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

FILED

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Missouri Public Service Commission

DATE OF REQUEST: July 3, 2003

DATE RECEIVED: July 3, 2003

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

REQUESTOR: Douglas E. Micheel

QUESTION:

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

RESPONSE: Please see attached.

ATTACHMENT: Response to Minnesota Public Utilities Commission letter dated September 9, 2003.

ANSWERED BY: Mark Reed

Exhibit No. 51
Case No(s). EF-2003-0465
Date 10-21-03 **Rptr** KF

SEP 23 2003

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September 15, 2003

Clark Kaml
Minnesota Public Utilities Commission
121 Seventh Place East, Suite 350
St. Paul, MN 55101-2147

Re: Request by Aquila, Inc. for Authority to Use Aquila Networks-PNG and Aquila Networks-NMU Utility Property To Secure Indebtedness
Docket No. G007,011/S-03-681

Dear Mr. Kaml:

This is in response to your letter dated September 9, 2003 in which you asked the following two questions.

1. Starting on page 3, Aquila's reply comments in the above-referenced docket indicate that the Term Loan is not a higher cost loan for Aquila and states the following:

> Aquila has \$500 million of 14.875% debt; \$250 million of 9.95% debt; \$20.2 million of 9.03% debt; \$5.0 million of 9.0% debt and another \$120 million of debt at 8.2%. Using the proceeds from the sale of the nonregulated assets to buy down debt improves the Company's financial position over the forced retirement of the Term Loan.

Are there any pre-payment, early retirement, or costs that would be incurred as a result of buying down any of the debt listed above? If so, please include a list of the debt that would have costs associated with a buy down along with the amount of those costs.

Response: See the attached matrix.

2. On Page 7, Aquila's reply comments state:

> Rather, Aquila has consistently acted to ensure that the cost of debt allocated to its utility operations reflects the cost of debt appropriate to an investment grade utility.

Please explain the actions that Aquila has taken to ensure that the cost of the debt allocated to its utility operations reflect the cost of debt of an investment grade utility. Please provide supporting documentation, including comparisons of the debt allocated to Aquila's utility operations with the average cost of debt for investment grade utilities at the time the debt was allocated to Aquila's utility operations.

Response: The cost of debt for Aquila Networks-PNG and Aquila Networks-NMU (the "Company") was fully investigated in the just concluded rate case (G007,011/GR-00-951). In that proceeding, the Company, through its witness John Dunn, explained that a divisional capital structure is used to determine the cost of debt for the two divisions. Mr. Dunn further explained that a divisional capital structure, rather than the consolidated capital structure, was used to make sure that the utility operations incurred debt costs that reflected utility operations, rather than the cost of debt associated with the Company's non-utility businesses. See Dunn Direct Testimony, pages 23-27. Mr. Dunn also explained that when a utility operating division needed additional capital, those needs where aggregated with the needs of other utility divisions until there was a sufficient amount to justify a new debt issuance, and that the cost of the new debt issuances was assigned to a division based on the actual amount of the debt issuance proceeds provided to that division. See Dunn Direct Testimony, page 27.

Attached to this response is a copy of Section D, Schedule 2, from the rate case Information Requirements, which lists each of the debt issuances that were included in the PNG and NMU divisional capital structures. The weighted average cost of debt was 8.159 percent.

In response to Commission staff data request 202, subparts (a) and (b), issued in the rate case proceeding, a copy of which is attached, Mr. Dunn explained that the Company's "debt is rated". That is, the Company was an investment grade utility at the time of each of the debt issuances that made up the 8.159 percent cost of debt. Mr. Dunn further explained: "For entities such as UtiliCorp [now Aquila] whose debt is rated, bond ratings, which are assigned by rating agencies such as Duff & Phelps, are the primarily determinant (along with market conditions when the debt is issued) of the cost of debt. * * * UtiliCorp cost of debt for domestic U.S. utility activities is primarily related to the U.S. utility operations of UtiliCorp, which includes NMU and PNG."

