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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(Mark One)

☒ **Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the fiscal year ended December 31, 2006
or

☐ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from ____________ to ____________

Commission file number: 1-03562

AQUILA, INC.
(Exact name of registrant as specified in its charter)

Delaware	**44-0541877**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

20 West Ninth Street, Kansas City, Missouri 64105
(Address of principal executive offices)

Registrant's telephone number, including area code (816) 421-6600

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $1.00 per share	New York Stock Exchange
7.875% Quarterly Interest Bonds, due March 1, 2032	New York Stock Exchange
Premium Income Equity Securities, 6.75%, mandatorily convertible to common shares on September 15, 2007	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☒

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12B-2 of the Exchange Act. (Check one):

Large accelerated filer ☒ Accelerated Filer ☐ Non-accelerated Filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The aggregate market value of the voting stock held by non-affiliates of the Registrant, based upon the closing sale price of the Common Stock on June 30, 2006 as reported on the New York Stock Exchange, was approximately $1,179,115,910. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

Title	Outstanding at February 23, 2007
Common Stock, par value $1.00 per share	**374,636,015**
Documents Incorporated by Reference: **Proxy Statement for 2007** **Annual Shareholders Meeting**	**Where Incorporated:** **Parts II and III**

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Glossary of Terms and Abbreviations

APB—Accounting Principles Board.

AFUDC—Allowance for Funds Used During Construction.

Aquila Merchant—Aquila Merchant Services, Inc., our wholly-owned merchant energy subsidiary.

BART—Best Available Retrofit Technology.

Black Hills—Black Hills Corporation, a South Dakota corporation.

Btu—British Thermal Unit, which is a standard unit for measuring the quantity of heat energy required to raise the temperature of one pound of water by one degree Fahrenheit.

CAIR—Clean Air Interstate Rule.

CAMR—Clean Air Mercury Rule.

CO_2—Carbon dioxide.

Crossroads plant—the Crossroads Energy Center, a non-regulated, 340 MW electric generation "peaking" facility located in Clarksdale, Mississippi which is contractually controlled by Aquila Merchant.

EBITDA—Earnings before interest, taxes, depreciation and amortization.

EITF—Emerging Issues Task Force, an organization that is designed to assist the FASB in improving financial reporting through the identification, discussion and resolution of financial issues within the framework of existing authoritative literature.

Energy Act—Energy Policy Act of 2005.

EPA—Environmental Protection Agency, a governmental agency of the United States of America.

ERISA—Employee Retirement Income Security Act of 1974, as amended.

Exchange Act—Securities Exchange Act of 1934, as amended.

FASB—Financial Accounting Standards Board, a rulemaking organization that establishes financial accounting and reporting standards in the United States of America.

FERC—Federal Energy Regulatory Commission, a governmental agency of the United States of America that, among other things, regulates interstate transmission and wholesale sales of electricity and gas and related matters.

FIN—FASB Interpretation intended to clarify accounting pronouncements previously issued by the FASB.

Fitch—Fitch Ratings, a leading global rating agency.

GAAP—Generally Accepted Accounting Principles in the United States of America.

Great Plains Energy—Great Plains Energy Incorporated, a Missouri corporation.

GWh—Gigawatt-hour.

Heat Rate—The measure of efficiency of converting fuel to electricity, expressed as British thermal units (Btu) of fuel per kilowatt-hour. The lower the heat rate, the more efficient the plant.

IUB—Iowa Utilities Board, a governmental agency of the State of Iowa that, among other things, regulates the tariffs and service quality standards of our regulated utility operations in Iowa.

Kansas Commission—Kansas Corporation Commission, a governmental agency of the State of Kansas that, among other things, regulates the tariffs and service quality standards of our regulated utility operations in Kansas.

KCPL—Kansas City Power & Light Company, an electric utility company with operations in Missouri and Kansas that is wholly owned by Great Plains Energy.

kWh—Kilowatt-hour.

LIBOR—London Inter-Bank Offering Rate.

Mcf—One thousand cubic feet.

Merger—the merger of Gregory Acquisition Corp., a wholly-owned subsidiary of Great Plains Energy, with and into Aquila.

MGP—Manufactured Gas Plant.

MISO—Midwest Independent System Operator, which is a FERC-approved RTO.

Missouri Commission—Missouri Public Service Commission, a governmental agency of the State of Missouri that, among other things, regulates the tariffs and service quality standards of our regulated electric utility operations in Missouri.

MMBtu—One Million Btus.

Mmcf—One million cubic feet.

Moody's—Moody's Investors Service, Inc., a leading global rating agency.

MW—Megawatt, which is one thousand kilowatts.

MWh—Megawatt-hour.

NOx—Nitrogen oxide.

NYMEX—New York Mercantile Exchange.

NYSE—New York Stock Exchange.

OCI—Other Comprehensive Income (Loss) as defined by GAAP.

PCB—Polychlorinated Biphenyl.

PGA—Purchased Gas Adjustment tariffs, which impact our natural gas utility customers.

PIES—Premium Income Equity Securities, our series of 6.75% mandatorily convertible senior notes.

RTO—Regional Transmission Organization.

S&P—Standard and Poor's, a division of The McGraw-Hill Companies, Inc., a leading global rating agency.

SEC—Securities and Exchange Commission, a governmental agency of the United States of America.

SFAS—Statement of Financial Accounting Standards, the accounting and financial reporting rules issued by FASB.

SO_2—Sulfur dioxide.

Westar—Westar Energy, Inc., a Kansas utility company.

Part I

Item 1. Business

History and Organization

Aquila, Inc. (Aquila or the Company, which may be referred to as "we," "us" or "our") is an integrated electric and natural gas utility headquartered in Kansas City, Missouri. We began as Missouri Public Service Company in 1917 and reincorporated in Delaware as UtiliCorp United Inc. in 1985. In March 2002, we changed our name to Aquila, Inc. As of December 31, 2006, we had 2,456 employees in the United States, 1,095 of which are represented by union locals. Our business is organized into three business segments: Electric Utilities, Gas Utilities and Merchant Services. Electric Utilities comprises our regulated electric utility operations, Gas Utilities comprises our regulated gas utility operations, and Merchant Services comprises our unregulated energy activities operated by Aquila Merchant. All other operations are included in Corporate and Other, including costs that are not allocated to our operating businesses; our former controlling interest in a broadband company operating in Kansas City, Everest Connections, which was classified as "held for sale" prior to its sale on June 30, 2006 and reported in discontinued operations; and our former investment in the United Kingdom. Substantially all of our revenues are generated by our Electric and Gas Utilities.

We have entered into an agreement to sell our Electric utility in Kansas and in 2006 sold our Gas utilities in Michigan, Minnesota, and Missouri, which results in these operations being reported as discontinued operations. Excluding discontinued operations, our Electric Utilities include 1,843 MWs of generation and 14,992 pole miles of electric transmission and distribution lines, and our Gas Utilities include 516 miles of intrastate gas transmission pipelines and 11,283 miles of gas distribution mains and service lines. Our Electric and Gas Utilities generated revenues from continuing and discontinued operations of $1,379.2 million and $489.1 million, respectively, in the year ended December 31, 2006, and had total assets in continuing and discontinued operations of $2.6 billion and $.3 billion, respectively, at December 31, 2006.

