BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

In the Matter of the Application of Aquila, Inc., for Approval of Its Experimental Regulatory Plan and for a Certificate of Convenience and Necessity Authorizing It to Participate in the Construction, Ownership, Operation, Maintenance, Removal, Replacement, Control and Management of a Steam Electric Generating Station in Platte County, Missouri, or Alternatively for an Order Specifically Confirming That Aquila, Inc. Has the Requisite Authority under Its Existing Certificate(s).	)	Case No. EO-2005-0293

STAFF'S RECOMMENDATION TO GRANT AQUILA'S MOTION FOR SUPPLEMENTAL ORDER

COMES NOW the Staff of the Missouri Public Service Commission (Staff) and for its Recommendation to Grant Aquila's Motion For Supplemental Order states:

1. On March 30, 2006 Aquila filed its Motion For Supplemental Order in which it "request[ed] a supplemental order from the Commission authorizing [Aquila] to secure [Aquila's] obligations under interest rate hedges related to the Iatan Facility with a first priority security interest in the electric utility properties of Aquila Networks—MPS division."

2. The order Aquila requests be supplemented is the Commission's August 9, 2005 Order in which the Commission approved a Stipulation and Agreement that, among other things, "allow[ed] Aquila to encumber its Aquila Networks—MPS division's assets as security for a five-year loan to be used solely for Aquila's participation in the construction of Iatan Unit 2 and environmental upgrades to Iatan Unit 1."

3. The purpose of Aquila's current request is for it to obtain express authority from the Commission to enter into certain hedging agreements designed to minimize Aquila's variable

interest rate exposure under the five-year loan encumbrance on Aquila Networks—MPS assets the Commission expressly authorized in its August 9, 2005 Order and that Aquila has entered into.

4. The Staff believes it is prudent for companies to manage their variable interest rate exposure and, therefore, in the attached Staff memorandum marked Appendix A the Staff recommends, subject to the following conditions, the Commission grant Aquila's motion:

a. The outstanding amount of the authorized loan encumbrance ***plus*** the hedging exposure do not exceed the encumbrance authority of $300 million the Commission authorized in this case by its August 9, 2005 Order;

b. Aquila submit to the Commission's Financial Analysis Department all final terms and conditions on each interest rate hedging agreement that encumbers assets of Aquila's Aquila Networks-MPS division;

c. Aquila submit to the Commission's Financial Analysis Department quarterly reports on the performance of the interest rate hedging agreements that encumber assets of Aquila's Aquila Networks-MPS division, including the nature of any activity or inactivity during the reported quarter. The quarterly reports shall contain the information and be in the format shown in Attachment 1.

WHEREFORE, the Staff of the Missouri Public Service Commission recommends the Commission, subject to the conditions above, grant Aquila's Motion For Supplemental Order and authorize Aquila to enter into certain hedging agreements designed to minimize Aquila's variable interest rate exposure under the five-year loan encumbrance on Aquila Networks—MPS assets.

Respectfully submitted,

/s/ Nathan Williams

Nathan Williams
Senior Counsel
Missouri Bar No. 35512

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or emailed to all counsel of record this 30th day of May, 2006.

/s/ Nathan Williams

MEMORANDUM

TO: Missouri Public Service Commission Official Case File
Case No. EO-2005-0293, Aquila, Inc.

FROM: David Murray
Financial Analysis Department

David Murray 05/30/06
Project Coordinator / Date

Nathan Williams 05/30/06
General Counsel's Office / Date

SUBJECT: Staff Recommendation Concerning Aquila, Inc.'s Request for a Supplemental Order from the Commission for the Authorization to Secure Interest Rate Hedging Agreements with Aquila Networks-MPS Properties to Hedge Interest Rate Exposure Under its Commission Authorized $300,000,000 Credit Agreement.

