Exhibit No.	
Witness:	Michael Gorman
Type of Exhibit:	Rebuttal Testimony
Sponsoring Party:	SIEUA and AGP
Subjects:	Collateralization
Date:	September 10, 2003

BEFORE THE

PUBLIC SERVICE COMMISSION OF MISSOURI

In the Matter of the Application by Aquila, Inc. for	)	
Authority to Assign, Transfer, Mortgage or Encumber	)	Case No. EF-2003-0465
Its Franchise, Works or System	)	

Rebuttal Testimony and Schedule of

Michael Gorman

On behalf of

Sedalia Industrial Energy Users Association
and Ag Processing, Inc.

September 10, 2003
Project 8006

BAI

BRUBAKER & ASSOCIATES, INC.
ST. LOUIS, MO 63141-2000

BEFORE THE

PUBLIC SERVICE COMMISSION OF MISSOURI

In the Matter of the Application by Aquila, Inc. for	)	
Authority to Assign, Transfer, Mortgage or Encumber	)	Case No. EF-2003-0465
Its Franchise, Works or System	)	

Affidavit of Michael Gorman

STATE OF MISSOURI)
) SS
COUNTY OF ST. LOUIS)

Michael Gorman, being first duly sworn, on his oath states:

1. My name is Michael Gorman. I am a consultant with Brubaker & Associates, Inc., having its principal place of business at 1215 Fern Ridge Parkway, Suite 208, St. Louis, MO 63141-2000. We have been retained by the Sedalia Industrial Energy Users Association and Ag Processing, Inc. in this proceeding on their behalf.

2. Attached hereto and made a part hereof for all purposes is my rebuttal testimony and schedule which was prepared in written form for introduction into evidence in the EF-2003-0465 Proceeding.

3. I hereby swear and affirm that the rebuttal testimony and schedule are true and correct and show the matters and things they purport to show.

Michael Gorman

Michael Gorman

Subscribed and sworn before this 9th day of September, 2003.

CAROL SCHULZ
Notary Public - Notary Seal
STATE OF MISSOURI
St. Louis County
My Commission Expires: Feb. 26, 2004

Carol Schulz

Notary Public

My Commission expires on February 26, 2006.

BEFORE THE

PUBLIC SERVICE COMMISSION OF MISSOURI

In the Matter of the Application by Aquila, Inc. for Authority to Assign, Transfer, Mortgage or Encumber Its Franchise, Works or System	)))	Case No. EF-2003-0465

Rebuttal Testimony of Michael Gorman

Introduction

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A My name is Michael Gorman and my business address is 1215 Fern Ridge Parkway, Suite 208, St. Louis, MO 63141-2000.

Q WHAT IS YOUR OCCUPATION?

A I am a consultant in the field of public utility regulation and a principal in the firm of Brubaker & Associates, Inc., energy, economic and regulatory consultants.

Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE.

A These are set forth in Appendix A to my testimony.

Q ON WHOSE BEHALF ARE YOU APPEARING IN THIS PROCEEDING?

A I am appearing on behalf of the Sedalia Industrial Energy Users Association (SIEUA) and Ag Processing, Inc. (AGP).

Q WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A The purpose of my testimony is to explain why I recommend the rejection of Aquila, Inc.'s (Aquila) request to include the utility assets located in the state of Missouri (Missouri Assets) with Aquila's other utility assets as collateral supporting a three-year term loan. Although its application does not clearly identify the utility names of its Missouri Assets, for the remainder of my testimony I will refer to Aquila's Missouri Assets (which I believe are the Missouri Public Service Company and St. Joseph Power & Light Company) as "The Missouri Utilities."

Q WHY SHOULD THE COMMISSION REJECT AQUILA'S REQUEST TO INCLUDE THE MISSOURI UTILITIES' ASSETS AS COLLATERAL IN THE AQUILA TERM LOAN?

A For several reasons:

(1) Aquila's proposal will eliminate a liquidity option that The Missouri Utilities currently have to ensure their ability to provide safe and reliable service. The Missouri Utilities should maintain as much liquidity as possible.

(2) Aquila already has the collateral needed for the domestic utility working capital term loan. Therefore, it is not necessary to include The Missouri Utilities in the collateral pool.

