

FILED
December 19, 2007
Data Center
Missouri Public
Service Commission

BOARD OF DIRECTORS MEETING
JANUARY 20, 2007

HC

STAFF Exhibit No. 100HC
Case No(s). EM-2007-0374
Date 12-5-07 Rptr. RP

PENGAD 800-531-6889
EXHIBIT
4
11-27-0

AQUILA, INC.

**SPECIAL BOARD OF DIRECTORS MEETING
January 20, 2007**

AGENDA

**Saturday 7:00 a.m. (CST) – Breakfast
7:30 a.m. – Convene in Boardroom**

- I. Call Meeting to Order – Rick Green

- II. Financial Due Diligence and Consideration of Execution Issues -
Aquila Management / Lehman Brothers / Blackstone Group

- III. Fairness Analysis – Lehman Brothers / Blackstone Group / Evercore Partners
 - A. Financial Terms of the Transaction
 - B. View of Break-up Fee and Deal Protection Provisions

- IV. Legal Matters – Fried Frank Harris Shriver & Jacobsen
 - A. Fiduciary Duties
 - B. Terms of Agreements with Navy / National Guard
 - C. Legal Due Diligence
 - D. Employee Considerations

- V. Executive Session With Independent Directors

- VI. Consideration of Next Steps

- VII. Adjournment

Date of Next Scheduled Board of Directors' Meeting – February 28, 2007

Highly
Confidential

132 Introduction

The objective of this meeting is to have the board determine whether it is in the best interest of Aquila shareholders to continue to pursue the proposed transaction with Navy and National Guard and if so, under what conditions. The reverse due diligence, which is almost complete, has not resulted in any significant issues or concerns. So, if you decide to proceed, the next step will be to first satisfy any conditions imposed by the board and then permit Navy to visit with regulators and National Guard to visit with state vice presidents. Assuming favorable reports on those activities, the board would then authorize appropriate individuals to move forward with the transaction. If you decide not to proceed with Navy and National Guard we will have to start developing the next prospect.

At this point the board has reached a level of comfort with the price we have been offered for the company and must now get comfortable that the expected value can be delivered 12 to 18 months after signing the agreement. Our focus for this meeting will therefore be on the execution issues associated with closing this transaction and delivering \$4.50 per share of value to our shareholders. While every transaction has some degree of execution risk, some risk not only reduces the likelihood of closing the transaction but also create residual issues if the transaction fails to close. It is also true in this transaction that one failure to execute on a required regulatory approval causes the entire deal to fail. In our review we will therefore focus primarily on those elements of risk that have the greatest potential to significantly diminish our probability to close and thereby diminish our credibility/viability as a future merger candidate.

We realize that this is one of the most important decisions a board can be asked to make. Furthermore, realizing that good decisions are usually made when good data is provided to support the decision, we are committed to doing our best to provide the board with candid, factual and objective information about the issues that represent the highest risk to close the transaction. The highest risk to close is regulatory risk and at issue is the level of confidence the board has that this transaction will deliver the expected value in the 12 to 18 months it will take to close. The reality is that there is a complex set of regulatory factors associated with this transaction that are unique and unavoidable given the size and financial strength of our bidder.

The policies, precedents and political pressures of the regulatory environment must be understood before an adequate assessment of the associated execution issues can be made. Making this call will not be easy because there are no absolutes on which to rely. We can lay out the policies of the commissions and evaluate how they will apply to our filings. We can also explain how past commission practices have become precedents that are troubling to the proposed approach. However, at the end of the day, we must also forecast the condition of the political climate in the months ahead that will influence how regulators will respond.

132 Introduction (cont.)

Understanding this complex set of issues requires that we step through them and answer the questions raised by the board the following way:

- Identify the top execution issues that are unique to this transaction based on managements past experiences.
- Explain the financial implications
- Review the unique regulatory issues
- Discuss potential shareholder reaction
- Receive advisor status reports on the agreement, reverse due diligence, etc.

On page 3 we have identified the execution issues for this transaction. The issues marked with yellow are the most significant execution issues. Note that in the far right column are page references to allow you to review more information for these issues.

We recognize the importance of providing sufficient information to ensure a thorough understanding of the issues so we will stop periodically to make sure that we are conveying materials effectively and adequately answering your questions.

Thank you for the time you are devoting to this important work and please let me know if there is anything else we can do to help you through the process.

