

Decision No. C04-0942

**BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO**

DOCKET NO. 04A-375SEG

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IN THE MATTER OF THE APPLICATION OF AQUILA, INC. FOR AN ORDER  
AUTHORIZING THE ISSUANCE OF UP TO \$700 MILLION OF MANDATORY  
CONVERTIBLE SECURITIES AND COMMON EQUITY.

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**ORDER OF THE COMMISSION  
GRANTING VERIFIED APPLICATION**

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Mailed Date: August 11, 2004  
Adopted Date: August 11, 2004

**I. BY THE COMMISSION**

**A. Statement**

1. Aquila, Inc. (the Applicant, Aquila, or the Company), a Delaware corporation, filed with this Commission on July 19, 2004 an Application, along with Exhibits A through I, requesting an order to replace the authority granted in Decision No. C03-0888 in Docket No. 03A-309SEG as amended, in order to allow Aquila to issue up to \$700 million of securities.<sup>1</sup> The securities to be issued, if the application is granted, will be limited to: (1) unsecured long-term debt securities which will be converted into shares of Common Stock of Aquila (Mandatory Convertible Securities); and (2) shares of Common Stock of Aquila (separate and apart from the shares of Common Stock to be issued upon conversion of the Mandatory Convertible Securities).

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<sup>1</sup> Decision No. C03-0888, mailed August 8, 2003, authorized Aquila to issue up to and including \$150 million of convertible long-term debt securities, all of which would be convertible to Common Stock at a later date, and \$100 million of Common Stock. No securities were ever issued by Aquila pursuant to the authority granted in that Decision.

2. After the Commission issued notice of filing of the Application on July 20, 2004, the Application was set for hearing at 9:00 a.m. on Friday, August 13, 2004, in the Commission Hearing Room, Office Level 2, 1580 Logan Street, Denver, Colorado.

3. On July 26, 2004, Aquila filed its first Supplement to the Verified Application, by which Aquila added Paragraph 12.5 to the Verified Application, in which Aquila agreed to continue to use the hypothetical capital structures and the debt assignment process, as described in detail in this supplemental paragraph.

4. On August 5, 2004, Aquila filed a second Supplement to the Verified Application, by which Aquila added Paragraph 12.6 to the Verified Application, in which Aquila agreed that the quality of service plan to be adopted by the Commission in Docket No. 04A-046E for its Colorado electric operations should contain a Bill Credit Adjustment provision. Specifics of the Bill Credit Adjustment provision will be determined in the aforementioned docket; however, Aquila and Commission Staff (Staff) agree to pursue a bill credit provision for the calendar year 2005 of \$125,000. The agreement to establish a bill credit adjustment provision exemplifies a commitment by the Commission and Aquila to ensure acceptable service quality.

5. No petitions to intervene were filed in opposition to the Application, therefore the Commission has the authority to determine the Application under its modified procedure as a non-contested and unopposed matter pursuant to § 40-6-109(5), C.R.S., and Rule 4 *Code of Colorado Regulations* (CCR) 723-1-24, of the Commission's Rules of Practice and Procedure. The hearing on the Application, set for August 13, 2004, will be vacated.

## **B. Findings of Fact**

6. Applicant is a public utility as defined in § 40-1-103, C.R.S. Applicant, a Delaware corporation, is engaged, in the State of Colorado, principally in the generation,

purchase, transmission, distribution, and sale of electricity and in the purchase, distribution, and sale of natural gas in various areas.

7. Copies of Applicant's Certificate of Authority, issued by the Colorado Secretary of State on September 27, 2002, and of Applicant's Certificate of Incorporation and amendments containing its Articles of Incorporation were filed, respectively, as Exhibits A and B to the Application, are accepted, and will be on file with the Commission until the Applicant files amended corporate documents.

8. Applicant is engaged, generally, as an electric and natural gas utility company operating in seven states in the mid-continent of North America. Through Aquila Networks, the Company serves approximately 431,000 retail electric distribution customers in three states: Colorado, Missouri, and Kansas; and approximately 874,000 retail natural gas distribution customers in Colorado, Missouri, Kansas, Nebraska, Iowa, Michigan, and Minnesota.

