

REBUTTAL TESTIMONY

OF

TED ROBERTSON

AQUILA INC.

CASE NO. EF-2003-0465

INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. Ted Robertson, P.O. Box 7800, Jefferson City, Missouri 65102.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by the Office of the Public Counsel of the State of Missouri ("Public Counsel" or "OPC") as a Public Utility Accountant III.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND OTHER QUALIFICATIONS.

A. I graduated from Southwest Missouri State University in Springfield, Missouri, with a Bachelor of Science Degree in Accounting. In November 1988, I passed the Uniform Certified Public Accountant Examination, and obtained a C. P. A. Certification from the State of Missouri in 1989.

1 Q. WHAT IS THE NATURE OF YOUR CURRENT DUTIES WHILE IN THE EMPLOY OF THE
2 PUBLIC COUNSEL?

3 A. Under the direction of the Public Counsel Chief Public Utility Accountant, Mr. Russell W.
4 Trippensee, I am responsible for performing audits and examinations of the books and records of
5 public utilities operating within the State of Missouri.

6
7 Q. HAVE YOU EVER TESTIFIED BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION?

8 A. Yes, I have. On Schedule 1 (attached to this Rebuttal Testimony), I have included a listing of the
9 cases in which I have presented testimony before the Missouri Public Service Commission
10 ("MPSC" or "Commission").

11
12 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

13 A. The purpose of my Rebuttal Testimony is to support the Public Counsel's recommendations
14 regarding the Aquila, Inc. ("Aquila" or "Company") Application for an order authorizing a pledge
15 of, and the creation of liens on, its regulated assets located in the State of Missouri in order to
16 secure recently incurred debt.

PUBLIC COUNSEL SUMMARY

Q. DOES OPC RECOMMEND THAT THE COMMISSION APPROVE AQUILA'S APPLICATION?

A. No. Public Counsel recommends that the Commission deny the application sought by Aquila, Inc. Our recommendation is based upon the fact that the Company has already encumbered collateral sufficient to satisfy the \$250 million portion of new debt ("Term Loan" or "Term Loan Facility") it alleges necessary for the working capital requirement of its domestic regulated utilities. In addition, Public Counsel believes that the Missouri regulated utilities owned by Aquila are cash flow positive (as explained in detail in the following testimony, and the testimony of OPC witness, Mr. James Busch), and if they are not, the amount of the peak day cash flow required, according to estimates provided by the Company, is so minuscule when compared to the dollar value of the Missouri regulated assets Company seeks to collateralize, as to be an unreasonable proposition. Also, if this Commission allows Aquila to encumber the Missouri utilities assets, it is likely that those assets will be utilized as collateral for debt associated with Company's non-regulated activities. Lastly, Public Counsel also believes it unreasonable for this Commission to acquiesce to Aquila's request for "rollover" collateralization of the regulated Missouri utilities assets for future debt not yet determined or issued.

Q. DOES THIS COMMISSION HAVE THE AUTHORITY TO APPROVE OR DISALLOW AQUILA'S APPLICATION?

1 A. Yes. As pointed out in Aquila's Application, this request is governed by Chapter 393.180 of the
2 Missouri Revised Statutes, which states:

3
4 393.180. Right to issue stocks, bonds, notes subject to regulation

5
6 **The power of gas corporations, electrical corporations, water**
7 **corporations, or sewer corporations to issue stock, bonds, notes and other**
8 **evidences of indebtedness and to create liens upon their property situated in**
9 **this state is a special privilege,** the right of supervision, regulation, restriction and
10 control of which is and shall continue to be vested in the state, and such power shall
11 be exercised as provided by law and under such rules and regulations as the
12 commission may prescribe. (R.S. 1939, § 5650. Amended by L.1967, p. 578, § 1.)

13
14 Emphasis added by OPC.
15
16

17 However, the Public Counsel believes that the Commission should understand that Aquila's request
18 is not a financing case in the typical sense.
19

20 Q. WHY IS AQUILA'S CURRENT APPLICATION NOT A TYPICAL FINANCING CASE?

21 A. This case is unique from prior financing cases brought before the Commission. Pubic Counsel is
22 unaware of any financing application filed with this Commission where the regulated utility has
23 requested authority to encumber the Company's system or works, as a component of a financing
24 where the Company had, a) closed the financing, b.) received the proceeds of the financing, and c.)
25 disbursed the funds without having first obtained Commission approval to encumber the
26 Company's system or works. Finally, Public Counsel is unaware of any other financing application
27 filed with the Commission where the regulated utility requesting authority to encumber its regulated

assets was not investment grade and had limited access to capital.

Q. DOES AQUILA'S REQUEST REPRESENT A SPECIAL PRIVILEGE?

A. Yes. Chapter 393.180 of the Missouri Revised Statutes clearly states that the opportunity of utilities to create liens (i.e., utilize assets of the regulated utilities as collateral for debt) upon their property situated in this state is a special privilege governed by this Commission. Thus, the Public Counsel believes that Aquila's request to substitute the collateral in the Term Loan with Missouri regulated assets is not a right guaranteed the Company under normal regulatory ratemaking concepts. If allowed at all, it would be a special privilege. A special privilege that Public Counsel believes should not be approved since the Company's request seeks to over-collateralize the Term Loan with Missouri regulated assets, and to gain pre-approval of those same assets as collateral for future debt financings.

AQUILA'S APPLICATION

Q. HAS AQUILA RECENTLY ACQUIRED NEW DEBT FINANCING THAT RESULTED IN THE FILING OF ITS APPLICATION?

A. Yes. On April 9, 2003, Aquila entered a \$430 million three-year Term Loan Facility and a 364-day \$100 million loan that replaced an amount outstanding under the Company's prior revolving credit facilities and retired other maturing debt obligations. In connection with the Term Loan, Aquila has issued First Mortgage Bonds under its Indenture of Mortgage and Deed of Trust, dated as of April 1, 2003, to Bank One Trust Company, N.A., Trustee (the Indenture) and its First Supplemental Indenture thereto dated April 9, 2003, to Bank One Trust Company, N.A. Trustee (the First Supplemental Indenture). The Indenture, as amended and supplemented by the First Supplemental Indenture, constitutes a first mortgage lien on the property of Aquila.

Q. WHAT ASSETS OF AQUILA ARE CURRENTLY SERVING AS COLLATERAL FOR THE TERM LOAN?

A. Currently, various Aquila assets, including regulated utility assets located in Michigan and Nebraska are subject to the lien of the Indenture (note: Michigan and Nebraska do not have state laws that require Commission approval for encumbrance of regulated assets. Furthermore, the \$100 million loan can be increased to \$200 million under certain circumstances, but would continue to be secured exclusively by non-domestic utility property.). The regulated assets in the States of Missouri, Kansas, Minnesota, Iowa and Colorado were originally excluded as collateral

1 for the Term Loan due to a short timeframe prior to a financial waiver deadline and the necessity to
2 receive regulatory approval from the appropriate organizations in the respective jurisdictions.

3
4 Q. WHAT DOES AQUILA'S APPLICATION SEEK FROM THIS COMMISSION?

5 A. According to Aquila, the Term Loan is needed due to the Company's particular financial
6 difficulties, and the financial difficulties and requirements of the energy sector at large. Subsequent
7 to obtaining the new financing (i.e., on April 30, 2003), Aquila, Inc. filed an Application with this
8 Commission seeking, 1) a Commission order authorizing the assignment, transfer, mortgage or
9 encumbrance of Aquila's utility franchise, works, or system necessary or useful in the provision of
10 regulated electrical, natural gas and heating company utility services to the public in Missouri in
11 order to secure Aquila's \$430 million three-year Term Loan, and to proceed with an encumbrance
12 of its utility assets located in Missouri and/or to create liens on its property situated in Missouri in
13 order to secure the \$430 million three-year Term Loan and related First Mortgage Bonds by
14 subjecting said property to the lien of the indenture as supplemented and amended by the First
15 Supplemental Indenture, and 2) to secure the future replacement debt offerings for working capital
16 requirements not to exceed \$430 million.

17
18 The Term Loan is currently secured by Aquila utility assets located in Michigan and Nebraska
19 along with a pledge of the capital stock of the holding company of Aquila's Canadian utilities and
20 other non-regulated assets. However, Aquila wants to sell the Canadian assets. The resulting loss
21 of the Canadian collateral as security for the Term Loan would render the utility assets in Michigan

1 and Nebraska insufficient to support the Term Loan under collateral principles used by Aquila's
2 lending institutions. In addition, Aquila believes that its utility assets should support the working
3 capital requirement for its utility operations.

