

Exhibit No.: 035
Issues: Cost of Debt
Witness: Richard J. Winterman
Sponsoring Party: Aquila Networks-MPS
& L&P
Case No.: ER-2007-0004

Before the Public Service Commission
of the State of Missouri

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Missouri Public
Service Commission

Rebuttal Testimony

of

Richard J. Winterman

Aquila Exhibit No. 35
Case No(s). ER-2007-0004
Date 4-12-07 Rptr *5

**BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
REBUTTAL TESTIMONY OF RICHARD J. WINTERMAN
ON BEHALF OF AQUILA, INC.
D/B/A AQUILA NETWORKS-MPS AND AQUILA NETWORKS-L&P
CASE NO. ER-2007-0004**

1 Q. Please state your name and business address.

2 A. Richard J. Winterman, 20 West 9th Street, Kansas City, Missouri.

3 Q. Who is your employer and what is your title?

4 A. I am Senior Manager, Financial Analysis for Aquila, Inc. ("Aquila" or "Company").

5 Q. What is your educational and professional background?

6 A. I graduated from Kansas State University with a B.S. in Business Administration and

7 Accounting in 1984. I have worked as an auditor for the former Arthur Andersen &

8 Company, receiving my Certified Public Accountant license in Missouri in 1987.

9 Subsequently, I have worked in various accounting and financial positions with both

10 public and private companies. I have been employed by Aquila for the past twelve years

11 in various accounting and financial management positions.

12 Q. What is the purpose of your rebuttal testimony?

13 A. The purpose of my rebuttal testimony is to respond to the cost of debt recommendations

14 of Federal Executive Agencies/Sedalia Industrial Energy Users' Association/St. Joe

15 Industrial Group ("FEA/Industrials") witness Michael Gorman. Additionally, I will

16 introduce an updated cost of debt schedule (Schedule RJW-1) as of December 2006.

17 Q. What changes occurred during 2006 to the long-term debt assigned to MPS and L&P?

1 A. During 2006, specific maturities of long-term debt assigned to MPS and L&P were
2 tendered early and retired at maturity. In accordance with Aquila's capital structure
3 assignment policy, reviews were performed of MPS' and L&P's capital structures to
4 determine whether to refinance/reassign this debt. In both cases, this debt was refinanced
5 with other Aquila long-term debt. Additionally, both MPS and L&P required additional
6 assignments of long-term debt to maintain their target capital structures.

7 Q. What impact did these changes have on MPS' and L&P's weighted average cost of debt?

8 A. MPS' cost of debt declined from 6.726% in the original filing to 6.668%, as reflected in
9 Schedule RJW-1. L&P's cost of debt declined from 7.947% to 7.698%.

10 Q. How do you respond to Mr. Gorman's adjustment to Aquila's estimated embedded cost
11 of debt for MPS and L&P?

12 A. First, I will address Mr. Gorman's adjustments to MPS. I disagree with his adjustment to
13 reflect the retirement of debt due in 2007, as this is outside of the test year and true-up
14 period for this case. I also disagree with his repricing of the 2006 maturity at a rate of
15 6.3%, using only 18 basis points to reflect issuance expenses. Refinancing a relatively
16 small issue of \$50-60 million could not likely be done in the capital markets as a public
17 offering, but would rather need to be a more expensive private placement. Further,
18 Aquila's experience with small issues suggests that 28-42 basis points would need to be
19 added to the stated interest rate to appropriately reflect issuance expenses.

20 Q. Does Mr. Gorman recommend a specific adjustment to L&P's cost of debt?

21 A. No, though Mr. Gorman eventually, on page 16 of his testimony, recommends using MPS'
22 embedded cost of debt since it is lower than L&P's.

23 Q. Do you agree with Mr. Gorman's arguments and eventual recommendation?

1 A. No. Mr. Gorman begins his argument by concluding that since L&P's embedded cost of
2 debt appears to be higher than other Missouri utilities that it must have been negatively
3 impacted by Aquila's financial distress recently.

4 Q. What has been the impact to L&P's cost of debt in the six years since Aquila acquired
5 L&P in December 2000?

6 A. L&P's weighted average cost of debt for the specific long-term debt that Aquila assumed
7 in the purchase transaction was 8.415%, as shown in Schedule RJW-2. Since that time,
8 L&P's cost of debt has been reduced by 0.717% to an average of 7.698%. Additionally,
9 since all of L&P's debt was fixed rate without any step-up or step-down provisions, there
10 have been no increases to those rates as a result of Aquila's credit rating downgrades.

