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

INITIAL BRIEF OF STAFF

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SUMMARY OF THE STAFF'S POSITION

As explained and supported in this brief, the Staff reviewed each reason that Aquila raised for why this Commission should grant its application and additional reasons that the Staff felt were relevant to the public interest, including potential benefits to Aquila should the application be granted. As a result of its review and consideration of a number of factors, the Staff has reached the conclusion that grant of any part of Aquila's application would be detrimental to the public interest. Further, due to the acute financial stress on Aquila, the Staff proposes that the Commission order Aquila to continue the customer service quality measure reporting that Aquila is making to the Staff and that it increase the frequency of that reporting from quarterly to monthly

BACKGROUND

I. AQUILA'S APPLICATION

On April 30, 2003 Aquila, Inc. filed an application with the Public Service Commission of Missouri seeking authorization to both encumber its regulated assets in Missouri as collateral for an existing $430 million three-year term loan and related First Mortgage Bonds, and secure its working capital needs up to $430 million after expiration of the three-year term loan. These are the assets that Aquila's Aquila Networks-L&P and Aquila Networks-MPS divisions use to provide utility services in this state. The loan proceeds have already been disbursed.[1] To the Staff's knowledge these facts create a case of first impression before this Commission.

In its application Aquila states that it has peak day U.S. utility working capital need of $250 million, that the remaining $180 million of the $430 million term loan would be used to meet the working capital needs of its other activities, and that approval of the application would aid it in carrying out its financial plan to "restore it to financial health" and, ultimately, to "a capital structure reflective of a 'traditional' utility and [an investment grade] debt rating." Aquila further states that encumbering its utility assets in Missouri as requested "[would] not materially increase the risk of Aquila's customers . . . ."[2]

In its application Aquila also reveals that the existing three-year term loan is secured with its utility assets in Michigan, Nebraska and Canada as well as its independent power plant investments, and that it was seeking authority to encumber its utility assets in the states of Kansas, Colorado, Iowa, Minnesota and Missouri.[3]

In the loan Aquila made a commitment to its lenders to "[u]se its commercially reasonable efforts to, as promptly as practicable, obtain all necessary governmental and regulatory approvals [to add the assets of Aquila's U.S. utility operations as collateral for the loan until the 'fair value' of such assets together with the 'fair value' of Aquila's Michigan and Nebraska utility assets equal or exceed 167% of the outstanding balance of the loan]."[4] The outstanding loan balance presently is $430 million, and $430 million multiplied by 1.67 equals $718.1 million.[5]

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[1] Dobson Direct, Ex. 4, p. 10; Tr. 261, ll. 3-7; Tr. 477, ll. 23-25.
[2] Application, p. 5, ¶ 13 and pp. 9-10, ¶ 21; Dobson Direct, Ex. 4, pp. 10, 11-12.
[3] Application, pp. 5-6, ¶14, Dobson Direct, Ex. 4, p. 9; Application, pp. 6-7, ¶ 16; Dobson Direct, Ex. 4, p. 16.
[4] Dobson Direct, Ex. 4, Sch. RD-9, p. 64, § 5.13.
[5] Dobson Direct, Ex. 4, p. 10.

II. SURROUNDING CIRCUMSTANCES

To help put this loan into perspective, the Commission should keep in mind that at the time Aquila entered into this loan in April of 2003 it had about $3 billion in debt and by the time of the hearing in this case in October of 2003 it still had about $3 billion in debt.[6] At the time of the hearing Aquila owed about $2 billion to unsecured senior note holders and about $430 million to secured senior note holders.[7]

Since mid-2002 Aquila has sold $1.3 billion in assets.[8] Aquila has about $2.2 billion in U.S. utility assets.[9] It has Canadian assets worth about $500 million.[10] It has independent power plant assets worth about $200 million.[11] It also has peaking assets that have a book value of about $500 million.[12] At the time of the hearing Aquila held about $475 million in its Northern Trust Account, where it holds funds for general corporate purposes.[13] Under the terms of the loan Aquila could have up to $2.9 billion in assets securing $430 million, about $2.2 billion of which are U.S. utility assets.[14] If all of the $2.2 billion worth of U.S. utility assets were collateral for the loan, the utility property coverage ratio would exceed five; i.e., the value of the utility assets would be over five times the loan amount of $430 million.[15] The loan requires only a utility property coverage ratio of 1.67 to obtain a reduced interest rate.[16]

The event that triggered Aquila entering into the three-year term loan was its violation of loan covenants on a revolver that it had with CitiCorp. Aquila used part of the $430 million

[6] Tr. 425, ll.2-7.
[7] Tr. 489, l. 13 to Tr. 491, l. 4.
[8] Dobson Direct, Ex. 4, p. 7.
[9] Tr. 491, l. 5 to Tr. 492, l. 11.
[10] Tr. 493, ll. 4-11.
[11] Tr. 493, ll. 13-15.
[12] Tr. 493, ll. 17-23.
[13] Tr. 272, l. 2 to Tr. 273, l. 12; Tr. 434, l. 1 to 435, l. 25; Tr. 438, ll. 7-21; Tr. 454, l. 23 to Tr. 455, l. 1.
[14] Tr. 494, ll. 8-14; Tr. 491, l. 25 to Tr. 492, l. 13.
[15] Tr. 533, l. 16 to Tr. 534, l. 3.
[16] Dobson Direct, Ex. 4, Sch. RD-4, pp. 20-21, definition of "Rate Reduction Date."

proceeds of the three-year term loan to pay off the remaining approximately $356 million it owed on the CitiCorp revolver.[17] Aquila paid interest of approximately 3% on funds that it borrowed on the CitiCorp revolver.[18]

Aquila's interest rate under the three-year term loan is the London InterBank Rate (LIBOR) plus 5.75%, with a LIBOR floor of 3%, or 8.75%, with a possible 0.75% rate reduction.[19] Aquila has debt outstanding at interest rates exceeding the rate of this loan, including ** HC ** of senior notes with a maturity date of July 1, 2012 that bear an interest rate of ** HC **.[20] If Aquila's rating had been investment grade at the time it executed the loan, it would have been able to obtain an interest rate in the range of 3-4%.[21] However, Aquila's debt ratings are non-investment grade, being CCC/B, or, less formally, "high-yield junk."[22]

At the time Aquila executed the three-year term loan, it had pre-existing authority from FERC to issue debt up to $430 million.[23] That authority predated the FERC's February 21, 2003 Westar Order in which the FERC stated:

> The Commission will impose four additional restrictions and it is the Commission's intention that these restrictions will be applied to all future public utility issuances of secured and unsecured debt authorized by this Commission. First, public utilities seeking authorization to issue debt that is secured (i.e., backed) by utility assets must use the proceeds of the debt for utility purposes only. Second, with respect to such utility asset-backed debt issuances, if any utility assets that secure such debt issuances are divested or "spun off," the debt must "follow" the asset and be divested or "spun off" as well.
>
> Third, if assets financed with unsecured debt are divested or "spun off," the associated unsecured debt must follow those assets. Specifically, if any of the proceeds

[17] Tr. 446, l. 16 to Tr. 448, l. 21.
[18] Tr. 322, l. 7 to Tr. 323, l. 12.
[19] Tr. 380, l. 24 to Tr. 382, l. 13; Dobson Direct, Ex. 4, Sch. RD-4, p. 41, § 2.10 & p. 9, definition of "eurodollar base rate."
[20] Tr. 403, ll. 18-21; Ex. 24.
[21] Tr. 449, l. 16 to Tr. 450, l. 1.
[22] Tr. 425, l. 22 to Tr. 426, l. 6; Tr. 457, ll. 7-13.
[23] Tr. 442, l. 24 to Tr. 443, l. 13; Wandel Revised Rebuttal, Ex. 13, p. 24, ll. 2-5.

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> from unsecured debt are used for non-utility purposes, the debt likewise must "follow" the non-utility assets and if the non-utility assets are divested or "spun off" then a proportionate share of debt must "follow" the associated non-utility assets by being divested or "spun off" as well. Last, with respect to unsecured debt used for utility purposes, if utility assets financed by unsecured debt are divested or "spun off" to another entity, then a proportionate share of the debt also must be divested or "spun off."
>
> These restrictions should prevent public utilities from borrowing substantial amounts of monies and using the proceeds to finance non-utility businesses. These restrictions thus should ensure that future issuances of debt are compatible with the public interest, will not impair a public utility's ability to perform in the future and provide appropriate ratepayer protection.[24]

Not coincidently, the amount borrowed under the loan is $430 million even though the loan was oversubscribed with potential lenders offering in excess of $1 billion in the aggregate.[25]

III. EVENTS IN OTHER STATES

Subsequent to filing its application, but before briefing in this case, Aquila obtained approvals from the Public Utility Commission of Colorado, effective in July 2003,[26] and from the Iowa Utilities Board, in October 2003,[27] to use its utility assets in those states as collateral for the $430 million three-year term loan. Neither the Colorado Commission nor the Iowa Board gave Aquila the authority it requested to use assets in their states as collateral for borrowings after expiration of the three-year term loan.[28]

In contrast to the Colorado Commission and Iowa Board, the Minnesota Public Utilities Commission denied Aquila's request, apparently on the basis that Aquila already had sufficient U.S. utility collateral to fully secure the loan.[29] At this time, Aquila's application in Kansas is

[24] Wandel Revised Rebuttal, Ex. 13, p. 24, ll. 10-13, Sch. 2, p. 2-7, ¶¶ 20-22.
[25] Tr. 443, l. 17 to Tr. 444, l. 5.

[26] Robertson Rebuttal, Ex. 35, Schedule TJR-12.
[27] Ex. 59.
[28] Robertson Rebuttal, Ex. 35, Schedule TJR-12; Ex. 59.
[29] Ex. 58.

pending. The evidentiary hearing in Kansas was scheduled for November 20-21, 2003, with initial and reply briefs due November 28 and December 4, 2003, respectively.[30]

ANALYSIS AND ARGUMENT

IV. LEGAL ISSUES

A. The Standard of Review

The statutes under which Aquila seeks authority to encumber its franchise, works or system, necessary or useful in the performance of its duties to the public in Missouri, sections 393.180 and 393.190.1 RSMo 2000, do not specify a standard by which the Commission is to measure such an application, nor is a standard found elsewhere in Missouri law; therefore, the standard lies within the Commission's broad, but not unlimited, discretion.

Section 393.180 expressly subjects both gas and electrical corporations to this Commission's jurisdiction as to their issuances of stocks, bonds, notes and other evidences of debt, as well as the creation of liens on their property that is situated in Missouri. Section 393.190.1, among other things, prohibits gas and electrical corporations from selling, assigning, leasing, transferring, mortgaging, or otherwise disposing of or encumbering any part of their franchise, works or system, necessary or useful in the performance of their duties to the public without first obtaining from this Commission authorization to do so.

The Staff is unaware of any decision by this Commission, or any court having jurisdiction over it, where the Commission, or court, has expressly addressed either (1) the standard to apply when reviewing an application that seeks only authority to encumber part of a utility's franchise, works or system, necessary or useful in the performance of its duties to the public in Missouri or (2) the extent of the discretion that the Commission may have in determining that standard.

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[30] Order Establishing Procedural Schedule entered August 7, 2003 In KCC Case No. 02-UTCG-701-GIG, attached.