4
5 Q. HAS AQUILA ON ITS OWN FURTHER DEFINED HOW IT WILL TREAT THE \$430
6 MILLION TERM LOAN?

7 A. Yes. Company's Application, at paragraph 13, states that approximately \$250 million of the \$430
8 million Term Loan will be used to meet the cash working requirements of Aquila's United States
9 utility businesses with the remaining \$180 million used to meet the working capital needs of
10 Aquila's non-regulated activities. Company alleges that while the financial institutions have only
11 required Aquila to pledge sufficient assets in total to secure the \$430 million Term Loan, Aquila is
12 separating the Term Loan and collateral into United States utility and other categories to ensure that
13 the utility customers and utility assets are not supporting the non-utility debt requirements.
14 Company states that it is its intent to maintain a proper alignment of United States utility collateral
15 with the United States utility loan needs, and non-utility and non-regulated business collateral with
16 the loan needs of those activities.

17
18 Q. ARE THE LOANS ALREADY IN PLACE, COLLATERALIZED, AND THE MONIES THAT
19 THEY PROVIDE CURRENTLY BEING UTILIZED BY AQUILA?

20 A. Yes. The loans have already been finalized, and the Company currently has full utilization of the
21 funds that they provided. The proceeds of the Term Loan reside at the corporate level and Aquila is

1 using the proceeds to meet the needs of both its regulated and non-regulated operations. (OPC Data
2 Request No. 1006 attached as Schedule 2 to this Rebuttal Testimony)

3
4 Q. WHY IS AQUILA SEEKING TO COLLATERALIZE THE ASSETS OF ITS MISSOURI
5 REGULATED UTILITIES?

6 A. The combination of Aquila's August 2002 decision to exit its non-regulated merchant business, and
7 the rapid divestiture of other non-core assets that resulted in net book losses (OPC Data Request
8 No. 1027 attached as Schedule 3 to this Rebuttal Testimony), caused the Company to breach loan
9 agreement covenants for maintaining specified interest coverage ratios. In order to avoid a
10 mandatory repayment of the loans, Aquila subsequently received waivers of the breached covenants
11 from its lenders in order to provide it time to obtain new sources of financing. The waivers on the
12 breeched debt expired on April 12, 2003.

13
14 Q. WHAT DID AQUILA DO AFTER IT RECEIVED WAIVERS OF THE BREECHED
15 CONVENANTS?

16 A. In order to refinance the outstanding obligations, as discussed in its Application, Aquila entered
17 into two new loan arrangements, 1) a \$430 million, three-year secured credit facility, comprising a
18 Term Loan facility and a pre-funded letter of credit facility, and 2) a \$200 million, 364-day bridge
19 facility, comprising up to \$100 million payable at closing and an option to draw an additional
20 amount of up to \$100 million. The \$430 million three-year Term Loan is secured by a pledge of
21 certain utility network assets in Nebraska and Michigan, the stock of the holding company for the

1 Canadian utility operations, and a junior lien on certain of the Company's independent power
2 projects ("IPP"). While the 364-day bridge facility was borrowed by UtiliCorp Australia, Inc., a
3 wholly-owned subsidiary of Aquila, and is non-recourse to Aquila. That is, the bridge facility will
4 not be supported by an Aquila parent guarantee.

5
6 Q. DOES THE 364-DAY BRIDGE LOAN HAVE ANY RELEVANCE TO THE COMPANY'S
7 CURRENT APPLICATION?

8 A. No. The 364-day \$200 million loan to UtiliCorp Australia Inc. bears no relevance to the
9 Application's collateralization request, except that, certain non-regulated property currently utilized
10 to secure the 364-day loan is also utilized, or may be utilized in the future, as security for the \$430
11 million three-year Term Loan. (Informal Interview Transcript page 554, lines 4-15, and page 557,
12 lines 17-25, attached as Schedule 4 to this Rebuttal Testimony)

13
14 On April 22, 2003, Aquila announced that it would sell all of its Australian interests for
15 approximately US\$589 million, which after fees, expenses and taxes is projected to yield net cash
16 proceeds of US\$445 million at closing. It is expected that the 364-day bridge facility, borrowed by
17 UtiliCorp Australia, Inc., will be repaid from these proceeds. This information was further
18 substantiated by the Company's response to OPC Data Request No. 1013 which states that upon the
19 closing of the Australian sales process it will utilize a portion of the net proceeds to repay the \$200
20 million borrowed under this financing agreement. (OPC Data Request No. 1013 attached as
21 Schedule 5 to this Rebuttal Testimony)

1
2 Q. DOES THE COMPANY'S APPLICATION TO COLLATERALIZE MISSOURI REGULATED
3 UTILITY ASSETS PERTAIN ONLY TO THE PROCEEDS OF THE \$430 MILLION TERM
4 LOAN?

5 A. Yes, however, Aquila has also requested to utilize those same assets as collateral for future debt
6 issues. Company requests Commission approval to pledge all of its Missouri regulated utility
7 assets as collateral for the \$430 million three-year Term Loan. Company alleges that \$250 million
8 of the \$430 million is needed to support the working capital requirement of all its domestic
9 regulated utilities. (Schedule RD-3 of Mr. Rick Dobson's Direct Testimony) Aquila believes it
10 appropriate to allow all its domestic utility assets to participate as collateral on an equal basis as all
11 utility assets have working capital requirements. (page 11 of Mr. Rick Dobson's Direct Testimony)
12 Company further alleges that it is not possible to divide the collateral value by individual assets
13 within a state to issue mortgage bonds and therefore has requested to provide the collateral based on
14 its entire pool of utility assets. (MPSC Staff Data Request No. 40 attached as Schedule 6 to this
15 Rebuttal Testimony) Company further offers that to assure the adequacy of collateral, commercial
16 lenders typically require collateral substantially in excess of the loan amount. (Informal Interview
17 Transcript pages 250, and 251, lines 1-9, attached as Schedule 7 to this Rebuttal Testimony)

18
19 Q. ARE THE LOAN PROCEEDS CURRENTLY BEING UTILIZED TO MEET THE WORKING
20 CAPITAL NEEDS OF THE MISSOURI REGULATED UTILITIES?

21 A. Company alleges that a portion of the proceeds of the \$430 million three-year Term Loan is

1 currently meeting Aquila's regulated utility working capital need in this state. However, Aquila has
2 not provided any analysis that would verify the specific nature of that claim.

3
4 Q. HAS AQUILA FILED FOR SIMILAR REGULATORY TREATMENT IN OTHER STATES?

5 A. Yes. The Application is one of five applications that were filed concurrently by Aquila in the States
6 of Colorado, Iowa, Kansas, Minnesota and Missouri to secure regulatory approval for Aquila to
7 pledge all of its electric and natural gas utility assets located in those states, in order to secure the
8 payment of the \$430 million three-year Term Loan and to secure the future replacement debt
9 offerings for working capital requirements.

10
11 Q. DID THE LENDERS OF THE TERM LOAN REQUIRE THAT \$250 MILLION OF ITS
12 PROCEEDS BE SET ASIDE AS WORKING CAPITAL FOR THE DOMESTIC REGULATED
13 UTILITIES AQUILA OWNS?

14 A. No. The financial institutions only required Aquila to pledge assets sufficient to secure the \$430
15 million Term Loan. In compliance with the Term Loan, Aquila pledged collateral sufficient to
16 secure the credit facility up to the full amount of the \$430 million. Aquila asserts that \$250 million
17 of the \$430 million Term Loan is required for its domestic utility working capital needs. Company
18 bases its claim is based on alleged historical and anticipated domestic utility working capital needs.
19 That is, Aquila, by itself, determined internally that \$250 million of the \$430 million is needed to
20 support the ongoing working capital requirements of its domestic regulated utility businesses.

ENCUMBRANCE OF MISSOURI REGULATED UTILITIES ASSETS

Q. WHY HAS THE COMPANY COME BEFORE THIS COMMISSION SEEKING TO USE MISSOURI REGULATED UTILITY ASSETS AS COLLATERAL FOR LOANS ALREADY IN PLACE AND COLLATERALIZED?

