STATE OF MINNESOTA
BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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|---|---|
| Gregory Scott | Chair |
| Edward Garvey | Commissioner |
| Marshall Johnson | Commissioner |
| LeRoy Koppendrayer | Commissioner |
| Phyllis Reha | Commissioner |

In the Matter of an Inquiry Into Possible Effects of the Financial Difficulties at Aquila, Inc. on Peoples Natural Gas Company and Northern Minnesota Utilities Company and their Customers

MPUC Docket No.:
G-007, 011/CI-02-1369

**COMPLIANCE FILING**

Pursuant to the Minnesota Public Utilities Commission ("Commission") Order Requiring Responses, issued on September 4, 2002, in the above entitled Docket, Aquila, Inc. ("Aquila") provides the following responses to the Commission's questions:

## Questions on Corporate Structure, Finance and Related Issues

**a.** Provide organization charts and descriptions of the structure of Aquila (UtiliCorp) overall, U.S. Networks, and the Minnesota operations as of the end of 2001. Provide the same for those organizations as they now exist, and as proposed to be when the current restructuring is complete.

**Response:**

Two fundamental changes occurred in the structural organization of Aquila, Inc. (UtiliCorp United) from year-end 2001 and today:

1. The business focus shifted from a balanced strategy of merchant and global networks to a strategy of operating an integrated utility and portfolio of non-regulated merchant generation.

2. The U.S. Network business orientation changed from a centralized utility structure organized around the concept of unbundled services to each operating division to a state-focused, integrated utility concept.

These two fundamental shifts are reflected in the three sets of organizational charts in attachment A.

- Aquila, Inc.
- U.S. Networks
- Minnesota operations

However, the final organizational structure for Aquila, Inc. is dependent upon the degree of success in selling the identified non-strategic assets.

**b.** Provide a general description of the current organization of corporate financing activities for Aquila, subsidiaries, and divisions. Also provide specific information on:

i. How are the short-term credit, long-term debt, and equity needs and capital structure of PNG and NMU determined? How are each of these types of financing provided?

ii. How would the above change when restructuring is complete?

iii. What capital structure would be imputed/assigned to PNG and to NMU at June 30, 2002 and projected December 31, 2002?

**Response:**

i. Aquila has one corporate financing group located in Kansas City that provides treasury and financing support to all its North American subsidiaries and divisions. Treasury and financing services are also provided to certain subsidiaries in the international ownership structures. The core operating companies in Australia, New Zealand and the United Kingdom perform their own treasury and financing functions with input from the central group in Kansas City.

The capital structures for each of the operating divisions and subsidiaries are determined based on comparisons to other companies in similar industries. For example, comparable gas distribution companies, which mirror the operations of PNG and NMU (collectively referred to as PND on the Aquila general ledger), carry debt/equity structures of 50/50. PND's capital structure is targeted to that level on an ongoing basis and there is no plan to change this methodology. This system of capital allocation used by Aquila was detailed in the pending rate case. Therefore the ongoing capital structure is unchanged from the rate case.

As explained in the rate case, long-term debt is supplied to PNG and NMU based on need and request. All debt is assigned to the division for the life of the issue. Once a division is assigned long-term debt, that debt becomes a part of that division's permanent capital and is not reallocated or used in the financing of other divisions. The cost of the assigned debt to the division is exactly the same as the cost of the debt to Aquila, Inc.

ii. It is not anticipated that this approach would change upon completion of the restructuring.

iii. Each subsidiary or division would be assigned debt and equity according to their capital needs and their targeted capital structure. Surplus capital, if any, will be retained at the corporate headquarters and not assigned to subsidiaries and divisions.

**c.** Provide a general description of the current financial situation of Aquila, including debt ratings (if different than what is described in Commission Staff August 29, 2002 briefing papers) liquidity, ability to raise long-term debt and equity, and costs of capital.

Also provide specific information on:

i. What issuances and redemptions of securities are projected for the next 12 months by Aquila or other corporate financing entity?
ii. What action is Aquila management taking to mitigate the adverse impacts of credit downgrades?
iii. What would be the impact of further downgrades of Aquila debt by bond rating agencies? What types of collateral requirements or other conditions might come into play?

**Response:**

The rating agencies first began expressing concern regarding Aquila's credit rating earlier this year. The Company responded to these concerns by: reducing costs by about $100 million, exiting from the energy trading business, lowering the common stock dividend by 42%, issuing $800 million of equity and debt to bolster liquidity, exiting from the announced purchase of Cogentrix, and selling assets as part of a $1 billion divestiture program. The utility cost reduction actions, while included in the $100 million, were initiated as part of a restructuring plan that preceded the focus on credit quality. Over a 3–4 month period, management made these decisions and began implementation. The Company believed its reactions to the issues raised by the rating agencies were responsive, decisive and significant. In fact, as of today, Aquila has entered into sales agreements for about $786 million of assets and expects to announce another transaction over the coming weeks. Most of these asset sales are scheduled to close prior to year-end and the proceeds will be used to reduce debt. The plan developed by management results in regulated activities representing about 95% of Aquila's operations and financial metrics that are commensurate with a "BBB" rating. During the presentations to the rating agencies, management expressed its commitment to an investment grade rating and its willingness to take the actions necessary to maintain those ratings.

On September 3, Moody's downgraded Aquila to a "Ba2" with a stable outlook, citing execution risk on the asset divestiture program as a major concern. While S&P also downgraded the Company that same week to a "BBB-" from a "BBB", their actions are a welcomed offset to Moody's more severe perspective. S&P acknowledged execution risk relating to the asset divestiture program but is clearly willing to give management additional time to implement their plan. Aquila's current corporate credit ratings are:

| | |
|---|---|
| Fitch: | BBB-, Negative Watch |
| Moody's: | Ba2, Stable Outlook |
| S&P: | BBB-, Negative Outlook |

Both S&P and Fitch's ratings are considered investment grade. No additional ratings actions from either S&P or Moody's are expected until early next year, after Aquila completes its asset divestiture program and finalizes its 2002 financial results.

Depressed stock prices and lowered credit ratings are not unique to Aquila, as many other energy industry players have experienced similar misfortunes. The deterioration in Aquila's credit ratings and stock prices has impacted its marginal capital costs. The completion of earlier capital issuances and minimal needs for external capital requirements for the next 1 – 2 years helps mitigate the realization of these higher capital costs. In fact, the next US based debt maturity is not until third and fourth quarter ($250 million and $150 million, respectively) of 2004. Through the end of 2003, Aquila's major debt maturities total about $512 million, and all are outside of the United States and pertain to the Company's international investments. Approximately 60% of this balance will be repaid using the proceeds from the New Zealand and United Kingdom sales process. The remaining balances will be refinanced in the local bank markets available to those enterprises.

The impact of higher capital costs is mitigated by the fact that Aquila is not expected to be a "net borrower" over the coming months. In fact, over $1 billion in proceeds from the asset divestiture program will be used to reduce debt. These proceeds will allow Aquila to use cash to meet financing requirements including debt maturities and open market repurchases of debt. The Company's most recent debt offering ($500 million, 11 7/8%, due July 1, 2012) will be targeted for repurchase given its higher interest rate. This debt was issued amidst the high capital costs over the past few months, and is the only issuance that would negatively impact Aquila's embedded cost of debt, none of which has been allocated to PNG or NMU.

Aquila started several months ago to enhance its liquidity with the $250 million debt issuance (30-year, 7 7/8%) in January, the corporate revolver getting up-sized to $650 million in April, and the $500 million debt issuance referenced earlier. The proceeds from the debt issuances were used to repay debt maturities which had been temporarily funded with the corporate revolver.

Aquila continues to have sufficient liquidity despite being downgraded to "Ba2" by Moody's. Primary sources of liquidity include cash flow from operations, cash from asset divestitures, cash on hand, borrowing capacity under existing loan facilities, and the ability to raise additional capital on a timely basis, if required. For example, Aquila, as a precautionary step, entered into a bank facility within a five-day period, which provided $200 million of additional liquidity during a period of tight liquidity last December. Primary uses of cash and liquidity include debt maturities, capital calls, capital expenditures, and dividends. In short, the Company currently has approximately $550 million in liquidity, and demands on liquidity resulting from Moody's downgrade are estimated to total approximately $372 million. Liquidity projections under various scenarios through the end of 2003 indicate that the Company should have sufficient liquidity to fulfill capital expenditures, debt maturities, and collateral calls.

**d.** What obligations does Aquila have with respect to the credit facilities and other debt of its subsidiaries, partnerships, or other entities? Specifically, are there cross-default, or similar, provisions in any of the loan agreements? Does Aquila act as guarantor, endorser, surety, or other similar role with respect to its subsidiaries, partnerships, or other similar entities?

**Response:**

The debt at the operating companies in Australia (United Energy, Alinta Gas, and Multinet), New Zealand (UnitedNetworks), and the United Kingdom (Avon and Midlands) is non-recourse to Aquila, is not reflected in Aquila's financial statements from an accounting perspective, and is not usually imputed onto Aquila's financial statements by the rating agencies. The debt of these operating companies is not guaranteed by Aquila and does not cross-default to Aquila. The debt at the operating companies in Canada (ANC(A) and ANC(BC)) is non-recourse to Aquila but is consolidated with Aquila for accounting and credit purposes. Aquila has non-operating subsidiaries in each of these countries which have debt outstanding. This debt totals about $750 million and is guaranteed by Aquila. The guarantees usually include cross-default language since they are modeled after the covenants in Aquila's corporate revolvers. This cross-default language generally appears in any loans that are guaranteed by Aquila. However, as stated in Mike Jonagan's letter to the Commission dated August 26, 2002, "Aquila has not and will not secure debt with Minnesota utility property without receiving prior approval from the Minnesota Commission".

From time to time, on a negotiated basis, Aquila issues two types of guaranties to support debt issuances by its subsidiaries: (a) a "loan guaranty" in support of a subsidiary's borrowing or other loan arrangement and (b) a "performance guaranty" in support of a subsidiary's contractual performance obligations.

Loan Guaranties. The Federal Energy Regulatory Commission ("FERC") prohibits FERC-regulated utility companies from issuing guaranties in respect of any security (e.g., any note, stock, debenture, commercial paper, or other evidence of indebtedness) of another person. Accordingly, Aquila is prohibited from issuing loan guaranties in support of any of its subsidiaries, including Aquila Merchant Services, Inc. ("AMS"), unless Aquila first obtains FERC approval for the loan guaranty. Aquila has standing FERC approval to issue short-term loan guaranties for amounts up to $500 million in the aggregate.

Performance Guaranties. FERC does not assert jurisdiction over Aquila guaranties that are unrelated to securities, making FERC approval unnecessary for Aquila to issue performance guaranties. From time to time, a counter party of an Aquila subsidiary seeks, and Aquila issues, a guaranty for such subsidiary's contractual performance (e.g., in respect to an agreement for a power or gas purchase or sale contract).

**e.** What risks and potential liabilities does Aquila have with respect to Aquila Merchant Services (AMS) and any other division or subsidiary, with respect to the SEC energy trading investigation, Federal Energy Regulatory Commission (FERC) investigations, lawsuits, and similar issues?

**Response:**

The short answer is "none" because Aquila believes that no liability will ultimately attach to AMS, or any of Aquila's other subsidiaries, as a result of the SEC or FERC investigations or other pending lawsuits. A more detailed response follows:

Regulatory Investigation into "Wash Transaction" Trading: The SEC announced investigations in the energy industry, including Aquila, relating to transactions by which companies may have booked revenue that is misleading. Aquila has received similar inquiries for the Commodity Futures Trading Commission ("CFTC") and the Texas Public Utility Commission (the "Texas PUC"). The transactions being investigated are known as "wash-transactions" or "round-trip trades," and they involve a simultaneous purchase and sale of the same commodity at the same price for the purpose of inflating trading volumes and revenue. At the request of the FERC, Aquila has conducted a review of its trading activity for 2000 through 2001 to identify those electricity and gas trades in the U.S. portion of the Western Systems Coordinating Council that could have some of the characteristics of these sell-buyback trades. The trades identified by Aquila accounted for less that one-half of one percent of its trading and marketing revenues during this period. These trades were conducted for legitimate business purposes, such as determining market price, depth, and direction and to manage the risk of our portfolio due to changing market information. None of the trades that Aquila participated in were "wash-transactions" entered into for the purpose of increasing volumes or revenues, and Aquila's President and Chief Executive Officer Robert K. Green filed affidavits with the FERC responding accordingly. Similar responses have been filed with the CFTC and the Texas PUC, and no further action has been taken as to Aquila by either agency.

FERC Investigation into Enronean Trading Activities: In April 2002, the FERC requested that approximately 150 energy merchants, including Aquila, respond to questions relating to questionable California trading activities by Enron that were recently uncovered through the publication on internal Enron memoranda. After an internal review, Aquila believes that it has not engaged in any of the trading practices identified in the FERC inquiry or Enron memoranda, and Aquila's President and Chief Executive Officer Robert K. Green filed an affidavit with the FERC responding accordingly.

