BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the matter of the Joint Application of Aquila, Inc. d/b/a Aquila Networks – MPS and Aquila Networks – L&P ("Aquila"), The Empire District Gas Company ("EDG") and The Empire District Electric Company ("EDE") for an Order authorizing the sale, transfer and assignment of certain assets and liabilities from Aquila to EDG and in connection therewith, certain other related transactions.	)))))))))	**Case No. GO-2006-0205**

STAFF MEMORANDUM IN SUPPORT OF UNANIMOUS STIPULATION AND AGREEMENT

COME NOW the Staff ("Staff") of the Missouri Public Service Commission ("Commission") and for its Memorandum in support of the Unanimous Stipulation and Agreement ("Stipulation") submitted for Commission approval, states the following:

BACKGROUND

1. On November 8, 2005, the Joint Applicants, Aquila, EDE and EDG, filed their Joint Application with the Commission under Sections 393.170, 393.190, RSMo 2000 and 4 CSR 240-2.060 and 4 CSR 240-3.210, for an order from the Commission authorizing the sale, transfer and assignment of certain assets and liabilities from Aquila to EDG (as EDE's assignee under the Purchase Agreement), and in connection therewith, certain other related transactions. EDE and Aquila filed testimony in support of the Joint Application on November 10, 2005, and November 14, 2005, respectively. ("EDE" and "EDG" collectively "Empire")

2. On November 10, 2005, the Commission issued its Order and Notice setting an intervention date of November 30, 2005; an Order Setting Settlement Conference for December 7, 2005; and an Order Establishing Protective Order. Thereafter, Pittsburgh-Corning Corporation ("PCC"), Cornerstone Energy, Inc. ("CEI"), and Crane Plumbing, LLC ("Crane")

filed applications to intervene in this matter. The applications to intervene of PCC and CEI were granted on December 7, 2005, and the application to intervene of Crane was granted on December 21, 2005.

3. Most of the Signatories[1] appeared at the prehearing conference on December 7, 2005. Thereafter, on December 16, 2005, the Joint Applicants filed, on behalf of the Signatories, a proposed procedural schedule for this case, which was adopted by the Commission by Orders issued on December 21, 2005, and January 3, 2006. Pursuant to the procedural schedule, all non-applicant Signatories provided their lists of conditions for approval of the Joint Application to all Signatories on or about January 17, 2006, and an initial settlement conference was held on January 23-24, 2006.

4. Most Signatories attended the January 23-24, 2006 settlement conference and engaged in various follow-up discovery and discussions to determine whether an amicable settlement of this proceeding was possible. As a result of those discussions, the Signatories reached a resolution of the issues and concluded a settlement as reflected in the unanimous Stipulation filed on February 28, 2006. The Staff believes this Stipulation to be reasonable and not detrimental to the pubic interest.

5. Paragraph 9 of the Stipulation requires Staff to submit its suggestions or memorandum in support not later than March 13, 2006, with other Signatories providing responsive suggestions or memorandum not later than five business days thereafter. Accordingly, the Staff submits its memorandum to the Commission, as discussed below, as to how this Stipulation resolves all issues in this proceeding.

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[1] "Signatories" refers collectively to the parties (Aquila, EDE and EDG, Staff, PCC, CEI, Crane, and Office of Public Counsel) in this proceeding that have signed the Stipulation.

REPRESENTATIONS OF EMPIRE AND AQUILA

6. The Staff relied upon representations made by Empire and Aquila, as described in the “Background” section of the Stipulation, to construct the agreements contained in this Stipulation. These representations include the following:

* Empire represents that it has performed such investigations and reviews of the financial viability of this transaction as seemed to it to be reasonable and prudent.

* Empire represents that it has the creditworthiness to accept assignment of the Southern Star Central, ANR Pipeline, and Panhandle Eastern Pipeline contracts to be assigned from Aquila to EDG, and that these pipelines have consented (as required) to the assignment of all applicable transportation and storage contracts from Aquila to EDG.