A. Aquila seeks, **in order to proceed with its restructuring efforts**, to sell the non-regulated assets that currently back the Term Loan. If those non-regulated assets are sold, the Company must either pay-down the Term Loan to a level commensurate with the collateral requirements or add additional assets as a collateral replacement. Aquila's plan is that the regulated assets of all its domestic utilities be encumbered and pledged to directly support the entire \$430 million Term Loan Facility. (Informal Interview Transcript page 283, lines 3-16, attached as Schedule 8 to this Rebuttal Testimony)

Q. WERE THE LENDERS AWARE OF THE FACT THAT AQUILA WOULD HAVE TO SEEK AUTHORITY FROM CERTAIN LEGISLATIVE BODIES TO ENCUMBER ITS REGULATED UTILITY ASSETS?

A. Yes. The following terms were included in the Term Loan credit agreement attached, as Appendix 3, to the Direct Testimony of Aquila witness, Mr. Rick Dobson:

** _____

1 _____
2 _____
3 _____
4 _____
5 _____
6 _____
7 _____
8 _____
9 _____
10 _____
11 _____
12 _____
13 _____ **
14 _____
15 _____

16 Q. ARE ANY ASSETS OF AQUILA'S DOMESTIC REGULATED UTILITIES CURRENTLY
17 BEING UTILIZED AS COLLATERAL FOR THE \$430 MILLION TERM LOAN?

18 A. Yes. As discussed earlier, a portion of the collateral utilized to originally secure the \$430 million
19 Term Loan included the regulated assets of Aquila's Michigan and Nebraska utilities. This
20 information was substantiated by the Company's response to OPC Data Request No. 1011
21 (attached as Schedule 9 to this Rebuttal Testimony), which states:

22
23 ** _____
24 _____
25 _____
26 _____
27 _____
28 _____
29 _____
30 _____
31 _____
32 _____
33 _____
34 _____

1 _____
2 _____
3 _____
4
5
6 Subsequently, after a limited review by the Staff of the Colorado Public Utilities Commission (i.e.,
7 the Colorado Staff sent 7 data requests to which no formal responses were prepared since Company
8 met with the Staff and discussed the questions orally (OPC DR Nos. 1004 and 5006 attached as
9 Schedules 10 and 11 to this Rebuttal Testimony)), the Colorado Commission approved a stipulation
10 and settlement agreement that gave Aquila permission to encumber its regulated utility assets
11 located in State of Colorado. The Colorado Public Service Commission did however withhold its
12 approval for “rollover” of the collateralization of the regulated assets pending review of the
13 outcome of Aquila’s applications in the other four states (i.e., Missouri, Minnesota, Iowa and
14 Kansas). (Recommended Decision Of Administrative Law Judge Dale E. Isley Approving
15 Stipulation And Settlement Agreement attached as Schedule 12 to this Rebuttal Testimony)
16

17 Q. SHOULD THE COLORADO PUBLIC UTILITIES COMMISSION DECISION TO APPROVE
18 AQUILA’S APPLICATION HAVE ANY BEARING ON THE ISSUE IN THE STATE OF
19 MISSOURI?

20 A. No, it should not. The State of Colorado’s investigation into Aquila’s Application was, in the
21 Public Counsel’s opinion, limited. If the State of Colorado chooses to accept the Company’s
22 positions, as a matter of public policy, that is their right. However, in the State of Missouri, and I
23 believe the States of Iowa, Kansas, and Minnesota, we have found the investigation into the

1 Company's Application to be a bit more complex; requiring significant time and manpower in
2 order to understand and report on just what it is exactly that Aquila is asking for from the various
3 Commissions.

4
5 Q. WHAT IS THE VALUE OF THE COLLATERAL PROVIDED BY THE MICHIGAN,
6 NEBRASKA AND COLORADO REGULATED UTILITIES?

7 A. Pursuant to the terms of the Term Loan agreement an appraisal of the respective utilities assets was
8 performed by ** _____

9 _____

10 _____

11 _____

12 _____

13 _____

14 _____

15 _____ * (relevant sections of the appraisals are attached as Schedules 13 and 14 to this Rebuttal
16 Testimony)

17
18 Q. DOES "FAIR VALUE" AND "BOOK VALUE" HAVE THE SAME MEANING?

19 A. No. Book value implies the original costs recorded on a utility's financial books of record;
20 whereas, "fair value," as utilized by ** _____ * can be defined as follows:

1 ** _____
2 _____
3
4

5 Q. HOW MUCH REGULATED UTILITY COLLATERAL WOULD BE REQUIRED TO
6 SUPPORT THE ALLEGED \$250 MILLION WORKING CAPITAL REQUIREMENT?

7 A. Assuming that the \$250 million is an accurate amount (which the Public Counsel does not), the
8 Term Loan requires utility assets be collateralized at a fair value of 1.67 times the value of the
9 proceeds. Thus, if \$250 million were actually required by the regulated utilities, the collateral
10 required from them would equal approximately \$417.50 million.

11
12 Q. ASSUMING THAT \$250 MILLION IS THE APPROPRIATE WORKING CAPITAL
13 REQUIREMENT FOR ALL THE DOMESTIC REGULATED UTILITIES, DOESN'T AQUILA
14 ALREADY HAVE SUFFICIENT COLLATERAL TO COVER THAT COMMITMENT?

15 A. Yes. The fair value of the Michigan, Nebraska and Colorado regulated utility assets approximates
16 ** _____ * thus, the \$250 million is **over-collateralized** by approximately ** _____
17 _____ * (i.e., ** _____ * less \$417.50).

18
19 Q. IN IT REPLY COMMENTS TO THE MINNESOTA PUBLIC UTILITIES COMMISSION DID
20 AQUILA ALLEGE THAT IT COULD NOT OBTAIN STAND ALONE DEBT FOR THE \$250
21 MILLION BECAUSE IT DID NOT HAVE ENOUGH REGULATED ASSETS AS SECURITY
22 FOR THE DEBT?

23 A. Yes. On page eight of the Aquila, Inc. Reply Comments, **dated August 29, 2003**, Minnesota

Public Utilities Commission Docket No. G007,011/S-03-681 (OPC Data Request No. 5008,
Supplement 9/03/03, attached as Schedule 15 to this Rebuttal Testimony), Company states:

Aquila needed to replace \$650 million of revolving credit agreements and other maturing obligations that became due on April 12, 2003 or it would go into default and likely bankruptcy. **To do so, Aquila needed to issued new debt, and to obtain that debt, Aquila needed to secure the debt. \$250 million of the new debt was needed to meet the cash working capital needs of Aquila's utility operations. Aquila could not provide adequate security for the \$250 million needed for its utility operations using only utility property by April 12th because of the need to obtain regulatory approvals. Therefore, Aquila was forced to issue consolidate debt, initially using primarily non-regulated assets to secure the debt needed by its utility operations.**

Emphasis added by OPC.

Q. IS THE ABOVE STATEMENT MISLEADING?

A. Yes. The fair value of security necessary to support the \$250 million approximates \$417.50 million, but the fair value of the Michigan and Nebraska utility assets, properties which incidentally were included as part of the original collateral package for the \$430 million Term Loan, were appraised at ** _____ * The appraisal of the assets in those jurisdictions is only * _____ * less than the \$417.50 million Aquila alleges to need as working capital collateral for the entire U. S. Networks (i.e., the domestic utilities in all the seven states).

In addition, Schedule RD-3 attached to the Direct Testimony of Mr. Rick Dobson clearly states that peak day working capital requirement, after ** _____
_____ * is only ** _____ * The Company bumped that

1 ** _____ * amount up to \$250 million to include items or events which were not materially
2 supported by any testimony or evidence. Therefore, assuming that the * _____ * is a
3 verifiable number (which we do not because Public Counsel believes even that amount has been
4 inflated), the fair value assets needed to secure this amount of debt would have been, according to
5 the language of the \$430 million Term Loan, approximately * _____ ** (i.e., 1.67 times
6 ** _____ *). That amount is nearly equal to the exact fair value of the regulated assets of
7 the Michigan and Nebraska jurisdictions on a stand alone basis.

8
9 Assuming that Aquila had desired to create stand alone debt for the entire \$250 million regulated
10 utility working capital requirement it champions (a scenario which Company apparently did not
11 desire), it could have simply reduced its estimate of the amount of utility working capital needed by
12 a little more than \$9 million and it would have had enough regulatory assets to securitize that debt
13 (i.e., ** _____ * fair value of the Michigan and Nebraska assets equals 1.67 times
14 ** _____ * regulated working capital requirement). Our conclusion being that Aquila's
15 response to the Minnesota Public Utilities Commission was not entirely accurate with regards to the
16 amount of regulated utility collateral it had to support its estimated regulated utility working capital
17 need.

