BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE 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

JOINT INITIAL BRIEF OF THE OFFICE OF THE PUBLIC COUNSEL, THE STATE OF MISSOURI, SEDALIA INDUSTRIAL ENERGY USERS' ASSOCIATION AND AG PROCESSING INC.

I. INTRODUCTION

In this proceeding, Aquila, Inc. conducting business in Missouri through its Aquila Networks-MPS and Aquila Networks-L&P operating divisions ("Aquila" or "Company") has sought Commission approval to secure all of its Missouri utility assets as collateral for its $430 million Three Year Term Loan and related First Mortgage and to secure the future replacement debt offerings for working capital requirements not to exceed $430 million at the maturity of the three-year $430 million Term Loan. The Office of the Public Counsel, the State of Missouri, through the Attorney General, Sedalia Industrial Energy Users' Association and Ag Processing Inc a cooperative (hereinafter "Consumer Groups") oppose Aquila's application to encumber its Missouri utility assets and to secure the future replacement debt offerings for working capital requirements not to exceed $430 million. This brief explains the Consumer Groups' reasons for opposing Aquila's request.

II. FACTS

A. The Applicant

On April 30, 2003 Aquila, Inc. filed its verified Application pursuant to Section 393.180 and 393.190.1 RSMo 2000 and 4 CSR 240-2.060(1) and (7) seeking Commission approval to

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encumber its Missouri assets in accordance with the Term Loan (attached as Appendix 3 to its Application); the Indenture (attached as Appendix 4 to its Application); and the First Supplemental Indenture (attached as Appendix 5 to its Application). Aquila is a Delaware corporation with its principal office and place of business at 20 West 9th Street, Kansas City, Missouri. Aquila is authorized to conduct business in Missouri through its Aquila Networks-MPS and Aquila Networks-L & P operating divisions. (Application ¶ 5). Aquila is an "electrical corporation," a "gas corporation," a "heating company" and a "public utility" as those terms are defined in Section 386.020 RSMo. 2000. Consequently, it is subject to the jurisdiction and supervision of the Commission as provided by law. (Application ¶ 6).

B. Aquila's Financial Condition

Aquila's current credit rating is below investment grade. (Ex. 31, p. 11, l. 11-19). As a result, Aquila does not have access to the commercial paper markets. (Tr. p. 238, l. 6-9). According to witness Dobson, Aquila's credit rating has junk bond status. (Tr. p. 457, l. 11-13). Aquila's current weakened financial condition is due to the Company's unregulated operations. (Ex. 31, p. 3, l. 15-17). The record evidence demonstrates that Aquila lost hundreds of millions of dollars when its investments into non-regulated business were not successful. (Ex. 34 H.C, Schedule 3). Witness Dobson admitted that Aquila takes full responsibility for the failure of Aquila's unregulated merchant energy business (Tr. p. 328, l. 7-10) and the millions of dollars of losses related to other non-regulated businesses. (Tr. p. 329, l. 3-25; p. 330, l. 1-4). Witness Dobson also admitted Aquila was not blaming the credit rating agencies for the fact that Aquila's current credit rating is below investment grade. (Tr. p. 328, l. 17-23). On the other hand, Aquila's regulated utility properties continue to provide Aquila with positive net income and the

regulated utility properties did not contribute to the losses Aquila sustained. (Tr. p. 330, l. 20-25; Tr. p. 331, l. 9-13; Ex. 31, p. 3, l. 17-18). Richard Green the President, CEO and Chairman of the Board admitted at his deposition that the reason Aquila found it necessary to secure the three-year $430 million Term Loan was a result of Aquila's losses in its unregulated business. (Tr. p. 330, l. 10-19).

C. The Term Loan

On April 9, 2003, Aquila entered a new $430 million three-year Term Loan Facility and Letter of Credit Facility (sometimes hereinafter "the Term Loan"). (Application ¶ 10). In connection with the Term Loan, Aquila issued First Mortgage Bonds Under its Indenture of Mortgage and Deed of Trust dated April 1, 2003, to Bank One Trust Company, N.A. Trustee ("the Indenture") and its First Supplemental Indenture thereto dated April 9, 2003, to Bank One Trust Company, N.A., Trustee ("the First Supplemental Indenture"). (Application ¶ 10). Aquila has already received the $430 million in proceeds from the Term Loan. (Ex. 12, p. 24, l. 1-2).

Initially, the $430 million 3-year term loan was secured with collateral from the Nebraska and Michigan domestic utilities,[1] a pledge of the capital stock of the holding company of Aquila's Canadian utilities, and a silent 2nd lien on the equity's interest in the holding company of Aquila's IPP investments. (Ex. 4, p. 9, l. 15-18). Aquila has alleged that $250 million of the $430 million Term Loan is needed to support the ongoing working capital requirements for the domestic utility business. (Ex. 4, p. 10, l. 9-11). Aquila has committed to separating the proceeds of the Term Loan and related collateral to ensure that the utility customer and assets are

[1] By law, Aquila did not need to get approval from the regulatory bodies in Michigan and Nebraska to encumber the utility assets located in those states. (Ex. 34, p. 21, l. 6-11).

not supporting the non-utility debt requirement, i.e. Aquila has committed to having non-utility collateral cover the outstanding collateral obligations of the remaining $180 million non-utility portion of the $430 million Term Loan. (Ex. 4, p. 10, l. 21-25). However, pursuant to the Term Loan the funds are available to all areas of Aquila's business. (Ex. 45).

Pursuant to Section 5.13 of the Term Loan in order that the non-regulated operations of Aquila used as collateral can be released as collateral, Aquila contracted to pursue "commercially reasonable" efforts to encumber the assets of its domestic regulated utility companies. Section 5.13 states:

> Post-Closing Matters. (a) Use its commercially reasonable efforts to, as promptly as practicable, obtain all necessary governmental and regulatory approvals (x) to add as additional property under the First Mortgage Indenture the tangible assets of each of the Borrower's operating divisions, to the extent necessary to cause the fair value of the Collateral Utility Business (including the fair value of such additional property (as evidenced by an appraisal dated within three months (or sooner if there has been a material adverse change affecting such additional property)) to be equal to or exceed 167% of the outstanding aggregate principal amount of First Mortgage Bonds then held by the Collateral Agent (such commercially reasonable efforts by the Borrower shall not require it or any of its subsidiaries to, among other thing, (i) modify the conduct of its ordinary course of business in any material respect, (ii) divest itself of any significant assets or business, (iii) refund any amounts to any customer, or (iv) reduce its rates or other charges to its customers) **(once the Borrower shall have caused such additional property to be added and caused such ratio described in clause (x) above to have been first met, the Borrower shall have no further obligation to add additional property under this clause**. (Emphasis added.)

In compliance with Section 5.13 of the Term Loan Aquila filed applications in Colorado, Iowa, Minnesota, Kansas and Missouri seeking approval to encumber utility assets in these various jurisdictions. (Ex. 4, p. 16, l. 14-16). Pursuant to the Term Loan agreement Aquila is **not** required to get regulatory approval to collateralize all of its domestic utility property. Aquila is only required to employ commercially reasonable efforts to do so. (Term Loan Section 5.13).

D. Other States Action

On or about July 11, 2003 the Colorado Public Utilities Commission approved a settlement allowing Aquila to collateralize its Colorado jurisdictional utility assets. (Ex. 34, Schedule TJR 12.1-12.30). The fair value of Aquila's Colorado utility assets is ** ____ ** million. (Ex. 47) and the combined fair value of Aquila's Michigan and Nebraska utility assets is ** ____ ** million. (Ex. 46). Based upon the collateral principles used by the lending institutions, Aquila only needs $417.5 million of utility collateral to support the $250 million of working capital it claims as needed to operate its entire domestic utility business. (Ex. 4, p. 16, l. 19-21). The Colorado, Michigan and Nebraska utility assets combined provide Aquila's creditors with $658 million in collateral, far in excess of the $417.5 million of utility collateral Aquila says it needs to support its $250 million in working capital requirements for its domestic utilities.