Other Material Litigation:

Chubb Indemnity Litigation: On February 19, 2002, Aquila and AMS filed a suit in United States District Court for the District of Nebraska against Chubb Insurance Group

("Chubb"), the issuer of surety bonds in support of AMS' performance under certain long-term gas supply contracts. Under the surety bonds, the insurance company could be required to pay up to $561 million. Notwithstanding Aquila's continued performance under the gas supply agreements, Chubb has demanded that Aquila replace it as the surety or, alternatively, post collateral to secure all of Chubb's obligations under the surety bond. If Chubb were to prevail, this would have a material adverse impact on Aquila's liquidity and financial position. However, Aquila believes there is no merit to Chubb's position given AMS' full compliance with the underlying gas supply contracts, and that the court will agree with Aquila's interpretation of Chubb's right to demand discharge under the indemnity agreements.

Aquila and AMS Recombination Litigation: A consolidated lawsuit was filed against Aquila and AMS in Delaware Chancery Court in connection with the recombination of Aquila and AMS that occurred pursuant to an exchange offer completed in January 2002, raising allegations concerning the lack of independent members of the board of directors of AMS to negotiate the terms of the exchange offer on behalf of the public shareholders of AMS. The Delaware Chancery Court denied the plaintiffs' claim for equitable relief in January 2002, and there has been no further activity with the lawsuit. Securities fraud complaints seeking damages based on the same conduct were recently filed against Aquila in federal court. Persons holding certificates formerly representing approximately 1.8 millions shares of AMS common stock are also pursuing their appraisal rights in connection with the recombination. Aquila does not believe that any of these actions will have an outcome materially adverse to Aquila or AMS.

**f.** After it exits the wholesale trading business, what obligations would Aquila have for the past activities of AMS, with respect to the issues in D and E above?

**Response:**

As Aquila winds down the wholesale trading business of AMS, the contracts and arrangements comprising the AMS "book of business" grows smaller each day. Aquila's obligations under the guaranties related to the contracts of AMS will persist as long as the underlying contractual obligations continue.

Aquila believes that the pending investigations and lawsuits related to AMS will result in no material liability attaching to AMS or Aquila. However, Aquila's potential liability related to such investigations and lawsuits will remain unchanged following the wind down of AMS' wholesale trading business. In this regard, it is helpful to understand that there are no plans to liquidate or dissolve the corporate entity of AMS. Instead, to reduce the risk of Aquila's overall operations, the trading and risk management businesses within AMS have been discontinued and are being shut down. AMS will retain any liabilities in respect of the company's past operations and its remaining operations going forward.

## Questions about Protection of PNG and NMU Ratepayers

g. What actions are Aquila management taking to protect PNG and NMU, their ratepayers and customers from existing and potential impacts of Aquila's financial difficulties? Specifically:

i. What are the projected financing needs for P NG and NMU over the next 12 months?

ii. What action is Aquila management taking to ensure that PNG and NMU have access to needed short-term operating capital? Is Aquila willing to make a commitment that any credit capacity of PNG and NMU will not be used by Aquila for non-utility purposes?

iii. What actions are Aquila management taking to ensure PNG and NMU have access to needed long-term capital? Is Aquila willing to make a commitment that any credit capacity of PNG and NMU will not be used by Aquila for non-utility purposes?

iv. What actions are Aquila management taking to ensure that PNG and NMU will have access to needed equity?

v. What actions are Aquila management taking to assure service quality for Minnesota customers, including but not limited to: handling customer complaints, call center response time, meter reading and billing, maintenance of utility equipment and facilities, line locate requests, leak response time, new service requests, and adequate staffing levels?

vi. How will the announced staffing reductions in U.S. Network Services affect Minnesota operations? Provide employee counts by function assigned to Minnesota operations at the end of 2001, currently, and projected after restructuring is complete.

**Response:**

i-vi Relative to Aquila's cash generation and access to capital, PNG and NMU's capital requirements should not pose any significant challenges for Aquila. At this time, no incremental external financing needs exist for PNG and NMU as explained in question c. The Company remains committed to its regulated operations (including PNG and NMU) and will take whatever actions are necessary to support these activities. As described above, Aquila management has taken a number of steps to protect credit quality and to ensure the Company is able to raise capital when needed. While concerned, management believes that the Company has, and will continue to have, sufficient access to capital. First, the Company will be generating over $1 billion of cash from asset sales over the next three to four months, and this cash will be used to meet incremental capital requirements and to reduce debt. Second, Aquila was able to increase its corporate revolver and access the debt and equity capital markets multiple times this year, and the Company has no reason to believe that either the bank markets or capital markets are now inaccessible. Third, the non-investment grade debt capital markets in the United States had over $800 billion in debt outstanding at the end of August. The US capital markets are clearly willing and able to invest in non-investment grade companies. With its split rating (i.e. "BBB-"/"Ba2"), there is no reason to believe that Aquila will be unable to access the capital markets. And fourth, Aquila's credit situation is an improving one, and one that is strongly supported by management actions that should result in improved credit ratings. Management has clearly demonstrated its commitment to credit quality over the past few months, and will continue with that commitment until investment grade ratings with key credit agencies are restored.

Rating agencies first determine a company's overall credit rating before they assign ratings to specific issuances. Each individual issuance is then notched off of this corporate credit rating based on each issuance's structural and security attributes. Aquila has an "operating company" structure rather than a "holding company" structure. As such, Aquila's credit ratings are based on a blending of all of its activities. Absent structural and legal separation, it is not possible to segregate the impact that particular enterprises have on Aquila's overall credit capacity. However, Mike Jonagan, CEO of U.S. Utilities, submitted a letter to the Minnesota Commission on August 26, 2002, stating that:

- The Minnesota ratepayers should pay no more for debt costs than would be incurred by an investment grade utility, and
- The Commission has the authority during the ratemaking process to use a hypothetical debt structure to address debt costs higher than those of an investment grade utility, if such a case arises.

v. Mike Jonagan, CEO of U.S. Utilities, has established the goal of maintaining and improving service quality for utility customers as a top priority. Each state Operating Vice President, including Bennie Smith, Operating VP for Minnesota, will be required to submit a report on a monthly basis identifying trends and issues. The disaggregation of the consolidated utility operational metrics is currently underway and the complete internal management report should be available in 60 days. Mike Jonagan has already committed to voluntarily share this internal report with the Minnesota Commission and Staff. The current metrics that will be contained in this report include:

- Safety (i.e. lost time accidents and vehicle accidents)
- Call Center response time
- Operations leak/emergency response time
- Meter reading and billing accuracy
- Overall customer satisfaction index

vi Each Operating Vice President was asked to identify the staff required to maintain a safe and reliable utility operation that would continue to maintain high levels of customer satisfaction. Aquila is not anticipating any adverse impact from the announced staffing reductions and in fact, believes that the shift to a state focused structure and the alignment of responsibility and accountability will improve utility operations.

The change in employee counts for the Minnesota operation is as follows:

| mployees by Function | Aug. 02 | Dec. 01 |
|---|---|---|
| Customer Service | 156 | 177 |
| Operations | 49 | 51 |
| Material Management | 1 | 1 |
| Gas Planning & Design | 1 | 1 |
| Safety | 1 | 1 |
| Technical Training | 1 | 1 |
| Customer Relations (sales, economic development, community services) | 5 | 14 |
| Environmental | | 1 |
| Human Resources | 1 | 1 |
| IT | 1 | 1 |
| Governmental Services | 1 | 1 |
| Financial Management | 1 | 1 |

The total staffing in Minnesota has been reduced from 251 to 218. However, there are currently 4 vacancies (3 in customer service and 1 in engineering/operations) so the total authorized staff is 222.

h. Does Aquila plan to ask the Minnesota Public Utilities Commission for rate relief that is in any way associated with its current financial difficulties? How does the current corporate restructuring relate to the pending Minnesota general rate case?

**Response:**

Aquila does not plan to ask the Commission for rate relief related to the financial matters addressed in these responses. The current corporate restructuring is not in any way related to the pending Minnesota general rate case. The rate case used a 2000 test year period. The current corporate restructuring would be expected to have some effect on a 2002 test year period and would likely have a greater impact on a 2003 test year period, just as other changes in expenses, investments and revenues have changed since 2000. It is inappropriate to make changes to a 2000 test year period because of isolated out-of-period changes in expenses. Rather, any evaluation of rates on a going forward basis related to 2002 or 2003 would require an evaluation of all revenues, investments and expenses.

Dated: September 18, 2002

Respectfully submitted,

By ______________________________
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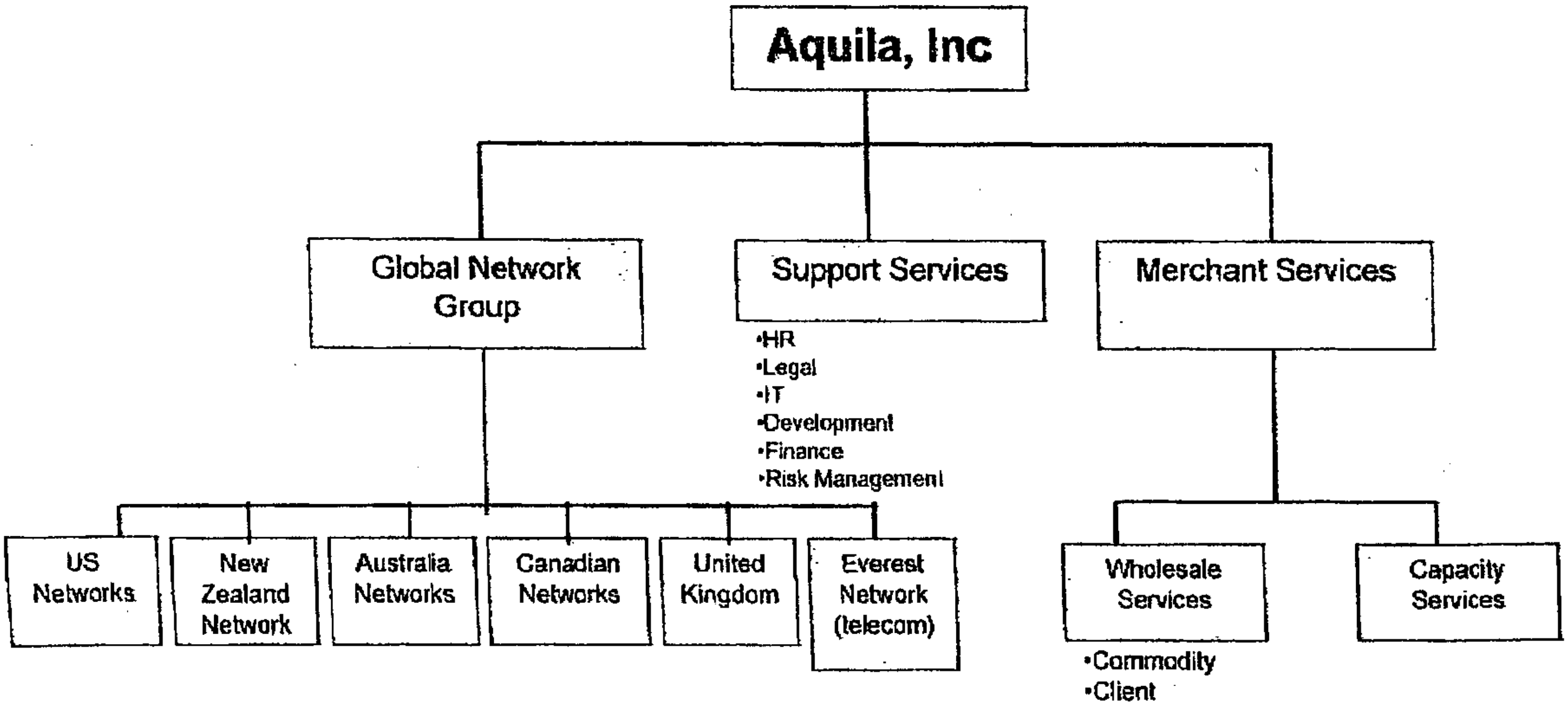
Aquila

# December 2001




Appendix C-12

# September 2002

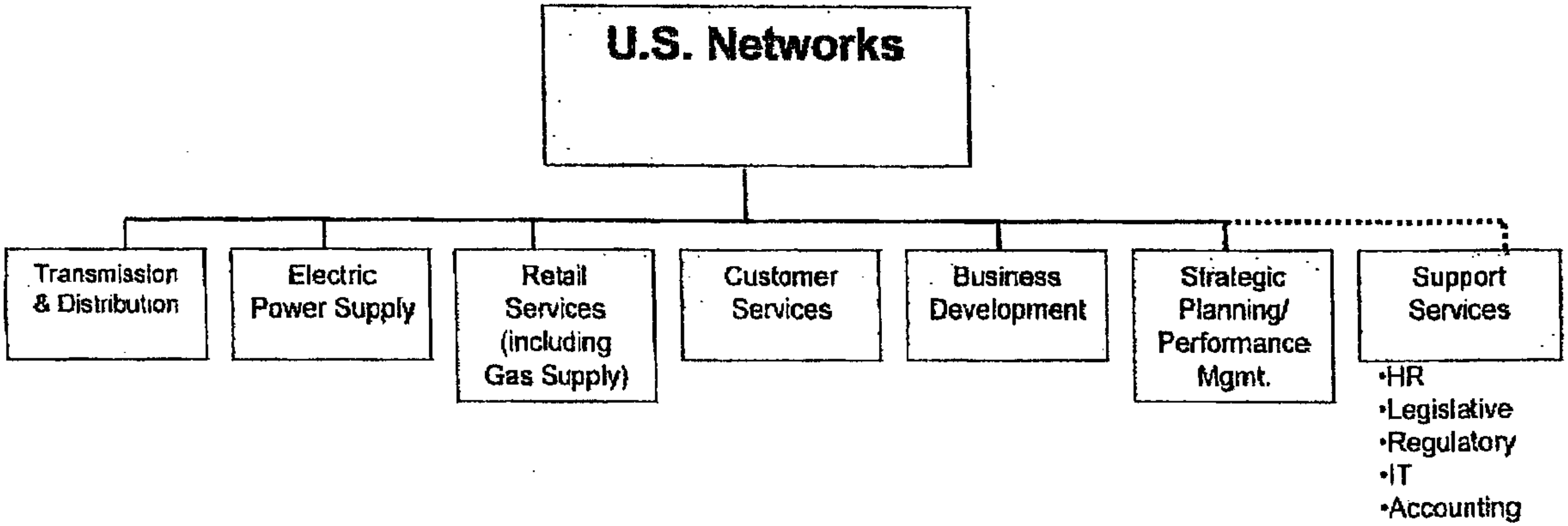
**Aquila, Inc**

- U.S. Networks (Currently includes Canada)
- International Networks/Merchant (Segregated for assets for sale or optimization)
- Support Services
  - •HR
  - •IT
  - •Finance
  - •Risk Management
  - •Legal