9. This Commission has jurisdiction over Applicant and the subject matter of this Application.

10. Pursuant to Applicant's Certificate of Incorporation, as amended, the Board of Directors of Applicant is authorized to approve the issuance of up to 400 million shares of Common Stock, par value of \$1 per share; up to 20 million shares of Class A Common Stock, \$1 par value, in one or more series; and up to 10 million shares of Preference Stock, without par value, in one or more series. On March 31, 2004, there were issued and outstanding 195,531,786 shares of Common Stock, no shares of Class A Common Stock, and no shares of Preference Stock.

11. As of March 31, 2004, the aggregate principal amount of long-term debt of Applicant was \$2,207.2 million, issued in Applicant's various indentures of trust, purchase agreements, and bonds.

12. As of March 31, 2004, Applicant had short-term indebtedness totaling \$215 million. During the three-month period ending March 31, 2004, Applicant incurred total interest charges of approximately \$64.3 million.

13. Applicant currently has an effective shelf registration statement on file with the Securities and Exchange Commission (SEC) which provides standing authority to issue up to \$700 million of securities into the public markets from time to time as market conditions warrant. Applicant sought approval of this Application in order to align Aquila's state regulatory authorization with its current SEC authorization and will allow Aquila the flexibility (subject to the conditions and commitments made in the Application) to access the capital market from time to time as market conditions warrant. Applicant advised the Commission that applications similar to the instant Application were also filed with State regulatory commissions in Iowa and Kansas.

14. The purpose of Applicant's request is to replace the authority granted by this Commission in Decision No. C03-0888 in Docket No. 03A-309SEG as amended, with the authority to issue up to \$700 million of securities. The securities to be issued will be limited to: (1) Mandatory Convertible Securities; and (2) shares of Common Stock of Aquila (separate and apart from the shares of Common Stock to be issued upon conversion of the Mandatory Convertible Securities).

15. If Applicant is granted its request for authority to issue up to \$700 million of securities, Aquila cannot predict the order in which it will issue these securities. These issuances

will depend on market conditions, prudent financing practices, and capital structure requirements, among other things. The Mandatory Convertible Securities will, prior to conversion, bear interest at rates to be determined at such time of issuance. There is no current cash dividend rate per share on the Common Stock.

16. Applicant advised the Commission that its plans, at the time the Application was filed, were as follows: The Mandatory Convertible Securities will be issued in one or more series over a two-year period commencing upon receipt of all required regulatory approvals, but any Common Stock issued pursuant to the conversion of the Mandatory Convertible Securities, will be issued on the dates for such conversion. Aquila will advise Staff by letter when this two-year period commences. Conversion of the Mandatory Convertible Securities from long-term debt into Common Stock may occur at any time that the underlying long-term debt security is outstanding. If not converted sooner, it will automatically convert into Common Stock on or about the third, but no later than the fourth, anniversary of issuance, except if there is an event of default on the long term debt security. The conversion rate and exact time of mandatory conversion will be established by market conditions at the time of issuance.<sup>2</sup> The securities may be listed on the New York Stock Exchange.

17. Applicant has stated that no bond indenture or other limitations on interest and dividend coverage impact the issuance of the proposed securities, except that orders of the Kansas Corporation Commission and Aquila's \$430 Million Credit Agreement dated April 9,

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<sup>2</sup> The term of the note, the interest rate, the conversion rate, and the conversion date will all be determined at the time of the issuance. The term of the note will correspond to the conversion date. The conversion date will happen on or about the third, but no later than the fourth, anniversary of the issuance. Aquila makes commitments concerning the interest rate in Paragraph 12 of this Application.

2003, place limitations on Aquila's ability to pay dividends on Common Stock and restrict the purposes for which the proceeds from the securities may be used.<sup>3</sup>

18. The net proceeds of the securities contemplated herein will be added to Aquila's general funds and applied to retire liabilities through the repayment of Aquila's obligations, which could include senior notes, prepay gas obligations, the \$430 million credit agreement, short-term debt or will be used for working capital, consistent with Aquila's corporate purposes. Aquila's corporate purposes include, but are not limited to, the construction, completion, extension, or improvement of facilities; the improvement or maintenance of service; the discharge or lawful refunding of obligations; and the reimbursement of monies actually expended for these purposes.