On October 22, 2003 in Docket No. G-007, 011/5-03-681 the Minnesota Public Utilities Commission issued its Order Denying Request for Authority to Encumber Minnesota Assets. (Ex. 58). On October 27, 2003 Iowa Utilities Board in Docket No. SPU-03-7 issued its Order Not Disapproving Proposal For Reorganization, Denying Request For Extension of Authority, and Requiring Reports. (Ex. 59). Aquila's request is currently pending in Kansas.

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III. ARGUMENT

A. The Standard of Review By the Commission.

The standard of review has been in serious dispute in this case. Aquila argues for a narrow view that the transaction cannot be rejected by the Commission unless there is "present detriment." If rates do not change and the service quality does not deteriorate, the "status quo" is preserved, argues Aquila, and the Commission cannot reject the transaction. Consumer Groups suggest that the proper standard neither assumes naiveté of, nor foists insouciance upon, the Commission. Indeed, these parties contend that, were Aquila's interpretation actually correct, a crafty utility could entirely frustrate Commission review by separating any rate impact and service quality deterioration from the transaction it sought to justify.

The "no detriment" test was established in *State ex rel. City of St. Louis v. Pub. Serv. Comm'n.*, 73 S.W.2d 393 (Mo. *en banc* 1934), a case involving a merger by stock acquisition -- which is certainly not the factual context of this case. Regardless, Aquila argues that there must be a "direct and present detriment" through an increase in rates or an immediate deterioration in quality of service. (Ex. 3, p. 4, l. 12-14; Tr. p. 256, l. 19-25; p. 257, l. 1-17). If the "status quo" is maintained immediately following the transaction, there can be no detriment, argues Aquila. Aquila's gloss implicitly allows approval of a transaction despite serious public detriments simply because they may not "immediately" occur. *St. Louis*, however, simply does not contain the language claimed by Aquila.

St. Louis dealt with an acquisition through stock purchase of the outstanding shares of one utility by another. While certainly establishing the "no detriment" test, the Court also opined:

> The whole purpose of the [Public Service Commission Act] is to protect the public. The public served by the utility is interested in the service

> rendered by the utility and the price charged therefore; investing public is interested in the value and stability of the securities issued by the utility. State ex rel. Union Electric Light and Power Co. v. Public Service Commission, et al., (Mo. Sup) 62 S.W.2d 742. In fact, the act itself declares this to be the purpose. *Id.* at 399.

Continuing with a discussion of the Commission's obligation, the Court's language is pertinent to this dispute:

> It is . . . their [the Commission's] duty is to see that no such change shall be made ***as would work*** to the public *detriment*. (italics in original; bolded italics are our emphasis).

We draw attention, first, to the absence of the words "immediate," "status quo" or "maintain" in any of this judicial discussion. Aquila, like an earlier Commission, has erroneously engrafted that additional language to the *St. Louis* test and thereby imposed a new requirement well beyond that approved by the Court. Under Aquila's test, since (a) rates cannot change without an intervening Commission order; and (b) any detriment must be essentially simultaneous with the approval of the transaction, no transaction could ever fail -- obviously an incorrect result both logically and under *St. Louis*. *St. Louis* sought to balance the public protection of the Public Service Commission Act with property rights, not establish a rule that rendered Commission review meaningless.

Instead, review of the *St. Louis* case draws attention to the phrase "as would work" suggesting quite the contrary of the interpretation urged by Aquila. Instead these words explicitly indicate that the initiation of a ***process*** that "would work," that is, ***result*** in a detriment is sufficient to cause the rejection of a transaction as against the public interest.

Aquila's argument that the Commission can overlook public detriments that result from the events that are set in motion is also inconsistent with general ratemaking principles that look forward to the period in which the rates that are being set are expected to be in place. In a general

rate case, a test year is utilized, then adjusted for known and measurable changes in an attempt to make it representative of the future period in which the rates to be made are expected to be in effect. Were the Commission, as eagerly invited by Aquila, to fail to look beyond the end of its nose to the possible effects of this transaction, neither the interests of the ratepaying public nor those of the investing public are well served.

This transaction does not directly fit the structure of Section 393.190, despite Aquila's exhaustive efforts to press it into that mold. In fact, the record evidence demonstrates that **none** of the cases cited in paragraph 18 of its Application or appendix six to its Application are similar to the facts and circumstances in the case at bar. (Ex. 55). Simply stated a utility seeking to mortgage or encumber its utility property to secure a debt obligation that **had already been incurred** is a matter of first impression for this Commission.

For its argument that only a "direct and present" detriment can be considered by the Commission, Aquila cites the 2000 case involving the merger of Missouri-American Water Co. and United Cities Water Co. reported at 9 MoPSC 3d 56, 2000 Mo. PSC LEXIS 304 (Mo. PSC 2000).[2] Aquila seizes upon a limited portion of the decision as follows:

> The only purported public detriment that any party has identified is the possibility of a future attempt to recover the acquisition premium from ratepayers. The Commission reads State ex rel. City of St. Louis v. Public Service Commission, supra, 335 Mo. at 459, 73 S.W.2d at 400, to require a direct and present public detriment. The acquisition premium, which MAWC may seek to recover from ratepayers in a rate case yet to be filed, is not a present detriment. "The Commission is unwilling to deny private, investor-owned companies an important incident of the ownership of property unless there is compelling evidence on the record tending to show that a public detriment will occur."

Aquila, however, has failed to consider that the Commission in that decision misread *St. Louis*. Certainly the language of *St. Louis* does not support the construction given by that earlier

[2] Both witness Lowndes and Dobson admitted this proceeding is neither a merger nor an asset sale case. (Tr. p. 257, l. 18-24; p. 325, l. 17-22).

Commission, but even more pertinent, the recent case of *Ag Processing v. Pub. Serv. Comm'n.*, ___ S.W.3d ___, No. SC85352 Mo. en banc October 28, 2003, 2003 Mo. LEXIS 142 October 28, 2003, belies the Commission's interpretation. In *Ag Processing*, as is probably well known to this Commission, an earlier Commission, like that in *Missouri-American, supra*, refused to consider an acquisition premium (roughly valued at $92 million) that Aquila had incurred in connection with a proposed merger involving St. Joseph Light & Power Co. The Commission's approach of preferring to deal with the issue of the acquisition premium in a future rate case and thus defining it as not a "detriment" because it was to be dealt with in a ***future*** proceeding was soundly rejected by the Missouri Supreme Court, in reaffirming the *St. Louis* case. This disposes of Aquila's argument that to be considered in a Section 393.190 proceeding (that Aquila contends applies to this proceeding) a detriment must be "present and immediate." With respect, the *Missouri-American* Commission simply misread *St. Louis*, as does Aquila in this proceeding.

The closest statutory parallel to the facts involved in this case is Section 393.180 which characterizes the ability to encumber assets as a "special privilege."[3] Aquila argues that Section 393.180 does not apply because Aquila is a "foreign" corporation, citing *Public Service Com. v. Union P. R. Co.*, 271 Mo. 258, 197 S.W. 39 (Mo. 1917) ("Union Pacific"). Once again, careful review of Union Pacific repudiates Aquila's weak logic. In *Union Pacific*, the Commission had argued that the UP Railroad was required to have PSC approval before it could complete and sell bonds. The UP argued that because it was a foreign corporation, ***and enjoyed no franchise granted by Missouri***, it was not subject to PSC jurisdiction. While the court upheld the UP's

[3] Section 393.180 provides:

The power of gas corporations, electrical corporations, water corporations, or sewer corporations to issue stocks, bonds, notes and other evidences of indebtedness and to create liens upon their property situated in this state ***is a special privilege,*** the right of supervision, regulation, restriction and control of which is and shall continue to be vested in the state, and such power shall be exercised as provided by law and under such rules and regulations as the commission may prescribe. (emphasis added)

argument, it does not follow that the same ruling would be given to Aquila. Even a cursory reading of the case indicates that the decision turned on the lack of any state granted franchise or privilege granted to the UP by Missouri and for Aquila, that is certainly not the case. Aquila undisputedly is a Delaware corporation, but it obtains considerable and important privileges from Missouri. It is entitled to exercise the sovereign power of eminent domain in furtherance of its public service obligation. It enjoys numerous franchises granted by subdivisions of the state, *i.e.*, towns and municipalities throughout its service territory to be the exclusive provider of electricity and gas within that community. Aquila obtains protection of its monopoly service territory from Missouri law and the Commission. Moreover, Aquila has the bulk of its public utility assets in Missouri, indications in this case was that these assets were valued at over $1 Billion. This is a far different picture than was the case in *Union Pacific*, where less than 1% of the company's assets were in Missouri and where its only activities within the state were to run rolling stock over its right-of way granted to it by federal enactments. Pointedly, the Court held:

> The purpose of section 54 was to embody in the form of positive law the general legal principle that the right to control corporations owing duties to the public, was an incident to the grant to them of special privileges by the State asserting such authority.

