BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MISSOURI

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

Staff's Suggestions in Support of Stipulation and Agreement

COMES NOW the Staff of the Missouri Public Service Commission ("Staff") and for its Suggestions in Support of the Stipulation and Agreement filed in this case on July 18, 2005 states:

1. Kansas City Power & Light Company, with other parties including the Staff, presented an experimental regulatory plan to the Commission in Case No. EO-2005-0329 for construction of a new coal-fired electric generation unit at its existing Iatan site and environmental upgrades to its existing coal-fired electric generation unit located at its Iatan site. These units are referred to as Iatan Unit 1 and Iatan Unit 2, the existing unit and the planned unit, respectively.

2. Aquila participates in ownership of Iatan Unit 1 as an eighteen percent (18%) owner. The Empire Electric District participates in ownership of Iatan Unit 1 as twelve percent (12%) owner. Kansas City Power & Light Company owns the remainder of Iatan 1. As part of

its experimental regulatory plan Kansas City Power & Light Company agreed that Aquila and Empire were preferred partners for ownership of thirty percent (30%) of Iatan Unit 2.

3. Aquila filed its application on March 2, 2005 seeking approval of a regulatory plan that would allow Aquila to participate in ownership of Iatan Unit 2. Originally Aquila proposed a plan similar to the experimental regulatory plan the parties in Case No. EO-2005-0329 developed for construction of Iatan Unit 2 by Kansas City Power & Light Company.

4. Aquila's need for additional electric power generation that provides electricity continuously (base load capacity) and its desire to participate in ownership of Iatan Unit 2 are the driving forces behind its application in this case. Based on projected load growth in the service areas of both Aquila Network-MPS and Aquila Networks-L&P Aquila needs additional generation to meet its Missouri customers' power needs. Iatan Unit 2 is planned to begin supplying such power in 2010. Aquila, like the other utilities in western Missouri has not added any base-load capacity since the late 1980s

5. In the integrated resource planning presentations Aquila has made to Staff and the Office of the Public Counsel over the past two years and in the detailed resource plan it filed in April 2005, Aquila has acknowledged a need for additional base-load capacity in the 2010 time period While resource planning is not an explicit requirement of this Stipulation and Agreement as it has been in the Kansas City Power & Light Company and The Empire District Electric Company regulatory plans, it is the Staff's intention to continue discussions with Aquila regarding its resource plan and its resource planning process. In addition, as part of the Stipulation and Agreement approved by the Commission in Aquila's last general electric rate increase case, Case No. ER-2004-0034, Aquila agreed to make integrated resource planning

presentations to the Staff and others and to file detailed resource plans every two years. This corresponds with the expiration of Aquila's waiver from the requirements of the Commission's Chapter 22 Rule that requires Aquila to begin making filings regarding its resource plans pursuant to that chapter in early 2007.

6. In the Stipulation and Agreement in this case Aquila agrees that the signatories to the Stipulation and Agreement relied on information provided to them by Aquila in entering into the Stipulation and Agreement and that, if the Commission finds: (1) Aquila failed to provide them with material and relevant information in its possession or which should have been available to Aquila through reasonable investigation; or (2) Aquila misrepresented facts relevant to the Stipulation and Agreement, then the Stipulation and Agreement shall be terminated.

7. The parties in this case held numerous meetings regarding Aquila's proposed regulatory plan. As a result of those meetings Aquila twice amended its plan fundamentally changing and limiting it so that now the plan is for authorization to encumber the electric property of its MPS operating division—Aquila Networks-MPS—as security for a $300 million senior secured multi-draw term loan ("facility") it states is needed for Aquila to participate in Iatan Unit 2 at an ownership level of not less than 100 MW and in Iatan Unit 1 air pollution upgrades. In the Stipulation and Agreement Aquila agrees to participate at an ownership level of about 140 MW of the planned 800-900 MW generation capacity of Iatan Unit 2 (about 15.6%-to 17.5% ownership), as generation subject to regulation by this Commission.

8. The authority Aquila is seeking now is limited to encumber the assets held by its MPS division for purposes of a construction facility for Iatan 2 and environmental upgrades to Iatan 1. The facility has a term of five years; thus, when the facility expires near the time construction is complete, MPS division assets will no longer be encumbered by the facility. The

funds borrowed from this facility will refinanced through future financings likely to be brought to the Commission for approval or repaid from corporate cash proceeds generated from the sale of Aquila's Iatan assets.