(3) Finally, Aquila has not demonstrated any off-setting benefit to the Missouri customers from eliminating liquidity. Instead, as noted above, Aquila's proposal will increase the risk that The Missouri Utilities may be unable to secure outside capital needed to provide reliable and safe service. Consequently, Aquila's proposal increases the operating risk of The Missouri Utilities while providing no benefit to consumers.

Q PLEASE DESCRIBE WHY PRESERVING THE ABILITY OF THE MISSOURI UTILITIES TO ARRANGE FOR A COLLATERALIZED LINE OF CREDIT TO SUPPORT UTILITY OPERATIONS IS IMPORTANT IN ENSURING THAT THEY CAN PROVIDE SAFE AND RELIABLE SERVICE.

A Because Aquila's credit rating has dropped below investment grade, suppliers to Aquila and therefore to The Missouri Utilities, will require credit enhancements for delivery of important utility services and commodities including: fuel for generating stations, natural gas for resale to gas customers, gas transportation and purchased power procured for the benefit of Missouri consumers (Rick Dobson interview, pp. 149-150 and 246-248).

These credit enhancements will be in the form of cash deposits, prepayment of expenses, or irrevocable lines of credit. The Missouri Utilities will need access to cash or credit lines in order to supply these credit enhancements.

If a collateralized Missouri line of credit can be arranged, The Missouri Utilities will have a line of credit option in the event Aquila is unable to support The Missouri Utilities' operations. It is highly likely that such a line of credit for The Missouri Utilities will require collateral support. This line of credit will ensure that The Missouri Utilities will be able to procure fuel for generation, gas for resale to gas customers, gas delivery and purchased power delivery to Missouri retail operations, and other goods and services. Further, a line of credit is necessary to provide cash for The Missouri Utilities to make infrastructure investments needed to maintain system reliability and to meet debt retirements or refinancings for debt obligations of The Missouri Utilities.

Q HOW DO THE MISSOURI UTILITIES RECEIVE WORKING CAPITAL?

A The Missouri Utilities currently receive operating capital from Aquila. Because of adverse events affecting unregulated operations, Aquila's credit rating has deteriorated to below investment grade. This credit rating decline has caused significant liquidity constraints that increase Aquila's risk of being able to meet its cash obligations, including debt retirements, collateral support for trading operations, and working capital requirements. The deterioration of Aquila's bond rating to below investment grade makes the ability of The Missouri Utilities to secure capital from Aquila to fund utility operations a significant concern.

In the event the line of credit is exhausted to meet cash requirements from businesses other than The Missouri Utilities, then under Aquila's proposed term loan structure, The Missouri Utilities may not be able to secure capital from Aquila, or on their own, to meet operating requirements of The Missouri Utilities, since their assets will have been encumbered to support the Aquila line of credit.

Q HAS AQUILA PLEDGED TO USE THE TERM LOAN ONLY FOR DOMESTIC UTILITY CASH WORKING CAPITAL REQUIREMENTS?

A Yes. Aquila has represented that $250 million of the $430 million line of credit will be used only for utility working capital; and utility collateral will be separated by Aquila, not the lender, from non-regulated collateral (Dobson direct at 10). However, Aquila has not provided any assurance that non-regulated companies will be prohibited from drawing upon the utility working capital portion of the line of credit to meet their own cash requirements (Aquila's response to SIEUA and AG Data Request No. SIE-11, attached as Schedule 1) to the detriment of Aquila's regulated utility operations. Aquila's management has made a commitment to prevent this, but has given no guarantees that non-regulated company borrowings from the line of credit will be limited to $180 million.

Given the significant liquidity constraints of Aquila's non-regulated operations,[1] the prospects of using the line of credit to meet the significant non-utility Company cash requirements is very real. Therefore, given the significant liquidity needs of Aquila's non-regulated businesses, the ability of these companies to fully exhaust this line of credit for non-regulated company cash requirements is very real.

Q WHY WOULD AQUILA'S PROPOSAL ELIMINATE THE OPTION OF THE MISSOURI UTILITIES TO ENTER INTO THEIR OWN LINE OF CREDIT FOR THEIR OWN CASH WORKING CAPITAL REQUIREMENTS?

A Under Aquila's proposal, the assets of The Missouri Utilities would be encumbered to collateralize the Aquila line of credit. It is therefore more problematic whether a creditor would be willing to accept a mortgage or lien on Missouri Assets to extend credit to The Missouri Utilities that is junior to Aquila's creditors claims. A junior lien means that a lender to The Missouri Utilities would have to stand in line behind Aquila's creditors in the event of default. Given Aquila's precarious financial condition, it is problematic whether a lender would be willing to extend a line of credit to The Missouri Utilities under those conditions.

