

**STATE OF MISSOURI
PUBLIC SERVICE COMMISSION**

At a session of the Public Service
Commission held at its office in
Jefferson City on the 23rd day
of April, 2002.

[In the Matter of the Application of UtiliCorp United Inc.)	
for Authority to Acquire the Shares of Avon Energy)	<u>Case No. EO-2002-215</u>
Partners Holdings and to Take All Other Actions)	
Reasonably Necessary to Effectuate Said Transaction.)	

ORDER APPROVING SECOND AMENDED APPLICATION

Syllabus

On March 18, 2002, Aquila, Inc., f/k/a UtiliCorp United Inc., filed a Second Amended Application requesting approval of a Purchase and Sale Agreement between Aquila Europe, Inc., a wholly owned Aquila, Inc. subsidiary, and EI UK Holdings, Inc.. The agreement, dated March 15, 2002, provides for Aquila, Inc. to acquire an interest in Avon Energy Partners Holdings from EI UK. This order approves the Second Amended Application and authorizes Aquila, Inc. to complete the transaction.

Procedural History

On December 18, 2001, the Commission issued an Order Approving Application in this case authorizing UtiliCorp to acquire the outstanding shares of Avon as provided in a Share Purchase and Sale Agreement between UtiliCorp and EI UK. The Commission's Order was subject to certain conditions set forth in the Order. Among those conditions was the following:

That the authority granted in this order is conditioned on the participation of a financial partner and the representations described

in the application, particularly paragraphs 8 and 12. If UtiliCorp United Inc. determines to proceed differently, UtiliCorp shall file a new application.

On February 15, 2002, UtiliCorp filed its First Status Report pursuant to Ordered Paragraph 15 of the Commission's Order Approving Application. UtiliCorp advised the Commission that certain events had resulted in an arrangement under which UtiliCorp's partner in the acquisition of the shares of Avon was to be FirstEnergy Corp. instead of Deutsche Bank, as originally had been contemplated.

On February 28, 2002, the Commission issued an Order Directing Filing. The Order directed that the Staff of the Commission file a response to UtiliCorp's First Status Report. The primary purpose for Staff's response was to determine whether UtiliCorp's new proposal would require the filing of a new application. The Commission directed that the Staff file its response no later than March 15, 2002.

On March 15, 2002, UtiliCorp filed its Second Status Report, as required by Ordered Paragraph 15 of the Commission's Order Approving Application. The Second Status Report advised that the negotiations leading to the participation of FirstEnergy as UtiliCorp's financial partner in the acquisition and ownership of Avon were nearing completion. Also on March 15, 2002, the Staff of the Commission filed its Response to UtiliCorp's First Status Report. Staff's response updated the Commission on events that had occurred since the filing of UtiliCorp's First Status Report. Staff stated its understanding that UtiliCorp intended to make a formal filing with the Commission seeking additional approval through a motion for supplemental order or, alternatively, a second amended application as soon as the new financial partner arrangement was formalized. Staff requested that it have an opportunity to review the final documentation concerning the

revised acquisition transaction and to make a further recommendation to the Commission regarding the transaction.

On March 18, 2002, UtiliCorp filed its Motion for Supplemental Order or Alternatively Second Amended Application. In doing so, UtiliCorp filed a copy of a Purchase and Sale Agreement dated March 15, 2002, an updated diagram of the acquisition structure, and updated *pro forma* financial information. UtiliCorp stated that its arrangement with FirstEnergy had been formalized, providing for a joint venture vehicle indirectly owned by UtiliCorp and FirstEnergy to hold 100% of the outstanding shares of Avon. UtiliCorp stated that it expected to acquire an indirect 79.9 percent economic interest in Avon, with FirstEnergy retaining a 20.1 percent economic interest. UtiliCorp stated that there would be no change from the original partnership arrangement with respect to voting rights, with UtiliCorp and its partner each having 50 percent control. UtiliCorp stated that the updated *pro forma* financial statements reflected only very slight changes from the original partnership arrangement, having an insignificant impact on ratios relevant to its credit rating. UtiliCorp requested that the Commission issue an order stating that no further Commission authority was required for UtiliCorp to proceed in accordance with the terms of the new Purchase and Sale Agreement. Alternatively, UtiliCorp further amended its application and requested that the Commission issue an order approving its application, as further amended, and authorizing it to perform in accordance with the terms of the Purchase and Sale Agreement, providing for the new partnership arrangement, investment level and acquisition structure described in its pleading.