11 Q. Please continue.

12 A. Mr. Gorman further asserts that "L&P appears to be locked out of refinancing debt
13 instruments in support of its utility operations". In fact, very little of L&P's debt can be
14 refinanced at attractive/economical rates. Of the specific debt acquired from L&P, the
15 5.85% (\$5.6 million) pollution control bonds can be called at 100.5, the two 20 year
16 MTN and two 30 year MTN series bonds (totaling \$20 million, with effective rates
17 ranging from 7.541% to 7.753%) cannot be called, the 8.36% (\$20 million) 10 year MTN
18 series bonds were retired in March 2005 and the 9.44% (\$22.5 million) First Mortgage
19 Bonds (FMB) have a "make whole" provision that makes them uneconomical to
20 refinance. It should also be noted that the FMB has annual principle payments due of
21 \$1.125 million that regularly reduce its outstanding balance.

22 Q. Is Mr. Gorman's comparison to other Missouri utilities valid?

1 A. No. Mr. Gorman compares L&P's cost of debt to that of AmerenUE, KCP&L and
2 Empire District. However, he provides unknown data points for his comparison. The
3 "Embedded Debt Cost" in Table 3 on page 13 of his testimony only notes that these rates
4 were taken from recent rate filings. No details are provided as to whether these rates
5 were calculated consistently and at the same point in time. He makes the assumption that
6 operating as a utility in the same state is the key driver to the cost of debt for all utilities.
7 There are, in fact, numerous drivers that influence the cost of debt for any company,
8 including but not limited to the timing and amounts of the issuances, the life of the
9 issuances, the terms and conditions of the agreements (calls, fixed vs. variable rate, rate
10 step-up/down provisions), the company's credit ratings and market capitalization and, of
11 course, general financial market conditions.

12 Q. Is his assumption flawed?

13 A. Yes. First, the three utilities he gives as example have a wide disparity of rates, as he
14 lists them. L&P's cost of debt at 7.698% is much closer to Empire District's 7.02%, than
15 is AmerenUE's cost of debt at 5.473%. Second, he gives no weight to the drivers listed
16 above, such as market conditions at date of issuance or the remaining life of the debt.

17 Q. Does this conclude your rebuttal testimony?

18 A. Yes.

Aquila Missouri
Weighted Average Cost of Debt: MPS
December 2006

<u>Assigned Debt</u>	<u>Effective Rate</u>	<u>MO Electric Assigned Debt 12/31/06</u>	<u>Computed Interest on 12/31/06 Assigned Debt</u>	<u>MO Electric Weighted Avg Cost of Debt</u>
30 Yr 8.27%, Due 11/15/21 Effective Rate 8.502%	8.502%	33,140,579	2,817,612	
15 Yr 8.2%, Due 1/15/07 Effective Rate 9.114%	9.114%	1,198,595	109,240	
30 Yr 8.0%, Due 3/1/23 Effective Rate 8.129%	8.129%	24,493,301	1,991,060	
Sr 6.70%, Due 10/15/06 Effective Rate 6.745%	6.745%	0	0	
Wamego 96, Due 3/1/26 Avg Effective Rate 3.404%	3.404%	7,300,000	248,492	
Environ Improve, Due 5/1/28 Avg Effective Rate 3.701%	3.701%	5,000,000	185,050	
Sanwa Bank Loan, Due 12/9/09 Effective Rate 7.02%	7.020%	2,475,606	173,788	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 5.35% (10/01/04)	5.350%	108,063,961	5,781,422	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 6.05% (7/15/04)	6.050%	66,171,000	4,003,346	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 6.474% (6/26/06)	6.474%	101,965,118	6,601,222	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 5.848% (12/29/06)	5.848%	26,502,110	1,549,843	
Sr 7.625%, Due 11/15/09 Effective Rate 7.742%	7.742%	0	0	
Sr 7.95% (downgrade 9.95%), Due 2/1/11 Effective Rate 8.01%	8.010%	67,675,446	5,420,803	
Sr 7.875% (QUIBS) Effective Rate 8.142%	8.142%	49,097,890	3,997,550	
Total		493,083,606	32,879,428	6.668%

