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BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Missouri Public
Service Commission
Chair
Commissioner
Commissioner
Commissioner
Commissioner

In the Matter of Aquila, Inc.'s Request to Use
Aquila Networks-PNG and Aquila
Networks-NMU Utility Property to Secure
Indebtedness

ISSUE DATE: October 22, 2003

DOCKET NO. G-007,011/S-03-681

ORDER DENYING REQUEST FOR
AUTHORITY TO ENCUMBER
MINNESOTA ASSETS

PROCEDURAL HISTORY

On April 30, 2003, Aquila, Inc. (Aquila) filed a petition requesting Commission approval to encumber utility property of its two Minnesota-based divisions (Aquila Networks-PNG and Aquila Networks-NMU) to secure the payment of a \$430 million loan and to secure future replacement debt offerings for working capital requirements not to exceed \$430 million.

On June 18, 2003, Aquila filed supplemental direct testimony.

On June 30, 2003, the Minnesota Department of Commerce (the Department) filed comments recommending the Commission reject Aquila's request.

On July 15, 2003, Aquila filed reply comments.

On August 19, 2003, the Residential and Small Business Division of the Office of Attorney General (RUD-OAG) filed comments and the Department filed additional comments. Both recommended that the Commission reject Aquila's request.

On August 29, 2003, Aquila filed reply comments.

The Commission met on October 9, 2003 to consider this matter.

FINDINGS AND CONCLUSIONS

I. BACKGROUND

Aquila, a Delaware corporation, seeks authority from the Commission to encumber utility property of its two divisions in Minnesota (Aquila Networks-PNG and Aquila Networks-NMU) to secure the payment of a \$430 million loan and to secure future replacement debt offerings for working capital requirements not to exceed \$430 million. Aquila's request comes before the Commission

pursuant to Minn. Stat. § 216B.49, subd. 3, which requires public utilities organized under the laws of any other state or foreign country to obtain Commission approval prior to using utility property in Minnesota for the purpose of securing the payment of any indebtedness.

II. AQUILA'S POSITION

Aquila stated that it has a debt reduction and restructuring plan aimed at returning the Company to a capital structure reflective of a utility and to restore its debt rating to investment grade. The Company stated that as part of this plan it has obtained a \$430 million Term Loan Facility¹ to meet the working capital requirements of its regulated and non-regulated operations. The Company stated that the Term Loan Facility was initially secured by the Company's Nebraska, Michigan, and Canadian utility properties and a silent second lien on its interests in independent power projects.

Aquila stated that it planned to sell part of the collateral, its Canadian utility assets, and that if it did so, it would need to substitute other assets to fully collateralize its Term Loan Facility or suffer a reduction in the amount of that Term Loan Facility. The Company also stated that the encumbrance of the Minnesota regulated assets would entitle the Company to a 75 basis point reduction in the interest rate for the Term Loan Facility because its collateralized assets would then equal or exceed 167% of the outstanding principal amount.²

The Company requested, therefore, that the Commission authorize it to use its utility assets in Minnesota to, in effect, substitute for the soon-to-be-sold Canadian assets. The Company specified that if its Minnesota utility assets were not allowed to be used as collateral to secure the Term Loan Facility the portion of the Facility it has allocated to its utility operations (\$250 million) would have to be reduced, jeopardizing the utility's liquidity (working capital needed to support the day-to-day operations of the Company's utility operations).

III. THE DEPARTMENT'S POSITION

The Department recommended that the Commission deny Aquila's request. The Department objected that since Aquila needed the Term Loan Facility due to failed nonregulated businesses, none of this debt (the \$430 Term Loan Facility) should be backed up by regulated assets.

¹ A Term Loan Facility makes a certain amount of money available to the borrower pursuant to a set of complex interrelated financial arrangements.

² The Term Loan Facility provides that Aquila pays eight percent interest if the value of its collateral equals or exceeds 167 percent of the outstanding aggregate principal amount and 8.75 percent if the value of its collateral falls below 167 percent of the outstanding aggregate principal amount. Including the value of the Canadian assets, the value of Aquila's collateralized assets exceeds the 167 percent mark. If those assets were removed without being replaced, however, the value of the collateralized assets would fall below 167 percent, subjecting Aquila to the higher interest rate, 8.75 percent. At no time during the Term Loan Facility has the value of Aquila's collateralized assets fallen below the 167 percent mark. It is more accurate to say, therefore, that when Aquila filed its request on April 30, 2003, the Company needed authority to pledge additional assets in an amount sufficient to maintain enough collateralized assets to meet or exceed the 167 percent mark after the Canadian assets were sold, thereby continuing its entitlement to the eight percent rate.

