AQUILA, INC.
CASE NO. EF-2003-0465
DATA REQUEST NO. OPC-5008

DATE OF REQUEST: July 3, 2003

DATE RECEIVED: July 3, 2003

DATE DUE: July 23, 2003 **Supplemented 9/2/03.**

REQUESTOR: Douglas E. Micheel

QUESTION:

Please provide complete copies of any and all testimony, recommendations, or comments filed in the Minnesota docket G007, 011/S-03-681.

RESPONSE: Please see attached.

ATTACHMENT: Copies of comments filed by staff of Minnesota Department of Commerce and Minnesota Attorney General.

ANSWERED BY: Mark Reed

MINNESOTA
DEPARTMENT OF
COMMERCE

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August 19, 2003

Burl W. Haar
Executive Secretary
Minnesota Public Utilities Commission
121 7th Place East, Suite 350
St. Paul, Minnesota 55101-2147

RE: *Additional Comments* of the Minnesota Department of Commerce
Docket No. G007,011/S-03-681

Dear Dr. Haar:

On April 30, 2003, Aquila, Inc. (Aquila, or the Company) filed its initial request (Initial Request) for,

> approval to encumber Aquila Networks-Peoples and Aquila Networks-NMU Minnesota utility property to secure the payment of a $430 million loan[.]

On June 30, 2003, the Minnesota Department of Commerce (Department) issued its *Initial Comments* (*Comments*) in this matter. On July 15, 2003, Aquila issued its *Reply Comments* (*Reply Comments*) On July 21, 2003, the Minnesota Public Utilities Commission (Commission) issued a formal notice of a fifteen-day *Additional Comment* period. The *Additional Comment* period was extended to August 19, 2003. These comments constitute the Department's *Additional Comments* pursuant to the Commission's notice.

The Department has had a face-to-face meeting with the Company and several phone conversations in order to fully understand Aquila's position. However, these discussions have led the Department to conclude approval of the Company's request would not be in the public interest. Therefore, the Department recommends that the Commission deny the Company's request to encumber Minnesota assets. The Department does appreciate the Company's willingness to meet with the Department and discuss the details of this matter.

The Company's original intent with regards to the Term Loan Facility (TLF) has changed since the Company's April 30, 2003, Initial Request. Aquila's original intent for the TLF, as discussed by the Department on page 8 of its *Comments*, would be to use $180 million of the $430 million TLF to buy back the Company's more expensive outstanding debt The Department protested this use of the TLF as a violation of the separation principle. However, per the Company's *Reply Comments* this would no longer be the case. According to the Company on page 3 of its *Reply Comments*,

> Aquila agrees not to use the 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. (Emphasis in original.)

On Wednesday, July 30, 2003, the Department and Aquila met to discuss the finer points of the Company's proposal and to see if a potential agreement could be reached. The Department wanted to ensure that regulated assets were not being used to secure a larger credit facility than was needed to support domestic utility working capital needs. Thus, Aquila verbally agreed at the meeting that upon selling collateralized nonregulated assets, it would "pay down" the current $430 million TLF to $250 million. This would properly align the amount of credit required by Aquila's regulated domestic utilities and the size of the credit line that should properly be secured by regulated assets. This would preserve the separation principal discussed by the Department in its June 30, 2003 *Comments*.

However, after the meeting, Aquila changed its response to the Department's offer by concluding that if it would buy down the TLF other than as required by the terms of the TLF, there would be a significant pre-payment penalty, the "Make Whole Premium."[1]

A review of the appropriate section of the TLF convenants (Section 2.7(a)(1)) did not fully answer the Department's questions, so on August 4, 2003, the Department contacted Chris Reitz of Aquila for further clarification. This discussion revolved around the distinction of the definition of "pre-payment." It was learned that there are two different pre-payments, an "Optional" and "Mandatory" pre-payment. The Make Whole Premium is required only when Aquila makes an "Optional" pre-payment.