Id., 271 Mo. at 266, 197 S.W. at 41. In fact, UP obtained no privileges from Missouri; its operational authority came from other sources. Commission involvement in UP's operations would interfere with interstate commerce. *Union Pacific* does not support Aquila's assertion that it is not subject to Section 393.180. "It follows," held the court, "upon the hypothesis of section 54, supra, that the provisions therein have no application to the [UP], ***which acquired no charter rights nor special privilege from the State of Missouri at any time.***" *Id.*, 271 Mo. at 266, 197 S.W. at 41 (Emphasis added).

B. Commission Approval Should Also Be Denied Because Aquila Lacks Authority to Place a Lien or Other Security Interest Upon the Property of St. Joseph Light & Power Company

1. The UtiliCorp/SJLP Merger Has Been Rejected by Missouri Courts

In early 2000 Aquila, Inc. (at that time known as UtiliCorp United Inc.) and St. Joseph Light & Power Co. (SJLP) jointly applied to the Commission for authority to merge under Section 393.190.1. The Commission case number assigned was EM-2000-292. Commission Staff recommended that the merger not be approved because it was detrimental to the interests of the ratepayers and this recommendation was joined by numerous other parties. Only the two joint applicants favored the transaction. Among other issues was the handling of a $92 million acquisition premium that Aquila had agreed to pay to acquire the SJLP shares. The Commission disposed of this issue by asserting that it was not a present "detriment" and instead would be dealt with in a future rate case. The Commission approved the merger, but before the effective date of the order, Ag Processing and the City of Springfield both filed Applications for Rehearing. Springfield also requested a stay. Despite these pending Applications for Rehearing and the pending Motion for Stay, Aquila and SJLP closed their merger on December 31, 2000. On January 9, 2001, the Commission denied the Applications for Rehearing and Springfield request for a stay. Thereafter, Ag Processing processed judicial review of the decision, which review has finally culminated in a decision from the Missouri Supreme Court remanding the case again to the Commission to consider the issue of the $92 million.

The Missouri Supreme Court ruled as follows:

> The fact that the acquisition premium recoupment issue could be addressed in a subsequent ratemaking case did not relieve the PSC of the duty of deciding it as a relevant and critical issue when ruling on the proposed merger. While PSC may be unable to speculate about future merger--related rate increases, it can determine whether the acquisition premium was reasonable, and it should have considered it as

> part of the cost analysis when evaluating whether the proposed merger would be detrimental to the public. The PSC's refusal to consider this issue in conjunction with the other issues raised by the PSC staff may have substantially impacted the weight of the evidence evaluated to approve the merger. The PSC erred when determining whether to approve the merger because it failed to consider and decide all the necessary and essential issues, primarily the issue of UtiliCorp's being allowed to recoup the acquisition premium.

The Court concluded by remanding the case to the Circuit Court and then to the Commission as follows:

> The judgment is ***reversed***, and the case is remanded. The circuit court shall remand the case to the PSC to consider and decide the issue of recoupment of the acquisition premium in conjunction with the other issues raised by PSC staff and the intervenors in making its determination of whether the merger is detrimental to the public. ***Upon remand the Commission will have the opportunity to reconsider the totality of all of the necessary evidence to evaluate the reasonableness of a decision to approve a merger between UtiliCorp and SJLP.*** (footnotes omitted; emphasis added)

If the Commission has now been directed to consider the recoupment of the acquisition premium and invited to reconsider its decision to "approve a merger between UtiliCorp and SJLP" it follows that there has been no lawful merger of the two entities. Section 393.190.1 states that "[e]very such sale, assignment, lease, transfer, mortgage, disposition, encumbrance, merger or consolidation made other than in accordance with the order of the commission authorizing same shall be void." Since there was no lawful order of the Commission approving the merger, the claimed merger between UtiliCorp and SJLP is void and Aquila has no more authority to encumber the assets of SJLP than does any third party.

2. The UtiliCorp/SJLP Merger "Closed" Without an Order of the Commission Authorizing the Transaction.

A brief review of the relevant dates surrounding the Aquila [UtiliCorp]/SJLP "merger" is instructive:

12/14/00	Missouri PSC issues Report and Order, approving the merger but rejecting several aspects of Aquila's and St. Joseph Light & Power's (SJLP) plan of merger. The Report and Order is stated to be effective December 27, 2000.
12/22/00	Ag Processing files its timely Application for Rehearing under Section 386.500. The City of Springfield also files an Application for Rehearing. Both were filed before the effective date of the Report and Order being challenged as required by Section 386.500. Springfield also files for a stay.
12/28/00	UtiliCorp files a Motion for Expedited Treatment and Response of UtiliCorp United Inc. to Application for Rehearing, Motion for Reconsideration and Request for Stay of City of Springfield and to Application for Rehearing of AG Processing, Inc. with the Commission.
12/31/00	With two Applications for Rehearing and one Application for Stay still pending, Aquila and SJLP nevertheless proceed to "close" their merger.
1/9/01	Missouri PSC denies both AGP and Springfield's Applications for Rehearing and denies Springfield's Application for Stay. The Report and Order is now final and subject to judicial review by either or both parties. Section 386.500.
1/16/01	AGP files a Petition for Writ of Review with the Cole County Circuit Court, well within the thirty days following denial of its Application for Rehearing that are allowed by Section 386.510.

The "merger" was closed without proper approval from this Commission. Even after December 14, UtiliCorp still had the ability to control its fate and cancel or -- importantly -- defer closing the merger pending Commission disposition of any timely filed applications for rehearing. Instead, Aquila and SJLP chose to go forward -- at their own risk -- and in the face of pending Applications for Rehearing and to proceed with their merger.

Nor was this an unforeseen risk. Aquila was well aware of what it was doing and the risk it was running in proceeding to "close" its merger with the Applications for Rehearing still pending. On December 28, 2000 it filed its Motion for Expedited Treatment and Response of UtiliCorp United Inc. to Application for Rehearing, Motion for Reconsideration and Request for Stay of City of Springfield and to Application for Rehearing of Ag Processing, Inc. In that Motion UtiliCorp stated that it "desires that the Application for Rehearing, Motion for Reconsideration and Request for Say filed by City Utilities and the Application for Rehearing filed by AGP be processed on an expedited basis and denied immediately." UtiliCorp then stated the following:

> 5. As indicated previously, the UtiliCorp/SJLP merger is scheduled to be closed on December 29, 2000. In the event the Commission ***fails to act*** upon the involved pleadings of City Utilities and AGP prior to December 29, 2000, UtiliCorp intends to close the subject merger on that date thereby rendering said pleadings moot. (Emphasis added).

Aquila cited the Commission to no authority supporting this bold -- indeed arrogant -- assertion.[4] Regardless, UtiliCorp was obviously concerned about what it was doing and the risk it was running.

The Supreme Court's decision properly draws attention to the question of whether these merger partners merged their operations in violation of Section 393.190 which provides:

> No gas corporation, electrical corporation . . . shall hereafter sell, assign, lease, transfer, mortgage or otherwise dispose of or encumber the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public, nor by any means, direct or indirect, merge or consolidate such works or system, or franchise or any part thereof, with any other corporation, person or public utility, ***without having first secured from the commission an order authorizing it so to do. Every*** such sale, assignment, lease, transfer . . . ***merger*** or consolidation ***made other than in accordance with the order of the commission authorizing same shall be void***. (emphasis added).

