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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF COLORADO

DOCKET NO. 03A-177SEG

IN THE MATTER OF THE VERIFIED APPLICATION OF AQUILA, INC., FOR AN ORDER AUTHORIZING A PLEDGE OF, AND THE CREATION OF LIENS ON, ITS ASSETS LOCATED IN THE STATE OF COLORADO IN ORDER TO SECURE LONG-TERM DEBT

STIPULATION AND SETTLEMENT AGREEMENT

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Aquila, Inc. (Aquila or the Company) and Staff of the Colorado Public Utilities Commission (Staff), by and through their respective undersigned counsel, and for good and valuable consideration, enter into this Stipulation and Settlement Agreement (Agreement) to stipulate and to settle all disputed issues regarding Aquila's Verified Application for an order authorizing a pledge of, and the creation of liens on, its assets located in the State of Colorado in order to secure long-term debt. Aquila and Staff (collectively, Parties) respectfully submit that this Agreement is just and reasonable, that it results in a fair disposition of this docket, and that, therefore, the Colorado Public Utilities Commission (Commission) should approve the Agreement without hearing.

THE PUBLIC UTILITIES COMMISSION
ENTERED
JUN - 9 2003
THE STATE OF COLORADO

INTRODUCTION

1. On May 1, 2003, Aquila filed the Application for an order authorizing a pledge of, and the creation of liens on, its assets located in the State of Colorado in order to secure the payment of a \$430 million three-year term loan and to secure the future replacement debt offerings for working capital requirements not to exceed \$430 million. Entering into the \$430 million term loan, and the securitization of the loan with domestic utility assets required by the lenders, was a critical first step to ensure that Aquila has sufficient liquidity in the near term, so

that Aquila can continue to implement the final steps of Aquila's Debt Reduction and Restructuring Plan (Financial Plan). The ultimate goal of Aquila's Financial Plan is to return the Company to a capital structure reflective of a gas and electric utility and to restore its debt rating to investment grade. This goal requires the restructuring, retirement, or replacement of existing debt. Subject to obtaining permission from the various state regulatory commissions, including this Commission, the replacement debt referenced in this Application will be secured by a collateral pool that will include Aquila's utility assets, including utility assets located in Colorado.

2. This Application is one of five (5) applications that were filed concurrently by Aquila in the States of Colorado, Iowa, Kansas, Minnesota and Missouri to secure regulatory approval for Aquila to pledge all of its electric and natural gas utility assets located those states, in order to secure the payment of the \$430 million three-year term loan and to secure the future replacement debt offerings for working capital requirements, not to exceed \$430 million. At the present time, utility assets in Michigan and Nebraska and certain Canadian utility assets primarily secure the \$430 million term loan. Aquila has determined internally that about \$250 million of the \$430 million is needed to support the ongoing working capital requirements for Aquila's domestic utility business. However, based upon the collateral principles used by the lending institutions, the assets in Michigan and Nebraska are not sufficient in value to support a \$430 million loan. Therefore, Aquila had to use the Canadian investment both to support the remaining \$180 million portion of the loan and to fill the gap on the required collateral for Aquila's \$250 million domestic utility working capital requirement.

3. The financial institutions only required Aquila to have pledged sufficient assets in total to secure the \$430 million loan. The entire \$430 million is available to Aquila, and the

credit facility does not "break out" portions of the loan on a state-by-state basis. In compliance with the terms of the loan, Aquila must pledge sufficient collateral to secure the credit facility up to the full amount of \$430 million. The determination by Aquila itself that \$250 million of the \$430 million amount is required for its future domestic utility cash working capital needs was based upon Aquila's historical and anticipated domestic utility working cash needs. Aquila has separated the loan and collateral to ensure that the utility customers and assets are not supporting the non-utility debt requirements. It is Aquila's intent to maintain a proper alignment of domestic utility collateral with domestic utility loan needs and non-domestic utility and non-regulated business collateral with their loan needs. The Commission's approval of this Agreement and the Application will greatly contribute to Aquila's success in implementing its Financial Plan.