The Public Counsel and SIEUA/AGP each assert in their Statement Of Position that "[s]ection 393.180 recognizes that when a regulated utility such as Aquila seeks to encumber its property situated in Missouri, doing so is a 'special privilege.'" Both go on to propose that "[b]ased upon the specific facts and circumstances of each case, the Commission should determine whether or not to grant the special privilege to encumber Missouri regulated assets." The Office of the Missouri Attorney General states in its Statement Of Position that it "adopts the positions articulated by the Office of Public Counsel in its contemporaneously filed position statement." The Staff concurs with SIEUA/AGP when it also states that "the 'public detriment' test that is urged by some is often misstated as though it requires *immediate* detriment or an *immediate* change from what some term the 'status quo' to constitute detriment."

Section 393.180 states as follows:

> *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 supplied.

The Staff notes that, while the Commission has incorporated the legal standard for the exercise of its authority in some of the rules that it has promulgated, as provided by statute, the Commission has not done so in every instance. For example, the Commission has incorporated the legal standard "not detrimental to the public" in its rules 4 CSR 240-3.110 Filing Requirements For Electric Utility Applications For Authority To Sell, Assign, Lease Or Transfer Assets; 4 CSR 240-3.210 Filing Requirements For Gas Utility Applications For Authority To Sell, Assign, Lease Or Transfer Assets; 4 CSR 240-3.115 Filing Requirements For Electric

Utility Applications For Authority To Merge Or Consolidate; and 4 CSR 240-3.215 Filing Requirements For Gas Utility Applications For Authority To Merge Or Consolidate. There is no legal standard incorporated in 4 CSR 240-3.120 Filing Requirements For Electric Utility Applications For Authority To Issue Stock, Bonds, Notes And Other Evidences Of Indebtedness, or 4 CSR 240-3.220 Filing Requirements For Gas Utility Applications For Authority To Issue Stock, Bonds, Notes And Other Evidences Of Indebtedness. Nonetheless, regarding the filing requirements for authority to issue stock, bonds, notes or other evidences of indebtedness, there is reference in 4 CSR 240-3.120(1)(G) and 4 CSR 240-3.220(1)(G) to section 393.200 where certain legal standards do appear.

Section 393.200.1 states that Missouri corporations issuing stock, bonds, notes or other evidences of indebtedness must obtain from the Commission an order authorizing the issuance and that the money, property or labor to be procured or paid for is or has been reasonably required for the purposes specified in the order:

> *A gas corporation, electrical corporation*, water corporation or sewer corporation *organized or existing or hereafter incorporated under or by virtue of the laws of this state may issue stocks, bonds, notes or other evidences of indebtedness payable at periods of more than twelve months after the date thereof,* when necessary for the acquisition of property, the construction, completion, extension or improvement of its plant or system, or for the improvement or maintenance of its service or for the discharge or lawful refunding of its obligations or for the reimbursement of moneys actually expended from income, or from any other moneys in the treasury of the corporation not secured or obtained from the issue of stocks, bonds, notes or other evidence of indebtedness of such corporation, within five years next prior to the filing of an application with the commission for the required authorization, for any of the aforesaid purposes except maintenance of service and except replacements in cases where the applicant shall have kept its accounts and vouchers of such expenditure in such manner as to enable the commission to ascertain the amount of money so expended and the purposes for which such expenditure was made; *provided, and not otherwise, that there shall have been secured from the commission an order authorizing such issue, and the amount thereof, and stating the purposes to which the issue or proceeds thereof are to be applied, and that, in the opinion of the commission, the money, property or labor*

> *to be procured or paid for by the issue of such stock, bonds, notes or other evidence of indebtedness is or has been reasonably required for the purposes specified in the order, and that except as otherwise permitted in the order in the case of bonds, notes and other evidence of indebtedness, such purposes are not in whole or in part reasonably chargeable to operating expenses or to income.*

Emphasis supplied.

Aquila relies on the 1917 Missouri Supreme Court case *Public Service Commission v. Union Pacific Railroad Company*,[31] for the proposition that section 393.200 is not applicable to it on the basis that the section only applies to Missouri corporations. In particular, Aquila relies on the discussion found in the opinion handed down in *Union Pacific* that the statutory language "organized or existing or hereafter incorporated under or by virtue of the laws of this state" means corporations chartered under Missouri law.

While, as indicated above, because the plain language of section 393.200.1 supports Aquila's position, the Staff does not disagree with Aquila that because it is a foreign corporation[32] section 393.200 is inapplicable to Aquila. The Staff, however, does not find the *Union Pacific* case to be conclusive on the issue. In *Union Pacific* the railroad was issuing bonds after the effective date of the Public Service Commission Act pursuant to an agreement made before the effective date of the Act that authorized their issuance. This Commission asserted jurisdiction and sought to enjoin issuance of the bonds because it had not approved them. These facts formed one of the two independent bases relied upon by the drafter of the opinion for the result that no injunction issued. The other basis is the limiting construction of the statute to which Aquila cites. Only one other judge agreed with the drafter's opinion in full, three agreed with the result, one agreed expressly only on the basis that the right to sell the bonds

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[31] 197 S.W. 39 (Mo. Banc 1917)
[32] Aquila is a Delaware corporation, Tr. 311, ll. 21-22.

predated the Public Service Commission Act and one judge dissented. The Staff was unable to find any other Missouri appellate court decisions addressing whether foreign entities fall without the scope of section 393.200.1.

Although the Staff does not find *Union Pacific* to be dispositive, the plain language of the statute limiting its effect to Missouri corporations is persuasive. Further, the Staff has reviewed the analogue to section 393.200 in New York law and found no case addressing whether it applies to foreign corporations, or is limited to New York corporations. Missouri Courts, on occasion, have looked to New York case law for guidance since the Public Service Act of 1913 was based on the 1907 New York Act.[33]

There is no indication in the Public Service Commission statutes or case law, and Public Counsel, SIEUA/AGP and the AG have not cited the Commission to any statute (other than section 392.180.1) or case law in support of their proposition that "[b]ased upon the specific facts and circumstances of each case, the Commission should determine whether or not to grant the special privilege to encumber Missouri regulated assets."

The Staff notes that the term "special privilege" appears in *Union Pacific* with regard to the Commission's jurisdiction over Union Pacific Railroad Company. There the railroad planned to issue bonds to cover its expenditures for improvements and betterments and the Commission sought to enjoin it from doing so without first having obtained authority from the Commission to issue the bonds. One percent of the book value of Union Pacific's assets were located in Missouri. Union Pacific contended that the Public Service Commission Act did not apply to it because it was incorporated under the laws of a state other than Missouri, it had no franchise from the state of Missouri and, in Missouri, it engaged exclusively in interstate

[33] See *State ex rel. Philipp Transit Lines v. Public Serv. Comm'n, 552 S.W.2d 696 (Mo. banc 1977); State ex rel. Jackson County v. Public Serv. Comm'n, 532 S.W.2d 20 (Mo. banc 1975), cert. denied, 429 U.S. 822, 97 S.Ct. 73, 50 L.Ed.2d 84 (1976).*

commerce. Thus, Union Pacific argued, and the Court agreed, that it obtained no "special privilege" from the state of Missouri.

Present sections 393.180 and 393.200 are implicated in the Missouri Supreme Court's *Union Pacific* opinion. Section 54 of the Public Service Act of 1913 (applying to railroad corporations, street railroad corporations and common carriers) is virtually identical to section 73 of the Public Service Act of 1913 (applying to gas corporations, electrical corporations and water corporations), and section 73 of the Public Service Act of 1913 is virtually identical to the present section 393.180. Section 57 of the Public Service Act of 1913 (applying to railroad corporations, street railroad corporations and common carriers) is virtually identical to section 75 of the Public Service Act of 1913 (applying to gas corporations, electrical corporations and water corporations), and section 75 of the Public Service Act of 1913 is virtually identical to the present section 393.200. Although the words "organized and existing or hereafter incorporated, under or by virtue of the laws of the state of Missouri" appear in section 57 of the Public Service Act of 1913, but not in section 54 of the Public Service Act of 1913, the Court held that the Legislature intended both sections 54 and 57 to apply to the same corporations, which are described in section 57 as "organized and existing or hereafter incorporated, under or by virtue of the laws of the state of Missouri." Thus, the Court held section 54 to apply only to domestic, i.e., Missouri, corporations.[34]

Given that the Staff has not encountered the fact pattern in this case before—where the applicant is seeking authority to use utility assets as collateral for a completed financing—and the lack of an explicit standard in the statute that requires the applicant to obtain that authority from the Commission, section 393.190.1, the Staff elected to apply a standard that the

[34] 197 S.W. at 41.

Commission typically applies and that the Staff views to be one of the least demanding for an applicant to satisfy—the standard of "not detrimental to the public interest."[35]

Regarding the limits of the Commission's discretion, the Staff notes the following by analogy. Under section 393.140(11) and section 393.150.1 and .2, the Commission may allow changes in schedules of rates, charges or service, rules and regulations and forms of contract or agreement, to occur without suspension and holding a hearing. The Court of Appeals, Kansas City District, in *State ex rel. Laclede Gas Co. v. Public Service Commission*,[36] acknowledged that "[s]imply by non-action, the Commission can permit a requested rate to go into effect." Nonetheless, the Missouri Supreme Court in *State ex rel. Utility Consumers Council of Missouri, Inc. v. Public Service Commission*,[37] specifically stated that under the "file and suspend" method a utility's rates may be increased without requirement of a public hearing, but noted that when deciding no hearing is necessary and the filed rate should not be suspended, the Commission must consider all relevant factors.

Further, the Missouri Supreme Court has stated, in the context of a sale of regulated assets, that under the "not detrimental to the public interest" standard the Commission's review may be broad. [38] In the mid-1980's this Commission, applying the standard of "not detrimental to the public interest," approved the sale of steam operations from a regulated utility to an unregulated subsidiary of the Bi-State Development Agency. The sale was part of a plan by the Bi-State Development Agency to ultimately use refuse to fuel the steam generation and included an immediate rate increase. In its opinion, the Missouri Supreme Court stated:

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[35] *See State ex rel. City of St. Louis v. Public Serv. Comm'n,* 73 S.W.2d 393 (Mo. banc 1934) and *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz,* 596 S.W.2d 466 (Mo. App. 1980).
[36] 535 S.W.2d 561, 566 (Mo. App. 1976).
[37] 585 S.W.2d 41, 49 (Mo. banc 1979).
[38] *Love 1979 Partners, et al. v. Public Serv. Comm'n*, 715 S.W.2d 482 (Mo.banc 1986)

> The Commission's decision and order shows that concern for the public interest was predominant in its deliberations. It considered not only the interest of its customers, but the interest of the St. Louis metropolitan area in solving its refuse problems. The thought of using refuse to produce worthwhile energy is certainly appealing. The Commission is justified in looking at the broad picture.[39]

Likewise, in this case, rather than limiting itself to reviewing only impacts on the rates Aquila's Missouri customers pay and quality of service they receive, the Commission is justified in looking at the broad picture in making its determination of whether to grant Aquila the authority it seeks.