Because different utilities have different ratings, and because market conditions change rapidly, it is not possible to compare the Company's actual cost of debt with other utilities. However, because the Company was an investment grade utility at the time it issued all of the debt assigned to PNG and NMU, 8.159 percent is the weighted average market cost of debt for a utility with the same ratings as the Company.

Department of Commerce witness Dr. Amit concluded that the Company's cost of debt was reasonable, and the Commission approved a stipulated cost of capital that included the Company's 8.159 percent cost of debt.

Aquila has also committed to the Commission that it will continue to use comparable utility company debt/equity ratios and that any debt assigned to Aquila Networks-PNG and Aquila Networks-NMU prior to the time the Company returns to the status of an investment grade utility will be assigned at the cost of a comparable utility with a BBB investment grade credit rating. See Jon Empson's Direct Testimony, page 5, filed with the Original Filing in this Docket.

Very truly yours,

MOSS & BARNETT
A Professional Association

Michael J. Bradley

Michael J. Bradley
Attachments
cc: Parties of Record
MJB/mjb
618577/1

Estimated prepayment or open market purchase costs for selected Aquila Senior Notes

Debt issue	Redemption terms	Price as percentage of principal	Current Market price as percentage of principal	Yield to Maturity[1]
$500 million, 14.875% notes due 2012	Make-whole premium	171%	117%	11.7%
$250 million, 9.95% notes due 2011	Make-whole premium	133%	100%	9.9%
$20.2 million, 9.03% notes due 2005	Make-whole premium	115%	102%	7.8%
$5 million, 9.0% notes due 2021	Callable on Nov 15, 2003	104%	N/A	N/A
$36.9 million, 8.2% notes due 2007	Notes are not redeemable	None	97%	9.0%
$430 million 3-year term loan due 2006	Make-whole premium	117%	100%	8.75%

It is expected that the company would retire debt with a higher yield to maturity than the $430 million term loan to maximize the economic benefit of the debt reduction program.

[1] Yield to maturity is the equivalent return a bond investor should expect over the remaining life of the bonds given the (1) coupon, (2) time to maturity and (3) market price.

INFORMATION REQUEST

Docket No.: G-007/GR-00-951

Date Requested: November 7, 2000

Requested Reply Date: November 17, 2000

Requested By: Clark Kaml

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202) Direct Testimony of Mr. Dunn

On page 27:

The cost of the assigned debt to the division is exactly the same as the cost of the debt to UtiliCorp.

On page 24:

With a diversified company such as UtiliCrop, the consolidated capital structure bears no particular relationship to any one of the individual liens of business. . . Each of these activities has a specific capital structure or capital requirement based upon its specific industry and risk characteristics. The consolidated capital structure of UtiliCorp is just the summation of these specific capital structures with no special relationship to any of the parts which make it up.

On page 23:

The use of a divisional capital structure insulates and separates each of the existing divisions form the other activities of UtiliCorp . . . It also holds the cost of debt and equity for each of the divisions to a level which is precisely related to that division's activities, and more importantly, not related to the overall activities of UtiliCorp.

On page 23 and 24:

. . . [T] to assure that the capital entrusted to it is invested so that the return produced for the original individual investors in Utilicorp is commensurate with the combined risk of the funds allocated to UtiliCorp's various activities. As a result, UtiliCorp must use risk-return calculations in its investment decisions and each recipient of capital from

Response by: Debra Keim List Sources of Information:

Title: Senior Regulatory Analyst John Dunn

Department: Regulatory Services

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UtiliCorp must provide the proportionate return. Key in this risk-return determination is the assignment of divisional capital structures as UtiliCorp has done for NMU and PNG.