4. On May 4, 2003, Aquila caused a Notice concerning the filing of this Application to be published in *The Colorado Springs Gazette* and in *The Pueblo Chieftain*, newspapers of general or local circulation in Aquila's service area. That Notice indicated that the pledge of Colorado assets was needed to secure the payment of a \$430 million term loan issued by Aquila pursuant to authority granted by the Commission on March 25, 2003 in Docket No. 03A-071SEG by Decision No. C03-0299, to secure future replacement debt offerings for working capital requirements in amounts not to exceed \$430 million. On May 5, 2003, the Commission issued its Notice that the application had been filed.

5. On May 15, 2003, Staff filed its notice of intervention and entry of appearance. Aquila and Staff are the only parties to this docket. Since the date of the filing, Staff has conducted a thorough review and investigation of the filing and the supporting testimony and

exhibits. Aquila and Staff have also conducted extensive discussions and settlement negotiations.

THE SETTLEMENT

6. Staff and Aquila agree that the Application should be granted, including the terms and conditions to which the parties agree herein. They also agree that the approval of this Agreement is just, reasonable and not contrary to the public interest.

7. Aquila and Staff agree that the terms of this Agreement should be included in the Commission's decision granting this Application as terms and conditions of approval of the Application and the relief requested therein.

8. Aquila agrees that, in future electric or natural gas rate cases relying on a test year containing all or a part of the years 2003, 2004 and 2005, it will use a hypothetical capital structure. 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. Aquila also agrees to maintain the debt allocation and pricing process described in the Direct Testimony of Jon Empson, pages 2-5, filed in this Docket. Staff and Aquila agree that the continued use of hypothetical capital structures and debt assignment provides Aquila's Colorado utility customers with financial protection during this period of transition through December 31, 2005.

9. Aquila agrees that proceeds from the actions described in the Financial Plan should be used to reduce the debt and other outstanding financial liabilities on Aquila's balance sheet relating to the nonregulated and nondomestic utility operations. The recording of the receipt of proceeds from an asset sale transaction on Aquila's books of account will occur within seven (7) business days of month end, and after cash working capital needs are met, Aquila will

record the retirement of such debt from its books of account within seven (7) business days of month end. Aquila will notify Staff of the application of the funds in the updates discussed below.

10. Aquila agrees that during the three (3) year time period reflected in the Financial Plan (*i.e.*, 2003 through 2005), Aquila will not start any new unregulated business ventures.

11. Aquila and Staff agree that Aquila has a critical need for long-term financial stability so that reliable service to its Colorado customers will continue to be provided, as Aquila has done for many years. Staff agrees to work with Aquila in the effort to ensure Aquila's long-term financial stability as an operating utility in Colorado. In the Application, Aquila requested the ability to extend the asset pledge granted in this docket to secure future replacement long-term debt offerings for working capital requirements not to exceed \$430 million. Aquila would prefer an agreement here to the extension or roll-over of the current \$430 million credit facility, as long as the same terms and conditions set forth in this Agreement and in the Commission's approval order in this Docket are also adopted. However, Staff would prefer to defer any agreement to the extension or roll-over of the current \$430 million credit facility, as long as the same terms and conditions set forth in this Agreement and in the Commission's approval order in this Docket are also adopted, until after the four (4) other States (Iowa, Kansas, Minnesota and Missouri) have disposed of the pending similar applications. Therefore, Staff and Aquila agree that the Commission in its Decision approving this Agreement should not deny the extension or rollover relief requested in the Application. Rather, the decision on that issue would be deferred until Staff and Aquila jointly file a motion in this Docket requesting disposition of that issue. Aquila agrees to advise Staff within seven (7) business days of the entry of final orders in each of the four other state application of the disposition of those applications by the respective state

commissions. Within forty-five (45) days after Aquila advises Staff of the disposition by the fourth state commission, Staff and Aquila will file an appropriate pleading with the Commission requesting disposition of the extension or rollover relief requested in the Application. For purposes of approval of this Paragraph No. 11, Aquila waives the statutory limit of Colo. Rev. Stat. § 40-1-104(5) only for purposes of determining the extension or rollover relief requested in the Application.