The Staff believes that the language of the Missouri Supreme Court in *State ex rel. City of St. Louis v. Public Service Commission*[40] is a better statement of the standard of "not detrimental to the public" as the Staff has applied it, than the language of the Western District Court of Appeals in *State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz.*[41] The Court in *City of St. Louis* stated, in relevant part, as follows:

> . . . The whole purpose of the 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 & 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. Section 5251, R.S. 1929 Mo. Stat. Ann. Section 5251, p. 6674), in part reads: "The provisions of this chapter shall be liberally construed with a view to the public welfare, efficient facilities and *substantial justice between patrons and public utilities*." (Italics ours.)
>
> . . . .
>
> The state of Maryland has an identical statute with ours, and the Supreme Court of that state in the case of *Electric Public Utilities Co. v. Public Service Commission*, 154 Md. 445, 140 A. 840, loc. cit. 844, said: "To prevent injury to the public good in the clashing of private interest with the public good in the operation of public utilities, is one of the most important functions of Public Service Commissions. It is not their province to insist that the public shall be benefited, as a condition to change of ownership, but their duty is to see that no such change shall be made as would work to the public detriment. 'In the public

[39] *Love 1979 Partners*, 715 S.W.2d at 490.
[40] 73 S.W.2d 393, 399-400 (Mo.banc 1934).
[41] 596 S.W.2d 466 (Mo.App. 1980).

interest,' in such cases, can reasonably mean no more than 'not detrimental to the public.'"

The Staff has concluded that since Aquila failed to meet the lenient standard of "not detrimental to the public" as the Staff has applied it, the Commission need not consider whether Aquila could meet a more demanding standard. The meaning of the phrase "not detrimental to the public" respecting section 393.190.1 was not addressed by the Missouri Supreme Court in its opinion that was handed down on October 28, 2003 in *State ex rel AG Processing, Inc. v. Public Service Commission*[42] (hereinafter referred to as *AG Processing*), although there is language in that decision worth noting.

Aquila states in its Statement of Position that "[t]he issue presented in this case is whether granting the relief sought by Aquila will cause a direct and present detriment. *Re Missouri-American Water Company*, 9 Mo.P.S.C.3d 56, 59 (2000)." (hereinafter referred to as *MAWC*.) In MAWC, the Commission stated that "[t]he Commission reads *State ex rel. City of St. Louis v. Public Service Commission*, 335 Mo. at 459, 73 S.W.2d at 400 to require a direct and present public detriment." The words "a direct and present public detriment" do not appear in section 393.190.1 or in the three Missouri Supreme Court decisions addressing the application of section 393.190.1. In fact, in the recent *AG Processing* decision, the Court stated: "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. [Footnote omitted.]"

[42] Case No. SC85352 , 2003 WL2434720 (Mo.)

The Staff notes that the Commission referred in its *MAWC* decision to the "applicant's general financial health" as being an appropriate factor to consider in determining whether to grant the authority sought pursuant to section 393.190.1:

> . . . "*The obvious purpose of [section 393.190] is to ensure the continuation of adequate service to the public served by the utility.*" State ex rel. Fee Fee Trunk Sewer, Inc. v. Litz, 596 S.W.2d 466, 468 (Mo. App., E.D. 1980). To that end, *the Commission has previously considered such factors as* the applicant's experience in the utility industry; the applicant's history of service difficulties; *the applicant's general financial health* and ability to absorb the proposed transaction; and the applicant's ability to operate the asset safely and efficiently. *See* In the Matter of the Joint Application of Missouri Gas Energy et al., Case No. GM-94-252 (*Report and Order,* issued October 12, 1994) 3 Mo.P.S.C.3d 216, 220.[43]

Emphasis supplied.

The Staff does not concur with the meaning that some utilities are ascribing to language of the Missouri Supreme Court in the *City of St. Louis* case regarding the time frame for which the Commission is to consider whether the proposed transaction would result in a detriment to the public. These utilities contend that this time frame is immediate, i.e., the utility need only guarantee that there must not be a detriment to the public reflected immediately in the utility's rates or quality of service. Adoption of this contention would render the standard of "not detrimental to the public interest" a nullity because an entity could structure its proposal to the Commission in a manner such that there would be no immediate increase in rates or charges and no immediate deterioration in the quality of the service. Then, soon thereafter, the entity could apply to the Commission for an increase in rates or charges, or there would be deterioration in the quality of service, either or both of which were predestined by the utility maintaining the status quo for the period immediately following the action for which the Commission's authorization was sought.

[43] 9 Mo. P.S.C.3d at 58.

An example of this phenomenon is the regulatory plan proposed by Aquila when it was known as UtiliCorp United, Inc. in its separate merger cases respecting St. Joseph Light & Power Company (SJLP) and Empire District Electric Company (EDE). Under UtiliCorp's regulatory plans, it would not file rate increase cases for SJLP or EDE for the first four years following the mergers, but during the fifth year following the mergers UtiliCorp would file rate increase cases for both SJLP and EDE with the new increased rates to take effect at the conclusion of the fifth year subsequent to the mergers. The Commission declined to adopt UtiliCorp's regulatory plan.[44] (The rate increase moratorium proposal did not include UtiliCorp's Missouri Public Service (MPS) division, and a UtiliCorp witness admitted that UtiliCorp projected that it would file with the Commission for rate increases for MPS during the five-year period covered by UtiliCorp's proposed regulatory plan.)

Thus, as indicated above, although the Staff has applied the standard of "not detrimental to the public interest" broadly in evaluating Aquila's application in this case, the standard that the Commission may chose to apply lies within its broad, but not unlimited, discretion.

B. Creditors' Rights and Issues

Unless mandatorily overridden by the law of another jurisdiction, the law of the state of New York governs both the credit agreement and security agreement that constitute the three-year term loan.[45] Under the stated terms of the security agreement, in the event of a default as defined in section 9.01,[46] the trustee under the security agreement may accelerate and make

[44] 9 Mo.P.S.C. at 472-75.
[45] Dobson Direct, Ex. 4, Sch. RD-9, p. 93, § 9.13 (credit agreement); Dobson Direct, Ex. 4, Sch. RD-10, p. 27-28, § 1,14 (security agreement).
[46] Dobson Direct, Ex. 4, Sch. RD-10, p. 71-72, § 9.01.

immediately due and payable all or part of the principal, any premium, and accrued interest.[47] Additionally, in the event of default, to the extent not overridden by the laws of the state of New York or the jurisdiction where the property is situated, upon demand by the trustee, Aquila is obligated to "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 and make all needful repairs and such renewals, replacements, betterments and improvements as to the Trustee shall seem prudent; . . . ."[48]

Further, and more importantly, the security agreement includes a power of sale provision that provides that the trustee, "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, or as may be required by applicable law; . . . ."[49]

It appears to the Staff that the security agreement is a security instrument as defined in section 443.005 RSMo 2000 and, as such, sales of realty made in the state of Missouri under the security agreement would be held in a county where any part of the realty being sold is located.[50] Further, the trustee would be required to publish notice of the sale in a newspaper in each county where the property lies at least twenty times with the last notice being not less than one week preceding the sale.[51]

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[47] Dobson Direct, Ex. 4, Sch. RD-10, p. 73-74, § 9.02.
[48] Dobson Direct, Ex. 4, Sch. RD-10, p. 74-75, § 9.03.
[49] Dobson Direct, Ex. 4, Sch. RD-10, p. 75, § 9.04.
[50] Section 443.310 RSMo 2000.
[51] Section 443.320 RSMo 2000

As to personalty, it appears that, so long as the trustee does not breach the peace, the trustee may take possession of the personalty without resorting to the courts and sell it in a commercially reasonable manner,[52] or with realty.[53]

The question also arose during the hearing as to whether, if the Commission were to authorize Aquila to encumber its Missouri utility assets with the three-year term loan, the Commission would, at the same time, also be authorizing the trustee to sell the collateral. The Commission could easily avoid the issue by expressly stating that, while it is approving encumbering the assets, it is not authorizing the sale of those assets with that approval or by expressly stating that it is authorizing the trustee to sell the collateral, in conformance with Missouri law, in the event of a default.

The Commission also raised issues regarding Aquila in the context of bankruptcy. The Staff addressed bankruptcy issues in section 9 of the December 2002 Staff Report on Aquila, Inc. that is attached to the revised rebuttal testimony of Staff witness Wandel as Schedule 1 and the supplement to her testimony,[54] and, rather than restating its analyses here, the Staff directs the Commission's attention to that report.

V. THE MERITS

After giving due consideration to all of the factors bearing on the question of the public interest, the Staff has concluded that it would be detrimental to the public interest to approve Aquila's application. The remainder of this brief sets out Staff's bases for recommending that the Commission deny Aquila's application.

AQUILA'S REASONS FOR GRANTING AUTHORITY TO ENCUMBER ASSETS

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[52] Section 400.9-609 & 400.9-610 RSMo Supp. 2002.
[53] Section 400.9-604 RSMo Supp. 2002.
[54] Ex. 13, Sch. 1, pp. 56-59 and Ex. 14, Appendices E (E-1 to E-25) and F (F-1 to F-10).

In its application, Aquila gave the following four reasons for why the Commission should authorize it to encumber its Missouri utility assets:

> First, 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. Second, as a matter of equity, utility assets should support the working capital requirements for the utility operations. Third, it is only fair that since the working capital is needed to support the day-to-day operations of all Aquila's utility operations, then all of Aquila's utility assets should be part of the pool. Fourth, the borrowing rate under the Term Loan drops 75 basis points, to 8.00 percent, 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 the debt in the Term Loan is 1.67 or higher.[55]

In response to a query by Commissioner Forbis asking Aquila's Chief Financial Officer, Rick Dobson, to summarize why Aquila was before the Commission, he stated two reasons. The first was that Aquila had stated that it would make a good faith effort to obtain sufficient utility assets as collateral for the loan to provide an asset to debt coverage ratio of 1.67 and the second was that it was fair that all of Aquila's U.S. utility assets secure its U.S. utility working capital needs.[56] It appears that Mr. Dobson recognizes that Aquila's first and fourth reasons no longer apply, but that he still supports the second and third reasons stated in the application.

While Aquila's commitment to make a good faith effort to obtain sufficient utility assets as collateral for the loan to provide an asset to debt coverage ratio of 1.67 is a condition of the loan,[57] even Aquila is satisfied that it has met that condition by its actions in this case.

1. Aquila's first and fourth reasons are no longer applicable.

Aquila's first and fourth reasons turn on the amount of its U.S. utility property that it can pledge as collateral for the loan. Even before it obtained its recent authorization from the Iowa Utilities Board, Aquila had pledged more than enough utility assets from Michigan, Nebraska

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[55] Application, p. 7, ¶ 17; Dobson Direct, Ex. 4, p. 11.
[56] Tr. 484, l. 4 to Tr. 485, l. 22.
[57] Dobson Direct, Ex. 4, Sch. RD-9, p. 64, § 5.13 Post Closing Matters.

and Colorado to support its asserted peak day utility operations working capital need of $250 million.[58] For purposes of the loan, the Michigan and Nebraska assets were collectively assigned a "fair value" of $** HC **,[59] and the Colorado assets were assigned a "fair value" of $** HC **.[60] Together the "fair value" of Aquila's utility assets in these three states totals $ 658 million.[61] Under the terms of the loan, the minimum fair value of the utility assets needed to support $250 million is $250 million multiplied by 1.67, or $417.5 million.[62] Moreover, as was acknowledged by Aquila's Chief Financial Officer during the hearing, even with the addition of only the Colorado assets as collateral, the sale of Aquila's Canadian assets would not trigger a mandatory repayment.[63] Thus, the first reason given for why Aquila's application should be granted no longer exists.