19. Applicant has agreed to the inclusion in this Decision of the following conditions, the substance of which were set forth in Decision No. C03-0888 in Docket No. 03A-309SEG:

- A. Aquila shall submit a written report to the Chief of Fixed Utilities by letter when this two-year period referenced in Paragraph 7(c) of the Application commences and when the Mandatory Convertible Securities or Common Stock, as authorized in the Commission's Order, are issued. The latter written report shall inform the Commission of the amount and type of said securities sold, identify the terms and conditions of the securities sold, and provide information concerning the cost incurred with issuing the securities sold. The latter report shall be submitted within 90 days following the transaction. Aquila will be required to file such a report following the closing and issuance of each sale of securities authorized in this Order.
- B. The following three conditions are just and reasonable and will be made conditions to the approval of this Verified Application:
  - a. Aquila will use the proceeds from the issuance of the Mandatory Convertible Securities to reduce or replace existing liabilities;
  - b. Aquila will not issue the securities unless the issuance in the aggregate results in a reduction to the Company's interest expense (or liability costs

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<sup>3</sup> In Decision No. C03-0299, mailed March 25, 2003, in Docket No. 03A-071SEG, the Commission authorized Aquila to enter into the \$430 million Credit Agreement dated April 9, 2003.

to the extent cash proceeds are used to reduce or replace existing liabilities rather than debt); and

- c. Aquila will use the proceeds from the issuance of common equity to reduce liabilities or to maintain required working capital.
- C. Aquila will be directed to file a written report to the Commission immediately, if it fails to meet any of its obligations prescribed under existing debt indentures.
- D. The Commission reserves the right to review the financing costs, including interest rates, incurred in issuing the Mandatory Convertible Securities and Common Stock requested in this Application. Full recovery of such expenses from ratepayers may or may not be allowed in future rate proceedings before this Commission. Accordingly, the Commission may consider imputing an appropriate interest rate expense that is less than the actual interest rate expenses incurred by Aquila with respect to the Mandatory Convertible Securities in any future rate proceeding.

*See*, Decision No. C03-0888, paragraphs II. A. 3-6, pages 8-9.

20. Hence, the Commission finds that Applicant plans to use the proceeds of the issuance of the convertible long-term debt securities to reduce or to replace existing liabilities, and proceeds from the issuance of the Common Stock will be used to reduce liabilities or to maintain required working capital.

21. In its first Supplement to the Verified Application, Applicant agreed to the following:

- a. Aquila agrees that, in future electric or natural gas rate cases, it will use a hypothetical capital structure until the date it has regained its investment grade status. In future electric rate cases the capital structure used in Docket No. 02S-594E of 47.5% equity and 52.5% debt will be used. In future natural gas rate cases the hypothetical capital structure of 50% equity and 50% debt will be used.
- b. Aquila also agrees to maintain the debt allocation and pricing process described as follows: Since 1988, Aquila has maintained a capital allocation process that was specifically designed to insulate and separate each of its regulated utility operating units from the other activities of Aquila. Aquila's regulated utility operating units receive capital based upon what a comparable utility would receive. Based upon the needs of the business unit, Aquila assigns specific debt issuances to those business

units receiving the proceeds of the issuance and that assignment is not changed until corporate retires the debt series. As part of this internal capital allocation process, Aquila's customers would continue to be charged debt costs that reflect representative costs for comparable utilities with a BBB investment grade credit rating.

- c. Aquila believes that the continued use of hypothetical capital structures and this debt assignment process, as described herein, provides Aquila's Colorado utility customers with financial protection during the transition period back to an investment grade rating.

22. Aquila agrees to the specifics of incorporating a Bill Credit Adjustment provision in Docket No. 04A-046E and agrees to work in good faith to that end.

23. The Commission finds that the substantive conditions carried over from Decision No. C03-0888, to which Applicant has agreed, as well as the points in both the first and second Supplements, quoted above, to which Applicant has committed are just and reasonable, and they will be made terms of the approval of this Verified Application.