9. Not all of the parties in this case are signatories to the Stipulation and Agreement that is before the Commission in this case.

10. Commission Rule 4 CSR 240-2.115 provides that parties in a contested case have seven days from the date a stipulation and agreement is filed to object to the agreement. In this case the signatories to the Stipulation and Agreement are Aquila, Inc., Staff, the Office of the Public Counsel, and Sedalia Industrial Energy Users' Association. The parties in this case who did not sign the Stipulation and Agreement are Kansas City Power & Light Company, The Empire District Electric Company, Union Electric Company and the Missouri Department of Natural Resources. Each of the parties who did not sign the Stipulation and Agreement filed on July 19, 2005 pleadings indicating their non-opposition to the Stipulation and Agreement. Consequently, under Commission Rule 4 CSR 240-2.115(2), the Stipulation and Agreement filed in this case may be treated by the Commission as if it is a unanimous stipulation and agreement.

11. Although Aquila failed to reference section 393.190.1, RSMo 2000 in its applications filed in this case, Aquila requests in each application that the Commission authorize it to encumber the electric property of its MPS operating division as security for the financing arrangements it states are needed for Aquila to participate in Iatan Unit 2 at an ownership level of not less than 100 MW and in Iatan Unit 1 air pollution upgrades. As finally amended, Aquila's application is limited to a request for such relief and ancillary authorizations.

12. Section 393.190.1 RSMo 2000 provides:

> No gas corporation, electrical corporation, water corporation or sewer corporation shall hereafter sell, assign, lease, transfer, mortgage or otherwise dispose of or

> encumber the whole or any part of its franchise, works or system, necessary or useful in the performance of its duties to the public, nor by any means, direct or indirect, merge or consolidate such works or system, or franchises, or any part thereof, with any other corporation, person or public utility, without having first secured from the commission an order authorizing it so to do. Every such sale, assignment, lease, transfer, mortgage, disposition, encumbrance, merger or consolidation made other than in accordance with the order of the commission authorizing same shall be void. The permission and approval of the commission to the exercise of a franchise or permit under this chapter, or the sale, assignment, lease, transfer, mortgage or other disposition or encumbrance of a franchise or permit under this section shall not be construed to revive or validate any lapsed or invalid franchise or permit, or to enlarge or add to the powers or privileges contained in the grant of any franchise or permit, or to waive any forfeiture. Any person seeking any order under this subsection authorizing the sale, assignment, lease, transfer, merger, consolidation or other disposition, direct or indirect, of any gas corporation, electrical corporation, water corporation, or sewer corporation, shall, at the time of application for any such order, file with the commission a statement, in such form, manner and detail as the commission shall require, as to what, if any, impact such sale, assignment, lease, transfer, merger, consolidation, or other disposition will have on the tax revenues of the political subdivisions in which any structures, facilities or equipment of the corporations involved in such disposition are located. The commission shall send a copy of all information obtained by it as to what, if any, impact such sale, assignment, lease, transfer, merger, consolidation or other disposition will have on the tax revenues of various political subdivisions to the county clerk of each county in which any portion of a political subdivision which will be affected by such disposition is located. Nothing in this subsection contained shall be construed to prevent the sale, assignment, lease or other disposition by any corporation, person or public utility of a class designated in this subsection of property which is not necessary or useful in the performance of its duties to the public, and any sale of its property by such corporation, person or public utility shall be conclusively presumed to have been of property which is not useful or necessary in the performance of its duties to the public, as to any purchaser of such property in good faith for value.

13. Section 393.190 RSMo 2000 does not expressly provide a standard of review; however, in its Report and Order issued February 24, 2004 in the case *In the Matter of the Application of Aquila, Inc. for Authority to Assign, Transfer, Mortgage or Encumber Its Utility Franchise, Works or System in Order to Secure Revised Bank Financing Arrangements*, Case No. EF-2003-0465, the Commission stated, at page six, "The Commission has already concluded that it should approve Aquila's request if doing so would not be detrimental to the public

interest.[1]" (footnote 10 in original) The Commission, on page six of the Report and Order, further stated, "The Commission concludes a detriment to the public interest includes a risk of harm to ratepayers." And in the context of that case the Commission concluded on page seven of the Report and Order, "The detriment to the public interest is the unreasonable risk of harm to Missouri ratepayers compared to the minimal benefit Aquila would receive."

