THE STATE CORPORATION COMISSION
OF THE STATE OF KANSAS

Before Commissioners: Brian J. Moline, Chair
John Wine, Comissioner
Robert E. Krehbiel, Comissioner

In the Matter of the Investigation Into)
the Affiliate Transactions Between) Docket No. 02-UTCG-701-GIG
UtiliCorp, Inc. (UCU) and Its)
Unregulated Businesses.)

POST HEARING BRIEF OF THE CITIZENS' UTILITY RATEPAYER BOARD

COMES NOW, the Citizens' Utility Ratepayer Board ("CURB") and files its Post Hearing Brief in the above captioned docket.

I. Procedural History:

In its November 14, 2002, Form 10-Q, filed at the Securities and Exchange Commission, Aquila[1] disclosed that it was not in compliance with certain debt covenants, including a $650 million revolving credit facility. On March 4, 2003, the Kansas Corporation Commission ("Commission"), in response to these financial disclosures by Aquila issued its Order Requiring The Submission Of Additional Information. Specifically, the Commission directed Aquila to: (a) submit a financial plan as described in the order; (b) provide detailed financial information about its long term debt and its current or other assets and liabilities; (c) provide detailed information about its legal structure, internal organization, directors/officers and management contracts or other

[1] Aquila, Inc. ("Aquila"), formerly known as UtiliCorp United, Inc, through its operating divisions Aquila Networks-WPK (formerly known as WestPlains Energy Kansas) and Aquila Networks-KGO (formerly known as Kansas Public Service Company and Peoples Natural Gas Company), provides electric and natural gas public utility service to approximately 165,000 retail customers in Kansas.

similar agreements; and (d) submit an evaluation of the feasibility and desirability of interim standstill protections as discussed within the Order.

On March 10, 2003, Aquila filed a Motion seeking an extension of time to file certain of the information requested by the Commission in its March 4, 2003 Order.

On March 12, 2003, the Commission granted Aquila's Motion for extension of time to file the requested information. However, to "protect Aquila's Kansas public utility operations and customers at risk of harm flowing from Aquila's current financial situation," the Commission required Aquila to seek "Commission review and approval in advance of any substantial transactions entered into by Aquila." The Commission set forth six specific restrictions [Order, paragraphs 3(A)(i) through 3(A)(vi)], and required Aquila to seek Commission approval in advance of entering into any transaction that would violate one of the specified restrictions.

On March 13, 2003, Aquila filed its Motions For Waiver. Aquila specifically sought a waiver of the restriction placed on Aquila in Paragraph 3(A)(iv) of the Commission's March 12, 2003, Order so that Aquila could complete the renegotiation of its $650 million revolver in a timely manner. As part of its request for waiver, Aquila specifically agreed to not pledge any regulated assets located in the State of Kansas as security under the new revolver until it had filed and received Commission approval in this docket to pledge said Kansas regulated assets.

On March 14, 2003, the Commission granted Aquila's Motion for Waiver of Paragraph 3(A)(iv), subject to the condition that Aquila not pledge any regulated assets located in the State of Kansas as security for the renegotiated revolver, and that the revolver be submitted to the Commission directly after its execution.

On April 11, 2003, Aquila entered into the Term Loan Facility. In connection with the Term Loan Facility, Aquila issued First Mortgage Bonds under its Indenture of Mortgage and Deed of Trust, dated April 1, 2003, to Bank One Trust Company N.A., Trustee ("the Indenture"); and its First Supplemental Indenture thereto, dated April 9, 2003, to Bank One Trust Company, N.A., Trustee ("the First Supplemental Indenture"). The Term Loan Facility is secured by $430 million of First Mortgage Bonds, backed by Aquila's utility assets in the States of Michigan and Nebraska, along with other unregulated or non-domestic utility assets. Aquila pledged to make "commercially reasonable efforts" to seek authority from the relevant state public utility commissions to add additional domestic utility assets owned by Aquila as further collateral in support of the Term Loan Facility. (Crane Direct, P. 8, line 18, citing Response to CURB Data Request 32, attached to the Direct Testimony of Andrea C. Crane)

On April 30, 2003, in compliance with the Commission's March 14, 2003, Order Granting Waiver, and as required by the Term Loan Facility, Aquila filed its Motion For An Order Authorizing Aquila, Inc. To Pledge And/Or Create Liens On Its Utility Assets Located In The State Of Kansas In Order To Secure A Portion Of The Term Loan Facility ("Motion" or "Aquila's Motion").