On March 26, 2002, the Commission issued an Order Denying Motion for Supplemental Order, Granting Request for Amended Application, and Directing Staff

Recommendation. The Commission denied UtiliCorp's request for a supplemental order, but granted UtiliCorp's motion to further amend its application. The Commission directed its Staff to expeditiously review the amended application and to make its recommendation no later than April 20, 2002.

On March 27, 2002, Aquila, Inc., filed a Notice of Applicant Name Change. The Notice stated that UtiliCorp had completed the merger authorized by the Commission in its Case No. EM-2002-297, and that its name had been changed to Aquila, Inc. Consequently, any further references to the applicant in this case will be to the new name, Aquila, Inc., except where reference to its former name, UtiliCorp, is necessary for clarity.

On April 16, 2002, Staff filed a Staff Response. Staff recommended conditional approval of the Second Amended Application. On April 17, 2002, Aquila, Inc. filed a Response of Aquila, Inc., to Staff's Supplemental Recommendation in which it ratified its certification of corporate commitments and, also, stated that it had no objection to the conditions proposed by Staff. The Office of the Public Counsel filed its response on April 18, 2002. Public Counsel stated that it agreed with Staff's conditional recommendation.

Standard of Review

Aquila, Inc. has requested approval of its application, as amended, and proposed acquisition pursuant to Section 393.190, RSMo 2000, and 4 CSR 240-2.060(12). Section 393.190 requires an electrical corporation regulated by the Commission to obtain the Commission's approval to acquire the stock of any other corporation engaged in the same or similar business. The Commission must approve the application, as amended, absent a showing that the transaction is detrimental to the public interest.¹

¹ *State ex rel. City of St. Louis v. Public Service Commission*, 73 S.W.2d 393, 400 (Mo. banc 1934).

The requirement of a hearing has been fulfilled when all those that have a desire to be heard are offered an opportunity to be heard. If no proper party is granted intervention and neither the Commission Staff nor the Office of the Public Counsel requests a hearing, the Commission may determine that a hearing is not necessary and that the applicant may submit evidence in support of the application by verified statement.² No applications for intervention have been filed in this case. No proper party to the case has requested a hearing.

Staff Recommendation

In the Staff Response, Staff recommended approval of the Second Amended Application provided that the Commission include the conditions proposed by Staff and certain commitments previously made by UtiliCorp. Aquila, Inc.'s response to Staff's supplemental recommendation states that it has no objections to the conditions proposed in the Staff Response.

The Transaction and Its Impact

As noted in the Commission's earlier Order Approving Application, Avon owns and operates Midlands Electricity plc, which conducts a substantial electrical utility distribution business and related businesses based in the United Kingdom. Midlands is one of twelve regional electricity companies in the United Kingdom that came into existence as a result of the privatization of the United Kingdom electric industry in 1990. Midlands provides regulated distribution of electricity to approximately 2.3 million industrial,

² *State ex rel. Rex Deffenderfer Enterprises Inc. v. Public Service Commission*, 776 S.W.2d 494, 496 (Mo. App. 1989).

commercial and residential consumers in south central England. Midlands also has unregulated businesses in electrical contracting, metering services and related businesses and, through a subsidiary, owns minority interests in three generating plants in the United Kingdom and overseas.

Aquila, Inc. proposes to pay approximately \$285 million (U.S.) to acquire a 79.9 percent economic interest in Avon. FirstEnergy, the current owner of 100 percent of the outstanding shares of Avon, will retain a 20.1 percent economic interest in Avon. Aquila, Inc. and FirstEnergy will each control 50 percent of the voting power of Avon. Aquila, Inc.'s acquisition of Avon and the Midlands is intended to provide it with a base to expand and diversify its operations in the United Kingdom and the rest of Europe.