18
19 Q. HOW DID AQUILA DETERMINE THAT \$250 MILLION OF THE \$430 MILLION TERM
20 LOAN WAS REQUIRED BY ITS DOMESTIC REGULATED UTILITIES?

21 A. Company's estimate is based upon a model created by Aquila in conjunction with its reviewing the

1 working capital facilities of similar utilities (Direct Testimony of Mr. Rick Dobson Schedules RD-3
2 and RD-4).

3
4 Q. DID MR. DOBSON'S ANALYSIS ATTEMPT TO SEPARATE THE TOTAL WORKING
5 CAPITAL NEED BETWEEN THE VARIOUS DOMESTIC UTILITY JURISDICTIONS?

6 A. No. The Company did not attempt to "allocate" the \$250 million to each state according to their
7 needs. (Iowa Office of Consumer Advocate Data Request No. 13, received in response to OPC
8 Data Request No. 1001, attached as Schedule 16 to this Rebuttal Testimony)

9
10 Q. THE DIRECT TESTIMONY OF COMPANY WITNESS, MR. RICK DOBSON, ALLEGES IT IS
11 FAIR AND EQUITABLE THAT SINCE \$250 MILLION OF THE TERM LOAN IS NEEDED
12 TO SUPPORT THE DAY-TO-DAY OPERATIONS OF ALL AQUILA'S UTILITIY
13 OPERATIONS, THEN ALL OF AQUILA'S REGULATED ASSETS SHOULD BE PART OF
14 THE POOL. IT THIS A REASONABLE STATEMENT?

15 A. No. Until recently, the Company had not provided Public Counsel with any analysis that would
16 show the Missouri regulated utilities require any portion of the \$250 million to support the working
17 capital needs of their respective operations. However, in the responses to Sedalia Industrial Energy
18 User's Association and AG Processing Inc. ("SIE") Data Request No. 9 and MPSC Staff Data
19 Request No. 75, and the Supplemental Testimony of Aquila witness, Ms. Beth A. Armstrong, in the
20 Iowa Utilities Board, Docket No. SPU-03-7 (attached as Schedules 17, 18 and 19, respectively), the
21 Company provided additional analyzes of the **estimated** peak day cash working capital needs of the

1 seven states domestic utilities. Those analyzes, and their results (which are discussed in detail in
2 the Rebuttal Testimony of OPC witness, Mr. James Busch), show the peak day cash working
3 capital needs of the other domestic utilities of the Company to be significant, but that of the
4 Missouri utilities to be either negative or extremely miniscule.

5
6 Q. WAS AQUILA CONCERNED WITH FAIRNESS WHEN IT ENCUMBERED THE ASSETS OF
7 THE MICHIGAN AND NEBRASKA UTILITIES?

8 A. Apparently not. In the States of Michigan and Nebraska, Aquila did not seek or request
9 regulatory authorization to pledge utility assets. Instead, it encumbered the assets of those
10 respective jurisdictions in conjunction with obtaining legal opinions from counsel that it could
11 pledge the assets without seeking the regulator's or ratepayers approval. Though the laws of
12 those two states may in a sense dictate their "public policy," it is ironic that Mr. Dobson alleges
13 fair and equitable treatment in the State of Missouri as a necessity when in the States of
14 Michigan and Nebraska Aquila offered their ratepayers no choice at all in the matter.

15
16 Q. DOES THE TERM "PEAK DAY CASH WORKING CAPITAL," AS USED BY AQUILA,
17 MEAN THE SAME AS WHAT IS NORMALLY DEFINED AS "CASH WORKING
18 CAPITAL?"

19 A. No.

20
21 Q. PLEASE DEFINE WHAT YOU MEAN BY THE PHRASE "CASH WORK CAPITAL."

1 A. Though cash working capital may be defined differently depending on the individual components
2 of the total working capital it usually denotes the following:

3
4 The average amount of capital provided by investors, over and above the investment
5 in plant and other specifically measured rate base items, to bridge the gap between
6 the time expenditures are required to provide services and the time collections are
7 received for such services. (Accounting for Public Utilities, Hahne & Aliff,
8 Publication 16, Release 19, November 2002, page 5-4 § 5.04)
9
10

11 Basically, cash working capital represents the amount of cash required to finance the day-to-day
12 operations of a utility, and it is usually determined via a lead-lag study that analyzes the lag between
13 the date customers receive service and the date that customers' payment is available to the utility.
14 This lag is offset by a lead time during which the Company itself receives goods and services, but
15 pays for them at a later date. The "lead" and "lag" are both measured in days. The dollar-weighted
16 net lag days (i.e., revenue lag minus expense leads) are divided by 365 to determine a daily cash
17 working capital factor ("CWC factor"). This CWC factor is then multiplied by the applicable test
18 year operation expenses to determine the amount of cash working capital required for operations. If
19 the result is positive, it means that shareholders have provided the needed working capital, but if the
20 resulting amount is negative, then it is ratepayers who have provided the funds for the working
21 capital needs of the utility. Either way, the result (i.e., negative or positive) is utilized as a rate base
22 component in the determination of a utility's total cost of service.
23

24 Q. WHAT DOES AQUILA MEAN BY ITS PHRASE "PEAK DAY WORKING CAPITAL?"

1 A. According to Aquila, the concept of working capital for inclusion in rate base in the context of a
2 rate case is quite different concept than working capital required for “financing purposes” to
3 meet peak day requirements of utility operations. (MPSC Staff Data Request No. 15 attached to
4 this Rebuttal Testimony as Schedule 20) The working capital study supporting the Company’s
5 filing allegedly calculates the daily requirements for cash to demonstrate the U.S. Network’s
6 need to access additional cash funds during peak days of the year. Company alleges that without
7 access to these funds the Company could find itself in a situation where there is not enough cash
8 on hand to purchase its gas requirements for customers during a winter peak.

9
10 Q. HOW DOES AQUILA PHRASE ITS WORKING CAPITAL REQUEST?

11 A. Company’s response to MPSC Staff Data Request No. 5003 (attached as Schedule 21 to this
12 Rebuttal Testimony) states:

13
14 It should be noted that Aquila is not proposing rate recovery for the balances
15 included in the working capital study; only the ability to pledge certain assets in
16 order to provide access to the necessary cash on a short-term basis. **The working**
17 **capital study was conducted to determine the maximum single peak day need**
18 **to ensure sufficient cash would be available for daily liquidity purposes.** Rate
19 relief for items included in the working capital study are normally determined
20 through a lead lag study or a calculation of certain rate base items which are
21 calculated on an average number of days or an average for the year, not a single
22 peak day need.

23
24 Emphasis added by OPC.
25
26
27

1 Q. IS IT YOUR UNDERSTANDING THAT, BASED UPON NORMAL REGULATORY
2 RATEMAKING CONCEPTS OF CASH WORKING CAPITAL, THE CURRENT CASH
3 REQUIREMENTS OF THE COMPANY ARE SUFFICIENTLY PROVIDED FOR BY
4 ITS RATEPAYERS?

5 A. Yes, and apparently Aquila is in agreement with Public Counsel on this issue. For example,
6 the Company's cash working capital studies filed in its recent general rate increase case,
7 Case No. ER-2004-0034, shows a negative cash working capital requirement of
8 (\$2,795,426) for its MPS division electric operation and a negative cash working capital
9 requirement of (\$1,496,271) for its St. Joseph division electric operation. Also, its St.
10 Joseph steam case, Case No. HR-2004-0024, shows a negative cash working capital
11 requirement of (\$27,856) and its MPS gas case, Case No. GR-2004-0072, shows a negative
12 cash working capital requirement of (\$572,143). In each of those general rate increase
13 cases, the Company has determined that it is the ratepayer, not the shareholder, who is
14 providing for Aquila's regulatory cash working capital needs.

15
16 Q. IS THIS FACT CONSISTENT WITH AQUILA'S LAST ELECTRIC OPERATIONS
17 GENERAL RATE INCREASE CASE?

18 A. Yes. In its last general rate increase filing for the Missouri Public Service electric
19 operations, Case No. ER-2001-672, the Company witness, Mr. Gary Clemens, offered as
20 Schedule GLC-2 to his Direct Testimony a rate base analysis that included a negative
21 (\$21,191,139) cash working capital requirement.

1
2 Q. WILL THE MISSOURI REGULATED UTILITIES OF AQUILA HAVE ADEQUATE
3 WORKING CAPITAL IF THE COMMISSION DENIES THE COMPANY'S
4 APPLICATION?