[4] Aquila later sought to dismiss Ag Processing's appeal, then lodged at the Missouri Court of Appeals, Western District, by asserting that the merger had closed and Ag Processing's appeal was, therefore, "moot." This motion was so summarily rejected by the Court of Appeals that it was not renewed by Aquila after the matter was transferred to the Missouri Supreme Court.

This “merger” was closed unlawfully under Section 393,190, for the December 14, 2000 Report and Order of the Commission was not a final order. The provisions of Section 393.190 appear unambiguous. An order of approval first must be “secured” from the commission before proceeding with any such plan as a merger and the failure to “secure” such an order makes any transfer or merger void. The Joint Applicants had not "secured" a final authorization from the Commission ***as they were required to do under Section 393.190*** at the time they closed their merger. The Report and Order did not become final until both pending rehearing applications had been denied on January 9, 2001, ***after*** Aquila had "closed" its "merger."

Nor can Aquila argue that, somehow, the Commission decision permitting the merger became "final," then ceased to be so at some later time. Section 386.510 RSMo denies access to the Courts and judicial review until the administrative decision is final. Section 386.510 conditions access to the courts upon a denial of an application for rehearing or, if a rehearing application is granted, thirty days after the rendition of a decision upon that rehearing.

Missouri appellate courts have recently held that a commission report and order that is subject to rehearing is not a "final order" of the Commission. *State ex rel. County of Jackson v. Public Service Commission*, 14 S.W.3d 99 (Mo. App., W.D. 2000). And if multiple applications for rehearing have been filed under Section 386.510, ***all*** applications for rehearing must be denied before the Report and Order becomes final and judicial review may be initiated by any party. *Id.*

In *State ex rel. Riverside Pipeline Company et al., v. Public Service Commission*, 26 S.W.2d 396 (Mo. App., W.D. 2000) the Court of Appeals rejected an attempt to obtain immediate judicial review of a PSC order that denied the appealing parties' motion to dismiss:

> Both the Missouri Constitution and Mo. Rev. Stat. § 536.150 (1986), impose the additional requirement that the decision be final before it is deemed reviewable. 'Finality' is found when 'the agency arrives at a ***terminal, complete resolution of the case before it***. An order lacks finality in this sense while it remains tentative, provisional, ***or contingent, subject to recall, revision or reconsideration*** by the issuing agency.'

Id., at 400 (emphasis added) (quoting from *Dore & Assoc Contracting, Inc. v. Missouri Dept. of Labor & Indus. Relations Comm'n,* 810 S.W.2d 72, 75-76 (Mo. App 1990)).

Timely filing by AGP of its Application for Rehearing in advance of the effective date, accompanied by the separate filing by City of Springfield also for Rehearing meant that the Report and Order was still "tentative, provisional, or contingent, subject to recall, revision or reconsideration." *Id.* Timely filing of these applications for rehearing robbed the December 14, 2000 decision of finality until the Commission disposed of those applications on January 9, 2001, some ten days after the merger "closed" as recited by Aquila. It thus follows that on December 31, 2000 Aquila acted to merge its assets and perform numerous other transactions that are undenied by Aquila ***"without having first secured from the commission an order authorizing it so to do."*** Section 393.130 RSMo. The "merger" is void under Section 393.190 and Aquila has no lawful authority to encumber SJLP assets.

3. The Commission Cannot Lawfully Act Retroactively to Validate the Earlier Order.

The Missouri Supreme Court, in banc, has now ruled on the UtiliCorp/SJLP merger and found that the Commission's decision was not supported by competent and substantial evidence, reversed the decision of the Commission and the Circuit Court, and redirected the matter again to the Commission where the Commission is to consider "recoupment of the acquisition premium in conjunction with the other issues raised by PSC staff and the intervenors ***in making its determination of whether the merger is detrimental to the public.***" Obviously that

"determination" was not made in the December 14, 2000 Report and Order. The Commission's orders have prospective effect only. *Lightfoot v. City of Springfield*, 236 S.W.2d 348, 353 (Mo. 1951). Thus, Aquila is presently without authority to encumber SJLP assets, was without that authority when the Term Loan documents were signed, was without that authority when this Application was filed and, indeed, has no authority to apply for Commission authorization to encumber SJLP assets -- assets that do not legally belong to Aquila.

C. The Commission should deny Aquila's Application to encumber its Missouri jurisdictional regulated assets to secure its three-year $430 million Term Loan Facility and related First Mortgage Bonds.

1. Aquila's Four Reasons To Encumber Missouri Assets

In both its Application and its prefiled testimony, Aquila has proffered four essential reasons to encumber its Missouri assets. (Application ¶ 17; Ex. 4, p. 10, l. 25; p. 11, l. 1-14). The four reasons are as follows: 1) to have full use of the Term Loan, upon the sale of the Canadian assets those assets will need to be replaced as security by additional utility assets; 2) utility assets should support the working capital requirements for the utility operations; 3) since the working capital is needed to support the day-to-day operations of all Aquila's utility operations it is only fair that all of Aquila's utility assets should be in the collateral pool and; 4) the borrowing rate under the Term Loan drops 75 basis points, to 8.00%, if Aquila adds additional utility assets from other states as collateral so that the ratio of utility assets in the collateral pool to the total amount of debt in the Term Loan is 1.67 or higher. (Application ¶ 17; Ex. 4, p. 11, l. 1-12). Since Aquila filed its Application on April 30, 2003, three of these four "reasons" are no longer valid and the final reason is not persuasive.

The record evidence demonstrates that Aquila will still have full use of the Term Loan, *i.e.*, use of the entire $430 million even after the sale of the Canadian assets if its Application is denied. This is because subsequent to filing its Application, Colorado approved placing its state's utility collateral in the pool to support the $430 million 3-year Term Loan. (Tr. p. 350, l. 15-19). Under cross-examination witness Dobson admitted this "reason" had been vitiated by the fact that Aquila has enough assets currently in the pool to have full use of the Term Loan after the sale of the Canadian assets. (Tr. p. 350, l. 20-25; p. 351, l. 1-4).

The record evidence demonstrates that Aquila's second reason -- utility assets should support the working capital needs for the utility operations -- has also been satisfied. Aquila currently has $658 million worth of utility assets in the collateral pool to support its alleged $250 million peak day working capital need. (Tr. p. 351, l. 10-14).[5] Based upon the collateral principles used by the lending institutions, Aquila only needs $417.5 million of utility collateral to support the alleged $250 million peak day working capital needed to operate the domestic utility business. (Tr. p. 260, l. 13-18; Ex. 4, p. 16, l. 19-21; Ex. 34, p. 17, l. 5-10). During cross-examination, witnesses Dobson and Lowndes admitted that Aquila's utility assets already in the pool exceeded what was needed by more than $200 million. (Tr. p. 351, l. 15-20; Tr. p. 371, l. 10-13; Tr. p. 260, l. 19-25; p. 261, l. 1-2). Aquila already has met and exceeded this requirement (Ex. 34, p. 17, l. 12-17), this "reason" has already been satisfied and cannot support this Commission allowing Aquila to encumber its Missouri jurisdictional utility assets.

[5] This $658 million amount will increase once the Iowa utility assets are appraised and placed into the collateral pool.

The third reason offered by Aquila for encumbering over $1 billion worth of Missouri utility assets is that it is only "fair" that all of Aquila's utility operations need peak day cash working capital. This "fairness doctrine" has been created out of whole cloth by Aquila (Tr. p. 352, l. 1-7) and does not justify subjecting over $1 billion worth of Missouri utility assets to support some undefined alleged peak day cash working capital requirement for Missouri. The theory undergirding this argument is that the Missouri ratepayers owe some sort of "duty" to ratepayers in Minnesota, Nebraska, Michigan, Colorado, Kansas and Iowa such that Missouri jurisdictional assets should be encumbered whether those assets are needed or not to fulfill the requirements of the Term Loan. This theory is simply wrong.

