Exhibit No.:	
Issue:	Encumbrance of Missouri Assets
Witness:	Rick Dobson
Sponsoring Party:	Aquila, Inc.
Type of Exhibit:	Direct Testimony
Case No.:	
Date Testimony Prepared:	April 30, 2003

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Missouri Public Service Commission

MISSOURI PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF

RICK DOBSON

ON BEHALF OF

AQUILA, INC.

Exhibit No. 4
Case No(s). EF-2003-0465
Date 10-20-03 Rptr TL

April 30, 2003

BEFORE THE MISSOURI PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI
DIRECT TESTIMONY OF RICK DOBSON
ON BEHALF OF AQUILA, INC.

Q. Would you please state your name and position with Aquila, Inc? ("Aquila" or "Company")?

A. My name is Rick Dobson and I currently hold the position of Senior Vice President and Interim Chief Financial Officer of Aquila, Inc.

Q. Mr. Dobson, please provide the Missouri Public Service Commission (the "Commission") with a brief description of your educational background, professional designations and business experience.

A. I am a CPA and hold a BBA in Accounting from the University of Wisconsin at Madison and an MBA with an emphasis in finance from the University of Nebraska at Omaha. I worked for Arthur Anderson from 1981 to 1989 as an audit manager, for ProEnergy in 1996 and 1997 as Vice President and Controller and for Aquila from 1989 to 1995 and 1997 to 2002 as Vice President and Controller and Vice President of Financial Management respectively.

Q. What is the nature of your responsibilities as Interim Chief Financial Officer of Aquila?

A. I lead the accounting, finance, tax and treasury functions at Aquila. I have the responsibility for the effective and efficient operations of these functions.

Q. What is the purpose of your testimony?

A. Aquila is filing today with the Commission for authority to use Missouri utility assets as collateral to support a 3-year term loan. This term - loan was closed on April 11, 2003, the same date that Aquila retired its obligation under its previous unsecured $650 million revolving credit facility ("revolver") that supported the working capital requirements for Aquila's operations.

My testimony describes in detail Aquila's financial plan, the role the 3-year term loan plays in that financial plan, and why the pledging of utility assets as collateral to support the loan is necessary and not detrimental to Aquila's customers.

Q. Can you first provide some background information about Aquila?

A. Yes, I can. In the mid-1980's, Aquila, then UtiliCorp United Inc. ("UtiliCorp") began its growth strategy by acquiring domestic utility properties. The basic strategy was to diversify risk by product, geography, and regulatory jurisdiction. By building a larger utility, Aquila would be creating economies of scale and scope that would benefit both customers and shareholders. In 1985, Aquila made a very significant acquisition of Peoples Natural Gas ("Peoples"), a natural gas distribution utility operating in five midwestern states. Embedded in Peoples Natural Gas was a small natural gas merchant operation that was created in response to FERC Order 436. This small activity would eventually grow into Aquila Merchant Services, one of the most significant players in the energy merchant industry.

Q. What was the end result of Aquila's domestic utility acquisition strategy?

A. Aquila made eight domestic utility acquisitions from 1984 – 1993 and created a natural gas and electric utility that now serves 890,000 gas and 335,000 electric customers located in seven mid-continent states.

Q. Did Aquila apply the same diversification of risk principles outside the United States?

A. Yes. As it became more difficult to find domestic utilities that could be acquired by or merged with Aquila, opportunities became available internationally. However, Aquila carefully approached international options by focusing only on English speaking countries that have stable governments and sound economies. From 1995 to 2002, Aquila made significant utility acquisitions in Australia, New Zealand, Canada, and the United Kingdom.

Q. Did the international acquisitions perform well?

A. Yes. Operating Earnings Before Income and Taxes ("EBIT") was $133 million in 2001. The International acquisition program further diversified the overall utility portfolio of businesses and made a significant contribution to earning growth for Aquila.

Q. As part of its growth strategy, did Aquila also enter the telecommunications industry?

A. Yes it did. First, Aquila made an equity investment in Quanta Services Inc.("Quanta"), which was one of the largest specialized contractors serving utilities, telecommunications and cable television operators. As we entered 2002, our cost basis in Quanta for our 38% equity investment was $26.69 per share. Second, we became 96% owner of Everest Connections, a company which provided local and long distance telephone, cable television, high-speed Internet and data services to the Greater Kansas City area.

