordance with the following schedule: for the period from January 1 through March 31, file by April 30; for the period from April 1 through June 30, file by July 31; for the period July 1 through September 30, file by October 31; and for the period October 1 through December 31, file by January 31. EQRs must be prepared in conformance with the Commission's software and guidance posted and available for downloading from the Commission's Web site (http://www.ferc.gov).

Order No. 2001 requires public utilities to electronically file an EQR summarizing the contractual terms and conditions in their agreements for all jurisdictional services (including market-based power sales, cost-based power sales, and transmission service) and transaction information for short-term and long-term market-based and cost-based power sales during the most recent calendar quarter, including bookouts. Furthermore, Order No. 2001 defines bookouts as the "offsetting of opposing buy-sell transactions", and provides hypothetical examples of booked out transactions in which all or part of the delivery obligation of the transactions is offset.[25] Order No. 2001-A, Order No. 2001-D, and Order No. 2001-F further clarify and discuss the requirement to report booked out transactions.[26]

The Commission has stated that "the market-based rate tariff, with its appurtenant conditions and requirement for filing transaction-specific data in EQRs, is the filed

[25] Order No. 2001 at 30,116.

[26] Order No. 2001-A at 61,285, Order No. 2001-D at 62,138, and Order No. 2001-F at 61,192.

rate."[27] The Commission noted in Order No. 697-A that "the Ninth Circuit has explained that the reporting requirements are 'integral' to the market-based rate tariff and that they, together with the Commission's initial approval of market-based rate authority, comply with the FPA's requirements."[28]

Background

While examining Aquila's EQR filings from January 1, 2005 through December 31, 2007, audit staff noted that Aquila did not report any bookout transactions. Interviews and data responses confirmed that Aquila did not report any bookouts in Aquila's EQR since it began filing in 2003. According to Aquila's Sr. Contract Administrator, Aquila did not submit bookout transactions in its EQR filings because it assumed the EQR only captured physical transactions that "touched its company's control area." Audit staff verified that these transactions were properly accounted for and correctly reported in Aquila's Form No. 1. Contrary to Aquila's assumption, Order No. 2001 requires *all* transaction information for short-term and long-term market-based and cost-based power sales to be included in a company's EQR filing including bookouts.

Audit staff requested Aquila to identify all bookout transactions from January 1, 2005 through December 31, 2007, that did not "touch" Aquila's control area. Aquila's assessment identified two types of bookout transactions that were not reported in its EQR. Additionally, it identified a third type of transaction, power sales that were sourced and delivered external to the Aquila system, which should have been reported as well. For purposes of this finding, these three types of transactions will be identified as follows:

<u>Bookouts</u>

- Type A – Power sale transactions at a Hub/Regional Transmission Organization (RTO) where purchase and sale cleared at the same location. For example, purchased power at the RTO day-ahead price at a location within the RTO footprint and sold to the same RTO in real-time for delivery at the same location.

- Type B – Physical bilateral power transaction that was unable to be delivered. For example, purchase from a customer with liquidated damage terms and cut by transmission constraints and sold back to the same customer that had sold it to Aquila with no physical delivery.

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[27] Order No. 697-A at P 434.

[28] *Id*. at P 458 (footnote omitted).

Energy Sales

- Type C – Physical bilateral power sale transaction that was sourced and delivered external to the Aquila system. For example, a transaction with power sourced from a RTO with delivery at another non-adjacent RTO external to the Aquila system.

The table below quantifies the number of transactions Aquila identified in 2005, 2006, and 2007 that should have been reported as bookouts or power sales; the combined megawatts associated with those transactions; and the total correlated dollar values. The Type A or C transactions were identified by Aquila that should have fallen into either Type A or C as sales to PJM Interconnection, LLC (PJM) sold under the Contract ID of "Enabling Agreement." Aquila was unable to determine if those transactions were Type A or Type C due to it not retaining the information for transactional point of receipt. Regardless, all transactions were required to be submitted within Aquila's EQR.