24. The authority requested herein and the issuance of the Mandatory Convertible Securities and the shares of Common Stock of Aquila (separate and apart from the shares of Common Stock to be issued upon conversion of the Mandatory Convertible Securities) will have no adverse effect on Applicant or its financial condition, nor will the issuance of these items have any adverse effect upon the cost or quality of service provided to Applicant's Colorado ratepayers.

25. The issuance of the Mandatory Convertible Securities and shares of Common Stock of Aquila (separate and apart from the shares of Common Stock to be issued upon conversion of the Mandatory Convertible Securities) are for a lawful object, within Aquila's corporate purposes and not contrary to, and is consistent with, the public interest. The issuance of these securities is necessary for the operations of Aquila's business, will not impair its ability



to operate its business, and is reasonably necessary and appropriate for the corporate purposes set forth above.

26. Neither the granting of this Application nor the issuance of these securities will require the filing of a new Registration Statement with the SEC. If the securities are sold in a public offering, they will be sold pursuant to a shelf registration statement already on file with the SEC.

27. The proposed issuance of these securities would have no material adverse effect on the Applicant's existing capital structure.

28. Applicant has advised the Commission that the estimated costs of financing related to issuance of these securities are presently unknown and will probably not be known until shortly before the securities are issued. Applicant has committed to report to the Commission the estimated financing costs as soon as practicable after any securities are issued. The recovery of such costs will be subject to review by the Commission in any subsequent rate case proceeding.

29. The Applicant has caused Notices of the filing of this Application to be published on July 20, 2004, in *The Gazette Telegraph*, a newspaper of general circulation in the Applicant's areas of service, and in *The Pueblo Chieftain*, a newspaper of local circulation in the Applicant's service area, in accordance with Rule 4 CCR 723-1-56 of the Rules of Practice and Procedure, 4 CCR 723-1.

30. The issuance of the Mandatory Convertible Securities and shares of Common Stock of Aquila (separate and apart from the shares of Common Stock to be issued upon conversion of the Mandatory Convertible Securities) are reasonably required and necessary for Applicant's proper corporate financing and should be authorized and approved.

**C. Conclusions**

31. The issuance of up to and including \$700 million of the Mandatory Convertible Securities and shares of Common Stock of Aquila (separate and apart from the shares of Common Stock to be issued upon conversion of the Mandatory Convertible Securities), as proposed by Applicant, is consistent with the public interest and with the Public Utilities Laws of the State of Colorado.

32. The Commission finds that the continued use of hypothetical capital structures and the debt assignment process, as described in Paragraph No. 12.5 of the first Supplement to the Verified Application, provides Applicant's Colorado utility customers with financial protection during the Applicant's transition period back to an investment grade rating.

33. The Commission finds that the inclusion of a bill credit adjustment provision, as described in Paragraph 12.6 of the second Supplement to the Verified application, as a component of a quality of service plan is beneficial to Aquila's electric customers in Colorado.

34. The Commission finds that the conditions and commitments made by Applicant in the Verified Application and in both Supplements are just, reasonable, and consistent with the public interest.

35. The Application should be granted, and the issuance of up to and including \$700 million of the Mandatory Convertible Securities and shares of Common Stock of Aquila (separate and apart from the shares of Common Stock to be issued upon conversion of the Mandatory Convertible Securities) will be authorized and approved.

## **II. ORDER**

### **A. The Commission Orders That:**

1. The Application of Aquila, Inc., for an order authorizing the issuance of up to and including \$700 million of the Mandatory Convertible Securities and shares of Common Stock of Aquila, Inc. (separate and apart from the shares of Common Stock to be issued upon conversion of the Mandatory Convertible Securities) is deemed complete, and is granted.

2. Aquila, Inc., is authorized to issue up to and including \$700 million of Mandatory Convertible Securities and shares of Common Stock of Aquila, Inc. (separate and apart from the shares of Common Stock to be issued upon conversion of the Mandatory Convertible Securities). The securities may be issued by Aquila, Inc., at one or more times, in one or more public offerings or private placements, and in one or more series depending on the cash requirements of Aquila, Inc., the Applicant's capital structure, and market conditions.