In addition, with the authorization it recently obtained from the Iowa Board, Aquila acknowledges that it has authority to include sufficient utility assets ($430 million times 1.67, or $718.1 million) as collateral to support the full $430 million it has borrowed under the three-year term loan.[64] According to Aquila, the potential fair value of its Iowa utility assets is $** HC HC **[65] Aquila needs only utility assets with a fair value of at least $60.1 million ($718.1 million minus $658 million) to have sufficient U.S. utility assets as collateral for the loan to secure the full $430 million that it has borrowed.[66]

[58] Tr. 260, l.19 to Tr. 261, l.2.
[59] Ex. 46; Tr. 346, l. 24 to Tr. 347, l. 25.
[60] Ex. 47; Tr. 348, l. 16 to Tr. 349, l. 6.
[61] Tr. 351, ll. 10-20.
[62] Dobson Direct, Ex. 4, p. 16; Tr. 384, ll. 10-13.
[63] Tr. 350, l. 3 to Tr. 351, l. 4.
[64] Tr. 482, l. 20 to Tr. 483, l. 4.
[65] Ex. 4, p. 10; Ex. 6.
[66] Empson, Tr. 603, ll. 1-5; Dobson, Tr. 365, ll. 20-23.

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That Aquila recognizes it has authority to fully support the $430 million it has borrowed with utility assets is shown by the testimony of its Chief Financial Officer,[67] Rick Dobson, in response to a query from Commissioner Forbis:

> Q. . . . . One, I'm still confused on the 75 basis point reduction. Do you need the Missouri assets to be collateralized in order to get the 75 percent—75 basis point reduction?
>
> A. What we need is another $60 million of collateral to come into the pool from some source, some regulated source, some state is a better way to put it, for us to get the reduction. It doesn't have to mean Missouri. *If the State of Iowa would come in, that would be enough to cause the reduction to happen*, hypothetically speaking.[68]

Emphasis added.

Further recognition of this authority is found in the response of Aquila's attorney, made to a Commissioner inquiry on October 23, 2003, that "it would seem likely that [with the approval of Aquila's application in Iowa it] would be the case [that Aquila would have sufficient utility assets as collateral for the loan to obtain the reduced interest rate]."[69]

Having already received authority to encumber sufficient utility assets to fully secure the $430 million that it has borrowed, Aquila is now able, regardless of this Commission's decision in this case, to obtain the 0.75% reduction in interest available in the loan. As a consequence, Aquila's fourth stated reason that the Commission should grant its request, like the first, no longer exists.

In summary, Aquila no longer needs authority to pledge its Missouri assets as collateral to enable it to either sell its Canadian assets without requiring it to pay down on the $430 million it has borrowed or obtain the 0.75% interest rate reduction.

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[67] Tr. 317, ll. 23-24.
[68] Tr. 482, l. 20 to Tr. 483, l. 4.
[69] Tr. 942, l. 21 to Tr. 943, l. 8.

2. Aquila's second and third reasons are without merit.

With respect to Aquila's second reason, that "as a matter of equity, utility assets should support the working capital requirements for the utility operations, " generally, the Staff does not disagree that there could be circumstances where it would be appropriate for utility assets to support utility working capital needs; however, the facts in this case do not present such circumstances. Circumstances where such support is required to obtain a benefit otherwise unavailable, a benefit such as a more favorable interest rate or to be able to borrow funds might justify the use of utility assets to support working capital needs. However, in such circumstances utility assets located in Missouri should only be used to support the working capital requirements of the utility operations that are using those assets in Missouri.

Here, however, the Commission is presented with a proposal that meets neither of these criteria. Other than flexibility in the release of its utility assets in other states that are held as collateral for the loan, the Staff sees no tangible benefit to Aquila, much less its utility customers in Missouri, from adding its Missouri utility assets as collateral for the loan. Based on the language of the security agreement, it appears that, if its Missouri utility assets were collateral for the loan, Aquila could obtain releases from the security agreement for its other U.S. utility property upon request.[70] This is because, according to Aquila, the potential "fair value" for its Missouri utility assets is $** HC ________ **, well in excess of the $718.1 million required under the terms of the loan to secure the $430 million borrowed.[71] While this flexibility in releasing assets from the encumbrance may be of some benefit to Aquila, substitution of Aquila's Missouri utility assets for those it owns in other states is not in the interest of Aquila's Missouri utility customers.

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[70] Dobson Direct, Ex. 4, Sch. RD-9, p. 48, §2.20(e); Ex. 4, Schedule RD-10, p. 58 (release rights).
[71] Ex. 6.

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Commission approval of Aquila's application would not produce any tangible benefits.[72] In the circumstances here, the loan has already been granted and the proceeds received. Moreover, Aquila already has authority to commit sufficient utility assets as collateral to obtain the interest rate reduction available under the loan terms and, further, as Aquila acknowledges,[73] any interest rate reduction will not benefit Aquila's Missouri utility customers.

While Aquila has made a commitment to internally "separate" the loan into one component for utility uses and another for non-utility purposes, it has not committed any level of funds for purposes of its Missouri utility operations. More importantly, regardless of any commitment by Aquila to internally "separate" the loan, the apparent benefits of such a separation are illusory in that the separation is non-existent under the terms of the financing documents for the loan.

If Aquila's Missouri utility assets are used to secure the three-year term loan, they will be securing the full $430 million, which Aquila asserts is needed for both the working capital needs of all of its U.S. utility operations and its nonregulated operations. Under these circumstances, even without considering the fact that Aquila no longer needs to pledge its Missouri assets in order to fully secure the $430 million loan or to obtain the 0.75% interest rate reduction, fairness dictates that the Commission should deny Aquila's application for authority to use its Missouri utility assets as collateral for the loan.

Aquila's third reason for why the Commission should grant its application is that "it is only fair that since the working capital is needed to support the day-to-day operations of all Aquila's utility operations, then all of Aquila's utility assets should be part of the [collateral] pool." This reason also has no merit. At the outset, it should be noted that Aquila did not

[72] Tr. 471, ll. 6-7.
[73] Tr. 365, ll. 13-16.

perform state-specific peak day working capital studies for its utility operations.[74] However, it did perform a peak day working capital study for its U.S. utility operations that yielded a result of $241 million, which Aquila rounded to $250 million, purportedly to account for items not explicitly considered in the study itself.[75] For reasons detailed below, this study is flawed in several respects; however, even if it were reliable, as the following paragraphs demonstrate, it provides no compelling support for Aquila's "fairness" argument.

Carol Lowndes, Aquila's Senior Financial Manager for Gas Supply and Regulatory, testified that she allocated Aquila's overall U.S. utility peak day working capital need by state as follows: MN, ** HC ** ; MI, ** HC ** ; IA, ** HC ** ; NE, ** HC ** ; KS, ** HC ** ; CO, ** HC ** ; and MO, ** HC **.[76] Thus, the peak day working capital requirements were the greatest for Aquila's utility operations in Minnesota and were the lowest, in fact *negative*, for its utility operations in Missouri.[77]

After performing the breakdown by state, Aquila adjusted its result for Missouri by about $40 million to achieve a need of about $36 million.[78] Even with this adjustment, which the Staff questions, the working capital needs of Aquila's Missouri utility operations would constitute less than 15% of the total unadjusted needs that Aquila asserts overall for its U.S. utility operations.

Significantly, despite its Minnesota utility operations being the largest contributor to Aquila's U.S. utility peak day working capital requirements, the Minnesota Public Utilities Commission, unpersuaded by any appeal to fairness Aquila made there, has denied Aquila's

[74] Tr. 247, ll. 5-14.
[75] Tr. 248, l. 14 to Tr. 249, l. 10.
[76] Busch Rebuttal, Ex. 33, Sch. JAB-6, p. 3 of 14.
[77] Tr. 305, l. 23 to Tr. 306, l. 20.
[78] Tr. 250, ll. 2-12.

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request to use its assets in that state as collateral for the three-year term loan, or for any future replacement debt offerings.[79]

In contrast to the results of Aquila's peak day working capital need study of negative $3 million or positive $36 million for Missouri, low in comparison to Aquila's results for its utility operations in other states, the assets of Aquila's Missouri operations constitute the lion's share of its U.S. utility assets. About fifty percent of Aquila's U.S. regulated utility assets are located in Missouri.[80] For Missouri to contribute about fifty percent of the total U.S. utility collateral (valued at about $2.2 billion) to support the term loan when Missouri, by the result Aquila obtained for its Missouri utility operations that is most favorable to its position, accounts for no more than 15% of Aquila's purported $250 million U.S. utility operations working capital needs would be, in marked contrast to Aquila's assertion, patently unfair.

In addition, the issue of the fairness of including utility assets in some states as collateral, but not the assets in other states, is one that, if it were a significant concern, would be raised by the appropriate authorities in those states. Aquila's Senior Vice-President for Regulatory, Legislative and Gas Supply Services, Jon Empson, testified that before Aquila filed its applications on April 30, 2003 seeking authority to use utility assets as loan collateral, only regulators in Michigan, a state where Aquila did not need approval, expressed concern with what Aquila would do to seek authority from other states to include Aquila's assets in those states as collateral for the three-year term loan.[81]

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[79] Ex. 58.
[80] Tr. 609, ll. 9-13; Tr. 491, l. 21 to Tr. 492, l. 13; Ex. 6.
[81] Tr. 560, l. 11 to Tr. 562, 16.

A. Other factors the Staff considered

Not only does the record refute all four of Aquila's reasons why its application should be granted, there are additional reasons why Aquila should not be authorized to encumber its Missouri utility assets with the three-year term loan. Following is a discussion of those reasons.

1. Aquila's peak day working capital study is deficient.

As noted above, Aquila did not perform state-specific peak day working capital studies for its utility operations.[82] Instead, Aquila's peak day working capital study generated a working capital need for its U.S. utility operations of $241 million, which Aquila rounded up to $250 million to account for items not explicitly considered in the study itself.[83] When Aquila allocated the $250 million by state, it determined that, rather than requiring capital, its Missouri utility operations actually contributed $3 million of working capital.[84] Rather than accepting this result, although it had already adjusted the original result of $241 million to $250 million,[85] Aquila chose to make a further adjustment, for its Missouri utility operations only, based on a worst-case scenario of all of the following happening coincidently: a very severe winter, extremely high gas prices and an ice storm.[86] Even with this further adjustment, Aquila came up with a peak working capital need for its Missouri utility operations of only $36 million.[87] However, despite this adjustment to increase its Missouri working capital needs by nearly $40 million, Aquila did not further adjust its overall U.S. utility peak day working capital needs upward from the $250 million.[88]

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[82] Tr. 247, ll. 5-14.
[83] Tr. 248, l. 14 to Tr. 249, l. 10.
[84] Tr. 248, ll. 4-13; Tr. 249, ll. 15-19; Wandel Revised Rebuttal, Ex. 12, p. 30, l. 13 to p. 31, l. 18.
[85] Lowndes surrebuttal. Ex. 3, p. 16; Tr. 248, ll. 14-24.
[86] Wandel Revised Rebuttal, Ex. 12, p. 35, ll. 14-20; Busch Rebuttal, Ex. 33, Sch. JAB-6, p. 2 of 14.
[87] Tr. 250, ll. 2-12; Wandel Revised Rebuttal, Ex. 12, p. 31, ll. 24-25.
[88] Tr. 275, ll. 16-22.