Q IS IT YOUR UNDERSTANDING THAT AQUILA ALREADY HAS THE COLLATERAL NEEDED TO ENGAGE THE THREE-YEAR LINE OF CREDIT WITHOUT INCLUDING THE MISSOURI UTILITIES' ASSETS AS PART OF THE COLLATERAL POOL.

A Yes.

[1] Aquila has identified a large amount of debt maturities scheduled for non-regulated operations in calendar year 2004. Aquila projects that it will be able to fund this significant debt retirement primarily from cash flows. However, if Aquila is not able to achieve its cash flow projections, then its ability to fund mandatory debt retirements in 2004 is problematic (Aquila response to SIE-4).

Q PLEASE ELABORATE.

A As part of the interviews conducted by the Staff, Aquila witness Dobson indicated that Aquila now has received approval from enough state commissions to collateralize the three-year term loan up to the estimated domestic utility working capital requirement (TR p. 241, July 16, 2002). Therefore, it does not need to use The Missouri Utilities' assets as collateral to close this loan and Commission authorization to do so should be denied.

Q PLEASE EXPLAIN WHY AQUILA'S PROPOSAL WILL NOT PROVIDE BENEFITS TO THE MISSOURI UTILITIES.

A Aquila argues that the line of credit will ensure that its domestic utility operations will have the working capital sources necessary to provide utility services. However, there are several deficiencies in the Company's position including:

(1) Aquila is attempting to collateralize a $430 million line of credit when it estimates that domestic utility operations only require a cash working capital requirement of $250 million (Aquila Application at 5). Aquila's collateralization and the amount of its line of credit is more than what is needed for only domestic utility operations. Aquila is not providing any assurance that this line of credit will not be used to enhance liquidity for unregulated businesses (Aquila's response to SIE-11). This is a material deficiency because Aquila's non-regulated businesses are having severe liquidity problems and management's ability to use the line of credit collateralized by utility assets to fund the cash requirements of non-regulated business is not prohibited.

(2) The Missouri Utilities have very limited working capital requirements in comparison to Aquila's total United States domestic utility operations. Aquila estimated that a $250 million line of credit is needed for working capital in the domestic utility operations. But, The Missouri Utilities' net working capital requirements are negligible due to

internal cash generation (Aquila's Application at 5, and also see Aquila's response to SIE-9).

Q IF THE MISSOURI UTILITIES WERE INCLUDED IN THE COLLATERAL POOL, WOULD THAT LOWER AQUILA'S BORROWING COST THAT WILL BE ALLOCATED TO THE MISSOURI UTILITIES' OPERATIONS?

A No. Aquila witness Rick Dobson indicated that the borrowing rate under the loan will be reduced by 75 basis points if Aquila adds additional utility plant as collateral to the term loan (Dobson direct testimony at 11). However, this reduced interest cost will not have an impact on the interest cost that will be allocated to The Missouri Utilities' operations. Aquila has committed to only charge interest cost to The Missouri Utilities' operations consistent with investment grade interest rates. The interest rates under the proposed credit facility will reflect Aquila's distressed below investment grade rating. Therefore, Aquila's interest cost under the loan will be higher than the interest cost cap Aquila has committed to in its cost allocation to The Missouri Utilities' operations (Aquila's response to SIE-8, attached as Schedule 1), and rates charged to consumers would not be lowered.

Q HAS AQUILA BEEN ABLE TO DEMONSTRATE WHETHER IT IS PROHIBITED FROM ARRANGING FOR A MISSOURI-ONLY COLLATERALIZED LINE OF CREDIT TO SUPPORT THE MISSOURI UTILITIES' WORKING CAPITAL REQUIREMENTS?

A While Aquila has indicated that it has certain first mortgages in existence for The Missouri Utilities, it has not identified a prohibition from using Missouri assets except that it cannot use assets that are already being used as collateral. Not all Missouri assets are being used as collateral. It has noted that in order to increase borrowings collateralized by The Missouri Utilities' assets, it must receive permission from the Missouri Public Service Commission. Therefore, it appears the only condition to using Missouri Assets to collateralize a Missouri line of credit is Commission approval (Aquila's response to SIE 159, attached as Schedule 1). Because the collateralization is not needed as noted earlier, this approval should be denied.