14. While the facts in Case No. EF-2003-0465 differ from those presented here, the following analysis from pages seven through nine of the Report and Order in that case is instructive:

> The unreasonable risk of harm includes the possibility that Missouri's regulated assets alone would support Aquila's $430 million dollar loan. That loan includes money for Aquila's non-regulated businesses. Aquila's Missouri ratepayers alone might shoulder the burden of Aquila's financial difficulty, including a potential default on the note, or even bankruptcy. That burden could include a loss of service, since the loan agreement arguably allows the creditor to bypass the Commission, and immediately foreclose upon and sell the assets. In contrast, Aquila would receive little, if any, benefit. That is because other states have already allowed Aquila to pledge enough regulated assets to meet the collateral ratio in the term loan agreement, and to receive the 75 basis point reduction.
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> The public would also suffer a detriment because the pledge would over-collateralize the loan. Aquila intends to sell its unregulated assets. Once the loan is over-collateralized, and Aquila sells an unregulated asset, then Aquila has two choices: either use the proceeds to pay down the $430 million loan, or use it for another purpose.
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> If Aquila uses the funds to pay down the loan, which it has committed to do if Aquila does not have enough unregulated assets in the collateral pool,[2] (footnote 14 in original) then Aquila would have to pay a Make Whole Premium.[3] (footnote 15 in original) The Make Whole Premium ensures that the lender will receive the full value of all expected future interest and principal payments.[4](footnote 16 in original) Over-collateralization, therefore, would result in Aquila paying more to its creditors than it would have to pay if it did not over-

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[1] See *Order Denying Motion for Summary Disposition* (issued October 9, 2003)(Gaw, C., concurring).

[2] See *Dobson Cross-examination, Tr. 371,* l. 1-9.

[3] See *Burdette Rebuttal*, *Ex. 31*, pp. 16-20.

[4] See *Id.* at 19, see also *Ex. 4*, Sch. RD-9, pp. 14-15, 35.

> collateralize the loan. If the creditors receive more money, then that leaves less money for an already financially unstable Aquila. Thus, if Aquila fulfills its promise to pay down the loan, then paying down the loan would be detrimental to the public interest.
>
> On the other hand, if Aquila uses the sale proceeds in another manner, then regulated assets would replace the unregulated assets in the collateral pool. Those regulated assets would support debt Aquila incurred for its unregulated activities. But Aquila's unregulated activities are the source of its financial peril.[5] The Commission finds that Missouri ratepayers would suffer a detriment if Aquila used its Missouri regulated assets to support debt for its riskier, unregulated operations.

15. As indicated in the preceding paragraph, the facts here differ from those that were before the Commission in Case No. EF-2003-0465. In Case No. EF-2003-0465 Aquila sought authority to encumber its Missouri assets as security for financing to fund general working capital needs of the entire company which at the time had both multi-state, multi-national and nonregulated operations. In contrast, although Aquila still has multi-state operations with a few remaining nonregulated operations, with the Stipulation and Agreement the funds Aquila will receive from the facility that would encumber the assets of its MPS division will be restricted exclusively to payment of construction costs of Iatan Unit 2 and environmental upgrades to Iatan Unit 1. Electricity generated by those units is and will be used to serve Aquila's Missouri regulated utility customers. The Stipulation and Agreement preserves the rights of the parties to present to the Commission their views regarding the assignment of costs and benefits between Aquila's current electric operations in the L&P Division versus the MPS Division.

16. Kansas City Power & Light Company, the majority owner of both Iatan Unit 1 and Iatan Unit 2, will manage and oversee the construction of Iatan Unit 2 and the environmental upgrades to Iatan Unit 1. Kansas City Power & Light Company will invoice Aquila for Aquila's share of the costs that are incurred in constructing Iatan Unit 1 and the environmental upgrades

to Iatan Unit 1. Aquila has agreed to provide copies of all such invoices to both the Staff and the Office of the Public Counsel.