A large driver of Aquila's claimed working capital needs is its inclusion of its suppliers' requirements that it prepay both for the natural gas it uses as a fuel to generate electricity and for purchased power.[89] These prepayment requirements are not attributable to Aquila's U.S. utility operations, but rather, are due to Aquila's current lack of creditworthiness caused by its recent missteps in its unregulated ventures.[90] Nevertheless, Aquila included these prepayments in the study it used to determine its peak U.S. utility working capital needs.[91]

The peak day working capital needs study is also very imprecise. Using a two standard deviation confidence interval (95%) around the mean (or average), Aquila arrived at $241 million, with a mean of $107 million.[92] Therefore, two standard deviations in Aquila's model equals $134 million. The upshot of this is that two standard deviations below the mean (the other one-half of the 95% confidence interval) is $107 million less $134 million, or negative $27 million. In other words, ignoring the aforementioned $9 million adjustment, Aquila is 95% confident that its peak day working capital need ranges somewhere between negative $27 million and positive $241 million!

Finally, regardless of whether or not it is considered to be a flaw in the study itself, each quarter Aquila permanently transfers 17.5% (1/4 of 70%) of the budgeted annual income of each of its operating divisions to its Northern Trust account.[93] From November 13, 2002 through June 30, 2003 (three quarters), Aquila has transferred on its books $40.434 million from its utility operating divisions to its Northern Trust account.[94] Had those funds been left booked with the divisions, the working capital needs of those divisions would have been reduced concomitantly.

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[89] Wandel Revised Rebuttal, Ex. 12, p. 29, l. 19 to p. 30, l. 5; Tr. 241, ll. 20-23.
[90] Wandel Revised Rebuttal, Ex. 12, p. 35, ll. 8-13; Tr. 241, l. 24 to Tr. 242, l. 2.
[91] Lowndes Surrebuttal, Ex 3, p. 11, l. 20 to p. 12, l. 2.
[92] Tr. 480, l. 23 to Tr. 481, l. 13; Tr. 521, l. 21 to Tr. 522, l. 21.
[93] Wandel Revised Rebuttal, Ex. 12, p. 43, ll. 4-11.
[94] Wandel Revised Rebuttal, Ex. 12, p. 43, ll. 8-11.

2. Pledging Missouri utility assets increases risk to Aquila's Missouri customers.

As previously noted, Aquila has already obtained authority to encumber sufficient utility assets to fully secure the $430 million it has borrowed and to obtain the 0.75% interest rate reduction under the loan; therefore, adding its Missouri utility assets as collateral for the loan appears to serve no purpose other than to put Aquila in a position to have any or all of its utility assets located in Iowa, Michigan, Colorado or Nebraska released from the encumbrance of the loan.[95] This is because, as noted earlier, Aquila's utility assets in Missouri alone should have sufficient "fair value" to secure the $430 million. Aquila's rights to release collateral are found in section 7.03 of the indenture of mortgage and deed of trust.[96] Similarly, there are no assurances that, in the event of a default, a secured creditor will not choose to foreclose on Aquila's Missouri utility assets, rather than those in some other state.

Additionally, if its Missouri utility assets are added to the collateral securing the loan, Aquila will come within the scope of the "make whole premium" provision (a prepayment penalty) found in section 2.7 of the loan,[97] should it choose to make loan prepayments. Aquila has represented that it will include sufficient non-utility assets as collateral for the loan to support the amount of the debt that exceeds $250 million.[98] Thus, if Aquila carries through on this representation and the value of the non-utility assets securing the loan drops sufficiently, Aquila would be in a position of having to repay a portion of the $430 million, which could trigger payment of a "make whole premium."

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[95] Dobson Direct, Ex. 4, Sch. RD-9, p. 48, §2.20(e).
[96] Ex. 4, Schedule RD-10, p. 58.
[97] Ex. 4, Schedule RD-9, p. 35, and p. 14 (make whole premium defined).
[98] Tr. 371, l. 1 to Tr. 374, l. 21; Tr. 382, l. 23 to Tr. 384, l. 3.

On the other hand, *mandatory* repayments, also in section 2.7 of the loan and required when collateral coverage is insufficient, do not trigger payment of a "make whole premium."[99] Further, Aquila has provided no assurance that funds for working capital will be available to its regulated operations when they need them. Aquila's Northern Trust Account is nothing more than a general corporate purpose account into which Aquila makes deposits and from which it pays bills, including those for its utility working capital needs.[100] Aquila has stated that it will assure that sufficient funding is available to support its U.S. utility operations; however, Aquila has put no procedure in place to carry out that commitment.[101] Moreover, when queried as to what would happen should it fail to carry out its commitment to the Commission to keep its collateral alignment for the loan of sufficient utility collateral to support $250 million in debt and sufficient non-utility collateral to support any debt exceeding $250 million, Aquila was unable to provide a response other than that it would carry out its commitment.[102]

As exemplified by its affiliate transaction rules, such as those codified at 4 CSR 240-20.015, 20.017 (electric), 40.015, 40.016, 40.017 (gas), 80.015 and 80.017 (steam), this Commission has a longstanding approach of not allowing regulated utility operations to subsidize non-regulated operations.[103] Approving Aquila's application would violate this approach by allowing Aquila to use its Missouri utility assets to support the amount that is has borrowed that exceeds its U.S. utility operations' needs. Based on Aquila's figures, this would

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[99] Tr. 382, ll. 14-22.
[100] Lowndes Surrebuttal, Ex. 3, Sch. CL-9; Ex. 45; Tr. 252, l. 16 to Tr. 253, l. 9 ; Tr. 479, ll. 7-23.
[101] Ex. 44; Ex. 45; Tr. 280, l. 19 to Tr. 281, l. 3; Tr. 433, ll. 5-21.
[102] Tr. 422, ll. 2-21.
[103] There is Missouri case law holding that the Commission has authority to examine and make adjustments respecting affiliate transactions. *State ex rel. General Tel. Co. v. Public Serv. Comm'n*, 537 S.W.2d 655, 659 (Mo. App. 1976); *State ex rel. Southwestern Bell Tel. Co. v. Public Serv. Comm'n*, 645 S.W.2d 45 (Mo. App. 1982. The Court in the *General Telephone* case noted that the Commission has disallowed license contracts and fees charged operating utilities by a parent company respecting utility industries other than the telephone industry: "The commission has disallowed license contracts and fees charged operating utilities by a parent company. *In re Springfield City Water Co.*, 83 PUR (N.S.) 213 (Mo. 1949); *P.S.C. v. Kansas City P. & L. Co.*, 30 PUR (N.S.) 193 (Mo. 1939); *P.S.C. v. Empire Dist. Elec. Co.*, 10 PUR (N.S.) 302 (Mo. 1935); *P.S.C. v. Missouri Southern P.S. Co.*, 6 PUR (N.S.) 269 (Mo. 1934)." 537 S.W.2d at 659.

be the $180 million portion of the $430 million debt that Aquila states will be used for non-utility working capital needs.

Aquila's proposal to "protect" its Missouri customers by, for ratemaking purposes, hypothetically treating its utility operating divisions as if they are separate entities with investment grade credit ratings is wholly inadequate. Specifically, for ratemaking purposes, Aquila proposes to impute to its utility operating divisions in Missouri the capital structure of an investment grade utility, and also to impute investment grade interest rates to intra-corporate transfers that, if made by a separate legal entity, would typically be accomplished through loans.[104] However, as noted earlier, Aquila treats quarterly intra-company transfers from each of its utility operating divisions in the amount of 17.5% (1/4 of 70%) of the budgeted net annual income of that operating division as permanent transfers of funds.[105] Aquila is free to use these funds, including those from its Missouri operations, for any corporate purpose. Thus, whatever protection is suggested by Aquila's proposed treatment of its Missouri utility operations for ratemaking purposes is completely negated by the fact that Aquila is able to use the quarterly funds that it extracts from its Missouri utility operations in any manner it chooses, including to support its non-regulated operations and its utility operations in other states.[106] Such transfers, then, are detrimental to Aquila's Missouri utility operations because, to the extent that they are used to support non-Missouri utility activities, they increase the operating division's need to "borrow" funds for its expenses, such as working capital needs, and therefore to incur "interest" expense.

This same conclusion can be reached by considering the situation from an overall financial perspective. Aquila states that the purpose of allocating a capital structure to Aquila's

[104] Bible Rebuttal, Ex. 15, p. 4.
[105] Wandel Revised Rebuttal, Ex. 12, p. 43, ll. 4-11.
[106] Tr. 474, ll. 9-16; Tr. 757, ll. 10-15.

regulated utility operation is to separate and insulate each of Aquila's utility divisions from Aquila's other activities.[107] However, Missouri's ratepayers are far from insulated by Aquila's proposal to treat its regulated utility operations in Missouri as investment grade companies.

In his Rebuttal testimony, Staff witness Ronald Bible presents a considerable number of insulating conditions (both structural and regulatory) promulgated by Standard and Poor's. It is notable that these conditions do not include an allocated capital structure or an imputed cost of debt.[108] If the listed conditions are present to an extent deemed acceptable by the rating agency, a subsidiary may be able to enjoy a higher credit rating than that assigned to the parent company. However, none of those conditions exists at Aquila.[109] In fact, under Aquila's existing corporate structure, some of them, such as "partial ownership of a subsidiary by an outside party," and "separate boards of directors for each entity," cannot exist. It is therefore impossible to guarantee that the Missouri ratepayers will be totally insulated, or "ring-fenced," from the adverse effects of Aquila's forays into unregulated businesses.[110] Aquila itself has admitted this.[111]

When a subordinate entity cannot be ring-fenced and does not have in place a considerable number of conditions that will enable it to earn a higher credit rating than that of the overall corporation, the credit rating assigned to the subordinate entity by a rating agency such as Standard and Poor's will be that of the consolidated company. Given Aquila's current financial condition, this means that Aquila's lower overall credit rating, resulting from the much greater business and financial risk associated with Aquila's non-regulated operations, will ultimately also be attributed to Aquila's regulated utilities in Missouri. The result is effectively an increase

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[107] Empson Direct, Ex. 9, p. 2.
[108] Bible Rebuttal, Ex. 15, p. 15.
[109] Bible Rebuttal, Ex. 15. p.14.
[110] Bible Rebuttal, Ex. 15, p.9.
[111] Tr. 573, ll. 5-14; Empson Surrebuttal, Ex. 10, p. 22, ll. 11-13.

in the cost of capital of Aquila's Missouri utilities, which clearly works to the detriment of Aquila's Missouri customers, with no offsetting benefit.[112]

The central problem for Aquila, and one that looms for its Missouri customers, is Aquila's projection that, upon completion of its transition to a vertically integrated utility company, it will have a residual debt of approximately ** HC ** resulting from its non-regulated operations.[113] Although Aquila claims that it intends to "protect" its Missouri customers from adverse financial consequences through its ratemaking proposals, the fact is that upon completion of Aquila's transition to a vertically integrated utility company, its utility customers are going to be its only significant source of revenue.[114] It will be almost impossible for Aquila to finance the lion's share of its residual obligations with common equity, or with anything other than revenue generated from its regulated utility operations. Even if it could do so by issuing common stock, Aquila's Missouri ratepayers would still experience a detriment in the form of a higher cost of equity.[115]

Furthermore, with all of its Missouri utility assets needlessly pledged to support the $430 million loan, there is also a risk that Aquila will be more limited in its ability to secure needed financing in the future. At a minimum, if it is successful in finding a lender, Aquila can expect to pay a higher interest rate, which, given Aquila's precarious financial circumstances, could well be detrimental to Aquila's Missouri customers.