Aquila Identified Transactions Not Reported in its EQR

Transaction Type	Total Number of Transactions	Total Number of Megawatts	Total Dollar Value
2005			
Type A	133	8,621	249,929
Type B	296	18,946	1,048,086
Type C	1,662	272,442	20,151,356
Type A or C	1,304	86,354	5,287,891
2005 Totals	3,395	386,363	$26,737,262
2006			
Type A	31	1,745	74,348
Type B	52	36,708	3,069,436
Type C	406	67,674	4,782,262
Type A or C	750	50,813	3,026,615
2006 Totals	1,239	156,940	$10,952,661
2007			
Type A	21	1,035	63,778
Type B	51	4,805	332,808
Type C	385	43,548	2,744,062
Type A or C	400	33,267	1,918,601

Aquila Identified Transactions Not Reported in its EQR			
Transaction Type	**Total Number of Transactions**	**Total Number of Megawatts**	**Total Dollar Value**
2007 Totals	857	82,655	$5,059,249
Total Bookouts	**584**	**71,860**	**$4,838,385**
Total Energy Sales	**4,907**	**554,098**	**$37,910,786**

Aquila's total number of transactions has decreased considerably since 2005 – an indication that Aquila has been winding down operations attributable to its merger with Great Plains Energy and Black Hills Corp. Nevertheless, Aquila's operations would have been in full swing prior to 2005 and bookout and power sale transactions that should have been reported would have numbered in the thousands per filing year. Therefore, audit staff recommends that Aquila revise all EQR filings since it began reporting in 2003 to include all bookouts and power sale transactions prior to its acquisition.

Recommendations

We recommend Aquila:

1. Establish written procedures to ensure that Aquila's EQR reports include all bookout and power sale transactions accurately and completely.

2. Identify all bookout and power sale transactions that were not submitted with Aquila's EQR filings since January 1, 2003.

3. File revised EQR filings to include all bookout and power sale transactions from January 1, 2003 forward.

2. Aquila's Cost-based Sales

During the audit period, Aquila misreported its Kansas municipal cost-based sales as market-based and failed to report all of its Missouri and Kansas cost-based sales for resale in its EQR filings.

Pertinent Guidance

Order No. 2001 requires public utilities to electronically file an EQR summarizing the contractual terms and conditions in their agreements for all jurisdictional services (including market-based power sales, cost-based power sales, and transmission service) and transaction information for short-term and long-term market-based and cost-based power sales during the most recent calendar quarter.

Background

Misreported Sales

Audit staff's analysis of Aquila's MBR authority included the review of Aquila's original MBR application, subsequent filings, Commission approval of its MBR application, and its filings of Form No. 1 and EQR. In audit staff's examination of the EQR, audit staff noted what appeared to be market-based sales in its Kansas control area made during the period when Aquila was prohibited from doing so. Specifically, Aquila was reporting a product type name and rate description of market-based sales contracts with each municipal located within Aquila's Kansas control area. In response to audit staff's data request, Aquila responded that it did not make any MBR power sales in its Kansas control area. Aquila further stated that it had made sales to the Kansas municipals under stand-alone tariffs, referenced as FERC Rate Schedules 121-132.

Audit staff analyzed each Kansas municipal service agreement, Aquila Energy Resources' transactional workbooks calculating hourly incremental costs, and invoices to verify that charges to the Kansas municipals were in fact at cost-based rates. Furthermore, interviews with Aquila's Sr. Contract Administrator identified how the mistake occurred. Aquila's Sr. Contract Administrator explained that when the 12 Kansas municipal contracts were entered into the filing before the Commission, it had made the statement that "Aquila, Inc. respectfully submits an original and six copies of the following additional rate schedule (the "Agreement")" with the footnote of "Aquila is submitting this Agreement as stand-alone rate schedule because its market-based rate

power sales tariff is currently the subject of a Section 206 investigation…"[29]. Aquila's Sr. Contract Administrator inadvertently gathered the "market-based rate" phrase and reported each Kansas municipal contract as market-based. Since the Sr. Contract Administrator is the lone person responsible for compiling, reviewing, and filing the EQR, the mistake went undetected and continued with every following quarterly filing.

Aquila's Sr. Contract Administrator stated that it filed these transactions in the EQR as market-based rate sales in error and plans to revise its EQR data accordingly.

Sales for Resale

While examining Aquila's Form No. 1 filings, audit staff noted that Aquila reported sales for resale for particular Missouri and Kansas purchasers during the audit period. The Missouri sales for resale where made to Aquila's Missouri full requirements municipal customers and the Kansas sales for resale where made to Aquila's Kansas full and partial requirements municipal customers. Aquila transacted all of the sales for resale under pre-existing cost-based agreements on file with the Commission. Audit staff cross-checked Aquila's 2006 Form No. 1 Missouri and Kansas purchaser names with the customer names reported in its 2006 EQR filings to determine if Aquila was reporting all sales within its EQR filings. With the exception of two Kansas partial requirements customers for whom it reported sales at market-based rather than cost-based rates in its EQR, Aquila did not report the associated contracts and sales transactions for its Kansas partial and full requirements customers or its Missouri full requirements customers in its EQR.