17. In the Stipulation and Agreement Aquila agrees that, if an invoice from Kansas City Power & Light Company exceeds the facility draw minimum of $10 million, payment of the invoice will be made by the lender directly to Kansas City Power & Light Company. If the invoice is less than $10 million, then Aquila will pay the invoice and when the aggregate of its payments reaches $10 million it will then seek reimbursement of the payments it has made to Kansas City Power & Light Company through a draw on the facility. Before Aquila may obtain such reimbursement it must seek verification by the Staff and the Office of the Public Counsel that the aggregate of those payments to Kansas City Power & Light Company exceed the facility draw minimum of $10 million and the Kansas City Power & Light invoices show the Aquila payments were made for construction of environmental upgrades to Iatan Unit 1 or construction of Iatan Unit 2. In the event of a dispute, the Commission will resolve the dispute.

18. That part of the Stipulation and Agreement which requires Aquila to draw on the facility only by either a direct payment to Kansas City Power & Light Company for invoices $10 million or more and to Aquila as reimbursement for amounts it pays to Kansas City Power & Light Company for invoices below $10 million was established to ensure that all monies from the facility are spent only on the construction of Iatan Unit 2 and environmental upgrades to Iatan Unit 1. This process ensures that no monies from the facility will be diverted by Aquila to other purposes. The Staff will provide an oversight role in the release of monies from the facility as a safeguard that funds from the facility are used only for the construction of Iatan Unit 2 and environmental upgrades to Iatan Unit 1.

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[5] See *Dobson Direct, Ex. 4,* pp. 2-8.

19. Staff has analyzed the possible financial impact that the facility will have on Aquila's ability to attract additional funds at a reasonable cost. Because the majority of the funds needed for capital investments associated with Iatan Unit 1 and Iatan Unit 2 will not be drawn until 2007 and beyond, it is difficult to project the magnitude of the impact that such additional capital expenditures will have on Aquila's credit quality. It is the nearer term events such as the impact of the legal issues with Aquila's South Harper generation facilities near Peculiar, Missouri and the success, or lack thereof, of Aquila's current divestiture activities that will have the most impact on Aquila's credit quality. The impact of the capital expenditure needs for Iatan Unit 2 and Iatan Unit 1 on Aquila's creditworthiness are already considered in Aquila's current rating with the majority of the expenditures for these projects incurred in time periods beyond those considered by analysts.

20. The Staff contacted Standard & Poor's (S&P) on July 20, 2005 to inquire whether S&P had concerns with Aquila's required capital expenditures for construction of Iatan Unit 2 and environmental upgrades to Iatan Unit 1. S&P indicated that it is not giving much, if any, weight to Aquila's pro forma financial statements past 2007. Consequently, Aquila's announcement of its participation in construction of Iatan Unit 2 and environmental upgrades to Iatan Unit 1 has not had an impact on Aquila's current non-investment grade S&P credit rating of B-. However, S&P indicated that it does consider Aquila's proposed use of the funds to invest in coal based generation as a positive step for Aquila.

21. According to the pro forma financial statements Aquila submitted with its Application, Aquila would meet the minimum ratio covenants contained in the terms and conditions of the facility. The three ratios that are contained in the covenants of the terms and conditions that were submitted with the Second Amended Application are EBITDA (Earnings

Before Interest, Taxes, Depreciation and Amortization) interest coverage, debt to EBITDA and debt to total capitalization. Each of these ratios becomes more restrictive with the passage of time. The minimum ratios required are shown on page five (5) of the terms and conditions attached to the Second Amended Application. Although S&P doesn't publish financial ratios for a B credit rating, it appears that the funds from operations (FFO) interest coverage ratios and the FFO/total debt ratio are consistent with a B credit rating based on Aquila's pro forma financial statements submitted with its Application. Assuming Aquila's divestiture of some of its utility properties are consistent with the assumptions shown in its pro forma financial statements, then Aquila's total debt to total capitalization ratio would be consistent with the benchmarks for a BB credit rating. However, this will not occur until 2007. Aquila's future creditworthiness is highly dependent on events other than its expenditures on the Iatan Project. [6]