An evidentiary hearing on Aquila's Motion was held before the Commission on November 20, 2003. Testimony was received by the Commission from Rick Dobson, Carol A. Lowndes and Jon R. Empson, on behalf of Aquila, Inc.; James M. Proctor, on behalf of the Commission Staff; and Andrea C. Crane, on behalf of CURB.

II. Argument

In its May 7, 2003, Order Establishing Hearing Procedures, the Commission stated "in light of Aquila's financial condition, the Commission must assure the proposed collateralization of Kansas utility assets, as requested by Aquila, is reasonable, serves the public interest and is not otherwise harmful to Kansas utility customers." (Order at Paragraph 4) The Commission set forth four regulatory questions with which it would evaluate Aquila's motion. The four questions are:

> i) Whether the collateralization is for a level of debt that is reasonable and appropriate to finance Kansas utility operations.
>
> ii) Whether the debt supported by the collateral will be paid off within a fixed number of years, such number of years appropriately related to the utility purpose of the collateralization.
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> iii) Whether the extent of collateralization of Kansas utility assets is comparable to the collateralization of utility property in each of the other states in which Aquila serves as a public utility, and to other utilities serving Kansas customers.
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> iv) Whether the collateral--which Aquila would encumber-- is confined to assets specified in the new loan agreement, or whether the collateralization also could include after-acquired property and to what extent.

Based on the above criteria, the Commission should deny Aquila's Motion seeking to pledge Kansas regulated assets as collateral for the term Loan Facility as contrary to the public interest, unreasonable and harmful to Kansas utility customers.

A) The level of Kansas utility assets requested by Aquila to be used as collateral for the Term Loan far exceeds what is reasonable and appropriate to finance Kansas utility operations, and is therefore unreasonable and contrary to the public interest.

The Term Loan at issue in this case provides Aquila with $430 million of cash working-capital. Unlike most utilities in Kansas, who use short-term unsecured financial instruments to provide for cash for working-capital needs, Aquila's precarious financial position requires that Aquila provide asset security for its short term cash financing. The Term Loan requires a collateralization ratio of 1.67%, meaning that Aquila must have $718 million dollars of assets securing the $430 million loan[2]. (Empson Rebuttal P. 15-16)

Only $250 million of the total $430 million Term Loan proceeds are needed for Aquila's domestic utility peak-day working-capital needs. (Dobson Direct, P. 9, Ln.. 25-P 10, Ln. 6) The remaining $180 million of the Term Loan is for the working-capital needs of Aquila's unregulated or non-domestic utility business. (Transcript P. 90, Ln. 21-24) At the 1.67% ratio, Aquila needs $420 million ($250 million times 1.67%) of domestic utility assets to secure the portion of the Term Loan that Aquila claims is necessary for domestic utility working-capital needs. However, the net book value of Aquila's domestic utility assets, all of which Aquila seeks to use as security for the Term Loan, is approximately $2 billion (Transcript P. 66, Ln. 17), far in excess of the $420 million domestic utility assets necessary to provide security for Aquila's domestic utility working-capital needs.

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[2] However, see response to CURB data request 32, attached to the Direct Testimony of Andrea C. Crane. "Under the Term Loan, there are no ongoing collateral requirements. The lenders were willing to accept the assets that Aquila could pledge at signing as collateral for the entire loan, subject to Aquila agreeing to use commercially reasonable efforts to add regulated assets to the collateral package. Collateral ratios are relevant in limited areas only, such as prepayments, interest rates and financial covenants." This seems to indicate that the 1.67% ratio carries very little significance, and is not necessary related to any requirement that Aquila reach a specific level of utility collateral to back the Term Loan.

According to Aquila's peak-day working-capital model, Aquila's Kansas utility properties have a peak-day working-capital requirement of $41.35 million. (Response to CURB Data Request 19, Attached to the Direct Testimony of Andrea C. Crane) Assuming that Aquila's peak working-capital model is correct, a point that CURB does not concede, applying the 1.67% security ratio results in $69.70 million of Kansas utility assets needed to secure that portion of the Term Loan Aquila claims is necessary to meet Kansas utility peak-day working-capital needs. However, in this case Aquila is requesting that the entirety of its Kansas utility assets be pledged to secure the Term Loan, utility assets with a net book value of close to $300 million. (Transcript P. 72, Ln. 9) Again, Aquila's request to use Kansas utility assets as security far exceeds the level of security necessary to provide for Kansas utility working-capital needs. The level of Kansas assets Aquila is requesting be used as collateral for the Term Loan so far exceeds what is necessary to provide working-capital for Kansas utility customers that Aquila's request is unreasonable, contrary to the public interest, and must be denied by the Commission.