Q DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A Yes.

Qualifications of Michael Gorman

Q PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A Michael P. Gorman. My business mailing address is P. O. Box 412000, 1215 Fern Ridge Parkway, Suite 208, St. Louis, Missouri 63141-2000.

Q PLEASE STATE YOUR OCCUPATION.

A I am a consultant in the field of public utility regulation and a principal at Brubaker & Associates, Inc., energy, economic and regulatory consultants.

Q PLEASE SUMMARIZE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A In 1983 I received a Bachelors of Science Degree in Electrical Engineering from Southern Illinois University, and in 1986, I received a Masters Degree in Business Administration with a concentration in Finance from the University of Illinois at Springfield. I have also completed several graduate level economics courses.

In August of 1983, I accepted an analyst position with the Illinois Commerce Commission (ICC). In this position, I performed a variety of analyses for both formal and informal investigations before the ICC, including: marginal cost of energy, central dispatch, avoided cost of energy, annual system production costs, and working capital. In October of 1986, I was promoted to the position of Senior Analyst. In this position, I assumed the additional responsibilities of technical leader on projects, and my areas of responsibility were expanded to include utility financial modeling and financial analyses.

In 1987, I was promoted to Director of the Financial Analysis Department. In this position, I was responsible for all financial analyses conducted by the staff. Among other things, I conducted analyses and sponsored testimony before the ICC on rate of return, financial integrity, financial modeling and related issues. I also supervised the development of all Staff analyses and testimony on these same issues. In addition, I supervised the Staff's review and recommendations to the Commission concerning utility plans to issue debt and equity securities.

In August of 1989, I accepted a position with Merrill-Lynch as a financial consultant. After receiving all required securities licenses, I worked with individual investors and small businesses in evaluating and selecting investments suitable to their requirements.

In September of 1990, I accepted a position with Drazen-Brubaker & Associates, Inc. In April 1995 the firm of Brubaker & Associates, Inc. (BAI) was formed. It includes most of the former DBA principals and Staff. Since 1990, I have performed various analyses and sponsored testimony on cost of capital, cost/benefits of utility mergers and acquisitions, utility reorganizations, level of operating expenses and rate base, cost of service studies, and analyses relating industrial jobs and economic development. I also participated in a study used to revise the financial policy for the municipal utility in Kansas City, Kansas.

At BAI, I also have extensive experience working with large energy users to distribute and critically evaluate responses to requests for proposals (RFPs) for electric, steam, and gas energy supply from competitive energy suppliers. These analyses include the evaluation of gas supply and delivery charges, cogeneration and/or combined cycle unit feasibility studies, and the evaluation of third-party asset/supply management agreements. I have also analyzed commodity pricing indices and forward pricing methods for third party supply agreements. Continuing, I have also conducted regional electric market price forecasts.

In addition to our main office in St. Louis, the firm also has branch offices in Corpus Christi, Texas; Plano, Texas; Asheville, North Carolina; Denver, Colorado; and Chicago, Illinois.

Q HAVE YOU EVER TESTIFIED BEFORE A REGULATORY BODY?

A Yes. I have sponsored testimony on cost of capital, revenue requirements, cost of service and other issues before the regulatory commissions in Arizona, Delaware, Florida, Georgia, Illinois, Indiana, Michigan, Missouri, New Mexico, Oklahoma, Tennessee, Texas, Utah, Vermont, West Virginia, Wisconsin and Wyoming. I have also sponsored testimony before the Board of Public Utilities in Kansas City, Kansas; presented rate setting position reports to the regulatory board of the municipal utility in Austin, Texas, and Salt River Project, Arizona, on behalf of industrial customers; and negotiated rate disputes for industrial customers of the Municipal Electric Authority of Georgia in the LaGrange, Georgia district.

Q PLEASE DESCRIBE ANY PROFESSIONAL REGISTRATIONS OR ORGANIZATIONS TO WHICH YOU BELONG.

A I earned the designation of Chartered Financial Analyst (CFA) from the Association for Investment Management and Research (AIMR). The CFA charter was awarded after successfully completing three examinations which covered the subject areas of financial accounting, economics, fixed income and equity valuation and professional and ethical conduct. I am a member of AIMR's Financial Analyst Society.