12. Aquila agrees that, within fifteen (15) days after submitting its quarterly financial reports to the Securities and Exchange Commission (SEC), Aquila will file the following financial reports in this Docket:

a. Aquila will submit to Staff any updates to the confidential Financial Plan within fifteen (15) days of release of the updated Financial Plan. Aquila will report to Staff the progress made in implementing the actions detailed in the Financial Plan, including the use of sales proceeds to retire outstanding debt or other financial liabilities, through the Cash Flow Statement attachment described in Paragraph 12b below.

b. Aquila will submit a report, including Statements of Cash Flows. As part of this report, within the Statement of Cash Flows, Aquila will itemize activities from Investing Activities and from Financing Activities between regulated and unregulated items, and among unregulated items highlight and footnote the components of its Financial Plan. To facilitate the comparison of the Financial Plan with the itemized Statement of Cash Flows, the itemized Statement of Cash Flows shall use comparable items as are used in the Financial Plan. Attachment A to this Agreement is the format for this report to which Staff and Aquila have agreed.

13. Aquila agrees to submit a notice report to Staff, via a confidential letter to the Chief of Fixed Utilities, within seven (7) business days, if any of the following occur:
- a. Material deviation from the Financial Plan. "Material deviation," as used herein, means either a scheduled milestone occurs in excess of three (3) months from the scheduled date for occurrence, or a dollar amount received is more than 10% less than an expected value.
 - b. Violation or event of default in (1) the covenants in Aquila's indentures, (2) the loan agreement for the April 9, 2003 \$430 million long-term debt facility, or (3) an order of another state utility regulatory commission approving the pledge of Aquila's assets located in that state to secure the \$430 million long-term debt facility.
 - c. Aquila files for protection of a federal bankruptcy court under any chapter of the federal bankruptcy laws.
14. In the event there is a bankruptcy filing, foreclosure, or liquidation involving Aquila's assets located in Colorado, or other need to transfer Aquila's assets located in Colorado, Aquila agrees to advise other parties to any such actions that the Colorado Public Utilities Commission would require the filing and approval of an application to transfer Aquila's assets located in Colorado, pursuant to Rule 723-1-55 of the Commission's Rules of Practice and Procedure (4 *Colo. Code Regs.* 723-1-55).
15. Aquila and Staff have agreed to the following relating to the development by Aquila of a Colorado natural gas quality of service plan:¹
- a. Aquila agrees that during the three (3) year time period reflected in the Financial Plan (*i.e.*, 2003 through 2005), Aquila will continue to maintain an adequate

quality of natural gas and electric service provided to its end-use customers in Colorado, as required by the standards set forth in the Colorado Public Utilities Law, as to quality of service to gas customers the Commission's rules regulating the service of gas utilities (4 *Colo. Code Regs.* 723-4) and the rules governing gas pipeline safety (4 *Colo. Code Regs.* 723-11), and as to quality of service to electric customers the Commission's rules regulating the service of electric utilities (4 *Colo. Code Regs.* 723-3).

b. Aquila and Staff agree to address quality of service issues by reviewing key outputs in four ways:

i) Staff will continue to review Aquila's performance and reporting under the requirements of the rules governing gas pipeline safety (4 *Colo. Code Regs.* 723-11). Unlike the electric industry, the natural gas industry already has a prescribed set of minimum requirements for operators in areas such as cathodic protection, leak survey, leak repair, odorization, and various other operational and maintenance activities. These standards are mandated under the Commission's rules governing gas pipeline safety (4 *Colo. Code Regs.* 723-11) and Title 49, Code of Federal Regulations, Part 192, and are audited on a periodic basis by the enforcement staff of the Commission.