* Empire represents that EDG has the creditworthiness and ability to contract with gas supply and financial counterparties on a firm basis to provide reliable gas supplies and financial hedging tools. Empire has agreements with adequate and reliable suppliers sufficient to supply the needs of the newly-acquired gas system. Any transactions under these agreements will be separate and have separate confirmations from any gas supplies dedicated to the EDE electric operations

* Empire and Aquila represent that this transaction will not have any detrimental effect on either Empire’s or Aquila’s Missouri utility customers, including, but not limited to: increased rates or any effect on quality of service.

* EDG represents that for its gas supply planning, transportation, and storage acquisition, including injection and withdrawal plans, it will not consider its transportation customers’ gas supply and related storage and transportation arrangements as a source of system supply.

GAS SUPPLY SERVICES

Background

(a) One of the significant areas of the Staff review of this transaction related to the area of Gas Supply Services. In this case, the term "Gas Supply Services" has been used to encompass the broad range of gas procurement services that are typically provided by Local Distribution Companies ("LDC"s) in Missouri. "Gas Supply Services" (natural gas procurement activities) are typically performed by a natural gas supply department or group. Examples of these services include:

* *Maintaining a qualified Staff of individuals with experience in the gas procurement area.*
* *Negotiating Gas Supply, Transportation and Storage contracts*
* *Analyzing and evaluating historical data to develop peak day studies*
* *Forecasting daily load for operational purposes*
* *Developing monthly and annual gas procurement plans*
* *Evaluation of upstream and downstream pipeline capacity options.*
* *Monitoring and participation in FERC proceedings.*
* *Evaluation of pipeline open seasons and gas reserve (supply basin) options.*
* *Monitoring of pipeline communications including critical notices and operational flow orders and other operational factors.*
* *Management of capacity release activities.*
* *Developing and maintaining reports to management.*
* *Monitoring the natural gas market.*
* *Interacting with natural gas marketers and end-user transportation customers*
* *Tracking and management of Loss & Unaccounted for gas.*
* *Developing and implementing hedging plans*
* *Monitoring, controlling and reporting hedging activity.*
* *Nominating or ordering the natural gas with suppliers and pipelines*
* *Evaluating the mix of baseload, swing, spot, and other supply combinations.*
* *Dispatching the gas in a reliable and economic fashion*
* *Monitoring and controlling pipeline imbalances*

* *Monitoring imbalances of end-use transportation customers.*
* *Managing services related to end-user/school transportation programs*
* *Monitoring the school aggregation program*
* *Developing and implementing natural gas storage plans*
* *Tracking, reconciling, and properly recording the costs and volumes related to gas procurement.*
* *Acquiring and maintaining information management systems to assist in interstate pipeline communication, weather monitoring, provision of end user transportation services, gas accounting, hedging, and contract administration.*
* *Interacting with other related areas such as supplier credit evaluations, risk management control functions, accounting, regulatory functions, metering and measurement, etc.*

(b) Aquila has historically provided Gas Supply Services to several states (Kansas, Michigan, Minnesota, Iowa, Nebraska, Colorado, and Missouri) through its Gas Supply Services Group in Omaha, Nebraska. This group relied on individuals with extensive LDC natural gas procurement experience with expertise in the day-to-day and long term operation of gas supply planning and management. *These individuals are not being transferred as part of this transaction.* The Omaha group relied on custom built information management systems that were highly integrated with various gas supply related functions including the end-user transportation function. *These systems are not being transferred as part of this transaction.*

(c) Empire has extensive experience in buying and arranging the transportation for natural gas for its electric generating units. It has experience in planning the gas supply for its natural gas fired units and has historically developed detailed hedging plans related to its natural gas purchasing function as it relates to the generation of electricity. However, Empire does not have experience in running an LDC gas procurement function.

(d) Empire is not experienced with developing peak day studies, developing LDC gas supply and storage plans, and managing end-user transportation programs. Although Empire is experienced in hedging price exposures for its gas fired generating units, it does not have specific experience in hedging LDC price exposure. Since Empire does not currently serve LDC load, it does not have all the information management systems in place to automate the gas supply communication functions between interstate pipelines, end-user transportation functions, and other systems related to natural gas procurement.

(e) Two of the more general provisions of the Stipulation and Agreement address Staff concerns in the gas supply area.