22. In the Stipulation and Agreement Aquila agrees that the terms of the Stipulation and Agreement will bind any Aquila affiliate, successor or assignee. Aquila also agrees that if it sells any portion of its interest in Iatan Unit 1 or Iatan Unit 2, it will require any purchaser to assume Aquila's liabilities and future financial obligations associated with the interest being sold. Further, Aquila agrees that a proportionate level of expenditures made by Aquila in connection with environmental upgrades to Iatan Unit 1 or construction of Iatan Unit 2 will be included in the purchase price of any interest in Iatan Unit 1 or Iatan Unit 2, respectively; and, therefore, Aquila agrees that Commission required approval of any such sale will be conditioned upon Aquila demonstrating that it has made payment to the Agent Bank for the facility of that amount of the sale proceeds imputed or assumed as reimbursement for Iatan Unit 1 air pollution

[6] Aquila estimates a drawdown in 2006 of $18 million for Iatan 2 and $25 million for Iatan 1. Aquila estimates a drawdown in 2007 of $82 million for Iatan 2 and $25 million for Iatan 1. The rest of the expenditures will occur thereafter until completion of the entire project.

upgrades or Iatan Unit 2 construction costs as determined by the Commission in the sale approval proceeding.

23. Aquila also agrees that signatories to the Stipulation and Agreement have raised the following issues that may arise in future cases and that by signing the Stipulation and Agreement no signatory to the Stipulation and Agreement has conceded that Aquila was prudent, reasonable and "created no detriment to its Missouri electric operations in 1) the acquisition of 140 MW of the Iatan Unit 2 plant 2) the commitment to make its Iatan Unit 1 common facilities investment available to other entities or 3) the assignment of all of Iatan Unit 2 capacity to its MPS Division."

24. Aquila agrees as part of the Stipulation and Agreement that it will not seek to avoid any disallowance of an Iatan Unit 1 or Iatan Unit 2 cost on the ground that such cost was the responsibility of Kansas City Power & Light Company and was not within Aquila's control.

25. The signatories to the Stipulation and Agreement expressly agree that the Stipulation and Agreement "does not constitute any rate making determination or commitment on behalf of the signatory Parties" and that it "does not bar any signatory party from contending in a future rate proceeding that Aquila's commitment to a participation level in Iatan Unit 2 of approximately 140 MW was insufficient."

26. The signatories to the Stipulation and Agreement have agreed to not assert that further Commission authorization is required regarding Aquila's participation in the siting of Iatan Unit 2 beyond that Aquila obtained when it acquired St. Joseph Light & Power Company and Aquila's existing certificates of convenience and necessity.

27. The Stipulation and Agreement includes a provision which expressly states that the signatories to the agreement have not "approved or acquiesced in any question of

Commission authority, accounting authority order principle, cost of capital methodology, capital structure, decommissioning methodology, ratemaking principle, valuation methodology, cost of service methodology or determination, depreciation principle or method, rate design methodology, cost allocation, cost recovery, or prudence that may underlie this Agreement, or for which provision is made in this Agreement."

28. Further, the Stipulation and Agreement includes the following disclaimers:

- This Agreement shall not be construed as fulfilling any requirements for environmental permits necessary for construction or operation of the infrastructure investments delineated in this Agreement.
- Nothing in this Agreement shall be construed to limit the ability of any party to assert that the appropriate amount of these investments to include in Aquila's rate base or in its cost of service is an amount different than that proposed by Aquila.
- This Agreement shall not be construed to have precedential impact in any other Commission proceeding.

29. Significantly, the Stipulation and Agreement provides that unless approved without condition or modification the Stipulation and Agreement is void, and that the Stipulation and Agreement is only effective if approved by the Commission.

30. Based on the benefit to future Missouri customers from regulated utility ownership of Iatan Unit 1 and Iatan Unit 2 serving the Aquila Networks-MPS and Aquila Networks-L&P service areas in light of the protections set out in the Stipulation and Agreement, the Staff believes approving the Stipulation and Agreement and allowing Aquila to encumber the assets of its MPS operating division is not detrimental to the public interest.

WHEREFORE, the Staff submits to the Commission the foregoing Suggestions in Support of the Stipulation and Agreement filed in this case July 18, 2005.

Respectfully submitted,

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Certificate of Service

I hereby certify that copies of the foregoing have been mailed, hand-delivered, transmitted by facsimile or emailed to all counsel of record this 29th day of July 2005.

/s/ Nathan Williams