Aquila's Sr. Contract Administrator stated in writing that the FERC rate schedules referenced in Aquila's Form No. 1 are the rate schedules for its full and partial requirements customers who are billed by monthly meter readings processed by Aquila's Customer Accounts Services group. The relationships with these municipalities are handled via customer service managers. As a result, the municipalities are billed in essentially the same manner as a local retail customer. Aquila has had this procedure in place for many years.

Aquila further explained that Aquila's merchant function, Energy Resources, does not market power to these municipal customers. Thus, account billing information is not readily available to the accounting group that supports the Energy Resources group. When gathering information for the EQRs, under its procedures, Aquila's staff gathers only information on sales completed by the Energy Resources group.

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[29] *Aquila, Inc.*, Docket No. ER05-999-000 through ER05-1008-000, at 1 (May 23, 2005), *Aquila, Inc.*, Docket No. ER05-1121-000, at 1 (June 17, 2005), and *Aquila, Inc.*, Docket No. ER05-1148-000, at 1 (June 27, 2005).

Through the process of this audit, Aquila has come to understand that it should have reported its cost-based sales as cost-based and included its other full and partial requirements sales in its EQRs.

Recommendations

We recommend Aquila:

4. Modify its EQR procedures to include all relevant sales information from the Customer Accounts Services group for Aquila's Missouri full requirement customers.

5. File revised EQR filings to include all Missouri and Kansas full and partial requirement customer contracts and transactions from January 1, 2003 forward and accurately report its 12 Kansas municipal cost-based sales as cost-based within the fields product type name and rate description.

3. EQR Reporting Errors

Aquila incorrectly reported in its first quarter 2005 through the fourth quarter 2006 EQR filings: 1) current effective contracts, 2) Data Universal Numbering System (DUNS) numbers, 3) contract information, and 4) affiliate identification.

Pertinent Guidance

Order No. 2001 revised the Commission's filing requirements to require public utilities to electronically file quarterly reports summarizing pertinent data about their currently effective contracts (contract data) and data about wholesale power sales they made during the reporting period (transaction data). Order No. 2001, Attachment C, provides a description of the contract data and transaction data fields to be filed in the EQR.[30] Attachment C provides definitions for the following contract data fields:

Contract Information	
Information	**Definition**
Customer company name	Name of company (For consistency sake, it must be represented the same as it is listed in the DUNS Report).
Customer DUNS number	DUNS Number for Company Unique Identification
Contract execution date	Date contract was signed by contracting parties.
Class name	Transmission service class provided as defined in OASIS. Name of class. Valid entries are "Firm", "Non-Firm", "TTC", "Secondary", "N/A", or {registered}.
Term name	Name for term. LT = Long-Term (>= one year), ST= Short-Term (< one year).
Contract affiliate	This is a flag to determine if the customer is an affiliate. Set to Yes if the customer is an affiliate of the provider.

Furthermore, Order No. 2001-H, EQR Data Dictionary, Version 1.0, provides clarity and guidance for preparing and filing the EQR.[31]

[30] Order No. 2001, 99 FERC ¶ 61,107, at 30,116 (2002).

[31] *Order on Rehearing and Clarification*, Order No. 2001-H, 121 FERC ¶ 61,289, at 62,563 (2007).

Background

Aquila initially prepared for filing an EQR in early 2003 and commenced reporting with its second quarter 2003 submission. During its initial phase, Aquila states it undertook great effort to correctly identify and file contract and transaction data as required by the Commission. At that time, Aquila designated the Sr. Contract Administrator as the lone person responsible for managing its EQR compilation, review, and filing. Since 2003 Aquila has revised its process minimally to maintain accurate and consistent information.

Audit staff has identified four areas of non-compliance with Aquila's EQR filings, including: 1) the reporting of current effective contracts, 2) incorrect DUNS numbers, 3) incorrect reporting of contract information, and 4) incorrect affiliate identification. Each of these is discussed in detail below.

Current Effective Contracts

Audit staff's initial review of Aquila's EQR filings identified that Aquila reported its contract information without contract termination dates. Therefore, audit staff held discussions with Aquila staff to determine if Aquila reported effective contract information in its EQR filings. Aquila's Sr. Contract Administrator stated that it is known or is believed that many of Aquila's counterparties are no longer in business or may have been bought by another company. As a result, Aquila reported many dated service agreements with various counterparties that may or may not have been transacted against since the mid-to-late 1990s that have never been terminated. Audit staff requested Aquila to identify those contracts that could be eliminated from its EQR filings and Aquila documented 179 ineffective contracts.