B) Aquila's Kansas utility customers receive no additional benefit from pledging Kansas utility assets as security for the Term Loan Facility.

Aquila, in its Motion at paragraph 16, states that pledging Kansas utility assets as security for the Term Loan Facility is "not detrimental to the public interest and, in fact, is beneficial to the public interest, because public health, safety and welfare will be served by the ability of Aquila to obtain financing on the most favorable terms available." However, contrary to Aquila's claim that pledging Kansas utility assets is, in fact, beneficial to the public interest, the record in this case clearly establishes that Commission approval of Aquila's request will provide no additional benefit to the public interest above that which Aquila's Kansas utility customers currently receive.

i) Aquila's financial troubles are not the fault of Aquila's utility assets or utility customers.

Aquila's utility ratepayers and Aquila's utility properties did not cause and should not responsible for Aquila's financial troubles. Aquila, of its own accord, embarked on a diversification strategy, first acquiring domestic utility properties, then non-domestic utility properties. Aquila entered the telecommunications industry with the purchase of Quanta and Everest Communications. Through its unregulated merchant services business, Aquila became one of the nation's largest providers of wholesale energy and risk management services, holding a diverse portfolio of unregulated assets including electric generation plants, gas pipelines, gathering systems and gas storage facilities. Aquila also traded commodities such as natural gas, global liquids and sold weather derivatives and risk management services. (*See generally* Dobson Direct, P.2-4)

According to Aquila, after the Enron and California energy crises, credit rating agencies tightened liquidity requirements to a level Aquila could not sustain on an ongoing basis, forcing Aquila, again of its own accord, to exit the merchant services business. (*See generally* Dobson Direct, P.4-6) Aquila also exited the telecommunication industry, selling its stake in Quanta at a substantial loss ($693 million), and stopping the funding of Everest Communications. (Dobson Direct P. 7, Ln. 12-16). (*See also* Proctor, Direct, P. 8-14, for a general discussion of Aquila's recent financial history)

However, during this period of financial reversal, Aquila's domestic utility properties continued to perform in a solid manner. (Empson, Rebuttal P. 4, Table) Aquila finds it important to state, "Aquila assumes total responsibility for its strategy". (Dobson, Direct, P. 6, Ln. 17) Under cross-examination from CURB, Mr. Dobson again reiterated the position that "utility ratepayers are not responsible for Aquila's business strategy." (Transcript P. 52, Ln. 9)

To the extent that Aquila's utility properties and utility customers are not responsible for Aquila's business strategy, or its failure, utility customers should not be held hostage by Aquila's request to use excessive levels of utility assets to collateralize its working-capital needs.

ii) Aquila has already obtained the $430 million proceeds of the Term Loan Facility and currently holds said proceeds in its corporate treasury.

Aquila has already executed the Term Loan and has received the proceeds. (Transcript, P. 51, Ln. 15-19) The $430 million is currently being held in Aquila's corporate treasury account and is available today to service Aquila's daily working-capital needs. Aquila will receive no additional financing, and no better terms by adding the Kansas assets to the collateral pool. Aquila can receive no additional cash over and above that which it already has in its treasury under the Term Loan if the Commission approves the Aquila's Motion. Aquila will suffer no harm by this Commission denying Aquila's Motion. Utility ratepayers receive no additional benefit above that which already exists by adding Kansas assets to the collateral pool. Clearly, the public interest is not advanced in any way by Aquila's request.

iii) Aquila has already obtained approval from various state public utility commissions to pledge a level of domestic utility assets to fully satisfy the requirements of the Term Loan Facility.