When a utility company subject to the Commission's regulation is in financial difficulty such as that facing Aquila, the Commission should exert more supervision over the utility, not less. Permitting Aquila to pledge its assets as collateral to support the $430 million loan would

[112] Bible Rebuttal, Ex. 15, pp.10-11.
[113] Bible Rebuttal, Ex. 16, p. 17.
[114] Tr. 722, ll. 3-14.
[115] Bible Rebuttal, Ex. 16, pp. 17-19.

amount to ceding a degree of supervision over Aquila's utility assets in Missouri. In effect, the Commission would be moving in the direction of *less* insulation of the regulated assets and activities of Aquila.[116]

4. Credibility Concerns

Although Aquila repeatedly states that it will carry through on the commitments it makes in its application, commitments such as maintaining sufficient non-utility collateral to secure the amount of the loan exceeding $250 million,[117] there are several reasons that the Commission should be skeptical that Aquila will do so. These are discussed below.

Past violations of loan covenants

Aquila has failed to keep commitments it has made to lenders in recent financings. Aquila executed a $650 million revolving loan facility with CitiCorp in early 2002.[118] By the fall of 2002, for reasons its Chief Financial Officer was unable to state, Aquila had borrowed all the funds available under that loan.[119] By the third quarter of 2002, Aquila had violated commitments it made in that loan.[120]

In July of 2003 Aquila also violated commitments (defaulted) on a loan that it had made in connection with the construction of the Aries plant in Missouri.[121] Aquila's Chief Financial Officer, Rick Dobson, testified that he did not recall whether Aquila voluntarily violated those commitments on that loan, but he was able to recall that the amount of the loan was about $110-120 million.[122]

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116 Tr. 749, l. 16 to Tr. 751, l. 8.
117 Tr. 422, ll. 2-21; Tr. 597, ll. 15-23
118 Tr. 426, ll. 7-14.
119 Tr. 429, ll. 12-19.
120 Tr. 423, ll. 9-21; Tr. 429, l. 20 to Tr. 430, l. 14.
121 Dobson, Tr. 432, ll. 13-23.
122 Tr. 432, l. 21 to Tr. 433, l. 4.

Changing financial plan

With its application Aquila provided the Commission with a copy of its financial plan.[123] Despite the fact that the financial plan filed with its application had changed so much that Aquila's officers planned to submit a new plan to Aquila's board of directors for their approval, Aquila successfully objected to admission of, and refused to provide to this Commission in this proceeding as a late-filed exhibit the new plan Aquila's board of directors approves, or to disclose to this Commission during the hearing the plan that Aquila's officers then anticipated submitting to Aquila's board of directors, with the understanding that it was not yet approved by that board.[124] The plan that Aquila disclosed with its application set out planned divestures of assets and other anticipated actions to affect Aquila financially, actions that also would affect collateral for the three-year term loan as well as assets that could be used as collateral for that loan.[125]

Use of marketing estimates of fair value rather than appraisal fair values in application

Although Aquila had available to it a fair value appraisal that established the values of assets as collateral for the loan as early as March 21, 2003 (multiple assets including Nebraska and Michigan utility assets), [126] rather than disclosing the appraised values in its application before this Commission filed April 30, 2003, Aquila only disclosed estimated values that were created for purposes of soliciting potential lenders for the term loan.[127]

Investment-grade companies must pay dividends.

In her surrebuttal testimony Aquila witness Lowndes states:

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[123] Ex. 5.
[124] Tr. 331, l. 14 to Tr. 332, l. 5; Tr. 416, l. 3 to Tr. 422, l. 1.
[125] Ex. 5.
[126] Tr. 349, ll. 17-20.
[127] Tr. 344, l. 4 to Tr. 350, l. 2; Ex. 46.

> Second, it would be inconsistent for the Company to treat the utility as investment grade quality by insulating it from the increased cost of capital resulting from the Company's current non-investment grade status and simultaneously cease to recognize the dividends that would be required by the market for a utility that is investment grade status. This would impose a double standard upon the Company.[128]

and

> If the Company is expected to treat the ratepayer as if we are an investment grade utility, then as an investment grade utility, we would be required to pay dividends. To do otherwise is inconsistent treatment for the shareholder.[129]

The Staff disagrees that imputed investment grade cost of debt requires imputation of the payment of dividends. The purpose of imputing investment grade debt is to protect ratepayers. Therefore, it does not follow that dividends that an investment grade company likely would pay should also be recognized. In fact, Aquila's financial situation argues against the payment of dividends and, apparently in recognition of this fact, on November 13, 2002 Aquila ceased paying dividends to its shareholders.[130] Aquila's double standard argument has no merit. Further, the argument appears to be based on a misunderstanding that investment grade companies have some obligation to pay dividends. During the hearing Aquila witness Lowndes testified that investment grade utilities must pay dividends due to shareholder expectations.[131] She also acknowledged that paying dividends reduces both equity and cash available to repay debt, and that credit ratings are based on a company's ability to pay debt.[132] On the facts of this case where Aquila is in financial distress, one should not ignore the reality that Aquila's divisions are merely a part of Aquila and, therefore, it is in the interests of Aquila's Missouri ratepayers that cash generated by Aquila's utility operating divisions in Missouri remain with those divisions to finance the cash needs of those divisions.

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[128] Lowndes Surrebuttal, Ex. 3, p. 15, ll. 6-12.
[129] Lowndes Surrebuttal, Ex. 3, p. 23, ll. 14-18.
[130] Wandel Rebuttal, Ex. 13, p. 43, ll. 8-9.
[131] Tr. 268, ll. 22-24.
[132] Tr. 268, l. 25 to Tr. 269, l. 6.

Characterization of the three-year term loan as supplying working capital.

Despite Aquila's efforts in this case to characterize the loan as having been entered into to support its working capital needs, presumably because proceeds from the three-year term loan were used to pay down the outstanding balance on the CitiCorp revolving loan facility, with the following exchange during the hearing, Aquila's Chief Financial Officer[133] admitted that the loan was obtained for general corporate purposes:

Mr. Conrad:
Q. The $430 million that we've been talking about here for the last day and a half, that was for general corporate purposes?

Mr. Dobson:
A. I believe it was.[134]

This admission helps explain Aquila's failure to perform any study to determine the working capital needs of its non-utility operations.[135] In fact, as shown by the use in the study of gas prices taken from April 23, 2003 when the loan closed April 11, 2003, Aquila did not complete its working capital study for its utility operations until after the loan closed.[136]

In addition, Aquila had borrowed the maximum amount available under the $650 million revolving line-of-credit on which it had defaulted and which it claims it replaced with the $450 million three-year term loan.[137] Aquila limited its borrowing to $430 million due to the fact that it had FERC authorization to borrow up to that amount. As indicated in its application at paragraph 19, Aquila is in need of liquidity, *i.e.*, having sufficient cash, or near cash, on hand to pay its obligations as they come due. Aquila deposited the $430 million from the term loan into

[133] Tr. 317, ll. 23-24.
[134] Tr. 454, l. 23 to Tr. 455, l. 1.
[135] Dobson, Tr. 438, l. 22 to Tr. 439, l. 3; Tr. 443, ll. 14-16.
[136] Empson, Tr. 568, l. 22 to Tr. 569, l. 1; Lowndes, Tr. 274, l. 25 to Tr. 275, l. 4; Dobson direct, Ex. 4, sch. RD-9; Dobson direct, Ex. 4, p.1; Busch rebuttal, Ex. 33, p. 18, l. 15 to p. 19, l. 5.
[137] Dobson, Tr. 429, ll. 12-19.

its Northern Trust Account, where it aggregates its funds for general corporate purposes. Aquila has made no assurances that the $250 million that it asserts is needed for utility operations working capital will be available for use by its regulated operations when needed. Although working capital is normally financed with short-term debt, Aquila has included no short-term debt in its U.S. utility operating divisions in its target capitalization for each division for each year in the ten-year period 1998 through 2007.[138]

Taken in their entirety, the preceding paragraphs in this section suggest that while the peak day working capital study was performed as part of an effort to anticipate Aquila's liquidity, or cash, needs, it was not performed for purposes of securing the $430 million term loan.

VI. CUSTOMER SERVICE CONDITIONS

Staff witnesses J. Kay Niemeier and James L. Ketter submitted testimony[139] that regardless of whether the Commission approves Aquila's request to use Missouri electric and natural gas assets as collateral to support a $430 million line of credit, the Commission should order Aquila to submit to the Staff on a monthly basis within 21 days of the last day of each month (except on a quarterly basis for one reliability index), until Aquila's financial condition attains investment grade and the Staff determines that reporting is no longer necessary, certain service quality measurements.[140]

Mr. Empson in his direct testimony noted that "Aquila has developed internal service quality metrics. . . . includ[ing] such functions as meter reading accuracy, emergency response

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[138] Ex. 25, p. 3.

[139] Niemeier Rebuttal, Ex. 22. During the course of the hearings, Aquila advised the Staff that all the information in Ms. Niemeier's Rebuttal testimony could be treated as nonproprietary.

[140] Niemeier Rebuttal, Ex. 22, pp. 2, 17, 19-20; Ketter Rebuttal, Ex. 23, pp. 2, 5. The Staff is taking the same position in the direct testimony that the Staff is filing in Aquila's electric and steam rate increase cases, Case Nos. ER-2004-0034 and HR-2004-0024, on December 9, 2003.

time, safety, SAIDI, SAIFI, CAIDI, generation availability, heat rates, and call center performance."[141] He noted that *"[e]very state Operating Vice-President provides written status reports on a monthly basis*."[142] The Commission by ordering the Staff's recommendations would not create an undue hardship or burden on Aquila since Aquila already tracks the customer service quality measurements on a monthly basis. The information that the Staff wants forwarded to it on a monthly basis is monthly information that Aquila is currently collecting and producing. Aquila would just be forwarding to the Staff monthly information on a monthly basis rather than its present procedure of forwarding to the Staff monthly information quarterly.[143] One of the system reliability indices, momentary average interruption frequency index (MAIFI), is compiled on a quarterly basis. Due to the unique nature of the information covered by MAIFI, the Staff is not asking that this index be reported to the Staff on a monthly basis.[144]

The service quality measurements in question are the following:

(1) **Call Center Average Speed of Answer (ASA) All Other Calls (Nonemergency) (monthly reporting)** – number of seconds a caller waits before his/her nonemergency call to the Call Center is answered – comprises the speed of answer for calls other than emergency calls – includes calls answered by a customer service associate and calls handled by the Interactive Voice Response (IVR) system and the high volume call answering (HVCA) system which are answered automatically without the intervention of a customer service associate – ASA – All Other Calls is calculated as the total combined answer time for all nonemergency calls divided by the total number of nonemergency calls – for 2000, 2001, 2002 and January through May 2003, Aquila has not attained its targeted ASA – All Other Calls (Nonemergency) goal – ASA – All Other Calls (Nonemergency) index is trending upward throughout this period – thus, there is a deterioration in customer service.[145]

(2) **Call Center Average Speed of Answer (ASA) Emergency Calls (monthly reporting)** – emergency calls are answered by a live customer service associate and Aquila's targeted answer time is quicker for these calls than for nonemergency calls – for 2001, 2002 and January through May 2003, Aquila met its targeted ASA –

[141] Empson Direct, Ex. 9, p. 5.
[142] *Id.*; Emphasis supplied.
[143] Niemeier Rebuttal, Ex. 22, p. 21; Ketter Rebuttal, Ex. 23, p. 4.
[144] Ketter Rebuttal, Ex. 23, p. 4.
[145] Niemeier Rebuttal, Ex. 22, pp. 6, 11-12.