DATE: May 30, 2006

On March 30, 2006, Aquila, Inc. ("Aquila" or the "Company") filed a Motion For Supplemental Order requesting the Commission authorize it to use its Aquila Networks-MPS ("MPS") assets as collateral for certain interest rate hedging agreements Aquila may use to hedge the variable interest rates on its $300 million credit facility ("credit facility"). The proceeds from Aquila's credit facility are intended to be used to finance the Company's participation in the Iatan Unit 2 project and for construction of environmental upgrades to Iatan Unit 1. On August 9, 2005, the Commission, by its Order Approving Stipulation and Agreement, authorized Aquila to encumber its MPS assets to secure the credit facility. Because Aquila was uncertain as to whether the Commission's authority granted under its August 9, 2005 Order extended to interest rate hedging agreements that may be used in conjunction with hedging variable interest rate exposure under the credit facility, it is requesting that the Commission specifically authorize the use of the MPS assets as security for this purpose.

Staff believes that it is prudent for Aquila to manage its variable interest rate exposure. Debt that is issued for construction work in progress tends to be issued as a bridge loan until long-term financing is issued to refinance this shorter-term debt. Short-term debt, such as the debt issued under this credit facility, will tend to be issued at variable interest rates. If the amount of this debt is sizable, then this will increase a company's exposure to changes in its interest expense obligation, which creates more risk to the company's earnings. Consequently, it is fairly routine for larger, more sophisticated companies to review interest rate hedging possibilities to manage this risk.

The primary ways to manage ongoing variable interest rate exposure is through the use of interest rate caps, interest rate collars and interest rate swaps. Interest rate caps require an upfront premium to place a ceiling on how high the effective interest rate will be for the company purchasing the cap. An interest rate collar adds a floor to how low the interest rate can fall. Although this limits the amount of gains from a reduction of interest rates, it provides the company a premium for selling a floor. The final primary way to hedge interest rate exposure is through an interest rate swap. In the case of Aquila, this means that it will pay a fixed interest rate in order to receive variable interest rate payments. These payments will be used to cancel any increases in the underlying variable interest rate debt.

Staff's main concern about the use of MPS assets as security for interest rate hedging agreements was whether exposure under any of the interest rate hedging agreements would ever cause Aquila to exceed the $300 million lien authority that was granted by the Commission in its original order on this case. In a follow-up response to Staff Data Request 0015.1, Aquila assured Staff that it was the Company's "intention to monitor the value of the swap (based on interest rate movements) and ensure the outstanding amount of the facility *plus* the swap value does not exceed our authority of $300 million." This ensures that the lien on the MPS assets will not exceed the $300 million level, which was already authorized under the original authority. Staff recommends that the Commission impose a specific condition in its approval of these transactions to ensure that this level is not exceeded.

In Paragraph 5. of its Motion for Supplemental Order the Company references a Kansas City Power & Light Company (KCPL) case, Case No. EF-2002-1094, in which KCPL was granted the authority to utilize interest rate management products to manage its variable interest rate risk. Staff has recommended approval of KCPL's past requests to utilize interest rate management products, but in doing so has requested that KCPL provide the Financial Analysis Department with quarterly reports on the status of the interest rate management products. Staff recommends that the Commission apply the same requirement to Aquila for any interest rate hedging agreements it executes in which the MPS assets are used as security for the agreements. Staff has communicated to Aquila that it expects these reports to contain the same information and be in substantially the same format as the reports that KCPL currently provides to the Financial Analysis Department. KCPL currently provides a description of the general terms of the interest rate hedges which includes, but is not limited to: the start and end dates of the hedges, the interest rate periods of the hedge, the net basis points received or paid and the net dollar amount received or paid per period and on an aggregate level. Staff has provided Aquila an example of a report that shows the information and the format of the information that KCPL currently provides to the Financial Analysis Department. This example is marked Attachment 1 which is attached to this recommendation.

Finally, instead of presuming Aquila had not executed any interest rate hedging agreements in which MPS properties were pledged as collateral, Staff requested Aquila to confirm that this was the case. Aquila's response to Staff Data Request 0016 indicates Aquila has not executed any transactions that are the subject of its request under this supplement to the original Application.