DUNS Numbers

Aquila's EQR filings from January 1, 2005, through December 31, 2006, inconsistently identified, under the same DUNS number, customer company names throughout its contract and transaction spreadsheets. For example, a company DUNS number of "015635220" was listed as Constellation Energy Commodities Group Inc., while other times it was listed as Constellation Power Source. Another example was DUNS number "006982151" for Columbia Energy Power Marketing Corp. and Columbia Power Marketing Corp. Additionally, Aquila reported more than 200 transactions per quarter with a customer DUNS number of "000000000," used six DUNS numbers more than once for more than one company, and a spot check of reported DUNS numbers against the Dun & Bradstreet website (http://www.dnb.com/us/) resulted in numerous instances of invalid DUNS numbers.

According to data responses provided by Aquila's Sr. Contract Administrator, Aquila admits to "not being certain how to best identify a correct DUNS number for a company." Aquila initially used the Transmission Service Information Service site (http://reg.tsin.com/query/default.asp) in 2003 to search for and obtain DUNS numbers. However, it never switched to obtaining DUNS numbers from the Dun & Bradstreet site (http://www.dnb.com/us/) or followed Commission guidance for identifying DUNS numbers.

Aquila has adequately explained some of the invalid DUNS numbers as companies that are no longer in business or who have changed their name; yet, many of the companies for which Aquila reported a DUNS number of "000000000" are in business and do have a valid DUNS number. Aquila is required to maintain customer company names as represented in the DUNS report maintained by Dun & Bradstreet and update its EQR whenever changes occur.

Reporting Contract Information

Audit staff's random review of EQR contract data requested from Aquila found inaccurately reported data for Connectiv Energy Supply, Inc. (Connectiv) and Allegheny Energy Supply Company, LLC (Allegheny). Specifically, the contract execution dates located on the signed Connectiv and Allegheny contracts were shown as March 8, 2000, but were reported in the EQR as March 23, 2000 and March 20, 2000, respectively. In addition, the filed EQRs did not reflect the Connectiv, Allegheny, and Sunflower Electric Power Corp. contracts as short-term firm point-to-point transmission service.

Affiliate Identification

Aquila reported Aquila Power Corp. as an affiliate for two of three point-to-point transmission contracts within each EQR filing. According to Aquila's Sr. Contract Administrator, the contract in question was originally a service agreement between Aquila Power Corp. and St. Joseph. At the time the contract was executed Aquila Power Corp. and St. Joseph were not affiliates. This information was inadvertently carried forward and was incorrectly reported with an 'N' designation in the affiliate field since it began reporting EQRs in 2003.

In addition to Aquila's misidentification of its affiliates, it did not update the customer name of Aquila Power Corp. to Aquila Merchant Services, Inc.[32] Regardless,

[32] A Notice of Succession was filed with the Commission on February 5, 1999, to change Aquila Power Corp.'s name to Aquila Energy Marketing Corporation, effective January 12, 1999. Effective March 1, 2002, Aquila Energy Marketing Corporation merged into Aquila, which then changed its name to Aquila Merchant Services, Inc.

each of the three Aquila Power Corp. contracts were identified on Aquila's list of ineffective contracts.

Recommendations

We recommend Aquila:

6. Establish written procedures to ensure that Aquila reports contract and transaction data accurately and completely, consistent with the Commission's EQR filing guidance. These procedures should include quality control procedures to review all contract and transaction information prior to filing.

7. Eliminate ineffective contracts from Aquila's EQR filings that were identified by Aquila during the audit.

8. Examine all customer company names and DUNS numbers reported in Aquila's EQRs to ensure accurate and consistent use of customer names for the same DUNS number and to ensure customer company names are represented with the correct DUNS number as maintained by Dun & Bradstreet.

9. Identify all customer company contracts with a reported DUNS number of "000000000" and report an accurate DUNS number. EQR filings that are missing a DUNS number are considered incomplete.

10. Review contract information reported in Aquila's 1st Quarter 2007 and 2008 EQRs to ensure accurate and complete information is being reported.

11. File revised EQR filings from January 1, 2003, forward to correctly report current effective contracts, DUNS numbers, contract information, and affiliate identification.

4. Form No. 714

Aquila's hourly system lambda values reported in its Form No. 714, Part II – Schedule 6, were incorrectly reported for filing years 2005, 2006, and 2007.