2002 interim (final organization dependent upon asset sale success)

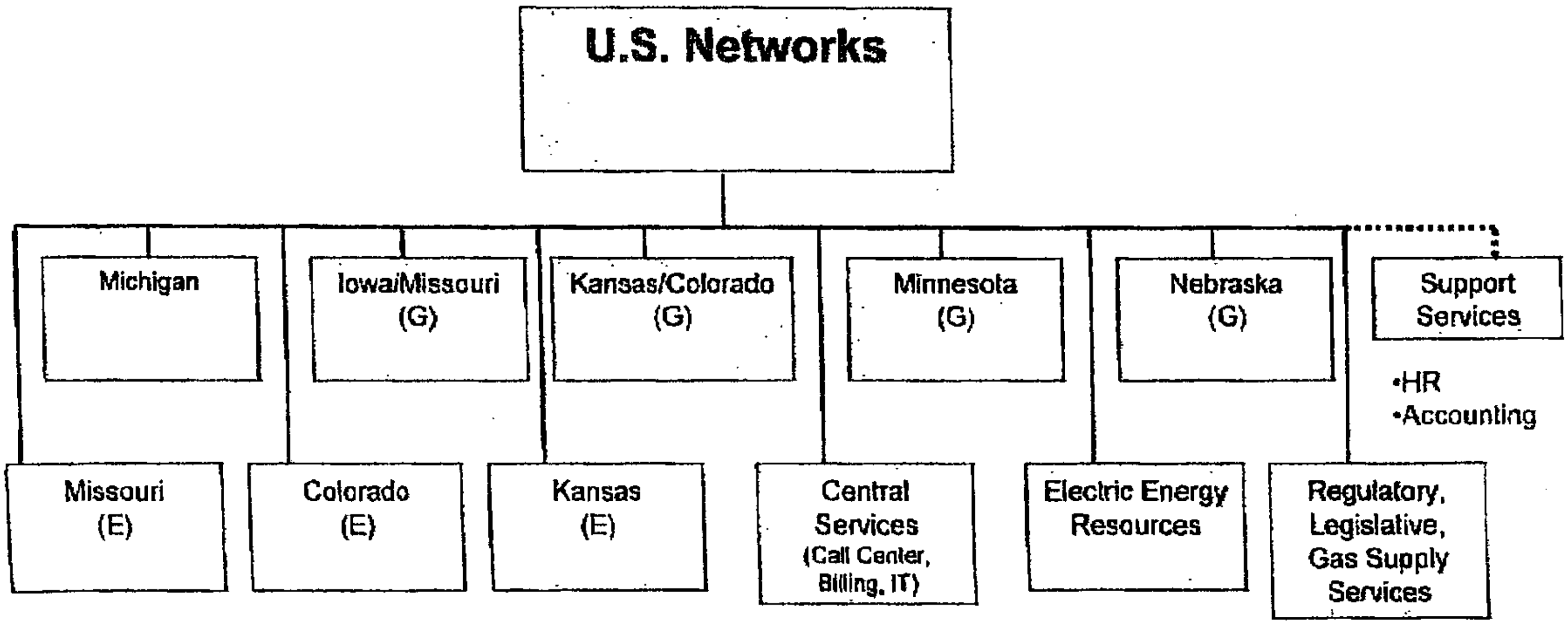
Aquila

# December 2001

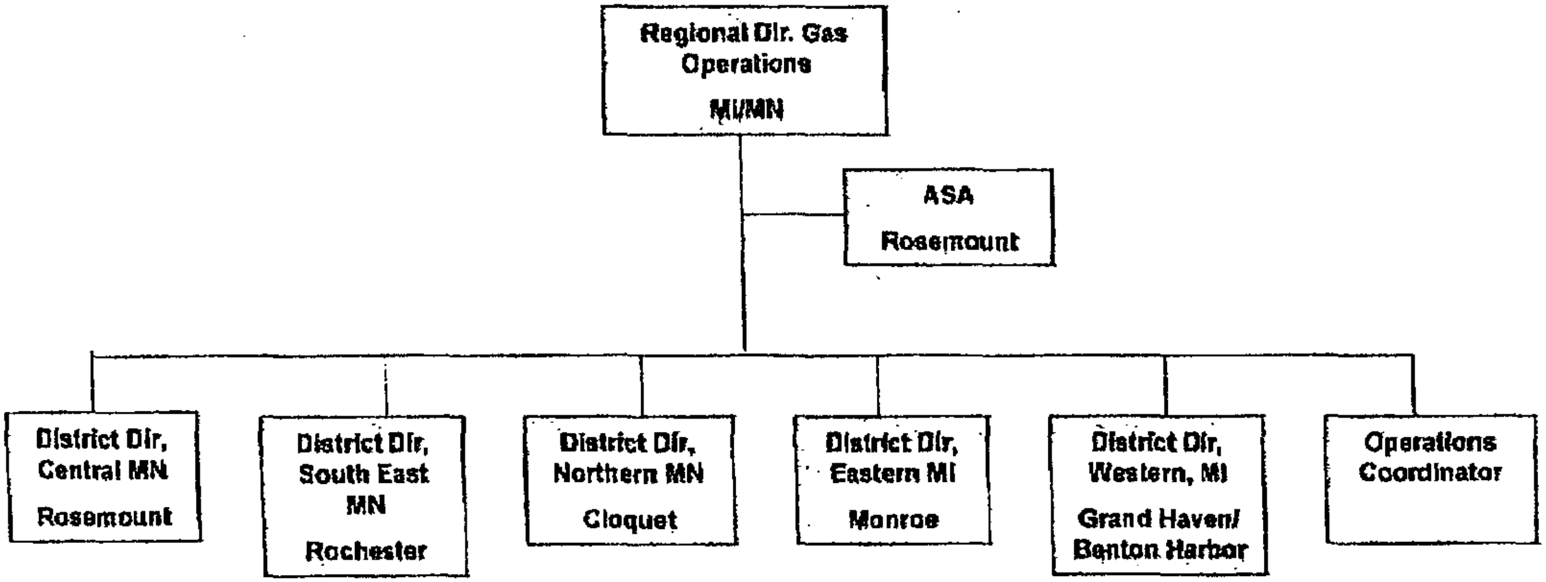



**NOTE:** Personnel working in Minnesota had functional reporting relationships to the departments in Kansas City. For example, operations personnel (see Minnesota 2001 Org Chart) reported to Transmission & Distribution; sales personnel reported to Retail Services.

# September 2002



# December 2001




NOTE: A "Minnesota" organization chart does not exist for 2001, per se. The organizational structure was centralized with functional reporting to Kansas City Departments This chart covers the Customer Service and Operations personnel, which was the majority of the personnel.

# September 2002

- Minnesota VP Operations
  - ASA
  - Field Svcs. Mgr.
    - •Bemidji
    - •Detroit Lakes
    - •Thief River Falls
    - •Wadena
  - Field Svcs. Mgr.
    - •Chisholm
    - •Cloquet
    - •Eveleth
    - •Grand Rapids
    - •International Falls
    - •Silver Bay
  - Field Svcs. Mgr.
    - •Rosemount
  - Field Svcs. Mgr.
    - •Chatfield
    - •Kasson
    - •LaCrescent
    - •Rochester
  - Field Svcs. Mgr.
    - •Pine City
    - •Fairmont
  - Business Operations Mgr.
  - Customer Relations Mgr.
  - Support Services
    - •Legislative Svcs
    - •Regulatory Svcs
    - •Accounting Svcs
    - •Human Resources

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

COMMENTS OF THE
MINNESOTA DEPARTMENT OF COMMERCE

DOCKET NO. G007,011/CI-02-1369

## I. INTRODUCTION

The Minnesota Public Utilities Commission (Commission) has regulatory authority over Peoples Natural Gas Company-Minnesota (Peoples) and Northern Minnesota Utilities (NMU). The Peoples Natural Gas Company has operations in Minnesota, Iowa, Colorado, Kansas, South Dakota, Michigan, Oklahoma, Texas, and Nebraska, and NMU serves customers in Minnesota only.[1] These two utilities are operating divisions of Aquila, Inc (Aquila or the Company). The following comments on the *Inquiry into Possible Effects of Financial Difficulties at Aquila, Inc. on Peoples Natural Gas and NMU and its Customers* (Comments) discuss the potential effects of Aquila's financial concerns on the ratepayers of the Company's two Minnesota regulated operating divisions.

In the last year, the Enron Corporation's bankruptcy, accounting misdeeds of Arthur Andersen, and the California energy crisis have focused regulatory attention onto energy companies. Several investigations were undertaken by federal agencies, including the: Commodities Future Trading Commission (CFTC); Federal Energy Regulatory Commission (FERC), and the Securities and Exchange Commission (SEC). In turn, this led, in part, to companies in the energy sector experiencing a severe credit shortage. This credit shortage was, in the Department's view, due to investor and lender mistrust and caused by a perception that all energy companies were involved in some level of accounting improprieties and/or market manipulations. In addition to the plethora of problems identified above, the economy slowed down such that there was less price volatility and lower energy prices and, thus, lower earnings for energy companies.

[1] Peoples Natural Gas Company information comes from the direct testimony of Debra Keim, exhibit DAK-4 in the Company's recent Minnesota rate case, Docket No. G007,011/GR-00-951.

As a result of these events, among other investor concerns, Aquila stock dropped from a high of $33 to its current price (as of October 17, 2002) of about $4 per share. Additionally, the Company has had its senior unsecured debt rating lowered. On September 3, 2002, Moody's Investor Services (Moody's) downgraded Aquila's senior unsecured debt to Ba2, which is non-investment grade (junk) status. That same week, Standard and Poor's (S&P) downgraded the Company's senior unsecured debt to BBB- which is one step above junk status. On August 19, 2002, Fitch Ratings (Fitch) downgraded Aquila's senior unsecured debt to BBB-, one step from junk status. In an effort to regain its financial stability Aquila announced "Project BBB+/Baa1" in late spring. Three of the main components of this plan were to target $1 billion of its non-core assets for sale, cut costs by $100 million, and complete equity and debt offerings of $764 million. As of October 10, 2002, the latter two goals have been met and, Aquila reported closed or pending sales of $876 million of its non-core assets.[2]

The credit situation has eased somewhat as Aquila has aggressively taken steps to ensure its continued solvency, but certainly the Company is not completely out of danger. This report is meant to provide information to the Commission about the current state of Aquila's financial affairs and the potential impacts on Peoples' and NMU's regulated ratepayers. These comments by the Minnesota Department of Commerce (Department) are not meant to be an all-encompassing financial review or a statement of fact about Aquila's financial situation, but rather to review Aquila's potential financial issues that may affect Peoples' and NMU's Minnesota regulated ratpayers. The Department highlights six issues in this report, Aquila's:

- status as an "operating company";
- sale of non-core assets;
- low stock price;
- overall debt issues (debt ratings and cross-default);
- cost of capital issues (Peoples'-NMU's cost of capital), and;
- service quality issues and service quality measures.

## II. DEPARTMENT ANALYSIS

### A. *AQUILA'S STATUS AS AN "OPERATING COMPANY"*

Aquila is an operating company, which means that it directly owns operating assets. In Aquila's case, the Company owns and directly controls the distribution pipelines, metering equipment, etc. that is used to deliver natural gas to Minnesota customers.

[2] See Section B. *Aquila's Sale of Non-Core Assets* for a discussion on assets that have been sold.

There certainly are some similarities between the financial situations of Aquila and Xcel Energy (Xcel), but the first major difference is Aquila's status as an "operating" company and Xcel's status as a "holding" company. In the case of Xcel, as a "holding company" it does not own or directly control any of the utility assets, rather it owns and provides administrative support functions to its various subsidiaries, one of which is NSP-Minnesota (NSP), which is doing business as Xcel Energy.