Emergency Calls goal for 2001, is on the cusp of its target for January through May 2003 and missed its target by greater than 100% in 2002.[146]

(3) **Call Center Abandoned Call Rate (ACR) (monthly reporting)** – percentage of calls terminated by customers after being placed in the network queue to be answered by a customer service representative – ACR does not include calls handled by IVR or HVCA because these calls are answered automatically without the intervention of a customer service associate – ACR is calculated as follows: (a) number of calls answered is subtracted from the number of calls received and (b) the difference is divided by the number of calls received.[147]

(4) **Call Center Service Level All Other Calls (Nonemergency) (monthly reporting)** – this measurement is an objective of answering within a certain number of seconds a certain percentage of nonemergency calls – Aquila did not meet its targeted goal for 2000, 2001, 2002 or January through may 2003 and its performance has been steadily declining since 2000 when this performance indicator was first calculated.[148]

(5) **Call Center Service Level Emergency Calls (monthly reporting)** – Aquila's target answer time is quicker for emergency calls than for nonemergency calls and the target for the percentage of emergency calls answered within this shorter period is higher than the percentage target for answering nonemergency calls – this objective is expressed as answering within a certain number of seconds a certain percentage of emergency calls – for the two periods reported, 2002 and January through May 2003, Aquila has not met its targeted performance – in fact, there is a deterioration in customer service.[149]

(6) **Percentage of Total Electric and Gas Meters Read (monthly reporting)** – Aquila has a meter reading contractor that reads near 50% of Aquila's approximately 300,000 meters – said contractor is utilized mostly in Aquila's suburban areas and Aquila employees read the other 50% of Aquila's meters, primarily located in rural areas – curbing occurs when a meter reader does not read a meter, estimates usage and records the estimate as if it were an actual meter reading – Aquila became aware of a curbing problem involving its meter reading contractor – Aquila advised the Staff of the problem and how it planned to address the problem – Aquila commenced providing the vendor with control reports to assist in the identification of curbings more quickly.[150]

(7) **Number of Consecutive Estimated Meters Read (monthly reporting)** – 4 CSR 240-13.020 states in part that a utility shall not render a bill based on estimated usage for more than three (3) consecutive billing periods or one year whichever is

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[146] Niemeier Rebuttal, Ex. 22, pp. 12-13.
[147] Niemeier Rebuttal, Ex. 22, pp. 6, 9.
[148] Niemeier Rebuttal, Ex. 22, pp. 13-14.
[149] Niemeier Rebuttal, Ex. 22, p. 14.
[150] Niemeier Rebuttal, Ex. 22, pp. 15-16.

less except under certain specified conditions described in the rule – whenever a customer's meter is estimated for more than three (3) months there is greater potential for a billing problem to occur and go undetected and a substantial balance due from the customer or credit due the customer may be created.[151]

(8) **Number of service interruption occurrences per customer (SAIFI) (monthly reporting)** – measures reliability by reflecting the average frequency of interruptions per customer – this index is adjusted to remove the time and frequency of events that are the result of major storms in order to better reflect the operation of the system under normal conditions rather than reflect extraordinary events.[152]

(9) **Hours or minutes of service interruption per customer served (SAIDI) (monthly reporting)** – measures reliability by reflecting the average interruption duration for the period covered – this index is adjusted to remove the time and frequency of events that are the result of major storms in order to better reflect the operation of the system under normal conditions rather than reflect extraordinary events.[153]

(10) **Hours or minutes of service interruption per customer interrupted (CAIDI) (monthly reporting)** – measures reliability by reflecting the average interruption duration – this index is adjusted to remove the time and frequency of events that are the result of major storms in order to better reflect the operation of the system under normal conditions rather than reflect extraordinary events.[154]

(11) **Momentary average interruption frequency index (MAIFI) (quarterly reporting)** – measures reliability by reflecting the average number of momentary outages; momentary outages being defined as outages that are the result of a device interrupting a fault on the system, but the system is re-energized after a short delay without outside human intervention – (Rebuttal Ketter, Ex. 23, p. 4) – for an industrial customer like AGP, a momentary outage takes off-line the entire production line and it takes several hours to restart the production line.[155]

Aquila has two Call Centers – one is located in Lincoln, Nebraska and the other is located in Raytown, Missouri. The Call Centers receive calls from Aquila customers in all seven states in which Aquila has utility operations, and performance measurements are not presently kept on a state-by-state basis. Aquila is currently in the process of developing procedures for aggregating Call Center data on a state-by-state basis rather than on a total company basis. Staff

[151] Niemeier Rebuttal, Ex. 22, p. 16.
[152] Ketter Rebuttal, Ex. 23, pp. 2-3.
[153] Ketter Rebuttal, Ex. 23, pp. 2-3.
[154] Ketter Rebuttal, Ex. 23, pp. 2-3.
[155] Tr. 193-94.

is requesting that Aquila be directed by the Commission to provide the Call Center data to the Staff on a state-by-state basis and also provide notification to the Staff of any delay in the timetable for implementation of the project to aggregate this data on a state-by-state basis or the scope of the project.[156]

Although Aquila presently provides these quality of service measures on a quarterly basis, pursuant to the settlement of Aquila's last rate increase case and the Staff's excess earnings complaint case and by informal agreement, customer quality of service measures should be monitored more closely, i.e., on a monthly basis rather than on a quarterly basis, which would otherwise be recommended by the Staff, because customer services is one of the first areas where financially distressed companies cut costs, and Aquila is financially distressed. Moreover, Aquila's service quality performance generally has been in decline since 2000. Aquila is not meeting its own service quality objectives or the service quality objectives previously recommended by the Staff. Therefore, the Commission should require that Aquila submit reports on these measures of customer service to the Staff, on a monthly, state-by-state basis so that the Staff can more timely monitor Aquila's service quality performance and determine whether some course of action other than monitoring is required.[157]

The fact that Aquila is taking action to address customer service performance concerns does not mean that the action being taken or that is intended to be taken by Aquila is appropriate or effective. Aquila itself has indicated that improvement will occur over time. Mr. Brett Carter, Aquila Vice President of Central Services, testified that "[i]mproving on processes through standardized business rules while maintaining and/or improving customer service will continue

[156] Niemeier Rebuttal, Ex. 22, p. 18.
[157] Niemeier Rebuttal, Ex. 22, pp. 2, 6, 18-20.

to be a balancing act for the next couple of years."[158] The Staff needs to scrutinize the Aquila customer service data on a more timely basis than receiving monthly data quarterly.

The table below for ACR shows Aquila's and Staff's performance objectives and Aquila's actual performance on an annual basis for 2000 through 2002 and cumulatively for the first five months of 2003:[159]

Aquila's ACR Performance				
	2000	2001	2002	January-May 2003
Staff's Recommended Objective	8%	8%	8%	8%
Company's Objective	5%	5%	5%	5%
Company's Actual Performance	6%	4%	10%	11%

The table below for ASA – All Other Calls (Nonemergency) shows Aquila's and Staff's performance objectives and Aquila's actual performance on an annual basis for 2000 through 2002 and cumulatively for the first five months of 2003:[160]

Aquila's ASA for All Other Calls (Nonemergency) Performance				
	2000	2001	2002	January-May 2003
Staff's Recommended Objective	65 seconds	65 seconds	65 seconds	65 seconds
Company's Objective	30 seconds	30 seconds	30 seconds	30 seconds
Company's Actual Performance	52 seconds	53 seconds	80 seconds	90 seconds

The table below for ASA – Emergency Calls shows Aquila's performance objectives and Aquila's actual performance on an annual basis for 2000 through 2002 and cumulatively for the first five months of 2003:[161]

[158] Carter Surrebuttal, Ex. 2, p. 7.
[159] Niemeier Rebuttal, Ex. 22, p. 10.
[160] Niemeier Rebuttal, Ex. 22, pp. 11-12.

Aquila's ASA for Emergency Calls Performance			
	2001	2002	January-May 2003
Company's Objective	15 seconds	15 seconds	15 seconds
Company's Actual Performance	9 seconds	36 seconds	15 seconds

The table below for Service Level – All Other Calls (Nonemergency) shows Aquila's performance objectives and Aquila's actual performance on an annual basis for 2000 through 2002 and cumulatively for the first five months of 2003:[162]

Aquila's Service Level of All Other Calls Answered within 20 seconds				
	2000	2001	2002	January-May 2003
Company's Objective	80%	80%	80%	80%
Company's Actual Performance	65%	60%	62%	58%

The table below for Service Level – Emergency Calls shows Aquila's performance objectives and Aquila's actual performance on an annual basis for 2002 and cumulatively for the first five months of 2003:[163]

Aquila's Service Level of Emergency Calls Answered within 10 seconds		
	2002	January-May 2003
Company's Objective	90%	90%
Company's Actual Performance	71%	73%

This information was not calculated by Aquila prior to 2002.[164]

[161] Niemeier Rebuttal, Ex. 22, pp. 12-13.
[162] Niemeier Rebuttal, Ex. 22, p. 14.
[163] Niemeier Rebuttal, Ex. 22, p. 13.
[164] *Id.*

The aggregated data for 2003 does not reveal that on a monthly basis in 2003, (1) the ACR has ranged from a high of 20% to a low of 6%; (2) the ASA – All Other Calls (Nonemergency) has ranged from a high of 160 seconds to a low of 30 seconds; and (3) the ASA – Emergency Calls has ranged from a high of 25 seconds to a low of 9 seconds:[165]

	January 2003	February 2003	March 2003	April 2003	May 2003	June 2003
Abandoned Call Rate (actual) %	16%	9%	6%	20%	14%	12%
Staff's Recommended Objective %	8%	8%	8%	8%	8%	8%
Company's Objective %	5%	5%	5%	5%	5%	5%
Average Speed of Answer – All Other Calls (in seconds) (actual)	150	78	30	160	111	100
Staff's Recommended Objective (in seconds)	65	65	65	65	65	65
Company's Objective (in seconds)	30	30	30	30	30	30
Average Speed of Answer – Emergency (in seconds) (actual)	16	15	9	25	20	17
Company's Objective (in seconds)	15	15	15	15	15	15

Ms. Niemeier, in response to a question from Commissioner Murray regarding what would be the effect of the Staff receiving the customer service performance information on a monthly basis rather than on a quarterly basis, explained that the indices information, whether received on a monthly or a quarterly basis, would be reviewed and evaluated for trends immediately upon receipt.[166] The performance of a company in the financial situation confronted by Aquila would be more closely monitored by the Staff and performance indices reported every month rather than only every quarter would facilitate this higher level of scrutiny.[167] If the information for a single month caused alarm on the part of the Staff, Aquila would be called for an explanation and possibly a meeting would be arranged between Aquila

[165] Niemeier Rebuttal, pp. 10-12; Ex. 28HC, Aquila Networks – Missouri Monthly Performance Data Through Second Quarter 2003. Aquila has advised the Staff that the information utilized in this table is not Highly Confidential, although the document containing the Aquila Networks – Missouri Monthly Performance Data Through Second Quarter 2003 was designated as Highly Confidential by Aquila.
[166] Tr. 831-32.
[167] *Id.* at 833-34.

and the Staff respecting the results.[168] Although the Staff would be looking for trends, this review and analysis would be performed twelve times a year by the Staff if the monthly information were provided on a monthly basis to the Staff rather than being performed four times a year when, as presently, the monthly information is provided on a quarterly basis to the Staff.[169] Ms. Niemeier testified that Aquila reporting and the Staff analyzing monthly data from Aquila on a monthly basis rather than quarterly would not be a burden for the Staff.[170]

Exhibit 28HC is the monthly customer service indices data for the second quarter of 2003 for Aquila Networks – MPS and L&P that Aquila provided to the Staff. A review of that document reveals that it is nothing more than customer service indices data provided on a month-by-month basis. It is accompanied by a transmittal letter from Dennis R. Williams, Vice President – Regulatory Services. This document contains no analysis of the data that is provided. It merely provides data.[171]

Mr. Carter seemed to attempt to suggest that the Staff's concern regarding the level of customer service being provided by Aquila was the result of a lack of communication between the Staff and Aquila and that Aquila was offering a new approach in proposing that Aquila meet quarterly with the Staff when the customer service indices are provided to the Staff.[172] Ms. Niemeier indicated that the Staff routinely calls Aquila personnel and meets with Aquila personnel when the Staff believes explanation of the information provided is appropriate or necessary.[173]

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[168] *Id.* at 833.
[169] *Id.* at 831-834.
[170] *Id.* at 835, ll. 1-5.
[171] Ex. 28HC.
[172] Tr. 209, ll. 4-22.
[173] Tr. 833, l. 4 to 834, l. 2.