Q. You mentioned earlier the embryonic merchant activity that was acquired as part of Peoples Natural Gas. How did that business perform?

A. Aquila Merchant Services became one of the largest providers of wholesale energy and risk management services in North America. In addition to these services, the Company had a diverse portfolio of investments in electric generation plants, gas pipelines, gathering systems and gas storage facilities whose operations were optimized using its energy trading capabilities. The company also traded commodities such as natural gas, power global liquids and weather derivatives and provided risk management solutions to clients. In the late 1990's, our merchant business began to experience tremendous growth in volumes, revenues and profits, culminating with an exceptional year in 2001. The Merchant Services Group provided $384 million in operating earnings before interest and taxes in 2001, about 56% of Aquila's total operating income.

Q. By year-end 2001, what was the business profile of Aquila?

A. Aquila had created a business platform that was generating a diversified stream of earnings. The operating earnings before interest and taxes were split about evenly between utility network operations, which included the telecommunication businesses, and merchant services.

Q. Given the results of 2001, was Aquila optimistic coming into 2002?

A. Yes. Aquila had just completed a year where earnings per share ("EPS") had grown by 17% from the previous year and our capitalization ratios were the strongest they had ever been. With the fall of Enron, we saw a tremendous opportunity for our merchant services group, as one of the top energy marketing and trading companies, to pick up new market share and dramatically grow its risk management business. We were very confident in our risk management capabilities and the performance of our merchant business. Finally, with about 50% of EBIT coming equally from our global networks (domestic and foreign) and energy merchant operations in 2001, we felt we had achieved a balanced and complementary business mix poised to provide our customers with needed energy solutions and the company with continued growth and profitability.

Q. Did anything happen during the beginning of 2002 to change that outlook?

A. The fallout from the Enron and California energy crises was far more devastating to the entire energy sector than originally anticipated. Revelations concerning corporate governance failures created an environment where the energy industry experienced the adverse impacts of credit downgrades, dramatic reductions in stock value, and major efforts to restructure business operations.

Q. How did the credit rating agencies react to the rapid downfall of the merchant sector?

A. The credit agencies were obviously caught off-guard and had to quickly initiate corrective actions.

Q. What actions did the credit agencies take?

A. Both Standard & Poor's and Moody's issued reports in mid-2002 discussing new, more stringent credit guidelines for those players still left in the energy merchant sector.

Q. Can you briefly explain how the credit agencies changed their guidelines?

A. Standard & Poor's and Moody's significantly broadened the scope of their credit tests for marketing and trading companies to include much more than the traditional Value at Risk (VAR) measure. Standard & Poor's mentioned in its publication *Updated Approach for Rating U.S. Energy and Marketing Firms – June 11, 2002,* it was looking for "an amount equal to about 25% of the sum of market, operational and credit risk, plus all other identified capital requirements such as broker deposits and commodity inventories be in liquid assets." In addition, although it did not cite specific quantitative requirements for merchant companies to receive acceptable credit ratings, Moody's in it publication, *Moody's View on Energy Merchants: Long on Debt Short on Cash, Restructuring Expected – May 2002,* stated that "we focus on cash flow from operations after working capital because of the relatively high volatility in this area for companies with trading operations". Thus, to shield against potential adverse merchant market events, both Standard & Poor's and Moody's were now looking for merchant companies to have operating cash flow and/or access to additional liquidity substantially beyond their traditional levels.

Q. How did Aquila react to these changes?

A. The credit agencies raised the requirements for liquidity and balance sheet strength for merchant companies to a level that Aquila could not meet nor sustain on an ongoing basis. On August 6, 2002, Aquila announced its difficult decision to voluntarily exit the merchant business, the first Top 10 energy merchant company to make this decision. While we had planned as we began 2002 to assume a leading, stronger role in the merchant industry, we instead aggressively moved to exit the merchant industry business as market conditions deteriorated for companies in this sector

Q. Have other companies in the sector arrived at a similar decision?

A. Yes. Dynegy, Williams, El Paso, Duke, AEP and Reliant have since announced decisions to completely exit or significantly reduce their merchant energy activities.

Q. With all of the issues that have surrounded the energy merchant activities, do you believe there is still a legitimate role for an energy merchant function?