The Department understands that NSP's regulated ratepayers may be insulated to some extent from an NRG bankruptcy, as NSP and NRG are different companies. This would not be true in Aquila's situation. In response to Commission Staff September 4, 2002, Information Request II.B.i-vi., on page 9, which was answered by Aquila on September 18, 2002, the Company states in regard to an "operating company,"

> As such, Aquila's credit ratings are based on a blending of all of its activities. Absent structural and legal separation, it is not possible to segregate the impact that particular enterprises have on Aquila's overall credit capacity.

As can be understood from this explanation, Aquila's regulated operations (Minnesota included) are intertwined with Aquila's nonregulated operations.

In order for the Department to understand the effect on Peoples and NMU in the event of a potential Aquila bankruptcy the Department issued Information Request 6, on October 4, 2002, (DOC Attachment 1). In its response to this Information Request, Aquila appears to represent that Minnesota law completely protects Minnesota ratepayers. The Company says, without further explanation,

> Aquila's Minnesota PNG and NMU operations are conducted as a division of the corporate entity Aquila, Inc. Accordingly, if Aquila, Inc. were to file for protection under the bankruptcy laws, the assets held by that corporate entity (i.e., including its divisions) would fall under the jurisdiction of the bankruptcy court. However, it is Aquila's belief that Minnesota Statute 216B.50 will continue to prohibit dispositions (in excess of $100,000) of PNG's and NMU's assets without first obtaining Commission approval. This statutory protection will operate to preserve the commission's jurisdiction over the utilities' assets for the benefit of the rate-paying customers.

The potential situation that Aquila has presented is quite disconcerting to the Department. From a legal perspective, it is not clear at this time which entity would have authority over the disposition of the sale of Aquila's Minnesota properties, a bankruptcy court or the Commission. As will be discussed further below, the Company currently has certain ratings triggers attached to some of its obligations that could potentially require the Company to pay up to $159 million to its creditors. In light of the fact that Aquila was recently obligated to pay $233 million to its creditors due to certain ratings triggers, the Company's dubious liquidity situation may be irreparably damaged if further ratings triggers necessitate additional payment.

Because of the potential bankruptcy exposure to Minnesota utility property, the Department recommends that the Commission order Aquila to provide a full and complete report to the Commission that would investigate the Company's claim that Minnesota Statute (Minn. Stat.) 216B.50 would protect ratepayers' interests in the event of an Aquila bankruptcy such that to deny the sale of Aquila assets to satisfy the Company' creditors. This report should specify the legal standing the Commission would have in a bankruptcy proceeding and protections that could be put in place to protect Peoples' and NMU's ratepayers.

## B. *Aquila's Sale of Non-Core Assets*

Aquila has proceeded with certain sales of its nonregulated operations. As of October 10, 2002, the Company has sold $876 million of its targeted $1 billion in assets sales.[3] Two recent sales included the Company's 50 percent stake in the Oasis Pipe Line Company and its 70 percent stake in UnitedNetworks Ltd.

Specifically, Aquila closed sales of its Southeast Texas and Mid-Continent natural gas pipeline systems, including natural gas and gas liquids processing assets, and its 50 percent ownership in Oasis Pipe Line Company. The Aquila pipeline facilities and other assets in this sale, owned and operated by Aquila subsidiary Aquila Gas Pipeline Corporation (AQP), included three natural gas pipeline systems, two processing facilities and eight natural gas treating facilities, all in Southeast Texas. The Mid-

| [3] Aquila Asset Sales As of October 10, 2002 (Millions) | Total Proceeds |
|---|---|
| Lockport power project | $ 37.5 |
| Natural gas pipeline and processing assets | 265.0 |
| UnitedNetworks | 362.0 |
| Texas gas storage assets (pending) | 180.0 |
| Quanta stock (open market and private sales) | 13.8 |
| Corporate aircraft | 15.4 |
| Other businesses | 2.4 |
| Total asset sales closed or pending | $876.1 |

Continent assets, located primarily in western Oklahoma, included AQP's Elk City natural gas and gas liquids processing plant and its associated gas gathering system. In addition to these assets, the sale also included AQP's ownership interests in two joint venture arrangements with assets located in South Texas and the Permian Basin area of West Texas. The Oasis pipeline system, which consists of some 600 miles of pipeline, connects the Waha natural gas hub in the Permian Basin of West Texas with the Katy market hub near Houston, Texas. Physical throughput capacity of the pipeline is approximately 1 billion cubic feet of gas per day (Bcf/d). In addition to these natural gas gathering and delivery assets, the Company has announced the sale of its Texas gas storage assets valued at $180 million.

On September 9, 2002, Aquila announced that it had sold its 70 percent interest in UnitedNetworks, the Company's New Zealand assets, and on October 11, 2002, announced that the sale was completed for $503 million.[4] UnitedNetworks is a network infrastructure company that owns and manages electricity, gas, and fiber optic networks. It is New Zealand's 11th largest company by market capitalization and has net assets valued at NZ$2.28 billion and annual capital expenditures around NZ$80 million. UnitedNetworks owns 30,022 kilometers of electricity lines, 7,098 kilometers of gas lines and 100 kilometers of fiber optic cable. It owns "state of the art" fiber optic networks in the Auckland and Wellington Central Business Districts, distributes electricity to around 30% of New Zealand's electricity consumers and distributes gas to around 50% of the country's gas consumers.

Additionally, on September 30, 2002, the Company announced that it had completed the sale of its 16.58 percent interest in the Lockport Energy facility. This facility is a 180-megawatt gas-fired power plant approximately 30 miles north of Buffalo, New York, in the town of Lockport. Aquila apparently is also interested in selling it Midlands Electricity properties (now Aquila Networks UK) but has stated publicly that it will only part with this property for what it deems a fair price. This asset was purchased by the Company in May, and is the fourth largest regional electric company in the United Kingdom.

1. Aquila's current nonregulated subsidiaries

Following the sales detailed above, Aquila currently has four major subsidiaries: United Energy Limited; Multinet; AlintaGas Limited; and Quanta Services, Inc. (Quanta). The first three subsidiaries are in Australia, which limits the extent of financial information that can be accessed publicly, beyond the standard Company provided financial data.[5]

[4] Aquila's share of the net proceeds in this sale was estimated to be approximately $362 million.

[5] The Aquila website can be used to download some financial information for United Energy Limited and AlintaGas Limited. These companies are required by Australian regulations to have filings similar to SEC required 10-Q, except on a biannual instead of quarterly basis

Quanta Services' financial information has been included as a part of this report. For the quarter ended June 2002, Quanta's revenues are down, net income is negative (two quarters running), and long term debt is higher, but not significantly so when compared with the Company's debt situation in June 2000. The Compustat credit scorecard seems to show that Quanta is at the same range, A to BBB, (one step above speculative) as is Aquila.[6] (See DOC Attachment 2). As stated, however, there are three other foreign subsidiaries in Australia of which the Department has limited information.

The bottom line is that it is not clear the extent to which Aquila's nonregulated subsidiaries are contributing to the Company's financial problems. As will be discussed further in Section D. *Overall Debt Issues*, the issue is the Aquila guarantee of certain subsidiary debt. In one case, Aquila was required to make payment when its credit rating fell to non-investment status. In another case, subsidiary obligations could require further payments by the Company. (See DOC Attachment 3).

However, Aquila has endeavored to sell these non-core assets. The Company has stated its intent to return to a regulated utility, thus, if the non-core asset sales proceed, the subsidiary issue should be less important in the overall viability of the Company. It does seem rather clear, however, that a further ratings downgrade would seriously inhibit Aquila's ability to regain its financial stability.

## C. *AQUILA'S LOW STOCK PRICE*

Aquila's low stock price is reflective of several legitimate issues: fluctuating earnings due to energy prices, regulatory investigations, and a large amount of debt. However, investors' perception of the Company is very important also, and perception may be based less on actual facts and more on innuendo. Aquila has been aggressively selling assets, $876 million as of October 10, 2002, to stabilize their debt situation and improve liquidity.

Aquila's higher financial risk will raise the cost of common equity for the Company. At the time of the next rate case the cost of common equity for Aquila may or may not be higher, based on the perceived financial risk of the Company at the time of the next rate case. If Aquila has returned to financial stability, the cost of common equity capital will not be higher as a result of what happened in the past. Unlike the cost of debt, the cost of equity is forward looking and does not have an imbedded historical cost. However, if Aquila is still in financial difficulty at the time of the next rate case, the cost of common equity capital may be higher at that time. If this is the case, Minnesota ratepayers should be protected from this higher cost of common equity capital.

[6] It has been rumored that Aquila is trying to sell its 38 percent interest in Quanta.

## D. *OVERALL DEBT ISSUES (DEBT RATINGS AND CROSS-DEFAULT)*

### a. Debt Ratings

In terms of the Company's financial status, for the period ended June 2002, revenues are up but its net income shows a loss of $810 million.[7] Long term debt is higher compared with the Company's June 2000 situation, but not significantly. The Compustat credit scorecard shows Aquila's credit grade at the A to BBB long-term date rating range. This is one step above speculative, at which Fitch and S&P have rated the Company's senior unsecured debt. In sum, based on the financial information provided and obtained and the Company's business performance, as assessed by Compustat, there appear to be reasons for the Company's current near speculative debt rating. (See DOC Attachment 4).

The long-term debt issue of Aquila and its subsidiaries is not as dire as Xcel/NRG's current situation. However, two issues are relevant to this debt discussion: Aquila's current debt rating and its existing cross-default provisions.

As to debt rating, in response to Commission Staff Information Request I.C.i-iii., on page 3, Aquila states,

> On September 3, Moody's downgraded Aquila to a 'Ba2' with a stable outlook, citing execution risk on the asset divestiture program as a major concern. While S&P also downgraded the Company that same week to a 'BBB-' from a 'BBB', their actions are a welcomed offset to Moody's more severe perspective. S&P acknowledged execution risk relating to the asset divestiture program but is clearly willing to give management additional time to implement their plan.

The current Aquila senior unsecured bond ratings are:

| | |
|---|---|
| Fitch: | BBB-, Negative Watch (one step from non-investment grade) |
| Moody's: | Ba2, Stable Outlook (non-investment grade) |
| S&P: | BBB-, Negative Outlook (one step from non-investment grade) |

[7] Due in large measure to one-time costs Aquila absorbed in the second quarter, including: "Restructuring charges" and "Impairment charges." This information is from Aquila's 10-Q filing of August 14, 2002, page 4.

The Company does not expect any ratings actions until early next year. This means that Aquila will have some time to continue its asset sale, pay down debt, and resolve some of its regulatory issues. Of course, the low ratings raise Aquila's cost of capital and can make it difficult to borrow. These issues will be discussed further in Section E. *Cost of Capital Issues* below.

b. Cross-Default

A major impact of the low ratings, however, as with Xcel/NRG, is the cross-default provisions that Aquila has in place. Commission Staff Information Request I.D. specifically asked,

> What obligations does Aquila have with respect to the credit facilities and other debt of its subsidiaries, partnerships, or other entities? Specifically, are there cross-default, or similar, provisions in any of the loan agreements?

In its response to Commission Staff Information Request I.D., page 5, the Company states,

> The debt at the operating companies in Australia (United Energy, AliantGas, and Multinet), New Zealand (UnitedNetworks), and the United Kingdom (Avon and Midlands) is non-recourse to Aquila, is not reflected in Aquila's financial statements from an accounting perspective, and is not usually imputed onto Aquila's financial statement by the ratings agencies. **The debt of these operating companies is not guaranteed by Aquila and does not cross-default to Aquila.** (Emphasis added.)

The Department is concerned that Aquila's statements to the Commission are contradicted by the information the Company provided in its SEC 10-Q form dated August 14, 2002 (DOC Attachment 5). In this, Aquila states on page 18 under the heading "Ratings Trigger" that,

> Certain of our subsidiaries have trigger events tied to specific credit ratings. Because of guarantee and cross default provisions between Aquila, Inc. and these subsidiaries, the ratings triggers of our subsidiaries discussed below should be viewed as if they are directly applicable to Aquila, Inc. Our Australian subsidiaries have issued six series of Australian denominated bonds,

> guaranteed by us, that contain provisions that could require us to repurchase the bonds. The put right for two series aggregating approximately $85 million can be exercised 30 days after a downgrade to non-investment grade by either S&P or Moody's. Those series mature in October 2002. The put right for the other four series aggregating approximately $92 million can be exercised on the next scheduled interest payment date if we are rated below investment grade by S&P.
>
> Our Merchant Services subsidiary also has three 'tolling agreements,' a construction loan and certain margining agreements that have trigger events tied to Aquila's credit ratings. Under the tolling agreements, our subsidiary uses a third party's generation assets to convert fuel into electric power for its subsequent resale. The maximum aggregate amount of collateral that it could be required to post in the event of a ratings trigger under these contracts is approximately $172 million. Of this amount, $45 million must be posted within 10 days of a downgrade below investment grade by either Moody's or S&P; $37 million must be posted within 70 days of the date we are rated below investment grade by both Moody's and S&P; and $28 million under the construction loan must be posted within 10 business days of a downgrade below investment grade by both S&P and Moody's.