Through 2004 our operations also included significant international utility investments and Merchant Services was a much larger component of our business. In 2002 we began to reposition our business to concentrate on our Electric and Gas utilities and reduce our financial obligations. As part of that repositioning, we sold all of our international investments and a substantial portion of our Merchant Services assets. Additionally, we wound down most of our Merchant Services energy trading portfolio. Our remaining Merchant Services group contractually controls the Crossroads Energy Center, a non-regulated domestic power generation facility, and owns our remaining wholesale energy trading portfolio. In 2006 we sold our Raccoon Creek and Goose Creek merchant power plants, which resulted in these operations being reported as discontinued operations. See Management's Discussion and Analysis for further discussion of our strategic and financial repositioning.

Pending Merger

On February 6, 2007, we entered into a merger agreement with Great Plains Energy, Gregory Acquisition Corp., a wholly-owned subsidiary of Great Plains Energy, and Black Hills, which provides for the merger (the Merger) of Gregory Acquisition Corp. into us, with Aquila continuing as the surviving corporation. If the Merger is completed, we will become a wholly-owned subsidiary of Great Plains Energy, and our shareholders will receive cash and shares of Great Plains Energy common stock in exchange for their shares of Aquila common stock. At the effective time of the Merger, each share of Aquila common stock will convert into the right to receive 0.0856 shares of Great Plains Energy common stock and a cash payment of $1.80. The companies expect that upon consummation of the Merger our shareholders will own approximately 27% of the outstanding common stock of Great Plains Energy, and the Great

Plains Energy shareholders will own approximately 73% of the outstanding common stock of Great Plains Energy.

In connection with the Merger, we also entered into agreements with Black Hills under which we have agreed to sell our Colorado electric utility and our Colorado, Iowa, Kansas and Nebraska gas utilities to Black Hills for $940 million, subject to certain purchase price adjustments. These asset sales will occur immediately prior to consummation of the Merger. The Merger and the asset sales are each contingent upon the closing of the other transaction, meaning that one transaction will not close unless the other transaction closes.

Further information concerning the Merger and asset sales will be included in a merger proxy statement we will file with the SEC and mail to our shareholders. This proxy statement will also constitute a prospectus for the Great Plains Energy common stock to be issued to our shareholders in the Merger and be included in a registration statement on Form S-4 to be filed with the SEC by Great Plains Energy. See Note 20 to the Consolidated Financial Statements for additional information related to these transactions.

The information disclosed by the Company in this Form 10-K regarding its strategy, risks and specific plans is subject to change if the Merger is completed.

Access to Company Information and Officer Certifications

The reports we file with the SEC are available free of charge at our website *www.aquila.com* as soon as reasonably practicable after they are filed. In addition, the charters of our Audit, Nominating and Corporate Governance, and Compensation and Benefits Committees are located on our website along with our Code of Business Conduct, Code of Ethics for Senior Financial Officers, and Corporate Governance Principles. The information contained on our website is not part of this document.

Our Chief Executive Officer and Chief Accounting Officer have filed with the SEC, as exhibits to our Annual Report on Form 10-K, the certifications required by Section 302 of the Sarbanes Oxley Act regarding the quality of our public disclosure.

Our Chief Executive Officer certified to the NYSE following our 2006 annual shareholder meeting that he was not aware of violations by us of the NYSE corporate governance listing standards.

Each of the foregoing documents is available in print to any of our shareholders upon request by writing to Aquila, Inc. 20 West Ninth Street, Kansas City, Missouri 64105: Attention: Investor Relations.

Business Group Summary

Segment information for the three years ended December 31, 2006 is included in Note 17 to the Consolidated Financial Statements.

I. Electric and Gas Utilities

Electric Utilities generates, transmits and distributes electricity to 396,829 customers in our continuing operations in Colorado and Missouri and to 68,972 customers in our discontinued operations in Kansas. Our electric generating facilities and purchased power contracts supply electricity principally to our own distribution systems. Additionally, we sell excess power to other utilities and marketing companies. Approximately 66% of our electric customers are located in Missouri. Gas Utilities distributes natural gas to 515,760 customers in Colorado, Iowa, Kansas, and Nebraska. Approximately 65% of our continuing utility operations, based on the book value of our regulated assets, are located in Missouri.

Electric Utilities

As of December 31, 2006, our owned or leased interests in electric generation plants were as follows:

Unit	Location	Year Installed	Unit Capability (MW)	Fuel
Missouri:				
Sibley #1-3	Sibley	1960, 1962, 1969	508	Coal
Ralph Green #3	Pleasant Hill	1981	71	Gas
Nevada	Nevada	1974	20	Oil
Greenwood #1-4	Greenwood	1975-1979	232	Gas/Oil
KCI #1-2	Kansas City	1970	34	Gas
Lake Road #1, 3	St. Joseph	1951, 1962	33	Gas/Oil
Lake Road #2, 4	St. Joseph	1957, 1967	125	Coal/Gas
Lake Road #5	St. Joseph	1974	68	Gas/Oil
Lake Road #6-7	St. Joseph	1989, 1990	43	Oil
Iatan 1	Iatan	1980	118	Coal
Jeffrey #1-3	St. Mary's	1978, 1980, 1983	175	Coal
South Harper #1-3	Peculiar	2005	315	Gas
Colorado:				
W.N. Clark #1-2	Canon City	1955, 1959	42	Coal
Pueblo #6	Pueblo	1949	20	Gas
Pueblo #5	Pueblo	1941, 2001	9	Gas
AIP Diesel	Pueblo	2001	10	Oil
Diesel #1-5	Pueblo	1964	10	Oil
Diesel #1-5	Rocky Ford	1964	10	Oil
Total continuing operations			1,843	
Kansas:				
Judson Large #4	Dodge City	1969	142	Gas
Arthur Mullergren #3	Great Bend	1963	99	Gas
Cimarron River #1-2	Liberal	1963, 1967	75	Gas
Clifton #1-2	Clifton	1974	76	Gas/Oil
Jeffrey #1-3	St. Mary's	1978, 1980, 1983	175	Coal
Total discontinued operations			567	
Total capability			2,410	

The following table shows Electric Utilities' overall fuel mix and generation capability for 2006:

Fuel Source (MW)	Continuing	Discontinued
Coal	843	175
Gas	449	316
Oil	93	—
Coal and gas	125	—
Gas and oil	333	76
Total generation capability	1,843	567

At December 31, 2006, Electric Utilities owned or leased the electric transmission and distribution lines shown below:

Line Type—In Miles

	Continuing	Discontinued
Electric transmission	2,131	2,500
Electric distribution	12,861	3,851

The following table summarizes regulated sales, volumes and customers for our Electric Utilities business:

	2006	2005	2004
Sales (in millions)			
Residential	$ 328.7	$ 303.8	$ 263.3
Commercial	206.9	190.0	173.0
Industrial	91.9	91.6	84.2
Other	140.4	98.5	73.6
Total continuing electric operations	767.9	683.9	594.1
Total discontinued electric operations	188.8	190.9	165.2
Total	$ 956.7	$ 874.8	$ 759.3
Volumes Generated and Purchased (GWh)			
Coal	5,463	5,248	5,275
Gas	149	91	2
Coal/Gas	521	611	686
Gas/Oil	82	61	21
Total generated	6,215	6,011	5,984
Purchased	5,547	5,860	4,630
Total generated and purchased	11,762	11,871	10,614
Company use	(15)	(15)	(14)
Line loss	(713)	(691)	(668)
Total continuing electric operations	11,034	11,165	9,932
Total discontinued electric operations	2,304	2,311	2,431
Total	13,338	13,476	12,363
Volumes Sold (GWh)			
Residential	3,997	3,961	3,603
Commercial	3,244	3,050	2,893
Industrial	1,863	1,870	1,838
Other	1,930	2,284	1,598
Total continuing electric operations	11,034	11,165	9,932
Total discontinued electric operations	2,304	2,311	2,431
Total	13,338	13,476	12,363