When asked why Aquila's lenders require the Term Loan be collateralized by all of Aquila assets, the frank and honest answer is that "they do not." (Transcript, P. 70, Ln. 1; *See also*, Footnote 2, *supra*) In fact, Aquila already has adequate domestic utility collateral supporting the Term Loan to satisfy its lenders. Mr. Dobson acknowledged that the Term Loan is already collateralized with utility assets in Michigan (net book value of approximately $180 million), utility assets in Nebraska (net book value of approximately $150 million), utility assets in Iowa (net book value of approximately $80 million) and utility assets in Colorado (net book value of approximately $170 million). (Transcript P. 54, Ln. 3-P.55, Ln. 3)

Aquila suggests that $250 million of the Term Loan is required for domestic utility peak-day working-capital. As noted, applying the appropriate collateralization ratio of 1.67%, Aquila needs only $420 million of domestic utility assets to secure domestic utility working-capital needs. As testified to by Mr. Dobson, Aquila currently has domestic utility assets with a total net book value of $580 million[3] securing the amount of the Term Loan needed for domestic utility peak-day working-capital. The Term Loan, at least that portion related to Aquila's utility operations, is already fully collateralized. Kansas utility ratepayers receive no additional benefit, and the public interest is not furthered by allowing Kansas utility assets to be utilized to provide further excessive security for the Term Loan.

iv) Aquila has already met the collateral benchmarks to receive reduced interest rates pursuant to the terms of the Term Loan Agreement. No additional interest rate benefit is available.

The Term Loan does contain provisions that provide an interest rate reduction once certain levels of collateral have been established. The interest rate paid by Aquila would drop from 8.75% down to 8.0%, amounting to a $3 million annual savings to

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[3] It is important to note that the Market Value of Aquila's utility assets is likely in excess of the net book value of the assets. (*See generally* Crane, Direct, P.7, Ln. 7; P.13, Ln. 19) Mr. Dobson generally agrees with this premise also. (Transcript, P. 66, Ln. 14- P. 67, Ln.. 15) Therefore, using a net book value figure provides a conservative estimate of the value of the assets already pledged as collateral for the Term Loan.

Aquila. (Transcript, P. 90, Ln. 1-8) However, Aquila has already obtained the collateral necessary to receive this interest rate reduction. As stated by Mr. Dobson, "I will get that interest rate irrespective of Kansas at this point in time coming in. We will get a better interest rate without these assets to be completely clear." (Transcript, P. 82, Ln. 9-12) Again, Kansas utility ratepayers receive no additional benefit, and the public interest is not furthered by adding Kansas utility assets to the collateral pool.

C) Aquila's Kansas utility customers face substantial additional risks if Kansas assets are pledged as security for the Term Loan Facility.

i) Aquila provides no guarantee that the proceeds of the Term Loan Facility will be available for utility peak-day working-capital if needed.

While Aquila makes many interesting statements about how the proceeds from the Term Loan are handled at the corporate level, it is clear that Aquila is offering no guarantee that the proceeds of the Term Loan will be available, if needed, to meet peak-day utility needs. All of Aquila's business units have access to the proceeds from the Term Loan on an "as needed" basis. (Response to CURB Data Request 35, attached to the Direct Testimony of Andrea C. Crane) The proceeds from the Term Loan are held in corporate treasury, a treasury that handles both the regulated and non-regulated portion of the proceeds. (Transcript, P. 46, Ln. 7) While Aquila "intends" to maintain proper alignment of domestic utility collateral and domestic utility loan requirements (CURB DR 35) and align the collateral type-utility and non-utility, with cash need- utility and non-utility (Empson, Rebuttal, P. 14, Ln. 23), and will itself is separate the loan to ensure that the utility customer and assets are not supporting the non-utility debt requirements (Dobson, Direct, P. 10, Ln. 11), provide daily reviews of cash (Transcript, P.45, Ln. 16), and constant projections of 13 week estimates of gas costs and other commitments

(Transcript, P. 47, Ln. 6), at no point does Aquila commit that utility customers are guaranteed to have this money available when needed.

In fact, there is no escrow account to segregate and insure that the Term Loan proceeds secured by utility assets for utility peak-day working-capital needs, will in fact be available from the corporate treasury. (Transcript, P. 46, Ln. 16) As Ms. Lowndes testified, "there is not a written guarantee" that the money will be there if needed. (Transcript, P. 47, Ln. 23) Mr. Dobson reiterates this same point. (Transcript, P. 58, Ln. 19) This is a truly astounding flaw in Aquila's application. Given that Aquila's request is fundamentally based on the premise that Aquila must insure that it has adequate available cash to meets a worst-case peak-day working-capital requirement for utility service, under the worst scenario imaginable, or as Ms. Lowndes states, "it is to make sure that if the stars align against us that the cash is there." (Transcript, P. 38, Ln. 5) It is unthinkable that Aquila would provide no assurance that, in fact, the cash will be available from the corporate treasury if needed by the utilities.