On October 4, 2002, the Department issued Information Request 8 (DOC Attachment 6) to clear up this seeming contradiction. In its October 11, 2002, response to this Information Request the Company stated,

> The debt referenced on page 18 of our 10-Q refers to Australian debt Aquila guarantees and consolidates onto its financial statements. The proceeds from these debt offerings were used to fund Aquila's' 'equity investments' into the underlying utility operating companies (i.e., Alinta Gas, United Energy, and EPG/Multinet). Equity distributions from these utility operating companies is used to service and repay Aquila's debt borrowed in the local currencies. The debt of the utility operating companies is not supported by Aquila or consolidated on its financial statements. The

> statements in the 10-Q and our earlier response are not inconsistent.

From the Department's reading of the information provided in information requests and the Company's 10-Q filing, Aquila has not accurately represented its cross-default situation to the Commission. For example, in response to Department Information Request 7 (DOC Attachment 3) the Company provides information in detail on the $233 million of Australian debt, Tolling and Margining Agreements, and Commodity Contracts the Company has had to repay since Moody's downgraded its debt rating to junk status. Further, this Information Request details that an additional $159 million may be required if S&P should downgrade Aquila's debt rating.[8] These "capital calls" have siphoned almost a quarter of a billion dollars from Aquila, right when the Company is in its most dire financial position.[9] It is at best disingenuous for the Company to say to the Commission that "[T]he debt of these operating companies is not guaranteed by Aquila and does not cross-default to Aquila."

Aquila has guaranteed debt and has been forced to repay the Australian issuance, and other costs, due to the Company's debt rating downgrade by Moody's. There exist other potential triggers that could take effect. It appears that Aquila was not forthright in response to Commission Staff Information Request I.D.

Additionally, the letter of August 26, 2002 letter from Mike Jonagan, Chief Executive Officer (CEO) of U.S. Utilities, to the Commission cited in the Company's response to Commission Staff Information Request I.D., on page 5, appears to mislead in its intent to assuage the Commission's fears of Aquila's Minnesota utility property being liquidated to pay off the Company's debts. According to Aquila's response to Department Information Request 6, the Commission's only recourse in an Aquila bankruptcy would be Minn. Stat. § 216B.50. The fact that this statute would protect Minnesota ratepayers is not at all certain. The Jonagan letter states that "Aquila has not and will not secure debt with Minnesota utility property without receiving prior approval from the Minnesota Commission." As discussed above, however, the debt of Aquila is the debt of Peoples and NMU, ~~and~~ thus, all of Aquila's debt is secured with all of the Company's properties, including the Minnesota utility property.[10]

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[8] Currently, S&P has Aquila's long term debt rated one step from junk status.

[9] Aquila is currently involved in a lawsuit that could potentially cost the Company $561 million. Aquila Merchant Service sold long term gas contracts to certain Nebraska municipalities and had the Federal Insurance Company (Chubb Insurance Group) issue surety bonds in support of these contracts. Chubb has demanded that Aquila replace it as the surety or, alternatively, post collateral to secure all of Chubb's obligations under the surety bond. On February 2, 2002, Aquila filed suit against Chubb's (case #802CV3059) to avoid replacing Chubb or to post collateral. The case has recently been moved to the US District Court in Kansas City, Missouri.

[10] This letter seems to have been sent less to ease tension about the Company's financial situation and more to be in response to any concern some party may have that the Company violated Minn. Stat. §

The Company has been less than forthright with the Commission about its current debt situation and the exposure of its Minnesota regulated operations to the Company's tenuous financial condition. Above, the Department recommended that the Commission order the Company to author a report that would explain specifically the Company's claim that Minn. Stat. § 216B.50 would protect ratepayers' interests and give the Commission discretion over the potential selling of Aquila assets to satisfy the Company's creditors. This report may begin to answer some of the Department's concerns.

## E. *COST OF CAPITAL ISSUES (PEOPLES-NMU COST OF CAPITAL)*

The cost of debt of Peoples and NMU is the cost of debt to Aquila. The capital structures of both Peoples and NMU are based on comparisons to other companies in similar industries such as comparable gas distribution companies, which mirror the operations of Peoples and NMU. The current capital structure for Peoples and NMU is roughly 50/50 debt to equity. This system of capital allocation was proposed by Aquila in its most recent rate case (Docket No. G007,011/GR-00-951). The Department agreed that this method was reasonable.[11] This is one of the primary links between Aquila and Peoples/NMU as Aquila borrows all the money for the financial needs of Peoples and NMU and then allocates the borrowed funds to each division based on need. The cost of the assigned debt to the division is exactly the same as the cost of the debt to Aquila.

In response to Commission Staff Information Request II.B i-vi., on page 8, Aquila states,

> Relative to Aquila's cash generation and access to capital, PNG and NMU's capital requirements should not pose any significant challenges for Aquila. At this time, no incremental external financing needs exist for PNG and NMU as explained in question c.

The Company in another response to Commission Staff Information Request I.C. i-iii., on page 4, states that its higher capital costs are not an issue to PNG and NMU because, ["T]he impact of higher capital costs is mitigated by the fact that Aquila is not expected to be a 'net borrower' over the coming months."

---

216B.49, subdivision 3. This statute prevents a utility from specifically encumbering Minnesota utility property "for the purpose of securing the payment of any indebtedness" without prior Commission approval. As discussed above, Minnesota property was not specifically used to secure any credit facilities, but if Aquila cannot make payments on its debts, the Company's Minnesota property would be subject to a potential bankruptcy court. Although Aquila did not pledge Minnesota property to secure debt, the practical effect may be the same as if the Company had.

[11] Direct Testimony and Exhibits of Eilon Amit, page 26, lines 9-16.

The Department interprets both these statements to mean that Peoples and NMU can pay the operational costs of each utility and service the cost of each utility's debt with the cash generated internally. In response to Commission Staff Information Request II.B.i-vi., on page 8, the Company discusses further the steps that it has taken to ensure access to credit, for each utility should it be needed, such as increasing its corporate revolver.

The Company has stated that it directly assigns the cost of debt to either Peoples or NMU based on the requested needs from each utility. Therefore, a higher cost of debt for Aquila, due to its debt ratings downgrades discussed earlier, is directly passed to Peoples and NMU's regulated Minnesota customers in each utility's capital structure when debt is assigned to either utility. At the time of the next rate case, each utility's capital structure, which may include the current higher cost of debt to Aquila, will be used to determine the Company's Rate of Return (ROR). The ROR is one component that makes up the non-gas margin rate that Minnesota regulated customers pay for each Mcf of gas used. Thus, higher capital costs would be reflected in Minnesota regulated customers' rates if Aquila assigned this higher cost debt to either Peoples or NMU, consequently, the need for regulatory vigilance.

However, the Company has also stated that it does not foresee any capital infusion needed at either Peoples or NMU. Nevertheless, the Department wants to ensure that the cost of Aquila's financial problems is not passed onto regulated Minnesota ratepayers.

As a related issue, during the course of this investigation, the Department discovered that Aquila has not made a Capital Structure filing since 1998.[12] The Department is aware that Aquila completed a debt issuance ($500 million, 11 $^{7}/_{8}$%, due July 1, 2012) this summer. It is the Department's understanding that the Commission must approve all such issuance. Therefore, the Department recommends that as part of its Reply Comments, the Company should explain why it did not file for Commission approval of its most recent debt issuance. Further, Aquila should provide a list of the dates and amounts of all issuance since the Company's last Capital Structure filing in 1998 and a discussion of why the Company did not file for approval, per Minn. Stat. § 216B.49.

Thus, as to the issue of ratepayer protection from higher capital costs, the Department recommends that:

[12] *A Petition by UtiliCorp United, Inc. for Minnesota Public Utilities Commission Certification to Invest in a Foreign Utility.* Docket No. G007,011/S-98-682.

- In Aquila's next rate case, the Company would identify all issuance of debt and associated cost from January 1, 2002, until its next rate case in a manner that will facilitate a potential adjustment to mitigate impacts of adverse market factors caused by Aquila's financial problems. Specifically, the Company must provide information sufficient to allow the Commission to evaluate what Peoples' and NMU's debt and equity costs would be but for the effects of its other operations;

- The Company provide a discussion and analysis in its next rate case of the effects at that time of Aquila's financial situation on Peoples' and NMU's cost of common equity;

- Aquila should report any significant financial event for Aquila and provide copies of any report made to the SEC or any other federal agency from now on; and

- In its Reply Comments, the Company should explain why it did not file for Commission approval of its most recent debt issuance. Further, Aquila should provide a list of the dates and amounts of all issuance since the Company's last Capital Structure filing in 1998 and a discussion of why the Company did not file for approval, per Minn. Stat. § 216B.49.

F. *SERVICE QUALITY ISSUES AND SERVICE QUALITY MEASURES*

It is well known that Aquila has eliminated some staff positions to save money and, at the same time, the Company reorganized each operating unit to focus on a state-by-state level. Aquila states in its response to Commission Staff Information Request II.B.vi, on page 9, on the impact of the layoffs to Minnesota operations,

> Each Operating Vice President was asked to identify the staff required to maintain a safe and reliable utility operation that would continue to maintain high levels of customer satisfaction. Aquila is not anticipating any adverse impact from the announced staffing reductions and in fact, believes that the shift to a state focused structure and the alignment of responsibility and accountability will improve utility operations.

The Company reduced staff levels for the Minnesota operations from 251 to 218 people, the "Customer Service" area experienced the largest portion of the layoffs, going from 177 employees to 156.[13] However, no explanation is offered as to what these employees currently do and why this area would be able to afford the greatest amount of layoffs. The Department is concerned with the Company's service quality on a going-forward basis, in light of the Company's many financial difficulties and the recent downsizing of its Minnesota operations. This is of particular concern in light of the Company's implicit representation in its current rate case that costs reflecting personnel staffing are reasonable at pre-staff reduction levels.

Service quality is a key concern for customers, and as such the Department has recommended that NSP and CenterPoint Energy Minnegasco (CenterPoint) have approved service quality standards that can be measured to ensure customer service. By ensuring that Aquila has similar quality standards it is hoped that the Company's Minnesota customers should not be harmed due to current layoffs, since Minnesota regulated customers are paying for the larger number of employees in their rates.

Therefore, the Department recommends that the Commission require Aquila to file a proposed gas service quality standards plan (including information on how service quality response times will be traced through regulated operations) similar to those required of NSP in merger Docket No. E,G002/PA-99-1031 within thirty days of the *Order* in this docket and begin using these mechanisms on a going-forward basis to gauge customer service quality. The Company's results should be filed quarterly. These standards should protect Minnesota customers from potentially eroding customer service and allow the Department and the Commission to monitor and compare the service quality of Minnesota's three largest natural gas providers, NSP, CenterPoint, and Peoples/NMU.

## III. CONCLUSION AND RECOMMENDATIONS

Certainly the financial situation at Aquila concerns the Commission and the Department. This analysis was undertaken as a means to attempt to assess the level of financial difficulty and the extent to which regulated Minnesota ratepayers potentially could be affected by the situation.

The Company has taken aggressive steps to improve liquidity and remove debt from its balance sheet. Although these measures have, as of yet, failed to improve the Company's debt ratings, Aquila's long term strategy seems to offer the Company the best route to financial security and continued viability. However, the Department

[13] "Customer Service" has the greatest current number of employees, 156 out of 218

continues to have concerns which center on protecting ratepayers in the short run from a potential Aquila bankruptcy, and protecting ratepayers in the long run from higher capital costs, and the potential for service quality erosion caused by the Company's financial difficulties and staff reductions.

1) As to ratepayer protection from a potential Aquila bankruptcy, the Department recommends that the Commission order Aquila to: provide a full and complete report to the Commission that would investigate the Company's claim that Minnesota Statute 216B.50 would protect ratepayers' interests in the event of an Aquila bankruptcy such that to deny the sale of Aquila assets to satisfy the Company' creditors. This report should specify the legal standing the Commission would have in a bankruptcy proceeding and protections that could be put in place to protect Peoples' and NMU's ratepayers.

2) As to the issue of ratepayer protection from higher capital costs, the Department recommends that:

   - In Aquila's next rate case, the Company identify all issuance of debt and associated cost from January 1, 2002, until its next rate case in a manner that will facilitate a potential adjustment to mitigate impacts of adverse market factors caused by Aquila's financial problems. Specifically, the Company must provide information sufficient to allow the Commission to evaluate what Peoples' and NMU's debt and equity costs would be but for the effects of its other operations;

   - The Company provide a discussion and analysis in its next rate case of the effects at that time of Aquila's financial situation on Peoples' and NMU's cost of common equity;

   - Aquila should report immediately any significant financial event for Aquila and provide copies of any report made to the SEC or any other federal agency from now on; and

   - In its Reply Comments the Company should explain why it did not file for Commission approval of its most recent debt issuance. Further, Aquila should provide a list of the dates and amounts of all issuance since the Company's last Capital Structure filing in 1998 and a discussion of why the Company did not file for approval, per Minn. Stat. § 216B.49.

3) Finally, as to the potential for a decreased level of service, the Department recommends that the Commission require Aquila to: file a proposed gas service quality standards plan (including information on how service quality response times will be traced through regulated operations) similar to those required of NSP

in merger Docket No. E,G002/PA-99-1031 within thirty days of the *Order* in this docket and begin using these mechanisms on a going-forward basis to gauge customer service quality. The Company's results should be filed quarterly. These standards should protect Minnesota customers from potentially eroding customer service and allow the Department and the Commission to monitor and compare the service quality of Minnesota's three largest natural gas providers, NSP, CenterPoint, and Peoples/NMU.