BEFORE THE

PUBLIC SERVICE COMMISSION OF MISSOURI

In the Matter of the Application by Aquila, Inc. for Authority to Assign, Transfer, Mortgage or Encumber Its Franchise, Works or System	)))	Case No. EF-2003-0465

Index to Schedule 1

AQUILA, INC.
CASE NO. EF-2003-0465
SEDALIA INDUSTRIAL ENERGY USERS ASSOCIATION
AND AG PROCESSING INC.
DATA REQUEST NO. SIE-8

DATE OF REQUEST: June 5, 2003

DATE RECEIVED: June 5, 2003

DATE DUE: June 25, 2003

REQUESTOR: Stuart W. Conrad

QUESTION:

Please provide copies of all investigations or analyses Aquila has undertaken in order to determine how to "ring fence" or financially isolate its Missouri utility operation's credit standing and borrowing protection from all other Aquila regulated and non-regulated businesses.

RESPONSE:

Aquila's corporate structure is that of an "operating company" where all of the regulated activities are operating divisions at the parent company. Holding companies would commonly have a parent company and distinct subsidiaries where the majority of the operating activities reside. The process for Aquila to move to a holding company structure would be a lengthy, difficult and expensive project requiring approvals from numerous counterparties and creditors.Even then, there are no assurances that a utility subsidiary would be completely isolated from the financial performance of another subsidiary.

As described in both Mr. Dobson's and Mr. Empson's testimony in this case, Aquila has maintained a capital allocation process since 1988 that was specifically designed to "financially ring-fence" all utility operations from the activities of the nonregulated businesses. This process has been reconfirmed in this proceeding with the added commitment that any incremental debt required to support the utility operations will be priced at investment grade. This step essentially isolates Missouri utility operations from the impact of the non-investment grade credit rating. The rationale for this process has been presented by Mr. John Dunn's testimony in Aquila's past Missouri rate cases and has been viewed favorably by most of Aquila's regulatory commission's or staff's as discussed in the filed testimony.
As the company continues to divest of its non-regulated entities and move towards being a pure domestic utility company through the implementation of its financial plan, it is in effect achieving the "isolation" impact desired by establishing a "ring fenced " structure.

ATTACHMENT: NA

ANSWERED BY: Mike Cole

AQUILA, INC.
CASE NO. EF-2003-0465
SEDALIA INDUSTRIAL ENERGY USERS ASSOCIATION
AND AG PROCESSING INC.
DATA REQUEST NO. SIE-11

DATE OF REQUEST: June 5, 2003

DATE RECEIVED: June 5, 2003

DATE DUE: June 25, 2003

REQUESTOR: Stuart W. Conrad

QUESTION:

Based on the Company's request to use domestic utility operations to collateralize a line of credit, please explain all assurances and guarantees Aquila will make that the collateralized loan by domestic utility operations will be used only for the working capital needs of domestic utility companies, and will not be used in any way to fund the cash and/or letter of credit requirements of non-utility and non-regulated operations.

RESPONSE:

The Company states on page 5 of its application:

> "...Aquila is separating the Term Loan and collateral into United States utility and other categories to ensure that the utility customers and utility assets are not supporting the nonutility debt requirements. It is Aquila's intent to maintain a proper alignment of United States utility collateral with United States utility loan needs and nondomestic utility and nonregulated business collateral with the loan needs of those activities."

As described in Rick Dobson's testimony, the Company has scaled back its non-regulated activities and is in the midst of selling many of those assets. This sales process has, and will continue to, generate cash that is being used to reduce liabilities and to fund the cash and/or letter of credit requirements of Aquila's non-utility and non-regulated operations separate from its domestic utility business as mentioned above.

There exist a management commitment to assure that sufficient funding will be available to support the domestic utility operations.

ATTACHMENT: NA

ANSWERED BY: Mike Cole

AQUILA, INC.
CASE NO. EF-2003-0465
SEDALIA INDUSTRIAL ENERGY USERS ASSOCIATION
AND AG PROCESSING INC.
DATA REQUEST NO. SIE-159

DATE OF REQUEST: July 24, 2003

DATE RECEIVED: July 25, 2003

DATE DUE: August 9, 2003

REQUESTOR: Stuart W. Conrad

QUESTION:

Please provide a summary of all legal and financial analyses that describe or address the following:

(a) All mortgages and/or collateral contracts that rely only on Missouri utility assets to support loans, bonds, or other borrowing facilities.