The definition of these two different pre-payments is based on the level of collateralization of the $430 TLF. The following two examples should explain the distinction between "Optional" and "Mandatory" pre-payments.

> Optional Pre-payment: The Company is required to maintain a collateral-to-debt ratio of 1.67 to 1; this is important to keep in mind. Thus, the minimum amount of collateral that is required for the $430 million TLF is $718 million. So, for example, if Aquila had $900 million in assets securing the TLF, the Company could sell $100 million of the $900 million in collateral and not be obliged to pay down the $430 million TLF. The ratio of collateral would be $800 million to $430 million, or 1.86 to 1, still in excess of the minimum ratio of 1.67 to 1. Therefore, Aquila could use the $100 million to repurchase more expensive outstanding debt or whatever uses it had for this money. However, if Aquila decided to use the proceeds to pay back part of the $430 million debt, it would have to pay a significant pre-payment (a.k.a. "Make Whole Premium) penalty.
>
> Mandatory Pre-payment: If, on the other hand, Aquila only had the minimum amount of collateral required for the TLF, $718 million, then any proceeds from the sale of assets would have to be used to pay down, without penalty, the $430 million TLF and maintain the 1.67 to 1 ratio. So, for example, if Aquila had $718 million in collateral for the TLF and then sold $100 million in assets, the collateral ratio would be $618 million to $430 million, or a ratio of 1.44 to 1. Thus, the bank would not allow Aquila to maintain the $430 million TLF because it would not be

[1] The "Make Whole Premium" basically refers to the loan conditions agreed to by the parties that govern the changes in the original payment schedule and terms

properly collateralized, according to the terms of the loan agreement. So for Aquila to maintain the 1.67 ratio with $618 million in collateral, the TLF would have to be paid down from $430 million to $370 million with no penalty involved.

By over-collateralizing the TLF to such an extent, which would be the result if all five of the states (Colorado, Iowa, Minnesota, Missouri, and Kansas) approved the Company's request, the Company cannot pay down the TLF without penalty. If, on the other hand, the collateral and the TLF were properly aligned, based on the ratio of 1.67 to 1, portions of the asset sale proceeds would have to be used to pay down the TLF.

The bottom line is that the over-collateralization of the TLF does not allow the Company to refinance where it is most efficient. The $430 TLF has an interest rate of 8.75 percent (lowered to 8.00 percent when the 1.67 ratio of collateral to the amount of the TFL outstanding), which is expensive in today's environment. But if the loan is over-collateralized, Aquila cannot pay down the TLF without penalty. Thus, the Company would have an incentive to buy back other outstanding debt, but debt that is lower cost than the cost of the current $430 TLF.

Ideally, without the "Make Whole Premium" the Company would pay down the relatively expensive TLF, but because of the onerous loan covenants, the Company cannot do this. Thus, the Department concludes that it is counter to the needs of Minnesota ratepayers and even to the Company itself, to allow Aquila to encumber Minnesota regulated property. By properly aligning the collateral pool with the size of the TLF, the Company can more efficiently refinance its outstanding debt and thus benefit its ratepayers and shareholders.

The Department concludes that it would not be in the public interest if the Commission approved the Company's request. Therefore, the Department recommends that the Commission **deny** Aquila's request to encumber Minnesota regulated assets. The Department is available for any questions that the Commission may have on this matter.

Sincerely,

VINCENT C. CHAVEZ
Supervisor, Natural Gas Planning and Advocacy
(651) 296-0404

VCC/MDG/ja

STATE OF MINNESOTA)
) ss
COUNTY OF RAMSEY)

AFFIDAVIT OF SERVICE

I, **Linda Chavez,** on the **19th** day of **August, 2003,** served the attached **Minnesota Department of Commerce – Additional Comments**

Docket Number(s): **G007,011/S-03-681**

X by depositing in the United States Mail at the City of St. Paul, a true and correct copy thereof, properly enveloped with postage prepaid.

X by personal service

by express mai

by delivery service

to all persons at the addresses indicated below or on the attached list:

Linda Chavez

G007,011/S-03-681

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