

Exhibit No.:

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Witness:

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Case No.:

Date Testimony Prepared:

Encumbrance of
Missouri Assets

Rick Dobson

Aquila, Inc.

Surrebuttal Testimony

EF-2003-0465

September 26, 2003

MISSOURI PUBLIC SERVICE COMMISSION

SURREBUTTAL TESTIMONY

OF

RICK DOBSON

ON BEHALF OF

AQUILA, INC.

September 26, 2003

VERIFICATION

STATE OF MISSOURI)
)
COUNTY OF JACKSON) ss.

Rick Dobson, having been duly sworn upon my oath, state that I am the Chief Financial Officer of Aquila, Inc., that I am authorized to make this affidavit on behalf of Aquila, Inc., and that the matters and things stated in the foregoing sur-rebuttal Testimony and schedules thereto are true and correct to the best of my information, knowledge and belief.

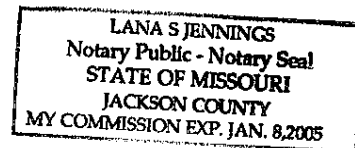


Signed and sworn to before me, the undersigned notary public, on this 25th
day of September, 2003.


Notary Public

My Commission Expires:

January 8, 2005



1 **BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION**
2 **OF THE STATE OF MISSOURI**
3 **SURREBUTTAL TESTIMONY OF RICK DOBSON**
4 **ON BEHALF OF AQUILA, INC.**
5

6 Q. Would you please state your name and position with Aquila, Inc.? (“Aquila” or
7 “Company”)?

8 A. My name is Rick Dobson and I currently hold the position of Senior Vice
9 President and Chief Financial Officer of Aquila.

10 Q. Are you the same Rick Dobson that filed direct testimony in this case before the
11 Missouri Public Service Commission (the “Commission”)?

12 A. Yes.

13 Q. What is the purpose of your surrebuttal testimony?

14 A. To respond to the testimony filed in this case by the Commission’s Staff (“Staff”)
15 and certain intervening parties related to the Company’s application for authority
16 to use Missouri utility assets as collateral to support a 3-year term loan.

17 Q. In staff witness Joan C. Wandel’s testimony at page 9, lines 19 - 20, she
18 indicates that none of the interest incurred on the loan relates to debt incurred by
19 Aquila’s utility operations. Is this true?

20 A. No. The proceeds from the \$430 million loan were used to pay off the remaining
21 balance on its \$650 million revolving credit agreements. At the time of
22 repayment, the facility was fully utilized and the cash on hand from that
23 borrowing was used for both regulated and non-regulated working capital needs.
24 As previously stated, Aquila maintains a centralized treasury and cash
25 management program so any of the utility operations in need of working capital

1 would have access to the funds on hand prior to the \$430 million term loan
2 closing as well as afterward. Ms. Wandel makes a related comment at page 15,
3 Lines 8 – 14 with respect to “additional funds” not being available. It is true that
4 Aquila will not receive additional proceeds if Missouri assets are pledged as
5 collateral, but Missouri operations will still have access to the funds provided
6 previously by the facility.

7 Q. Can you comment about Ms. Wandel’s statements at page 11, lines 9 - 10 of her
8 testimony regarding the use of proceeds from the \$430 million term loan?

9 A. Ms. Wandel mistakenly assumes that since the value of the debt retired following
10 the closing of the \$430 million term loan was greater than the amount received
11 that there are effectively no available working capital proceeds. There was cash
12 on hand at the time of the term loan close that was used, in part, to reduce
13 maturing liabilities. This cash was primarily driven by revolver borrowings to meet
14 working capital needs. Ms. Wandel believes that since the Company did not have
15 an additional \$430 million of cash on hand following the loan closing there were
16 no real “proceeds” to benefit the utility operation’s working capital needs. In
17 reality, the term loan allowed the Company to keep working capital cash
18 balances available for the utility operations. In addition, because the utility
19 operations are only charged an investment grade interest rate they have seen no
20 change in either their access to funds or the cost of those funds.

21 Ms. Wandel indicates, on multiple occasions, (P 15, L 13 – 14; P 25, L 5 – 15; P
22 26, L 16 – 18) that if Missouri assets are pledged that they will not be available

1 for future senior secured financings and will restrict the financing flexibility
2 available to Aquila in the future (P 27, 11 - 14). Do you agree with her view?

3 A. No. The Indenture of Mortgage and Deed of Trust, which underlies the security
4 granted to the lenders in the \$430 million term loan, allows, pursuant to Section
5 4.02, the issuance of additional senior secured debt. Section 3.01 of the First
6 Supplemental Indenture allows such issuances in amounts that do not exceed
7 60% of the appraised value of regulated assets. This being the case, the
8 Company would have the ability to use all excess regulated asset collateral as
9 first lien mortgage property for additional secured debt. The Company expects
10 this excess regulated asset collateral to have approximately \$800 to \$900 million
11 of loan value. Thus, by approving this application the Commission would not be
12 limiting the Company's future financing flexibility.

13 Q. Are there other witnesses in this case who share Ms. Wandel's view?

14 A. Yes, Mr. Burdette who provided testimony on behalf of the Office of Public
15 Counsel ("OPC") indicated this same loss of flexibility at page 14 lines 20 - 22 of
16 his testimony. Mr. Gorman, who provided testimony on behalf of the Sedalia
17 Industrial Energy Users Association, indicated at page 2, lines 12 - 14, that it
18 would eliminate an option currently available to the Company. As discussed
19 above, the Company with the permission of the Commission would have first lien
20 mortgage property access to substantially all of Missouri's regulated assets for
21 future financing purposes.