A. Yes. There is still a need for a mechanism for companies to both efficiently access supplies and efficiently manage their energy costs in fluctuating and uncertain markets. An energy merchant function is the appropriate mechanism to serve these needs, given that the merchant service providers have ample liquidity and the solid balance sheets now required to comply with today's tighter credit standards. In fact, Daniel Ford, CFA with Lehman Brothers in a speech given at the 2003 Iowa Energy Outlook Conference, (*"Power/Utilities Sector" January, 2003 - Daniel F. Ford, CFA –Lehman Brothers)* identified the loss of liquidity and a mechanism for providing risk insurance in the utility sector as one of the biggest challenges that must be effectively resolved. Large banks, brokerage and major oil companies may fill the market void left by the exit of the previous energy merchants, including Aquila. These companies include Bank of America, Conoco, Phillips and Goldman Sachs, among others. In fact since December 2001, 54 firms have filed applications with the Federal Energy Regulatory Commission ("FERC") to trade electricity. In addition to their strong financial profiles, these players can use the hedging and trading experience they currently use with their existing commodity and financial businesses, to leverage into the diversified energy markets and allow them to provide the necessary merchant services.

Q. As Aquila was swept up in the turmoil within the energy industry, what happened?

A. First, it is important to state that Aquila assumes total responsibility for its strategy. We chose to embark on this journey into the merchant and telecommunications businesses. While many external factors in 2002 influenced our ability to continue to *execute our strategy, the choice to enter those businesses was clearly ours.* Along with other players in these industries, Aquila started experiencing credit downgrades by Fitch, Moody's and S&P in mid-2002. In order to address credit quality, Aquila initially launched a project called BBB+, which was designed to restore the Company to a respectable "investment grade" status through a combination of cost reductions and business restructuring. However, as stated earlier, we realized by the summer of 2002, with the announcement of the much stricter Moody and S&P credit metrics for merchants, that our initial approach outlined in BBB+ couldn't work in isolation. We also had to look to exiting the merchant business, more aggressive asset sales and equity issuances to help restore financial stability.

Q. What specific actions has Aquila undertaken to date to help restore its credit quality?

A. *Aquila has taken several dramatic* steps *to restore its financial health.* Since mid-2002, the Company has closed its merchant trading operations, sold $1.3 billion in assets and has eliminated its common stock dividend. While the majority of the assets we sold were performing well within the "old Aquila" strategy, they could not be retained if Aquila was to meet its objective of restoring its financial stability. The Company has also reduced its work force by over 1,500 employees and has restructured its U.S. utility operations into a state-based organization to provide additional transparency for both the regulators and employees. To preserve cash and refocus the business on its regulated utility operations, Aquila has also stopped funding the expansion of its Everest Communications business and has sold its entire equity investment in Quanta. Unfortunately, with the continuing decline in the telecommunications industry and reduced utility construction spending, Quanta's stock dropped to $3.00 per share in July 2002 and Aquila wrote its investment down by $693 million in the second quarter.

Q. *What were the consequences of executing this first phase of your financial plan?*

A. There were at least four very significant consequences. First, by disaggregating our merchant business and eliminating our energy trading capabilities, we isolated several merchant assets from the optimization support of the trading organization. This stranding of assets left Aquila with significant residual financial liabilities such as the completed, but un-contracted peaking plants, tolling agreements and gas prepays which had to be managed. Second, Aquila Merchant's financial performance was dependent upon maintaining a portfolio of revenue sources. For example, with a portfolio, in any given year, the upside potential of energy trading might offset the poor performance of asset investments and visa versa. Not only did Aquila lose the merchant services business that had provided over 50% of our earnings, but we also lost the benefit of portfolio diversification when we exited the merchant trading business and basically left the Company fully exposed to the potential downside risks within the remaining merchant assets. Unfortunately, these merchant legacy financial risks have been accentuated in this market of extraordinarily high gas prices and low electric prices. Third, being forced to concurrently sell merchant assets along with many of its former competitors, Aquila had to recognize significant book losses as it sold many of assets and its equity investments into a "buyers market". As disclosed in Aquila's 2002 10-K (page 33), the total impairment charges and net loss on sale of assets was $1.6 billion. Aquila also incurred a $426.6 million loss or an impairment charge and net losses on asset sales that were reflected in discontinued operations. Finally, by rapidly selling assets, recognizing the accompanying book losses and reducing our scope of business activities, we violated certain interest coverage ratio covenants in our bank credit revolver. In order to gain a waiver of the covenant violation from the banks, we had to agree to several conditions, including a commitment to make a reasonable effort to gain state regulatory approval to secure a new revolver with utility assets.