Aquila has created this "fairness doctrine" in its attempt to subject Missouri assets to encumbrance to support the Term Loan. No record evidence exists that any other state or any one other than Aquila believed in this fairness doctrine. When Colorado approved placing its jurisdictional collateral into the asset pool, Colorado did so with the knowledge that other states might not subject their jurisdictional assets to collateralization. In fact, the Minnesota regulatory authority rejected Aquila's request. (Ex. 58). Moreover, Aquila has not even attempted to justify how encumbering over $1 billion worth of Missouri assets is "fair" given that the record evidence demonstrates that Missouri's peak day working capital needs are either negative or extremely miniscule. (Ex. 34, p. 20, l. 10-21; p. 21, l. 1-4). In response to a question from Commissioner Murray witness Dobson admitted encumbering all of Missouri's jurisdictional utility assets to support the Term Loan would not be fair to Missouri given his view of Missouri's peak day working capital needs. (Tr. p 471, l. 17-25). Simply put, Aquila's "fairness doctrine" rings hollow and should be rejected by the Commission.

The final reason proffered by Aquila was that the borrowing rate under the Term Loan drops 75 basis points, to 8.00%, if Aquila adds additional utility assets from other states as collateral so that the ratio of utility assets in the collateral pool to the total amount of debt in the Term Loan is 1.67 or higher. To achieve this borrowing rate reduction, Aquila must have $718.5 million worth of utility assets in the collateral pool. (Tr. p. 384, l. 4-9). When the hearing in this matter began, Aquila had $658 million worth of utility assets in the pool. (Ex. 35, p. 17, l. 12-17). Thus, Aquila needs only $60 million of regulated assets to be placed in the pool to achieve the interest rate reduction. (Tr. p. 365, l. 20-23).

First, a 75 basis point reduction in the Term Loan interest rate will not reduce the rate Aquila charges the utility operations for its loans. (Ex. 12, p. 18, l. 11-12). The only beneficiary of the interest rate reduction will be Aquila's non-regulated operations despite utility assets being used to achieve the interest rate reduction. (Ex. 12, p. 18, l. 13-14). During cross-examination and in response to questions from Commissioner Murray, witness Dobson admitted that Missouri's regulated customers do not get any direct benefit from this interest rate reduction. (Tr. p. 365, l. 24-25; Tr. p. 366, l. 1-4; Tr. p. 42, l. 1-7). He also admitted Aquila will have adequate financial liquidity for the next three years whether or not Missouri utility assets are placed into the collateral pool. (Tr. p. 368, l. 17-25; Tr. p. 369, l. 1-12).

Second, on October 27, 2003, the Iowa Utilities Board approved Aquila's Application to secure its utility assets in that state to support the three-year $430 million Term Loan. (Ex. 59). During cross-examination from counsel, Aquila witness Empson equivocated as to whether the Iowa utility assets being placed in the collateral pool would result in enough utility assets to trigger the 75 basis point reduction in the Term Loan interest rate. (Tr. p. 553, l. 16-25; Tr. p. 554, l. 1-16). However, in response to a question from Commissioner Forbis witness Dobson candidly admitted

that placing the Iowa utility assets in the collateral pool would trigger the 75 basis points rate reduction in the Term Loan. (Tr. p. 482, l. 18-25; p. 483, l. 1-9). In its most recent Form 10-Q filed on November 6, 2003 with the Securities and Exchange Commission at page 20, Aquila stated:

> After our Iowa utility assets have been formally pledged, we will request that our interest rate be reduced as described above, and we will have pledged utility assets in Michigan, Nebraska, Iowa and Colorado which would then fully collateralize the loan. Following the pledge of our Iowa utility assets, we will not be required by the credit facility to maintain collateral for the loan beyond the utility assets pledged. However, it is our intention that borrowings under the credit facility that are not needed to support our utility operations be collateralized by non-utility assets. (Emphasis added.)

This statement clearly demonstrates that placing the Iowa assets in the collateral pool triggers the 75 basis point reduction. The 10-Q was certified pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 by Richard C. Green, Jr., Chairman, President and Chief Operating Officer and Rick J. Dobson, Chief Financial Officer. (A copy of the pertinent pages from Aquila's 10-Q are attached as Attachment 1). Simply stated, Aquila now has enough utility assets in the collateral pool to receive the 75 basis point reduction in the Term Loan interest rate. Thus, this "reason" for granting Aquila's request is no longer valid.

The unstated reason Aquila filed this Application with the Commission is found in Section 5.13 (Schedule RD-9, Ex. 4) of the Term Loan requiring Aquila to pursue "commercially reasonable" efforts to encumber the assets of its domestic regulated utility divisions. Witness Dobson testified in response to a question from Commissioner Forbis that the number one reason Aquila was seeking approval to encumber the Missouri utility assets was the contractual requirement in the Term Loan. (Tr. p. 484, l. 4-10). Pursuant to Section 5.13 of the Term Loan, Aquila is not required to get approval to collateralize all of its domestic utility property. (Tr. p. 369, l. 13-16; Ex. 34, p. 30, l. 1-5). And in response to questions from Commissioner Forbis witness

Dobson admitted that there is no net negative effect on Aquila from a loan perspective if its Application is rejected. (Tr. p. 486, l. 22-25; p. 487, l. 1-4). By filing this Application and seeking a Commission decision, Aquila has fully satisfied its contractual obligations to its lenders to use its "commercially reasonable" efforts to encumber its Missouri jurisdictional assets. (Ex. 12, p. 8, l. 8-17).

In the case at bar, the reasons Aquila sought to encumber Missouri utility assets have been satisfied. Aquila now has received authorizations to encumber more than enough combined utility assets to meet Aquila's claimed requirement of $417.5 million in utility collateral to support the alleged $250 million peak day working capital requirements for the U.S. utilities and Aquila has more than enough utility assets in the collateral pool to receive the 75 basis point reduction in the Term Loan interest rate. Aquila has used "commercially reasonable efforts" in the form of its Application to encumber its Missouri assets to meet its obligations under Section 5.13 of the Term Loan.

Aquila has wholly failed to offer any justification or any reason to encumber its Missouri utility property. This Commission can no longer grant Aquila any meaningful relief. Aquila has already obtained more than sufficient authorizations to encumber assets in other jurisdictions that satisfies all of Aquila's alleged reasons for this Commission to approve its Application. Because Aquila has failed to offer any justification or reason to encumber its Missouri utility property the Commission should deny Aquila's Application.

2. Public Detriment

a. Reduced Financial Flexibility

Aquila's request to encumber all of its Missouri jurisdictional regulated assets to support this single three-year $430 million Term Loan will severely reduce Aquila's future financial flexibility. (Ex. 31, p. 14, l. 18-21). If this Commission approves encumbering all of Missouri's regulated assets, Aquila will have no uncollateralized utility assets to support future potential debt issuances. (Ex. 31, p. 14, l. 20-21). This lack of financial flexibility is a detriment to both Aquila and its ratepayers.

As addressed in the testimony of Staff witness Mantle (Ex. 18), Aquila will need to address capacity expansion requirements sometime within this decade. By not encumbering Aquila's Missouri assets, it leaves those assets available to address future financing needs that Aquila has indicated will be required. To encumber assets unnecessarily would not be sound regulatory policy and would be detrimental to Aquila's customers in the long run. (Ex. 12, p. 25, l. 1-2).

The record evidence demonstrates that Aquila cannot seek **any** secured debt instrument that matures during the tenure of Aquila's three-year $430 million Term Loan. (Tr. p. 400, l. 14-22; Tr. p 531, l. 10-15). Any future secured debt would be second in line behind the three-year $430 million Term Loan. As noted, Aquila currently has more than enough collateral to secure its $250 million portion of its Term Loan for utility purposes. (Tr. p. 351, l. 15-20). In fact, with the addition of the Iowa property, Aquila has more than enough utility property to secure the entire three-year $430 million Term Loan. (Tr. p. 482, l. 18-25; p. 483, l. 1-9).