22 Q. Do you agree with Ms. Wandel's testimony on page 49, Lines 1 – 11 related to
23 the Missouri operations' standalone financing capability?

1 A. No. Ms. Wandel concludes that if Missouri were a standalone entity it would not
2 need to pledge its assets in order to procure debt for working capital needs. In
3 reaching her opinion, Ms. Wandel makes several assumptions that may or may
4 not be true. First of all, she assumes that the Missouri operations would be rated
5 investment grade by the credit rating agencies.

6 Q. How do you respond?

7 A. This cannot be known without the credit rating agencies completing a standalone
8 credit analysis of Aquila's Missouri operations. Given the recent level of
9 profitability and operating cash flows of the Missouri operations combined with
10 the fuel cost risk of Missouri electric utilities, it would be difficult to draw any
11 investment grade conclusions without an in-depth analysis by the credit rating
12 agencies.

13 Q. Please go on.

14 A. Secondly, Ms. Wandel assumes that the Missouri operations would have access
15 to "traditional financing" which I interpret as unsecured financing. Even if the
16 Missouri operations were able to achieve an investment grade rating, the market
17 may require or the operations may choose (for economic reasons) to use
18 secured funding. The debt markets for utilities have changed and investment
19 grade utilities often times (for economic reasons) issue secured debt. Based on
20 information provided by Credit Suisse First Boston there has been approximately
21 \$49.7 billion of utility debt issued thus far in 2003. Of that amount, approximately
22 \$18.5 billion (37% of the total) has been issued on a secured basis. I
23 acknowledge that Ms. Wandel is referring to working capital only in her

1 testimony, but I think it's important to point out the fact that utilities (including
2 investment grade utilities) do issue a substantial amount of secured debt. In fact,
3 based on information obtained from several Missouri-based utilities' publicly filed
4 financial statements, the level of secured debt to total debt ranges from 18.8% to
5 100% (Ameren – 39.7%, Empire District – 51.2%, Laclede Gas – 100%, Great
6 Plains Energy – 18.8%). Aquila's current level of secured domestic debt
7 represents approximately 17% of its total debt burden.

8 Q. Are there other material issues with either Mr. Burdette's or Mr. Gorman's
9 testimony with which you take exception?

10 A. Yes. One point in particular related to Mr. Gorman's testimony should be
11 clarified. On page 3, lines 13 – 21 Mr. Gorman indicates that the Missouri
12 operations, exclusive of the current contemplated encumbrance, could effectively
13 go out and obtain a collateralized line of credit on its own. This is not possible.

14 Q. Why?

15 A. Under the current legal structure of Aquila, the utility divisions are not stand-
16 alone legal entities, and therefore cannot borrow funds on their own. The
17 corporate entity, Aquila, Inc., is the only entity that can borrow for the utilities'
18 needs. The Company could establish a line of credit supported only by the
19 Missouri assets, but the lenders in that facility could still look to all of the un-
20 encumbered assets of the Company in the event of a default. The ultimate actual
21 borrower on any third-party debt arrangement, given the Company's current legal
22 structure, will always be Aquila, Inc.

23 Q. Do you have any issues with Mr. Burdette's testimony?

1 A. Yes. In his testimony he indicates on Page 12, Lines 8 – 16 and again on Page
2 20, Lines 21 and 22 that Missouri customers have suffered detriment due to the
3 Company's current financial position. I do not agree with that conclusion.

4 Q. Please explain.

5 A. The Company's shareholders have suffered detriment due to Aquila's weakened
6 financial condition, but its customers continue to receive safe and reliable service
7 at rates prescribed by this Commission. The Company's higher cost debt is not
8 borne by its utility customers. The Company acknowledges that it currently has
9 significant liabilities and is undertaking actions to sell its non-core assets to
10 reduce such liabilities. Upon completion of these non-core asset sales, there may
11 be some level of excess liabilities. Excess liabilities are those obligations that
12 create unnecessary instability in the Company's operating cash flows. It will be
13 the Company's intention, if excess liabilities exist, to use whatever means are
14 available to continue to restructure, re-negotiate or otherwise reduce these
15 liabilities in the most efficient manner possible. At all times, the utility customers
16 in our jurisdictions will continue to receive safe and reliable service and will be
17 charged rates prescribed by the requisite utility commission.

18 Q. Are there other witnesses who believe this plan to strengthen Aquila's financial
19 situation will somehow cause harm to the Missouri ratepayers?

20 A. Yes, Mr. Ted Robertson who submitted testimony on behalf of the OPC said on
21 Page 41, line 19, that the plan the Company is executing is fraught with peril.

22 Q. How do you respond?

1 A. I would agree that no one can absolutely predict the outcome of our
2 undertakings, but thus far the Company has executed on all of its stated
3 objectives and will continue to do so. Also, it has executed on the plan without
4 any harm to Missouri customers. The consummation of the \$430 million term
5 loan was an integral step in the Company's financial recovery plan and I believe
6 there will be other significant events that aid in our recovery. The Commission
7 should take whatever steps are necessary to protect the Missouri customers, but
8 it has not been demonstrated that the pledging of the Missouri assets will harm
9 those customers.

10 Q. Does this conclude your rebuttal testimony?

11 A. Yes it does.