Q. What were Aquila's next steps?

A. There were three basic components of our plan. First, we had to continue to maintain a focus on providing service to our utility customers and ensure that the steps we take to restore Aquila's financial stability would not have any adverse impact on the utility business or its customers. Jon Empson discusses how Aquila intends to fulfill this objective in his testimony filed in this case. Second, Aquila had to enter into a new debt agreement by April 12, 2003 and provide itself with sufficient working capital to allow it to maintain its ongoing business and complete the implementation of its debt reduction plan. Third, Aquila had to enter into a Phase 2 of additional asset sales, from which the proceeds would be used to eliminate debt not needed to support the remaining utility and nonutility businesses and eliminate the residual financial liabilities from the merchant business.

Q. Did Aquila successfully renegotiate the new debt agreements by April 12, 2003?

A. Yes. Aquila was successful in replacing the expiring $650 million revolver and loan waivers with two new debt instruments: a $430 million three-year term loan and a $100 million, 364-day loan. The $430 million term loan was secured with collateral from the Nebraska and Michigan domestic utilities, a pledge of the capital stock of the holding company of Aquila's Canadian utilities, and a silent 2nd lien on the equity interest in the holding company of Aquila's IPP investments. The collateral for the 364-day loan was Aquila's equity interest in its Australian assets ("WAPL"), first priority lien of two peaking facilities, and Aquila's equity interest in the IPP investments and a junior lien in the Canadian collateral. The primary purpose of the 364-day loan was for Aquila to get effectively an advance on its sale of the Australian assets to retire outstanding debt with an option to increase to $200 million if repayment of debt or retirement of financial liabilities could be accelerated.

Q. Given that Aquila now has its liquidity issues addressed, what is its plan to restore financial stability to the business operations?

A. Attached to my testimony, as <u>Schedule RD-1</u> is the financial plan that Aquila has developed. This plan is highly confidential in that the details concerning asset sales, contract renegotiations, and debt retirement are specifically provided in its contents. The successful execution of this plan will substantially improve Aquila's financial stability.

Q. If Aquila has already closed on the $430 million loan and had adequate collateral, why are you filing this application to add Missouri assets to the collateral pool?

A. At the present time, utility assets in Michigan and Nebraska and the Canadian investment primarily secure the $430 million term loan. Aquila has determined that about $250 million of the $430 million is needed to support the ongoing working capital requirements for the domestic utility business. However, based upon the collateral principles used by the lending institutions, the assets in the two domestic utility states are not sufficient in value to support a $250 million loan. Therefore, Aquila had to use the Canadian investment both to support the remaining $180 million portion of the loan and to fill the gap on the required collateral for the $250 million utility requirement. I have provided the details of the collateral support in <u>Schedule RD-2</u>. This schedule is highly confidential since it shows the potential value of specific assets.

Q. Did the financial institutions actually split the loan and collateral pools at you described?

A. No. The financial institutions only required Aquila to have pledged sufficient assets in total to secure the $430 million loan. Aquila itself is separating the loan and collateral to ensure that the utility customer and assets are not supporting the nonutility debt requirements. It is Aquila's intent to maintain a proper alignment of domestic utility collateral with domestic utility loan needs and nondomestic utility and nonregulated business collateral with their loan needs.

Q. What happens if the Canadian investment is sold as described in your financial plan?

A. If the Canadian assets are sold, 100% of the net proceeds must be used to repay the term loan until the remaining utility collateral value equals or exceeds 1.67 times the then outstanding term loan balance. At that point in time, Aquila will re-examine its liquidity needs and the available collateral pool to ensure that the proper alignment described above still exists.

Q. Is that the reason for seeking Commission approval to pledge utility assets as collateral?

A. That is one reason. Utility assets should support the working capital requirements for the utility operations. Second, it is only fair that since the working capital facility is needed to support the day-to-day operations of all Aquila's utility operations, then all of Aquila's utility assets should be part of the pool. Third, the borrowing rate under the facility drops 75 basis points if Aquila adds additional utility operations as collateral.