Pertinent Guidance

18 C.F.R. § 141.51(a)(1) (2007) requires any electric utility, as defined by section 3(4) of the Public Utility Regulatory Policies Act,[33] operating a control area, and any group of electric utilities, which by way of contractual arrangements operates as a single control area, must complete and file the applicable schedules in Form No. 714 with the Commission. The Form No. 714 instructions state, among other things, that in each balancing authority area there is generally one electric utility charged with operating the balancing authority area and its associated automatic generation balancing authority equipment. It is that utility's responsibility to complete Part II of the Form No. 714.

Specifically, Part II – Schedule 6 instructions require the balancing authority to provide the area's system lambda, in dollars per megawatt-hour (MWh), calculated for each hour of the day starting with 1 a.m. on January 1. This schedule will have 365 records (or 366 for a leap year) with 24 hourly lambda values reported per day for each day of the year. For balancing authority areas where demand following is primarily performed by thermal generating units, the system lambda is derived from the economic dispatch function associated with automatic generation control performed at the balancing authority area's controlling utility or pool control center. Excluding transmission losses, the fuel cost ($/hr) for a set of on-line and loaded thermal generating units (steam and gas turbines) is minimum[34] when each unit is loaded and operating at the same incremental fuel cost ($/MWh)[35] with the sum of the unit loadings (MW) equal to the system demand plus the net of interchange with other balancing authority areas. This single incremental cost of energy is the system lambda. System lambdas are likely recalculated many times in one clock hour. However, the indicated system lambda

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[33] 16 U.S.C. 2602.

[34] Some utilities may also include variable operation and maintenance costs that they consider "dispatchable." Therefore the costs to be minimized could include a variable operation and maintenance component as well as the fuel costs.

[35] Because unit heat rates and fuel costs vary, some units may not be able to operate at the same incremental fuel cost as the other units and, thus, those units may be loaded differently.

occurring on each clock hour would be sufficient for reporting purposes.

In addition to the area's system lambda, the Respondent shall provide a detailed description of how it calculates system lambda. For those systems that do not use an economic dispatch algorithm and do not have a system lambda, the Respondent is required to provide in writing a detailed description of how balancing authority area resources are efficiently dispatched.

Background

The Commission prohibited Aquila from making MBR sales within its Missouri and Kansas control areas effective June 27, 2005.[36] While examining Aquila sales within Aquila's Kansas control area, audit staff discovered that data provided to the Commission in Aquila's Form No. 714 was not reflective of the calculated hourly system lambda values gathered from the company. Not one of the hourly lambda values per day for each day of the year correlated with one another and in some cases, the difference between the actual sale price and the filed Form No. 714 incremental cost data was over $87/MWh. Under normal circumstances, this data should be identical.

Audit staff expressed its concern to Aquila and held discussions with Aquila's Director of Wholesale Energy (the position responsible for determining and ensuring economic use of Aquila's network resources) and Sr. Electric Systems Analyst (the preparer of the Form No. 714) to understand the differences. Aquila's Director of Wholesale Energy stated that the data used to calculate system lambda values for Form No. 714 compilation has to be pulled from the same system where Aquila's Wholesale Energy houses it because it is the only system Aquila has. Therefore, Aquila's Sr. Electric Systems Analyst reviewed the code that was written to the data from Aquila's system and realized that Aquila had been reporting an hourly average cost in the Form No. 714, resulting in inaccurate Form No. 714 filings for each of Aquila's Kansas and Missouri control areas.[37] If the code was properly written, it should have captured the hourly system lambda, unaveraged, and the correct information would have been reported in the Form No. 714.

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[36] *Aquila, Inc.*, 114 FERC ¶61,281, at 61,921 (2006).

[37] Aquila did not file a Form No. 714 on behalf of Aquila's Colorado electric utility operations since it is not a balancing authority area or planning area as specified in the Commission's filing guidance. Therefore, a submittal of a Form No. 714 was not required for Aquila's Colorado electric operations.

Recommendation

We recommend Aquila:

12. Recalculate hourly system lambda values for each of Aquila's Kansas and Missouri control areas for reporting years 2004, 2005, 2006, and 2007 and file revised Form No. 714 filings accordingly. Additionally, include in the filings the updated economic dispatch algorithm used by Aquila to calculate system lambda values.

5. Cost Allocation

Aquila did not charge its unregulated affiliate, AMS, for the actual time Aquila's VP Energy Resources spent working on unregulated affiliate tasks, nor has it conducted a time study to support an alternate method of allocation.