/jd

# State of Minnesota
## Department of Commerce

**Utility Information Request**

Docket Number: G007,011/CI-02-1369 Date of Request: October 4, 2002

Requested From: Aquila, Inc. Response Due: October 10, 2002

Analyst Requesting Information: Marcus Gross

| Type of Inquiry: | | | |
|---|---|---|---|
| | [ ]___Financial | [ ]___Rate of Return | [ ]___Rate Design |
| | [ ]___Engineering | [ ]___Forecasting | [ ]___Conservation |
| | [ ]___Cost of Service | [ ]___CIP | [ ]___Other: |

***If you feel your responses are trade secret or privileged, please indicate this on your response.***

| Request No. | |
|---|---|
| 6 | How are the Peoples' Natural Gas-Minnesota and Northern Minnesota Utilities' assets insulated from a potential bankruptcy of Aquila, Inc. Please provide a detailed explanation. |

**Response:**

Aquila's Minnesota PNG and NMU operations are conducted as a division of the corporate entity Aquila, Inc. Accordingly, if Aquila, Inc. were to file for protection under the bankruptcy laws, the assets held by that corporate entity (i.e., including its divisions) would fall under the jurisdiction of the bankruptcy court. However, it is Aquila's belief that Minnesota Statute 216B.50 will continue to prohibit dispositions (in excess of $100,000) of PNG's and NMU's assets without first obtaining Commission approval. This statutory protection will operate to preserve the commission's jurisdiction over the utilities' assets for the benefit of the rate-paying customers.

Response by: ______________________ List sources of information:

Title: ______________________ ______________________

Department: ______________________ ______________________

Telephone:

Print All Sheets

# Company Quarterly Debt Structure Overview

| | | | | | |
|---|---|---|---|---|---|
| QUANTA SERVICES INC | 713-629-7600 | Report generated: | 9/30/2002 | Exchange: New York Stock Exchange | |
| 1360 Post Oak Blvd Ste 2100 | | Ticker: | PWR | Stock Ownership | Publicly Traded Company |
| Houston TX | 77056 | SIC: | Electrical Work | GICS Sub Industry | Construction & Farm Machinery & He |

| Debt Structure | $ Annual | % of LTD |
|---|---|---|
| Annual data as of: | Dec01 | |
| Convt Debt Senior | 0 | 0.0% |
| Convt Debt Subord | 172.5 | 33.7% |
| Total Convertible | 172.5 | 33.7% |
| Subordinated Debt | 0 | 0.0% |
| Notes | 225.425 | 44.1% |
| Debentures | 0 | 0.0% |
| Other - Long Term | 109.33 | 21.4% |
| Cap Lease Oblig | 1.082 | 0.2% |
| Unamort Debt Disc & Prem | 0 | 0.0% |
| Debt - Mortgage & Secured | 335.837 | 65.7% |
| LTD Tied to Prime | 109.33 | 21.4% |
| Contingent Liab Guarantees | @NA | #VALUE! |
| Qtrly data as of: | Jun02 | |
| Total Qtrly Debt | 518.7829 | 101.5% |
| Long Term Qtrly Debt | 511.1929 | 100.0% |
| Debt in Current Liabilities | 7.59 | 1.5% |

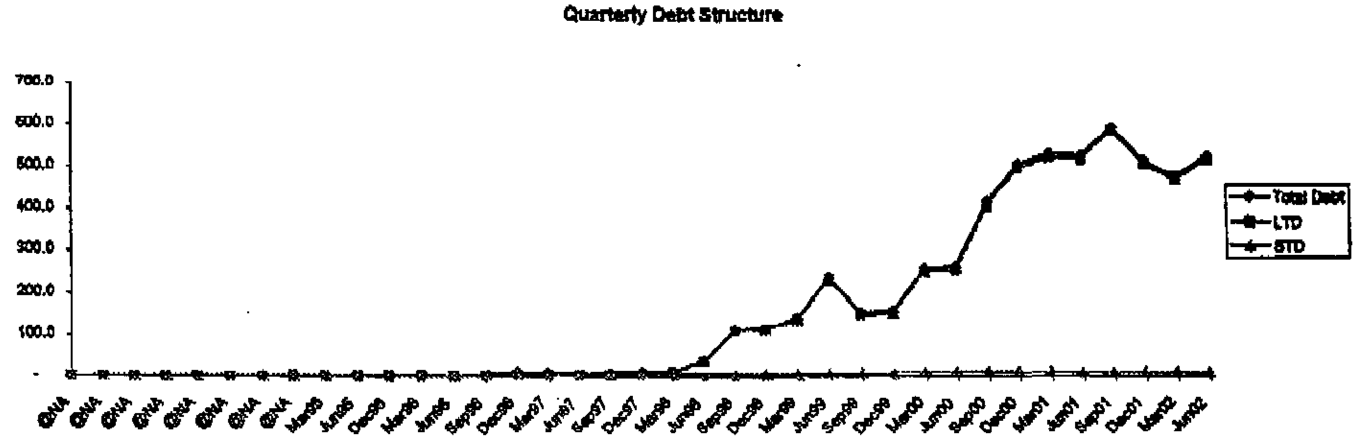
| Officers Names |
|---|
| John R Colson |
| Chairman, Chief Executive Officer |
| James H Haddox |
| Chief Finance Officer, Secretary |
| Derrick A Jensen |
| Vice President, Controller |

| Qtrly Growth Rates | 1 Year | 3 Year |
|---|---|---|
| Revenues | -14.1% | 30.7% |
| Net Income | @NC | @NC |
| Total Debt | -0.4% | 30.2% |
| Curr Debt | -3.0% | 10.9% |
| Sh's Eqty | -48.7% | 14.8% |
| Tot Liab | -6.5% | 32.5% |

| Market Information | |
|---|---|
| Qtrly data as of: | Jun02 |
| Market Capitalization | 592.9 |
| Dividend Yield | 0.0% |
| Price/Book | 1.0 |
| Shares Outstanding | 61.409 |
| Available for Interest | (176.726) |
| Fixed Chg Cov erage: | |
| Before Tax | (21.995) |
| After Tax | (21.053) |
| LTD/Com Equity | 86.33% |
| LTD/Stkhldr's Eqty | 86.33% |
| LTD/Total Assets | 86.33% |
| STD/LTD | 1.48% |
| LT S&P Issuer Rating | |
| Subord Debt Rating | |
| ST S&P Issuer Rating | |
| S&P Stock Ranking | |

| QUARTERLY | Revenue | Net Income | Interest Expense | Long Term Debt | Current Debt | Total Liabilities to Assets | Debt to Capital | Debt to Sh'h's Equity | Curr Debt / Tot Debt | YOY Total Debt | YOY Liabilities Growth | Financial Leverage |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Jun00 | 423.5 | 31.1 | 6.4 | 251.7 | 9.0 | 34.0% | 20.99% | 26.6% | 3.5% | 10.8% | 38.5% | 1.52 |
| Sep00 | 487.8 | 40.7 | 6.9 | 401.1 | 11.4 | 40.2% | 28.16% | 39.2% | 2.8% | 169.2% | 111.7% | 1.68 |
| Dec00 | 548.2 | 14.4 | 7.8 | 491.1 | 8.8 | 43.0% | 31.48% | 45.9% | 1.8% | 218.4% | 99.9% | 1.83 |
| Mar01 | 519.0 | 29.3 | 9.2 | 516.8 | 8.9 | 43.0% | 31.37% | 45.7% | 1.7% | 105.5% | 85.5% | 1.88 |
| Jun01 | 503.3 | 16.7 | 9.1 | 513.3 | 7.8 | 43.0% | 30.78% | 44.5% | 1.5% | 99.9% | 78.4% | 1.74 |
| Sep01 | 504.5 | 26.3 | 9.0 | 578.9 | 8.3 | 43.6% | 32.77% | 48.8% | 1.4% | 42.4% | 33.4% | 1.76 |
| Dec01 | 488.0 | 13.5 | 8.7 | 500.3 | 8.1 | 40.9% | 29.31% | 41.5% | 1.6% | 1.7% | 3.9% | 1.74 |
| Mar02 | 449.2 | (435.2) | 7.9 | 482.6 | 7.3 | 39.5% | 27.45% | 37.8% | 1.5% | -10.6% | -6.6% | 1.72 |
| Jun02 | 432.5 | (177.2) | 8.0 | 511.2 | 7.6 | 57.9% | 46.33% | 86.3% | 1.5% | -0.4% | -6.5% | 1.80 |
| ANNUAL | | | | | | | | | | | | |
| @NA | @NA | @NA | @NA | @NA | @NA | @NA | @NA | @NA | @NA | #VALUE! | #VALUE! | @NA |
| Dec95 | @NA | @NA | @NA | @NA | @NA | @NA | @NA | @NA | @NA | #VALUE! | #VALUE! | @NA |
| Dec96 | 42.7 | 0.8 | 0.6 | 2.1 | 5.0 | 62.8% | 21.2% | 26.9% | 70.5% | #VALUE! | #VALUE! | @NC |
| Dec97 | 49.1 | 2.3 | 0.6 | 3.6 | 5.1 | 60.2% | 26.3% | 35.7% | 59.0% | 23.8% | 16.6% | 2.59 |
| Dec98 | 309.2 | 15.2 | 4.6 | 109.6 | 3.8 | 49.2% | 38.1% | 64.3% | 3.3% | 1201.7% | 987.2% | 2.00 |
| Dec99 | 925.7 | 53.9 | 15.2 | 199.7 | 6.7 | 34.7% | 20.9% | 26.4% | 3.2% | 82.0% | 144.6% | 1.61 |
| Dec00 | 1,793.3 | 105.7 | 25.7 | 491.1 | 8.8 | 43.0% | 31.5% | 45.9% | 1.8% | 142.3% | 99.9% | 1.86 |
| Dec01 | 2,014.8 | 85.8 | 36.1 | 500.3 | 8.1 | 40.8% | 29.3% | 41.5% | 1.6% | 1.7% | 3.9% | 1.72 |

Quarterly Debt Structure

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QUANTA SERVICES INC
TICKER: PWR
Latest FY: Dec01
CURRENT RATING AS OF: 30Aug02
S&P LT ISSUER CREDIT RATING:

**S&P LONG TERM ISSUER CREDIT RATING RATIOS**
Industry Comparisons

Select Industry Comparables by:
GICS Group [Capital Goods]

*To change company,

| Rating | # of Cos. 123 | Long Term Debt % of Total Capital Min | Avg | Max | Pretax Interest Coverage x Min | Avg | Max | Cash Flow Interest Coverage x Min | Avg | Max |
|---|---|---|---|---|---|---|---|---|---|---|
| AAA | 1 | 57.1 | 57.1 | 57.1 | 25.5 | 25.5 | 25.5 | 27.0 | 27.0 | 27.0 |
| AA | 5 | 6.9 | 18.6 | 26.4 | 3.7 | 16.8 | 25.8 | 9.5 | 17.8 | 22.5 |
| A | 25 | 0.0 | 33.4 | 66.8 | 0.0 | 12.1 | 109.2 | 1.6 | 13.2 | 109.2 |
| BBB | 33 | 0.2 | 38.1 | 54.6 | (6.2) | 3.6 | 26.1 | (0.5) | 5.1 | 38.2 |
| Speculative | 59 | 4.7 | 72.3 | 227.2 | (13.3) | 0.6 | 6.7 | (8.0) | 1.3 | 6.8 |
| In Default | 0 | @NC | @NC | @NC | @NC | @NC | @NC | @NC | @NC | @NC |
| QUANTA SVC | | | 29.3 | | | 5.4 | | | 5.6 | |

@NC = Not Calculable

| Rating | # of Cos. 123 | Cash Flow % of Long Term Debt Min | Avg | Max | Asset Turnover x Min | Avg | Max | Equity Book Value/ Book Value of Liabilities Min | Avg | Max |
|---|---|---|---|---|---|---|---|---|---|---|
| AAA | 1 | 26.6 | 26.6 | 26.6 | 0.3 | 0.3 | 0.3 | 0.1 | 0.1 | 0.1 |
| AA | 5 | 50.6 | 121.5 | 218.5 | 0.8 | 1.2 | 2.0 | 0.4 | 1.1 | 2.2 |
| A | 25 | 7.6 | 113.2 | 1,134.9 | 0.0 | 1.0 | 2.7 | 0.2 | 1.1 | 14.0 |
| BBB | 33 | (11.1) | 271.5 | 8,043.9 | 0.5 | 1.1 | 2.6 | 0.3 | 0.7 | 1.8 |
| Speculative | 59 | (1,562.9) | (26.1) | 98.0 | 0.4 | 1.1 | 3.1 | (0.4) | 0.3 | 1.0 |
| In Default | 0 | @NC | @NC | @NC | @NC | @NC | @NC | @NC | @NC | @NC |
| QUANTA SVC | | | 33.0 | | | 1.0 | | | 1.4 | |

| Rating | # of Cos. 123 | Return on Total Capital % Min | Avg | Max | Operating Income % of Sales Min | Avg | Max | Total Liabilities % of Tangible Net Worth Min | Avg | Max |
|---|---|---|---|---|---|---|---|---|---|---|
| AAA | 1 | 10.1 | 10.1 | 10.1 | 22.1 | 22.1 | 22.1 | 1,899.5 | 1,899.5 | 1,899.5 |
| AA | 5 | 5.5 | 10.0 | 17.6 | 5.1 | 13.5 | 23.6 | 50.3 | 175.3 | 278.5 |
| A | 25 | (3.2) | 7.6 | 32.6 | (8,825.6) | (339.8) | 21.0 | (4,045.3) | 593.6 | 12,927.5 |
| BBB | 33 | (13.6) | 3.1 | 11.8 | 2.8 | 11.8 | 28.3 | (9,159.7) | (361.8) | 2,329.6 |
| Speculative | 59 | (212.6) | (8.8) | 25.2 | (3.8) | 9.8 | 38.2 | (8,787.9) | (466.8) | 7,966.8 |
| In Default | 0 | @NC | @NC | @NC | @NC | @NC | @NC | @NC | @NC | @NC |
| QUANTA SVC | | | 5.0 | | | 14.5 | | | 492.5 | |