Q. Please explain why you believe that a liquidity facility of $250 million is required for the operations of your domestic utility business.

A. We have completed an internal study of our domestic utility working cash needs using the detailed budget information supporting the financial plan in Schedule RD-1. We stress tested this data to make sure the facility is adequate to meet the peak working capital requirements of the business. In this study we noted that a key driver for working capital for the utility business is natural gas purchased for distribution and fuel for power generation. These purchases typically settle on the 25th day of the month following the flow of the gas. Natural gas cost combined with power purchases that typically settle on the 20th of the month after the power is delivered drive the peak which generally occurs in the winter season.

Q. Please describe the methodology used in the internal study to determine the peak working capital needs and stress tests applied to the data.

A. The detailed methodology, assumptions and results of the study are described in Schedule RD-3.

Q. Please summarize the findings of your study.

A. The study shows that with 30 year normal weather conditions and gas prices that reflect the April 23, 2003 forward gas curve (NYMEX), the working capital peak is approximately $170 million in January 2004. With the tremendous volatility we have seen recently in the price of natural gas and weather, we stress tested our $170 million peak with gas prices of $11.63 per mmbtu, and a 10% increase in volumes purchased. This scenario increased the working capital requirement for January 2004 to approximately $240 million. During the winter season, the electric system also has the potential for significant storm damage. Based upon the above study, liquidity capacity of at least $250 million is reasonably required to adequately protect the domestic utility business.

Q. Do you have any historical reference points for this level of liquidity capacity?

A. Yes. Also included in Schedule RD-3 is a graph showing Aquila's historic under recovery of purchased gas costs and the impact of budget billing on the utility capital requirements when weather and prices move significantly during the winter season. In February 2001, Aquila incurred approximately $116 million of under-recovered gas costs. During this same month, the difference between the budget billing revenues and the total amount due from the customers on the budget bill program peaked at $75 million. The combined impact of these two items created a liquidity need of $191 million. The January 2001 ice storm repair costs in Missouri resulted in additional cost of $8.7 million during this same winter season.

Q. Aquila is using a three-year term loan as a working capital source for its utility business. *Since working capital is an ongoing utility requirement, how does Aquila intend to meet* its working capital requirements once the term loan expires?

A. While it is difficult to project what financial instruments might be available to Aquila when the term loan expires, it would be our intent to continue with a working capital debt instrument secured by utility assets, but always aligned in a manner that utility assets are only supporting utility working capital needs. At this time, Aquila would anticipate that the initial loan could be repaid and replaced with similarly secured debt as necessary to meet the ongoing working capital debt instrument.

Q. Do other companies have working cash balances of similar size?

A. Yes. I have attached a schedule in Schedule RD-4 that illustrates the available credit capacity for a sample of combination of gas and electric utility companies as well as for Kansas City Power & Light Company and The Empire District Electric Company, both neighboring electric utilities. The schedule reveals that on a relative basis, the amount of liquidity we feel is necessary to maintain our remaining utility operation is not unreasonable. Our estimate of a required $250 million in credit capacity for the Aquila domestic utility business going forward is less than the sample group average, both as a percentage of revenues and also of net utility plant.

Q. How will Aquila internally manage the 3-year term loan funds to support the utility working capital requirements?

A. Aquila will hold the term loan at the corporate level and use the funds as if a revolver existed. That is, Aquila, Inc. will function as the bank for the business operations. The utility operations will only be charged for the use of funds when working capital is needed and the cost of the funds used will be based upon a BBB investment grade utility. The difference between the investment grade cost and the actual cost of the debt will be retained at the corporate level. Aquila is effectively sheltering the utility customer from the cost of working capital if it exceeds investment grade levels

Q. Does Aquila currently have the internal capability to track the utility use of working capital and appropriately price the debt cost for dollars that are used?

A. Yes. Corporate Treasury manages short-term funding facilities, which the 3-year term loan will become for the utility. Short-term borrowings are tracked in account 233 – Advance To And From Parent. Entries are made on the utility division books with offsetting entries made at the corporate level. The use of funds will be segregated and as stated earlier priced to reflect the appropriate BBB investment grade.