5 A. Yes. Public Counsel has shown in this testimony, and the Company's recent rate increase case
6 filings substantiate, that regarding the normal definition of cash working capital, ratepayers in
7 Missouri, on an average annual basis, are providing Aquila with an excess amount of cash needed
8 to fund the regulated utilities operations.

9
10 Q. WILL THE MISSOURI REGULATED UTILITIES OF AQUILA HAVE ADEQUATE "PEAK
11 DAY" WORKING CAPITAL IF THE COMMISSION DENIES THE COMPANY'S
12 APPLICATION?

13 A. Public Counsel believes that it will. As discussed in greater detail in the Rebuttal Testimony of
14 Public Counsel witness, Mr. James Busch, Company's allegation that the assets of the Missouri
15 specific jurisdictions should be collateralized because they have a peak day working capital need
16 lacks merit. Mr. Busch's analysis which provides an estimate of the actual Missouri jurisdictional
17 peak day cash working capital requirement (based on the Company's own forecasts and cash flow
18 model), clearly shows that the Missouri regulated utilities of Aquila, in fact, may have a significant
19 negative peak day working capital need.

20
21 In essence, Company's argument that Missouri should collateralize its regulated utilities assets in

1 order to be fair to the other states is probably groundless. What Company fails to tell this
2 Commission is that, based upon its own operational forecasts, the Missouri utilities probably
3 produce enough cash to meet their own needs. In fact, they may have excess cash which the
4 Company uses to subsidize the peak day cash flow needs of the other states in its U.S. Networks, or
5 its non-regulated operations.

6
7 Q. IS IT AQUILA'S BELIEF THAT WORKING CAPITAL GENERATED BY A UTILITY IN ONE
8 STATE SHOULD BE UTILIZED FOR THE OPERATIONS IN A DIFFERENT STATE IF NEED
9 BE?

10 A. It would appear that that is Aquila's position. Beginning on page 1, line 19, of the Supplemental
11 Testimony of Aquila witness, Ms. Beth A. Armstrong, in Iowa Utilities Board, Docket No. SPU-
12 03-7 (attached as Schedule 19 to this Rebuttal Testimony), she states:

13
14 Q. Would you please describe in detail the calculation of Iowa's portion of the
15 working capital requirement?

16
17 A. Yes. The working capital requirements were initially developed for U. S.
18 Networks in total. This analysis was performed at a total U. S. Networks
19 level for cash management purposes because it is important to know when
20 the coincident peak working cash requirement occurs across the entire utility
21 system versus determining utility by utility peaks that may occur at different
22 times during the year but be offset by the working capital generated from
23 another utility.
24
25

26 Q. ACCORDING TO MS. ARMSTRONG'S ASSUMPTION, WOULD A SUBSIDY OCCUR IF
27 AQUILA'S REQUEST IS APPROVED?

1 A. Yes, the Public Counsel believes that a subsidy could occur. However, we believe that the subsidy
2 that may occur would be the transfer of cash generated by the Missouri regulated utilities to the
3 other six states in the U. S. Networks.

4
5 Q. DOES THE PUBLIC COUNSEL BELIEVE IT APPROPRIATE THAT THE CASH WORKING
6 CAPITAL GENERATED IN ONE STATE BE SHARED WITH OTHER JURISDICTIONS
7 ACCORDING TO NEED?

8 A. No, we do not believe that to be appropriate. Ms. Armstrong's assumption that the Missouri
9 regulated utilities assets should share responsibility for collateralizing the Term Loan just because
10 they are divisions of the same parent company as the other domestic regulated operations is bizarre.

11
12 OPC believes that Missouri utility assets should not be utilized to support the other domestic
13 regulated operations of Aquila anymore that they should be utilized to support Aquila's ventures
14 into the non-regulated activities which have led it to the brink of bankruptcy in the first place. To
15 my knowledge, this Commission has never burdened Missouri ratepayers with the effects of
16 operations or the liabilities of utilities outside of their respective franchise. To allow cross-
17 subsidization of working capital as proposed by Ms. Armstrong would not be fair to Missouri's
18 ratepayers. Especially since the Missouri working capital needs, even on a peak day basis, may be
19 negative.

1 Q. COMPANY ALLEGES THAT TO BE FAIR ALL REGULATED UTILITY ASSETS IN EACH
2 OF THE SEVEN STATES SHOULD SUBMIT TO COLLATERALIZATION. IS THAT A
3 REASONABLE REQUEST?

4 A. No. Company's response to MPSC Data Request No. 27 (attached as Schedule 22 to this Rebuttal
5 Testimony) states, "If one or a number of state's do not grant their approvals, then there will be a
6 disproportion between the state assets pledged and the percentage of the working capital facility
7 used to support Aquila's utility operations in those states." Public Counsel believes that this
8 allegation has no relevance or bearing on the matter at hand given that the Missouri regulated
9 utilities probably do not need additional working capital and the Term Loan already has sufficient
10 collateral for those states that do.

11
12 Q. IF AQUILA HAS A PEAK DAY WORKING CAPITAL DEFICIENCY SPECIFIC TO THE
13 OPERATION OF ITS MISSOURI REGULATED UTILITIES, IS THAT REASON ENOUGH TO
14 COLLATERALIZE THEIR ENTIRE ASSETS TO SUPPORT THE \$430 TERM LOAN?

15 A. No. Even if the Missouri regulated utilities have a positive peak day cash flow need (which Public
16 Counsel witness, Mr. Jim Busch, disputes in his Rebuttal Testimony), it would be irresponsible of
17 this Commission to allow Aquila to encumber their entire Missouri asset base for a peak day cash
18 working requirement that is miniscule in comparison. Particularly, since any Missouri specific
19 peak day working capital requirement that exists (if it exists at all), is the direct result of the
20 financial quagmire the Company now finds itself.

1 Q. PLEASE EXPLAIN THE PUBLIC COUNSELS' POSITION ON THIS ISSUE.

2 A. Aquila's owners and management have taken, as they should, full responsibility for the Company's
3 current financial situation; however, those same owners and managers continue to have the
4 responsibility to operate the utility franchise as a monopoly provider. Whether or not Company
5 has the cash on hand to make the purchases it needs for the services it provides is not the
6 ratepayers concern. When the owners and managers of the Company took on the operation of
7 this utility, they, and they alone, accepted the responsibility to manage its operations
8 appropriately. That means that should working capital, peak or otherwise, be required to operate
9 the utility safely, the owners and managers must plan and provide for those needs. Thus, if the
10 working capital available is not sufficient to meet those needs (even more so, if it is not available
11 due to the forays of Company's managers into non-regulated activities), the owners and
12 managers of the Company must manage its operations to resolve the lack of funds without harm
13 to ratepayers or the services provided them. If that means Aquila must come up with additional
14 funds, from other sources, to meet those needs, so be it. If funds cannot be accessed at all, or
15 accessed at a reasonable cost, due to the financial distress caused by the disastrous results of its
16 owner's/manager's much-herald leap into the realm of unregulated business ventures (e.g., stock
17 trades and merchant trading), that in and of itself results in a detriment to the ratepayers of the
18 Company's Missouri regulated utilities.

19
20 Q. IF THE COMMISSION REJECTS AQUILA'S APPLICATION, WOULD THAT RESULT IN A
21 VIOLATION OF THE \$430 MILLION LOAN TERMS?

1 A. No. Aquila is required to make reasonable efforts to obtain collateralization approval for the
2 domestic regulated utility assets in the remaining five states; however, failure to obtain the
3 approvals **is not** a violation of the Term Loan. Nor, is the future continued availability of the Term
4 Loan conditioned upon any eventual achievement to collateralize the domestic regulated utility
5 assets.

DEBT/COLLATERAL ROLLOVER

Q. WHY HAS AQUILA REQUESTED COMMISSION APPROVAL TO “ROLLOVER” THE TERM LOAN DEBT WHILE CONTINUING TO BIND THE ASSOCIATED REGULATED UTILITY COLLATERAL IT SEEKS IN ITS APPLICATION?

A. Essentially, what Aquila wants is for this Commission to approve the use of the Missouri regulated utilities assets as collateral for the current three-year Term Loan then, once the assets collateralization is approved (that is, if approved for use as collateral), Company will not have to come back to the Commission in the future seeking the same collateralization approval when the current three-year Term Loan expires and new debt must be negotiated.