Pertinent Guidance

General Instruction No. 9, Distribution of Pay and Expenses, of the Uniform System of Accounts (18 C.F.R. Part 101 (2007)) requires Aquila to record only the actual time spent performing work for its affiliates. To the extent that Aquila cannot determine the actual time, the regulations require Aquila to perform a time study to allocate costs. Specifically, General Instruction No. 9 states:

> The charges to electric plant, operating expenses and other accounts for services and expenses of employees engaged in activities chargeable to various accounts, such as construction, maintenance and operations, shall be based on the actual time engaged in the respective classes of work, or in case that method is impracticable, upon the basis of a study of the time actually engaged during the representative period.

Background

Aquila employed, as of December 31, 2007, 2,213 employees in the United States. These employees include shared employees in Legal, Finance, Accounting, IT, and Corporate who provide services to the Colorado and Missouri electric utility divisions (this includes Transmission and Energy Resources – the regulated power activities, including fuel, purchase power and generation dispatch) and energy affiliate AMS.

Aquila employees record time on an actual basis. Within its time recording program, the default is set for time to be charged to the employee's business unit, unless they indicate time to be charged to a different business unit, project, or task. Time incurred for non-regulated business units by employees of regulated business units are charged directly to the non-regulated business unit. Conversely, time incurred specifically for a regulated business unit by employees of a non-regulated business unit are charged directly to the regulated business unit. In addition, Aquila's regulatory accounting group allocates time on a preconceived annual percentage from common general ledgers to represent services that non-regulated business units would consume or receive.

While on-site, audit staff identified that AMS' two remaining employees have reported to Aquila's VP Energy Resources since August 28, 2007 – two months after AMS terminated its market-based rate authority.[38] However, Aquila's VP Energy Resources declared that he has never directly charged time to the AMS business unit. Furthermore, records provided in response to data requests indicated that Aquila failed to allocate time on behalf of the VP Energy Resources and did not allocate the appropriate administrative and general expenses.

Aquila's VP Energy Resources stated that his duties and responsibilities regarding these two AMS employees have been solely managerial in nature with minimal involvement in day-to-day activities. His management function varied from month-to-month, but on average he estimated spending less than eight hours per month on these AMS duties. He also participated in quarterly AMS Board of Director meetings. Preparing for and participating in these meetings required approximately two hours once a quarter.

Recommendations

We recommend Aquila:

13. Strengthen written procedures to ensure that Aquila's VP Energy Resources' appropriately assigns time spent between regulated and unregulated operations.

14. Communicate cost allocation procedures to Aquila's VP Energy Resources and provide training if necessary to ensure the proper procedures are followed.

[38] *Aquila Merchant Services, Inc.*, Docket No. ER07-860-000 (June 12, 2007) (unpublished letter order).

Aquila

750 NW Missouri Road
Lee's Summit, MO 64086-5720

August 21, 2008

Bryan K. Craig, Director
Division of Audits
Federal Energy Regulatory Commission
888 First Street NE, RM 51-37
Washington, DC 20426

Re: FERC Compliance Audit of Aquila, Inc.
Docket No. PA08-5-000

Dear Mr. Craig:

This letter is in response to the draft *Audit of Market-based Rate Authority and Electric Quarterly Report Filing Requirements at Aquila, Inc.* ("Draft Report"), dated August 6, 2008.[1]

Aquila, Inc. ("Aquila") appreciates this opportunity to comment on the Draft Report. Aquila accepts the findings proposed by audit staff. Further, Aquila accepts audit staff's recommendations, with only minor requested clarifications concerning the sale of Aquila's jurisdictional assets and operations located outside Missouri.

It is important to note that the announced acquisition of Aquila and its Missouri electric operations by Great Plains Energy Incorporated ("Great Plains Energy") has been consummated. Great Plains Energy is the holding company of Kansas City Power & Light Company ("KCP&L"). As part of the transaction, first announced in February of 2007, Aquila sold its Colorado electric operations and its natural gas operations in Colorado, Iowa, Kansas and Nebraska to Black Hills Corp. The transactions closed July 14, 2008. Audit staff provides details of the transactions in the Draft Report in Section B of the Executive Summary.

Additionally and also noted in the Draft Report's Executive Summary, prior to April 1, 2007, Aquila had electric utility operations in Kansas. Aquila's Kansas electric utility operations were sold to Mid-Kansas Electric Company ("MKEC") effective on that date.

Because Aquila has been acquired, responses, corrective actions taken or planned, and procedures developed by Aquila will be reflective of its corporate relationship as a wholly-owned subsidiary of Great Plains Energy. Aquila's Missouri electric operations now do business as KCP&L Greater Missouri Operations Company.

[1] For convenience, this response is organized using the same headings as the Draft Report.

In addition to the 14 recommendations covered in the Draft Report, audit staff provided specific recommendations for overall compliance and implementation. Aquila accepts each of the recommendations detailed in Section E of the Draft Report, "Compliance and Implementation of Recommendations."