ii) Aquila agrees to submit to Staff quarterly reports on natural gas utility quality of service. These reports will be based upon the monthly internal reports currently used by Aquila's senior management to monitor quality of service, so that Staff may also monitor the status of quality of service being provided by Aquila to its end-use natural gas customers in Colorado. These

¹ Aquila's development of a quality of service plan for its Colorado retail electric utility operations was addressed in the Settlement Agreement in Docket No. 02S-594E, Phase I of Aquila's electric general rate case, a

reports will include such measures as default ratio, meters read on time, meter reading error rate, emergency response greater than one hour, and unplanned outages.

iii) Aquila agrees to submit to Staff on a quarterly basis its reports currently used by Aquila's senior management to monitor electric quality of service. These reports will include measures such as generating station base and peak availability, generating station starting reliability, CAIDI, SAIDI, SAIFI, meters read on time, and default ratio.

iv) Aquila agrees to provide to Staff combined gas and electric measures for the centralized call center function, such as average speed of answering telephone calls.

c. Aquila agrees to provide the first report for Paragraph No. 15(b)(i) through (iv) above within sixty (60) days of the Commission's final decision approving this Application, and with the first submittal Aquila will also include three (3) years of historical data for each measure (when available), definitions of the measures, and the methodology for calculating the measures. Aquila also agrees to respond to any questions raised by Staff concerning these reports within ten (10) days of Aquila's receipt of the question. If Aquila needs additional time to respond to a specific question, it will so advise Staff. Aquila agrees to provide the reports specified in Paragraph No. 15(b)(i), Paragraph No. 15(b)(ii), and Paragraph No. 15(b)(iv) to Staff during the three (3) year time period reflected in the Financial Plan. Aquila agrees to an initial meeting with Staff within one hundred twenty (120) days of the Commission's final decision approving this

decision on which is currently pending before the Commission.

Application to review and discuss the materials provided by Aquila in accordance with Paragraph No. 15(b)(i), Paragraph No. 15(b)(ii), and Paragraph No. 15(b)(iv).

d. Additionally, Aquila and Staff agree to continue discussing the quality of Aquila's natural gas service in Colorado for the purpose of determining whether the review and monitoring of the foregoing gas-related outputs are sufficient to demonstrate a legally adequate level of quality of natural gas service, or whether further collaborative discussions are required to develop a formal application to approve a quality of service plan for Aquila's Colorado natural gas operations. However, neither this paragraph nor any other provision of this Agreement shall be construed to prohibit Staff from commencing any action in the future that it deems necessary concerning Aquila's quality of service.

GENERAL STIPULATIONS

16. Through active prehearing investigation and negotiation, the Parties have reached the agreement set forth herein resolving all contested and disputed issues in this docket in a manner which the Parties agree is just and reasonable and in the public interest. The Parties further agree that reaching agreement by means of negotiation and settlement rather than through litigation is in the public interest.

17. The Parties agree to present, to support, and to defend this Agreement before the Commission and the courts. The Parties further agree, if necessary, to present testimony and exhibits to the Commission to secure the approval of this Agreement.

18. The Parties hereby agree that all pre-filed testimony and exhibits shall be admitted into evidence in this docket without cross-examination. This Agreement reflects compromise and settlement of all issues raised or that could have been raised in this docket.

19. This Agreement shall not become effective until the issuance of a final Commission Order approving the Agreement, which Order does not contain any modification of the terms and conditions of this Agreement that is unacceptable to either of the Parties. In the event the Commission modifies this Agreement in a manner unacceptable to either Party, that Party shall have the right to withdraw from this Agreement and proceed to hearing on the issues that may be appropriately raised by that Party in this docket. The withdrawing Party shall notify the Commission and the Parties to this Agreement by e-mail within three (3) business days of the Commission modification that the Party is withdrawing from the Agreement and that the Party is ready to proceed to hearing; the e-mail notice shall designate the precise issue or issues on which the Party desires to proceed to hearing (Hearing Notice).