Q. But isn't issuing secured debt by utilities an unusual event?

A. No, not at all. I have attached to my testimony as Schedule RD-5, a graph of secured vs. unsecured utility debt issuances from 1988 – 2002. As demonstrated by the graph, in the early 1990's, it was very typical for utilities to issue secured debt.

Q. But isn't Aquila issuing secured debt because its credit rating has been reduced to below investment grade?

A. At this point in Aquila's financial history, that is the only option. However, being non-investment grade is not the only determining factor in issuing secured debt. On Schedule RD-6, I have included a list of all of the secured utility debt issuances for 2002 and 2003 YTD. The schedule reveals that there have been over 40 separate issuances of "secured" utility debt for a cumulative total of $12.4 billion since January 2002. The issuance of debt by domestic utilities, both "investment grade" and "non-investment grade", on a "secured" basis has become more commonplace over the course of this period. In fact, only two of the secured debt issuances during this period of time were by non-investment grade utilities. The issuance of secured debt by utilities is not an unusual event.

Q. Have you reviewed other information about secured debt issuances that also support your conclusion?

A. Yes. Attached to my testimony as Schedule RD-7, is a listing of secured debt issued in the State of Missouri from 1973 to 2002. It is interesting to note that Aquila (then UtiliCorp) issued $100 million First Mortgage Bonds in 1986, effectively mortgaging the company's Missouri utility property to permanently finance its purchase of Peoples Natural Gas, a gas utility that operated in Nebraska, Iowa, Colorado, Kansas and Minnesota. Again, it is clear that utilities issuing secured debt are not an uncommon practice.

Q. What are the implications for a utility and its customers for having secured debt vs. unsecured debt?

A. Up until April 2003, Aquila essentially had all unsecured debt except for about $20 million of mortgage bonds it acquired through the merger with St. Joseph Light & Power Company. Aquila will now have significant "secured creditors" with the issuance of the April 12, 2003 debt. Accordingly, if Aquila would ever become insolvent, the secured creditors achieves an advantage from security over unsecured creditors as the secured creditor has a "priority claim" to any distribution of payments.

Q. What do you mean by a "priority claim"?

A. The probable remedy for an insolvent utility is to invoke the protection of the Federal Bankruptcy Court through a Chapter 11 reorganization. While I am not an expert in utility bankruptcy proceedings, it is my understanding that a company in reorganization continues as an operating business and its debts are paid through a plan confirmed by the bankruptcy court. Under the plan, debts are paid to creditors based on a descending order of the priority of their claims as established in the Bankruptcy Code. Secured creditors are paid first to the extent that their claims are covered by the value of the collateral they have taken as security. Unsecured creditors are paid next. Generally, priority claims are entitled to be satisfied in full before unsecured claims are paid out of the bankruptcy estate. Depending on the value of the estate, unsecured creditors may be paid only a fraction of the value of their claims. The bottom line is that a secured creditor is in a much better position to have its claim paid in full than is an unsecured creditor.

Q. Is secured debt detrimental to the interest of a public utility or its customers?

A. It is my opinion that secured debt is no more "detrimental" to the public utility or its customers than is unsecured debt. Both represent a financial obligation on the part of the company and therefore, a potential claim against the assets of the company. Whether there is a mortgage or security interest involved is a matter of commercial convenience. It does not represent a greater or lesser degree of risk on the part of the debtor utility. Also, the grant of a pledge does not increase the likelihood of a bankruptcy filing, nor does it expose to creditors in bankruptcy any assets that might otherwise have been exempt from their claims.

In sum, a mortgage or security interest merely serves to establish the priority of creditors claims in the event that the debtor defaults on its obligations. I have attached to my testimony as Schedule RD-8, two papers presented by separate attorneys at a recent Federal Energy Bar Conference relating to utility bankruptcy issues.

Q. Is Aquila filing applications with all its states to use the utility assets as collateral?

A. Applications are being filed concurrently in Missouri, Colorado, Kansas, Iowa and Minnesota.

Q. If all states approve the application, will Aquila have more utility collateral than is needed to support the $250 million working capital requirement?