(i) Paragraph 5 of the Stipulation states:

> *Empire and Aquila represent that this transaction will not have any detrimental effect on either Empire's or Aquila's Missouri utility customers, including, but not limited to: increased rates or any effect on quality of service.*

(ii) Section I, paragraph (b) states:

> *Unless specified in this Stipulation, EDG understands and agrees that it has the same rights and obligations regarding matters before this Commission that Aquila had regarding the subject gas properties and operations.*

Both of the above sections provide that Empire is under prudence review in the gas procurement/supply area just as Aquila has been. They also provide Empire's and Aquila's commitment for a reasonable transition of the gas procurement/supply services function with no diminishment of the quality of the services traditionally provided by Aquila.

Specific Provisions of the Gas Supply Services Section

(f) Section II, paragraph (a) provides references to the transition services agreement for gas supply services. This provision includes a commitment for transitional services in the gas supply area between Empire and Aquila. Therefore, support is available from Aquila at least until March 31, 2007, with an option to extend for an additional 3 months.

(g) Section II, paragraph (b) provides that a hedging plan for the winter of 2006-2007, in similar detail to Aquila's traditional hedging plan, must be presented by Aquila and EDG no later than May 15, 2006. Hedging plans subsequent to the 2006-2007 plan will be provided by May 1st of each year by EDG.

(h) Section II. paragraph (c) provides that Aquila's normal gas supply planning and hedging will not be delayed and that the progress of this case should not delay or hamper Aquila's normal gas supply responsibilities.

(i) Section II, paragraph (d) addressed the transferring of hedges that have already been implemented by Aquila. For physical hedges (e.g., fixed priced gas supply contracts) a simple transfer will take place. Financial hedges (e.g., futures contracts) are typically nontransferable and must be liquidated rather than transferred. As a result, this introduces some uncertainty as to when and how hedges are reestablished. This provision keeps EDG's gas costs on the same cost basis as Aquila's hedged costs would have been assuming the sale of the gas properties did not take place. The practical effect of this provision reflects Aquila's hedges as if they were transferred to EDG and not liquidated.

(j) Section II, paragraph (e) obligates Aquila to provide EDG with all records related to the Actual Cost Adjustment ("ACA") and restricts EDG's ability to claim lack of access to Aquila records or personnel as a defense against disallowances in future ACA cases.

(k) Section II, paragraph (f) provides that the gas supply plan shall be consistent with the balancing and curtailment provisions as set out in the adopted tariffs. This provision is somewhat related to a previous provision where EDG represents that for its gas supply planning, transportation, and storage acquisition, including injection and withdrawal plans, it will not consider its transportation customers' gas supply and related storage and transportation arrangements as a source of system supply. These provisions clarify that EDG may not rely on transportation customer's gas supply, transportation and storage when planning for its system supply, transportation and storage.

(l) Section II, paragraph (g) provides that EDG shall, within three months after closing of the transaction, and annually in May thereafter, submit to the Staff and Public Counsel a plan that includes not only the elements in Section II (b), the hedging plan, but also includes the additional gas supply planning features outlined in paragraph (g). Therefore, a more comprehensive plan will be developed and documented every May (or within 3 months after closing for the 1st year) in addition to the annual hedging presentation discussed in paragraph (b).

(m) Section II, paragraph (h) provides, in part, that EDG will, not later than 180 days after close of the transaction, acquire an electronic system or develop an in-house system with customer functionality similar to Aquila's GasTrak (sic) Online system and in conformance with EDG's tariffs. Gas Track Online is Aquila's proprietary internet-enabled electronic bulletin board that facilitates communication between Aquila and its transportation customers.

(n) Section II, paragraph (i) states that EDG will provide, once every 60 days after close of the transaction until termination of gas supply transition services by Aquila, a status report of its progress toward assuming the gas supply services that are being provided by Aquila under the transition services agreement. In addition, not less than 30 days prior to the termination of gas supply transition services from Aquila, EDG will hold a technical conference with the Signatories to describe how the gas supply services will be provided by EDG. This provision helps the Staff to monitor the progress of the transition services and the development of EDG's stand-alone gas supply function.

TARIFFS

EDG agreed to file tariffs to be effective upon closing of the transaction adopting the rates, tariffs, rules and regulations for gas service in effect for Aquila's Missouri jurisdictional gas utility operations which are the subject of this proceeding. Therefore, ratepayers should not experience any change in their non-gas rates as a result of this transaction until the next general rate case; which due to the rate moratorium, is not expected to occur for at least three years.