3. In authorizing Aquila, Inc., to issue up to and including \$700 million of Mandatory Convertible Securities and shares of Common Stock the Commission also approves Aquila, Inc.'s request to replace the previous authority to issue up to \$150 million in long term debt securities and \$100 million in common stock as granted in Decision No. C03-0888 in Docket No. 03A-309SEG. Accordingly, the Commission in granting the replacement formally rescinds the authorization granted in Decision No. C03-0888.

4. Aquila, Inc., shall submit a written report to the Chief of Fixed Utilities by letter when the Mandatory Convertible Securities or Common Stock, as authorized in this Order, are issued. The written report shall inform the Commission of amount and type of said securities sold, identify the terms and conditions of the securities sold, and provide information concerning the cost incurred with issuing the securities sold. The report shall be submitted quarterly with

the first report due 90 days following an initial sale of either the mandatory convertible security or common stock authorized in this Order.

5. The following three conditions are just and reasonable and will be made conditions to the approval of this Verified Application:

- a. Aquila will use the proceeds from the issuance of the Mandatory Convertible Securities, as authorized in this Order, to reduce or replace existing liabilities;
- b. Aquila will not issue the securities, as authorized in this Order, unless the issuance in the aggregate results in a reduction to the Company's interest expense (or liability costs to the extent cash proceeds are used to reduce or replace existing liabilities rather than debt); and
- c. Aquila will use the proceeds from the issuance of Common Stock to reduce liabilities or to maintain required working capital.

6. Aquila, Inc., is directed to immediately file a written report to the Commission if it were to fail to meet any of its obligations prescribed under existing debt indentures.

7. In future electric or natural gas rate cases, Applicant will use a hypothetical capital structure until the date it has regained its investment grade status. In future electric rate cases the capital structure used in Docket No. 02S-594E of 47.5 percent equity and 52.5 percent debt will be used. In future natural gas rate cases the hypothetical capital structure of 50 percent equity and 50 percent debt will be used.

8. Applicant will maintain the debt allocation and pricing process described in Paragraph No. 12.5 of its Supplement to the Verified Application, as follows: Since 1988, Aquila, Inc., has maintained a capital allocation process that was specifically designed to insulate and separate each of its regulated utility operating units from the other activities of Aquila, Inc. Aquila, Inc.'s regulated utility operating units receive capital based upon what a comparable utility would receive. Based upon the needs of the business unit, Aquila, Inc., assigns specific

debt issuances to those business units receiving the proceeds of the issuance and that assignment is not changed until corporate retires the debt series. As part of this internal capital allocation process, Aquila, Inc.'s customers would continue to be charged debt costs that reflect representative costs for comparable utilities with a BBB investment grade credit rating.

9. Applicant will be required, consistent with Paragraph 12.6 of the second Supplement, to provide, if deemed appropriate, up to \$125,000 in Bill Credit Adjustments for quality of service relating deficiencies for the calendar year 2005.

10. The Commission reserves the right to review the financing costs, including interest rates, incurred in issuing the Mandatory Convertible Securities and Common Stock requested in this Application. Full recovery of such expenses from ratepayers may or may not be allowed in future rate proceedings before this Commission. Accordingly, the Commission may consider imputing an appropriate interest rate expense that is less than the actual interest rate expenses incurred by Aquila, Inc., with respect to the long-term debt in any future rate proceeding.

11. Nothing herein shall be construed to imply any recommendation or guarantee of, or any obligation with respect to, said securities on the part of the Colorado Public Utilities Commission or the State of Colorado.

12. The Commission retains jurisdiction of this proceeding and may make such further order or orders in the matter as it may deem to be necessary and proper.

13. This Order shall be the initial Decision and Order of the Commission as provided in § 40-6-109(6), C.R.S.

14. The hearing set for Friday, August 13, 2004, is vacated.

15. This Order is effective on its Mailed Date.

**B. ADOPTED IN COMMISSIONERS' WEEKLY MEETING  
August 11, 2004.**

THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF COLORADO

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Commissioners

CHAIRMAN GREGORY E. SOPKIN NOT  
PARTICIPATING.