	2006	2005	2004

Customers at Year End						
Residential		347,352		341,589		335,003
Commercial		46,486		46,029		45,084
Industrial		336		372		383
Other		2,655		3,416		3,359
Total continuing electric operations		396,829		391,406		383,829
Total discontinued electric operations		68,972		68,920		68,817
Total		465,801		460,326		452,646

Continuing Operations Statistics—

Average annual volume per residential customer (kWh)		11,508		11,597		10,755
Average annual sales per residential customer	$	946	$	889	$	786
Average residential sales per kWh (cents)		8.22		7.67		7.31
Units of Fuel Used in Generation						
Coal—thousand tons		3,607		3,569		3,582
Natural gas—Mmcf		3,548		2,120		782
Average Cost of Fuel						
Coal—per ton	$	29.91	$	24.97	$	23.34
Natural gas—per Mcf		11.55		9.85		6.97

Gas Utilities

At December 31, 2006, Gas Utilities owned the gas transmission and distribution lines shown below:

Line Type—In Miles	**Continuing**
Intrastate gas transmission pipelines	516
Gas distribution mains and service lines	11,283

The following table summarizes regulated sales, volumes and customers for our Gas Utilities business:

		2006		**2005**		**2004**
Sales (in millions)						
Residential	$	381.5	$	400.7	$	334.6
Commercial		144.6		156.7		124.5
Industrial		26.6		27.3		25.0
Transportation and other		28.7		21.6		22.4
Total continuing gas operations		581.4		606.3		506.5
Total discontinued gas operations		294.6		614.2		525.5
Total	$	876.0	$	1,220.5	$	1,032.0

Volumes Sold (Mcf)			
Residential	23,462	34,922	34,331
Commercial	10,666	14,886	14,230
Industrial	5,342	3,399	3,789
Transportation and other	44,950	42,580	41,341
Total continuing gas operations	84,420	95,787	93,691
Total discontinued gas operations	52,659	123,136	121,285
Total	137,079	218,923	214,976
Customers at Year End			
Residential	464,825	456,592	448,889
Commercial	42,825	43,213	42,921
Industrial	1,529	1,699	1,691
Transportation and other	6,581	7,039	7,306
Total continuing gas operations	515,760	508,543	500,807
Total discontinued gas operations	—	414,556	409,309
Total	515,760	923,099	910,116

Seasonal Variations of Business

Our electric and gas utility businesses are weather-sensitive. We have both summer- and winter-peaking utility businesses to reduce dependence on a single peak season. The table below shows normal utility peak seasons.

Operations	**Peak**
Gas Utilities	November through March
Electric Utilities	July and August

Competition

We currently have limited competition for the retail distribution of electricity and natural gas in our service areas. While various restructuring and competitive initiatives have been discussed in the states in which our utilities operate, none have been implemented. Although we face competition from independent marketers for the sale of natural gas to our industrial and commercial customers, in instances where independent marketers displace us as the seller of natural gas, we still collect a distribution charge.

Regulation and Rates

State Regulation

Our utility operations are subject to the jurisdiction of the public service commissions in the states in which they operate. The commissions oversee services and facilities, rates and charges, accounting, valuation of property, depreciation rates and various other matters. Certain commissions also have jurisdiction over the creation of liens on property located in their state to secure bonds or other securities.

Our regulated businesses produce, purchase and distribute power in three states and purchase and distribute natural gas in four states. All of our Gas Utilities have purchased gas adjustment (PGA) provisions that allow them to pass the prudently-incurred cost of gas through to the customer. To the extent that gas prices are higher or lower than amounts in our current billing rates, adjustments are made on a periodic basis to "true-up" billed amounts to match the actual cost we incurred. These adjustments are subject to periodic prudence reviews by the state utility commissions. The Kansas and Nebraska Commissions also allow us to recover the gas cost portion of uncollectible accounts through the PGA. The Kansas Commission has also established a weather normalization tariff which provides a pass-through mechanism for weather margin variability from the level used to establish base rates to be paid by the customer.

In our continuing regulated electric business in 2006, we generated approximately 53% of the power that we sold and we purchased the remaining 47% through long-term contracts or in the open market. The regulatory provisions for recovering power costs vary by state. In Kansas and Colorado, we have Energy Cost Adjustment (ECA) clauses which serve a purpose similar to the PGAs for our gas utilities. To the extent that our fuel and purchased power energy costs vary from the energy cost built into our tariffs, the difference is passed through to the customer. In Missouri, we currently do not have the ability to adjust the rates we charge for electric service to offset all or part of any increase or decrease in prices we pay for natural gas, coal or other fuel we use in generating electricity (i.e., a fuel adjustment mechanism). As a result, our electric earnings can fluctuate more in Missouri than in our other electric rate jurisdictions. The Missouri Commission approved a settlement agreement in April 2004 for our electric operations that established our right to recover costs up to $13.98/Mwh in our St. Joseph Light & Power operations and $19.71/Mwh in our Missouri Public Service operations for a two-year period. If our actual costs were higher than those allowed costs, we could not recover the excess costs through rates. If our actual costs were less than those allowed costs, we would refund the difference to our customers, except to the extent actual costs were below $12.64/Mwh for our St. Joseph Light & Power operations and $16.65/Mwh for our Missouri Public Service operations. In the period after the rate increase went into effect, our actual costs exceeded the allowed costs for our Missouri Public Service operations. However, in connection with our settlement of the Missouri electric rate case in February 2006, we agreed to refund $1.0 million to our St. Joseph Light & Power customers and terminate our interim energy charge when new base rates became effective on March 1, 2006.

On July 14, 2005, new legislation in Missouri established a means for recovering prudently-incurred fuel and purchased power costs without going through a general rate case. This legislation, which also permits the recovery of government-mandated environmental investments, has been implemented through the issuance of rules by the Missouri Commission. The initial filing of fuel and environmental tariffs must be made in connection with a general rate proceeding. The Missouri Commission established rules subsequent to the conclusion of our most recent rate decision in March 2006. These rules became effective on January 30, 2007 and we expect these provisions to be considered in our current electric rate case, which we filed in July 2006. We cannot estimate with certainty the impact that implementing these provisions may have on our financial results and financial condition.

In 2003, the Kansas Commission issued orders in connection with its investigation into the affiliated transactions between our regulated utilities and our other businesses that require us to obtain the approval of the Kansas Commission before taking the following actions:

- pledge for the benefit of our current and prospective lenders any regulated utility assets presently devoted to serving Kansas retail customers;

- invest any money in new non-utility businesses or invest in any existing business except in the ordinary course of business or to fulfill an existing financial, contractual or operational obligation;

- incur any new or modify any existing indebtedness other than routine, short-term borrowings incurred in the ordinary course of business for working capital needs;

- pay any dividends; or

- enter into any contract or agreement that: (1) alienates, conveys or creates an interest in our assets (e.g., through issuing stock or debt or arranging other securitization), including any agreement to modify an existing obligation to alienate, convey or create an interest in our assets, or (2) relates to products or services not required for the provision of continuing utility operations.