RECORDS

Aquila has agreed to transfer to EDG, and EDG has agreed to maintain, certain financial and operational data as specified in the Stipulation. Such data will be readily available to Staff and Public Counsel upon request. This provision makes available the necessary historical and comparative data so that an appropriate cost of service may be established in future rate proceedings.

EDG has also agreed to maintain all records necessary to meet the requirements of the Uniform System of Accounts, gas utility depreciation studies and rate case filings. Data maintained and provided for gas utility depreciation studies will include cost of removal and salvage associated with plant retirements. This data will be provided to Staff in its requested format or as ordered by the Commission. In addition, EDG has agreed to use the current approved depreciation rates for Missouri gas properties acquired from Aquila until such rates are changed as provided by law. EDG will also maintain plant by account that allows for the specific identification of the property acquired from Aquila. These provisions will assure the availability of necessary data to establish the appropriate depreciation rates in the future. In addition, the depreciation reserve will continue to accumulate consistent with the expense included in rates.

Beginning with the first month after the closing of the transaction, EDG has agreed to provide monthly gas financial surveillance reports similar to those previously provided by Aquila. This provides for the same monthly reporting by EDG that the Staff uses to monitor Aquila's Missouri gas operations. After conversion from Aquila's billing system to EDG's billing system, EDG has agreed to provide quarterly to the Commission's Energy Department certain monthly natural gas sales (units) and natural gas revenue data. This data will facilitate the development of the class cost of service in future rate proceedings.

ELECTRIC REGULATORY PLAN

EDE has agreed to adjust the amortization required to meet the financial ratio targets in the Electric Regulatory Plan (Case No. EO-2005-0263) to eliminate any adverse impacts that result from the purchase of Aquila's Missouri gas properties, if necessary. EDE has also agreed that any adverse impacts on cash flows or other factors used in the calculation of the financial ratio targets in the Electric Regulatory Plan (Case No. EO-2005-0263) which results from the purchase will be eliminated from the calculation of such financial ratio targets. These provisions reiterate the agreement in the Stipulation and Agreement in Case No. EO-2005-0263 that EDE will not seek to recover in Missouri jurisdictional electric rates, any adverse impact resulting from any significant merger, sale or acquisition, or corporate restructuring activities.

PENSIONS AND OTHER POST-EMPLOYMENT BENEFITS (OPEBs)

EDG has agreed to the following provisions regarding pensions and OPEBs:

(a) the total amount transferred from Aquila for pension and OPEB liabilities will be deposited into the Empire pension fund and appropriate VEBA accounts, respectively;

(b) the calculation FAS 87 and FAS 106 costs, for pensions and OPEBs, respectively, without regard to purchase accounting for regulatory purposes; and

(c) the records necessary to determine the expense and account balances in accordance with the current regulatory pension accounting, as ordered by the Commission, will be maintained through the time period of the next EDG general rate proceeding.

These provisions assure that employee benefit plans are appropriately funded and that the amounts accumulated are appropriately accounted for on EDG's and/or EDE's financial statements. In addition, records will be preserved to establish, in future rate proceedings, the amounts collected from ratepayers in accordance with regulatory treatment previously approved by the Commission.

GAS SAFETY

Empire will continue to follow all of the Commission's pipeline safety regulations. This includes having qualified employees, a drug testing program, and 24-7 response to emergency, leak and odor calls. To assure that this provision is met, as discussed in the General section of the Stipulation, item (i), EDG will offer employment to all of the Aquila employees currently involved in field operations on the natural gas distribution system being transferred and has accepted limitations on changes to the number of these positions.

CHILLICOTHE MANUFACTURED GAS PLANT SITE

EDG may initially reflect on its balance sheet the liability and offsetting regulatory asset, not to exceed $260,000, for the former manufactured gas plant site in Chillicothe, being transferred as part of the Purchase Agreement, in accordance with Generally Accepted Accounting Principles, ("GAAP"). This site contains a plant that is currently providing utility service. In a future rate case, EDG may request recovery of actually incurred expenditures for the remediation of this site. This provision allows EDG to recognize this item on its financial statements in compliance with GAAP, while limiting any possible recovery only to actual incurred expenditures.