In summary, Aquila agrees to submit for audit staff's review plans for implementing audit staff's recommendations, will submit quarterly reports to audit staff describing Aquila's progress in completing corrective actions recommended until such time as all such corrective actions have been completed, will submit copies of any written policies and procedures developed in response to the recommendations, and will conduct annual internal audits for the next two years to examine existing internal procedures used to compile and review its Electric Quarterly Reports ("EQRs" or "EQR") and ensure compliance with Commission EQR rules and regulations.

1. Reporting of Bookouts and Power Sales

The Draft Report concludes that "Aquila did not report any bookout transactions." *Draft Report*, at page 12.

Aquila accepts this finding. As noted in the Draft Report, Aquila inadvertently did not report bookout transactions because it assumed the EQR only captured physical transactions that touched its control area. Including bookout transactions was not a requirement when the EQR system was first introduced in 2003. The Commission's directive to include these transactions unfortunately was missed by Aquila. These bookout transactions were properly accounted for and correctly reported in Aquila's Form No. 1 submission to the Federal Energy Regulatory Commission's ("FERC").

Recommendation Nos. 1-3: Aquila accepts Recommendation Nos. 1 through 3. Aquila commits to establish written procedures to ensure that Aquila's EQR reports include all bookout and power sale transactions accurately and completely. These procedures will be established and provided to audit staff on or before October 1, 2008. Aquila commits to identify all bookout and power sale transactions that were not submitted with Aquila's EQR filings since January 1, 2003. Aquila commits to file revised EQR filings to include all bookout and power sale transactions.

Beginning on or shortly after October 1, 2008, Aquila will begin submitting revised EQRs. Aquila will begin with the most recent quarter's EQR and work backward to the first quarter of 2003. Aquila anticipates that all revised EQRs from January 1, 2003 forward will be submitted to FERC by February 15, 2009.

2. Aquila's Cost-based Sales

The Draft Report concludes that "Aquila misreported its Kansas municipal cost-based sales as market-based and failed to report all of its cost-based sales for resale in its EQR filings." *Draft Report*, at page 15.

Aquila accepts this finding. The Draft Report accurately reflects how Aquila inadvertently misreported its sales as market-based and how it failed to report all of its cost-based sales to its partial and full requirement customers for resale in its EQR filings.

Recommendation Nos. 4-5: Aquila accepts Recommendation Nos. 4 and 5, with one minor requested clarification. Aquila commits to revise its EQR procedures to include all relevant sales information from the Customer Accounts Services group for its Missouri full requirement customers. However, because Aquila sold its Kansas operations, Aquila does not believe it would be beneficial to revise procedures for gathering information for full and partial requirements customers in Kansas. Therefore, Aquila respectfully requests that Recommendation Nos. 4 be modified accordingly for the final report. Nonetheless, Aquila commits to file revised EQR filings to include all Missouri and Kansas full and partial requirement customer contracts and transactions from January 1, 2003. Further, Aquila commits to accurately report the former 12 Kansas municipal cost-based sales as cost-based within the fields product type name and rate description.

Beginning on or shortly after October 1, 2008, Aquila will begin submitting revised EQRs. Aquila will begin with the most recent quarter's EQR and work backward to the first quarter of 2003. Aquila anticipates that all revised EQRs from January 1, 2003 forward will be submitted by February 15, 2009.

3. EQR Reporting Errors

The Draft Report concludes that "Aquila incorrectly reported in its first quarter 2005 through the fourth quarter 2006 EQR filings: 1) current effective contracts, 2) Data Universal Numbering System (DUNS) numbers, 3) contract information, and 4) affiliate identification." *Draft Report*, at page 18.

Aquila accepts this finding. In 2003, when the EQR system was launched, Aquila completed an extensive search to gather contract information for all counterparties regardless of current business activity with the counterparties. All information remained in the EQR data system even though no transactions took place with many of the counterparties. As noted in the Draft Report, Aquila documented 179 ineffective contracts. Aquila is certain many of the issues pointed out in the Draft Report will be resolved simply by eliminating these contracts.

To resolve all other issues, Aquila will schedule meetings with FERC's EQR staff in order to best determine procedures to accurately report EQR data. Aquila plans to schedule these meetings to take place in September and October of 2008.