RECOMMENDED CONDITIONS:

Staff recommends that the Commission approve Aquila's request with the following conditions:

1. The outstanding amount of the authorized loan encumbrance ***plus*** the hedging exposure do not exceed the encumbrance authority of $300 million the Commission authorized in this case by its August 9, 2005 Order;

2. Aquila submit to the Financial Analysis Department all final terms and conditions on each interest rate hedging agreement that encumbers assets of Aquila's Aquila Networks-MPS division;

3. Aquila submit to the Commission's Financial Analysis Department quarterly reports on the performance of the interest rate hedging agreements that encumber assets of Aquila's

Aquila Networks-MPS division, including the nature of any activity or inactivity for the reported quarter. The quarterly reports shall contain the information and be in the format shown in Attachment 1.

Kansas City Power & Light Company
MPSC Interest Rate Management Products Report
Active Transactions

Quarter Ended 3/31/2006

	ACTIVE TRANSACTIONS	Notional Amount	Start Date	End Date	Interest Period Start Date	Interest Period End Date	Net BP Received/(Paid)	Net $ Received/(Paid)
	Interest Rate Swaps[1]:							
1	Receive Fixed Rate (4.75%, tax-exempt) for Variable Rate (reset quarterly to the 3-month LIBOR rate plus 95.3bp; paid semi-annually beginning March 2003)		8/30/02	10/1/07				
					8/30/2002	3/3/2003		
					3/3/2003	9/2/2003		
					9/2/2003	3/1/2004		
					3/1/2004	9/1/2004		
					9/2/2004	3/1/2005		
					3/1/2005	9/1/2005		
					9/1/2005	3/1/2006		
	Cumulative Savings/(Cost)						0.0	$0
2	Receive Fixed Rate (4.75%, tax-exempt) for Variable Rate (reset quarterly to the 3-month LIBOR rate plus 95.3bp; paid semi-annually beginning March 2003)		8/30/02	10/1/07				
					8/30/2002	3/3/2003		
					3/3/2003	9/2/2003		
					9/2/2003	3/1/2004		
					3/1/2004	9/1/2004		
					9/2/2004	3/1/2005		
					3/1/2005	9/1/2005		
					9/1/2005	3/1/2006		
	Cumulative Savings/(Cost)						0.0	$0
3	Receive Fixed Rate (4.75%, tax-exempt) for Variable Rate (reset quarterly to the 3-month LIBOR rate plus 95.3bp; paid semi-annually beginning March 2003)		8/30/02	10/1/07				
					8/30/2002	3/3/2003		
					3/3/2003	9/2/2003		
					9/2/2003	3/1/2004		
					3/1/2004	9/1/2004		
					9/2/2004	3/1/2005		
					3/1/2005	9/1/2005		
					9/1/2005	3/1/2006		
	Cumulative Savings/(Cost)						0.0	$0
	Totals: Quarterly Active Transactions						#DIV/0!	$0
	Totals: Cumulative Active Transactions						#DIV/0!	$0

[1] The interest rate swaps payment terms are semi-annually in March and September.

Attachment 1

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Application of Aquila, Inc., for Approval of Its Experimental Regulatory Plan and for a Certificate of Convenience and Necessity Authorizing It to Participate in the Construction, Ownership, Operation, Maintenance, Removal, Replacement, Control and Management of a Steam Electric Generating Station in Platte County, Missouri, or Alternatively for an Order Specifically Confirming That Aquila, Inc. Has the Requisite Authority under Its Existing Certificate(s)	)	Case No. EO-2005-0293

AFFIDAVIT OF DAVID MURRAY

STATE OF MISSOURI)
) ss.
COUNTY OF COLE)

David Murray, of lawful age, on his oath states: that he has participated in the preparation of the following Staff Memorandum; that the information is given by him; that he has knowledge of the matters set forth; and that such matters are true and correct to the best of his knowledge and belief.

David Murray
David Murray

Subscribed and sworn to before me this 30th day of May 2006.

D. SUZIE MANKIN
Notary Public - Notary Seal
State of Missouri
County of Cole
My Commission Exp. 07/01/2008

D Suzie Mankin