(b) All mortgage or collateral contracts on Aquila Inc. assets that support loans, bonds, or other borrowing facilities, that are, in part or whole, allocated to Missouri utility operations.

(c) Whether any existing mortgage or collateral contracts that rely only on Missouri utility assets can be used to securitize a line of credit, revolving credit facility, or any other type of borrowing facility that could be used only for Missouri utility working capital requirements.

RESPONSE:

(a) Aquila is the borrower under a Promissory Note that was executed to fund the acquisition of the Ralph Green Generating Unit located in Pleasant Hill, Missouri. The Generating Unit was purchased off of a lease to which Aquila was party, and has been pledged as collateral to secure the borrowing. The borrowing matures in 2009 and the balance stands at $4.8m. The credit agreement is available for review at the Aquila offices should the SIEUA wish to review it. Aquila is also party to, and borrower under, a First Mortgage Indenture originally entered into by St Joseph Power & Light in 1946. There is currently one amortizing issue for $20.250m outstanding under the Indenture, which is due in 2021. The assets of St. Joe Power & Light are pledged as collateral to secure any borrowings under the Indenture. Copies of the Indenture and the Supplemental Indenture are available for review at the Aquila offices should the SIEUA wish to review them.

(b) Please see attached for a copy of pages 14-15 of Aquila's Form 10-Q for the quarterly period ended March 31, 2003, which includes a description of our Three-Year Secured Credit Facility. The credit agreement is has been filed as Exhibit 10(a)(3) to Aquila's Annual Report on From 10-K and can be found at the following link should the SIEUA wish to review the entire document: http://www.sec.gov/Archives/edgar/data/66960/000104746903013308/a2107467zex-10_a3.txt.

(c) Aquila does not have any Missouri utility assets that can be used to securitize any type of borrowing facility. First, in the acquisition of St Joseph Light & Power in December

2000, Aquila undertook the obligations of the St Joe Light & Power First Mortgage Indenture dated April 1, 1946. A requirement of the Indenture prohibits Aquila from offering any utility assets in the state of Missouri currently encumbered by theIndenture as long as there are any First Mortgage Bonds still outstanding under the Indenture. This restriction would not run to the Missouri Public Service utility assets. Second, Aquila has not yet been granted such authority by the Missouri Public Service Commission.

ATTACHMENT:

(b) Pages 14 and 15 from the Company's Form 10-Q for the quarterly period ended March 31, 2003.

ANSWERED BY: Randy Miller

SIGNATURE OF RESPONDENT

Among other restrictions, the 364-day facility contains the following debt covenants:

(1) If the sale of our Australian equity investments has not been completed within 180 days from April 11, 2003, a formal public sale process will commence on both our Australian equity investments and our independent power project investments.

(2) We are restricted from paying dividends, issuing additional debt, entering into any mergers or acquisitions not meeting a specified leverage requirement or the repurchase or redemption of common stock.

(3) The fair market value of our collateral provided must be at least twice the value of the debt outstanding.

We can voluntarily prepay amounts under the 364-day facility without penalty at any time. However, amounts that are repaid cannot be reborrowed. To the extent we default on any of our loan covenants, our interest rate will increase an additional 2% during the default period.

Three-Year Secured Credit Facility

On April 11, 2003, we closed on a $430.0 million, three-year secured loan. The initial interest rate on the facility will be LIBOR (which has a 3% floor) plus 5.75%. In addition, we were required to pay up front arrangement fees of $17.8 million. Proceeds from the financing will be used to retire debt and support existing and future letters of credit.

The three-year facility is secured by (i) $430.0 million first mortgage bonds issued under a new indenture that constitutes a lien on our existing and future Michigan and Nebraska tangible utility network assets, (ii) a pledge of the equity of a wholly-owned subsidiary that indirectly holds our Canadian utility business, and (iii) a pledge, junior to that in favor of the lenders under the 364-day secured credit facility, of the equity of a wholly-owned subsidiary that indirectly holds our interests in independent power projects. If we default on this loan, the lenders would be entitled to be fully repaid from the sale proceeds of this collateral before other creditors could assert their claims against the collateral.