Aquila Missouri
Weighted Average Cost of Debt: SJLP
December 2006

<u>Assigned Debt</u>	<u>Effective Rate</u>	<u>SJLP Electric Assigned Debt 12/31/06</u>	<u>Computed Interest on 12/31/06 Assigned Debt</u>	<u>SJLP Electric Weighted Avg Cost of Debt</u>
Poll Cntrl Bonds 5.85%, Due 2/1/13 Effective Rate 6.991%	6.991%	5,600,000	391,496	
20 Yr MTN 7.13%, Due 11/29/13 Effective Rate 7.541%	7.541%	1,000,000	75,410	
20 Yr MTN 7.16%, Due 11/29/13 Effective Rate 7.573%	7.573%	6,000,000	454,380	
30 Yr MTN 7.17%, Due 12/1/23 Effective Rate 7.584%	7.584%	7,000,000	530,880	
30 Yr MTN 7.33%, Due 11/30/23 Effective Rate 7.753%	7.753%	3,000,000	232,590	
Sr 7.625%, Due 11/15/09 Effective Rate 7.742%	7.742%	53,355,087	4,130,751	
Sr 7.95% (downgrade 9.95%), Due 2/1/11 Effective Rate 8.01%	8.010%	19,661,000	1,574,846	
Sr 11.875% (downgrade 14.875%), Due 7/1/12 Effective Rate 6.474% (6/26/06)	6.474%	33,544,913	2,171,698	
Sr 7.875% (QUIBS) Effective Rate 8.142%	8.142%	17,600,000	1,432,992	
Total		<u>146,761,000</u>	<u>10,995,043</u>	
9.44% FMB, Due 2/1/2021 Effective Rate 9.487%	9.487%	16,875,000	1,600,931	
		<u>163,636,000</u>	<u>12,595,974</u>	<u>7.698%</u>

Debt on SJMOE books - assumes 100% Electric

Aquila Missouri
Weighted Average Cost of Debt: SJLP
December 2000

<u>Long-term Debt</u>	<u>Effective Rate</u>	<u>SJLP Electric Long-term Debt 12/31/00 *</u>	<u>Computed Interest on 12/31/00 Debt</u>	<u>SJLP Electric Weighted Avg Cost of Debt</u>
Poll Cntrl Bonds 5.85%, Due 2/1/13 Effective Rate 6.991%	6.991%	5,600,000	391,496	
20 Yr MTN 7.13%, Due 11/29/13 Effective Rate 7.541%	7.541%	1,000,000	75,410	
20 Yr MTN 7.16%, Due 11/29/13 Effective Rate 7.573%	7.573%	9,000,000	681,570	
30 Yr MTN 7.17%, Due 12/1/23 Effective Rate 7.584%	7.584%	7,000,000	530,880	
30 Yr MTN 7.33%, Due 11/30/23 Effective Rate 7.753%	7.753%	3,000,000	232,590	
10 Yr MTN 8.36%, Due 3/15/05 Effective Rate calculated at 8.421%	8.421%	20,000,000	1,684,200	
9.44% FMB, Due 2/1/2021 Effective Rate 9.487%	9.487%	22,500,000	2,134,575	
Total		68,100,000	5,730,721	8.415%

* Source: 2000 FERC Form 1, pages 256-257

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the matter of Aquila, Inc. d/b/a Aquila
Networks-MPS and Aquila Networks-L&P,
for authority to file tariffs increasing electric
rates for the service provided to customers in
the Aquila Networks-MPS and Aquila
Networks-L&P area

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Case No. ER-2007-0004

County of Jackson)
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State of Missouri)

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AFFIDAVIT OF RICHARD J. WINTERMAN

Richard J. Winterman, being first duly sworn, deposes and says that he is the witness who sponsors the accompanying testimony entitled "Rebuttal Testimony of Richard J. Winterman;" that said testimony was prepared by him and under his direction and supervision; that if inquiries were made as to the facts in said testimony and schedules, he would respond as therein set forth; and that the aforesaid testimony and schedules are true and correct to the best of his knowledge, information, and belief.

Richard J. Winterman
Richard J. Winterman

Subscribed and sworn to before me this 20th day of February, 2007,

Terry D. Lutes
Notary Public
Terry D. Lutes

My Commission expires:

8-20-2008



TERRY D. LUTES
Jackson County
My Commission Expires
August 20, 2008