Q. WHAT IS AQUILA’S EXPECTATION ONCE THE THREE-YEAR TERM OF THE LOAN AT ISSUE MATURES?

A. Once the current Term Loan matures, it is expected that the loan will need to be replaced with another facility to meet Aquila’s continuing utility working capital needs. Aquila has requested permission to rollover the collateral to a new or renegotiated debt facility in order to avoid the uncertainty created in the financial marketplace by the existence of a definite expiration date. Company alleges the continuity in financing could be very critical to Aquila in the execution of its restructuring plan.

1 Q. WAS IT AQUILA WITNESS DOBSON THAT ASSERTED CONTINUITY IN FINANCING
2 WAS IMPORTANT TO AQUILA?

3 A. Yes. Beginning on page 16, line 19, of the Supplemental Testimony of Company witness, Mr. Rick
4 Dobson, in Iowa Utilities Board Docket No. SPU-03-7 (attached as Schedule 23 to this Rebuttal
5 Testimony), he states:

6
7 Aquila requested authority from the Board to extend or rollover the existing term
8 loan partially secured by Iowa assets in order to maintain continuity in its financial
9 liquidity, avoid creating another “financial deadline” where the lenders have a
10 negotiating advantage, and provide a longer term outlook for financial stability for
11 our employees, suppliers, customers, and shareholders. The creation of a longer-
12 term horizon of financing certainty enables our employees to see that their careers
13 with Aquila are viable and enhances our ability to retain the dedicated employees
14 that are currently supporting the utility operations. If this Board and other
15 Commissions deny this application to secure debt, more uncertainty will be created
16 in the marketplace. By granting this application, Aquila will be placed in a stronger,
17 long term financial position and can focus on the effective execution of its
18 restructuring plan rather than having to be distracted by the complexities and
19 uncertainties involved in stating the entire debt securitization process all over again.
20
21

22 Q. SHOULD THIS COMMISSION ABDICATE ITS RESPONSIBILITIES FOR OVERSEEING
23 AQUILA’S REGULATED OPERATIONS JUST SO ITS MANAGERS DO NOT HAVE TO BE
24 BURDENED BY THE WORK ASSOCIATED WITH FUTURE DEBT FINANCING
25 PROCESSES?

26 A. No, it is the Public Counsel’s belief that the Commission does not have the authority to relinquish
27 its statutorily defined duties, and even if it does, now is certainly not the time to abandon those
28 responsibilities. Those Aquila managers who would be “burdened” are essentially the same

managers that “drove the bus” that created the financial quagmire the Company now finds itself.

Now is not the time to give those very same managers “carte blanche” approval of financing events that will occur years down the road.

Q. DOES THE COMPANY WANT THIS COMMISSION TO PUT ITS STAMP OF APPROVAL ON IT PROPOSED “FINANCIAL PLAN?”

A. It would appear so. Beginning on page 7, line 8, of Mr. Jon Empson’s Direct Testimony, he states:

Q. Do you have some concluding comments?

A. Clearly, Aquila understands and appreciates the sensitivity the Commission might have about this request to use utility assets to secure utility debt. However, while Aquila accepts full responsibility for its past strategy, Aquila is also taking full responsibility for restoring financial stability without adversely impacting the customer. Aquila believes that the guiding principles we outlined in the financial plan and presented in my testimony today provide the required protection. **By enabling Aquila to maintain adequate working capital by approving this application, the Commission is providing Aquila with the necessary support to execute its financial plan.**

Emphasis added by OPC.

Q. IS IT THIS COMMISSION’S RESPONSIBILITY TO ENDORSE OR SUPPORT THE AQUILA CORPORATION’S “FINANCIAL PLAN” TO RECOVER FROM ITS NON-REGULATED ACTIVITIES DEBAUCLE?

A. No. Public Counsel believes that the Aquila Corporation’s “financial plan” to withdraw from its money losing non-regulated activities has little or no bearing on the actual operation of its Missouri

1 regulated utilities. Whether or not the Aquila Corporation will survive its current financial
2 dilemma is anybody's guess. Public Counsel has not attempted to perform any "what if" type
3 analysis regarding its potential for entry into bankruptcy because we do not believe that is our
4 function, or the function of the Commission. What is important is that for the known future, the
5 "financial plan" is of little consequence with regard to the operation of the Missouri regulated
6 utilities because those utilities are currently operating efficiently and providing a benefit of positive
7 net income to Aquila.

8
9 Q. IS AQUILA'S "FINANCIAL PLAN" DETRIMENTAL TO MISSOURI RATEPAYERS?

10 A. Yes. The financial difficulties in which the Aquila Corporation now finds itself has caused the
11 Company difficulties in securing working capital debt for its regulated utilities (i.e., assuming
12 additional working capital is actually needed in the State of Missouri). OPC believes that that fact
13 alone creates a detriment to the operation of the Missouri regulated utilities. For example, as
14 discussed in detail in the Rebuttal Testimonies of OPC witnesses, Mr. Mark Burdette and Mr.
15 James Busch, the fact the Aquila must now pre-pay for certain resources creates a situation whereby
16 the utilities operations and financial flexibility is negatively impacted. This occurs, in part, due to
17 cash being used for pre-payment obligations that could have been utilized for other important
18 functions of the operations. Furthermore, the financial flexibility of the utilities would be further
19 endangered by Aquila's request to collateralize the Term Loan by encumbering **all** the assets of the
20 Missouri regulated utilities. It doesn't take much imagination to understand that if a lien is placed
21 upon all the assets of the Missouri regulated utilities, those operations will be at a severe

disadvantage in future debt negotiations. Thus, the “financial plan” that the Aquila Corporation hopes will secure its own future is actually creating a detriment to the ratepayers of the Missouri regulated utilities.

Q. PLEASE EXPLAIN OTHER DETRIMENTS THAT THE “FINANCIAL PLAN” CAUSES MISSOURI RATEPAYERS.

A. Another detriment concerns Aquila’s alleged intention to maintain separate regulated and non-regulated collateral for the respective regulated and non-regulated portions of the Term Loan. On pages 2 and 3 of the Aquila, Inc. Reply Comments, **dated July 15, 2003**, Minnesota Public Utilities Commission Docket No. G007,011/S-03-681 (attached as Schedule 24 to this Rebuttal Testimony), Company states:

...Aquila has internally separated the \$430 million into two components; \$250 million to support the ongoing working capital requirements of the domestic utility business and \$180 million to support the non-utility businesses. Aquila also testified that: “It is Aquila’s intent to maintain a proper alignment of domestic utility collateral with domestic utility loan needs and nondomestic utility and nonregulated business collateral with their loan needs.” (Dobson, page 11, lines 1-3.)

It appears that both Aquila and the Department agree on what the intent should be but the actual execution of that intent needs clarification. The needed clarification is a description of what will happen when Aquila sells nonregulated and international utility collateral. In that case, the \$430 million loan will be reduced, as necessary, to maintain the alignment stated in Mr. Dobson’s testimony. That is, the \$250 million needed by the domestic utility will be secured by utility collateral and the \$180 million will be reduced to reflect the available nonregulated collateral. If no nonregulated business collateral is available, the portion of the Term Loan Facility not supporting the utility operations would be reduced to zero. If sufficient utility collateral is not available to secure the working capital needed by the utility, it

would also have to be reduced to meet the collateralization ratio requirement.

As the Department recommends (page 9), the loan will be “waterfalled” down to an amount less than \$430 million to reflect the available nonregulated collateral.

Regulated assets will not be used to support a credit facility for use by nonregulated operations. Aquila agrees not to use encumbered regulated assets in order to use a credit facility to buy back debt that was created by Aquila to pay for its various nonregulated activities. The Department’s concern about violating the principal of separation will not happen.

Emphasis in original.

However, Aquila’s statements have proven to be convoluted and misleading. On August 19, 2003, in Minnesota Public Utilities Commission Docket No. G007,011/S-03-681, the Minnesota Department of Commerce filed comments (OPC Data Request No. 5008, Supplement 9/02/03, attached as Schedule 25 to this Rebuttal Testimony) whereby it recommended that the Minnesota Public Utilities Commission deny Aquila’s application because its attempt to **over-collateralize** the Term Loan limits the Company’s financial flexibility thus, is counter to the needs of Minnesota ratepayers and even the Company itself. The Department of Commerce’s comments are based on actual language in the Term Loan that limits “optional” prepayments if its encumbered collateral exceeds the minimum \$718.10 million (i.e., 1.67 times the \$430 million loan amount) required.