Given Aquila's precarious financial situation, Aquila should have more financial flexibility not less. Aquila recognizes that financial flexibility is important (Ex. 31, p. 14, l. 23-32; p. 15, l. 1-3) and yet seeks to reduce that financial flexibility by unnecessarily seeking to encumber its over $1

billion worth of Missouri jurisdictional assets. It is simply untenable for Aquila to claim the need for financial flexibility while at the same time requesting over-collateralization of regulated utility assets. (Ex. 31, p. 15, l. 11-13). This reduction in Aquila's financial flexibility results in a detriment to both Aquila and its ratepayers.

b. Regulated Assets Supporting Non-Regulated Debt

Aquila has stated its intention to return to its roots as a regulated utility company. (Ex. 31, p. 13, 1. 1-20). To achieve that goal, Aquila has engaged in and continues to engage in the sale of its non-regulated assets. Currently, Aquila has a contract to sell its Canadian properties (Tr. p. 394, l. 14-17), its English properties and its independent power producers. (Tr. p. 336, l. 22-24). Aquila also has undefined plans to rid itself of its other non-regulated assets. (Tr. p. 399, l. 15-18; Ex. 44). One hundred and eighty million ($180) of the $430 million three-year Term Loan is designed to support Aquila's unregulated business cash needs. Using the lenders' collateral requirements, this means Aquila needs $360 million worth of non-regulated collateral to support the $180 million portion of the Term Loan. Aquila has made a commitment to pay down the Term Loan if it does not have enough non-regulated assets to support the $180 million. (Ex. 4, p. 10, l. 23-25; Tr. p. 371, l. 19-23). However, to meet this commitment, Aquila will either have to make an optional prepayment on the Term Loan or have regulated assets supporting non-regulated debt. Either of these events results in a public detriment to Aquila's ratepayers.

Currently, Aquila has $658 million worth of utility assets supporting the three-year $430 million Term Loan. With the inclusion of the Iowa utility assets in the pool, Aquila will have well over the $718.5 million worth of utility assets to support the entire $430 million amount of the three-year Term Loan. Thus, if this Commission approves Aquila's request to encumber its Missouri assets, the Term Loan would be over-collateralized. (Ex. 31, p. 16, l. 9-12).

If Aquila is allowed to collateralize Missouri's regulated assets, which will further over-collateralize the Term Loan, when Aquila sells its unregulated assets as the record evidence demonstrates Aquila is doing, the end result will be that the entire Term Loan will be collateralized with regulated assets. (Ex. 31, p. 17, l. 25-34). This will be true even though the Company has said that only $250 million of the $430 million Term Loan will support regulated operations. (Ex. 31, p. 17, l. 34-36). That means that Missouri regulated utility assets will be supporting debt that was acquired for and being used for unregulated operations. (Ex. 31, p. 16, l. 1-6). That is detrimental to Missouri's ratepayers because regulated assets and/or debt should not be used to support higher-risk unregulated operations that do not provide utility service to those customers.

If Aquila over-collateralizes its Term Loan, it can only pay down that Term Loan using the Optional Prepayment provisions found in Section 2.7(a)(1). This optional prepayment will result in Aquila having to make a penalty payment to the lenders referred to in the loan document as the Make Whole Provision. (Ex. 31, p. 19, l. 1-4). If the loan is over-collateralized, as it would be if the Missouri assets are placed in the pool, and Aquila wishes to pay down the loan, it would have to pay the noteholders, in present value dollars, the value of all future interest and principle payments. (Ex. 31, p. 19, l. 5-6).

Witness Dobson admitted that if the Term Loan is over-collateralized and Aquila makes an optional prepayment to meet its commitment to the Commission, it would be required to pay the penalty provisions, the make whole premium, contained in the Term Loan. (Tr. p. 399, l. 12-14; Ex. 12, p. 7, l. 2-4). Aquila will be unable to meet its commitment to reduce the Term Loan upon the sale of unregulated assets without paying the investors the full value of the investment. (Ex. 31, p. 19, l. 11-13). Thus, over-collateralization results in Aquila having to pay more money to the creditors than it would if it maintained a proper collateral distribution. This results in a detriment to

Missouri ratepayers because Aquila would be required to pay more money to creditors thus exasperating its already bad financial situation.

c. Default Provisions

Another detriment to the ratepayers is the risk created by rights granted by Aquila to the bond holders and the trustee contained in Article IX, Events of Default; Remedies of the Indenture of Mortgage and Deed of Trust of Aquila, Inc. to Bank One Trust Company, N.A. (Ex. 4, Schedule RD 10, pp. 71-81), the document that memorializes the securitization of the Term Loan.

That article begins with Section 9.01 and lays out six events of default generally summarized as follows: (a) default in the payment of any interest upon any Security (meaning bonds, notes or other evidences of indebtedness under the Indenture of Mortgage and Deed of Trust - See Ex. 4, Sch. RD 10, p. 1) when due and payable and the continuance of that default for 30 days (Ex. 4, Sch. RD10, p. 71); (b) default in the payment of principal of or any premium on any Security when it becomes due and payable (Id.); (c) default in the performance, or breach, of any covenant or warranty of Aquila in the Indenture, and the continuance of that default or breach for 90 days after Aquila receives notice from the Trustee, Bank One, or Aquila and the Trustee receive notice of the default from at least 33% of the Holders (meaning the persons in whose name the Security is registered - See Ex. 4, Sch. RD10, p. 9) (Ex. 4, Sch. RD10, p. 72); (d) a default by Aquila under any bond, debenture, note or other evidence of indebtedness for money borrowed by Aquila or under any mortgage, indenture or instrument under which Aquila may borrow money, secure or evidence any indebtedness, now existing or created in the future, where the default would result in an indebtedness whose aggregate principal amount due would exceed $40 million, being declared due and payable prior to its maturity (Ex. 4, Sch. RD10, p.

72); (e) the entry by a court having jurisdiction of a decree or order for relief against Aquila, in an involuntary case, proceeding under federal or state bankruptcy, insolvency, reorganization or similar law, or a decree or order, unstayed and in effect for 90 consecutive days, adjudicating Aquila bankrupt or insolvent or approving as properly filed a petition filed by someone other than Aquila seeking Aquila's reorganization, or the appointment of a custodian, receiver, liquidator, assignee, trustee, etc., over Aquila or part of its property or ordering Aquila's winding up or liquidation (Ex. 4, Sch. RD10, p. 72); and (f) Aquila's commencing voluntary proceedings under applicable federal or state bankruptcy, insolvency, reorganization or similar law, or consent to the entry of a decree or order for relief against it in an involuntary case or Aquila's consent to the commencement of a bankruptcy or insolvency proceeding against it or Aquila's filing a petition, answer or consent seeking reorganization or relief under applicable federal or state law, or Aquila's consent to the filing of such a petition or to the appointment of or taking possession by a custodian, receiver, liquidator, assignee, trustee, etc., of Aquila or any substantial part of its property, or Aquila's making an assignment of a substantial part of its property and assets for the benefit of creditors, or Aquila's admission in writing of its being unable to pay its debts generally as they come due, or Aquila's taking corporate action in furtherance of any such action (Ex. 4, Sch. RD10, p. 72-73). As is evident, even in simplified, summary form, the Indenture casts a wide net of occurrences that would constitute a default and trigger the remedies set out in the ensuing sections of the Indenture. Those sections begin with Section 9.02 (Ex. 4, Sch. RD10, p. 73-74).

Section 9.02, entitled "Acceleration of Maturity; Rescission and Annulment," states generally that if an event of default occurs and remains uncured, either the Trustee or the Holders of not less than 33% in principal amount of the Securities then outstanding may declare the

principal amount of all the Securities outstanding due and payable immediately. Upon notice to Aquila, the principal, any premium and any accrued interest "shall become immediately due and payable." (Ex. 4, Sch. RD10, p. 73). That immediate acceleration of payment due would create a capital crisis for Aquila. Since Aquila's only meaningful source of revenue are its regulated utilities, those utilities' ratepayers would bear a heavy weight on their shoulders.

The default provisions continue with Section 9.03, "Entry Upon Mortgaged Property." That section states that in the event of a default, to the extent permitted by applicable law, Aquila "shall forthwith surrender to the Trustee the actual possession of, and the Trustee, by such officers or agents as it may appoint, may enter upon and take possession of, the Mortgaged Property; and the Trustee may hold, operate and manage the Mortgaged Property[.]" (Ex. 4, Sch. RD10, p. 74). The Mortgaged Property "means, as of any particular time, all property which at such time is subject to the Lien of this Indenture." (Ex. 4, Sch. RD10, p. 11). Under the Indenture, Lien "means any mortgage, deed of trust, pledge, security interest, encumbrance, easement, lease, reservation, restriction, servitude, charge or similar right and any other lien of any kind[.]" (Id.) If the Commission allows Aquila to encumber its Missouri regulated assets, those assets will fall under the definition of Mortgaged Property, and the Trustee will have rights, for the benefit of the security Holders, with respect to the Missouri utilities.