20. Within three (3) business days of the date of the Hearing Notice from the withdrawing Party, the Parties shall confer to arrive at a comprehensive list of issues that shall proceed to hearing and a list of issues that remain settled as a result of the first Party's withdrawal from this Agreement. Within five (5) business days of the date of the Hearing Notice, the Parties shall file with the Commission a formal notice containing the list of issues that shall proceed to hearing and those issues that remain settled and a proposed procedural schedule for the filing of answer and rebuttal testimony and exhibits and proposed hearing dates. Hearing shall be scheduled on all of the issues designated in the formal notice filed with the Commission as soon as practicable.

21. In the event that this Agreement is not approved, or is approved with conditions that are unacceptable to any Party who subsequently withdraws, the negotiations or discussions undertaken in conjunction with the Agreement shall not be admissible into evidence in this or any other proceeding, except as may be necessary in any proceeding to enforce this Agreement.

22. Approval by the Commission of this Agreement shall constitute a determination that the Agreement represents a just, equitable and reasonable resolution of all issues that were contested, or could have been contested, among the Parties in this proceeding.

23. The Parties specifically agree and understand that this Agreement represents a negotiated settlement in the public interest with respect to the various issues presented by this Docket, for the sole purpose of the settlement of the matters agreed to in this Agreement. No Party or person shall be deemed to have approved, accepted, agreed to, or consented to any concept, theory or principle underlying or supposed to underlie any of the matters provided for in this Agreement, other than as specifically provided for herein. Notwithstanding the resolution of the issues set forth in this Agreement, none of the regulatory principles herein contained shall be deemed by the Parties to constitute a settled practice or precedent in any future proceeding, except as otherwise specifically provided in Paragraph Nos. 8 through 15 of this Agreement.

24. This Agreement may be executed in counterparts and by facsimile copies of signatures, all of which when taken together shall constitute the entire Agreement with respect to the issues addressed by this Agreement.

CONCLUSION

For the reasons stated above, the Parties respectfully request that the Commission enter an order approving this Stipulation and Settlement Agreement finding and concluding that the Commission's approval of this Stipulation and Settlement Agreement represents a fair, just, and reasonable resolution of all disputed issues and all issues that could have been raised in this Docket.

DATED this 6th day of June 2003.

Accepted on behalf of
AQUILA, INC.:

By: _____
Jon R. Empson
1815 Capitol Avenue
Omaha, NE 68102


Approved as to form:

ABEL, BAND, RUSSELL, COLLIER,
PITCHFORD & GORDON, CHARTERED

By: _____
Steven H. Denman, CO Reg. #7857
240 South Pineapple Avenue
Post Office Box 49948
Sarasota, FL 34230-6948
(941) 366-6660
(941) 366-3999 facsimile
(303) 623-6660 Denver number


Attorneys for Aquila, Inc.

Accepted on behalf of
STAFF OF THE COLORADO PUBLIC
UTILITIES COMMISSION:

By: 
Eric Jorgensen
1580 Logan Street, Office Level 2
Denver, CO 80203

Approved as to form:

OFFICE OF THE ATTORNEY GENERAL

By: 
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Business and Licensing Section
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Facsimile: 303-866-5395

Attorneys for the Staff of the Colorado
Public Utilities Commission

* Counsel of Record

DATED this _____ day of June 2003.

Accepted on behalf of
AQUILA, INC.:

By: Jon R. Empson
Jon R. Empson
1815 Capitol Avenue
Omaha, NE 68102

Approved as to form:

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Attorneys for Aquila, Inc.

Accepted on behalf of
STAFF OF THE COLORADO PUBLIC
UTILITIES COMMISSION:

By: _____
Eric Jorgensen
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Approved as to form:

OFFICE OF THE ATTORNEY GENERAL

By: _____
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Attorneys for the Staff of the Colorado
Public Utilities Commission

* Counsel of Record

DATED this 5th day of June 2003.