Execution Issues	Key		More Detail
	No/minor Issue	Priority Issue for Discussion	
<u>Material Adverse Event - Aquila</u>			
New Litigation			
Operational Event			
Financial Event			
<u>Material Adverse Event - National Guard</u>			
New Litigation			
Operational Event			
Financial Event			
Pending Litigation			
<u>Material Adverse Event - Navy</u>			
New Litigation			
Operational Event			
Financial Event			
Pending Litigation			page 8; item 2F
<u>Shareholder Approvals</u>			
Navy Shareholders Approve Transaction			
Aquila Shareholders Approve Transaction			page 10; item 5
<u>Regulatory Approvals</u>			
FERC Approves Transaction			
Hart Scott Rodino Approval			
Nuclear Regulatory Commission Approves Transaction			
Colorado Regulators Approve Asset Sale			
Colorado Regulators Approve Merger			
Iowa Regulators Approve Asset Sale			page 9; item 4
Iowa Regulators Approve Merger			
Kansas Regulators Approve Asset Sale			page 9; item 3
Kansas Regulators Approve Merger			
Missouri Regulators Approve Transaction			page 5; item 2
Nebraska Regulators Approve Asset Sale			
Nebraska Regulators Approve Merger			
<u>Financing</u>			
Navy Proforma			page 4; item 1 (B-C)
National Guard Financing			page 4; item 1A

Project 132 – Most Significant Execution Issues

Execution Issues	Comments	More Detail
I. Financial		pages 11-36
<p>A.</p> <ul style="list-style-type: none"> • National Guard Financing of the asset transaction for approximately \$1 billion. 	<p>The merger with Navy is dependent on the asset sale to National Guard because the asset sale proceeds are being used as a financing vehicle for Navy. National Guard is working to finalize a commitment letter with Credit Suisse for bridge financing. Aquila provided comments on the commitment letter last week to National Guard and we are awaiting their response. National Guard is expected to deliver this signed commitment at transaction signing.</p>	
<p>B.</p> <ul style="list-style-type: none"> • Navy's post merger financial pro-forma is dependent on receiving the following treatment from Missouri Regulators: <ul style="list-style-type: none"> ○ Regulatory amortization of \$6 million in 2008 and \$65 million in 2009; ○ synergy sharing at 50% for three years ○ Regulatory asset deferral for \$63 million of estimated transition and restructuring cost; ○ A 2007 Aquila rate case to be filed using pro-forma post merger assumptions; 	<p>Navy has stated that they require the support of the Missouri Commission beyond the merger approval in order to proceed with the transaction.</p> <ul style="list-style-type: none"> ○ Regulatory amortization is important for maintaining targeted Funds From Operations (FFO) to debt ratio and investment grade rating. ○ Synergies are important for EPS accretion. ○ There is precedent for the deferral of transition and restructuring so this is not seen as an issue. ○ 2007 Aquila filing could result in a rate reduction. 	
<p>C.</p> <ul style="list-style-type: none"> • Navy assumes they will achieve a full run rate of \$65 million of synergies in the first 	<p>Assuming a full year impact of synergies in 2008 is important to Navy post merger EPS accretion.</p>	

CONFIDENTIAL

Project 132 – Most Significant Execution Issues

Execution Issues	Comments	More Detail
<p>year (2008) following merger close.</p>		
<p>D.</p> <ul style="list-style-type: none"> • Synergies increase from \$65 million in 2008 to \$95 million in 2012. <ul style="list-style-type: none"> ○ \$15 million of the increased synergies results from capital investments that would be added to rate base in the 2009-2011 timeframe. ○ Joint dispatch synergies increase from \$10-12 million in 2008-2010 to \$19 million after Iatan 2 is placed in service. 	<p>The Commission’s evaluation of synergies the critical element in the evaluation of the no net detriment standard.</p> <ul style="list-style-type: none"> ○ It is unclear if the Commission would recognize these as “merger synergies” in evaluating the “no net detriment” standard. ○ It is unclear how the Commission will include these in their “no net detriment” evaluation. 	
<p>2. Missouri Regulatory Approvals</p>		<p>pages 37-42</p>
<p>A.</p> <ul style="list-style-type: none"> • Aquila Personal and Company Commitments <ul style="list-style-type: none"> 1986: <ul style="list-style-type: none"> ○ Divisional Capital Structure: Insulate each business unit from UtiliCorp operations. 2003: <ul style="list-style-type: none"> ○ Debt Reduction and Restructuring Plan: Protect utility customers from potential adverse financial impacts created by the non-regulated business strategy. 	<p>Aquila has maintained a commitment since 1986 with state commissioners to create operational and financial insulation between business units. Aquila has been very focused in rate case filings to ensure that only costs necessary to operate a safe and reliable electric utility were included in the cost of service. The MPSC, Staff, and intervenors have consistently reinforced the policy of segregating the Aquila business risks and not having the regulated customers subsidizing the business risks created by the nonregulated business strategy. The MPSC Management Audit specifically addressed “Decisions Aquila Made to Protect Its Regulated Activities From the Company’s Involvement in Unregulated Activities.” <u>The request for amortization will be in direct conflict with both Aquila’s business insulation policy commitment and the past policy decisions of the</u></p>	