Following the acquisition, Avon and its subsidiaries will maintain significant debt related to operations. That debt will be nonrecourse to Aquila, Inc., meaning that creditors cannot demand payment from Aquila, Inc. Aquila, Inc. may, however, borrow moneys to fund its share of the acquisition of Avon. Aquila, Inc. expects eventually to structure its funding of the acquisition as 50 percent debt and 50 percent equity, but initially it will be 100 percent debt.

Staff calculated and evaluated the impact of the acquisition on the financial position of Aquila, Inc. based upon the "most conservative scenario" of 100 percent debt financing. Based upon Staff's review of current and pro forma financial data submitted by Aquila, Inc., the company's capital structure as of June 30, 2001, consisted of 44.50 percent long-term debt, 2.70 percent short-term debt, 6.30 percent preferred stock, and 46.50 percent common equity. If Aquila, Inc. incurs \$285 million of long-term debt to complete the transaction, its capital structure would consist of 47.20 percent long-term

debt, 2.60 percent short-term debt, 6.00 percent preferred stock, and 44.20 percent common equity. The total debt of the company would increase 1.80 percent from 47.20 percent to 49.80 percent of total capital.

According to Staff, a 49.80 percent debt ratio is consistent with credit ratings above BBB-rated electric utilities. Staff states that the other *pro forma* financial data concerning pre-tax interest coverage, funds from operations interest coverage, and funds from operations to total debt ratio is consistent with credit ratings above that of BBB-rated utilities. Staff further states that Aquila, Inc. currently has a BBB rating assigned by Standard & Poors. Staff concluded that the transaction will not result in problems with Aquila, Inc.'s future credit rating and its ability to attract capital.

Aquila, Inc. Commitments

Aquila, Inc. has represented in its application that it is committed to maintaining its investment-grade credit rating. Aquila, Inc. stated that cost allocations to Missouri jurisdictional operations will not increase as a result of the transaction and that it will reduce allocations where appropriate to reflect the effect of the transaction. Aquila, Inc. stated that any acquisition premium paid by Aquila, Inc. will be treated below the line for ratemaking purposes and that no recovery of any acquisition premium from this transaction will be sought in any future Missouri rate case. Aquila, Inc. stated that it will not seek an increase in cost of capital or request a risk premium as a result of the acquisition. Aquila, Inc. stated that it would provide the Staff and the Office of the Public Counsel with post-closure information about the transaction if it is approved and current credit agency reports, as available. Aquila, Inc. ratified those representations and commitments in its April 17, 2002, response to Staff's supplemental recommendation.

Staff Conditions

Staff has recommended approval of the application, as amended, subject to the following conditions:

- a) That nothing in the Commission's order be considered a finding by the Commission of the value of the transaction for ratemaking purposes and that the Commission reserves the right to consider the ratemaking treatment to be afforded the transaction in any subsequent proceeding;
- b) That the Commission's order shall not be deemed to be precedent for any future acquisition, even if the facts may be similar;
- c) That any adverse financial effects of this acquisition be borne by the shareholders of Aquila, Inc., and not by Missouri ratepayers;
- d) That all records pertaining to this transaction be maintained at Aquila, Inc.'s headquarters at 20 West Ninth Street, Kansas City, Missouri 64105-1704 and be made available to the Commission's Staff as Staff deems necessary;
- e) That Aquila, Inc. be prepared to provide documentation of proper cost allocations to nonregulated entities;
- f) That Aquila, Inc. include any costs borne by its Missouri Public Service and St. Joseph Light & Power divisions related to the nonregulated subsidiaries in monthly surveillance reports sent to the Commission's Staff; and
- g) That Aquila, Inc. shall not take any action that would cause the financial statements of Aquila Sterling Holdings LLC to become consolidated with those of Aquila, Inc. until it files and receives approval to do so from the Missouri Public Service Commission.