Q. WHAT IS THE SIGNIFICANCE OF THE OPTIONAL PREPAYMENT LIMITATION?

A. If the fair value of the assets of the U. S. Networks domestic utilities encumbered exceeds the \$718.10 minimum collateral for the \$430 million Term Loan, Aquila cannot pay down the Term

1 Loan to \$250 million when it sells the non-regulated assets utilized as collateral for the \$180
2 million non-regulated portion without suffering a significant “make whole premium” penalty.
3 Therefore, it is likely that the assets of the Missouri regulated utilities could end up being utilized
4 as collateral for the \$180 million non-regulated portion of the \$430 million Term Loan. (the
5 rationale for the limitation of Company’s financial flexibility is addressed in detail in the
6 Rebuttal Testimony of OPC witness, Mr. Mark Burdette)

7
8 Q. HAS AQUILA RECOGNIZED THAT REGULATED ASSETS COULD POTENTIALLY BE
9 UTILIZED AS COLLATERAL FOR THE NON-REGULATED PORTION OF THE TERM
10 LOAN?

11 A. Yes, but Company doesn’t seem to care. On page 1 of the Aquila, Inc. Reply Comments, **dated**
12 **July 15, 2003**, Minnesota Public Utilities Commission Docket No. G007,011/S-03-681 (attached
13 as Schedule 24 to this Rebuttal Testimony), Company states:

14
15 **The Department’s recommendation is premised on the mistaken belief that it**
16 **would be in the best interest of the ratepayers and the Company to use the**
17 **proceeds for the sale of non-utility assets to eliminate as much of the Term**
18 **Loan as quickly as possible. The OAG’s recommendation is premised on the**
19 **mistaken belief that Minn. Stat. § 216B.49 requires utility operations to be**
20 **funded by stand-alone debt. There is nothing in Section 216B.49 supporting**
21 **such a conclusion, and the argument ignores the reality of how a utility that is**
22 **not owned by a holding company must operate.**

23
24 Emphasis added by OPC.
25
26
27

1 Q. DID AQUILA ESSENTIALLY STATE TO THE PUBLIC COUNSEL THE SAME THING IT
2 TOLD THE MINNESOTA PUBLIC UTILITIES COMMISSION?

3 A. Yes. In Aquila's response to OPC Data Request No. 5020 (attached as Schedule 31 to this
4 Rebuttal Testimony), it stated:

5
6 Our traditional approach has been to file for financing approval before a loan
7 agreement is closed. However in this case, we are in effect filing to substitute
8 collateral in an existing loan agreement, not for approval to enter into a new loan.
9 For example, we are seeking to replace the Canadian assets that currently serve as
10 loan collateral, with domestic utility assets.

11
12 **Without this approval, we will not have sufficient collateral to support the**
13 **entire loan amount if Canada is sold. To keep the loan amount intact, we**
14 **would be forced with either not selling Canada or our IPP portfolio, both of**
15 **which are key elements to the successful implementation of our restructuring**
16 **plan.**

17
18 Emphasis added by OPC.
19
20

21 Company would have the Missouri Public Service Commission, and the regulatory Commission's
22 in the other states, believe that on the one hand it intends to never collateralize the non-regulated
23 proceeds of the Term Loan with regulated assets then, on the other hand, if they do, tough, because
24 that is the reality of how a utility that is not owned by a holding company must operate. Public
25 Counsel believes that the facts speak for themselves; the potential for regulated assets to be utilized
26 as collateral to support the non-regulated proceeds of the Term Loan is real, and likely, if Aquila's
27 Application is approved.
28

1 Q. HAS AQUILA MADE THE SAME COMMITMENT TO THE MISSOURI PUBLIC SERVICE
2 COMMISSION ENSURING THAT THE UTILITY COLLATERALIZED PORTION OF THE
3 \$430 MILLION TERM LOAN WILL NOT BE UTILIZED TO FUND THE CASH
4 REQUIREMENTS OF ITS NON-UTILITY AND NON-REGULATED OPERATIONS?

5 A. Yes. Aquila states on page five of its Application:

6
7 ...Aquila is separating the Term Loan and collateral into United States utility and
8 other categories to ensure that the utility customers and utility assets are not
9 supporting the nonutility debt requirements. It is Aquila's intent to maintain a
10 proper alignment of United States utility collateral with United States utility loan
11 needs and nondomestic utility and nonregulated business collateral with the loan
12 needs of those activities.
13
14

15 Q. HAS AQUILA BEEN COMPLETELY ACCURATE IN ITS CLAIM THAT IT INTENDS TO
16 KEEP SEPARATE THE ASSET COLLATERALIZATION OF FUNDS UTILIZED FOR NON-
17 REGULATED AND REGULATED ACTIVITIES?

18 A. No. Aquila has consistently denied any intention of using utility assets to collateralize the cash
19 working capital needs of its non-regulated activities; however, its Minnesota reply comments tell a
20 different story.

21
22 The Term Loan contains barriers to repayment of the \$180 million (i.e., the alleged non-regulated
23 portion of the proceeds of the Term Loan) in the event that the assets of all the U. S. Networks
24 regulated utilities are encumbered to support the loan. If the current non-regulated collateral were
25 to be sold, and no other non-regulated assets were available to be substituted as collateral (which is

likely since Aquila claims it is seeking to become a pure play regulated company), Company would have but two choices, 1) pay down the amount, but suffer a “make-whole premium” penalty payment that will put additional financial stress on the entire corporation, or 2) allow the regulated the assets of the regulated utilities to remain as the collateral for the non-regulated portion of the Term Loan.

Option No. 2 would result in the regulated assets the Missouri utilities being utilized as collateral for Aquila’s non-regulated activities. The result would be wholly contrary to Aquila’s assertions, and Public Counsel believes that this Commission should never allow such subsidization of the Company’s non-regulated activities by the Missouri regulated utilities ratepayers to occur.

Q. WILL ALL OF AQUILA’S VARIOUS BUSINESSES HAVE ACCESS TO THE TERM LOAN PROCEEDS?

A. Yes. Company’s response to SIE Data Request No. 4 (attached as Schedule 26 to this Rebuttal Testimony) states:

All consolidated entities/businesses of Aquila, Inc. have access to the Term Loan facility. The Term Loan replaced our working capital revolver, and therefore is held by Aquila, Inc. Cash is managed on a centralized basis but used by each business entity. Aquila, Inc. is in effect functioning as a bank for all of the business operations.

1 Q. SINCE THE CASH ISN'T KEPT SEPARATED IS IT THEREFORE PROBABLE THAT
2 AQUILA WILL UTILIZE THE TERM LOAN PROCEEDS TO SUPPORT ITS NON-
3 REGULATED ACTIVITIES?

4 A. Yes, Public Counsel believes that it is. Since Aquila already has the Term Loan proceeds in its
5 possession, it can utilize those funds pretty much anyway its management chooses. However, in
6 its response to SIE Data Request No. 3 (attached as Schedule 27 to this Rebuttal Testimony),
7 Company did state that it was its **intention** to ensure that the domestic regulated businesses
8 would have priority access to the capital provided by the loan agreement.

9
10 Q. HAS AQUILA INSTITUTED ANY SAFEQUARDS TO ENSURE THAT ONLY NON-
11 REGULATED ASSETS WILL ALWAYS BE UTILIZED TO COLLATERALIZE THE
12 ALLEGED \$180 MILLION NON-REGULATED PORTION OF THE TERM LOAN UNLESS
13 THE AMOUNT IS REPAYED?

14 A. No. Aquila would have this Commission believe that the "sworn testimony" of its witnesses, along
15 with the "intentions" of Company's management, are the only safeguards necessary. Public
16 Counsel believes the Company's "promises" to be a weak foundation on which to build a house.

17
18 Q. IS AQUILA'S FINANCIAL PLAN FRAUGHT WITH PERIL?

19 A. Yes. In assigning a rating to Aquila's new \$430 million three-year service credit facility Moody's,
20 on April 9, 2003, issued a rating action that stated:

21
22 Aquila's rates reflect (1) weak cash flow generation relative to total debt despite

1 recent asset divestitures; (2) **asset sales proceeds which do not reduce debt**
2 **incurred to purchase the same assets;** (3) liquidity concerns related to unwinding
3 its trading business; and (4) the quality of the collateral as mostly stock in
4 subsidiaries. The ratings reflect Moody's concern that asset sales do not allow
5 sufficient cash flow to repay parent debt to a level consistent with the expected cash
6 generation of the remaining businesses.