Project 132 – Most Significant Execution Issues

Execution Issues	Comments	More Detail
	<p><u>Commission</u>. We can anticipate that the intervenors will raise this inconsistency in policy commitments which will create political pressure on the approval process.</p>	
<p>B.</p> <ul style="list-style-type: none"> • Navy Regulatory Plan Commitments <ul style="list-style-type: none"> ○ Take prudent and reasonable actions to achieve the goal of maintaining its debt at investment grade. ○ Take prudent and reasonable actions that do not place its investment grade debt rating at risk. ○ Any negative impact from its failure to be adequately insulated from Great Plains Energy Inc. business risks will not be supported by its Missouri jurisdictional customers. ○ If Navy is unable to meet the BBB+ credit ratio values because of any risk associated with Great Plains that is unrelated to Navy's Missouri regulated operations, Navy will not argue for or receive increased cash flows from its Missouri regulated operations in order to meet the BBB+ credit ratio values. 	<p>The proposed transaction is in conflict with Navy's regulatory plan commitments to not jeopardize its investment grade credit rating and inconsistent with the segregation principles since the request for amortization will require Aquila's regulated customers to pay the costs to elevate the non-investment grade credit rating to investment grade. The perception will be that Navy is attempting to shift the accountability for maintaining investment grade to complete this transaction from itself to the MPSC in a manner that is inconsistent with its approved regulatory plan. This request will again be a trigger point for the intervenors and create the opportunity for more political pressure on the transaction.</p>	
<p>C.</p> <ul style="list-style-type: none"> • Aquila Financing Plan for Iatan II 	<p>Staff has stressed that the amortization alternative was appropriate to help <u>maintain</u> the investment grade credit metrics for KCPL and Empire but was not appropriate for Aquila since we needed the amortization to move from non-investment grade to investment grade. That improvement was requiring the regulated customers to repair the non-</p>	

10/13/10
 10/13/10
 10/13/10

Project 132 – Most Significant Execution Issues

Execution Issues	Comments	More Detail
	<p>investment credit rating created by the non-regulated business strategy, an inappropriate subsidization and detrimental to the public. Staff would support the amortization alternative for Aquila if it was used to maintain investment grade credit metrics.</p>	
<p>D.</p> <ul style="list-style-type: none"> • Merger Standard <ul style="list-style-type: none"> ○ Application must state the reason the transaction is not detrimental to the public interest (MPSC Rule). ○ The obvious purpose of this provision is to ensure the continuation of adequate service to the public received by the utility at just and reasonable rates. ○ Commission has considered such factors are the applicant’s experience in the utility industry; the applicant’s history of service difficulties, <u>the applicant’s general financial health and ability to absorb the proposed transaction</u>; and the applicant’s ability to operate the assets safely and efficiently. 	<p>The Missouri Supreme Court has recently clarified the analytical use of the standard which the MPSC applied to a transaction in an order issued February 10, 2005. The MPSC has stated that the court decision requires the Commission to conduct a cost benefit analysis in which all of the benefits and detriments in evidence are considered to determine whether the proposed transaction is likely to be a net benefit or a net detriment to the public. Approval should be based upon a finding of <u>no net detriment</u>. The Commission cannot defer issues with ratemaking impacts to the next rate case. The mere fact that a proposed transaction will cause rates to increase is not detrimental to the public interest where the transaction will confer a benefit of equal or greater value or remedy a deficiency that threatens the safety or adequacy of the service. We can also anticipate that intervenors will raise the “financial health” factor as a threshold issue and that the required incremental rate cases are proof that Navy fails the test. The ability to quantify that no net detriment exists with reasonable certainty will be the cornerstone for gaining approval especially since the upfront detriment of a rate increase is known and the benefits are projected. Staff and intervenors have historically taken the position that synergies are impossible to track and quantify and are based on the assumption that the acquired entity is static. Given Aquila’s history with Six Sigma and our focus on gaining efficiencies, this analysis becomes is even more challenging.</p>	