On page 29:

The cost of common equity for UtiliCorp is very different from the cost of common equity for PNG or NMU for the same reasons the capital structure requirements are different. The costs of common equity of the individual activities including PNG and NMU are related to the risks and opportunities of each of the specific business activities, not to the weighted average of UtiliCorp as a whole.

a. Does UtiliCorp's capital structure impact the cost of debt when the Company is seeking new debt financing?
b. Is a company's cost of debt dependent upon the individual activities of the company?
c. Is a company's cost of debt dependent upon its capital structure?
d. Please explain why the capital structure and cost of equity would be dependent upon the risks and opportunities of each of the specific business activities, but the cost of debt is not dependent upon these same factors.
e. (i) Please explain how use of a divisional capital structure insulates the cost of equity and debt in one division from the business activities of another division or the overall company.
   (ii) Please explain how the use of a divisional capital structure can "hold the cost of debt and equity for each of the divisions to a level which is precisely related to that division's activities. . . " when all of the division's debt financing is supplied by Utilicorp and "is exactly the same as the cost of the debt of UtiliCorp".
   (iii) By its comments on page 23, is UtiliCorp alleging that creditors for the company do not have recourse against NMU and PNG related utility properties?

RESPONSE:

a)

For entities such as UtiliCorp whose debt is rated, bond ratings, which are assigned by rating agencies such as Duff & Phelps, are the primary determinant (along with market conditions when the debt is issued) of the cost of debt. Bond rating agencies employ wide brackets for equity ratios in relation to the rating of a company' s debt. Accordingly, a bond rating (and resulting cost of debt) is affected only to a very minor degree by capital structure.

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b)
It is assumed the term " company' s" and this Information Request refer to UtiliCorp in particular, rather than to companies in general. While UtiliCorp has a wide range of business activities, it is predominantly a utility company, and most of its activities are utility or utility related. A substantial part of UtiliCorp total debt (41%) is comprised of separate issuances of debt that are restricted to specific business activities, including companies that are not wholly owned by UtiliCorp and utility activities in countries other than the United States. Because of the terms of those debt issuances, the costs of debt of those issuances are very specifically dependent on the related business activities. In contrast, UtiliCorp cost of debt for domestic U.S. utility activities is primarily related to the U.S. utility operations of UtiliCorp, which includes NMU and PNG.

c)
See the Response to Information Request 202(a).

d)
As explained in the Response to Information Request 202(a) above, for rated debt, capital structure has only a very minor effect on the rating assigned to the debt and to its resulting cost. In contrast, the cost of equity is dependent upon both the amount of debt and the business activity because equity has the highest risk in that the return on equity is variable and equity is not recovered until all other capital has been paid in full. Capital structure is dependent on the risks and opportunities of each of the specific business activities because the proportion of debt (capital structure) and the nature of the business combine to determine both the variability of return to the equity capital and the risk of non-recovery, both of which determine the risk and cost of equity.

e) (i)
Using the division capital structure approach, the cost of equity for a single division can be determined without being affected by the costs and risks associated with the activities of other divisions of the company. In the context of regulation, the cost of equity for a regulated business can be determined without being affected by other, riskier activities of a company. The result is to insulate the regulated division from other activities of the company.

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(ii)
A division's activities determine how much capital will be needed by the division and when that capital will be needed. If the division capital structure is used, that structure will determine how much of the capital needed by a division in any given year will be provided by debt and how much by equity. As previously discussed, the cost of debt issued by UtiliCorp is based primarily on its debt rating. However, overall market conditions when debt is issued also affect the cost of a particular debt issuance. As a result, the use a divisional capital structure will lead to different proportions of different cost debt issuances being included in cost of debt over a number of years. The assignment of debt in this fashion matches the cost of debt with the debt requirement for the division so that the embedded cost of debt for the division relates precisely to the historical development of the division. In addition, the debt is assigned to the division, as it is needed.

The cost of equity for a division established with an appropriate capital structure, using a comparable earnings analysis with a carefully selected group of comparable companies, would produce a cost of equity precisely related to the division's activities.

(iii)
UtiliCorp no longer issues first mortgage bonds, which are directly secured by specific properties, including NMU and PNG.

Response by: Debra Keim	List Sources of Information:
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