The rates that we are allowed to charge for our services are determined by state public service or utility commissions. Decisions are influenced by many factors, including the cost of providing service, capital expenditures, the prudence of our costs, views about appropriate rates of return, the rates of other utilities, general economic conditions and the political environment.

The following summarizes our recent rate case activity:

In millions	Type of Service	Date Requested	Date Effective	Amount Requested	Amount Approved
Kansas *(1)*	Electric	6/2004	4/2005	$ 16.4	$ 8.0
Kansas *(2)*	Gas	11/2004	6/2005	6.2	2.7
Iowa *(3)*	Gas	5/2005	4/2006	4.1	2.9
Missouri *(4)*	Electric	5/2005	3/2006	78.6	44.8
Missouri *(4)*	Steam	5/2005	3/2006	5.0	4.5
Missouri *(5)*	Electric	7/2006	Pending	118.9	Pending
Kansas *(6)*	Gas	11/2006	Pending	7.2	Pending
Nebraska *(7)*	Gas	11/2006	Pending	16.3	Pending

(1) In connection with the settlement, our ECA provision was modified to allow the pass through of SO_2 emission allowance costs to customers.

(2) The Kansas gas settlement included $244,000 per year for three years for a pipe replacement program.

(3) Under Iowa regulations, we instituted interim rates, subject to refund, totaling approximately $1.7 million in May 2005. On March 1, 2006, the IUB issued an order approving a $2.9 million rate increase, including recovery of rate case costs. The order denied a settlement provision that would have provided a more timely recovery mechanism for investments in distribution system integrity. Final rates became effective March 17, 2006.

(4) The Missouri electric settlement terminated the interim energy charge established in our 2003 rate case filing and required a $1.0 million refund to our St. Joseph Light & Power customers as part of the termination. The settlement also established the value of our South Harper peaking facility at approximately $140 million, resulting in an additional $4.4 million impairment of the plant's turbines. See Note 5 to the Consolidated Financial Statements for further discussion. The settlement was approved by the Missouri Commission on February 23, 2006, and the new rates became effective on March 1, 2006. In addition, in February 2006, we settled the Missouri steam rate case for a $4.5 million

rate increase. This settlement includes a provision for sharing 80% of fuel cost variability from the established base fuel rates. It was approved by the Missouri Commission in February 2006 and the new rates became effective on March 6, 2006.

(5) On July 3, 2006, we filed for a $94.5 million rate increase, or 22.0%, in our Missouri Public Service territory and a $24.4 million increase, or 22.1%, in our St. Joseph Light & Power territory. These increases were requested to recover increases in the cost of fuel and purchased power capacity and increased operating costs. The amount of the request is based, among other things, on a return on equity of 11.5% and an adjusted equity ratio of 47.5%. In addition, we requested the implementation of a fuel adjustment clause.

Our original filing reflected flow-through power capacity costs equivalent to the estimated revenue requirement for the purchase of the Aries plant, for which we had been named the stalking horse bidder in an auction process run on behalf of creditors of Calpine Corporation. However, the bidding reached a point at which it did not make economic sense for Aquila to continue in the process. Consequently, we secured lower cost short-term purchased power contracts.

The Missouri Commission staff's case was filed January 18, 2007. The staff recommended a return on equity in the range of 9% to 10.25% which, together with other recommendations of the staff, would yield a rate increase in the range of $45.9 million to $56.4 million. The staff's case included the effects of not acquiring Aries, as discussed above. The staff also recommended implementing an interim energy charge instead of a fuel adjustment clause. Rebuttal testimony was filed on February 20, 2007. Surrebuttal testimony will be filed by all parties on March 20, 2007, following the filing on February 27, 2007 of the staff's revised position based upon a "true-up" of major revenue requirement issues through December 31, 2006. Evidentiary hearings are scheduled to begin April 2, 2007. We expect the Commission to rule on our request in May 2007, with approved rate changes taking effect no later than June 1, 2007.

(6) On November 1, 2006, we filed for a $7.2 million rate increase, or 5.1%, in our Kansas natural gas service territory. Also included in the filing is a redesign of the rate structure to shift most fixed cost of service recovery from the usage-based delivery charge to a flat monthly fee for service and system costs. The change in rates is expected to take effect in June 2007.

(7) In November 2006, we filed for a $16.3 million rate increase, or 7.7%, in our Nebraska natural gas service territory. Interim rates were implemented February 15, 2007, and the Nebraska Commission has up to 240 days to analyze the rate request. If the interim rates are higher than final approved rates, the difference plus interest will be refunded or credited to customers.

Federal Regulation

With Order 2000, FERC encouraged investor-owned utilities to join an RTO approved by the FERC. RTO characteristics include independence, scope and configuration, operational authority, and short-term reliability. An RTO has the responsibility to provide tariff administration, regional planning, and scheduling functions, as well as monitor and coordinate the regional grid. We have FERC jurisdictional transmission facilities in Colorado, Kansas and Missouri.

In Colorado, our only RTO option (WestConnect) has not yet been approved by the FERC. The members of that RTO include utilities in Arizona, New Mexico, Nevada and Colorado. We will continue to monitor the status of WestConnect.

The FERC order approving our merger with St. Joseph Light & Power Company contained a stipulation requiring us to file with the FERC a plan to join an RTO. At that time, MISO was the only FERC-approved RTO in the Midwest. Thus, we informed the FERC that our Kansas and Missouri facilities planned to join MISO, subject to obtaining the necessary state regulatory approvals.

With respect to our Missouri facilities, in 2001 we submitted an application to the FERC and to the Missouri Commission to join MISO and transfer operational control of our transmission system to MISO. The FERC application was approved, but the application to the Missouri Commission was dismissed in early 2002 when the MISO footprint was modified and AmerenUE was no longer a participant. We were relying upon AmerenUE interconnections to provide electric connectivity from our transmission system to the MISO footprint. Upon further evolution of the MISO footprint, in June 2003 we submitted another application to the Missouri Commission to join and transfer operational control to MISO. In response to that application, the Missouri Commission asked for additional cost-benefit information from us and MISO, and dismissed the application pending completion of the additional cost-benefit studies.

During 2006, two Missouri electric utilities, KCPL and Empire District Electric, requested and were granted approval by the Missouri Commission to become members of the Southwest Power Pool (SPP). We are currently conducting a cost/benefit study to determine whether to join MISO, SPP or neither. We do not expect a significant impact to our financial statements upon participation.

In Kansas, we submitted an application to join the SPP RTO in August 2005 along with the other FERC jurisdictional utilities in Kansas. The Kansas Commission order approving our participation in the SPP RTO and Energy Imbalance Services market was issued on September 19, 2006.

Effective February 8, 2006, the Energy Act repealed the Public Utility Holding Company Act of 1935, as amended (PUHCA), and gave the FERC access to books and records of holding companies and other affiliate companies within a holding company system as the FERC determines it is necessary for the protection of utility customers. The Energy Act also authorized state regulatory commissions to obtain access to the books and records of holding companies, as well as their affiliates, if access to the books and records is necessary for the effective discharge of the FERC's responsibilities. The Energy Act has not had a material impact on our operations, as we were not a public utility holding company under PUHCA and we were otherwise subject to extensive "books and records" review by various state and federal regulatory authorities previously.