The following question and answer of Mr. Dobson should cause grave concern the Commission:

> Q (Ms. Bos) Well, just assume with me that you do find yourself in a situation where the non-regulated businesses require $220 million dollars. Would you then draw on the $250 million allegedly segregated for the public utility businesses?
>
> A (Mr. Dobson) To avoid Chapter 11, I would.
>
> (Transcript, P 81, Ln. 14-20)

Failure to insure that the proceeds from the Term Loan necessary to meet utility peak-day working-capital needs are appropriately escrowed and isolated from other Aquila unregulated, non-utility corporate cash needs places utility customers at an unacceptable risk. Making these proceeds available to any other Aquila business units, for any other events that may come up cannot be held to be in the public interest of Kansas utility consumers. Kansas utility assets should not be used as security to provide corporate funds for Aquila's general corporate purposes.

ii) Aquila provides no guarantee that it will not use excess utility asset collateral authority to further encumber Kansas assets in the future.

Aquila fundamentally sees no flaw in attempting to use $2 billion (net book value) of Aquila's domestic utility assets to secure a $430 million term loan, only $250 of which, by Aquila's estimate, is needed for peak-day utility working-capital. However, granting Aquila the authority at this time to use all of the Kansas utility assets as collateral places Kansas utility customers at undue risk. Once the authority has been granted to use Kansas assets as collateral, there is nothing restricting Aquila from pledging those assets to secure new debt tomorrow. In fact, this may be Aquila's intent, according to Mr. Empson, who testified that the "over-collateralization of the indenture does not limit the financing flexibility with respect to pledging the over-collateralized assets to raise additional financing at a later date if such becomes necessary." (Empson, Rebuttal, P.16, Ln. 3)

Aquila promises that it will not use any of the excess collateral provided by having the Commission grant authority to pledge Kansas utility assets without first obtaining Commission approval. However, Aquila's promise provides little assurance to Kansas utility customers. Even Mr. Dobson acknowledges that the excess collateral allows Aquila to put additional first mortgages on utility assets above the $430 million of the term loan. (Transcript, P. 67, Ln. 21- P. 68, Ln. 1) The excess collateral would be available to Aquila "if we were to need them in dire straits, obviously with Commission approval" (Transcript, P. 75, Ln. 8)

However, by having pre-granted authority, as requested in Aquila's Motion, Kansas utility ratepayers are at risk that, "in dire straits", Aquila may make the judgment to pledge the excess Kansas utility assets as collateral for new loan without first coming to the Commission. Having pre-granted collateral authority, if Aquila chooses to break its promise to seek Commission approval, CURB is unsure whether this Commission will be legally able to abrogate Aquila's new loan contract, or withdraw Kansas utility assets being used as collateral. Recall Mr. Dobson's response above that he would use working-capital needed for utility operations "to avoid Chapter 11." Granting the authority to use Kansas utility assets as collateral places Kansas utility customers at an unacceptable risk. As pointed out above, given that there is little benefit in adding the Kansas utility assets to the asset pool, the risks inherent in granting the authority requested far outweigh any benefit. Again, the Commission must deny Aquila's request as being unreasonable and contrary to the public interest.

iii) If approved, Aquila's Motion will result in Kansas utility assets being used as collateral for the working-capital needs of Aquila's unregulated businesses.

By definition, any utility collateral provided over and above that amount needed to provide security for utility peak-day working-capital needs, is collateral supporting Aquila's unregulated business working-capital needs. Kansas utility consumers should not, and must not, be required to provide collateral to secure loans used to provide working-capital to Aquila's unregulated business.

As pointed out above, Aquila identifies $250 million as the domestic utility peak-day working-capital requirement, requiring $420 million of utility assets needed as collateral for utility working-capital needs. Aquila already had $580 million (net book value) of utility assets assigned as collateral for the Term Loan. Therefore, Aquila already has $160 million (net book value) of utility assets serving as collateral for the $180 million of the Term Loan proceeds that Aquila identifies for unregulated or non-domestic utility needs. By granting Aquila's motion in this case, the Commission will add the $300 million (net book value) of Kansas assets to the collateral pool. By definition, since Aquila already has more than adequate utility assets to secure utility working-capital needs, this $300 million of Kansas assets will be securing working-capital debt for Aquila's unregulated and non-domestic utility activities.

It is unreasonable and contrary to the public interest to allow Kansas utility assets, and Kansas utility ratepayers to provide security to support Aquila's unregulated businesses.

D) Aquila's peak-day working-capital model is flawed, resulting in excessive peak-day utility working-capital requirements.