What that means is the Trustee, Bank One, N.A., a national banking association operating out of Chicago (Ex. 4, Sch. RD10, p. 1), for the benefit of bond holders, people whose investment interest is not the steady security of a regulated business, but rather, the high risk – high pay off world of junk bonds, would assume possession and operation of Aquila's regulated assets. There is no public record indicating that Bank One, N.A. holds a certificate issued by this Commission to provide any service in Missouri as described in Chapters 386 or

393 of Revised Statutes of Missouri. Nor is there any evidence in the record of this case indicative that Bank One, N.A. has any expertise in operating a regulated utility. But, in the event of default, the Trustee's rights are not limited to possession and operation of the Mortgaged Properties.

According to Section 9.04 of the Indenture, in the occurrence and continuation of any event of default, among other remedies, "the Trustee, directly or by its agents or attorneys, with or without entry upon the Mortgaged Property, in its discretion, subject to the provisions of Section 9.16 [entitled, "Control by Holders" (Ex. 4, Sch. RD10, p. 80)] and if, and to the extent, permitted by applicable law (a) may sell, subject to prior Liens, to the highest and best bidder, all or any part of the Mortgaged Property of every kind and all right, title and interest therein and right of redemption thereof, which sale shall be made at public auction at such place and at such time and upon such terms as the Trustee may fix and briefly specify in a notice of sale[.]" (Ex. 4, Sch. RD10, p. 75). There are no provisions in the Indenture to ensure that the "highest and best bidder" be qualified or certificated to operate a public utility in Missouri or any other state.

In fact, according to Section 9.05 of the Indenture, "Incidents of Sale," even the Trustee or the Holders "may bid for and purchase the property offered for sale[.]" (Id.)

If the Commission approves Aquila's application to encumber its Missouri regulated assets, it will be approving an encumbrance that includes the rights described above. Nothing in the Indenture nor anything in the Term Loan (Ex. 4, Sch. RD9) suggests that Aquila, the Trustee, the Holders, or Credit Suisse First Boston (Cayman Islands Branch), will have to return to the Commission to seek approval of any terms of transfer of a Missouri public utility. Creating that risk of losing regulatory control is a detriment to the public.

Aquila will likely respond in their reply brief that the default terms of the Indenture are standard financing terms. And, for companies that have driven their crediting rating into the ground so that they are at the mercy of those willing to provide them with any financing at all, that may be true. But the quality of a utility's management affects ratepayers. (Tr. 760, l. 2-4.). And control of Missouri regulated assets by speculative, junk bond investors would be a detriment to ratepayers because their interests are not aligned with the interests of ratepayers. (Tr. 760, l. 8-15).

d. Bankruptcy

As noted above, bankruptcy is one of the many events of default under the Indenture. ** _____ ** (Dobson HC Testimony, Tr. 464, l. 6-8).

If Aquila were to go into bankruptcy, it would be better for the company and its ratepayers that the Missouri assets not be pledged as collateral. Even Aquila cannot seriously argue with the premise that the more debt Aquila can discharge in bankruptcy, the less debt burden it will carry as it emerges from bankruptcy, the better financial shape it will be in. That will benefit ratepayers because Aquila's only meaningful source of revenue comes from its regulated utility businesses. Broken out from the company as whole, those businesses are profitable. (Tr. p. 330, l. 20-25; p. 331, l. 9-13). The ratepayers will be servicing a smaller post-reorganization debt.

In addition, there are more specific reasons why Aquila and its ratepayers would be better off in the event of an Aquila bankruptcy if the Commission did not allow Aquila to pledge the Missouri regulated assets. As a general premise, a debtor in bankruptcy, in confirming a plan, can discharge its unsecured debt. See 11 U.S.C. § 1141 (d)(1), which states, subject to qualifications, that the confirmation of a plan "discharges the debtor from any debt that arose

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before the date of such confirmation, and any debt of a kind specified in section 502(g), 502(h), or 502(i) of this title[.]"

Aquila will argue that the $430 million term loan is fully collateralized now that Iowa's public utility commission allowed Aquila to pledge its Iowa regulated assets. Therefore, Aquila will argue, its secured debt going into or emerging from bankruptcy will not change. It will be $430 million that its ratepayers will have to shoulder, regardless of which states allowed the company to pledge its assets. But, Aquila and its ratepayers (in all states) will still be better off if Aquila cannot pledge its Missouri assets as collateral for the $430 million Term Loan.

Secured creditors in bankruptcy have a myriad of protections that preserve their liens on the debtor's property through the confirmation of a reorganization plan. For example, 11 U.S.C. § 1129(b) states that the court, on request of the proponent of the plan, shall confirm the plan if the plan does not discriminate unfairly and is fair and equitable with respect to each class of claims or interests that is impaired under, and has not accepted, the plan. With respect to secured claims, 11 U.S.C § 1129(b) mandates, among other things, that for a plan to be fair and equitable with respect a class of secured claims, the plan must provide that the holders of such claims retain the liens securing such claims, whether the property subject to such liens is retained by the debtor or transferred to another entity, to the extent of the allowed amount of such claims. The plan must also provide that each holder of a secured claim receive on account of such claim deferred cash payments totaling at least the allowed amount of such claim, of a value, as of the effective date of the plan, of at least the value of such holder's interest in the estate's interest in such property. So, if the Commission allows Aquila to pledge its Missouri assets, those liens will survive reorganization and burden Aquila's ratepayers.

Having an over-secured claim also gives the secured creditor certain rights in bankruptcy that creditors would not otherwise have. For example, 11 U.S.C. § 506(b) of the bankruptcy code states: "To the extent that an allowed secured claim is secured by property the value of which, after any recovery under subsection (c) of this section, is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement under which such claim arose." Of course, since ratepayers are the Aquila's only meaningful source of revenues, the ratepayers would be paying that interest and those "reasonable fees, costs, or charges." Next, under 11 U.S.C. § 506(c), the bankruptcy trustee may recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving, or disposing of, such property to the extent of any benefit to the holder of such claim. That recovery, would of course, come from Missouri property if Missouri property secures a claim. Finally, by not over-securing the Term Loan with Missouri's regulated assets as collateral, Aquila is more likely to find reorganization financing at reasonable interest rates.

e. Peak Day Cash Working Capital

Aquila alleges that approximately $250 million of the $430 million three-year Term Loan will be used to meet the peak day working capital requirements of Aquila's United States utility business. (Application ¶ 13). Aquila attached its U.S. Networks Working Capital Requirements Study as Schedule RD-3 (Ex. 7) to witness Dobson's direct testimony. Based upon this study Aquila believes the Commission should allow it to encumber the over $1 billion worth of Missouri jurisdictional utility assets. The record evidence demonstrates that Missouri is a net provider of peak day working capital to Aquila's other U.S. utilities and that allowing Aquila to encumber its Missouri assets based upon this study would result in a detriment to the public interest.

Aquila's U.S. Networks Working Capital Requirements Study estimated that on January 2, 2004, its peak day, Aquila would need approximately $241 million extra cash to cover its costs for all of its U.S. utility operations.[6] (Ex. 32, p. 7, l. 6-8). Aquila then added an extra $9 million to the study results to account for the effects of weather, budget billing, coal contracts and other miscellaneous items not specifically accounted for in the study. (Tr. p. 247, l. 19-25; p. 248, l. 1-3). Aquila did not perform a state specific peak day working capital study (Tr. p. 247, l. 5-14) and witness Lowndes admitted Aquila has no idea what Missouri's peak day working capital need is or if Missouri has a specific peak-day working capital need. (Tr. p. 255, l. 3-14).