Environmental Matters

General

We are subject to a number of federal, state and local laws and regulations relating to the protection of the environment and the safety and health of personnel and the public. These laws and regulations affect a broad range of our activities, and generally require:

- the protection of air and water quality;
- the identification, generation, storage, handling, transportation, disposal, record-keeping, labeling, reporting of, and emergency response in connection with hazardous and toxic materials and wastes, including asbestos;
- the protection of plant and animal species and minimization of noise emissions; and

- safety and health standards, practices and procedures that apply to the workplace and to the operation of our facilities.

Water Issues

The Clean Water Act protects water quality and generally prohibits the discharge of any pollutants, including heat, into any body of surface water, except in compliance with a discharge permit issued by a state environmental regulatory agency or the EPA.

316(b) Fish Impingement Requirements

In July 2004, the EPA issued new rules requiring power plants with cooling water intake structures to undertake studies and implement technologies to minimize fish kills resulting from water withdrawal. We own two plants that are affected by these rules. We are currently completing the required studies and working with state and federal agencies involved with the Missouri River regulations to determine compliance options and benefits to Missouri River fish populations for these two plants. Due to a recent court decision, these rules were remanded back to the EPA for revision. At this time, we do not know what the revised rules will require or what impact they might have on our compliance options.

Missouri River Levels

Recent attempts have been made to address items such as drought conditions, endangered species, navigation, and recreational interests along the course of the Missouri River through litigation and the revision of plans that manage the level of water flow. The U.S. Army Corps of Engineers has proposed changes for the management of the Missouri River that may, in coming years, lower water levels. Reduced river levels can impact the net capacity of generating facilities along the Missouri River, which may have a material impact on utility operations in the future.

Air Emissions

Our facilities are subject to many federal, state and local laws and regulations relating to the protection of air quality. These laws and regulations cover, among other pollutants, those contributing to the formation of ground-level ozone, carbon monoxide, SO_2, NOx, mercury and particulate matter. In addition, CO_2 is also included as a potential emission that may be regulated. Power generating facilities burning fossil fuels emit each of the foregoing pollutants and, accordingly, are subject to substantial regulation and enforcement oversight by various governmental agencies.

Clean Air Act

Title IV of the Clean Air Act created an SO_2 allowance trading program as part of the federal acid rain program. Each allowance gives the owner the right to emit one ton of SO_2. Certain facilities are allocated allowances based on their historical operating data. At the end of each year, each emitting unit must have enough allowances to cover its emissions for that year. Allowances may be traded so affected units that expect to emit more SO_2 than their allocated allowances may purchase allowances in the open market. Our facilities emit SO_2 in excess of their allocated allowances. Currently, we purchase additional allowances to stay in compliance. We are continuing to evaluate the cost of purchasing allowances as compared to the cost of adding pollution control equipment.

Multi-pollutant regulations

Approximately 53% of our continuing Electric Utilities generating capacity is coal-fired. The EPA has issued the Clean Air Interstate Rule (CAIR) and the Clean Air Mercury Rule (CAMR) regulations with respect to SO_2, NOx and mercury emissions from certain power plants which burn fossil fuels. These new rules would require significant reductions in these emissions from our power plants, especially coal-fired plants, in phases beginning as early as 2009. The rules are being challenged in the courts. We are completing a study to determine the best options for compliance with CAIR and CAMR and participating in state work groups that will adopt the final Federal regulations. Federal multi-pollutant legislation is also being considered that would require reductions similar to the EPA rules and some that could add greenhouse gas emission requirements. We anticipate additional capital costs to comply with the CAIR and CAMR rules.

New Source Review

The EPA has been conducting enforcement initiatives nationwide to determine whether certain activities conducted at electric generating facilities are subject to the EPA's New Source Review requirements under the Clean Air Act. The EPA is interpreting the Clean Air Act to require coal-fired power plants to update emission controls at the time of major maintenance or capital activity. Several utility companies have entered into settlement agreements with the EPA that resulted in fines and commitments to install the best available pollution controls at facilities alleged to have violated New Source Review requirements.

In January 2004, Westar received a notification from the EPA that it had violated New Source Review requirements and Kansas environmental regulations by making modifications to the Jeffrey Energy Center without obtaining the proper permits. The Jeffrey Energy Center is a large coal-fired power plant located in Kansas that is 84% owned by Westar and operated exclusively by Westar. We have a 16% interest in the Jeffrey Energy Center and are generally responsible for this portion of its operating costs and capital expenditures. The electric generation plants we own or lease are described in the table at Item 1, page 7. At this time, no settlement has been reached with the EPA; however, it is possible that Westar could be subject to an enforcement action by the EPA and be required to make significant capital expenditures to install additional pollution controls at the Jeffrey Energy Center. Irrespective of the NSR case, the recent high cost of SO_2 allowances may make it economical to install SO_2 technology. In either case, we could potentially be responsible for up to 16% of those costs, including the 8% lease interest held by our Kansas electric utility which is expected to be sold by April 1, 2007, and is included in discontinued operations.

On January 31, 2006, KCPL was issued an air permit for Iatan 2 that included additional air pollution control equipment for Iatan 1. As an 18% owner of Iatan 1, we will be responsible for 18% of the costs of the additional air pollution control equipment for Iatan 1.

Our capital expenditure forecasts include $215.2 million over the next three years for these types of environmental improvements. These estimates are subject to change based upon the timing and extent of the upgrades.

Global Climate Change

We utilize a diversified energy portfolio that includes a fuel mix of coal, natural gas, biomass, wind and nuclear sources. Of these fuel mixes, coal-fired power plants are the most significant sources of CO_2 emissions. We believe that it is possible that greenhouse gases may be regulated within the next five years. There are no specifics on how greenhouse gases will be regulated, but any federally mandated greenhouse gas reductions or limits on CO_2 emissions could have a material impact on our financial position or results of operations.

In 2006, we had a multi-disciplinary team perform a comprehensive review of all our greenhouse gas impacts. Our February 2007 integrated resource plan for Missouri incorporates the estimated impacts of a "cap and trade" program for CO_2 emissions, similar to that in place for SO_2 emissions, on our future generation mix. We will continue to review greenhouse gas impacts as legislation or regulation develops.

Solid Waste

Various materials used at our facilities are subject to disposal regulations. Our coal facilities generate ash that is sent to a permitted landfill or is utilized either in roofing material, road construction or as flowable fill. The useful life of the permitted landfill at our Sibley location is set to expire in 2007. Therefore, we have begun permitting of a new landfill for this waste disposal and beneficial utilization of additional fly ash. We estimate that we will incur approximately $3 million of capital expenditures in 2007 to close the current landfill and open the new landfill.

Past Operations

Some federal and state laws authorize the EPA and other agencies to issue orders compelling potentially responsible parties to clean up sites that are determined to present an actual or potential threat to human health or the environment. We are named as a potentially responsible party at two disposal sites for PCBs, and we retain some environmental liability for several operations and investments that we no longer own. In addition, we also own or have acquired liabilities from companies that once owned or operated former MGP sites, which are subject to the supervision of the EPA and various state environmental agencies.