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# State of Minnesota
## DEPARTMENT OF COMMERCE

**Utility Information Request**

Docket Number: G007,011/CI-02-1369 Date of Request: October 4, 2002

Requested From: Aquila, Inc. Response Due: October 10, 2002

Analyst Requesting Information: Marcus Gross

Type of Inquiry: [ ]___Financial [ ]___Rate of Return [ ]___Rate Design
[ ]___Engineering [ ]___Forecasting [ ]___Conservation
[ ]___Cost of Service [ ]___CIP [ ]___Other:

***If you feel your responses are trade secret or privileged, please indicate this on your response.***

| Request No. | |
|---|---|
| 7 | On page 18 of Aquila's August 14, 2002, 10-Q filing certain "Ratings Triggers" are discussed. Please provide a complete listing (and description) of the ratings triggers that could occur in the next year. Provide a dollar amount that would be associated with each trigger that could be initiated. |

**Response:**

Following is a summary of the potential capital calls listed in the 10-Q and an update of the capital calls actually made of the Company:

POTENTIAL CAPITAL CALLS

| | Moody's Downgrade | If S&P Also Downgrades | Total |
|---|---|---|---|
| Australian Debt | $85 | $92 | $177 |
| Tolling & Margining Agreements | $172 | $0 | $172 |
| Commodity Contracts | $135 | $0 | $135 |
| | $392 | $92 | $484 |

Response by: ________________ List sources of information:

Title: ________________ ________________

Department: ________________ ________________

ACTUAL CAPITAL CALLS MADE TO DATE (w/ Moody's Downgrade)

| | Possible Calls | Actual Calls | Possible Additional Calls |
|---|---|---|---|
| Australian Debt | $85 | $85 | $0 |
| Tolling & Margining Agreements | $172 | $113 | $59 |
| Commodity Contracts | $135 | $35 | $100 |
| | $392 | $233 | $159 |

Most of the capital calls related to the Moody's downgrade of the Company have already been made and reflected in the above chart. If S&P were to downgrade Aquila to non-investment grade, then about US$92 million of Australian debt could be put to Aquila. Also, we would expect some of the Commodity Contracts that did not seek capital calls when Moody's downgraded the Company to seek collateral upon an S&P downgrade.

Response by: ____________________ List sources of information:

Title: ____________________ ____________________

Department: ____________________ ____________________

Print All Sheets

## Company Quarterly Debt Structure Overview

AQUILA INC — 816-421-6600 — Report generated: 9/30/2002 — Exchange: New York Stock Exchange

20 W 9th St — Ticker: ILA — Stock Ownership: Publicly Traded Company

Kansas City, MO 64105-1704 — SIC: Electric & Other Serv Comb — GICS Sub Industry: Multi-Utilities & Unregulated Power

| Debt Structure | $ Amount | % of LTD |
|---|---|---|
| Annual data as of: | Dec01 | |
| Convt Debt Senior | @NA | #VALUE! |
| Convt Debt Subord | @NA | #VALUE! |
| Total Convertible | 3.7 | 0.1% |
| Subordinated Debt | @NA | #VALUE! |
| Notes | @NA | #VALUE! |
| Debentures | @NA | #VALUE! |
| Other - Long Term | @NA | #VALUE! |
| Cap Lease Oblig | @NA | #VALUE! |
| Unamort Debt Disc & Prem | 0 | 0.0% |
| Debt - Mortgage & Secured | @NA | #VALUE! |
| LTD Tied to Prime | @NA | #VALUE! |
| Contingent Liab Guarantees | @NA | #VALUE! |
| Qtrly data as of: | Jun02 | |
| Total Qtrly Debt | 3531.9 | 128.3% |
| Long Term Qtrly Debt | 2752.2 | 100.0% |
| Debt in Current Liabilities | 779.7 | 28.3% |

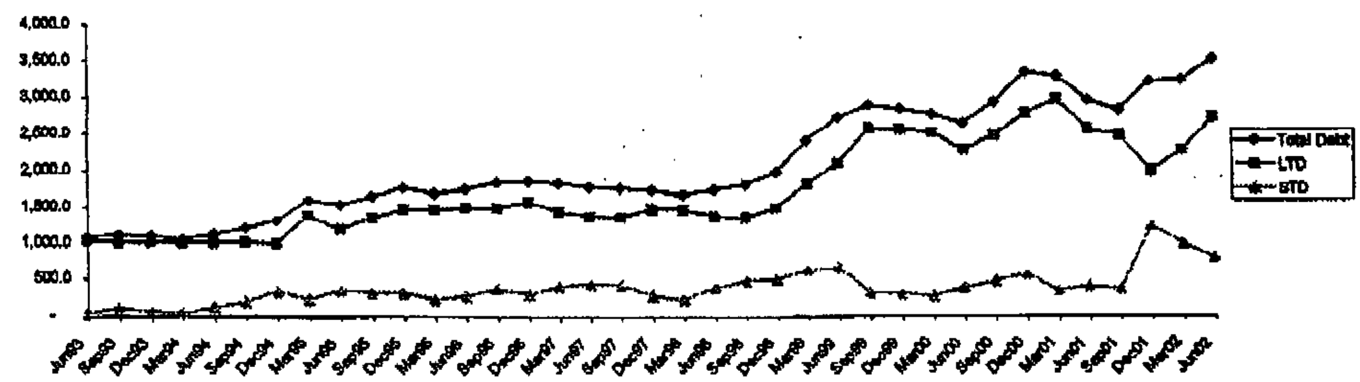
| Officers Names |
|---|
| Richard C Green |
| Chairman |
| Robert K Green |
| President, Chief Executive Officer |
| Leslie J Parrette |
| Senior Vp, General Counsel |
| Dan Streek |
| Chief Financial Officer |

| Qtrly Growth Rates | | |
|---|---|---|
| Revenues | -7.5% | 34.5% |
| Net Income | @NC | @NC |
| Total Debt | 18.5% | 9.1% |
| Curr Debt | 97.0% | 6.8% |
| Shr's Eqty | -6.4% | 16.3% |
| Tot Liab | -9.9% | 21.6% |

| Market Information | |
|---|---|
| Qrtly data as of: | Jun02 |
| Market Capitalization | 1137.5 |
| Dividend Yield | 15.0% |
| Price/Book | 0.5 |
| Shares Outstanding | 142.673 |
| Available for Interest | (628.800) |
| Fixed Chg Cov erage: | |
| Before Tax | (15.667) |
| After Tax | (14.312) |
| LTD/Com Equity | 116.18% |
| LTD/Shrhldr's Eqty | 116.18% |
| LTD/Total Assets | 116.18% |
| STD/LTD | 22.08% |
| LT S&P Issuer Rating | BBB |
| Subord Debt Rating | |
| ST S&P Issuer Rating | Satisfactory (A2) |
| S&P Stock Ranking | Above Average (A-) |

| QUARTERLY | Revenue | Net Income | Interest Expense | Long Term Debt | Current Debt | Total Liabilities to Assets | Debt to Capital | Debt to Shhr's Equity | Curr Debt Tot Debt | YOY Total Debt | YOY Liabilities Growth | Financial Leverage |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Jun00 | 5,760.9 | 29.3 | 49.1 | 2,282.5 | 367.9 | 82.7% | 60.06% | 150.4% | 13.9% | -2.5% | 36.2% | 5.36 |
| Sep00 | 7,998.9 | 74.9 | 44.3 | 2,490.1 | 454.3 | 84.4% | 61.45% | 159.4% | 15.4% | 1.7% | 21.3% | 5.98 |
| Dec00 | 10,606.0 | 48.2 | 47.3 | 2,795.9 | 552.7 | 87.3% | 60.60% | 155.4% | 16.5% | 17.7% | 104.8% | 6.36 |
| Mar01 | 11,980.0 | 73.4 | 55.0 | 2,976.0 | 325.7 | 83.6% | 57.50% | 138.4% | 9.9% | 18.9% | 84.9% | 6.55 |
| Jun01 | 10,441.4 | 143.2 | 50.4 | 2,584.1 | 395.7 | 80.4% | 48.54% | 99.9% | 13.3% | 12.4% | 46.7% | 6.23 |
| Sep01 | 9,315.5 | 69.0 | 46.8 | 2,489.5 | 346.1 | 78.0% | 47.21% | 95.1% | 12.2% | -3.7% | 9.2% | 5.72 |
| Dec01 | 8,639.9 | (6.2) | 42.6 | 1,997.9 | 1,227.7 | 78.6% | 42.44% | 78.3% | 38.1% | -3.7% | -23.7% | 5.07 |
| Mar02 | 8,881.3 | 44.4 | 44.2 | 2,281.0 | 989.2 | 74.0% | 41.67% | 71.6% | 29.8% | -1.8% | -18.4% | 4.51 |
| Jun02 | 9,654.3 | (810.0) | 52.8 | 2,752.2 | 779.7 | 80.2% | 53.70% | 116.2% | 22.1% | 18.5% | -9.8% | 4.46 |
| ANNUAL | | | | | | | | | | | | |
| Dec94 | 1,514.6 | 94.4 | 102.3 | 976.9 | 321.2 | 70.0% | 50.4% | 104.8% | 24.7% | 20.0% | 13.8% | 3.39 |
| Dec95 | 2,798.5 | 79.8 | 113.4 | 1,455.4 | 303.7 | 75.0% | 60.0% | 149.8% | 17.3% | 35.5% | 33.7% | 3.78 |
| Dec96 | 4,332.3 | 105.8 | 126.7 | 1,570.7 | 277.7 | 74.9% | 55.9% | 132.8% | 15.0% | 5.1% | 20.9% | 4.08 |
| Dec97 | 8,826.3 | 122.1 | 128.4 | 1,458.6 | 263.4 | 77.2% | 54.4% | 125.4% | 15.3% | -6.8% | 12.2% | 4.23 |
| Dec98 | 12,563.4 | 132.2 | 123.7 | 1,475.8 | 484.4 | 75.9% | 48.0% | 102.0% | 24.7% | 13.8% | 15.1% | 4.25 |
| Dec99 | 18,621.5 | 160.5 | 170.2 | 2,552.3 | 291.7 | 79.8% | 61.4% | 167.3% | 10.3% | 45.1% | 32.3% | 4.55 |
| Dec00 | 28,974.9 | 206.8 | 184.1 | 2,795.9 | 552.7 | 87.3% | 60.6% | 155.4% | 16.5% | 17.7% | 104.8% | 6.51 |
| Dec01 | 40,376.8 | 279.4 | 194.6 | 1,997.9 | 1,227.7 | 78.6% | 42.4% | 78.3% | 38.1% | -3.7% | -23.7% | 5.99 |

Quarterly Debt Structure



* AQUILA INC
TICKER: ILA
Latest FY: Dec01
CURRENT RATING AS OF 31Aug02
S&P LT ISSUER CREDIT RATING: BBB

**S&P LONG TERM ISSUER CREDIT RATING RATIOS**
Industry Comparisons

Select Industry Comparables by:
GICS Group [Utilities]

* To change company, double click the [illegible]

| Rating | # of Cos. 243 | Long Term Debt % of Total Capital Min | Avg | Max | Pretax Interest Coverage Min | Avg | Max | Cash Flow Interest Coverage Min | Avg | Max |
|---|---|---|---|---|---|---|---|---|---|---|
| AAA | 0 | @NC | @NC | @NC | @NC | @NC | @NC | @NC | @NC | @NC |
| AA | 9 | 17.2 | 37.5 | 50.3 | 2.5 | 4.7 | 7.6 | 3.0 | 5.4 | 9.6 |
| A | 89 | 17.8 | 49.4 | 92.1 | (1.3) | 3.3 | 9.4 | 0.6 | 4.2 | 9.5 |
| BBB | 116 | 12.4 | 52.4 | 80.8 | (5.0) | 2.9 | 8.6 | 0.0 | 3.8 | 9.1 |
| Speculative | 25 | 24.0 | 58.8 | 86.3 | 0.4 | 2.5 | 6.1 | 1.3 | 3.0 | 5.4 |
| In Default | 4 | 28.3 | 56.9 | 97.2 | (0.8) | 2.0 | 3.2 | (0.1) | 2.3 | 3.4 |
| AQUILA INC | | | 42.4 | | | 3.7 | | | 3.8 | |