Aquila did prepare a state-by-state breakdown based upon Aquila's study of the U.S. Network's peak day working capital requirement that occurs in January. (Ex. 32, Schedule JAB-6). Based upon Aquila's breakdown of its own study, Missouri was a net provider of over $3 million of peak day working capital (Ex. 32, Schedule JAB-6, p. 3 of 14) to other Aquila U.S. utilities, which witness Lowndes admitted during cross-examination. (Tr. p. 248, l. 4-13). In essence, Aquila's own working capital study demonstrated that Missouri does not contribute any needs to Aquila's January 2, 2004 peak day working capital requirement. (Ex. 12, p. 31, l. 13-18). In fact, Missouri contributed over $3 million to support **other** Aquila U.S. utility needs. (Ex. 12, p. 31, l. 16-17). Rather than supporting Aquila's request to encumber all of its Missouri utility property to support an alleged peak day working capital need, Aquila's own study demonstrates that Missouri is subsidizing Aquila's other non-Missouri U.S. utility operations. Such a subsidy is a direct public detriment to Missouri ratepayers.

Recognizing its initial study did not support Aquila's assertion that Missouri had peak day working capital needs on January 2, 2004, Aquila made additional adjustments to its study. These

[6] Along with Missouri, Aquila has regulated utility operations in Colorado, Michigan, Minnesota, Nebraska, Iowa and Kansas. (Ex. 32, p. 3, l. 9-18).

adjustments resulted in Missouri's peak day working capital needs being changed from an approximately negative $3 million to a positive of over $36 million. Aquila arrived at the $36 million peak day working capital need by adding additional adjustments to the original study for weather, budget billing and coal contracts. (Ex. 12, p. 33, l. 1-10; Ex. 32, p. 13, l. 4-13).

However, Aquila already had bumped under its initial peak day working capital study from $241 million to $250 million to take into account the exact factors it now alleges create an over $36 million peak working capital requirement. (Tr. p. 247, l. 23-25). In fact, the peak day working capital needs for Missouri are overstated based on the assumptions applied to the model and the additional adjustments applied to the model outcome for Missouri. The assumptions and adjustments, such as the prepayment of natural gas supplies (Ex. 31, p. 9, l. 10-19) and for interstate pipeline transportation capacity (Ex. 31, p. 11, l. 1-8) would not be necessary if were it not that Aquila's Missouri operations are a division of Aquila and thus associated with Aquila's non-regulated activities and the negative consequences related to Aquila's failures in non-regulated activities.

The inclusion of such assumptions and adjustments inflates the calculated working capital needs associated with Missouri's regulated operations. (Ex. 32, p. 23, l. 9-16; Ex. 12, p. 34, l. 17-19). Erasing these natural gas prepayments and pipeline prepayments lowers Aquila's company-wide peak day needs to $80 million. (Ex. 32, p. 23, l. 7-20). Asking ratepayers to provide collateral for a $250 million loan that is largely needed to meet prepayment obligations caused by the negative consequences of Aquila's failed non-regulated activities results in public detriments caused by non-regulated activities. (Ex. 32, p. 23, l. 6-16).

Public Counsel witness Busch conducted his own peak day working capital study for Missouri based upon Aquila's methodology. His study shows that Missouri is a net provider of $8

million of peak day working capital. (Ex. 32, p. 14, l. 20-23, Sch. JAB-7). Further, witness Busch estimated Missouri's share of Aquila's peak day capital need with a $9.00 per mmbtu maximum price for natural gas. Under this scenario, Missouri would be a net provider of approximately $10.5 million of peak day working capital. (Ex. 32, p. 23, l. 1-4). Aquila witness Lowndes reviewed witness Busch's study and claims that his study underestimates peak day working capital needs for Aquila's Missouri properties by $6.3 million. (Tr. p. 264, l. 7-10). Even accepting witness Lowndes' criticisms of witness Busch's study demonstrates that Missouri is still a net provider of over $4 million of peak day working capital. Thus, Missouri would be subsidizing Aquila's other U.S. utility operations. Such a subsidy is a direct detriment to Missouri ratepayers.

D. The Commission should reject Aquila's request for authority to use Missouri regulated assets as collateral to secure future replacement debt offerings for working capital requirements not to exceed $430 million after the three-year term of the current Term Loan Facility expires.

Aquila has requested that this Commission grant it authority to secure the future replacement debt offerings for working capital requirements not to exceed $430 million to replace the current three-year Term Loan. (Aquila Application ¶ 16; Prayer for Relief ¶ A). The Commission should reject Aquila's request for authority to secure future replacement debt offerings for working capital requirements not to exceed $430 million.

Aquila has alleged that once the three-year term of the current Term Loan matures, it is expected that the loan will need to be replaced with another facility to meet Aquila's continuing peak day working capital needs. Aquila has requested permission to rollover the collateral to a new or renegotiated debt facility in order to avoid the uncertainty created in the financial marketplace by

the existence of a definite expiration date. The Company alleges the continuity in financing could be very critical to Aquila in the execution of its restructuring plan. (Ex. 34, p. 32, l. 1-20).

The Missouri Supreme Court has stated that "the relevant inquiry in determining which party has the burden of proof is to identify who, as is disclosed from the pleadings, asserts the affirmative of an issue. Generally that party has the burden of proof." *Anchor Centre Partners, Ltd. v. Mercantile Bank, N.A.*, 803 S.W.2d 23, 30 (Mo. banc 1991). In this proceeding, Aquila is affirmatively asserting that it will have cash working capital needs not to exceed $430 million in three years.

Aquila has failed to carry its burden to demonstrate that it will have $430 million working capital requirement for its Aquila Networks – MPS and Aquila Networks – L&P operating divisions in three years. Aquila was wholly unable to articulate what its near term financial plan for its operations were, let alone what its financial plan or needs will be three years from now. The record in this proceeding is devoid of any substantial much less competent evidence regarding Aquila's peak day working capital needs for MPS and L&P, if any, three years in the future.

In fact, Aquila only alleges that its entire U.S. utility operations currently have peak day working capital needs of $250 million. (Aquila Application ¶ 13; Ex. 4, p. 10). As discussed in Section III C.2.e. of this brief, Consumer Groups' evidence demonstrates that Aquila's Missouri utilities are net providers of working capital to Aquila's other U.S. utility operations. Aquila's own breakdown of its $250 million peak day working capital study supports this conclusion indicating that Missouri is a net provider of over $3 million in peak day working capital to Aquila's other U.S. utility operations. (Ex. 32, Schedule JAB-6, p. 3 of 14; Tr. p. 248, l. 4-13).

Consumer Groups do not believe this Commission should abdicate its responsibilities for overseeing Aquila's regulated operations just so Aquila's managers do not have to be burdened by

the work associated with securing future debt financing. (Ex. 34, p. 32, l. 22-28). This is especially true given the undefined nature of Aquila's current and future financial plans. (Tr. p. 338, l. 8-25; p. 339, l. 1-12). Witness Dobson testified that Aquila's financial plan attached as Schedule RD-1 to his direct testimony is currently **not** Aquila's financial plan. (Tr. p. 331, l. 19-25). Witness Dobson testified that Aquila's upper management was going to be presenting a new financial plan to the Aquila Board in early November, but refused to provided details of this new plan. (Tr. p. 338, l. 11-15).

Even the Company agrees that its financial plan is risky and not totally within management's control. (Ex. 35, p. 42, l. 21-25; p. 43, l. 1-19). Witness Dobson acknowledged this fact in his surrebuttal testimony. (Ex. 10; p. 7, l. 1-9). Simply put, it was Aquila's management decisions that resulted in the financial difficulties the Company now finds itself. (Tr. p. 330, l. 10-19). Now is not the time to give Aquila management "carte blanche" approval of financing events that will occur years down the road.

Finally, Colorado, Iowa and Minnesota all have rejected Aquila's request for authority to secure future replacement debt offerings for working capital requirements not to exceed $430 million after the three-year $430 million Term Loan matures. (Ex. 58; Ex. 59; Ex. 34, p. 46, l. 1-8). Colorado and Iowa rejected this request in spite of approving Aquila's request to collateralize Aquila's utility property located in Colorado and Iowa.

IV. CONCLUSION

For the above reasons, Consumer Groups request that this Commission reject Aquila's application to encumber its Missouri utility assets and to secure the future replacement debt offerings for working capital requirements not to exceed $430 million.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing has been faxed, mailed or hand-delivered to the following counsel of record on this 8th day of December 2003:

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