As of December 31, 2006, we estimate probable costs of future investigation and remediation on our identified MGP sites, PCB sites and retained liabilities to be $3.5 million. This estimate was based upon our review of the potential costs associated with conducting investigative and remedial actions at our identified sites, as well as the likelihood of whether such actions will be necessary. There are also additional costs that we consider to be less likely but still "reasonably possible" to be incurred at these sites. Based upon the results of studies at these sites and our knowledge and review of potential remedial actions, it is reasonably possible that these additional costs could exceed our estimate by approximately $4.9 million. This estimate could change materially after further investigation. It could also be affected by the actions of environmental agencies and the financial viability of other responsible parties.

We have received rate orders that enable us to recover environmental cleanup costs in certain jurisdictions. In other jurisdictions, there are regulatory precedents for recovery of these costs. We are also pursuing recovery from insurance carriers and other potentially responsible parties.

II. Merchant Services

Merchant Services consists principally of our interest in the Crossroads plant and our remaining wholesale energy trading portfolio. The Crossroads plant does not have dedicated customers and is designed to operate only during periods of peak demand in the geographic area in which the plant is located. The table below shows information about the Crossroads plant as of December 31, 2006:

Plant & Location	Location	Type of Investment	Capacity (MW)	Heat Rate	Date in Service
Crossroads Energy Center	Mississippi	Contractually Controlled	340	11.9	September 2002

Although we have exited the wholesale energy trading business, we were previously one of the largest marketers and traders of wholesale natural gas, electricity and other commodities in North America and Western Europe. We stopped wholesale energy trading during 2002, and subsequent activity has focused on limiting our credit risk to counterparties and liquidating our trading positions. However, we still have certain contracts that remain in the trading portfolio because we were unable to liquidate or terminate them under economically feasible terms. Most, but not all, of our positions have been hedged to limit our exposure to price movements, and these contracts will continue to be our assets and liabilities until the contracts are settled or assigned.

Competition

Our Crossroads plant competes with other non-utility generators, regulated utilities, unregulated subsidiaries of regulated utilities, and other energy service companies in the development and operation of energy-producing projects. There is an oversupply of power in the geographic area in which the Crossroads plant is located, resulting in strong price competition for electric power. Often our marginal cost of producing power exceeds the marginal costs of other generators or normal market prices. Our Crossroads plant, which is a peaking plant, is generally dependent on outages and transmission difficulties occurring at generation facilities and distribution networks of others or short-term spikes in demand for power resulting from extreme weather. Those events, if they occur, can create short-term opportunities for the Crossroads plant to produce and sell power at favorable prices. Although we continue to work in the marketplace to mitigate our costs, if such events do not occur, or the spread between the cost of gas and the price of power does not increase, we will incur losses related to this plant, including continued operating and maintenance costs. The plant has not operated since August 2005.

Regulation

Natural Gas Marketing Regulation

Our natural gas purchases and sales are generally not regulated by the FERC or other regulatory authorities. However, we depend on natural gas transportation and storage services offered by companies that are regulated by the FERC and state regulatory authorities to transport natural gas we purchase or sell.

Power Generation and Marketing Regulation

The Federal Power Act and other FERC rules regulate the generation and transmission of electricity in interstate commerce and sales for resale of electric power. As a result, portions of our operations are under the jurisdiction of the Federal Power Act and the FERC.

The Federal Power Act grants the FERC exclusive rate-making jurisdiction over wholesale sales of electricity in interstate commerce. It also provides the FERC with ongoing as well as initial jurisdiction, enabling the FERC to modify previously approved rates. Such rates may be based on a cost-of-service approach or through competitive bidding or negotiation on a market basis. Independent power projects must obtain FERC acceptance of their rates under Section 205 of the Federal Power Act. The Crossroads plant has been granted market-based rate authority and complies with the requirements governing the approval of wholesale rates.

Our Executive Team

Name	Age at December 31, 2006	Position
Richard C. Green (Rick)	52	President, Chief Executive Officer and Chairman (our principal executive officer)
Keith G. Stamm	46	Senior Vice President and Chief Operating Officer
Beth A. Armstrong	44	Vice President and Chief Accounting Officer (our principal financial officer)
Leo E. Morton	61	Senior Vice President and Chief Administrative Officer
Christopher M. Reitz (Chris)	40	Senior Vice President, General Counsel and Corporate Secretary
Jon R. Empson	61	Senior Vice President, Regulated Operations
Scott H. Heidtbrink	45	Vice President, Power Generation and Energy Resources

Richard C. Green (B.S., Business, Southern Methodist University)

Rick joined our Company in 1976 and held various financial and operating positions between 1976 and 1982. In 1982, he was appointed Executive Vice President at Missouri Public Service Company, the predecessor to Aquila, Inc. Rick served as President and Chief Executive Officer from 1985 to 1996 and has been Chairman of the Board of the Company since 1989. He was also Chief Executive Officer from 1996 through 2001. In October 2002, Rick resumed the roles of President and Chief Executive Officer.

Keith G. Stamm (B.S., Mechanical Engineering, University of Missouri at Columbia; M.B.A., Rockhurst University)

Keith joined our Company in 1983 as a staff engineer at the Sibley Generating Station. Between 1985 and 1995, he held various operating positions. In 1995, Keith was promoted to Vice President, Energy Trading and in 1996, to Vice President and General Manager, Regulated Power. In 1997, he became the Chief Executive Officer of United Energy Limited, an affiliated electric distribution company that was listed on the Australian Stock Exchange in 1998. From January 2000 to November 2001, he served as Chief Executive Officer of what is now Aquila Merchant. In November 2001, he was appointed President and Chief Operating Officer of what is now our Electric and Gas Utilities. In October 2002, Keith became Chief Operating Officer of Aquila, Inc.

Beth A. Armstrong (B.S., Business Administration, Southeast Missouri State University)

Beth joined our Company in 1991 as Manager of Financial Reporting and Property Accounting for our Missouri Public Service division. Between 1991 and July 2005, she served in various accounting and financial analysis positions, including Controller of Missouri Public Service and analytical positions within Aquila Merchant. In July 2005, she was appointed Vice President, Controller of the Company. In July 2006, Beth was appointed Vice President and Chief

Accounting Officer. Prior to joining the Company, Beth served as an audit manager with Price Waterhouse LLP.

Leo E. Morton (B.S., Mechanical Engineering, Tuskegee University; M.S., Management, Massachusetts Institute of Technology)

Leo joined our Company in 1994 as Vice President, Performance Management. He was appointed Senior Vice President in 1995 and Senior Vice President, Human Resources and Operations Support in 1997. In 2000, he was named Senior Vice President and Chief Administrative Officer. Prior to working for us, Leo held executive and management positions in manufacturing and engineering for AT&T beginning in 1973.

Christopher M. Reitz (B.S., Accounting and Business, University of Kansas; J.D., University of Kansas Law School)

Chris joined our Company in July 2000 in our General Counsel's office, serving most recently as Assistant General Counsel. In February 2005, he was appointed Interim General Counsel and Corporate Secretary of Aquila, Inc. In May 2005, Chris was appointed Senior Vice President, General Counsel and Corporate Secretary of Aquila, Inc. Prior to joining our Company, Chris held corporate counsel positions with Cerner Corporation, Sprint Corporation and the law firm of Blackwell Sanders Peper Martin LLP.