Aquila's peak-day working-capital model has numerous problems that make the results unreliable, specifically the Kansas projected peak-day working-capital need of $41.35 million. Aquila's model is based on numerous projections regarding future prices and energy demand rather than an actual lead lag study based on historical test periods. As shown in response to CURB Data Request 19 (Attached to the Direct Testimony of Andrea C. Crane), Aquila's December and January gas supply and purchased power costs total $29.1 million while projected revenues total $29.3 million, resulting in a revenue surplus. Adding in storage and pipeline costs and coal prepayments, Aquila's model shows a peak-day working-capital requirement of $13.9 million. Aquila, however, claims it needs $41.35 million for peak-day working-capital. The difference between the $13.9 million and the $41.35 million is due to additional components that should not be included in a peak-day working-capital study. (Crane, Direct, P. 16, Ln. 13)

Aquila adds $7.1 million to account for "stress testing" its gas supply requirement. This stress test amounts to increasing 34% of Aquila's gas volumes by an additional 10%, and pricing all of those volumes at $11.63 per Mmbtu. (Crane, Direct, P. 16, Ln. 16; Transcript, P. 36, Ln. 10- P. 37, Ln.2) Aquila adds $1 million in payroll costs, even though payroll is including in normal working-capital recovered in Aquila's base rates. Including payroll in the model is interesting given that Mr. Dobson testifies Aquila has reduced its employees by 1500. (Dobson, Direct, P. 7, Ln. 9) While we do not know how many of those employees were utility employees, it is possible that Aquila is currently over recovering in base rates for employee costs. Aquila adds $17.1 million to its peak-day requirements based on its February 2001 PGA balance. The PGA balance in February 2001 is totally irrelevant to prospective potential peak-day working-capital needs. (Crane, Direct, P. 17 Ln. 1-5) Finally, Aquila includes other items such as hypothetical storm damage expenses and project capital expenditures, both of which are inappropriate to include in a working-capital study. As a result, Aquila's peak-day working-capital model vastly overstates the level of working-capital need to serve Kansas utility ratepayers.

Aquila counters that using average working-capital, as is done in a rate setting process, is not an appropriate methodology when trying to determine the total working-capital needed on Aquila's peak-day. (*See generally* Lowndes, Rebuttal, P. 9-12) Assuming for the sake of discussion that there is some validity to this argument, that peak-day working-capital needs may be in excess of average working-capital need, it does not automatically follow that it is appropriate, in constructing a peak-day model, to include every conceivable potential expenditure, at the highest possible expenditure level while assuming the expenditures will all happen on the same day, without also taking a critical look at how probable this potential peak-day outcome may be.

Ms. Lowndes testifies that Aquila performed no probability analysis on its peak-day model. (Transcript, P. 38, Ln. 14) This type of probability analysis is extremely important in determining the reasonableness of Aquila's request. Aquila suggests that its model indicates Kansas peak-day working-capital needs at $41.35 million. Ms. Lowndes acknowledges that Aquila's model is fundamentally built assuming the coldest winter, the highest gas prices, and the most consumer use. (Transcript, P. 37, Ln. 12) When the attorney for CURB asked, "in a simple sense, its sort of a disaster scenario, correct? That's what you are planning for?", Ms. Lowndes simply replied "Yeah." (Transcript, P. 37, Ln. 24) However, if a probabilistic analysis showed that the likelihood of this disaster scenario actually happening was only .000000001%, it might lead one to conclude that Aquila's peak-day model overstates Aquila's actual peak-day working-capital needs. Since Aquila did not perform this type of probability analysis, it cannot say whether its peak-day requirements are reasonable or even remotely likely to happen.

Further, Aquila's model takes a point-in-time snapshot of Aquila's peak-day working-capital needs. Aquila determines that its peak-day for working-capital needs will occur in winter, and that one large driver in its model is the timing mismatch between when Aquila is required to expend cash, for instance to purchase gas, and when Aquila receives that cash back from consumers through the billing cycle. (Transcript, P. 29, Ln. 18) Aquila's model determines that the peak-day working-capital expenditures will occur in January, but that revenues received are low, since the revenues are from the November or December billings. Of course, the corollary to this timing mismatch is that at the end of winter, when Aquila's expenditures have decreased, revenues will remain high, since Aquila is receiving revenue from bills sent in the middle of winter. Aquila has excess cash on hand at the end of winter based on this same timing mismatch.