Accepted on behalf of
AQUILA, INC.:

By: _____
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OFFICE OF THE ATTORNEY GENERAL

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Attorneys for the Staff of the Colorado
Public Utilities Commission

* Counsel of Record

CERTIFICATE OF SERVICE

This is to certify that I have duly served the within STIPULATION AND SETTLEMENT AGREEMENT upon all parties herein by depositing copies of same in the United States mail, first class postage prepaid, or as otherwise indicated, at Denver, Colorado, this 10th day of June 2003, addressed as follows:

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Sarasota, FL 34230-6948

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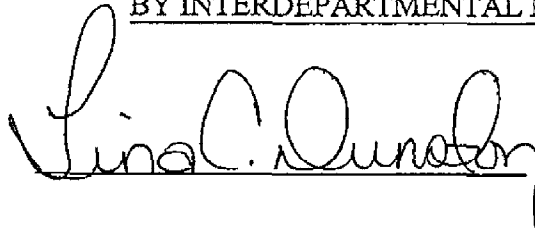
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Linda C. Oundy

Aquila Inc.				
Cashflow Statement				
Quarter Ended March 31, 2003				
	(dollars in thousands)	U.S. Utilities	Other Non-Regulated	Consolidated Aquila Inc.
Line #	Cashflow from Operations			
1	Net Income			
2	Adjustments to reconcile net income (loss) to net cash:			
3	Depreciation & amortization expense			
4	Restructuring charges			
5	Impairments & Other Charges			
6	Cash paid on impairments & other chrg.			
7	Net chg. price risk mgm			
8	Deferred taxes & Investment tax credits			
9	Equity in earn. of inve			
10	Dividends & fees from investments			
11	Change in assets & liab.			
12	A/R & A/P, net			
13	Restricted cash			
14	Inventory & Supplies			
15	Prepayments & Other			
16	Accrued & Other current liab			
17	Deferred Credits			
18	Deferred Charges & Other			
19	Customer funds on deposit			
20	Funds on deposit			
21	Other			
22	Total Cashflow From Operations			
23				
24	Cashflow from Investing			
25	Additions to Utility Plant			
26	Merchant Capital Expenditures			
27	Cash received on sale of assets			
28	Other			
29	Total Cashflow From Investing			
30				
31	Cashflow From Financing			
32	Issuance of common Stock			
33	issuance of LTD			
34	Retirement of LTD			
35	Short-term borrowings			
36	Net chg in long-term gas contracts			
37	Other			
38	Total Cashflow From Financing			
39				
40	Inc (Dec) in Cash Equiv			
41	Cash-Begin-(December)			
42	Cash-Ending			
	Footnotes:			
	See detail explanation of bolded line items on the "Detail Info" worksheet.			

Line #		Other Non-Regulated
25	Canada utility capital expenditures	
26	Capacity Services (MEP) capital expenditures (Power plant construction commitments)	
	Cash received on sale of assets:	
	U.S. Networks--Sale of STI	
	Capacity Services--Cash rec on sale of AQP recorded as AR at year end	
	Wholesale Services--Cash received on sale of AECC classified as restricted cash at year end	
	Wholesale Services--Cash received on sale of AECC held as escrow at year end	
	Quanta Services--Cash received on sale of remaining Quanta shares	
27	Total Other Non-Regulated Cash received on sale of assets	
	Total Cash received on sale of assets	
	Retirement of LTD:	
	Capacity Services:	
	Raccoon Creek	
	Goose Creek	
	Total	
	less: non cash adj--cash collateral used to pay down debt (cash outflow in investing activity when posted earlier in year)	
	Total Capacity services	
	Canada	
	Australia	
	Corporate	
	UCS	
	Wholesale	
34	Total Other Non-Regulated Retired LTD	