Jon R. Empson (B.A., Economics, Carleton College; M.B.A., Economics, University of Nebraska at Omaha)

Jon joined our Company in 1986 as Vice President, Regulation, Finance and Administration of one of our major utility divisions. In 1993, Jon was appointed Aquila's Senior Vice President, Gas Supply and Regulatory Services and in 1996 he was appointed Senior Vice President, Regulatory, Legislative and Environmental Services. In December 2003, Jon was appointed Senior Vice President, Regulated Operations. Prior to joining the Company, Jon worked for a predecessor company in various executive and management positions for seven years, held executive management positions at the Omaha Chamber of Commerce and Omaha Economic Development Council and worked as an economist with the U.S. Department of Housing and Urban Development.

Scott H. Heidtbrink (B.S., Electrical Engineering, Kansas State University)

Scott joined our Company in 1987 as a field engineer at our Lee's Summit, Missouri service center. He has held various engineering, field and customer operations management positions involving both gas and electric utility operations. Prior roles with the Company include State President and General Manager—Kansas from 1994 to 1997; Vice President, Network Management from 1998 to 2000; Vice President, Aquila Gas Operations in 2001; and Vice President, Kansas/Colorado Gas from 2002 to 2004. Scott led the deployment of Six Sigma into our utility operations in 2004 and 2005 and is a certified Six Sigma Black Belt. In January 2006, Scott was appointed Vice President, Power Generation and Energy Resources.

Item 1A. Risk Factors

Operating Risks

Our strategic repositioning plan depends on our ability to raise adequate proceeds from the Kansas electric asset sale and retire a sufficient amount of debt and other long-term liabilities with the net sale proceeds.

In March 2005, we announced our strategic repositioning plan. Asset divestitures, including the sale of our Kansas electric utility property, were a key element of our plan. We have signed definitive agreements to sell our electric utility operations in Kansas for a base purchase price of $249.7 million. We anticipate using the net proceeds generated by this divestiture to retire debt and other obligations, and to fund capital expenditures, including rate-base investments required to satisfy our long-term power generation and transmission needs and comply with environmental rules and regulations. On February 23, 2007, the Kansas Commission issued an order approving the settlement agreement signed in connection with the sale of our Kansas electric operations. We expect this transaction to close by April 1, 2007.

If we cannot complete this asset sale, or if we are not able to retire a principal amount of debt sufficient to reduce our interest expense to a level that can be satisfied by the cash flow generated by our remaining utility operations, we will continue to have a cash flow shortfall. We may also need to explore alternatives with respect to financing the significant capital expenditures anticipated in connection with environmental upgrades and compliance, as well as capital expenditures generally required to continue to provide safe and reliable service to our remaining utility customers.

We must sustain the reduced level of corporate costs.

In 2005, we allocated $42.3 million of operating costs, comprised of corporate overhead and central services, to our utility divisions held for sale. During 2006, we eliminated the majority of these costs following the sale of the Michigan, Minnesota and Missouri gas operations. Our 2007 plan includes a $39.5 million reduction in corporate costs compared to 2005. A portion of the cost reductions were achieved in non-allocated corporate costs. The remaining corporate costs have been reallocated to our remaining utilities. There can be no assurances that we will be successful in our efforts to sustain these cost reductions and/or recover the remaining costs in rates in our continuing utility operations.

We may continue to incur losses in our Merchant Services business.

We may incur a material impairment charge if we decide to sell our interest in our Crossroads merchant peaking power plant. In addition, we expect to continue to incur operating losses from our remaining Merchant Services business.

Our non-investment grade credit ratings have an adverse effect on our liquidity and borrowing costs.

Our long-term senior unsecured debt is presently rated "B2" (Stable Outlook) by Moody's, and "B" (Positive Outlook) by S&P. Our non-investment grade ratings have increased our borrowing costs. These increases in our borrowing costs are not recoverable in our utility rates. In addition, our non-investment grade ratings generally require us to prepay our commodity purchases or post collateral to obtain trade credit. As of December 31, 2006, we had posted $265.1 million of collateral (in the form of cash or letters of credit) with counterparties.

Our ability to further reposition our Company as a regulated utility could be restricted by the terms of our finance agreements and our regulatory orders.

Our credit facilities and regulatory orders contain restrictive covenants that could negatively impact our ability to continue to implement our strategic plan. For example, we must generally obtain the approval of the Kansas Commission prior to selling assets, and certain negative covenants contained in our credit facilities limit our ability to sell assets (or use the sale proceeds for various purposes) unless certain conditions are satisfied.

The terms of our credit facilities and regulatory orders also limit the amount of additional indebtedness that we can incur. For example, our ability to incur indebtedness is restricted unless the additional indebtedness satisfies certain conditions (including use of proceeds restrictions), and prior to issuing long-term debt securities we must obtain the approval of the FERC and certain state commissions. Even if we were to repay our credit facilities, we would still be required to seek regulatory approvals to issue long-term debt. Thus, our ability to raise capital quickly (if at all) on favorable market terms could be limited.

Our utility operations are subject to risks associated with higher fuel and purchased power prices, and we may not be able to recover costs of fuel and purchased power.

Our regulated utilities produce, purchase and distribute power in three states and purchase and distribute natural gas in four states. Generally, the regulations of the states in which we operate allow us to pass through changes in the costs of natural gas to our natural gas utility customers through PGA provisions in the applicable tariffs. All of our Gas Utilities have PGA provisions that allow them to pass the prudently-incurred cost of the gas to the customer. To the extent that gas prices are higher or lower than amounts in our current billing rates, adjustments are made on a periodic basis to "true-up" billed amounts to match the actual cost we incurred. There is, however, a timing difference between our purchases of natural gas and the ultimate recovery of these costs.

In our continuing regulated electric business, we generated approximately 53% of the power utilized by our utility customers and we purchased the remaining 47% through long-term contracts or in the open market in 2006. The regulatory provisions for recovering energy costs vary by state. In Kansas and Colorado, we have ECAs that serve a purpose similar to the PGAs for our gas utilities. To the extent that our fuel and purchased power costs vary from the energy cost built into our tariffs, the difference is passed through to the customer. In Missouri, which is our largest service area, we currently do not have the ability to adjust the rates we charge for electric service to offset all or part of any increase or decrease in prices we pay for fuel we use in generating electricity or for purchased power (i.e., a fuel adjustment mechanism). These costs could substantially reduce our operating results.

We filed a rate case in July 2006 to implement a mechanism that will allow us to fully recover these costs; however, even if we are successful, we will not realize any rate relief until June 2007. Our inability to pass through fuel and purchased power costs to our Missouri electric customers may also adversely affect our ability to satisfy the financial covenants in our credit agreements, which if breached could cross default our other debt instruments.

Regulatory commissions may refuse to approve some or all of the utility rate increases we may request in the future.

Our regulated electricity and natural gas operations are subject to cost-of-service regulation and earnings oversight. This regulatory treatment does not provide any assurance as to achievement of earnings levels. Our rates are regulated on a state-by-state basis by the relevant state regulatory authorities based on an analysis of our costs, as reviewed and approved in a regulatory proceeding. The rates that we are allowed to charge may or may not match our related costs and allowed return on invested capital at any given time. While rate regulation is premised on the full recovery of prudently incurred costs and a reasonable rate of return on invested capital, there can be no assurance that the state public utility commissions will judge all of our costs to have been prudently incurred or that the regulatory process in which rates are determined will always result in rates that will produce a full recovery of our costs and the return on invested capital allowed by the applicable state public utility commission.

Our operating results can be adversely affected by milder weather.