What Aquila's model fails to account for is that Aquila holds a diversified portfolio of utility properties, both electric and gas, in different regions of the country. As noted by Mr. Dobson, Aquila's basic strategy was to diversify risk by product, geography and regulatory jurisdiction. (Dobson, Direct, P. 2, Ln. 3) So, while there is a timing mismatch between when Aquila spends cash in the winter, and when it receives billing revenue, there is an equivalent timing mismatch in the summer for Aquila's electric properties. At the beginning of summer, Aquila's cash outlay for its electric properties may be higher than the revenue it receives, but at the end of the summer billing revenues will exceed Aquila's cash outlay. (Transcript, P. 31, Ln. 1-6) Aquila should have this cash on hand as it goes into its winter season for its natural gas utility properties, which is fundamentally the objective of Aquila's diversified portfolio strategy. By taking a snapshot of only winter expenditures and revenues, Aquila's peak-day working-capital model ignores the effects of Aquila's diversified portfolio of utility properties, and ignores the cash on hand Aquila will have coming out of the summer cooling season from its electric properties.

In fact, when you view Aquila's cash flow over the course of a year, given its diversified portfolio of utility properties, "peak-day" needs become much more analogous to the annual average cash working-capital analysis suggested by Ms. Crane on behalf of CURB, and Mr. Proctor on behalf of Staff. While there may be a grain of truth in how Aquila views its peak-day model, it is clear that the model overstates Aquila's peak-day working-capital needs. Even if the Commission gives some credence to Aquila's model and testimony in support thereof, there is no evidence in the record to guide the Commission on whether Aquila's Kansas peak-day working-capital needs based on its model are reasonable or even remotely likely to happen. As such, CURB does not believe that Aquila's $41.35 million peak-day working-capital request is reasonable, and it should not form the basis justifying Aquila's request in this case to utilize all of its Kansas assets as security for the Term Loan.

E) Aquila's argument that it only "fair" that Kansas utility assets be used as collateral for the Term Loan must be rejected.

Since all of Aquila's other arguments have been shown to lack merit, Aquila is left only to argue that since all states need access to the working-capital provided by the Term Loan, "it is a matter of basic fairness that the assets in all of the states be used as collateral, and not just certain states." (Empson, Rebuttal, P. 20, Ln. 8) Aquila appears to concentrate on the Commission's May 7, 2003, Order, which sets forth as one of the review criteria "Whether the extent of collateralization of Kansas utility assets is comparable to the collateralization of utility property in each of the other states in which

Aquila serves as a public utility, and to other utilities serving Kansas customers". [May 7, 2003, Order, Paragraph 4(iii)].

While CURB believes that this is the lower of the standards for review the Commission set forth in its May 7, 2003 Order, for the sake of argument, CURB asks: is Aquila's request to use Kansas assets "comparable" to the collateralization of utility property in each of the other states? Certainly, the Kansas request is not comparable to the States of Michigan and Nebraska. Aquila made no request in those two states; they were summarily added to the collateral pool at Aquila's option. While Colorado and Iowa have apparently approved using utility assets in those states as collateral, Minnesota has denied Aquila's request. Missouri is at this time considering Aquila's Motion. While there is no decision yet, both the Missouri Public Commission Staff and the Missouri Office of Public Counsel both testified that Aquila's request should be denied. Again: to which of these states should Kansas be "compared"?

If fairness is truly the issue in this case, Aquila's request to use all of the Kansas utility assets to secure the Term Loan is anything but "fair" to Kansas utility customers. Aquila did not ask for authority to use Kansas' "fair" allocation of assets to secure Kansas utility peak-day working-capital needs. Again, Aquila estimates Kansas peak-day working-capital needs at $41.35 million, requiring $67.9 million of utility collateral if the 1.67% ratio is applied. How Aquila determines that it is "fair" to request authority to use $300 million (net book value) of Kansas assets to secure Kansas' portion of the Term Loan is beyond reason.

Regardless of whether Aquila's request in Kansas is comparable to the collateralization of utility property in each of the other states in which Aquila serves as a public utility, or even "fair", the more relevant question for Kansas is whether Aquila's request is reasonable and promotes the public interest. Without repeating all of the previous arguments stated above, it is clear that Aquila's request to use Kansas utility assets is unreasonable and does not advance or promote the public interest in any way. Therefore Aquila's Motion must be denied, whether comparable or fair.