@NC Not Calculable

| Rating | # of Cos. 243 | Cash Flow % of Long Term Debt Min | Avg | Max | Asset Turnover Min | Avg | Max | Equity Book Value/ Book Value of Liabilities Min | Avg | Max |
|---|---|---|---|---|---|---|---|---|---|---|
| AAA | 0 | @NC | @NC | @NC | @NC | @NC | @NC | @NC | @NC | @NC |
| AA | 9 | 16.9 | 46.8 | 123.2 | 0.4 | 0.7 | 1.0 | 0.4 | 0.5 | 0.8 |
| A | 89 | (2.5) | 26.6 | 82.2 | 0.2 | 0.5 | 1.4 | 0.0 | 0.5 | 1.4 |
| BBB | 116 | (5.6) | 23.9 | 92.3 | 0.1 | 0.6 | 3.1 | 0.1 | 0.4 | 1.1 |
| Speculative | 25 | 2.5 | 17.7 | 65.2 | 0.2 | 0.5 | 1.8 | 0.1 | 0.4 | 1.1 |
| In Default | 4 | (9.0) | 22.2 | 40.1 | 0.3 | 0.9 | 2.0 | 0.0 | 0.4 | 1.1 |
| AQUILA INC | | | 27.6 | | | 3.1 | | | 0.3 | |

| Rating | # of Cos. 243 | Return on Total Capital % Min | Avg | Max | Operating Income % of Sales Min | Avg | Max | Total Liabilities % of Tangible Net Worth Min | Avg | Max |
|---|---|---|---|---|---|---|---|---|---|---|
| AAA | 0 | @NC | @NC | @NC | @NC | @NC | @NC | @NC | @NC | @NC |
| AA | 9 | 3.7 | 7.6 | 12.2 | 8.0 | 17.2 | 25.2 | 127.2 | 213.6 | 424.2 |
| A | 89 | (9.7) | 5.2 | 12.0 | 5.8 | 24.9 | 64.4 | (47,823.9) | (191.1) | 8,222.6 |
| BBB | 116 | (34.3) | 4.5 | 14.6 | (12.7) | 23.0 | 95.5 | (7,679.9) | 186.4 | 3,707.4 |
| Speculative | 25 | (3.2) | 4.6 | 29.2 | 2.9 | 30.2 | 77.7 | (312.9) | 465.6 | 1,350.7 |
| In Default | 4 | (14.0) | 2.3 | 13.6 | 2.8 | 19.0 | 32.3 | (26,336.3) | (6,166.8) | 891.6 |
| AQUILA INC | | | 5.9 | | | 1.7 | | | 348.3 | |

**AQUILA INC filed this 10-Q on 08/14/2002.**

owers. As of August 12, 2002, our senior unsecured long-term debt ratings, as assessed by the three major credit ıg agencies, were as follows:

| Agency | Rating | Levels above non-investment grade |
|---|---|---|
| Standard & Poor's Corporation (S&P) | BBB | Two |
| Fitch Ratings (Fitch) | BBB- | One |
| Moody's Investor Service (Moody's) | Baa3 | One |

Our credit ratings were placed under review for possible downgrade by S&P on April 23, 2002, and by Moody's Aay 30, 2002. The reasons given by the ratings agencies included our announced acquisition of Cogentrix Energy, ; associated with our foreign investments, concerns that we lacked the financial resources to support our energy ng operations and an analysis of our operations under more stringent credit metrics. Since that time we have taken ollowing actions:

- Terminated the Cogentrix acquisition;
- Reduced our dividend by 42%;
- Exited from wholesale energy trading;
- Targeted over $1 billion in asset sales in which we have signed sale agreements totaling $218 million and publicly announced bid processes for the sale of our investments in UNL and Midlands. In addition, we have active bid processes for a number of other assets;
- Completed equity and debt offerings totaling $764 million in proceeds;
- Targeted over $100 million in cost reductions, the majority of which have already been achieved.

Our management is currently in discussions with representatives of Moody's, S&P and Fitch. However, we cannot ict the actions, if any, that may be taken by the credit rating agencies subsequent to these meetings.

*ngs Triggers*

Our credit agreements, debt instruments and other financial obligations provide that the occurrence of certain ts could (if not cured) require early payment, additional collateral support or similar actions. These events include ailure to achieve leverage ratios, insolvency events, defaults on scheduled principal or interest payments, leration of other financial obligations and a change of control. We are currently in compliance with covenants or r provisions relating to these events. We do not have any trigger events tied to our stock price and have not uted any transactions that require us to issue equity based on our credit ratings or other trigger events.

Certain of our subsidiaries have trigger events tied to specified credit ratings. Because of guarantee and cross ılt provisions between Aquila, Inc. and these subsidiaries, the ratings triggers of our subsidiaries discussed below ld be viewed as if they are directly applicable to Aquila, Inc. Our Australian subsidiaries have issued six series of ralian denominated bonds, guaranteed by us, that contain provisions that could require us to repurchase the bonds. put right for two series aggregating approximately $85 million can be exercised 30 days after a downgrade to non-stment grade by either S&P or Moody's. Those series mature in October 2002. The put right for the other four s aggregating approximately $92 million can be exercised on the next scheduled interest payment date if we are . below investment grade by S&P.

Our Merchant Services subsidiary also has three "tolling agreements," a construction loan and certain margining ements that have trigger events tied to Aquila's credit ratings. Under the tolling agreements, our subsidiary uses a a party's generation assets to convert fuel into electric power for its subsequent resale. The maximum aggregate ount of collateral that it could be required to post in the event of a ratings trigger under these contracts is roximately $172 million. Of this amount, $45 million must be posted within 10 days of a downgrade below estment grade by either Moody's

&P; $37 million must be posted within 70 days of the date we are rated below investment grade by both Moody's S&P; and $28 million under the construction loan must be posted within 10 business days of a downgrade below stment grade by both S&P and Moody's. We expect the trigger under the construction loan will terminate upon the pletion of construction and permanent project financing in late September 2002. We also have certain standard gining agreements that would require collateral of $62 million if we were downgraded below investment grade. se potential collateral requirements are expected to decline as we exit the wholesale energy trading business over iext two months.

*er Potential Demands for Collateral*

Although we are in the process of exiting the energy trading operations of our Merchant Services subsidiary, a tantial number of energy trading agreements remain to be settled. The majority of these contracts will be settled in the next two months. These contracts typically include provisions which allow counterparties the right to request tional collateral or suspend or terminate credit if events occur that cause counterparties to feel that there has been a rioration in our underlying credit. In connection with our exit from the wholesale energy trading business, we have tified key commercial relationships that will be important to our ongoing business. If a downgrade were to occur, e relationship companies could potentially demand collateral support for ongoing and future activity. While it is cult to predict how many parties would successfully demand some form of collateral, we currently estimate that the unt of cash collateral would be no more than $135 million. We expect that potential claims on liquidity will be ier reduced as we exit our wholesale energy trading business over the next two months.

*ıl Proceeding*

On February 19, 2002, we filed a suit against Chubb Insurance Group, the issuer of surety bonds in support of iin of our long-term gas supply contracts. Previously, Chubb had demanded that it be released from its up to ı million surety obligation or, alternatively, that we post collateral to secure its obligation. We do not believe that bb is entitled to be released from its surety obligations or that we are obligated to post collateral to secure its gations unless it is likely we will default on the contracts. Chubb has not alleged that we are likely to default on the racts. If Chubb were to prevail, it would have a material adverse impact on our liquidity and financial position. We : performed under the contracts since their inception and believe we will be able to continue to perform on the racts and that we will prevail in the action. We rely on other suretys in support of long-term gas supply contracts lar to those described above. There can be no assurance that these suretys will not make claims similar to those :d by Chubb.

**ıcome Taxes**

The second quarter 2002 income tax benefit was reduced primarily as a result of two factors. First, the tax benefit ı the $692.9 million pre-tax write-down of our investment in Quanta Services is limited to available capital gains in receding three years and subsequent five years. Because capital gains within the carryback period were less than oss and significant capital gains could not be assured in the foreseeable future, a $201 million valuation allowance established. Second, the $178.6 million impairment charge related to Wholesale Services goodwill is considered a ıanent difference between book and taxable income and does not result in the recognition of a tax benefit. These stments have had a significant impact on the 2002 effective tax rate for both the quarter and six months ended 30, 2002.

**Reduction of Dividend**

On June 17, 2002, we announced that, going forward, our Board of Directors expected to reduce the quarterly lend to $.175 per share, or $.70 per share annually, down from the prior quarterly dividend of $.30 per share, or 0 per share annually. This decision was made in connection with our decision to scale back the wholesale energy ng business and was influenced by, among other things, decreased earnings, a substantial increase in the number of anding shares, and the Company's credit concerns. On August 7, 2002, our Board of Directors declared a dividend 175 per share. The record date for the dividend is August 22, 2002, and the dividend is payable on September 12, !.

# State of Minnesota
## DEPARTMENT OF COMMERCE

**Utility Information Request**

Docket Number: G007,011/CI-02-1369 Date of Request: October 4, 2002

Requested From: Aquila, Inc. Response Due: October 10, 2002

Analyst Requesting Information: Marcus Gross

| Type of Inquiry: | | | |
|---|---|---|---|
| | [ ]___Financial | [ ]___Rate of Return | [ ]___Rate Design |
| | [ ]___Engineering | [ ]___Forecasting | [ ]___Conservation |
| | [ ]___Cost of Service | [ ]___CIP | [ ]___Other: |

***If you feel your responses are trade secret or privileged, please indicate this on your response.***

| Request No. | |
|---|---|
| 8 | Please reconcile the information on page 18 of Aquila's August 14, 2002, 10-Q filing ("Ratings Triggers") with the Company's response to Commission Staff's Information Request No. 1.D. filed on September 18 where the Company states, "The debt of these operating companies is not guaranteed by Aquila and does not cross-default to Aquila." |

**Response:**

The debt referenced on page 18 of our 10-Q refers to Australian debt Aquila guarantees and consolidates onto its financial statements. The proceeds from these debt offerings were used to fund Aquila's "equity investments" into the underlying utility operating companies (i.e., Alinta Gas, United Energy, and EPG/Multinet). Equity distributions from these utility operating companies is used to service and repay Aquila's debt borrowed in the local currencies. The debt of the utility operating companies is not supported by Aquila or consolidated on its financial statements. The statements in the 10-Q and our earlier response are not inconsistent.

Response by: ____________________ List sources of information:

Title: ____________________ ____________________

Department: ____________________ ____________________

Telephone:

STATE OF MINNESOTA )
) ss
COUNTY OF RAMSEY )

## AFFIDAVIT OF SERVICE

I, **Kathy Aslakson**, being first duly sworn, deposes and says: than on the **22nd** day of **October, 2002**, served the attached **Minnesota Department of Commerce Comments**

**DOCKET NUMBER: G007,011/CI-02-1369**

XX by depositing in the United States Mail at the City of St. Paul, a true and correct copy thereof, properly enveloped with postage prepaid
XX by personal service (MN PUC)
by express mail
by delivery service

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

see attached service list

Kathy Aslakson

Subscribed and sworn to before me

this 22nd day of October, 2002

KAREN L. BANTORI
NOTARY PUBLIC - MINNESOTA
MY COMMISSION EXPIRES
JANUARY 31, 2005

(WED)11. 6.02 10:11/ST. 9:54/NO. 3760327492 P 39

G007,011/CI-02-1369

In the Matter of Peoples Natural Gas
and NMU Inquiry into Possible effects
of Financial Difficulties at Aquila,
1 Service List

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In the Matter of Peoples Natural Gas
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MICHAEL J. BRADLEY
612.347.0337
BradleyM@moss-barnett.com

November 1, 2002

***HAND DELIVERED***

Dr. Burl Haar
Executive Secretary
MN Public Utilities Commission
121 Seventh Place E, Suite 350
St. Paul, MN 55101

RE: *In the Matter of an Inquiry Into Possible Effects of the Financial Difficulties at Aquila, Inc. on Peoples Natural Gas Company and Northern Minnesota Utilities Company and their Customers*
MPUC Docket No. G-007,011/CI-02-1369

Dear Dr. Haar:

Enclosed for filing in your office please find the original plus 15 copies of the Aquila Reply Comments in the above-referenced docket, together with an Affidavit of Service.

Please contact the undersigned if further information is needed.

Very truly yours,

MOSS & BARNETT
A Professional Association

Michael J. Bradley

MJB/krm
Enclosures
cc: Service List
534983/1

## AFFIDAVIT OF SERVICE

STATE OF MINNESOTA )
) ss
COUNTY OF HENNEPIN )

In the Matter of an Inquiry Into Possible Effects of the Financial Difficulties at Aquila, Inc. on Peoples Natural Gas Company and Northern Minnesota Utilities Company and their Customers

MPUC Docket No.: G-007,011/CI-02-1369

Kim R. Manney, being first duly sworn on oath, deposes and states that on the 1st day of November, 2002, copies of Aquila Reply Comments in the above referenced matter, were hand delivered or mailed by United States first class mail, postage prepaid thereon, to the following:

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Kansas City, MO 64105

Kim R. Manney
Kim R. Manney

SWORN TO BEFORE ME this
1st day of November, 2002.

NOTARY PUBLIC

CYNTHIA KAY ANDERSON
Notary Public
Minnesota
My Commission Expires Jan. 31, 2005

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