Our utility businesses are seasonal businesses and weather patterns can have a material impact on our operating performance. Demand for electricity is typically greater in the summer and winter months associated with cooling and heating, and demand for natural gas is extremely sensitive to winter weather effects on space heating requirements. Because natural gas is heavily used for residential and commercial heating, the demand for this product depends heavily upon weather patterns throughout our service territory and a significant amount of natural gas revenues are recognized in the first and fourth quarters related to the heating seasons. Accordingly, our operations have historically generated less revenues and income when weather conditions are cooler in the summer and warmer in the winter. We expect that unusually mild summers and winters would have an adverse effect on our financial condition and results of operations.

Our utility business is subject to complex government regulations and changes in these regulations or in their implementation may affect the costs of operating our businesses, which may negatively impact our results of operations.

Our natural gas and electric utilities operate in a highly regulated environment. Retail operations, including the prices charged, are regulated by the state public utility commissions for our service areas. Changes in regulatory requirements or adverse regulatory actions could have an adverse effect on our performance by, for example, increasing competition or costs, threatening investment recovery or impacting rate structure.

In addition, our operations are subject to extensive federal, state and local statutes, rules and regulations relating to environmental protection. To comply with these legal requirements, we must spend significant sums on environmental monitoring, pollution control and emission fees.

New environmental laws and regulations affecting our operations, and new interpretations of existing laws and regulations, may be adopted or become applicable to us. For example, the laws governing air emissions from coal-burning plants have recently been revised by federal and state authorities. These changes will result in the imposition of substantially more stringent limitations on these emissions than those currently in effect.

We may not be able to obtain or maintain all environmental regulatory approvals necessary to our business. If there is a delay in obtaining any required environmental regulatory approval or if we fail to obtain, maintain or comply with any such approval, operations at our affected facilities could be halted or subjected to additional costs.

The outcome of legal proceedings cannot be predicted. An adverse finding could have a material adverse effect on our financial condition.

We are a party to various material litigation matters and regulatory matters arising out of our business operations. The ultimate outcome of these matters cannot presently be determined, nor can the liability that could potentially result from a negative outcome in each case presently be reasonably estimated. The liability we may ultimately incur with respect to any of these cases in the event of a negative outcome may be in excess of amounts currently reserved and insured against with respect to such matters and, as a result, these matters may have a material adverse effect on our consolidated financial position.

As further discussed in Note 18 to the Consolidated Financial Statements, Cass County is seeking to require us to remove the South Harper power peaking facility. Effective May 31, 2006, the Missouri Commission issued an order specifically authorizing our construction and operation of the power plant and substation. On June 2, 2006, the Circuit Court of Cass County further stayed its injunction, and authorized us to operate the plant and substation while Cass County appealed the Missouri Commission's order.

In June 2006, Cass County filed an appeal with the Circuit Court, challenging the lawfulness and reasonableness of the Missouri Commission's order. On October 20, 2006, the Circuit Court ruled that the Missouri Commission's order was unlawful and unreasonable. The Missouri Commission and Aquila have appealed the court's decision, and the Missouri Court of Appeals for the Western District of Missouri is expected to hear oral arguments in May 2007. If we exhaust all of our legal options and are ordered to remove the plant and substation, we estimate the cost to dismantle the plant and substation to be up to $20 million based on an engineering study. Significant additional costs would be incurred to store the equipment, secure replacement power and/or build the plant and substation on other sites. We cannot estimate with certainty the total amount of these incremental costs that could be incurred, or the potential impairment of the carrying value of our investment in the plant we could suffer to the extent the cost exceeds the amount allowed for recovery in rates.

We have several matters pending before the Internal Revenue Service, the negative outcome of which could materially impact our financial condition.

All of our federal income tax returns are examined by the IRS. Currently, our federal income tax returns for the years 1998-2004 are under audit. As of December 31, 2006, we had approximately $377.3 million of cumulative tax provisions for tax deduction or income positions that we believe are proper but for which it is reasonably likely that these deductions or income positions will be challenged upon audit by the IRS. The timing of the resolution of these issues is uncertain. If our positions are not sustained, we may be required to utilize our capital loss and net operating loss or alternative minimum tax credit carryforwards and/or make cash payments plus interest.

Risks Relating to the Merger

The Merger and asset sales may not be completed, which could adversely affect our business operations and stock price.

We will not be able to complete the Merger and the associated asset sales until we obtain regulatory approvals from the Missouri Commission, the Kansas Commission, the IUB, the Colorado Public Utilities Commission, the Nebraska Public Service Commission, and the FERC, as well as obtain regulatory clearance under the Hart-Scott-Rodino Antitrust Improvements Act. If these regulatory approvals and clearances are not received, or they are not received on terms that satisfy the conditions in the transaction agreements, then the parties will not be obligated to complete the transactions.

In addition, the Merger and the associated asset sales are subject to other customary conditions. For example, the transactions may not be completed if either the operations being sold to Black Hills or our remaining businesses suffer a material adverse effect between signing of the merger agreement and closing. Shareholder approval of the Merger and the issuance of

Great Plains Energy common stock in connection with the Merger is also required from our shareholders and Great Plains Energy's shareholders, respectively.

Furthermore, the Merger and the asset sales are each contingent upon the closing of the other transaction, meaning that one transaction will not close unless the other transaction closes.

The failure of the Merger to close could have a material adverse effect on the financial results of operations or the trading price of our common stock.

We will be subject to business uncertainties and contractual restrictions while the Merger is pending that could adversely affect our business.

Uncertainty about the effect of the Merger and the associated asset sales on employees and customers may have an adverse effect on us, regardless of whether the transactions are eventually completed. Although we have taken steps designed to reduce any adverse effects, these uncertainties may impair our ability to attract, retain and motivate key personnel until the Merger is completed or is terminated, and for a period of time thereafter, and could cause customers, suppliers and others that deal with us to seek to change existing business relationships with the parties.

Employee retention and recruitment may be particularly challenging during the pendency of the Merger, as employees and prospective employees may experience uncertainty about their future roles. The departure of existing key employees or the failure of potential key employees to accept employment with us, despite our retention and recruiting efforts, could have a material adverse impact on our business, financial condition and operating results, regardless of whether the transactions are eventually completed.

In addition, the transaction agreements restrict us from taking certain actions until the transactions are completed or the agreements are terminated. These restrictions may prevent us from pursuing otherwise attractive business opportunities and making other changes to our businesses prior to completion of the transactions or termination of the agreements.

We will incur significant costs in connection with the Merger and associated asset sales.

We expect to incur significant costs (primarily investment banking, legal and employee retention costs) in connection with the Merger and associated asset sales, regardless of whether or not the transactions are completed. We will expense these costs as they are incurred. In 2006, we incurred approximately $2.3 million of costs (primarily investment banking and legal costs) related to these transactions. In February 2007, we incurred fees payable to our financial advisors of $6.1 million in connection with the signing and announcement of the merger agreement. In February 2007, we also executed retention agreements totaling $8.4 million with numerous non-executive employees to mitigate employee attrition prior to the closing of the Merger. The agreements will be paid on the earlier of the closing of the Merger or January 31, 2008. We cannot at this time estimate the total costs to be incurred by the Company prior to consummation of the Merger and the associated asset sales. In addition, if the Merger is completed, the combined company will incur significant transaction costs, such as fees payable to our financial advisors, amounts payable to employees under change-in-control agreements, and employee severance costs.

Item 1B. Unresolved Staff Comments

None.