III. Summary

Based on the evidence above, it is clear that Aquila's Motion to use Kansas utility assets as collateral for the Term Loan must be denied. Aquila's request to use $300 million of Kansas utility assets as collateral for the term loan far exceeds any justified level of collateral tied to actual Kansas utility peak-day working-capital needs. Aquila has already obtained the proceeds of the term loan, has already fully satisfied its lenders need for collateral and has already reached the level of collateral that will reduce interest rates. Adding the Kansas utility assets to the collateral pool will not result in any additional benefit to Kansas consumers. However, Kansas utility consumers may be placed at great risk by the Commission granting Aquila authority to use Kansas utility assets as collateral. There is no guarantee that should Kansas utility customers need the proceeds of the Term Loan for peak-day working-capital requirements, that some other Aquila business won't have already spent the money. Also, aside from promises, there is virtually no control over whether Aquila, if faced with dire straits, will pledge the Kansas assets for additional loans without first seeking Commission approval. While not suggesting that Aquila would intend this to be the case, what is clear is that the Commission may have little control over Aquila's actions if Aquila's back is against the wall. Aquila's peak-day working-capital model vastly overstates peak-day working-capital needs for the Kansas utility properties. Aquila's Motion does not reflect any notion of a fair and reasonable proposal. Aquila's request to use Kansas utility assets as collateral for the term loan is not reasonable, does not serve the public interest and may be harmful to Kansas utility customers. The Commission must reject Aquila's Motion.

If the Commission chooses to allow Kansas utility assets to be used as collateral for Aquila's Term Loan, the Commission must include several safeguards with respect to Kansas assets, and the proceeds those assets secure. First, the Commission must determine the appropriate level of peak-day working-capital needed to support the Kansas utility properties. As can be seen from the above analysis, Aquila's model overstates peak working-capital needs and should not be used as the basis for a Commission decision. Some lower peak-day working-capital amount must be used. Second, once the appropriate level of Kansas peak-day working-capital needs are determined, the Commission must allow only that level of Kansas utility assets to be used as collateral as is necessary to secure the portion of the Term Loan used to meet the Commission determined Kansas peak-day working-capital needs. The Commission must not allow Kansas utility assets to be used to over collateralize the Term Loan. Third, the Commission should limit its approval of the use of Kansas utility assets to only this particular Term Loan, and only for the three year time period of this Term Loan. This restriction will prevent Aquila from arbitrarily using the Commission approval in this case for securing other loans or refinancing the Term Loan for larger amounts or longer terms. Any use of Kansas utility assets for any purpose other than the limited purpose allowed in this case must be strictly prohibited. Finally, the Commission must order Aquila to segregate and place in escrow any proceeds of the Term Loan backed by

Kansas Assets. Aquila currently is utilizing the entire proceeds of the Term Loan as corporate treasury funds, available to any corporate entity, for any corporate purpose deemed necessary by Aquila's management. If it is Aquila's argument that the funds backed by Kansas utility assets are truly needed to fund Kansas peak working-capital needs, the Commission must insure that these funds will in fact be available for the Kansas utility properties when needed. Aquila has offered no guarantee that the funds will be available for Kansas consumer if needed. The Commission must require the appropriate mechanisms are in place to provide Kansas utility customers the guarantee that the proceeds will be available if needed.

WHEREFORE, based on the above cited evidence and arguments, CURB respectfully requests that the Commission issue an order rejecting and denying Aquila's Motion For An Order Authorizing Aquila, Inc. To Pledge And/Or Create Liens On Its Utility Assets Located In The State Of Kansas In Order To Secure A Portion Of The Term Loan Facility.

Respectfully submitted,

David Springe #15619
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VERIFICATION

STATE OF KANSAS)
)
COUNTY OF SHAWNEE) ss:

I, David Springe, of lawful age, being first duly sworn upon his oath states:

That he is the attorney for the above named petitioner; that he has read the above and foregoing Notification, and, upon information and belief, states that the matters therein appearing are true and correct.

David Springe

SUBSCRIBED AND SWORN to before me this 18th day of December, 2003.

Audrey Bosley

Notary Public

AUDREY BOSLEY
Notary Public - State of Kansas
My Appt. Expires October 1, 2006

My Commission expires: 10-1-2006.

CERTIFICATE OF SERVICE
(02-UTCG-701-GIG)

I, David Springe, hereby certify a true and correct copy of the foregoing, was deposited in the United States Mail, postage prepaid on this 19th day of December, 2003 to the following along with the attached list:

Anne Bos
Kansas Corporation Commission
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Topeka, KS 66604
Hand Delivered

James G. Flaherty
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David Springe