Ms. Niemeier also indicated that the Staff routinely looks for explanations as to what may be the cause of anomalies or trends in the data provided.[174] In fact, Ms. Niemeier testified that Aquila's customer services indicies have been declining since 2000, she has met twice in the recent past with Aquila personnel regarding issues relating to the Aquila Call Centers.[175] She stated that Aquila is aware that its customer service indices have been in decline and that the Staff has been told that this performance will be addressed.[176] Mr. Carter himself states in his surrebuttal testimony "[a]dmittedly the call center service level statistics have not been where we wanted them to be in the past."[177]

Mr. Glenn P. Keefe, Aquila Operating Vice President – Missouri Electric, identified Exhibit No. 27HC as being what Aquila refers to as its "Dashboard," which displays 14 service goals and objectives for Aquila Missouri electric operations and is utilized to try to improve customer service.[178] Among the indices on Exhibit No. 27HC are CAIDI, SAIDI and SAIFI. Mr. Keefe testified that the performance indices that Aquila utilizes are updated on a monthly basis.[179] Mr. Keefe testified that rather than submit to the Staff the indices monthly and receive data requests from the Staff regarding this data, Aquila would prefer to provide the monthly data quarterly so that he and his Staff could attempt to fix any problem before it came to the attention of the Staff: "So I would rather spend my time and my staff's time on recognizing the problem ourselves and fixing that problem and then share with the Staff on a quarterly basis."[180] Mr. Keefe acknowledged that under Aquila's proposed approach the Staff and the Commission might not become aware of a deterioration in service for as much as three months, but under the Staff's

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[174] Tr. 831, l. 21 to 832, l. 15; Tr. 833, ll. 14-20; Tr. 834, ll. 19-25.
[175] Tr. 832, ll. 9-15; Tr. 830, l. 10-15.
[176] Tr. 830, l. 16 to 831, l. 10.
[177] Carter Surrebuttal, Ex. 2, pp. 6-7.
[178] Tr. 175.
[179] *Id.* at 174.
[180] *Id.* at 181.

proposed approach the Staff would become aware of a such a deterioration within one month.[181] He testified that shifting to monthly reporting from quarterly reporting would probably not require that additional personnel be hired.[182]

Mr. Carter in his surrebuttal testimony states that Aquila has "begun benchmarking our call center results against other utilities as a way to help guide planning and decision making"[183] and "[c]urrently, we are using industry benchmark data to ensure appropriate service level targets and staffing levels."[184] The Staff notes the Commission's finding in the Union Electric Company case where UE sought to place the Callaway nuclear generating unit in rate base and the Kansas City Power & Light Company case where KCPL sought to place the Wolf Creek nuclear generating unit in rate base that "[i]ndustry comparisons do not establish a standard of prudence."[185]

The Commission in its Report And Order in the UtiliCorp – SJLP merger case [186] related that since "pressures and dislocations associated with the merger might lead to a decrease in the quality of service that UtiliCorp would provide to the former customers of SJLP," the Staff proposed that the Commission require, among other things, that UtiliCorp provide monthly reports to the Staff regarding ACR, ASA, CAIDI, SAIFI and SAIDI, and establish specified objectives for UtiliCorp for ACR and ASA. The Commission determined that the only customer service condition that it would impose on UtiliCorp was to require UtiliCorp to provide Staff with monthly customer services indices reports for one year following the merger. The Commission stated: "The mere fact that UtiliCorp seeks to acquire SJLP does not require that the

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[181] *Id.* at 186-87.
[182] *Id.* at 188.
[183] Carter Surrebuttal, Ex. 2, p. 5.
[184] *Id.* at 7.
[185] *Re Kansas City Power & Light Co.*, Case No. EO-85-185 and EO-85-224, 28 Mo.P.S.C.(N.S.) 228, 281 (1986); *Re Union Electric Co.*, Case Nos. EO-85-17 and ER-85-160, 27 Mo.P.S.C.(N.S.) 183, 193 (1985).
[186] *Re UtiliCorp United, Inc. and St. Joseph Power & Light Co.*, Case No. EM-2000-292, 9 Mo.P.S.C.3d 454, 463 (2000).

Commission endeavor to micromanage UtiliCorp's customers service program by imposing special conditions that are not applicable to the other utilities in this state."[187] Aquila provided this information for the one-year specified by the Commission in its Report And Order in Case No. EM-2000-292, then on a quarterly basis for 2002 and 2003 pursuant to the Commission's February 21, 2002 Order Accepting Stipulation And Agreement in Case No. ER-2001-672[188] and is providing other information voluntarily.[189] The Staff is unaware of Aquila's service quality performance unless these measurements are provided to the Staff.[190]

Commencing as early as Case No. EM-97-515, the Staff has endeavored to obtain similar reporting of ASA and ACR data in all electric and gas merger cases and SAIFI, SAIDI and CAIDI data in all electric merger cases.[191]

CONCLUSION

Due to Aquila's recent failure to carry out its commitments to lenders as well as other factors bringing Aquila's credibility into question, the Staff has serious reservations about Aquila's ability to carry out the commitment it makes in its application to maintain sufficient non-regulated assets to secure debt on the loan exceeding the $250 million it asserts it needs for U.S. utility working capital. Additionally, the Staff finds any apparent protection offered by that commitment to be illusory as the lenders are not bound by that separation.

Aside from the Staff's concerns about the quality of Aquila's plan for allocating assets and its ability to meaningfully execute that plan, Aquila's arguments suggesting any direct financial benefit to Aquila no longer exist. As Aquila acknowledges, the recent decisions of the

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[187] 9 Mo.P.S.C.3d at 464.
[188] See Case Nos. ER-2001-672 and EC-2002-265, Attachment A, page 4 of 66 to Order Accepting Stipulation And Agreement.
[189] Niemeier Rebuttal, Ex. 22, p. 17; Keefe Surrebuttal, Ex. 1, p. 3.
[190] Niemeier Rebuttal, Ex. 22, p. 18.
[191] Niemeier Rebuttal, Ex. 22, p. 20; *Re Western Resources, Inc. and Kansas City Power & Light Co.*, Case No. EM-97-515, Customer Service Standards Agreement And Conceptual Framework For A Generation And Transmission Costs Allocations Agreement, August 24, 1999.

commissions in both Colorado and Iowa, allowing Aquila's assets in their states to be encumbered by the three-year term loan, mean that this Commission's approval of its application is no longer necessary for Aquila to avail itself of the full $430 million amount of the loan at the reduced interest rate.

Furthermore, the Staff has exposed the hollowness of Aquila's fairness argument, by demonstrating that, among other things, Aquila is asking this Commission to authorize it to pledge a very large share of Aquila's total U.S. utility assets to support a small, perhaps negative, share of Aquila's purported total peak day working capital need. Nevertheless, even if Aquila's argument were accepted, with the rejection of Aquila's application in Minnesota, the state for which Aquila shows the greatest working capital need, Aquila's position that the assets of all of its U.S. utility operations should be securing their working capital needs cannot be achieved; thus, its fairness argument, even if accepted, is unattainable. Regardless, any fairness argument with substance should look to the relationship between Aquila and its creditors. The rights that Aquila's creditors will obtain if Aquila's Missouri utility assets become collateral for the three-year term loan would permit them, in the event Aquila defaults on the loan, to seek repayment from Aquila's Missouri assets first, regardless of the cause of the default. Additionally, while a benefit to Aquila, if Aquila has more utility collateral securing the loan than is required, it may be in a position to seek release of its assets in other states from the security interest and it may also be subject to a prepayment penalty, the "make whole" provision, if it prepays amounts on the loan.

Increasing the likelihood that Aquila may incur a "make whole" premium in carrying out its commitment to maintain sufficient non-regulated assets as collateral to support amounts it has borrowed that exceed $250 million is not in Aquila's interest. The risk that Aquila might release utility assets in other states as loan collateral, but not its Missouri utility assets is a detriment to Aquila's Missouri customers.

Aquila seeks relief that it does not need, that provides no direct benefit to itself or its Missouri customers, but that clearly increases the risk to its Missouri customers. Furthermore, Aquila states that denial of its application will not result in an increase in rates or a decrease in the quality of service.[192] Based on the facts of this case, it is not difficult to conclude that to grant Aquila authorization to encumber its Missouri jurisdictional regulated assets to secure its three-year $430 million Term Loan Facility and related First Mortgage Bonds would be detrimental to the public interest. Likewise, for many of the same reasons, it is not difficult to conclude that to grant Aquila authorization to encumber its Missouri jurisdictional assets 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 would be detrimental to the public interest.

The Staff recommends that the Commission deny Aquila's requests for authorization (1) to encumber its Missouri jurisdictional regulated assets to secure its three-year $430 million Term Loan Facility and related First Mortgage Bonds and (2) to secure, with its Missouri jurisdictional regulated assets, 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.

In addition, due to the intense financial pressure under which Aquila is currently operating, which highly motivates it to cut costs where it can, including those associated with customer service, the Commission should order Aquila to submit to the Staff on a monthly basis within 21 days of the last day of each month (except on a quarterly basis for MAIFI), until

[192] Tr. 455, l. 25 to Tr. 456, l. 5.

Aquila's financial condition attains investment grade and the Staff determines that reporting is no longer necessary, the following service quality measurements:

> Average Speed of Answer (ASA) – All other calls
> Average Speed of Answer (ASA)– Emergency calls
> Abandoned Call Rate (ACR)
> Service Level – All other calls
> Service Level – Emergency calls
> Percentage of Total Electric and Gas Meters Read
> Number of Consecutive Estimated Meters Read
> SAIFI (number of service interruption occurrences per customer)
> SAIDI (hours or minutes of service interruption per customer served)
> CAIDI (hours or minutes of service interruption per customer interrupted)
> MAIFI (momentary average interruption frequency index)

Further, the Commission should order Aquila to submit to the Staff the service quality measurements listed above for each state in which it provides service when it completes implementing the capability to do so, and to keep the Staff apprised of the progress of Aquila's implementation of its capability to capture data to report these measurements on a state-by-state basis.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or e-mailed to all counsel of record this 8th day of December 2003.

/s/ Nathan Williams