RATE MORATORIUM

EDG agrees that it will not file a rate increase request for non-gas costs and the other Signatories agree that they will not file an earnings complaint against EDG, for a period of 36 months following the date of closing, unless there is the occurrence of a significant, unusual event that has a major impact on any of its service territories. This provision provides for a period of regulatory stability for both the company and ratepayers during the transition of gas operations from Aquila to EDG.

QUALITY OF SERVICE

Empire agrees that it will track and routinely report call center metrics to the Staff and the Office of the Public Counsel. Such reporting will include the timing of implementation of Integrated Voice Response technology ("IVR") in the operations of its call centers. At least 15 days prior to the date of closing, EDG agrees to provide written notice to all Missouri natural gas customers in the Aquila gas system (*i.e.,* Aquila's Missouri jurisdictional gas utility operations which are the subject of this proceeding) to inform them of the change in management and ownership of such system, including EDG's address and applicable phone numbers. This provision assures that information will be available to the Staff to continue monitoring the level of customer service being offered to the prior Aquila gas customers. This provision also provides for the communication of contact information to gas customers during the transition in ownership.

ACQUISITION ADJUSTMENT

EDG has agreed that it will not seek to recover any of the acquisition costs and acquisition premiums associated with this transaction in any future rate proceeding unless and until there is a change in GAAP that would require EDG to write-off any portion of the acquisition premium resulting in a significant deleterious effect on EDG. EDG agrees that in any case in which it seeks recovery of any portion of the acquisition premium, it must prove that such recovery does not make the transaction as a whole detrimental to its customers. EDG agrees that it will not seek recovery of any portion of the acquisition premium in any case filed later than fifteen years after the effective date of the order approving this Stipulation. EDG may reflect the acquisition adjustment resulting from this transaction for financial statement purposes, but must maintain this item in a separate account specifically identified as related to this transaction.

All documentation regarding the purchase of Aquila's Missouri jurisdictional gas utility operations will be maintained by EDG and Aquila through the effective date of the rates in EDG's next general rate proceeding following the close of this transaction.

These provisions allow EDG to recognize the acquisition adjustment on its financial statements, while significantly limiting the ratepayers' possible exposure to future inclusion in rates. These provisions also provide for the specific identification of these items and the preservation of the associated records.

THE STANDARD OF NOT DETRIMENTAL TO THE PUBLIC INTEREST

Staff evaluated this proposal based on the standard of "not detrimental to the public interest." In establishing this standard, the Supreme Court recognized that one of the most important functions of the Public Service Commission is to balance competing interests and noted:

> To prevent injury to the public, in the clashing of private interests with the public good in the operation of public utilities, is one of the most important functions of Public Service Commissions. It is not their province to insist that the public shall be *benefited*, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public *detriment*. In the public interest, in such cases, can reasonably mean no more than 'not detrimental to the public'. *State ex rel. City of St. Louis v. Public Service Commission of Missouri, et al.*, 73 S.W. 2d 393, 400.

"The Commission may not withhold its approval of the disposition of assets unless it can be shown that such disposition is detrimental to the public interest." *State of Missouri ex rel. Fee Fee Trunk Sewer, Inc. v. Litz*, 596 S.W.2d 466, 468, (Mo.App.E.D. 1980). In trying to determine whether this proposed transaction might harm the public, Staff defined "public interest" as the nature and level of the impact or effect that the proposed transaction might have on Aquila's Missouri gas customers transferred to Empire, as well as Empire's existing electric customers. This is the standard Staff used to determine this Stipulation to be reasonable and not detrimental to the pubic interest.

WHEREFORE Staff has agreed to and entered into a Stipulation and Agreement that it believes addresses any potential detriments to consumers, the Staff recommends that the Commission approve the transfer in accordance with the provisions of the Unanimous Stipulation and Agreement.

Respectfully submitted,

/s/ Robert S. Berlin___________

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CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing Staff Memorandum in Support of Unanimous Stipulation and Agreement have been mailed, hand-delivered, transmitted by facsimile or electronically mailed to all counsel of record this 13th day of March, 2006.

/s/ Robert S. Berlin_________