Recommendation Nos. 6-10: Aquila accepts Recommendation Nos. 6 through 10. Aquila commits to establish written procedures to ensure that Aquila reports contract and transaction data accurately and completely. The procedures will include quality control procedures to review all contract and transaction information prior to filing. Aquila will eliminate ineffective contracts. Aquila commits to examine all customer company names and DUNS numbers reported in EQRs. Aquila plans to work with FERC's EQR staff to best determine how to gather and report accurate DUNS numbers and to eliminate any customer company contracts with a reported DUNS number of "000000000" and to report an accurate DUNS number. Aquila commits to review contract information reported in its first quarter 2007 and first quarter 2008 EQRs to ensure accurate and complete information is being reported. Aquila commits to file revised EQR filings from January 1, 2003, forward to correctly report current effective contracts, DUNS numbers, contract information and affiliate identification.

Beginning on or shortly after October 1, 2008, Aquila will begin submitting revised EQRs. Aquila will begin with the most recent quarter's EQR and work backward to the first quarter of 2003. Aquila anticipates that all revised EQRs from January 1, 2003 forward will be submitted to FERC by February 15, 2009.

4. Form No. 714

The Draft Report concludes that "Aquila's hourly system lambda values reported in its Form No. 714, Part II – Schedule 6, were incorrectly reported for filing years 2005, 2006 and 2007." *Draft Report*, at page 23.

Aquila accepts this finding, with the clarification that a Form No. 714 was not filed on behalf of Aquila's Colorado electric utility operations. Because the Colorado electric operations were not a balancing authority area or planning area as specified in the Commission's filing guidance, submittal of a Form No. 714 was not a requirement for Aquila's Colorado electric operations. Therefore, Aquila respectfully requests that this Recommendation 12 be modified accordingly for the final report.

The Draft Report accurately reflects how Aquila inadvertently utilized hourly average cost in the Form No. 714, which resulted in inaccurate information for the Form No. 714 filings for Aquila's Missouri and its former Kansas control areas.

Recommendation No. 12: Aquila accepts, with the clarification noted below, Recommendation No. 12. In 2008, Aquila submitted with FERC a Form No. 714 for the 2007 filing year on behalf of Aquila's Missouri electric operations, which accurately reflects the system lambda values. A Form No. 714 for 2007 information was not filed on behalf of Aquila's former Kansas or Colorado electric operations. Form No. 714 guidance received from FERC's form manager indicated that a Form No. 714 is not required if the respondent was not operating

that part of the system at the conclusion of the reporting year. The Kansas electric utility operations were sold and operated by MKEC beginning on April 1, 2007. Also as noted above, since Aquila's Colorado electric utility operations were not a balancing authority area or planning area, a Form No. 714 was not a filing requirement. Moreover, those assets and operations were sold to Black Hills Corp. as part of the transactions that closed on July 14, 2008. Therefore, Aquila respectfully requests that this Recommendation 12 be modified accordingly for the final report.

Aquila commits to recalculate hourly system lambda values for the Missouri control area and its former Kansas control area for reporting years 2004, 2005 and 2006 and to file revised Form No. 714 filings accordingly. Aquila will submit these filings by November 1, 2008.

5. Cost Allocation

The Draft Report concludes that "Aquila did not charge its unregulated affiliate, AMS (Aquila Merchant Services, Inc.), for the actual time Aquila's VP Energy Resources spent working on unregulated affiliate tasks, nor has it conducted a time study to support an alternate method of allocation." *Draft Report*, at page 26.

Aquila accepts this finding. AMS employees formerly reported up through a corporate officer of Aquila. This officer's time, administrative and general expenses were accurately allocated to all of Aquila's business units, inclusive of the electric and gas utility operations and AMS. That officer left the company in May of 2007. With the officer's departure, Aquila's VP Energy Resources was assigned oversight of the two remaining AMS employees and their functions. The question was asked internally if the VP Energy Resources was "allocated," which was confirmed. However, during the audit process it was discovered that the allocation formula for the VP Energy Resources only allocated costs to Aquila's electric utility operations (the regulated operations) and did not include AMS.

Recommendation Nos. 13-14: Aquila accepts Recommendation Nos. 13 and 14, while adapting the recommendations to apply to its current corporate structure. With the acquisition of Aquila by Great Plains Energy, the VP Energy Resources role no longer exists. It has been communicated to the KCP&L employees handling the AMS gas legacy contracts and the managers overseeing these functions to record their time to accurately reflect time spent on AMS functions. Written procedures will be created to ensure that time is properly assigned between regulated and unregulated operations.

Please contact me with questions or comments concerning this submission.

Respectfully submitted,

/s/ David Douglass
(signed original sent via overnight delivery)

David Douglass
Regulatory Compliance Manager
KCP&L and Aquila, Inc.

Document Content(s)