We have also committed to use reasonable efforts to obtain approvals that would provide these lenders additional utility assets as collateral for their loans. If, as a result of the addition of any such collateral, the value of the collateral securing the indenture exceeds 167% of the loan secured by the indenture, the pledge of the Canadian equity interest may be released and the interest rate would be reduced to LIBOR (which has a 3% floor) plus 5.00%. In April 2003, we filed applications with the state regulatory bodies in Colorado, Iowa, Kansas, Minnesota and Missouri requesting authority to pledge utility assets in their respective states.

We are required to use certain funds to prepay amounts outstanding under the three-year facility unless the value of the collateral will, absent such payment, remain equal to at least 200% of the outstanding loan amount under this facility (subject to certain reductions following certain events). These funds include:

(1) all proceeds from the disposition of any collateral subject to the lien of the first mortgage indenture; and

(2) all distributions and proceeds from our Canadian utility business and independent power project investments so long as the applicable pledge agreements continue to secure this facility.

In addition, the $430.0 million secured debt would become immediately due and payable if we do not complete an exchange offer, tender offer, refinancing or other retirement transaction with regard to 80% of the outstanding principal of our 7% senior note series due July 15, 2004 and our 6.875% senior note series due October 1, 2004, at least two weeks prior to their respective maturity dates. Among other restrictions, the three-year secured facility contains the following financial covenants:

(1) We must maintain a ratio of total debt to total capital of not more than .75 to 1.00 as of September 30, 2003 and December 31, 2003, decreasing to .70 to 1.00 for quarters ending after December 31, 2003.

(2) Beginning July 1, 2003, we must maintain a trailing twelve-month ratio of earnings before interest, taxes, depreciation and amortization (EBITDA) from pledged assets to interest expense related to these assets of no less than 1.05 to 1.00, increasing to 2.0 to 1.0 for quarters ending after December 31, 2004.

(3) Beginning July 1, 2003, we must maintain a trailing twelve-month ratio of debt outstanding on our pledged assets to EBITDA from our pledged assets of no more than 10.5 to 1.0, decreasing to 5.5 to 1.0 for quarters ending after June 30, 2004.

The three-year facility also contains covenants that restrict certain activities including, among others, limitations on additional indebtedness, restrictions on acquisition and sale transactions, and restrictions on the amount that we can fund our unregulated merchant businesses and our Everest telecommunications business. In addition, we are prohibited from paying dividends and from making certain other payments if our senior unsecured debt is not rated at least Ba2 by Moody's and BB by Standard & Poor's, or if such a payment would cause a default under the three-year facility.

Amounts under the three-year facility cannot be voluntarily prepaid except with payment of a make-whole amount. Amounts that are repaid cannot be reborrowed. To the extent we default on any of our loan covenants, our interest rate will increase an additional 2% during the default period.

Letter of Credit Facility

In April 2003, we executed a 364-day Letter of Credit Agreement with a commercial bank. Under terms of the Agreement, the bank has committed to issue up to $200.0 million of letters of credit under the facility. Any letter of credit issued must be fully secured by cash deposits with the bank. We have the option to decrease the commitment amount at any time. The committed amount will automatically decrease to $175.0 million at June 30, 2003 and to $150.0 million at December 31, 2003. At April 30, 2003, $66.8 million of letters of credit have been issued under this facility.

Canadian Finance Subsidiary

In June 2001, our wholly owned Canadian finance subsidiary, Aquila Networks Canada Finance Corporation, issued $200.0 million of 7.75% senior notes in the U.S. public debt market. Aquila has fully and unconditionally guaranteed these notes.

8. Restatement of Consolidated Statement of Cash Flow

As stated in our 2002 Annual Report, in 1997 through 2000, we entered into long-term gas contracts that require us to deliver natural gas to municipal utility customers over a period of 10 to 12 years. In exchange for our commitment to deliver the natural gas, we were paid in advance. We considered these contracts part of our energy trading operations. As such, both the receipt of the advance cash payments and the monthly cash outflows to purchase the gas to be delivered to the customers in satisfaction of our commitments were included in our Consolidated Statements of Cash Flows under the caption Net Changes in Price Risk Management Assets and Liabilities and included in Cash Flows From Operating Activities. These contracts were included under the caption Price Risk Management Liabilities in our Consolidated Balance Sheets prior to December 31, 2002, but are now separately disclosed as Long-term Gas Contracts.