7
8 Emphasis added by OPC.
9
10

11 (Note: The Moody's rating actions document was provided in Company's response to MPSC Staff
12 Data Request No. 66 and SIE Data Request No. 12, and is attached as Schedule 28 to this Rebuttal
13 Testimony.)
14

15 Thus, it is highly likely that Aquila will not generate sufficient cash flow from in non-regulated
16 assets sales to meet its non-regulated debt payment requirement. Aquila will continue to have a
17 significant amount of residual debt to support even after the non-regulated and international assets
18 are sold. (Aquila, Inc. Reply Comments, **dated July 15, 2003**, Minnesota Public Utilities
19 Commission Docket No. G007,011/S-03-681, page 7)
20

21 Even the Company agrees that its financial plan is risky, and not totally within management's
22 control. Attached as Schedule RD-1 to the Direct Testimony of Mr. Rick Dobson is a copy of the

23 ** _____ * which states, on
24 page 4 of the document:
25

26 ** _____

On page 5, Company adds:

**

The likely outcome of Aquila Corporation's current financial dilemma cannot be resolved by this Commission by simply approving, well in advance, the collateralization of regulated utility assets for the **future** debt offerings of the Aquila Corporation. The Company's financial situation, and its Missouri regulated utilities financial situation, at that future date, are not currently known and measurable. Thus, this Commission could not possibly know whether it was making the best decision it could based on the Company's future financial situation. The Commission should not approve Aquila's application for collateralization of the Missouri regulated assets for the many reasons discussed in this, and the other OPC witnesses Rebuttal Testimonies, but if it does, it definitely should not extend that special privilege now to Aquila's future debt offerings.

Q. SHOULD THE COMMISSION APPROVE AQUILA'S REQUEST AS A GOOD FAITH EFFORT TO HELP IT RESOLVE THE FINANCIAL PROBLEMS CAUSED BY IT NON-REGULATED ACTIVITIES?

A. No. This Commission should not become embroiled in Aquila Corporation's affairs regarding its

1 exit from non-regulated activities, or the resulting costs incurred to resolve those issues. Just as the
2 regulated utility's ratepayer received no share of recognition of the alleged profits or benefits
3 provided by the non-regulated activities, those same ratepayers should **not** share in the costs, or
4 other detriments, associated with their demise.

CURRENT POSITIONS OF THE OTHER FOUR STATES

Q. DID AQUILA SEEK REGULATORY APPROVAL TO PLEDGE ITS UTILITY ASSETS IN ALL STATES?

A. No. As discussed earlier, regarding its regulated utility assets in the States of Michigan and Nebraska, Aquila did not seek or request regulatory authorization to pledge assets. Instead, it pledged the assets of those respective jurisdictions in conjunction with obtaining legal opinions from its counsel that it could pledge the assets **without** seeking a regulatory body or ratepayers' approval.

Q. HAS THE COMPANY SOUGHT THE SAME REGULATORY TREATMENT FROM THE REMAINING FIVE STATES IN WHICH IT HAS DOMESTIC REGULATED UTILITY OPERATIONS?

A. To my knowledge, yes.

Q. HAS COLORADO APPROVED A STIPULATION AND SETTLEMENT AGREEMENT REGARDING AQUILA'S REQUEST?

A. Yes. The State of Colorado, after a limited review by the Staff of its Commission, approved Aquila's request for collateralization of the regulated utility's assets, but the Colorado Commission postponed ruling on the "rollover" request because the parties agreed to a stipulation to await disposition of similar applications in the other four states. On page 4 of the Recommended

1 Decision of Administrative Law Judge Dale E. Isley Approving Stipulation And Settlement
2 Agreement, in Colorado Public Utilities Commission Docket No. 03A-177SEG (attached as
3 Schedule 12 to this Rebuttal Testimony), it states:

4
5 (4) the parties' agreement to defer Aquila's request to extend or "rollover" the
6 pledge of Colorado utility assets to secure future replacement long-term debt
7 offerings for working capital requirements not to exceed \$430 million until after the
8 disposition of similar applications in Iowa, Minnesota, Kansas, and Missouri...

9
10
11 Q. HAVE CERTAIN PARTIES IN IOWA AND MINNESOTA OPPOSED AQUILA'S
12 REQUESTS?

13 A. Yes. In the States of Iowa and Minnesota there have been recommendations filed that Aquila's
14 applications be denied.

15
16 Q. WHAT WAS THE RESPONSE IN THE STATE OF IOWA TO AQUILA'S APPLICATION?

17 A. On or about June 2, 2003, in Iowa Utilities Board Docket No. SPU-03-7, the Iowa Department of
18 Justice, Consumer Advocate Division ("OCA"), filed Direct Testimony recommending that the
19 Iowa Commission deny Aquila's application. The testimony prepared by OCA witness, Mr.
20 Gregory Vitale (attached as Schedule 29 to this Rebuttal Testimony), states, beginning on page
21 17, line 10:

22
23 The Board should reject Aquila's request to encumber its Iowa utility assets for
24 this loan which is not needed for working capital in Iowa, unnecessarily
25 encumbers and restricts future options that would be in its ratepayers' interest and

1 has made ratepayers worse off.
2
3

4 And, beginning on page 18, line12, he adds:
5

6 Aquila's Iowa utility operations already support a surplus of working capital.
7 Aquila's proposal to pledge its Iowa assets as collateral for this loan which is not
8 needed for its Iowa utility operations and that may be used to support Aquila's
9 other operations, including its unregulated operations, is not in its Iowa utility
10 customers' interest or the public interest. It is also not in the interest of Aquila's
11 Iowa utility customers or the public interest to have Iowa utility operations and
12 vital services dependent on a financially distressed firm that continues to fail to
13 correct the structural flaws that created this credit crisis that now puts its utility
14 operation at risk.
15
16

17 It's my understanding, that the Iowa Utilities Board subsequently sought supplemental
18 information from the parties, and is now in the process of reviewing that information.
19

20 Q. WHAT WAS THE RESPONSE IN THE STATE OF MINNESOTA TO AQUILA'S
21 APPLICATION?

22 A. On or about June 30, 2003, In Minnesota Public Utilities Commission Docket No. G007,011/S-
23 03-681, the Minnesota Department of Commerce filed comments (attached as Schedule 30 to
24 this Rebuttal Testimony) whereby it recommended, on page 11, that the Minnesota Public
25 Utilities Commission deny Aquila's application:
26

27 Based on its analysis, the Department concludes that Aquila's request for approval
28 to encumber Minnesota regulated assets is not consistent with the public interest.

1 Upon review of Aquila's request to encumber Minnesota regulated property, the
2 Department recommends that the Commission deny the Company request for
3 approval, absent a showing in Aquila's Reply Comments of:

- 4
- 5 ● A showing that the encumbrance is in the public interest; and
 - 6
 - 7 ● a compelling reason(s) to violate the principle of keeping a clear
 - 8 accounting separation between a utility's regulated and nonregulated
 - 9 activities.
 - 10
 - 11

12 Subsequent to further talks with Aquila, the Minnesota Department of Commerce provided a
13 letter, dated August 19, 2003, to the Minnesota Public Utilities Commission wherein it again
14 recommended, on page 3, that Aquila's request would not be in the public interest:

15

16 The Department concludes that it would not be in the public interest if the
17 Commission approved the Company's request. Therefore, the Department
18 recommends that the Commission **deny** Aquila's request to encumber the
19 Minnesota regulated assets.
20
21

22 Q. WHAT IS THE CURRENT STATUS OF AQUILA'S APPLICATION IN THE STATE OF
23 KANSAS?

24 A. The parties in the State of Kansas have yet to offer their positions on Aquila's Application due to
25 the fact that the investigation is ongoing.

26

27 Q. IS AQUILA'S REQUEST TO USE ITS MISSOURI REGULATED ASSETS AS COLLATERAL
28 IN THE "PUBLIC INTEREST?"

29 A. No, it is not.

1
2 Q. WHY IS AQUILA'S REQUEST NOT IN THE PUBLIC INTEREST?

3 A. Aquila's request is not in the public interest for several reasons, 1) Aquila already has enough
4 regulated utility assets encumbered to support the alleged \$250 million working capital requirement
5 for the entire U. S. Networks, 2) ratepayers in the Missouri jurisdiction already provide an excess of
6 cash working capital to support the utilities owned by Aquila in this state, 3) Company's alleged
7 peak day cash working capital calculation specific to the State of Missouri ratepayers has not been
8 adequately supported or verified, and 4) the Term Loan language shows that Aquila intends to
9 encumber its Missouri regulated utility assets in order to support the working capital needs of the
10 other U. S. Networks states, and/or the working capital needs of its non-regulated operations.
11

12 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

13 A. Yes, it does.