Project 132 – Most Significant Execution Issues

Execution Issues	Comments	More Detail
<p>E.</p> <ul style="list-style-type: none"> • Aquila 2007 Rate Case Filing <ul style="list-style-type: none"> ○ Amortization ○ Shared synergies ○ Transaction costs ○ Maintain Aquila’s Fuel Adjustment Clause (FAC) ○ Traditional revenue requirement 	<p>Navy is requiring Aquila to file a rate case in the summer of 2007 that will be consolidated with the merger application. Both of these applications will explicitly quantify the costs and benefits of the transaction. Aquila still has reservations about the need and potential impact on both the merger approval process and our shareholders if a 2007 rate case is filed. The requested result will be an immediate rate increase which, over time, Navy must demonstrate is essentially an investment that will provide lower rates to customers than Aquila’s stand alone capability. This will be the first time that the MPSC will be asked to approve a merger that requires a known rate increase. The rate case is aggressive in that it requires the MPSC to grant Aquila:</p> <ul style="list-style-type: none"> ○ Amortization to repair and maintain credit which is in conflict with issues describe above. ○ Shared synergies which are not confirmed and result in rates that could be determined to not be just and reasonable (i.e. overearn). ○ Recovery of amortized transaction costs that have not been incurred. ○ Retention of the Aquila FAC even though Navy gave up its FAC rights to gain amortization and other elements in its regulatory plan. <p>Navy has stated and will confirm in the merger application that the MPSC must approve amortization for it to maintain its investment grade status. Navy has stated that shared synergies and retention of the FAC are not required but if not granted increases the need for amortization and increases the fuel price exposure. The MPSC will not approve a merger application that creates or has a significant possibility of creating a non-investment grade utility.</p>	

Project 132 – Most Significant Execution Issues

Execution Issues	Comments	More Detail
<p>F.</p> <ul style="list-style-type: none"> • Potential Litigation 	<p>Both Empire and KCPL have completed their first rate cases to implement the approved regulatory plans for Iatan II and the amortization alternative. Empire was granted over \$10 million of additional amortization to maintain its credit metrics and KCPL over \$21 million. Interveners have requested rehearing in both cases, citing as one issue the granting of amortization being illegal (i.e. effectively granting Construction Work In Progress (CWIP). It is anticipated that the MPSC will deny the rehearing motions and that one or both of their cases will then advance to the courts, a process that will likely last at least 18 months. The concern is the pending legal challenge could cause the MPSC to suspend the amortization processor perhaps approval of the Merger.</p>	
<p>3. Kansas Approval of Asset Sale</p>		
<ul style="list-style-type: none"> • Ring-fencing 	<p>KCC and Staff have been the most aggressive in Aquila's operations during the financial restructuring. We can expect the same aggressive posturing in the asset rate application where National Guard has given us a preliminary indication that it will agree to comply with the ring-fencing draft rules. This commitment will be very significant in gaining approval. However, National Guard's business mix, non-regulated growth strategy and marginal credit quality will create concerns that will need to be effectively addressed in the application.</p>	
<ul style="list-style-type: none"> • Premium recovery 	<p>National Guard intends to request premium recovery to the extent that synergies can be demonstrated. This is a traditional policy position in Kansas but is also a source of contention that normally requires a hearing to resolve, thus negating the possibility of settlement.</p>	

Project 132 – Most Significant Execution Issues

Execution Issues	Comments	More Detail
4. Iowa Approval of Asset Sale	<p>Iowa Utilities Board (IUB) and Staff will require ring-fencing, and the use of the Kansas rules should address their concerns. However, the IUB will also be concerned about National Guard's marginal credit rating and ongoing exposure to the Exploration & Production and energy trading businesses. The concern will be that even with the ring-fencing, if the parent holding company which is providing the source of capital for the utility subs, is downgraded to noninvestment grade, there will be an adverse impact on the utilities. Assuming approval, we can expect significant conditions placed upon the National Guard business diversification strategy.</p>	
5. Shareholders Approve		
<ul style="list-style-type: none"> • The fixed exchange ratio currently contemplated in the transaction exposes our shareholders to Navy price risk for up to 18 months. 		
<ul style="list-style-type: none"> • How do we expect <u>each</u> of our 15 largest shareholders to vote? 		
<ul style="list-style-type: none"> • How do we expect our stock price to react upon announcement and will this influence sentiment towards the transaction? 		