The Department also stated that once Aquila sells its Canadian properties, the Company wants 100 percent of the \$430 million Term Loan Facility to be supported by regulated assets even though only \$250 million was needed to operate its regulated operations. The Department reasoned that this meant that the balance of the \$430 million amount (\$180 million) would be used to support nonregulated activities. The Department stated that it was unreasonable for regulated assets to be used to support a credit facility for use by nonregulated operations.

The Department concluded that the Company failed to show that the proposed encumbrance is in the public interest and failed to demonstrate compelling reasons to violate the principle that there should be a clear accounting separation between the utility's regulated and nonregulated activities.

IV. THE RUD-OAG's POSITION

The RUD-OAG noted that Aquila has expressed the intent that regulated assets not be used to support a loan for use by its unregulated operations. The RUD-OAG asserted, however, that nothing in the credit facility restricts the lender's collection rights in the manner that Aquila describes. The RUD-OAG stated that if Aquila cannot obtain language in the loan agreement that sequesters the two aspects of the loan, the Commission should deny the Company's request.

The RUD-OAG also questioned whether, in light of Minn. Stat. § 216B.49, subd. 3 and § 216B.02, subd. 4, the Commission had statutory authority to approve the use of regulated assets to secure the debt of what is not legally defined in Minnesota as a public utility.

V. COMMISSION ANALYSIS

The Department and the RUD-OAG raised several arguments against approving Aquila's request, concluding that such approval was unwarranted and contrary to the public interest. Aquila responded to these arguments asserting that its request is in the public interest and insisting that ratepayers will not assume responsibility for debts incurred to support non-regulated businesses. The Commission has heard and evaluated these arguments. However, due to a critical intervening factual development and the disposition of this matter indicated thereby, the Commission need not discuss and make findings regarding these arguments in this Order.

The key factual development is this: subsequent to Aquila's April 30, 2003 request to the Minnesota Commission in this matter, the Colorado Public Utilities Commission on July 11, 2003 approved Aquila's request for authority to encumber the Company's Colorado regulated assets in support of the \$430 million Term Loan Facility. All parties agree that the value of Aquila's Colorado regulated assets is sufficient, together with the Company's assets pledged in Nebraska and Michigan, to meet the Term Loan Facility's collateral requirements.

Due to the availability of the Colorado assets, Aquila will remain entitled to the full amount of the \$430 million Term Loan Facility and to continue to pay the lower interest rate (eight percent) even after the Company sells its Canadian assets. In these circumstances, the principal reasons advanced by the Company for its request [i.e. to continue to be entitled to the full \$430 million facility and at the lower (eight percent) interest rate] have been fulfilled.

The Commission further finds that Aquila, by submitting its request in this matter and arguing for its approval has made "commercially reasonable efforts" to secure authority to encumber its Minnesota regulated assets, as required by terms of the Term Loan Facility.

VI. COMMISSION ACTION

In light of the full collateralization assured by the availability of the Company's assets in Colorado, the Commission concludes that granting Aquila's request to encumber the Company's Minnesota assets would authorize an overcollateralization that is clearly not in the public interest. The Commission will, accordingly, deny the Company's request for authority to encumber its regulated assets in Minnesota.

Given these findings and disposition, the Commission has not needed to address the merits of the Department's argument that no part of the Company's Minnesota assets should be used to secure any portion of the \$430 million Term Loan Facility. Nor, of course, has the Commission had before it a proposal that a "fair share" of the Company's Minnesota regulatory assets be pooled, along with a fair share of regulatory assets from all the other states in which the Company operates to secure the Term Loan Facility. If the Company makes a "fair share" proposal, the Commission will address the merits of that proposal in light of the arguments of all parties and also decide whether a contested case proceeding would be appropriate to address the issues raised by the parties. What is clear now, however, is that it is unnecessary to encumber all the Company's regulated assets in Minnesota and, hence, that it is not in the public interest to do so.

ORDER

1. Aquila's request for authority to encumber its regulated assets in Minnesota to support its \$30 Million Term Loan Facility is denied.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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