A. There is both a theoretical and practical answer to that question. Theoretically, Aquila only needs to have about $420 million ($250 x 1.67) of debt collateral capacity to support the $250 million of working capital. The domestic utility debt collateral capacity, per Schedule RD-2, is approximately $1.3 billion. Therefore, if all states approve the application, Aquila will have $1.3 billion of collateral value supporting a $250 million loan. In reality, however, if Aquila were to become insolvent, the secured creditors will have access to the first $430 million of sale proceeds from the liquidation of regulated and non-regulated assets and the unsecured creditors would receive the balance. So while in theory, only a portion of the assets in each state is needed to secure the loan, the practical result of a worse case scenario of insolvency could require the total liquidation of assets to meet the demands of all creditors with the secured creditor demands met first.

Q. Assuming that all of the states approve your application, is it Aquila's intent to use the excess collateral available to issue additional secured debt beyond the 3-year term loan of $430 million?

A. Aquila will not issue any additional secured utility debt other than the term loan and future replacement debt offerings for the working capital requirements of Aquila's domestic utility operations, not to exceed $430 million, unless a formal application to do so is submitted to and approved by this Commission. However, it is important to note that Aquila's financial plan as presented to this Commission incorporates assets sales, debt repayments, and contractual restructurings as means for restoring the Company's financial stability and credit quality. The absence of other liability reduction strategies (such as debt for equity swaps or debt exchange offers) in the financial plan does not mean that these strategies do not have merit. Aquila intends to continue to evaluate alternative strategies and will then seek the appropriate approvals from this Commission if the execution of the strategy requires additional utility security.

Q. Do you have any other comments at this time?

A. Yes. The Term Loan, referred to at page 1 of my testimony and discussed thereafter is attached to my testimony as Schedule RD-9. In connection with the Term Loan, Aquila, Inc. has issued First Mortgage Bonds under its Indenture of Mortgage and Deed of Trust dated as of April 1, 2003 to Bank One Trust Company, N.A., Trustee and its First Supplemental Indenture thereto dated as of April 9, 2003 to Bank One Trust Company, N.A., Trustee. The Indenture and First Supplemental Indenture are attached to my testimony as Schedules RD-10 and RD-11 respectively. The Resolutions of the

Board of Directors of Aquila authorizing the filing of the subject Application are attached to my testimony as Schedule RD-12.

Q. Does this complete your testimony?

A. Yes it does.

VERIFICATION

STATE OF Missouri)
) ss.
COUNTY OF Jackson)

I, Rick Dobson, having been duly sworn upon my oath, state that I am the Senior Vice President & Interim Chief Financial Officer, of Aquila, Inc.; that I am authorized to make this affidavit on behalf of Aquila, Inc., and that the matters and things stated in the foregoing testimony and schedules thereto are true and correct to the best of my information, knowledge and belief.

Rick Dobson

Signed and sworn to before me, the undersigned notary public, on this 29th day of April, 2003.

Lana S Jennings
Notary Public

My Commission Expires:
January 8, 2005

LANA S JENNINGS
Notary Public - Notary Seal
STATE OF MISSOURI
JACKSON COUNTY
MY COMMISSION EXP. JAN. 8,2005

Before the Missouri Public Service Commission

Of the State of Missouri

Direct Testimony of Rick Dobson

On Behalf of Aquila, Inc.

Schedules

Schedule RD-1	**Aquila, Inc. Debt Reduction and Restructuring Plan**
Schedule RD-2	**Credit Suisse First Boston, fair Value Approximation - Collateral for Term Loan**
Schedule RD-3	**U.S. Networks, Working Cash Needs**
Schedule RD-4	**Proxy Combination Electric & Gas Utilities Working Capital Facilities**
Schedule RD-5	**Utility Debt Issuance Trends from 1988**
Schedule RD-6	**Secured Utility Issuances, 2002 – 2003**
Schedule RD-7	**Missouri Public Service Commission Financing Cases 1973 - 2002**

Schedule RD-8	***Utility Financial Restructuring Panel –Is Bankruptcy an Option?*** Darrell W. Clark –Stinson Morrison Hecker ***Public Utility Bankruptcy Issues*** Ronald M. Giteck – Assistant Attorney General State of Minnesota Office of the Attorney General Residential Utilities Division
Schedule RD-9	**Term Loan**
Schedule RD-10	**Indenture of Mortgage and Deed of Trust**
Schedule RD-11	**First Supplemental Indenture**
Schedule RD-12	**Resolutions of the Board of Directors of Aquila**