Decision

Aquila, Inc. has provided the Commission with a copy of its Purchase and Sale Agreement to acquire an interest in Avon and a copy of the Resolutions of its Board of Directors authorizing the transaction. Aquila, Inc.'s Second Amended Application and supplemental information and responses filed by the Staff demonstrate that the transaction is not detrimental to the public interest and offer conditions to protect the public interest.

Thus, the application, as amended, satisfies all the requirements of Section 393.190, RSMo 2000, and 4 CSR 240-2.060(12).

The acquisition will permit Aquila, Inc. to expand and diversify its operations by extending and expanding its operations in the United Kingdom and the rest of Europe. The investment and any related debt will not adversely affect Aquila, Inc.'s investment-grade credit rating or its ability to attract capital to fund its operations. Therefore, approval of the application will benefit Aquila, Inc. with no detriment to the public interest.

In addition, commitments offered by Aquila, Inc. and Staff's recommended conditions provide further assurance that there will be no detriment to the public interest by the Commission's approval of the application.

The Commission finds that the transactions presented in Aquila, Inc.'s Second Amended Application are not detrimental to the public interest and may be approved subject to the commitments offered by Aquila, Inc. and the specific conditions recommended by Staff.

IT IS THEREFORE ORDERED:

1. That the Second Amended Application of Aquila, Inc., requesting the Commission to authorize Aquila, Inc.'s acquisition of an interest in Avon Energy Partners Holdings from, and in partnership with, FirstEnergy Corp. as provided in the Purchase and Sale Agreement between Aquila Europe, Inc. and EI UK Holdings, Inc. is hereby approved.
2. That Aquila, Inc. may take the actions necessary and as authorized in this proceeding to carry out the transactions described in the Second Amended Application.
3. That nothing in this order shall be considered a finding by the Commission of the value of this transaction for ratemaking purposes, and that the Commission reserves

the right to consider the ratemaking treatment to be afforded the transaction in any subsequent proceeding.

4. That the Commission's order shall not be deemed to be precedent for any future acquisition, even if the facts are similar.

5. That any adverse financial effects of this acquisition are to be borne by the shareholders of Aquila, Inc.

6. That all records pertaining to this transaction shall be maintained at Aquila, Inc.'s headquarters and be made available for the Commission's Staff, as Staff deems necessary.

7. That Aquila, Inc. shall be prepared to provide documentation of the proper cost allocations to nonregulated entities.

8. That Aquila, Inc. shall include any costs borne by its Missouri Public Service and St. Joseph Power & Light divisions related to the nonregulated subsidiaries in monthly surveillance reports sent to the Commission's Staff.

9. That Aquila, Inc. shall not take any action that would cause the financial statements of Aquila Sterling Holdings LLC to become consolidated with those of Aquila, Inc. without the prior approval of the Commission.

10. That Aquila, Inc. shall exercise reasonable diligence and prudence to maintain its investment-grade credit rating.

11. That Aquila, Inc.'s cost allocations to its Missouri jurisdictional operations shall not increase as a result of the transaction and that Aquila, Inc. will reduce allocations, where appropriate, to reflect the effect of the transaction.

12. That Aquila, Inc. shall treat any acquisition premium from this transaction below the line for ratemaking purposes and that it shall not seek recovery from any acquisition premium resulting from the transaction in any future Missouri rate case.

13. That Aquila, Inc. shall not seek an increase in its cost of capital or request a risk premium as a result of the acquisition.

14. That Aquila, Inc. shall provide the Commission's Staff and the Office of the Public Counsel with post-closure information concerning the transaction no later than 30 days after the closing and shall provide current credit agency reports, as available.

15. That Aquila, Inc. shall continue to file status reports in this proceeding beginning June 24, 2002, and every 30 days thereafter until the transaction is completed.

16. That no later than ten days after the completion of the transaction, Aquila, Inc. shall file a notice indicating that this case may be closed.

17. That this Order shall become effective on May 3, 2002.

BY THE COMMISSION

(SEAL)



Dale Hardy Roberts
Secretary/Chief Regulatory Law Judge

Simmons, Ch., Murray, Lumpe,
Gaw, and Forbis, CC., concur.

Dippell, Senior Regulatory Law Judge